# Taking Shareholder Rights Seriously

*Julian Velasco*[*]

*Recent events in the business world have once again focused attention on the role of the shareholder in the corporation. Those who favor an expanded role for shareholders in corporate governance tend to focus on developing new legal rights for shareholders, while their critics respond with reasons why such rights are unnecessary and inappropriate. Although these issues certainly are worthy of consideration, issues concerning existing shareholder rights are more fundamental. If existing rights are adequate or could be improved, then new rights may not be necessary; but if existing rights cannot be salvaged, then efforts to add new rights may be equally unavailing. This Article argues that the traditional shareholder rights to vote and to sell their shares could be adequate but are undermined by other laws that impede their exercise. This Article assumes that the traditional role of the shareholder in corporate governance is the appropriate one: the business and affairs of every corporation should be managed by or under the direction of the board of directors, and shareholder rights can and should be limited accordingly. Nevertheless, shareholder rights remain an important component of corporate governance. Unfortunately, the law does a poor job of securing even these limited rights for shareholders. This Article only seeks to make traditional shareholder rights more meaningful; it does not seek to expand shareholder rights beyond the traditional core or to empower shareholders to intrude on the directors' managerial role. After demonstrating how the current law indirectly eviscerates explicit shareholder rights, this Article*

[*] Associate Professor of Law, Notre Dame Law School. J.D. Columbia University; B.S., Georgetown University. I would like to thank the participants of faculty workshops at Notre Dame Law School and the University of Illinois College of Law for comments and suggestions; Amy Coney Barrett, Matthew J. Barrett, Patricia L. Bellia, Lisa L. Casey, Jennifer Mason, and Franklin G. Snyder for their thoughts, comments, and assistance; Dwight B. King and Patti Ogden for their expert research assistance; and Carolyn A. Blessing, Kathleen Shields Dugan, and Katrina Camille Mauricio Ng for their excellent student assistance. This Article is dedicated to the memory of my parents, Juan Francisco Velasco (1937-2006) and Eneris Velasco (1946-2007).

*proposes and defends a number of legal reforms to both state and federal law that would safeguard traditional shareholder rights.*

TABLE OF CONTENTS

INTRODUCTION ..... 607
I. THE LEGAL STATUS OF SHAREHOLDER RIGHTS ..... 609
A. *The Right to Vote* ..... 610
1. Election of Directors ..... 611
2. Fundamental Transactions ..... 612
3. Proxy Rules ..... 614
B. *The Right to Sell Shares* ..... 616
1. Takeover Defense ..... 617
2. Antitakeover Statutes ..... 617
3. Tender Offer Rules ..... 620
II. THE CRITIQUE OF SHAREHOLDER RIGHTS ..... 621
A. *The Right to Vote* ..... 622
1. Shareholder Apathy ..... 622
2. Shareholder Inadequacy ..... 625
3. Shareholder Misconduct ..... 628
4. Director Authority ..... 629
B. *The Right to Sell Shares* ..... 631
1. Unnecessary Right ..... 631
2. Other Constituencies ..... 633
3. Investment Horizon ..... 635
4. Director Superiority ..... 638
III. TAKING THE RIGHT TO VOTE SERIOUSLY ..... 641
A. *Election of Directors by Majority Vote* ..... 641
1. Unnecessary? ..... 642
a. *Default Rules* ..... 642
b. *Less Drastic Solution?* ..... 644
2. Too Problematic? ..... 645
a. *Failed Elections* ..... 646
b. *Holdover Rule* ..... 649
c. *Contested Elections* ..... 651
d. *Amendment* ..... 654
B. *Fiduciary Duties* ..... 656
C. *The Right to Vote "No"* ..... 659
D. *Shareholder Proposals* ..... 661
IV. TAKING THE RIGHT TO SELL SHARES SERIOUSLY ..... 669
A. *Shareholder-Initiated Auctions* ..... 669
B. *Fiduciary Duties* ..... 672
C. *Antitakeover Statutes* ..... 675

*D. Disclosure in Tender Offers* .............................................. 679
CONCLUSION ........................................................................ 681

## INTRODUCTION

The great corporate scandals of the recent past and the resulting push for legal reform have revived the role of the shareholder in the corporation as a subject of great debate. One recent manifestation of the scholarly debate can be found in the pages of the *Harvard Law Review*. Harvard Law Professor Lucian Arye Bebchuk pressed for an expanded role for shareholders in setting the rules for corporate governance,[1] while UCLA Law Professor Stephen M. Bainbridge defended the status quo.[2] Those who favor an expanded role for shareholders in corporate governance tend to focus on developing new legal rights for shareholders, while their critics respond with reasons why such rights are unnecessary and inappropriate. Although these issues certainly are worthy of consideration, issues concerning existing shareholder rights are more fundamental. If existing rights are adequate or could be improved, then new rights may not be necessary; but if existing rights cannot be salvaged, then efforts to add new rights may be equally unavailing. In this Article, I will argue that traditional shareholder rights could be adequate but are undermined by other laws that impede their exercise.

In previous work, I have argued that the shareholder rights to vote in the election of directors and to sell shares should be considered "the fundamental rights of the shareholder," and as such deserve a great deal of respect and protection by law.[3] In this Article, I will consider what it would mean to take shareholder rights seriously.[4] I assume that the traditional role of the shareholder in corporate governance is

---

[1] *See* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) [hereinafter Bebchuk, *Power*]; Lucian Arye Bebchuk, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006) [hereinafter Bebchuk, *Rules*].

[2] *See* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006); *see also* Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759 (2006).

[3] *See* Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 UC DAVIS L. REV. 407 (2006).

[4] The *fundamental* rights of the shareholder are the most important of her *traditional* rights. In this Article, my discussion at times extends beyond the fundamental rights to include the shareholder's right to vote on fundamental transactions. While this right may not be quite as fundamental, it is nevertheless an important traditional right.

the appropriate one:[5] "The business and affairs of every corporation . . . [should] be managed by or under the direction of the board of directors";[6] shareholder rights can and should be limited accordingly. Nevertheless, shareholder rights remain an important component of corporate governance. Unfortunately, the law does a poor job of securing even these limited rights for shareholders. In this Article, I only seek to make traditional shareholder rights more meaningful; I do not seek to expand shareholder rights beyond the traditional core or to empower shareholders to intrude on the directors' managerial role.

Part I will demonstrate how the current law indirectly eviscerates explicit shareholder rights. Various statutory provisions and judicial decisions on both a state and federal level have the effect of blocking meaningful exercise of legitimate shareholder rights. I will argue that many of these legal developments were never intended to have such a negative effect on the exercise of shareholder rights and therefore deserve reconsideration.

Part II will address the issue of whether shareholder rights should be made more meaningful. I will present some of the objections commonly raised against shareholder rights. I then will argue that restricting shareholder rights is not an appropriate solution for any of the perceived problems.

Part III will discuss how the shareholder right to vote could be made more meaningful through the adoption of four specific legal reforms. First, the default rule should require that directors be elected by a majority vote rather than a plurality vote. Second, fiduciary duties should prevent any director interference with the exercise of the right to vote. Further, shareholders should be permitted to vote against directors. Finally, shareholders should be allowed greater access to the company's proxy materials, but only for those matters on which they are entitled to vote.

[5] In his response to Bebchuk, Delaware Vice Chancellor Strine sets forth a very different account of the "traditionalist perspective." *See generally* Strine, *supra* note 2. With all due respect, I believe that Strine's account makes a few too many questionable value judgments with respect to its trust in management, its hostility towards institutional investors and takeovers, and its favorable inclination toward other constituencies to be considered traditional. It might be more accurate to label Strine's perspective as "conservative" rather than "traditional." Nevertheless, his proposals would enhance the effectiveness of shareholder voting rights significantly, and I suspect that they would be quite controversial if taken seriously. *Cf. infra* notes 308-13 and accompanying text (discussing opposition to shareholder access).

[6] DEL. CODE ANN. tit. 8, § 141(a) (2001); *see also* MODEL BUS. CORP. ACT § 8.01(b) (2005).

Part IV will discuss how the shareholder right to sell shares could be made more meaningful through the adoption of four additional legal reforms. First, shareholders should have the power to initiate an auction of the company. Second, fiduciary duties should prevent any director interference with the exercise of the right to sell. Further, antitakeover statutes should be repealed. Finally, the federal tender offer rules should not require the acquirer to disclose future plans whenever the acquirer commits to an "all-or-nothing" takeover.[7]

These proposals may strike some readers as excessive. As a practical matter, they would have dramatic consequences, especially with respect to contests for corporate control. As a theoretical matter, however, they are entirely moderate. They do not extend the role of the shareholder beyond its traditional limits, or empower shareholders to intrude on the directors' management role. Rather, they only make existing shareholder rights more meaningful.

## I. THE LEGAL STATUS OF SHAREHOLDER RIGHTS

Shareholders have various rights, among which are the right to vote on a limited number of issues and the right to sell their shares.[8] State corporate law provides that shareholders vote to elect directors,[9] and that they must approve certain fundamental matters, such as mergers[10] and charter amendments.[11] In addition, because shares are the personal property of shareholders,[12] general principles of property law allow shareholders to sell them freely.[13] These rights traditionally have been recognized as being the most important of shareholders'

---

[7] *See infra* notes 390-91 and accompanying text.

[8] For a more complete description of shareholder rights, see Velasco, *supra* note 3, at 413-24.

[9] *See* DEL. CODE ANN. tit. 8, § 211(b) (2001); MODEL BUS. CORP. ACT § 7.28(a) (2005).

[10] *See* DEL. CODE ANN. tit. 8, § 251(c) (2001); MODEL BUS. CORP. ACT § 11.04 (2005).

[11] *See* DEL. CODE ANN. tit. 8, § 242(b) (2001); MODEL BUS. CORP. ACT § 10.03 (2005).

[12] *See* DEL. CODE ANN. tit. 8, § 159 (2001); MODEL BUS. CORP. ACT § 1.40(22) (2005).

[13] "Under the corporate law of Delaware and other states, the usual rule is that shares of stock are freely transferable. State corporations codes do not see the need to specify this basic right of property, but it is implicit in statutory provisions regulating restrictions on share transfer." Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 304 (2002); *see also* WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 109 (10th ed. 2007).

rights: shareholders generally have placed the greatest value on the right to sell,[14] while courts have emphasized the importance of the right to vote.[15]

Yet shareholder rights are far more limited than this cursory description suggests. In the first place, these rights represent only default rules. They are subject to change by contractual arrangement, either in the corporate charter or otherwise. Moreover, even the default rules are subject to legal restriction in various respects. This Part will illustrate how various provisions of state and federal law work together to minimize the impact of traditional shareholder rights.

Some scholars would argue that the proper way to assess any right is to look at the entire legal landscape, which includes all limits on that right.[16] To such scholars, it may seem misguided to discuss specific rights in isolation. However, the claim that the limits on shareholder rights should be viewed as integral components of those rights fails because the status quo is not the product of deliberate policy choices. As I will demonstrate, most of the legal rules that limit shareholder rights were never intended to have such an effect. The current state of shareholder rights is the result of an unfortunate blend of competing regulations that undermine more fundamental aspects of corporate law and therefore would benefit from reform.

### *A. The Right to Vote*

Corporate law clearly grants shareholders the right to vote in the election of directors and on certain fundamental transactions. However, it also contains other provisions that undermine those rights. This section will review some of those restrictions.

[14] *See* J.A. LIVINGSTON, THE AMERICAN STOCKHOLDER 60-67 (1958); *see also* Velasco, *supra* note 3, at 450.

[15] *See* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003) ("The stockholder franchise has been characterized as the 'ideological underpinning' upon which the legitimacy of the directors' managerial power rests." (quoting Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988))).

[16] *See, e.g.*, Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 568-72 (2003) ("[D]irect restrictions on shareholder power are supplemented by a host of other rules that indirectly prevent shareholders from exercising significant influence over corporate decision-making.").

1. Election of Directors

The general rule is that shareholder action requires some type of majority vote.[17] In the 1980s, the rule was changed with respect to the election of directors.[18] State corporate codes now provide that directors are elected by a plurality vote.[19] "In the context of an election of directors, 'plurality vote' is well understood to mean more affirmative votes cast for a nominee or nominees than for other nominees without regard to votes against or not cast."[20] The purpose of the change was to prevent inconclusive elections.[21]

A plurality voting requirement makes sense for contested elections because it ensures that the candidates with the most votes win. By comparison, a majority vote requirement could result in a failed election[22] if there are more candidates than positions because of the possibility that no candidate would receive a majority of the votes. However, a plurality vote requirement makes very little sense for uncontested elections. Under plurality voting, an uncontested candidate is elected if she gets just one vote in her favor; this is true even if all the other votes are cast against her.[23] Because the candidate is herself often a shareholder entitled to vote, her election is a foregone conclusion.

---

[17] For a description of different types of "majority voting," see *infra* notes 234-36 and accompanying text.

[18] *See* 2 MODEL BUS. CORP. ACT ANN. § 7.28 historical background n.2, at 7-189 (Supp. 2000-2002) ("following the publication of the Exposure Draft in 1983"); 2 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS, at VII-28 to -28.1 (3d ed. 2007 Supp.) (noting Chapter 136, laws of 1987).

[19] *See* DEL. CODE ANN. tit. 8, § 216(3) (Supp. 2006); MODEL BUS. CORP. ACT § 7.28(a) (2005).

[20] *See* ABA SECTION OF BUS. LAW, REPORT OF THE COMMITTEE ON CORPORATE LAWS ON VOTING BY SHAREHOLDERS FOR THE ELECTION OF DIRECTORS (2006), *reprinted in* Comm. on Corp. Laws, ABA Section of Bus. Law, *Changes in the Model Business Corporation Act — Proposed Amendments to Chapters 8 and 10 Relating to Voting by Shareholders for the Election of Directors*, 61 BUS. LAW. 399, 404 (2006) (citing MODEL BUS. CORP. ACT ANN. § 7.28 cmt. at 7-186 to -187 (3d ed. 2002)) [hereinafter ABA REPORT].

[21] *See id.* at 406 (citing MODEL BUS. CORP. ACT ANN. § 7.28 cmt. at 7-187; *id.* historical background n.2 at 7-189; LEWIS S. BLOCK, JR. & A. GILCHRIST SPARKS III, ANALYSIS OF THE 1987 AMENDMENTS TO THE DELAWARE CORPORATION LAW 314 (1987)).

[22] The term "failed election" often is used ambiguously to mean either an election in which no director is elected to fill one or more positions or an election in which one or more incumbent directors fail to be reelected. *See infra* notes 213-15 and accompanying text.

[23] ABA REPORT, *supra* note 20, at 407.

The vast majority of director elections are uncontested, and most often the candidates are incumbent directors seeking reelection. Under plurality voting, shareholders have no easy means to reject such candidates.[24] Incumbent directors are virtually immune to the effects of a shareholder vote. In most cases, it seems misleading to claim that there is any election or right to vote at all. Thus, the significant drawbacks in uncontested elections outweigh the limited benefits of plurality voting in contested elections.

In fairness, plurality voting is only a default rule. Changing the default rule, however, is not an easy task. Under the Model Business Corporation Act, on which most states base their corporate laws, plurality voting can be changed only by charter amendment.[25] This requires the approval of the directors as well as the shareholders.[26] Under Delaware law, which applies to most of the nation's largest corporations, the default rule can be changed through a bylaw amendment.[27] This does not require the consent of the directors.[28] Nevertheless, it remains difficult for the shareholders to pass a bylaw amendment, as will be discussed below.[29]

2. Fundamental Transactions

With respect to fundamental transactions, such as mergers and charter amendments, shareholder voting rights are severely limited by the fact that directors largely control the voting agenda. Shareholders vote only on such matters as are submitted to them. Generally, fundamental matters must be proposed by directors first.[30] This control allows directors to prevent shareholders from deciding on many matters that directors would rather avoid.

---

[24] To defeat incumbent directors, they must field competing candidates. This is a difficult and expensive endeavor, and one that very few shareholders would be willing to undertake. *See infra* notes 51-55 and accompanying text.

[25] *See* MODEL BUS. CORP. ACT § 7.28(a) (2005). *But see infra* notes 202-06 and accompanying text (discussing "modified plurality" approach that can be adopted via bylaw amendment).

[26] *See* MODEL BUS. CORP. ACT § 10.03 (2005).

[27] *See* DEL. CODE ANN. tit. 8, § 216 (Supp. 2006).

[28] *See id.* §109(a) (2001). *But see infra* notes 199-201 and accompanying text.

[29] *See infra* notes 40-41, 51-56 and accompanying text. *But see infra* note 197 and accompanying text.

[30] *See, e.g.*, MODEL BUS. CORP. ACT § 10.03 (charter amendments); *id.* § 11.04 (2005) (merger). *But see id.* § 10.20(a) (2005) (noting bylaws may be amended by shareholders acting alone).

Shareholders may vote in favor of the directors' proposal or against it, but neither on a modified version of the proposal nor on any alternative. Shareholders may be able to get their own proposals before other shareholders, but often only in the form of a nonbinding recommendation.[31] Thus, directors do not need to ensure that proposals are optimal from the shareholders' perspective, but only that they are adequate to obtain majority approval.

It might seem that the shareholder right to vote on fundamental matters amounts to a veto power over objectionable transactions. In fact, however, the right does not extend so far. Shareholders generally have the right to vote on certain fundamental matters, but not others. As a result, directors often can restructure a transaction that should require shareholder approval into one that does not.[32] Long ago, courts of equity would police such behavior for abuse by looking beyond the form of a transaction to its substance;[33] but it is clear that they no longer will do so.[34] Thus, shareholders often cannot veto even fundamental transactions desired by directors.

Shareholders generally do have the right to amend the bylaws of the corporation without director approval.[35] This is a substantial power, but there are limits to what shareholders can do in the bylaws. Bylaws are "self-imposed rules and regulations deemed expedient for [the] convenient functioning [of the corporation]";[36] they are not a collection of substantive business decisions. In addition, the bylaws cannot be inconsistent with the law or the charter.[37] Some insist that this means that shareholder bylaws cannot interfere with the directors' authority to manage the business and affairs of the corporation.[38] I

---

[31] *See* 17 C.F.R. § 240.14a-8 (2007); *id.* § 240.14a-8(i)(1).

[32] *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1145-48 (Del. 1989) (merger of equals was restructured into asset purchase to avoid shareholder vote).

[33] *See, e.g.*, Farris v. Glen Alden Corp., 143 A.2d 25, 28-31 (Pa. 1958) (applying de facto merger doctrine).

[34] *See, e.g.*, Hariton v. Arco Elecs., Inc., 188 A.2d 123, 125 (Del. 1963) ("[T]he sale-of-assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity, and the framers of a reorganization plan may resort to either type of corporate mechanics to achieve the desired end.").

[35] *See* DEL. CODE ANN. tit. 8, § 109(a) (2001); MODEL BUS. CORP. ACT § 10.20(a).

[36] Gow v. Consol. Coppermines Corp., 165 A. 136, 140 (Del. Ch. 1933).

[37] *See* DEL. CODE ANN. tit. 8, § 109(b); MODEL BUS. CORP. ACT § 2.06(b) (2005).

[38] *See, e.g.*, Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409 (1998) (arguing allocation of power does not give shareholders right to manage affairs of corporation).

disagree.[39] Nevertheless, it is difficult for shareholders to coordinate their efforts to get bylaws adopted. Even if they manage to do so, directors generally can amend the bylaws as well,[40] and may be able to use this power to undermine or even undo any action shareholders may take.[41] Thus, the shareholder right to amend the bylaws is not quite as significant as it may seem.

### 3. Proxy Rules

Recognizing the importance of the shareholder vote and the potential for abuse by directors, Congress authorized the Securities and Exchange Commission ("SEC") to regulate proxy solicitations for the benefit of investors.[42] Section 14(a) of the Securities Exchange Act of 1934 provides that "[i]t shall be unlawful for any person . . . in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit . . . any proxy or consent or authorization in respect of any security . . . registered pursuant to . . . this title."[43] The SEC responded by promulgating Regulation 14A, commonly known as the proxy rules.[44] These rules follow the general approach of the federal securities laws of mandating disclosure.[45] This

[39] *See* Julian Velasco, *Just Do It: An Antidote to the Poison Pill*, 52 EMORY L.J. 849, 851-54 (2003).

[40] *See* DEL. CODE ANN. tit. 8, § 109(a) (stating charter may confer power to amend bylaws on directors); MODEL BUS. CORP. ACT § 10.20(b) (stating charter may deny directors power to amend bylaws).

[41] Some scholars have argued on policy grounds that directors should not be able to amend shareholder-adopted bylaws. *See, e.g.*, John C. Coates IV & Bradley C. Faris, *Second-Generation Shareholder Bylaws: Post* Quickturn *Alternatives*, 56 BUS. LAW. 1323, 1368 (2001) (noting argument that shareholders have residual authority over bylaws and can "adopt a bylaw that is beyond board repeal"); John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. MIAMI L. REV. 605, 617 (1997) (similar). However, courts tend to be formalistic in their interpretation of corporate law, *see generally* Velasco, *supra* note 3, at 427-30 (discussing formalism in corporate law), and the formalistic legal conclusion almost certainly is that directors can amend shareholder-adopted bylaws. The authority of directors to amend the bylaws is usually set forth in the law or in the charter. *See supra* note 40. If neither limits the directors' authority to amend shareholder-adopted bylaws, then there is no such limit. Any limit included in a shareholder-adopted bylaw would be invalid because bylaws cannot be inconsistent with the charter. *See supra* note 37 and accompanying text.

[42] *See* H.R. REP. NO. 73-1383, at 13-14 (1934).

[43] Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (2000).

[44] *See* 17 C.F.R. §§ 240.14a-1 to .14b-2 (2007).

[45] *See* IV LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1931-33 (3d ed.,

makes sense in the context of a contested election of directors or a transaction requiring shareholder approval because, in such circumstances, shareholders can use the information in making decisions. However, given the uncontested nature of most elections and the plurality vote requirement, shareholders often do not have the opportunity to make any decision at all on electing directors or on fundamental transactions. Thus, disclosure is of limited value.

Federal proxy regulation is not limited to disclosure requirements.[46] Congress authorized the SEC "to control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders."[47] Using this authority, the SEC has promulgated rules that not only regulate the procedures of proxy solicitations, but also impose certain requirements that "lie in a murky area between substance and procedure."[48] However, despite the goal of promoting "fair corporate suffrage,"[49] the proxy rules do little to facilitate shareholder voting in uncontested elections. They provide that the company's proxy materials only must allow shareholders to vote for a candidate or to withhold their votes, but not necessarily to vote against a candidate.[50] This may seem irrelevant under plurality voting, but it is not. It prevents shareholders from making the clear, if somewhat symbolic, statement of voting against an incumbent director. Shareholders are relegated to the much more ambiguous statement of withholding their vote.

Moreover, the demanding requirements for proxy solicitation, which were intended to benefit shareholders, also have certain drawbacks. If anyone would like to run a proxy contest in order to replace one or more incumbent directors (or for any other reason), they would be subject to the same strict requirements. Preparing the necessary proxy materials is difficult and expensive, even before factoring in the additional costs necessary to persuade "rationally

rev. 2000).

[46] *See id.* at 1931; *see also* Bus. Roundtable v. SEC, 905 F.2d 406, 411 (D.C. Cir. 1990).

[47] H.R. REP. NO. 73-1383, at 13-14; *see also* S. REP. NO. 73-792, at 12 (1934).

[48] *Bus. Roundtable*, 905 F.2d at 411.

[49] Voting Rights Listing Standards: Disenfranchisement Rule, Exchange Act Release No. 25,891, 53 Fed. Reg. 26,376, 26,380 (July 12, 1988) (to be codified at 17 C.F.R. pt. 240).

[50] *See* 17 C.F.R. § 240.14a-4(b) (2007). If state law "gives legal effect to votes cast against a nominee," then the proxy statement must provide shareholders with a means of voting no. *Id.* §240.14a-4(b)(2) instruction 2.

apathetic" shareholders.[51] While directors are able to use the company's resources for a proxy solicitation, an insurgent would be required to bear the cost herself.[52] The expense of a proxy contest is likely to discourage many who otherwise might consider the possibility.[53] In fact, overly strict requirements not only deter proxy contests, but they also can prevent shareholders from acting together to influence elections.[54] In short, the proxy rules arguably have done more to exclude insurgents than they have to empower shareholders.[55] Recognizing this problem, the SEC has been easing the restrictions on shareholder communications for some time.[56] These reforms have improved shareholders' ability to exercise their right to vote in a meaningful manner, but formidable obstacles to shareholder cooperation remain.

### *B. The Right to Sell Shares*

Shareholders generally have a very broad right to dispose of their shares. However, that right is much less absolute in situations involving hostile takeovers. This section will review some of the limitations on the right to sell.

---

[51] For a discussion of rational apathy among shareholders, see *infra* Part III.A.1.

[52] Shareholders may vote to reimburse a successful contestant for reasonable expenses. *See* Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291, 293 (N.Y. 1955).

[53] New rules permitting the electronic delivery of proxy materials would reduce the costs associated with a proxy contest, but would do little to reduce the significant costs of preparing proxy materials and of persuading shareholders.

[54] The proxy rules define "solicitation" to include "any request for a proxy," "any request to execute or not to execute, or to revoke, a proxy," and any "communication . . . under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." 17 C.F.R. § 240.14a-1(l)(1). Arguably, this definition is broad enough to include even casual conversations among shareholders. *See* Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, 57 Fed. Reg. 48,276, 48,277-78 (Oct. 22, 1992) (to be codified at 17 C.F.R. pts. 240, 249).

[55] *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 823-24 (1992) [hereinafter Black, *Agents*]; Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 536-42 (1990) [hereinafter Black, *Passivity*].

[56] *See, e.g.*, 17 C.F.R. § 240.14a-1(l)(2)(iv) (2007) (exceptions to scope of proxy rules); *id.* § 240.14a-2(b) (2007) (same); *id.* § 240.14a-12 (2007) (permitting certain solicitations before furnishing of proxy statement).

1. Takeover Defense

The courts have allowed directors to resist hostile takeovers under certain circumstances. The leading case on the issue is *Unocal Corp. v. Mesa Petroleum Co.*[57] In that case, the Delaware Supreme Court ruled that the directors of a company subject to a hostile takeover may take steps to defend the company against the takeover as long as their conduct is consistent with their "fiduciary duty to act in the best interests of the corporation's stockholders."[58] In evaluating whether directors should get the benefit of the business judgment rule, the court developed a two-part test often referred to as enhanced scrutiny: first, "the directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed . . . ," and second, the "defensive measure . . . must be reasonable in relation to the threat posed."[59]

Although the *Unocal* test seems reasonable on its face, subsequent case law has proven the test to be superficial:[60] almost anything will count as a threat, including a threat to the corporate culture and the possibility that shareholders will be mistaken about the company's value,[61] and any response is likely to be deemed reasonable as long as it is not coercive or preclusive.[62] Thus, directors have a great deal of freedom in responding to a hostile takeover. As a result, they are often able to prevent shareholders from selling their shares to the hostile bidder.

2. Antitakeover Statutes

Many states have adopted legislation intended to make hostile takeovers more difficult. These antitakeover statutes come in various forms, and only a few will be discussed below.[63] To the extent that these laws are successful, they interfere with the shareholder right to sell shares to hostile bidders.

[57] 493 A.2d 946 (Del. 1985).

[58] *Id.* at 955.

[59] *Id.*

[60] *See* Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 847 (2004).

[61] *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990).

[62] *See* Unitrin Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387-88 (Del. 1995).

[63] For more complete descriptions of antitakeover statutes, see 1 ARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE §§ 4.05-.06, at 4-24 to -52 (6th ed. Supp. 2004) and 1 MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS & FREEZEOUTS §§ 5.02-.03, at 5-5 to -56 (2005).

The most common types of antitakeover statutes utilize state control over corporate government to make hostile takeovers more difficult and less attractive.[64] For example, the "business combination statute"[65] prevents an acquirer from engaging in various transactions with the target company for some time after the acquisition.[66] This is a significant deterrence because acquirers want immediate control over the assets of the target company.[67] Similarly, the "control share acquisition statute"[68] deters the acquirer by denying it voting rights if it acquires a specified percentage of the company's shares.[69] This prevents the acquirer from having any control over the target company and its assets. Statutes such as these generally do provide some means by which acquirers may escape their reach.[70] However, such provisions only serve to mitigate, not eliminate, the deterrence effect of antitakeover statutes.

Not all antitakeover statutes are based in corporate governance. One interesting alternative is to ground them in labor law, as Pennsylvania has.[71] Its "tin parachute" provision[72] requires a hostile

---

[64] The popularity of these types of antitakeover statutes is based on the holding in *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987). In that case, the U.S. Supreme Court upheld the Indiana control share acquisition statute as a valid regulation of the internal affairs of the corporation, *id.* at 89, which Congress could overrule, but would have to do so explicitly. *Id.* at 86.

[65] *See, e.g.*, DEL. CODE ANN. tit. 8, § 203 (2001 & Supp. 2006) (Delaware's business combination statute).

[66] For more complete descriptions of business combination statutes, see FLEISCHER & SUSSMAN, *supra* note 63, § 4.05, at 4-24 to -37, and LIPTON & STEINBERGER, *supra* note 63, § 5.03[1][a], at 5-25 to -28.

[67] This is especially true with respect to leveraged buy-outs because the acquirer needed access to the target company's assets to pay down the debt incurred in the transaction. *See* STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 16 (2003).

[68] *See, e.g.*, IND. CODE ANN. § 23-1-42-1 to -11 (West 2005) (Indiana's control share acquisition statute).

[69] For more complete descriptions of control share acquisition statutes, see FLEISCHER & SUSSMAN, *supra* note 63, § 4.06[A], at 4-37 to -43 and LIPTON & STEINBERGER, *supra* note 63, §5.03[1][b], at 5-28 to -31.

[70] *See, e.g.*, DEL. CODE ANN. tit. 8, § 203(a)(2) (Supp. 2006) (stating statute does not apply if acquirer obtains 85% interest in tender offer); IND. CODE ANN. § 23-1-42-9 (West 2005) (stating other shareholders can, by true majority vote, approve voting rights for acquirer).

[71] *See* 15 PA. CONS. STAT. ANN. §§ 2581-2588 (West 1995). "Pennsylvania has enacted the most comprehensive scheme of anti-takeover protections of any state in the union. The legislation includes a daunting business combination statute, a control share acquisition statute, . . . a corporate constituencies statute, as well as . . . other provisions . . . ." LIPTON & STEINBERGER, *supra* note 63, § 5.03[1][f][iii], at 5-35. I focus on two minor, but interesting, provisions.

bidder to provide a specified severance payment to long-term employees if the acquisition leads to their termination;[73] its "succession of labor contracts" provision prohibits an acquirer from unilaterally canceling the labor contracts of the target company.[74] Both of these provisions aim to protect employees rather than shareholders. They have an antitakeover effect because they raise the cost of an acquisition significantly.

Perhaps the most far-reaching variety of antitakeover statute is known as the constituency statute.[75] Such a statute explicitly authorizes directors, in making business decisions, to consider not only the interests of shareholders but also of all other corporate constituencies — including even the local community and the national economy.[76] Under such statutes, directors arguably are freed from any duty to maximize shareholder wealth or otherwise to pursue the interests of shareholders.[77] Even interpreted narrowly, these statutes

[72] The term "tin parachute" is a play on the term "golden parachute." For a definition of golden parachute, see LIPTON & STEINBERGER, *supra* note 63, at § 6.02[4][a][i].

[73] *See* 15 PA. CONS. STAT. ANN. § 2582 (West 1995).

[74] *See id.* § 2587 (West 1995).

[75] These statutes are known by many different names. *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 16-17 (1992). The term "constituency statute" was selected for its simplicity and purported neutrality. *See id.* at 18.

[76] For example, the Florida statute provides as follows:

> In discharging his or her duties, a director may consider such factors as the director deems relevant, including the long-term prospects and interests of the corporation and its shareholders, and the social, economic, legal, or other effects of any action on the employees, suppliers, customers of the corporation or its subsidiaries, the communities and society in which the corporation or its subsidiaries operate, and the economy of the state and the nation.

FLA. STAT. § 607.0830(3) (2005). For a complete list of state constituency statutes, see Velasco, *supra* note 3, at 463 n.293. Although Delaware does not have a constituency statute, its common law contains a similar provision. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (allowing directors to consider "the impact on 'constituencies' other than shareholders"). *But see* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986) (requiring "that there be some rationally related benefit accruing to the stockholders").

[77] *See* David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 242-43 (1991); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 582, 640 (1992); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2075 (2001).

could have a significant impact on the right to sell shares: they authorize the directors to resist any transaction that would harm any of the corporation's various stakeholders, including a transaction, such as a hostile takeover, that is clearly in the shareholders' interests.

In all fairness, antitakeover statutes, including even constituency statutes, as well as cases such as *Unocal*, only allow directors to interfere with hostile takeovers. Shareholders remain free to sell their shares on the open market at any time. However, takeovers present a significant selling opportunity for shareholders because hostile bidders generally offer a significant premium to the prevailing market price of the shares. Thus, limits on hostile takeovers represent a significant restriction of the right to sell.

3. Tender Offer Rules

Congress enacted the Williams Act of 1968[78] to regulate tender offers relating to public corporations. No statutory or regulatory definition of the term "tender offer" exists, but a "typical" tender offer might be described as "a general, publicized bid by an individual or group to buy shares of a public[] company . . . at a price substantially above the current market price."[79] Generally, hostile takeovers are conducted by means of tender offers. Thus, federal law has a big impact on shareholders' ability to sell their shares in hostile takeovers.

"The purpose of the Williams Act is to ensure that public shareholders who are confronted by a . . . tender offer for their stock will not be required to respond without adequate information . . . ."[80] Congress deliberately took a neutral stance as between acquirers and target management:[81] "[T]he sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer."[82] Despite the intended neutrality, the tender offer rules operate to the disadvantage of acquirers.[83] This is because rules that protect shareholders from fraud and coercion also serve to limit acquirers' freedom, even as to perfectly legitimate offers. The increased cost of conducting a tender offer may make it prohibitively expensive in some

[78] Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2000)).

[79] Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 54-55 (2d Cir. 1985).

[80] Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975).

[81] *See* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22-35 (1977).

[82] *Id.* at 35.

[83] *See* Daniel R. Fischel, *From MITE to CTS: State Anti-Takeover Statutes, the Williams Act, the Commerce Clause, and Insider Trading*, 1987 SUP. CT. REV. 47, 72-73.

cases. As a result, shareholders who would be interested in selling their shares may be prevented from doing so, and this negative effect should not be ignored.

One of the requirements of the Williams Act is particularly illustrative. The tender offer rules provide that acquirers must disclose not only the purpose of the transaction, but also any significant future plans with respect to the target company.[84] Because this is a disclosure requirement, it would seem to be beyond reproach and squarely within the purview of the federal securities laws. Information about the acquirer's plans can be extremely helpful to shareholders in deciding whether or not to tender their shares.[85] However, such disclosure can have negative consequences. In many cases, anyone would be capable of implementing the acquirer's plans, including a competing bidder or the target company's own management. If so, disclosure would expose the acquirer to competition from free-riders. As a result, tender offers are likely to fail more often and to be less profitable when successful.[86] This is a huge disincentive for acquirers to initiate tender offers in the first place.

Of course, the Williams Act is not concerned with the acquirer's interests. However, it is concerned with the impact on shareholders. If excessive disclosure rules discourage tender offers, then shareholders suffer as well: they lose not only the premium offer made by the acquirer, but also any subsequent offer that might have been made by a third party.[87] In short, they lose their ability to sell shares at a substantial premium.

## II. THE CRITIQUE OF SHAREHOLDER RIGHTS

In Part I, I demonstrated how existing law indirectly undermines the rights that are explicitly granted to shareholders. I also argued that, because it generally was not the purpose of such laws to diminish shareholder rights, a reconsideration of the status quo was in order. However, perhaps legal reform is unnecessary. Many scholars have argued that the current state of shareholder rights is appropriate, if not

[84] *See* SEC Regulation M-A, 17 C.F.R. § 229.1006 (2007).

[85] Assuming the tender offer is within an acceptable range, shareholders can make their decision based on the acquirer's plans: if they approve of the plans, they can decide not to tender and remain as minority shareholders. Otherwise, they can sell their shares and exit the firm.

[86] *See* BAINBRIDGE, *supra* note 67, at 292-95.

[87] In fact, the shareholders also lose the benefits of the acquirer's information. Without the tender offer, the acquirer's plans are never implemented or even disclosed.

excessive.[88] In this Part, I will address those arguments.[89] Taken together, they raise a very important question: why should shareholder rights be taken seriously?

### *A. The Right to Vote*

In theory, the courts are very clear about the value of shareholder voting rights: "The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[90] Thus, shareholder voting rights must be taken quite seriously. Accepting this proposition, however, does not answer the question of how strong those rights should be. There may be countervailing reasons why the rights should be restricted, perhaps even severely. In this section, I consider some of the objections commonly raised against the shareholder right to vote.

#### 1. Shareholder Apathy

A first line of objection to shareholder voting rights is grounded in the concept of rational apathy.[91] It is often said that shareholders simply are not interested in voting rights because each individual shareholder has only a small interest in any given company. As a result, the expense of remaining informed about the company exceeds the expected benefit; this is especially true given that any one shareholder's vote is unlikely to affect the outcome of any election

---

[88] *See, e.g.*, Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006); Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 808 (2007); E. Norman Veasey, *The Stockholder Franchise Is Not a Myth: A Response to Professor Bebchuk*, 93 VA. L. REV. 811 (2007); *see also* Melvin Aron Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CAL. L. REV. 1, 16-17 (1969) (quoting Abram Chayes, *The Modern Corporation and the Rule of Law*, *in* THE CORPORATION IN MODERN SOCIETY 25, 40-41 (E.S. Mason ed., 1959)).

[89] In previous work, I have set forth the affirmative case for shareholder rights. *See generally* Velasco, *supra* note 3.

[90] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988); *see* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003) (citing *Blasius*, 564 A.2d at 659).

[91] *See generally* ROBERT C. CLARK, CORPORATE LAW 390-92 (1986) (discussing rational apathy among shareholders); Black, *Passivity*, *supra* note 55, at 526-29 (same).

anyway.[92] If shareholders do not value the right to vote, then they probably ought not to have it.

The argument certainly has great rhetorical force: no one wants an apathetic decision maker. However, the argument establishes more that shareholders are "rational" than that they are "apathetic." "A rational shareholder will expend the effort necessary to make informed decisions [whenever] the expected benefits of doing so outweigh its costs."[93] For very small investments, shareholders may rely upon the directors to manage the business (as the typical individual shareholder tends to do), while for very large investments, they may follow the business more closely (as controlling shareholders tend to do).[94] Likewise, for ordinary matters, shareholders may trust the directors, while for very important matters requiring their approval, shareholders may become better informed.[95] Such behavior is perfectly logical: it is not that shareholders do not care, but rather that they find it inefficient to over-invest in monitoring behavior.[96] Thus, the negative connotation of the term "apathy" is unjustified. If shareholders are understood to be rational rather than apathetic, then entrusting them with voting rights seems much more sensible.

The rise of the institutional investor has the potential to change the conventional equation significantly.[97] Investments in monitoring behavior that do not make sense for the typical individual shareholder may be economical for institutional investors who have larger holdings and greater resources.[98] Of course, no minority shareholder will have the incentive to engage in the ideal level of monitoring

---

[92] *See* FRANKLIN A. GEVURTZ, CORPORATION LAW 230 (2000); George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 903-04.

[93] *See* Bainbridge, *supra* note 16, at 558 (stating "only if" in original).

[94] *Cf.* Black, *Passivity*, *supra* note 55, at 524 (discussing limits of rational apathy).

[95] *Cf.* Troy A. Paredes, *The Firm and the Nature of Control: Toward a Theory of Takeover Law*, 29 J. CORP. L. 103, 135 (2003) ("[T]akeovers are such significant events in a corporation's life that shareholders inform themselves and participate in tender offers in a way they might not when it comes to day-to-day business decisions.").

[96] *See* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 420 (1983).

[97] *See generally* Black, *Agents*, *supra* note 55 (arguing that institutional investors are not as rationally apathetic as individual investors); Black, *Passivity*, *supra* note 55 (similar). The increasing presence of hedge funds only magnifies this effect. *See* Chris Young, *Hedge Funds to the Rescue*, BUS. WK., July 31, 2006, at 86.

[98] *See* Black, *Agents*, *supra* note 55, at 821-22; Black, *Passivity*, *supra* note 55, at 575-91.

because the benefits of doing so are shared while the costs are not.[99] And there may be other reasons why many institutional investors may not want to become active in company affairs,[100] for example, to preserve profitable relationships with their corporate clients.[101] But the shareholder apathy argument that has so much intuitive appeal with respect to individual shareholders does not resonate quite so well vis-à-vis institutional investors.

Additionally, the source of shareholder apathy can be questioned. Perhaps it is not a natural or inevitable state of affairs, but at least partly synthetic. Shareholder apathy may not be due solely to economic incentives, but also to a legal regime which frustrates shareholder participation.[102] As discussed earlier, there are significant obstacles to the effective exercise of the right to vote.[103] A shareholder who is inclined to be involved might not bother if the law makes it too difficult or expensive. If shareholder apathy is due in part to legal restrictions, then elimination of those restrictions could enable shareholder participation to flourish.

In any event, shareholder apathy does not justify the elimination or evisceration of the right to vote. The fact that shareholders rarely want to oppose management does not suggest that they never should be able to do so.[104] To the contrary, shareholder deference to the directors could be interpreted as a sign of responsible shareholder citizenship.

Finally, if shareholders truly are rationally apathetic, then little harm could come from more meaningful voting rights: such rights simply would be disregarded. The fact that there is so much debate on the issue strongly suggests that neither side believes this to be the case: shareholder activists pursue enhanced voting rights because they

---

[99] *See* Easterbrook & Fischel, *supra* note 96, at 402; Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119, 134 (1987).

[100] *See generally* Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 280-82 (2003) (discussing "limited institutional willingness to engage in activism"); Robert C. Pozen, *Institutional Investors: The Reluctant Activists*, HARV. BUS. REV., Jan.-Feb. 1994, 140, 140-49 (similar).

[101] *See* Bainbridge, *supra* note 2, at 1754; John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1321 (1991).

[102] *See* Black, *Passivity*, *supra* note 55, at 529-66.

[103] *See supra* Part II.A.

[104] *See* Bebchuk, *Power, supra* note 1, at 878; *see also* Henry G. Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399, 412 (1962).

believe shareholders would take advantage of them, and others oppose such changes because they fear the same.

2. Shareholder Inadequacy

A second line of objection to shareholder voting rights is based on the notion of shareholder inadequacy: that shareholders simply are not capable of making good business decisions, so voting rights work to the detriment of the corporation and of the shareholders themselves.[105] This inadequacy is often attributed to shareholders' inferior access to information,[106] but can be based on any number of factors on which shareholders trail the directors, such as time, education, experience, and business judgment. Of course, the inadequacy argument does not seem quite as plausible when the relevant shareholders are understood to be institutional investors rather than individuals.[107] Nevertheless, even institutional investors are unlikely to be as informed and experienced with respect to a company's affairs as its directors.

This objection gives rise to two major framing issues. First, the relevant question is not whether shareholders are skilled enough to run the business, because no one seriously suggests that they should do so.[108] Rather, it is whether shareholders possess the skills necessary to decide how to exercise their rights. Given their limited role in corporate governance, shareholders probably are up to the task. On the most important matters, they may be willing to assess the merits for themselves.[109] Generally, however, they are likely to rely on the advice of others who are more competent.[110] Usually this will be the directors, but sometimes it may be a third party, such as Institutional Shareholder Services.[111] As long as shareholders have the option of

[105] *See* Bainbridge, *supra* note 2, at 1745-49; Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1276-77 (1982).

[106] *See, e.g.*, Manne, *supra* note 104, at 408 ("The great fault has been the lack of information available to shareholders, with a resulting inertia on the part of shareholders about corporate matters.").

[107] *See* Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 1003 (2002); Black, *Passivity*, *supra* note 55, at 584-91.

[108] "[T]he shareholder's role is and ought to be limited. Under almost any model, management assumes control of the business and assets of the enterprise, subject to such constraints as prescribed by . . . law . . . ." Louis Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 260 (1983).

[109] *See supra* note 95 and accompanying text.

[110] *See* Bebchuk, *supra* note 107, at 1003.

[111] Institutional Shareholder Services ("ISS") is an organization that, among other

relying on others, and can decide reasonably well when and how to do so, it need not matter that shareholders would not be capable of running the business themselves.[112]

One might object that shareholders will follow the advice of others too readily, thereby shifting power from directors to unaccountable third parties.[113] It is unlikely, however, that shareholders would follow the advice of anyone blindly — other than, perhaps, the directors. Most likely, they would compare the arguments made by the directors and the adviser. Even those who would not bother to do so, at least, would rely on the reputation of the adviser; and an adviser that does not give consistently good recommendations could not hold shareholders' attention for very long.

One also might object that shareholders and their advisers will tend not to focus on the specific needs of individual corporations but instead will apply general policies across the board.[114] Even if true, this is not necessarily foolish. A general rule may not lead to the best result in each specific case, but nevertheless may be more efficient than a policy of case-by-case determination. Thus, for example, shareholders reasonably could conclude that increased accountability for all directors would lead to a significant improvement over the status quo ante. Shareholders should not be denied the ability to implement such a policy merely because it would be suboptimal in some cases.[115]

Second, the relevant question is not whether directors or shareholders are better at making business decisions. Rather, it is whether the directors should make all decisions entirely on their own

---

things, provides voting advice to institutional investors. RiskMetrics Group — ISS Governance Services, http://issproxy.com/issgovernance.html (last visited Nov. 14, 2007).

[112] "There is little reason to believe that the decisions of institutional investors on whether to defer would be so poor that mandating deference would be preferable to letting them make such decisions." Bebchuk, *supra* note 107, at 1003.

[113] *See, e.g.*, Strine, *supra* note 2, at 1765 ("The influence of ISS and its competitors over institutional investor voting behavior is so considerable that the traditionalist will be concerned that any initiative to increase stockholder power will simply shift more clout to firms of this kind — firms even more unaccountable than their institutional investor clients.").

[114] *See id.* at 1770-71.

[115] The issue seems to be whether an improvement should have to be Pareto efficient — it makes some better off and none worse off — or merely Kaldor-Hicks efficient — wealth maximization. Because "[t]he conditions for Pareto superiority are almost never satisfied in the real world," Kaldor-Hicks efficiency is generally accepted as a more reasonable standard. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 12-13 (6th ed. 2003).

or whether shareholders should have a say on some of the most important issues. Given the agency problem — the risk that directors will act in their own interests rather than those of the shareholders[116] — the former alternative is not a viable option.[117] Although shareholders may not be as capable as the directors, they nevertheless serve a valuable oversight role.[118] The real issue is how much oversight the shareholders should be able to exercise. On this question, traditional voting rights are not particularly generous. If there is one issue on which shareholder voice is indispensable, it is the election of directors. When it comes to this fundamental right, unreviewable discretion for directors is not a viable alternative.

Finally, one could question whether shareholders are, in fact, inadequate. Such assertions often are made without much support and do not go uncontested.[119] Moreover, any analytical conclusion to that effect would seem to be of questionable value given that after-the-fact review of business decisions is fraught with danger.[120] Ultimately, business decisions are not so much a matter of right or wrong as of risk preference. Because shareholders bear the risk, it seems reasonable that they be entitled to share in the decision making process.[121]

[116] *See* Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980) (providing general discussion of agency problem); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (same); *see also* GEVURTZ, *supra* note 92, at 229-41.

[117] "Human nature being what it is, the law, in its wisdom, does not presume that directors will be competent judges of the fair treatment of their company where fairness must be at their own personal expense." Gottlieb v. Heyden Chem. Corp., 90 A.2d 660, 663 (Del. 1952).

[118] *See* Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895, 917-27 (1992); John Pound, *The Rise of the Political Model of Corporate Governance and Corporate Control*, 68 N.Y.U. L. REV. 1003, 1027-32 (1993).

[119] *Compare* Strine, *supra* note 2, at 1770-71 (asserting that institutional investors are incapable of identifying value-maximizing corporate governance proposals), *with* Bebchuk, *Rules*, *supra* note 1, at 1802-03 (defending institutional investors' competence with respect to corporate governance proposals). *See also* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 926 (1993).

[120] This is, after all, a premise of the business judgment rule. *See* Velasco, *supra* note 60, at 831.

[121] *Cf.* Easterbrook & Fischel, *supra* note 96, at 403-06 (describing voting as part of risk bearing).

3. Shareholder Misconduct

A third line of objection to shareholder voting rights is premised on the possibility of shareholder misconduct. Some critics argue that voting rights allow shareholders to pursue their individual interests rather than the interests of the shareholders as a group.[122] This is especially troubling with respect to institutional shareholders that have large holdings and commensurate voting power.

This argument, however, is little more than a bogeyman. It certainly is possible that certain shareholders may engage in opportunistic behavior, but that is equally true of anyone, including the directors. The possibility alone cannot justify a denial of power. One must at least inquire into the likelihood of abuse, and there is no reason to suppose that the threat of shareholder misconduct is any greater than that of director misconduct, or even nearly as great.[123]

Opportunities for shareholder misconduct are quite limited. The vast majority of business decisions are made exclusively by management. More important decisions are made by the directors. Shareholders only get to vote on fundamental matters, and most require director approval. As to these matters, directors could refuse to cooperate with opportunistic shareholders, and presumably would do so. Therefore, the argument only applies to matters on which shareholders can impose their will on directors — but that is a very limited universe, consisting primarily of bylaw amendments.[124] Thus, the benefits of an increase in director accountability through shareholder voting rights are likely to outweigh the cost of a potential increase in shareholder self-dealing.

One scholar who remains concerned about the potential for shareholder misconduct is Professor Bainbridge. He makes much out of the possibility that a shareholder could blackmail management for side payments by threatening to initiate proposals disfavored by

[122] *See, e.g.*, Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006) (arguing that institutional investors have substantial private interests that conflict with maximizing shareholder value); K.A.D. Camara, *Classifying Institutional Investors*, 30 J. CORP. L. 219 (2005) (similar).

[123] Some argue that management is constrained by fiduciary duties while shareholders are not. *See, e.g.*, Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67, 78-79 (2003). However, given the deference of the business judgment rule, *see* Velasco, *supra* note 60, at 828-30, judicial review does not constitute much of a constraint on director behavior.

[124] Even this power is quite limited. *See supra* notes 36-41 and accompanying text.

management, whether value-reducing or value-increasing.[125] Professor Bebchuk is less concerned. He argues that the threat should be viable only when there is a realistic chance that the proposal will achieve majority support.[126] Bainbridge disagrees;[127] but if he is correct, he has provided a serious indictment of management. On the one hand, if the shareholder proposal is value-reducing and unlikely to garner majority support, then the directors would be irrational in submitting to the blackmail. On the other hand, if the directors are attempting to suppress a value-enhancing shareholder proposal, then they would be engaging in outright misconduct. Regardless of whether the directors are assumed to be foolish or sinister, they should not be trusted with unreviewable discretion.

#### 4. Director Authority

A final line of objection to shareholder voting rights is rooted in the value of director authority: that the law properly authorizes the directors to run the business, and strong shareholder voice upsets this system.[128] Bainbridge is a leading advocate of this theory. He argues that "[a]ctive investor involvement in corporate decisionmaking seems likely to disrupt the very mechanism that makes the widely held public corporation practicable: namely, the centralization of essentially nonreviewable decisionmaking authority in the board of directors."[129]

Authority is but one value in corporate law; a competing value is accountability.[130] "Corporate directors are only human . . . . [T]hey may sometimes allow self-interest to prevail over duty, and shirk or even steal from the firm."[131] Because of human frailty, the directors' decisionmaking authority cannot be beyond review.[132]

---

[125] *See* Bainbridge, *supra* note 2, at 1755-57; *see also* Anabtawi, *supra* note 122, at 596-97.

[126] *See* Bebchuk, *Power*, *supra* note 1, at 883-84.

[127] *See* Bainbridge, *supra* note 2, at 1756-57; *see also* Anabtawi, *supra* note 122, at 594-96.

[128] *See generally* Bainbridge, *supra* note 16; Lipton & Rosenblum, *supra* note 123.

[129] Bainbridge, *supra* note 2, at 1749.

[130] *See* Velasco, *supra* note 60, at 823. "Authority and Responsibility are both essential values because each responds to one of the two principal kinds of costs incurred in operating as a firm." Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 464 (1992).

[131] Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1199 (2002).

[132] *See supra* notes 116-17 and accompanying text.

Unfortunately, as Bainbridge has noted, the values of authority and accountability inherently conflict, and either one can be increased only at the expense of the other.[133] Thus, increased accountability for directors necessarily entails decreased authority. Nevertheless, Bainbridge's claim that "giving investors . . . power of review differs little from giving them the power to make board decisions in the first place"[134] is overstated. "Effective centralized management does not require boards to retain absolute power."[135] After all, too much authority comes at the expense of too little accountability.

The issue is one of balance between authority and accountability.[136] Bainbridge acknowledges this, but insists that "shareholder voting is properly understood not as a primary component of the corporate decisionmaking structure, but rather as an accountability device of last resort, to be used sparingly, at most."[137] In other words, he would strike the balance decisively in favor of authority.[138]

However, this conclusion does not follow from the argument. Bainbridge bases his theory on the work of Professor Arrow,[139] but Arrow's position is much more moderate:

> [Accountability mechanisms] *must be capable of correcting errors* but should not be such as to destroy the genuine values of authority. Clearly, a *sufficiently strict and continuous* organ of [accountability] can easily amount to a denial of authority. If *every decision* of A is to be reviewed by B, then all we have really is a shift in the locus of authority from A to B and hence no solution to the original problem.[140]

[133] *See* Bainbridge, *supra* note 2, at 1747.

[134] *Id.* at 1749-50.

[135] Bebchuk, *Rules*, *supra* note 1, at 1792-95.

[136] *Cf.* E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 403 (1996) ("The defining tension in corporate governance today is the tension between deference to directors' decisions and the scope of judicial review.").

[137] Bainbridge, *supra* note 2, at 1750.

[138] This becomes especially evident when one considers Bainbridge's favorable attitude towards judicial deference under the business judgment rule. *See* Bainbridge, *supra* note 2, at 1747. *See generally* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004) (describing business judgment rule as representing policy of judicial abstention).

[139] *See generally* KENNETH J. ARROW, THE LIMITS OF ORGANIZATION (1974).

[140] Bainbridge, *supra* note 2, at 1747 (quoting ARROW, *supra* note 139, at 78) (emphasis added).

Where Bainbridge seems to believe that any accountability undermines authority,[141] Arrow asserted only that too much accountability does so. There is no easy way to determine the appropriate balance, but it seems implausible that traditional shareholder voting rights create excessive accountability. Thus, while expanding the issues on which shareholders are entitled to vote may be problematic, ensuring meaningful exercise of existing voting rights should not be.

Fortunately, the courts place a greater value on accountability than does Bainbridge. Although they tend to be very deferential to directors when it comes to litigation, they are much less so with respect to voting rights.[142] According to the Delaware Supreme Court, "Maintaining a proper balance in the allocation of power between the stockholders' right to elect directors and the board of directors' right to manage the corporation is dependent upon the stockholders' unimpeded right to vote effectively in an election of directors."[143] In fact, the courts insist that shareholder voting rights provide the justification for judicial deference to director judgment in other contexts.[144]

### *B. The Right to Sell Shares*

Why should the shareholder right to sell shares be taken seriously? Shareholders are likely to answer that it is the right that they value most. Nevertheless, there may be strong policy reasons why the right should be curtailed, perhaps even severely. In this section, I consider some of the objections commonly raised against the shareholder right to sell shares.

#### 1. Unnecessary Right

A preliminary objection to a "more meaningful" right to sell might be that it is unnecessary. The shareholder right to sell is already very robust: shareholders can sell their shares on the open market at any time.[145] They may exercise this right in order to make a profit,[146] or to

---

[141] *See id.* ("[D]irectors cannot be held accountable without undermining their discretionary authority.").

[142] Professor Bainbridge demands "an account of why shareholder voting rights should differ," *id.* at 1749, and dismisses the *Blasius* principle, *see infra* note 255 and accompanying text, as "mere ipse dixit," Bainbridge, *supra* note 2, at 1749 n.74.

[143] MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1127 (Del. 2003).

[144] *See infra* note 255 and accompanying text.

[145] *See supra* note 13 and accompanying text.

[146] *See* Zetlin v. Hanson Holdings, Inc., 397 N.E.2d 387, 388 (N.Y. 1979).

express disapproval with management.[147] It is only in certain limited contexts — most importantly, hostile takeovers — that this right is curtailed. Despite such restrictions, it would be difficult to maintain that the right to sell shares is not meaningful as is. Even a "fundamental right" does not have to be absolute.

This is a valid point, but the argument fails to appreciate the importance of the right to sell shares specifically in a hostile takeover where both the shareholder's economic rights and control rights are implicated significantly. Economic rights are at stake because selling shares is the shareholder's primary means of extracting value from her investment.[148] The opportunity is especially lucrative in the context of a hostile takeover, where the acquirer usually offers a significant premium to market value. Moreover, control rights are at stake because of the market for corporate control which disciplines management.[149] If management is inefficient, the company's stock price suffers, which makes a hostile takeover relatively inexpensive; if management is efficient, the company's stock price increases, which makes a hostile takeover relatively expensive. Because hostile takeovers often lead to the replacement of management, even the threat of one can provide a strong incentive for management to be efficient. Thus, a strong right to sell can have a disciplinary effect even in the face of a relatively weak right to vote.[150]

Ultimately, this objection only suggests that it may be acceptable to limit the shareholder right to sell in a hostile takeover, but it does not provide any independent basis for doing so. Even if one is not persuaded about the market for corporate control, the right to sell shares should be restricted in hostile takeovers only if there are reasons for doing so. The next few sections consider those reasons.

[147] "The Wall Street Rule holds that shareholders who are dissatisfied with management decisions can 'vote with their feet' by selling their shares and finding a different enterprise in which to invest." Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late*, 43 AM. U. L. REV. 379, 406 (1994).

[148] *See* Velasco, *supra* note 3, at 414-15.

[149] *See* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965) (describing market for corporate control); *see also* Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON U. L. REV., Summer 1989, at 99, 111-13.

[150] However, the right to elect directors is a necessary element of the market for corporate control. *See* Velasco, *supra* note 3, at 451.

2. Other Constituencies

A second objection to a strong shareholder right to sell shares is based on the rights of other corporate stakeholders, such as lenders, employees, suppliers, customers, and even the communities in which corporations operate. Many believe that the corporation should not be operated solely in the interests of shareholders, but rather should be run in the greater interests of society.[151] Even those who disagree might nevertheless agree that society has the right to limit shareholder rights to the extent that they cause mischief.[152] Thus, if hostile takeovers are harmful to society, then the right to sell shares may have to yield.

Hostile takeovers have a bad reputation. In the popular imagination, they are the product of corporate raiders and complicit shareholders selfishly seeking huge profits at the expense of other corporate stakeholders in transactions that provide little or no benefit to society. In fact, however, hostile takeovers were never the real problem. Undoubtedly, they can have a negative impact on many stakeholders. However, any harm that they seem to cause is, in fact, the result of underlying market forces.[153] If a company is inefficient, it will be a strong candidate for a restructuring; even in the absence of a takeover, the company must initiate similar reforms or risk failure.

[151] *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 288-89 (1999) (characterizing directors' role as mediating hierarchs); Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 189 (1991) ("[T]he ultimate goal of corporate governance is the creation of a healthy economy . . . . Corporate governance is a means of ordering the relationships and interests of the corporation's constituents . . . ."); David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1378-79 (1993) ("[C]orporate law must confront the harmful effects on nonshareholder constituencies of managerial pursuit of shareholder wealth maximization.").

[152] *See, e.g.*, CLARK, *supra* note 91, at 20-21 ("The interests of nonshareholder groups like employees can be protected by contract, common law developments, and special legislation."); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1444 (1993) ("[M]any nonshareholder constituencies have [the ability] to protect themselves through the political process.").

[153] *See generally* MICHAEL C. JENSEN, A THEORY OF THE FIRM: GOVERNANCE, RESIDUAL CLAIMS, AND ORGANIZATIONAL FORMS (2000) (arguing that gains from takeovers come from increased operating efficiencies and reduced waste of free cash flows); Dale Arthur Oesterle, *Revisiting the Anti-Takeover Fervor of the '80s Through the Letters of Warren Buffett: Current Acquisition Practice is Clogged By Legal Flotsam from the Decade*, 19 CARDOZO L. REV. 565 (1997) (arguing legitimate net benefits of hostile takeovers).

For example, massive layoffs are among the most dreaded and reviled consequences of corporate restructurings, but such dislocations are inevitable in competitive markets: the takeovers of the 1980s were followed by downsizings in the 1990s[154] and outsourcing in this decade.[155] Thus, blocking hostile takeovers will not do much to protect other constituencies.

Concern for other constituencies is perfectly legitimate, but must be put in perspective. Most stakeholders are able to protect themselves contractually, but shareholders are not. Lenders can secure their rights in an indenture or credit agreement; employees can do so in their individual employment contracts and in collective bargaining agreements; and suppliers and customers can enter into long-term contracts. Even the community is armed with the power to write laws. But the shareholder, as the holder of the residual interest, must rely on very incomplete contracts. The nature of business demands that directors have wide discretion to run the business. Without specific contractual (or legal) rights, however, shareholders are vulnerable. Thus, shareholders are accorded the loyalty of management, and the business is run in their interests.[156] If other stakeholders want protection against the sort of disruption that occurs in hostile takeovers, they can bargain for it or seek protective legislation. If they do not, they should not expect shareholder interests to be subordinated to their own.

Finally, there is an issue of means. Relying on directors to balance the various competing interests seems to be the preferred method for protecting the interests of other corporate stakeholders. However, this is a function that directors are not capable of performing.[157] As discussed above, directors are needed to protect the rights of shareholders. Moreover, because shareholders are the only ones with the disciplinary powers of voting and selling (however enfeebled), directors are likely to be loyal to them. The fact that directors have

[154] *See* Louis Uchitelle, *Strong Companies Are Joining Trend to Eliminate Jobs*, N.Y. TIMES, July 26, 1993, at A1.

[155] *See* Pete Engardio, Michael Arndt & Dean Foust, *The Future of Outsourcing: How It's Transforming Whole Industries and Changing the Way We Work*, BUS. WK., Jan. 30, 2006, at 50-58.

[156] *See* Bainbridge, *supra* note 16, at 585-91; Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 36-39 (1991).

[157] *See* David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1, 29-34 (1979); Milton Friedman, *A Friedman Doctrine — The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine) at 124.

proven quite willing to authorize the same types of restructurings that they tend to resist in hostile takeovers should suggest that they are not motivated by concern for other stakeholders.[158] If directors do act against the interests of shareholders, it very well may be in the pursuit of their own interests rather than those of third parties. Yet directors' authority to protect other stakeholders can be used to defend almost any action they may take, however self-interested.[159] Thus, director authority to resist hostile takeovers can greatly injure shareholder interests without providing any real benefit to other stakeholders.

3. Investment Horizon

Another line of objection to a strong shareholder right to sell shares focuses on the investment horizon. Many believe that shareholders are improperly fixated on short-term profitability, and that directors should be permitted to pursue the long-term interests of the corporation.[160] According to the Delaware Supreme Court, the directors' "broad mandate" under corporate law requires them "to charter a course for a corporation which is in its best interest without regard to a fixed investment horizon," not "to maximize shareholder value in the short term."[161] Thus, the argument runs, directors should have the authority to resist a hostile takeover that looks more profitable in the short run if they believe a different course of action would be more profitable in the long run.

A preliminary response would challenge the premise that there is a difference between a long-term and a short-term investment horizon. A discounted cash flow analysis equalizes all horizons: the net present value of an investment reflects all of its future profitability.[162]

[158] *See* Bainbridge, *supra* note 152, at 1445-46.

[159] *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991); Macey, *supra* note 156, at 31-32.

[160] *See, e.g.*, MICHAEL T. JACOBS, SHORT-TERM AMERICA: THE CAUSES AND CURES OF OUR BUSINESS MYOPIA (1991) (describing various causes of short-term thinking in corporations and proposing solutions); Lipton & Rosenblum, *supra* note 151, at 202-15 (describing short-term bias among institutional investors and its impact on corporations); *see also* Thomas Lee Hazen, *The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law*, 70 N.C. L. REV. 137 *passim* (1991) (arguing financial markets and increasing array of derivative investment vehicles impede directors' ability to manage companies for long-term).

[161] Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1990).

[162] *See generally* KLEIN & COFFEE, *supra* note 13, at 322-33 (discussing time value of money).

Moreover, according to the efficient capital market hypothesis, the market price of a security reflects all available information about the investment's future cash flows. Thus, the current market price of a company's common stock adequately reflects both its short-term and its long-term profitability.[163] Although the efficient capital market hypothesis has been subject to valid criticism, it remains generally accepted as an important financial theory.[164]

Another response would point to the limits of director authority. Corporate law authorizes the directors to decide upon the horizon for the profitability of business investments, but not upon the horizon for the profitability of shareholders' investments. A decision to sell shares involves only the latter, not the former.[165] Thus, just as shareholders should not be able to interfere with the company's business decisions, neither should directors be able to interfere with shareholder investment decisions.[166]

Despite the common argument to the contrary, the situation does not change in the context of a hostile takeover. The acquisition itself does not interfere with corporate policy. Admittedly, the acquirer may be determined to make policy changes. However, if it is to do so, it must follow legitimate channels. The acquirer as shareholder cannot directly effect changes in corporate policy, but must elect new directors who might be inclined to do so. There is nothing illegitimate about this approach. Directors get to manage the business only for as long as they are directors, and no longer; they do not have the right to block new directors from changing course.[167]

[163] *See generally* RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 333-54 (8th ed. 2006) (discussing efficient capital market hypothesis).

[164] *See generally* KLEIN & COFFEE, *supra* note 13, at 417-25 ("[W]hile the classical ECMH cannot be reconciled with evidence of a variety of anomalies and discontinuities . . . , it remains a simple and useful tool for understanding many market phenomena."); BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET (7th ed. 1999) (defending efficient capital market hypothesis and investment strategies based thereon).

[165] "The sale of a company . . . has important consequences for the target's business and long-term strategy." Paredes, *supra* note 95, at 131. This fact leads many to assume that "takeovers raise a number of corporate policy issues that fall within the scope of the board's authority." *Id.* However, this is a non sequitur. The corporation and its shareholders have separate legal status, each with their own domain of authority. Although the actions of one may have serious consequences for the other, this is true of any two actors and cannot serve as the basis for expansion of the board's authority.

[166] *See* Velasco, *supra* note 3, at 430-34.

[167] "Section 141(a) . . . confers upon any newly elected board of directors full

One also might question whether directors are capable of preferring the long term over the short term. While commentators often insist that directors should do so, they also often lament the fact that directors do not.[168] It would seem that only further insulation from accountability to shareholders would enable them to do so, and that would be too great a price. Even with reduced accountability, it is questionable whether directors would take a long term perspective. The state of compensation practices at large, public companies does not instill confidence in the ability of directors to provide the correct incentives.[169] Even performance-based incentive compensation must be meted out in increments that fall short of the long term. Moreover, many top executives are at the end of their careers and thus face a "final period problem":[170] they have an incentive to maximize the short-term impact of their tenure in order to reap any rewards while in office.

Finally, the law actually purports to be agnostic as to investment horizons.[171] This is as it should be. Even setting aside the efficient capital market hypothesis and assuming that there is a difference, it is not clear that a long-term investment horizon is always better than a short-term one. Investing for the long term entails greater risks and opportunity costs than investing for the short term. One cannot always sacrifice the present for the future. Exactly how much gratification should be delayed in any given situation is a matter of prudential judgment and risk preference. Therefore, the law should not impose any such bias on business decisions, and certainly not by a means as crude as the restriction of shareholder rights.

---

power to manage and direct the business and affairs of a Delaware corporation." Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1291-92 (Del. 1998) (invalidating poison pill provision that "would prevent a newly elected board of directors from completely discharging its fundamental management duties to the corporation and its stockholders for six months").

[168] *See, e.g.*, JACOBS, *supra* note 160, at 37-38 (noting that "many managers blame stock market pressures for short-termism . . . ."); Lipton & Rosenblum, *supra* note 151, at 210-13 (discussing management's susceptibility to short termism of institutional investors).

[169] *See generally* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004) (discussing shortcomings in executive compensation practices).

[170] Daniel J.H. Greenwood, *Democracy and Delaware: The Mysterious Race to the Bottom/Top*, 23 YALE L. & POL'Y REV. 381, 395-96 (2005); Mitu Gulati, *When Corporate Managers Fear a Good Thing Is Coming to an End: The Case of Interim Nondisclosure*, 46 UCLA L. REV. 675, 694-702 (1999).

[171] *See supra* note 161 and accompanying text.

4. Director Superiority

One final line of objection to a strong shareholder right to sell shares is grounded in the superiority of the directors: because directors have better information about the true value of the company, they are better able to determine whether a takeover bid represents a good offer.[172] This objection is similar to the shareholder inadequacy objection considered earlier, but goes a step further. Whereas shareholder inadequacy merely suggests that shareholders are not capable of performing the directors' managerial role, director superiority insists that directors are fully capable of performing the shareholders' investment function. Thus, it arguably is in the shareholders' interests to have directors make decisions with respect to hostile takeovers.

Yet shareholders are not interested in giving directors the final say. This is so even though they recognize that directors generally do have greater access to information than they do. There are many possible reasons for shareholder mistrust.

First, the fact that directors have greater access to information is not decisive because they are capable of disclosing such information to the shareholders. In fact, the directors have a strong incentive to disclose all positive information in order to defeat the hostile takeover.[173] The objection is persuasive only when disclosure is not possible, perhaps because the information is secret and could be exploited by competitors.[174] Unfortunately, it is easy for directors to make an unverifiable claim of hidden value.[175] However, given that so much information must be disclosed under the federal securities laws, and that additional voluntary disclosures could be made as carefully as necessary,[176] situations involving truly hidden value are not likely to

[172] *See* Richard E. Kihlstrom & Michael L. Wachter, *Precommitment and Managerial Incentives: Corporate Policy and the Coherence of Delaware Takeover Law*, 152 U. PA. L. REV. 523, 541-45, 573 (2003); *see also* Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 106-09 (1979) (arguing shareholders benefit when management successfully blocks takeover bid).

[173] *See* Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 608 (1989); Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 259-60 (1989).

[174] *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 529-30 (2002).

[175] *Cf.* Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. CORP. L. 381, 418 (2002) (discussing substantive coercion).

[176] While mandatory disclosures are often held to a higher standard, voluntary disclosures generally only need to avoid being untrue or misleading. *See* Securities

be common. Thus, such claims reasonably can be rejected as implausible.[177]

Even assuming the existence of hidden value, it does not follow that the directors are in the best position to determine the company's value. They may have perfect information about their own company, but they have much less information about other companies. This lack of information is especially significant with respect to competitors because a company's future prospects depend, in large part, upon those of its competitors. Although "firms within the same industry have greater knowledge about each other's properties, products and prospects,"[178] they will not be aware of each other's hidden value. Thus, the directors' valuation is likely to be biased in the company's favor. In other words, additional information does not necessarily translate into superior knowledge.

Even assuming that the directors have superior knowledge, there is still a question of judgment. Information may be perfectly accurate, but the data must be analyzed and evaluated to be useful. A company's value is based on projections of future performance, which are nothing more than estimates generated from the evaluation of available data. If the directors are optimistic with respect to the company's prospects, and hopefully they will be, then their projections may be overly optimistic. Thus, their determination of company value may tend to be excessive. This problem is likely to be exacerbated in the context of a hostile takeover, where reputations and careers are at risk.[179] Directors may be tempted to become more optimistic than they should be.

Finally, even assuming that the directors can process information perfectly, the agency problem remains. Although the directors may be able to make the best decisions on behalf of the shareholders, they may not do so in fact. They may be tempted to make decisions in

Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (2007).

[177] "Arguments based on confidential information are always easy to make, and, unless investigated on a case-by-case basis, serve only to insulate target managers from accountability. Such a case-by-case evaluation would be costly and a broader rule disfavoring the arguments based on confidential information may prove the more prudent choice." Dale Arthur Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 126 (1986).

[178] John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1214 (1984).

[179] *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (recognizing "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders").

their own interests, and in the interests of management,[180] while maintaining the facade of loyalty to the shareholders. This seems especially likely in the context of a hostile takeover, where the incentive to engage in opportunistic behavior is great. Although most directors may be able to avoid temptation and live up to their fiduciary duties despite the personal cost, the conflict of interest makes deference inappropriate.[181]

It may be argued that the theoretical problem can be eliminated by aligning management's interests with those of shareholders. This could be done by giving management a sufficient equity interest in the corporation.[182] Given the prevalence of stock options and golden parachutes[183] in the compensation packages of top executives, it may seem plausible that management's incentives are properly aligned with shareholders. On the other hand, there are those who believe that stock options can cause more problems than they solve.[184]

It is extremely difficult to craft a compensation package that aligns the interests of management and shareholders perfectly. Even a large equity interest does not eliminate the benefits of employment for top executives. Although existing compensation may be dealt with in a hostile takeover, it is more difficult to address management's confidence in its ability to secure greater compensation, especially an

[180] Structural bias may tie the interests of directors with those of management. *See generally* Velasco, *supra* note 60, at 853-65 (describing structural bias in terms of implicit conspiracy, personal relationships, and ingroup bias).

[181] *See generally id.* at 834-35 ("Although the interests of directors usually are aligned with those of the shareholders, there are times when their interests conflict. In those situations, the deference afforded to directors by the business judgment rule is wholly inappropriate.").

[182] *See* Sanjai Bhagat, Dennis C. Carey & Charles M. Elson, *Director Ownership, Corporate Performance and Management Turnover*, 54 BUS. LAW. 885, 890 (1999); Charles M. Elson & Robert B. Thompson, Van Gorkom*'s Legacy: The Limits of Judicially Enforced Constraints and the Promise of Proprietary Incentives*, 96 NW. U. L. REV. 579, 587-91 (2002).

[183] For a definition of "golden parachute," see LIPTON & STEINBERGER, *supra* note 63, § 6.02[4][a][i], at 6-13.

[184] *See, e.g.*, Margaret M. Blair, *Shareholder Value, Corporate Governance, and Corporate Performance: A Post-Enron Reassessment of the Conventional Wisdom*, *in* CORPORATE GOVERNANCE AND CAPITAL FLOWS IN A GLOBAL ECONOMY 53, 60-62 (Peter K. Cornelius & Bruce Kogut eds., 2003) ("Although stock options do help tie CEO pay to the performance of the stock price, they create other incentives that can be quite perverse."); *see also* Calvin H. Johnson, *The Disloyalty of Stock and Stock Option Compensation*, 11 CONN. INS. L.J. 133, 134 (2004) (arguing "stock option compensation . . . harm[s] the equity investors' interests"); Matthew A. Melone, *Are Compensatory Stock Options Worth Reforming?*, 38 GONZ. L. REV. 535, 556 (2003) (similar).

increasing equity interest, in the future. Assuming it could be done, it would be extremely expensive. In addition to raising serious fairness issues — why should shareholders have to pay large amounts of additional compensation for directors to do that which is required of them by their fiduciary duties? — such compensation would be inefficient. The conflicts of interest could be dealt with more easily by means of greater accountability for directors.

Ultimately, if there were no conflicts of interest, there would seem to be no need to give directors the ability to block a hostile takeover. They could simply express their opinion on an offer and the shareholders should be willing to trust them. However, directors are unwilling to yield their power to block takeovers and shareholders are unwilling to trust directors. These facts strongly suggest that both groups realize that their interests can diverge.

## III. TAKING THE RIGHT TO VOTE SERIOUSLY

In Part II, I considered some common objections to shareholder rights. I argued that shareholder rights are important and that the objections did not provide a solid basis for restricting them. In this Part, I will propose and defend a number of legal reforms that would make the right more meaningful without intruding on the directors' managerial role. I offer these proposals, some of which are quite popular already, to illustrate the types of reform that ought to be considered if the right to vote is to be taken seriously.

### A. *Election of Directors by Majority Vote*

As previously discussed, plurality voting renders director elections meaningless most of the time: in uncontested elections, candidates are elected regardless of how shareholders vote.[185] Whatever else it may or may not mean, taking the right to elect directors seriously must mean, at a minimum, that the shareholders have the right not to elect a given candidate. Not surprisingly, "a change from plurality voting for the election of directors of public corporations has recently become a major focus of shareholder activists, certain academics and others as a means to enhance the accountability of corporate boards."[186]

My first proposal is a very popular one among contemporary shareholder rights activists: to change the default rule so that directors are elected by a majority vote. Unlike plurality voting,

[185] *See supra* notes 23-24 and accompanying text.
[186] ABA REPORT, *supra* note 20, at 407.

majority voting would allow shareholders to prevent the election of director candidates. Shareholders could vote effectively in favor of, or against, any director candidate. If the candidate receives a majority of the votes, she is elected; otherwise, she is not.

It would be difficult to deny that plurality voting renders shareholder voting rights meaningless in uncontested elections, or that a majority vote requirement would make elections much more meaningful. However, it is possible to argue that a change in the voting standard nevertheless would be inappropriate. This could be because such a drastic change is unnecessary, or because it might cause more problems than it solves. These arguments are considered below.

1. Unnecessary?

A move from plurality voting to majority voting might be unnecessary for at least two reasons. First, the legal voting standard is only a default rule which companies can change on their own. Second, less drastic solutions might be adequate.

*a. Default Rules*

For the most part, corporate law is enabling rather than mandatory.[187] Most of the rules provided by corporate law are only default rules; companies can adopt different rules if they so desire.[188] The voting standard for director elections fits this mold.[189] Some would argue that, because companies can change the voting standard on their own, there is no need for legislatures to change the default rule.[190]

The situation is more complicated than the argument suggests. The move from plurality voting to majority voting would make directors more accountable, and therefore more vulnerable. Regardless of any benefits that could accrue to the corporation and its shareholders, directors might not be interested in such reform.[191] This is relevant

[187] *See* Jonathan R. Macey, *Corporate Law and Corporate Governance: A Contractual Perspective*, 18 J. CORP. L. 185, 186 (1993); *see also* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1620 (1989).

[188] *See* EASTERBROOK & FISCHEL, *supra* note 159, at 34-35.

[189] *See supra* notes 25-29 and accompanying text.

[190] *See* ABA REPORT, *supra* note 20, at 413.

[191] *See* Bebchuk, *Rules*, *supra* note 1, at 1788-89.

because director cooperation is often necessary to establish a new voting standard.

In many states, including those that follow the Model Business Corporation Act, the voting standard can be changed only by charter amendment.[192] A charter amendment requires the approval of both the shareholders and the directors.[193] Thus, directors would be able to block any change in the voting standard.

In some states, most notably Delaware, the voting standard can be changed by an amendment of the bylaws.[194] Generally, shareholders can amend the bylaws on their own, without director approval.[195] Thus, in many cases, directors would not be able to block the change. However, it is not very easy for shareholders to amend the bylaws. As previously discussed, they face many obstacles along the way, both legal and practical.[196] Directors can make the process even more difficult. Thus, such reforms may not be implemented in many cases where it would be beneficial.

Admittedly, shareholders increasingly are successful in getting their corporate governance proposals adopted.[197] More specifically, companies recently have been adopting variations of the majority voting standard.[198] This trend indicates that reform through shareholder action is promising, and perhaps legal reform is unnecessary (at least in states, such as Delaware, where the voting standard can be changed in the bylaws). However, to the extent that the trend is significant, it also suggests that plurality voting may not be the efficient default rule any longer. Thus, the time may have come to change the law.

In any event, shareholder action is not necessarily an adequate solution, even if the voting standard can be changed in the bylaws. This is because it is most often the case that both the shareholders and the directors can amend the bylaws on their own, without the

---

[192] *See* MODEL BUS. CORP. ACT § 7.28(a) (2005). *But see infra* notes 202-06 and accompanying text (describing recent amendments allowing for "modified plurality" approach in bylaws).

[193] *See* DEL. CODE ANN. tit. 8, § 242(b) (2001); MODEL BUS. CORP. ACT § 10.03 (2005).

[194] *See* DEL. CODE ANN. tit. 8, § 216 (Supp. 2006).

[195] *See id.* § 109(a) (2001).

[196] *See supra* notes 51-55 and accompanying text.

[197] *See* Jena McGregor, *Activist Investors Get More Respect: Boards are Listening, and Shareholder Proposals are Making Headway*, BUS. WK., June 11, 2007, at 34.

[198] *See* CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS, at i-x (2007), *available at* http://www.ngelaw.com/files/upload/majority_callen_020707.pdf.

approval of the other.[199] In the absence of a specific statutory provision to the contrary,[200] that leaves open the very real possibility that directors could amend or repeal any shareholder-adopted bylaws.[201] If so, shareholder action would be futile; directors would be able to restore plurality voting at any time. Thus, the fact that the plurality voting standard is only a default rule does not support the conclusion that legal reform is unnecessary. To the contrary, it suggests that the default rule amendment process also needs reform.

#### *b. Less Drastic Solution?*

One could also argue that, even if some legal reform is necessary, it need not be drastic. Perhaps a less disruptive alternative for increasing director accountability would be preferable. One popular option is a director resignation policy, also known as a "modified plurality" approach.[202] Under such a system, plurality voting remains intact. However, a director is required to tender her resignation if she does not receive a majority vote. The remaining directors then have the opportunity to decide whether to accept the resignation. Both the Model Business Corporation Act[203] and the Delaware General Corporation Law[204] have authorized corporations to adopt a modified plurality approach in their bylaws. Thus, further reforms may be unnecessary.

There is no doubt that such a system increases director accountability over the status quo ante. The problem is that it does not go far enough. In fact, it could be argued that any shareholder gains under the modified plurality approach are merely symbolic.[205] It allows shareholders to vote against director candidates, and it sets in motion a process that could lead to the removal of directors who do not receive majority approval from the shareholders. However, it does not allow shareholders to prevent the election of a director candidate.

---

[199] *See supra* note 40 and accompanying text.

[200] *See, e.g.*, DEL. CODE ANN. tit. 8, § 216 (Supp. 2006) (prohibiting directors from amending shareholder-adopted bylaw specifying voting requirement for election of directors); MODEL BUS. CORP. ACT § 10.21(a)(1) (2005) (same).

[201] *See supra* note 41 and accompanying text.

[202] *See* ABA REPORT, *supra* note 20, at 411-12.

[203] *See* MODEL BUS. CORP. ACT § 10.22 (2006).

[204] Delaware law already allowed the voting standard to be set in the bylaws, but recently authorized binding director resignations. *See* DEL. CODE ANN. tit. 8, § 141(b) (Supp. 2006).

[205] Admittedly, a symbolic gain is not necessarily insignificant. *See infra* notes 222-24 and accompanying text.

The directors have the final say, and often they are specifically authorized to allow directors whom the shareholders have rejected to remain on the board.[206]

The Committee on Corporate Laws of the Section of Business Law of the American Bar Association has suggested that such occurrences would be rare because it might violate directors' fiduciary duties.[207] Despite the intuitive appeal of its assertion, the ABA Committee is probably wrong. Courts tend to be formalistic when applying corporate law.[208] One of the basic principles of corporate law is the requirement that directors exercise their own business judgment: directors need not simply follow the wishes of the shareholders[209] — in fact they cannot abdicate their responsibilities.[210] A straightforward application of this principle easily could lead to the conclusion that, because directors are empowered to reappoint rejected directors, they have the discretion to do so without reference to shareholder preferences. The result is a situation that is in some ways worse than the holdover rule: directors would not only remain in office until a successor is elected and qualified, but would be reinstated and granted legitimacy. Thus, a modified plurality approach is not an adequate substitute for majority voting.[211]

2. Too Problematic?

Even if there are serious problems with existing law, legal reform would not be worthwhile if it would cause more harm than good.[212] Plurality voting may be imperfect, but so is majority voting. Thus, one could argue that a change in the default rule might be imprudent.

[206] *See* ABA REPORT, *supra* note 20, at 419; MODEL BUS. CORP. ACT § 10.22(a)(3); *id.* § 10.22(a)(3) cmt. 1.

[207] *See* ABA REPORT, *supra* note 20, at 419.

[208] *See* Velasco, *supra* note 3, at 427-37.

[209] *See* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); People *ex rel.* Manice v. Powell, 94 N.E. 634, 637 (N.Y. 1911).

[210] *See* Grimes v. Donald, 673 A.2d 1207, 1214 (Del. 1996).

[211] The SEC staff apparently does not consider a director resignation policy/modified plurality approach to be an effective substitute for majority voting. *See* Hewlett Packard Co., SEC No-Action Letter, 2006 SEC No-Act. LEXIS 8 *passim* (Jan. 5, 2006).

[212] *See* Bainbridge, *supra* note 2, at 1741 & n.36 (citing Dooley, *supra* note 130, at 525).

*a. Failed Elections*

In deliberations leading up to the recent amendments to the Model Business Corporation Act, the ABA Committee considered adopting a majority vote requirement. It decided not to do so because of concern that the potential consequences of "failed elections" — elections "in which one or more nominees are not seated on the board"[213] — might be too great.[214] The consequences identified by the ABA Committee are as follows:

- "If a candidate who is the CEO or other senior executive is not elected, it could constitute a breach of that executive's employment agreement, and may trigger an obligation on the part of the corporation to make severance payments to that executive.
- "The failure to elect a specified percentage of directors could result in a 'change of control,' thus accelerating debt or canceling a line of credit provided in a credit agreement, or triggering changes in licenses, franchise agreements or other important corporate arrangements.
- "If a fixed number of directors is to be elected by holders of one class of securities, a failure to elect one or more directors could alter the relationship among shareholders of different classes.
- "The failure to elect one or more candidates could adversely affect the corporation's ability to comply with listing standards or other requirements for maintaining independent directors or directors with particular qualifications.
- "The failure to elect one or more candidates may alter the consequences of having a classified board, where directors have staggered terms.
- "A dissident group with minority representation on the board of directors could enlarge its percentage of directors if new nominees to the board are not elected — thereby avoiding the

[213] ABA REPORT, *supra* note 20, at 410; *see also supra* note 22.
[214] *See* ABA REPORT, *supra* note 20, at 409-11.

> need for a direct proxy contest challenge and altering the existing dynamics of control contests."[215]

The first two listed consequences are presumably the most significant. Yet these are entirely the result of director action: directors are the ones who enter into employment agreements with senior executives and who enter into "change of control" provisions in other contracts. Contractual provisions adopted by directors cannot be the justification for insulating directors from accountability to shareholders. On the contrary, their fiduciary duties should prevent directors from entering into such agreements in the first place, or at least require them to craft such provisions more carefully so as to preserve shareholder voting rights.

Many of the other listed consequences are not generally applicable: most companies do not have a charter providing that shareholders of different classes elect different directors, or a dissident group with minority representation on the board. While many companies do have staggered boards, it is far from universal. In any event, shareholders can take the "consequences" into consideration in deciding how to vote and whether to reject an incumbent director. It would seem overly paternalistic to deny shareholders the opportunity to reject a director candidate on these grounds. It would be excessive to deny that opportunity to shareholders in all companies because of such cases.

The most legitimate concern seems to be the issue of compliance with listing standards and other requirements for maintaining independent directors or directors with particular qualifications. However, once again, denial of shareholder voice is too severe a remedy. In the first place, shareholder hostility is most often directed against executive officers who would not qualify as independent directors.[216] But even as to independent director candidates, there are workable alternatives. For example, the bylaws could provide for reasonable qualifications for director candidates,[217] and directors could

---

[215] *See id.* at 410-11.

[216] There are various "independent director" standards. *See, e.g.*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, 116 Stat. 745, 775-76; SEC Rule 10A-3, 17 C.F.R. § 240.10A-3 (2004); NYSE, Listed Company Manual § 303A (2004), *available at* http://www.nyse.com/pdfs/section303A_final_rules.pdf (last visited Nov. 15, 2007); NASDAQ, Inc., Marketplace Rule IM-4200, *available at* http://nasdaq.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=18; NASDAQ, Inc., Marketplace Rule IM-4350-4, *available at* http://nasdaq.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=18.

[217] *See* DEL. CODE ANN. tit. 8, § 141(b) (Supp. 2006); MODEL BUS. CORP. ACT § 8.02

use their power to fill any vacancies so as to avoid problems.[218] Even if no simple solution presented itself, however, it would make more sense to restructure elections entirely than to deny shareholders effective voting rights.

One also can question the likelihood of a failed election. Because of rational apathy,[219] shareholders tend to vote in favor of incumbent directors. Only when directors have ignited considerable hostility among shareholders would their reelection be in doubt. In other words, failed elections would be relatively rare events. Experience bears out this intuition. It was not very long ago that a majority vote requirement was the default rule for American corporations; in many countries, it still is. Yet failed elections were not a great problem in the United States back then, and they are not a great problem in other countries now.

Certainly, there may be particular situations where a failed election would cause more than a minor inconvenience. But the way to deal with the problem is to inform shareholders of the consequences before the election. In fact, directors have every incentive to make those consequences clear, perhaps even to exaggerate them, in order to ensure the election of their candidates. If shareholders nevertheless would prefer to accept the consequences of a failed election, then the law should not force the director candidate upon them.

Finally, the possibility of a failed election should not be so troubling. Even the existing plurality standard can lead to many of the same consequences as a failed election if, in a contested election, the shareholders reject the incumbent candidates. Yet that is not considered a valid reason for eliminating proxy contests. The merger approval process carries a similar risk. A merger agreement can provide for negative consequences very similar to those of a failed election if the shareholders should fail to approve the transaction.[220] But this has never been considered a legitimate reason to deny shareholders a vote on mergers. Obviously, then, the consequences of a failed election are not unacceptable.

The real concern should be with unintentionally failed elections, in which shareholders merely fail to agree, as opposed to those in which

---

(2005).

[218] In many companies, a vacancy on the board of directors can be filled not only by shareholders in an election, but also by the other directors. *See* DEL. CODE ANN. tit. 8, § 223(a) (2001); MODEL BUS. CORP. ACT § 8.10(a) (2005).

[219] *See generally supra* Part III.A.1 (discussing rational apathy among shareholders).

[220] *See, e.g.*, Brazen v. Bell Atl. Corp., 695 A.2d 43, 49-50 (Del. 1997) (upholding $550 million reciprocal termination fee as valid liquidated damages provision).

they purposefully reject an incumbent. Evisceration of shareholder voting rights is not necessary to deal with this problem. Majority voting can be structured to minimize the likelihood of unintentionally failed elections.

*b. Holdover Rule*

Even if a failed election were to occur, state law generally provides that an incumbent director remains in office "until such director's successor is elected and qualified or until such director's earlier resignation or removal."[221] This "holdover rule" eliminates the possibility that failed elections would result in vacancies on the board of directors. It also gives the company an opportunity to replace the rejected director with one who would minimize the consequences of a failed election.

However, many find the holdover rule itself to be problematic: "If the holdover rule were retained in its present form, a majority default rule would represent only a symbolic change to the plurality voting system because directors who are not elected would nevertheless remain in office until a successor is elected and qualified."[222] While the result clearly is suboptimal from the shareholders' perspective, the significance of the "symbolic change" should not be underestimated. Under majority voting, a holdover director would serve under a cloud of illegitimacy because she would have been rejected affirmatively and clearly by the shareholders. The same is not true under plurality voting because an uncontested director candidate is always validly elected. In fact, there cannot even be a clear rejection because shareholders cannot vote against a candidate.[223]

The rejection of directors permitted by majority voting would be more than merely symbolic. With respect to new director candidates, it would be determinative because the holdover rule would be inapplicable. With respect to incumbent directors, it is true that they would remain in office after an uncontested election despite being rejected by a majority of the shareholders; however, this would only be true temporarily. Because of the clear mandate from the shareholders, the rejected director may feel pressure to resign. Moreover, the shareholders may be able to replace the rejected

[221] DEL. CODE ANN. tit. 8, § 141(b); *see also* MODEL BUS. CORP. ACT § 8.05(e) (2005).

[222] ABA REPORT, *supra* note 20, at 410.

[223] *See supra* note 50 and accompanying text.

director before the next annual meeting.[224] In fact, the remaining directors may be willing to assist them in doing so, both to quell shareholder anger and to increase their role in selecting the successor. Thus, although the holdover rule can hinder the effect of a shareholder vote, it would not necessarily render the rejection of a candidate meaningless.

One minor change to the holdover rule could ensure that it would not undermine majority voting. The law could provide that a holdover director cannot be reelected or appointed until a successor — a different successor — is elected and qualified.[225] This would limit a holdover director's tenure: her term would almost certainly end by the next election because she would not be eligible for reelection. Thus, the shareholders' wishes may be delayed, but they would not be denied.

If the holdover rule is deemed an insurmountable problem, however, simple solutions are available. The elimination of the holdover rule is one possibility, although this would do nothing to minimize the impact of a failed election. Another possibility is to limit the term of a holdover director to a specified amount of time after the election.[226] This would give the company — its shareholders preferably, but more likely the directors[227] — time to find an adequate

[224] According to the Delaware Court of Chancery, electing a successor to a holdover director "logically entail[s] removal and filling of the resulting vacancy." Hoschett v. TSI Int'l Software, Ltd., 683 A.2d 43, 46 (Del. Ch. 1996). Thus, whether shareholders can replace a rejected director likely depends on whether they may remove a director without cause. *See* DEL. CODE ANN. tit. 8, § 141(k); MODEL BUS. CORP. ACT § 8.08 (2005).

[225] *Cf.* MODEL BUS. CORP. ACT § 10.22(a)(3) (2006) (noting "board of directors may select any qualified individual to fill the office held by a director who received more votes against than for election"). In order to prevent gaming behavior by the directors, the prohibition would have to include more than just reelection. A holdover director should not be eligible for a vacancy appointment, either, until a successor is elected and qualified. *See* DEL. CODE ANN. tit. 8, § 223 (2001 & Supp. 2006) (stating "vacancies . . . may be filled by a majority of the directors then in office"); MODEL BUS. CORP. ACT § 8.10(a)(2) (2005) (similar).

[226] Instead of providing that "[e]ach director shall hold office until such director's successor is elected and qualified," DEL. CODE ANN. tit. 8, § 141(b), state law could be amended to provide that "[t]he terms of . . . directors expire at the next annual shareholders' meeting following their election," MODEL BUS. CORP. ACT § 8.05(b) (2006), unless neither the director nor a successor is elected and qualified at that shareholders' meeting, in which case the director shall hold office for an additional 90 days.

[227] Because it is much easier for the directors to take action than it is for shareholders, directors often would be the ones to fill any vacancies resulting from a failed election.

replacement for a rejected director candidate. In fact, some public companies with majority voting have somewhat similar provisions.[228]

To be clear, I am not arguing that it would be unwise to repeal the holdover rule. I am arguing only that not doing so would not necessarily undermine majority voting entirely. If the consequences of failed elections are a major obstacle to the adoption of a majority voting default rule, then solutions short of a repeal of the holdover rule might be more politically viable. Even with the holdover rule, majority voting is much better for the shareholders than plurality voting.

*c. Contested Elections*

A final concern with majority voting would be that, although majority voting can be quite helpful in uncontested elections, it can be problematic in contested elections. This is because it is possible that no director candidate would receive a majority vote.[229] While the scenario where no director candidate receives a majority vote is far-fetched, the possibility that one or more directorships may not be filled because not enough director candidates receive a majority vote is much more plausible. Moreover, after giving effect to the holdover rule, an incumbent director could remain in office even though a challenger may have received a greater number of votes.[230] Thus, the advantage of a majority vote in those uncontested elections in which shareholders want to reject a director must be weighed against its disadvantage in contested elections.

One possible response would be to carve out contested elections so that uncontested elections are subject to the majority vote requirement while contested elections are subject to a plurality vote.[231] This

[228] *See, e.g.*, Gen. Motors Corp., Bylaws § 2.2 (Mar. 5, 2007), *available at* http://www.gm.com/corporate/investor_information/docs/corp_gov/bylaws.pdf (establishing majority voting provision coupled with irrevocable resignation policy; board must accept resignation within 90 days unless "a compelling reason exists for concluding that it is in the best interests of the Corporation for an unsuccessful incumbent to remain as a director").

[229] For example, assume that there are three candidates competing for one position. If they split the vote evenly, none receives a majority.

[230] Depending on the precise majority vote standard, this is likely to be a very rare circumstance. *See infra* notes 234-40 and accompanying text.

[231] This is a common approach. *See, e.g.*, Intel Corp., Bylaws art. III, § 1 (Jan. 17, 2007), *available at* http://www.intel.com/intel/finance/docs/bylaws.pdf (requiring majority vote for uncontested elections of directors and plurality vote for contested elections); NVIDIA Corp., Bylaws art. IV, § 15(b) (Mar. 9, 2006), *available at* http://www.sec.gov/Archives/edgar/data/1045810/000104581006000012/bylawsamend

solution would preserve the shareholders' ability to block a candidate's election. However, this compromise is not unproblematic. As the ABA Committee has noted, it is difficult to define the concept of "contested election" with precision.[232] Moreover, plurality voting for contested elections has the effect of reducing the shareholders' ability to reject candidates in contested elections: because every available position must be filled, the maximum number of directors that could be rejected would be equal to the number of extra candidates.[233] It would seem incongruous that shareholders could reject all candidates in uncontested elections but only one or a few in a contested election.

A superior solution would be to draft a majority standard that functions properly in both uncontested and contested elections. This is entirely possible. Corporate law already recognizes a number of different "majority vote" standards. A "true majority" requirement is one in which a proposal or candidate must receive the affirmative vote of a majority of outstanding shares entitled to vote.[234] A "simple majority" requirement is one in which a proposal or candidate must receive the affirmative vote of a majority of shares present and entitled to vote.[235] A "majority of votes cast" requirement is one in which a proposal or candidate must receive more votes in favor than against, without regard to shares that are not voted.[236]

The true majority requirement is the most demanding and would lead to many more unintentionally failed elections than either of the other two standards.[237] For this reason, the simple majority and

ment.htm (same); *see also* MODEL BUS. CORP. ACT § 10.22(b) (2006).

[232] *See* ABA REPORT, *supra* note 20, at 409, 420-21.

[233] For example, assume there are eight candidates — six incumbents and two challengers — competing for six positions. If the two challengers are elected, there are four positions that must be filled. Thus, two incumbent candidates can be rejected, but four of them cannot be.

[234] *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c) (Supp. 2006) (providing voting requirements for mergers).

[235] *See, e.g.*, *id.* § 216 (Supp. 2006) (providing voting requirement for action by shareholders).

[236] *See* MODEL BUS. CORP. ACT § 7.25(c) (2005) (providing voting requirement for action by shareholders).

[237] Under a true majority requirement, any share that is not affirmatively voted in favor of a proposal or candidate is treated as a negative vote. Not all shares are present or represented at any shareholders' meeting, and not all that are present or represented cast votes. Thus, a supermajority of shares present, and an even greater supermajority of votes cast, must vote in favor of the proposal or candidate for it to prevail. At the extreme, if a bare quorum of shares are present at the meeting, the candidate or proposal will prevail only if all such shares are voted in its favor. In fact, if the required quorum is less than a majority, victory might be impossible.

majority of votes cast standards are preferable. These two standards are very similar. Under either, a shareholder can vote against candidates she dislikes simply by not voting for them. This is because the shareholder will be deemed to have cast a vote, but will not have contributed to the disfavored candidates' required majorities. The difference between the two standards is how they treat abstentions: under a simple majority standard, abstentions are the equivalent of "no" votes, while under a majority of votes cast standard, they do not count as votes cast at all.[238] In other words, a simple majority standard counts everything other than an affirmative vote as a negative vote while a majority of votes cast standard gives shareholders a right to abstain. As a result, a simple majority could lead to unintentionally failed elections somewhat more often.[239] A majority of votes cast standard would not eliminate the possibility of unintentionally failed elections,[240] but it would minimize their incidence in contested elections while allowing shareholders an effective vote in uncontested elections.

An election under a simple majority standard could operate almost as it would under plurality voting. There would be one election at large and the ballot would list all director candidates together. Shareholders could select as many director candidates as there are open positions on the board, but would be free to select fewer candidates. The difference would be that a decision not to vote in favor of a candidate would count as a vote against the candidate rather than being ignored.

In contrast, a majority of votes cast might be preferable in order to preserve the right to abstain. It could operate in the same manner, with one exception: the ballot would have an additional option — "abstain as to all other candidates." This abstention option could be selected only in lieu of at least one candidate. Consequently, the shareholder's ballot would count as a "vote cast" only with respect to the candidates selected; as to all others, it would count as an abstention — it would not count at all. This abstention option would complicate matters somewhat. It would create the very real possibility that too many candidates would receive a majority of votes cast.[241]

[238] *See* MODEL BUS. CORP. ACT § 7.25 cmt. n.4, at 7-53.

[239] *See id.* at 7-53 to -54.

[240] If there are more than two candidates per available position, a failed election becomes increasingly likely. *See supra* note 229 and accompanying text. However, corporate elections in which there are more than two candidates per available position are extremely rare.

[241] For example, assume an election with three candidates competing for two

Obviously, this result must be avoided. A simple solution would be to resolve such ties by reference to the plurality standard: if too many candidates receive a majority of votes cast, then only those with the greatest number of affirmative votes would be elected.

This modified majority of votes cast standard has many advantages. It is a one-size-fits-all policy that works equally well in contested and uncontested elections. It empowers shareholders to block the election of disfavored candidates while preserving their right to abstain if they choose. In addition, it would be reasonably unlikely to result in an unintentionally failed election. Admittedly, it would be somewhat more difficult to administer because vote counting would be more involved.[242] However, this could be managed quite easily with the aid of a simple computer program. Given the choice between a simple majority standard and a more complicated majority of votes cast standard, directors likely would prefer the latter because it increases the likelihood that board nominees will be elected.[243]

#### *d. Amendment*

It bears emphasis that the current proposal is to change the default rule, not to impose a mandatory voting standard. If the proposal were adopted, it would remain true that companies could change the voting standard to accommodate their individual needs. The issue, then, is about how easy it should be to change the default rule and whether the burden should be borne by directors or shareholders. If shareholder voting rights are to be taken seriously, any burden should rest on directors.

If the default rule were changed, no corporate action would be necessary to implement majority voting. Admittedly, it seems unlikely that majority voting will become the default rule any time soon. Both the Delaware law and the Model Business Corporation Act have been amended recently, and in both cases a change to majority voting was

---

positions. If every shareholder were to vote for one candidate and abstain as to all other candidates, then no votes would be cast against any candidate. In that case, all three candidates would receive a majority of votes cast.

[242] Under a majority of votes cast standard, the number of votes cast varies from candidate to candidate. For each candidate, it is equal to the number of shares present or represented at the meeting, *minus* the total number of abstentions, *plus* the number of ballots that both voted for the candidate and abstained as to all other candidates.

[243] Even if most shareholders are unsatisfied, board nominees can be elected if enough unsatisfied shareholders are persuaded to abstain rather than cast votes against the board nominees.

specifically rejected.[244] Thus, for the foreseeable future, some form of corporate action will be necessary. Nevertheless, in order to put the burden on directors, all authority regarding the voting standard should be allocated to the shareholders. This would allow shareholders to act without being undermined by the directors, as discussed above.[245] If directors would like to effect a change, they would be free to submit their proposal for a shareholder vote. In that sense, the directors would be no worse off than if the change had to be made by charter amendment, because both require shareholder approval. Moreover, because shareholders tend to defer to management, it should not be too difficult for directors to effect a reasonable change in this manner.

One might object that it should not be too easy for shareholders to change the default rule. However, such a position would seem to be at odds with the enabling nature of corporate law.[246] In any event, shareholders rarely exercise their power to amend the bylaws, so predictions of ensuing disaster should not be given much weight. At most, allowing shareholders to control the voting standard will allow for more experimentation with majority voting. If it proves to be an inefficient standard, it will not catch on; and if changes go too far, they can be undone easily.

What is most important is that directors not be able to move away from majority voting without the approval of the shareholders. Otherwise, directors could simply undo any reform, whether adopted by law or by the shareholders. In states that follow the Model Business Corporation Act, the voting standard can be changed only by charter amendment, which requires the approval of both directors and shareholders.[247] However, in states where the voting standard can be changed by amendment of the bylaws, directors may be able to change the standard on their own initiative.[248] Recognizing this problem, the Delaware legislature recently amended its General Corporation Law to provide that "[a] bylaw amendment adopted by stockholders which

[244] *See supra* notes 203-04.

[245] *See supra* note 41 and accompanying text.

[246] *See supra* note 187 and accompanying text.

[247] The Model Business Corporation Act's modified plurality standard deviates slightly from this principle. It can be implemented in the bylaws by either directors or shareholders and, if adopted by directors, it can also be repealed only by them. *See* MODEL BUS. CORP. ACT § 10.22(c)(2) (2006). Unfortunately, this would allow directors to adopt the standard in order to preserve their ability to repeal it whenever necessary.

[248] *See supra* notes 199-201 and accompanying text.

specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors."[249] This is a step in the right direction. It is not an adequate substitute for a change in the default rule, but it does prevent directors from undoing shareholder action.[250]

### *B. Fiduciary Duties*

As previously discussed, directors may be tempted to use the broad discretion granted them under corporate law in order to pursue their own interests. Thus, the law imposes fiduciary duties and requires directors to act in the interests of the corporation and its shareholders.[251] For a court of equity, the fact that directors may be exercising legally authorized powers is not enough: "[I]nequitable action does not become permissible simply because it is legally possible."[252] When directors misbehave, the courts may be willing to step in on behalf of shareholders. My second proposal is that the courts do so consistently.

If shareholder voting rights are to be taken seriously, then directors should not be permitted to interfere with their exercise. The courts have recognized this principle in a line of cases best represented by *Blasius Industries, Inc. v. Atlas Corp.*[253] In that case, the directors attempted to expand the size of the board and appoint new directors in order to prevent a significant shareholder from naming a majority of directors.[254] Noting that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests,"[255] the court ruled that any action taken by directors with the primary purpose of interfering with the shareholder vote will not

---

[249] DEL. CODE ANN. tit. 8, § 216 (Supp. 2006).

[250] In fact, even with a new default rule, a change of this type would be necessary to prevent directors from changing the voting standard by amending the bylaws. The precise wording of the Delaware provision would require further amendment to accommodate a change in the statutory default rule. Currently, because the default rule would not be a "bylaw amendment adopted by stockholders," *id.*, it could be amended by directors. Only shareholders should have the power to adopt any bylaw "which specifies the votes that shall be necessary for the election of directors." *Id.*

[251] *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

[252] Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

[253] 564 A.2d 651 (Del. Ch. 1988).

[254] *Id.* at 654-56.

[255] *Id.* at 659.

be upheld without compelling justification.[256] The court found that the directors' action was taken with an improper purpose, and that there was no compelling justification.[257]

Since *Blasius*, the case's holding and rationale have been upheld and reaffirmed.[258] However, the courts have expressed hesitancy in applying the *Blasius* rule because it is so strict.[259] Such hesitancy is misplaced. The proper role of directors does not demand the ability to interfere with the rights of shareholders. The *Blasius* principle should be applied whenever necessary, and not only "rarely."[260]

In fact, the *Blasius* principle does not go far enough. It covers only actions taken with the primary purpose of interfering with shareholder democracy.[261] This standard is too demanding of the shareholder plaintiff and too forgiving of the director defendant. Establishing an intent to interfere is difficult enough: directors will never admit to it because the admission would almost certainly lead to invalidation.[262] Establishing that such an intent was the primary purpose would be nearly impossible in many cases. Thus, I propose that the holding in *Blasius* be extended.

Director action that is taken with any intent to interfere with shareholder democracy should be suspect, whether or not interference is the primary purpose. As a matter of principle, directors ought not to be interfering with shareholder affairs. State laws authorize directors to manage the business and affairs of the corporation; they do not authorize directors to manage the business and affairs of the corporation's shareholders.[263] Therefore, it should not matter whether the plaintiff can establish that the intent to interfere was the primary purpose for the action taken. For those extreme circumstances in which intentional interference should be permissible, it is fair to require directors to provide a compelling justification.[264]

---

[256] *Id.* at 661-62.

[257] *Id.* at 662-63.

[258] *See* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1129-30 (Del. 2003); Stroud v. Grace, 606 A.2d 75, 79, 91 (Del. 1992).

[259] *See MM Cos.*, 813 A.2d at 1130; Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996).

[260] *See supra* note 259.

[261] *See Williams*, 671 A.2d at 1376.

[262] *See* Chesapeake Corp. v. Shore, 771 A.2d 293, 319-20 (Del. Ch. 2000).

[263] *See* DEL. CODE ANN. tit. 8, § 141(a) (2001); MODEL BUS. CORP. ACT § 8.01(b) (2005).

[264] Admittedly, it would be difficult for directors to establish a compelling justification. *See* David C. McBride & Danielle Gibbs, *Interference with Voting Rights: The Metaphysics of* Blasius Industries v. Atlas Corp., 26 DEL. J. CORP. L. 927, 941-43

In fact, it might make sense to extend *Blasius* beyond the intent to interfere standard to also cover any action with a significant effect of interference with shareholder democracy. Of course, not every impact on the right to vote should be deemed an "interference": minor or incidental effects of otherwise valid actions should not be problematic. But significant interference with shareholder rights is problematic even if the shareholders cannot establish that it was intentional.

The main objection to an extension of *Blasius* is likely to be grounded in the rationale of the business judgment rule.[265] The business judgment rule is a policy of extreme deference that courts give to business decisions made by directors.[266] Among the reasons for the deference is the fact that the corporate law grants the authority to make business decisions to the directors, not to the shareholders or to the courts; that, because business decisions are inherently risky and made under conditions of uncertainty, they ought not to be subject to second guessing; and that courts are ill-equipped to make, or review, business decisions.[267] For reasons such as these, it could be argued that courts should not increase their review of business affairs by extending the holding of *Blasius*.

The principle response to this argument is grounded in the rationale of the entire fairness test.[268] No one doubts that directors are better qualified to make business decisions than judges. However, "the business judgment rule extends only as far as the reasons which justify its existence."[269] When there are conflicts of interest, "directors cannot be trusted to pursue the interests of shareholders over their own."[270] Under such circumstances, the courts always have been willing, however reluctantly, to subject business decisions to judicial

(2001). However, the difficulty is not unwarranted. Courts tend to be highly deferential to directors, so requiring anything less than a compelling justification would make the *Blasius* principle meaningless.

[265] *See generally* Velasco, *supra* note 60, at 828-34 (discussing business judgment rule).

[266] *See* 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS cmt. to § 4.01(c), cmt. a (1994).

[267] *See* 1 BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 12-18 (5th ed. 1998) [hereinafter BUSINESS JUDGMENT RULE].

[268] *See generally* Velasco, *supra* note 60, at 834-38 (discussing entire fairness test).

[269] Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982); *see also* Bayer v. Beran, 49 N.Y.S.2d 2, 6 (N.Y. Sup. Ct. 1944) ("The 'business judgment rule,' however, yields to the rule of undivided loyalty.").

[270] Velasco, *supra* note 60, at 837 & n.54.

scrutiny.[271] Because the interests of shareholders and directors conflict with respect to voting rights, judicial review is appropriate.

Perhaps more fundamentally, directors are not entitled to the deference of the business judgment rule because a decision to interfere with shareholder voting is not an exercise of business judgment at all.[272] As the *Blasius* court noted, "the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context."[273] Voting issues can be considered the "business and affairs of [the] corporation"[274] only in a very limited sense. They "do[] not involve the exercise of the corporation's power over its property, or with respect to its rights or obligations."[275] Nor do they involve matters as to which directors have greater information or competence than shareholders, or even the courts. Shareholder voting is about the allocation of power: "A decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance . . . ."[276] Courts should recognize and respect the balance of power established in corporate law. In almost all respects, power is allocated to the directors. The courts respect and protect director authority by deferring to director judgment pursuant to the business judgment rule. However, in matters relating to voting — particularly in the election of directors — power is allocated to shareholders. The courts ought to respect and protect this shareholder authority, and the way to do so is to subject director action to close scrutiny.

### *C. The Right to Vote "No"*

As previously discussed, the federal proxy rules regulate the conduct of director elections for public corporations.[277] The federal proxy rules generally do not require that shareholders be allowed to vote

---

[271] *See* AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986).

[272] *See* BUSINESS JUDGMENT RULE, *supra* note 267, at 39-41 (listing business decision as prerequisite for application of business judgment rule).

[273] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988).

[274] DEL. CODE ANN. tit. 8, § 141(a) (2001).

[275] *Blasius*, 564 A.2d at 660 (emphasis omitted).

[276] *Id.* at 659-60.

[277] *See supra* Part I.A.3.

against director candidates.[278] As everyone should recognize instinctively, there is something deeply unsettling about an election in which the only options are voting in favor of the candidate and abstaining. As regulator of the proxy solicitation process, the SEC ought to ensure that director elections are fair and reasonable.[279] Therefore, I propose that the federal proxy rules be amended to allow shareholders not only to withhold consent, but also to vote against any director candidate.[280]

The main objection to this proposal is likely to be grounded in federalism: that voting standards are governed by state law and the federal government should not intervene.[281] A related objection is less normative: that the SEC has not been authorized by Congress to affect the substance of corporate elections.[282] However, this proposal implicates neither concern. The proposal in no way would affect the underlying voting standard; it merely would empower shareholders to register a negative vote in elections. That this is not exceptional is evidenced by the fact that the proxy rules already allow shareholders to vote "no" with respect to all other matters.[283] The effect of any vote would be governed entirely by state law: under plurality voting, a negative vote would be ignored while under majority voting it would not. Thus, there would be no interference with state law.

Another objection might be that the SEC has better things to do than to waste its time on meaningless reforms.[284] While the effect of the proposed reform may be primarily symbolic, it would be far from meaningless. Although a negative vote is ineffective under plurality voting, the ability to vote against a candidate would allow shareholders to make a clear statement of opposition; under the

---

[278] *See supra* note 50 and accompanying text.

[279] *See supra* notes 46-49 and accompanying text.

[280] Of course, if the states were to adopt a majority vote requirement, the proposed amendment to the proxy rules would be unnecessary. *See supra* note 50. But it is highly unlikely that every state will do so in the near future, and the proposed reform would in no way interfere with those that do so.

[281] *See generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993) (defending virtues of federalism).

[282] *See* DETAILED COMMENTS OF BUSINESS ROUNDTABLE ON THE "PROPOSED ELECTION CONTEST RULES" OF THE U.S. SECURITIES AND EXCHANGE COMMISSION 4-11 (2003), *available at* http://www.sec.gov/rules/proposed/s71903/brt122203.pdf [hereinafter DETAILED COMMENTS]; *see also* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478-79 (1977) (expressing hesitation to extend federal law to matters traditionally relegated to state law without clear indication of congressional intent).

[283] *See* 17 C.F.R. §240.14a-4(b)(1) (2007).

[284] *See* DETAILED COMMENTS, *supra* note 282, at 23-27.

current proxy rules, there is no way for shareholders to do so. Thus, it is fair to say that federal law ensures that directors always operate with the presumption of legitimacy, regardless of shareholder opposition. This is not the role of federal law.

One final objection is that the right to vote "no" might be confusing. In fact, the SEC once considered adopting a provision that would allow shareholders to vote against specific candidates.[285] However, the SEC decided not to do so citing the concern that "shareholders might be misled into thinking that their against votes should have an effect when, as a matter of substantive law, such is not the case since such votes are treated simply as abstentions."[286] This decision was unfortunate and inappropriate. "Disclosure, and not paternalistic withholding of accurate information, is the policy chosen and expressed by Congress."[287] The SEC should have insisted that adequate disclosure could educate shareholders as to the effect of their vote. Shareholders are not "nitwits";[288] with minimal disclosure, they could understand the dynamics of plurality voting. Disclosure that shareholder votes against a director candidate will not be given any legal effect is unlikely to be confusing. To the contrary, it is likely to lead to investor outrage. However, the SEC should not be protecting directors from shareholders.

### *D. Shareholder Proposals*

A further reform that would empower shareholders with respect to their right to vote would be to give them greater access to the company's proxy materials. Of course, there must be limits to shareholder access. After all, it is costly, both in terms of distribution expenses for the company and in terms of time and attention required of other shareholders.[289] Moreover, the proxy rules should respect the fact that it is not the role of the shareholders to manage the business.

---

[285] *See* Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 16,104, 44 Fed. Reg. 48,938, 48,939 (Aug. 20, 1979).

[286] *See* Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 16,356, 44 Fed. Reg. 68,764, 68,765 (Nov. 29, 1979).

[287] Basic Inc. v. Levinson, 485 U.S. 224, 234 (1988).

[288] *Id.*

[289] *Cf.* DETAILED COMMENTS, *supra* note 282, at 52-58 (discussing costs associated with election contests); *supra* note 53 (discussing electronic delivery of proxy materials).

The current rules on shareholder access, embodied in Rule 14a-8,[290] demonstrate these concerns on shareholder access to proxy materials. If shareholders satisfy certain requirements, they are permitted to include certain proposals on management's proxy.[291] However, in order to keep shareholder access manageable, management may exclude shareholder proposals pursuant to certain specified criteria.[292] This general framework is sensible, but the rule does not reflect the proper priorities in all respects.

I propose that shareholder access to the company's proxy materials be made to correspond to shareholder voting rights. Consistent with their right to elect directors, shareholders should be permitted to nominate director candidates. Currently, the proxy rules arbitrarily deny them the ability to do so.[293] Consistent with their right to vote on fundamental matters, shareholders should be permitted to propose amendments to the corporation's bylaws.[294] Currently, the proxy rules permit management to exclude legitimate proposals if they meet certain criteria which are unrelated to the right.[295] Of course, shareholder access should not necessarily be limited to these specific situations.[296] Rather, shareholders should have access to the corporation's proxy materials for any matters on which they are entitled to vote.[297]

On the other hand, state corporate law does not give shareholders any voice with respect to management generally while the federal proxy rules do. The proxy rules allow shareholders to make nonbinding proposals on matters that are "otherwise significantly

---

[290] 17 C.F.R. § 240.14a-8 (2007).

[291] *See id.* § 240.14a-8(b)-(e).

[292] *See id.* § 240.14a-8(i).

[293] *See id.* § 240.14a-8(i)(8). The proxy rules do provide that directors must disclose any policy that the nominating committee may have for considering director candidates recommended by shareholders or state why they believe it is appropriate not to have such a policy. *See id.* § 240.14a-101 Item 7(d)(2)(ii)(E)-(F) (2006); *see also infra* note 313 (discussing Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc., 462 F.3d 121 (2d Cir. 2006)).

[294] *See supra* note 35 and accompanying text.

[295] *See supra* note 292 and accompanying text.

[296] For example, if state law gives them such power, shareholders could be permitted to propose an auction or voluntary dissolution. *See infra* Part V.A.

[297] Arguably, shareholder access should extend as far as permitting nonbinding recommendations regarding fundamental matters, such as mergers and charter amendments. Although shareholders cannot unilaterally implement such proposals, state law does give them a voice in the approval process. Thus, a nonbinding proposal could be seen as facilitating communication between co-participants rather than as interference with director prerogative.

related to the company's business."[298] At times, this has been interpreted to allow shareholders to make recommendations on ethical or political matters.[299] Such recommendations are difficult to reconcile with the overall approach of corporate law, which leaves the management of the business to the discretion of directors.[300]

Thus, under current law, shareholder access simultaneously encompasses certain matters that do not fall within the shareholder's role and excludes other matters that clearly do. This is unfortunate and inappropriate. Rather, shareholders should be allowed access to the company's proxy materials for all legitimate proposals — those relating to matters on which shareholders are entitled to vote — but not for any others. Under this approach, legitimate proposals could not be excluded from the company's proxy materials for almost any reason,[301] but all other proposals could be rejected without excuse.

One example of a shareholder voice initiative that is gaining momentum but may not be ideal is commonly referred to as the "Say-on-Pay" initiative. It would require directors to put executive compensation packages to a nonbinding vote of the shareholders. The idea is that executive compensation is getting out-of-hand, and thus shareholders should be able to express their disapproval. The initiative is proceeding on at least two fronts, legislative and contractual. On the legislative front, Congress is contemplating requiring Say-on-Pay for all public corporations.[302] On the contractual front, shareholders are demanding bylaws provisions or other corporate policies granting shareholders a Say-on-Pay right.[303]

---

[298] *See* 17 C.F.R. § 240.14a-8(i)(5).

[299] *See* IV LOSS & SELIGMAN, *supra* note 45, at 2019-26.

[300] Although there is nothing illicit in shareholders expressing their opinions in a nonbinding way, they have no specific right to do so and no official role in general decision making. Even when adopting Rule 14a-8, the SEC did not claim otherwise. *See* Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, 41 Fed. Reg. 52,994, 52,996 (Dec. 3, 1976); Proposals by Security Holders, Exchange Act Release No. 12,598, 41 Fed. Reg. 29,982, 29,983 (July 20, 1976). Thus, such proposals arguably should not be considered "a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization." 17 C.F.R. § 240.14a-8(i)(1).

[301] The bases on which the company could exclude shareholder proposals would have to be reworked and narrowed substantially. *See* 17 C.F.R. § 240.14a-8(i).

[302] *See* Shareholder Vote on Executive Compensation Act, H.R. 1257, S. 1181, 110th Cong. (2007).

[303] *See, e.g.*, Verizon Communications Inc., Proxy Statement (Schedule 14A), at 16-17 (Mar. 28, 2007), *available at* http://www.sec.gov/Archives/edgar/data/732712/000119312507067030/ddefr14a.htm (requesting advisory vote by shareholders on executive compensation). This proposal received a majority of votes cast at the

My proposal does not contemplate any "Say-on-Pay." Under state corporate law, directors have responsibility for setting officers' salaries, and shareholders do not have any say on the matter. Thus, Say-on-Pay should not be considered a proper subject for action by shareholders under the federal proxy rules. Instead, shareholders would be able to express their disapproval by replacing directors who agree to exorbitant compensation packages.

Of course, Congress does have the right to preempt state law and could enact Say-on-Pay granting shareholders a new right which would then be perfectly legitimate. Moreover, even under my proposal, shareholders could adopt a Say-on-Pay bylaw, which would then be a proper subject for action by shareholders under the federal proxy rules. Thus, my proposal does not interfere with the Say-on-Pay initiative in any way. My proposal merely suggests that a "Say-on-Pay" is unnecessary and, in an ideal world, perhaps inappropriate.[304]

Returning to my proposal, there would have to be limits to shareholder access even with respect to legitimate proposals. Shareholders cannot have an unlimited right to nominate director candidates and propose bylaw amendments. Reasonable regulation of shareholder access would be necessary, if only to limit the quantity to manageable levels.[305] However, such limits should not relate to the substance of the proposals. Instead, there should be a reasonable cap on the number of proposals, as well as a neutral method for selecting the proposals to be included in the proxy materials. In order to avoid director interference, such regulations must be set by law rather than left to the directors' discretion. Although the proper extent of shareholder access could be debated at length, I believe that it would be reasonable to allow as many shareholder nominees as there are positions available on the board of directors — so that each incumbent may be matched by a challenger — and as many as a half-dozen other

annual meeting of shareholders. *See* Gretchen Morgenson, *Investors Get Voice on Pay at Verizon*, N.Y. TIMES, May 19, 2007, at C1.

[304] However, in a world where corporate law is far from ideal, Say-on-Pay nevertheless may be a step in the right direction.

[305] It also would be necessary to develop an appropriate disclosure regime. One obvious candidate would be based on the system already proposed by the SEC. *See* Shareholder Proposals, Exchange Act Release No. 56,160, 72 Fed. Reg. 43,466, 43,471–75 (July 27, 2007).

proposals.[306] Regulations along these lines would strengthen shareholder rights while respecting the demands of practicality.

Finally, my proposal would be to institute a mandatory shareholder access rule rather than an enabling rule.[307] Although the rule would be mandatory, it would not interfere with state law in any way. It would grant shareholders access to the company's proxy only for matters on which they are entitled to vote under state law. In effect, the rule would enable shareholders to initiate votes themselves. However, if state law, or the company's charter or bylaws, were to eliminate voting rights on any matter, it would eliminate shareholder access on the matter as well. Thus, my proposal really amounts to a default rule. Shareholder voting rights would still be subject to the provisions of the charter and bylaws, and shareholder access could be limited accordingly.

Clearly, such reforms might be difficult to effect as a political matter. Not long ago, the SEC proposed amendments that would increase shareholder access to management's proxy quite modestly[308] and faced fierce political opposition.[309] In fact, it seemed safe to say that the shareholder access proposal was dead.[310] The main objection was that it allowed shareholders to nominate directors at all. Although this was true only under very limited circumstances,[311] it was considered a serious threat to incumbent management, who

[306] Selection among various proposals for inclusion in the company's proxy could be based on the number of shares supporting the various proposals. To extend the benefits of shareholder access beyond the top few shareholders, each share should be entitled to offer only one proposal. This would be different than the current rule, which states that no shareholder can offer more than one proposal. *See* 17 C.F.R. § 240.14a-8(c). However, it seems fair to allow substantial shareholders somewhat greater access to the proxy than other shareholders.

[307] By comparison, the SEC has proposed an enabling rule that would allows shareholder to opt in. *See* Shareholder Proposals, *supra* note 305, at 43,470.

[308] *See* Security Holder Director Nominations, Exchange Act Release No. 48,626, 68 Fed. Reg. 60,784 (Oct. 23, 2003).

[309] *See ABA's Federal Regulation of Securities Panel Opposes Proposed Direct Shareholder Access*, 36 Sec. Reg. & L. Rep. (BNA) 99 (Jan. 19, 2004); *Nine Business Organizations Seek Defeat of SEC Proxy Proposal*, 35 Sec. Reg. & L. Rep. (BNA) 2141 (Dec. 22, 2003). "The proposal saw a record [number] of comments — 16,000 . . . ." Mark Cecil, *Proxy Access: To Be or Not To Be?*, MERGERS & ACQUISITIONS REP., Nov. 22, 2004, at 1, 1.

[310] *See Donaldson Looks Beyond Proposal on Shareholder Nominations of Directors*, 37 Sec. Reg. & L. Rep. (BNA) 306 (Feb. 21, 2005).

[311] *See* Proposed Rule 14a-11, *in* Exchange Act Release No. 48,626, *supra* note 308, at 60,819.

opposed it bitterly.[312] Therefore, the political chances of a much broader rule, such as my proposal, are admittedly slim. It is fair to note, however, that the political climate has changed considerably since the SEC submitted its original shareholder access proposal.[313] In such a rapidly changing environment, it becomes difficult to predict what types of reform may be possible.

Some of the major substantive objections to shareholder access have already been considered under the rubrics of shareholder inadequacy and shareholder misconduct.[314] An additional line of substantive objection is that too much shareholder access, especially with respect to shareholder nominations, would destroy the collegial environment of the boardroom and render the company dysfunctional.[315] As a policy matter, the argument is a fairly strong one. However, there is also much to be said for the contrary argument — that too much collegiality can be detrimental.[316] These arguments should be raised in

[312] *See, e.g.*, Letter from Henry A. McKinnell, Jr., Chairman, Bus. Roundtable, to Jonathan G. Katz, Sec'y, SEC (Dec. 22, 2003), *available at* http://www.sec.gov/rules/proposed/s71903/s71903-381.pdf (objections to shareholder access proposal by Business Roundtable).

[313] Of particular relevance, the U.S. Court of Appeals for the Second Circuit recently decided that a company could not exclude a shareholder proposal that would amend the bylaws to require the company to publish the names of shareholder-nominated director candidates under certain circumstances. *See* Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc., 462 F.3d 121, 123 (2d Cir. 2006). As a result of this holding, the SEC has decided to reconsider the issue of shareholder access. *See* Press Release, SEC, Commission Calendars Proposed Amendment to Rule 14a-8 Governing Director Nominations by Shareholders (Sept. 7, 2006), *available at* http://www.sec.gov/news/press/2006/2006-150.htm. Admittedly, the SEC's initial response to this decision has been less than encouraging. It has proposed two alternative rules, one which specifically would allow companies to block proposals related to shareholder nominations, *see* Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, 72 Fed. Reg. 43,488, at 43,492-93 (Aug. 3, 2007), and another that would permit a very limited right to nominate director candidates, *see* Shareholder Proposals, *supra* note 305, at 43,470. Nevertheless, shareholder activists have been making significant strides on the corporate ballot, *see supra* notes 197-98 and accompanying text, in state legislatures, *see supra* notes 203-04 and accompanying text, and at the SEC, *see, e.g.*, Executive Compensation and Related Person Disclosure, Exchange Act Release No. 54,302A, 71 Fed. Reg. 53,158 (Sept. 8, 2006) (requiring greater transparency in disclosure of executive compensation), and even with Congress, *see supra* note 302 (discussing Say-on-Pay).

[314] *See supra* Part III.A.2-3.

[315] *See* Lipton & Rosenblum, *supra* note 123, at 80-87.

[316] *See, e.g.*, Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003) (discussing significant psychological impediments to group deliberations); Velasco, *supra* note 60, at 858-65 (discussing structural bias).

the context of each particular election rather than in the general context of defining shareholder voting rights. If collegiality is so important and shareholder nominations lead to corporate dysfunction, then shareholders will learn, if only eventually, to prefer incumbent candidates to challengers. If, on the other hand, too much cohesiveness and too little accountability is a bigger problem, then shareholders will tend to favor reasonable challengers. Directors may prefer a non-contentious environment, but they should be professional enough to function with whatever colleagues the shareholders give them. Their preference for collegiality is a weak basis for limiting shareholder voting rights.

In terms of process, one might object that the SEC does not have the authority to implement the proposed reforms. According to The Business Roundtable, "Section 14(a) [of the Exchange Act] empowers the [SEC] to ensure that shareholders receive full and accurate disclosure in connection with proposed corporation action, . . . [not] to regulate corporate action directly."[317] The Business Roundtable's argument relies heavily on the D.C. Circuit Court's opinion in *The Business Roundtable v. SEC*.[318] In that case, the SEC had adopted a regulation, Rule 19c-4, which prevented securities self-regulatory organizations from listing the stock of a corporation that took action to reduce the voting power of existing shares.[319] While the rule did not exactly mandate a strict "one share, one vote" voting policy, it would have prevented companies from moving away from that standard. The court held that "[b]ecause the rule directly controls the substantive allocation of powers among classes of shareholders," it exceeded the SEC's authority under the Exchange Act.[320]

The case is inapposite. Shareholder access rules do not "regulate corporate action directly" or "directly control the substantive allocation of powers." They do not affect substantive shareholder voting rights at all — directly or indirectly. They merely empower shareholders to exercise their state law voting rights more effectively.

The authority vested in the SEC under the plain meaning of section14(a) is quite broad;[321] it is not limited to "disclosure (and

---

[317] *See* DETAILED COMMENTS, *supra* note 282, at 5.

[318] 905 F.2d 406 (D.C. Cir. 1990).

[319] *See* Voting Rights Listing Standards; Disenfranchisement Rule, Exchange Act Release No. 25,891, 53 Fed. Reg. 26,376, 26,376 (1988) (codified at 17 C.F.R. § 240.19c-4 (1990)).

[320] *Bus. Roundtable*, 905 F.2d at 407.

[321] *See supra* note 43 and accompanying text.

corresponding procedural) requirements."[322] It includes the "'power to control the conditions under which proxies may be solicited.'"[323] Pursuant to this power, the SEC requires the inclusion of shareholder proposals in the company's proxy materials.[324] If the SEC is authorized to require the inclusion of shareholder proposals, it is also authorized to require the inclusion of shareholder candidates. The Business Roundtable makes much of the fact that the latter are merely precatory and nonbinding while the former would be mandatory and binding.[325] However, this is entirely a function of state law rather than federal law: it follows from the fact that shareholders do not have authority to implement business policies, but do have the authority to elect directors.

Perhaps The Business Roundtable's best argument is that the SEC should not be permitted to convert a proxy solicitation into a binding ballot.[326] However, "[t]he goal of federal proxy regulation was to improve [proxy] communications and thereby to enable proxy voters to control the corporation *as effectively as they might have by attending a shareholder meeting*."[327] If the shareholders were at the meeting, they would be able to vote for any valid candidate, not just those nominated by the incumbent board. In any event, the argument fails under existing law: Rule 14a-4(e) already provides that each proxy must be voted in accordance with the shareholder's wishes.[328] The proxy solicitation already is a binding ballot in many respects. Thus, the claim that the SEC is not authorized to require shareholder access must be rejected.

It is difficult to escape the conclusion that those who oppose shareholder access simply do not take shareholder voting rights seriously. They seek to protect management's privileged status as paternalistic guardians of shareholder interests.[329] To the extent that such status is derived from state law, it may be legitimate; however,

---

[322] DETAILED COMMENTS, *supra* note 282, at 5; *see Bus. Roundtable*, 905 F.2d at 411 ("We do not mean to be taken as saying that disclosure is necessarily the sole subject of § 14."); IV LOSS & SELIGMAN, *supra* note 45, at 1931.

[323] *Bus. Roundtable*, 905 F.2d at 410 (citing H.R. REP. NO. 73-1383, at 14 (1934); S. REP. NO. 73-792, at 12 (1934)).

[324] *See* 17 C.F.R. § 240.14a-8 (2007).

[325] *See* DETAILED COMMENTS, *supra* note 282, at 8.

[326] *See id.* at 10.

[327] *Bus. Roundtable*, 905 F.2d at 410 (emphasis added).

[328] *See* 17 C.F.R. § 240.14a-4(e) (2007).

[329] *See, e.g.*, Bainbridge, *supra* note 16, at 550-51 (describing board of directors "not [as] a mere agent of the shareholders, but rather . . . a sort of Platonic guardian" that pursues "the shareholder wealth maximization norm").

the federal proxy rules should not contribute to it. Yet critics of shareholder access are, in a very real sense, seeking to have the SEC use its power to regulate proxy solicitations to favor management over shareholders in a way that is not required by state law. Such action by the SEC would seem to raise the very federalism and agency authority issues that the critics of shareholder access generally brandish. The most logical and neutral position the SEC could take would be to make shareholder access correspond to their voting rights.

## IV. Taking the Right to Sell Shares Seriously

In Part III, I focused on the shareholder right to vote. In this Part, I will propose and defend a number of legal reforms that would make the right more meaningful without intruding on the directors' managerial role. I offer these proposals, some more novel than others, to illustrate the type of reform that ought to be considered if the right to sell is to be taken seriously.

### *A. Shareholder-Initiated Auctions*

As previously discussed, directors are permitted to resist hostile takeovers as long as they do so in the interests of shareholders.[330] Hostile takeovers pose a threat to shareholders because the acquirer gets to set the terms, conditions, and timetable for the sale of the company.[331] The courts permit directors to protect shareholders from such offers. However, courts have no problem when the directors decide to sell the company (provided shareholders have the final say). Likewise, there should be no problem if the shareholders decide to sell the company.

I propose that shareholders be authorized to initiate an auction of the company: by a vote of a majority of outstanding shares, shareholders should be able to demand that the directors sell all of the company's shares (or its assets) to the highest bidder.[332] At first glance, this proposal might seem to expand the voting power of shareholders — a goal that I disavowed at the beginning of this Article. However, the proposal actually has very little to do with

[330] *See supra* note 58.

[331] *See, e.g.*, LIPTON & STEINBERGER, *supra* note 63, § 1.08[1], at 1-88.16 (describing "two-tier, front-end loaded bids"); THERESE H. MAYNARD, MERGERS AND ACQUISITIONS 363-64 (2005) (describing "Saturday night specials").

[332] Shareholders should be able to initiate a vote on the matter through access to management's proxy materials. *See supra* notes 293-96 and accompanying text.

voting rights: it does not give shareholders any real power over the management of the business. Actually, it is about the right to sell shares.

This proposal would empower shareholders to act collectively to exercise the right to sell shares for maximum effect. In addition, it would be very helpful as a corporate governance tool by putting the market for corporate control at the shareholders' disposal.[333] Although directors might be permitted to block a hostile takeover that poses a threat to shareholders, they would not be able to block a sale that is initiated by shareholders. Thus, the proposal would enhance director accountability tremendously. In doing so, it would reinforce the traditional division of labor under corporate law.[334]

Critics may object to this proposal on various grounds. One objection might be that it would effect a drastic change in corporate law. However, while the balance of power between shareholders and directors would be altered significantly, the actual change in law would not be drastic. Essentially the same thing could be accomplished with a more modest rule. For example, shareholders could be given the right to initiate a voluntary dissolution[335] — the sort of fundamental transaction that calls for shareholder voice. In most states, shareholders currently can vote only on a director proposal to dissolve the corporation.[336] However, in some states, including California and New York,[337] shareholders already have the right to initiate dissolution without director approval.[338] Thus, extending this rule to other states could not be considered a radical reform. Yet, "a shareholder right to initiate voluntary dissolution . . . would have the practical effect of forcing the corporation's auction."[339]

[333] *See supra* note 149.

[334] "By dramatically reducing opportunistic management's leeway to damage shareholders, . . . [it] would justify courts' current unwillingness to intervene on shareholders' behalf and would even allow further relaxing of legal constraints on boards . . . ." Park McGinty, *The Twilight of Fiduciary Duties: On the Need for Shareholder Self-Help in an Age of Formalistic Proceduralism*, 46 EMORY L.J. 163, 179 (1997).

[335] *See id.* at 178-79.

[336] *See, e.g.*, DEL. CODE ANN. tit. 8, § 275 (2001) (requiring approval of directors and shareholders for corporate dissolution); MODEL BUS. CORP. ACT § 14.02 (2005) (same).

[337] *See, e.g.*, CAL. CORP. CODE § 1900(a) (Deering 2007) (requiring only shareholder approval for corporate dissolution); N.Y. BUS. CORP. LAW § 1001 (Consol. 2007) (same).

[338] *See* McGinty, *supra* note 334, at 179-80 & n.16.

[339] *See id.* at 178-79.

Directors would be charged with selling the corporation's assets at the highest value obtainable. This is only technically different from selling all of the shares of the corporation to the highest bidder.

Importantly, this proposal would not disrupt the nature of the relationship between directors and shareholders. The role of the directors as managers of the business would remain unchanged. The only impact would be to conscript them to conduct the auction. However, the directors could and likely would hire an investment banking firm to do most of the work.[340] In all other respects, directors would remain in charge of the affairs of the business without shareholder interference — at least unless and until they are removed from office and new directors take their place.[341]

Another objection might be that the collective action problem makes it unlikely that shareholders would exercise this power very often.[342] This is not unfortunate: that shareholders should have the power does not mean that they should use it often. But it would be foolish to assume that the power would never be used. In all likelihood, auctions most often would be initiated by acquirer-run proxy contests. This might seem problematic at first glance, but further reflection confirms that there is no problem. The upper hand remains with the shareholders, who have the right to decide whether or not to sell the company. If they decide to do so, the company would be sold to the highest bidder, which may or may not be the would-be acquirer. Thus, the interests of the shareholders would remain paramount, and there would be little need for protection by the directors.

A final objection might be that a right to initiate an auction of all of the company's shares deprives the individual shareholder of her right not to sell her shares. However, the right not to sell shares is not nearly as fundamental as the right to sell. In many transactions, including cash-out mergers, shareholders effectively are forced to sell their shares;[343] in some states, acquisitions can be structured formally

---

[340] In order to preserve directors' autonomy, the law could provide for an independent trustee to conduct the auction. However, I suspect that directors would prefer to retain control over the process.

[341] *See supra* note 167 and accompanying text.

[342] *Cf.* Bainbridge, *supra* note 2, at 1751-54 (discussing limits of shareholder activism).

[343] Merger statutes generally provide that the consideration for a merger need not be shares of the surviving corporation, but can be cash. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(b)(5) (Supp. 2006); *see also* Weinberger v. UOP, Inc., 457 A.2d 701, 703-04 (Del. 1983).

as compulsory share purchases.[344] Thus, the right to initiate an auction would not be extraordinary.

### *B. Fiduciary Duties*

The interplay between directors' discretionary authority over the business and the temptation to misuse that power is nowhere more evident than in the context of takeover defense. The courts would prefer to defer to the directors' business judgment,[345] but they recognize the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . . ."[346] The conflicts of interest make judicial involvement to ensure directors' fidelity to their fiduciary duties unavoidable.[347]

If the shareholder right to sell shares is to be taken seriously, directors should not be permitted to interfere with its exercise. I propose that the holding of *Blasius*,[348] as extended earlier,[349] be extended further to cover the right to sell shares. In principle, any director interference with the rights of shareholders is illegitimate. The right to sell deserves as much protection as the right to vote. In fact, shareholders generally consider the right to sell their shares to be the more important of the two rights.[350]

One objection to this proposal might be that the extension would be inappropriate because the *Blasius* opinion is grounded clearly and explicitly in the special importance of the right to vote.[351] However, a close examination of the opinion reveals that the logic of *Blasius* applies equally well to the right to sell. Although the court insisted that "matters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power,"[352] it is important to remember that directors do not have any delegated power over the sale of shareholders' own shares either. To paraphrase the *Blasius* court:

[344] *See* MODEL BUS. CORP. ACT § 11.03 (2005).

[345] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (citing Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984)).

[346] *Unocal*, 493 A.2d at 954.

[347] *See supra* note 271 and accompanying text.

[348] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661-62 (Del. Ch. 1988).

[349] *See supra* Part III.B.

[350] *See supra* note 14 and accompanying text.

[351] *See Blasius*, 564 A.2d at 659-60.

[352] *Id.* at 659.

> A board's decision to act to prevent the shareholders from [selling their shares] does not involve the exercise of the corporation's power over its property, or with respect to its rights and obligations; rather, it involves the allocation, between shareholders as a class and the board, of effective power with respect to [property rights in the company's shares].[353]

Directors have authority to manage the assets of the business, not those of its shareholders. However, shares are the assets of the shareholders, not those of the business. Thus, "the ordinary considerations to which the business judgment rule originally responded are simply not present . . . ."[354] As with voting, "[a] decision by the board to act for the primary purpose of preventing the [shareholders from selling their own shares] inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter . . . ."[355]

The Delaware Supreme Court's simultaneous elevation of the right to vote (through *Blasius* and its progeny) and deprecation of the right to sell (through *Unocal* and its progeny) has been the subject of scholarly criticism.[356] Because of the market for corporate control, the right to sell involves the same issues of control as does the right to elect directors:[357] a decision to sell shares to a hostile bidder is functionally equivalent to a decision to elect directors who are determined to dissolve the corporation. In short, the two rights are not only equally important but also intimately related, and different legal treatment makes no sense. Thus, application of *Blasius* to the right to sell shares would be a natural extension of the principle.

A second objection might be that the extension is unnecessary. Fiduciary duties are always at work, and the takeover defense context is already adequately covered by *Unocal Corp. v. Mesa Petroleum Co*.[358] Unfortunately, this is not so. The courts have watered down *Unocal*

[353] Velasco, *supra* note 60, at 891-92; *see Blasius*, 564 A.2d at 660.

[354] *Blasius*, 564 A.2d at 659.

[355] *Id.* at 659-60.

[356] *See, e.g.*, Chesapeake Corp. v. Shore, 771 A.2d 293, 326-28 (Del. Ch. 2000) (finding portions of Delaware's Supreme Court's logic "somewhat contradictory"); Ronald J. Gilson, Unocal *Fifteen Years Later (And What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 500-06 (2001) (criticizing "court's apparent conclusion . . . that proxy contests are preferable to tender offers as a means of resolving a control contest").

[357] *See supra* note 149 and accompanying text; *see also* Velasco, *supra* note 3, at 449-51.

[358] 493 A.2d 946 (Del. 1985).

significantly; its "enhanced scrutiny" provides little more protection than the business judgment rule.[359] Moreover, *Blasius* and *Unocal* are not mutually exclusive. In the context of voting rights, the courts have already recognized that the two holdings complement each other.[360] The same easily could be true in the context of the right to sell. If the *Blasius* rule were extended, it would come into play only if the plaintiffs could establish that there was an intent to interfere (or a significant interference) with the shareholder right to sell. Otherwise, existing law would be applied without change.

The interaction between *Blasius*, as extended, and *Unocal* merits special attention. If a target company's directors were to respond to a hostile takeover with defensive measures, enhanced scrutiny would be the correct initial framework. Defenses could be judged on the basis of reasonableness and proportionality.[361] Attempts to negotiate a better deal on behalf of shareholders may fall within the "range of reasonableness."[362] However, if shareholders could establish that the directors were interfering significantly with their right to sell shares, perhaps by taking a "just say no" stance,[363] the standard would become one of compelling justification, which would be very difficult to satisfy. Claims of substantive coercion or superior judgment on the part of directors would not be considered compelling justifications.[364] In short, *Unocal* would allow the directors some negotiating room to secure a better deal from the acquirer and the opportunity to convince the shareholders of the inadequacy of the offer; however, *Blasius*, as extended, would ensure that the final decision always rests with the shareholders.

Alternatively, one might argue that extension of *Blasius* is unnecessary because it is logically implied in the *Unocal* holding, and can be subsumed under that rubric.[365] As a logical matter, I would

[359] *See* Velasco, *supra* note 175, at 416-22.

[360] For a discussion of the current interaction between *Blasius* and *Unocal*, see MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1129-32 (Del. 2003).

[361] *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995) (quoting *Unocal*, 493 A.2d at 955). *But see* Velasco, *supra* note 60, at 870-87.

[362] *See Unitrin*, 651 A.2d at 1385-86 (quoting Paramount Comm'cns, Inc. v. QVC Network, Inc., 637 A.2d 34, 45-46 (Del. 1994)).

[363] "'Just say no' is a label used to describe a context in which a board of directors attempts to stonewall a hostile takeover bid indefinitely." Thompson & Smith, *supra* note 13, at 315.

[364] Substantive coercion is defined as "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value." Gilson & Kraakman, *supra* note 173, at 267.

[365] *See* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A*

tend to agree. However, *Unocal*'s progeny demonstrates that the courts do not. Under *Unocal*, the courts refuse to say that there is always a point at which the directors must permit the shareholders to sell.[366] *Blasius* would help courts overcome that hesitancy.[367] It provides a much richer framework for reminding the courts that the takeover decision is not about the management of the business, but rather about ownership and the right to sell shares, and therefore belongs to the shareholder. Under the *Unocal* framework, this is easily forgotten. Thus, an extended *Blasius* is indispensable.[368]

### C. *Antitakeover Statutes*

As previously discussed, antitakeover statutes interfere with the right to sell shares by inhibiting hostile takeovers, including those which shareholders have the right to approve. Therefore, I propose that all such legislation be repealed. This proposal is unlike my other proposals in one very important respect: it attempts to undo a deliberate legislative choice. Most of the other proposals relate to either judicial decisions or legislation with unintended consequences.[369] Antitakeover statutes, on the other hand, were adopted with full knowledge, and even the intention, that they would interfere with hostile takeovers. Accordingly, this proposal is not a presumptively appropriate legal reform, but one that would bear a greater burden of justification. Nevertheless, antitakeover statutes should be repealed because they are fundamentally misguided.

*Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1311-16 (2001).

[366] *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1152-53 (Del. 1990).

[367] *Cf.* Allen, Jacobs & Strine, *supra* note 365, at 1315 ("The interpretive flavor is . . . also important. *Unocal*, with its enhanced business judgment language proved to be rather management friendly, whereas the noninterference[] . . . tone of *Blasius* was undeniably less management friendly.").

[368] The *Revlon* line of cases does not obviate the need for *Blasius* either. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). *Revlon* holds that, when a sale of control is inevitable, the directors must seek the maximum value available for shareholders. *Id.* at 182. However, under *Revlon*, it is the directors who get to decide whether a sale of control is inevitable. *See Paramount Commc'ns*, 571 A.2d at 1151. *Blasius*, as extended, would make clear that it is the shareholders who should get to decide.

[369] The proposal for shareholder-initiated auctions does not quite fall into either category. However, the absence of such provisions was not due to a "deliberate legislative choice."

In the first place, such legislation was adopted on a faulty premise — that hostile takeovers are bad for the economy.[370] In the 1980s, with the ascendancy of the bust-up takeover,[371] it may have appeared so. But that is because it was a time of transition for the economy. The failed experiment of business conglomeration had to be undone,[372] and investors demanded better utilization of free cash flows.[373] Bust-up takeovers were a convenient method of achieving these goals. Despite the rhetoric, bust-up takeovers were, in many respects, quite beneficial. They generated tremendous wealth which cannot be attributed primarily to wealth transfers.[374] They did so by forcing companies to become more efficient. The popular notion that bust-up takeovers destroyed jobs is mistaken.[375] Businesses generally were not destroyed, but sold off to more suitable partners.[376] Any jobs that were lost were due to underlying market forces.[377] It seems that legislators simply overreacted. It is time for reconsideration.

In any event, antitakeover statutes are ineffective. Some types, such as business combination statutes and control share acquisition statutes, are intended to protect shareholders. However, such statutes are unnecessary because of the availability of sophisticated takeover defenses such as the poison pill.[378] More importantly, they are excessive because they make it more difficult for shareholders to sell if

---

[370] *See generally supra* notes 153-55 and accompanying text (discussing "bad reputation" of hostile takeovers).

[371] A bust-up takeover can be defined as "[a]ny acquisition in which the successful acquirer sells off target subsidiaries or other assets in order to repay debt incurred in the acquisition." BAINBRIDGE, *supra* note 67, at 14.

[372] *See* Oesterle, *supra* note 153, at 609 & n.218.

[373] *See* THE DEAL DECADE: WHAT TAKEOVERS AND LEVERAGED BUYOUTS MEAN FOR CORPORATE GOVERNANCE 3 (Margaret M. Blair ed., 1993); Michael C. Jensen, *Takeovers: Their Causes and Consequences*, J. ECON. PERSP., Winter 1988, at 21, 28-36.

[374] *See* Oesterle, *supra* note 153, at 583-90.

[375] *See* Michael C. Jensen & Donald H. Chew, *U.S. Corporate Governance: Lessons From the 1980s*, *in* PETER L. BERNSTEIN, THE PORTABLE MBA IN INVESTMENT 377 *passim* (1995) (citing Frank Lichtenberg & Donald Siegel, *The Effect of Control Changes on the Productivity of U.S. Manufacturing Plants*, J. APPLIED CORP. FIN., Summer 1989, at 60-67); *see also supra* notes 154-55 and accompanying text.

[376] *See* Oesterle, *supra* note 153, at 607-08.

[377] *See supra* notes 153-55 and accompanying text.

[378] "The importance of a takeover statute recedes when the target has a poison pill, because the pill has proven to be an effective means for the target to gain negotiating leverage with a bidder, and to extend the time period of an offer." FLEISCHER & SUSSMAN, *supra* note 63, § 4.03[A], at 4-12 to -13. For a description of the poison pill, see Velasco, *supra* note 39, at 856-68.

they want to.[379] Although directors often are able to waive the protection of antitakeover statutes quite easily,[380] shareholders have only a limited ability to do the same.[381] Thus, it is not at all clear that such antitakeover statutes advance shareholder interests.

Other types of antitakeover statutes are intended to protect other stakeholders. For example, the tin parachute and succession of labor contracts provisions are intended to protect employees. In many respects, this type of legislation is perfectly legitimate.[382] Society has the right to pass laws protecting its members by burdening certain types of harmful conduct — whether by the imposition of a tax or otherwise — and corporations treat compliance with such legislation as a cost of doing business. However, such laws should not be styled as antitakeover statutes. As such, they provide woefully inadequate protection: they only protect against hostile takeovers, and not against similar restructurings approved by the directors.[383] If the goal of the legislation is to protect employees, then this is a major shortcoming. There is no reason why the cost of doing business in a particular way should depend upon the directors' fancy.

In contrast to tin parachute and succession of labor contracts provisions, constituency statutes are intended to protect all of the corporation's stakeholders. This type of legislation is dangerous.

---

[379] This is especially true if a state has multiple antitakeover provisions, as many states do. *See* LIPTON & STEINBERGER, *supra* note 63, § 5.03[1], at 5-25.

[380] *See* DEL. CODE ANN. tit. 8, § 203(a)(1) (2001) (stating statute does not apply if directors approve of transaction in advance); IND. CODE § 23-1-42-2(d)(4) (2005) (stating statute does not apply to certain transactions which require director approval).

[381] Some antitakeover statutes, most notably control share acquisition statutes, explicitly allow shareholders to vote on whether an acquirer should escape their effect. *See, e.g.*, IND. CODE § 23-1-42-9(a) (2005). Some others, including many business combination statutes, give shareholders an indirect ability to exempt the acquirer. *See, e.g.*, DEL. CODE ANN. tit. 8, § 203(a)(2) (Supp. 2006). Such conditions generally are fairly onerous. For example, most control share acquisition statutes require either a true majority or a supermajority of uninterested shares to approve the exemption. *See* LIPTON & STEINBERGER, *supra* note 63, § 5.03[1][b], at 5-29. Similarly, business combination statutes sometimes provide that shareholders can grant an exemption by tendering a very high percentage of their shares to the acquirer, "usually 85 or 90%." *See id.* § 5.03[1][a], at 5-27.

[382] *See supra* note 152 and accompanying text.

[383] For example, the Pennsylvania statutes only apply to control-share acquisition transactions, *see* 15 PA. CONS. STAT. § 2581 (1995), which excludes mergers, consolidations, and statutory share exchanges, *see id.* § 2561(b)(5)(vii) (1995), all of which require director approval, *see id.* § 1922(c) (Supp. 2007).

Most such statutes are not even styled as antitakeover statutes.[384] Rather, they broadly redefine the scope of directors' fiduciary duties to include all corporate stakeholders.[385] However, directors are very poor guardians of nonshareholder interests.[386] Although they may speak nobly of protecting various stakeholders, they tend to pursue their business goals regardless of the impact on others.[387] In fact, constituency statutes could allow directors to justify virtually any decision, even if entirely self-interested, by referring to one constituency or another.[388] Thus, constituency statutes expose shareholders to great risk while providing little benefit for others.

One might object that the repeal of antitakeover statutes would leave shareholders unprotected against coercive offers from hostile bidders. However, defenses such as the poison pill provide adequate protection. One also might object that the repeal of antitakeover statutes would leave other stakeholders unprotected. However, as the discussion above indicates, antitakeover statutes provide little real protection. Finally, one might object that the repeal of antitakeover statutes is unnecessary. There is some merit to this argument. The repeal of antitakeover statutes is not a high priority item on the shareholder rights agenda. This is probably because the reduced incidence of hostile takeovers in recent years has made other contemporary issues, such as majority voting, more important.

This proposal is, in some respects, less important than the others included in this Article. As long as antitakeover statutes are limited to hostile takeovers, a shareholder right to initiate an auction would adequately protect their right to sell shares.[389] Similarly, if *Blasius* were extended, directors should not be able to deny shareholders the right to sell by hiding behind such statutes. Nevertheless, if the right to sell shares is to be taken seriously, antitakeover statutes should be repealed. Given their limited benefits and extensive drawbacks, the time has come to undo such ill-conceived legislation.

---

[384] Only a few antitakeover statutes are limited to change of control situations. *See* IOWA CODE § 491.101B (2004); LA. REV. STAT. ANN. § 12:92(G) (2005); MO. REV. STAT. § 351.347 (2005); OR. REV. STAT. § 60.357(5) (2003); R.I. GEN. LAWS § 7-5.2-8 (2005); S.D. CODIFIED LAWS § 47-33-4 (2005); TENN. CODE ANN. § 48-103-204 (2005).

[385] *See supra* note 76.

[386] *See supra* notes 157-59 and accompanying text.

[387] *See* Bainbridge, *supra* note 152, at 1445-46.

[388] *See supra* note 159 and accompanying text.

[389] Antitakeover statutes would have to be amended to make clear that a sale pursuant to a shareholder-initiated auction would not be covered.

### *D. Disclosure in Tender Offers*

As previously discussed, the tender offer rules can have a negative effect on the shareholders' ability to exercise their right to sell their shares. This is unfortunate. The tender offer rules should help shareholders exercise their right to sell shares more deliberately;[390] they should not inhibit tender offers unnecessarily. Although the existing tender offer rules may be beneficial on balance, improvement of particular provisions is possible.

Disclosure requirements may be reasonable when information could be helpful to shareholders, even though these requirements discourage the initiation of tender offers. For example, where an acquirer is seeking only control of a corporation and not full ownership, information about its plans for the business can be important for shareholders in deciding whether to tender.[391] However, there are situations where information about future plans is not helpful. This is true, for example, when an acquirer has committed itself to an all-or-nothing takeover. By "all-or-nothing takeover," I mean a takeover strategy in which only two possibilities would be acceptable to the acquirer: 100% ownership of the company or abandonment of the takeover attempt.[392] In such a case, the acquirer's plans for the business are irrelevant to the shareholders' investment decision.[393] Assuming the acquirer is successful, the shareholder will be cashed out, either in the tender offer or in a subsequent squeeze-out merger. Information about the acquirers' plans would be relevant to the shareholders only to the extent that the acquirer is unsuccessful — so that the plans can be implemented despite the acquirer's defeat. However, the tender offer rules do not entitle shareholders to information for such purposes.

I propose that the tender offer rules be amended to provide that no disclosure of future plans would be required if the acquirer commits

---

[390] *See supra* notes 80-82 and accompanying text.

[391] *See supra* note 85 and accompanying text.

[392] The obvious way for an acquirer to implement this strategy would be to condition the tender offer upon receiving enough shares to achieve voting control over the company and, if successful, to follow up promptly with a squeeze-out merger (or similar transaction) to eliminate minority shareholders.

[393] Of course, this is true only of shareholders *as shareholders*. Some shareholders may have unrelated reasons for making a decision. For example, as employees or members of the community, some shareholders may have a strong interest in the acquirer's future plans regardless of whether they will be squeezed out. Such concerns, however, are not relevant to the Williams Act, the sole purpose of which is to protect investors. *See supra* notes 81-82 and accompanying text.

itself to an all-or-nothing takeover of the target corporation. Such a reform would not harm shareholders in any legitimate respect. It would, however, have the benefit of reducing the disincentive to acquirers to initiate tender offers. This, in turn, would enhance the ability of shareholders to sell their shares.

One might object that a proposal to reduce disclosure to shareholders runs counter to the most fundamental animating principle of the federal securities laws, which is to mandate disclosure for the benefit of investors.[394] However, the federal securities laws do not seek to provide investors with all available information; they only require disclosure of "material fact[s]."[395] A fact is considered material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to [act]."[396] Information that is not relevant to shareholders in making the decision at hand is simply not material. Thus, in cases where there is a commitment to an all-or-nothing takeover, the disclosure of the acquirer's future plans is entirely unnecessary and should not be required. Others — the target company, its employees, and potential bidders — may profit from such disclosures, but they are not the intended beneficiaries of the Williams Act.[397] The federal securities law should mandate only relevant disclosure and not mere wealth transfers.

Another objection might question the nature of the acquirer's commitment to an all-or-nothing takeover of the target company: how does the acquirer make such a commitment, and what happens if it does not honor its commitment? This is a legitimate concern, but one that is easily dealt with. The acquirer could be required to make a written commitment in the tender offer statement to follow up with a squeeze-out merger. This would subject the acquirer to the antifraud liability of the federal securities laws.[398] If a stronger commitment is deemed necessary, the law could provide that the acquirer must, within a specified amount of time after a successful tender offer, initiate a merger (or similar transaction) for the squeeze-out of

[394] *See* IV LOSS & SELIGMAN, *supra* note 45, at 169-92.

[395] *See, e.g.*, Securities Exchange Act of 1934 § 14(e), 15 U.S.C. § 78n(e) (2000) (prohibiting use of "any untrue statement of a material fact . . . in connection with any tender offer").

[396] TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (stating "vote" in original).

[397] *See supra* notes 80-82 and accompanying text.

[398] *See* Securities Exchange Act of 1934 § 14(e).

minority shareholders at a price not less than the tender offer price, or face a severe penalty.[399]

## CONCLUSION

The current state of the law with respect to shareholder rights is dysfunctional. While state law clearly grants shareholders the rights to vote on certain matters and to sell their shares, various provisions in state and federal law severely limit those rights. Some argue that we need to expand the role of the shareholder in corporate governance; others insist that we need not concern ourselves with shareholder rights. This Article stakes ground somewhere between these two positions: I assume that we do not need to expand the role of the shareholder in corporate governance, but that we do need to safeguard traditional shareholder rights. Taking these rights seriously necessitates legal reform. I have offered and defended a number of proposals, some of which are more obvious and politically viable than others. All of the proposals, however, would make the shareholder's traditional rights more meaningful without intruding on the directors' managerial role.

After the recent financial scandals, Congress responded with the Sarbanes-Oxley Act of 2002.[400] However, that was not the final word on reform. Change is in the air. One side argues for further reforms while the other calls for a halt; but modest reforms proceed. This is especially evident with respect to shareholder voting: although the SEC failed to reform shareholder access not so long ago, the issue has been revived at the prodding of the Second Circuit.[401] Moreover, the ABA Committee and the Delaware legislature have taken moderate action. The recent amendments to the Model Business Corporation Act and the Delaware General Corporation Law may not go far enough to satisfy some shareholders, but they certainly enhance shareholder voting rights significantly.

Not everyone believes that shareholder rights should be taken very seriously. But even those who do not should be uncomfortable with the obfuscation worked by existing law. If shareholders are to be

---

[399] Admittedly, this would not guarantee that the acquirer would obtain 100% ownership of the target company because a court of equity, or some other authority, could block the merger. However, by the time the initial tender offer has succeeded, an injunction would no longer be very likely. More importantly, the acquirer would have to honor its commitment unless legally prevented from doing so.

[400] Pub. L. No. 107-204, 116 Stat. 745.

[401] *See supra* note 313 and accompanying text.

removed from corporate governance, then the merits of doing so should be weighed openly. Consideration should be given to proposals diametrically opposed to those offered in this Article, such as the elimination of shareholder voting rights and tender offers entirely. If, on the other hand, society believes that shareholders should have a meaningful role in corporate governance, then they should be given that role in fact. Rights should be carefully defined and not indirectly undermined by other laws. At whatever level we may decide to set them, we should take shareholder rights seriously.