The Future of Shareholder Democracy

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In 2007, the Securities and Exchange Commission (SEC) considered, and ultimately rejected, a rule that would have required corporations to include shareholder-nominated candidates on the ballot. This Article seeks to ascertain the impact of this rejection. On the one hand, the SEC's rejection appears to be a stunning blow to the shareholders' rights campaign. This is because many shareholders' rights advocates have long considered access to the corporate ballot as the "holy grail" of their campaign for increased shareholder power. Such advocates believe that access to the corporate ballot is critical to ensuring that shareholders can participate legitimately in the corporate electoral process and thereby influence corporate affairs. On the other hand, some corporate experts contend that the SEC's rejection should not be viewed as a major setback. Such experts maintain that characterizing proxy access as the sine qua non of shareholder influence fails to appreciate the significance of recent developments, such as the success of majority voting and the adoption of the e-proxy rules. Because these developments provide shareholders with alternative methods for influencing corporate affairs, some have even argued that they may make the issue of proxy access moot. This Article reveals the fallacies of such an argument, and hence the importance of the continued pursuit of proxy access. Indeed, after carefully considering the impact of such developments, and critically examining the probable impact of proxy access on shareholders' efforts to enhance their influence on corporate governance, this Article concludes that although other devices may prove useful, it is not likely that they will be as effective as proxy access in empowering shareholders. In this respect, future shareholder democracy campaigns must continue to focus on the historical battle for proxy access.

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INTRODUCTION

Shareholder activism recently has dominated the corporate governance landscape. In particular, shareholders have waged an aggressive campaign to enhance their voting power and authority within the corporation. Shareholder activists refer to their campaign as one for "shareholder democracy" because it focuses on increasing the efficacy of their voting right.[1] In the wake of corporate governance scandals and other high-profile incidences of corporate malfeasance, the shareholder democracy campaign is aimed at making corporate officers and directors more accountable, and hence less likely to engage in misconduct. The campaign generally has achieved success, resulting in changes that many believe will enhance shareholder power.

The one element missing from this success has been proxy access.[2] In every election for directors, corporations prepare and distribute a proxy statement to shareholders, which enables shareholders to vote on directorial candidates without being present at the annual meeting.[3] Proxy access refers to shareholders' ability to nominate directorial candidates of their choice to the corporation's proxy statement. Shareholder advocates have long considered proxy access to be the "holy grail" of shareholder democracy.[4] Currently, only the names of management-supported candidates appear on the corporation's proxy statement; corporations can exclude the names of candidates supported by shareholders.[5] This exclusion means that the vast majority of directors run unopposed. Because there is no election contest, this exclusion also means that the results of director elections become an almost foregone conclusion. In light of this phenomenon, shareholder advocates have been fighting to obtain proxy access for

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1. *See* Thomas W. Joo, *Comment: Corporate Governance and the "D-Word"*, 63 WASH. & LEE L. REV. 1579, 1587 (2006); Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1390 (2006). *But see* Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1509–10 (2006) (explaining competing conception of shareholder democracy).

2. As this Article was going to press, Delaware's governor signed into law Delaware House Bill No. 19, which amends the Delaware General Corporation Law by adding a new section 112 providing, among other things, that a corporation may adopt (but is not required to adopt) a bylaw allowing individuals nominated by stockholders to be included on the corporation's proxy statement, and that the corporation may subject such inclusion to any lawful procedures and conditions. *See* H.B. 19, 145th Gen. Assem., Reg. Sess. (Del. 2009) This new section makes clear that Delaware corporations can include a proxy access provision in their bylaws, though it falls short of requiring proxy access. *See id.*

3. *See* Securities Exchange Act of 1934 Rule 14a-3, 17 C.F.R. § 240.14a-3 (2007). The proxy statement is a statement containing information about the candidates to be voted on.

4. *See* Karey Wutkowski, *SEC to Look Outside Ballot on Proxy Access*, REUTERS, Jan. 4, 2008, http://www.reuters.com/articlePrint?articleId=USN1741224720080104.

5. *See* Securities Exchange Act of 1934 Rule 14a-8, 17 C.F.R. § 240.14a-8(i)(8) (2007) (providing exclusions for shareholder proposals related to election of directors).

more than half a century.[6] Shareholder advocates believe that proxy access ensures that shareholders have the ability to influence both corporate elections and day-to-day affairs because it allows them to nominate and vote on candidates of their choice.

In late 2007, the Securities and Exchange Commission (SEC) considered, but then ultimately rejected, proxy access for shareholders.[7] This Article critically assesses the impact of that rejection on shareholder democracy efforts. In fact, while shareholder advocates view such rejection as a significant setback, some corporate scholars and securities experts recently have argued that new initiatives may render proxy access a moot issue.[8] Given the importance shareholder advocates historically have placed on proxy access, that argument, if valid, could dramatically alter future shareholder rights efforts, enabling advocates to shift their focus and resources to other measures.

By evaluating the validity of this argument, this Article makes a number of critical and novel contributions to the corporate governance literature as well as the shareholder democracy campaign. In fact, this Article undertakes the first-ever comprehensive evaluation of new shareholder empowerment measures and their probable impact on enhancing shareholders' voting rights. After that evaluation, this Article concludes that while such measures may augment shareholders' power, they have flaws that make them less appealing than proxy access as a vehicle for shareholder empowerment. This conclusion, therefore, discredits the assertion that such new initiatives render proxy access moot. In so doing, this conclusion underscores the importance of the continued fight for proxy access and provides important guidance to shareholder advocates and the future of their shareholder rights efforts.

To be clear, the purpose of this Article is not to determine whether proxy access or any other mechanism will achieve the ultimate goal of enhancing corporate governance or reducing instances of corporate misconduct.[9] Instead, this Article seeks to determine the most efficient and effective mechanism for enhancing shareholders' voting power. Of course, it would be difficult to make such a determination without understanding the purpose of shareholders' voting power. This Article contends that such purpose is twofold: (1) to directly impact election outcomes, and (2) to indirectly influence director behavior and hence corporate affairs by increasing the likelihood that directors will engage with shareholders or otherwise incorporate shareholder concerns in their decision making. This Article measures the effectiveness of all initiatives using both of these metrics.

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6. *See infra* Part II.A (describing historical efforts to gain access to the proxy statement).

7. *See* Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914, Investment Company Act Release No. 28,075, 72 Fed. Reg. 70,450, 70,453 (Dec. 11, 2007) [hereinafter 2007 Final Shareholder Proposal Rule].

8. *See, e.g.*, Wutkowski, *supra* note 4 (quoting former SEC Chairman Harvey Pitt).

9. For a debate regarding the propriety of increasing shareholder power, see Stephen Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1746 (2005) [hereinafter Bainbridge, *Director Primacy*]; Stephen Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 624 (2006) [hereinafter Bainbridge, *Shareholder Voting Rights*]; Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 851 (2005). For a discussion of shareholders' historical role in the corporation, see Mitchell, *supra* note 1. This Article does not seek to address the normative question of whether increasing shareholder power is appropriate. Instead, this Article presumes the propriety of that increase, and focuses on the best mechanism for achieving it.

Part I of this Article provides an overview of the federal proxy system, and then discusses the manner in which proxy access could increase shareholders' voting power. This Part highlights why shareholder advocates believe that proxy access represents the crux of any campaign for shareholder democracy. Part II discusses the historical and current proposals for proxy access. This Part underscores the manner in which such access has been rejected repeatedly. Part III assesses recent initiatives aimed at improving shareholder power, and then critically examines whether those initiatives can be viewed as viable alternatives to proxy access. This Part includes an evaluation of majority voting, the abolition of staggered boards, proxy solicitation over the Internet, and rules aimed at facilitating Internet-based communications among shareholders as well as such communications between shareholders and managers. Part III reveals that these initiatives represent important victories in the battle for shareholder power, and thus augment shareholders' voting rights in meaningful ways. Nevertheless, Part III concludes that these alternative initiatives fall short of providing the type of power promised by proxy access. Hence, this Article contends that proxy access should continue to be a core component of any future shareholders' rights campaign.

I. PROXY ACCESS IN CONTEXT

A. The Proxy Access Hurdle

Shareholders' ability to elect directors has been characterized as one of shareholders' most fundamental rights.[10] Because shareholders are the only group empowered to vote, their voting right appears to reflect a critical source of power within the corporation. Shareholders do have other avenues for influencing corporate affairs, such as the ability to sue directors and officers.[11] However, courts have emphasized the importance of shareholder voting.[12]

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10. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988); Bebchuk, *supra* note 9, at 851; Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 607 (2007).

11. Shareholders have the power to bring suit against directors for breaching their duty owed to shareholders and the corporation. *See, e.g.*, MODEL BUS. CORP. ACT, ch. 7, subch. D (2007) (describing derivative proceedings). However, there are significant procedural and substantive hurdles to such suits that may impair the ability of that power to ensure managerial accountability. *See* James D. Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of* Zapata *& the ALI Project*, 1982 DUKE L.J. 959, 960; Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 286 (1986) (noting that the overall effect of the legal rules regarding derivative suits is to deemphasize the role of liability rules in conforming managerial behavior); Donald E. Schwartz, *In Praise of Derivative Suits: A Commentary on the Paper of Professors Fischel and Bradley*, 71 CORNELL L. REV. 322, 339–40 (1986).

Shareholders also have the right to sell their shares. This so-called exit right has been viewed by some as particularly important because it facilitates the market for corporate control by enabling the displacement of poorly performing managers. *See* ROBERT C. CLARK, CORPORATE LAW 95 (1986). However, scholars have pointed out that the market for corporate control is imperfect. *See* John Coffee, *Regulating the Market for Corporate Control: A Critical*

The right to vote in elections for directors represents one of the few, and perhaps most significant, aspects of shareholders' voting rights. To be sure, shareholders' voting rights are limited to approving certain fundamental transactions and voting to elect directors.[13] By contrast, the vast majority of power is reserved to the board of directors and corporate officers, collectively referred to as managers.[14] Shareholders neither can vote to elect or remove officers,[15] nor interfere in the ordinary business decisions made by officers and directors.[16] Hence, shareholders' ability to elect directors represents one of the primary ways in which shareholders can use the vote to influence corporate affairs.

In fact, the voting right is designed to encourage managerial accountability to shareholders.[17] While directors may be viewed as serving as agents for shareholders, directors' interests may diverge from those of shareholders.[18] The voting right aims to align those interests. Thus, shareholders' ability to vote directors out of office or refuse to elect them into office gives them direct control over poorly performing directors. Moreover, the fact that shareholders have the power to replace directors indirectly should induce directors to make decisions beneficial to shareholders.[19]

Encompassed in the shareholders' voting right is their right to nominate candidates for directors.[20] Both directors and shareholders have the ability to nominate directorial

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Assessment of the Tender Offer's Role in Corporate Governance, 84 COLUM. L. REV. 1145, 1211–12 (1984) (noting that even when shareholders sell their shares and attendant voting rights, management often remains in power after the takeover); James D. Cox, *Compensation, Deterrence and the Market as Boundaries for Derivative Suit Procedures*, 52 GEO. WASH. L. REV. 745, 752–53 (1984) (noting that while hostile takeovers may be effective for grossly abusive management, derivative suits are the only real means to deal with single breaches of fiduciary duty).

12. *See Blasius*, 564 A.2d at 659 (noting that the shareholder voting right represents a critical underpinning of corporate power); Stokes v. Cont'l Trust Co., 78 N.E. 1090, 1093 (N.Y. 1906) (noting that shareholders' power to vote is vital).

13. These fundamental transactions include approving amendments to the corporation's charter and approving mergers, major asset sales, and dissolutions. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 242 (amendments to certificate of incorporation), 251 (mergers), 271 (sale of assets), 275(c) (dissolutions) (2007); MODEL BUS. CORP. ACT §§ 10.03(b) (articles of incorporation), 11.04(b) (mergers), 12.02(a) (disposition of assets), 14.02(e) (dissolution) (2007).

14. *See* DEL. CODE ANN. tit. 8, § 141 (2007) (requiring corporations to be managed by or under the direction of the board of directors); MODEL BUS. CORP. ACT § 8.01(b) (2007).

15. *See* McQuade v. Stoneham, 189 N.E. 234, 236 (N.Y. 1934) (prohibiting shareholders from making agreements to elect officers and to interfere with discretion of board).

16. *See id.*

17. *See* Bebchuk, *supra* note 9, at 851.

18. Corporate scholars refer to this divergence as an agency problem and note that much of corporate law is aimed at responding to this agency problem. *See, e.g.*, ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–7 (1932); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976). *But see* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 290–91 (1999) (noting that a director's role is more consistent with a trustee than that of an agent).

19. *See* Bebchuk, *supra* note 9, at 851.

20. *See* Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466, 43,467 (proposed July 27, 2007) [hereinafter 2007 Shareholder Proposals] (noting that a key right of shareholders is the right to appear at a

candidates. For shareholders, the nomination right not only gives shareholders voice in the selection process, but also ensures that directors selected by management have challengers. In this regard, the nomination right bolsters the shareholders' voting right.

However, the widespread use of proxies impacts the nomination right. Shareholders in public companies typically vote by proxy.[21] A proxy refers to a shareholder's grant of authority to a third party to cast a vote on the shareholder's behalf.[22] Because of the dispersed nature of public shareholders, not all shareholders can be present at the shareholders' meeting, which makes it difficult to amass the quorum necessary to conduct an election or other business.[23] Voting by proxy remedies this problem.

Because shareholders vote by proxy, however, corporations must solicit proxies in advance of the shareholders' meeting. Federal law, known as the proxy rules, governs the solicitation of proxies by public corporations.[24] These rules make it unlawful for anyone to solicit a proxy without first filing a proxy statement with the SEC and furnishing solicited shareholders with this proxy statement.[25] A proxy statement is a document containing information regarding the corporation and the matters on which shareholders will vote.[26] The statement must include a proxy card—a card on which shareholders can record their votes.[27] Thus, when the corporation solicits proxies, it must prepare and distribute a proxy statement to all of its shareholders. In the case of meetings for director elections, that statement must include information about the candidates running for election. Such a proxy statement is sometimes referred to as the "corporate ballot."[28]

The corporation is not required to include shareholder-nominated candidates for directors on the corporate ballot. Because the proxy rules apply to all persons seeking to solicit proxies, shareholders must comply with the rules. However, if shareholders seek to solicit on behalf of nominees unsupported by management, shareholders cannot rely on the corporation's proxy machinery. To be sure, Rule 14a-8 of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended, known as the shareholder proposal rule, provides that corporations must afford shareholders who satisfy certain conditions the ability to place various proposals on the corporation's proxy statement, and a mechanism for allowing other shareholders to vote on such proposals.[29]

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shareholder meeting and advance proposals on which to vote, including proposals for nominating directorial candidates).

21. *See* CLARK, *supra* note 11, at 360.

22. *See* DEL. CODE ANN. tit. 8, § 212 (2007) (authority to vote by proxy).

23. *See* Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1135 (1993) (noting that the main reason corporations solicit proxies is to satisfy state quorum rules).

24. *See* Securities Exchange Act of 1934 Regulation 14A, 17 C.F.R. § 240.14A (2007).

25. *See* Securities Exchange Act of 1934 Rule 14a-3, 17 C.F.R. § 240.14a-3(a) (2007). When a proxy statement is made on behalf of an issuer in connection with the annual meeting involving the election of directors, the proxy statement must also be accompanied or preceded by an annual report. *See* 17 C.F.R. § 240.14a-3(b) (2007).

26. *See* 17 C.F.R. § 240.14a-3 (2007).

27. *See* Securities Exchange Act of 1934 Rule 14a-4, 17 C.F.R. § 240.14a-4(a)(2) (2007).

28. *See* Jayne W. Barnard, *Shareholder Access to the Proxy Revisited*, 40 CATH. U. L. REV. 37, 56 (1990); Bebchuk, *supra* note 9, at 856; Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 688 (2007) [hereinafter Bebchuk, *The Myth of the Shareholder Franchise*].

29. *See* Securities Exchange Act of 1934 Rule 14a-8, 17 C.F.R. § 240.14a-8 (2007). Those

However, Rule 14a-8 enables the corporation to exclude certain proposals from the proxy statement, including any proposal relating to the election of a director.[30] According to the SEC, the purpose of the exclusion was to make clear that the shareholder proposal rule was not the proper forum for waging election contests or reform efforts.[31] As a result of this exclusion, any shareholder seeking to put forth a candidate for director not supported by management must wage a proxy contest by preparing and distributing her own proxy statement.

Proxy contests are rare. On average, despite the existence of thousands of public corporations, there are forty or fewer proxy contests each year.[32] This number drops significantly outside of the hostile takeover contests. Hence, Professor Lucian Bebchuk found that from 1996–2002 there were an average of only eleven proxy contests a year unconnected to takeover fights.[33] The lack of proxy contests reveals that shareholders rarely rely on the proxy rules to nominate insurgent candidates.

Experts believe that this rarity stems from the costs associated with preparing and delivering a proxy statement. The SEC has long recognized that for most shareholders, "an election contest is not feasible because of the huge expenses involved."[34] Empirical evidence confirms the significant expenses associated with preparing and distributing a proxy statement.[35] Such expenses deter most shareholders from waging a proxy campaign.[36]

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conditions encompass certain procedural requirements including that the shareholders must hold at least one percent or $2000 in market value of the securities entitled to vote at the meeting and must give notice of the proposal. *See* 17 C.F.R. § 240.14a-8(b). In addition, the company must receive the proposal at its principal executive office no later than 120 calendar days before "the date of the company's proxy statement released to shareholders in connection with the previous year's annual meeting." 17 C.F.R. § 240.14a-8(e)(2). Moreover, a shareholder may submit no more than one proposal per shareholders' meeting. *See* 17 C.F.R. § 240.14a-8(c); Adam G. Brimer, *Getting Wired at the SEC: Reforming the Proxy Process to Account for New Technologies*, 58 ALA. L. REV. 179, 185–86 (2006); Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 886 (1994).

30. *See* 17 C.F.R. § 240.14a-8(i)(8). There are a variety of bases upon which a company may exclude a shareholder proposal, even if that proposal satisfies the procedural requirements of Rule 14a-8. *See generally* Palmiter, *supra* note 29, at 890–92 (noting the most common bases used to exclude shareholder proposals).

31. *See* Proposed Amendments to Rule 14a-8, Exchange Act Release No. 12,598, Investment Company Act Release No. 9343, 41 Fed. Reg. 29,982, 29,982 (proposed July 7, 1976). Such exclusion also was designed to prevent the circumvention of disclosure requirements required by other aspects of the proxy rules. *See* Shareholder Proposal Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488, 43,491 (proposed July 27, 2007); 2007 Shareholder Proposals, *supra* note 20, at 43,469.

32. *See* Bebchuk, *The Myth of the Shareholder Franchise*, *supra* note 28, at 683 tbl.1.

33. *See* Bebchuk, *supra* note 9, at 856.

34. *See* Reexamination of Rules Relating to Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 13,482, Investment Company Act Release No. 9740, 42 Fed. Reg. 23,901, 23,902 (May 11, 1977) [hereinafter Shareholder Participation].

35. *See* Melvin Aron Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1499 (1970) (noting that 1969 estimates placed the cost of proxy fights at forty thousand to one million dollars).

36. *See* Bebchuk, *The Myth of the Shareholder Franchise*, *supra* note 28, at 683; Elizabeth

Shareholders' inability to access the proxy statement also produces inequities. Indeed, the current rules mean that incumbent directors or directors supported by managers have their expenses borne by the corporation, while shareholders' challengers must bear their own cost.[37] In this regard, the current regime advantages managerial nominees.

Moreover, shareholders' inability to access the corporation's proxy statement significantly diminishes their ability to nominate candidates for directors. Shareholders do have the ability to recommend candidates to the corporation's nominating committee. However, such ability rarely translates into management acceptance of such recommendations.[38] If shareholders' recommendations are ignored or rejected, they have very little recourse.[39] Thus, shareholders can seek to nominate candidates from the floor of the shareholders meeting.[40] Yet because of the dispersed nature of shareholders, the proxy solicitation process has supplanted the shareholder meeting as the forum for nominating directorial candidates.[41] This means that nominating candidates from the floor of the shareholders' meeting is ineffective because such nominations occur after the vast majority of shareholders already have cast their vote by proxy. Thus, if shareholders cannot nominate candidates via the proxy statement, the nomination right is rendered relatively meaningless.

As a result, corporate elections reflect little more than a rubber stamp of management's choice.[42] Because shareholders do not have adequate means to advance their own candidates for directors, most director nominees run for election without challenge. When elections are uncontested, the election results become an almost foregone conclusion. In this regard, the current rules transform the shareholder vote into a pro forma exercise. As one expert noted, "to give any group exclusive access to

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Cosenza, *The Holy Grail of Corporate Governance Reform: Independence or Democracy?*, 2007 BYU L. REV. 1, 43 (2007).

37. Shareholders are not entitled to reimbursement of their expenses associated with waging proxy contests. *See* Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1071, 1107–09 (1990). Instead, shareholders may be reimbursed only if their costs are viewed as reasonable and the board approves the reimbursement. By contrast, incumbents have a right to be reimbursed for their expenses related to proxy contests so long as those expenses are reasonable. *See id.*

38. Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,784, 60,786 (proposed Oct. 23, 2003) [hereinafter 2003 Proposed Nomination Rule] (noting that recommendations to nominating committees are rarely effective).

39. *See id*.

40. *See* 2007 Shareholder Proposals, *supra* note 20, at 43,467; FRANKLIN BALOTTI & JESSE FINKELSTEIN, DELAWARE LAWS OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 7.9 (4th ed. 2006).

41. *See* Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 19,135, Investment Company Act Release No. 12,734, 47 Fed. Reg. 47,420 (proposed Oct. 14, 1982) [hereinafter 1982 Proposed Shareholder Access Amendments]; Eisenberg, *supra* note 35, at 1505 (noting that "the designation of candidates in the proxy materials is today's nomination").

42. *See* Eisenberg, *supra* note 35, at 1504 (noting that the inability to choose among various candidates makes the process of voting pro forma).

the corporate proxy materials for the purpose of designating its directorial candidates would be virtually tantamount to giving that group the power to elect the board."[43]

The lack of shareholder access to the corporate ballot strips the voting right of much of its ability to directly influence elections as well as its potential indirect power. This is because directors are virtually guaranteed reelection, decreasing their need to be concerned with repercussions for their failure to act in a manner that benefits shareholders.[44] As a result, the shareholders' voting right becomes largely ineffective as a means for ensuring managerial accountability.[45]

B. The Promise of Proxy Access

1. Effectuating the Voting Right

Efforts to breathe life into shareholders' voting rights inevitably coalesce around campaigns to obtain proxy access. Proxy access is ideal because it promises both direct and indirect benefits. By removing the cost barrier associated with proxy solicitations, proxy access directly influences election outcomes by ensuring that shareholders have a realistic opportunity to elect candidates of their choice.[46] Moreover, proxy access indirectly ensures that directors pay heed to shareholders' concerns or risk potential removal.[47] To be sure, shareholders' removal power must be credible or directors may feel free to ignore shareholders' interests. However, proxy access poses a realistic threat of removal because it ensures that shareholders have a realistic opportunity to nominate and vote on insurgent directors. As a result, such access represents the kind of threat most likely to encourage engagement between shareholders and corporate managers. In this regard, proxy access indirectly augments shareholders' participatory rights within the corporation, and hence appears to be an optimal mechanism for enhancing shareholder power.

Proxy access also appears to represent an ideal mechanism for effectuating shareholder power because it promotes participation by a broad spectrum of shareholders. Because shareholders' ability to wage proxy contests currently depends upon their ability to bear significant costs, only a limited number of shareholders can effectively take advantage of the current proxy solicitation system.[48] This is problematic because it means that a small pool of shareholders may wield significant influence over corporate affairs. By ensuring that shareholders have a cost-effective means of nominating directorial candidates, proxy access enables participation by a

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43. *Id*.

44. *See* Bebchuk, *supra* note 9, at 856.

45. *See* Blair & Stout, *supra* note 18, at 310 (noting that shareholders' voting rights give them little or no control over directors).

46. *Cf.* Bebchuk, *The Myth of the Shareholder Franchise*, *supra* note 28, at 688–90.

47. *See* Cosenza, *supra* note 36, at 42–43 (noting that allowing for proxy access improves corporate monitoring).

48. *See* Bebchuk, *The Myth of the Shareholder Franchise*, *supra* note 28, at 687 (noting small number of challengers); *id.* at 691 (noting costs of contests). Indeed, hedge funds have increasingly wielded influence in proxy contests. *See* INSTITUTIONAL S'HOLDER SERVS., 2006 POSTSEASON REPORT: SPOTLIGHT ON EXECUTIVE PAY AND BOARD ACCOUNTABILITY 2 (2006) [hereinafter 2006 PROXY REPORT] (report on file with the Indiana Law Journal).

broad range of shareholders. Then, too, most proposals enable shareholders to acquire proxy access so long as they own a minimum level of stock.[49] Such proposals thus ensure that a broad array of shareholders will have the ability not only to nominate candidates to the corporate ballot, but also to influence the election process, and hence corporate affairs.

At the same time, at least indirectly, proxy access encourages shareholders to collaborate with one another, increasing the probability that elected directors will focus on issues germane to the entire shareholder class. Indeed, one concern with the current system is that if only one group (i.e., corporate managers) has the ability to nominate candidates, then those candidates may feel beholden to that group.[50] Moreover, those candidates may advance the interest of that group at the expense of advancing concerns that benefit the corporation more generally. By opening up the ballot to more shareholders, proxy access may alleviate this concern. Additionally, because nominating shareholders would need to garner the support of other shareholders to get their candidates elected, proxy access would require shareholders to collaborate with one another. In fact, shareholders might need to join forces with one another to ensure that they have the percentage of shares necessary to nominate a director candidate. Because it depends upon these forms of coordinated efforts, proxy access encourages shareholder cooperation, thereby increasing the likelihood that directors will represent the interests of the entire shareholder group.

2. Roadblocks to Optimal Effectiveness

i. Collective Action Problems

To be sure, proxy access may not achieve its desired result because of collective action problems associated with shareholders' exercise of the vote.[51] The two most notable collective action problems involve rational apathy and the free rider problem. Many commentators describe shareholders as rationally apathetic.[52] In their seminal work, Berle and Means described the problem of rational apathy and its centrality to corporate governance concerns.[53] Rational apathy refers to the notion that the cost to shareholders of informing themselves about a particular action and casting a vote in

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49. *See infra* notes 92, 105 and accompanying text. For example, the two most recent proposals for shareholder access to the ballot would provide access to any shareholder or group of shareholders holding at least five percent of a company's securities for a period of one year. *See infra* notes 105, 123. However, some advocates have criticized this threshold as too onerous, particularly in light of the fact that the only requirement for submission of other proposals is that shareholders own $2000 worth of securities. *See* RISKMETRICS GROUP, 2007 POSTSEASON REPORT: A CLOSER LOOK AT ACCOUNTABILITY AND ENGAGEMENT 16 (2007) [hereinafter 2007 PROXY REPORT]; *see also* 17 C.F.R. § 240.14a-8(b) (2007) (noting shareholders must hold at least one percent or $2000 in market value of securities).

50. *See* Cosenza, *supra* note 36, at 42–43; Eisenberg, *supra* note 35, at 1504.

51. *See* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 526–28 (1990) (noting the view that "[c]ollective action problems make shareholder passivity inevitable").

52. *See* BERLE & MEANS, *supra* note 18, at 81; Black, *supra* note 51, at 527.

53. *See* BERLE & MEANS, *supra* note 18, at 81.

opposition to management exceeds the expected or actual benefit gained from such voting.[54] Given this cost-benefit analysis, shareholders rationally decide not to vote or at least not to vote in opposition to management. The free rider problem stems from shareholders' realization that they can benefit by relying on the actions of other shareholders, thereby undermining shareholders' incentive to take action on their own.[55] Shareholders' current failure to utilize the proxy machinery may stem from rational apathy, the free rider problem, or both. If so, then affording shareholders' proxy access may not serve to invigorate their voting rights.

Yet evidence suggests that these collective action problems can be overcome. Indeed, in recent years shareholders have been increasingly active, waging a variety of campaigns to increase their voting power within the corporation and influence corporate policies on a range of issues. Moreover, their activism has yielded results.[56] Thus, as Part III will demonstrate, shareholders' voting campaigns, including those that oppose management policies, have garnered strong shareholder support. Even individual shareholders have engaged in activism with impressive results.[57] Additionally, investors have been more willing to withhold their support from directors, particularly when directors ignore shareholders' request for action.[58] Moreover, despite the obstacles involved with waging a proxy battle, there have been incidences in which shareholders not only have engaged in such battles, but also in which those battles have culminated in shareholder nominated candidates defeating those supported by management.[59] This discussion suggests that shareholders can and will use their power, even under the current regime in which there exists obstacles to such use. As a result, collective action concerns should not represent a significant hurdle to shareholders' effective use of proxy access.

ii. Shareholder Competency

Shareholder competency concerns also may undermine the impact of proxy access. Indeed, shareholders may believe that directors are better positioned to select directorial nominees.[60] By contrast, shareholders may be at an informational disadvantage, and may lack the resources and expertise required to select candidates for directors.[61] Based on this assessment, proxy access may not yield its desired result because shareholders may believe that granting their fellow shareholders a broad nomination right is inappropriate and inefficient.

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54. *See* CLARK, *supra* note 11, at 390–91; Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1277 (1983).

55. *See* CLARK, *supra* note 11, at 392–93; Black, *supra* note 51, at 528; Fischel, *supra* note 54, at 1277.

56. *See* 2007 PROXY REPORT, *supra* note 49, at 5–7.

57. *See id*. at 5.

58. *See id*. at 26.

59. *See id.* at 22. In 2007, thirty-four proxy fights went to vote, up from twenty-one contests in 2006. At least one group of shareholders prevailed in their fight, securing three board seats. *See id*.

60. *See* Bebchuk, *supra* note 9, at 877 (noting that the shareholders' tendency to vote with management may result from rational deference to a party believed to be better informed).

61. *See id*. at 880.

To support this proposition, some may point to recent unsuccessful efforts to gain shareholder support for proxy access bylaws. Indeed, in the 2007 proxy season, shareholders voted on three proposals relating to proxy access.[62] The most high-profile proposal was submitted at Hewlett-Packard Company (HP). After the submission, HP sought to exclude the proposal. Thus, HP requested a "no-action" letter from the SEC's staff, which is a letter indicating that the SEC would not take action against HP for its exclusion decision. Because the SEC was actively considering the issue of proxy access at that time, the SEC's staff refused to issue such a letter.[63] Thereafter, HP included the access proposal on its proxy statement. One would presume that the attention HP garnered would have increased the likelihood of the proposal's success. Instead, the proposal failed: it received forty-three percent of the shareholder vote.[64] The fact that it failed to receive the two-thirds vote necessary for passage may reflect shareholders' lack of desire for such access. Then, too, another proxy access proposal at UnitedHealth Group similarly failed to muster the requisite shareholder support.[65] These votes suggest that shareholder activists may be pressing for issues that other shareholders do not support. The votes also suggest that shareholders may not deem it appropriate to confer a proxy access privilege on other shareholders, undermining the extent to which such access will be effective.

However, other evidence belies this suggestion. Of note, at least one bylaw access proposal did receive majority support in 2007.[66] Moreover, shareholder activists argued that the HP vote was a sign of success.[67] Indeed, the proposals at HP and UnitedHealth Group received more than forty percent of the shareholder vote.[68] As proxy experts note, such tallies reflect strong support for proxy access, particularly given that they were first-time votes and most shareholder proposals tend to receive a low level of support their first time on the ballot.[69] The strong percentage of shareholders who approved of proxy access suggests that a significant portion of shareholders do favor such access. It further suggests that shareholders feel comfortable with their fellow shareholders' ability to exercise the nomination right appropriately.

iii. Special Interest Shareholders

Many contend that proxy access may prove ineffective because it may confer power on special interest shareholders who will advance concerns that are not beneficial to the larger shareholder body or the corporation as a whole. Shareholders such as public

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62. 2007 PROXY REPORT, *supra* note 49, at 16.

63. *See* Hewlett-Packard Co., SEC No-Action Letter, 2007 WL 224970, at *1 (Jan. 22, 2007) (noting that the SEC's staff expressed no view on whether HP can exclude the proposal).

64. *See* Tomoeh Murakami Tse, *HP Investors Reject 'Proxy Access'; Proposal Would Have Opened up Board-Nominating Process*, WASH. POST, Mar. 15, 2007, at D02. The proposal received thirty-nine percent of the vote, but was later revised to forty-three percent. *Id*.

65. The vote stemmed from a proposal submitted at UnitedHealth Group, which garnered 45.3% of the shareholder vote. 2007 PROXY REPORT, *supra* note 49, at 16.

66. *See id*. (describing vote at Cryo-Cell International, a small biotech firm).

67. *See* Tse, *supra* note 64.

68. *See* 2007 PROXY REPORT, *supra* note 49, at 16.

69. *See* Tse, *supra* note 64.

pension funds and so-called social investors (shareholders that advance issues related to social or environmental concerns) have been the primary users of the shareholder proposal apparatus. Yet historical evidence suggests that these shareholders have a tendency to advocate for narrow or personal issues.[70] Given their history of activism, it is probable that such shareholders will be the most likely to utilize proxy access. More recently, hedge funds have been increasingly active in the corporate governance landscape.[71] The prevailing understanding is that such funds tend to have short-term horizons that may not align with the interests of other shareholders.[72] Yet their resources enable them to wield considerable direct and indirect power over corporate managers.[73] In light of these shareholders, several scholars and commentators have expressed concern that efforts to increase shareholder power will provide enhanced leverage for investors concerned with advancing their own narrow agendas.[74] Even if such shareholders do not gain direct support for their candidates, they could use proxy access as a platform to indirectly pressure corporations,[75] or engage in nuisance campaigns.[76] The potential that some shareholders will use proxy access to focus the corporation on issues beyond those that impact all shareholders could undermine significantly the effectiveness, and thus desirability, of proxy access.

However, while this potential represents a cause for concern, the extent of that concern may have been exaggerated. First, it may not be accurate to characterize social investors or even hedge funds as having interests necessarily inapposite with the larger body of shareholders. In fact, some concerns raised by such investors generate significant shareholder support.[77] Thus, in the most recent proxy season some social proposals fared as well as governance-related proposals.[78] Then, too, recent evidence suggests that some hedge funds engage in actions beneficial to all shareholders.[79] In this respect, it cannot be automatically presumed that social investors or even hedge

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70. *See* Bainbridge, *Director Primacy*, *supra* note 9, at 1754; Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 811–12 (1993).

71. *See* Frank S. Partnoy & Randall S. Thomas, *Gap Filling, Hedge Funds, and Financial Innovation* 2, 20 (Vanderbilt Univ. Law Sch. Law & Econ. Research Paper Series, Paper No. 06–21, 2006), *available at* http://ssrn.com/abstract=931254.

72. *See id*. at 24. But Partnoy and Thomas have found that hedge funds engage in a variety of activities, some of which are focused on more long-term strategies. *Id*.

73. *See id.* at 49.

74. *See* Bainbridge, *Director Primacy*, *supra* note 9, at 1754; Romano, *supra* note 70, at 811–12 (noting the distinction between public and private funds and the pressure public funds face to focus on local and/or social issues); Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1022–23 (1998).

75. *See* Bainbridge, *Director Primacy*, *supra* note 9, at 1754; Bebchuk, *supra* note 9, at 878.

76. *See* Bebchuk, *supra* note 9, at 879–80.

77. *See* 2007 PROXY REPORT, *supra* note 49, at 20, 31 (pinpointing shareholder proposals receiving strong, and in some cases, majority support).

78. *See id*. at 44.

79. *See* Partnoy & Thomas, *supra* note 71, at 46 (noting that some forms of hedge fund activism, particularly those that focused on targeting corporate governance procedures, may be beneficial to the broader shareholder class).

funds will introduce candidates with narrow views or otherwise engage in campaigns that do not benefit all shareholders.

Second, by providing all shareholders with a more cost-effective means of exercising their voices, proxy access may undercut the influence of groups with greater resources. Indeed, one reason for the success of hedge funds' activism is their greater resources. Yet, proxy access could undermine their influence by minimizing the importance of those resources in determining shareholders' ability to wage proxy contests. Then, too, shareholders have rebuffed the efforts of hedge funds and other investors when such investors have been perceived as advancing interests inconsistent with those of the broader shareholder class.[80] For example, shareholders have voted down hedge fund buyouts, demonstrating a willingness to put the interests of the corporate enterprise and other constituents above their own short-term profit-making interests.[81] These actions suggest that increasing shareholder power may enable more shareholders to take an active role in governance matters and better fend off those who would harm the interests of the corporation as a whole.

Third, the fact that candidates need majority support reduces the extent to which shareholders with special interests can hijack the election process.[82] Simultaneously, it increases the possibility that shareholders will put forth candidates with broad appeal. The evidence on current shareholder activism supports this possibility. Thus, the last few years of proxy data reveal increased coordination among various shareholder groups.[83] This suggests that shareholders' increased power also has increased their incentive to work together. The proxy data therefore support the notion that shareholders will use proxy access to advance candidates that appeal to a broad group of shareholders, thereby undermining the contention that such access will result in shareholders imposing candidates inclined to advance only narrow or specialized issues.

3. Concluding Assessments

As this discussion reveals, while there may exist drawbacks to proxy access, on the whole, it appears to live up to the promise of ensuring that shareholders' voting rights are meaningful. Moreover, it appears to strengthen the voting rights of a broad cross-section of shareholders, while decreasing the likelihood that a few shareholders will improperly influence either the election process or corporate affairs more generally. In this respect, shareholder activists' focus on proxy access seems both legitimate and understandable.

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80. *See id*. at 21.

81. *See id*.

82. *See* Partnoy & Thomas, *supra* note 71, at 14–15; Schwab & Thomas, *supra* note 74, at 1035–36, 1082–83 (noting that shareholder proposals cannot succeed without the support of other shareholders, and that such support will not be forthcoming unless such proposals relate to issues that resonate with the majority of shareholders).

83. *See* INSTITUTIONAL S'HOLDER SERVS., 2005 POSTSEASON REPORT: CORPORATE GOVERNANCE AT A CROSSROADS 10, 41 (2005) [hereinafter 2005 PROXY REPORT]; INSTITUTIONAL S'HOLDER SERVS., 2004 POSTSEASON REPORT: A NEW CORPORATE GOVERNANCE WORLD: FROM CONFRONTATION TO CONSTRUCTIVE DIALOGUE 5, 28 (2004) [hereinafter 2004 PROXY REPORT].

Of course, proxy access represents a limited right. Such access merely grants shareholders the power to replace incumbent directors or elect different ones. However, it does not provide shareholders with the power to initiate corporate policies, or as Bebchuk describes it, set the "rules-of-the-game."[84] Hence, even with proxy access, directors and officers will continue to have the authority to manage corporate affairs without significant shareholder interference. From that perspective, proxy access does not dramatically alter the balance of power within the corporation.[85] However, such alternation is not the goal of proxy access. Instead, proxy access is aimed at ensuring that shareholders can more effectively wield their voting power within the existing framework. Currently, the cost associated with conducting proxy contests has unnecessarily burdened the voting right. The goal of proxy access is to remove that burden, and thus restore voting rights to its proper role in the corporate governance landscape.

II. THE PROXY WARS

A. Historical Proxy Access Battles

The SEC first considered granting shareholders access to the corporate ballot in 1942. In that year, the SEC proposed a rule that would have required corporations to include on their proxy statements shareholder-nominated candidates for director.[86] After receiving an overwhelming amount of criticism regarding the rule, the SEC declined to implement it.[87]

In 1977, the SEC revisited the question of proxy access in the context of its more comprehensive examination of election procedures and corporate governance.[88] Thus, in April 1977, the SEC invited comments regarding whether the proxy rules should be altered to allow shareholders access to the corporate ballot for purposes of nominating candidates of their choice.[89] As a result of this process, in 1982, the SEC put forth three proposals relating to shareholders' access to the corporation's proxy statement.[90] Proposal I retained the existing framework, but added additional procedural rules while

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84. Bebchuk, *supra* note 9, at 856–57. However, proxy access does promise indirect benefits that may influence corporate decision making. *See id.* at 878.

85. *But see* Bainbridge, *Shareholder Voting Rights*, *supra* note 9, at 603–06 (noting that any increase in managerial accountability necessarily limits managerial power).

86. Securities Act Release No. 2887, Exchange Act Release No. 3347, Investment Company Act Release No. 417, 7 Fed. Reg. 10,655, 10,656 (Dec. 18, 1942); *see also* Barnard, *supra* note 28, at 54 n.102. The SEC also proposed a rule allowing shareholders to include a 100-word statement on the proxy statement opposing any management proposal—a predecessor to Rule 14a-8. *See* Securities Act Release No. 2887, 7 Fed. Reg. at 10,656; Barnard, *supra* note 28, at 47.

87. *See* Barnard, *supra* note 28, at 54; Fisch, *supra* note 23, at 1163.

88. *See* Shareholder Participation, *supra* note 34, at 23,901.

89. *See id.* at 23,903. The question submitted for consideration was the following: "Should shareholders have access to management's proxy soliciting materials for the purpose of nominating persons of their choice to serve on the board of directors?" *Id.* The Release then posed questions about the process for such nomination. *Id.*

90. *See* 1982 Proposed Shareholder Access Amendments, *supra* note 41, at 47,420.

providing interpretive guidance regarding some substantive rules.[91] One of the principal changes embodied in Proposal I was a revision requiring shareholders to hold a minimum number of shares for a period of at least one year in order to submit a shareholder proposal.[92] At the time, such restrictions did not exist.

Proposal II would have enabled a corporation, with the approval of its shareholders, to adopt its own procedures for shareholders to access the ballot. Thus, Proposal II essentially allowed corporations to opt-out of the federal proxy rules regarding proposals,[93] giving shareholders and corporations the flexibility to determine their own plan for the shareholder proposal process.[94] Proposal III would have eliminated the corporation's ability to exclude shareholder proposals from the ballot, other than those that would be improper under state law and those impacting director elections.[95] Proposal III would be subject to a numerical limit on the aggregate number of proposals required to be included in the corporate proxy statement.[96]

Ultimately, the SEC declined to embrace the proposal extending proxy access to shareholders. Of the three proposals, Proposal II would have granted some form of proxy access because it enabled shareholders and corporations the flexibility to establish their own procedures for accessing the ballot. Yet Proposal II prompted significant criticism.[97] Commentators complained that the discretion it afforded corporations and shareholders would lead to a lack of uniformity among corporations, prompting potential confusion and increased litigation based on that confusion.[98] Hence, the SEC rejected Proposal II. Instead, the SEC adopted Proposal I, which basically reaffirmed the status quo of nonaccess.[99]

In 1992, the SEC engaged in a comprehensive review of the proxy rules.[100] However, while the SEC implemented a variety of amendments to the federal proxy rules, the SEC did not institute any provisions providing proxy access.[101]

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91. *See id.* at 47,421.

92. *See id.* Shareholders would have to be a record or beneficial holder of at least one percent or $1000 in market value of an issuer's securities. *Id*.

93. *See id.* at 47,422.

94. The SEC expected that any rules for such a plan would establish minimum limits on eligibility and the basis for exclusion of any shareholder proposals. *See id*.

95. *See id.* In this regard, Proposal III would have been self-executing, thereby eliminating much of the SEC staff's participation in the shareholder proposal process. *Id.*

96. *Id.*

97. *See* Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 20,091, 48 Fed. Reg. 38,218, 38,218 (Aug. 16, 1983) [hereinafter 1983 Final Rule] (Final Rule).

98. *See id*.

99. *See id.* In fact, a substantial majority of commentators favored Proposal I. *Id*. Proponents believed that ensuring that shareholders had an economic stake in the company would curtail abuses of the rule. *Id*. at 38,219. Interestingly, the adoption of Proposal I triggered sharp criticism from Commissioner Longstreth who believed that the additional procedural rules encompassed in the new amendments "[tilt] significantly and unnecessarily against shareholders seeking access to the proxy machinery." *Id.* at 38,223. Commissioner Longstreth would have simply retained Rule 14a-8 in its then existing form. *Id.*

100. *See* Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, Investment Company Act Release No. 19,031, 57 Fed. Reg. 48,276, 48,277 (Oct. 16, 1992) (noting extensive three-year examination of proxy voting rules and procedures).

101. *See* Fisch, *supra* note 23, at 1170.

B. Recent Skirmishes

The corporate governance scandals of 2002 spurred renewed consideration of proxy access. In early 2003, the SEC directed its staff to conduct a study of proxy regulations with an eye towards improving corporate democracy.[102] The study revealed several areas of concern, including once again highlighting the inequities generated by shareholders' inability to nominate their own candidates on the corporate ballot.[103]

As a result, in 2003 the SEC proposed Rule 14a-11, which would have granted shareholders proxy access under certain circumstances.[104] Under the proposed rule, upon one of two triggering events, a corporation would have been required to include a shareholder-nominated candidate on its proxy statement so long as the shareholder making such a nomination held at least five percent of the voting stock for a period of two years.[105] Under the first triggering event, shareholders would have the right to access the corporate ballot if a resolution requesting the corporation to adopt majority voting had received more than fifty percent of the shareholder vote, and the corporation had failed to implement majority voting within 120 days of such vote.[106] The second triggering event occurred if shareholders had withheld at least thirty-five percent of their votes from one or more director candidates in a previous director election.[107] Rule 14a-11 also amended Rule 14a-8 to make clear that proxy access proposals regarding director election procedures could not be excluded under Rule 14a-8.[108]

The opposition to Rule 14a-11 eventually led to its demise. Indeed, after receiving comments on the rule, the SEC made no effort to adopt it. By 2005, the SEC's staff interpreted the inaction as a signal that the SEC had abandoned its commitment to providing proxy access.[109]

The Second Circuit revived the issue in *American Federation of State, County, and Municipal Employees* (AFSCME) *v. American International Group, Inc*. (AIG).[110] In that case, AFSCME, an employee pension plan and shareholder of AIG, sought to compel AIG to include a shareholder proposal in its proxy statement related to a bylaw

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102. *See* 2003 Proposed Nomination Rule, *supra* note 38, at 60,784; Press Release, U.S. Securities & Exchange Comm'n, Commission to Review Current Proxy Rules and Regulations to Improve Corporate Democracy, 2003-46 (Apr. 14, 2003), *available at* http://www.sec.gov/news/press/2003-46.htm.

103. *See* 2003 Proposed Nomination Rule, *supra* note 38, at 60,784.

104. *See id.*

105. *See id.* at 60,794.

106. *See id.* at 60,789–90. The majority vote resolution could be submitted only by a shareholder holding at least one percent of a company's outstanding shares for a year. *Id*. at 60,789.

107. *Id.* at 60,789.

108. *Id*.

109. Thus, in a series of "no-action" letters, the SEC's staff took the position that shareholder proposals based on Rule 14a-11 could be excluded from the corporation's proxy statement because, given the passage of time without SEC action, the adoption of such proposal appeared to reflect a position that the SEC no longer supported. *See, e.g.*, Halliburton Co., SEC No-Action Letter, 2005 WL 283290, at *1 (Feb. 7, 2005); Qwest Communications Int'l Inc., SEC No-Action Letter, 2005 WL 283288, at *1 (Feb. 7, 2005).

110. 462 F.3d 121 (2d Cir. 2006).

provision permitting shareholder-nominated candidates to be included on the corporate ballot under certain circumstances.[111] The SEC's staff took the position that AIG could exclude the proposal from its proxy statement.[112] Indeed, for almost two decades, the SEC had interpreted Rule 14a-8 to mean that shareholder proposals on election procedures could be excluded based on the provision allowing exclusion of proposals related to elections.[113] However, the Second Circuit argued that such a position was in conflict with the SEC's earlier interpretations of the proxy rules.[114] According to the Second Circuit, after the passage of Rule 14a-8, the SEC had neither clearly interpreted nor applied the proxy rules as excluding proposals on election procedures.[115] Therefore, the SEC's more recent interpretation of the rules reflected a change, and a change that was made without any explanation.[116] The Second Circuit reasoned that the SEC's earlier interpretation should be given greater weight because it was pronounced at the time that the exclusion was implemented.[117] Based on that interpretation, the Second Circuit held that shareholder proposals encompassing procedures for proxy access could not be excluded because they did not relate to an election within the meaning of Rule 14a-8.[118] The Second Circuit then suggested that the SEC clarify its position on shareholder proposals adopting election procedures.[119]

Eventually, the SEC responded.[120] In July of 2007, the SEC invited comments on two conflicting proxy access proposals.[121] One proposal would have amended Rule 14a-8 to permit inclusion of shareholder proposals in the company's proxy materials relating to bylaws mandating procedures for shareholders to nominate candidates to the board.[122] Such bylaw proposals could be included so long as the shareholder (or a

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111. *See id.* at 123. The proposal provided that shareholder nominees could be included on the corporate ballot so long as the shareholder making such a nomination held three percent of the outstanding shares for at least a year. *Id*. at 124 n.3.

112. Am. Int'l Group, Inc., SEC No-Action Letter, 2005 WL 372266, at *1 (Feb. 14, 2005).

113. *See* 2007 Final Shareholder Proposal Rule, *supra* note 7, at 70,453; *AFSCME*, 462 F.2d at 123.

114. *AFSCME*, 462 F.3d at 126; *see also* 2007 Final Shareholder Proposal Rule, *supra* note 7, at 70,451 (noting that the SEC's position did not allow exclusions based on the election exclusion).

115. *See AFSCME*, 462 F.3d at 123.

116. *Id*. at 129.

117. *See id*.

118. *See id.* at 129–30. This ruling occurred because the Second Circuit interpreted the rule to prohibit only those proposals that would result in an immediate election contest, and bylaws focused on procedures did not create such immediate election battles.

119. *See id.* at 131 (noting that the SEC "[could] certainly change its interpretation of the election exclusion").

120. The SEC held a series of roundtables in May 2007 on the issue of shareholder rights more generally. *See generally* U.S. Securities & Exchange Comm'n, Spotlight on: Roundtable Discussions Regarding the Proxy Process, http://www.sec.gov/spotlight/proxyprocess.htm.

121. The SEC also sought comments on electronic shareholder forums and whether corporations or shareholders should have the ability to propose and adopt bylaw procedures for including nonbinding shareholder proposals in the corporation's proxy materials. 2007 Shareholder Proposals, *supra* note 20, at 43,469.

122. *Id*.

group of shareholders) submitting the proposal had held more than five percent of the company's securities for at least one year.[123] The amended rule also would require that any submitted shareholder proposal be consistent with state law as well as the company's existing bylaws and charter.[124] Hence, the proposal gave shareholders the ability to craft their own rule rather than mandate a specific rule.[125] The second proposal would have amended Rule 14a-8 to make clear that corporations could exclude from their proxy statement any proposal for a bylaw aimed at adopting procedures for allowing shareholder access to the ballot.[126]

Consistent with its prior record, the SEC ultimately embraced the proposal denying shareholders access to the corporate ballot. Disagreeing with the Second Circuit, the SEC argued that the inclusion of shareholder nominees for director in a company's proxy materials would create a contested election.[127] However, the proxy rules contain a provision aimed at regulating proxy contests and ensuring adequate disclosure in connection with such contests.[128] In the SEC's view, if the election exclusion were not available for bylaw proposals establishing a process for the inclusion of shareholder nominated candidates, shareholders would be able to circumvent the proxy rules and wage an election contest without providing important disclosures.[129] In this respect, the SEC insisted that Rule 14a-8 was not the proper vehicle to wage a proxy contest, and thus not the proper forum for allowing shareholder proposals concerning access to the ballot.[130] Thus, the SEC adopted the rule permitting exclusion of bylaw provisions that would establish procedures for conducting an election.[131] Although some

123. *See id*. The one-year holding period would apply to each member of the shareholder group. *Id.* In addition, any soliciting shareholder must be eligible to file and file a Schedule 13G. *Id*. Schedule 13G is available only for people who have acquired securities without the intention of seeking a change of control of the issuer. *See id.*

124. *See id.* at 43,470.

125. *See id.* Indeed, shareholders could even determine the minimum level of share ownership necessary to have such nominations included in the corporation's proxy statement. *See id.*

126. *See* Shareholder Proposal Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488, 43,488–89 (proposed July 27, 2007). Thus, the proposal would change the existing language which enables the corporation to exclude a proposal if the proposal "relates to an election for membership on the company's board of directors or analogous governing body." *Id.* at 43,490. In its place, the new rule would provide for exclusion "[i]f the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election." *Id.* at 43,496.

127. See 2007 Final Shareholder Proposal Rule, *supra* note 7, at 70,450.

128. *See* Securities Exchange Act of 1934 Rule 14a-12, 17 C.F.R. § 240.14a-12 (2007).

129. *See* 2007 Final Shareholder Proposal Rule, *supra* note 7, at 70,450. To be sure, the proposed rule allowing shareholder access included additional disclosure requirements under Schedule 13G and new Item 24 and Item 25. 2007 Shareholder Proposals, *supra* note 20, at 43,471–73.

130. *See* 2007 Final Shareholder Proposal Rule, *supra* note 7, at 70,451.

131. *See id.* at 70,452. In addition to excluding such bylaw provisions, the rule also excluded any provisions that would have the impact of disqualifying a nominee, removing a director prior to the end of her term, or questioning a director's competence or business judgment. *See id.* at 70,454. Importantly, however, the SEC made clear that corporations cannot use the rule to

commentators urged the SEC to wait and assess the impact of *AFSCME* before adopting any rule impacting proxy access,[132] the SEC believed it was important to adopt a rule to provide clarity for corporations and shareholders during the upcoming proxy season.[133] Hence, the new rule went into effect almost immediately.[134]

C. The Road Ahead

Despite its rejection, some members of the SEC have indicated a willingness to reopen the proxy access issue. Thus, Chairman Cox insisted that he intended to make proxy access part of the SEC's agenda for 2008.[135] And in a recent speech, Cox stated that the SEC's 2008 agenda would continue to focus on ensuring that shareholders can more effectively utilize their voting power.[136]

However, others have suggested that recent developments may lessen the need for proxy access. Indeed, former SEC Chairman Harvey Pitt argued that some recent initiatives may make the issue of proxy access moot.[137]

Given the difficulties they have encountered, shareholder advocates should experience relief if other measures undercut the need for proxy access. To be sure, commentators' rejection of proxy access proposals sometimes turns on the form of the proposed rule.[138] In this respect, such rejection is not necessarily a rejection of proxy access itself. However, even that rejection highlights the difficulty with drafting an acceptable access rule. Moreover, many in the business community consistently have opposed any efforts to grant proxy access.[139] Some fear that granting shareholders an access right would be too costly because it would transform every election contest into a proxy fight. Shareholder advocates not only question the extent of such costs, but also contend that such cost concerns may not be a legitimate reason to reject proxy access given the importance of such access to effectuating shareholders' voting power. Still others fear that nuisance proposals and special interest shareholders will undermine the effectiveness of proxy access. Opponents also fear that such proposals

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exclude proposals relating to voting procedures, such as those requiring majority voting in the election of directors. *See id.*

132. *See id.* at 70,453.

133. *See id.* at 70,452 (noting that inaction by the SEC would promote uncertainty, escalating the confusion created by the *AFSCME* decision and effectively requiring shareholders and courts to litigate the meaning of the proxy rules).

134. *See id.* at 70,450. The new rules took effect January 10, 2008.

135. *See* Wutkowski, *supra* note 4.

136. *See* Christopher Cox, Chairman, U.S. Securities & Exchange Comm'n, The SEC Agenda for 2008: Remarks to the 'SEC Speaks in 2008' Program of the Practising Law Institute (Feb. 8. 2008), *available at* http://www.knowledgemosaic.com/Gateway/Rules/SP.spch020808cc.020808.htm. In his speech, Cox stated that the SEC's Division of Corporate Finance would "continue to pursue our fundamental objective of making the federally-regulated proxy system fit better with the state-authorized rights of shareholders to determine the directors of the companies they own." *Id.* To be sure, such a statement is not necessarily a promise to seek some form of proxy access. However, it may ensure that such access will remain part of the governance conversation.

137. *See* Wutkowski, *supra* note 4.

138. *See* 1983 Final Rule, *supra* note 97, at 38,218 n.3 (noting that some commentators supported the concepts underlying Proposal II, but did not support the proposal itself).

139. *See id*. at 38,218 n.2 (noting the large number of comments opposing proxy access).

may dissuade management-supported candidates from participating in corporate elections.[140] These kinds of fears apparently have prompted the SEC to reject proxy access. The past and most recent history of rejection reveals that the fight for proxy access has been, and will continue to be, an uphill struggle. Hence, if shareholder activists can reach their goal of empowering shareholders through other mechanisms, then focusing on such mechanisms may be a more optimal strategy. The next section seeks to evaluate the viability of this alternate strategy.

III. ALTERNATIVE CAMPAIGNS FOR SHAREHOLDER POWER

This Part explores four recent measures aimed at increasing shareholder power. After pinpointing the benefits and drawbacks of those measures in Parts III.A–D, Part III.E more deeply probes their impact on shareholders' ability to indirectly impact election outcomes and corporate affairs.

A. E-Proxy

1. The "Notice and Access" Regime

At the end of 2006, the SEC issued new rules aimed at facilitating the use of the Internet in proxy solicitations.[141] The Internet solicitation rules, or the so-called e-proxy rules, went into effect July 1, 2007.[142] The rules, referred to as the "notice and access" model, allow both companies and soliciting shareholders to disseminate proxy materials by providing notice to shareholders regarding availability of proxy materials and posting such materials on a generally accessible Web site.[143] The notice can be sent electronically to any shareholder that previously has consented to electronic

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140. *See* William J. Feis, *Is Shareholder Democracy Attainable?*, 31 BUS. LAW. 621, 640 (1976).

141. *See* Internet Availability of Proxy Materials, Exchange Act Release No. 55,146, Investment Company Act Release No. 27,671, 72 Fed. Reg. 4148, 4148–88 (Jan. 29, 2007) [hereinafter Final E-proxy Rule]. These rules mark the first time the SEC has sought to rely on the Internet to provide an alternative method for proxy solicitation. *See* Brimer, *supra* note 29, at 191. In the past, the SEC has provided interpretive guidance regarding the manner in which electronic measures may satisfy the existing proxy delivery requirements. Thus, the SEC published an interpretive release in October 1995 focusing on the use of electronic media to communicate with investors. *See* Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7233, Exchange Act Release No. 36,345, Investment Company Act Release No. 21,399, 60 Fed. Reg. 53,458 (Oct. 13, 1995). In April 2000, the SEC published another interpretive release. *See* Use of Electronic Media, Securities Act Release No. 7856, Exchange Act Release No. 42,728, Investment Company Act 24,426, 65 Fed. Reg. 25,843 (May 4, 2000). *See* Brimer, *supra* note 29, at 186–90 (describing the SEC's historical guidance on electronic methods of communication). In contrast, these new rules provide shareholders with an alternative method of delivering proxy materials.

142. *See* Final E-proxy Rule, *supra* note 141, at 4148.

143. *See* Internet Availability of Proxy Materials, Exchange Act Release No. 52,926, Investment Company Act Release No. 27,182, 70 Fed. Reg. 74,598 (proposed Dec. 8, 2005) [hereinafter Proposed E-proxy Rule].

disseminations.[144] Under the rules, the soliciting party must provide a paper copy of the solicitation materials to any shareholder who requests them at no charge.[145] The rules allow a shareholder to make a permanent request to receive paper or e-mail copies of proxy materials.[146] Then, too, a soliciting shareholder, but not an issuer, may limit her solicitation to shareholders who have previously agreed not to request a paper copy of the soliciting materials.[147] Such a limitation does not prevent any solicited shareholder from requesting a paper copy.[148]

2. Impact on Shareholder Power

i. The Cost Savings Conundrum

The potential cost savings afforded under the e-proxy rules makes it perhaps one of the most promising alternatives to proxy access. The consensus view is that cost is the principal impediment to waging proxy contests.[149] The SEC estimated that the printing and mailing costs to issuers and other soliciting persons associated with soliciting proxies was approximately $962.4 million in 2006.[150] The e-proxy rules are aimed specifically at reducing those kinds of costs.[151] In so doing, the e-proxy rules should

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144. *See* Final E-proxy Rule, *supra* note 141, at 4151 n.49. In addition, the notice must be sent forty calendar days before the shareholder meeting date. *See id.* at 4150. The notice must include such information as a statement of the matters to be voted on and information regarding how to request a paper copy of the proxy materials. *See id.* at 4151–52. To mitigate concerns that shareholders would vote prior to reviewing their proxy statement, a proxy card cannot be sent along with the notice. *See id.* at 4150. Instead, the proxy card must be posted on the Web site containing the proxy statement, and such site must provide a mechanism for executing the proxy card electronically. *See id.* at 4153. However, soliciting shareholders and issuers have the option of sending a proxy card ten days after they have distributed notice. *See id.*

145. *See id.* at 4154.

146. *See id.* at 4149, 4154. The request, however, can be revoked. *See id.* at 4154 n.86.

147. *See id.* at 4158.

148. The proposed rules included a provision allowing soliciting shareholders, but not the issuer, to engage in a conditional solicitation by conditioning proxy solicitation on a solicited shareholder's agreement to rely solely on the Internet to access proxy materials. Such a conditional solicitation would mean that soliciting shareholders would not have to furnish paper copies to those who requested them. However, the final rules rejected such conditional solicitations, and hence a soliciting shareholder must send a paper copy to any shareholder to whom notice was sent. *See id.* at 4150, 4158.

149. *See id*. at 4164 (noting that "undertaking a proxy contest is often a very costly endeavor"); *see also supra* note 140 and accompanying text.

150. *See* Final E-proxy Rule, *supra* note 141, at 4162. Issuers and others spent $481.2 million on printing and mailing costs in 2006. Automated Data Processing (ADP) mails proxy materials for beneficial owners, and in 2005, ADP was responsible for mailing about fifty percent of proxy materials. *See id.* ADP's costs together with issuers and others amounted to $962.4 million. *See id.*

151. In the adopting release, the SEC noted that the new rules were designed to give soliciting shareholders "an alternative method to furnish proxy materials that may have the effect of reducing the cost of engaging in a proxy contest." *See* Proposed E-proxy Rule, *supra* note 143, at 74,599. Elsewhere in the release, the SEC pointed out that the rules could "significantly decrease the cost of proxy solicitation, given the potential decrease in printing and

enhance significantly shareholders' use of the proxy machinery.[152] Therefore, the rules should reinvigorate shareholders' nomination and voting rights.

If this occurs, then the e-proxy rules should facilitate both indirect and direct benefits for shareholders. By removing the cost barrier to nomination, the e-proxy rules increase shareholders' ability to elect candidates of their choice. The fact that the e-proxy rules may enable shareholders to impact election outcomes also means that such rules have the ability to enhance engagement between shareholders and management. If shareholders can realistically determine which directors remain in office, it increases the likelihood that directors will pay heed to shareholders' concerns. Thus, the e-proxy system appears to provide an optimal alternative to the benefits promised under proxy access.

Then, too, as SEC Commissioner Annette Nazareth argued, the cost savings generated by the e-proxy rules "help level the playing field between management and dissenting shareholders."[153] Hence, the rules should reduce the relative advantage of management nominees.

Unfortunately, it is unclear if shareholders will realize these cost savings. Given that such savings represent the primary benefit of the e-proxy rules, that lack of clarity diminishes significantly the viability of the e-proxy rules.

Indeed, the extent of any cost savings will be influenced by several unpredictable factors. First, the rules do not preempt state law; thus if state law requires paper notice of shareholder meetings or proxy materials, then soliciting shareholders will incur costs associated with compliance with state rules. Second, the e-proxy rules provide that solicited shareholders have the right to request a paper copy of proxy materials.[154] The SEC estimates that nineteen percent of shareholders will choose to have paper copies sent to them, meaning that some costs associated with providing paper copies will persist despite reliance on the e-proxy rules.[155] Then, too, the SEC recognizes that the potential percentage of investors seeking paper copies is unpredictable and may fluctuate from year to year.[156] Hence, issuers and soliciting shareholders will have to predict the requested number of paper copies. Overestimating will mean encountering unnecessary costs, while underestimating could increase cost dramatically because of the expense involved with printing and furnishing proxy materials on demand.[157] Thus, the SEC noted that the cost savings associated with the e-proxy rules may not be as significant as they could be because of the need to ensure sufficient paper copies for shareholders who request them.[158] Because cost savings represents the core benefit of

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mailing costs." *Id.* at 74,607; *see also* Final E-proxy Rule, *supra* note 141, at 4162 (noting that reduction in printing and mailing costs and the potential decrease in costs of proxy contests represent the most significant sources of the new rules' economic benefit).

152. *See* Brimer, *supra* note 29, at 198 (noting that e-proxy rules should increase efficiency and effectiveness of proxy contests).

153. *SEC Proposes to Modernize Rules Governing Proxy Solicitations*, 37 Sec. Reg. & L. Rep. (BNA) No. 47, at 1958 (Dec. 5, 2005).

154. *See* Final E-proxy Rule, *supra* note 141, at 4154.

155. *Id*. at 4162.

156. *See id.* at 4163.

157. *See id.* at 4163 (noting that cost savings will be substantially reduced if paper copies are supplied on an on-demand basis).

158. *See* Proposed E-proxy Rule, *supra* note 143, at 74,613.

an e-proxy regime, this uncertainty appears to moot the appeal of such rules when compared to proxy access.

To be sure, soliciting shareholders may be able to reduce the cost associated with making paper copies by soliciting only those shareholders who have agreed to receive electronic copies of proxy materials.[159] However, since such shareholders are not prevented from requesting paper copies, this does not avoid entirely the cost of making such copies. Nor does such solicitation avoid the cost of uncertainty associated with seeking to predict the number of requested paper copies.[160] In fact, this uncertainty is increased because shareholders may revoke a permanent election to receive copies in a certain manner.[161] At the same time, limiting proxy solicitations to a particular group of shareholders may undermine the reach, and hence effectiveness, of a proxy battle. Thus, soliciting shareholders may find it less appealing to choose such an option. Regardless of whether shareholders engage in a limited solicitation or one with a broader reach, cost concerns will persist, stripping the e-proxy rules of much of their appeal relative to proxy access.

Ultimately, the cost savings under an e-proxy regime may depend on the extent to which shareholders will embrace electronic-only campaigns. One cause for concern is that prior efforts at electronic communications proved unsatisfactory.[162] Yet more recent evidence suggests that shareholders may be more comfortable with reliance on Internet communications. Indeed, during the 2006 proxy season, some eighty-seven percent of shares voted were voted either electronically or telephonically.[163] Moreover, some seventy-five percent of households have Internet access, while eighty percent of investors have Internet access.[164] The SEC believes that such levels of Internet access merited adoption of the e-proxy rules, apparently because such levels suggest growing ease with reliance on the Internet.[165] Also, the SEC expects that while first movers may experience significant cost, that cost should decline as investors become more comfortable with Internet-based communications.[166] This suggests that while e-proxy currently may not represent a realistic alternative to proxy access, it may be a viable option in the future.

However, even this prediction may not be accurate. This is because general Internet use or access may not be a reliable predictor of shareholders' willingness to depend upon proxy dissemination through the Internet. Indeed, one study revealed that some sixty-eight percent of shareholders would take steps to receive paper copies of their proxy materials at least some of the time.[167] This reveals that even with Internet access,

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159. *See* Final E-proxy Rule, *supra* note 141, at 4150.

160. *See id*. at 4154. However, the ability to predict the number of requested paper copies with accuracy may increase over time as issuers and shareholders gain familiarity with shareholder preferences.

161. *See id*. at 4154 n.86.

162. *See* Brimer, *supra* note 29, at 192 (noting problems associated with prior electronic releases).

163. *See* Final E-proxy Rule, *supra* note 141, at 4149.

164. *See id.*; *see also* Brimer, *supra* note 29, at 179. Other studies reveal that Americans spend an average of fourteen hours online each month. *See id*.

165. *See* Final E-proxy Rule, *supra* note 141, at 4149.

166. *See id*. at 4163.

167. *See id.*

shareholders may desire paper copies of their proxy materials.[168] This undermines the extent to which we can rely on that access to support the proposition that investors will make use of the e-proxy regime.

Perhaps more devastating to the notion that e-proxy rules can serve as an alternative to proxy access are studies revealing reduced participation as a result of such rules. A few studies have suggested that shareholders are more likely to cast a vote when they receive a paper copy than when they receive an e-mail notice. For example, some forty-nine to sixty-five percent of shareholders indicate that they may not visit the Web site contained in an e-proxy notice, thereby reducing the level of participation under an e-proxy regime.[169] A more recent study reveals that within the first five months of the e-proxy rules, retail participation fell by seventy-five percent, and thus only four percent of retail shareholders participated in e-proxy solicitations while most others do not bother to go online and access proxy statements.[170] This dramatically reduces the appeal of the e-proxy rules.

Additionally, the e-proxy rules may be less appealing than proxy access because there are some costs that persist even after elimination of printing and mailing costs. The SEC estimated that the costs of preparing, producing, and sending the notice required under the e-proxy rules could be about $2 million.[171] This is because while the e-proxy rules reduce the costs associated with mailing and printing proxy materials, they do not impact the costs associated with hiring legal counsel and document preparation.[172] As the SEC notes, the persistence of these costs reduces the cost savings associated with e-proxy solicitations.[173] They also reduce the relative attractiveness of e-proxy when compared to proxy access. Of note, the SEC estimated that the cost associated with having shareholder nominees included on the corporate ballot was $130,000.[174] This is a significant difference from the $2 million legal and document preparation costs estimated under the e-proxy regime. When that cost is added to the cost of producing paper copies, the cost savings associated with the e-proxy rules become more apparent than real. If this is true, then such rules have no advantage over proxy access.

Moreover, the e-proxy rules may be less ideal than proxy access because their effectiveness, and hence any potential cost savings, may depend upon corporate actions that may never materialize. As an initial matter, the effectiveness of the e-proxy rules may depend upon the extent to which corporations maintain well-developed e-mail lists for their shareholders. To be sure, federal law requires that corporations deliver to requesting shareholders a list of the names, addresses and security positions of the

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168. *See id.*

169. Memorandum from David Huntington, Office of the Chairman, to File S7-10-05: Internet Availability of Proxy Materials 14 (Nov. 28, 2006), *available at* http://www.sec.gov/rules/proposed/s71005/s71005-159.pdf.

170. *See* TheCorporateCounsel.net Blog, http://www.thecorporatecounsel.net/blog/archive/001628.html (Jan. 15, 2008 6:07 EST).

171. *See* Final E-proxy Rule, *supra* note 141, at 4163. The exact cost estimate was $2,020,475. *Id.*

172. *See id.* at 4158.

173. *See id.* The SEC hopes that this will curtail abuses of shareholders conducting nuisance contests. *Id.*

174. 2007 Shareholder Proposals, *supra* note 20, at 43,483.

record and beneficial holders of a corporation's stock.[175] However, federal law only requires that corporations deliver a list of e-mail addresses if the corporation already maintains such a list.[176] Whether corporations maintain such a list will vary by corporation because state statutes do not require the maintenance of such lists. For example, Delaware law specifically disavows any requirement that corporations maintain e-mail address lists of shareholders.[177] This means that shareholders may find it difficult to secure e-mail addresses of their fellow shareholders, making reliance on an e-proxy regime impractical.

The effectiveness of that regime also may depend upon corporations' willingness to rely on electronic mechanisms to conduct director elections. Indeed, if corporations choose not to conduct an Internet-based proxy solicitation while soliciting shareholders rely on the Internet, it could put such shareholders at a disadvantage. In this regard, soliciting shareholders may only feel comfortable waging an Internet-based proxy contest when corporations also engage in electronic disseminations. So what is the likelihood that corporations will use the e-proxy rules? To be sure, the e-proxy rules generate cost savings to both corporations and shareholders. However, there may be less incentive for corporations to choose Internet solicitations because the corporation, and not individual directors and officers, bears the cost of proxy solicitations. Moreover, the knowledge that Internet solicitations could facilitate proxy contests may curtail management's willingness to rely on the e-proxy rules. Then, too, because corporations can choose the meetings on which to rely on the e-proxy rules,[178] managers may be able to strategically avoid reliance on such rules when there is a strong likelihood of a proxy contest. If corporations only use e-proxies when shareholders do not use or are otherwise less inclined to use e-proxies, shareholders also may be less inclined to do so. If this occurs, the cost savings promised under the e-proxy rules may never materialize.

ii. Shareholder Participation and Special Interest Shareholders

One benefit of proxy access is that it would apply to a broad spectrum of shareholders, thereby enabling more shareholders to influence election outcomes and corporate affairs. The e-proxy rules may enable even broader shareholder participation than proxy access, and consequently could be viewed as more beneficial, even if only on the margins. Thus, although some commentators requested it, the e-proxy rules do not contain a minimum share ownership requirement.[179] Hence, any shareholder may rely on the notice and access model. This differs from proxy access because such access is generally contingent on a shareholder holding a minimum amount of shares for a specified period of time. Additionally, some proxy access proposals would

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175. *See* 17 C.F.R. § 240.14a-7(a)(2)(A)–(B) (2007).

176. Thus, the shareholder list must be provided in the format requested by shareholders, but only to the extent that such form is available to the corporation "without undue burden or expense." 17 C.F.R. § 240.14a-7(a)(iii).

177. *See* DEL. CODE ANN. tit. 8, § 219(a) (2007) ("Nothing contained in this section shall require the corporation to include electronic mail addresses or other electronic contact information on such list.").

178. *See* Final E-proxy Rule, *supra* note 141, at 4154.

179. *See id.* at 4151, 4158.

impose triggers for such access that would require significant shareholder support.[180] These proposals create limitations on participation that do not exist under the e-proxy rules. Given these limitations, the e-proxy rules enable shareholder participation on a broader level than proxy access, suggesting that such rules may be preferable to such access at least with respect to the issue of participation. Of course, the extent of that preference may depend on how burdensome shareholder limitations are under a proxy access regime.

With regard to special interest groups, the e-proxy rules appear to mirror the protections afforded by proxy access. Indeed, the essential difference between the e-proxy rules and proxy access is that the e-proxy rules allow for nomination through the Internet. In most other respects, the rules are similar to proxy access and hence should ensure the same kind of protections against special interest shareholders that exist with proxy access. The adoption of an e-proxy regime therefore should make shareholders no worse off with regard to special interest investors than they would be under a proxy access regime. In this regard, if not for the concerns regarding costs, the e-proxy regime would be a sufficient substitute for proxy access.

iii. Shareholder Control vs. Corporate Imprimatur

Some may contend that the e-proxy rules are preferable to proxy access because they allow shareholders to control both the content of the proxy statement and the solicitation process. Indeed, one drawback of proxy access is that when shareholder-nominated candidates appear on the corporation's proxy statement, corporate managers have the right to include statements opposing such candidates.[181] Shareholders do not have any corresponding right to rebut management's statements or otherwise oppose management nominees unless they choose to do so within the context of their statements supporting their own candidates.[182] Such a choice is difficult to make given the five hundred-word limit associated with such statements—a word limit not imposed on management.[183] Moreover, such a choice is difficult given that it must be made before shareholders have knowledge of the content of the company's statements.[184] In this regard, corporate managers in a proxy access regime would have the ability to cast shareholder-nominated candidates in a negative light, potentially undermining the strength of such candidates. And this ability is not subject to any word limitation. By contrast, the e-proxy rules would allow shareholders to distribute their own supportive proxy statement free from any negative remarks by management, and with ample opportunity to address any concerns they have with management candidates. In this respect, the e-proxy rules may provide a better opportunity for shareholders to garner support for their candidates.

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180. *See supra* note 105.

181. *See* 17 C.F.R. § 240.14a-8(m)(1) (noting company's right to include reasons it believes shareholders should vote against a proposal).

182. *See id*. (noting that shareholders may express their views in the context of their supporting statement).

183. *See* 17 C.F.R. § 240.14a-8(d).

184. A company must send a copy of its opposing statement to shareholders before it mails the proxy materials. *See* 17 C.F.R. § 240.14a-8(m)(3). However, such a notification occurs after shareholders have submitted their proposals. *See* 17 C.F.R. § 240.14a-8(e)(2).

Moreover, the e-proxy rules grant shareholders the ability to track the level of support their candidates receive, and hence engage in any necessary last-minute solicitations.[185] By contrast, this ability is reserved to management under a proxy access system because in that system management controls the solicitation machinery. Given the control over the proxy statement and solicitation process afforded by the e-proxy rules, such rules may be deemed a preferable alternative to proxy access.

Yet this control must be weighed against the potential inherent value associated with having access to the corporate proxy statement. Such inherent value emerges in two respects. First, there may be an advantage to having all directorial candidates' names appear on the same ballot. Second, there may be a psychological advantage to having a candidate appear on the corporate ballot, and hence appear to have the corporation's imprimatur or stamp of approval.[186] On the one hand, any such advantage may be diluted by the corporation's ability to make opposing statements regarding shareholder-nominated candidates.[187] On the other hand, to the extent the corporation advances opposing arguments against shareholder-nominated candidates, it may be more effective to view those arguments in the context of shareholders' supporting statements, rather than in an entirely separate document. In other words, management arguments may be less effective when they appear next to shareholders' statements regarding particular candidates. This is not only because shareholders are able to view the arguments against one another, but also because shareholders' arguments may be given more weight when they appear on a document seemingly approved by the corporation. The fact that many shareholder proposals that appear on the corporation's ballot have won approval despite management opposition gives credence to this point.[188]

To be sure, empirical evidence suggests that soliciting shareholders can wage an effective proxy battle even without having their nominees on the corporation's proxy statement.[189] However, this does not negate the possibility that including a nominee on the corporate ballot provides some psychological advantage—it just indicates that such an advantage can be overcome. Of course, it is difficult to prove the negative proposition regarding whether, and to what extent, having a nominee's name appear on the corporate proxy statement does not generate an inherent advantage. Without such proof, however, it is also difficult to conclude that the e-proxy rules provide an effective alternative to proxy access. Thus, even without the issues associated with cost, e-proxy may represent a second-best alternative to proxy access.

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185. The e-proxy rules enable shareholders to solicit votes and hence receive such votes from other shareholders. As a result, those rules enable shareholders to track the voting behavior or shareholders. By contrast, under a proxy access regime where shareholders would be entitled to have their names included on the corporation's proxy statement, shareholders submit their votes to the corporation and hence the corporation—and not the shareholders—have the ability to track those votes.

186. *See* Eisenberg, *supra* note 35, at 1504 ("[I]ncumbents gain an important psychological advantage in soliciting under the name of 'the corporation.'").

187. *See supra* note 181 and accompanying text.

188. For example, majority voting proposals have won significant shareholder support in the last few years. *See infra* note 218 and accompanying text.

189. *See supra* note 66 and accompanying text.

iv. Accuracy and Security Issues

An additional drawback of the e-proxy rules may be the accuracy and security problems associated with voting through electronic means. The e-proxy rules appear to strongly encourage corporations to enable shareholders to vote electronically.[190] At first glance, this seems ideal because it makes use of technology. However, our experience with federal, state, and municipal elections reveals significant defects with electronic voting. Recent elections reveal hundreds of cases involving voting inaccuracies including instances of misplaced votes, added votes, and switched votes.[191] As an example, in 2000, an electronic voting machine in Iowa recorded four million votes in a county with only three hundred voters.[192] Also, a 2007 investigation revealed that one company's electronic voting machines changed some thirty to forty percent of votes cast.[193] These inaccuracies associated with electronic voting may make a regime that relies on such voting both less reliable and less desirable.

Moreover, electronic voting poses security risks. Studies reveal that electronic voting systems are vulnerable to attack and bugs, some of which could alter the ability of such systems to accurately record votes.[194] Experts contend that voting over the Internet is the riskiest form of voting because of the increased exposure to viruses and potential vote tampering. To be sure, commentators to the e-proxy proposal raised security concerns.[195] However, the concerns focused on issues related to confidentiality and potential theft of shareholder information as opposed to potential attacks or other ways in which voting systems may be compromised.[196] As a result, the SEC's response, which focused on ensuring that issuers and soliciting shareholders ensure confidentiality and anonymity on the Internet, failed to capture the breadth of the problem.[197] In this regard, we should be careful adopting regimes that encourage over-reliance on electronic voting, particularly without any assessment of accuracy or security issues.

Corporations may eventually shift to electronic voting in some fashion.[198] Hence, the problems associated with electronic voting may exist even without reliance on an e-proxy regime. However, at least with proxy access, electronic voting is confined to the single voting system established by the corporation. The e-proxy rules raise the specter

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190. *See* Final E-proxy Rule, *supra* note 141, at 4153. The Rule requires that the issuer concurrently provide shareholders with at least one method of executing a proxy card, which includes providing an electronic voting platform or a telephone number. However, merely requiring a means to request a paper copy of the proxy card would be insufficient. *See id.* at 4153–54.

191. *See* Danielle Keats Citron, *Open Code Governance*, 2008 U. CHI. LEGAL F. 355, 363–65 (discussing instances where thousands of votes were lost or added during various municipal, state, and federal elections, including the presidential election).

192. *Id.* at 364.

193. *Id.* at 364–65.

194. *See id*. at 368–69.

195. *See* Final E-proxy Rule, *supra* note 141, at 4152.

196. *See id*. at 4152–53.

197. *See id*. at 4153.

198. *See id.* at 4152 (noting that a large majority of shares are already voted electronically).

of multiple voting processes, and consequently multiple voting errors and security concerns.

3. Concluding Assessments

In the end, there are many advantages to the e-proxy rules, but those advantages do not outweigh the drawbacks of such rules, making them less preferable than proxy access. Indeed, the e-proxy regime promises to reduce the cost associated with proxy solicitations, a major impediment to engaging in proxy contest. By providing such cost savings, the rules promise to make shareholders' voting power more meaningful. Yet the cost savings associated with the rules are not only uncertain, but also may depend on the corporation's willingness to engage in Internet-based solicitations and maintain e-mail addresses of its shareholders. Both of these factors significantly undermine the benefits of the e-proxy rules by stripping them of their primary advantage over proxy access. Then, too, the possibility that proxy access would afford shareholders an important psychological advantage may undermine the extent to which any system promoting separate solicitations can ever be more appealing than direct access to the corporate ballot. Finally, potential defects with electronic voting that may cause inaccuracies in the voting process should represent a source of concern. For all of these reasons, the e-proxy rules do not represent an appealing alternative to proxy access.

B. Majority Voting

1. The Majority Voting Campaign

Until recently, the vast majority of corporations elected directors based on a plurality system.[199] Under that system, a director is elected if she receives the most votes cast, without regard to votes that are withheld or cast against her.[200] Theoretically, then, a director may be elected even if only one vote is cast in her favor. Or to put it differently, a director could be elected even if ninety-nine percent of shareholders cast a vote against her.

Several high-profile campaigns to defeat the reelection of particular directors highlighted the limits of the plurality system. In many corporations, shareholders can either vote for a director or withhold their vote; shareholders cannot cast a vote against a director.[201] Hence, when shareholders seek to prevent a director from being elected,

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199. *See* CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS ii (2007), *available at* http://www.ngelaw.com/files/upload/majority_callen_020707.pdf.

200. *See* 2003 Proposed Nomination Rule, *supra* note 38, at 60,786 n.52; J.W. Verret, *Pandora's Ballot Box, or a Proxy with Moxie? Majority Voting, Corporate Ballot Access, and the Legend of Martin Lipton Re-Examined*, 62 BUS. LAW. 1007, 1010 (2007).

201. Part of the reason corporations have a withhold option, but not one providing for a vote against a director, is grounded in the proxy rules. The proxy rules require corporations to ensure that their proxy card has a place where shareholders can withhold their vote. *See* Securities Exchange Act of 1934 Rule 14a-4(b)(2), 17 C.F.R. § 240.14a-4(b)(2) (2007). However, the SEC decided against implementing a proposal that would have required proxy cards to contain a mechanism to allow shareholders to vote against a director because of concerns about its legal effect. *See* Shareholder Communications, Shareholder Participation in the Corporate Electoral

shareholders wage "withhold-the-vote" or "just-say-no" campaigns pursuant to which shareholders encourage others to withhold their votes from a particular director or group of directors.[202] In 2004, shareholders of Walt Disney Corp. ("Disney") waged a withhold-the-vote campaign against then-CEO and board chair Michael Eisner to express their disapproval regarding his role in initiating and approving an excessive compensation package for former Disney president Michael Ovitz.[203] Forty-five percent of shareholders withheld their votes against Eisner.[204] Similarly, in 2004, sixty-one percent of shareholders withheld their votes against a slate of four directors at Federated Department Stores, Inc. (FDS).[205] Although the FDS vote did not occur in the context of a withhold-the-vote campaign, both it and the vote at Disney represented the highest withheld votes in recent history.[206] Yet they underscored the fact that, under a plurality system, even a majority of withheld votes would not have prevented any director's reelection.[207] In this way, withhold-the-vote campaigns revealed the difficulty of impacting election outcomes under a plurality system.

A majority voting system appears to rectify this difficulty. A true majority vote model refers to a system pursuant to which a director must receive a majority of votes cast during an uncontested election in order to be elected. In other words, a candidate must receive more votes for her than are cast against her or withheld.[208] Under this model, a withhold-the-vote campaign would have a direct impact on election outcomes, ensuring that directors who fail to receive majority shareholder support are not elected.

Such a system raises the possibility of a failed election pursuant to which no candidate receives sufficient votes to be elected. In fact, the possibility of a failed election is one reason why corporations embraced the plurality system.[209]

Process and Corporate Governance Generally, Exchange Act Release No. 34-16356, 44 Fed. Reg. 68,764, 68,765 (Nov. 29, 1979).

202. Withhold-the-vote campaigns were recommended in a 1993 law review article by former SEC Commissioner and Professor Joseph Grundfest. *See* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857 (1993). Withhold-the-vote campaigns must comply with the proxy rules. Generally, those rules allow shareholders who conduct such campaigns an exemption for filing a proxy statement so long as such shareholders do not solicit proxies during the campaign. *See* Rule 14a-2(b)(1), 17 C.F.R. § 240.14a-2(b)(1) (2007).

203. *See In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 352 (Del. Ch. 1998), *aff'd in part, rev'd in part, and remanded in part sub nom.*, Brehm v. Eisner, 746 A.2d 244 (Del. Super. Ct. 2000). Indeed, Eisner encouraged Disney directors to hire Michael Ovitz. Yet almost immediately after his hire, directors became dissatisfied with Ovitz's performance and eventually fired him some fourteen months later. *See id*. Ovitz's severance package enabled him to receive $140 million upon his termination. *Id*. at 350.

204. 2004 PROXY REPORT, *supra* note 83, at 5.

205. *See id.* at 9. Shareholders withheld their vote to express their dissatisfaction with directors' decision not to implement majority voting. *See id.*

206. *See id*.

207. To be sure, the Disney vote did appear to generate indirect pressure on Eisner to resign. Hence, within hours of the vote, Disney removed Eisner from his position as board chair, and six months later, Eisner resigned from his post as CEO. *See id.* at 5.

208. Most corporations require that a candidate receive a majority of the votes present and voting at a meeting or a majority of the quorum, as opposed to the more stringent standard of a majority of the outstanding votes. *See* ALLEN, *supra* note 199, at iv.

209. *See* Verret, *supra* note 200, at 1010.

Because of this and other perceived problems with a true majority voting system, some corporations have adopted a "plurality plus" model. First introduced by Pfizer, Inc.,[210] such a model retains the plurality system as the default rule. However, a director who fails to receive a majority of the votes cast must tender her resignation.[211] The board then has some window of time (generally ninety days) in which to determine if it will accept the resignation.[212] Thus, a plurality plus system guards against a failed election by giving corporations adequate time to find a replacement for the director who has failed to win majority shareholder support. Though not as straightforward as a true majority vote regime, such a model nevertheless seeks to ensure that candidates who fail to receive majority support are not able to secure a board seat.

Recognition of the limits of the plurality system as well as frustration with the failure of proxy access has spurred the campaign for majority voting. Over the past three years, shareholders have submitted an increasing number of majority vote shareholder proposals to be included on the corporation's proxy statement.[213] In 2004, shareholders submitted twelve majority vote proposals.[214] In sharp contrast, shareholders submitted over 150 proposals in 2006.[215] More than 150 proposals were submitted in 2006 and 2007.[216] In fact, the number of majority vote proposals submitted in recent years far outnumbered the number of proposals submitted on other issues, making majority vote the most high-profile issue of the recent proxy seasons.[217] Moreover, such proposals have garnered a record amount of shareholder support. In 2007, the average support for such proposals topped fifty percent, up from a mere twelve percent in 2004.[218]

More importantly, corporations have begun implementing majority voting systems in record numbers.[219] Prior to 2005, only a handful of companies had a majority voting

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210. *See* PFIZER INC., CORPORATE GOVERNANCE PRINCIPLES 1–2 (2008), *available at* http://media.pfizer.com/files/investors/corporate_governance/cg_principles.pdf; s*ee also* 2005 PROXY REPORT, *supra* note 83, at 10. Pfizer adopted the plurality plus model in June 2005. *See* Press Release, Pfizer, Inc., Pfizer to Amend Corporate Governance Principles Regarding Election of Directors (June 23, 2005), *available at* http://www.pfizer.com/news/press_releases/pfizer_press_releases.jsp (follow "Press Release Archive," then follow "2005 Archives").

211. *See* PFIZER, INC., *supra* note 210, at 1.

212. *Id.* at 2.

213. Between January 1 and June 10 of 2005, 2006, and 2007, shareholders submitted 54, 84, and 37 such proposals, respectively. *See* 2007 PROXY REPORT, *supra* note 49, at 6.

214. *See* Stephen Taub, *Investors Back Shareholder Resolutions*, CFO.COM, Aug. 22, 2006, http://www.cfo.com/article.cfm/7826000?f=search.

215. 2006 PROXY REPORT, *supra* note 48, at 2. In 2005, Council of Institutional Investors urged 1500 of the largest U.S. companies to adopt majority voting. *See* Arthur Fleischer, Jr., *Majority Voting and Shareholder Access*, *in* PRE-CONFERENCE BRIEFING TO THE 39TH ANNUAL INSTITUTE ON SECURITIES REGULATION: SHAREHOLDER ACTIVISM: FINDING THE BALANCE 313, 320 (PLI Corp. Law & Practice, Course Handbook Series No. 11508, 2007).

216. *See* 2007 PROXY REPORT, *supra* note 49, at 16.

217. *See* 2006 PROXY REPORT, *supra* note 48, at 3 chart 1.

218. *See* 2007 PROXY REPORT, *supra* note 49, at 6, 17. The average shareholder support was 44.3% in 2005, 47.7% in 2006, and 50.3% in 2007. *Id.* at 6.

219. *See* Fleischer, *supra* note 215, at 317 ("Majority voting is clearly becoming the norm in United States corporations.").

system in place.[220] By February 2006, sixteen percent of S&P 500 companies had some form of majority voting regime in place.[221] But by the start of the 2008 proxy season, sixty-six percent of S&P 500 companies and fifty-seven percent of Fortune 500 companies had adopted some form of majority voting.[222] As this empirical evidence reveals, the voting standard at most major corporations has undergone a dramatic shift.

This shift is particularly remarkable given that corporations are under no obligation to implement majority voting proposals. The vast majority of shareholder proposals requesting corporations to implement majority voting have been nonbinding.[223] Hence corporations are not required to implement them even if they receive majority shareholder approval. Underscoring this discretion, in previous years, corporations largely ignored many shareholder proposals even when they garnered majority shareholder support.[224] Thus, the fact that corporations have chosen to comply with shareholders' requests for majority voting highlights the success of that campaign. Indeed, in 2007 fifty-five percent of majority vote proposals (70 out of 150) were withdrawn, as compared to twenty-four percent in 2006 and twenty-three percent in 2005.[225] Generally, withdrawn proposals reflect a corporation's decision to either adopt majority voting or put a majority voting proposal to a shareholder vote.[226] The high level of withdrawn proposals, therefore, further underscores the fact that corporations are responding to the majority vote campaign even without significant shareholder votes on them.

Then, too, the campaign for majority voting has spurred the enactment of several laws designed to facilitate the adoption and retention of majority voting. Prior to 2006, virtually every state as well as the American Bar Association (ABA) had embraced plurality voting as the default rule in director elections.[227] Yet in 2006, California amended its corporate code enabling corporations to adopt majority voting as the default rule in the election of directors.[228] In a similar vein, half a dozen other states altered their corporate statutes to enable corporations to adopt a majority voting provision through either a bylaw or charter amendment.[229]

The ABA took a less drastic, but no less significant approach.[230] Thus, in 2006, the ABA amended the Model Business Corporation Act (MBCA) to allow for the adoption

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220. *See* Brooke A. Masters, *Proxy Measures Pushing Corporate Accountability Gain Support*, WASH. POST, June 17, 2006, at D1 (noting that fewer than thirty companies had majority vote regimes in place at the start of 2005).

221. *See* ALLEN, *supra* note 199, at i. These percentages include corporations that adopt true majority voting regimes as well as those that have adopted a plurality plus model.

222. *See id*. at iii.

223. *See id*. at vi.

224. *See* Bebchuk, *supra* note 9, at 854.

225. 2007 PROXY REPORT, *supra* note 49, at 17.

226. *See id.*

227. *See, e.g.*, DEL. CODE ANN. tit. 8, § 216(3) (Supp. 2008); MODEL BUS. CORP. ACT § 7.28(a) (2007); ALLEN, *supra* note 199, at 4–5 n.7.

228. The California code also requires that a director who does not receive a majority vote be removed from office within ninety days. *See* CAL. CORP. CODE § 708.5 (West Supp. 2009).

229. These states include Nevada, North Dakota, Ohio, Virginia, and Washington. *See* ALLEN, *supra* note 199, at v–vi.

230. *See* COMM. ON CORPORATE LAWS, AM. BAR ASS'N, PRELIMINARY REPORT OF THE COMMITTEE ON CORPORATE LAWS ON VOTING BY SHAREHOLDERS FOR THE ELECTION OF

of a bylaw amendment providing a plurality plus system pursuant to which directors who fail to receive a majority of the votes cast must tender their resignation the earlier of ninety days or the date upon which a successor is elected.[231] Then, too, if shareholders adopt such a bylaw amendment, only shareholders may repeal it.[232] Since twenty-four states follow the MBCA, these changes should have a significant impact on state statutes throughout the country.

In 2006, Delaware, the incorporation home of roughly half of public corporations,[233] enacted two amendments to its general corporation code that facilitate the majority vote effort. Like the ABA's changes to the MBCA, one Delaware provision prevents the board from unilaterally repealing a stockholder-adopted bylaw addressing the votes necessary for the election of a director.[234] The other amendment allows a board member's resignation to be effective upon a later date or future event, and allows the resignation to be irrevocable if it is tied to a director's failure to garner a specified vote for reelection.[235] Other states similarly have adopted amendments enabling director resignations to be both contingent and irrevocable.[236] While these rules do not alter the plurality voting regime, they do facilitate the adoption and retention of a majority vote model.

The majority vote campaign also may be boosted by a proposed New York Stock Exchange (NYSE) rule that would prevent brokers from voting beneficial ownership shares in uncontested elections when they do not receive instructions from the record owner.[237] NYSE Rule 452 governs the discretionary voting of proxies by brokers on behalf of customers who are beneficial owners of shares.[238] Rule 452 requires that brokers receive voting instructions for matters on which shareholders must vote. However, if brokers do not receive those instructions ten days before a meeting date, brokers have the discretion to vote on matters deemed to be "routine."[239] Under current

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DIRECTORS 7 (2006), http://www.abanet.org/buslaw/newsletter/0044/materials/f3.pdf (discussing reasons for adopting the plurality plus model).

231. *See* MODEL BUS. CORP. ACT § 10.22(a)(2) (2007); Comm. on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments to Chapter 7 and Related Provisions Relating to Shareholder Action Without a Meeting, Chapters 8 and 10 Relating to Shareholder Voting for the Election of Directors, and Chapter 13 Relating to Appraisal and Other Remedies for Fundamental Transactions*, 61 BUS. LAW. 1427, 1432–33 (2006).

232. *See* MODEL BUS. CORP. ACT § 10.22(c)(1).

233. *See* Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1210 (2001).

234. *See* DEL. CODE ANN., tit. 8, § 216 (Supp. 2008).

235. *See* DEL. CODE. ANN., tit. 8, § 141(b) (Supp. 2008).

236. *See* ALLEN, *supra* note 199, at vi. Such states include Maine, Texas, Utah, and Virginia. *See id.*

237. *See* Fleischer, *supra* note 215, at 317. As of January 2009, however, the SEC has not acted on the NYSE proposal to amend Rule 452. *See* Abigail Arms, *Trends in Corporate Governance of the Largest U.S. Public Companies General Governance Practices*, *in* PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 2009, at 17, 29 (PLI Corp. Law & Practice, Course Handbook Series No. 18393, 2009).

238. *See* NYSE, Inc., Rule 452 (2009), *available at* http://rules.nyse.com/nysetools/Exchangeviewer.asp?SelectedNode=chp_1_2&manual=/nyse/nyse_rules/nyse-rules/.

239. Marcel Kahn & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J.

NYSE rules, uncontested director elections are deemed to be "routine" matters, and thus brokers are permitted to vote shares held even if they do not receive voting instructions.[240] Evidence reveals that brokers overwhelmingly cast votes in favor of management proposals and candidates.[241] Thus, as Professor Bernard Black notes, Rule 452 "simply pads the affirmative vote on routine matters."[242] Moreover, shareholder activists blame the defeat of some high-profile "vote no" campaigns on the influence of broker votes.[243]

However, the NYSE has proposed amending this Rule so that brokers no longer have such flexibility.[244] Without instructions, brokers would be prohibited from casting shares in favor of a particular director. Thus, such shares would not be deemed withheld unless shareholders specifically instructed brokers. Ultimately, such an amendment not only would serve to enhance the impact of a majority voting rule by reducing the block of favorable votes directors usually receive from brokers during uncontested elections, but also would enhance shareholder voice by ensuring that votes cast in favor of a candidate truly reflect shareholders' voting preferences.

As this discussion reveals, majority voting not only has become the norm in many corporations, but several new initiatives augment the majority vote regime. Illustrative of the success of the majority vote campaign is a Latham & Watkins LLP report that advised its clients not to resist shareholder proposals requesting majority vote structures, noting that the issue had "left the proverbial station," and that there were no effective "sound bites" against shareholder demands for majority vote.[245] Other experts, including Martin Lipton, predict that the majority voting standard will soon be universal.[246]

2. Probing the Effectiveness of Majority Voting

As a descriptive matter, and despite predictions regarding universality, majority voting does not as yet broadly apply to most shareholders. A corporation's decision to establish a majority voting system is voluntary, and thus it is not inevitable that such systems will apply to all corporations or even every public corporation. While the majority voting movement has experienced tremendous success, there still exist many companies that have a plurality system in place. Currently thirty-four percent of S&P 500 companies and forty-three percent of Fortune 500 companies have not adopted any form of majority voting.[247] This makes the current majority voting system less

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1227, 1250 (2008).

240. Verret, *supra* note 200, at 1040.

241. *See* Black, *supra* note 51, at 561.

242. *Id.*

243. *See* 2007 PROXY REPORT, *supra* note 49, at 29 (noting belief that broker votes were decisive in defeating the withhold-the-vote campaign against directors at CVS).

244. *See* PROXY WORKING GROUP, NYSE, INC., REPORT AND RECOMMENDATIONS 20–23 (2006), *available at* http://www.nyse.com/pdfs/REVISED_NYSE_Report_6_5_06.pdf.

245. LATHAM & WATKINS LLP, MAJORITY VOTE FOR DIRECTORS: THE LATEST CORPORATE GOVERNANCE INITIATIVE 1–3 (2005), http://www.lw.com/upload/pubContent/_pdf/pub1437_1.pdf.

246. *See* Martin Lipton, *What Directors Can Expect in the New Year*, COMPLIANCE WEEK, Jan. 3, 2006, http://www.complianceweek.com/article/2161/what-directors-can-expect-in-the-new-year.

247. *See* ALLEN, *supra* note 199, at iii.

attractive than proxy access, which, if properly implemented, would broadly apply to all public companies.[248] However, even if majority voting were universal, the next sections reveal several reasons why majority voting nevertheless is less attractive than proxy access.

i. Direct and Indirect Impact

Majority voting ensures that a withhold-the-vote campaign actually impacts election outcomes. It therefore represents a particularly strong alternative to proxy access.[249] Professor Joseph Grundfest, an early advocate of withhold-the-vote campaigns, notes that majority voting also has an indirect benefit. Thus, by enabling shareholders to reject specific directors, majority voting may serve to communicate shareholders' discontent with particular directors or their policies.[250] Because it allows shareholders to impact corporate affairs both directly and indirectly, majority voting appears to be an ideal mechanism for invigorating shareholders' voting rights.

One potential drawback of majority voting is that, despite shareholder support, shareholders may be reluctant to utilize the power inherent in such voting. Very few directors receive more than fifty percent of votes cast against them. In 2006, just eight out of 31,000 directors received more than fifty percent shareholder opposition.[251] In 2007, only one director received a majority "against vote" at companies with majority vote regimes.[252] One reason for these low numbers may be shareholders' reluctance to use such a powerful tool. Indeed, other scholars have recognized that while shareholders may be willing to withhold votes when such an action is merely symbolic, such willingness may wane when the action actually has an impact on director's position.[253] This is especially true if such action could impact the corporation and its performance.[254] To be sure, shareholders should use their removal power with caution. However, if shareholders experience too much reluctance in wielding their authority, then a majority vote system will prove ineffective.

Of course, even if shareholders exercise their power, it is simply not as potent as the direct power inherent in proxy access because it is a negative right.[255] The fact that

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248. Some proxy access proposals allow corporations to opt into proxy access, hence even proxy access does not promise universal coverage. *See supra* note 94 and accompanying text. Yet recent proposals allow shareholders the choice of deciding whether to implement proxy access or one that broadly covers all public corporations. *See supra* Part II.B.

249. *See* Wutkowski, *supra* note 4 (quoting Professor Grundfest, a former SEC commissioner, regarding the significance of majority voting to shareholder empowerment).

250. *See* Grundfest, *supra* note 202, at 865–66.

251. 2007 PROXY REPORT, *supra* note 49, at 28.

252. *See* ALLEN, *supra* note 199, at i, 177 n.156.

253. *See* Verret, *supra* note 200, at 1035.

254. *See id.*

255. Of course, the fact that it is a negative right can be viewed as beneficial to shareholders for at least two reasons. First, it may alleviate any problems associated with gaining shareholder agreement on a particular candidate. Indeed, shareholders have varied, and sometimes divergent, interests. *See e.g.*, Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564 (2006) (noting the distinct and sometimes conflicting interests among shareholders); K.A.D. Camara, *Classifying Institutional Investors*, 30 J. CORP. L. 219, 229–42 (2005) (discussing divergent concerns among investors). Their diversity of interests may make it

majority voting serves as only a veto power means that it does not provide shareholders with the positive right to put forth the candidates of their choice. Thus, shareholders cannot determine the identity of the successor director even if they manage to remove a particular candidate. This makes it less viable than proxy access.

To be sure, even if shareholders refuse to actually employ their removal power, majority vote regimes nevertheless could have an indirect influence on corporate practices. As Grundfest insists, the most significant benefit of withhold-the-vote campaigns, and hence majority voting, may be its ability to indirectly impact corporate behavior.[256] The problem with a plurality voting system was that it posed no genuine threat of removal, and thus votes cast under that system were unlikely to shape director behavior. Majority voting rectifies this problem, thereby ensuring that a withhold-the-vote campaign represents a credible threat of removal for directors.[257] That threat should serve to indirectly pressure directors to undertake policies consistent with shareholders' interests. In fact, in some instances where votes fell short of a majority, directors nevertheless were removed.[258] In this regard, we should expect shareholders to exercise their removal power rarely because the threat should be sufficient to encourage directors and officers to conform their behavior in a manner beneficial to shareholders. Thus, even if shareholders seldom affirmatively remove directors from office, majority voting can have a powerful impact on corporate behavior.

Because majority voting embodies the ability to indirectly influence corporations, it may be viewed as a viable alternative to proxy access. However, this viability may be compromised significantly because, as Part III.E emphasizes, indirect power is only as strong as the direct power upon which it is based. Hence, the significance of the indirect power promised by majority voting is diminished not only because the direct power inherent in proxy access is more potent than that in a majority vote system, but also because, as Part III.2.c will reveal, there exist flaws in the majority vote regime that may make its power illusory.

ii. Shareholder Participation and Special Interests Shareholders

Majority voting does appear to be an adequate alternative to proxy access with respect to ensuring a broad cross-section of shareholder participation. Thus, similar to proxy access, majority voting requires that shareholders cooperate with one another to obtain the majority vote necessary to defeat particular candidates. Empirical evidence underscores this phenomenon, revealing that a variety of different shareholders have worked together to ensure the success of a majority voting campaign.[259] A similar

far easier for shareholders to collaborate when the only issue is rejection of an incumbent candidate and the status quo, as opposed to seeking agreement on a particular candidate. Second, majority voting may be ideal because it leaves the choice regarding the nomination of directorial candidates to the discretion of the board, thus alleviating concerns regarding competency. *See* ALLEN, *supra* note 199, at iv (describing mechanics of majority voting, which does not impact the ability to nominate a candidate).

256. *See* Grundfest, *supra* note 202, at 866.

257. *See* Bebchuk, *supra* note 9, at 878; Grundfest, *supra* note 202, at 865. To be sure, it remains possible that if shareholders are reluctant to use their withhold power, then the threat also may ring hollow.

258. *See* 2007 PROXY REPORT, *supra* note 49, at 30.

259. Given the high levels of support for majority voting, no one class of shareholder would

collaboration would need to occur in order for majority voting to be effective. By encouraging such collaboration, majority voting represents an ideal mechanism through which shareholders can effectuate their power. Moreover, because it facilitates such collaboration in a manner similar to proxy access, it represents an ideal substitute for proxy access.

Given this need for collaboration, the majority voting system also guards against the possibility that shareholders with special or narrow interests will be able to advance their personal agendas. As pointed out previously, one concern continuously raised in the context of shareholder power is that such power may confer power on shareholders whose interests diverge from those of the broader shareholder class. Thus, Professor Stephen Bainbridge emphasized this possibility in his criticism of Bebchuk's proposal for shareholder empowerment.[260] At least some evidence supports this phenomenon. As Part I.B revealed, investors with more tailored interests have dominated the shareholder proposal process. To the extent majority voting gives greater power to these investors, it also gives them the power to further advance those interests. However, this power may be muted by the fact that such investors need to obtain the support of other shareholders, and thus only those candidates who appeal to all shareholders will be successful in gaining the requisite support. Also, the evidence of shareholder collaboration during recent voting campaigns reveals that the need to garner a significant level of shareholder support causes investors to shape their agenda in a manner aimed at appealing to the broadest range of shareholders.[261] Thus, to the extent majority voting relies on significant shareholder support for success, the existing evidence suggests that shareholders will continue to work together, decreasing the possibility that personal issues will improperly dominate voting campaigns. Then, too, because it guards against capture by narrow shareholder groups in a manner similar to proxy access, majority voting seems to be a suitable substitute for such access, even if it does not promise more than a proxy access regime.

iii. Power and Its Illusions

Unfortunately, the rights conferred under the majority voting regime could be illusory, making the benefits of a majority voting system illusory as well. As an initial matter, corporations continue to control the resignation decision in at least two respects. In corporations that have adopted plurality plus regimes, the decision regarding resignation is left to the board's discretion. Most director resignation policies give the board wide discretion.[262] Thus, boards can reject a director's resignation for reasons unconnected to a particular director's performance.[263] Of note, some corporations provide that a director resignation can be made irrevocable. However, even those corporations retain the discretion to reject such resignations. Then, too, some corporations provide that a director's resignation may be rejected only upon a

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be sufficient to garner such support. Instead, the nature of the support indicates that different types of shareholders combined to support majority voting.

260. *See* Bainbridge, *Director Primacy*, *supra* note 9, at 1754–57.

261. *See* 2004 PROXY REPORT, *supra* note 83, at 28.

262. *See* ALLEN, *supra* note 199, at iv.

263. *See id.* Because of concerns associated with the discretion afforded directors under the plurality plus regime, Institutional Shareholder Services (ISS) began recommending against such voting policies. *See id.* at 217.

compelling reason.[264] Yet recently, two of those corporations amended their majority voting provisions to eliminate the "compelling reasons" clause.[265] Such actions demonstrate the ease with which directors can eliminate some of the protections afforded under majority voting, while underscoring the fact that directors prefer broad discretion over these matters. That discretion means that directors, not shareholders, control the extent to which directors who fail to receive majority shareholder support can remain in office. In effect, therefore, that discretion could nullify the impact of majority voting. This latent ability to nullify the threat posed by majority voting not only diminishes its ability to increase shareholder power, but also diminishes its desirability as a substitute for proxy access.

The number of corporations with plurality plus models embracing this kind of discretion is not insignificant. Currently, twenty-two percent of S&P 500 companies and nineteen percent of Fortune 500 companies have plurality plus regimes.[266] Hence, a large percentage of corporations retain the flexibility to reject director resignations, thereby undermining shareholders' ability to impact election outcomes. To be sure, the current trend appears to be away from the plurality plus model. Thus, while in 2006 eighty percent of adopting corporations gravitated toward a plurality plus system, in 2007 only forty-seven percent of companies adopting majority voting chose a plurality plus model.[267] As a result, true majority voting models dominate the landscape by a two-to-one margin.[268] Despite this trend, there remains a significant number of corporations that have a plurality plus system, which means there remains a significant number of corporations with discretion over the resignation process, and hence that can mute the impact of majority voting.

Then, too, even boards with true majority voting regimes retain discretion to reject director resignations. The distinction between a plurality plus regime and a true majority vote regime is that a director who fails to receive a majority of the votes in the latter regime is not duly elected. In this regard, corporations operating under a true majority vote model do not have any discretion over whether directors seeking election for the first time actually remain in office. However, a true majority vote system has a different impact for incumbent director because such directors are covered by the so-called "holdover rule." Under that rule, a director remains in office until her successor is duly elected.[269] Hence, if an incumbent director fails to receive the requisite majority vote, but there is no successor to take her place, the incumbent director remains in office until a new director is chosen. The holdover rule was designed to guard against a failed election. However, if the holdover rule remains in effect, a director who fails to receive a majority of the votes would continue in office until another director is elected to replace her, thereby defeating the impact of the majority voting system.

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264. *See id.* at iv.

265. *See id.* (General Electric Co. and JPMorgan Chase & Co.).

266. *See id.* at iii–iv.

267. *See id.* at ii. The trend to move away from the plurality model was sparked by Intel Corporation's adoption of a true majority regime as well as ISS's refusal to support such models.

268. *See id.* at iii–iv. Thus, forty-four percent of S&P 500 companies and thirty-eight percent of Fortune 500 companies have true majority systems.

269. *See* DEL. CODE ANN., tit. 8 § 141(b) (Supp. 2008); MODEL BUS. CORP. ACT § 8.05(e) (2007).

While corporations have sought to ameliorate the holdover problem, it continues to diminish the power of majority voting. Some corporations have amended the holdover rule to require that a director who fails to receive a majority vote must automatically tender her resignation.[270] Others have adopted provisions requiring that such directors leave office within a set period of time, generally ninety days. Such a provision is consistent with that embraced by the ABA. However, when such resignations are tendered, boards remain free to accept or reject them. Then, too, even if a director resigns, the board retains the power to fill the vacancy. Such power once again ensures that directors have the ability to determine the composition of the board, muting the effect of majority voting. The fact that even under a true majority voting system incumbent directors can remain in office and/or the existing board can determine who serves as a replacement director means that the majority voting system may only provide the illusion of shareholder power, which has led two commentators to call majority voting "little more than smoke and mirrors."[271]

In fact, a majority vote system may depend upon proxy access to be effective, because if directors lose their seats, the nomination ability provided by proxy access could ensure that shareholders have some part in choosing their ultimate replacement.

In addition to control over resignation, many boards retain the ability to repeal majority voting provisions, therefore retaining the ability to eliminate shareholder gains in this area. First, there are several corporations that only have adopted a majority voting policy.[272] Hence some nineteen percent of S&P 500 companies and seventeen percent of Fortune 500 companies have adopted majority voting policies.[273] Such policies are embodied in a corporation's governance guidelines as opposed to its charter or bylaws, which means that the policies are not binding. Hence, the policies can potentially be ignored or easily amended. Like plurality plus, the current trend is away from adopting majority vote procedures in the form of policies.[274] The percentage of companies adopting policies has declined while the percentage adopting either bylaw or charter provisions have increased.[275] Nevertheless, there remains a significant portion of companies embracing such policies, leaving open the possibility that they can be discarded at any time.

The vast majority of corporations have implemented majority vote provisions in their bylaws. Generally, bylaws may be amended by either shareholders or the corporation,[276] which means that in many instances directors retain the power to easily repeal majority vote provisions, thus nullifying the right embedded in those provisions. However, many states and corporations have enacted provisions requiring that majority vote procedures adopted by shareholders may be amended or repealed only by

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270. *See* ALLEN, *supra* note 199, at 171 (noting resignation policy of General Electric Co.).

271. William K. Sjostrom, Jr. & Young Sang Kim, *Majority Voting for the Election of Directors*, 40 CONN. L. REV. 459, 487 (2007).

272. In fact, Pfizer adopted majority voting in the form of a policy. *See* ALLEN, *supra* note 199, at ii.

273. *See id.* at iii.

274. *See id*. at ii.

275. Thus, in February 2006, seventy-nine percent of companies adopting a majority vote provision did so by way of a policy. In comparison, by the start of 2008, only forty-two percent of companies chose to adopt a majority voting provision via a policy. *See id.* at ii.

276. *See* MODEL BUS. CORP. ACT § 10.20 (2007).

shareholders.[277] These provisions may seem to protect such provisions from management interference. However, if corporations adopt bylaw changes, then they have the ability to repeal those changes. Recognizing the flexibility this ability affords, corporate experts like Martin Lipton have recommended that corporations take the initiative in putting forth and approving majority vote proposals.[278] In 2007, roughly fifty percent of majority vote proposals were withdrawn,[279] which means that they did not come to a shareholder vote; rather corporations took the initiative in enacting them without shareholder action.[280] While activists may view such managerial pro-action as a victory, they also should recognize that such management-adopted standards leave open the possibility that corporate managers can determine the fate of those standards.[281]

3. Concluding Assessments

On the one hand, majority voting appears to be a promising mechanism for enhancing the shareholder vote. On the other hand, there are several drawbacks that make such a measure less attractive than proxy access. Indeed, majority voting is not yet universal and the potential that it may never apply to all public corporations may undercut its attractiveness. Yet even if it did apply to large numbers of corporations, majority voting has several flaws that mute its effectiveness. Most notably, the discretion boards retain over defeated directors' decisions to resign blunts the impact of any potential for enhanced shareholder power. Additionally, the control many corporations retain over the repeal process for majority voting provisions may undercut the effectiveness, as well as the permanence, of that regime. In this regard majority voting appears to promise more than it actually delivers, leading skeptics to conclude that the primary reason why corporations acceded so quickly to shareholder demands to implement majority voting was corporate managers' recognition that such demands ultimately offered little more than the illusion of increased shareholder power.[282]

A final point to consider is that proxy access mutes the significance of majority voting, because proxy access increases the likelihood of a proxy contest. The vast majority of majority voting policies contain provisions providing that the plurality standard remains the default rule whenever there is a contested election.[283] Hence, proxy access could cancel out majority voting in many instances, which suggests that

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277. *See* DEL. CODE ANN., tit. 8, § 216 (Supp. 2008).

278. *See* Lipton, *supra* note 246.

279. *See* 2007 PROXY REPORT, *supra* note 49, at 17.

280. *See id.* (noting that proposals have been withdrawn primarily because companies have agreed to amend their bylaws and allow for majority voting).

281. If proxy access occurs by way of a bylaw, then similar concerns may be raised about such a mechanism. However, the SEC's latest rule appears to have foreclosed bylaw proposals as a possibility. *See supra* notes 126–31 and accompanying text. Instead, it is likely that if proxy access occurs, it will be through a more permanent vehicle, such as a change in the proxy rules themselves.

282. *See* Sjostrom & Kim, *supra* note 271, at 487–89.

283. *See* ALLEN, *supra* note 199, at iv (noting that ninety-two percent of majority voting provisions have carve-outs for contested elections).

proxy access could make majority voting, if not moot, then certainly a less important phenomenon.

C. Electronic Shareholder Forums

1. A New Platform for Discourse?

In 2008, the SEC adopted rules facilitating the use of electronic shareholder forums.[284] As noted in Part I, the proxy rules require that any solicitation of proxies be accompanied by filing of a proxy statement.[285] Solicitation has been defined broadly to include not just a request for proxy authority, but also any communication reasonably calculated to result in the attainment, withholding, or revocation of a proxy.[286] This definition encompasses any actions aimed at influencing the voting of proxies.[287] Based on this definition, many communications among shareholders could be construed as proxy solicitations and therefore be subject to the filing requirements under the proxy rules. If that occurs, it could stifle communications between shareholders. However, the new amendments provide that communications made in an electronic forum are exempt from the proxy rules so long as certain conditions are satisfied.[288] These exemptions mean that shareholders involved in such a forum need not be worried about potentially complying with the expensive process of filing a proxy statement.[289]

In addition, the new rules provide a safe harbor for solicitations. Thus, any proxy solicitation on an electronic shareholder forum will be exempt so long as it occurs more than sixty days prior to the announced date of a shareholder meeting, or if the announcement occurs less than sixty days prior to the meeting, no more than two days after the announcement.[290] In this respect, the new rules ensure that people who make solicitations on an electronic forum can still request proxy authority after such solicitation.[291]

The SEC also enacted new Rule 14a-7, which provides liability protection for those who host electronic forums. Rule 14a-7 provides that people who maintain or operate

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284. *See* Electronic Shareholder Forums, Exchange Act Release No. 57,172, Investment Company Act Release No. 28,124, 73 Fed. Reg. 4450 (Jan. 25, 2008) [hereinafter Electronic Shareholder Forums]. The rules took effect February 25, 2008. *See id.*

285. *See* 17 C.F.R. § 240.14a-3(a) (2007).

286. *See* 17 C.F.R. § 240.14a-1(1); *see also* Long Island Lighting Co. v. Barbash, 779 F.2d 793, 796 (2d Cir. 1985) (defining a solicitation as any communication that is part of a continuous plan that will result in a request for a proxy).

287. *See* Electronic Shareholder Forums, *supra* note 284, at 4453.

288. *See id.* The rules add a new exemption to Rule 14a-2, making clear that participation in an electronic shareholder forum would not constitute a solicitation so long as the soliciting person, directly or indirectly, does not seek the power to act as a proxy.

289. While the proposing amendment sought comments on whether electronic shareholder forums should supplant the nonbinding shareholder proposal process, the SEC decided against supplanting Rule 14a-8. *See id*. at 4452. Instead, the communications serve as an additional device for communications between shareholders and managers.

290. *See id*. at 4453.

291. *See id*.

an electronic shareholder forum will not be held liable for statements or information supplied by a third party participating in their forum.[292]

2. Benefits and Drawbacks of Online Forums

By removing the two major obstacles to participation in shareholder forums, these new rules facilitate shareholder communications. Indeed, the SEC identified two key concerns related to the effective use of Internet-based forums. One was the potential burden of preparing and delivering proxy materials, and the other related to potential liability for such sites.[293] The new rules respond to both concerns. As compared to proxy access, the rules may serve as a more effective source of communication between shareholders and the corporation. The rules also enable corporations to interact with shareholders in a more informal setting, and to engage in such interactions throughout the year, which represents an improvement over using the proxy apparatus as a communicative device because such an apparatus only can be used periodically, and at a great expense. Such forums also may facilitate broader participation because they allow participation by those who would not otherwise use the proxy apparatus or attend a shareholder meeting in person. Thus, the electronic shareholder forums enhance the potential for better communication in ways that proxy access cannot.

Then, too, electronic shareholder forums potentially provide shareholders with a vehicle for influencing corporate affairs in a manner superior to proxy access. At best, by potentially encouraging dialogue during proxy solicitations, proxy access represents an indirect and infrequent form of communication between shareholders and the corporation. By contrast, corporations may use electronic shareholder forums to obtain shareholder input into polices and to determine shareholders' sentiments on those polices.[294] This forum access enables shareholders to have a direct voice in shaping corporate affairs. Then, too, electronic shareholder forums enable back and forth communication, encouraging genuine dialogue between corporations and their shareholders. Therefore, these forums may promote communication in a manner that is more beneficial than proxy access.

Electronic shareholder forums also may facilitate enhanced communication between shareholders, reducing the cost of collective action. Moreover, because shareholders can solicit proxies even if they participate in such forums, these new rules enhance the ability of shareholders to wage effective proxy contests and other voting campaigns. As an example, Eric Jackson, an individual shareholder at Yahoo!, led an online withhold-the-vote campaign against three directors that ultimately garnered thirty-one percent of the shareholder vote.[295] This example reveals that expanded use of the Internet enables shareholders with small resources to organize more effectively. Thus, electronic shareholder forums not only afford shareholders the opportunity to assess other shareholders' appetite for various actions, but also enable shareholders to build

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292. *See id*. at 4454.

293. *See id*. at 4453–54.

294. *See id*. at 4451.

295. 2007 PROXY REPORT, *supra* note 49, at 11. Jackson's campaign stemmed from his frustration with the directors' approval of a CEO salary of $107.5 million despite the company share price falling by almost ten percent. *See id.*

coalitions around various issues. In this regard, electronic shareholder forums represent a more cost effective mechanism for shareholders to interact with one another.

Unfortunately, it is unclear if electronic shareholder forums will evolve into effective communicative tools. Indeed, the choice of hosting or engaging in such a forum is completely voluntary. Thus, the potential communicative benefits between corporations and shareholders depend upon whether and to what extent corporations utilize electronic shareholder forums. If corporations do not feel comfortable or are unwilling to use such forums as a mechanism to gain shareholder input on policies, the ability of such forums to give greater voice to shareholders will be diminished. Then, too, the potential impact of enhanced collective action among shareholders is uncertain. Indeed, several commentators worried that electronic shareholder forums could evolve into mere chat rooms for shareholders.[296] If this occurs, then the value of such forums will be reduced significantly. Thus, while these forums represent an important development, it is too soon to determine how significant they will be in promoting more effective communication. This concern alone may demonstrate that such forums are not suitable substitutes for proxy access.

In addition, shareholder forums actually may stifle effective communication. In the context of electronic shareholder meetings, shareholder activists have complained that electronic forms of communications may inhibit real dialogue between shareholders and management. These activists contend that face-to-face communication is superior to electronic communication because it allows for deliberation and confrontation.[297] In contrast, it may be difficult to generate meaningful discourse and debate with the large number of shareholders that may participate in an online forum. Moreover, shareholder advocates worry that online forums may be a way for corporations to avoid interacting with shareholders,[298] because e-mails can be ignored, while corporations cannot avoid answering questions when they are posed in person at a meeting.[299]

The concerns raised in the context of electronic shareholder meetings seem to have some saliency in the context of shareholder forums. To be sure, shareholder forums are not designed to supplant the shareholder meeting, and hence they do not supplant shareholders' ability for face-to-face interactions with corporate managers. Nevertheless, there is a possibility that such forums may enable managers to more easily ignore or otherwise avoid interactions with shareholders. Moreover, it is possible that such forums undermine meaningful discourse and debate not only because they do not present a controlled flow of communication, but also because they occur in the context of comments by a large group of shareholders. Of course, proxy access is not a form of face-to-face interaction, and hence a similar complaint may be lodged against such access. However, unlike the e-mails generated on shareholder forums, it is difficult for corporations to ignore shareholder concerns or candidates when they appear on the corporation's own ballot. Indeed, some analysts have suggested that

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296. *See* Electronic Shareholder Forums, *supra* note 284, at 4457.

297. *See, e.g.*, Daniel Adam Birnhak, *Online Shareholder Meetings: Corporate Law Anomalies or the Future of Governance?*, 29 RUTGERS COMPUTER & TECH. L.J. 423, 445 (2003); Elizabeth Boros, *Virtual Shareholder Meetings*, DUKE L. & TECH. REV. 8, 9 (2004); *see also* SECURITIES IN THE ELECTRONIC AGE: A PRACTICAL GUIDE TO THE LAW AND REGULATION § 8.04 (John F. Olson & Carmen J. Lawrence eds., 3d ed. 2002).

298. *See* Birnhak, *supra* note 297, at 445–46.

299. *See id.* at 445.

shareholders' ability to raise concerns and issues on the corporation's ballot is one important way for shareholders to begin dialogue with the corporation,[300] because when issues or candidates appear on the corporation's ballot, the corporation often feels compelled to respond. In this regard, proxy access virtually guarantees some coherent response to shareholder issues or candidates.[301] As activists note in the context of virtual meetings, there is no guarantee of such response with regard to electronic communications.

3. Concluding Assessments

While shareholder forums promise advantages with respect to enhanced communications, there is reason to doubt that those advantages will ever materialize. In addition, it is probably not accurate to contend that electronic shareholder forums could supplant proxy access, because while they may afford shareholders some enhanced access to corporations, they do not grant shareholders any affirmative powers to determine election outcomes or any other business decision.

D. Board Declassification

1. The Annual Election Campaign

Shareholder activists contend that staggered or classified boards reduce their power.[302] Staggered or classified boards refer to boards in which only a portion of the membership is reelected each year. Typically, that portion is one-third.[303] Staggered boards prevent shareholders from replacing the entire board in one election cycle, which hinders shareholders' ability to elect a majority of the board, and hence change control of the corporation. By making it difficult to change control of the corporation, staggered boards also make it difficult for shareholders to shift the manner in which corporations conduct business. This difficultly is particularly relevant in the context of proxy battles or hostile takeovers because even if a shareholder is successful in gaining a majority of shares or otherwise electing members of the board, that success will not translate into an ability to alter the composition of the entire board, and hence will not translate into a true change in control. In fact, some scholars contend that the true power of shareholders' voting rights is only realized in the context of change of control transactions such as takeovers when there is an ability to alter the course of corporate conduct.[304] Moreover, the threat of such transactions increase managerial accountability by ensuring that corporate managers respond to shareholder concerns in an effort to fend off transactions pursuant to which they could be replaced. However,

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300. *See* W. Trexler Proffitt, Jr. & Andrew Spicer, *Shaping the Shareholder Activism Agenda: Institutional Investors and Global Social Issues*, 4 STRATEGIC ORG. 165, 173–74 (2006).

301. *See id.*

302. There is also evidence that staggered boards not only reduce shareholder returns, but also correlate with low firm value. *See* Bebchuk, *supra* note 9, at 853.

303. Rivka Weill, *Declassifying the Classified*, 31 DEL. J. CORP. L. 891, 895 (2006).

304. *See* CLARK, *supra* note 11, at 95.

by hindering shareholder ability to effectuate a change in control, staggered boards sterilize shareholders' voting power in these contexts.

For almost two decades, shareholders have sought to abolish staggered board terms, and thereby require all directors to be elected annually. Thus, shareholders have submitted proposals seeking to abolish staggered boards for years.[305] And those proposals have garnered consistently high levels of shareholder support.[306] Since 2000, such proposals have averaged more than fifty percent shareholder support.[307] In the past few years, the number of shareholder proposals seeking to eliminate staggered boards has not been as high as majority voting proposals.[308] However, they have received more support.[309]

While the efforts to dismantle staggered boards are not new, historically they have not been very successful. Thus, in the past, most boards appeared to have simply ignored shareholders' request for change in this arena. Indeed, a study by Bebchuk reveals that by the fall of 2004, more than two-thirds of the shareholder proposals receiving majority support to dismantle staggered boards had not been implemented.[310] Moreover, his study revealed that directors refused to implement an annual election system even when proposals received majority shareholder support two or three years in a row.[311] Hence, in the past, corporations mainly disregarded shareholders' efforts to implement an annual election system.

By contrast, corporations are now responding positively to campaigns to abolish staggered boards. In fact, by the end of 2006, directors at a majority of S&P 500 companies were eligible to be elected annually.[312] This trend appears as if it will continue into subsequent proxy seasons.[313] Thus, similar to the campaign for majority voting, the declassification effort has resulted in a dramatic change in board structure at major corporations.

2. Demystifying Declassifying Boards

To be sure, annual elections are a long way from being universal, so we cannot rely on them as the primary vehicle for augmenting shareholder power. Indeed, some forty percent of S&P 500 corporations continue to employ staggered terms.[314] Then, too, the declassification effort is not having the same traction at smaller companies. Only forty-one percent of mid-cap companies and forty-two percent of small-cap companies have

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305. *See* Bebchuk, *supra* note 9, at 852.

306. *See id*.

307. *See id*.

308. Thus, such proposals received an average shareholder support of 60.5% in 2005, 66.8% in 2006, and 63.9% in 2007. 2007 PROXY REPORT, *supra* note 49, at 6.

309. *See* 2006 PROXY REPORT, *supra* note 48, at 3–4. In the first half of 2005, only forty-two proposals were submitted regarding declassification, while eighty-four majority vote proposals were submitted relating to majority voting during that same period. *Id.* at 3 chart 1.

310. Bebchuk, *supra* note 9, at 854 (examining the period from1997–2003).

311. *See id*. at 854–55.

312. *See* 2007 PROXY REPORT, *supra* note 49, at 23. About sixty percent of S&P companies have converted to annual elections. *Id.*

313. *See id.*

314. *See id.*

declassified their boards,[315] which means that there are a significant number of corporations that do not have annual elections, and hence that potentially undercut shareholder voting power.

However, even if declassification were to become universal, it would not be preferable to proxy access. Declassification merely facilitates shareholders' ability to elect an entire board. In so doing, such declassification does not just increase the voting power of shareholders in ordinary elections, but also enables bidding companies or shareholders to gain control of a corporation during takeover transactions, thereby enhancing the shareholder vote during those transactions as well. However, it does not facilitate shareholders' ability to remove individual board members. In this regard, the declassification effort may need the support of the majority voting effort to be effective. Moreover, because declassification does not affirmatively enable shareholders to determine the members of the board, it also needs the support of proxy access. Thus, while declassification may be an important and perhaps necessary component of any shareholder voting rights' campaign, it cannot supplant the effort to achieve proxy access.

E. "It's the Indirect Benefits, Stupid!"[316]

The foregoing discussion reveals that there are flaws with each of the alternative mechanisms for increasing shareholder power that undermine their ability to directly impact election outcomes and hence make them less attractive than proxy access.

Of course, Bebchuk and others have argued that one of the primary benefits of increased shareholder power is the ability to indirectly influence corporate affairs.[317] In this regard, the principal purpose of such increased power is not to actually effectuate a particular action such as electing or removing a director. Rather, the purpose is to facilitate increased dialogue between shareholders and managers so that managers act in ways that benefit shareholders.

Viewed from this indirect purpose, one can argue that it is a mistake to discount any mechanism simply because it may fail to achieve its direct goal. Hence, the fact that the e-proxy rules may fail to generate significant cost savings, majority voting may prove illusory, and shareholder forums may evolve into mere chat rooms ignored by corporate managers may not be enough to undermine their viability. Instead, the more relevant inquiry should focus on whether any of these mechanisms can generate indirect benefits for shareholders by prompting corporations to increase engagement with shareholders.

Some preliminary and anecdotal evidence suggests that some of the recent mechanisms can in fact produce indirect benefits. According to proxy analysts, the recent proxy seasons have revealed unprecedented levels of engagement between shareholders and management.[318] Presumably some of that increased engagement may be attributed to the fact that shareholders' powers have increased with regarding to majority voting and declassification. Moreover, there have been several instances where managers have acceded to shareholders' demands even when shareholders failed

315. *Id*.
316. Bebchuk, *supra* note 9, at 878.
317. *See id*.
318. 2007 PROXY REPORT, *supra* note 49, at 3.

to directly impact election outcomes. These concessions suggest that shareholders can achieve their goals without direct action. Moreover, it suggests that some alternative mechanisms can impact shareholder power by increasing managers' willingness to engage shareholders and take their concerns seriously.

Yet a deeper probe of the proxy data cast doubt on this suggestion. Thus, despite the instances where corporations acceded to shareholder demands without direct shareholder intervention, there exist many more cases where managers have refused to engage with shareholders. These cases can best be interpreted as instances where managers feel free to ignore shareholder action because they do not fear any repercussions. In fact, a study on withhold-the-vote campaigns, and hence majority voting, found that while such voting had produced some indirect benefits, such benefits were episodic at best.[319] Then, too, although there has been an increase in engagement between shareholders and managers, it is not clear if that increase stemmed from the possibility that shareholders would gain proxy access or from the implementation of other mechanisms.

It is clear, however, that shareholders' indirect power is only as potent as the direct threat upon which that power is based. Indeed, when Bebchuk focused on indirect benefits, he focused on those measures where shareholders do in fact have some direct voice in the corporate process, such as the ability to vote on fundamental changes.[320] It is in these circumstances that Bebchuk notes that the ability to have a direct impact need not be exercised because the threat of such an impact should be sufficient to influence director conduct. In this regard, Bebchuk's observation regarding indirect benefits can best be understood as recognizing that when shareholders do have the ability to directly impact corporate decisions, such ability translates into the power to indirectly influence corporate affairs.[321] Hence, it would be a mistake to presume that a mechanism's inability to directly influence election outcomes has no bearing on its propensity to procure indirect benefits, which means that to the extent that other mechanisms are flawed or otherwise less effective than proxy access, they are less effective with regard to their potential to advance indirect benefits. By comparison, because proxy access offers the most potent direct threat, it is also the most likely to yield indirect benefits.

F. The Importance of the "Bird in the Hand"

Some might argue that focusing on proxy access in lieu of other mechanisms for increasing shareholder power may be impractical, and hence less efficient and less effective. In other words, shareholder activists should adopt a "bird in the hand" approach and focus on strengthening their existing gains as opposed to securing a measure that has thus far been out of reach. Indeed, shareholders have made important

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319. *See* Diane Del Guerico, Laura Seery & Tracie Woidtke, *Do Boards Pay Attention When Institutional Investors "Just Vote No"?*, 90 J. FIN. ECON. 84 (2008); Partnoy & Thomas, *supra* note 71, at 10.

320. *See* Bebchuk, *supra* note 9, at 878.

321. In fact, Bebchuk's study, pinpointing directors' willingness to ignore nonbinding shareholder resolutions, demonstrates that shareholders' ability to indirectly influence managers is significantly undermined when managers perceive that there are no genuine repercussions for their actions.

strides in their efforts to increase their power, and these strides should not be deemphasized simply because they do not encompass proxy access. In fact, each of the new initiatives could have important effects on shareholder power independently. Collectively, those effects will be enhanced. In addition, while recent initiatives may be flawed, some of those flaws may be subject to cure. More importantly, these initiatives have actually been enacted. By contrast, proxy access has not fared well in the past and, given the historical and current level of resistance to such access, may not fare well in the future. From this perspective, continuing to devote significant resources and efforts on proxy access may not be the best strategy for shareholder activists. Instead, the best strategy may be to focus on eliminating the flaws associated with recent initiatives, and thus shoring up the gains that have been made.

However, this Article contends that while other mechanisms should not be ignored or diminished in their importance, focusing on proxy access should remain a priority. Indeed, despite the recent defeat of such access, at least some members of the SEC have indicated a willingness to revisit the issue.[322] In light of this indication, proxy access may still represent an achievable goal. Moreover, activists should continue to press for such access while the issue is still on the SEC's agenda or activists risk losing whatever momentum they now possess. Finally, as this Article reveals, proxy access does have significant advantages over other empowerment mechanisms, and hence it is important that activists do not abandon the quest for access in order to focus on admittedly less appealing measures.

CONCLUSION

In recent years, shareholder activists have experienced many successes in their campaign to enhance shareholder power. They have convinced a majority of corporations to adopt a majority vote standard, which ensures that only directors who receive majority support will be elected. Shareholders also have convinced many corporations to abolish staggered boards, ensuring that directors will be up for election every year. Then, too, the SEC has enacted rules that enable shareholders to solicit proxies via the Internet. Such rules are designed to reduce the cost of waging proxy contests, and hence increase shareholders' ability to put forth candidates of their choice. Finally, the SEC has adopted rules aimed at facilitating electronic shareholder forums. These rules augment shareholders' ability to communicate not only with other shareholders, but also with corporate directors and officers. All of these initiatives increase shareholders' voting power, and thus reflect the success of the recent shareholder democracy campaign.

Yet shareholders have yet to secure proxy access. In fact, currently only corporate managers can nominate candidates of their choice on the corporations' proxy statement; shareholders cannot. After considering whether to grant shareholders proxy access twice within the last five years, the SEC to date has failed to do so.

This failure seems to be a significant defeat for the proxy access campaign. Indeed, shareholder activists have long considered proxy access to be the cornerstone of any effective shareholders' rights movement because such access affords shareholders the ability to nominate candidates of their choice on the corporation's ballot. Such

322. *See supra* note 135 and accompanying text.

nomination right not only eliminates the cost associated with proxy solicitation campaigns, but also enables shareholders to take advantage of any potential psychological advantage gained by having a nominee on the corporation's ballot. By denying shareholders such right, the SEC's rejection of proxy access appears to undermine the shareholders' rights effort.

To be sure, some contend that such a view places too much emphasis on proxy access, while failing to appreciate the value of recent successes. While this Article reveals that these other successes are significant and hence produce value to the shareholders' rights effort, this Article also maintains that they are not viable substitutes for proxy access. Such access is simply a stronger, and thus more meaningful, right than these other initiatives. Thus, while we should not diminish the importance of the many advances that have been made to date, shareholder activists should continue advocating for proxy access. Indeed, while the battle for such access has been, and will no doubt continue to be, a difficult one, it appears well worth the effort, because it is not clear that shareholders can lose the battle for proxy access and still claim victory in their larger shareholder democracy campaign.