PANDORA'S BALLOT BOX, OR A PROXY WITH MOXIE? MAJORITY VOTING, CORPORATE BALLOT ACCESS, AND THE LEGEND OF MARTIN LIPTON RE-EXAMINED

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Pandora's Ballot Box, Or a Proxy with Moxie? Majority Voting, Corporate Ballot Access and the Legend of Martin Lipton Re-Examined

*By J. W. Verret**

In August 2006 the Delaware General Assembly adopted an amendment to the Delaware General Corporation Law which provides that where shareholders have adopted a majority voting bylaw for corporate elections over the traditional plurality scheme, a corporation may not subsequently amend its bylaws to return to plurality voting without shareholder approval. This Article compares this provision to other approaches and explains the reasons underlying its adoption. It also briefly summarizes the evolving shareholder empowerment debate and analyzes the majority voting provision in the context of that discussion. The presence of activist shareholders will be an especially important phenomenon affecting this analysis. This Article then describes some unique and unanticipated interactions between majority voting bylaws and various other working parts of corporation and securities laws affecting the shareholder franchise. The most prevalent corporate strategies responding to this movement are explored and the difficulties of implementing majority voting are described. Finally, voting schemes from the political sphere are analyzed to find analogous lessons for the corporate arena, including exploring a runoff election proposal for corporate elections. The Article concludes with some predictions about future developments which will hinge on the outcome of SEC rules proposals, further DGCL revisions, New York Stock Exchange regulatory initiatives, and the responses from Delaware incorporated entities. This Article blends financial regulatory theory, interpretation of Delaware Court of Chancery cases, and practical analysis on the future of the majority voting movement and the strategic

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choices facing board of directors. The result is a developed framework for how majority voting could serve to alter significantly the balance of power between shareholders and board members.

"The private corporation or firm is simply one form of legal fiction which serves as a nexus for contracting relationships and which is also characterized by the existence of divisible residual claims . . . and . . . which can generally be sold without permission of the other contracting individuals."—Michael C. Jensen and William H. Meckling.[1]

"You own the company. That's right—you, the stockholder. And you are all being royally screwed over by these, these bureaucrats, with their luncheons, their hunting and fishing trips, their corporate jets and golden parachutes."—Gordon Gekko (Played by Michael Douglas), Annual Stockholders Meeting of Teldar Paper, The Movie *Wall Street* (1987).

Table of Contents

1. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structures,* 3 J. Fin. Econ. 305 (1976), *as reprinted in* The Economic Nature of the Firm, at 315, 321 (Louis Putterman & Randall S. Kroszner eds., 2d ed. 1996).

I. Introduction

The Delaware General Assembly has recently adopted an amendment to the Delaware General Corporation Law ("DGCL") which provides that where shareholders have adopted a majority voting bylaw for corporate elections over the traditional plurality scheme, a corporation may not subsequently amend its bylaws to return to plurality voting without shareholder approval.[2] This article compares this provision to other approaches and attempts to explain the reasons underlying its adoption. The article also briefly summarizes the evolving shareholder empowerment debate and analyzes the majority voting provision in the context of that discussion. This article also describes some unique and unanticipated interactions between majority voting bylaws and various other working parts of corporation and securities laws affecting the shareholder franchise, a carefully protected right in Delaware jurisprudence.[3] The most prevalent corporate strategies responding to this movement are explored and the difficulties of implementing majority voting are described. Finally, voting schemes from the political sphere are analyzed in an attempt to find analogous lessons for the corporate arena. The article ends with some predictions about future developments which will hinge on the outcome of SEC rules proposals, further DGCL revisions, and the responses of Delaware incorporated entities.

This article blends three distinct groups of thought: (i) theoretical corporate law scholarship and financial regulatory theory; (ii) interpretation of Delaware Court of Chancery cases; and (iii) practical analysis on the future of the majority voting movement and the strategic choices facing boards of directors in the aftermath of the Delaware amendments and corollary Securities and Exchange Commission and New York Stock Exchange regulatory initiatives. The result is a developed framework for how majority voting could serve to alter significantly the balance of power between shareholders and board members, with the magnitude of that effect contingent on the result of pending governance changes at forums, board responses,

2. 75 Del. Laws ch. 306 (S.B. 322), § 5 (2006) (codified at Del. Code tit. 8, § 216 (2007)). (Citations to the Delaware Code are to the official online version at http://www.delcode.delaware.gov/ (last accessed May 30, 2007)).

3. *See* Harrah's Entertainment, Inc. v. JCC Holding Co., 802 A.2d 294, 311 (Del. Ch. 2002).

and the continuing evolution of the Delaware General Corporation Law. The presence of activist shareholders will be an especially important phenomenon affecting this analysis. The article also briefly explores one alternative to majority voting, the runoff election proposal, to allow that concept to enter into the debate.

As a secondary thesis to the ideas summarized above, this article will also respond to Martin Lipton's latest article, *The Many Myths of Lucian Bebchuk,* which summarizes Lipton's views as the leading voice against the shareholder empowerment movement.[4] This article will argue that, though there may be many valid criticisms of the shareholder empowerment movement, Lipton's latest invective diatribe is bereft of them.

II. A Summary of the Statutory Changes

An analysis of Delaware corporate law must necessarily begin with Section 141 of the Delaware General Corporation Law ("DGCL") which provides: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors."[5] The DGCL further provides that, in the absence of a bylaw to the contrary, directors shall be elected by a plurality of the votes cast.[6] Plurality voting means that the candidate receiving the greatest number of affirmative votes cast, limited by the number of seats up for election, is victorious in that election. Thus it would be possible for an uncontested candidate to receive one vote in favor, and millions of no or "withhold" votes, and still emerge victorious in the election. Since corporate elections are not subject to a runoff process, and shareholders are able to nominate rival candidates for corporate elections, the plurality default was adopted in response to the potential situation in which no nominee was able to obtain a majority of the votes cast, thus resulting in a failed election.[7]

Under the DGCL, the bylaws of a corporation may contain any provision not in conflict with the DGCL, and may be adopted by the shareholders, or, if given the

4. Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk,* 93 Va. L. Rev. 733 (2007). In that article, Lipton responds to Lucian Bebchuk's piece that forms the foundation for our understanding of the shareholder empowerment movement in this article. Lucian A. Bebchuk, *The Myth of the Shareholder Franchise,* 93 Va. L. Rev. 675 (2007). Though it is not the intention of this article to take a side in the empowerment debate, Bebchuk's piece is vital to understanding how majority voting fits into the shareholder empowerment movement. For another of Lipton's responses to Bebchuk, see Martin Lipton & Steven A. Rosenblum, *Election Contests In the Company's Proxy: An Idea Whose Time Has Not Come,* 59 Bus. Law. 67 (2003).

5. Del. Code tit. 8, § 141 (2007).

6. Section 216 provides: "In the absence of such specification in the certificate of incorporation or bylaws of the corporation: . . . (3) Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors." Del. Code tit. 8, § 216 (2007).

7. *See* American Bar Association, *Committee on Corporate Laws Discussion Paper on Voting by Shareholders for the Election of Directors (June 22, 2005), in* Third Annual Directors' Institute on Corporate Governance, Corporate Law and Practice Course Handbook Series, 1506 PLI/Corp 473, 479 (Sept. 15–16, 2005) (citing S. 93, 134th Gen. Assembly, 66 Del. Laws ch. 136, § 11 (1987), *reprinted in* 2 R. Franklin Balotti & Jesse A. Finkelstein, Delaware Law of Corporations and Business Organizations § 216).

power to do so in the corporate charter, the board of directors.[8] A recent addition to Section 216 of the DGCL, and the subject of this article, adopted in August of 2006, specifies that "A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors."[9] This effectively means that a shareholder approved change to the default plurality voting standard cannot be unilaterally altered by the board without shareholder ratification.

Another aspect of Delaware law important to this subject is the ability of the shareholders to remove a director. Section 141 of the DGCL provides that "Any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors," but then subjects that provision to the following exception: "(1) Unless the certificate of incorporation otherwise provides, in the case of a corporation whose board is classified as provided in subsection (d) of this section, shareholders may effect such removal only for cause."[10] The result is that classified board charters will allow removal (between elections) by a majority of shareholders only for cause, thus requiring some alternative means for removal of a director. The classified board removal limitation to for-cause only, combined with the fact that removal in non-classified boards would require first calling a special meeting (which the shareholders may not even have the authority to do in the bylaws), plus obtaining the necessary votes to remove, marginalize the statutory removal power in the DGCL.[11] Furthermore, in any event, a removed director continues to serve until a replacement can be nominated and elected under the "holdover" rule.[12]

Another recent addition to the DGCL, relevant to this exploration, is the advance resignation provision providing that "A resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable."[13] This is because a majority voting bylaw is most effective when the director who has failed to receive a majority vote is required to step down because of an advance resignation agreement in which the director has contracted to do so. The Delaware Legislature's recent amendment that protects the permanence

8. Del. Code tit. 8, § 109(b) (2007).

9. 75 Del. Laws. ch. 306 (S.B. 322), § 5 (2006) (codified at Del. Code tit. 8, § 216 (2007)).

10. Del. Code tit. 8, § 141(k) (2007).

11. Vice-Chancellor Strine has stated in dictum that the removal power is a fundamental right, thus it is likely that a bylaw purporting to restrict the removal power for unclassified boards would be held invalid. *See* Rohe v. Reliance Training Network, Inc., No. 17992, 2000 WL 1038190, *11 (Del. Ch. July 21, 2000) ("Like the right to elect directors, Delaware law considers the right to remove directors to be a fundamental element of stockholder authority."). However, the fact that a statutory removal requires a vote of a majority of "all shares entitled to vote" makes the removal power extremely difficult to exercise.

12. Del. Code tit. 8, § 141(b) (2007). Presumably, a shareholder could, after a successful withhold vote election, petition the Court of Chancery for a special election under Section 225, Del. Code tit. 8, § 225 (2007), but it is uncertain how the Court of Chancery would react to situations in which the bylaw leaves discretion in the hands of the board in how it responds to the vote. *See infra* Section VII.C.

13. 74 Del. Laws ch. 306 (S.B. 322), § 3 (2006) (codified at Del. Code tit. 8, § 141(b) (2007)).

of such a board policy may fall in line with an emerging trend in Delaware courts[14] toward holding boards firmly to their representations to their shareholders.

II. The Genesis of the Majority Voting Amendment and a Comparison to Other Regulatory Approaches

A. Development of Withhold Vote Campaigns by Institutional Investors and the Grey Line between Symbolic and Pyrrhic Victories

Former SEC Commissioner Joseph Grundfest initially proposed the use of withhold vote campaigns in a law review article in 1993.[15] At the time, the active takeover market of the 1980s was killed by a cocktail of poison pills, anti-takeover legislation, and diminished access to capital; takeovers could no longer be used to control management excess and to urge boards to respond to shareholder discontent.[16] Proxy fights were also of marginal utility because the institutional investors who could lead the charge suffered from a collective action problem.[17]

The victor in that battle was an attorney who has become one of the most respected members of the corporate bar, Martin Lipton. He has been a frequent contributor to *The Business Lawyer,* most notably in a 1979 article which laid the groundwork for the modern interpretation of the business judgment rule as understood in the area of anti-takeover charter provisions.[18] On the twenty-fifth anniversary of that article, a number of notable authors paid proper tribute to Lipton's legendary innovations to corporate law.[19] As we shall see, the intellectual rigor of his new cause against shareholder empowerment is more quixotic than the stuff of legend. Lipton's mistake is that, in resisting Bebchuk and the shareholder empowerment movement's call for shareholder nominations and expense reimbursement, he argues against any iteration of shareholder empowerment and attacks the entire ideological underpinning of shareholder primacy and the franchise right, thus widely overshooting the mark. An in-depth analysis of Lipton's criticism is contained later in this article.[20] For now, we shall return to the withhold vote movement of the late 1990s.

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14. *See, e.g.,* Unisuper Ltd. v. News Corp., No. 1699-N, 2005 WL 3529317, at *5 (Del. Ch. Dec. 20, 2005).

15. *See* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates,* 45 Stan. L. Rev. 857 (1993).

16. *Id.* at 934.

17. Grundfest cites three iterations of the institutional investor collective action problem: (i) rational apathy where each discounts the marginal effectiveness of individually joining the group; (ii) a game-theory type dilemma whereby each individual has an incentive to free ride; and (iii) the difficulty of finding a homogenous result that they can all agree on with the attendant costs of communicating among shareholders in the group. *Id.* at 909. This concept is also explored in more detail in Section IV.B. *infra.*

18. Martin Lipton, *Takeover Bids in the Target's Boardroom,* 35 Bus. Law. 101 (1979).

19. William T. Allen & Leo E Strine, *When the Existing Economic Order Deserves a Champion: The Enduring Relevance of Martin Lipton's Vision of the Corporate Law* 60 Bus. Law. 1383 (2005); R. Franklin Balotti, Gregory V. Varallo & Brock E. Czeschin, *UNOCAL Revisited: Lipton's Influence on Bedrock Takeover Jurisprudence,* 60 Bus. Law. 1399 (2005); Lynn A Stout, *Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May Be Right,* 60 Bus. Law. 1435 (2005).

20. *See infra* notes 82–121 and accompanying text.

Grundfest's proposal was to use withhold votes as a mechanism whereby investors could communicate dissatisfaction with a board at low cost.[21] Compared to the enormous expense of running an independent proxy fight, investors, both institutional and otherwise, would find that a withhold vote campaign would be more capable of sustaining momentum.[22] SEC proxy rules require that a proxy allow for withhold votes, or an instruction to not vote for a management slate even if the management slate is unopposed.[23]

Many have since challenged the usefulness of withhold vote campaigns.[24] However, Grundfest urged that they would provide institutional investors with the facility to negotiate with boards concerned about the prospect of becoming a target.[25] Grundfest reasoned that board members taking the job out of a desire for prestige would want to avoid the negative publicity[26] surrounding a withhold vote campaign.[27] A looming withhold vote would also give directors more of an incentive and justification to challenge a domineering CEO.[28] Or, in the aftermath of a withhold vote, takeover artists may smell weakness and be more willing to run the gauntlet of a tender offer (with its attendant proxy fight and risk of expensive litigation).[29] He also raised the possibility of the Court of Chancery enhancing its review of a board's decision not to withdraw a poison pill in response to a tender on the heels of a successful withhold vote campaign.[30] Grundfest noted that, as a signal without the necessity of legally binding effect, withhold votes would not even need to obtain a majority vote to be useful.[31]

Majority voting is the true progeny of the withhold vote movement. This is because majority voting turns a symbolic withhold vote into an effective vote

21. Grundfest, *Just Vote No, supra* note 15, at 866.

22. *Id.* at 909.

23. SEC Rule 14a-4(b)(2), 17 C.F.R. § 240.14a-4 (2007). In compliance, the proxy may include (i) a "withhold" box next to the name of each nominee, or (ii) an instruction in bold face type that a voter may strike through a name to vote against the nominee, or (iii) designated blank spaces in which the voter is permitted to enter names of nominees for which they intend to withhold a vote, or (iv) any other similar means, provided that clear instructions are furnished indicating how the security holder may withhold authority to vote for any nominee. *Id.*

24. Diane Del Guercio, Laura Wallis & Tracey Woidtke, *Do Board Members Pay Attention When Institutional Investors 'Just Say No'?* (June 2006) (unpublished manuscript, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=575242).

25. Grundfest, *Just Vote No, supra* note 15, at 865.

26. That negative publicity would be facilitated by the SEC's directive that the results of corporate elections, including a tally of withhold votes, be publicly disclosed. SEC Rules 14a-1 to 14a-7, and 14a-10, 17 C.F.R. §§ 240.14a-1 to 240.14a-7, § 240.14a-10 (2007).

27. Grundfest, *Just Vote No, supra* note 15, at 927–30.

28. *Id.* at 930.

29. *See id.* at 934–35.

30. *Id.* at 935. *See, e.g.,* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 (Del. 1985); Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1152 (Del. 1989); Shamrock Holdings, Inc. v. Polaroid Corp.,559 A.2d 278, 286–92 (Del. Ch. 1989).

31. Grundfest, *Just Vote No, supra* note 15, at 913. This prediction ultimately proved to be quite prescient. *See, e.g.,* Stephen Deane, *Majority Voting in Director Elections, From the Symbolic to the Democratic,* Institutional Shareholder Services Center for Corporate Governance (2005) [hereinafter "ISS Report"], *available at* http://www.issproxy.com/pdf/MVwhitepaper.pdf (withhold vote campaigns at Safeway, Inc., Disney, Inc., and Home Depot).

of "no" (which otherwise does not appear on the corporate proxy). Seeing the effectiveness of withhold vote campaigns when they were merely a symbolic gesture, institutional investors have lately moved to make withhold votes into a more effective negotiating tool by supporting majority voting in certain circumstances.[32]

B. Case in Point: The Disney Withhold Vote Campaign; It's a Small World After All, Mr. Eisner

Michael Eisner, former Chairman and CEO of the Walt Disney Co., faced a number of challenges in his final years at the helm.[33] Due to these ongoing problems, Institutional Shareholder Services ("ISS") recommended shareholders withhold their votes for his unopposed election as director of Disney.[34] A number of large institutional investors followed suit, resulting in a 43% withhold vote against Eisner.[35] The Board responded by forcing Eisner to step down as Chairman, and he eventually left Disney when his contract expired.[36] Here, no majority voting bylaw was in effect (although Disney has since adopted a majority voting regime for uncontested elections[37]), Eisner managed to receive a majority of the votes cast, and the holdover rule would have still maintained his office until a replacement could be elected even if the vote had legal effect. Further, he remained as CEO for the remainder of his contract. Nevertheless, the board responded to the outcome by replacing him as Chairman. If institutional investors were able to convince owners of 43% of the shares cast to withhold their votes when the result had no legal significance, then it is conceivable that they could come close to breaking the 50% threshold when legal consequences are present.[38] If as in the case of Disney, a board of directors reacts to a vote result with no legal significance and takes affirmative action, it is conceivable they would respond even more strongly to a vote that has legal significance. This proves that even if the majority voting amendment is later shown to be ill advised, it is at least not irrelevant.

32. Former Chancellor William Allen observed that just voting no is "like chicken soup; it couldn't hurt, and what if it helps?" Grundfest, *Just Vote No, supra* note 15, at 868 (citing a "Private Communication with Chancellor William T. Allen (Mar. 6, 1992)"). Perhaps, as we shall see, majority voting is the spice to liven the soup up a bit. However, with corollary SEC and NYSE action, *see infra* notes 166–96 and accompanying text, perhaps too many cooks will also spoil the broth.

33. Phyllis Furman, *Joy in the Mouse House: Disney Shareholders Give Eisner Thumbs Up,* N.Y. Daily News, Feb. 12, 2005, at 47. For instance, Eisner was engaged in momentous litigation over the hiring of Michael Ovitz and had just lost Pixar Studios over what was arguable a personality conflict. *See* Greg Hernandez, *Taking Final Bow Disney's Departing Eisner Upbeat in Wake of Tumultuous, 21-Year Roller-Coaster Ride,* Daily News (Los Angeles, CA) Sept. 28, 2005, at B1.

34. *See* Frank Ahrens, *N.Y. Times Investors Urged to Withhold Votes for Directors,* Washington Post, Apr. 6, 2007, D3.

35. *See* Michael McCarthy, *Disney Strips Chairmanship from Eisner,* USA Today, Mar. 3, 2004, *available at* http://www.usatoday.com/money/media/2004-03-03-disney-shareholder-meeting_x.htm.

36. James Kristie, *The evolution of corporate governance, continued,* 31 Directors & Boards 94, Sep. 22, 2006; *Eisner foes say new CEO search too slow,* Chicago Tribune, Feb. 9, 2005.

37. *Disney Adopts Majority Voting,* CFO Magazine, Aug. 19, 2005.

38. Absent broker street voting, the vote would have been a majority withhold vote. *See infra* Section VI.B.

C. Political Analysis of the Majority Voting Amendment: A Tour Inside the Corporate Law Factory

When viewed through the lens of the various academics that have sought to explain the process of how Delaware makes corporate law,[39] one can begin to understand the factors shaping the amendment restricting the board of directors' authority to change the shareholder votes necessary to elect the board. The Delaware response cannot be characterized as anything but conservative. The amendment merely requires that, where shareholders adopt a majority voting bylaw, the board will not be able to unilaterally amend that bylaw. Its necessary corollary provides that advance resignation letters conditioned on failure to get a majority vote are binding. The shareholders' ability to nominate directors was not enhanced by the amendment, and the plurality default was not altered. This structure is consistent with Professor Lawrence Hamermesh's three-fold observation that Delaware (i) will not act in the absence of clear policy implication, (ii) favors private parties ordering their own relations, and (iii) always makes slow, conservative changes to corporate law when it is moved to make a change at all.[40] The Delaware response allows shareholders and boards of directors to decide the election system they favor and merely makes such a decision concrete if it is approved by the shareholders. The shareholder empowerment debate began at the federal level,[41] subsequently moved to Delaware and ultimately led to majority voting.[42]

Professor Mark Roe has also explored in some depth the process by which Delaware Corporate Law evolves and the interest groups and goals shaping that

39. *See* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law,* 106 Colum. L. Rev. 1749, 1750 n.2 (2006), citing the relevant literature as follows:

E.g., Lucian Arye Bebchuk & Assaf Hamdani, Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters, 112 Yale L.J. 553 (2002); William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale L.J. 663 (1974); Jill E. Fisch, The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters, 68 U. Cin. L. Rev. 1061 (2000); Daniel R. Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 Nw. U. L. Rev. 913 (1982); Renee M. Jones, Rethinking Corporate Federalism in the Era of Corporate Reform, 29 J. Corp. L. 625 (2004); Marcel Kahan & Edward Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 Vand. L. Rev. 1573 (2005); Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 Colum. L. Rev. 1908 (1998); Jonathan R. Macey & Geoffrey P. Miller, Toward an Interest Group Theory of Delaware Corporate Law, 65 Tex. L. Rev. 469 (1987); Brett H. McDonnell, Two Cheers for Corporate Law Federalism, 30 J. Corp. L. 99 (2004); Mark J. Roe, Delaware's Competition, 117 Harv. L. Rev. 588 (2003); Mark J. Roe, Delaware's Politics, 118 Harv. L. Rev. 2491 (2005); Roberta Romano, The State Competition Debate in Corporate Law, 8 Cardozo L. Rev. 709 (1987); Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251 (1977).

40. Hamermesh, *Policy Foundations, supra* note 39, at 1773–74. Hamermesh indeed uses the majority voting amendment as an example of his theory in action. *See id.*

41. *See* Section VI. *infra* on shareholder proxy nominations.

42. *See* David C. McBride, *Delaware Considers Majority Voting for Directors: Proposed Amendments to the Delaware General Corporation Law, in* What All Business Lawyers & Litigators Must Know About Delaware Law Developments 2006, 1543 PLI/Corp 289, 297–99 (May 2006).

evolution.[43] In effect, he posits that in order to attract and maintain corporate franchise fees, Delaware will respond jointly to the interests of shareholders and management to the exclusion of other affected groups, as the ratification of both groups is required for re-incorporation into or out of Delaware.[44] Thus, when the two groups can agree, they get a quick change, and when they disagree the state will offer a moderated proposal that balances their interests. Roe also argues that Delaware will be spurred to act where the threat of federal action is imminent, because once both groups have achieved a result in Delaware they will be unmotivated to move beyond the status quo to push for changes on the federal level, which might bring in other parties (e.g., Unions) who may advocate for a result that neither of them favor.[45] Thus Delaware is a place to pre-empt unwieldy and unpredictable federal reform.[46] Delaware might also act to pre-empt in cases where national scandal make federal response likely.[47] Furthermore, to make Delaware pre-emption of federal action more likely, Delaware will moderate its action to minimize the chances of federal ire.[48] Consistent with that thesis, former Chief Justice Veasey of the Delaware Supreme Court commented at an SEC roundtable discussion that the Delaware Corporate Law's Committee should consider adopting majority voting to pre-empt federal legislation.[49]

In order to fully understand the Roe hypothesis in the context of the majority voting amendment, one must also understand the interest groups involved. For that, one need only look to the comment letters submitted to the committee whose task it was to study the proposal. The Council of Institutional Investors ("CII"), a trade group representing large pension funds, wrote to the committee charged with examining the majority voting amendment to express its whole hearted support of majority voting as a new default standard for shareholder elections.[50] ISS, a proxy advisory firm that represents the interests of a broader group

43. *See generally* Mark J. Roe, *Delaware's Competition,* 117 Harv. L. Rev. 588 (2003) [hereinafter "Roe*, Delaware's Competition*"]; Mark J. Roe, *Delaware's Politics*, 118 Harv. L. Rev. 2491 (2005) [hereinafter "Roe*, Delaware's Politics*"].

44. Roe, *Delaware's Politics, supra* note 43, at 2495.

45. *Id.* at 2513.

46. *Id.* at 2516.

47. *Id.* at 2516–17.

48. *Id.* at 2513.

49. In re SEC Roundtable on Proposed Security Holder Director Nominations, File No. 57-19-03, March 10, 2004, *available at* http://sec.gov/spotlight/dir-nominations/transcript03102004.txt ("And perhaps the Commission would want to consider if you want to adopt the provision you have on the table to create an exception for any state law that allows . . . majority . . . voting, for example, or any organic document of a corporation like the certificate of incorporation or bylaws be effective, to allow that, then this provision wouldn't apply to any such situation as that. I think it would be an interesting proposal for the Delaware legislative branch to consider through the good offices of the counsel of the Delaware State Bar Association Corporate Law's Committee, and there are others.").

50. Ann Yerger, Executive Director, Council of Institutional Investors, Letter to David McBride from the Delaware State Bar Assn., June 15, 2005, *available at* http://www.cii.org/library/correspondence/061705_mcbride.htm ("I am writing to you in your capacity as Chairman of the Corporation Law Section (the "Section") of the Delaware State Bar Association to request that the Section consider recommending to the Delaware legislature an amendment to Section 216 of the Delaware General Corporation Law ("DGCL"), 8 Del. C. § 216, to make majority voting for director elections the presumptive choice for Delaware corporations.").

of institutional investors, also has exhibited support for majority voting.[51] The Business Roundtable, representing the interest of corporate management of Delaware Corporations, felt that there was no need at present for a revision, but the businesses it represents were happy to institute board approved (and thus board revocable) bylaws or director resignation policies.[52]

The Delaware result can be viewed as a middle ground. The default rule of plurality voting wasn't altered, despite the insistence of the CII and ISS, but bylaws that pass with shareholder approval are protected from board meddling. Further, the director advance resignations that companies were already offering in response to corporate governance activists to keep the wolves at bay become permanent once received. Institutional investors and management each get a little something; reform was measured and narrowly tailored, and wheels of commerce were permitted to continue to spin.

In this case, the specter of corporate ballot reform is also looming on the federal level consistent with the Roe hypothesis. After a failed effort at granting shareholders proxy access to the corporate ballot, the SEC is again considering a hotly contested proposal to allow shareholders access.[53] A move to make majority voting bylaws resolute, once passed, could be a measure to minimize institutional shareholder interest in such a proposal.[54] The Delaware amendment does not give unions the opportunity to place divisive directors onto the ballot, something they might achieve under a ballot access rule. But it does allow institutional investors to send a message by voiding directors when they are dissatisfied with their performance.[55] Thus, after having explored Professors Hamermesh and Roe's architecture of the Delaware corporate lawmaking process, we can understand the *raison de-etre*

51. In 2007, ISS plans to include the presence and strength of a company's majority voting bylaw as an additional factor in the scoring systems it uses to rate the effectiveness of the company's corporate governance effectiveness. *See* ISS U.S. Corporate Governance Policy 2007 Updates, *available at* http://www.issproxy.com/pdf/2007%20US%20Policy%20Update.pdf.

52. Michael Schroeder, *CEOs Fight Making it Easier for Holders To Stop Board Picks,* WALL ST. J., May 27, 2005, at C4 (noting the Business Roundtable's press campaign opposing majority voting). *See also* Section VII.B. *infra* on the majority voting bylaws.

53. Patricia A. Vlahakis, *Takeover Law and Practice 2006, in* 38TH ANNUAL INSTITUTE ON SECURITIES REGULATION, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, 1571 PLI/Corp 259, 278 & n.2 (Nov. 2006) (citing *Proxy Access: To Be or Not to Be? Thirteen Months after SEC Proposes Rule, Resolution is No Closer,* 17 M&A REP. 45 (Nov. 22, 2004) (noting that proxy access proposal received 16,000 comment letters, a record-breaking number) and Judith Burns and Siobhan Hughes, SEC *Chairman Sees "Consensus" on US Market Reforms,* DOW JONES NEWSWIRES (Feb. 10, 2005) (quoting SEC Chairman William Donaldson as acknowledging that the SEC's original proxy access proposal "doesn't fly," is "too complicated," and that he would like to start over with "wholly new thoughts" on how to tackle the subject).").

54. Indeed, former Commissioner Grundfest wrote to the SEC to urge that majority voting is a proper alternative to corporate proxy access. *See* ISS Report, *supra* note 31, at 9.

55. ISS lists three reasons for targeting individual directors for withhold vote campaigns: (i) interlocking directorates involving key board committees; (ii) poor director attendance; and (iii) serving on too many boards. They also cite four factors it uses in targeting boards overall: (i) ignoring majority votes on shareholder precatory proposals; (ii) payment of excessive non-audit fees; (iii) overlooking obvious boardroom conflicts; and (iv) adoption of dead-hand poison pills. *See* ISS Report, *supra* note 31, at iii. Additionally, one can see this as following in the scandal, seen among institutional investor advocacy groups, of the Eisner saga. Excessive executive compensation and the last vestiges of post-Enron outrage could be seen as having given advocates of investor democracy just enough fuel to bring

for these amendments to the DGCL. What remains to be seen is if the amendments will, in interaction with other regulatory measures, have the effect that was originally intended.

D. Alternative Regulatory Schemes

1. The Model Business Corporation Act Recommendation

The American Bar Association's Committee on Corporate Laws promulgates the Model Business Corporation Act ("MBCA"), which serves as a model corporate code utilized by most states (except, of course, Delaware).[56] Though some groups advocated for an alteration to the plurality voting default found in the code, the Committee opted against recommending a change from the plurality default for three reasons: (i) it virtually assures a successful election of directors in every election, (ii) voting results are delivered in a simple and transparent way, and (iii) it is a standard that fits well with the many varying shareholder rights schemes (e.g., cumulative voting, multiple share classes, etc.).[57]

However, it recommended a change to the MBCA that substantially mirrors the Delaware majority voting amendments (including facilitating a director resignation policy) with the following caveat: operation of the holdover rule default[58] could be stayed to require a director failing to receive a majority vote in favor of their election, in a company that adopted majority voting in its bylaws, to step down within 90 days of the election.[59] The Committee reasoned that, absent an alteration to the holdover rule, the consequences of a majority voting bylaw would remain largely symbolic.[60] So its recommendation would amend the MBCA to expressly permit a bylaw to opt out of the holdover default in the sole circumstance of a director elected by plurality vote but failing to achieve a majority of votes cast.

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this to the attention of federal regulators. In that case, perhaps Delaware is hoping it can moderate the eventual federal response. *See* Roe, *Delaware's Politics, supra* note 43, at 2529. This analysis does run the risk of a reverse-causation paradox. Does the SEC act because of a lack of attention in the Delaware General Corporation Law ("DGCL")? Then does Delaware act to pre-empt the SEC? And then does the Delaware action alter the SEC's response? Here we have a Delaware amendment related to an SEC proposal that previously failed to pass, but is subsequently being reconsidered due to a federal court ruling. In the end, the portion of the Roe hypothesis regarding Delaware action in advance of federal pre-emption is helpful for analyzing this policy, but shouldn't be taken to excess limits.

56. *See* ABA, Committee on Corporate Laws, *Preliminary Report of the Committee on Corporate Laws on Voting by Shareholders for the Election of Directors,* at 7 (Jan. 17, 2006), *available at* http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20060117000001.pdf [hereinafter "ABA Preliminary Report"] ("Delaware is not a Model Act State, but Delaware lawmakers carefully study the work of Committee and Model Act Developments").

57. *Id.* at 20.

58. The holdover rule, allowing for a director failing to win an election to stay on until a replacement is elected and qualified, serves the purpose of ensuring that "the power of the Board of Directors to act continues uninterrupted even though an annual shareholder's meeting is not held or the shareholders are deadlocked and unable to elect directors at the meeting." *See* ABA Mod. Bus. Corp. Act §8.05, at 8-14 (2005) (Official Comment).

59. *See* ABA Preliminary Report, *supra* note 56, at 4–5.

60. *See id.* at 16.

The recommendations specifically exempt private, non-traded corporations and corporations that allow cumulative voting, since the justification of empowering shareholders is not as availing in those cases.[61]

2. California's Approach

California, in considering amendments concerning majority voting, had to also take into account the effect of majority voting on cumulative voting, as California mandates cumulative voting for firms incorporated in California (but then provides an exemption for firms listed on a national exchange).[62] The effect of majority voting on cumulative voting is subject to some debate. In California, no director may be removed by a majority of shareholders whose votes would be sufficient to win under cumulative voting.[63] Otherwise, a majority vote may eliminate a director who would otherwise be victorious under a cumulative voting regime. So, if one must choose between the two methods, the choice would depend on whether the relevant value judgment presented is either (i) to empower all shareholders or the board or (ii) empower the large shareholders or the small shareholders. Adopting cumulative voting for contested elections, but allowing a majority withhold vote provision for uncontested elections may resolve the disparity.[64]

A bill amending the California Corporation Code, much like the MBCA, exempts corporations with cumulative voting (and also, by implication, corporations not listed on a national exchange).[65] It only permits shareholders to opt out of plurality voting for uncontested elections, reaching the same result as the MBCA but by different means.[66] It also allows no discretion in effecting the resignation, and mandates that the director leave within the earlier of 90 days or as soon as the Board has found a replacement.[67]

3. The Grundfest Proposal

Professor Grundfest has proposed tailoring SEC regulations and listing standards to take into account a successful majority withhold vote against a director.[68]

61. *See id.* at 13.
62. Cal. Corp. Code § 301.5(a) (West Supp. 2007).
63. Cal. Corp. Code § 303 (West 1990).
64. See an exchange between Broc Romanek and a CalPERs representative, posted Aug. 2, 2006 on www.thecorporatecounsel.net/blog/archive/2006_08.html.
65. *See* 2006 Cal. Legis. Serv. ch. 871 (S.B. 1207) (to be codified at Cal. Corp. Code §§ 708, 708.5).
66. *Id.*
67. Cal. Corp. Code § 708.5(c) (West Supp. 2007) ("Notwithstanding subdivision (b) of Section 301, if an incumbent director fails to be elected by approval of the shareholders (Section 153) in an uncontested election of a listed corporation that has amended its articles of incorporation or bylaws pursuant to subdivision (b), then, unless the incumbent director has earlier resigned, the term of the incumbent director shall end on the date that is the earlier of 90 days after the date on which the voting results are determined pursuant to Section 707 or the date on which the board of directors selects a person to fill the office held by that director pursuant to subdivision (d).").
68. Joseph A. Grundfest, *Advice and Consent: An Alternative Mechanism for Shareholder Participation in the Nomination and Election of Corporate Directors*, *in* Shareholder Access to the Corporate Ballot (Lucian Bebchuk, ed., Harvard University Press, 2004).

This would have the benefit of not requiring abolition of the holdover rule to give effect to a successful campaign against a recalcitrant board. Among many alternative strategies for his proposal, Grundfest notes that SRO listing standards could be amended to exclude from the definition of independent director one from whom a majority of votes has been withheld,[69] or they could have their vote unrecognized for purposes of any listing standard voting requirement.[70] Furthermore, the SEC could enhance the disclosure liability of such directors, commit to challenging indemnification of such directors, or enhance regulatory scrutiny of filings by companies with a majority withheld director.[71] For that matter, the Chancery Court could also alter its review of decisions by directors in which a majority withhold vote has been successful.[72]

Grundfest would temper his approach with a 90-day delay of the effective date of a successful withhold vote campaign, and a cure mechanism using shareholder consents to allow the board an opportunity to respond to a successful withhold campaign without penalty.[73] This approach would enhance the negotiating leverage for financial intermediaries that are able to institute successful campaigns, without entirely halting a board's ability to function.[74]

4. An International Perspective

For European companies, majority voting is the default method for electing directors in both contested and uncontested elections, with some rare exceptions.[75] Japan uses a supermajority voting requirement to oust directors.[76] Proponents of majority voting use examples from corporate elections in Europe and Japan to counter arguments that the collateral damages of majority voting makes it inherently too risky (failed elections, etc.).[77] Critics might counter that the numerous other governance differences between the United States and Europe/Japan strain a meaningful comparison.[78]

69. *Id.* at 10.
70. *Id.*
71. *Id.*
72. *Id.* at 12. For instance, decisions of special litigation committees are afforded discretion under business judgment rule. Upon proper pleading, those decisions will be examined under "entire fairness review." *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984), *overruled in part,* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).
73. Grundfest, *Advice and Consent, supra* note 68, at 12. Grundfest also notes that allowing cures by shareholder consent could allow the regulatory body to designate replacements as tainted by the withhold vote as well, thus keeping the board from using its power to replace to minimize the effect of Grundfest's proposal. *Id.* at 12–13.
74. ISS Report, *supra* note 31, at 10.
75. ISS Conference, Institutional Shareholders Services, Inc., *Around the World in Sixty Minutes, An Overview of International Corporate Governance Trends,* Oct. 21, 2005, at 5, *available at* http://www.issproxy.com/pdf/GlobalCorporateGovernancePerspectivesSD.pdf.
76. *Id.* at 16.
77. ISS Report, *supra* note 31, at 13.
78. For more information on those differences, see generally Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe,* 14 Int'l Rev. L. & Econ. 203 (1994).

III. The Shareholder Power Debate, A Foucault Pendulum

A. The General Debate

In a sense, this article started the reader at Act III of a multi-part drama, so a brief history lesson is appropriate to set the stage for majority voting's place in the tug of war between managers and shareholders. Professors Adolph Berle and Gardner Means were the first noble souls to develop the story of corporate development that began in the 19th century.[79] They argued that the development of capital intensive operations of the industrial revolution required larger capital inflows than any individual could provide. That, combined with an interest in diversification, resulted in a fragmentation of share ownership and a resulting divergence between ownership and control in the modern corporate organism.[80] Professors Meckling and Jensen's model of agency conflict presents a discussion of the relationship between a board of directors and its shareholders by describing how the separation of ownership from control can complicate matters in the modern Berle-Means corporation.[81] They described that relationship as one in which principals engage agents to perform a service that entails delegation of authority.[82] If both parties to the relationship are utility-maximizers, many situations may arise in which the agent's interest will diverge from that of the principal. Principals would in turn create incentives for agents to limit aberrant activities, and agents would frequently incur bonding costs to ensure principal interest and to maintain a profitable relationship. But if agents can take advantage of information asymmetries to engage in profitable aberration at the principals' expense and without the principals' knowledge, it may be rational for them to do so.[83]

We return to scrutinize the Legend of Lipton, and examine his argument that this is merely "The Myth of the Runaway Agency Costs."[84] In one brief sentence, Lipton boldly attempts to sweep away the Jensen and Meckling foundation for modern corporate scholarship when he criticizes Bebchuk for citing their seminal

79. *See generally* Adolf A. Berle & Gardiner C. Means, The Modern Corporation and Private Property 6 (1933). The Berle-Means theory of corporate history is far from universally accepted. For instance, Walter Werner argues that the ownership/control dichotomy preceded the industrial revolution. *See* Walter Werner, *Corporation Law in Search of its Future,* 81 Colum L. Rev. 1611, 1612 (1981). Mark Roe also presents a more nuanced explanation of how market segmentation resulted from interested groups exercising political influence in favor of financial disintermediation. *See* Mark J. Roe, Strong Managers, Weak Owners: The Political Roots of American Corporate Finance 44 (1994). However, this article uses Berle and Means as a useful model. In much the way that Einsteinian relativity and quantum physics did not replace Newtonian mechanics as much as it demonstrated circumstances in which it was unable to describe the world, leaving Newtonian mechanics to still describe most conventional physical phenomena, the Berle-Means theory of corporate history is still a useful explanation despite the various alternate versions of economic history that it inspired.

80. Berle & Means, *supra* note 79, 4–7.

81. *See generally* Jensen & Meckling, *supra* note 1.

82. *Id.* at 318–19.

83. Berle & Means, *supra* note 80, at 6.

84. Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 749. Lipton cites another article approvingly on this point. *Id.* at 750 n.60 (quoting Theodore N. Mirvis et al., *A Response to Bebchuk's The Case for Increasing Shareholder Power,* 119 Harv. L. Rev. (forthcoming June 2007) (manuscript at 7)

work on agency costs. He writes "Bebchuk . . . is instead satisfied to assert that the theory 'is widely recognized,' citing as support a lone thirty-year-old article."[85] A "lone thirty-year-old article" is certainly one way to characterize *Theory of the Firm;* another way would be as the third most downloaded article on the Social Science Research Network, garnering, as of June 5, 2007, nearly 40,000 downloads by social science and legal scholars as well as nearly 900 citations in legal journals based on a simple Westlaw search.[86] Lipton's best move is invoking Lynn Stout and Margaret Blair's well crafted assault on the traditional agency model.[87] Succinctly, Stout and Blair argue that:

> unlike traditional principals, shareholders in publicly traded corporations have little control over who the directors are, and no direct control over what the directors do. Under the rules of agency, an agent generally owes her principal a "duty of obedience." Directors, however, are not required to follow shareholder mandates in any way.[88]

Their point is well taken, general agency principles do not completely carry over to the field of corporate law. We might describe the basic powers of a principal as (i) the power to select the agent, (ii) the power to direct the agent, and (iii) the power to expect loyalty from the agent.[89] The corporate principal agency relationship is a quasi-agency one because the power to direct has been modified.[90] But this is something we have always understood; the analogy to principal/agency paradigms has always taken into account the variation and has focused on the costs resulting from structures intended to minimize the problem of separating ownership from control.[91] Indeed, shareholders are not held liable for the actions of their agents, the board, precisely because they lack the power to direct their actions.[92] This does not justify, however, minimizing the power to select, as

("[T]he assumption that undergirds much of Bebchuk's analysis,—that directors are generally engaged in a constant struggle to maximize their private benefits at shareholders' expense—cannot be even remotely squared with the experience of those of us who actually work with directors as they strive to meet their fiduciary obligations."). Lipton's conclusion fails on two grounds: he relies on anecdotal rather than empirical evidence, an analytical failing he accuses Bebchuk of on the same page and he suffers from an obvious conflict of interest. The New York Code of Professional Responsibility prohibits him from publicly disparaging his clients. *See* New York Lawyer's Code of Professional Responsibility Cannon 4 ("A Lawyer Should Preserve the Confidences and Secrets of a Client"), *available at* http://www.nysba.org/Content/NavigationMenu/Attorney_Resources/Lawyers_Code_of_Professional_Responsibility/Lawyers.Code.pdf. Even if Bebchuk's characterization of the agency conflict were accurate, Lipton's fiduciary obligations would prohibit him from admitting it.

85. Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 749.

86. *See* http://papers.ssrn.com/sol3/topten/topTenResults.cfm?groupingtype=3&groupingId=1.

87. Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 751 n.63 (citing Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomolies in Corporate Law,* 31 J. Corp L. 719 (2006)).

88. Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomolies in Corporate Law,* 31 J. Corp L. 719, 726 (2006)

89. Restatement (Third) of the Law of Agency §§ 1.01 (power to select and direct), 8.01 (duty of loyalty) (2006).

90. Del. Code tit. 8, § 141(a) (2007) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .").

91. *See* Jensen & Meckling, *supra* note 1, at 318–19.

92. Lipton identifies this distinction. *See* Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 755.

incarnated in the shareholder franchise. Agency theory, much like shareholder democracy, is a concept that is not merely grafted directly into corporate scholarship, but has been woven into the tapestry with care for the differences between the corporate world and the world of the concept's origin. It is unavailing to argue that, because the concepts are not exactly applicable, they should be completely abandoned in the corporate arena.

As a consequence, the concept of corporate law fiduciary duties was instituted to address the potential conflict of this quasi-agency relationship; however, corporate law is generally deferential to board (i.e. agents') decisions.[93] The shareholder franchise also serves as a partial justification for this deference of authority given to the board of directors in the form of the business judgment rule and the demand requirement for derivative litigation.[94] In essence, the argument goes, "you elected them, now let them do their jobs, and if you don't like it, replace them."[95] The threat of being able to replace directors should mean that shareholders will be in a better position to negotiate for change, and directors will have added incentive to avoid results that will induce shareholders to initiate a campaign to replace them.[96] Lipton argues that *Blasius*[97] dicta stands for the proposition that shareholder voting need not be contestable to be legitimate, and therefore restrictions on such voting comports with the theme of Delaware Corporate law.[98] That conclusion, however, completely misconstrues the case. The *Blasius* court took no view on whether contests are or should be frequent,[99] but merely that the

93. *See* E. Norman Veasey, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments,* 153 U. Pa. L. Rev. 1399, 1419 (2005).

94. Bebchuk, *The Myth of the Shareholder Franchise, supra* note 4, at 680. *See generally* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power,* 118 Harv. L. Rev. 833, 851 (2005) ("A key element of the corporate structure is the shareholder franchise—shareholders' power to elect and replace directors. Corporate statutes provide shareholders with this power, which courts view as a fundamental element of the corporate structure.") (citing Blasius Indus. Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (noting the "central importance of the franchise to the scheme of corporate governance")). *See also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

95. Some argue that shareholder supremacy fails to take into account stakeholders, such as employees or creditors, who deserve a say in corporate decision-making. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law,* 85 Va. L. Rev. 247, 275, 278 (1999). The U.S. model provides for shareholder supremacy, as shareholders are the only group with a fixed and permanent interest in the underlying assets of the corporation. Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 66–72 (1991). This article does not address the shareholder v. stakeholder debate but focuses on the shareholder v. manager conflict, including the debatable assumption that the U.S. shareholder supremacy model is superior.

96. This is also observed in Stephen Bainbridge, The *Case for Limited Shareholder Voting Rights* 53 UCLA L. Rev. 601, 614 (2006) [hereinafter "Bainbridge, *Limited Voting*"].

97. Blasius Indus. Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

98. *See* Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 736. This is part of Lipton's response to Bebchuk's arguments, though he again misses the point. Bebchuk's argument is not that contests have to be frequent for the franchise to be real, but merely that the apparent lack of contests point to structural defenses, instituted by boards, that have diluted the franchise (like the staggered board, asymmetric cost reimbursement to the corporate ballot, shareholder collective action problems, broker street voting, etc.). *See* Bebchuk, *The Myth of the Shareholder Franchise, supra* note 4, at 686–94.

99. The Delaware Chancery Court stated:

> It has, for a long time, been conventional to dismiss the stockholder vote as a vestige or ritual of little practical importance. It may be that we are now witnessing the emergence of new institutional

franchise must be protected. Remember the theme that Delaware's corporate law is an enabling act.[100] So if shareholders seek enhanced electoral powers through bylaws, the Delaware Code guarantees them that ability. Therefore, elections may not be regularly contested, but the possibility of a contest needs to be real for there to be a true franchise.[101]

So the field of corporate law is awash in battles over whether shareholder control is largely a myth perpetrated by those who stand to benefit by board entrenchment.[102] The thrust of Lipton's response to Bebchuk's argument that shareholder democracy is a myth[103] is to criticize Bebchuk for asserting that the incidence of contests is too low. Bebchuk presents evidence that, over the period from 1996 to 2005, there were 303 contested solicitations identified by Georgeson Shareholder.[104] He further counts that only 118 of those contests were over an alternative team for the company, also noting that only 24 of those companies, three per year on average, had a market capitalization exceeding $200 million.[105] Lipton fails to see the problem presented by Bebchuk's data.[106] Three contests per year, out of a universe of thousands of large firms, sounds about right in his view.[107]

> voices and arrangements that will make the stockholder vote a less predictable affair than it has been. Be that as it may, however, whether the vote is seen functionally as an unimportant formalism, or as an important tool of discipline, it is clear that it is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own. Thus, when viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power.

Blasius Indus., 564 A.2d at 659 (footnote omitted).

100. E. Norman Veasey, *Should Corporation Law Inform Aspirations For Good Corporate Governance Practices—or Vice Versa?,* 149 U. Pa. L. Rev. 2179, 2179–80 (2001).

101. *See* David C. McBride & Danielle Gibbs, *Interference with Voting Rights: The Metaphysics of* Blasius Industries v. Atlas Corp., 26 Del. J. Corp. L. 927, 929 (2001) ("No Delaware decision has ever found a 'compelling justification' for an action deemed to have been taken for the primary purpose of thwarting, impeding or interfering with a shareholder vote.") Lipton fails to admit that, with the structural management advantages that he has helped to craft over the years, the franchise has been diluted. His article on the quinquennial election can be viewed as favoring the staggered board, which stands as a bulwark against shareholder ability to replace a board of directors. Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors,* 58 U. Chi. L. Rev. 187, 225–28 (1991). Though his proposal at that time did not consider staggered terms, his argument for longer terms comports with the three-year director term that makes the staggered board possible.

102. Robert C. Clark, Corporate Law 95 (1986) (noting a cynic's view that "the whole institution of shareholder voting is a fraud"). *See also* Lynn Stout, *The Mythical Benefits of Shareholder Control* (working paper *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=929530); Stephen Bainbridge, *Director Primacy and Shareholder Disempowerment* 119 Harv. L. Rev. 1735, 1736 (2006) [hereinafter Bainbridge, "*Director Primacy*"*];* Lucian Arye Bebchuk, *Letting Shareholders Set the Rules,* 119 Harv. L. Rev. 1784 (2006). Recent evidence compiled by Professor Bebchuk indicates that the balance of power in corporate elections has, over the last 10 years, run markedly in favor of boards. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power,* 118 Harv. L. Rev. 833 (2005).

103. Bebchuk, *The Myth of the Shareholder Franchise, supra* note 4.

104. *Id.* at 683.

105. *Id.* at 686.

106. *See* Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 737.

107. *Id.* at 738.

Lipton is correct to argue that Bebchuk never shows us how many contested elections should be expected, and it is a difficult question to answer.[108] Yet, when we examine the number of elections, and understand the structural limitations of the system that limit the availability of contested solicitations (the staggered board, asymmetric expense reimbursement, and broker-street voting being the three most prevalent examples)[109] we can develop an appreciation for why Bebchuk is suspicious of the low incidence of contests.

But corporate law traditionalists still maintain that, even if the franchise forms an underpinning for the business judgment rule, and even if it lacks real power, the case for increasing shareholder power is inherently flawed as a policy matter.[110] They urge that the internal inconsistency of a shareholder's commitment to a company and the inconsistent goals of different shareholders make it extremely difficult for corporate law to make shareholders absolutely prime, even if that is the outcome favored.[111] The question arises: which type of shareholder matters more:[112] the day trader or the pensioner, the institutional investor or the small investor?[113] The different interests of shareholders makes it difficult for corporate policymakers to engineer legal regimes in such a way as to determine which type of shareholder the board member should serve.[114] Lipton subscribes to this

108. *Id.*

109. *See* Bebchuk, *The Myth of the Shareholder Franchise, supra* note 4, at 688–94, 697. *See also* infra notes 218–25 and accompanying text on broker street voting. *See also* infra notes 238–51 and accompanying text on staggered boards. Control of vast economic resources is at stake in this debate. The structure of the contest is weighed in favor of management, management at times has incentives that work against the best interest of shareholders, and incidents of contested elections average three per year among thousands. Although the thrust of this article is not to conclude in favor of, or against, the empowerment movement, and indeed proving that the franchise is diluted still fails to answer the question of whether or not it should be enhanced, observation of these combined factors seems to unavoidably lead one to conclude that Lipton is dead wrong when he argues that the shareholder franchise is alive and well. Unfortunately, former Chief Justice Veasey, now in private practice, makes the same mistake, perhaps for a similar reason. *See generally* E. Norman Veasey, *The Shareholder Franchise Is Not A Myth: A Response to Professor Bebchuk,* 93 VA. L. REV. 811 (2007).

110. "Far from the single owner of a building, the shareholders are a diverse and ever-shifting group of people and institutions, with differing interests and, in the case of institutional investors, differing obligations to their own diverse constituencies." Martin Lipton & Steven Rosenblum, *Election Contests in the Company's Proxy, An Idea Whose Time Has Not Come,* 59 BUS. LAW. 67, 68 (2003). A logical observation; but also a consistent one, coming from the inventor of the poison pill.

111. "Shareholders with private interests, however, might prefer the firm to pursue those interests at the expense of the interests they have in common with other shareholders." Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power,* 53 UCLA L. REV. 561, 575 (2006).

112. *Id.*

113. This is also observed by Bainbridge, *Limited Voting, supra* note 96, at 634. The time horizon and the character of the investor determine the ability of corporate lawmakers and chancellors to encourage the shareholder primacy model. Lipton & Rosenblum, *supra* note 110, at 74.

114. Another of Lipton's positions is that shareholder democracy encourages short term thinking that erodes value. Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 747. Although he is correct that short term thinking is usually best avoided, perhaps his efforts might be better directed at reforming the quarterly reporting approach embraced by the federal securities laws that fuels short term thinking. *See* REPORT AND RECOMMENDATIONS OF THE COMMITTEE ON THE REGULATION OF U.S. CAPITAL MARKETS IN THE 21ST CENTURY, 72–77 (U.S. Chamber of Commerce, March 2007), *available at* http://www.capitalmarketscommission.com.

line of thinking, calling it the "Myth of the Monolithic Shareholder," and it is one of his more convincing arguments.[115] This describes the difficulty in determining whether shareholder primacy goals are attainable without even addressing the non-financial goals that shareholders may have. Corporate pensions plans investing in the companies that employ their membership are one example. Those shareholders potentially have an interest in full employment that could conflict with the wealth maximization goals of other shareholders.[116] Socially responsible investors who seek policy changes like divestment present yet another interesting problem.[117] Lipton signs on to this view of shareholder activism with the assumption that activist investors are all of the same stripe when he argues that labor unions and state governments are the source of shareholder activism.[118] This statement ignores the financial institutions that signed on to the Eisner withhold vote, or the Caremark withhold vote, or a variety of other recent activist activity during the 2007 proxy season.[119]

As we shall see later in this section,[120] the assumption that all activist shareholders are cut from the same cloth is an outdated modality. Lipton will certainly be correct about some activists, but it remains to be seen whether he is right about all of them, or whether activists whose goals diverge from long term shareholder wealth will be successful where the shareholder empowerment mechanism is crafted with a majority vote as the triggering mechanism. Assuming a firm with a majority of dispersed shareholders, and assuming rational voting decisions by shareholders,[121] the drawbacks identified by Lipton may be subverted by a majority vote trigger.

The corporate law traditionalists[122] urge that a corporation is merely a "nexus of contracts,"[123] and that shareholders deserve no more than the benefit of the contracts they are able to negotiate.[124] The pro-management side of the argument

115. Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 756.

116. Bainbridge, *Limited Voting, supra* note 96, at 609 (citing Morris M. Kleiner & Marvin L. Bouillon, *Providing Business Information to Production Workers: Correlates of Compensation and Profitability,* 41 Indus. & Lab. Rel. Rev. 605, 614–15 (1988)).

117. Continuing that line of analysis, one might ask what about shareholders that have moderate risk preferences, versus high risk preferences? Also, conflicts may directly arise between shareholders that implicate anti-competitive practices. Would a large hedge fund that owns an interest in each of two competing companies make voting decisions that would work to erode value for other shareholders?

118. *See* Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 744.

119. *See supra* notes 33–38 and accompanying text regarding the Disney vote. *See also* L. Reed Walton, *Vote Results,* Governance Weekly (Institutional Shareholders Services June 15, 2007), *available at* http://www.issproxy.com/governance_weekly/2007/031.html.

120. *See infra* notes 143–53 and accompanying text.

121. Although arguments about shareholder irrationality in pricing are widespread, see Lynn Stout, *Share Price as a Poor Criterion For Good Corporate Law,* 3 Berkeley Bus. L.J. 43, 50 (2005), shareholder rationality in voting decisions is, however, an entirely distinct field of inquiry.

122. For an effective summary of the traditionalist view, see Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 Harv. L. Rev. 1759, 1762 (2006).

123. *See* Jensen & Meckling, *Theory of the Firm, supra* note 1, at 321.

124. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract,* 89 Colum. L. Rev. 1416, 1444 (1989). *But cf.* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract,* 85

continues that corporate law will not be nearly as effective at setting up a shareholder primacy regime, in that its efficiency would lag behind that of an information market such as the securities market.[125] But not everyone agrees that the Wall Street Rule (selling shares)[126] is a cogent justification for a lack of real shareholder democracy.[127] For one, large investors need to diversify, which means they can't sell off their whole portfolio. Further, too much buying and selling may lead to tax and fee consequences that will diminish returns for investors.[128] Moreover, institutions selling their position to express dissatisfaction will diminish the share value for other investors, leading to a downward spiral effect on prices.[129] Although shareholders can diversify against individual corporate operational risk, finding a way to minimize operational risk (from shirking and self-dealing) systematically might well be worth the cost of changing the balance of power, according to advocates of the shareholder democracy movement.[130]

COLUM. L. REV. 1403, 1444 (1985) (arguing that analyzing corporate law using a contract rights paradigm is inaccurate and inefficient). Some claim that one should leave it up to shareholders to express dissatisfaction with their share performance by taking the "Wall Street Walk," (Selling your shares, also known as the "Wall Street Rule," is explored in further detail in Bainbridge, *Limited Voting, supra* note 96, at 619), thus access to capital markets may be sufficient to discipline managerial shirking or self-dealing. If one assumes semi-strong market efficiency, shareholders should be looking out for their own interests already without the need for corporate law by simply determining who they invest in. There is a substantial literature regarding bounded rationality, beyond the scope of this article, which calls into question the rational choices of economic actors. *See generally* John Conlisk, *Why Bounded Rationality?* 34 J. ECON. LIT. 669 (1996). Reputation costs in the capital market should be the controlling force that keeps management focused on the interests of shareholders, but may be minimized by the bounded rationality of those shareholders. Another interesting dimension to the shareholder democracy debate is whether one share, one vote is the even the right allocation of voting rights. *See generally* Shaun Martin & Frank Partnoy, *Encumbered Shares,* 2005 U. ILL. L. REV. 775. For instance, warrant and option holders, who have an expected interest somewhat similar to plain vanilla shareholders, get no voting rights. *See id.* at 791–92. This analysis can get quite complicated. For instance, a shareholder who also sells shares short is betting against the enterprise but still gets to vote in elections controlling its future. *Id.* at 779.

125. Bainbridge, *Limited Voting, supra* note 96, at 627. Some argue that what corporate law can provide is a regime that mandates accurate disclosure to make this market more efficient, as the securities laws do, but it cannot be an effective instrument to force companies to put shareholders first. They effectively argue that all we can do is require disclosure of financial data and other information, leave ultimate power and discretion in the hands of managers, and allow the capital markets to reward managers if shareholders like what the managers are doing. Traditionalists also cite what is essentially an "if it ain't broke, don't fix it" argument that the U.S. financial markets perform well in comparison to other countries, so corporate governance and board primacy cannot be all that bad. *See* Stephen Bainbridge, *Director Primacy, supra* note 102, at 1739 ("Despite the alleged flaws in its governance system, the U.S. economy has performed very well, both on an absolute basis and particularly relative to other countries."). Lipton is also a subscriber to this philosophy. *See* Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 733. This argument, however, is the least convincing proposed by traditionalist apologists. The question remains: Under an optimal governance regime, how much better would our markets perform?

126. *See supra* note 124.

127. Jayne W. Barnard, *Institutional Investors and the New Corporate Governance,* 69 N.C. L. REV. 1135, 1149–51 (1991).

128. *Id.* at 1151.

129. *Id.* Furthermore, institutional investors who index a portion of their portfolios, which represents an increasingly larger proportion of institutional assets, are constrained from selling shares based on the idiosyncratic characteristics of a particular stock. *Id.* at 1152.

130. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power,* 118 HARV. L. REV. 833, 865–70 (2005).

Professor Bebchuk argues that shareholders should be able to decide the balance of power they favor.[131] In effect, he would let the shareholder decide, through adopting bylaws that control the balance of power, where their preference sits in the shareholder power debate. It seems a consistent resolution, as most of the arguments in favor of management discretion rest on assumptions about preferences for capital owners, efficiencies that work to the benefit of capital owners, and freedom of contract. Perhaps the power to adopt bylaws that change Bebchuk's rules of the game[132] is a way of minimizing the adhesive contract that purchasing a share is currently and would, effectively, make the contract bargaining process more balanced.[133]

The analysis has now come full circle. The majority voting amendment comports with Bebchuk's challenge to resolve the debate by allowing shareholders to initiate rules of the game changes into the corporate bylaws, with Lipton's criticism of the shareholder empowerment movement unable to convince the legislature that the underpinning of a real shareholder franchise should be ignored. The majority voting provision initiated by Delaware will not end the tug of war between management and shareholders that has picked up speed over the last 30 years. This power struggle is bound to continue well into the 21st century. But the majority voting accommodation will interact with other elements of corporate governance policy in as yet unforeseen ways, and will likely have a more powerful effect on the balance of power between boards and shareholders than is presently understood. On the other hand, the effectiveness of majority voting will depend, as will be shown, on the ability of firms to outflank majority voting amendments with various evasive tactics still available. Before exploring ways in which the majority voting scheme

131. *See generally* Lucian Arye Bebchuk, *The Myth of the Shareholder Franchise, supra* note 4; Lucian Arye Bebchuk, *Letting Shareholders Set the Rules,* 119 Harv. L. Rev. 1784 (2006). Bebchuk offers evidence that management typically ignores precatory proposals to eliminate staggered boards: "The evidence put forward below shows that management often elects not to initiate rules-of-the-game decisions for which shareholders register strong support in precatory resolutions." Bebchuk, *The Case for Increasing Shareholder Power, supra* note 130, at 852. Bebchuk, Coates, and Subramanian aptly note that staggered boards serve as an effective sandbar against any wave of shareholder reform. *See generally* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy,* 54 Stan. L. Rev. 887, 925–39 (2002). Indeed, companies failing to accommodate the precatory proposals, as members of staggered boards, would be difficult to replace in response to their refusal to eliminate the staggered board under the precatory proposal. Critics may use this as evidence that changing election defaults is a useless endeavor. It is nevertheless uncertain whether this is an indictment of the argument of board accountability, or merely a reflection of a lack of board accountability. In other words, do shareholders fail to hold directors to the carpet because they are disinterested due to cost inefficiencies, or because they are unable due to staggered directorships? At present, about half of the top 5,000 (by size) publicly traded U.S. corporations have staggered boards, ISS Report, *supra* note 31, at 15, so perhaps reform activity can be effective at those companies notwithstanding.

132. Bebchuk, *The Case for Increasing Shareholder Power, supra* note 130, at 836–37.

133. It might be that some firms would experience shareholder adoption of pro-management bylaws, others wouldn't. Policy makers may then be able to regress the performance of the different allocations of authority, something has not been studied previously. Perhaps the difference in whether such a bylaw passes would depend in part on earning performance preceding the election, and would only target perennial under-performers.

may be undermined, it is important to consider the present economic incentives facing those shareholders who would make use of the power of majority voting.

B. Institutional Investors and the Collective Action Problem: Why No One Volunteers for Kitchen Patrol in Mutual Fund Families

Some may argue that there is no need debate about ways in which to resolve the management and shareholder power struggle, as shareholders consistently refuse to exercise the powers of the shareholder franchise in any meaningful fashion. This assumption of shareholder abdication should be evaluated to determine if that is still true in the case of institutional shareholders. Additionally, the rise of activist hedge funds as institutional shareholders is significantly altering the dynamic in the power struggle between management and the shareholder.

Institutional investors own a significant percentage of the outstanding equity in the U.S. markets.[134] However, their ability to influence corporate decision making is minimized by the effect of securities laws,[135] conflicts of interest,[136] and economic cost phenomena.[137] Numerous academics (notably, Professors Grundfest, Rock and Black, among others) have modeled investor rationality through mathematical analysis to describe where it becomes economically rational for an investor to undertake action[138] using variants of the following equation:

134. *See, e.g.,* Robert C. Pozen, *Institutional Perspective on Shareholder Nominations of Corporate Directors,* 59 Bus. Law 95, 95 n.2 (2003) (institutional investors held 55.8% of publicly traded equities in the United States in 2001).

135. *See* Bainbridge *Limited Voting, supra* note 96, at 618.

136. *See* Strine, *supra* note 122, at 1765 ("Those institutions most inclined to be activist investors are associated with state governments and labor unions, and often appear to be driven by concerns other than a desire to increase the economic performance of the companies in which they invest. By contrast, those institutional investors one might think are best situated to make wise voting decisions—the money managers who operate mutual funds, particularly index funds—have little desire to spend money on stockholder activism or offend corporate management."). *See also* James A. Brickley, *et al.,Ownership Structure and Voting on Antitakeover Amendments,* 20 J. Fin. Econ. 267 (1988).

137. *See* John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor,* 91 Colum. L. Rev.1277, 1354–59 (1991). *See also* Grundfest, *Just Vote No, supra* note 15, at 909 & n.234. Activism was also classically constrained by the free rider problem. "Even the most activist institutions spend less than half a basis point of assets under management (.005%) per year on their governance efforts." Del Guercio and Hawkins, The Motivation and Impact of Pension Fund Activism, working paper, 1997 (quoted *in* Bernard B. Black, *Shareholder Activism and Corporate Governance in the United States,* at 5, in The New Palgrave Dictionary of Economics and the Law (Peter Newman, ed., 1998)). Historically, institutional investors used their power in two ways: "jawboning" management in negotiations and presenting a shareholder governance proposal at an annual meeting. Black, *supra,* at 2. Institutions would typically target a small number of underperforming firms to make examples of them. "For example, CalPERs, the largest state pension plan and the Council of Institutional Investors annually identify a handful of poorly performing firms as targets for governance initiatives. This lets a proposal serves double duty: as a way to improve governance procedures and as a signal of investor displeasure with management." Black, *supra,* at 5–6. Merely voting no is certainly less costly than submitting an alternate slate of directors. Withhold vote campaigns are more of a remote-control sort of activism, allowing institutional investors to go along with a campaign without the cost of more onerous activity leading the apathy that classically constrained it.

138. This equation and its explanation in the paragraph that follows it is drawn from Grundfest, *Just Vote No, supra* note 15, at 910 (citing Bernard S. Black, *Shareholder Passivity Reexamined,* 89 Mich.

(A) $c_i < p_i * x_i * B_i$

where,

c_i = shareholder i's expected cost of participation;

p_i = shareholder i's estimate of the probability that her decision to participate will result in successful collective action with benefits B_i;

x_i = the percentage of the corporation's shares owned by shareholder i; and

B_i = shareholder i's estimate of the aggregate net benefits to all shareholders that will result from successful collective action.

This equation states that a profit-maximizing shareholder will agree to bear the private costs of participation, c_i, only when those costs are less than the anticipated benefits to that individual shareholder, x_iB_i, weighted by the estimated probability, p_i, that the shareholder's participation in the initiative will contribute to generating those benefits.[139]

This simple equation helps describe why mutual funds and other institutional investors are not more active in calling for change. Institutional activism is picking up speed, however, in both majority voting and calls for a shareholder nomination capability. Granted, withhold votes are still an inexpensive means to call for change as before, it is just that the law is changing to give this inexpensive form of activism legal consequence. But, assuming the rationality model is still valid, there may be more that can be added to the rationality equation. It is reasonable to posit that just a handful of phenomena uniquely alter the calculus of investor rationality and explain part of the reason for this change from the status quo.

First, the expected rapid decrease in the cost of proxy solicitation[140] due to the SEC's move toward online proxy availability makes the variable c_i significantly lower than before. The elimination of broker voting[141] will also make shareholder initiatives more likely to succeed by decreasing the number of votes necessary to achieve success, thus increasing the variable p_i. Additionally, the development of information intermediaries, such as ISS and Glass Lewis, Inc., that specialize in compiling data and quantifying and rating the corporate governance function of companies, and then use that information to advise institutions how to vote their proxy, dramatically decrease the cost of collaboration in a proxy campaign and also work to increase the odds of its success.[142]

L. Rev. 520, at 575–91 (1989) and Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism,* 79 Geo. L.J. 445, 453–63 (1991)).

139. Grundfest, *Just Vote No, supra* note 15, at 910. Grundfest further explains: "This last variable, p_i, incorporates (1) each shareholder's ex ante estimate that the process as a whole will overcome the collective action problems described above, as well as (2) the shareholder's subjective assessment of the extent to which her participation in the process contributes to reaching the final outcome." *Id.*

140. *See infra* Section VI.C. for a discussion of online proxy solicitation.

141. *See infra* Section VI.B. for a discussion of the NYSE's amendment to Rule 452.

142. *See* Strine, *supra* note 122, at 1765 ("For that reason, many rely heavily on the advice of yet another level of agency, firms like Institutional Investor Services (ISS) that provide advice on how to vote on corporate ballot issues, to satisfy their legal obligation to vote in an informed manner on behalf of their investors.").

Additionally, one must add activist hedge funds into the calculus.[143] Hedge funds currently manage more over 1.5 trillion dollars,[144] and investors in hedge funds count on their managers for active management to increase alpha (returns). Hedge funds earn a percentage of their fund returns and a management fee based on the size of funds under management.[145] By one estimate, there are currently $60 billion invested in activist hedge funds, and the size of assets under management is rapidly growing.[146] One strategy that hedge funds use to achieve returns is instituting shareholder activist activity. After taking a significant position in an underperforming company, it may agitate for corporate policy changes through threatening to lead a proxy fight or threatening litigation by using rights afforded shareholders.[147] Recognizing legal consequence for withhold vote campaigns adds another tool to the activist fund's arsenal. Whether this works to the benefit of other shareholders is legitimately debated.[148] Some say they are reminiscent of the greenmailers of the 1980s,[149] while others argue that such activities can, in some cases, effectively

143. Bainbridge observes that hedge funds are a new exception to the rarity of institutionally funded proxy fights. *See* Bainbridge, *Limited Voting, supra* note 96, at 630. *See generally* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control,* working paper, *available at* http://ssrn.com/abstract = 919881.

144. *See* Troy Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission,* 2006 U. Ill. L. Rev. 975, 976.

145. *See* Staff Report to the United States Securities and Exchange Commission, *Implications of the Growth of Hedge Funds,* at 61–64 (Sept. 2003), *available at* http://www.sec.gov/news/studies/hedgefunds0903.pdf.

146. *See* Rob Cox, *Activists To The Rescue,* Wall St. J., March 31, 2007, at B14.

147. For more on this, see Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control,* at 4–13 (Univ. of Pa., Inst. for Law & Econ. Research Working Paper No. 06-16) (December 2006), *available at* http://ssrn.com/abstract=919881. Some types of actions that shareholders use are Section 220 actions (Del Code tit. 8, § 220 (2007)), shareholder derivative suits, appraisal rights, and injunctions against corporate merger activity. *See id. See, e.g.,* Highland Select Equity Fund, L.P. v. Motient Corp., 906 A.2d 156, 157 (Del. Ch. 2006), *clarified by,* 2007 WL 907650 (Del. Ch. Mar. 14, 2007), *aff'd,* 922 A.2d 415 (Del. 2007) (Section 220 action for inspection of corporate records); Shamrock Activist Value Fund, L.P. v. iPass Inc., C.A. 2462-N, 2006 WL 3824882, at *1 (Del. Ch. Dec. 15, 2006) (same); Polygon Global Opportunities Master Fund v. West Corp., Civ. A. 2313-N, 2006 WL 2947486, at *1 (Del. Ch. Oct. 12, 2006) (same).

The potential for such annoyance could make it economically rational for the board to pay the fund to go away by, say, buying back the fund's shares at a premium.

148. For an exploration of some of the disturbing implications of empty voting, where hedge funds purchasing the right to vote other owners' shares may result in an incentive to vote in a way that actually harms the firm, see Henry T.C. Hu and Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms,* 61 Bus. Law. 1011 (2006). Hedge fund participation in withhold vote campaigns using borrowed shares could mean that this shareholder democracy movement could be hijacked by market players with perverse incentives, as in the case of a fund with a leveraged short position in a firm that bought voting rights in that firm. Whether hedge fund participation in the shareholder democracy movement will be collaborative or parasitic remains to be seen. This concern was also recently relayed by SEC Commissioner Paul Atkins. *See* Paul Atkins, Remarks at the Corporate Directors' Forum, January 22, 2007, *available at* http://www.sec.gov/news/speech/2007/spch012207psa.htm#10.

149. *See* Iman Anabtawi, *Some Skepticism about Increasing Shareholder Power,* 53 U.C.L.A. L. Rev. 561, 583 (2006). For a history of greenmail, see generally David Manry & David Strangeland, *Greenmail: A Brief History,* 6 Stan. J.L. Bus. & Fin. 217 (2001). Greenmail takes place when a firm pays a hostile bidder a premium for the bidder's shares in exchange for dropping the bid. Anabtawi, *supra,* at 583 n.112.

overcome the shareholder collective action problem and inure benefits for their fellow shareholders.[150]

A rational activist fund would include the expected returns of future inflows of investment that might result from a successful campaign to alter management policies through a withhold vote campaign or a proxy fight. Proxy fights are usually heavily covered in the business press, and raising funds from even sophisticated investors is inherently a sales exercise. Therefore a sensible fund would include the value of that good public relations in its calculus. This might be modeled in the following manner:

(B) $c_i < p_i * x_i * B_i + p_{ii} * R_{ii}$

Where

p_{ii} = The expected probability of the proxy campaign's overall success.

R_{ii} = The expected present value of future benefits to activist hedge fund ii in the form of management fees and performance fees earned in the future on an influx of future capital due to the favorable signals to hedge fund investors that the fund initiating the campaign has a distinct advantage in increasing returns through activism.

R_i might look something like the standard equation for discounting future cash flows:

$R_i = \Sigma_{\tau = 0} FV_t / (1+d)_t$

Put more simply, R_i would represent the sum of future cash flows over the applicable period. Those cash flows would come as a percentage of the influx of future capital in the form of a management fee and would include a percentage of the performance fee that is represented by the amount by which the fund presumed it could make the capital influx grow. Part of the benefit that activist hedge funds may be able to internalize, that previously the large institutions with more passive investors have not realized, is the present value of benefits from the good public press in a fight against management. That reputation advantage will be quantifiably valuable to the hedge fund in a way that pensions, trusts and other institutional investors have not and will not experience. This speaks to more active

150. Alon Brav, et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance* (Nov. 2006) (ECGI—Finance Working Paper No. 139/2006), *available at* http://ssrn.com/abstract=948907. For example, consider the share buyback programs initiated at AOL Time Warner as a result of Carl Icahn's activism at those firms. *See* Matthew Flam, *Time Warner CEO on Mayoral Run,* New York Business.com (Mar. 21, 2007), *available at* http://www.newyorkbusiness.com/apps/pbcs.dll/article?AID=/20070321/FREE/70321011/1084/STATIC; *see also* Proxy Statement, Schedule 14A, SEC filing by Ichan Partners, LP., *et al.,* Exhibit 3 (Sep. 12, 2005), *available at* http://www.sec.gov/Archives/edgar/data/1105705/000110465905043682/a05-16099_1ex3.htm. In a share buyback, a company may buy shares and convert them to treasury holdings, which has the effect of increasing the per share price of all shares outstanding as the total market value is divided over a lower number of shares. This method may be preferred over a simple dividend due to income tax efficiency. Whether this works to the benefit of other shareholders would depend on whether the time horizon of the fund, typically very short, meshes well with the other shareholders. For instance, some shareholders may prefer that more money be invested in research and development for future appreciation in share value because the firm has a distinct advantage in some area over the long term. Other shareholders may want appreciation immediately.

investment management generally. People don't tend to make pension decisions based on which pension manager recently made the front page of *Business Week* for taking on the CEO of a company in a proxy fight or a withhold vote campaign. The same cannot be said of institutional investments in hedge funds.[151] Thus the activist hedge fund internalizes the positive externality of the future reputation benefits of making a name as a strong force in corporate activism.

Activist hedge funds would use Equation (B) in ascertaining whether or not a proxy fight was worth their while. Additionally, though it would be difficult to quantify, one might analogize that union or private pension fund investors may also obtain some private benefit, either for political advantage for the appointed board or future membership drives in a union, that would make activism more profitable for them than it would be for, say, a mutual fund whose investors are more passive.[152] Making hedge funds especially relevant to this discussion is the fact that the institutions that traditionally served as active intermediaries, such as CalPERs, are increasingly investing in activist hedge funds.[153] Lipton is, of course, highly skeptical of the motivations of hedge funds. Indeed, he has crafted a thirty point plan to help boards defend against hedge fund "attacks."[154] What Lipton fails to appreciate is if the form of shareholder empowerment adopted involves majority vote triggering, then the activist fund will have to convince a majority of shareholders that their plan has value. He also fails to differentiate between hedge funds that generally trade in securities with those that seek to build a reputation for value that can help them in future proxy fights.[155] Lipton's thirty point hedge fund defense plan may help to protect long term shareholder value in cases where a hedge fund seeks a quick return from a stable company, but it may be counterproductive for hedge funds that seek to break apart inefficient conglomerates or withhold votes from ineffective directors. That observation

151. For an example of the popularity contest that activist investing has become, see the Financial Times' ranking of activist investors. *Most influential activist investors,* FT.COM (Ap. 11, 2007), *available at* http://www.ft.com/cms/s/90229caa-e831-11db-b2c3-000b5df10621,dwp_uuid=c82c0bde-e9cd-11db-91c7-000b5df10621.html. It would be reasonable to assume that finance analysts at large institutional investors are more the target of FT's ranking than individual pensioners who generally fail to meet the investment minimums for these funds.

152. Romano explores institutional shareholder conflicts of interest in more detail. *See* Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance,* 18 YALE. J. ON REG. 174, 177 (2001).

153. CalPERs has a significant investment in the activist hedge fund Shamrock Holdings. *See* California Public Employees' Retirement System Hybrid Investments Monitoring Report, at 8 (First Quarter 2006), *available at* http://www.calpers.ca.gov/eip-docs/about/board-cal-agenda/agendas/invest/200606/item03-02.pdf. CalPERS has increased its portfolio of activist investing, or "corporate governance investments," to a total of $5 billion, or over 2% of its total portfolio, from 1.5% just last year. *See* Press Release, *CalPERS Increases Corporate Governance Investments—Raises Potential Market Assets to $5 Billion* (Sept. 13, 2006), *available at* http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2006/sept/corpgov-invest.xml. Some of the more recognizable names in the CalPERs governance portfolio include Breeden partners, Shamrock, and Hermes. *Id.*

154. Martin Lipton, *Dealing With Activist Hedge Funds* (Apr. 2, 2007), *available at* http://www.realcorporatelawyer.com/pdfs/wlrk033007.pdf.

155. *See generally* J.W. Verret, *Economics Makes Strange Bedfellows: Pensions, Trusts, and Activist Hedge Funds in an Era of Financial Re-Intermediation,* U. PA. J. BUS. & EMPL. L. (forthcoming Vol. 10, Issue 1, 2007) (on file with *The Business Lawyer*).

aside, majority vote triggering would minimize instances in which funds seeking to "turn and burn" would have any chance of success.

One reason that activist hedge funds might be especially interested in withhold vote campaigns, as opposed to proxy fights to place one of their directors on the board, is that it would avoid the insider trading liability and the application of short swing trading rules that becoming an insider entail. This gives the activists a way to get the board's attention without having to limit their trading flexibility.

IV. The Shareholder Power Debate as Applied to Majority Voting

A. General Arguments

Lipton, among others, criticizes electoral reform, fearing it will decrease incentives for eligible directors to want to serve, would turn usually collegial board activity divisive, or would distract board members from more productive activity.[156] The argument has also been raised that giving the power to eliminate directors through a withhold vote campaign would make directors prey to the self interested desires of groups, like labor unions and public pensions, whose interests may run counter to the larger group of shareholders.[157] Directors would be risk-adverse, the argument runs, and would fold in negotiations with these groups in the event a withhold vote was threatened.[158] However, this presumes that the threat was credible. Would a board give credence to the threat of a union shareholder to institute a withhold vote campaign if the board didn't enhance its retention policies? An institutional investor such as Fidelity or CalPERs would prove more difficult to convince in such a campaign than those who joined in the shareholder dissatisfaction with Michael Eisner. Thus when shareholders have reasons that don't

156. Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 747–49. *See also* Strine, *supra* note 122, at 1768 ("Due to her knowledge of how corporate boards work, the traditionalist has little interest in initiatives that single out specific board members for defeat or embarrassment. She knows boards almost always work by consensus and it is therefore silly to hold a solitary director responsible for a company's poor performance or lack of responsiveness to shareholder interests."). Of course, every change in corporate governance that works against the discretion and the financial security of management is hailed as yet another factor diminishing the pool of talent willing to serve on boards of directors. Lipton, *The Many Myths of Lucian Bebchuk, supra* note 4, at 747. The response is that if the potential director is a prestige seeker, that interest does not conflict with the interest of the company. Alternatively, if the potential director is interested in making money, increasing board compensation will encourage those interested in becoming directors. Diminishing interest in serving on boards is not nearly as convincing an argument in this context as it is when the issue is an increase in director liability. The embarrassment of a withhold vote pales in comparison to the obligations directors face in the wake of Sarbanes-Oxley, especially the Section 302 certification provision. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 302, 116 Stat. 745, 777 (codified at 15 U.S.C. § 7241 (Supp. IV 2004)). *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance,* 114 Yale L.J. 1521, 1540–41 (2005).The marginal disincentive against serving on boards presented by the prospect of a withhold vote campaign would be minimal.

157. *See* Robert S. Saunders, *Why Majority Voting in Director Elections is a Bad Idea,* 1 VA. L. & Bus. Rev. 107, 114 (2006).

158. *Id.* at 122.

comport with benefits to share value, the other sophisticated shareholders would presumably side with management in the campaign. The only exception may be that unions and public pensions might use their clout for private benefit in companies where a withhold vote would be salient for other reasons.[159]

Yet another argument against giving legal effect to withhold votes is that it would actually have the unintended effect of making them less likely. The same group that originally argued against withhold votes as damaging director reputations now asserts that symbolic withhold votes are a positive force in governance, but only when they remain symbolic.[160] An institution may be less likely to institute a withhold vote if it has powerful and concrete effects on the firm in which they are invested. This is clearly a complicated quantitative question, one that will probably not be answered until more time has passed. Interestingly, ISS does not see this as an issue.[161]

B. A First Strike Capability for Financial Intermediaries

Critics assert that, should a withhold vote be successful against a number of directors, the ability of the board to function could be constrained.[162] Institutional shareholders claim that, far from killing the golden goose, they only want an opportunity to single out individual directors and hope to negotiate in advance of the specter of a withhold vote campaign.[163] But, even if the holdover rule were abolished and withhold vote wars could create such chaos, would the ability to threaten such an outcome be without precedent? And if such brinkmanship is a legitimate tool of corporate power negotiations, why not give some of that power to institutional investors? If a withhold vote could eliminate the independent

159. For example, an employee's union could have agreed not to go along with the withhold vote against Eisner in exchange for concessions on employee bargaining. Such collusion would, however, be possible without the specter of a voting challenge.

160. ISS Report, *supra* note 31, at 14–15. *See* Saunders, *supra* note 157, at 120.

161. ISS Report, *supra* note 31, at 16.

162. Some examples of negative consequences are as follows. The board may be unable to achieve a quorum to conduct business. As listed in the *Committee on Corporate Laws Discussion Paper, supra* note 7, at 481, the effect of a withhold vote could constitute a breach of an executive candidate's employment agreement resulting in a trigger of severance payments, result in a "change of control" under corporate credit agreements resulting in accelerating debt or canceling a line of credit, or trigger changes in licenses, franchise agreements or other important corporate arrangements. In addition, "if a fixed number of directors is to be elected by holders of one class of securities, a failure to elect one or more directors could alter the relationship among shareholders of different classes." *Id.* The company's ability to comply with stock exchange listing standards or other requirements for maintaining independent directors or directors with particular qualifications may be inhibited. *Id.* "The failure to elect one or more candidates may alter the consequences of having a staggered or classified board. . . . A dissident group with minority representation on the board of directors could enlarge its percentage of directors if new nominees to the board are not elected—thereby avoiding the need for a direct proxy contest challenge and altering the existing dynamics of control contests." *Id.*

163. *See* Roundtable Discussions Regarding the Federal Proxy Rules and State Corporation Law, at 98–102 (May 7, 2007) (Comments of John Wilcox, Vice-President for Corporate Governance at TIAA-CREF), *available at* http://www.sec.gov/spotlight/proxyprocess/proxy-transcript050707.pdf . In a different context, the President of the United Airlines Pilots Union claimed, "We don't want to kill the golden goose, just choke it by the neck until it gives us every last egg." Roger Lowenstein, *Into Thin Air,* N.Y. Times, Feb. 17, 2002, § 6 at 40.

members of a board, thus making the board non-compliant with independence rules and unable to create independent committees, then institutional investors would be vested with the same form of scorched-earth tactic that case law has at times allowed entrenched management through the use of the poison pill.[164] Though there would be no fiduciary check on such power,[165] one might expect some form of détente in this corporate arms race. After all, the threat would only be salient in the event that it appeared likely a majority of shareholders voting in the election would go along, and turnout would seemingly be higher if the prospect of such consequences were present. The traditionalist's ready response would be that the scorched earth tactic embodied in the poison pill is permitted only for a discrete case—a change of control transaction—a circumstance which is especially subject to a risk of erosion of shareholder value. Thus, it hardly justifies expansion of that form of power into the hands of institutional and activist investors for general use. This diversion is entirely academic, as the holdover rule would function (as a sort of missile defense) to ultimately protect against nearly all of the enumerated fallout, as the directors would be able to remain in office until replaced. However, in the event that alterations to the holdover rule enter the agenda, this analysis should be revisited.

Critics of institutional investor activism generally also cite concerns over the growth of influence wielded by ISS and other proxy solicitation firms.[166] Corporate law traditionalists also posit that institutions and proxy advisory services are not constrained by the strictures of fiduciary duty jurisprudence and are more short term oriented than corporate managers; thus they can't be trusted to wield corporate power as responsibly.[167] One response might be that such analysis flips fiduciary duty on its side—that shareholders were never meant to bear fiduciary burdens, and that a majority of diverse, non-control shareholders can usually be trusted to make decisions about bylaws and withhold votes that serve the interests

164. *See* Moran v. Household International, Inc., 500 A.2d 1346, 1353 (Del. 1985) ("Having concluded that sufficient authority for the Rights Plan exists in 8 Del.C. § 157, we note the inherent powers of the Board conferred by 8 Del.C. § 141(a) concerning the management of the corporation's "business and affairs" also provides the Board additional authority upon which to enact the Rights Plan."); Unocal v. Mesa Petroleum Corp., 493 A.2d 946, 953–954 (Del. 1985) ("The board has a large reservoir of authority upon which to draw. Its duties and responsibilities proceed from the inherent powers conferred by 8 Del.C. § 141(a), respecting management of the corporation's "business and affairs". Additionally, the powers here being exercised derive from 8 Del.C. § 160(a), conferring broad authority upon a corporation to deal in its own stock. From this it is now well established that in the acquisition of its shares a Delaware corporation may deal selectively with its stockholders, provided the directors have not acted out of a sole or primary purpose to entrench themselves in office."); Maldonado v. Flynn, 413 A.2d 1251, 1255 (Del. Ch. 1980), *rev'd on other grounds,* Zapata Corp. v. Maldonado, 430 A.2d 779, (Del. 1981).

165. Allied Chemical & Dye Corp. v. Steel & Tube Co. of Am., 120 A. 486, 492–93 (Del.Ch. 1923) (holding that shareholder's fiduciary duty to other shareholders only attaches where shareholder becomes a control shareholder).

166. *See* Strine, *supra* note 122, at 1765.

167. *Id.* at 1765 ("Unlike corporate managers, neither institutional investors as stockholders nor ISS as a voting advisor owe fiduciary duties to the corporations whose policies they seek to influence. And unlike the individual investors whose capital they use to wield influence, institutional investors and their advisors bear far less of the residual risk of poor voting decisions, as their compensation turns more on short-term factors than on long-run growth.").

of all shareholders. That debate need not be resolved here, however. The objective is merely to set the stage for withhold votes to enter the fray.

VI. Brewing a Perfect Storm—SEC Proxy Reform, NYSE Exchange Rule 452, and Internet Proxy Solicitation

This article now examines some initiatives that regulatory agencies have recently been exploring that will have a profound effect on majority voting, which is poised to alter the balance of power between boards and shareholders. This article will then examine strategies investors and boards should implement in response to these developments.

A. A Modest Proposal

In 2003 the Securities and Exchange Commission considered a rule to allow shareholders to include nominees on the corporate ballot upon the occurrence of certain triggering events.[168] This is extremely important, as companies typically vote on behalf of shareholders who are unable to attend the annual meeting, and solicit the proxies of those shareholders in order to do so. A proxy statement must be delivered to shareholders in connection with that solicitation that describes the issues and proposals that are put up for vote.[169] As a company uses its resources to pay the cost of these proxy solicitations, which can be prohibitive, having one's proposal included in the corporate proxy is vital to success.[170] However, a company may exclude a shareholder proposal if it relates to an election or falls under other criteria enumerated by the SEC.[171] Recently, the SEC has initiated a process to revisit its interpretation of the election[172] exclusion in response to *AFSCME v. AIG,* in which the Second Circuit held that a shareholder bylaw proposing a method for including shareholder nominees on the corporate ballot in future elections did not relate to "an election," as the SEC held in a letter ruling, but related to the election process in general, and thus could not be properly excluded from the corporate proxy.[173]

168. Security Holder Director Nominations, SEC Rel. No. 34-48626, 68 Fed. Reg. 60784 (Oct. 23, 2003).

169. Exchange Act Rule 14a-3(a), 17 C.F.R. § 240.14a-3 (2007).

170. Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills,* 3 Berkeley Bus. L.J. 205, 211 (2005).

171. This includes proposals that relate to an election, are improper under state law, have been substantially implemented by the company, or conflict with the company's own proposal on the current ballot, among other exclusions. *See* Exchange Act Rule 14a-8, 17 C.F.R. § 240.14a-8 (2007).

172. *See* SEC Press Release 2007-71, *SEC Announces Roundtable Discussion Regarding Proxy Process* (Apr. 24, 2007), *available at* http://www.sec.gov/news/press/2007/2007-71.htm. Chairman Cox expects rule proposals on proxy access by the summer of 2007. *See* Karey Wutkowski, *SEC to propose new proxy rules in early summer,* Reuters, May 7, 2007, *available at* http://www.reuters.com/article/governmentFilingsNews/idUSN0734596620070507?pageNumber=1.

173. Am. Fed. of State, Cty. & Mun. Employees v. Am. Int'l Group, Inc., 462 F.3d 121, 128 (2d Cir. 2006). ("Thus, we cannot agree with the second half of the SEC's interpretation of the 1976 Statement: that a proposal may be excluded under Rule 14a8(i)(8) if it would simply establish a process for shareholders to wage a future election contest.").

Additionally, the SEC instituted a proposal in 2003 to explicitly allow shareholder nominations to the corporate ballot under a new Rule 14a-11, which has since stalled in the review process.[174] The proposed rule would have required companies to include between one and three nominees of holders of at least 5% of all outstanding shares (for 2 years) if one of two triggers applied: (i)at least 35% of shareholders previously withheld support for a board nominee; or (ii)a majority of shareholders voted to be governed by Rule 14a-11.[175]

Shareholder bylaws regarding nominations would still need to be legal under state corporation law. The Delaware legislature seems to have presumptively blessed the legality of shareholder bylaws requiring removal upon a majority withhold vote, so clearly a shareholder bylaw will not be held illegal simply for relating to the election process for Delaware corporations. However, this does not guarantee that all iterations of shareholder nomination bylaws that are included on the corporate ballot will be enforceable under Delaware law.[176]

However, presuming that shareholders will manage to achieve the holy grail of corporate ballot access through one of these two SEC venues, either through SEC action adopting proposed Rule 14a-11 that will restrict corporate discretion to exclude shareholder nominees, or under a shareholder approved bylaw that survives the scrutiny of the Delaware courts, the withhold vote bylaw will interact with nominations to potentially flip the empowerment debate on its side. In the event that a company's board became host to an insurgent nominee who managed to win by a mere plurality, the company could use a withhold vote campaign to remove that director from its board in a successive election. Management would effectively be able to institute a withhold vote campaign against insurgent directors elected by a plurality vote in a contested election, but whose motives seem suspect to a majority of shareholders voting in a subsequent election.

Conversely, an institutional investor could potentially overcome the holdover rule by a combination withhold vote/insurgent nominee campaign over two successive annual meetings. The withhold vote campaign is muted by the phenomena where a director may lose a majority, but maintain his or her seat until a new director can be elected. Absent a shareholder access rule or bylaw, the replacement nominee will usually be hand picked by the board, and the director would thus always be replaced with a board nominee. However, if institutional investors are able to win a withhold vote, and in the process place a nominee on the corporate ballot at the next election, the power of the withhold vote bylaw would then be enhanced. The author has informed the SEC of these factors in a Comment Letter to the ongoing Proxy Nomination Rulemaking Process based on the analysis in this article.[177]

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174. *See* SEC Rel. No. 34-48626, 68 Fed. Reg. at 60819. *See also* Staff Report: *Review of the Proxy Process Regarding the Nomination and Election of Directors,* July 15, 2003, at 1, *available at* http://www.sec.gov/news/studies/proxyrpt.htm.

175. See proposed Rules 14a-11(a)(2)(i), 14a-11(a)(2)(ii), and 14a-11(b), 14a-11(d) in SEC Rel. No. 34-48626, 68 Fed. Reg. at 60819.

176. Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett,* 19 Cardozo L. Rev. 511, 546 (1997).

177. *See* J.W. Verret, *Comment Letter to the SEC* (May 1, 2007), *available at* http://sec.gov/comments/4-537/4537-4.pdf.

B. Rule 452

In addition to SEC regulation of the proxy solicitation process, the New York Stock Exchange ("NYSE") regulates proxy voting through rules defining when a broker who holds a share on behalf of his client (shares held in "street name") may vote that client's shares.[178] Brokers are permitted to vote in the absence of directions from the client in the event that the matter is considered routine.[179] The most compelling justification for allowing brokers to vote on behalf of clients is that attaining a quorum would otherwise be exceedingly difficult if broker-held shares went uncounted.[180] Historically, Rule 452 classified uncontested elections of directors as routine.[181] However, in response to the growing use of withhold vote campaigns and shareholder activism, the NYSE commissioned a working group to study the issue. The working group recommended that uncontested elections be classified as non-routine, meaning brokers could not vote shares on behalf of their client in an uncontested election.[182] That recommendation is being discussed in the SEC proxy process roundtables.[183]

The ability of brokers to vote shares held in street name has dramatic implications for the dynamics of withhold vote campaigns, a factor the NYSE considered in their exploration of the rule change.[184] By some estimates, from 70 to 80% of all

178. *See* NYSE Rule 452, *available at* http://rules.nyse.com/NYSE/NYSE_Rules/.

179. Rule 452, *supra* note 178, provides in relevant part:

> Voting procedure without instructions: A member organization which has transmitted proxy soliciting material to the beneficial owner of stock or to an investment adviser, registered either under the Investment Advisers Act of 1940 or under the laws of a state, who exercises investment discretion pursuant to an advisory contract for the beneficial owner and has been designated in writing by the beneficial owner of such stock (hereinafter "designated investment adviser") to receive soliciting material in lieu of the beneficial owner and solicited voting instructions in accordance with the provisions of Rule 451, and which has not received instructions from the beneficial owner or from the beneficial owner's designated investment adviser by the date specified in the statement accompanying such material, may give or authorize the giving of a proxy to vote such stock, provided the person in the member organization giving or authorizing the giving of the proxy has no knowledge of any contest as to the action to be taken at the meeting and provided such action is adequately disclosed to stockholders and does not include authorization for a merger, consolidation or any other matter which may affect substantially the rights or privileges of such stock.

180. *See Report and Recommendations of the Proxy Working Group to the New York Stock Exchange,* at 12 (June 5, 2006), *available at* http://www.nyse.com/pdfs/PWG_REPORT.pdf. [hereinafter "NYSE Report"].

181. *Id.* at 8 & n.9 ("Rule 452.11(2) defines a 'contest' as a matter that ?is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management.'").

182. *Id.* at 21.

183. *See Recent Developments: The NYSE's "Broker Vote" Rulemaking,* TheCorporateCounsel.net Blog, May 30, 2007, *available at* http://www.thecorporatecounsel.net/blog/archive/001487.html. Alternative ideas discussed have included i) proportional voting, where the broker votes uninstructed shares proportionally based on the percentage of votes either way on client instructed votes; ii) adopting the NYSE's recommendation, but only when there is no active withhold vote campaign, and iii) having broker agreements include a default voting instruction. *See* Ted Allen, *SEC Hears Testimony on Broker Votes,* Corporate Governance Blog (May 25, 2007), *available at* http://blog.issproxy.com/2007/05/sec_hears_testimony_on_broker.html.

184. NYSE Report, *supra* note 180, at 13.

publicly traded shares are held in street name.[185] Brokers typically vote in favor of management re-election and in favor of management proposals.[186] For instance, if broker votes had not been counted in the Eisner withhold vote campaign, Eisner would have only received 45% in favor of his re-election and a majority of votes withheld.[187] The NYSE working group estimated that, in 2004 alone, elimination of street voting would have meant 32 directors of publicly held companies would have failed to obtain a majority vote in favor of their re-election.[188] For a more recent example, the withhold vote campaign against Roger Headrick, a director at CVS/Caremark, would have been successful if broker street votes had been eliminated.[189] The NYSE Working Group remained cognizant of the effect the rule change would have on the costs of corporate elections, from increasing influence of special interest groups to increasing the cost of campaigns due to a renewed need to increase shareholder participation.[190] However, it recommended this move as vital to enhancing corporate accountability and the transparency of the election process.[191]

C. Online Solicitation

Yet another element of the securities law affecting majority voting is the SEC's policy shift to allow online proxy solicitation.[192] The SEC approved a proposal on December 13, 2006 to allow electronic delivery of proxy materials by anyone soliciting proxies through a model utilizing notice and access.[193] A proxy solicitor's obligation to furnish proxy materials would, under that rule, be satisfied by posting them to a web site and sending a notice of their availability, details of the meeting and proposal, and contact information for shareholders to request a hard copy.[194] The SEC only allows online proxy materials if the shareholder has previously consented in writing.[195] This proposal to allow online proxy solicitation would

185. *Id.* at 10 ("The majority of publicly traded shares are not registered in companies' records in the names of the beneficial owners. Instead, an estimated 70 to 80 percent of all public companies' shares are held in "street name," meaning that they are held of record by brokers, banks or their depositories.").

186. *See id.* at 14.

187. *See id.* at 9.

188. *See id.* at 13.

189. *See Recent Developments: The NYSE's "Broker Vote" Rulemaking,* TheCorporateCounsel.net Blog, May 30, 2007, *available at* http://www.thecorporatecounsel.net/blog/archive/001487.html.

190. *See id.* at 21.

191. *Id.*

192. *See* Internet Availability of Proxy Materials, SEC Rel. No. 34-52926, 70 Fed. Reg. 74598 (Dec. 15, 2005).

193. SEC Press Release 2006-209, *SEC Votes to Adopt E-Proxy Rule Amendments and Propose Mandatory Model,* Dec. 13, 2006, *available at* http://www.sec.gov/news/press/2006/2006-209.htm.

194. Internet Availability of Proxy Materials, SEC Rel. No. 34-55146, 72 Fed. Reg. 4148 (Jan. 29, 2007) (to be codified at C.F.R. Parts 240, 249, and 274).

195. *See, e.g.,* Use of Electronic Media for Delivery Purposes, SEC Rel. No. 33-7234, 60 Fed. Reg. 53468 (Oct. 15, 1995); Use of Electronic Media for Delivery Purposes, SEC Rel. No. 33-7233, 60 Fed. Reg. 53458 (Oct. 15, 1995); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, SEC Rel. No. 33-7288, 61

significantly reduce the costs of communicating with shareholders for anyone interested in soliciting proxies, including management, insurgent nominees, or institutions running withhold vote campaigns. Because corporate reimbursement of proxy costs has traditionally worked to benefit management,[196] the SEC's proposal would tilt the balance of power against management in proxy fights and in withhold vote campaigns.

D. Case in Point: The Heinz Proxy War: Would You Please Pass the Proxy?

Leading up to its annual meeting in August of 2006, H.J. Heinz Co.[197] was engaged in the most bitter proxy war in its history.[198] Leading the charge was billionaire investor Nelson Peltz and his activist hedge fund, Trian Investment Partners.[199] Trian purchased 5.5% of Heinz's outstanding shares and immediately started to rattle the saber.[200] It submitted SEC filings outlining a plan to save the company $575 million; within months Heinz management announced an alternative plan.[201]

The annual election became a referendum on the insurgent's plan. Five seats were up for election on the twelve member board. Peltz offered five candidates, including himself, three allies and, for good measure, former pro-golfer Greg Norman. The institutional investors were divided: CalPERs and PNC Financial announced that they would vote for re-election of all of Heinz's current board.[202] ISS, however, urged its institutional investor clients to accept three from Peltz's slate (including Norman).[203] Peltz's speech at the annual meeting was compared to the famous Gordon Gekko diatribe in the movie *Wall Street*.[204] Capital Research

Fed. Reg. 24644 (May 15, 1996); Use of Electronic Media for Delivery Purposes, Sec. Rel. No. 33-7289, 61 Fed. Reg. 24652 (May 15, 1996); Use of Electronic Media, SEC Rel. No. 33-7856, 65 Fed. Reg. 25843 (May 4, 2000).

196. *See* Bebchuk, *The Myth of the Shareholder Franchise, supra* note 4, at 694, 697.

197. Though H.J. Heinz is not a Delaware corporation, the pertinent operation of majority vs. plurality voting, and the process of a proxy fight, would remain the same if it were incorporated in Delaware. *See* 15 Pa. Cons. Stat. Ann. § 1725 (West 1995).

198. Lisa Gewirtz, *Heinz, Anticipation Still Buzzword,* The Daily Deal, Aug. 17, 2006, *available at* 2006 WLNR 14215438.

199. *Id.* Peltz is one of the more prolific activist hedge fund in the space, with a previous victory against Wendy's and a looming war against Tribune Co, see *Peltz Closes In on Heinz Board,* L. A. Times, Aug. 17, 2006, *available at* 2006 WLNR 14218025.

200. *Id.;* Teresa F. Lindeman *Dissidents apparently win 2 Heinz Seats,* Pittsburgh Post-Gazette, Sep. 9, 2006, *available at* 2006 WLNR 15647153.

201. *See* Gewirtz, *supra* note 198.

202. *Id.*

203. *Id.*

204. O'Neal, Michael, *Peltz Group Preaches its Gospel of Truth,* Chi. Trib., August 17, 2006, *available at* 2006 WLNR 14251264 ("When a reporter asked him if he considered his speech during the meeting "his Gordon Gekko moment"—a reference to Michael Douglas' classic "Greed is good" speech in the 1980s-era movie "Wall Street"—Peltz was not amused. "That doesn't warrant a response," he said frostily. Instead, Peltz sought to emphasize that he and his partners are interested in helping fix companies and participating in their growth—not tearing them down or flipping them for a quick profit.") *See also* opening quotation, *supra.*

and Associates (a large mutual fund family), owning 13% of Heinz stock, was the likely swing vote that would carry the day.[205]

The result: the insurgents went 2 for 5; Peltz and associate Michael Weinstein were elected over two of the board's candidates, and the management slate went 3 for 5.[206] At the time of the proxy fight, Heinz had a full plurality voting regime, but in November of 2006 they adopted majority voting for uncontested elections.[207] This means that, provided the new board members turn out to be inimical to a majority of the institutional investors (a distinct possibility given the divisive nature of the proxy fight), the board could institute a majority withhold vote campaign against the Trian directors. If CalPERs is amenable, a board initiated withhold vote may prove successful in ousting the Trian directors. Of course, the holdover rule would allow the directors to remain if they have not submitted previous resignation policies. But it is certainly interesting that majority voting would give management an entrenchment tool in situations such as in the Heinz contest.

VII. Implementation of Majority Voting and Its Many Iterations

Corporations have been in a rush to implement some form of majority voting even before the adoption of the Delaware amendments.[208] More than 120 companies had some form of majority voting related provision, predominately in the form of director resignation policies, as of March 2006.[209] But the question is, if plurality voting is more likely to allow management to control the election, then what would explain the lack of resistance? Three possibilities come to mind: (i) firms want to adopt a lighter version of the majority voting standard, and then keep shareholder versions of a similar bylaw off of the corporate ballot under SEC Rule 14a-8 or simply steal the thunder from an alternate campaign; (ii) firms anticipate that majority voting may have the converse result of helping them to fend off divisive directors proposed under a shareholder nomination rule, if the SEC's ongoing exploration of this issue eventually yields results; or (iii) firms are actually interested in improving their corporate governance apparatus in order to satisfy institutional investors.[210]

205. Lisa Gewirtz, "*Heinz Vote May Hinge On One Firm*" The Daily Deal, August 18, 2006, *available at* 2006 WLNR 14299690.

206. *See* Heinz Press Release, *Heinz Announces Preliminary Proxy Voting Results; Looks Forward with Confidence to Executing Its Plans to Increase Shareholder Value,* Sept. 8, 2006, *available at* http://www.heinz.com/News_f.aspx.

207. *Heinz Board Approves Majority Voting,* Business Wire, November 8, 2006, *available at* http://www.allbusiness.com/services/business-services/3924776-1.html.

208. Vlahakis, *supra* note 53, at 278 ("In June 2005, Pfizer Inc. became the first company to amend its corporate governance guidelines to require that any director who receives a majority of withheld votes submit his or her resignation to the board, leaving the outcome in the hands of the board. Since then, Walt Disney, Office Depot, Circuit City, Lucent Technologies, and over 30 other companies have adopted similar guidelines.").

209. *See* Dennis Berman, *Boardroom Defensetration—As Proxy Season Heats Up, Companies Consider Rules to Boot Unwanted Directors,* Wall St. J., Mar. 16, 2006, at B1.

210. ISS has indicated that it may decline to endorse a campaign for a majority voting bylaw in instances where a proposal has already been adopted that substantially implemented majority voting.

The question of using a policy to keep shareholder bylaws off the ballot under Rule 14a-8 has been answered by the SEC in the negative.[211] However, SEC letter rulings on Rule 14, as we have seen in *AFSCME v. AIG,* are not necessarily dispositive and challenges to it in federal court could be seen in future contests. Further, an open question also remains as to whether a majority voting bylaw adopted by the board, that provides wider board discretion in responding to a successful withhold vote, would keep an alternative bylaw proposal off the ballot.[212] However, the primary advantage to having a policy already in place is that it makes a contest to institute an alternative new bylaw more difficult to win. During the 2006 Proxy season, 86% of majority voting proposals put forward where no majority voting governance policy was currently in place, were successful.[213] Alternatively, only 18% of proposals passed where a company had previously adopted a policy similar to the Pfizer Governance Policy.[214]

A. Mechanical Issues in Tallying the Voting Outcome

The DGCL provides that "In the absence of such specification in the certificate of incorporation or bylaws of the corporation . . . Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors."[215] This seemingly straightforward definition of how a vote should be tallied, placing in the denominator the number of shares present in person or represented by proxy and entitled to vote in the election of directors, is subject to a surprisingly tangled web of case law defining its application.[216] For instance, any shares present that are entitled to vote, but do not vote in the election for some reason, would end up increasing the number of affirmative votes necessary to elect a director in a majority voting

See Majority Elections: Questions and Answers on ISS 2006 Voting Policy, at 3 (December 2005), *available at* http://www.issproxy.com/pdf/FAQMVPolicy2006.pdf.

211. Capital One Financial Corporation, SEC No-Action Letter, 2006 WL 129325, *1 (Jan. 12, 2006).

212. *See* Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, SEC Rel. No. 34-20091, 48 Fed. Reg. 38218 (Aug. 23, 1983). *See also* Texaco, Inc., SEC No-Action Letter, 1991 WL 178690 (Mar. 28, 1991) ("a determination that the Company has substantially implemented the proposal depends on whether its particular policies, practices and procedures compare favorably with the guidelines of the proposal."). In the context of majority voting proposals, see Bristol-Myers Squibb Company, SEC No-Action Letter, 2005 WL 372277 (February 14, 2005), where a stockholder proposal for a "simple majority vote" was properly excluded as "substantially implemented" under Rule 14a-8(i)(10) where the registrant was engaged in the process of removing supermajority voting provisions from its governing documents. *Compare* KeySpan Corporation, SEC No-Action Letter, 2006 WL 626123 (March 7, 2006).

213. *See* Wachtell, Lipton, Rosen, & Katz Client memo (white paper), *Majority Voting—A Look Back at the 2006 Proxy Season,* at 1 (June 12, 2006), *available at* http://www.realcorporatelawyer.com/pdfs/wlrk061306_02.pdf.

214. *See infra* Section VII. B. 1.

215. Del. Code tit 8, § 216 (2007).

216. By way of contrast, New York law uses as its metric a much simpler "votes cast" denominator. *See* Bank of New York Co. v. Irving Bank Corp., 531 N.Y.S.2d 730 (N.Y. Sup. Ct. 1988), *aff'd,* 533 N.Y.S.2d 411 (N.Y. App. Div. 1988); N.Y. Bus. Corp. Law § 614(a) (McKinney 2003).

regime (by increasing the denominator) and would also count as no votes (by being placed in the numerator).[217]

This issue becomes particularly interesting in the context of broker street voting. *Berlin v. Emerald*[218] outlines the various situations in which shares are counted in the denominator and which are not in determining voting outcomes.[219] To the extent that shareholders give their brokers directions on how to vote, even if that instruction is precisely not to vote or to abstain, those shares are counted in the denominator under Delaware law.[220] Where voting in uncontested elections was previously deemed discretionary by the NYSE, broker street votes were counted in the denominator of shares entitled to vote, even if the beneficial shareholders gave no instruction to their broker.[221]

Therefore, effectively, the alteration to Rule 452[222] to make voting in uncontested elections non-discretionary will mean that not only will there be fewer brokers voting in the affirmative for management candidates in the numerator, but there will also be fewer votes tallied in the total denominator. This will result in fewer withhold votes required to achieve a majority withhold vote for withhold vote campaigns against directors of Delaware corporations. The specter of this double whammy effect was not mentioned in the NYSE report, and it is uncertain whether that phenomenon was brought to their attention.[223]

Moderating this analysis is the fact that Delaware law merely provides a default provision for determining voting outcomes.[224] Adopting a bylaw that simplifies the process of counting votes, and addresses the complications inherent in a majority voting situation, would greatly simplify the question. Perhaps, in the aftermath

217. Licht v. Storage Technology Corp., Civ. A. 524-N, 2005 WL 1252355, at *1 (Del.Ch. May 6, 2005) (quoting R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations and Business Organizations § 7.25, at 7-51 (2004) ("[I]n determining whether a [shareholder] proposal has passed in a circumstance where the vote is required "a majority of the shares present and entitled to vote on the subject matter," abstentions . . . are to be treated as shares present and "entitled to vote on the subject matter." Applying that standard, an abstention would be counted as a "no" vote. . . .")).

218. Berlin v. Emerald Partners, 552 A.2d 482, 494 (Del.1988) ("Delaware law expressly recognizes the right of the corporation to rely upon record ownership, not beneficial ownership, in determining who is entitled to notice of and to vote at the meetings of stockholders. Therefore, from the perspective of the Delaware corporation, a broker who is the stockholder of record has the legal authority to vote in person or by proxy on all matters. Nevertheless, the relationship between a broker, who is the "record owner," and the beneficial owner is governed by the rules of the various stock exchanges . . . The shares represented by a limited proxy cannot be considered as part of the voting power present on a nondiscretionary proposal from which power has been withheld by crossing it out or otherwise.") (Citations omitted).

219. The Chancery Court has applied the test outlined in *Berlin* to interpret the "entitled to vote" language in Delaware Code section 216. *See* Hammersmith v. Elmhurst-Chicago Stone Co., Civ. A. No. 10,837, 1989 WL 99129, at *3 (Del Ch. Aug. 17, 1989).

220. North Fork Bancorpation., Inc. v. Toal, 825 A.2d 860 (Del. Ch.2000), *aff'd,* Dime Bancorporation, Inc. v. North Fork Bancorporation, Inc., 781 A.2d 693 (Del. 2001).

221. *Id.* at 866.

222. *See supra* Section VI.B.

223. *See* NYSE Report, *supra* note 180. The Report mentions that elimination of affirmative broker votes would have had a profound effect on the outcomes of majority withhold vote campaigns. However, it stands to reason that the calculation, if it omitted the double whammy effect of *Berlin v. Emerald Partners,* significantly underestimated the consequences of the alteration to Exchange Rule 452.

224. *Licht,* 2005 WL 1252355, at *3.

of Rule 452 and the Delaware Amendment, boards will have a reason to explore alternative arrangements.[225]

B. The Various Bylaw Strategies[226]

1. The Pfizer Governance Policy[227]

Pfizer included within its governance principles (and not in its charter or bylaws) a provision that, in any uncontested election in which a nominee receives a greater number of withhold votes than "for" votes that nominee must immediately offer his or her resignation to the board. In such a case, the Pfizer Corporate Governance Committee, without participation of the director against whom the withhold vote campaign was instituted, will make a recommendation to the Board as to whether action is required. The Board is then required to act within 90 days of receipt of the recommendation. Companies implementing the Pfizer approach have often defined a successful withhold vote as a majority of shares voting, rather than a majority of shares outstanding.[228] A few, however, have used the more onerous "majority of shares outstanding" approach.[229] Over 100 companies have adopted the Pfizer Governance Policy approach.[230]

This approach has been uniquely unpopular with institutional investors, and would be unlikely to convince many of them against supporting an alternative majority voting bylaw.[231] However, it seems that instituting such a policy is helpful

225. Institutional Investors and other activists will also have an incentive to monitor those arrangements, or propose their own alternatives. One company that seems to have implemented majority voting without qualification is Allstate, which announced that their previous majority voting policy would be replaced with a bylaw and their supermajority voting requirement for bylaw amendments would be removed. Press Release, *Allstate Corp. Announcement of Corporate Governance Improvements,* Feb. 20, 2007, *available at* http://media.allstate.com/categories/7-news-releases/releases/3901-allstate-announces-corporate-governance-improvements.

226. Although this article is skeptical of Lipton's arguments against any form of empowerment, it certainly recognizes that Lipton remains the unequivocal leader in corporate governance advising. Lipton's model documents for approval of a majority voting bylaw (one that gives board discretion in accepting the resignation, but that is included in the bylaws and also requires board disclosure of the reason for declining acceptance of that resignation) are instructive. *See* Wachtell white paper, *supra* note 213, at 1.

227. Pfizer Inc. Corporate Governance Principles, *available at* http://www.pfizer.com/pfizer/are/mn_investors_corporate_principles.jsp. Professors Sjostrom and Kim contrast Pfizer's plurality plus policy, where plurality votes determine the election but failure to achieve a majority vote requires resignation submission after being elected, with Intel's majority plus bylaw (*see infra* note 228) where failure to achieve a majority vote requires an incumbent to tender their resignation and resulted in no re-election. For purposes of this article, the distinction is ignored as the effect on incumbent directors and the presence of board discretion is the same. *See* William Sjostrom & Young Sang Kim, *Majority Voting for the Election of Directors,* (Feb. 24, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=962784.

228. *See* Simpson, Thacher & Bartlett, LLP, *Majority Voting in Director Elections: A Look Back and A Look Ahead,* at 4 (Aug. 4, 2006), *available at* http://www.stblaw.com/content/publications/pub560.pdf; Intel Corporation Bylaw, Article III, Section 1 (Jan. 17, 2007), *available at* http://www.intel.com/intel/finance/docs/bylaws.pdf.

229. Council of Institutional Investors, *Majority Voting Primer,* at 6–7 (Feb. 27, 2006), *available at* http://www.cii.org/policies/MajorityVotingPrimer.pdf.

230. Simpson, Thacher & Bartlett, LLP, *Majority Voting in Director Elections: A Look Back and A Look Ahead,* at 4 (Aug. 4, 2006), *available at* http://www.stblaw.com/content/publications/pub560.pdf.

231. Indeed, some have openly stated that they will push for recommend voting for an alternative bylaw in the event that a company has adopted the Pfizer approach. *Id.*

in preventing the efficacy of a campaign to install alternative bylaws. One relevant question would be how Delaware case law would treat a decision to reject a director's resignation under a modified plurality Pfizer Plan. Most business decisions receive business judgment review, but where a board acts for the sole or primary purpose of perpetuating its own control, this improper motive overrides the ordinary protection of the business judgment rule.[232] Thus, if the board's rejection is perceived to be for such an entrenchment purpose, and for no other reason, it may be subject to enhanced scrutiny.

2. The GE Bylaw

GE requires that any director nominee that receives more withhold votes than affirmative votes in an uncontested election must immediately tender his or her resignation.[233] A process is established for the board to then consider that resignation, in a similar fashion to the Pfizer Policy. The presence of the bylaw makes it more concrete. Under review of board action, presumably altering a bylaw in response to a threatened withhold vote would be reviewed more strictly than rescinding a policy.[234]

3. The Bebchuk Bylaw

Professor Bebchuk's proposal, contained in General Dynamics 2006 proxy statement, is a bylaw providing that a director candidate be ineligible to stand for election if he or she received more withheld votes than "for" votes in an immediately preceding uncontested election.[235] Though it failed to pass, it received a 37.9% favorable vote of the General Dynamics shareholders.[236] Interestingly, General Dynamics inserted an announcement of its recently adopted Pfizer Policy just below the section of its Proxy Statement recommending a no vote on the Bebchuk bylaw.[237]

C. The Sobering Effect of the Holdover Rule, the Staggered Board, and Board Replacement or Resignation Rejection

The holdover rule stems the tide of horrible outcomes put forward by the traditionalist apologists. Delaware corporate law provides that "Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal."[238] The significance of this provision depends on the type of majority provision in place. If the board or the shareholders have adopted a bylaw requiring the removal of a director that has failed to obtain

232. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).
233. Article II C. Bylaws of the General Electric Company, *available at* http://www.ge.com/en/citizenship/govcomp/bylaws/index.htm.
234. *See* Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437 (Del. 1971).
235. General Dynamics, Notice of Annual Meeting and Proxy Statement 2006, Mar. 31, 2006, at 38, *available at* http://www.sec.gov/Archives/edgar/data/40533/000119312506069331/ddef14a.htm#tx18358_15.
236. Wachtell white paper, *supra* note 213, at A-2.
237. *See* General Dynamics Proxy Statement, *supra* note 235, at 39.
238. Del. Code tit 8, § 141(b) (2007).

a majority vote, then the effect of the holdover rule would be that a director who fails to obtain such a vote in an uncontested election may stay on as a director until a new director can be found by the board. If, as in the GE bylaw, automatic resignation is required, then the holdover rule is inapplicable. In the case of a Pfizer policy, the holdover rule will be unnecessary as the Board can conceivably decide not to remove the director. The Bebchuk Bylaw realistically takes into account the effect of the holdover rule by only requiring a director targeted by a successful withhold vote to stand down from running in the next successive election.

Should Delaware at least allow the shareholders to amend the bylaws to immediately require removal of holdover directors? Some provisions in the DGCL are merely defaults that bylaws can alter at will; others are mandatory.[239] The distinction between them is subject to a multi-factor test.[240] The equal dignities rule may, nonetheless, allow a bylaw to conflict with other provisions.[241] Furthermore, a bylaw that interferes with what is understood to be the traditional province of the board will be struck down.[242] The next question is whether to make a bylaw altering the holdover rule, once approved by the shareholders, unalterable by

239. See *Hollinger Intern., Inc. v. Black,* 844 A.2d 1022 (Del. Ch.2004), *aff'd,* 872 A.2d 559 (Del. 2005) where the Chancery Court states:

> Stockholders are invested by § 109 with a statutory right to adopt bylaws. By its plain terms, § 109 provides stockholders with a broad right to adopt bylaws "relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees. This grant of authority is subject to the limitation that the bylaws may not conflict with law or the certificate of incorporation. Traditionally, the bylaws have been the corporate instrument used to set forth the rules by which the corporate board conducts its business. To this end, the DGCL is replete with specific provisions authorizing the bylaws to establish the procedures through which board and committee action is taken.While there has been much scholarly debate about the extent to which bylaws can-consistent with the *general* grant of managerial authority to the board in § 141(a)-limit the scope of managerial freedom a board has, e.g., to adopt a rights plan, there is a general consensus that bylaws that regulate the process by which the board acts are statutorily authorized. This includes the extent and manner in which the board shall act through committees. Indeed, before the recent Bylaw Amendments, the International Bylaws heavily regulated the corporation's committee procedures.

Id. at 1078–79 (citations and footnotes omitted, emphasis in original). *See also*Frantz Mfg. Co. v. EAC Industries, 501 A.2d 401, 407 (Del. 1985) ("The bylaws of a corporation are presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws . . . A bylaw that is inconsistent with any statute or rule of common law, however, is void; *see* Kerbs v. California Eastern Airways, Inc., 90 A.2d 652, 659 (Del. 1952), and bylaws must be reasonable in their application. Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437 (Del. 1971); State v. Jessup & Moore Paper Co., 77 A. 16 (Del. 1910).") (some citations omitted).

240. Jones Apparel Group, Inc. v. Maxwell Shoe Co., 883 A.2d 837, 845–53 (Del. Ch. 2004).

241. Under the so called equal dignities doctrine, "the general theory of the Delaware General Corporation Law is that action taken under one section of that law is legally independent, and its validity is not dependent upon, nor to be tested by the requirements of other unrelated sections under which the same final result might be obtained by different means." Orzek v. Englehart, 195 A.2d 375, 378 (Del. 1963). This idea has been applied to bylaw amendments in *Chesapeake Corp. v. Shore,* 771 A.2d 293, 346 (Del. Ch. 2000).

242. Professor Coffee explores four dimensions that seem to indicate whether a bylaw restricting the power of the board might be upheld. *See* John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the outcome of Corporate Control Contests?,* 51 U. Miami L. Rev. 605 (1997). Those are (i) "Ordinary vs. Fundamental"—courts are more likely to allow bylaws that affect fundamental changes to the

the board without shareholder approval.[243] Presently it is unclear whether bylaw provisions which purport to prohibit the board from altering or amending them are effective.[244] A board may be constrained in its ability to unilaterally remove bylaws adopted by shareholders by fiduciary duty obligations,[245] but fortifying holdover alterations into the DGCL, like the concrete provision for majority voting, would ensure that boards would not meddle with it. An alternative approach would be to require a replacement be found within a certain time frame, as the MBCA offers.[246]

Or, if you like clever lawyer legerdemain, consider the following: the shareholders adopt, in the same bylaw that specifies the number of votes required for election, a provision opting out of the holdover default. The iterations are limitless; the point though, is that arguably the holdover rule repeal would be contained in a bylaw already ensconced by the new majority voting amendment requiring that "A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed

corporation, but not day-to-day business decisions, (ii) "Affirmative Orders vs. Constraints"—courts prefer that shareholders restrain boards from certain actions by requiring shareholder approval than mandating that they take specified actions, (iii) "Procedure vs. Substance"—bylaws necessarily codify and express the corporation's "housekeeping" and procedural rules, but rarely address specific substantive decisions, and (iv) "Corporate Governance vs. Business Decisions"—bylaws are most viable where they generally re-allocate authority between shareholders and boards than when they affect specific instances of that authority. *Id.* at 613–15.

243. Thought unclear, directors may have the authority to unilaterally eliminate bylaws not otherwise protected by the DGCL. *See* Gen. DataComm Indus. Inc. v. State of Wis. Invest. Board, 731 A.2d 818, 821 (Del. Ch. 1999) (noting, in the context of a motion for expedited proceedings, that "the question of whether a stockholder-approved bylaw can be repealed by a board of directors with such authority has not clearly been answered by a Delaware Court. However, the Supreme Court's decision in *Centaur Partners* and the views of a learned commentator (Professor Lawrence Hamermesh) suggest that the affirmative answer may be the correct one."). *See* Am. Int'l Rent a Car, Inc. v. Cross, No. 7583, 1984 WL 8294, at *3 (Del. Ch. May 9, 1984) (Berger, V.C.) ("If a majority of American International's stockholders in fact disapproved of the Board's amendment of the bylaw, several recourses were, and continue to be, available to them. They could vote the incumbent directors out of office. *Alternatively, they could cause a special meeting of the stockholders to be held for the purpose of amending the bylaws and, as part of the amendment, they could remove from the Board the power to further amend the provision in question.*") (emphasis added).

244. Professors Coates and Faris consider the issue in some depth. John Coates & Bradley C. Faris, *Second-Generation Shareholder Bylaws: Post Quickturn Alternatives,* 56 Bus. Law. 1323 (2001). In their view, the "best argument in response is that Section 109(a) of DGCL reserves to the shareholders the residual authority to adopt, amend, and repeal bylaws. If the shareholders' residual authority under Section 109(a) is to mean anything, the argument would go, it must mean that the shareholders may adopt a bylaw that is beyond board repeal." *Id.* at 1368. However, they also argue that courts would likely find a non-repeal provision unenforceable, despite this argument. *Id.* Nonetheless, they believe that a similar restriction on repeal, such as a unanimous vote provision, would be evaluated in the same way as any other limiting provision, and thus could be upheld. *Id.* at 1356. They also note possible ways to uphold a no-repeal provision, either by arguing that the repeal of the bylaw is a violation of fiduciary duty, or that it is a *Blasius* like disenfranchisement of the shareholders. *Id.* at 1369. *Cf.* Larry Hamermesh, *Corporate Democracy and Stockholder-Adopted By-laws: Taking Back the Street?,* 73 Tul. L. Rev. 409, 469–70 (1998) (arguing that a bylaw which purports to limit a director's ability to amend the bylaw is highly suspect under Delaware corporate law).

245. Hollinger Int'l Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004), *aff'd,* 872 A.2d 559 (Del. 2005).

246. *See supra* notes 58–61 and accompanying text.

by the board of directors."[247] It doesn't say that the bylaw amendment cannot include provisions beyond the votes necessary provision, and it would literally read that the entire bylaw would be unalterable.

By way of complicating this question even further, if a director receives a majority withhold vote, and remains protected by the holdover rule, there is no way to replace that director in the interim between the next election if he or she is unwilling to resign. The other directors have no authority to remove a director.[248] Another relevant question will be: Who can replace a removed director? The default is that a director may be replaced by a vote of a majority of the other directors, but the corporation's charter will control the question.[249] If the board has the authority to do so, then it may mute the effect of a successful withhold vote. For instance, a removed Chairman could simply have the board appoint a director amenable to his aims if the target board were truly dysfunctional.

The presence of a staggered board may make majority voting less effective. As of 2005, 53% of the 5,000 largest U.S. Corporations by size had classified boards, meaning that the directors are divided into groups of three and ran for re-election in staggered years.[250] The practical effect of this practice is that it would take two successive elections to replace a majority of the board, thus serving as a means to entrench the present management. The presence of a staggered board also minimizes the effectiveness of a withhold vote campaign, as it will mean that at most a third of the board could be removed at any one time under either a majority voting bylaw or a resignation policy. Indeed, ISS is concerned that a negative drawback to the majority voting movement will be a diminished willingness on the part of firms to declassify their boards.[251] If the aim of majority voting is to replace the whole board, then staggering board terms is an issue. However, the flip side is that the presence of staggered boards may lessen board resistance to majority voting bylaws.

D. The Strategy of the Stalking Horse Candidate[252]

An idea heretofore unexplored in the literature that may be effective to halt completely the operation of a bylaw requiring majority voting in uncontested elections, would be to artificially create a contested election in advance of a threatened vote. Management could enlist a dummy candidate to add to the corporate ballot to make the number of nominees for the election exceed the number of seats up for election.

247. Del. Code tit 8, § 216 (2007).

248. Edward P. Welch, Andrew J. Turezyn & Robert S. Saunders, Folk on the Delaware General Corporation Law § 141.5 at GCL-IV-202 (5th ed. 2007). *See also* Bruch v. Nat'l Guarantee Credit Corp., 116 A. 738, 741 (Del Ch. 1922).

249. Del. Code tit. 8, § 223(d) (2007).

250. ISS Report, *supra* note 31, at 15.

251. *Id.*

252. The term stalking horse originally derived from hunting wildfowl. Sportsmen observed that birds flee on the approach of humans, but tolerate the presence of other animals, such as horses. Hunters would approach their quarry by walking alongside their horses, keeping their upper bodies out of sight until the flock was within range. Animals trained for this purpose are called stalking horses.

E. The Effect of Majority Voting, as Adopted, on Share Value

Professors Sjostrom and Kim have investigated the effect of firms adopting majority voting that deserves mention.[253] Their study performed a robust regression of market adjusted returns, and cumulative abnormal returns, surrounding announcements of adoption of various types of majority voting policies and bylaws. After controlling for industry, types of announcement, and a number of other variables, they found that majority voting has little effect on share value.[254] That finding would be consistent with much of the analysis in this section, but not all. In response, let us consider an anecdotal example, with the author as a shareholder.

I like to think of myself as a rational shareholder. I was trained as an accountant and attorney, and received a graduate degree specializing in financial regulation. I work at a court that specializes in corporate governance. I also have written this article on the effects of majority voting on the balance of power between boards and shareholders. And yet, I can admit that (i) I like to be fairly passive in my investments (between clerking and writing articles, I really just don't have the time to monitor) and (ii) I don't fully understand the effect that majority voting will have on share value, because I don't know how the SEC's access proposal will pan out, the magnitude of the effect on value if the broker street voting provision is eliminated, how the Court of Chancery will treat a decision to reject a director's resignation under a majority plus policy where no advance resignation has previously been submitted, etc., etc. Therefore, I am but one of the millions of shareholders that has ignored announcements of majority voting policies in making investment decisions that result in the Sjostrom/Kim analysis.

I certainly accept some notion of market efficiency; I just don't know how efficient it is in the face of uncertain information about the future efficacy of majority voting and the bounded rationality of shareholders.[255] In short, I find Professors Sjostrom's and Kim's investigation fascinating and useful. However, their thesis does not preclude that majority voting as adopted by firms could be made quite powerful by the working parts examined in this article, or that there are other iterations of majority voting that shareholders could propose that would be even more effective.

VIII. An Analysis of Voting Outcomes Using an Analogy to Political Science; A Feasible Runoff Proposal for Corporate Director Elections

This article advances a frustratingly attenuated thesis: that majority voting is poised to have a dramatic effect on the balance of power between shareholders and

The phrase has also come to include a candidate put forward to mask another candidate. *See* Webster's Third New International Dictionary, at 2221 (1993).

253. *See* Sjostrom and Kim, *supra* note 227.

254. Sjostrom and Kim, *supra* note 227, at 43–45.

255. *See generally* Conlisk, *supra* note 124.

management, the magnitude of which will depend on the outcome of a variety of working parts of corporate law, securities law, and board and institutional investor strategies for implementation and governance. This exploration elaborates the pieces that dominate the game board, even if it is still too early to anticipate the outcome of the match. To provide some insight into the potential outcomes, this article will make a brief foray into political science to see how majority voting stacks up against the criteria from that sphere, and to see if there is any alternative that might accomplish some of the same ends as majority voting for uncontested elections without the attendant drawbacks or uncertainty.

Some would argue that a comparison to democratic regimes is inappropriate, as voting in the corporate context, governed as it is by freedom of contract and transferability of rights, is simply too different for rational comparison to other systems.[256] In the end, comparison is unavoidable because the DGCL and the Delaware Court of Chancery have accepted that comparison,[257] despite the complex explanation for the origins of the shareholder voting process.[258] All one can do is keep the different objectives of the two spheres in mind throughout the comparison, and remain prepared to alter or abandon principles from civic democracy when comparison is inappropriate. It is also interesting to note that companies have used comparisons to civic democracy to justify plurality voting.[259]

The debate between plurality and majority voting schemes was originally sired in the context of political representation. Analysis in that sphere typically revolves around four distinct criteria.[260] The first factor is decisiveness, or the existence of a clear outcome at the final round of voting.[261] The second is anonymity of voters, meaning that we do not need to know who cast which votes to determine the outcome.[262] Neutrality is a third criterion; the voting result should be such that if

256. *See* Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy,* 63 WASH & LEE L. REV. 1389 (2006). Rodrigues argues that three factors make the comparison difficult, that (i) investing in a corporation is voluntary, (ii) representative democracy is limited in corporations, and (iii) the shareholder vote is largely an empty exercise. *Id.* at 1398–1401. The fact that shareholders can sell their shares is not without cost, especially for long term investors who want a stable and diversified portfolio, and the lack of shareholder voting power is descriptive. Rodrigues offers no predictions of how shareholder power might be enhanced, nor does it provide a normative answer to whether it should be enhanced. *See also* Professor Henry Manne, Editorial, *The Corporate Democracy Oxymoron,* WALL ST. J., January 2, 2007.

257. *See Blasius,* 564 A.2d at 659 ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.").

258. *See generally* Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights From the History of Shareholder Voting Rights,* 63 WASH. & LEE L. REV. 1347 (2006).

259. *See* General Dynamics Proxy Statement, *supra* note 235, at 39 ("This proposal would require that director nominees receive the support of a majority of votes cast to be elected. For a number of compelling reasons, plurality voting is the prevailing standard for the election of federal, state and local officials as well as for directors in U.S. public companies. Our Company elects its directors by a plurality standard for the same reasons that democracies use plurality standards.").

260. Nicholas R. Miller, *Voting, available at* http://research.umbc.edu/~nmiller/RESEARCH/VOTING.htm (reprinted in 4 THE NEW PLAGRAVE: A DICTIONARY OF ECONOMICS 826–30 (John Eatwell, Murray Milgate, and Peter Newman, eds.,1988) (citing Kenneth O. May, *A Set of Independent Necessary and Sufficient Conditions for Simple Majority Rule,* 20 ECONOMETRICA 680 (1952))).

261. *Id.* at 827.

262. *Id.*

everyone voted in the opposite fashion, then the other alternative would win (a criterion which becomes particularly cogent in the event that multiple alternatives are put forward, and the number of alternatives presented is greater by two or more than the number of selections permitted).[263] The fourth is positive responsiveness; if alternative A is at least tied with B, and someone then changes their vote to make it more favorable to A (by either voting for A instead of abstaining, or by abstaining instead of voting for B) then A wins.[264]

In analyzing these four criteria in the corporate context, it would seem the anonymity criterion is least important.[265] Shareholder votes are a matter of corporate record, and the large institutional shareholders that will have the most say in withhold vote campaigns typically are very vocal about their interest.[266] Decisiveness would be especially important to the board of directors; an inability to elect directors would stifle the board's ability to act. Shareholders would share that interest, unless one accepts the use of brinksmanship in reform negotiations.[267] Cost should also be added as a fifth criterion to analyze voting schemes for corporate elections; with fixed corporate resources and the voters sharing the cost of incumbent management's proxy solicitations (though not the cost of the challenger, unless they are victorious), shareholder voters would benefit from a cost efficient voting method.

Majority voting is the optimal method for a choice between two outcomes.[268] However, when the alternatives extend beyond a single binary choice, the analysis becomes increasingly complex. Some form of plurality voting must be utilized in order to achieve the decisiveness criterion, but the ordering of alternatives, the ordering of rounds of voting, and the inclusion of non-viable alternatives can all be used to game the outcome in favor of an alternative which may not be preferred, and in fact might otherwise be rejected, by a majority of the voters.[269] This outcome violates the positive responsiveness criterion.

Majority voting for uncontested elections of directors, as the bylaws adopted in response the majority voting movement provide, would enhance the ability of corporate plurality elections to achieve the four criterion *ex post* (and perhaps years later) by giving voters an opportunity to eliminate directors for which a majority of the electorate would express a clear preference against. In effect, the ability of a majority of shareholders to express a "withhold" or no vote against an incumbent director would allow the voters to mop up the results that spring from

263. *Id.*

264. *Id.*

265. Indeed, some would argue that hidden voting is dangerous. *See* Hu & Black, *supra* note 148.

266. *See, e.g.*, the Disney withhold vote campaign. Paul R. LaMonica, *Eisner Out as Disney Chair,* CNN MONEY, Mar. 4, 2004, *available at* http://money.cnn.com/2004/03/03/news/companies/disney/index.htm. Professor Romano argues that voting confidentiality has no effect on results either. *See* Roberta Romano, *Does Confidential Proxy Voting Matter?,* Yale ICF Working Paper No. 02-29; Yale L.& Econ. Res. Paper No. 265, *available at* http://ssrn.com/abstract=325640.

267. See *supra* text accompanying notes 162–67 for an analysis concerning a "first strike capability" for institutional shareholders.

268. *See* Miller, *supra* note 260, at 827.

269. For the seminal work on why voting systems are incapable of meeting all necessary criterion at once, see Kenneth Arrow, *A Difficulty in the Concept of Social Welfare,* 58 J. POL. ECON. 328 (1950).

a weakness in the plurality voting scheme by eliminating directors elected only because of a lack of alternatives or because of a gamed process in the subsequent round of voting.

But is that the only way for acolytes of shareholder empowerment to achieve this goal? There is another alternative that, even if ultimately unworkable for many companies, deserves a prominent place in the debate, an alteration to the process for resolving contested elections. The solution that political systems in the United States have discovered for the purposes of state-wide elections is a compromise between plurality and majority voting: the runoff election, with a plurality election followed by a majority election for the top two vote recipients.[270] In that system, decisiveness is achieved, as you eliminate the instance of a single candidate failing to win a majority in a race between three or more. You also minimize gamesmanship and the attendant risk to the neutrality criterion, as the winner of the runoff must be ultimately selected by a majority of the electorate.

Runoff elections may be a useful addition to tools of the shareholder democracy movement. The most significant roadblock to any reform of the corporate election process is the additional cost of the replacement system.[271] However, the SEC's current rule change to allow proxy solicitation via mere postcard notice, combined with internet access to the full proxy, should reduce the cost of contested elections for both corporations and challengers.[272] Furthermore, putting a runoff bylaw to a shareholder vote would allow shareholders to decide if the added cost of a runoff election for directors is worth their while. Besides, it is supposedly a rare occurrence anyway.

The most persuasive argument against runoff voting would be that the runoff election would take too long to accomplish; a two or three month lag time to re-solicit proxies between elections would leave a company without a working board. However, that problem could be simply solved with an ordinal voting ballot whose results could be used to determine the runoff (also called Instant Runoff Voting "IRV"). For example, if directors A, B, and C were running for one open slot, the proxy ballot would ask a voting shareholder to rank the candidates. The highest ranked selection will count as the shareholder's initial vote. In a subsequent runoff, the shareholder's top selection from among the two candidates in the runoff will be the candidate receiving that shareholders' vote. So if the shareholder voted for A but ranked B second, and B and C were in the runoff, then in a runoff that shareholder will be presumed to have voted for B if a second proxy solicitation had taken place. The assumption would be that the shareholder would vote their rational top choice from among the options

270. Also of interest are the various systems of tournament elimination used in sports playoffs, not analyzed in this context in light of the excessive cost they would require for corporate elections.

271. Opponents of any change in corporate elections would doubtless add a sixth criterion involving fiduciary duty—that the voting scheme cannot result in election of a director that would put his own interest before that of the corporation and fellow shareholders. Such a criterion is not included for two reasons: such a risk is not directly related to the form of the election, and it is also more properly addressed in the fiduciary duty strictures of shareholder derivative suits.

272. SEC Press Release, *SEC Votes to Adopt E-Proxy Rule Amendments and Propose Mandatory Model, supra* note 193.

remaining in the runoff.[273] The proxy card would inform the shareholders of this fact. No actual second vote would be required, and no additional proxy solicitations are necessary. The shareholder electorate is allowed to at least express their preference among the directors, and a majority of them are allowed to express a preference against a candidate, with minimal complication to the existing proxy machinery.

A word should also be added about the consequences of runoff elections in light of proxy access. The most common argument advanced against proxy access, embodied in one of Lipton's prior attacks on Bebchuk's shareholder access proposal, is that special interest directors would be a divisive presence on the board.[274] With this runoff option, a majority of the shareholders would be permitted to express a preference against this type of director. Thus responsible managers should not be so concerned with runoff elections of this type, as it can give them a tool to minimize instances of divisive directors advanced by a conflicted minority of the shareholder electorate. Perhaps runoff elections could help separate the wheat from the chaff; greenmailers and special interests might have a difficult time placing a candidate on the board because the majority support would be lacking, but those directors who are distasteful to a majority of their shareholders would no longer be insulated.

This article does not suggest that runoffs are appropriate for every company, or that this analysis is exhaustive. However, it does suggest that the concept of runoffs in contested corporate elections has been wrongfully left off the table of alternatives discussed in the shareholder democracy debate and is deserving of further study.

VIII. Conclusion and Predictions

Supporters of the majority voting amendment include a unique cast, including SEC Chairman Cox, Ira Milstein,[275] a number of Unions, CalPERs, Professors Grundfest and Bebchuk, and former Delaware Chief Justice Veasey.[276] However, the purple haze surrounding these multi-layered reforms, recently initiated at the federal level and the exchanges, that have affected or will affect the efficacy of

273. There is a substantial body of scholarship on the political economy of multi-choice decisions that holds that altering the choices available will also alter the ordinal ranking preferences among the choices presented. *See, e.g.,* Peter C. Fishburn & Steven J. Brams, *Paradoxes of Preferential Voting,* 56 Mathematics Magazine 207 (1983) (Describing the "Condorcet Paradox," where collective preferences of voters could be cyclic, meaning they change with the alternatives presented, even if the preferences of individual voters are not. This is paradoxical, because it means that majority wishes can be in conflict with each other. When this occurs, it is because the conflicting majorities are each made up of different groups of individuals. In other words, the winner of the vote depends on candidates' preferences for candidates who were not selected.). I admit that this is a drawback to my proposal, but it should be compared to political economy problems of absolute plurality voting. For more on rationality in voting methods, see Donald Saari, Chaotic Elections!: A Mathematician Looks at Voting (2001).

274. Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come,* 59 Bus. Law. 67, 83 (2003).

275. *See* ISS Report, *supra* note 31.

276. *Id.*

withhold vote campaigns, combined with the proximity of this change to the still recent wave of reform flowing form Sarbanes Oxley and its regulatory cousins, calls for a cooling off period before we stretch the analogy of corporate democracy too far. The working parts of corporate and securities law will interact in ways that are as yet incompletely understood in the context of withhold votes, so perhaps we should merely keep a keen eye on the golden goose and give the regulatory engines a rest.

What is the verdict in the Legend of Lipton? Though admitting that he remains the master of board corporate governance advising, we should be skeptical of bias in his arguments against shareholder empowerment. Lipton's thesis on the shareholder franchise is misguided; there are many drawbacks to shareholder empowerment, and reforms should be carefully tailored to ensure that those drawbacks can be avoided, but Lipton's latest diatribe against Bebchuk is not especially useful in that regard.

Instantaneous runoff voting for contested elections, utilizing ordinal voting preferencing from a single ballot, is an idea that merits further debate and exploration. However, rather than advocate further for a particular alternative proposal related to the shareholder democracy movement, or for a rollback of the reforms already instituted, or even attempt to justify the reform movement, the conclusion of this examination will be simply a few predictions about developments that can be reasonably expected in the near term based on the analysis presented in this Article.

1) *It is likely that the next move is for institutional investors to rally for an amendment to the DGCL to permit shareholders to adopt a bylaw altering the holdover rule, and making such a rule, once adopted, similarly unalterable by the board absent shareholder ratification.*

2) *Expect hedge funds to take an active role in withhold vote campaigns for firms that have adopted such a policy, but not to take an active role in fighting to get a strong majority voting amendment into the bylaws as that would make board seats won in proxy contest victories more difficult to keep.*

3) *Expect litigation in federal courts over whether firms can exclude from the corporate ballot under SEC Rule 14a-8 shareholder proposals for majority voting where a quasi-majority voting rule has already been adopted.*

4) *Expect attempts to institute holdover rule bylaws that result in challenges in federal courts, or seek declaratory judgments from Delaware Court of Chancery.*[277]

5) *Expect a withhold vote campaign, in the event that one occurs in the future in which the vote is close, to erupt into litigation over whether shares are properly counted as "able to vote" for purposes of establishing a majority.*[278]

277. *See* Bebchuk v. CA, Inc., 902 A.2d 737 (Del. Ch. 2006). Though Professor Bebchuk's move for a declaratory judgment declaring his bylaw proposal legal in the Delaware Chancery Court was dismissed for lack of ripeness, *id.* at 744–45, this doesn't mean that such challenges will not be likely once such bylaws are approved.

278. *See supra* Section VII.A., "Mechanical Issues in Tallying the Voting Outcome."

6) *Expect litigation over a board's response to any successful withhold vote campaigns, especially if its policy or ratified bylaw doesn't provide with specificity a board's response to a withhold vote campaign.*[279]

7) *In the event that the shareholder access rule is revisited and is a strong as before, look for management to institute or threaten withhold vote campaigns against insurgency directors.*[280]

8) *Expect that these victories by the shareholder democracy movement will add fuel to management decisions to sell out to private equity buyers that do not present the difficulties of accountability to disparate financial intermediaries.*[281]

9) *Expect that, as institutional investors gain negotiating leverage through victories in the shareholder democracy movement, activist hedge funds will make use of that leverage as well and their activity in that space will increase as they are able to acquire access to more capital.*

10) *Expect that, as financial intermediaries power is linked to flow of capital into their coffers, future recessions and major shifts in Federal Reserve policy will have an effect on activist investor activity.*[282]

279. Made more difficult by the provisions in Rule 14a-8 that a shareholder proposal to the corporate proxy cannot exceed 500 words. SEC Rule 14a-8 (17 C.F.R. § 240.14a-8 (2007)).

280. *See supra* Section VI.

281. *See* Andrew Ross Sorkin, *Private Firms Lure CEOs with Top Pay,* N.Y. TIMES, Jan. 8, 2007, § A, at 1.

282. In other words, rattling the saber loses its effectiveness when your opponent knows you can't afford to pay for the war.