Ask the Smart Money: Shareholder Votes by a "Majority of the Quality Shareholders"

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Corporate directors, shareholders, judges, and scholars are on edge. Directors yearn for a certain kind of shareholder, especially one that is patient and focused on the company, as opposed to indexers, who must hold it as part of their basket, or traders, who own fleetingly. Shareholders want a voice, and that patient-focused cohort has the softest one today, crowded out by indexers, like BlackRock, and legions of day traders, like those stalking GameStop. Courts, struggling under the conflicting pull of the business judgment rule and fairness scrutiny, look to shareholder voice as a solution. Yet scholars are troubled by the extensive weight judges give to shareholder voice, particularly to insulate director decisions from review.

While a perfect solution to these multiple conundrums is a pipe dream, there is one that will meet the appetite of many directors and shareholders, while easing the judicial burden and scholarly angst: on corporate matters where stakes run high, directors should submit proposals to a special vote of the patient-focused shareholders, in addition to any other vote required by law or contract. Directors achieve an important goal of cultivating this shareholder cohort; those shareholders appreciate their voice being temporarily amplified, without disenfranchising other shareholders; judges get a reliable datapoint for choosing between deference or scrutiny; and scholars are assured an additional source of investor protection. Not perfect, but inexpensive, useful, and posing scant downside. This Article explains the concept and puts it into historical, jurisprudential, and contemporary context.

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INTRODUCTION

Shareholders lost billions of dollars in one of the bitterest corporate battles of the past decade: Dell Inc.'s 2013 going private in a cash-out merger.[1] Founder and majority shareholder Michael Dell offered a price far below value — less than $14 for a stock later appraised at nearly $18.[2] Following conventional practice, a special Dell Inc. board committee added a condition that the deal be approved by a majority of the non-founder shares (called a "majority of minority" or MoM condition).[3]

A fierce fight followed, pitting Dell against such long-term and focused shareholders as Southeastern Asset Management and T. Rowe Price (called quality shareholders or QSs),[4] as short-term speculators piled in and passive index funds stood by. After only slightly improved terms, Dell narrowly eked out the required shareholder votes of 51%, and the shareholders ate a loss of $4 per share.[5] Those lost billions could have been saved by the device this Article introduces: a condition that the deal also be approved by a majority of shares owned by quality shareholders (call this a "majority of quality" or MoQ condition).

Cases like Dell stoke debate, as corporate proposals approved by independent committees and MoMs win directors significant judicial deference.[6] Observers discern a trend toward greater judicial deference

[1] *See* Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590, 595-610 (2016) (from June 2012 to May 2016, Dell MBO embarked on the journey to take their public company private).

[2] *Id.* at 609 (the offer was $13.75; a judicial appraisal proceeding after the transaction found the per share value was $17.62).

[3] *See* Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393, 402 (2003); Edward B. Rock, *MOM Approval in a World of Active Shareholders* 11 (Eur. Corp. Governance Instit. (ECGI), Working Paper No. 389, 2018).

[4] *See* Lawrence A. Cunningham, *Catering to the Quality Shareholders You Want*, NACD DIRECTORSHIP (May/June 2019), https://www.nacdonline.org/insights/magazine/article.cfm?ItemNumber=65491 [https://perma.cc/JW26-LQVG]; Buck Hartzell, *How to Find Companies with Quality Shareholders*, MOTLEY FOOL (Sept. 10, 2020, 6:54 PM), https://www.fool.com/investing/2020/09/10/how-to-find-companies-with-quality-shareholders [https://perma.cc/5RAN-PVEL]; Brian Langis, *Who Are the Quality Shareholders and Why Have Them?*, VALUE WALK (June 8, 2020, 3:52 PM) https://www.valuewalk.com/2020/06/quality-shareholders [https://perma.cc/9XGV-TJLW].

[5] Subramanian, *supra* note 1, at 608-09 (the fair value of Dell's shares at the time of closing of the transaction was found to be $17.62 per share, even though the deal price was negotiated at $13.75 per share).

[6] *E.g.*, Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312-14 (Del. 2015); Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644-45 (Del. 2014). Doctrinally, while courts would otherwise scrutinize board decisions in such settings for "entire fairness," taking

to these private arrangements, due in part to the rise of independent directors and, according to many, the increasing sophistication of shareholders.[7] In prevailing debate, some portray today's deference as an undesirable retreat from the judiciary's important disciplining role[8] while others pronounce the triumph of private market forces that happily rings the death knell for corporate law.[9] Yet others believe the current ad hoc approach works[10] while skeptics offer wholesale shifts.[11]

This Article takes a different view. First, while directors have certainly become more independent, it remains unclear if this contributes to increased firm value.[12] More importantly, while shareholders have become more institutional, they are neither monolithic nor omniscient.[13] Varying in their strategies and behavior, their votes on director proposals contain different signals that might warrant different judicial interpretations.

For instance, in a recognized body of academic research, institutional shareholders are segmented by time horizon and portfolio concentration.[14] Three dominant groups are indexers, who are long-term but never concentrate; transients, who may concentrate but never for long; and quality shareholders, who are both long-term and concentrated.[15] The quality of their voting may vary accordingly, and judges might prudently take such shareholder segmentation into consideration when weighing a vote's influence on judicial review of director decisions.

these two steps shifts the standard to business judgement rule deference, all but assuring no rebuke.

[7] *See infra* Appendices A, B.

[8] *E.g.*, Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. 161, 198-204 (2019); James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323, 380-81 (2018); Charles R. Korsmo, *Delaware's Retreat from Judicial Scrutiny of Mergers*, 10 U.C. IRVINE L. REV. 55, 61 (2019).

[9] Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263, 285-89 (2019).

[10] *See* Matteo Gatti, *Did Delaware Really Kill Corporate Law? Shareholder Protection in a Post-*Corwin *World*, 16 N.Y.U. J.L. & BUS. 345, 415 (2020).

[11] *E.g.*, Ann Lipton, *Shareholder Divorce Court*, 44 J. CORP. L. 297, 321-25 (2018).

[12] *See* Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811, 1857-59 (2020); *see infra* Part I.A.

[13] *See infra* text accompanying notes 170–205.

[14] *See* Brian Bushee, *Identifying and Attracting the "Right" Investors: Evidence on the Behavior of Institutional Investors*, 16 J. APPLIED CORP. FIN. 28, 29 (2004).

[15] *Id.* For examples, see *infra* text accompanying notes 178–182 (highlighting noted indexers are BlackRock, State Street, Vanguard; noted transients are AQR, AIM and Tradebot; and noted quality are Capital Research, Fidelity, and Wellington).

Second, judicial deference to such decisions may be approaching a zenith, but that is where Delaware courts have repeatedly invited corporate directors and shareholders to reach.[16] A review of the case law dating back nearly a century shows repeated deference to both independent directors and shareholder votes, long before the contemporary rise of institutional shareholders.

In fact, early cases express confidence in the shareholders of the day, largely individuals and families, who followed traditional buy-and-hold investment strategies.[17] The prevailing portrait of such institutions as "sophisticated," in contrast to individuals, is belied by the recent pattern of individual shareholders successfully outfoxing such institutions, at companies such as GameStop and AMC Entertainment.[18]

Third, rather than lamenting judicial retreat or celebrating a wake for corporate law's death, it is better to invent tools for directors to use in seeking shareholder approval and for courts to reference when deciding what weight to give it. Directors have long conditioned certain transactions on approval by such cohorts as a supermajority of the whole or majority of the minority or both.[19] This Article proposes another tool: the MoQ as an additional separate vote of those with the longest holding periods and highest concentration. Many directors and companies try to cultivate such shareholders through a variety of

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[16] *See infra* text accompanying notes 116–128.

[17] *See* John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 848 (1999) (noting salience of controlling shareholders in earlier periods); *infra* note 79 and accompanying text.

[18] *See* Caitlin Reilly, *Wall Street 'Hate' Seen Driving GameStop Trades*, ROLL CALL (Jan. 29, 2021, 3:24 PM), https://www.rollcall.com/2021/01/29/wall-street-hate-seen-driving-gamestop-trades [https://perma.cc/TGN3-2SL3].

[19] *E.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 707 (Del. 1983). Separate votes of different classes of stock are also sometimes required by law or corporate charter. *E.g.*, DEL. CODE ANN. tit. 8 § 242(b)(2) (2020) (requiring separate class voting on charter amendments that alter the rights of a class); VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1111 (Del. 2005) (comparing California and Delaware law on class voting on mergers). MoQs are analogous to dual class capital structures, where two classes have different voting rights, often with a high-vote class held by founders.) *See* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 590-91 (2016). The concepts may have the same rationale that certain shareholders — founders in particular, QSs in general — are uniquely focused and patient. On the other hand, dual class is criticized for insulating management from accountability and diminishing power of the rest of the shareholder body. *See* Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote, and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 468-69 (2008). MoQs have neither drawback. *See infra* text accompanying notes 248–249.

corporate policies, from communications to dividends, making this additional tool particularly appealing to that group.[20]

Boards opting to add this condition would have discretion in defining requisite duration and concentration. Their best starting point is to adapt the empirical academic research that developed the shareholder segmentation model.[21] The model has been applied to shareholder voting generally[22] and to the particular context of judicial review of board decisions approved by shareholders.[23]

Part I of this Article reviews the demographics of corporate directors and shareholders, as they have evolved over the past half century. It traces the gradual rise since 1965 of independent directors[24] and then shows the steady rise since 1985 of institutional investors.[25] Independent directors came to dominate corporate boards through a variety of forces, of which state corporation law was a modest but enthusiastic one.

While the evidence indicates that the director independence movement has contributed systemic value — more efficient stock markets, superior disclosure[26] — it also shows scant value added at the firm level, where corporate law and judicial review of board decisions operate. It is possible that the inside directors whom the independent directors displaced commanded diverse expertise that was of more value to their individual companies.[27]

Part II examines the courts' deference, reviewing the cases addressing judicial review of director decisions, based on director independence, shareholder votes, or both. It reveals the vintage, frequency, and rationales of such deference across various fact patterns and doctrinal

[20] *See* Tamara C. Belinfanti, *Shareholder Cultivation and New Governance*, 38 DEL. J. CORP. L. 789, 845 (2014); Edward B. Rock, *Shareholder Eugenics in the Public Corporation*, 97 CORNELL L. REV. 849, 895-96 (2012); *infra* text accompanying notes 156–169.

[21] *See* Bushee, *supra* note 14.

[22] *See* Lynne L. Dallas & Jordan M. Barry, *Long-Term Shareholders and Time-Phased Voting*, 40 DEL. J. CORP. L. 541, 545 n.6 (2016).

[23] *See* James D. Cox, Tomas J. Mondino & Randall S. Thomas, *Understanding the (Ir)relevance of Shareholder Votes on M&A Deals*, 69 DUKE L.J. 503, 556-60 (2019).

[24] *See infra* Part I.A.

[25] *See infra* Part I.B.

[26] *See* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1508-09 (2007).

[27] Lawrence A. Cunningham, *Rediscovering Board Expertise: Legal Implications of the Empirical Literature*, 77 U. CIN. L. REV. 465, 494-97 (2008).

frameworks.[28] It shows how judicial deference has routinely been given, for nearly a century, to informed board decisions made largely by independent directors. Such deference has been particularly strong when the decision was also approved by disinterested fully informed shareholders.

Discussion explains that reliance on shareholder voting has long had a particular shareholder type in mind — implicitly in the earlier period, the traditional buy-and-hold shareholder and, explicitly in more recent years, shareholders who are disinterested, fully-informed and uncoerced. In contrast, current scholarship talks of *increased* judicial deference tied to the rise of *sophisticated* institutional investors.[29] Accordingly, this Article suggests there is both less of an "increase" and less "sophistication" than often perceived.[30] To the contrary, as populist shareholder revolts have revealed, the dynamic is more nuanced.[31] On the other hand, the Part concludes with discussions of the limits of law's approach to contemporary voting patterns among institutional

[28] *Id.* It is customary to delineate corporate fiduciary duty cases into categories such as interested directors, takeover defense, one-bid takeovers, multiple-bid takeovers, and controlling shareholder cases. *E.g.*, LAWRENCE A. CUNNINGHAM, CORPORATIONS: CASES AND MATERIALS 461-81, 537-43, 551-70, 601-19, 619-44 (10th ed. 2019). But despite doctrinal contours among such fact patterns, Delaware courts in all of them have long and steadily encouraged using independent directors and shareholder votes by giving greater deference to challenged decisions when such procedures are used. For this reason, while a MoQ might be of most obvious use in controlling shareholder situations such as Dell, it may be appealing as an additional check on any major corporate decision.

[29] *E.g.*, Cox & Thomas, *supra* note 8, at 380-81 (noting contemporary judicial "retreat" to the "sophistication of public shareholders" would have little "salience except in a world [where] public ownership and trading are dominated by sophisticated institutional investors"); Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1167 (2019) ("Delaware's willingness to defer to the shareholder vote, especially when the shareholder base contains sophisticated institutional investors, follows corporate law scholarship's emphasis on the importance of sophisticated institutional investors."); Goshen & Hannes, *supra* note 9, at 306-08 (endorsing recent "death" of judicial oversight in light of "sophistication" of today's massive and powerful institutional investors); Lipton, *supra* note 11, at 318 ("The ostensible rationale behind these shifts in standards of review (occasionally stated explicitly, other times left as subtext) is that today's shareholder base is more sophisticated and powerful than the dispersed shareholder base of a previous era.").

[30] *See infra* text accompanying notes 134–53 (noting multiple impairments of institutional shareholders in shareholder voting and explaining the diverse strategies and some of their limitations).

[31] *See supra* note 18 and accompanying text.

shareholders,[32] which can be afflicted by such problems as conflicts of interests and inadequate information.[33]

To compensate for these problems while preserving traditional judicial deference to shareholder voice, Part III elaborates on the proposed MoQ. Boards wishing to do so can include a MoQ as an additional vote, for major transactions, by the segment of a company's shareholders with long holding periods and high investment concentrations.[34] This screens indexers and transients, whose business models make them most prone to conflicts and least engaged with information. Quality shareholders, on the other hand, maintain a business model that creates opposite results.[35] The Part portrays the menu of options available to a board wishing to design an MoQ vote, particularly how to segment a shareholder base.[36]

MoQ conditions should hold at least some appeal for all constituents — directors, shareholders, judges, and scholars. By adding a MoQ clause, a board would signal the corporate importance of long-term focused shareholders. Directors have long deployed many tools available to sculpt their shareholder base, from corporate communications to dividend policy. The MoQ adds a powerful new tool to the toolbox. The MoQs strategic and tactical appeal will vary with context, concerning the vote topic, board composition, shareholder makeup, and corporate financial condition.

Some shareholders might balk at first, indexers to guard their influence and transients to protect arbitrage options. But both cohorts still vote in the usual shareholder approvals, thereby retaining power. And if the work of quality shareholders on the MoQ adds value, as fact patterns such as the Dell case suggest it likely would, all other shareholders benefit too. Individuals, still owning at least one-third of all public equity, and lately exerting considerable power, should also welcome the proposal.

As a matter of public policy, the MoQ innovation is both modest and bold. It is modest as entirely voluntarily, something a board in certain circumstances might find appealing. It is bold because it entices deeper thought on weighty questions of the day: how we shape director-shareholder relations, the tenor of shareholder voice, and the evolution

[32] *See infra* text accompanying notes 127–48.

[33] *See infra* text accompanying notes 149–98.

[34] *See infra* text accompanying notes 194–231.

[35] *See* Lawrence A. Cunningham, *The Case for Empowering Quality Shareholders*, 46 BYU L. REV. 1, 9-31 (2021) [hereinafter *The Case for Empowering Quality Shareholders*].

[36] *See infra* text accompanying notes 206–218.

of judicial doctrine. These issues are assuming rising importance in light of major changes in director and shareholder demographics.

Consider widespread concerns about the concentration of power in one class of shareholders today: indexers.[37] The largest three indexers — BlackRock, State Street and Vanguard — manage more than $20 trillion in assets representing at least 20% of public equity capital. Another cohort that vexes many observers are short-term traders, commanding a substantial portion of market capital that trades frequently. Most recently, the power of this cohort manifested in a surprising way, as masses of retail traders drove the price of several speculative stocks on volatile rides, raising issues of systemic significance.[38]

Indexers and traders play useful roles — market returns for cheap and liquidity for instance — and the significance of these phenomenon are debated. But one way to promote stability in a system, whether a government or a market, is to have multiple centers of power. In the corporate sphere, and capital markets, it is valuable to have a substantial cohort of patient-focused shareholders. If they offer an additional center of shareholder power, that would diffuse rather than consolidate power. While directors have long used a variety of tools to appeal to such shareholders, from communications practices to dividend policy and even shareholder voting, the MoQ innovation adds a tool that offers considerable additional advantages.

I. DEMOGRAPHICS

This Part reviews the evolution of the demographic makeup of the two crucial corporate decision makers — directors and shareholders — in the past seventy to ninety years. Boards transformed gradually from advisors who were often also corporate officers to monitors who are almost always independent of management. Shareholders transformed from being overwhelmingly individuals to mostly institutions of various kinds, notably index funds, short-term traders, hedge fund activists, and long-term focused investors. Since 2015, however, a slight resurgence of individual shares has appeared, some of whom made their power

[37] *See* John C. Coates, IV, The Future of Corporate Governance Part I: The Problem of Twelve 1 (Sept. 20, 2018) (unpublished manuscript), www.ssrn.com/abstract=3247337 [https://perma.cc/V3AX-EF3R] (arguing the trend of rising power of institutional investors increases the "likelihood that in the near future roughly twelve individuals will have practical power over the majority of U.S. public companies").

[38] *See infra* Part I.

clear in early 2012 by driving up the prices of numerous speculative stocks such as GameStop in a frenzy of disruption.[39]

The two groups are the principal actors in corporate law.[40] For one, boards owe their duties to the corporation and its shareholders taken as a whole. Boards are elected by shareholders and subject to removal by them. Boards have plenary power and shareholders are the only other group that corporation law statutes recognize as having any voting authority on any matter. Accordingly, shareholder demographics are the relevant legal context in which boardroom decision-making and shareholder votes occur.

A. Independent Directors

Through the 1950s, corporate boards were advisory bodies.[41] Members were a CEO's kitchen cabinet. Most were also officers of the corporation. Many were professional advisors or had other relationships with the corporation and/or its management. Today, the opposite is the case: almost all are independent, seen as monitors of the CEO, and hardly any are officers of the corporation or professional advisors.

As chronicled by Professor Gordon, the rise of independent directors[42] dates from the turmoil of the mid-1960s through late 1970s. Investigations into the Watergate scandal revealed that U.S. corporations made extensive and illicit bribes to foreign officials without accurately accounting for them.[43] Flurries of SEC consent orders mandated corporate governance reforms, with an emphasis on installing independent directors.[44] This began a custom, which continues today, of responding to corporate crisis by looking to

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[39] *See* Reilly, *supra* note 18; *infra* Table 2.

[40] *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1416 (1989) (stating that the two groups that make up the principal actors in corporate law are the investors, or shareholders, and the managers, or directors).

[41] *See* MYLES L. MACE, DIRECTORS: MYTH AND REALITY 207 (1971); Myles L. Mace, *Directors: Myth and Reality — Ten Years Later*, 32 RUTGERS L. REV. 293, 293-94 (1979).

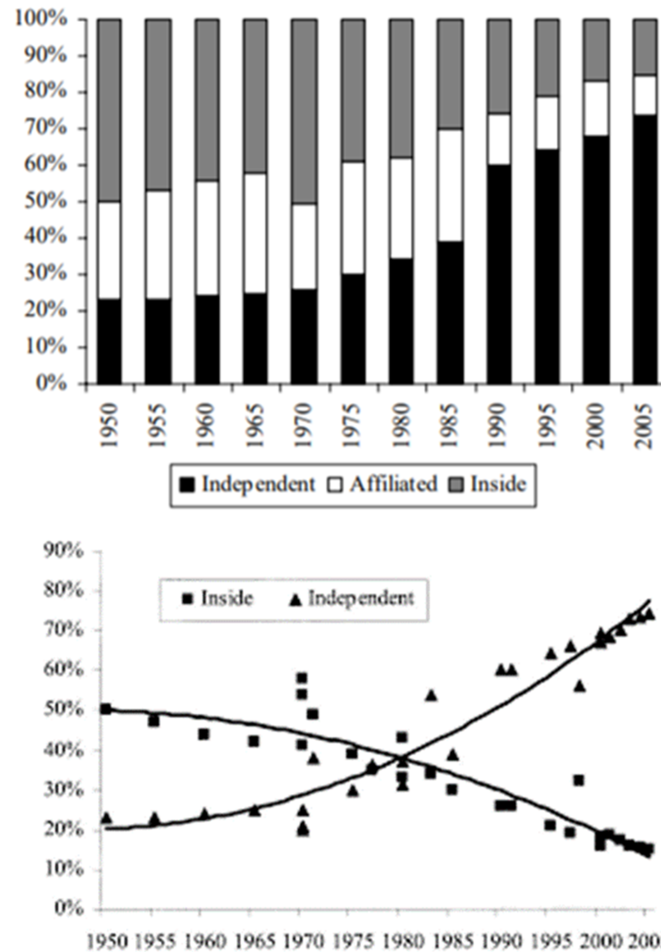
[42] *See* Gordon, *supra* note 26.

[43] *See* Arthur F. Mathews, *Internal Corporate Governance,* 45 OHIO ST. L.J. 655, 662-63 (1984); *see, e.g.*, ITT Corp., Exchange Act Release No. 76-0060, Fed. Sec. L. Rep. (CCH) ¶ 96,948 (Aug. 8, 1979) (enjoining ITT agents from sale or purchase of ITT securities after defendants accused of wasting corporate assets in the participation of bribes and improper payments to employees and agents); Lockheed Aircraft Corp., Exchange Act Release No. 76-0611, Fed. Sec. L. Rep. (CCH) ¶ 95,509 (Apr. 13, 1976) (enjoining Lockheed agents from purchase or sale of Lockheed securities after defendants charged with making secret payments to foreign government officials).

[44] Arthur F. Mathews, *Recent Trends in SEC Requested Ancillary Relief in SEC Level Injunctive Actions*, 31 BUS. LAW. 1323, 1326 (1976).

independent directors. Then, Congress banned such bribes and mandated systems of internal control and books and records maintenance to promote faithful financial reporting.[45]

Table 1. Boards: Towards Independent Directors[46]



Joining Congress, in the wake of the bribery scandals, Delaware courts began a decades-long process of rewarding the use of

[45] Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 102, 91 Stat. 1494 (codified as amended at 15 U.S.C. § 78m(b)(2)).

[46] Gordon, *supra* note 26, at 1565. The graphs have been adapted using the data from the article with the author's permission.

independent directors.[47] Before this time, Delaware courts had told directors they had no duty to maintain internal control or to discover misreporting within corporations whose boards they occupied.[48] In opinions arising out of later derivative litigation, however, Delaware courts accorded special deference to decisions of independent directors serving on special litigation committees ("SLCs") and made this role pivotal to the law of demand futility in derivative litigation.[49]

Amid a campaign for corporate social responsibility led by Ralph Nader and Joel Seligman,[50] Melvin Eisenberg focused on variation between state law,[51] which said that boards were to manage the corporation, and practice, which showed they did no such thing.[52] A brilliant political compromise resulted in the demise of the advisory board model — seen as non-functional — and its replacement with the monitoring board and a heightened emphasis on independence. Yet no consensus existed concerning exactly what independent directors were to do or how independence was to be defined.[53]

The 1980s takeover boom gave independent directors a specific role. Delaware courts, continuing a pattern dating at least to the bribery scandal litigation, strengthened the appeal of independent directors by increasingly deferring to their decisions.[54] Borrowing from the jurisprudence on SLCs, courts announced that using independent directors insulated from judicial review self-interested transactions,[55] cash-out mergers,[56] adoption of poison pills,[57] resisting

47 *See* Gordon, *supra* note 26, at 1487.

48 Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 129-30 (Del. 1963).

49 *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 787-89 (Del. 1981); *see also* Auerbach v. Bennett, 393 N.E.2d 994, 623-24 (N.Y. 1979).

50 *See* RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION 123-28 (1976).

51 *See* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 78-84 (1976).

52 *See* MACE, *supra* note 41.

53 *See* Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73, 77 (2007); Gordon, *supra* note 26, at 1518.

54 *See* Lawrence E. Mitchell, *The Trouble with Boards* 58 (Geo. Wash. Univ. L. Sch., Pub. L. & Legal Theory Working Paper No. 159, 2005), http://www.ssrn.com/abstract=801308 [https://perma.cc/MN2Z-FUUR].

55 *See* Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987); Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976).

56 *E.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983).

57 Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356-57 (Del. 1985). A "poison pill" is a plan by which shareholders have the right to be bought out by the corporation

hostile takeover threats,[58] and even refusing to consider a hostile takeover bid by "just saying no."[59] (These cases are highlighted in Part II.)

By the 1990s, director independence was heralded to solve virtually all corporate governance challenges.[60] The construct became a routine policy tool used in numerous contexts.[61] Independence was to promote optimal compensation and recruitment, despite directors lacking expertise in the relevant subjects. Some promoted "perspective and diversity" on boards,[62] which may have been considered an expertise in sensitivity toward the interests of other constituencies, although no expertise was sought on behalf of traditional shareholder constituencies. State courts made use of independent directors irresistible to corporations, giving deference to decisions that were widely condemned and hard to defend if made by independent directors.[63]

Despite enthusiasm, empirical research has found little correlation between independence and corporate performance.[64] Some evidence suggests a board's independence is less important than its active engagement.[65] Other evidence suggests that certain kinds of outside directors improve the performance of certain functions, such as adherence to accounting requirements.[66] But, clearly, there is a trade-

at a substantial premium when a stated triggering event occurs. Revlon, Inc. v. MacAndrew & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986).

58 Unocal Corp. v. Mesa Petroleum, Co., 493 A.2d 946, 954 (Del. 1985).

59 *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153-54 (Del. 1990).

60 *See* RICHARD A. EPSTEIN, IN DEFENCE OF THE CORPORATION 1, 16-17 (2004).

61 Contexts included compensation disclosure (1992); tax deductibility of certain compensation expenses (1995); and application of short swing profit rules (1996). *See* Clarke, *supra* note 53, at 95-97.

62 *See* Martin Lipton & Jay W. Lorsch, *A Modest Proposal for Improved Corporate Governance*, 48 BUS. LAW. 59, 68 (1992).

63 *See, e.g.*, Brehm v. Eisner, 746 A.2d 244, 257-58 (Del. 2000) (arguing that there was no reasonable doubt for Eisner's associations with the board with respect to Ovitz); *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 773-76 (Del. Ch. 2005) (holding that the new board was not under a duty to act and that the board did not act in bad faith in terminating Chairman Ovitz).

64 *E.g.*, Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Indep. and Long-Term Firm Performance*, 27 J. CORP. L. 231, 233-37 (2002); Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 922-23 (1999).

65 *See* Ira M. Millstein & Paul W. MacAvoy, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation*, 98 COLUM. L. REV. 1283, 1317-18 (1998).

66 *See* Cunningham, *supra* note 27, at 494.

off between the expertise of inside directors and the independence of outside directors.[67]

Other research counters by pointing to systemic advantages of independent directors that redound generally to the benefit of corporations and shareholders alike, such as more accurate stock prices and fuller financial disclosure that benefits all enterprises.[68] Today, these advantages extend to include systemic benefits, including board gender and racial diversity.[69] Yet even such perspectives face studies showing weak correlations between independence and specific tasks, suggesting yet other possibilities: that nominal independence was subverted by managerial control over the appointments process[70] or that nominal independence transforms into structural bias once an outsider joins a board.[71]

Although of equivocal value and uncertain purpose, director independence is ingrained in today's corporate governance ecosystem.[72] Overlapping with the rise of independent directors, an equally powerful trend has been the rise of institutional shareholders. These two trends together forge the central backbone of corporate governance, as directors and shareholders jointly command all the statutory power corporations are authorized to exercise. It is even possible that perceived limitations in the utility of one lever — say independence directors — may lead to greater reliance on the other — with shareholder votes today being the apotheosis of this joint exercise of power.

[67] *See* Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 460 (2008).

[68] *See* Gordon, *supra* note 26, at 1508-09.

[69] *See* Lawrence A. Cunningham, *Board Gender Diversity: Debate and Practice,* 63 CAN. BUS. L. REV. 244, 248-49 (2020); Gordon, *supra* note 26 at 1506-07; Lawrence A. Cunningham, *Opinion: S&P 500 Corporate Boards Lack Diversity, but These Top Companies are Leading Change — and the Stock Market Rewards Them*, MARKETWATCH (Oct. 24, 2020, 9:38 AM EST), https://www.marketwatch.com/story/sp-500-corporate-boards-lack-diversity-but-these-top-companies-are-leading-change-and-the-stock-market-rewards-them-2020-10-23 [https://perma.cc/DX76-FPW7].

[70] *See* William W. Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861, 1867-68 (1995).

[71] *See* James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 L. & CONTEMP. PROBS. 83, 108, 131-32 (1985).

[72] *E.g.*, *About ISS*, INSTITUTIONAL S'HOLDER SERVS., https://www.issgovernance.com/about/about-iss/ (last visited Oct. 24, 2021) [https://perma.cc/UTL3-WYQB]; *Company Overview*, GLASS LEWIS, https://www.glasslewis.com/company-overview/ (last visited Oct. 24, 2021) [https://perma.cc/3HQC-GSNL].

B. Institutional Shareholders

In decades past, most shareholders were individuals. In 1965, for example, institutional investors held $436 billion of $1.4 trillion in total market capitalization, with nearly $1 trillion owned by individual households.[73] Less than 15% of the market, or $100 billion, was held by the day's mutual funds, pension funds, and insurance companies (respectively holding $36, $43, and $21 billion or 5%, 6%, and 3% of the market).[74]

With shareholders so dispersed, prominent corporate theorists had for decades described the challenge of corporate life as the "separation of ownership from control."[75] It would be difficult for shareholders to act collectively and often irrational for them to incur the costs necessary to monitor corporate management.[76] In this structure, managers held the balance of power over corporate destiny — in American corporate finance, there were strong managers yet weak owners.[77] Corporate law's principal task, then, was to mitigate the attendant agency costs.[78]

The dominant investing philosophy of the period was to buy and hold stocks, perhaps a variety of stocks, as individuals and families have long been wont to do. This was long before the concept of indexing had been developed and long before it became easy for anyone to engage in rapid-fire day trading of the sort transients would later perfect.[79]

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[73] BD. OF GOVERNORS OF THE FED. RESERVE SYST., FINANCIAL ACCOUNTS OF THE UNITED STATES: HISTORICAL ANNUAL TABLES (1965–1974), at 109 (2014), http://www.federalreserve.gov/releases/z1/20140306/annuals/a1965-1974.pdf [https://perma.cc/UA9T-Z6GF].

[74] *Id.* at 130. *See generally* James M. Poterba & Andrew A. Samwick, *Stock Ownership Patterns, Stock Market Fluctuations, and Consumption*, *in* 2 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 295, 313 tbl.5 (William C. Brainard & George L. Perry eds., 1995) (describing changing pattern of stock ownership during previous three decades); Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 897 (2007) ("In 1965, institutional investors held 16% of U.S. equities; by 2001, institutional investors held 61%.").

[75] *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1st ed. 1933).

[76] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965).

[77] *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994).

[78] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 333-34, 357 (1976).

[79] *See* Lawrence A. Cunningham & Stephanie Cuba, *Annual Shareholder Meetings: From Populist to Virtual*, 2018 FIN. HIST. 15 (discussing how individuals dominated public company equity ownership from the 1940s to the 1980s); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 884-86 (2013) (noting that indexing emerged only after the development of modern portfolio theory in the 1970s);

Post-1965, however, trends moved from individual to institutional ownership, and by the 1990s, those trends had become so powerful that corporate law scholars came to believe that they might mitigate these historical problems.[80] A promising agenda emerged to enable institutional investors to monitor management more effectively.[81] Guidance was provided on what to expect, including realistic cautionary notes, but in general the rise of institutional investors held out great promise for corporate governance.[82]

These hopes, however, have been disappointed, as the rise of institutional investors altered but did not resolve the longstanding challenges. Today, institutions command the vast majority of the more than $30 trillion in total market capitalization.[83] Among these are mutual funds (controlling some $9.1 trillion) and pension funds (another $2.3 trillion).[84] They present the old problems of agency costs in new ways due to three changes in the institutional investor landscape that have occurred in the past two decades.

Foremost, a large and growing percentage of shares are held by indexers. Indexing involves buying proportional stakes in every stock listed in some benchmark index, such as the S&P 500 or Russell 3000,

cf. Ralph K. Winter, *On Protecting the Ordinary Investor*, 63 WASH. L. REV. 881, 883-85 (1988) (while not purporting to describe actual investor behavior, modeling their functions, including "ordinary" investors who buy and hold a moderately diversified portfolio). *See generally* PHIL FISHER, COMMON STOCKS AND UNCOMMON PROFITS (1958) (popular book advocating what is today called quality investing).

[80] *See* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 567-68 (1990).

[81] *See* Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 904 (1991).

[82] *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 888 (1992); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1336 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 479-80 (1991).

[83] *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: SECOND QUARTER 2018 130 (2018), at [hereinafter FINANCIAL ACCOUNTS: SECOND QUARTER 2018]; BD. OF GOVERNORS OF THE FED. RESERVE SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: HISTORICAL ANNUAL TABLES (2005-2015) 150-53 (2016) [hereinafter HISTORICAL ANNUAL TABLES].

[84] Bloomberg Intelligence, *Nightmare Looms for Active Funds as Outflows Could Hit $1 Trillion*, BLOOMBERG PROFESSIONAL SERVICES (May 7, 2020), https://www.bloomberg.com/professional/blog/nightmare-looms-for-active-funds-as-outflows-could-hit-1-trillion/ [https://perma.cc/YY6L-K27D]; Edward Siedle, *Nation's $2.3 Trillion In Public Pensions Run by Dummies*, FORBES (Feb. 22, 2010), https://www.forbes.com/2010/02/22/public-pension-fund-personal-finance-siedle-underfunding.html?sh=3aafbb6e4dcf [https://perma.cc/9GL5-E6ST].

without doing any research or being exposed to anything but the market risk-return. Large indexers command trillions of assets, representing one-quarter to one-third or more of total U.S. public company equity. Two decades ago, only a small minority of mutual funds were indexed but today nearly a majority are.[85] A related phenomenon is the rise of proxy advisors to advise these low-cost funds on how to vote.[86]

Second is the substantial shortening of average holding periods, indicative of increased trading for arbitrage, momentum strategies, and other short-term drivers. The pace of acceleration continues with sustained technological advances in computing algorithms, artificial intelligence, and machine learning.[87] Average holding periods shortened significantly from the mid-1960s through the early- or mid-2000s;[88] while the average has held steady since, this appears to be due to how the shorter horizons of many are offset by the more permanent holdings of the indexers.[89]

Third is the rise of activism. Shareholder gadflies have roamed corporate America since the Gilbert brothers popularized the practice in the 1950s.[90] And from the 1970s through the 1990s, incumbent managers faced constant threats to corporate control from rival firms, takeover artists, and colorful raiders.[91] But it is only in the past two decades that a vast pool of capital developed among specialty firms, dubbed shareholder activists, dedicated to the practice and featuring a well-developed playbook, a cadre of professional advisers, and repeat players.[92]

A final pivotal cohort with enduring power consists of individual and institutional investors who prefer old-fashioned techniques famously known as buy-and-hold. The style is epitomized by Warren Buffett and

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[85] Cunningham, *The Case for Empowering Quality Shareholders*, *supra* note 35, at 9.

[86] *See* Bernard S. Sharfman, *The Risks and Rewards of Shareholder Voting*, 73 SMU L. REV. 849, 858-59 (2020).

[87] *See* Tom C.W. Lin, *Artificial Intelligence, Finance, and the Law*, 88 FORDHAM L. REV. 531, 541 (2019).

[88] Paul H. Edelman, Wei Jiang & Randall S. Thomas, *Will Tenure Voting Give Corporate Managers Lifetime Tenure?*, 97 TEX. L. REV. 991, 1004 (2019); Anne M. Tucker, *The Long and the Short: Portfolio Turnover Ratios & Mutual Fund Investment Time Horizons*, 43 IOWA J. CORP. L. 581, 629-30 (2018) (describing the rise through 2000).

[89] K.J. Martijn Cremers & Simone M. Sepe, *Institutional Investors, Corporate Governance, and Firm Value*, 41 SEATTLE U. L. REV. 387, 388 (2018).

[90] *See* Cunningham & Cuba, *supra* note 79.

[91] *See* KNIGHTS, RAIDERS AND TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER 99 (John C. Coffee, Loius Lowenstein & Susan Rose-Ackerman eds., 1988).

[92] *See Introduction* to INSTITUTIONAL INVESTOR ACTIVISM: HEDGE FUNDS AND PRIVATE EQUITY, ECONOMICS AND REGULATION 1-38 (William W. Bratton & Joseph A. McCahery eds., 2015).

Berkshire Hathaway.[93] Such investors are a throwback to earlier decades, and there is a good case that much of the thinking in corporate boardrooms and courtrooms that put such significant weight on the shareholder vote had this particular type of shareholder and shareholder body in mind.[94]

In the past decade, moreover, individual shareholders are a growing cohort, as trading in stocks has become cheaper and easier through a variety of online tools, such as the free trading platform, Robinhood. Individual investors often follow a combination of this approach for significant parts of their portfolios, while using more diversified or index vehicles for the rest.[95] Others are more prone to short-term trading, as seen in the frenzy of activity in early 2021 associated with certain speculative stocks such as GameStop.[96]

The changes in shareholder demographics since 1950 occurred gradually, but steadily, and were a regular and recurring topic of conversation in both formal legal research and informal conversation among lawyers and judges. Consider the following periodic graphs of the changes, as compiled from Federal Reserve data.

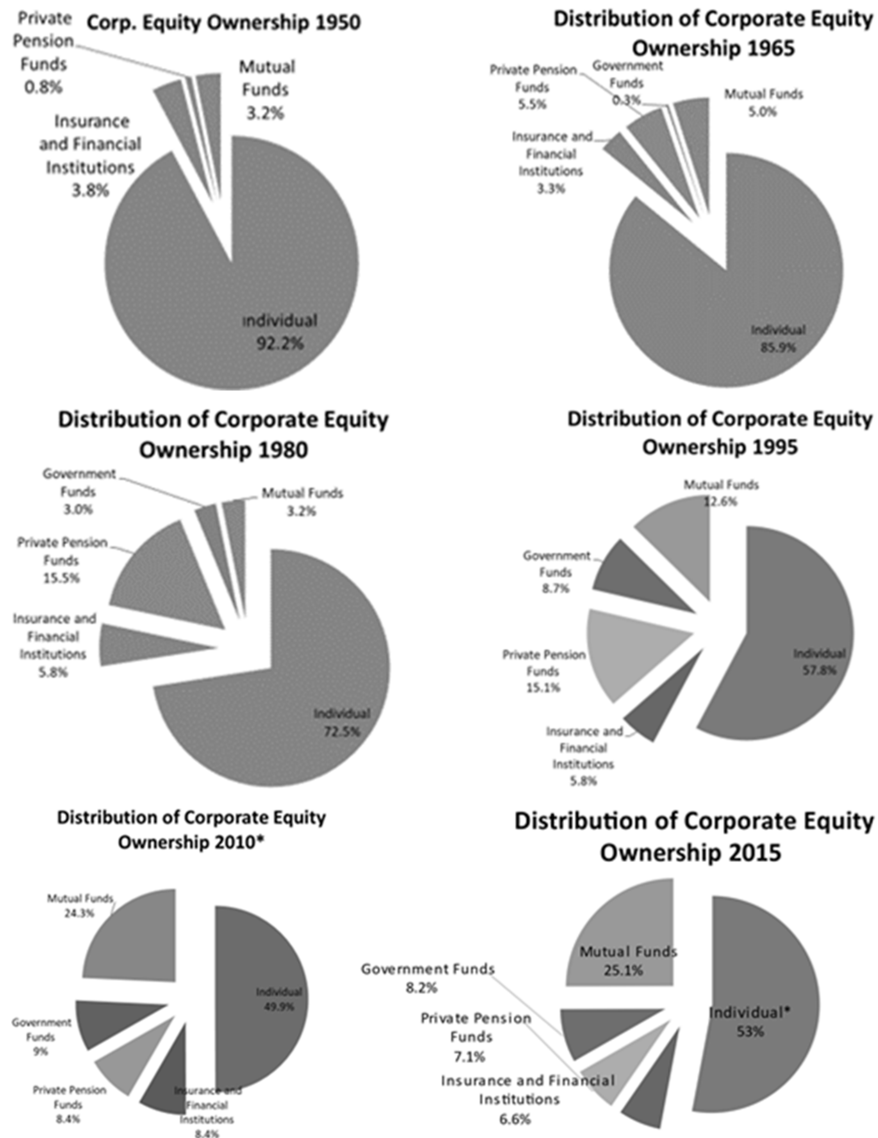
[93] *See* LAWRENCE A. CUNNINGHAM, QUALITY SHAREHOLDERS: HOW THE BEST MANAGERS ATTRACT AND KEEP THEM 2, 4, 34, 44, 119, 173, 195 (2020); Bushee, *supra* note 14, at 31.

[94] *See* Jensen & Meckling, *supra* note 79, at 343 and accompanying text.

[95] *See generally* AM. ASS'N OF INDIVIDUAL INVS., https://www.aaii.com (last visited Aug. 24, 2021) [https://perma.cc/LX3L-DHV3] (providing educational materials concerning fundamental buy-and-hold strategies as well as the benefits of diversification, if not indexing).

[96] Lawrence A. Cunningham, *That Shoeshine Boy with Stock Tips Is Now on Reddit and Robinhood — And This Bubble Will Burst Like All the Others*, MARKETWATCH (Jan. 29, 2021, 11:44 AM EST), https://www.marketwatch.com/story/that-shoeshine-boy-with-stock-tips-is-now-on-reddit-and-robinhood-and-this-bubble-will-burst-like-all-the-others-11611913095 [https://perma.cc/XT86-RJKF].

Table 2. Shareholders — Towards Institutions[97]



Besides the historical growth of institutions compared to individuals, the composition of the institutional cohort warrants segmentation.

[97] *See* FINANCIAL ACCOUNTS: SECOND QUARTER 2018, *supra*, note 83; HISTORICAL ANNUAL TABLES, *supra* note 83, at 130.

Institutional shareholders are diverse in their investment styles, strategies, goals, and behaviors. This diversity influences their approach to shareholder voting.[98] Such attitudes, in turn, influence the weight judges might give to such a vote for purposes of evaluating director performance.

As the charts above suggest, one way to segment the shareholder universe is by legal or descriptive category. These charts delineate mutual funds, government pension funds, and private pension funds along with insurance and financial institutions. These could be delineated further into subcategories.[99] For example, private pension funds may be sponsored either by corporations or by labor unions and financial institutions may be either asset managers or hedge funds. Smaller but important categories not shown would include endowments and trusts.[100]

But across all such categories, any investor's strategies and goals ultimately coalesce around two vital pivot points that distinguish the variety of shareholders: time horizon and corporate conviction, that is average holding periods and portfolio concentration. The empirical research follows this logic. In a famous line of work, Brian Bushee delineated three types of shareholders using these two measures: indexer, transient, and quality (he called the latter dedicated).[101] This work has been influential in many disciplines, such as for optimal securities regulation disclosure policy as well as corporate law's approach to shareholder voting.[102]

An adaptation appears in recent empirical work of Professors James D. Cox, Tomas J. Mondino and Randall S. Thomas, who segment standard categories of investors based on time horizon and concentration levels.[103] Time horizons are measured by portfolio turnover and concentration by the number of positions in their

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[98] *E.g.*, Edwin Hu, Joshua Mitts & Haley Sylvester, *The Index-Fund Dilemma: An Empirical Study of the Lending-Voting Tradeoff* 3-4 (NYU Law & Econs., Working Paper No. 20-52, Dec. 2020) (explaining that indexers frequently forego voting shares when they can instead profit from lending shares, as non-voting shares, to other parties, such as short-sellers).

[99] *See* Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, 2014 BYU L. REV. 1015, 1019 (2015).

[100] *See infra* text accompanying notes 135–154 (noting multiple impairments of institutional shareholders in shareholder voting and explaining the diverse strategies and some of their limitations).

[101] Bushee, *supra* note 14, at 29.

[102] This Article will discuss this shareholder segmentation model further in its proposal outlined in Part III. *See infra* text accompanying notes 173–78.

[103] Cox et al., *supra* note 23, at 556-62.

portfolio. As the following table presents graphically, hedge funds have the shortest time horizon while endowments and other traditional buy-and-hold investors have the lowest turnover.[104] In terms of concentration, hedge funds are among the more concentrated whereas pension funds and mutual funds are the most diversified.

Together, the two measures offer a ranking for quality, presented in the following table adapted from that study. Retaining investor categories and two measures (portfolio turnover and number of positions), this table combines the measures to produce an overall QS ranking on a scale of one to ten.[105] Clear QSs are endowments, asset managers, and corporations; clear non-QSs are pension funds and mutual funds (dominated by indexers) and investment banks and brokerages (dominated by transients); in between are hedge funds, insurance companies, and banks/trusts.

Table 3. Segmentation of Institutional Shareholder Universe[106]

	QS Rank	**Patience (Turnover)**	**Focus (Positions)**	**Size (AUM)**
Endowments	**1.41**	0.29	112	37
Asset Managers	**2.15**	0.62	153	2,575
Corporations	**2.42**	0.47	195	43
Hedge Funds	**3.82**	1.64	118	1,000
Insurance	**4.28**	0.42	386	468
Banks/Trusts	**4.67**	0.31	436	1,987
Mutual Funds	**5.54**	0.49	505	2,777
I-Banks/Brokerage	**6.27**	0.74	553	374
Pension Funds	**8.05**	0.26	779	321

These nine shareholder cohorts are diverse. Differences are salient in holding periods and concentration levels. Those have implications for the quality of their votes, particularly in terms of how informed and disinterested decision-making is. Along with director independence,

[104] *Id.* at 560. The sample is from 2000 to 2015.

[105] To produce a common size, this converts the authors' focus figures to a two-place decimal, which is then added to the patience figure. Size is the dollar amount of assets under management ("AUM"), in billions. The original contained a line called "other," without delineation, so this is omitted. But it is clearly QSs, with patience of 0.43 and focus of 150 for an overall rank of 1.93, with $150 billion in AUM.

[106] *See* Cox et al., *supra* note 23, at 560. For further illustration of members of the leading quality shareholder categories, see *infra* table accompanying note 187.

such demographics help understand and assess the jurisprudence of deference that has long characterized corporate law.

II. DEFERENCE AND ITS LIMITS

This Part captures how evolving director and shareholder demographics correspond to doctrinal evolution in corporate law. Judges experimented with deference to independent directors for many years before that cohort came to dominate boardrooms, encouraging the evolution toward independent directors. Meanwhile, judges had always encouraged shareholder votes, relying on them as a source of validation of director decisions. As a result, practitioners adopted a playbook, increasingly standard, of channeling approvals through disinterested directors and shareholders.[107]

It is possible to see recent cases as embracing a more generous degree of deference, and attribute this to contemporary shareholder sophistication.[108] But while it is true that shareholders have become more institutional, as this Part chronicles, judicial validation of shareholder votes long predates that rise. Judges have always been concerned about the quality of the shareholder vote, particularly that it be independent and fully informed. The salience of today's judicial deference may instead be due to wider use of the playbook judges have long encouraged. What seems most important at this point is the quality of the shareholder vote, the following review suggests.[109]

A. The Venerable Playbook

Corporate law vests general power in a board of directors to manage corporate affairs,[110] while requiring a shareholder vote on specific significant matters, mainly director elections, charter or bylaw amendments, and extraordinary transactions such as mergers or substantial asset sales.[111] Board power may be constrained by various governance provisions, often stated in the charter or bylaws, and are supplemented by longstanding fiduciary duties of care and loyalty.

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[107] *E.g.*, Practical Law Corporate & Securities, *Fiduciary Duties in M&A Transactions*, WESTLAW, https://content.next.westlaw.com/Document/Ic828c025f5ca11e598dc8b09b4f043e0/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true (last visited Jan. 30, 2021) [https://perma.cc/EL4S-ZB2K] (providing examples of approval statutes).

[108] *See infra* Appendices A, B.

[109] *See* Gatti, *supra* note 10, at 348.

[110] DEL. CODE ANN. tit. 8, § 141(a) (2021).

[111] *E.g., id.* §§ 109, 251, 271.

Along with the duty of care, the venerable business judgment rule carries a presumption that directors discharged that duty. After one of the rare cases holding directors personally liable for breach of the duty of care despite that presumption,[112] corporate law statutes were enacted to permit charter provisions that limit the personal liability of directors for breach of the duty of care.[113]

Corporate law's other long-settled doctrine, the duty of loyalty, is not covered by either the business judgment rule or such exculpation provisions. Directors facing a conflict of interest in a transaction with the corporation, rather, bear the burden of proof, in court, that the interested transaction was fair to the corporation.[114] However, statutory safe harbors dispense with such judicial scrutiny, and turn the transaction into one presumed valid under the business judgment rule, if approved by disinterested fully informed directors or disinterested fully informed shareholders.[115]

The upshot of this doctrinal framework is that corporate planners are well advised to design transaction procedures to obtain business judgment rule deference while those challenging corporate transactions probe for departures from such procedures. This framework readily applies to a wide range of recurring corporate decisions, from basic business decisions such as strategy[116] and dividend policy[117] at the quotidian end of the spectrum to clear instances of conflict of interest at the other, such as an exchange of property between the corporation and a director[118] or cash out merger at the other.[119]

The framework has been adapted slightly to address peculiar issues that arise in certain other categories of transactions where shareholder voice is recognized, particularly cash-out mergers orchestrated by a controlling shareholder and decisions resisting or protecting changes of control. Even in these more nuanced cases, however, the strategic objectives of the players remain the same: corporate planners pursue the route that will result in business judgment rule deference while those objecting to a course of action identify lapses in the ordained route to permit judicial scrutiny.

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112 Smith v. Van Gorkom, 488 A.2d 858, 871 (Del. 1985).

113 DEL. CODE ANN. tit. 8, § 102(b)(7).

114 *E.g.*, Marciano v. Nakash, 535 A.2d 400, 403 (Del. 1987).

115 DEL. CODE ANN. tit. 8, §144.

116 *E.g.*, Shlensky v. Wrigley, 237 N.E.2d 776, 781 (Ill. App. Ct. 1968).

117 *E.g.*, Kamin v. Am. Express Co., 383 N.Y.S.2d 807, 812 (N.Y. Sup. Ct. 1976).

118 *E.g.*, Benihana of Tokyo, Inc. v. Benihana, Inc., 906 A.2d 114, 122 (Del. 2006).

119 *E.g.*, Weinberger v. UOP, 457 A.2d 701, 714 (Del. 1983).

In all cases, the ordained route is a decision that is made by disinterested fully informed directors or shareholders. For corporate law, such exercises of corporate authority deserve judicial respect rather than judicial scrutiny or second-guessing. Thus, if approved by a disinterested fully informed board and/or shareholder vote, then there are few transactions to which courts apply any serious scrutiny. That is certainly true for ordinary business decisions and is even true for more fraught settings such as majority cash out mergers or sales of control. In fact, a recent line of cases clarifies this stance for such charged settings.[120]

B. Board Approval

Corporate law scholarship has extensively documented that the evolving case law has consistently encouraged using independent board committees. Rather than providing another rendition of this doctrine, this Article offers highlights in Appendix A and a condensed summary in Table 4.[121] In the Table, the "Quant" column presents a fraction, whose numerator is the number of independent directors and whose denominator is the whole board size; the "Quality" column notes the judicial assessment of the board's work and whether it gave deference or not.

Table 4. Ten Landmarks on Director Independence

Case	**Year**	**Quant**	**Quality**
Weinberger	1985	7/13 at best	Incestuous; no deference
Van Gorkom	1985	5/10	Fast shuffle; no deference
Moran	1985	10/16	Deference
Unocal	1985	8/14 or 8/13	Deference
Revlon	1986	6/16	Compromised; no deference
Ivanhoe	1989	4/7	Deference
Time	1990	10/16	Deference
QVC	1994	11/15	Supine; no deference
Lyondell	2009	10/11	Deference
C&J Energy	2014	5/7	Deference

[120] *E.g.*, Singh v. Attenborough 137 A.3d. 151, 153 (Del. 2016); Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 311-13 (Del. 2015); Kahn v. M&F Worldwide Corp., 88 A.3d 635, 653 (Del. 2014).

[121] This graph is a heuristic for illustration, abstracting away the richness and nuance of the discussion and other facts. Yet it is a useful thumbnail sketch of a most pivotal fact in the cases. Spanning thirty years, this sample dovetails with Part I.A on the rise of independent directors during that period: from about one-half to about two-thirds of the board in decades past to all but one or two today.

C. Shareholder Approval

Judicial enthusiasm for shareholder approval has a long pedigree, and has been an important factor in determining whether to defer to director decisions under the business judgment rule or scrutinize them for entire fairness. For instance, the recent *Corwin* case cites more than a dozen Delaware cases giving such credit to shareholder approval, stretching back nearly a century.[122] *Corwin* does not delineate such cases in terms of the types of shareholders or prevailing shareholder demographics when those votes were held.

But a review of the cases indicates that while they never mention shareholder "sophistication," they repeatedly emphasize that shareholders must be informed, disinterested and uncoerced. As with the topic of board approval, corporate law scholarship has extensively documented that the evolving case law has consistently encouraged disinterested fully-informed shareholder voting. Rather than providing another rendition of this doctrine, this Article offers highlights in Appendix B and the following discussion of the recent cases.

The 2014 case of *Kahn v. M&F Worldwide Corp.*[123] is a culmination of jurisprudence on both independent director and shareholder approval, illustrating the venerable playbook in action. A controlling shareholder proposed to acquire the rest of the stock. From the outset, it conditioned its proposal on two measures now long endorsed by this long line of Delaware cases: (1) that the merger be negotiated and approved by a special committee of independent MFW directors and (2) that it be approved by a majority of minority. Both conditions were met, with nearly two-thirds of the requisite shares voted in favor. Objecting shareholders lost handily, as those two conditions compelled application of the business judgment rule.[124]

Similarly, in the 2015 case of *Corwin v. KKR Financial Holdings LLC*,[125] the Delaware Supreme Court held that an uncoerced, fully-informed vote of disinterested stockholders in favor of a challenged transaction provided an independent basis to invoke the business judgment rule. The court elaborated:

> . . . the voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review and that the plaintiffs' complaint should be

[122] *Corwin*, 125 A.3d at 310 n.19.
[123] *Kahn*, 88 A.3d at 635.
[124] *Id.* at 653.
[125] *Corwin*, 125 A.3d at 313.

> dismissed. For sound policy reasons, Delaware corporate law has long been reluctant to second-guess the judgment of a disinterested stockholder majority that determines that a transaction with a party other than a controlling stockholder is in their best interests. . . .
>
> . . . the doctrine applies only to fully informed, uncoerced stockholder votes, and if troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked. . . .
>
> . . . When the real parties in interest — the disinterested equity owners —can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them.[126]

While some commentators have criticized both *M&F* and *Corwin*, often expressing surprise,[127] judges have long exhorted boards to seek approval of a majority of disinterested shareholders. When boards heed such judicial hortatory, credit should follow, not rebuke; deference should follow, not review. The business judgment rule only applies, however to such shareholder votes that are disinterested, informed ("without full disclosure, ratification would be ineffective") and uncoerced.[128] The court returns to a longstanding theme in Delaware that shareholders are better than courts to handle such decisions. Yet what remains open to litigation is whether particular shareholder votes qualify as disinterested, fully-informed and uncoerced, and there are inherent limits on law's approach to these issues, as discussed next.

D. Limits of Law's Ad Hoc Approach to MoMs

Delaware law can seem intricate when addressing various corporate transactions such as interested-director transactions, cash out mergers, and changes of control. In all cases, however, the law puts a premium on director independence and a shareholder vote. For interested director transactions, the combination of statutory safe harbors and

[126] *Id.* at 311.
[127] *E.g.*, *infra* Appendices A, B.
[128] *See* Gatti, *supra* note 10, at 415.

Fliegler v. Lawrence[129] mean that directors have the burden of proving fairness unless the transaction is improved by either a disinterested fully-informed board committee or a majority of the minority ("MoM"), in which case the standard shifts to business judgment rule along with putting the burden on shareholders to assert such unlikely claims as waste.

For cash out mergers, courts scrutinize the entire fairness of the exchange, as to both process and price, with burden of proving both on the directors. But if approval was given by either a disinterested full-informed board committee or a MoM vote, the standard remains entire fairness but the burden is shifted to the challenging shareholders. And if the transaction is approved by both such a committee and holders, then the standard shifts to business judgment rule along with putting the burden on shareholders to assert such unlikely claims as waste. Even control transactions can be simplified in these terms.

Yet despite judicial enthusiasm for MoM votes, and despite their utility, they also have inherent limitations that entice judicial review. In particular, to obtain favorable review thanks to a MoM shareholder vote, Delaware courts are willing to review challenger allegations that the vote was not carried by a requisite majority of disinterested, fully-informed, uncoerced votes. Related inquiries are made on an ad hoc basis. Each of those required features of the vote has a particular meaning.

Disinterested probes a variety of alleged conflicts, such as other securities or other incentives or other needs such as for liquidity; fully-informed probes what information the company provided, not whether the shareholder digested it. Neither of these would necessarily be displaced by a screen for quality, but be additive. For instance, quality screens for likely direct ownership conflicts, rather than those more specific contextualized ones, and probes for likely shareholder consumption of information rather than examining the corporation's disclosure of it.

To illustrate the ad hoc approach, consider a case involving shareholder voting by a shareholder, T. Rowe Price, that owned stock in both a parent and a majority-owned publicly-traded sub, and was also a lender to the parent.[130] The parent planned a tender offer for the sub's public stock, using a special committee of the sub's board. However, the parent reached out directly to T. Rowe Price, which held about six percent of each side's stock. The majority and T. Rowe agreed on a

[129] 361 A.2d 218, 221 (Del. 1976).

[130] *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 399 (Del. Ch. 2010).

tender offer price and T. Rowe agreed to tender at that price — which helped meet the tender offer's MoM condition.

Challengers questioned the vote of T. Rowe Price for purposes of the MoM condition. Holding nearly equal stakes in each side, they said, left it hedged and fairly indifferent to the allocation of value between the two merger partners. If parent underpays for sub shares in the merger, while other sub shareholders would be harmed, T. Rowe, as an equal holder of the parent, is not. Tipping the scales, since T. Rowe was also a creditor of parent, it may well have favored its side, the challengers claimed.

Proponents balked at this proposed judicial examination of shareholder incentives to be "unworkable as well as unwarranted."[131] They argued:

> Sophisticated institutional investors . . . often have diverse holdings that could include shares of both parent and subsidiary; they often own derivatives, have complex hedging arrangements, possess holdings in competitor corporations, and/or have made directional sector bets that could have some conceivable impact on their decision to tender. In most cases, Delaware courts will simply have no way of knowing the extent of institutional stockholders' other investments or of discerning their true motivations for tendering.

The court denied any need to make "generalized inquiries" into investor motivations, explaining that the only reason it was considering those of T. Rowe is that the buyer (parent) reached out for and got its support, outside the purview of the special board committee of the target (sub). The court wrote, "This case also is not the result of, nor should it be read to encourage, generalized fishing expeditions into stockholder motives."[132]

The court therefore agreed in principle with the limitations of such an ad hoc approach. Inquiry followed only after particular transaction facts exposed the potential conflict. Any hidden conflicts will remain hidden and outside the courtroom. But if the court is unwilling to accept the vote of a conflicted shareholder who self-identifies that way, it is difficult to say why it would be willing to accept the vote of a conflicted shareholder in hiding. On the court's own — parent-shareholder

[131] *Id.* at 416.

[132] *Id.* at 417. The court also rejected arguments to look into T. Rowe's different funds that owned the stock, one of which owned only sub stock, because the agreement was not with the particular funds, but with T. Rowe as a whole. At least that was the case on the preliminary record.

discussion or agreements signaling disqualifying conflict — is also unworkable, as such interactions are common and desirable, including in MoM situations, making this trigger potentially overinclusive.[133]

The court is clearly, and correctly, averse to permitting fishing expeditions into shareholder "motives" — or conflicts, information processing, or sophistication for that matter. What Delaware judges in these cases need is a way to provide general screening of voting imperfections. Historically, in the case law from the 1930s to the 1990s, this would embrace voting, without further inquiry, by the prevalent buy-and-old stock pickers of the day; modernly, this would exclude shareholders prone to the numerous frictions in contemporary shareholder voting, catalogued next.[134]

E. Frictions in Shareholder Voting

Numerous frictions impede the quality of shareholder voting by many of today's institutional investors.[135] As reviewed next, these frictions are serious and tend to be slightest for shareholders who concentrate their positions and hold for long periods and greatest for those who are widely diversified and hold fleetingly. The following summarizes these imperfections and why they tend to plague indexers and transients more than quality shareholders. The review points directly to the MoQ solution presented afterwards in Part III.

Specific Conflicts. Scholars express concern that many institutional investors today own shares in so many companies that they will often face conflicts of interest, particularly when two companies they own stock in merge.[136] In a merger, for instance, suppose a shareholder in both companies is entitled to vote on both. If the terms are incontestably fair to both sides, there is no problem voting yes on both. But what if the terms are lopsided so that they clearly favor one side, say Buyer, and

[133] *See* Lipton, *supra* note 11, at 324; Rock, *supra* note 3, at 11.

[134] As another case illustration, consider the merger of Zale, which the directors said was approved by the vote of a majority of disinterested and fully-informed shareholders, 53.1% to be exact. *In re* Zale Corp. S'holders Litig., No. 9388-VCP, 2015 WL 5853693, at *9 (Del. Ch. Oct. 1, 2015). Dissenting shareholders challenged both claims, of disinterest and information. *Id.* at *7. The court rejected each challenge. *Id.* at *22. Concerning disinterest, challenges alleged that Golden Gate, a 23.3% shareholder (with shares valued at about $225 million) was also a lender whose loan would be prepaid in the merger plus a prepayment fee of $3.2 million. *Id.* at *9. Such a conflict seemed cognizable to the court, but immaterial, given the numbers.

[135] *E.g.*, Cox et al., *supra* note 23; Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 101, 114 (2018); Sharfman, *supra* note 86.

[136] Cox et al., *supra* note 23.

disfavor the other side, Seller. A fund owning shares in both Buyer and Seller should theoretically vote its Buyer shares Yes and its Seller shares No. But the value-maximizing decision for the fund as a whole will rarely be that easy. Lopsided deals will usually lead the owner of both sides to vote Yes on both ballots or No on both ballots even though that is rational for one of the companies and its shareholders but not for the other.

This is a serious problem for indexers and a potentially serious problem for certain transients, but rarely one for stock pickers. Institutional investors diversify their portfolios to varying degrees, commonly measured today as relative active share.[137] At one extreme, fully-diversified index funds hold small positions in many hundreds or thousands of companies — all those in a given basket, such as the S&P 500 or the Russell 3000. This approach aims to deliver the market return at least cost and requires no particular knowledge of any of the companies. Indexers will therefore present a high risk of conflict of interest.[138]

Stock pickers, at one extreme, may concentrate on a dozen or perhaps a few dozen positions, the latter being enough to obtain the risk-mitigation benefits of diversification without impeding the investor's capacity to study and keep updated on the details of particular investments.[139] They will therefore face far fewer conflicts. Such a conflict can also arise when a short-term oriented investor opportunistically buys stakes in both sides of a pending merger and then vote to maximize the value of its portfolio, even if that means voting for a merger that is economically foolish for a company.

Firm-Specific Information. Index funds buy every stock in an index, without conducting any analysis of any of them. To fulfill their promise of delivering the market return, index funds cannot afford to spend resources on monitoring any of those companies either. As a result, index funds tend to favor adopting general guidelines about their preferred approaches to a variety of corporate topics, such as director qualifications, executive compensation, and shareholder rights.[140]

137 *See* Martijn Cremers & Ankur Pareek, *Patient Capital Outperformance: The Investment Skill of High Active Share Managers Who Trade Infrequently*, 122 J. FIN. ECON. 288, 302 (2016) ("active share" measures portfolio construction compared to a benchmark index on a zero-to-one scale, with a pure index at zero and a completely concentrated portfolio at one).

138 *See* Griffith & Lund, *supra* note 29, at 1159.

139 *See* Michael E. Murphy, *Pension Plans and the Prospects of Corporate Self-Regulation*, 5 DEPAUL BUS. & COM. L.J. 503, 508-09 (2007) (noting that almost all diversity benefits arise in a portfolio with as few as 20-30 investments).

140 *See* Lund, *supra* note 135.

When corporations ask shareholders to vote on particular matters, a passive reference to guidelines is common. In fact, recent evidence suggests that indexers increasingly avoid voting their shares altogether, as they earn a bit of revenue by lending shares they own to transient short-sellers, so the shares go unvoted.[141] Stock pickers, in contrast, conduct extensive research before making an investment and continuously analyze information, and prognostications, over time. When it comes time for a shareholder vote, they are likely to be among the best-informed.[142]

Advisor Problems. Index investors often minimize operational costs by retaining outside advisory firms to advise on how to vote on corporate proposals.[143] While the investor is said to retain ultimate discretion, the environment poses numerous fissures if not outright conflicts.[144] First, the advisor makes recommendations without usually owning the stock. Second, the recommendations are not always made transparently, some detect systemic biases in them, and advisor representatives sometimes serve as directors on boards making proposals.[145] Third, proxy advisors sometimes sell consulting services to corporations covering the exact ground as their recommendations — an arrangement creating the appearance that clients pay for services in exchange for desired recommendations, despite internal segmentation of these businesses by the advisors.

Fourth, the advisors have an incentive to persuade a critical mass of client investors to subscribe and follow their recommendations, creating incentives to produce a "sense of the investment community" on a host of general topics that therefore enter into the shareholder votes of particular firms. Such an environment may induce, if not coerce, customers to go along with advisor recommendations despite their own better judgment. True, index investor clients of the advisory firms remain free and uncoerced in how to vote, but the contexts in

141 *See* Hu et al., *supra* note 98. This is due to a 2019 SEC rule change. Previously, indexers could lend their shares but had to recall them for important votes. The 2019 SEC guidance allows indexers to lend their shares without ever having to recall them for any votes. The result has been a significant increase in indexer lending of their shares on terms that lead the shares to be unvoted.

142 Cunningham, *The Case for Empowering Quality Shareholders*, *supra* note 35, at 17-30.

143 *See* Sharfman, *supra* note 86.

144 *See* Tamara Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 STAN. J. L. BUS. & FIN. 384, 407 (2009).

145 Cox et al., *supra* note 23, at 538.

which the recommendations are generated raises doubt about the integrity of such votes.[146]

Abstract Guidelines. For indexers to meet fiduciary duties requires considerable staff and resources that are costly and, for avowed indexers, in contradiction to their business model, which is to deliver the market return at least cost. A popular solution is to create highly generalized guidelines or even engage a third party that creates a separate similar set of generalized guidelines. Such guidelines are criticized on several grounds, including how a preference for general standards obscures the importance of firm-level needs.[147]

Empty Voting. Contemporary capital market innovations enable numerous ways to separate the economic and voting interests in corporate shares.[148] When this occurs, those empowered to vote lack economic exposure, muting their voice of the meaning that Delaware corporate law vests in it as a corporate decision maker. While there is scant public data on the frequency or intensity of such practices,[149] it is not a strategy associated with long-term concentrated shareholders but rather with arbitrageurs, momentum traders, and other transients. Accordingly, it may be a concern in particular cases but difficult to claim as a systemic matter.

Quality to Transient Drift. Another serious problem is merger arbitrage. This refers to how, upon or soon after a merger is announced, a significant portion of quality shareholders sell to avoid the risk that a transaction may not close, while a corresponding cohort of transients — short-term hedge funds engaged in merger arbitrage — buy. Even quality shareholders who are skeptical of a merger's terms, may nevertheless prefer to cash out than to take their chances of what may unfold between signing and closing a transaction. Merger arbitrageurs

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[146] *See* Michael Cappucci, *The Proxy War Against Proxy Advisors*, 16 N.Y.U. J.L. & BUS. 579, 585 (2020).

[147] *See* James R. Copland, David F. Larcker & Brian Tayan, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry*, STAN. U. CLOSER LOOK SERIES, MAY 30, 2018, at 1, 6, https://www.gsb.stanford.edu/faculty-research/publications/big-thumb-scale-overview-proxy-advisory-industry [https://perma.cc/RP6D-62WD] ("When it comes to general issues common across the broad universe of companies—such as compensation design and director elections—resource and time constraints might compel proxy advisory firms to employ more rigid and therefore arbitrary standards that are less accommodating to situational information that is unique to a company's situation, industry, size, or stage of growth.").

[148] *See* Henry T. C. Hu & Bernard S. Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 823 (2006).

[149] Henry T. C. Hu & Bernard S. Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625, 652, 659 (2008).

earn profits from such trading only when the related merger closes. They therefore have every reason to vote yes on the merger even if quality shareholders would be inclined to vote no.[150]

Priority Conflicts. Another feature of today's landscape is much harder to deal with. This is that not all shareholders are focused on economic gain from their investments. For instance, the pension funds of the AFL-CIO advocate for shareholder proposals that push a labor agenda.[151] The boards of public employee pension funds include government appointees and elected officials, all of whom respond to politics. Inverting the critical economic thought associated with Karl Marx, labor has never controlled so much capital.[152]

All kinds of pension plans pose this problem, of subordinating shareholder interests to other interests — labor union plans may side with pro-labor practices even if that reduces shareholder returns, public pension plans may cater to political interests, and corporate plans may side with their own corporate managers. Structural conflicts arise when a shareholder has incentives to appease related parties whose interest might differ from those of the corporation.

But while such structural conflicts may be in tension with the idea that corporations are to be run for the economic benefit of the shareholders,[153] the concept is too elastic to discount resulting shareholder votes on that basis. For instance, labor union shareholders can plausibly contend that pleasing the workforce is good for shareholders and public pension funds may rightly believe that political and corporate interests are aligned. Moreover, federal securities regulations put fiduciary duties on such trustees to act in the best interests of their pension beneficiaries, and publicly explain how they resolve such conflicts.[154]

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[150] For more on Cox et al.'s version of empirical model, see *supra* text accompanying notes 104 and 105.

[151] *See* Ashwini K. Agrawal, *Corporate Governance Objectives of Labor Union Shareholders: Evidence from Proxy Voting*, 25 REV. FIN. STUDS. 187, 219-21 (2012).

[152] *See generally* DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON, at xi-xii (1st ed. 2018) (advocating that labor use its new and abundant capital to challenge corporate interests in ways they never could before).

[153] Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010) (en banc) (Holland, J.) ("[W]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization.").

[154] *See generally* William W. Clayton, *Public Investors, Private Funds, and State Law*, 72 BAYLOR L. REV. 294, 325, 351-52 (2020) (describing the regulation of fiduciary duties by the SEC in the context of pension plans).

With all such imperfections in the capacity of today's institutional shareholders to cast their votes in ways that warrant judicial recognition, what can a corporation — its board and shareholders — do, that would continue to warrant such judicial recognition or even heightened judicial veneration? Boards can add MoQ clauses to certain consequential shareholder votes, in addition to existing statutory or contractual shareholder approval conditions.

III. SEGMENTATION AND ITS VALUE

Corporations count on independent directors and increasingly shareholder votes, either as required by statute or charter or volunteered by contract, and whether specified as supermajority, majority of the minority or otherwise. But these votes are imperfect. Just as independent directors proved equivocal for shareholder value at particular firms (in favor of system-wide advantages), elevating shareholder votes to the status of exonerating ratifications may overshoot the mark.[155] Yet nor can such a vital route of corporate governance be forsaken or ignored.

Boards have long used MoMs as a part of the corporate approval process, both to add an element of fairness and discipline to the process, and to gain judicial deference if sued. Courts recognize the appeal and limits of MoM votes but have imperfect tools to assure reliability. Rather, they screen on an ad hoc basis for conflicts of interest of particular shareholders, lack of information due to inadequate disclosure, or coerced votes. Such an ad hoc approach, however, is both costly and imprecise.

Refining this approach to zero in on the most patient and focused shareholder group — QSs — would help. Boards could opt to add a majority of the quality condition ("MoQ") in addition to the usual statutory voting requirement and any MoM the board might also elect. Boards would adapt an academically respected tool that segments the shareholder universe, along the two critical dimensions of time horizon and investment concentration. Votes overwhelmingly supported by the most patient and focused shareholders — quality shareholders — would warrant presumptive effect, but not otherwise.[156]

[155] *See infra* Appendix B.

[156] An MoQ clause can be used in many ways. For instance, in shareholder litigation challenging the reliability or accuracy of a shareholder vote, whether pursuant to statute or by MoM, litigants could offer evidence of the voting by shareholder segment, including the QS vote. Judges could weigh such evidence in the overall context of evaluating what deference is due.

In this Part, Section A begins in the boardroom, with why directors might wish to attract QSs in general, and the social desirability of doing so. Section B details how a board could do so by including QS clauses in some shareholder proposals. For doing so, it presents a recognized academic model for segmenting the shareholder base. It uses time horizon and portfolio concentration to segment shareholders into three categories — indexers, transients, and dedicated shareholders (or quality shareholders). Indexers are completely diversified although they hold indefinitely, transients hold for short periods though they may concentrate their positions, and dedicated shareholders are both concentrated and long-term. Section D considers objections.

A. Why Quality?

Using a MoQ would equip directors to give a strong clear signal that they value QSs. That will appeal to those directors interested in attracting such a cohort, at their current or future companies. While some directors, and managers, are content with accepting whatever shareholders they get, many consciously cultivate particular shareholder types.[157] Evidence shows that companies that attract a high density of quality shareholders enjoy many benefits, from intangibles such as a longer time horizon to execute on strategy, to measurable economic outperformance compared to rivals.[158] The MoQ adds another tool to the kit of directors who wish to sculpt their company's shareholder list.

The current toolkit is robust, and the MoQ vote would fortify it. In the current toolkit, the most obvious way directors and managers cultivate particular shareholder types is through tailored corporate communications,[159] including a statement of corporate mission expressly written to attract certain kinds of shareholders and deter others.[160] Directors can deter short-term ownership by avoiding emphasis on quarterly earnings and forecasts[161] and repel indexers by

[157] *See* Belinfanti, *supra* note 20, at 862-63.

[158] Lawrence A. Cunningham, *Lessons From Quality Shareholders on Corporate Governance Practice, Research and Scholarship*, 5 GEO. WASH. BUS. & FIN. L. REV. 1, 10 (2021).

[159] *See* Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN. L. REV. 1822, 1843 (2011).

[160] *See* Henry T.C. Hu, *Corporate Governance: Buffett, Corporate Objectives, and the Nature of Sheep*, 19 CARDOZO L. REV. 379, 394 (1997).

[161] *See* Nadelle Grossman, *Turning a Short-Term Fling into a Long-Term Commitment: Board Duties in a New Era*, 43 U. MICH. J. L. REFORM 905, 915-18 (2010).

using dual class capital structures.[162] Directors targeting QSs can be most effective by mounting annual meetings tailored to that cohort[163] and annual letters addressed to such shareholders.[164]

When directors set corporate policy on shareholder distributions, they shape the shareholder base.[165] They choose the portion of earnings to retain or distribute and, if a distribution is to be made, whether that is done through cash dividends, share buybacks or spin-offs.[166] Differing tax consequences attract and repel different shareholder types. For instance, cash dividends impose a tax on taxable shareholders but not on tax-exempt shareholders whereas buybacks make tax implications optional to each shareholder. Directors likewise influence their shareholder base by their own level of share ownership in a company.[167]

Shareholder voting rules can also be tailored to cater to desired shareholder cohorts, especially time-weighted voting[168] that grants enhanced voting rights to a separate class of long-term shares.[169] Directors use these to attract long-term shareholders. Similarly, directors could seek to attract QSs by granting enhanced voting power to shareholders based on both long holding periods and high portfolio

[162] *See* Ron W. Masulis, Cong Wang & Fei Xie, *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697, 1700 (2009); Young Ran (Christine) Kim & Geeyoung Min, *Insulation by Separation: When Dual-Class Stock Met Corporate Spin-Offs*, 10 U.C. IRVINE L. REV. 1, 25-27 (2019); Rock, *supra* note 20.

[163] *See* Iris H-Y Chiu, *Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK*, 38 DEL. J. CORP. L. 983, 1006 (2014); Rock, *supra* note 20.

[164] *See* Michael R. Siebecker, *Bridging Troubled Waters: Linking Corporate Efficiency and Political Legitimacy Through a Discourse Theory of the Firm*, 75 OHIO ST. L.J. 103, 144-45 (2014).

[165] *See* Belinfanti, *supra* note 20; William W. Bratton, *The New Dividend Puzzle*, 93 GEO. L. J. 845, 892 (2005).

[166] *See* Edward S. Adams & Arijit Mukherji, *Spin-Offs, Fiduciary Duty, and the Law*, 68 FORDHAM L. REV. 15, 41-50 (1999); York Schnorbus, *Tracking Stock in Germany: Is German Corporate Law Flexible Enough to Adopt American Financial Innovations?*, 22 U. PA. J. INT'L ECON. L. 541, 616 (2001).

[167] *See* Lawrence A. Cunningham, *Opinion: Companies Whose Board Members Are Also Major Shareholders Typically Outperform. Here's How to Find Them*, MARKETWATCH (Nov. 11, 2020, 12:58 PM ET), https://www.marketwatch.com/story/click-here-on-a-companys-website-for-clues-about-how-the-stock-will-perform-2020-11-11 [https://perma.cc/FVD8-26JT].

[168] *See* Dallas, *supra* note 22, at 577 n.131.

[169] *See* Patrick Bolton & Frédéric Samama, *Loyalty-Shares: Rewarding Long-term Investors*, 25 J. APPLIED CORP. FIN. 86, 94-95 (2013); Belinfanti, *supra* note 20, at 827-28.

concentration.[170] The MoQ is an additional device that may appeal to directors seeking to cultivate the QS cohort. As discussed next, such a vote, in addition to those contemplated by statute or MoM clauses, could be a valuable datapoint for all concerned, including judges, given limitations on shareholder voting today.

B. The MoQ Solution

The rise of institutional shareholders documented in Part I is often incorrectly conflated with the rise of sophisticated investors. In this conflation, omniscient investors rule capital markets and invariably know better than others, including courts, what is best. In this portrayal, commentators construe Delaware courts as becoming increasingly deferential to shareholder votes due to this rise of sophisticated institutional shareholders.

But as Part II indicated, there is nothing new about Delaware's deference to shareholder votes and, as the following will explain, today's institutional shareholders are neither monolithic nor omniscient. To the contrary, they are fragmented and diverse, often myopic, conflicted, or ill-informed. If anything, their votes deserve less deference than Delaware judges historically gave shareholder votes, because they are quite different from the prevalent shareholder of earlier years, before the rising dominance of indexing and arbitrage. By the same token, individual shareholders continue to exert considerable power, and a degree of sophistication, that enables them to outfox many institutions often described as "sophisticated."[171]

Shareholder quality differs, along with how informed, objective, and free shareholder voting is. At one extreme, courts could ignore all of this and defer to the certified shareholder vote as foreclosing any judicial review of the transaction. At another extreme, courts could probe for a particular vantage point of shareholder wealth maximization (an abstraction that cannot be verified, is contestable around time horizon, and so on).[172]

In between, a court could use proxies for the kinds of shareholders the case law has long envisioned as reliable arbiters, lately articulated in terms of probable information, objectivity, and freedom. While many models may be imagined for this probe, a well-known academic model can be readily adapted. Pioneered decades ago by Brian Bushee, the

[170] *See* Cunningham, *The Case for Empowering Quality Shareholders*, *supra* note 35, at 6-7.

[171] *See supra* text accompanying note 18.

[172] *See* Lipton, *supra* note 11, at 306.

model segments the shareholder universe based on time horizon and investment concentration, delineating three cohorts of shareholders, indexer, transient, and quality.

1. The Quality Model

In the early 1990s, Michael Porter compared investor behavior in the United States with Germany and Japan, whose economies were more productive.[173] He reported a U.S. propensity toward indexing or trading compared to the more concentrated and patient investor prevalent abroad. In the late 1990s, Brian Bushee extended Porter's analysis.[174] Bushee noted that Porter's critique overlooked the significant group of U.S. investors who both concentrate and hold. But he stressed that Porter's insight warranted focusing on differences among shareholders represented by two variables: time horizon and conviction.[175]

In segmenting investors as indexers, transients, or quality (Bushee called the latter dedicated), Bushee's empirical work computed various measures of horizon and conviction: horizon by quarterly portfolio turnover as well as portion held more than two years and conviction by average percentage ownership of investees, the percentage of investees representing at least 5% of the portfolio, and the average size of each.[176] He then combined the horizon and conviction computations to capture the two factors together.

Bushee clustered the results into the three shareholder types and identified exemplars of each. *Transients*, with short time horizons and small stakes, are typified by Numeric, a fund that exploits dynamic stock market activity, not fundamental analysis of business; *quasi-indexers*, which buy small stakes in 500 to 3,000 stocks representing a market basket, is exemplified by CalPERS, the California pension fund; and *quality* shareholders, those who buy large stakes and hold them for long periods, are epitomized by Warren Buffett's Berkshire Hathaway.[177]

Professor Bushee's work has been influential. Decades after publication, consulting firm McKinsey & Company offered a similar take.[178] It calls equivalent categories by different names: intrinsic

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[173] MICHAEL PORTER, CAPITAL CHOICES: CHANGING THE WAY AMERICA INVESTS IN INDUSTRY 5 (1992).

[174] Bushee, *supra* note 14, at 30.

[175] *Id.* at 29-30 (using the words stability and stakes rather than horizon or conviction but synonymously).

[176] *Id.*

[177] *Id.*

[178] *See* Robert N. Palter, Werner Rehm & Jonathan Shih, *Communicating with the Right Investors*, 40 MCKINSEY ON FIN. 57, 58-59 (2011).

instead of dedicated; mechanical instead of quasi-indexers; and traders instead of transients.[179] But the analytical utility of the McKinsey and Bushee lexicons are the same and offer a valuable lens for purposes, especially their expected handling of information and likelihood of different shareholder cohorts being informed participants in shareholder voting.

In finance scholarship, numerous empirical studies identify shareholders who rank high by combined horizon duration and portfolio concentration. Paul Borochin and Jie Yang developed such a database to determine the effects of shareholder base on a company's governance structure and economic value.[180] Martjin Cremers and Ankur Pareek created a large data set of all institutional investors dating to 1980, presenting, quarter-by-quarter, each shareholder's concentration and average holding period.[181] At George Washington University, the Quality Shareholders Initiative, which I direct, has created similar classification schemes of both quality shareholders and the companies that attract them in large proportions.[182]

The private sector increasingly generates data analytics that classify shareholders based upon holding periods and concentration levels. That is the business, for example, of EQX Equity, which offers a specialized security designed to promote long-term ownership.[183] The boutique firm has developed a database to classify shareholder quality in terms of holding period and concentration based on billions of data points.

Most people can reel off the most prominent indexers — often dubbed the "big three," of BlackRock, State Street, and Vanguard. Exemplars of quality are Berkshire Hathaway, Capital Research, and Tweedy Browne; and the epitome of transients are AQR, Sun Trading, and Tradebot.[184] The following table presents examples in each category that appear in the literature.[185]

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[179] *See id.*

[180] Paul Borochin & Jie Yang, *The Effects of Institutional Investor Objectives on Firm Valuation and Governance*, 126 J. FIN. ECON. 171, 178 (2017) (including a robust propensity score model to identify quality shareholders, dubbed DED for dedicated, after Bushee, in the model).

[181] *See* Cremers & Pareek, *supra* note 137, at 289.

[182] *See* Lawrence A. Cunningham, *Initiative on Quality Shareholder Highlights*, 2020 C-LEAF OCCASIONAL PAPER SERIES 1, 2, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3697259 [https://perma.cc/A6JV-3Q2Q] [hereinafter *QSI*].

[183] *Long-Termism Through Finance*, EQX LLC, https://www.eqxse.com (last visited Aug. 29, 2021) [https://perma.cc/T7J4-CNW4].

[184] For a detailed treatment, multiple lists, and tests of the policies and practices that attract different shareholder types, see Cunningham, *supra* note 182, at 18-26.

[185] CUNNINGHAM, *supra* note 93, at 176; Borochin & Yang, *supra* note 180, at 175.

Table 5. Exemplars of Principal Shareholder Segments[186]

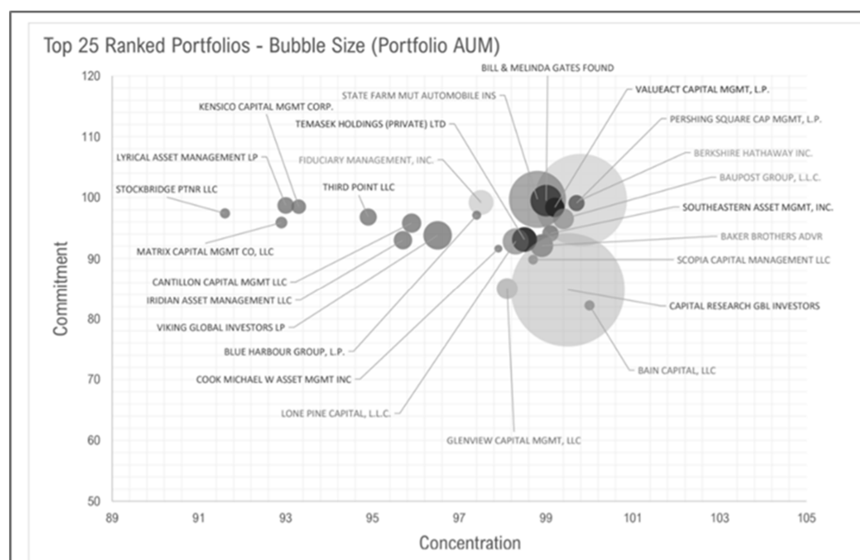
Quality	Transients	Indexers
Berkshire Hathaway	AIM	BlackRock
Capital Research & Mgmt.	Investors Research	State Street
Jennison Associates	Janus	Vanguard
Fidelity Mgmt. & Research	Putnam	
Harris Associates (Oakmark)	Marsico	
State Farm	Oppenheimer	
Southeastern Asset Mgmt.	UBS Warburg	
Wellington		

To illustrate the quality category further, the following table graphs twenty-five top-ranked portfolios by a combination of high commitment (holding period) and high concentration. Observe that quality shareholders in this ranking are members of the categories of investors that tend to rank high for quality as shown earlier in Table 3.[187] Among the larger members of this grouping, the Endowment category is represented by the Bill & Melinda Gates Foundation; Asset Managers by Capital Research Global Investors; Corporations by Berkshire Hathaway; Hedge Funds by Pershing Square; Insurance companies by State Farm Insurance.

[186] Borochin & Yang, *supra* note 180 at 175.

[187] *See supra* text accompanying note 106.

Table 6. Top Quality Shareholder Portfolios[188]



In legal scholarship, Belinfanti features Bushee's method prominently, describing it as a "contemporary" method to "drill down" beyond conventional classifications to focus on important behaviors and propensities.[189] Dallas and Berry use Bushee's classification system in empirical work on shareholder voting regimes, stressing the particular importance in shareholder voting of time horizons and concentration levels.[190]

As noted, in the current debate over Delaware's judicial review of board decisions that are approved by a shareholder vote, the empirical research of Cox, Mondino, and Thomas examines time horizon and concentration levels across a variety of formal investor types, such as endowments, asset managers, and pension funds.[191] In turn, that work is modeled on such a method that is widely recognized in the finance literature. All are akin to the Bushee system's focus on time horizon and concentration levels.

As another example, Sampson and Shi drew upon Bushee's classification, finding evidence that transients have a greater presence and quality shareholders (dedicated) a lesser presence over the period

[188] Lawrence A. Cunningham, Quality Shareholders Initiative (unpublished) (on file with the author).

[189] Belinfanti, *supra* note 20, at 820.

[190] *See* Dallas & Barry, *supra* note 22, at 625-26.

[191] *See* Cox et al., *supra* note 23, at 559-65.

from 1980–2013.[192] These observations take into account both time and conviction. Cremers and Sepe explain that accounts in the legal literature tend to present investors in "dichotomic" terms, as always short-term or always long-term, while the truth is more complex, requiring "a more exact taxonomy of institutional investor behavior: that includes time horizons and conviction levels.[193]

When it comes to shareholder voting, the Bushee categories are especially useful, because they are probative of the things Delaware courts have always signaled are important.[194] Quality shareholders were the dominant cohort from the 1940s to the 1980s — the period before either indexing or day trading emerged — when Delaware so exuberantly embraced shareholder voting's power to help boards avoid scrutiny of their decisions.[195]

Since then, Delaware courts have emphasized being disinterested and informed, again hallmarks of the quality shareholder. These traits are unlikely to be applicable to indexers, whose ownership of virtually every company presents conflicts and whose low-cost business model limits the capacity to be informed. Nor do they tend to characterize transients, for whom information costs are high and for many, especially arbitragers around mergers, creates conflicts.

Institutional shareholders should not simply be presented generally as sophisticated but segmented into particular traits relevant to a particular context. They may or not be sophisticated in any sense relevant to reliable shareholder voting — at least for the specific purpose of judicial deference to a board's decision-making. It is fair to say that institutional shareholders, as a group, alter the traditional rational *apathy* problem that plagues individual shareholders to something like a rational *reticence* problem.[196] It is true that certain types of institutional shareholders pose particular sorts of new problems, such as public pension funds with political conflicts, union pension funds that might promote labor goals over shareholder goals, arbs with skewed incentives, indexers and other cross-holders with conflicts.[197]

It is not safe to say that institutions are invariably more sophisticated than individuals. Many individuals are more sophisticated than many

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[192] *See* Rachelle Sampson & Yuan Shi, *Are Investor Time Horizons Shortening?*, 41 SEATTLE U. L. REV. 543, 549 (2018).

[193] Cremers & Sepe, *supra* note 89, at 388.

[194] *See infra* Appendices A, B.

[195] *See id.*

[196] Gilson & Gordon, *supra* note 79, at 867.

[197] *See supra* text accompanying note 151.

institutions. My research has identified dozens of sophisticated individual QSs, including luminaries, past or present, such as Ron Baron, Warren Buffett, Mellody Hobson, John Maynard Keynes, and Meryl Witmer.[198] Most people could name plenty of inferior institutions; a good list starting with Bear Stearns and Lehman Brothers[199] and followed by a dozen more, such as Countrywide, Deutsche Bank, J.P. Morgan, Merrill Lynch, Morgan Stanley, Washington Mutual, and Wells Fargo,[200] plus Bank of America, Citigroup, Goldman Sachs, and Morgan Stanley.[201] Add to this list the short-sellers pummeled by masses of individual traders through Reddit platforms and RobinHood apps: Citron, Melvin Capital, and Point72.[202]

Institutional investors adopt diverse philosophies, many pivoting around time horizon and concentration. Indexers buy the market, intending to hold forever, and believe that markets are efficient. Transients time the market, eking gains from inefficiencies. Neither is a regular consumer of proxy statements and other shareholder information that companies produce.[203] In contrast, that is the daily diet of quality shareholders.[204] Transients never hold for long, by definition, while indexers always sell when a stock is removed from the index; the favorite holding period of quality shareholders, to quote Buffett, is forever.

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198 CUNNINGHAM, *supra* note 93, at 182.

199 *See* Lucian A. Bebchuk, Alma Cohen & Holger Spamann, *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008*, 27 YALE J. REG. 257, 272-73 (2010) (discussing irrational behavior of major investment firms in setting executive compensation).

200 *See* Brent J. Horton, *Toward a More Perfect Substitute: How Pressure on the Issuers of Private-Label Mortgage-Backed Securities Can Improve the Accuracy of Ratings*, 93 B.U. L. REV. 1905, 1919-23 (2013) (discussing irrational investors in the MBS market and naming those firms).

201 *See* Mary Kreiner Ramirez, *Criminal Affirmance: Going Beyond the Deterrence Paradigm to Examine the Social Meaning of Declining Prosecution of Elite Crime*, 45 CONN. L. REV. 865, 883-84 n.74 (2013) (naming the relevant institutions).

202 *See* Ben Winck, *GameStop Short-Sellers Melvin Capital and Citron Surrender Bearish Bets After 700% Rally Drives Huge Losses*, BUS. INSIDER (Jan. 27, 2021, 9:42 AM), https://markets.businessinsider.com/news/stocks/gamestop-stock-short-sellers-melvin-capital-citron-surrender-bets-gme-2021-1 [https://perma.cc/XGV2-EWJS]; Gregory Zuckerman & Geoffrey Rogow, *After GameStop Backlash, Citron Research Will Stop Publishing Short-Seller Reports*, WALL ST. J. (Jan. 29, 2021, 9:56 AM ET), https://www.wsj.com/articles/citron-research-will-stop-publishing-short-seller-reports-11611932211 [https://perma.cc/V6BH-X28Y].

203 *See* Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2118 n.227 (2019) (explaining that major indexers rarely open SEC filings).

204 Cunningham, *The Case for Empowering Quality Shareholders*, *supra* note 35, at 9-12.

Professor Lipton summarizes:

> the same sophistication and diversification that justifies increasing reliance on the shareholder vote also gives rise to conflicts that make the shareholder vote an imperfect measure of the advisability of a proposed action across all equity holders. Delaware courts are trapped in an ouroboros: even if it were possible to tease out all of the myriad conflicts these entities face (a likely impossible task), to do so would leave the smallest, and least sophisticated, shareholders to approve deals, which would undermine the basis for relying on their votes to avoid judicial scrutiny in the first place.[205]

The quality approach avoids this problem. To the contrary, by diminishing the power of indexers and transients, the focus is on the highest quality shareholders, justifying rather than undermining this reference to shareholder votes.

2. The Board's Menu

To crystalize the proposal, consider illustrative approaches a board could use to identify a company's quality shareholders and implement MoQ voting. As is always the case, the board and corporate secretary schedule the shareholders' meeting and set a record date in the usual manner for all votes to be taken, whether statutory or contractual and whether MoM or MoQ. The board resolution calling for the MoQ vote would specify eligibility rules and any appeals process. These would be disclosed in the related proxy statement along with the rules applicable to such statutory and other votes. For the MoQ vote, disclosure would emphasize its precatory informational character, and not a legally required or legally binding resolution.

MoQ eligibility rules are a combination of minimum duration and minimum concentration. But the exact approach a board takes to delineating them will vary across a continuum that prioritizes inexpensive expediency at one end with costly precision at the other. For instance, some will accept paying a third-party service that already produces rankings of shareholders in these ways while others prefer creating their own algorithm tailored to suit. Some may be content with the portfolio-level classifications such services provide on general investor behaviors — average holding periods and overall portfolio concentration — while others will want the specific information about each investor's particular holdings in the company.

[205] Lipton, *supra* note 11, at 324.

Within that broad range of variables and discretion, many permutations are available. The easiest approach is for the board to refer to existing external databases ranking shareholders by these two metrics. Examples are those of Professor Bushee, EQX, and QSI.[206] All provide reliable inputs and rankings of a large number of institutional shareholders that file required periodic portfolio reports with the SEC.[207] Each database differs slightly in the covered population, the criteria applied, and the resulting classification scheme. This variety provides a menu for boards to choose from along with varying implications to address shareholders not included in a database.

For example, Professor Bushee's academic database classifies investors into dedicated, transient, and quasi-indexer, based on the combination of average holding periods and overall concentration level. A board could declare that all the company's shareholders classified in the Bushee database "dedicated" are eligible to vote as QSs, but not those classified as transient or quasi-indexer.[208]

Bushee's database aggregates each investor's portfolio, rather than its holdings in a particular company.[209] Some boards may be content with such an aggregation as indicia of shareholder quality generally, while others may wish to focus on the shareholder's particular positions in the company. The latter may turn to a service such as EQX. The EQX database is also maintained in a general format ranking investors by average relative holding periods and overall concentration levels but can be readily tailored to particular companies using a wide variety of criteria any board might specify.[210] The board could specify that the company's QSs for purposes of the vote are those having held the particular stock for at least x years and representing at least y% of its reported equity portfolio in that stock. Essentially any combination of variables a board wishes may be specified.[211]

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[206] Bushee, *supra* note 14; *Long-Termism Through Finance*, *supra* note 183; Cunningham, *QSI*, *supra* note 182.

[207] *See generally* SEC. EXCH. COMM'N, FORM 13F, https://www.sec.gov/pdf/form13f.pdf (last visited Sept. 2, 2021), [https://perma.cc/ZMG2-KRXT] (providing an example of Form 13: the form that "every Manager which exercises investment discretion with respect to accounts holding Section 13(f) securities . . . shall file").

[208] *See* Bushee, *supra* note 14; *supra* text accompanying notes 173–178.

[209] Email from Brian Bushee, Univ. of Pa., to Lawrence A. Cunningham, *Your Database — Dedicated Shareholders* (June 30, 2021, 09:11 PM) (on file with author).

[210] *See* email from Matthias Pitkowitz, EQX, to Lawrence A. Cunningham, *Question* (June 30, 2021, 06:03 PM) (on file with author).

[211] Many permutations are also possible. For instance, a board could treat most shareholders using the Bushee classification plus permit any who would be ineligible

For shareholders not in a designated database, the board could invite shareholders to self-select into the MoQ vote by submitting reasonable evidence of meeting the criteria used in the corresponding database eligibility protocol. For institutional investors, the board could require a corporate officer certificate with an accompanying condensed statement of assets or investments; for individuals, self-certification should suffice. For both, the company could readily create a portal on its website where shareholders submit required information in machine-readable form that can be readily tabulated and aggregated. Services such as EQX could assist related internal corporate staff from the technology and legal departments to assure integrity to the system.

For boards that prefer company-created matrixes to outsourcing this function, the board would state eligibility parameters separately for duration and concentration. Concerning duration, for example, the board could set at one, two or three years akin to determining shareholder eligibility for other purposes, such as making shareholder proposals.[212] Verification could be done in the same way it is done for this and the many other corporate settings where share ownership duration is a requirement or factor, as for companies that have used time weighted voting do so.[213]

Concerning concentration, for institutional investors, the easiest and most objective approach would refer to standing databases of independent researchers that delineate most institutional investors by concentration. A good example is the active share measure of Professors Cremers and Pareek.[214] Measuring portfolio construction on a 0-1 scale from pure index to pure concentration, the board could declare all those with active shares exceeding 0.8 count but not others. A board could set the general active share measure as the default and permit shareholders ineligible given their overall portfolio active share to show they are nevertheless concentrated in the particular company's stock within the board's threshold.

Menus such as these enable boards to calibrate the value of an MoQ with the associated degree of administrative difficulty, both of which

under its portfolio-level classification to show being an eligible shareholder for the particular company.

[212] *See* Shareholder Proposals, 17 C.F.R. § 240.14a-8(b)(1)(i) (2021) (amending traditional eligibility requirements to make shareholder proposals from a minimum of one year to different minimum amounts based on ownership intervals of one, two, or three years). Shareholder lists are readily sorted by purchase date.

[213] *See* Cunningham, *The Case for Empowering Quality Shareholders*, *supra* note 35, at 67-68 (discussing adoption of time-weighted share voting by a dozen U.S. companies and numerous French ones).

[214] *See* Cremers & Pareek, *supra* note 137.

will vary. The costs of the various options will vary with such factors as a company's number of total shareholders, number and percentage of institutional shareholders included or excluded from the relevant databases, and number and sophistication of individual shareholders. Efficacy would likewise vary, probably being unwieldy for some companies — such as those with millions of shareholders or complex capital structures — but attractive for thousands of companies, especially those with simple capital structures and only hundreds of shareholders.[215]

Moreover, errors of both over- and under-inclusion are inevitable given the fragmented and complex U.S. recordkeeping system of share ownership. For example, gaps arise due to differences between families of funds and individual funds and between quarterly and annual filers and due to how individual shareholders may hold stock directly through the issuer or indirectly through a variety of brokers, dealers, and other intermediaries. Neither companies nor the databases referenced above can guarantee classification precision, even when their systems operate at peak accuracy.[216]

But such problems afflict all contemporary shareholder voting situations, so this cannot be a reason to reject an MoQ.[217] To the contrary, such problems afflict votes mandated by statute or contract and nevertheless are legally binding.[218] MoQs are far more modest, being a non-binding way for boards to generate more reliable shareholder information and for others, including judges, scholars and fellow shareholders, to have an additional basis for weighing the meaning of a shareholder vote. Moreover, with the increased

[215] That means the proposal's addressable company population numbers are in the several thousands, as only the largest public companies have more than one-thousand shareholders. For example, using Bloomberg data for the largest 250 companies, we identified the number of institutional shareholders. Only Amazon, Apple and Microsoft have more than 5,000; 19 of these largest 20 companies have fewer than 1,000, including Airbnb, Palantir, and Snowflake. Company Search for Active U.S. Companies on the NYSE with Greater than One Institutional Shareholders, BLOOMBERG (on file with author).

[216] *See* Pitkowitz, *supra* note 210.

[217] *See* Marcel Kahan & Edward B. Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1249-54 (2008) (referencing three examples of problems in shareholder voting situations: (1) voting materials did not arrive; (2) voting tabulator stopped tabulating votes too early; and (3) difficulties verifying votes).

[218] A famous example occurred in a Procter & Gamble shareholder proxy contest where the voting margin was slight and a recount was required. *See* Crystal Kim, *P&G: How Many Proxy Recounts Do We Need Until We Admit There's a Problem?*, BARRON'S (Nov. 22, 2017, 11:14 AM ET), https://www.barrons.com/articles/p-g-how-many-proxy-recounts-do-we-need-until-we-admit-theres-a-problem-1511363970 [https://perma.cc/4DML-ZRU8].

application of blockchain technology to shareholder lists and records, it will become feasible and increasingly easy to create and maintain required information to reduce such errors and promote the efficacy of MoQ voting.[219]

C. Objections

Ready objections to this proposal would challenge the distinctive weight placed on time horizon and concentration. Why do these factors warrant such emphasis? After addressing both time horizon and concentration, this Section considers implementation challenges.

1. Time Horizon

This objection can be made as a matter of theory and empirics or policy and law. As a matter of theory, corporate law professors have for decades engaged in an unresolved debate over shareholder time horizons. Some critics challenge the shareholder value maximization norm because short-term shareholders pressure managers for short term results with related evidence of earnings management[220] while others cite evidence of short-termism to demand that corporations take greater social responsibility.[221] On the other side of the debate, many corporate law scholars find evidence of short-termism too limited to warrant substantial legal or policy changes.[222]

Resolving that debate is not necessary to weigh the import of a shareholder vote that consists of shareholders with a wide range of

219 *See* Cunningham, *The Case for Empowering Quality Shareholders*, *supra* note 35, at 80-81. In 2017, Delaware corporate law was amended to permit companies to use blockchain (or distributed ledgering) to maintain their shareholder lists. *See* DEL. CODE ANN. tit. 8, § 219(c) (2017). These enable digital records showing every transaction involving every share of stock, with precise details of beneficial rather than street ownership as well as duration and other data.

220 *See* Lynne Dallas, *Is There Hope for Change? The Evolution of Conceptions of "Good" Corporate Governance*, 54 SAN DIEGO L. REV. 491, 538 (2017).

221 David Millon, *Shareholder Social Responsibility*, 36 SEATTLE U. L. REV. 911, 914 (2013) ("[T]here is broad agreement that short-termism is widespread in the current investment landscape.").

222 George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 149-50 (2010) (very little evidence of short-termism); Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 1004 (2013) (insufficient evidence to warrant changes in corporate law); *see* Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1643-44 (2013) (arguing there is little evidence that short term holder influence undermines long-term value creation); Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE L.J. 1554, 1582 (2015).

holding periods in a particular company's stock (or proxied by their overall portfolio horizon). It is defensible to believe that short-term owners will vote according to short-term interests, whether or not that is optimal or profit-maximizing for the corporation and its shareholders taken as a whole.[223] It is true that activists motivated by short-term interests must persuade a critical mass of others; if those are mostly indexers rather than activists, the result does not negate the critique.[224]

Turning to policy, skeptics might ask in what other contexts shareholder time horizons are taken so seriously. Why punish newly acquired shares, for instance, of a holder with the intention of holding forever? One close analogy is to private voting rules of a dozen public companies that have experimented with tenured voting, usually granting enhanced voting power to shares held for more than four years.[225]

In public law, three years is the time frame used in Delaware's corporate statute limiting business combinations with interested shareholders[226] as well as in SEC rules regulating the making of shareholder proposals.[227] One year is the longstanding dividing line for capital gains tax treatment under federal income tax law.[228] Each of these is tailored to the particular context and are *ex ante* rules; judicial presumptions to aid judges in determining what deference is due to boards in light of shareholder votes is inherently flexible for litigants and judges to gauge in the particular case.

Delaware courts have repeatedly said that directors may segment the shareholder base in such ways, with a frequent focus on holding periods, especially short ones.[229] For example, as bidding rose in the

[223] *See* Fried, *supra* note 222, at 1583-84 (referencing that sometimes short-term shareholder interests do not "align with [profit] maximization").

[224] *See* Luca Enriques, Ronald J. Gilson & Alessio M. Pacces, *The Case for an Unbiased Takeover Law*, 4 HARV. BUS. L. REV. 85, 96 n.36 (2014).

[225] *See* Edelman et al., *supra* note 88 at 1005 n.89. *But see* David J. Berger, Steven Davidoff Solomon & Aaron J. Benjamin, *Tenure Voting and the U.S. Public Company*, 72 BUS. LAW. 295, 297 (2017).

[226] DEL. CODE ANN. tit. 8, § 219(c) (2017).

[227] *See generally* Shareholder Proposals, 17 C.F.R. § 240.14a–8(b)(1)(i)(A) (2021) (discussing the process for shareholder voting and proposals).

[228] *See* 25 U.S.C. § 1222(3).

[229] *E.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1386 (Del. 1995) ("This Court has stated that distinctions among types of shareholders are neither inappropriate nor irrelevant for a board of directors to make, e.g., distinctions between long-term shareholders and short-term profit-takers, such as arbitrageurs, and their stockholding objectives."); *see* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341-42 (Del. 1987); Unocal Corp. v. Mesa Petroleum, Co., 493 A.2d 946, 955-56 (Del. 1985) ("[A] board may reasonably consider the basic stockholder interests at stake, including

battle waged by Air Products for control of Airgas, many Airgas shareholders, including some quality shareholders, sold.[230] With almost half the remaining shares in the hands of transients, the Airgas board expressed concern that they would simply accept the $70 bid despite the company's greater long-term value.[231]

When Airgas's board tried to thwart the Air Products bid, a court battle ensued. Despite some skepticism — noting that many long-term holders had sold to the transients — the judge agreed with the board. After all, the judge noted, Air Products' own experts had acknowledged that many transients would sell at $70, even if they thought AirGas's long-term value was greater.[232]

In short, while transients may cast their lot according to immediate cash values, QSs take the long view. They always consider and generally support valid management plans over multiple time periods, giving due consideration to building value. If boards, such as Airgas, can consider transient dominance to defeat hostile tender offers, they certainly can evaluate how their ordinary business judgments shape the shareholder base.

2. Investment Conviction

A second objection asks why portfolio concentration in a given stock is probative. Some argue that the larger indexers command vast economies of scale and scope to grasp issues quickly across many diverse companies.[233] Others contend that their incentive to increase AUM alone suffices to assure casting informed votes — the greater a company's market capitalization, the more AUM indexers own in it, and the higher their fees.[234] They emphasize substantial behind-the-scenes avenues of engagement outside the limelight.[235] They point to how the

those of short term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long term investor.").

[230] *See* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 55-56 (Del. Ch. 2011).

[231] *Id.* at 56.

[232] *Id.* at 111.

[233] Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 26 (2019).

[234] Marcel Kahan & Edward Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders* 1793 (Eur. Corp. Governance Inst. Working Paper Series in Law, Paper No. 467/2019, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098# [https://perma.cc/949F-VXV4].

[235] Fisch et al., *supra* note 233, at 25 (referencing that "active funds compete based on . . . the use of their investment discretion").

largest three have publicized their decisions to increase their stewardship staff, even doubling headcount in one case.

Critics question these assertions.[236] Concerning maximizing AUM, of course, it is not in the interests of shareholders simply to grow — retaining and deploying earnings in suboptimal projects does that while hurting shareholders. At many companies, shareholders are best served not by increasing size but by dividends, buybacks, divestitures, spin-offs, and other techniques that reduce rather than increase corporate size.[237]

As troubling for supporters is the small staff size — even after the vaunted increases — in relation to the number and size of companies to be followed. Among largest indexers: BlackRock doubled its stewardship staff to 45; Vanguard has 21; and State Street 12. Yet these indexers have holdings in more than 11,000 companies each worldwide, and at least 3,000 in the U.S. alone. They cast votes at more than 4,000 annual meetings adding up to more than 30,000 proposals.

Put in dollar terms, total stewardship investment is about $13.5 million, $6.3 million, and $3.6 million, respectively, all less than one-fifth of 1% — only 0.2% — of total fees and expenses. Even if the staff focused only on the largest companies — say where their stakes exceed $1 billion, which still adds to hundreds — they could only devote two to four person-days per year studying them. The following table presents the stark picture.[238]

Table 7. Index Fund Engagement Resources

	BlackRock	Vanguard	SSGA
Stewardship Staff	45	21	12
Investees Worldwide	11,246	13,225	12,191
Investees U.S.	3,765	3,672	3,117
Maximum Person Day	<4	<2	<2
Stewardship Expense	$13.5 million	$6.3 million	$3.6 million
Total Fees & Expenses	$9.1 billion	$3.5 billion	$2.6 billion

[236] *See* Bebchuk & Hirst, *supra* note 203 (agency cost indictment of indexer capability).

[237] *See* CUNNINGHAM, *supra* note 93, at 29 (example of Washington Post Co.); *id.* at 113-26 (series of illustrations).

[238] *See* Bebchuk & Hirst, *supra* note 203, at 2077-78 (compiling data from Morningstar).

For context, consider the head count at two other companies involved in investment analysis. S&P Global, the bond rating agency covering a large swath of capital markets, employs 22,500 people.[239] Among the largest quality shareholders, Capital Group, which keeps up with a far smaller portfolio of companies, 7,500.[240]

Even assuming vast economies of scale or scope and motivation to boost AUM, it is hard for many to believe that such limited resources suffice to yield informed opinions on the tens of thousands of shareholder decisions required of an owner of shares in many thousands of companies. While many decisions are quotidian, at least a significant portion would require some knowledge that would entail reading the annual report and proxy statement, determining the company's strategic plan and past performance, components of its executive compensation plans, and pending shareholder and management proposals. Yet the evidence indicates that the big indexers access governance related public filings of their investees at surprisingly low rates.[241]

When it comes to so-called private engagement, the probabilities and public record point to inherent limitations. From 2017 through 2019, the largest indexers reported having multiple annual engagements with only a handful of their investees — 3.9% at Blackrock, 2.3% at Vanguard, and 0.6% at State Street; they had just one engagement with another 7.2%, 3.5%, and 5.0%, respectively.[242] In other words, over a recent three-year period, these firms had no engagement with the overwhelming majority of the companies they invest in.

Beyond the largest indexers, the smaller ones are influenced by the centralized voting recommendations of the two large proxy advisory firms, Institutional Shareholder Services ("ISS") or Glass Lewis. The two oligopolists, one owned by private equity and the other by two large Canadian pension funds, operate with lean staffs on low budgets. With just 1,000 employees at ISS and 1,200 at Glass Lewis, they cover a huge market: ISS boasts 1,700 institutional clients while Glass Lewis's clients together manage $35 trillion in assets.[243] Their small crews opine on

[239] *S&P Global*, WIKIPEDIA, https://en.wikipedia.org/wiki/S%26P_Global (last visited Sept. 3, 2021, 11:32PM) [https://perma.cc/777S-RX6H].

[240] *Capital Group Companies*, WIKIPEDIA, https://en.wikipedia.org/wiki/Capital_Group_Companies (last visited Sept. 3, 2021, 11:32PM) [https://perma.cc/539Y-PED5].

[241] *See* Bebchuk & Hirst, *supra* note 203, at 2081 n.132 (citing Peter Iliev, Jonathan Kalodimos & Michelle Lowry, Investors' Attention to Corporate Governance (Nov. 22, 2020) (unpublished manuscript) (available for download at https://ssrn.com/abstract=3162407) [https://perma.cc/4TSM-WVX7].

[242] *Id.* at 2087.

[243] Copland et al., *supra* note 147, at 2.

hundreds of thousands of separate decisions annually — ISS addresses 40,000 annual meetings and Glass Lewis 20,000.[244]

Measuring the exact influence of ISS and Glass Lewis is difficult since some investors might vote the same way anyhow. But estimates range from swaying 6% to 33% of any given vote, significant considering that many are decided by small margins. Evidence also shows that institutional investors are substantially more inclined to vote for proposals that advisors support than oppose — by margins ranging from 16-27% on executive compensation to 64-73% on directors in contested elections.[245]

Two forces propelled proxy advisors to such prominence. The rising popularity of low-cost index fund investing has made it too expensive for indexers to do independent research. That stokes rising market demand. Since 2003, the Securities and Exchange Commission has let institutional investors meet their fiduciary duty to adopt and disclose proxy voting guidelines by relying on advisors. That created a governmental license for such firms, a recipe for market failure.

Under this government-sanctioned system, indexers not only avoid homework and responsibility for stock selection but for voting decisions. As indexers pushed their fees toward zero, they shifted from traditional market competition based on price to a novel form of competition based on virtue signaling: they woo customers by stressing social and environmental factors in their voting preferences. While advisors disclose little about how they develop their guidelines, they do stress surveying such indexer appetites.

[244] The 12,000-person workforce at Moody's, conducting comparable coverage in scope, is ten to twelve times these; the Capital Group team of 7,500, covering a fraction of the scope, is four to seven times as large. *See* CUNNINGHAM, *supra* note 93, at 30.

[245] James R. Copland, David F Larcker & Brian Tayan, *Proxy Advisory Firms: Empirical Evidence and the Case for Reform*, MANHATTAN INST. (May 21, 2018), https://www.manhattan-institute.org/html/proxy-advisory-firms-empirical-evidence-and-case-reform-11253.html [https://perma.cc/K6D4-MEEB]; *accord* Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisory Firms: Myth or Reality?*, 59 EMORY L.J. 869, 870-72 (2010) (distinguishing correlation and causation); Christie Hayne & Marshall D. Vance, *Information Intermediary or De Facto Standard Setter?: Field Evidence on the Indirect and Direct Influence of Proxy Advisors*, 57 J. ACCT. RSCH. 969, 1003 (2019) ("Boards succumb to [proxy advisor] influence by making changes to their compensation design both before and in response to proxy voting . . . ."); Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 889-90 (2007) ("ISS advice has been cited as a decisive factor in a number of major corporate events . . . .").

3. Implementation

For directors, the concept of the MoQ is inherently appealing because it is optional. For certain directors, it will appeal because the quality cohort tends to be the most valuable cohort to promote long-term corporate interests.[246] More cynically, MoQ approval adds weighty evidence supporting deference to their decision if dissenting shareholders challenge it.

Yet directors might be concerned that asking for a QS vote signals that they are uncertain about the proposal or their role in betting it. But if the condition were made at the outset, before finalizing the proposal, this concern should disappear. Even if added at the end, a board can simply explain the value of the additional step in the deal approval process.

Directors must stand for election with votes cast by all shareholders. With majority rules, directors cater to the majority of the whole, not majority of segments. Accordingly, directors will opt for a MoQ only when they believe that the majority of the whole would concur with holding such a step.[247] Shareholder views may depend on the topic, the board, the shareholder list, and the company.

For instance, an MoQ may have greatest appeal on the topic of dividend policy, with a board that includes significant share ownership, a shareholder list that is most taxable, and a company with a good track record of capital allocation; at the other extreme might be a vote on defensive measures (such as poison pills and staggered boards), a board viewed as unduly deferential to management, a shareholder list that includes activists, and a company that persistently underperforms.

For votes involving transactions with third parties, such as mergers, the other side will treat an MoQ condition as an additional risk that the deal will not proceed. Some may view such a condition as likely to lead the board to negotiate for a superior deal. That might influence opening bids in a negotiation, a buyer offering a lower starting bid, for instance, anticipating the need to add more later. In some cases, such parties might balk at the prospect that some of the shareholders, rather than the board, have the last word on a transaction.

On the other hand, each of those three points arises for any shareholder vote, including MoM conditions. True, there is incremental closing risk, a chance for altered opening bids, and resistance to proceeding, but directors should be able to meet these concerns. For

[246] *See generally* CUNNINGHAM, *supra* note 93, at 25-27 (discussing the comparative advantage of shaping shareholder bases through valid management plans).

[247] *See* Goshen & Hannes, *supra* note 9, at 306-08.

instance, they can assure the other side that they would not opt for an MoQ if they had doubt about its prospects and therefore be able to offer assurances that dampen if not eliminate the desire to bid low or resist proceeding. Moreover, all such issues arise in all contexts where participants include deal protection clauses that run the risk of being invalidated. In other words, these are familiar problems that participants routinely anticipate, negotiate and price.

Finally, the MoQ would appeal most to boards prepared to signal the corporate importance of long-term focused shareholders. They would also have to be prepared to face challenges that might be mounted by other shareholders and explain the advantages to them of such a vote. The principal risk would be objections of powerful political groups in corporate governance, particularly indexers and transients.

While quality shareholders may welcome an MoQ in a given case, indexers and transients may well object, as might those who anticipate taking new opportunistic positions in companies announcing transactions, such as mergers, requiring a shareholder vote. There are several responses.

First, how much weight to give such objections will vary by company and transaction. Each board would decide whether an MoQ was appropriate in the particular circumstances. These deal-specific and contractual features distinguish the MoQ from other alternative voting arrangements, such as dual class or tenured voting, which are preset for all votes of designated types in corporate charters or bylaws.[248]

Second, such objections can only be partial, as the voice of all shareholders is still heard in the required statutory approval as well as any MoM vote; their voice is squelched only in the potential veto vote of the MoQ. Again, this is unlike other alternative voting arrangements, such as dual class, which draw criticism for permanently muting the voice of non-founder shareholders and eliminating managerial accountability.[249] An MoQ produces no such effects.

Third, the logic that justifies MoM exclusion of interested shareholders, while including transients and indexers, applies to the MoQ exclusion of non-quality shareholders as well: to minimize voting imperfections. If disinterested indexers and transients consider MoM votes to be a valid exercise of corporate power, consistency would require upholding MoQs as well.

[248] Cunningham, *The Case for Empowering Quality Shareholders*, *supra* note 35, at 61-71.

[249] *Id.* at 65.

Moreover, all shareholders would benefit from the MoQ in two ways. First, they stand to gain by free riding on the effort QSs tend to invest in research and monitoring their investments. Second, even shareholders who generally vote no, or in in a particular case, benefit because MoQ approval provides an additional way to challenge a vote in court. For instance, if the MoQ is not met, as the quality shareholders voted no, courts have less reason to defer, even if a majority of the minority approved.

Finally, worth noting is that shareholders wishing to circumvent the rule would face significant costs to do so. For instance, in a merger, absent such a clause, QS may sell to merger arbs, who hold the vote and bear the risk that the merger does not close. That is part of the point of the MoQ, and something that would keep QSs interested in continuing to hold. In order to undermine this intent, those interested in selling would have to enter into a futures contract with the prospective buyer, in which the seller agrees to vote for the merger, and both agree to transfer the shares after the merger closes.[250]

In court, judges would continue to apply all existing doctrines as before, using this additional feature prudentially to inform their ultimate judgment. Directors must calculate probable outcomes when deciding to include the condition or not in a particular resolution. That would induce attention to the appetites of the quality shareholder. In short, for judges, MoQ votes would provide an additional valuable data point to help them reach difficult judgments about what corporate behavior warrants how much deference, at limited cost.

CONCLUSION

Imagine how a MoQ would have changed the outcome of the Dell going private transaction mentioned in the Introduction. An independent board committee needed to push back against a controlling shareholder. Its principal leverage was the hurdle of obtaining a majority of the minority shares. It cleared that hurdle by a hair. The winning voting side included the pre-existing index owners as well as a substantial inflow of transients. Had the committee faced an additional hurdle of a majority of the quality shareholder vote, it would have either pushed back harder to give them a better deal or have failed to win the vote.

[250] *Cf.* Katz v. Oak Indus., Inc., 508 A.2d 873, 876-77 (Del. Ch. 1986) (discussing a restructuring agreement and exchange offer that required securities holders to consent to proposed amendments in order to tender their securities).

A MoQ vote both preserves the voting franchise of all shareholders, while adding a higher quality vote of shareholders that do not face the systemic problems that diversified indexers and short-term transients face. One problem is staying fully informed. Indexers face serious constraints on their ability to process information on the tens of thousands of votes they must cast annually. They may snap to attention for some high-ticket mergers, but their low-cost business model means small budgets and lean staffs. Transients, meanwhile, tend to prefer market calculations to business information.

Another problem concerns conflicts of interest. Indexers buy shares in virtually every public company, often owning shares in both sides to a deal, such as a merger. Even if merger terms are unfair to a buyer, indexers reap offsetting gains on the seller side and approve the buyer's proposal anyway. Transients pounce when mergers are announced, many taking multiple positions so that their best outcome is for the merger to close, whichever side terms favor.

By adding a MoQ clause, a board would signal the corporate importance of long-term focused shareholders. Other shareholders might balk at first, such as indexers to guard their influence and transients to protect arbitrage positions. But both should come around, when they understand how the separate vote of the quality shareholders adds value.

As for practical implementation, segmenting the shareholder list for quality is easier than one might imagine. Researchers use a respected technique based on a combination of holding periods and concentration levels. Boards use discretion in tailoring eligibility rules to suit, from choosing the minimum holding period to setting how to determine concentration.

There may be incremental costs to adding an MoQ clause, defining eligibility, administering the vote, addressing borderline cases, and litigating all of this. But these are the same costs associated with MoM clauses, and the MoQ benefits from shareholder protection would likely be significant. Former Dell shareholders can attest to that.

APPENDIX A: BOARD APPROVAL

Doctrine and practice always evolve. Interested transactions were once void. Then they gradually became voidable. One route was approval by disinterested directors. But that was far from automatic, at least early on and at least in certain settings.

A. Early Exploration (1940–1980)

In early modern Delaware corporate law, judges rarely excused conflicts based on the approval of disinterested directors.[251] But as early as 1960, when most shareholders were individuals and just 20% of directors were independent, Delaware courts began to grant legal significance to director status.[252]

During the 1970s, independent directors gradually began to appear in corporate boardrooms, moving from 25% in 1965 to 40% by 1980.[253] They made a difference in court. For instance, a board with a majority of outside directors (five of nine) won judicial deference in *Puma v. Marriott*.[254] In a contrasting landmark, *Sinclair Oil v. Levien*,[255] where no independent directors were present, they had the burden of proving the fairness of a decision that appeared to benefit the parent in a way that did not benefit the minority.

Accordingly, while courts in the 1970s had begun to recognize director independence as a reason to apply business judgment rule deference to a board decision,[256] before the 1980s director

[251] The classic example arose concerning breach of the duty of loyalty by usurping a corporate opportunity. In *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939), the Delaware Supreme Court admonished: "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest."

[252] In *Beard v. Elster*, 160 A.2d 731, 738 (Del. 1960), the Delaware Supreme Court wrote: "We think the fact that a disinterested Board of Directors reached this decision in the exercise of its business judgment is entitled to the utmost consideration by the courts in passing upon the results of that decision."

[253] *See supra* text accompanying notes 41–47.

[254] Puma v. Marriott, 283 A.2d 693, 696 (Del. Ch. 1971) ("[S]ince the transaction complained of was accomplished as a result of the exercise of independent business judgment of the outside, independent directors whose [sole] interest was the furtherance of the corporate enterprise, the court is precluded from substituting its uninformed opinion for that of the experienced, independent board members . . . .").

[255] Sinclair Oil v. Levien, 280 A.2d 717, 720 (Del. 1971).

[256] *See* Gimbel v. Signal Cos., 316 A.2d 599, 609-10 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974) (applying business judgment rule to valuation in sale of assets where

independence was not routinely stressed as an ideal. After all, through this period, the vast majority of directors were also corporate officers.[257] But changes were afoot, seen in a statutory innovation to address the persistent challenge of interested director transactions.[258]

At early common law, many courts held that transactions between a corporation and its directors were void.[259] The duty of loyalty prohibited them. But this strict rule prevented corporations from entering into a wide range of advantageous deals. Later courts relaxed that stance to render such transactions voidable, meaning not automatically disallowed, but could be challenged or sustained based upon a judicial assessment of their fairness to the corporation. The burden of proving fairness was on the directors and the business judgment rule did not apply.[260]

Due to continued perceived rigidity, states adopted interested director transaction statutes.[261] These authorize internal corporate procedures to approve interested transactions to protect them from judicial rebuke, typically by disinterested and fully informed director or shareholder approval. If directors can demonstrate meeting the statutory requirements, then the transaction enjoys a safe harbor from judicial review as to claims of conflict of interest.[262]

These statutes reflect a dominant corporate law motif: rules that channel corporate decision making into board rooms (and shareholder meeting rooms) rather than courtrooms.[263] This motif became the explicit exhortation of Delaware judges during the 1980s and 1990s.

"arm's length bargaining marked the transaction and the vote of interested directors was not necessary to approve the transaction").

257 *See supra* text accompanying notes 41–46.

258 DEL. CODE ANN. tit. 8, § 144 (2021).

259 *See* CUNNINGHAM, *supra* note 28, at 470-71.

260 This contemporary common law approach is illustrated by *Lewis v. S. L. & E., Inc.*, 629 F.2d 764, 769-70 (2d Cir. 1980) (applying New York law), holding that directors breached their duty of loyalty by effecting interested transactions unless they could prove they were fair to the corporation.

261 *E.g.*, DEL. CODE ANN. tit. 8, § 144 (2021).

262 *See* Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903, 910 (2011).

263 *See* Steven M. Haas, *Toward a Controlling Shareholder Safe Harbor*, 90 VA. L. REV. 2245, 2303-04 (2004).

B. *Explicit Exhortation (1980s–1990s)*

The 1980s ushered in a process-based emphasis on board information and independence.[264] While jettisoning some old doctrine, particularly the requirement that defendants show a proper business purpose,[265] the old chestnuts remained important on the issue of director independence.[266]

The transcendent case of this period is *Weinberger v. UOP, Inc.*[267] A cash out merger by a 50.1% parent with the sub, and parent calling all the shots. The sub's board had thirteen directors, six of whom were designated by the parent from among its officers, directors or advisors, and the parent had installed the sub's CEO, a long-time parent executive, who served on both the sub and parent boards.[268]

Two common directors, beholden to the parent, used the sub's resources to determine their highest price (up to $24 being a "good investment"). The sub president responded to the parent's bid by saying it "generous." A hurried process — with no negotiations — ensued. Both boards approved the merger in a joint meeting featuring overlapping directors and no effort to involve any independent directors — and no mention of the common directors' study, though they attended the meeting.[269]

The Delaware Supreme Court rebuked this process, urging both sides to have an independent board negotiating committee. It provided clear guidance many have followed in the decades since:

> Although perfection is not possible, or expected, the result here could have been entirely different if [the sub] had appointed an independent negotiating committee of its outside directors to deal with [the parent] at arm's length. . . . Particularly in a parent-subsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its

[264] *See* Matthew D. Cain & Steven M. Davidoff, *Form over Substance? The Value of Corporate Process and Management Buy-Outs*, 36 DEL. J. CORP. L. 849, 851-52 (2011).

[265] *E.g.*, Bennett v. Propp, 187 A.2d 405, 411 (Del. 1962).

[266] The following case review focuses intensively on the issue of board independence, as these landmark cases have been elaborately detailed in an abundant literature over many years, most recently in the copious treatment of Professors Cox and Thomas, *supra* note 8, at 380-81. A graphic summary of this aspect follows the discussion. *See supra* Table 4.

[267] Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

[268] *Id.* at 704-05.

[269] *Id.* at 707-08.

> bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness.[270]

Likewise, the other landmark case of this era that permanently altered corporate law and practice was *Smith v. Van Gorkom*.[271] It famously held personally liable hapless directors for failing to become adequately informed. The court's factual report emphasizes the Chairman-CEO as a commanding figure — the dissent says it portrays the directors as victims of his "fast shuffle"[272] — and it is notable that the board was comprised of half independent and half management directors — five to five.

Turning to the two foundational cases of this period addressing changes of control, the emphasis again is on director independence, in Justice Moore's classic opinions in both *Unocal Corp. v. Mesa Petroleum Co.*[273] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[274] In *Unocal,* the court decided that following the announcement of a hostile takeover bid, all director actions reasonably characterized as defensive were subject to enhanced duties and heightened scrutiny. This required directors to demonstrate "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that all defensive devices were "reasonable in relation to the threat posed."[275]

Having independent directors engage in an independent process goes a long way to meeting this burden. Justice Moore emphasized how the board meets that burden by showing good faith and reasonable investigation. In finding for the board, the court stressed the board's independence and information: a majority were independent (8 of 14 overall and 8 of 13 at a pivotal meeting).[276] The board, especially the independent directors, were fully informed, held extensive meetings, and consulted closely with numerous financial and legal advisors.

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[277] the board's initial defenses to a hostile bid that would break up the company met

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[270] *Id.* at 710 n.7.

[271] Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985).

[272] *Id.* at 894 (McNeilly, J., dissenting).

[273] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958-59 (Del. 1985). For my further assessment of this and related cases, see Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After* QVC *and* Technicolor*: A Unified Standard (and the End of* Revlon *Duties?)*, 49 BUS. LAW. 1593, 1602 (1994).

[274] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986).

[275] *Unocal*, 493 A.2d at 955.

[276] *Id.* at 950.

[277] *Revlon*, 506 A.2d at 176.

Unocal's threat/proportionality test.[278] The court found, however, that once management's defense also involved breaking up the company, a sale of the company became inevitable, and the board could no longer claim to be protecting against that threat. The Revlon board did not meet its burden under this standard.

Lack of independence was a major factor. Of 14 directors, 6 were also officers and 4 were associated with the companies having had "various business relationships" with the company.[279] The court therefore held that the board was not "entitled to certain presumptions that generally attach to the decisions of a board whose majority consists of truly outside independent directors."[280] Moreover, the board operated in the shadow of "personal antipathy" between their chairman and the bidder they disfavored;[281] and gave favorable terms to one bidder that appeared motivated by self-interest — supporting the price of outstanding securities to reduce their risk of personal liability.[282]

Moran v. Household Int'l, Inc.,[283] is a watershed case because it upheld the validity of a poison pill and again made director independence central. The court stressed it would be more deferential to decisions of boards with a majority of independent directors.[284] In this case, 10 of the 16-person board were independent.[285] The court added a rhetorical note, quoting testimony by one outside director that it had been the most extensive discussion in his twelve years on the Household board.[286]

The same emphasis on independence, and deference to it, appeared in the landmark case of *Ivanhoe Partners v. Newmont Mining Corp.*[287] Conflicted directors excused themselves from board discussions; ensuing deliberation and vote were conducted among seven directors

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[278] *See* Cunningham & Yablon, *supra* note 273.

[279] *Revlon*, 506 A.2d at 176 n.3.

[280] *Id.*

[281] *Id.* at 176.

[282] *Id.* at 182-83 ("[T]he Revlon board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders.").

[283] Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

[284] *Id.* at 1356 (stating proof of good faith "is materially enhanced, as we noted in *Unocal*, where, as here, a majority of the board favoring the proposal consisted of outside independent directors").

[285] *Id.* at 1348 n.2 ("Household's Board has ten outside directors and six who are members of management.").

[286] *See* Polk v. Good, 507 A.2d 531, 537 (Del. 1986) ("[A] company repurchasing its shares to eliminate a perceived danger must meet certain threshold standards to come within the ambit of the business judgment rule.").

[287] Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987).

— four independent and three management. With such a majority independent, as the court put it: "proof that the board acted in good faith and upon reasonable investigation was materially enhanced."[288]

In Delaware's next landmark case, *Paramount Communications, Inc. v. Time, Inc.*,[289] the state's Supreme Court held that *Revlon* applied when the board began an active auction of the company, but not when the board sought to protect and implement an extraordinary corporate transaction as part of its long-term strategy. In so holding, and finding for the directors, the court repeatedly emphasized that a majority of the directors were independent — coincidentally, 10 out of 16, just as in *Moran*;[290] and that they had developed a long-term strategic plan over many years before the transaction in question was made.[291]

In *Paramount Communications, Inc. v. QVC Network, Inc.*,[292] another board, though nominally independent, failed to exercise that independence. The Paramount board approved a merger with Viacom, the result of which would transfer control to Viacom's controlling shareholder, Sumner Redstone. The merger agreement contained significant deal protection clauses that Redstone publicly boasted guaranteed it would close. That, of course, would be inconsistent with the Paramount board's duties. When another suitor offered an alternative deal, however, the Paramount board seem constrained to favor Redstone, never exercising its bargaining power to extract better terms. Such favoritism, like that in *Revlon*, manifests a lack of independence, warranting no judicial deference.[293]

Throughout these cases, courts avoid telling directors what to do. Even the sternest judicial rebukes mandate no particular steps. A famous line sums up: "there is no single blueprint that a board must follow to fulfill its duties."[294] The cases also stress how unified the doctrine is, with repeated refutations of impressions that *Revlon* created special duties: "*Revlon* is merely one of an unbroken line of cases that seek to prevent the conflicts of interest that arise in the field of mergers

[288] *Id.* at 1343.

[289] Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1990).

[290] *Id.* at 1143 ("Time's board consisted of sixteen directors. Twelve of the directors were 'outside,' nonemployee directors. Four of the directors were also officers of the company.").

[291] *Id.* at 1143-44 (noting board involvement in strategic planning process spanning from 1983 to 1987).

[292] Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994); *see* Cunningham & Yablon, *supra* note 273.

[293] *See QVC Network Inc.*, 637 A.2d at 49.

[294] Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989).

and acquisitions by demanding that directors act with scrupulous concern for fairness to shareholders."[295] And while the standards and contexts delineated in these landmarks can require elaborate frameworks and diagrams to organize,[296] all are united by an emphasis on whether directors were independent.

C. *Ultimate Embrace*

The emphasis on director independence has in recent years been so fully embraced that some observers see a substantial weakening of this line of cases, especially of *Revlon*.[297] Consider *Lyondell Chemical Co. v. Ryan.*,[298] where the target board was almost entirely comprised of independent directors: all but one of ten were outside directors, that one being the CEO. That is a modern board that was unheard of when *Revlon* was decided. Despite a casual approach to the process and negotiations, the company's charter exculpated the directors from mere haplessness[299] and, on the sole issue of whether they acted in good faith, the evidence indicated that they had.[300] *Lyondell* reflects Delaware's veneration of director independence.

That veneration continued in *C&J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust*.[301] Again dealing with a board of mostly independent directors — five of seven[302] — the Delaware Supreme Court held that boards are not required to take any particular steps to satisfy *Revlon*.[303] Nor does *Revlon* require directors to have "impeccable knowledge" to justify their

[295] *Id.*; *see also* Malpiede v. Townson, 780 A.2d 1075, 1083-84 (Del. 2001) ("*Revlon* neither creates a new type of fiduciary duty in the sale-of-control context nor alters the nature of the fiduciary duties that generally apply.").

[296] *See* Cunningham & Yablon, *supra* note 273, at 1627-28.

[297] *See* Anabtawi, *supra* note 8; Cox & Thomas, *supra* note 8; Korsmo, *supra* note 8.

[298] Lyondell Chemical Co. v. Ryan., 970 A.2d 235 (Del. 2009).

[299] DEL. CODE. ANN. tit. 8, § 102(b)(7) (2021).

[300] On the other hand, the bidder initially proposed $26.50 to 28.50 in April 2006 and was up to $48 all cash by July 2007. *Lyondell Chemical Co.*, 970 A.2d at 237-38. The board instructed the CEO to get the bidder's best bid. The board was almost all independent, and well informed. *Id.* at 238. They had multiple meetings, though minimalist, and got a break-up fee reduced. *Id.* The board's advisors called the bid a "blowout" and a "home run." *Id.* at 239, 244. In the ensuing shareholder vote, 99% of the shares cast voted in favor of the proposal. *Id.* at 239.

[301] *See* C & J Energy Servs., Inc. v. City of Miami Gen. Emps.', 107 A.3d 1049, 1066 (Del. 2014).

[302] *Id.* at 1055.

[303] *Id.* at 1067.

decisions.[304] While the opinion goes on for 25 pages, and contains 120 footnotes, the board's independence animates all content.

[304] *Id.* at 1069.

APPENDIX B. SHAREHOLDER APPROVAL

Judicial enthusiasm for shareholder approval has a long pedigree and has been an important factor in determining whether to defer to director decisions under the business judgment rule or scrutinize them for entire fairness. For instance, the recent *Corwin* case cites more than a dozen Delaware cases giving such credit to shareholder approval, stretching back nearly a century.[305] *Corwin* does not delineate such cases in terms of the types of shareholders or prevailing shareholder demographics when those votes were held. But a review of the cases indicates that while they never mention shareholder "sophistication," they repeatedly emphasize that shareholders must be informed, disinterested and uncoerced.

A. *Early Embrace (1930–1980)*

Early on, courts assumed that shareholder approval, especially supermajority approval, sufficed to safeguard all shareholder interests. A 1928 Delaware Chancery Court decision, for instance, stressed that supermajority shareholder votes on both sides approving a merger meant that all shareholder interests were "sufficiently safeguarded."[306] On that basis, courts refused to enjoin a merger absent clear evidence that it was "so injurious and unfair to some minority complaining stockholders as to be shocking, and the court is convinced that it is so grossly unfair to such stockholders as to be fraudulent."[307]

Courts of this era reasoned that such a shareholder vote ought to be accorded the same doctrinal deference given to directors under the business judgment rule.[308] Under that reasoning, since director decisions win such deference only when meeting doctrinal requirements such as disinterest, the same was true for the shareholder vote. As for shareholder demographics, during this period, through the 1930s, public equity was largely held by "a small number of influential

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[305] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 310 n.19 (Del. 2015).

[306] MacFarlane v. N. Am. Cement Corp., 157 A. 396, 398 (Del. Ch. 1928).

[307] *Id.*

[308] Cole v. Nat'l Cash Credit Ass'n, 156 A. 183, 188 (Del. Ch. 1931) ("The same presumption of fairness that supports the discretionary judgment of the managing directors must also be accorded to the majority of stockholders whenever they are called upon to speak for the corporation in matters assigned to them for decision, as is the case at one stage of the proceedings leading up to a sale of assets or a merger. No rational ground of distinction can be drawn in this respect between the directors on the one hand and the majority of stockholders on the other.").

banks, financiers and dynasties, such as Morgan, Rockefeller and Vanderbilt."[309]

By the 1950s, after the Great Depression and its aftermath transformed the shareholder base to diffuse millions of individuals and families, shareholder votes continued to earn boards judicial deference.[310] The Delaware Supreme Court held in *Gottlieb v. Heyden Chemical Corp*.[311] that a voluntary stockholder approval of a stock option plan invoked the business judgment rule.[312] Two years later, the Chancery Court reasoned that the same logic applied to a statutorily required stockholder approval of an asset sale to the company's chairman and 30% stockholder. That meant a challenger would have to show such a valuation disparity as to indicate "reckless indifference" or "intentional disregard" for the "whole body of stockholders."[313]

A major case concerning application of section 144 to shareholder votes made clear that what counts are disinterested votes. *Fliegler v. Lawrence*[314] involved the purchase by a mining company of property from several of its directors — a classic interested director transaction. Although also approved by a majority of shareholders, the buying directors owned a majority. The plain meaning of the language would let any majority vote obviate proof of fairness, but the court read the concept "disinterested" shareholder into it:

> We do not read the statute as providing the broad immunity for which defendants contend. [The statute] merely removes an 'interested director' cloud when its terms are met and provides against invalidation of an agreement 'solely' because such a director or officer is involved. *Nothing in the statute sanctions unfairness . . . or removes the transaction from judicial scrutiny*.[315]

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[309] Cunningham & Cuba, *supra* note 79, at 14.

[310] *See supra* text accompanying notes 75–79.

[311] Gottlieb v. Heyden Chem. Corp., 91 A.2d 57, 58 (Del. 1952).

[312] *Id.*

[313] Schiff v. RKO Pictures Corp., 104 A.2d 267, 271-72 (Del. Ch. 1954).

[314] Fliegler v. Lawrence, 361 A.2d 218 (Del. 1976).

[315] *Id.* at 222 (emphasis added); *see* Benihana of Tokyo, Inc. v. Benihana, Inc., 906 A.2d 114 (Del. 2006) (holding that shareholder approval of an interested director transaction shifts a would-be duty of loyalty claim evaluated for entire fairness with the burden on interested directors into a duty of care case evaluated under the business judgment rule with the burden on the challengers); Marciano v. Nakash, 535 A.2d 400, 405 n.3 (Del. 1987) (in dicta, commenting that "approval by fully-informed . . . disinterested stockholders . . . permits invocation of the business judgment rule").

The Delaware Supreme Court reaffirmed these principles in the 1979 case of *Michelson v. Duncan*.[316] The court insisted that to challenge an interested director transaction approved by disinterested shareholders, the objecting shareholder had the burden of showing, in effect, waste.[317]

In *Weinberger*, merger approval was conditioned on a majority of the minority vote — a strong plus for deal proponents as the next section explores. But the minority lacked important information, including the report of the common directors on their reservation price. Said Justice Moore:

> [T]he minority stockholders were denied the critical information that [the parent] considered a price of $24 to be a good investment. Since this would have meant over $17,000,000 more to the minority, we cannot conclude that the shareholder vote was an informed one. Under the circumstances, an approval by a majority of the minority was meaningless.[318]

Justice Moore's urgings on director independence, and shareholder voting, seeped into practice; were repeatedly emphasized for decades by Delaware courts; and ultimately ordained in both boardrooms and courtrooms.[319] A straight line runs from *Weinberger* to today's cases, which continue to embrace the fundamental appeal of joint director and shareholder approval.

B. Continued Embrace

One of the better-known cases to take this position is *Stroud v. Grace*,[320] where the court noted that its application of enhanced scrutiny in a given case would follow only when "a board acted in the absence of an informed shareholder vote." In four different opinions in 1999 alone, the Delaware Chancery Court followed this approach, two of

[316] Michelson v. Duncan, 407 A.2d 211, 224 (Del. 1979) (noting that "shareholder ratification shifted the burden of proof . . . from defendants to plaintiff").

[317] *Id.* (quoting Kaufman v. Schoenberg, 91 A.2d 786, 791 (Del. Ch. 1952)) ("[N]o person of ordinary sound business judgment would say that the consideration received for the options was a fair exchange for the options granted.").

[318] Weinberger v. UOP, Inc., 457 A.2d 701, 712 (Del. 1983).

[319] *See supra* text accompanying notes 122–125 (discussing ensuing cases in this line).

[320] Stroud v. Grace, 606 A.2d 75, 83 (Del. 1992).

which the Delaware Supreme Court later affirmed — in a merger,[321] a spin-off,[322] a charter amendment,[323] and an asset sale.[324] In all these cases, the vote would need to meet the increasingly familiar requirements of informed, disinterested, and uncoerced.

In 1994, in *Kahn v. Lynch Commc'n Sys., Inc.*,[325] Delaware law extended the lessons from *Weinberger*, the controlling shareholder merger case. In such a case, the *Lynch* court held, courts scrutinize board actions for entire fairness, with the burden on the controller shareholder. However, the burden of proof shifts to the challenger if the merger was approved either by an independent board committee or a majority of the minority vote.

By the 2000s, the doctrine that a shareholder vote triggers the protections of the business judgment rule had been widely recognized.[326] Cases from 2006, 2007, 2011, and 2014 continued the pattern — recognizing the invocation of the business judgment rule and stressing all the threshold attributes, although without inquiring into the demographic makeup of the particular company to probe for these features.[327]

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321 *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 736-38 (Del. Ch. 1999) (finding a fully informed stockholder approval of a merger invoked the business judgment rule), *aff'd sub nom.* Walker v. Lukens, Inc., 757 A.2d 1278 (Del. 2000).

322 Solomon v. Armstrong, 747 A.2d 1098, 1133 (Del. Ch. 1999) (dismissing a challenge to a spin-off of a subsidiary because a fully informed, uncoerced vote of the stockholders that was required under the corporation's charter invoked the business judgment rule), *aff'd*, 746 A.2d 277 (Del. 2000).

323 *In re* Gen. Motors Class H S'holders Litig., 734 A.2d 611, 616 (Del. Ch. 1999) (finding the business judgment rule applies because shareholders had the "opportunity to decide for themselves" based on "accurate disclosures and in a non-coercive atmosphere").

324 Apple Comput., Inc. v. Exponential Tech., Inc., No. 16315, 1999 WL 39547, at *7 (Del. Ch. Jan. 21, 1999) (noting an informed vote of stockholders approving an asset sale potentially subject to § 271 invokes business judgment rule and obviates any statutory challenge).

325 638 A.2d 1110, 1117 (Del. 1994).

326 *E.g.*, William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 890-91 (2001) ("Under present Delaware law, a fully informed majority vote of the disinterested stockholders that approves a transaction (other than a merger with a controlling stockholder) has the effect of insulating the directors from all claims except waste.").

327 *In re* Morton's Rest. Grp., Inc. S'holders Litig., 74 A.3d 656, 663 n.34 (Del. Ch. 2013) ("[W]hen disinterested approval of a sale to an arm's-length buyer is given by a majority of stockholders . . . there is a long and sensible tradition of giving deference to the stockholders' voluntary decision, invoking the business judgment rule."); *In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761, 793 n.113 (Del. Ch. 2011) (Delaware law has long held that "approval of an uncoerced, disinterested electorate of

The 2014 case of *Kahn v. M&F Worldwide Corp.*[328] is a culmination of jurisprudence on both independent director and shareholder approval, illustrating the venerable playbook in action. A controlling shareholder proposed to acquire the rest of the stock. From the outset, it conditioned its proposal on two measures now long endorsed by this long line of Delaware cases: (1) that the merger be negotiated and approved by a special committee of independent MFW directors, and (2) that it be approved by a majority of minority. Both conditions were met, with nearly two-thirds of the requisite shares voted in favor. Objecting shareholders lost handily, as those two conditions compelled application of the business judgment rule.[329]

Similarly, in the 2015 case of *Corwin v. KKR Financial Holdings LLC*,[330] the Delaware Supreme Court held that an uncoerced, fully informed vote of disinterested stockholders in favor of a challenged transaction provided an independent basis to invoke the business judgment rule. The court elaborated:

> . . . the voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review and that the plaintiffs' complaint should be dismissed. For sound policy reasons, Delaware corporate law has long been reluctant to second-guess the judgment of a disinterested stockholder majority that determines that a transaction with a party other than a controlling stockholder is in their best interests. . . .
>
> . . . the doctrine applies only to fully informed, uncoerced stockholder votes, and if troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked. . . .

a merger (including a sale) would have the effect of invoking the business judgment rule"); Sample v. Morgan, 914 A.2d 647, 663 (Del. Ch. 2007) ("When uncoerced, fully informed, and disinterested stockholders approve a specific corporate action, the doctrine of ratification, in most situations, precludes claims for breach of fiduciary duty attacking that action."); *In re* PNB Holding Co., S'holders Litig., No. Civ.A. 28-N, 2006 WL 2403999, at *14 (Del. Ch. Aug. 18, 2006) (finding approval by an "informed, non-coerced majority of the disinterested stockholders" invokes business judgment rule deference).

[328] 88 A.3d 635, 638 (Del. 2014).

[329] *Id.* at 644.

[330] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306 (Del. 2015).

> . . . When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them.

While some commentators have criticized both *M&F* and *Corwin*, often expressing surprise,[331] judges have long exhorted boards to seek approval of a majority of disinterested shareholders. When boards heed such judicial hortatory, credit should follow, not rebuke; deference should follow, not review. The business judgment rule only applies, however to such shareholder votes that are disinterested, informed ("without full disclosure, ratification would be ineffective") and uncoerced.[332] The court returns to a longstanding theme in Delaware: shareholders are better than courts to handle such decisions. Yet what remains open to litigation is whether particular shareholder votes qualify as disinterested, fully-informed and uncoerced, and there are inherent limits on law's approach to these issues.

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331 *E.g.*, Anabtawi, *supra* note 8; Cox & Thomas, *supra* note 8; Korsmo, *supra* note 8.

332 *See* Gatti, *supra* note 10.