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Making the Corporation Safe for Shareholder Democracy

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Making the Corporation Safe for Shareholder Democracy

LISA M. FAIRFAX*

Shareholder democracy is on the rise. But will that democracy improve the fortunes of non-shareholder “stakeholders” such as employees, creditors, consumers, and the community? Many scholars argue that the legitimacy of shareholder democracy may turn on the answer to that question. This Article provides such an answer. Over the past few years, shareholders have launched an aggressive campaign to increase their voting power with the corporation—seeking to make the corporation more “democratic.” As part of their campaign, shareholders have sought to create a majority vote system for annual elections, to eliminate multi-year terms for directors, and to gain the ability to nominate director candidates on the corporation’s ballot. Such efforts not only have garnered record levels of shareholder support, but also have prompted corporations, legislatures, and judges to alter corporate governance structures. Shareholders’ quest for increased power and its seeming success have sparked intense debate between those who believe shareholder democracy is necessary to increase accountability and those who believe increased shareholder power will be ineffective and undermine corporate value. One of the most outspoken proponents of shareholder democracy, Harvard Professor Lucian Bebchuk, argues that one potentially devastating critique of shareholder democracy is the presumption that increased shareholder power will be detrimental to stakeholders because it will force directors and officers to focus on profits without regard to other corporate constituents. This Article rejects that presumption. Instead, it insists that shareholders not only have interests that align with stakeholders, but also introduces empirical evidence suggesting that shareholders will use their increased voting power to advance the interests of stakeholders. However, this Article acknowledges that shareholder democracy may benefit some stakeholders more than others. Nevertheless, by undermining one of the most lethal critiques against shareholder empowerment, this Article makes a vital contribution to the emerging debate regarding the propriety of shareholder democracy.

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Recently shareholders have launched an aggressive campaign to increase their voting power within the corporation. For example, shareholders have filed resolutions seeking to require corporations to elect directors every year, and in 2006 such resolutions garnered an average of 67% of the shareholder vote.¹ Shareholders also have filed a record number of resolutions aimed at requiring corporations to adopt a majority vote standard in director elections.² In 2006, such resolutions received an average shareholder vote of almost 50%.³ Like annual elections for all board members, many shareholders believe a majority vote standard will make their voting power more effective, and thus give them greater control over corporate affairs.

Shareholders' efforts to increase their voting power—referred to by some as “shareholder democracy”—are motivated by shareholders' desire to make corporate officers and directors more accountable to them. Indeed, many shareholders believe that accounting and other corporate governance scandals were caused, at least in part, by a lack of sufficient director and officer accountability. Then too, shareholders have grown increasingly dissatisfied with managers' failure to curb rising executive compensation packages. In the shareholders' view, if managers were more accountable to shareholders, they would be more likely to respond to shareholder demands to curtail executive pay schemes. Ultimately, many shareholders and their proponents believe that expanding shareholder democracy will lead to greater managerial accountability, thereby curbing managers' abuses of authority and ensuring that managers pay heed to shareholders' concerns.

Shareholders' efforts, and the potential that they may prove successful, have sparked intense debate regarding the propriety of expanding shareholder power, and hence potentially shifting authority from corporate officers and directors to the corporation's shareholders. Harvard Professor Lucian Bebchuk, one of the most outspoken proponents of shareholder democracy, argues that increasing shareholder power would improve corporate governance and enhance shareholder value.⁴ UCLA Professor Stephen Bainbridge maintains that the current regime of limited shareholder power is

¹ See INSTITUTIONAL SHAREHOLDER SERVICES, 2006 POSTSEASON REPORT: SPOTLIGHT ON EXECUTIVE PAY AND BOARD ACCOUNTABILITY 19 (2006), <http://www.issproxy.com/pdf/2006PostSeasonReportFINAL.pdf> [hereinafter 2006 PROXY SEASON REPORT] (finding that in 2006, proposals seeking corporations to eliminate their staggered boards garnered an average of 66.8% of the shareholder vote).

² See *id.* at 16 (finding that in the first half of 2006, proposals seeking corporations to adopt a majority vote standard outnumbered all other proposals submitted and averaged 47.7% of the shareholder vote).

³ See *id.*

⁴ Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005).

preferable because it allows for a system of centralized decision-making, which is the most cost-effective and efficient means of governing corporate affairs.⁵

This Article does not focus on the appropriateness of increased shareholder power per se, but instead analyzes the likely impact of that increase on corporate “stakeholders”—employees, customers, creditors, suppliers and other groups impacted by the corporation.⁶ In fact, one objection to increasing shareholder power is that such an increase would force directors and officers to focus solely on profits to the detriment of stakeholders.⁷ Bebchuk contends that this stakeholder-centered argument is very important because it has the potential to boost significantly the legitimacy of the case against shareholder power.⁸ This is because such an argument shifts the debate from a power struggle between shareholders and managers to a power struggle between shareholders and all other corporate constituents, thereby bolstering the appeal and seeming legitimacy of management’s position.⁹ Bebchuk has responded to the stakeholder-based argument by insisting that managers’ interests are not aligned with those of stakeholders, and thus insulating managers from increased shareholder power would enable them to advance their own self-serving goals at the expense of shareholders and stakeholders alike.¹⁰ This Article approaches this concern more affirmatively, and seeks to ascertain not only whether shareholders’ interests align with stakeholders, but also whether we should expect shareholders to use their increased power in a manner that benefits stakeholders.

To this end, this Article rejects the presumption that expanding shareholder power will have a negative impact on stakeholders, and instead argues that at least some shareholders will use their increased power to advance stakeholders’ concerns. Such an argument recognizes that shareholders have divergent concerns and some of those concerns parallel the

⁵ Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1746 (2005) [hereinafter Bainbridge, *Director Primacy*]; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 624 (2006) [hereinafter Bainbridge, *Shareholder Voting Rights*].

⁶ This Article appreciates that not all stakeholders have similar interests. Hence, this Article argues that shareholder power may benefit some stakeholders more than others. See *infra* Part II.D. I would like to thank Stephen Bainbridge for highlighting the importance of this distinction to my argument.

⁷ See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 304–05 (1999).

⁸ Bebchuk, *supra* note 4, at 912.

⁹ See *id.*

¹⁰ See *id.* at 909–11.

interests of many stakeholders, particularly employees, customers, and the broader community.¹¹ Moreover, shareholders can and do use their voting power to advance stakeholder-oriented issues. Thus, the available empirical evidence reveals that shareholder activism as it relates to stakeholder matters has increased along with activism on more traditional corporate governance matters.¹² Such evidence suggests that shareholders will use their increased power to continue their advocacy on behalf of stakeholders. Then too, a recent study on the impact of shareholder voting related to stakeholder concerns suggests that shareholders play a critical role in focusing corporate attention on stakeholder-related issues as well as building legitimacy for those issues.¹³ This study suggests that increased shareholder power may ensure that shareholders can more effectively influence long-term corporate policy as it relates to certain stakeholders. Thus, far from threatening the interests of stakeholders, shareholder democracy may enable shareholders to increase their advocacy on behalf of stakeholders.

This Article does recognize that not all stakeholders have interests that align with those of shareholders, and hence it is likely that shareholder empowerment will benefit some stakeholders more than others. Indeed, while shareholders often advance the concerns of groups such as employees and consumers, shareholders rarely focus on issues of concern to creditors. Despite this differential impact, the fact that many shareholders do embrace and support issues that impact a wide variety of stakeholders rebuts the prevailing presumption that shareholder democracy represents a negative development for all stakeholders.

To be sure, there are some factors that may undermine the extent to which increased shareholder power will benefit even those stakeholders whose interests coincide with shareholders' interests. Most notably, the types of shareholders most likely to use their increased power may be shareholders with short-term interests at odds with stakeholders. Hence, both Bainbridge and Delaware Vice Chancellor Leo Strine point out that many of the most activist shareholders are those with short-term agendas.¹⁴ If power is likely to reside in their hands, then stakeholders will not benefit from that power. However, while it is true that shareholders with short-term horizons—such as

¹¹ See *infra* Part II.A.

¹² See *infra* Part II.B.

¹³ See W. Trexler Proffitt, Jr. & Andrew Spicer, *Shaping the Shareholder Activism Agenda: Institutional Investors and Global Social Issues*, 4 STRATEGIC ORG. 165 (2006) (assessing trends in shareholder support of various stakeholder issues based on shareholder proposal data for a thirty-five year period).

¹⁴ See Bainbridge, *Director Primacy*, *supra* note 5, at 1754; Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1771 (2006).

hedge funds—have been extremely active recently, shareholders who promote stakeholder concerns also have been very active. As a consequence, shareholders concerned with stakeholder issues have managed to advance those issues despite the activism of shareholders with contrary agendas. Moreover, these stakeholder-oriented shareholders have a history of activism and hence may be more likely to sustain their activity over the long run. This observation suggests that not all shareholder power will have negative repercussions for stakeholders; rather, that power in the hands of some shareholders could be problematic and should be monitored.

A second concern posed by increasing shareholder power is that shareholders may use their enhanced power to advance personal or political agendas as opposed to issues that benefit the corporation as a whole.¹⁵ To be clear, while this Article contends that corporations should address the concerns of stakeholders, this Article also insists that corporations should address only those concerns that enhance the long-term health of the corporation or otherwise are viewed as important to the shareholder class. In other words, there are certain social or stakeholder concerns that corporate officers and directors should consider in carrying out their duties, and in many cases shareholders support a corporate focus on those concerns.¹⁶ Moreover, it is these concerns, and not narrow self-interested ones, that should not be ignored in the debate regarding shareholder democracy.¹⁷ As a consequence, it is particularly problematic if conferring increased power on individual groups of shareholders increases the potential that such groups will seek to maximize their own self-interest without regard to the corporation as a whole.¹⁸ On the one hand, this potential may be an inevitable by-product of increased shareholder power. On the other hand, this problem may be less of a concern for stakeholder-oriented investors because shareholders promoting narrow interests are the group who has experienced the most difficulty with advancing their agenda. Indeed, empirical evidence reveals that corporate managers are most likely to challenge their efforts and

¹⁵ See Bainbridge, *Director Primacy*, *supra* note 5, at 1756 (noting concern that rent-seeking institutions may use their increased power to bargain for private benefits).

¹⁶ See *infra* Part II.B (explaining shareholder support for stakeholder concerns).

¹⁷ To this end, this Article maintains that managers have a responsibility to maximize corporate value, which generally includes attending to the interests of shareholders and non-shareholders. However, there are settings pursuant to which it is not possible to advance the interests of both shareholders and stakeholders, and hence managers must choose between the two. In those instances, it is often appropriate for managers to choose to advance the interests of shareholders. However, if a sufficient number of shareholders believe that management should favor some stakeholder interests, then managerial action on such stakeholders' behalf would be legitimate.

¹⁸ See Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 577 (2006) (noting potential for increased rent-seeking behavior).

that the Securities and Exchange Commission (the SEC) is most likely to support those challenges.¹⁹ Moreover, such groups experience the greatest level of skepticism from other investors.²⁰ As a result, these investors' success stems from their ability to overcome these hurdles by framing their concerns in a manner that appeals to other investors.²¹ Hence, while increased shareholder power may produce a system under which all investors are more likely to pursue their own personal agenda, stakeholders may be the group least likely to experience success with that strategy. Thus, while this concern is important, it may not undermine the ability of shareholders to serve as allies for advancing stakeholder issues beneficial to the entire corporate enterprise.

Part I of this Article discusses some of the recent areas of shareholder activism, with a particular focus on shareholder voting. Part II outlines the stakeholder-centered objections to that activism, and then discusses the ways in which shareholders' interests may dovetail with those of stakeholders, and as a result, why shareholders may have an interest in advancing the concerns of stakeholders. Part III then examines factors that may limit the extent to which increased shareholder power will benefit stakeholders and addresses whether those factors can be overcome. Part IV concludes by pointing out the importance of stakeholders to the debate regarding shareholder democracy. In fact, while debate rages about the propriety of increasing shareholder power, the empirical evidence reveals that shareholders have experienced success in their quest for increased power. And hence the debate may be moot: increased shareholder power in some form has become the new corporate governance reality. If this is accurate, then stakeholders and their advocates must assess whether and to what extent that power can be harnessed for their benefit. To that end, this Article begins the process of examining how shareholder democracy can be beneficial for all corporate constituents.

I. THE NEW CAMPAIGN FOR SHAREHOLDER DEMOCRACY

A. *Some Fundamentals of Shareholder Voting and Participation*

Shareholder voting represents one of the principal ways in which shareholders can exercise voice within the corporation. Shareholders are the only group granted the right to vote on corporate affairs.²² Although that

¹⁹ See *infra* Part III.C.

²⁰ See *id.*

²¹ See *infra* notes 222–24 and accompanying text.

²² See, e.g., DEL. CODE ANN. tit. 8, § 141(k) (2005).

right is limited to voting in the election of directors and on certain fundamental transactions such as mergers or dissolutions,²³ courts view this voting right as fundamental.²⁴

The widely dispersed nature of public shareholders means that shareholders cast their vote by proxy rather than in person. Federal law, commonly referred to as the federal proxy rules, governs the solicitation of shareholder proxies and requires that any solicitation of proxies be accompanied with a proxy statement containing information on the matters to be voted.²⁵ Hence, public corporations must distribute proxy statements to shareholders for every election of directors and any other matter on which shareholders must vote.

Federal law enables shareholders to place proposals on the corporation's proxy statement related to annual elections. Specifically, Rule 14a-8 of the proxy rules requires that the corporation include in its proxy statement proposals of shareholders and provide some means by which other shareholders can vote on the proposals, so long as shareholders meet certain procedural requirements.²⁶ Most often, shareholder proposals take the form of recommendations, and hence are non-binding. Rule 14a-8 also permits a corporation to exclude a shareholder proposal and sets forth various grounds upon which such exclusions can be made.²⁷ Some grounds for exclusion include that the proposal relates to a matter of ordinary business operations, that the company has substantially implemented the proposal, or that the proposal relates to an election for directors.²⁸ When a corporation seeks to exclude a proposal, it must submit its reasons for exclusion to the SEC's staff. If the SEC's staff believes that the submitted reasons are consistent with Rule 14a-8, it will issue a "no-action" letter, signaling the SEC's

²³ See, e.g., *id.* §§ 251(c), 275(c) (mergers and dissolution, respectively).

²⁴ See *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (noting that the shareholder franchise 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).

²⁵ 17 C.F.R. § 240.14a-3 (2006).

²⁶ *Id.* § 240.14a-8. The Rule has several procedural requirements, including requirements regarding the number of shares a shareholder must hold in order to submit a proposal, proper notice, and limits on the number of proposals submitted. *Id.* § 240.14a-8(a).

²⁷ *Id.* § 240.14a-8(i).

²⁸ *Id.* § 240.14a-8(i)(7), (i)(8), (i)(10). For a discussion of other substantive exclusions, see Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 890-92 (1994).

decision to take no action against the corporation if it decides to exclude a particular shareholder proposal.²⁹

This shareholder proposal process represents one of the only formal mechanisms available for shareholders not only to initiate dialogue, but also to potentially initiate corporate programs or policies on a given issue. As such, that process represents a critical component of shareholder activism. The next section will demonstrate the manner in which shareholders have used the proposal process to increase their voting power within the corporation.

B. *Elements of the Campaign*

Concerns about managerial abuses of power and managers' seeming inability to stem the rise in executive pay have spurred shareholders to search for mechanisms that would increase their ability to influence corporate affairs. This section focuses on three of the most publicized efforts to enhance shareholder power: majority voting, board declassification, and shareholder access to the proxy.³⁰

1. *Majority Rules?*

The 2004 director election at the Walt Disney Co. (Disney) galvanized shareholders' campaign for majority voting. Shareholders at Disney wanted to convey their displeasure at Michael Eisner, who was then Disney's CEO and chairman of the board of directors. Believing that Disney needed a second-in-command, Eisner orchestrated the hire of Michael Ovitz as Disney's first president.³¹ However, problems emerged with Ovitz's job

²⁹ See 17 C.F.R. § 240.14a-8(j) (2006); see also Palmiter, *supra* note 28, at 880–81, 904–05.

³⁰ To be sure, these are not the only issues that have received significant shareholder support within the past few years. For example, shareholders have submitted and supported a significant number of proposals calling for the elimination of supermajority vote rules as well as the separation of the CEO and board chair positions. See 2006 PROXY SEASON REPORT, *supra* note 1, at 19. Shareholders also have focused on issues aimed at tackling rising executive compensation, calling for corporations to link executive pay to performance. See *id.* Shareholders also have requested that companies allow them to give an advisory opinion on executive pay. Aflac, Inc. became the first American company to implement such a rule, while Congress is considering a so-called "say on pay" bill. See Kevin Drawbaugh, *Soaring Executive Pay Meets Reforms*, REUTERS, Mar. 9, 2007, <http://www.reuters.com/article/ousiv/idUSN2427533920070311>; Tomoeh Murakami Tse, *Score One for Dissent: Aflac to be 1st U.S. Firm to Allow Advisory Votes on Pay*, WASH. POST, Feb. 15, 2007, at D01 (noting that shareholders at fifty companies would be voting on "say on pay" proposals).

³¹ *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 352 (Del. Ch. 1998).

performance and Disney terminated Ovitz after only fourteen months of employment.³² Pursuant to his employment agreement, Ovitz received over \$140 million in severance compensation.³³ Shareholders' outrage over such a lucrative severance package spurred numerous lawsuits.³⁴ Such outrage also prompted shareholders to organize a "vote no" campaign against Eisner in an effort to block his re-election to the board.³⁵ The campaign was very successful, resulting in 45% of shareholders withholding votes against Eisner.³⁶ Such a percentage represented one of the largest no votes in recent history.³⁷

³² See *id.*

³³ See *id.* (explaining no-fault termination agreement).

³⁴ See *id.* at 362 (granting motion to dismiss shareholder claims related to breach of fiduciary duty for failing to properly scrutinize Ovitz's compensation package); *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (affirming in part and reversing in part the chancery decision). After this reversal, the Delaware Supreme Court essentially affirmed the lower court's decision, but only for the limited purpose of allowing shareholders to amend their complaint in order to put forth a waste claim. When shareholders brought another suit in 2003 after Enron and related governance scandals, the Delaware Chancery Court did not dismiss the case and instead censured the board for its conduct. See *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 289 (Del. Ch. 2003). Ultimately, the Delaware Supreme Court ruled against the shareholders, finding that while the directors' lack of attention to corporate affairs failed to satisfy best practices, it did not constitute a breach of the directors' and officers' fiduciary duty.

³⁵ The first "vote no" campaign at Disney occurred in 1997 when shareholders first sought to express their outrage regarding Ovitz's severance and the new employment contract for Michael Eisner. See Lori B. Marino, *Executive Compensation and the Misplaced Emphasis on Increasing Shareholder Access to the Proxy*, 147 U. PA. L. REV. 1205, 1216 (1999). In that election, shareholders withheld 15% of their vote against five directors and 8% of their vote against Eisner's new contract. See *id.* at 1216; Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1073 (1998). At that time, Ovitz's severance package was estimated to be between \$19 to \$90 million. See Marino, *supra*, at 1216. The Delaware Chancery Court revised the estimated value to \$140 million. *In re Walt Disney Co.*, Derivative Litig., 731 A.2d 342, 350 (Del. Ch. 1998).

³⁶ See INSTITUTIONAL SHAREHOLDER SERVICES, 2004 POSTSEASON REPORT: A NEW CORPORATE GOVERNANCE WORLD: FROM CONFRONTATION TO CONSTRUCTIVE DIALOGUE 5, <http://www.issproxy.com/pdf/2004ISSPSR.pdf> [hereinafter 2004 PROXY SEASON REPORT] (noting that the initial tally calculated the withheld percentage at 42%). Within hours of the tally, Disney removed Eisner from his position as board chair and replaced him with George Mitchell. See *id.* Some six months later, amidst continued shareholder pressure, Eisner resigned his position as CEO. Eisner announced his resignation on the twentieth anniversary of his employment with Disney. See *id.* at 5.

³⁷ It is believed that the highest withheld vote occurred at Federated Department Stores, Inc., the national retail operator of Macy's and Bloomingdale's. Although it was not the target of an actual campaign, its refusal to implement majority voting caused shareholders at Federated Department Stores, Inc. to withhold 61% of their votes from

However, this campaign highlighted the fact that the current voting regime made it difficult for shareholders to impact election outcomes, and hence hold directors accountable for actions about which they disagreed.³⁸ Indeed, the default rule in the vast majority of states is that directors are elected by a plurality of the votes cast.³⁹ Hence, plurality is the default rule in Delaware, the state of incorporation for most public companies.⁴⁰ Similarly, the Model Business Corporation Act (the MBCA), adopted by some twenty-four states, embraces a plurality default rule.⁴¹

As a result, most shareholders elect directors under a plurality system. That system means that a person wins a director election so long as she

four directors up for re-election. See 2004 PROXY SEASON REPORT, *supra* note 36, at 9; Andrew R. Brownstein & Igor Kirman, *Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 BUS. LAW. 23, 51 (2004). Another highly publicized “vote no” campaign launched in 2004 involved Safeway, Inc. However, managers at Safeway were able to avoid a large percentage of withheld votes by implementing a variety of corporate governance measures prior to election day. See 2004 PROXY SEASON REPORT, *supra* note 36, at 5 (noting Safeway’s implementation of measures that would enhance board independence and ensure that shareholder resolutions that secured a majority vote were implemented). Instead, shareholders only withheld 17% of their votes from one director. See *id.*

³⁸ To be sure, the fact that Disney shareholders’ “vote no” campaign resulted in the removal of Eisner as chairman, and later CEO, may suggest that shareholders already have the ability to remove directors from office and hence hold them accountable for their actions. The campaign’s success suggests that, as a practical matter, corporations will not ignore actions that receive a significant portion of shareholder support. Thus, rather than highlighting a deficiency, the shareholders’ ultimate success can be interpreted as a signal that shareholders can have success without garnering the votes necessary to remove a director from office or otherwise securing the ability to affirmatively remove a director from office. Hence, altering the default rule may appear unnecessary. Bebchuk would disagree. Indeed, his study on corporate responsiveness to shareholder support of board declassification suggests that corporations do feel free to ignore shareholder votes, even when they receive an overwhelming amount of shareholder support. See Bebchuk, *supra* note 4, at 855. In this regard, some requirement is necessary to ensure that corporations respond to shareholder calls for action.

³⁹ Indeed, only four states (Alaska, Illinois, Missouri, and New Mexico) mandate majority voting, while two states (Alabama and Pennsylvania) make majority voting the default rule. See CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS, at 4–5 n.7 (last updated Feb. 5, 2007), http://www.ngelaw.com/files/upload/majority_callen_020707.pdf. This is in contrast to other countries, such as the United Kingdom, Germany, and France, where some form of majority voting is the default rule. See 2006 PROXY SEASON REPORT, *supra* note 1, at 18. In Canada, plurality voting is the default rule. However, like the United States, pressure to alter the voting structure in Canada has caused many corporations to adopt some form of majority voting. See *id.* at 17 (discussing Canadian campaign for majority vote elections).

⁴⁰ See DEL. CODE ANN. tit. 8, § 216(3) (2005).

⁴¹ See MODEL BUS. CORP. ACT § 7.28(a) (2002).

receives the most votes cast for her, without regard to votes cast against her or withheld. Theoretically, then, even if 99% of shareholders had withheld their votes against Eisner, he would have been victorious because all he needed was one vote cast in his favor. The plurality system suggests that nominees in an uncontested election are virtually guaranteed to be elected. By raising the possibility that a majority of shareholders would withhold their votes from a director nominee, Disney highlighted the fact that such a vote could ultimately prove ineffective, thereby spurring calls for corporations to adopt a majority vote default rule.

Implementation of a majority vote regime, however, is not without its complications. First, adopting such a system does not guarantee the removal of a director who fails to receive a majority of shareholder votes. State laws provide that a director who fails to receive sufficient votes for reelection continues in office until a successor is duly elected.⁴² This “holdover rule” means that a director who fails to receive a majority vote would remain in office until her successor is elected or she is otherwise removed. The holdover rule appears to nullify the impact of majority voting. To address the problems generated by this rule, shareholder advocates have suggested that corporations couple any majority vote regime with a provision requiring the resignation of a nominee who failed to receive a majority vote.⁴³ Second, implementing a majority vote system could result in a failed election. From this perspective, if such a rule governs contested elections, it is possible that no one candidate will receive a majority of the vote and, consequently, that no director will be effectively elected. Indeed, the plurality system was adopted to guard against failed elections. A change in that system requires attention to this problem. Third, the potential that a majority vote regime could result in the removal of directors raises concerns regarding whether the remaining board will satisfy listing standards or other rules regarding board qualifications. Indeed, federal law and listing standards require that a majority of members of a board as well as the members of certain committees are independent directors.⁴⁴ If a majority vote standard results in

⁴² See MODEL BUS. CORP. ACT § 8.05(e) (2002).

⁴³ See INSTITUTIONAL SHAREHOLDER SERVICES, MAJORITY ELECTIONS: QUESTIONS AND ANSWERS ON ISS 2006 VOTING POLICY 2 (Dec. 2005), <http://www.issproxy.com/pdf/FAQMVPolicy2006.pdf> [hereinafter MAJORITY ELECTIONS].

⁴⁴ See Sarbanes-Oxley § 301 (2002), amending Section 10A of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78f (requiring a majority of the audit committee to be independent); see also NYSE, Inc., Listed Company Manual §§ 303A.07(b) (2004) (requiring audit committee independence), 303A.01 (2003) (requiring that a majority of the board be independent), and 303A.04(a) (2004) (requiring that all nominating committee members be independent), available at http://www.nyse.com/lcm/lcm_section.html; NASDAQ, Inc., The NASDAQ Manual:

the removal of a corporation's independent directors, it could adversely affect the corporation's compliance with these standards.

Because of these and other concerns, some corporations responded to shareholder calls for greater voice in director elections with measures that fell short of majority voting. In June 2005, Pfizer, Inc. (Pfizer) adopted a policy now referred to as "plurality plus."⁴⁵ Under such a policy, Pfizer did not alter its plurality vote default rule. However, Pfizer amended its charter to require a director to tender her resignation if she receives a majority of withheld votes.⁴⁶ Pfizer's board would then have up to three months to determine whether to accept such resignation.⁴⁷ This rule enables corporations to address any negative consequences associated with shareholders' attempted removal of particular directors. By the end of 2005, several other companies, including Circuit City Stores, Inc., Walt Disney Co., Microsoft Corp., and Office Depot, Inc., had adopted policies similar to Pfizer.⁴⁸ These policies allowed corporations to retain the default rule of plurality while providing shareholders some greater ability to control election outcomes.

Yet shareholders and shareholder advisory services did not enthusiastically embrace these alternative provisions. Indeed, Institutional Shareholder Services (ISS), one of the most influential proxy advisory services, indicated that implementing a plurality plus procedure did not necessarily constitute a sufficient response to shareholders.⁴⁹ Instead, ISS

Marketplace Rules §§ 4350(d) (requiring audit committee independence), and 4350(c) (2004) (requiring that all compensation committee members, nominating committee members, and a majority of the board be independent) (2004), *available at* <http://www.nasdaq.com/about/MarketplaceRules.pdf>.

⁴⁵ See INSTITUTIONAL SHAREHOLDER SERVICES, 2005 POSTSEASON REPORT: CORPORATE GOVERNANCE AT A CROSSROADS 10 (2005), <http://www.issproxy.com/pdf/2005PostSeasonReportFINAL.pdf> [hereinafter 2005 PROXY SEASON REPORT].

⁴⁶ *See id.*

⁴⁷ *See* ALLEN, *supra* note 39, at 164. The Pfizer board is required to disclose its decision-making process and decision in a Form 8-K filed with the SEC.

⁴⁸ *See* 2005 PROXY SEASON REPORT, *supra* note 45, at 10. However, unlike Pfizer, some companies, such as Office Depot, require a director to tender her resignation only after she receives a withheld vote from a majority of the outstanding shares, as opposed to a majority of the shares cast. *See, e.g.*, OFFICE DEPOT, INC., CORPORATE GOVERNANCE GUIDELINES 2 (2005), *available at* http://media.corporate-ir.net/media_files/irol/94/94746/corpgov/guidelines_9_26_05.pdf. This standard is much harder to achieve.

⁴⁹ *See* MAJORITY ELECTIONS, *supra* note 43, at 3 (noting that ISS will examine alternative structures to ensure that they represent an effective equivalent to majority voting). In fact, ISS expressed concern that director resignation policies like Pfizer's allow the board to make the final determination regarding the status of directors who fail to receive a majority of the shareholders' support. *See id.* at 4. Illustrative of this concern, factors boards can consider include length of service, director qualifications, and

indicated that the “gold standard” was one providing for a majority vote provision coupled with modification of the holdover rule.⁵⁰ With regard to other measures, the burden would be on the corporation to ensure that its alternative framework allowed shareholders sufficient control over the election process.⁵¹ Then too, in January of 2006, Hewlett Packard Company (HP) sought to exclude a shareholder proposal for majority voting on the basis that its adoption of a plurality plus model represented substantial compliance with shareholders’ request.⁵² The SEC’s staff disagreed, and as a result, maintained that HP could not exclude the proposal from its proxy statement.⁵³ These responses reflected an apparent preference for a majority vote default rule.

For the next few years, majority voting became the most high profile issue of the proxy seasons.⁵⁴ Indeed, shareholders submitted a record number of proposals urging corporations to adopt majority vote standards. Thus, in 2005, shareholders submitted eighty-nine majority vote proposals.⁵⁵ In 2006, shareholders submitted virtually the same number of proposals during the first six months of the proxy season.⁵⁶ By the end of the 2006 season, more than 150 proposals had been submitted calling for a majority vote default rule, outnumbering all other proposals submitted.⁵⁷ These numbers stand in sharp contrast to the twelve majority vote proposals submitted during the 2004 proxy season.⁵⁸ Moreover, these proposals garnered an increasingly larger percentage of shareholder votes. In 2006, such proposals received an

contribution to the company. See Becky Yerak, *Allstate Changes Election Rules: Withheld Votes Can Pressure Directors*, CHI. TRIB., Mar. 2, 2006, at 3.

⁵⁰ See MAJORITY ELECTIONS, *supra* note 43, at 2.

⁵¹ See *id.* at 3.

⁵² See Hewlett Packard Co., SEC No-Action Letter, [2005–2006 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,137, at 77,233 (Jan. 5, 2006), 2006 WL 39271.

⁵³ See *id.* at ¶ 77,247.

⁵⁴ See 2006 PROXY SEASON REPORT, *supra* note 1, at 3 (revealing that the number of shareholder proposals submitted related to majority voting outstripped all other proposals submitted).

⁵⁵ See Thaddeus Kopinski, *Banner Year for Majority Elections*, in RISKMETRICS GROUP INSTITUTIONAL SHAREHOLDER SERVICES, 2006 (on file with author).

⁵⁶ Indeed, in the first half of 2006, shareholders submitted eighty-four majority vote proposals. See 2006 PROXY SEASON REPORT, *supra* note 1, at 16; Stephen Taub, *Investors Back Shareholder Resolutions*, CFO.COM, Aug. 22, 2006, http://www.cfo.com/article.cfm/7826000/c_7816474?f=TodayInFinance_Inside. By contrast, fifty-four proposals were submitted during the first half of 2005. See 2006 PROXY SEASON REPORT, *supra* note 1, at 16.

⁵⁷ See 2006 PROXY SEASON REPORT, *supra* note 1, at 2, 16.

⁵⁸ See Taub, *supra* note 56.

average level of 48% support, up from 43% in 2005.⁵⁹ The number of proposals that received more than 50% of the vote nearly tripled from thirteen in 2005 to thirty-six in 2006.⁶⁰ By comparison, such proposals only garnered an average of 12% of shareholder votes in 2004, and during that year, no proposal received majority shareholder support.⁶¹ Hence, shareholder support for these proposals has increased dramatically over a two-year period.⁶²

Although shareholder proposals were primarily non-binding, corporations responded to them. A study by the Council of Institutional Investors revealed that 63% of companies altered their voting mechanisms as a result of strong shareholder support for change.⁶³ While Pfizer triggered corporate adoption of plurality plus provisions, in January 2006, Intel Corp. (Intel) led the way by changing its bylaws to provide a majority vote rule coupled with a director resignation policy.⁶⁴ That same year, Dell, Inc.

⁵⁹ See 2006 PROXY SEASON REPORT, *supra* note 1, at 4, 16; Taub, *supra* note 56. Majority vote proposals received an average level of support of 47.8% in the first half of 2006 and an average of 44.3% in the first half of 2005. See also 2005 PROXY SEASON REPORT, *supra* note 45, at 8–9. Stories at individual companies underscore shareholders' activism in this area. As an example, for the first time in its history, shareholders at General Motors, Inc. rejected management's recommendation and voted in favor of a majority vote proposal. See Jeremy W. Peters, *In Switch, GM Shareholders Ask Board for Stronger Say in Elections*, N.Y. TIMES, June 7, 2006, at C1. At Textron, it had been more than a decade since any shareholder proposal had received a favorable vote. But shareholders approved the majority voting resolution by 59% of the vote. See Paul Grimaldi, *A Call for Change: Textron Shareholders Approve Proposal to Alter Voting*, PROVIDENCE J. (R.I.), Apr. 27, 2006, at F-01.

⁶⁰ See 2006 PROXY SEASON REPORT, *supra* note 1, at 16; see also Taub, *supra* note 56 (citing a 35% increase).

⁶¹ See Taub, *supra* note 56.

⁶² Interestingly, companies where proposals received the lowest levels of support were those companies that had already implemented a plurality plus voting system or some alternative voting mechanism. See 2006 PROXY SEASON REPORT, *supra* note 1, at 16; Kopinski, *supra* note 55. Hence, shareholder proposals received 19% of the vote at General Electric Co. and 29% of the vote at Avon Products, Inc., both companies that had already implemented a plurality plus voting regime. *Id.*

⁶³ Brooke Masters, *Proxy Measures Pushing Corporate Accountability Gain Support*, WASH. POST, June 17, 2006, at A1.

⁶⁴ See Intel Corp., Current Report (Form 8-K) (Jan. 19, 2006). Intel amended its bylaws to change the standard of voting in uncontested director elections from plurality to majority. Contested elections would remain as a plurality standard. In order to address the holdover rule, directors who fail to receive a majority of votes cast must resign, and then the board has ninety days to make a decision regarding whether to accept that resignation. During that time, the director cannot participate in company actions.

amended its charter to create a similar majority vote procedure.⁶⁵ By the end of the proxy season, at least 180 corporations had altered their director election policies.⁶⁶ Most of these corporations have adopted some version of a plurality plus standard.⁶⁷ However, at least forty companies have adopted full-fledged majority voting provisions.⁶⁸ One study indicated that as of June 2006, about 145 Standard & Poor (S&P) 500 companies either require their boards to be elected by majority vote or require directors to resign if a majority of shareholders withhold their votes for a director.⁶⁹ Fewer than thirty companies had such provisions in place at the start of 2005.⁷⁰ A more recent study revealed that 52% of S&P 500 companies and 45% of Fortune 500 companies have adopted some form of majority voting or plurality plus regime.⁷¹ Given that only a handful of companies had a majority vote system in place prior to 2005, the rate of change is striking.

This change is particularly noteworthy given the non-binding nature of most shareholder resolutions. Indeed, while the trend seems to be in favor of offering binding shareholder proposals, most proposals seeking to alter the voting regime have been advisory.⁷² Previously, corporations appeared less inclined to modify their policies as a result of these non-binding shareholder proposals, even when they received a majority of the vote.⁷³ Thus, while 63% of companies altered their voting rules as a result of shareholder proposals in 2006, only 28% of companies did so in 2005.⁷⁴ This suggests that corporations' greater willingness to comply with shareholder resolutions

⁶⁵ See ALLEN, *supra* note 39, at 59.

⁶⁶ See 2006 PROXY SEASON REPORT, *supra* note 1, at 2, 16.

⁶⁷ See *id.* at 16 (noting that at least 140 companies had adopted a plurality plus standard).

⁶⁸ See *id.* at 2, 16.

⁶⁹ Masters, *supra* note 63.

⁷⁰ *Id.*

⁷¹ See ALLEN, *supra* note 39, at iii.

⁷² See *id.*

⁷³ See Bebchuk, *supra* note 4, at 854. According to Bebchuk's study, between 1997–2003, 131 resolutions to abolish staggered boards received a majority of the votes cast by shareholders, but by the end of 2004, corporations only had responded to a third of such votes by declassifying their boards. *But see* Brownstein & Kirman, *supra* note 37, at 68 (explaining that a distinction must be made between corporations that ignore shareholder resolutions and those that decline to take a recommended action after due consideration). Brownstein and Kirman in fact insist that, at times, "ignoring" a resolution that receives a majority of the vote is appropriate and consistent with directors' fiduciary obligations. See *id.* at 77.

⁷⁴ Masters, *supra* note 63.

is a recent phenomenon.⁷⁵ In some cases, managers have even supported majority vote proposals advanced by shareholders.⁷⁶ This reveals not only that shareholders have increased their activism, but also that corporations have increased their response.

Moreover, shareholders' quest for greater democracy has prompted a response from legislatures. Hence, in August of 2005, Delaware amended its corporate code in two respects. First, Delaware added a provision providing that corporations can make irrevocable any resignation submitted as a result of the failure to receive a required percentage of votes for reelection.⁷⁷ Second, Delaware amended its statute to provide that directors cannot amend or repeal any bylaw amendment adopted by shareholders that specifies the votes necessary for election of directors.⁷⁸ Both of these changes ensure that if shareholders are successful in securing a majority vote standard, directors cannot alter it. Similarly, the ABA modified the MBCA in order to make resignations irrevocable when they result from the failure to receive a specified number of votes.⁷⁹ In addition, the ABA provides for the adoption of a plurality plus standard. Under the standard, directors who receive more votes against them than for them in any election must tender their resignation within ninety days or the date on which a replacement director is selected.⁸⁰ Neither the ABA nor Delaware adopted a majority vote standard,⁸¹ but they both offered an alternative measure designed to bolster shareholders' power in director elections.

This albeit limited legislative response coupled with the corporate response appears to have enhanced the momentum on the majority vote movement. Thus far, the 2007 proxy season has witnessed 104 proposals related to majority voting, by far the greatest number of proposals submitted on a single issue.⁸² Many practitioners appear to believe that majority voting

⁷⁵ See Brownstein & Kirman, *supra* note 37, at 68–69 (noting that there has been a “palpable shift” in the level of attention corporate actors pay to shareholder proposals).

⁷⁶ Managers at Marriott International and Host Hotels supported shareholder proposals calling for majority voting for directors. Both proposals received more than 95% of the vote, the largest level of shareholder support. See 2006 PROXY SEASON REPORT, *supra* note 1, at 16.

⁷⁷ DEL. CODE ANN. tit. 8, § 141(b) (Supp. 2006).

⁷⁸ DEL. CODE ANN. tit. 8, § 216 (Supp. 2006).

⁷⁹ MOD. BUS. CORP. ACT § 8.07 (2002).

⁸⁰ MOD. BUS. CORP. ACT § 10.22 (2006).

⁸¹ See DEL. CODE ANN. tit. 8, § 216(3) (Supp. 2006). Interestingly, California amended its statute to allow corporations to adopt majority voting as the default rule, which went into effect in January of 2007. See ALLEN, *supra* note 39, at iv.

⁸² Indeed, the next largest number of proposals was forty-five submitted for political contributions, and forty-four requesting that corporations link pay to performance. See

in some form will soon be the norm. Indeed, in a memo to its clients, Wachtell, Lipton, Rosen & Katz predicted that majority voting would become “universal.”⁸³ One official at International Shareholder Services (ISS) indicated that most corporate governance experts believed that a majority voting system was a “fait accompli.”⁸⁴

2. Term Limits for Directors

Since the hostile takeover battles, shareholders have been pushing to eliminate staggered boards. Staggered or classified boards refer to ones in which only a portion of the directors stand for reelection every year. Hence, each director on the board serves a multi-year term, generally three years. Many corporations instituted staggered board terms in an effort to preserve their discretion, but shareholders insist that such boards contribute to managerial entrenchment, making it difficult to replace directors during a proxy fight or hostile takeover battle.⁸⁵ As a result, shareholders have continually pressured corporations to declassify their boards and move to a system of annual elections. Thus, the average shareholder support for proposals on this issue has increased steadily from 47% in 1997 to 62% in 2003.⁸⁶ Beginning in 2000, such proposals have consistently averaged more than 50% shareholder support.⁸⁷ In 2004, the average support for declassification proposals peaked at 71%.⁸⁸

Support for this issue has remained high over the last two years, with one commentator referring to board declassification as the “sleeper” issue of

INSTITUTIONAL SHAREHOLDER SERVICES, 2007 PROXY SEASON WATCH LIST, <http://www.issproxy.com/ProxySeasonWatchlist/2007/index.jsp> [hereinafter 2007 WATCH LIST].

⁸³ William Baue, *Majority-Vote Director Election Shareowner Resolutions to Top 100, Dominate Proxy Season*, SOCIAL FUNDS, Jan. 10, 2006, <http://www.socialfunds.com/news/article.cgi/1902.html>. In a memo to its clients, Latham & Watkins, LLP 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 just no effective sound bites against shareholder demands for majority vote. See LATHAM & WATKINS, LLP., MAJORITY VOTE FOR DIRECTORS: THE LATEST CORPORATE GOVERNANCE INITIATIVE 3 (2005), http://www.lw.com/upload/pubcontent/_pdf/pub1437_1.pdf.

⁸⁴ See Sara Hansard, *With Patrick S. McGurn of Institutional Shareholder Services Inc. (One on One)*, INVEST. NEWS, Sept. 18, 2006, at 42 (quoting Patrick McGurn, special counsel, executive vice president, and director-corporate programs of ISS).

⁸⁵ Bebhuk, *supra* note 4, at 853.

⁸⁶ *Id.*

⁸⁷ *See id.*

⁸⁸ 2006 PROXY SEASON REPORT, *supra* note 1, at 4.

2006.⁸⁹ While shareholders submitted a smaller number of proposals on board declassification as compared to proposals on the more publicized majority vote rule, declassification proposals averaged a higher level of support. Thus, for the first half of 2005 and 2006, shareholders submitted 46 and 42 declassification proposals, respectively.⁹⁰ By contrast, the number of majority vote proposals submitted during the same period in 2006 was double that amount.⁹¹ However, in 2005, the average shareholder support for declassification proposals reached 60%, while in 2006 such support climbed to almost 67%.⁹²

Perhaps most significant, corporations appear more willing to alter their board structure in response to shareholder calls for declassification. Bebchuk found that at companies where shareholder support for declassification proposals surpassed 50%, less than one-third had eliminated their staggered boards as of 2003.⁹³ Indeed, at many companies, shareholders had been submitting proposals (and garnering more than 50% support for those proposals) for several years in a row without any favorable response.⁹⁴ However, more recent studies suggest that companies are beginning to eliminate their classified boards when shareholder support for such elimination is strong. As a result, by the end of 2006, shareholders will elect a majority of directors at S&P 500 annually.⁹⁵ While shareholder activism in this area is not new, such corporate responsiveness is new. In this respect, it is consistent with the broader trend towards increased shareholder democracy.

⁸⁹ Barry B. Burr, *Majority Vote Issue Draws the Most Proxies; But Declassifying Boards has Become 2006's 'Sleeper' Issue*, PENSION AND INVEST., Apr. 3, 2006, at 3 (quoting a managing director of a Virginia-based proxy advisory company).

⁹⁰ 2006 PROXY SEASON REPORT, *supra* note 1, at 3–4.

⁹¹ *See id.* Eighty-four majority vote proposals were submitted during the first half of 2006.

⁹² *Id.* at 4 (noting that in 2005, the average support was 60.5%, while the average support reached 66.8% in 2006).

⁹³ *See* Bebchuk, *supra* note 4, at 854.

⁹⁴ *See id.* at 855; 2005 PROXY SEASON REPORT, *supra* note 45, at 14 (explaining multiple year proposals at companies like Maytag, where shareholders had submitted such proposals for six consecutive years). Of note, shareholders withheld a record number of votes from a board that had ignored their request for declassified boards for five consecutive years, despite the majority support received by those requests. *See* 2004 PROXY SEASON REPORT, *supra* note 36, at 9 (explaining withheld vote against directors at Federated Department Stores).

⁹⁵ 2006 PROXY SEASON REPORT, *supra* note 1, at 19; Masters, *supra* note 63.

3. Shareholder Access to the Ballot

Another issue that has risen to prominence within the last few years is shareholders' access to the corporation's proxy for purposes of nominating their own candidates in director elections. Both shareholders and corporate managers have the ability to nominate candidates to be voted on at the corporation's annual election for directors. Rule 14a-8(i) allows the corporation to exclude from its proxy statement any proposal that relates to an election for membership to the board of directors.⁹⁶ This Rule means that only management nominees can appear on the corporation's proxy statement; shareholders are excluded from requiring the corporation to include the names of their nominees on the corporation's ballot.

Under pressure to make directors and officers more accountable in the wake of the governance scandals of 2002, the SEC proposed a new Rule 14a-11 that would allow shareholders a limited right to include their nominees on the corporation's proxy statement.⁹⁷ Under the proposed rule, shareholders would be able to make use of the corporation's proxy materials when nominating a director upon the occurrence of either of two triggering events. One, shareholders must have withheld more than 35% of their votes from at least one of the company's nominees for director.⁹⁸ Alternatively, a shareholder must have submitted a proposal requesting that the company become subject to the direct access procedures under Rule 14a-11, and the board must have failed to implement the proposal within 120 days after such proposal received more than 50% of the vote.⁹⁹ Any shareholder who submits a direct access proposal under the second triggering event must have held at least 1% of the company's outstanding shares for one year.¹⁰⁰ After either of these two triggering events, Rule 14a-11 required a corporation to place a shareholder nominee on its proxy statement in its next election for directors, so long as the shareholder putting forth the nominee has held more than 5% of the corporation's outstanding shares for at least two years.¹⁰¹ The proposed rule also required that nominees satisfy certain eligibility

⁹⁶ See 17 C.F.R. § 240.14a-8(i)(8) (2006). For a discussion of other substantive exclusions, see Palmiter, *supra* note 28, at 890-92.

⁹⁷ See Security Holder Director Nominations, 68 Fed. Reg. 60,784 (proposed Oct. 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, 274) [hereinafter Proposed Rule on Nominations] (noting that the adoption of the new rule stemmed from concern over "corporate scandals and the accountability of corporate directors").

⁹⁸ See *id.* at 60,789.

⁹⁹ See *id.* at 60,789-90.

¹⁰⁰ See *id.* at 60,789.

¹⁰¹ See *id.* at 60,794.

requirements.¹⁰² Finally, Rule 14a-11 modified Rule 14a-8(i) so that request for compliance with the Rule would not be excludable under the provision allowing corporations to exclude proposals that relate to the election of directors.¹⁰³

As crafted, the proposed rule was designed to afford long-term shareholders access to the corporation's proxy statement when the board appeared to be unresponsive to shareholder concerns. Indeed, the SEC and shareholders pointed out that excluding shareholder nominees from the corporation's proxy statement produced inequities because the exclusion allowed the corporation to bear the costs associated with the election of management candidates, while shareholders had to bear their own costs.¹⁰⁴ In their view, these inequities ultimately limited the extent to which shareholders could meaningfully put forth alternative candidates for director elections, thereby diminishing their influence of, and oversight over, corporate directors.¹⁰⁵ According to Bebchuk, the costs associated with filing a proxy statement and garnering investor support for director candidates can be prohibitive, making the shareholder power to nominate directors "largely inconsequential."¹⁰⁶ Illustrative of this point, Bebchuk found that during 1996–2002, there was only an average of eleven instances per year where director-nominated candidates faced competition from shareholder-nominated candidates.¹⁰⁷ In proposing the new rule, the SEC indicated that allowing access to the ballot would strengthen shareholder power by providing shareholders with the meaningful ability to wage election contest, enabling shareholders to impact election outcomes and hence corporate governance affairs more generally.¹⁰⁸

However, intense opposition to the rule led to it being tabled and ultimately abandoned.¹⁰⁹ In fact, after the rule proposal, several shareholders

¹⁰² See *id.* at 60,795–96. For example, the nomination must be consistent with applicable state and federal laws, and the nominees must not have certain prohibited relationships with the company or the nominating shareholder.

¹⁰³ See Proposed Rule on Nominations, *supra* note 97, at 60,789 n.74.

¹⁰⁴ See *Battling for Corporate America*, *ECONOMIST*, Mar. 11, 2006, at 69, 70 (noting cost associated with shareholder nomination of directors).

¹⁰⁵ See Proposed Rule on Nominations, *supra* note 97, at 60,784 (noting shareholders' mounting frustration with their perceived inability to influence director nomination process).

¹⁰⁶ Brief of Harvard Law Professors as Amicus Curiae Supporting Appellants at 3, *AFSCME v. AIG, Inc.*, 361 F. Supp. 2d 344 (S.D.N.Y. 2005) (No. 05 Civ. 2390(LLS)).

¹⁰⁷ See Bebchuk, *supra* note 4, at 856.

¹⁰⁸ See Proposed Rule on Nominations, *supra* note 97, at 60,784.

¹⁰⁹ See DAVID A. KATZ & LAURA A. MCINTOSH, *CORPORATE GOVERNANCE UPDATE: PROXY ACCESS—NOT THEN, NOT NOW* 3 (2006), <http://www.realcorporatelawyer.com/>

submitted proposals requesting that their corporations amend their bylaws to grant shareholders the ability to nominate directors consistent with Rule 14a-11. Reflecting its commitment to the new Rule's modified stance on director election proposals under Rule 14a-8(i), the SEC staff initially took the position that such proposals could not be excluded from a corporation's proxy statement.¹¹⁰ However, signaling the SEC's abandonment of the rule, the SEC staff eventually changed course and reversed this stance. Thus, in February 2005, the SEC's staff allowed Halliburton Company to exclude a shareholder nomination proposal requesting that the company become subject to Rule 14a-11. In its no-action letter, the SEC staff stated, "[g]iven the passage of time . . . without [SEC] action . . . the position that the staff intended to take . . . is no longer necessary or appropriate."¹¹¹ On the same day, the SEC took a similar position with respect to Qwest Communications International, Inc., and Verizon Communications Inc.¹¹² In doing so, the SEC staff underscored its intent to return to the status quo and prevent shareholders from accessing the corporate ballot.

However, at the end of 2006, the Second Circuit breathed new life into this issue.¹¹³ In December of 2004, American Federation of State, County

pdfs/wlrk092806.pdf (noting that the complexities raised by the proposal led the SEC to table its proposal indefinitely). The authors also note that the tabling of the proxy access proposal spurred the increased insistence for majority voting.

¹¹⁰ For example, in 2004, Disney shareholders submitted a proposal requesting that the company become subject to the nomination procedures set forth under Rule 14a-11. When Disney sought to exclude the proposal, the SEC indicated that its recent rule proposal meant that Disney could not use Rule 14a-8(i) to exclude the shareholders' request. *See* The Walt Disney Co., SEC No-Action Letter, 2004 WL 2848301, at *1 (Dec. 8, 2004).

¹¹¹ Halliburton Co., SEC No-Action Letter, 2005 WL 283290, at *1 (Feb. 7, 2005). The proposal requested that Halliburton become subject to the shareholder proposal rule contemplated by SEC proposed rule 14a-11. *See id.* at *1-2.

¹¹² *See* Qwest Commc'ns Int'l Inc., SEC No-Action Letter, 2005 WL 283288, at *1 (Feb. 7, 2005); Verizon Commc'ns Inc., SEC No-Action letter, 2005 WL 283289, at *1 (Feb. 7, 2005).

¹¹³ Interestingly, shareholders also began bargaining for a nomination right in connection with lawsuit settlements. Indeed, shareholders have managed to secure nomination rights in settlements involving Ashland and Microtune. *See, e.g.*, Corporate Governance, Jan./Feb. 2005 News, <http://www.corpgov.net/news/archives2005/Jan-Feb.html> (last visited Feb. 8, 2008). In 2005, Ashland became the fourth company to agree to allow shareholders to nominate directors in connection with a lawsuit settlement. *See id.* (noting suits at Hanover Compression and Broadcom). Ashland has agreed to solicit director candidates from its shareholders and nominate one candidate for election to the board. Ashland also has agreed to limit the time served of its directors so that no director serves for more than fifteen years and no director serves after the age of seventy. In addition, the settlement requires that executive bonuses be tied to financial performance and that two-thirds of its board would be independent directors. Similarly,

and Municipal Employees, an employee pension plan (AFSCME), submitted a proposal to be included on the proxy statement for the 2005 annual director election for American International Group, Inc. (AIG).¹¹⁴ The proposal sought to amend AIG's bylaws to require that, under certain circumstances, the company put the names of shareholder-nominated director candidates on its proxy statement.¹¹⁵ AIG requested that the SEC's staff issue a no-action letter allowing it to exclude the proposal under Rule 14a-8(i) because it related to an election. The SEC staff complied.¹¹⁶ AFSCME appealed the decision to federal district court in New York seeking to compel the inclusion of their proposal. The district court denied the request.¹¹⁷ However, in *AFSCME v. AIG*, the Second Circuit reversed, disagreeing with the district court and the SEC. Indeed, the SEC had taken the position that AFSCME's proposed bylaw provision related to an election for directors and on that basis could be excluded under Rule 14a-8(i). The Second Circuit concluded that the statutory language regarding the exclusions was ambiguous and could be interpreted as enabling corporations to exclude only those proposals that relate to a particular election rather than those that focus on election procedures.¹¹⁸ The Second Circuit also held that the SEC's interpretation did not merit deference because its current interpretation of the rule was inconsistent with prior SEC interpretations.¹¹⁹ The Second Circuit concluded its opinion by suggesting the need for the SEC to craft a more clear-cut statement regarding shareholder access to corporations' proxy statements.

The SEC's response has been both slow and confusing. In January of 2007, the SEC's staff affirmatively declined to state a position on the

Microtune agreed to solicit nominees from its shareholders for the consideration of its nominating committee, and then to provide for the election of two shareholder-nominated candidates. Like Ashland, Microtune also agreed to a fifteen-year service limit for its directors, and that two-thirds of such directors would be independent.

¹¹⁴ See *AFSCME v. AIG, Inc.*, 462 F.3d 121, 123–24 (2d Cir. 2006).

¹¹⁵ See *id.* at 124. The proposal provided, among other conditions, that the company include the names of candidates put forth by investors who have owned at least 3% of the outstanding common shares of AIG for at least a year. See *id.* at 124 n.3.

¹¹⁶ See American Int'l Group, Inc., SEC No-Action Letter, 2005 WL 372266 (Feb. 14, 2005).

¹¹⁷ See *AFSCME v. AIG, Inc.*, 361 F. Supp. 2d 344 (S.D.N.Y. 2005). After that denial, shareholders again sought the SEC to allow its submission on the corporation's proxy statement. However, the SEC confirmed its prior position, allowing the omission of the proposal. See American Int'l Group, Inc., SEC No-Action Letter, 2006 WL 721899, at *1 (Mar. 20, 2006).

¹¹⁸ See *AFSCME*, 462 F.3d at 125–26.

¹¹⁹ See *id.* at 126–29.

issue.¹²⁰ Indeed, shareholders of HP had submitted a proposal that would amend HP's bylaws to require that HP include shareholder nominees for director under certain circumstances.¹²¹ HP requested a no-action letter on its decision to exclude the proposal. HP argued that, as a California corporation, it was governed by the Ninth Circuit and hence not bound by the Second Circuit's opinion.¹²² As a result, HP contended that it should be free to exclude such a proposal consistent with the positions articulated in the Halliburton, Verizon, and Qwest no-action letters. The SEC's staff, however, decided that it would express no view on the merits of HP's exclusion.¹²³

The SEC Commissioner commended the staff's decision (or non-decision), indicating that the entire Commission should settle the matter.¹²⁴ Yet it appears that the members of the Commission disagreed regarding the manner in which proxy access should be settled.¹²⁵ As a result, the SEC removed shareholder access to the proxy from its January 2007 list of discussion items, signaling further delay in a definitive position on this issue.¹²⁶ Given the unsettled nature of this issue, the SEC's decision not to decide left HP with considerable uncertainty regarding the viability of its position. That uncertainty apparently prompted HP to include the proposal on its proxy statement.¹²⁷

Interestingly, the proposal received about 43% of the shareholder support, and both sides declared victory.¹²⁸ Indeed, opponents noted that the vote fell far short of the two-thirds necessary for it to pass. Proponents

¹²⁰ See Hewlett-Packard Co., SEC No-Action Letter, 2007 WL 224970, at *1 (Jan. 22, 2007) (noting that the SEC's staff expresses no view on whether HP can exclude the proposal).

¹²¹ Under the proposal, HP would be required to include in its proxy statement any person nominated by a stockholder holding at least 3% or more of HP stock for at least two years. See *id.* at *2.

¹²² See *id.* at *1.

¹²³ See *id.*

¹²⁴ See Carrie Johnson, *SEC Delays Decision on Board Nominations*, WASH. POST, Jan. 23, 2007, at D02.

¹²⁵ See *id.*

¹²⁶ See *id.*

¹²⁷ See *id.* Tomoeh Murakami Tse, *HP Investors Reject "Proxy Access" Proposal: Would Have Opened Up Board-Nominating Process*, WASH. POST, Mar. 15, 2007, at D02 (revealing that the HP proposal was included on the proxy statement, but did not receive majority approval).

¹²⁸ See Tse, *supra* note 127. Some news outlets reported that the proposal received 36% of the vote, but the figure apparently included abstentions. See Posting of Ted Allen to Risk & Governance Blog, http://blog.riskmetrics.com/2007/03/proxy_access_gets_43_at_hpsubm.html (Mar. 16, 2007).

argued that the vote represented strong support for the measure, particularly because it represented a first-time vote and most shareholder proposals tend to receive a low level of support during their first vote. Moreover, proponents maintain that such a strong level of shareholder support not only should encourage other shareholders to support similar efforts, but also should prompt the SEC to revitalize its attempts to allow shareholder access to the corporation's proxy.

As of the date of this Article, the SEC has finally spoken on the issue of proxy access, but with a divided voice. In July of 2007, SEC Chairman Christopher Cox requested public comment on two conflicting proxy access proposals.¹²⁹ Thus, Cox voted with two commissioners in favor of a proposal that would allow shareholders holding 5% or more of a company's shares to propose bylaw amendments that establish procedures for enabling shareholder nominees to be included in a company's proxy statement.¹³⁰ However, Cox also voted with two other commissioners to forbid shareholders from putting forth proposals related to board elections or nominations.¹³¹ As a result Cox has enabled the public to comment on the merits of two conflicting proposals, one that would grant access and the other that would restrict access and confirm the status quo.¹³² Such a result reveals the sharp divisions in the SEC, while making it unclear how the SEC ultimately will settle the question of proxy access. What is clear, however, is that Cox likely will be the swing vote on any proxy access decision. And Cox has promised a clear rule in time for the next proxy season.¹³³

While shareholders have experienced less success on this issue, there continue to be increased levels of activism around it. To date, the status of shareholder access to the corporation's proxy remains unclear. However, this lack of clarity appears to be keeping the issue alive. As a result, shareholder

¹²⁹ See Carrie Johnson, *SEC Proposal Raises Profile of Investors: Divided Panel Tackles Issues of Pay, Board Membership*, WASH. POST, July 26, 2007, at D01; Stephen Labaton, *A Public Airing for Proposals on Shareholders*, NY TIMES, July 26, 2007, at C3.

¹³⁰ See Shareholder Proposals, 72 Fed. Reg. 43466 (proposed Aug. 3, 2007) (to be codified at 17 C.F.R. pt. 240).

¹³¹ See *id.* at 43,488–96 (shareholder proposals relating to the election of directors).

¹³² And in fact, as this Article was going to press, the SEC did make a decision with regard to proxy access, deciding to reject such access. See *infra* note 133.

¹³³ As this Article was in the process of going to press, the SEC decided to embrace the proposal that would prevent shareholders from placing their director candidates on the proxy statement. See Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. 70,450 (proposed Dec. 11, 2007) (to be codified at 17 C.F.R. pt. 240). However, Cox has indicated a desire to reopen the issue. See Karey Wutkowski, *SEC to Look Outside Ballot on Proxy Access*, REUTERS, Jan. 4, 2008, <http://www.reuters.com/article/idUSN1741224720080104>.

activists predict that the 2007 proxy season will see renewed activity on this issue.¹³⁴

When viewed together, it appears that shareholders' recent activism has been successful. Most notably, the increased shareholder support for a majority vote regime and the elimination of staggered boards has caused many corporations to alter their governance structures. While shareholders' ability to obtain access to the proxy remains an open issue, shareholders have at least caused the SEC to reconsider the issue. More importantly, activism on these issues has not occurred in a vacuum. Instead, shareholders have seen success on a host of other issues that aim to enhance their power, while developments at the SEC and other agencies also seem to increase shareholder democracy.¹³⁵ Thus, one expert refers to the combination of developments regarding shareholders' voting rights as the proverbial "perfect storm" that should serve to shift corporate power into the hands of shareholders.¹³⁶

To be sure, it is not clear that shareholders will sustain their levels of activism or that their activism will produce its desired result. Indeed, some of the shareholders who have been active of late are relatively new to activism and thus may not sustain their activity in the long run. In fact, as Bainbridge suggests, shareholders' natural and rational apathy may undercut the extent to which they will use the power granted to them.¹³⁷ Moreover, it is not clear that increasing shareholder power will lead to better accountability or otherwise rectify corporate governance failures. In other contexts, scholars have pointed out that shareholder activism through the shareholder proposal process represents an ineffective mechanism for altering corporate practices, particularly practices involving executive compensation schemes.¹³⁸ Other studies confirm the notion that shareholder activism has minimal impact on corporate performance.¹³⁹ Thus it is not clear, and this Article does not contend, that increasing shareholder power will prove effective. However, if such power is augmented, this Article seeks to ascertain whether it will be detrimental to the interests of other constituents.

¹³⁴ See Tse, *supra* note 127.

¹³⁵ See ALLEN, *supra* note 39, at v (pinpointing various developments).

¹³⁶ *Id.*

¹³⁷ See Bainbridge, *Director Primacy*, *supra* note 5, at 1753.

¹³⁸ See Marino, *supra* note 35, at 1236–37, 1246 (noting that executive compensation levels continue to increase notwithstanding shareholders' increased ability to submit proposals related to such compensation).

¹³⁹ Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 182 (2001).

II. ALLIES OR ADVERSARIES: IS INCREASING SHAREHOLDER POWER A ZERO SUM GAME?

Calls for increasing shareholder power have sparked intense debate among academics, practitioners, legislators, and judges. One of the most prominent supporters of increasing shareholder power has been Professor Lucian Bebchuk. In his article, *The Case for Increasing Shareholder Power*, Bebchuk not only outlined a system for increasing shareholder power, but also set forth a normative rationale for the appropriateness of that increase.¹⁴⁰ His proposal would move beyond strengthening shareholders' existing rights and allow shareholders to initiate changes to the corporation's basic governance structures, as well as intervene in certain fundamental decisions.¹⁴¹ Bebchuk maintains that increasing shareholder democracy in these ways will enhance managerial accountability and thereby improve corporate performance and firm value.¹⁴²

In comparison, Professor Stephen Bainbridge has argued that proposals calling for increasing shareholder power would undermine one of the key virtues of the American corporation and therefore have a negative impact on corporate value.¹⁴³ In Bainbridge's view, the separation of ownership and control represents a valuable feature of American corporations.¹⁴⁴ Operating a large business entails managing the concerns of various constituents with divergent interests and access to information. The most cost-effective and efficient method of managing such an enterprise is for shareholders and other corporate constituents to delegate their authority to some centralized body.¹⁴⁵ In other words, the public corporation demands that some central body be vested with the power and discretion to make decisions on behalf of the entire firm.¹⁴⁶ The board represents that body and thus is best positioned to

¹⁴⁰ See Bebchuk, *supra* note 4, at 833.

¹⁴¹ See *id.* at 837–47 (outlining rationales for allowing shareholders to make “rules of the game” decisions such as those involving charter amendments and reincorporation, as well as reasons for allowing shareholders to intervene in certain “game-ending” decisions such as those involving mergers and dissolution).

¹⁴² See *id.* at 842–43. In fact, Bebchuk maintains that he is not interested in increasing shareholder power for its intrinsic value. Rather, he supports such increase only to the extent that it advances shareholder value.

¹⁴³ See Bainbridge, *Director Primacy*, *supra* note 5, at 1749.

¹⁴⁴ See *id.* at 1749, 1751; Bainbridge, *Shareholder Voting Rights*, *supra* note 5, at 636.

¹⁴⁵ See Bainbridge, *Director Primacy*, *supra* note 5, at 1746; Bainbridge, *Shareholder Voting Rights*, *supra* note 5, at 624.

¹⁴⁶ See Bainbridge, *Director Primacy*, *supra* note 5, at 1746; Bainbridge, *Shareholder Voting Rights*, *supra* note 5, at 624.

make the most effective and efficient decisions.¹⁴⁷ As a result, shifting power away from directors and into the hands of shareholders is not only inappropriate, but also inefficient. Given the success of American businesses throughout the year, we should be extremely reluctant to alter the status quo.¹⁴⁸ Others argue that the diverse nature of shareholders means that they do not share a common interest, and hence shifting power to them would encourage rent seeking and reduce shareholder value.¹⁴⁹ This Article's purpose is not to focus on the merits of shareholder power, but rather to assess the impact of that power on other constituents.

In fact, Bebchuk notes that one very important critique of his proposal is that it may have negative repercussions for stakeholders.¹⁵⁰ According to this critique, increasing shareholder power may undermine corporate officers and directors' ability to attend to the interests of other stakeholders. In fact, Professors Margaret Blair and Lynn Stout have suggested that the corporate board serves as a mediator of various interests within the corporation.¹⁵¹ Consistent with such a role, corporate power should remain in the hands of managers because they are best able to balance the interests of all corporate shareholders, and shifting power into the hands of shareholders will undercut directors' ability and willingness to pay heed to other corporate constituents.¹⁵²

¹⁴⁷ See Bainbridge, *Director Primacy*, *supra* note 5, at 1746; Bainbridge, *Shareholder Voting Rights*, *supra* note 5, at 624.

¹⁴⁸ See Bainbridge, *Director Primacy*, *supra* note 5, at 1739; Bainbridge, *Shareholder Voting Rights*, *supra* note 5, at 626.

¹⁴⁹ See Anabtawi, *supra* note 18, at 575. In fact, both Bainbridge and Chancellor Strine question whether shareholders will act in the best interests of the firm or will advance their own narrow self-interests. See Bainbridge, *Director Primacy*, *supra* note 5, at 1754; Strine, *supra* note 14, at 1771.

¹⁵⁰ See Bebchuk, *supra* note 4, at 912.

¹⁵¹ See Blair & Stout, *supra* note 7, at 253–54, 286 (describing board's function as a mediating hierarchy); see also John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443, 1446 (1994) (noting that the board is in the best position to mediate between the concerns of shareholders and other constituents within the firm).

¹⁵² See Bebchuk, *supra* note 4, at 908; Blair & Stout, *supra* note 7, at 304–05; Lynn A. Stout & Iman Anabtawi, *Sometimes Democracy Isn't Desirable*, WALL ST. J., Aug. 10, 2004 (noting that boards mediate conflicts among shareholders and other corporate constituents and ensure that corporate policy "will not be set by an anonymous, myopic, return-hungry pack of shareholders"). *But see* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 593–605 (2003) (advancing arguments against the conception of the board as a mediator); David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001, 1024–42 (2000) (noting that corporate law does not reflect the idea of the board as a mediator).

Bebchuk maintains that such a critique is important because of its potential to shift the debate away from one that pits shareholders against managers to one that pits shareholders against other corporate interests within the corporate arena.¹⁵³ Indeed, Bebchuk notes that these kinds of arguments played a critical role in the takeover debates, lending legitimacy to managerial efforts to retain their broad discretion in the face of shareholder efforts to exert greater influence over corporate takeover decisions.¹⁵⁴ Indeed, it was in the context of the takeovers that the Delaware courts acknowledged for the first time the directors' ability to pay heed to other constituents and even to advance the interests of those constituents over shareholders' financial concerns.¹⁵⁵ Moreover, takeover battles spurred the adoption of so-called "other constituency" or "stakeholder" statutes granting directors the express power to consider non-shareholder interests when carrying out their fiduciary responsibilities, and even subordinate shareholder concerns to those interests.¹⁵⁶ Hence, the notion that limited shareholder power is necessary to ensure adequate attention to stakeholder concerns played a key role in legitimizing managerial discretion, and therefore tipping the balance of power away from shareholders and towards managers. Injecting stakeholders into the debate regarding shareholder democracy similarly threatens to bolster the importance of managerial authority, thereby diminishing the legitimacy of shareholder democracy.

Bebchuk responds to this stakeholder-based critique principally by advancing reasons why managers' interests are not aligned with those of stakeholders. Of course, Bebchuk notes that there are some decisions,

¹⁵³ See Bebchuk, *supra* note 4, at 912 (noting the power of the argument and its ability to boost the legitimacy of claims against shareholder power).

¹⁵⁴ See *id.* at 908.

¹⁵⁵ See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (noting that a court may consider the impact of a takeover "on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)"); see also *Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (allowing shareholders to consider non-financial interests, and noting that a board is not under any "*per se* duty to maximize shareholder value").

¹⁵⁶ See, e.g., Lisa M. Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors' Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409, 460-61 (2002) (noting that thirty-two states had enacted some form of constituency statute granting directors the ability to consider a broad array of stakeholder interests such as employees, suppliers, customers, and the local or national community); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 610 (1992); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 26-27 (1992).

particularly “game-ending” decisions like those involving a takeover,¹⁵⁷ that may benefit shareholders and yet have adverse ramifications for stakeholders.¹⁵⁸ Hence, there may be occasions where stakeholder and shareholder interests diverge. However, Bebchuk insists that such divergence does not support a regime of limited shareholder power. This is because there is no reason to expect that managers will effectively protect shareholders’ interests.¹⁵⁹ In fact, Bebchuk argues that managers’ interests do not intersect with those of shareholders except in very limited ways.¹⁶⁰ Because of this, directors are more likely to use their discretion to advance their own self-interests.¹⁶¹ In Bebchuk’s view, because managers do not make effective agents for stakeholders, stakeholders should not be used to justify limits on shareholder power.

However, this Article seeks to respond to the argument in a different manner. Thus, the remainder of Part II seeks to determine whether shareholders can serve as allies for other corporate constituents in a manner that ensures that increased shareholder power will also increase the level of attention provided to other corporate interests.

A. *Multiplicity within Shareholder Ranks*

As an initial matter, the notion that shareholder interests are at odds with those of stakeholders appears to be based on a very narrow and one-dimensional conception of shareholders. Instead, as several scholars have recently pointed out, there are a variety of different shareholders with different sets of concerns.¹⁶² Many of these concerns align with stakeholder concerns.

¹⁵⁷ Game-ending decisions encompass decisions to merge, sell all the corporate assets, or dissolve. *See* Bebchuk, *supra* note 4, at 837.

¹⁵⁸ *See id.* at 909.

¹⁵⁹ *See id.* at 911.

¹⁶⁰ *See id.*

¹⁶¹ *See id.* at 912.

¹⁶² *See, e.g.*, Anabtawi, *supra* note 18, at 564 (noting the various and conflicting interests among shareholders); K.A.D. Camara, *Classifying Institutional Investors*, 30 J. CORP. L. 219, 229–42 (2005) (discussing different investors and their divergent concerns); Lynn Stout, *Shareholders Should Not Always Come First*, FIN. TIMES, Mar. 28, 2005, at 15 [hereinafter Stout, *Shareholders Not Always First*] (noting that many suffer from the mistaken assumption that shareholders in public companies have a single shared interest).

Indeed, one way in which shareholders' interests diverge is in their time horizons. Some shareholders are short-term investors, while others expect to hold their investments for a longer period of time.¹⁶³

Under this dichotomy, there are many shareholders with short-term horizons whose interests appear narrowly focused on financial return. Both mutual funds and hedge funds appear to be driven by the promise of short-term financial gain without regard to the interests of other constituents.¹⁶⁴ Moreover, mutual funds and hedge funds have increasingly larger stakes in the public market, and hence may be responsible for the increased focus on short-term profits.¹⁶⁵ These short-term investors appear to be the paradigmatic investors whose interests conflict with stakeholders. Hence, such shareholders legitimize the contention that increased shareholder power will be detrimental to the interests of stakeholders.

However, there are some investors with long-term horizons whose interests do align with those of stakeholders. These long-term investors, including institutional investors such as insurance companies and pension funds, have an interest in supporting policies that benefit stakeholders.¹⁶⁶ Such shareholders recognize that the corporation must pay heed to the interests of stakeholders in order to promote the long-term health of the corporation. As a result, such investors are willing to forego short-term financial gain.¹⁶⁷

Then too, many scholars have pinpointed the different interests animating diversified and undiversified shareholders. Undiversified shareholders have their investment tied up in one company, while diversified

¹⁶³ See Anabtawi, *supra* note 18, at 579 (explaining conflicting objectives of shareholders with different investment horizons); Matheson & Olson, *supra* note 151, at 1487 (noting long-term objectives of shareholders).

¹⁶⁴ See Anabtawi, *supra* note 18, at 580 (noting that mutual funds and hedge funds have short time horizons that pressure them to focus on short term profits gains); Camara, *supra* note 162, at 239. *But see* Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1445 (2006) (noting that "even the most narrowly focused shareholders" are concerned about other constituents because by advancing the concerns of such constituents, the corporation can avoid litigation and other costs associated with inflicting social harms).

¹⁶⁵ See Anabtawi, *supra* note 18, at 579.

¹⁶⁶ See Anabtawi, *supra* note 18, at 579–80; Matheson & Olson, *supra* note 151, at 1487 (noting that long-term shareholders understand that a corporation's sustained growth depends on focusing on other stakeholders); Ribstein, *supra* note 164, at 1459 ("A firm's long-run profits may depend significantly on satisfying the social demands of consumers, employees and local communities.").

¹⁶⁷ See Anabtawi, *supra* note 18, at 579.

shareholders own stock in a wide variety of corporations.¹⁶⁸ Diversified and undiversified shareholders differ in their concerns regarding externalities—that is, the impact of a given policy on the rest of the market.¹⁶⁹ Undiversified shareholders may only be concerned about the manner in which a given policy will impact their specific corporation.¹⁷⁰ Diversified shareholders worry about the impact of a specific corporation’s policies on the broader society and market because those policies affect the value of the portfolio of shares such investors hold. Diversified shareholders are more likely to care when companies engage in activities that prove detrimental to the broader community.¹⁷¹ Given the large number of diversified shareholders, this insight suggests that there are many investors who are likely to be concerned about the manner in which a corporation’s policies impact the broader pool of stakeholders.

More specifically, of course, there exist shareholders who invest with an eye towards advancing social concerns. These so-called “social investors” include faith-based organizations, pension funds, and socially responsible investor funds.¹⁷² Such shareholders clearly have an interest in issues beyond

¹⁶⁸ See JAMES P. HAWLEY & ANDREW T. WILLIAMS, *THE RISE OF FIDUCIARY CAPITALISM* 21 (2000) (referring to the notion that many shareholders are “universal” investors who “own the economy” as opposed to a specific corporation’s assets); Anabtawi, *supra* note 18, at 583–85; Richard A. Booth, *Stockholders, Stakeholders, and Bagholders (or How Investor Diversification Affects Fiduciary Duty)*, 53 *BUS. LAW.* 429, 434–35 (1998); Lynn A. Stout, *Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May be Right*, 60 *BUS. LAW.* 1435, 1447–48 (2005) [hereinafter Stout, *Ivory Tower*] (noting the interests of universal shareholders differ from those of undiversified shareholders).

¹⁶⁹ See Anabtawi, *supra* note 18, at 579.

¹⁷⁰ Interestingly, this does not mean that undiversified shareholders are unconcerned with stakeholders. Instead, undiversified shareholders tend to have large stakes in a given company. This increases the likelihood that they are long-term investors. Hence, it is likely that such shareholders care deeply about their own firm’s employees, customers, and creditors because their investment is linked with the well-being of these other stakeholder groups. In this regard, it is probably more accurate to state that diversified shareholders are concerned about a broader range of stakeholders.

¹⁷¹ See Anabtawi, *supra* note 18, at 584–85; Booth, *supra* note 168, at 434 (noting diversified investors’ concern for other stakeholders); Stout, *Shareholders Not Always First*, *supra* note 162 (noting conflicting interests between diversified and undiversified shareholders).

¹⁷² See Stout, *Ivory Tower*, *supra* note 168, at 1449 (discussing the social shareholder). While social activism is generally confined to particular investors within the U.S., in other countries there appears to be a broader level of shareholder support for such issues. In fact, mainstream investors in the United Kingdom have led the way in pressuring corporations to provide more robust social responsibility disclosures. See Cynthia A. Williams & John M. Conley, *Is there an Emerging Fiduciary Duty to Consider Human Rights?*, 74 *U. CIN. L. REV.* 75, 95–96, 97–98 (2005).

financial matters. The main purpose of socially responsible investment funds is to invest in ways that focus companies' attention on the impact of their actions on stakeholders.¹⁷³ Similarly, faith-based organizations often invest in companies in order to advance particular stakeholder-based concerns.¹⁷⁴ Then too, union and public pension funds tend to focus on concerns beyond short-term profits.¹⁷⁵

In fact, some shareholders are also stakeholders. The most obvious example of this phenomenon is union pension funds because such funds are comprised of employees and hence presumably seek to advance the interests of employees.¹⁷⁶ A less obvious example is the notion that shareholders also may be both consumers and members of a particular community.¹⁷⁷ This overlap of roles increases the likelihood that shareholders will support the corporate consideration of issues that extend beyond profit.¹⁷⁸

The existence of these and other shareholders whose interests align with stakeholders undermines the contention that investors as a class will object to the advancement of stakeholder concerns or otherwise use their increased power to undercut the interests of stakeholders.

¹⁷³ See George Djurasovic, *The Regulation of Socially Responsible Mutual Funds*, 22 J. CORP. L. 257, 260–61 (1997); Adam K. Kanzer, *Proxy Voting Guidelines and Procedures—Proxy Season 2004*, SL046 ALI-ABA 1, 7 (2005); Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681, 687–89 (2002); Maria O'Brien Hylton, "Socially Responsible" Investing: *Doing Good Versus Doing Well in an Inefficient Market*, 42 AM. U. L. REV. 1, 7 (1992).

¹⁷⁴ See Proffitt & Spicer, *supra* note 13, at 178 (noting that religious organizations were the innovators of every social issues topic later supported by pension funds). The Interfaith Center on Corporate Responsibility was founded in 1971, a group of some 275 faith-based investors whose principal objective is to advance issues of social responsibility. See Amelia J. Uelmen, *Religious Values and Corporate Decision Making: An Interdisciplinary Interfaith Conference for Corporate Executives and Legal Counsel: Foreword*, 11 FORDHAM J. CORP. & FIN. L. 537, 541 (2006); see also Interfaith Center on Corporate Responsibility, About ICCR, <http://www.iccr.org/about> (last visited Feb. 8, 2008).

¹⁷⁵ See Anabtawi, *supra* note 18, at 588–89; Camara, *supra* note 162, at 235; Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 803 (1993).

¹⁷⁶ However, it is also possible that certain pension funds will focus on issues that are not in the best interests of employees. See Romano, *supra* note 175, at 811–14 (discussing the political pressure that often motivates the advocacy of public pension funds).

¹⁷⁷ See Ribstein, *supra* note 164, at 1444.

¹⁷⁸ See *id.*

B. Shareholders as Advocates

The empirical evidence reveals that shareholders play an affirmative role in advancing the interests of stakeholders through the shareholder proposal process. Initially, the proxy rules prohibited shareholders from submitting proposals related to social issues.¹⁷⁹ However, in 1976, the SEC removed this social cause exclusion.¹⁸⁰ When this occurred, several groups emerged that began to use the proposal process to advance stakeholder-oriented issues. Since that time, shareholders have filed numerous proposals every year aimed at addressing stakeholder issues, from requesting sustainability reports to pushing for better employee benefits and environmental policies.¹⁸¹ The Episcopal Church led the way as the first faith-based institution to file a proposal as a shareholder to focus attention on a social issue, in that case

¹⁷⁹ See Solicitation of Proxies, Exchange Act Release No. 4775, 17 Fed. Reg. 11,431 (Dec. 11, 1952) (allowing management to exclude proposals submitted “primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes.”); see also Myron P. Curzan & Mark L. Pelesh, *Revitalizing Corporate Democracy: Control of Investment Managers’ Voting on Social Responsibility Proxy Issues*, 93 HARV. L. REV. 670, 676 (1980) (noting SEC’s view that matters related to political or social issues were not proper subjects for inclusion in the corporation’s proxy materials); Aaron A. Dhir, *Realigning the Corporate Building Blocks: Shareholder Proposals as a Vehicle for Achieving Corporate Social and Human Rights Accountability*, 43 AM. BUS. L.J. 365, 376–77 (2006); Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1152–53 (1993).

¹⁸⁰ In 1970, the D.C. Circuit asked the SEC to revisit the social cause exclusion. In *Medical Committee for Human Rights v. SEC*, shareholders submitted a proposal to Dow Chemical Co. requesting the corporation to cease using and manufacturing napalm. Med. Comm. for Human Rights v. SEC, 432 F.2d 659, 680 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972). When Dow Chemical chose to exclude the proposal, the SEC issued a no-action letter supporting the exclusion. However, in reviewing the decision, the D.C. Circuit indicated that such exclusions were not consistent with the legislative purpose of Section 14(a). See *id.* at 681–82. The court noted that shareholders had a legitimate interest in ensuring that a company’s resources be used in a socially responsible manner. See *id.* at 681. This case prompted the SEC to reverse its position and allow shareholders to submit proposals that advanced social causes. See Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, 41 Fed. Reg. 52,994, 52,998 (Nov. 22, 1976); see also Curzan & Pelesh, *supra* note 179, at 676–77; Fisch, *supra* note 179, at 1154–55.

The SEC replaced the social cause exclusion with a general exclusion for matters relating to the ordinary conduct of a corporation’s business. See *id.* The SEC applied a case-by-case approach to determine if shareholder proposals sufficiently transcended issues related to ordinary business to be deemed valid. See Dhir, *supra* note 179, at 379–82; Palmiter, *supra* note 28, at 892. The results of this application often produced inconsistent results. See Dhir, *supra* note 179, at 380–82.

¹⁸¹ See 2005 PROXY SEASON REPORT, *supra* note 45, at 41; Dhir, *supra* note 179, at 384.

divestment from South Africa.¹⁸² In fact, a recent study reveals that faith-based organizations are generally the first investors to submit proposals on a particular social issue.¹⁸³ Following such groups, public pension funds have been among the most active social investors, filing numerous proposals related to stakeholder concerns.¹⁸⁴ Socially responsible investment funds also use the proposal process to generate dialogue with companies on a variety of stakeholder issues.¹⁸⁵ For example, from 1994–2005, the Domini Funds filed over 100 shareholder resolutions at more than fifty corporations on a variety of social and environmental issues.¹⁸⁶ This data reveals that shareholders do use their voting power to advance stakeholder-oriented issues.

Moreover, these social proposals get the support of other investors. To be sure, social proposals have never received the kind of shareholder support that corporate governance proposals receive.¹⁸⁷ However, many of these proposals have garnered a significant percentage of the shareholder vote.¹⁸⁸ For example, in 1997, a request that Disney link its executive compensation to social and environmental performance garnered 10% of the shareholder vote, while a request that Household International, Inc. link its executive pay to predatory lending performance garnered an impressive 27% of the shareholder vote.¹⁸⁹ In 1999, a request that R.R. Donnelly issue a study on pay equity garnered sixteen percent shareholder support.¹⁹⁰ This support reveals that many shareholders are willing to use their voting rights to support the interests of other stakeholders.

¹⁸² See Patricia Daly, *Viable Models: Shareholder Resolutions*, 11 FORDHAM J. CORP. & FIN. L. 619, 620 (2006). The proposal was filed against General Motors, Inc. See *id.*

¹⁸³ See Proffitt & Spicer, *supra* note 13, at 178. In fact, the study revealed that such entities were the innovators of every topic that pension funds later came to support. See *id.*

¹⁸⁴ See Camara, *supra* note 162, at 235; Romano, *supra* note 175, at 814; see also Schwab & Thomas, *supra* note 35, at 1043–47 (describing labor unions' use of shareholder proposal process).

¹⁸⁵ See Kanzer, *supra* note 173, at 7; Knoll, *supra* note 173, at 689. As will be discussed in *infra* Part II.D, such funds tend to focus on issues of importance to particular segments of the stakeholder population.

¹⁸⁶ See Kanzer, *supra* note 173, at 9–15.

¹⁸⁷ See 2004 PROXY SEASON REPORT, *supra* note 36, at 28 (noting that social proposals have historically received relatively low levels of support, seldom in excess of the 20% mark).

¹⁸⁸ See *id.*

¹⁸⁹ See Kanzer, *supra* note 173, at 9.

¹⁹⁰ See *id.*

This support is critical to gain the attention of management. Indeed, while social investors often pave the way for consideration of stakeholder issues by submitting relevant proposals,¹⁹¹ they do not comprise a large component of the total shareholder class. Thus, social investors need the support of other investors in order for their proposals to garner a significant percentage of the shareholder vote. By highlighting the support social proposals receive from other investors, the proxy data suggests that traditional shareholders can be counted on to use their increased power to support social investors who advance stakeholder issues.

Perhaps most importantly, shareholder activism on these issues has increased along with the activism related to corporate governance issues. Thus, over the last few years, shareholders have submitted an increasingly greater number of proposals associated with stakeholders.¹⁹² In fact, in 2006, the number of social proposals outnumbered the number of proposals submitted on every corporate governance issue other than majority vote and pay-for-performance proposals.¹⁹³ Then too, there has been a steady increase in the level of shareholder support for these issues.¹⁹⁴ Thus, the percentage of proposals receiving a significant level of support nearly doubled from 2005 to 2006.¹⁹⁵ Then too, the average shareholder support for social proposals went from 18% in 2005 to close to 27% in 2006.¹⁹⁶ In fact, in the past few years, many stakeholder-oriented proposals have received a record level of

¹⁹¹ 2005 PROXY SEASON REPORT, *supra* note 45, at 41 (noting that faith-based organizations and labor and union pension funds submit most of the social proposals); Proffitt & Spicer, *supra* note 13, at 166 (same).

¹⁹² The number of proposals filed on these issues has steadily increased from 268 in 2002 to 329 in 2006. 2006 PROXY SEASON REPORT, *supra* note 1, at 31; 2004 PROXY SEASON REPORT, *supra* note 36, at 28 (noting a twenty percent increase in the number of socially oriented proposals filed from 2003 to 2004). As of the end of January 2007, 87 proposals have been submitted on social responsibility issues. See 2007 WATCH LIST, *supra* note 82. This includes 35 on reports related to sustainability, 7 related to reports on energy efficiencies, and 45 on political contributions.

¹⁹³ See 2006 PROXY SEASON REPORT, *supra* note 1, at 30–34.

¹⁹⁴ Beginning in 2003, shareholder proposals began receiving unusually high levels of support. See INVESTOR RESPONSIBILITY RESEARCH CENTER & INTERFAITH CENTER ON CORPORATE RESPONSIBILITY, 2003 SHAREHOLDER PROXY SEASON OVERVIEW: SOCIAL AND CORPORATE GOVERNANCE RESOLUTION TRENDS 2 (2003) (on file with author) [hereinafter SOCIAL TRENDS]; see also Bradley S. Austin & C. Keith Taylor, *Empirical Study: Recent Trends Surrounding the Responsiveness of Corporate Boards of Directors to Shareholder Proposals* (15 WAKE FOREST L. REV., Working Paper No. 2, 2005) (revealing a steady increase in the success rate of social proposals).

¹⁹⁵ 2006 PROXY SEASON REPORT, *supra* note 1, at 30. Twenty-seven percent of such proposals received more than 15% support from shareholders. In 2004 and 2005, only 15% of such proposals achieved this level of support. *Id.*

¹⁹⁶ See *id.*

support. Thus, in 2004, a request that the Coca-Cola Co. generate a report on the operational impact of HIV/AIDS garnered close to 98% of the shareholder vote.¹⁹⁷ Proposals calling for corporations to issue sustainability reports garnered as much as 42% of the shareholder vote.¹⁹⁸ In this same vein, shareholder support for proposals concerning greenhouse gas emissions or climate control reached a new high in 2006, garnering almost 40% of the shareholder vote.¹⁹⁹ Employment-related proposals also saw record levels of support in 2006, with several receiving as much as 35% of the shareholder vote.²⁰⁰ In addition, proposals requesting reports on global labor standards fared well, with one receiving almost 50% of the shareholder vote.²⁰¹ This evidence reveals that shareholders' increased activism and power have not had a negative impact on stakeholder issues. Instead, such concerns appear to have benefited from increased shareholder activism.

Of note, proxy data suggest that social proposals are drawing increased support from institutional and traditional investors as such shareholders have begun to equate good corporate governance with a focus on particular stakeholder concerns, including employees, consumers, and the larger community.²⁰² Indeed, proxy analysts have noted an increased level of collaboration between social investors and more traditional ones.²⁰³ This collaboration has generated a greater level of shareholder support on such

¹⁹⁷ 2004 PROXY SEASON REPORT, *supra* note 36, at 28–30. The proposal, which was backed by management, received 97.93% of the votes cast.

¹⁹⁸ *Id.* at 29. Request for sustainability reports received 20.34% of the vote at NVR Inc., 30.40% of the vote at Cooper Cameron Corp., 32.92% of the vote at Yum! Brands Inc., and 42.19% of the vote at The Ryland Group Inc.

¹⁹⁹ 2006 PROXY SEASON REPORT, *supra* note 1, at 30. Request for reports on energy efficiency plans won 39.3% of the vote at Standard Pacific and 28.7% of the vote at Bed Bath and Beyond. In a similar vein, reports focused on toxic emissions won 31.6% of the vote at one company and 28.9% of the vote at another. *Id.* at 30–31.

²⁰⁰ *Id.* at 33–34. For example, a resolution requesting corporations to amend their non-discrimination policy to include sexual orientation received 34.6% of the shareholder vote at Exxon Mobil and 33.6% of the vote at Expeditors International. *Id.* at 33.

²⁰¹ *Id.* at 32 (discussing a proposal at Lear that received 49.8% of the shareholder vote).

²⁰² See Olubunmi Faleye & Emery Trahan, *Is What's Best for Employees Best for Shareholders?* at 1, 24 (2006), <http://ssrn.com/abstract=888180> (noting that the market appears to value corporate concern for workers); Williams & Conley, *supra* note 172, at 78–79 (discussing trends that have altered society's expectations regarding business).

²⁰³ See 2005 PROXY SEASON REPORT, *supra* note 45, at 41 (noting that the most recent proxy seasons were characterized by increased collaboration between proponents of social responsibility issues and other investors).

issues.²⁰⁴ Moreover, this collaboration has blurred the lines between governance and social issues: traditional investors have begun to view social issues as important to shareholder value while social investors have become increasingly concerned with traditional governance matters.²⁰⁵ This suggests that, far from creating adversaries, activism within shareholder ranks has spurred alliances among shareholders. From this perspective, it is arguable that increased shareholder power may increase the ability of social investors to focus other shareholders' attention on stakeholder-oriented matters.

Then too, shareholders' advocacy on these issues has triggered responses from corporate managers. Proxy analysts tend to measure the success of social proposals in terms of management's willingness to engage shareholders on pertinent issues, rather than the level of shareholder support for such proposals.²⁰⁶ By this measurement, shareholders have experienced considerable success. In characterizing the corporate response to social proposals over the last two years, proxy analysts contend that there has been tremendous cooperation between shareholders and managers. Hence in 2005 and 2006, shareholders withdrew a record number of proposals.²⁰⁷ This withdrawal signals that corporate managers and shareholders have reached consensus regarding the best method to address issues raised by a particular proposal.²⁰⁸ Thus, the data reflect an increased willingness on the part of corporate leaders to engage on these issues.²⁰⁹ This suggests that there has been a "spill-over effect." As managers feel greater pressure to negotiate

²⁰⁴ See Timothy Smith, *Institutional and Social Investors Find Common Ground*, 14 J. OF INVESTING (Fall 2005) (noting that social and environmental issues have been integrated into concerns of institutional investors, leading such investors to support proposals related to these issues); 2004 PROXY SEASON REPORT, *supra* note 36, at 28 (noting that increased support for social proposals stems from the greater support from other traditional investors who view such proposals as important for shareholder value).

²⁰⁵ SOCIAL TRENDS, *supra* note 194, at 1 (noting increased collaboration between traditional shareholders and efforts by labor unions, religious investors, and socially responsible investment companies, which have blurred the lines between social and governance issues).

²⁰⁶ See Proffitt & Spicer, *supra* note 13, at 173.

²⁰⁷ See 2006 PROXY SEASON REPORT, *supra* note 1, at 30. For example, a large number of proposals submitted by Domini regarding expanding employment discrimination policies to include sexual orientation were withdrawn after favorable discussions with corporate management. See Kanzer, *supra* note 173, at 9.

²⁰⁸ See Proffitt & Spicer, *supra* note 13, at 174 (noting that a withdrawn proposal tells an important story about the campaigns' success). Of course, a withdrawn proposal may also signal that management has made some personal concession to the shareholder group at issue. This problem will be addressed in Part III *infra*.

²⁰⁹ 2004 PROXY SEASON REPORT, *supra* note 36, at 28.

with traditional shareholders on corporate governance issues, they also experience pressure to be more cooperative on these social issues.²¹⁰

C. Stakeholder Legitimacy and Shareholder Activism

A recent examination of shareholder activism related to social proposals suggests that shareholders play a critical role in both prompting dialogue on stakeholder issues and eventually legitimizing those issues so that corporate managers and other shareholders take them seriously. Professors Trexler Proffitt and Andrew Spicer examined shareholder proposals over a thirty-five year period.²¹¹ Based on their examination, Proffitt and Spicer likened shareholder activism to a social movement and explained that shareholders play an important role in building momentum for that movement.²¹² There appear to be roughly three stages to the shareholders' role in this regard.

First, shareholders draw attention to an important issue by submitting a proposal. As Proffitt and Spicer note, the submission of shareholder proposals "föcus[es] managerial attention publicly and officially" on a given issue.²¹³ The submission also serves to focus the attention of other shareholders and the broader community.

Second, shareholders' use of the proposal process prompts corporations not only to consider social issues, but also to generate the corporation's position on those issues. In other words, such proposals stimulate both dialogue and a corporate response to a particular issue.²¹⁴ Indeed, the proxy rules provide for corporations to respond to shareholder proposals.²¹⁵ Hence, corporations either must provide a reason for excluding a shareholder proposal or offer a recommendation if the proposal is included in the company's proxy statement.²¹⁶ In either case, this means that corporations must consider and generate a position on the issue.²¹⁷ In this way, shareholders force corporations to, at least rhetorically, address social issues,

²¹⁰ See Austin & Taylor, *supra* note 194, at 26.

²¹¹ See Proffitt & Spicer, *supra* note 13, at 166. Shareholder proposals submitted between 1969 and 2003 were analyzed for the study. Proffitt and Spicer defined social issues as proposals that urged corporations to pay attention to their social responsibilities to the various constituents impacted by their behavior. See *id.*

²¹² See *id.*

²¹³ *Id.* at 173.

²¹⁴ See *id.* (noting that shareholder proposals focus corporate managers to generate de facto policy positions on important social issues).

²¹⁵ See Palmiter, *supra* note 28, at 886-92.

²¹⁶ See *id.*

²¹⁷ See Proffitt & Spicer, *supra* note 13, at 173 (noting that management statements serve as de facto policy positions).

thereby operating as a disclosure forum.²¹⁸ And they do so in a public forum.²¹⁹ Moreover, such a process enables management and concerned shareholders to engage in discussions regarding the most appropriate business solutions to the given issues raised.

Third, shareholders help legitimize an issue either by ensuring that the issue remains on the corporate radar screen or by learning how best to frame the issue in order to gain a broader level of support. Sometimes shareholders help legitimize an issue simply through repeated submissions or by expanding the number of corporations receiving such proposals.²²⁰ This process increases the visibility of the issue and thus its ultimate legitimacy. Indeed, Proffitt and Spicer found that proposals are more likely to be successful after repeated introductions of a proposal on a similar theme.²²¹ More often, however, shareholders create legitimacy by learning how to reframe an issue so that it appeals to a broader audience. What emerges from this reframing is a generalized solution to a particular problem.²²² Thus, Proffitt and Spicer note that social proposals often evolve from a host of individual claims regarding a particular issue to a narrow set of concerns that can be generalized.²²³ In this way, the proposal process serves as a vehicle for shareholders to organize and educate themselves regarding the kinds of issues that resonate with other shareholders and management. This enables social investors to build coalitions with other investors from socially responsible investment funds to mutual funds and other institutional investors.²²⁴

Shareholders' efforts regarding labor issues are illustrative of this kind of process.²²⁵ Shareholders began by targeting specific companies and urging

²¹⁸ See Palmiter, *supra* note 28, at 925 (noting that allowing more social proposals on the corporate proxy statements forces management to "define a position or alert shareholders to a dimension of their investment they had not considered").

²¹⁹ See Proffitt & Spicer, *supra* note 13, at 173.

²²⁰ See *id.* at 175–76 (noting that while an expansion in the number of proposals reduces their success rate, such expansions heighten the visibility of the issue, which contributes to the overall success of the campaign).

²²¹ See *id.* at 167.

²²² See *id.* at 173.

²²³ See *id.* at 183.

²²⁴ See *id.* at 178–79.

²²⁵ Of course, possibly the most successful shareholder proposal campaign has been the one focused on divestment from South Africa. In that case, shareholders began submitting proposals requesting corporations to terminate their activities in South Africa. Eventually, shareholders shifted tactics, requesting that corporations generate detailed reports of their activities in South Africa and their impact on the South African community. See Curzan & Pelesh, *supra* note 179, at 677–80. Support for these kinds of

them to halt unfair labor practices.²²⁶ However, such requests were difficult to implement and hence garnered very little corporate or shareholder support.²²⁷ Eventually, shareholders recognized a more generalized response to the problem, and thus began requesting that corporations adopt codes of conduct and otherwise provide better disclosure on labor conditions.²²⁸ Such tactics not only have garnered support from a broader spectrum of shareholders, but also have prompted a more favorable response from corporate managers, generated better disclosure on the issue, and have focused corporate attention on finding solutions to the problem.²²⁹ Given the complexity of the labor problem, this can be viewed as a success.

As this suggests, shareholders' efforts to advance stakeholder-related concerns can influence corporate policy. Indeed, Proffitt and Spicer explain that while social shareholders have little hope of directly influencing the corporation on their own, their activism has a more long-term trajectory.²³⁰ From this perspective, shareholders represent a critical component of the campaign to advance other concerns, helping both to produce and to shape the stakeholder-oriented agenda. Obviously, this process does not generate success for all issues. In fact, some issues never receive more than small levels of support or visibility.²³¹ But this evidence reveals that shareholders, through their proposal rights, play a key role in ensuring that management focuses on stakeholder concerns.

Perhaps most importantly, this evidence reveals that shareholders do not impact merely isolated issues, but can genuinely influence corporate policy on an on-going basis. Indeed, the evidence reveals that shareholders' proposal strategies have evolved into requests for corporate implementation of policies that ensure a more lasting impact on stakeholders.²³² For example, with respect to environmental issues, shareholders initially requested that corporations halt particular undesirable practices.²³³ However, shareholders now submit proposals encouraging corporations to generate reports

reports increased from 25% in the mid-1980s to almost 70% in the early 1990s. See Proffitt & Spicer, *supra* note 13, at 174–75. This kind of support and the attention generated by shareholder activism represented one of the primary reasons why corporations began to sever ties with South Africa.

²²⁶ See Proffitt & Spicer, *supra* note 13, at 173.

²²⁷ See *id.*

²²⁸ See *id.*

²²⁹ See *id.*

²³⁰ See *id.* at 174.

²³¹ See *id.* (noting that some campaigns end because they fail or move into alternative venues).

²³² See discussion *supra* pages 91–92.

²³³ See Proffitt & Spicer, *supra* note 13, at 173–74.

concerning the environmental impact of their actions and the manner in which corporate practices may be tailored to promote sustainability.²³⁴ A similar phenomenon has developed with respect to labor issues as shareholders have learned to frame their proposal requests for improved labor practices in terms of requests for robust disclosure regarding such practices and implementation of effective workplace codes of conduct.²³⁵ Such measures ensure that corporate response is not short-term or issue-specific, but rather that corporate officers and directors maintain their efforts on behalf of stakeholders. In this regard, shareholders have a powerful impact on stakeholder-oriented corporate policies in the long-term. Shareholder democracy should serve to augment this impact.

D. Differentiating Among Stakeholder Beneficiaries

It is probable that shareholder democracy will benefit some stakeholders more than others. Most references to stakeholders appear to treat them as a single group with uniform interests. Instead, there are a number of different stakeholders including customers, creditors, employees, and the community. These groups have different and sometimes conflicting interests.²³⁶

The empirical evidence suggests that some of these groups benefit more from shareholder democracy than others who may not benefit at all. Specifically, my research did not reveal any evidence that shareholders advocate on behalf of creditors. Indeed, none of the empirical evidence I uncovered revealed that shareholders submit proposals aimed specifically at enhancing the welfare of creditors.²³⁷ Thus, it is not likely that creditors will benefit from any enhanced shareholder power.

²³⁴ *See id.*

²³⁵ *See id.*

²³⁶ Some may contend that the fact that stakeholders have varied, and sometimes conflicting, interests undermines directors' and officers' ability to advance those interests. However, this Article disagrees with that assertion. Instead, this fact just means that corporate officers and directors must weigh and balance each of these stakeholder interests when crafting corporate policies. While this may appear to be a difficult endeavor, it is instead precisely what directors and officers are charged to do on a daily basis. Indeed, given the diversity of interests associated with shareholders, it is very similar to the weighing and balancing that must occur with regard to shareholders. Moreover, it is arguable that allowing shareholders some role in identifying those stakeholder concerns that they believe should be pursued may assist corporate officers and directors in carrying out their responsibilities.

²³⁷ *See infra* notes 238–51 and accompanying text (revealing evidence of shareholder proposals on various social issues impacting groups including consumers and employees, but no corresponding evidence on issues that impact creditors).

By contrast, the empirical evidence suggests that employees should benefit from increased shareholder power. Studies suggest that employee-friendly and labor-friendly policies appeal to shareholders.²³⁸ Then too, data regarding shareholder proposals reveals that employee-related matters are frequent subjects of such proposals.²³⁹ Shareholder proposals focused on workers include calls to buttress anti-discrimination policies²⁴⁰ as well as requests to implement and strengthen workplace codes of conduct.²⁴¹ Then too, these proposals often receive a significant percentage of the shareholder vote.²⁴² Given the concern for employees reflected in the amount of submissions and the level of support associated with employee-related shareholder proposals, it is likely that shareholders will use their increased power to advance employees' interests.

Similarly, shareholders appear to have interests that coincide with those of consumers and customers. Hence, shareholders are concerned with protecting the corporation's brand and products, a concern that resonates with consumers and customers.²⁴³ Then too, historically shareholders have submitted numerous proposals involving consumer health and safety issues, often targeting companies with products viewed as unhealthy or unsafe.²⁴⁴ For example, in 2004, Disney shareholders requested a report on park safety

²³⁸ See Faley & Trahan, *supra* note 202, at 24 (finding that shareholders value corporate concern for workers).

²³⁹ See Proffitt & Spicer, *supra* note 13, at 170–72 (revealing that shareholders historically have used the proposal process to address employment and labor issues both within the United States and abroad).

²⁴⁰ See 2006 PROXY SEASON REPORT, *supra* note 1, at 33–34 (pinpointing increased proposals, equal opportunity measures, and implementation of sexual orientation anti-bias policies); 2005 PROXY SEASON REPORT, *supra* note 45, at 42 (noting increased efforts aimed at anti-discrimination policies); 2004 PROXY SEASON REPORT, *supra* note 36, at 32–33 (noting efforts to adopt anti-discrimination policies that extend to sexual orientation as well as efforts to enhance diversity in the boardroom).

²⁴¹ See Proffitt & Spicer, *supra* note 13, at 170–72; see also 2006 PROXY SEASON REPORT, *supra* note 1, at 32 (noting focus on global labor standards); 2005 PROXY SEASON REPORT, *supra* note 45, at 44–45 (noting shareholders' efforts at encouraging companies to develop and implement codes of conduct); 2004 PROXY SEASON REPORT, *supra* note 36, at 29.

²⁴² See 2006 PROXY SEASON REPORT, *supra* note 1, at 33–34 (showing strong shareholder support for employee-related policies at various companies including Exxon Mobil, Amsouth Bancorp, and Lockheed Martin); 2005 PROXY SEASON REPORT, *supra* note 45, at 42, 45 (revealing strong support for proposals at Emerson Electric Company, Exxon Mobil, Boeing Co., and Bed Bath & Beyond, Inc.).

²⁴³ See Ribstein, *supra* note 164, at 1452–54.

²⁴⁴ See 2005 PROXY SEASON REPORT, *supra* note 45, at 48–49; 2004 PROXY SEASON REPORT, *supra* note 36, at 31–32; see also Proffitt & Spicer, *supra* note 13, at 171 (noting shareholder proposals' historical focus on health and safety issues).

standards in an effort to boost and maintain customer safety within the company's various amusement parks.²⁴⁵ Like those involving employees, such proposals have generated significant support at various companies.²⁴⁶

Investors also have exhibited significant concern for the community and broader society. For example, in 2007, the social issues that received the most attention from shareholders were those centered on environmental concerns that impact the community.²⁴⁷ Hence, shareholders submitted more social proposals on sustainability and energy efficiency than any other type of proposal.²⁴⁸ Similarly, in 2004 and 2005, shareholders submitted a record number of proposals focused on the impact of toxic chemicals and greenhouse gas emissions on local communities.²⁴⁹ This pattern is consistent with the historical data, which reveals that issues regarding energy and the environment often dominate the social proposal agenda.²⁵⁰ These issues also draw strong support from shareholders.²⁵¹ Such support should only expand if shareholders obtain greater power within the corporation. Shareholders' advocacy on behalf of the community coupled with their efforts on behalf of employees and consumers reveals that many, but not all, stakeholders should benefit from increased shareholder power.

E. Concluding Assessments

This Part demonstrates not only that shareholders have interests that are compatible with other stakeholders, but also that they act on those interests in ways that influence corporate practices both short-term and long-term. Such a demonstration suggests that increased shareholder power may serve the interests of stakeholders. This Part also points out that stakeholders whose interests do not align with shareholders' interests may not benefit from shareholder empowerment. However, because the vast majority of stakeholders have interests that collide with shareholders, this Part reveals that on the whole, increased shareholder power should have positive repercussions for stakeholders.

²⁴⁵ See 2004 PROXY SEASON REPORT, *supra* note 36, at 32.

²⁴⁶ See *id.*

²⁴⁷ See 2007 WATCH LIST, *supra* note 82.

²⁴⁸ See *id.*

²⁴⁹ See 2005 PROXY SEASON REPORT, *supra* note 45, at 43; 2004 PROXY SEASON REPORT, *supra* note 36, at 30–31.

²⁵⁰ See Proffitt & Spicer, *supra* note 13, at 171.

²⁵¹ See 2004 PROXY SEASON REPORT, *supra* note 36, at 29.

III. SOME NOTES OF CAUTION

Of course, enhancing shareholder power will not necessarily lead to the advancement of stakeholder issues. Indeed, there are some factors that may undermine the extent to which a regime of increased shareholder power will benefit stakeholders. This Part pinpoints some of the most important of those factors, and discusses the extent to which they can be mitigated.

A. *Bolstering the Shareholder Primacy Norm*

It is entirely possible that increasing shareholder power could lead directors and officers to believe that their primary, if not exclusive, obligation is to focus on shareholders and their profit-making concerns. In corporate law, there has been a long-standing debate regarding the proper aims of corporate managers.²⁵² Some endorse the “shareholder primacy” norm, which maintains that corporate managers should focus primarily, if not exclusively, on maximizing shareholder profit.²⁵³ Others support the “social entity” or “stakeholder” theory of the firm, which maintains that corporate managers should seek to maximize the interests of all the constituents impacted by the corporation.²⁵⁴ While most scholars appear to agree on the

²⁵² See, e.g., Henry N. Butler & Fred S. McChesney, *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195, 1195 (1999) (noting that the issues have been debated *ad nauseam*); William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264 (1992) (explaining the competing conceptions of corporate law that have dominated our society).

²⁵³ See Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932) (arguing that corporations exist to enhance shareholder profit).

²⁵⁴ See E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147–48 (1932) (pinpointing corporation’s responsibilities to all corporate constituents and broader society); see also William W. Bratton, *The Economic Structure of the Post-Contractual Corporation*, 87 NW. U. L. REV. 180, 208–15 (1992) (discussing stakeholder theory); Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173, 184–86 (1997).

dominance of the shareholder primacy norm,²⁵⁵ others contend that it is neither normatively nor descriptively accurate.²⁵⁶

Increasing shareholder power appears to strengthen the legitimacy of the shareholder primacy norm. Indeed, shifting power into the hands of shareholders suggests that corporate managers *should* be accountable only to shareholders. It therefore also suggests that corporate managers should not have discretion to focus on non-shareholders. From this perspective, adopting a regime of increased shareholder power appears to settle the debate regarding the proper aims of corporate managers in favor of shareholder primacy.

In so doing, it also may cause directors and officers to believe that they do not have the flexibility to focus on stakeholders. Indeed, the shareholder primacy norm, at least in its strictest sense, appears to suggest that corporate managers should not take into account the interests of other constituents, particularly when those interests collide with shareholders' profit concerns.²⁵⁷ To be sure, this suggestion may be precisely what advocates of shareholder power intend to result from a regime of shareholder democracy. Indeed, as other scholars have recognized, corporate law allows managers considerable flexibility in carrying out their fiduciary duties, pursuant to which managers have discretion to attend to a variety of different interests.²⁵⁸ Even in a regime of increased shareholder power, corporate law will continue to allow such flexibility, and hence, managers will continue to have such discretion.²⁵⁹ However, Bebchuk believes that the principle benefit of increased shareholder power is the impact it will have on influencing management's behavior.²⁶⁰ In other words, Bebchuk believes that increased power will channel managerial discretion towards shareholders. If this occurs, directors and officers may feel constrained in their ability to focus on

²⁵⁵ See Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."); see also Ronald Chen & Jon Hanson, *The Illusion of Law: The Legitimizing Schemas of Modern Policy and Corporate Law*, 103 MICH. L. REV. 1, 37 (2004) (noting the dominance of the shareholder primacy norm).

²⁵⁶ See Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 406 (2001).

²⁵⁷ See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (noting a duty to focus on profit concerns without focus on other interests).

²⁵⁸ See Blair & Stout, *supra* note 256.

²⁵⁹ Bainbridge has indicated that allowing shareholders greater authority necessarily intrudes on the power and discretion of directors. See Bainbridge, *Director Primacy*, *supra* note 5, at 1747 (noting that directors cannot be held more accountable without also undermining their discretion).

²⁶⁰ See Bebchuk, *supra* note 4, at 878.

issues beyond shareholder wealth maximization. Thus, by strengthening the normative legitimacy of shareholder primacy, increasing shareholder power may decrease managers' willingness and ability to pay heed to stakeholders.

Bebchuk appears to dismiss this concern because it presumes that directors and officers use their discretion to advance stakeholder issues. Instead, Bebchuk emphasizes the likelihood that directors and officers use their discretion to advance their own self-serving goals.²⁶¹ Because he presumes that managers do not necessarily consider stakeholders' interests, Bebchuk suggests that stakeholders are not worse off in a regime where such considerations are discouraged.

While recognizing that managers can and do use their discretion for improper ends, this Article disagrees with the presumption that such actors do not also use their discretion to focus on stakeholder concerns. Hence, this Article contends that it would be extremely problematic if increased shareholder power resulted in legitimizing the shareholder primacy norm in its strictest sense.

However, such a result is not inevitable. Indeed, even if increased shareholder power encourages managers to focus on shareholders, if shareholders demonstrate a concern for stakeholders, then managers will come to appreciate that a focus on shareholders includes a commitment to stakeholders. As Professor Larry Ribstein notes, if shareholders are interested in issues beyond strict profits, then managers who act in shareholders' interests must consider such issues, even when they diverge from profit maximization.²⁶² In his view, shareholders' interests in these social issues undercut the belief that managers must be free from shareholder power in order to pursue the objectives of non-shareholders.²⁶³ Others similarly have pointed out that when groups successfully mobilize shareholder support on a social issue, it ensures that boards consider those issues as part of the process of considering shareholder concerns.²⁶⁴ Shareholder support for these issues counteracts the notion that maximizing shareholder interests requires strict adherence to profit concerns.

Then too, the evidence appears to confirm that when shareholders advance stakeholder-oriented issues, directors and officers feel some responsibility to focus on them. Hence, Part II revealed that corporations respond to shareholder proposals regarding other constituents when those proposals receive a significant portion of the shareholder vote.

²⁶¹ See *id.* at 911.

²⁶² See Ribstein, *supra* note 164, at 1442 (“[M]anagers who are accountable to shareholders have significant incentives to maximize social wealth rather than just accounting profits.”).

²⁶³ See *id.*

²⁶⁴ See Schwab & Thomas, *supra* note 35, at 1089–90.

Of course, this observation suggests that stakeholders' claims may not be adequately addressed if shareholders do not support them. Hence, in a regime of increased shareholder power, stakeholders must pay added attention to building coalitions with shareholders. Interestingly, the evidence suggests that this dynamic is already occurring. Thus, proxy data reveals that stakeholders and their advocates have paid particular attention to building broader levels of support by shaping their claims in terms of shareholder value. Such a strategy will be especially important in a system of expanded shareholder democracy.

B. *Prioritizing Stakeholder Concerns*

A second potential concern relates to the fact that social issues do not receive as much shareholder support as other corporate governance proposals that are linked to profit. In fact, historically such issues have fared less well than governance matters.²⁶⁵ Moreover, even though support for such measures has increased within the last few years, that support lags behind the level of support received for governance matters.²⁶⁶ This relatively low level of support for stakeholder-oriented issues may signal that shareholders view such issues as less important, thereby suggesting that such issues should be subordinated.

This is likely an accurate assessment of shareholders' interests. In other words, it is probably true that while shareholders are concerned about issues pertaining to other stakeholders, they do not want such issues to overwhelm the corporation and its ability to generate firm value. For those who support the shareholder primacy norm, the fact that these issues receive less support may prove comforting because it suggests that they are given their proper weight within the corporate framework.

On the one hand, this fact does not negate shareholders' ability to serve as allies for stakeholders. Indeed, Part II revealed that shareholders can and do play a critical role in advancing the concerns of other constituents. In fact, there are some issues where shareholder support has been fairly significant. At the very least then, shareholder support can identify for management those issues that shareholders believe merit attention as well as those issues that should supercede profit concerns. As some scholars argue, obtaining shareholder input may provide managers with useful cues regarding how best to balance such interests.²⁶⁷

On the other hand, the relatively low level of support stakeholder proposals receive reveals that the alliance between shareholders and

²⁶⁵ See 2004 PROXY SEASON REPORT, *supra* note 36, at 28.

²⁶⁶ See *id.*

²⁶⁷ See Matheson & Olson, *supra* note 151, at 1488–89.

stakeholders has its limits. In other words, it suggests that stakeholders cannot rely solely on shareholders to advance their claims. Indeed, the interests of shareholders and stakeholders do not always align. Stakeholders must become adept at learning to use their alliance with shareholders to exploit areas of commonality, while recognizing those areas pursuant to which other strategies must be employed.

C. *Special Interests Shareholders and their Power to Exploit*

One concern that several scholars have emphasized is the potential that granting shareholders enhanced power will give certain investors a greater ability to advance their own special, personal interests at the expense of the corporation as a whole. Thus, Bainbridge has expressed concern that increased shareholder power would simply provide investors more concerned with political interests than economic ones with greater leverage.²⁶⁸ In fact, it appears that some of the most active shareholders are particularly susceptible to political influence. Hence, Professor Roberta Romano points out that public pension funds face intense political pressure to focus on narrow personal and social issues.²⁶⁹ Other scholars similarly pinpoint the tendency of investors such as public pensions and labor unions to pursue their own interests without regard to how they impact the corporation as a whole.²⁷⁰ For example, there is some evidence that labor unions initiate shareholder proposals after failed talks with management.²⁷¹ This evidence suggests that increasing shareholder power will only augment the ability of certain investors to advance their narrow political or personal goals.

One easy response to this concern is that investors who seek to advance their own narrow self-interests are not likely to get the support of other shareholders, whose support may be necessary to capture the attention of corporate managers. In other words, in order to capture the attention of management, shareholder proposals must receive significant support from shareholders. This means that investors must garner the support of their fellow shareholders.²⁷² Such support is not likely to be forthcoming if an

²⁶⁸ See Bainbridge, *Director Primacy*, *supra* note 5, at 1754.

²⁶⁹ See Romano, *supra* note 175, 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).

²⁷⁰ See Frank S. Partnoy & Randall S. Thomas, *Gap Filling, Hedge Funds, and Financial Innovation 5* (Brookings-Nomura Papers on Financial Services, Working Paper Mp. 06–21, 2006), available at <http://ssrn.com/abstract=931254>.

²⁷¹ See *id.* at 14; Schwab & Thomas, *supra* note 35, at 1022–23.

²⁷² See Partnoy & Thomas, *supra* note 270, at 14–15; Schwab & Thomas, *supra* note 35, at 1035–36, 1082–83 (noting that labor initiatives cannot succeed without the

investor seeks to advance her own narrow personal agenda.²⁷³ Instead, investors will gravitate towards those issues that enhance the overall health of the corporation or that a broad range of shareholders otherwise view as important.²⁷⁴ This suggests that shareholder democracy will weed out all but the most value enhancing initiatives, undercutting shareholders' ability to advance their personal agenda.

Unfortunately, such a suggestion is not entirely satisfactory. Indeed, even Bebchuk acknowledges that shareholders' influence will stem primarily from indirect channels—that is, shareholders' increased power will translate into an enhanced ability to negotiate with directors rather than an augmented ability to garner majority support for their initiatives.²⁷⁵ In such a regime, an investor's ability to garner the support of other investors may be important, but is not critical to the success of the investor's campaign. Instead, the fact that shareholders have increased power will serve to pressure directors and officers to more readily comply with investors' wishes. Indeed, management may concede to investors' demands to avoid the costs and negative publicity associated with a drawn-out battle with shareholders. This may be particularly true in today's post-Enron environment where the public has less confidence in business leaders, and prosecutors have been more willing to hold such leaders accountable for corporate failings. Hence, it seems realistic to presume that increased shareholder power will allow some investors to advance their personal agendas.

In fact, such an occurrence seems to be an inevitable by-product of enhanced shareholder power. While this concern may not undercut the propriety of shareholder democracy, it does merit special recognition so that strategies can be developed to mitigate this potential for abuse. In this regard, we should be mindful of the fact that while there may be instances in which shareholders have been able to advance their own narrow concerns, there also appear to be occasions where corporate managers have successfully thwarted such efforts. What does this mean with regard to stakeholders?

On the one hand, there may be some reason to believe that this problem is especially acute in the context of investors seeking to advance stakeholder interests. First, the discussion thus far, which highlights the potential for

support of other shareholders, which will not emerge unless they relate to issues that have the potential to improve corporate performance); *Battling for Corporate America*, *supra* note 104, at 71 (“[P]olitically motivated shareholders and hedge funds are likely to gain any real power over management only if they can persuade the usually passive majority to support them.”).

²⁷³ See Partnoy & Thomas, *supra* note 270, at 14–15; Schwab & Thomas, *supra* note 35, at 1035–36, 1082–83; *Battling for Corporate America*, *supra* note 104, at 71.

²⁷⁴ See Schwab & Thomas, *supra* note 35, at 1041–42.

²⁷⁵ See Bebchuk, *supra* note 4, at 878.

social investors to advance their claim within a regime of increased shareholder power, likely confirms fears that shareholder democracy will lead to the advancement of personal interests at the expense of corporate concerns. Indeed, social investors appear to be the group most likely to advance interests at odds with the overall welfare of the corporation. In fact, many such investors, such as faith-based institutions, take positions in corporations with the sole purpose of advancing some broader societal concern, which may not necessarily resonate with the rest of the shareholder body. In this regard, this Article may confirm the notion that shareholder democracy will bolster investors' ability to advance issues of little concern to corporate well-being.

Second, social investors need less shareholder support to gain legitimacy for their concerns, undermining the extent to which other shareholders can serve as a filter for such concerns. Indeed, because social proposals tend to receive a smaller percentage of the shareholder vote, proxy analysts acknowledge that such investors measure their success in terms of support levels that are less than a majority. Hence, some analysts define success in terms of proposals that receive more than 20% of the vote,²⁷⁶ while others view 10% of the shareholder vote as a sign of success.²⁷⁷ Analysts suggest that once the level of shareholder support surpasses these thresholds, there is a greater likelihood that corporate managers will pay heed to them.²⁷⁸ This suggests that such investors do not need the broad support of shareholders in order to press their claims, increasing the likelihood that such investors will be able to advance issues that do not resonate with the corporation as a whole.

Then too, the fact that a principal strategy of stakeholder-oriented investors is to seek a negotiated resolution with management also may enhance their ability to influence corporate practices. Hence, social investors also view success in terms of the number of withdrawn proposals that occur within a given proxy season because withdrawal rates suggest increased dialogue with managers. As Part II revealed, such withdrawals have occurred with greater frequency in recent years. The fact that many proposals never reach a vote bolsters the notion that shareholders' tendency to abuse their influence will not be curtailed by other investors. Indeed, Proffitt and Spicer note that the rate of withdrawn proposals does not necessarily signal success in terms of the campaign's ability to advance a social issue of concern to the corporation more generally.²⁷⁹ Instead, such withdrawn proposals may suggest that investors have been able to extract some personal gain from the

²⁷⁶ See 2004 PROXY SEASON REPORT, *supra* note 36, at 28.

²⁷⁷ See Proffitt & Spicer, *supra* note 13, at 173–74.

²⁷⁸ See *id.*

²⁷⁹ See *id.* at 174.

corporation.²⁸⁰ Because these negotiated withdrawals are private, it is not clear if this is in fact the result. In this regard, stakeholder-oriented investors may be uniquely positioned to take advantage of their increased power to advance policies that do not benefit the corporation as a whole.

On the other hand, a realistic assessment of the historical proxy data suggests that such investors' ability to exploit corporate managers may be overblown. First, the evidence indicates that corporations are more likely to seek exclusions of social proposals than any other kind of proposal.²⁸¹ This suggests that corporations are more willing to discount the importance of these proposals. Such a suggestion is confirmed by other scholars who observe that managers are particularly suspicious of, and hostile towards, proposals submitted by social investors.²⁸² Second, other investors tend to be especially suspicious of the motives of social investors, which should bolster management's willingness to reject concerns raised by them.²⁸³ Third, empirical evidence suggests that the SEC is more likely to allow corporations to exclude proposals submitted by social investors.²⁸⁴ This should bolster managers' confidence in challenging such proposals. Moreover, it suggests that while such proposals may not need majority support, they appear to be subject to some of the most intense scrutiny from corporate managers, shareholders, and the SEC. The resistance that such proposals receive increases the likelihood that only those proposals with broad-based appeal achieve success. Indeed, the empirical evidence reveals that social proposals tend to achieve success (even success in terms of a negotiated withdrawal or surpassing 10–20% of the vote) only after extended efforts at coalition building and repeated proposal submissions.²⁸⁵ By contrast, many admittedly narrow and personal shareholder proposals either are routinely excluded or receive infinitesimal percentages of the shareholder vote. In this regard, we may be the least concerned with activism by social investors. Illustrative of this hypothesis, proxy analysts consistently have emphasized that social investors' recent success stems from their ability to find common ground with other traditional investors and develop agendas that focus more broadly on firm value.

²⁸⁰ *See id.*

²⁸¹ *See* 2006 PROXY SEASON REPORT, *supra* note 1, at 30.

²⁸² *See* Schwab & Thomas, *supra* note 35, at 1041–42 (noting that investors must overcome the hostility of management).

²⁸³ *See id.* at 1036.

²⁸⁴ *See* Palmiter, *supra* note 28, at 913–14.

²⁸⁵ *See* Proffitt & Spicer, *supra* note 13, at 178–79.

D. *The Danger of Hedge Funds*

Another concern is that the kinds of shareholders who are most active may have interests diametrically opposed to stakeholders. Specifically, hedge funds have been very active in this new campaign for shareholder democracy.²⁸⁶ Hedge funds tend to have greater success than traditional shareholders because they have greater resources, financial innovation, and flexibility.²⁸⁷ Indeed, hedge funds have moved beyond using the shareholder proposal process and have sought to negotiate directly with management. Moreover, hedge funds often couple their voting campaign with a threat of a proxy contest for corporate control.²⁸⁸ This threat dramatically increases their bargaining position. As a result, hedge funds have been successful at impacting corporate policies.

Unfortunately, hedge funds are not the kinds of shareholders who are likely to advance stakeholder issues. Instead, hedge funds tend to have very short-term horizons.²⁸⁹ If these are the kinds of shareholders who are most likely to use increased shareholder power, then that increase will not prove beneficial to stakeholders.

This observation does not mean that all shareholder power is bad for stakeholders; rather it suggests that such power can be problematic in the hands of certain shareholders. As a result, we need to monitor the types of shareholders who wield power. To this end, it is noteworthy that social investors have experienced success even as hedge funds have increased their activism.²⁹⁰ Then too, some corporations, in the face of considerable pressure, have effectively resisted hedge fund efforts that corporate managers perceive as detrimental to the corporation's best interests.²⁹¹ This suggests that managers as well as stakeholders can counteract less productive forces.

IV. CONCLUSION

Shareholder democracy is on the rise. Thus, shareholders have submitted a record number of proposals on a variety of different governance initiatives,

²⁸⁶ See Partnoy & Thomas, *supra* note 270, at 22. For a definition of hedge funds, see *id.* at 23.

²⁸⁷ See *id.* at 22.

²⁸⁸ See *id.* at 49.

²⁸⁹ See *id.* at 22.

²⁹⁰ See 2006 PROXY SEASON REPORT, *supra* note 1, at 28.

²⁹¹ See, e.g., Micheline Maynard & Nick Bunkley, *One Threat Averted but More Await GM*, N.Y. TIMES, Dec. 2, 2006, at C1; Micheline Maynard, *Kerkorian Retreats from GM*, N.Y. TIMES, Dec. 1, 2006, at C1 (noting GM's success in resisting the efforts of hedge fund manager Kirk Kerkorian).

and those proposals have garnered a record level of shareholder support. This support has prompted corporations to alter their governance policies, while prompting legislatures to alter corporate law to ensure the legitimacy and effectiveness of these policies.

Shareholder democracy has not been greeted with enthusiasm by the corporate community. Certainly, some welcome increased shareholder power as an appropriate and effective mechanism for ensuring greater managerial accountability and, hence, improving corporate value. Yet others express reservations about the propriety and potential effectiveness of shareholder democracy. Most notably, Professor Bainbridge asks, given the historical success of the American business model, why should we dramatically alter it? In fact, a centralized decision-making regime with limited shareholder power is a necessary and effective feature of efficient corporate governance.

Others, however, question the legitimacy of shareholder democracy based on its potential to hinder the advancement of concerns associated with stakeholders. Indeed, shifting power into the hands of shareholders has the potential to ensure that such power is used only in the pursuit of short-term financial gain, without regard to the interests of other corporate constituents.

Yet, this Article maintains that this objection to shareholder democracy is flawed. Instead, there are shareholders who have interests that align with stakeholders. Moreover, the empirical evidence indicates that those shareholders not only actively seek to advance the concerns of stakeholders, but also build support for those concerns so that they garner the attention of corporate managers and other more traditional shareholders. Such support ensures that shareholders play a critical role in shaping long-term corporate policy on behalf of stakeholders. Hence, the empirical evidence confirms the notion that shareholders can and will be effective allies for stakeholders.

To be sure, there are some stakeholders, such as creditors, that may not benefit from shareholder empowerment. Indeed, shareholders tend to gravitate towards employees, consumers, and the community. Hence, such groups can expect that shareholders will use their enhanced power to enhance corporate focus on their concerns. In this regard, many, but not all, stakeholders may view shareholder democracy as a positive development.

In addition, there are many factors that may hinder shareholders' ability to be effective advocates for stakeholders. Nonetheless, these concerns do not detract from the possibility that increased shareholder power can benefit a large variety of stakeholders.

Perhaps most importantly, if some form of increased shareholder power is inevitable, then stakeholders must assess how and to what extent that power can be used for their benefit. Indeed, Professor Bebchuk would like to dismiss stakeholders completely from the debate regarding shareholder

democracy and relegate them to the role of bystander.²⁹² However, if stakeholders desire to have an effective voice in this seemingly new corporate governance regime, they should resist that diminished role. Instead, stakeholders need to affirmatively assess the ways in which this new democracy not only increases the rights of shareholders, but also enhances the interests of all corporate constituents.

²⁹² See Bebchuk, *supra* note 4, at 912.