

# SHAREHOLDER PRIMACY AND THE BUSINESS JUDGMENT RULE: ARGUMENTS FOR EXPANDED CORPORATE DEMOCRACY

by

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## ABSTRACT

There is a fundamental flaw in the law's approach to corporate governance. While shareholder primacy is a well-established norm within U.S. corporate law, the business judgment rule essentially holds directors blameless when they fail to maximize shareholder wealth. During the past century, control of the corporation has passed from shareholders to managers. As a result, shareholders have little practical say in who runs the corporation, even though they cannot usually hold managers legally liable when those managers destroy shareholder wealth through incompetence. Despite a number of arguments asserting that shareholders do not deserve any additional management powers, this article concludes that this flaw in corporate governance compels greater shareholder democracy, primarily through access to the corporate proxy to nominate directors.

## I. INTRODUCTION

There is a fundamental flaw in the law's approach to corporate governance. Shareholder primacy is a well-established norm within United States corporate law.<sup>1</sup> Put simply, the majority view holds that the principal role of the corporation is to maximize the wealth of its shareholders.<sup>2</sup> Within corporations, the locus of power is the board of directors.<sup>3</sup> But under the business judgment rule, shareholders are often left with no legal recourse when their directors fail to maximize shareholder wealth.<sup>4</sup>

Shareholders have only two practical options when directors fail to maximize shareholder wealth: sell their shares,<sup>5</sup> or remove the directors.<sup>6</sup> The first option is of little value if shareholders have already lost a substantial amount of their investment.<sup>7</sup> The second option, however, as discussed in this article, is not as realistic as it sounds. But granting shareholders some additional avenues to more actively participate in the selection of directors is the most practical option shareholders have to protect their interests.

Part II of this article examines a corporate governance conundrum arising from the interplay between the shareholder primacy norm and the business judgment rule. Within Part II, the history of the shareholder primacy norm is reviewed, demonstrating it remains a core principle guiding corporate governance. Part II also traces the development of the business judgment rule, concluding with recent applications of the rule establishing it as the unwavering approach courts take with regard to director liability. The corporate governance conundrum—and flaw—lies in the fact that, due to the business judgment rule, shareholders have minimal legal recourse when directors fail to maximize shareholder wealth.

This leads to an examination in Part III of the concept of shareholder democracy—an approach to empower shareholders primarily by allowing them access to the corporate proxy to nominate directors. Part III examines the arguments against shareholder democracy, and then examines its advantages and counters many of its criticisms. Part IV moves beyond most shareholder democracy arguments by returning to the corporate governance conundrum examined in Part II. It is this article's principal thesis that the corporate governance conundrum provides the strongest argument yet presented for why shareholders should be provided greater democracy.<sup>8</sup>

## II. THE CORPORATE GOVERNANCE CONUNDRUM

### A. *The Shareholder Primacy Norm*

Under the shareholder primacy norm, corporate managers should only make decisions for the benefit of those who own shares of the corporation.<sup>9</sup> Shareholder primacy is reflected in arguments that the sole purpose of the corporation is to

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This article was made possible, in part, by the support of the Governor Geringer Award for Promising Young Scholars. The authors thank Jennifer A. Cook, J.D., University of Wyoming College of Law, 2011, for her excellent research assistance for this paper.

maximize profits,<sup>10</sup> or that management's objectives are to maximize shareholder wealth.<sup>11</sup> The foundation of the shareholder primacy norm is found in the directors' fiduciary duty to make decisions that are in the best interests of the shareholders.<sup>12</sup>

Shareholder primacy may arguably be traced back to the classic case of *Dodge v. Ford Motor Company*.<sup>13</sup> In *Dodge*, shareholders sued the Ford Motor Company for using surplus earnings to cut the price of its automobiles rather than pay dividends.<sup>14</sup> Concluding that corporations are organized and carried on primarily for the profit of the stockholders, the Michigan Supreme Court held "the powers of the directors are to be employed for that end."<sup>15</sup> Shareholder primacy remains the dominant force in corporate governance,<sup>16</sup> particularly in Delaware,<sup>17</sup> where a majority of the largest publicly-held corporations are incorporated.<sup>18</sup> Lyman Johnson refers to the shareholder primacy norm as "the supreme purpose of corporate activity, a purpose privileged above all others."<sup>19</sup>

Proponents of the shareholder primacy norm argue that maximizing shareholder wealth is in the best interests of society.<sup>20</sup> Smith argues that theoretical justifications for shareholder primacy arose, in part, from the purposes of early corporations themselves—to serve the public interest.<sup>21</sup> Angell & Ames, in their 1832 *Treatise on the Law of Private Corporations Aggregate*, expressly promote the notion that corporations exist for the public benefit.<sup>22</sup> They assert the primary purpose of limited shareholder liability is to encourage risk-takers to incorporate for the betterment of society.<sup>23</sup>

Additionally, courts initially viewed corporate directors as trustees and shareholders as the beneficiaries of that trust.<sup>24</sup> The United States Supreme Court extended the trust metaphor to shareholder value in *Dodge v. Woolsey*,<sup>25</sup> holding courts in equity have jurisdiction over corporations:

to prevent any misapplication of their capitals or profits, which might result in lessening the dividends of stockholders, or the value of their shares, as either may be protected by the franchises of a corporation, if the acts intended to be done create what is in the law denominated a breach of trust.<sup>26</sup>

*Dodge v. Woolsey* addressed a situation in which a shareholder of a bank filed suit to enjoin the imposition of a new tax after the directors of the bank refused to file a similar suit.<sup>27</sup> The Supreme Court considered the directors' refusal to contest the tax more than a mere error in judgment, but a disregard of their duty amounting to a breach of trust—amounting to an illegal application of the profits due to the stockholders of the bank.<sup>28</sup> *Dodge v. Woolsey* set in motion a series of cases upholding the right of shareholders to initiate actions to protect their investments when the directors failed to do so, but only when the shareholders faced irreparable loss,<sup>29</sup> demonstrating a propensity on the part of the courts to protect shareholder value in the corporation.

Protecting shareholder value also served as the basis to protect minority shareholders from abuses by majority shareholders who controlled the board.<sup>30</sup> In fact, Smith argues that *Dodge v. Ford Motor Company* is no more than a minority shareholder oppression case and the court's shareholder primacy holding merely followed a long line of minority shareholder oppression precedent, explaining why the court was able to make its "shareholder primacy" pronouncement without citation to authority.<sup>31</sup>

But recent anecdotal evidence suggests the shareholder primacy norm does not protect society at large, nor shareholders in particular. For example, the examiner appointed by the court for the Lehman Brothers Holdings Inc., bankruptcy reported that in 2006, "Lehman made the deliberate decision to embark upon an aggressive growth strategy, to take on significantly greater risk, and to substantially increase leverage on its capital[.]"<sup>32</sup> which included substantial investments in sub-prime mortgage-related securities. As the sub-prime mortgage market morphed into a financial crisis in 2007, rather than pare its losses, Lehman consciously chose to "double down, hoping to profit from a counter-cyclical strategy."<sup>33</sup> In 2008, it became apparent Lehman's growth strategy was flawed,<sup>34</sup> and the company filed Chapter 11 bankruptcy, the largest bankruptcy ever filed.<sup>35</sup> Citigroup suffered a similar fate, though not as severe as bankruptcy, when its management also chose to invest in sub-prime mortgage-related securities, causing, in part, the corporation's stock price to actually drop below its book value in 2008.<sup>36</sup> The sub-prime mortgage crisis, which precipitated a global financial crisis,<sup>37</sup> led to multi-trillion dollar government bailouts and guarantees.<sup>38</sup> In the opinion of one commentator, "There's no other way of saying it: today's doctrines of shareholder primacy and managerial self-interest have brought many companies to the brink of self-destruction."<sup>39</sup>

The shareholder primacy norm is also strengthened by the business judgment rule. Regardless of how "stupid," "egregious" or "irrational" a board decision may be that destroys, rather than maximizes, shareholder wealth, it "provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a good faith effort to advance corporate interests."<sup>40</sup>

### *B. The Business Judgment Rule*

To further bolster the shareholder primacy norm, courts, and particularly Delaware courts, have enforced the business judgment rule. It is argued that "[w]ealth is maximized when corporations are run by directors who know that their decisions will be reviewed by investors, by analysts, by stockholders, and by business partners—but not by the courts."<sup>41</sup>

## 1. A Brief History of the Business Judgment Rule

The first reported case in the United States addressing the duty of care of directors is from the Louisiana Supreme Court in *Percy v. Millaudon*, decided in 1829, in which shareholders of the Planters' Bank sued three of its directors for losses allegedly resulting from improper loans to the Bank's president and cashier.<sup>42</sup> The *Percy* court considered the directors "the agents or mandataries of the stockholders, ..." and focused its analysis on the duties of an agent in the given circumstances.<sup>44</sup> In particular, the Louisiana Supreme Court noted that bank directors are not expected to devote their entire time and attention to the institution, in contrast to those who may be compensated for their time devoted to the bank.<sup>45</sup> Ultimately, the *Percy* court found no liability because there was no proof of harm to the bank based on the directors' actions.<sup>46</sup>

In 1872, the Pennsylvania Supreme Court addressed the broad question of whether "the directors of a corporation can be made to account for losses arising from mismanagement merely."<sup>47</sup> Rather than consider directors trustees, the *Spering's Appeal* court described them as themselves stockholders and "mandataries—persons who have gratuitously undertaken to perform certain duties, and who are therefore bound to apply ordinary skill and diligence, but no more."<sup>48</sup> *Spering's Appeal* contains the first reported comprehensive analysis of director liability, concluding:

[W]hile directors are personally responsible to the stockholders for any losses resulting from fraud, embezzlement or wilful misconduct or breach of trust for their own benefit and not for the benefit of the stockholders, for gross inattention and negligence by which such fraud or misconduct has been perpetrated by agents, officers or co-directors, yet they are not liable for mistakes of judgment, even though they may be so gross as to appear to us absurd and ridiculous, provided they are honest and provided they are fairly within the scope of the powers and discretion confided to the managing body.<sup>49</sup>

New York preceded Delaware in formalizing a business judgment rule.<sup>50</sup> By 1944, New York courts had formally adopted the business judgment rule, holding that absent a showing of fraud or self-interest, management's decisions would not be reviewed by the court, regardless of how unwise those decisions might be.<sup>51</sup> Although directors were given wide latitude in the management of the affairs of a corporation, it was also assumed their judgment would be honest, unbiased, and reasonable exercised.<sup>52</sup>

While the Delaware courts did not formally recognize the business judgment rule, *per se*, until 1960, they did demonstrate respect for business judgment beginning in the early twentieth century.<sup>53</sup> Early attributes of the business judgment rule first began to appear in Delaware in 1924. In *Robinson v. Pittsburgh Refining Corp.*,<sup>54</sup> the corporation's directors were authorized by a shareholder resolution to entertain bids to sell the assets of the corporation. When the directors' decision to accept one bid over another was challenged, the Delaware Court of Chancery enunciated three of the basic premises of the modern business judgment rule: (1) it will be presumed the directors acted in the best interests of the corporation;<sup>55</sup> (2) the terms of the transaction must be so manifestly unfair as to overcome this presumption;<sup>56</sup> such that (3) the directors' "action was so unreasonable as to be removed entirely from the realm of the exercise of honest and sound business judgment."<sup>57</sup> As the Delaware Supreme Court explained as early as 1927, "an honest mistake of business judgment should not be reviewable by the court."<sup>58</sup> By the mid-1940s it had become established law in Delaware that directors would not be liable for "mere mistakes."<sup>59</sup> The business judgment rule was formally adopted in Delaware in 1960 when the Delaware Supreme Court refused to substitute its "uninformed opinion for that of experienced business managers of a corporation who have no personal interest in the outcome..." of the adoption of a corporate plan.<sup>60</sup>

The business judgment rule was further strengthened during the hostile takeover boom in the 1970s and 1980s. Although hostile takeovers experienced massive growth during those two decades, they were a concrete manifestation of an idea from the 1960s.<sup>61</sup> Robin Marris, a professor of economics, argued that inefficient input and output markets could be fixed by a third, corporate control market.<sup>62</sup> In theory, such a market would allow outside interests to redirect firms, forcing managers to make decisions that maximize shareholder profits.<sup>63</sup> Unsolicited takeover offers increased in number in the 1960s and exploded in the 1980s,<sup>64</sup> and became quite controversial. Many critics from traditional corporate backgrounds viewed corporate raiders as arrogant and regarded them with suspicion.<sup>65</sup> The public was generally hostile to corporate takeovers, largely because of negative media attention and their frequently negative local impact.<sup>66</sup> Junk bond-financed hostile takeovers threatened to shake up the corporate world, and, as such, gave rise to considerable resistance from corporate boards and directors, who devised a number of means of resisting them.<sup>67</sup> Many corporate directors viewed takeovers as a threat to their power, largely because takeovers were often followed by the firing of corporate managers.<sup>68</sup> As a result, managers began to develop a wide array of self-help measures designed to thwart takeovers.<sup>69</sup>

These self-help tactics posed new problems for corporate governance because they may have conflicted with boards' and managers' fiduciary duty to maximize shareholder profits.<sup>70</sup> There is a risk that corporate directors may act in their own interests, rather than those of their corporations' shareholders, in resisting hostile takeovers.<sup>71</sup> A line of court decisions addressed the problem by applying a modified business judgment rule, allowing corporate directors to make decisions pursuant to their best judgment, provided they met their initial burden of showing that their decisions were reasonable and proportional.<sup>72</sup> Delaware courts required corporate directors to meet two conditions before they would apply the business judgment rule: (1) corporate directors must show they possessed a reasonable belief in "a danger to corporate policy and

effectiveness[;]” and (2) their reaction was “reasonable in relation to the threat posed.”<sup>73</sup> Once those conditions were met, courts presumed corporate directors acted in good faith in the best interests of the shareholders and would not second-guess those decisions.<sup>74</sup> If corporate directors could demonstrate a reasonable belief that a tender offer posed a threat to the corporation and that they took reasonable steps in responding to it, they could take self-help measures, such as using poison pills, without violating their fiduciary duty to corporate shareholders.<sup>75</sup> Once the business judgment rule applies, plaintiffs have the burden of showing that directors breached their fiduciary duty or prioritized their own interests over those of the corporation.<sup>76</sup>

The situation came to a head at the close of the 1980s, when the Supreme Court of Delaware rendered its *Paramount* decision.<sup>77</sup> Near the closing of a complicated merger between Time, Inc. and Warner Communications, Paramount Communications announced an all-cash offer to purchase Time’s outstanding shares.<sup>78</sup> After negotiations, Time’s board decided to refuse Paramount’s tender offer and to continue with its merger with Warner.<sup>79</sup> Although Paramount offered a valuable cash premium, Time directors expressed concerns that the company’s shareholders did not understand the long-term benefits of the Warner merger, including the company’s ability to retain its corporate culture.<sup>80</sup> Time rejected Paramount’s offer and restructured its merger with Warner as a cash and securities acquisition.<sup>81</sup> Time’s directors persisted in this move, even after Paramount increased the size of its cash offer.<sup>82</sup> Subsequently, Paramount and some of Time’s shareholders sued Time.<sup>83</sup> The Delaware Supreme Court reaffirmed *Unocal*’s two requirements before applying the business judgment rule and noted that a refusal to accept a cash offer could comply with that rule.<sup>84</sup> The court found that Time’s directors possessed a reasonable belief that Paramount’s offer presented a threat to the company and acted reasonably in rejecting it.<sup>85</sup>

## 2. Recent Applications of the Business Judgment Rule

The 2007-2009 Citigroup shareholder derivative litigation reflects a very recent application of the business judgment rule, applied directly to the current financial crisis.<sup>86</sup> The *Citigroup* court summarized the shareholders’ claims as attempting to hold the directors personally liable for making, or allowing to be made, business decisions that, in hindsight, turned out poorly for the company.<sup>87</sup> This type of decisionmaking, according to the court, falls within the business judgment rule: “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”<sup>88</sup> The burden is on the shareholders who are challenging the directors’ decision to rebut this presumption.<sup>89</sup> In dismissing the plaintiffs’ complaint, the court stated that “absent an allegation of [self-]interestedness or disloyalty to the corporation, the business judgment rule prevents a judge or jury from second guessing director decisions if they were the product of a rational process and the directors availed themselves of all material and reasonably available information.”<sup>90</sup>

The *Citigroup* court repeated the rationale of the business judgment rule: “discretion granted [corporate] directors and managers allows them to maximize shareholder value in the long term by taking risks without the debilitating fear that they will be held personally liable if the company experiences losses.”<sup>91</sup> Further, in *In re Dow Chemical Company Derivative Litigation*,<sup>92</sup> the Delaware Chancery Court emphasized that it is not the substance of a board decision, but only the decisionmaking method, that can be reviewed by a court under the business judgment rule.<sup>93</sup>

In 2009, the Delaware Supreme Court examined in detail the good faith requirement under the business judgment rule in *Lyondell Chemical Company v. Ryan*.<sup>94</sup> *Lyondell* presents one of the complicating factors associated with the business judgment rule—Delaware’s General Corporation Law permits corporations to include in their charter an exculpatory provision protecting directors from personal liability for breaches of the duty of care.<sup>95</sup> To defeat such an exculpatory clause, plaintiffs, like those in *Lyondell*, must allege that the directors breached their duty of loyalty, which cannot be exculpated.<sup>96</sup> To establish a breach of loyalty, plaintiffs must prove the directors failed to act in good faith.<sup>97</sup>

Directors’ failure to act in good faith is most typically shown by: (1) intentional acts with a purpose other than that of advancing the best interests of the corporation; (2) intentional violations of applicable law; or (3) intentionally failing to act in the face of a known duty to act, demonstrating a conscious disregard for their duties.<sup>98</sup> Failure to act in good faith equates to acting in bad faith.<sup>99</sup> And “bad faith will be found if a fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.”<sup>100</sup> The standard adopted by the Delaware courts is that directors’ decisions need not be perfect, merely reasonable.<sup>101</sup> But unreasonableness requires a conscious disregard of duties. Stated another way, “In the transactional context, a *very extreme set of facts* would seem to be required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.”<sup>102</sup>

## 3. The Strength of the Business Judgment Rule

From the earliest days of the corporation, courts have demonstrated a reluctance to hold directors accountable for anything less than gross negligence or self-dealing. As early as 1907, commentators were beginning to recognize that directors had little to fear from the courts.<sup>103</sup> As of 1992, Carney wrote he could find only five cases in which directors had not been shielded by the business judgment rule, concluding there “is a rule of no liability for breaches of the duty of care.”<sup>104</sup>

Recent Delaware cases emphasize that liability will be found only where the board was not informed or disinterested. For example, in *McMullin v. Beran*,<sup>105</sup> the Delaware Supreme Court reversed the Chancery Court’s granting of the defendants’ motions to dismiss, recognizing that the plaintiffs’ allegations, if true, suggested that the directors breached

their duty of care by approving a merger without adequately informing themselves about the transaction.<sup>106</sup> In *Sample v. Morgan*, the Delaware Chancery Court denied the defendants' motion to dismiss the shareholder plaintiffs' claims they were materially misled by the board in voting to approve a compensation plan that would unfairly benefit the directors.<sup>107</sup> Finally, in *Blackmore Partners, L.P. v. Link Energy LLC*, the Delaware Chancery Court held an allegation that the defendant directors' approved sale of substantially all of the company's assets, which exceeded the company's liabilities by \$25 million, and a resultant distribution of proceeds that went exclusively to the company's creditors, raised a reasonable inference of disloyalty or intentional misconduct.<sup>108</sup>

### C. *The Business Judgment Rule and Shareholder Primacy*

A significant shortcoming of the shareholder primacy norm, as supported by the business judgment rule, is that corporate directors have a plain incentive to maximize short-term profits, possibly at the expense of the overall viability of the firm.<sup>109</sup> Commentators have argued the shareholder primacy norm has distracted corporations from their substantive business models to pursue increasing share prices.<sup>110</sup> For example, in a continual attempt to increase share prices, directors have resorted to share repurchases, restructuring, and reshuffling finances, such as changing inventory valuation methods, accelerating income, deferring expenses and changing pension actuarial assumptions.<sup>111</sup> And when the shareholder primacy norm "backfires," the business judgment rule can leave the shareholders with no meaningful avenue of recourse.<sup>112</sup>

There is one critical assumption underlying the discretion provided to corporate directors under the business judgment rule—if shareholders are displeased with directors the shareholders can elect new directors.<sup>113</sup> This replacement power is especially important when director decisions are insulated from judicial review due to the business judgment rule.<sup>114</sup> While shareholders elect the directors, they are actually left with little opportunity to actively participate in the director nomination process.<sup>115</sup>

## III. SHAREHOLDER POWER IN CONTROLLING THE CORPORATION

In practice, the power to remove and replace directors has proven quite limited, with most directors facing a very low probability of being ousted—largely neutralizing the shareholders' vote as an effective means of ensuring director accountability.<sup>116</sup> As former SEC chairman Arthur Levitt, Jr. stated, "A director has a better chance of being struck by lightning than losing an election."<sup>117</sup> There are three primary reasons shareholder voting power has been diminished: (1) existing boards select the slate of director nominees, and often re-nominate incumbents; (2) director candidates often run opposed; and (3) most directors are elected by a plurality, rather than a majority.<sup>118</sup> The combination of these factors means the outcome of almost all board elections is a foregone conclusion—incumbent directors win.<sup>119</sup>

Some commentators identify this as a defect in the democratic process of electing boards of directors. They argue that more effective oversight of directors by shareholders is necessary to improve corporate performance and prevent the kinds of scandals and economic crises that rocked the American economy during the past decade.<sup>120</sup>

### A. *Shareholder Democracy*

The principal method of addressing claimed shortcomings in corporate democracy is to provide shareholder's with proxy access.<sup>121</sup> Many modern public corporations are owned by a large number of dispersed shareholders, making it difficult for shareholders to attend annual shareholder meetings.<sup>122</sup> This necessitates voting by proxy, whereby shareholders provide written authorization for a "proxy holder" to represent the shareholders and vote their shares at the annual meeting.<sup>123</sup> Information is conveyed to shareholders via a proxy statement, which discloses material information about the corporation.<sup>124</sup>

The Securities and Exchange Act of 1934 gives the Securities and Exchange Commission (SEC) the authority to regulate proxies.<sup>125</sup> The SEC has promulgated rules regulating "when a company must include a shareholder's proposal in its proxy statement and identify the proposal in its form of proxy when the company holds an annual or special meeting of shareholders."<sup>126</sup> These rules allow a corporation to exclude a proposal if it "relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election."<sup>127</sup> While it is possible for shareholders to wage proxy contests with their own funds and nominate candidates at annual meetings, such campaigns can be expensive and, without access to the proxy statement, most shareholders have few means to effectively threaten incumbents on a board of directors.<sup>128</sup>

The effect of this rule has been to prevent shareholder nominations of directors via proxy.<sup>129</sup> The SEC has argued that the rationale for this interpretation was to prevent nominators from avoiding election disclosure requirements, although the rule has had the effect of solidifying the positions of incumbent directors.<sup>130</sup> Some of shareholders' initial responses to their lack of access to the proxy statement for electoral purposes included "just vote no" and "withhold-the-vote" campaigns.<sup>131</sup> While such strategies had initial success, including an instance in which shareholders forced the departure of Disney CEO Michael Eisner and targeted campaigns against Enron auditors, the techniques proved limited.<sup>132</sup> At best, shareholders could force certain directors off of the board, but could not select their replacements.<sup>133</sup>

In response, activist shareholders sought to adopt “bylaws that would open the issuer’s proxy to director nominations by shareholders. . . .”<sup>134</sup> In 1998, a public employees’ union, the American Federation of State, County and Municipal Employees (AFSCME), offered such an amendment that would have required American International Group, Inc. (AIG) to include shareholder-nominated director candidates in the company’s proxy materials.<sup>135</sup> AIG asked the SEC if it could exclude the proposal and the SEC issued a no-action letter, which led to the *AFSCME* litigation.<sup>136</sup> AFSCME argued it was only proposing to amend the corporate bylaws and such a proposal did not relate to a particular election, but elections in general.<sup>137</sup> AIG, joined by the SEC via an *amicus curiae* brief, argued the rule allowed a corporation to exclude any proposal that “would result in contested elections.”<sup>138</sup> The United States Court of Appeals for the Second Circuit sidestepped the substantive question and found the rule’s language to be ambiguous.<sup>139</sup> The phrase “relates to an election” could reasonably be interpreted to either exclude election proposals in general or only those related to specific elections.<sup>140</sup> The court noted the SEC had adopted the latter interpretation in its 1976 Statement,<sup>141</sup> but had gradually adopted the former interpretation over time.<sup>142</sup> The court found that, while the SEC has considerable discretion to interpret its own regulations and change such interpretations in response to capital markets or simply for a new regulatory approach, it must explain the rationale for any such shift.<sup>143</sup> Since the SEC failed to even proffer an explanation for its changed interpretation, the court held the exclusion only applied to proposals related to particular elections and not those that “would establish the procedural rules governing elections generally.”<sup>144</sup>

*AFSCME* revived debate about shareholder access to the corporate proxy and the SEC responded to the decision by recommending that Rule 14a-8 be amended regarding shareholder nomination of directors.<sup>145</sup> The SEC considered two proposals: the “Access Proposal” would provide qualified shareholders with access to company proxy materials to nominate directors; and the “Non-Access Proposal” would close proxy access.<sup>146</sup> The rulemaking process resulted in the SEC voting to adopt the Non-Access Proposal.<sup>147</sup>

The 2007 rulemaking did not end the debate over shareholder access to proxy materials for the purpose of nominating directors. In 2009, the SEC proposed rule amendments that “would provide shareholders with a meaningful ability to exercise their state law rights to nominate the directors of the companies that they own.”<sup>148</sup> The proposed rule would require corporations to allow shareholders meeting certain requirements to include shareholder-nominated directors in the company’s proxy materials.<sup>149</sup>

The proposed SEC rule amendment facilitating shareholder proxy access remains, at the time of this article, a mere proposal. In the meantime, the United States Congress has proposed similar shareholder empowerment provisions. As part of the “Restoring American Financial Stability Act of 2010,” Section 972 would amend Section 14A of the Securities Exchange Act of 1934 to require the SEC to issue rules to permit shareholder proxy access.<sup>150</sup> In 2009, “The Shareholder Bill of Rights Act of 2009” was introduced in the Senate.<sup>151</sup> It would require the SEC to amend its rules to allow shareholders who have owned at least 1% of the company’s voting shares for at least two years to use the company’s proxy materials to nominate members of the board of directors.<sup>152</sup> A “Shareholder Empowerment Act of 2009” was introduced in the House of Representatives with similar shareholder proxy access provisions.<sup>153</sup> Both 2009 bills have been referred to, but not voted out of, committee.<sup>154</sup>

The Delaware legislature has recently enacted an amendment to its General Corporation Law which permits corporations to include in their bylaws provisions requiring the corporation to include in proxy materials directors nominated by shareholders.<sup>155</sup> But the Delaware amendment merely *allows* corporations to include a shareholder nomination provision; it does not *require* corporations to do so.

Proponents of shareholder empowerment have argued shareholders should make use of their latent power to hold boards of directors accountable, particularly in light of the 2007 financial crisis.<sup>156</sup> However, many constituencies oppose such access, and the notions of corporate democracy and shareholder proxy access remain controversial.<sup>157</sup>

## B. Arguments Against Shareholder Proxy Access

Some commentators, including many from the business management community, oppose shareholder proxy access. Reasons for opposing access can be divided into the following categories: (1) access is unnecessary, (2) access does not serve, and may hurt, economic stability, (3) access hurts corporate performance, (4) access does not serve the goals of corporate democracy and fairness, (5) corporate responsibility concerns, (6) federalism concerns, and (7) workability concerns. Each argument is summarized below, followed by summaries of counterarguments asserted by proponents of shareholder proxy access.

### 1. Proxy Access is Unnecessary

For at least two decades, commentators have argued that corporate democracy advocates are a movement in search of a cause.<sup>158</sup> Some continue to argue mismanagement is the exception and that, as a general rule, directors approach their duties with care.<sup>159</sup> If shareholders are unhappy with decisions made by the board of directors, they have an available remedy: sell their shares.<sup>160</sup> While Professor Bebchuk argues this imposes an injustice on shareholders who are forced to sell their shares at less than their maximum value,<sup>161</sup> Professor White argues that too many other factors affect share price to “draw a direct positive correlation between the composition of the board of directors and the market’s valuation of a

corporation at a given time.<sup>162</sup> The difficulty of determining whether mismanagement caused the devaluation of shares might suggest that the costs imposed on corporations and the SEC by a proxy access rule may outweigh any fairness considerations.<sup>163</sup>

Another common argument for maintaining the status quo is that technology solves the problem of inadequate shareholder oversight.<sup>164</sup> In addition, production and distribution cost differentials that place shareholders at a disadvantage may be better addressed by the SEC's recent E-Proxy rules, "which permit reliance on proxy materials posted on a website."<sup>165</sup> The real issue in such a situation might be what kinds of disclosure are required, rather than access to proxy materials.<sup>166</sup>

## 2. Economic Stability

One of the major rationales for providing shareholder proxy access is that it might remedy some of the problems that resulted in the recent financial crisis.<sup>167</sup> In response, opponents of shareholder proxy access argue the current system is better at maintaining economic stability.<sup>168</sup> Bratton and Wachter argue: (1) shareholders have a myopic perspective that focuses on stock price at the expense of long-term stability; (2) risk adverse managers make safer decisions; and (3) directors have better access to information to make effective decisions than do shareholders.<sup>169</sup> They also answer two arguments in favor of shareholder proxy access, arguing shareholders do not have superior incentives to maintain stability, and stock price efficiency does not solve the problem of inequitable information distribution.<sup>170</sup> Empirical evidence may even indicate that shareholders bear some responsibility for worsening the financial crisis because shareholder pressure encouraged riskier strategies to raise stock prices, suggesting that shareholder empowerment may not create effective oversight for the good of the economy as a whole.<sup>171</sup>

## 3. Corporate Performance

Some have argued shareholder proxy access may damage corporate performance for a variety of reasons. One of the primary objections, as noted above, is that shareholders' myopic focus on short-term increases in stock price may interfere with long-term planning and increase the probability of risky corporate decisions.<sup>172</sup> The problem may be intensified in the context of institutional investors, who have greater incentives to focus on short-term results because they lack access to firm-specific information and are in a better position to evaluate a company's short-term value.<sup>173</sup> Institutional investors may also use proxy access to wage destructive proxy battles and make it more difficult for corporations to find qualified directors.<sup>174</sup> This may damage the operations of the majority of corporations, which do not face governance problems, to solve the problems faced by a minority of companies.<sup>175</sup>

Additional arguments have been offered to show that proxy access and shareholder oversight will not help corporate performance. First, even if corporate shareholders obtain proxy access, there is a risk they may not use it.<sup>176</sup> Second, encouraging election contests may discourage competent incumbent directors from seeking re-nomination.<sup>177</sup> Third, outside directors reduce the homogeneity of boards, which could disrupt their cohesiveness and the decisionmaking process.<sup>178</sup> Fourth, shareholder proxy access risks contested elections, which may waste company resources or disrupt the function of the board of directors.<sup>179</sup> Hedge funds and other activist shareholders may be more likely to trigger costly proxy contests, particularly at small and mid-capitalization companies.<sup>180</sup> Fifth, shareholder power may increase the power of institutional investors, which over-rely on the advice of independent advisors, risking a one-size-fits-all approach to governance which may be dangerous because it overlooks the diverse needs of different companies.<sup>181</sup> Special-interest shareholders may also be more likely to take on an activist role, which could destabilize a corporation.<sup>182</sup> Finally, shareholder proxy access may distract directors, forcing them to consider the public relations effects of every decision and potentially second-guess decisions they believe to be in the best interests of the corporation.<sup>183</sup>

## 4. Fairness/Democracy

Part of the opposition to shareholder proxy access may stem from conflicting philosophies regarding the role of democracy in the proper functioning of a corporation. According to one traditional view, corporations are properly founded on a separation between ownership and control, which leads to more efficient outcomes.<sup>184</sup> Shareholders are properly viewed as owners of a corporation, while boards of directors are tasked with making most corporate decisions.<sup>185</sup> Corporations are not political entities, but are economic entities in which shareholders give a corporation capital, which is then managed by professionals who attempt to maximize profits derived from that capital.<sup>186</sup> This suggests democracy is an inapt metaphor for corporate governance.<sup>187</sup>

Shareholder empowerment also raises questions regarding which shareholders will actually be empowered by proxy access. Access may empower certain special interest shareholders who might make decisions which are not in the best interest of the shareholders as a whole.<sup>188</sup> Minority shareholders may use their access to hurt shareholders with divergent interests.<sup>189</sup> Hedge funds and other activist shareholders are of special concern because they may be able to abuse changed SEC rules to the disadvantage of other shareholders.<sup>190</sup>

## 5. Corporate Social Responsibility

In addition to harming the corporation, opponents to shareholder proxy access argue shareholder short-termism may have undesirable effects on non-shareholder stakeholders.<sup>191</sup> According to this argument, boards mediate between the interests of different stakeholders and shareholder empowerment may force directors to focus on short-term returns at the expense of other constituencies, interfering with the goals of corporate social responsibility.<sup>192</sup>

## 6. Federalism

Another objection to an SEC rule mandating shareholder proxy access is that it might intrude on areas of business regulation that have traditionally been left to state governments. Without the ability to allow states to limit shareholder proxy access, mandatory access could represent a substantial encroachment on state regulatory power.<sup>193</sup> Shareholder rights have traditionally been regarded as lying within the realm of state regulation.<sup>194</sup> A critical element of the federalism argument is that while the SEC has the power to regulate so as to ensure investors have access to basic information about securities they purchase, a mandatory proxy access rule may stray too far into the realm of substantive regulation, which might be beyond the scope of the SEC's power and better addressed by state law.<sup>195</sup> Some commentators argue, not only is such substantive regulation of shareholder rights beyond the authority of the SEC, but states have more expertise in this area and are in a better position to protect shareholders' rights.<sup>196</sup>

## 7. Workability

Critics of shareholder proxy access have cited possible workability problems with an SEC access rule.<sup>197</sup> First, a mandatory access rule may be over-broad, failing to take into account the variety of board and capital structures that exist in American corporations.<sup>198</sup> Failing to account for diversity may create incentives for shareholders or boards to game the system.<sup>199</sup> For example, a rule might require notice of nomination access before boards make director nomination decisions in the spring, resulting in the perverse incentive to not include shareholder nominees in the proxy statement and intensifying shareholder-director conflicts.<sup>200</sup> Second, proxy access may create the problem of "access-creep," in which more directors are elected through the shareholder access process than are intended by the rule as a result of re-nominations.<sup>201</sup> This could lead boards to deny re-nomination of directors who utilize the access process, interfering with board cohesion.<sup>202</sup> Third, the access rule may encourage costly proxy contests, a problem that could be worsened by shareholders who might "use nominating groups with different compositions to end-run limitations based on prior low votes for access candidates."<sup>203</sup> Fourth, proxy access may allow parties to evade election disclosure requirements, interfering with the informed decisionmaking process of shareholders, a position taken by the SEC in the past.<sup>204</sup> Finally, it has also been suggested that a two-year holding period be implemented to ensure that nominations are available only to long-term shareholders.<sup>205</sup>

## 8. Alternatives

Critics of shareholder proxy access have offered alternative mechanisms of addressing the democratic deficit of board elections without causing the problems they identify with prescriptive shareholder access. A common suggestion is that the SEC adopt a middle position—allowing shareholder access through bylaws rather than mandating access.<sup>206</sup> Proponents of a more flexible approach argue that it may be superior to a one-size-fits-all approach because it: (1) allows policies to be tailored to specific companies; (2) allows for experimentation between different companies, theoretically revealing the best approach to proxy access; and (3) allows for the evolution of state laws on bylaws and proxy access.<sup>207</sup> Another alternative is the use of electronic forums, which supporters believe address problems with shareholder democracy while preventing myopia, waste and disruption, excessive empowerment of special interests, and deterrence of qualified directors from seeking election.<sup>208</sup>

### *C. Arguments for Shareholder Proxy Access*

A number of academics and proponents of shareholder activism argue that shareholder proxy access will have positive effects on corporations and the economy as a whole.<sup>209</sup> Generally, it is argued the SEC should accomplish this by amending SEC Rule 14a-8 to adopt a uniform rule allowing shareholders to nominate directors via proxy materials.<sup>210</sup> Rationales for more meaningful shareholder access may be divided into (1) fairness/democracy, (2) corporate performance and accountability, and (3) economic stability. Each rationale is summarized below, followed by responses to major criticisms of shareholder proxy access proposals.

#### 1. Fairness/Democracy

Proxy access campaigns take place in the larger context of movements to remedy the perceived democratic deficit of how American corporations nominate and elect their boards of directors.<sup>211</sup> Critics of the status quo argue the democratic process of electing directors has grown ineffective, insulating incumbent directors from being voted out by dissatisfied

shareholders.<sup>212</sup> The SEC has acknowledged that one of the goals of its proxy rules is to ensure that a proxy mirrors an actual shareholder meeting insofar as doing so is practical.<sup>213</sup> Proxy access may allow for more effective corporate democracy by giving shareholders a reliable means to nominate directors, even if they do not actually exercise that power.<sup>214</sup> This may provide for a more fair and equitable environment in which shareholders can become empowered and exercise control over the directors to which they delegate management authority.<sup>215</sup> Proxy advocates disagree with those who argue that dissatisfied shareholders already have an available remedy—selling their stock—and argue that it is unjust to force shareholders to sell their stock at a reduced value because of mismanagement by the board of directors.<sup>216</sup> Proxy access may also improve disclosure surrounding director nominees.<sup>217</sup>

Shareholder proxy access advocates argue that current mechanisms are insufficient to revive the concept of corporate democracy.<sup>218</sup> They point to imperfections in the market for corporate control, including anti-takeover statutes and defensive maneuvers, that have allowed boards to effectively shield their power from outside challenges.<sup>219</sup> While technological solutions, such as shareholder forums and E-proxy, seem to pose a means of improving corporate democracy by reducing costs imposed on shareholders seeking to dislodge ineffective directors, that may not be enough: “the e-proxy rules may fail to generate significant cost savings, majority voting may prove illusory, and shareholder forums may evolve into mere chat rooms ignored by corporate managers . . . .”<sup>220</sup> While it is possible such mechanisms may have an indirect effect on shareholder power, that effect will only be useful if they provide a means by which directors effectively engage with shareholders.<sup>221</sup> Proxy access may also be superior to an alternative offered by the American Law Institute—nomination of outside directors—because it allows shareholders to prod directors, including passive unaffiliated directors, into making more effective decisions.<sup>222</sup>

## 2. Accountability and Corporate Performance

A second justification for shareholder proxy access is that it provides for better corporate performance and decisionmaking by assuring boards of directors are accountable to shareholders.<sup>223</sup> The financial crisis and poor decisions made by firms like Enron and Lehman Brothers illustrate the problems created by insufficient board accountability.<sup>224</sup> There is evidence that management at those two companies made poor choices—including high risk accounting, conflicted transactions, unrecorded activities, excessive executive compensation, a “leisurely approach to overseeing the risk decisions and standards[,]” and excessive concentration of power in the hands of the CEO—that could have been cured if shareholders could more effectively replace directors or simply place pressure on them with the threat of doing so.<sup>225</sup> Shareholders are effectively prevented from ensuring accountability in the current system because of high agency costs.<sup>226</sup> Shareholders, including institutional investors, have relevant expertise and, if not for current SEC rules, they may be able to provide real oversight to boards of directors.<sup>227</sup> This may overcome the problems posed by directors’ self-interest and ineffective decisionmaking, particularly in the areas of takeovers and executive compensation.<sup>228</sup>

There remains the risk that shareholders will not exercise proxy access in a meaningful way, but proponents argue that the current model poses so many problems that we should attempt to reform it in the hopes that shareholders will hold directors accountable.<sup>229</sup> Commentators identify a litany of possible positive effects of such accountability.<sup>230</sup> There is also evidence suggesting a correlation between shareholder activism and firm value.<sup>231</sup>

## 3. Economic Stability

While the traditional rationales for shareholder proxy access have centered around the performance of specific corporations, the 2008 financial crisis gave rise to arguments that shareholder proxy access was necessary for broader economic stability.<sup>232</sup> Some critics lay part of the blame for the crisis at the door of poor management and argue that shareholder empowerment may be able to address that problem.<sup>233</sup> These arguments are similar to those for the accountability of particular firms, but also argue that such accountability will avoid the kinds of mismanagement that destabilized the economy and the financial system.<sup>234</sup> While short-term investing and the demands for increased stock value exerted by investors on boards of directors may be partially responsible for the crisis, shareholder proxy access can arguably ameliorate that effect by providing shareholders with a means of expressing their dissatisfaction with a company that is more consistent with long-term strategies.<sup>235</sup>

### *D. Answers to Objections to Shareholder Proxy Access*

Critics often argue shareholder proxy access interferes with corporate effectiveness, in addition to risking other negative effects.<sup>236</sup> Proxy access advocates have responses to these arguments.<sup>237</sup> This article now addresses objections to shareholder proxy access, specifically that it: (1) allows excessive empowerment of special interest shareholders; (2) wastes corporate resources; (3) contributes to dangerous short-term decisionmaking by boards of directors; and (4) impedes corporate social responsibility.

## 1. Empowering Institutional Investors and Other Special Interests

While it is possible the most likely shareholder activists will be institutional investors, such as unions and pension funds, that may be a good thing from the perspective of many stakeholders (such as employees and those affected by the environmental effects of a firm's conduct) who are insufficiently protected by the shareholder primacy norm of corporate decisionmaking.<sup>238</sup> The SEC can also amend the proxy rules in a way that limits the over-exertion of influence by institutional shareholders.<sup>239</sup> Regardless, institutional shareholders that nominate directors need to be careful that they insulate themselves from confidential information, avoid domineering behaviors, and recall that directors have fiduciary duties to all shareholders, not simply those who nominated them.<sup>240</sup>

It is possible that such shareholders may be able to "blackmail" directors, but that also may be a good thing if it makes directors more risk averse.<sup>241</sup> Critics have pointed to the possibility the ballot will be dominated by special interests, but that may not be much of a problem, since activists are more likely to succeed in using proxy access if their interests coincide.<sup>242</sup> Finally, activism by hedge funds, another special interest group, is a recent phenomenon, its negative consequences remain speculative, and some studies suggest that it may have positive effects.<sup>243</sup>

## 2. Corporate Waste

Some critics allege that shareholder proxy access wastes corporate resources.<sup>244</sup> This argument can be broken into three parts: (a) shareholder nominations are wasteful because shareholders are apathetic; (b) shareholder-nominated candidates will disrupt the efficient functioning of homogenous boards; and (c) access increases the likelihood of contested board elections, which are not only costly but may distract the board of directors from making effective decisions.

### a. Shareholder Apathy

Some critics argue shareholder proxy access wastes resources because shareholders are apathetic and unwilling to wield the power that the SEC might give them.<sup>245</sup> First, this argument may be circular, since it is a prediction of future shareholder behavior based on the past, in which substantial barriers have existed to shareholder participation.<sup>246</sup> Proxy access may change this pattern by making it less likely that shareholder proposals will draw management opposition and fail.<sup>247</sup> Shareholder apathy is arguably a symptom of status quo barriers to access.<sup>248</sup> There are also reasons shareholders may be more willing to exercise power and participate in the governance process if given the ability to do so.<sup>249</sup> While international evidence suggests shareholders may be reluctant to use their proxy access to challenge directors, access may influence managers in more subtle ways by strengthening the effect of "withhold-the-vote" campaigns and enhancing shareholder-director dialogue.<sup>250</sup> Finally, international evidence has shown shareholders are more willing to exercise their power during times of crisis, indicating that investors will overcome their passivity when it is most important that they do so.<sup>251</sup>

### b. Board Cohesion

Another objection is that shareholder proxy access will allow new directors, who may have special interest agendas, to infiltrate boards, interfering with cohesion.<sup>252</sup> However, there is some theoretical evidence suggesting shareholder-nominated directors may be more willing to question a board's traditional assumptions, leading to better decisionmaking and a net reduction in waste.<sup>253</sup> Even if there is some risk of waste, the current system already places a value on outside directors,<sup>254</sup> meaning there is little risk that shareholder-nominated directors would impose a greater lack of cohesion than already exists on many boards of directors.<sup>255</sup> Finally, there is a substantial amount of literature regarding the problem of group-think, whereby a homogenous group of individuals becomes blinded to problems faced by their organizations because of a tendency to penalize disagreement and marginalize contrary views.<sup>256</sup> Shareholder-nominated directors may alleviate this problem by injecting new perspectives and forms of expertise into an organization.<sup>257</sup>

### c. Proxy Contests

While critics argue the risk of election contests may deter qualified directors from risking rejection, the lucrative benefits of holding such positions will likely override that effect.<sup>258</sup> Costly control contests may also be avoided by setting criteria for shareholder nominations.<sup>259</sup> It is also possible competition for board positions will only increase the quality of the decisionmaking of those who end up on the board.<sup>260</sup>

## 3. Short-Term Decisionmaking

Critics of shareholder proxy access also argue shareholder empowerment may hurt corporate performance because of shareholder myopia and shareholders' interests in short-term profits will force directors to make decisions that are not necessarily in a firm's long-term interests.<sup>261</sup> One response to this objection is that current directors already focus on short-term concerns and there is little reason to believe that shareholder-nominated directors will worsen the problem.<sup>262</sup> If

anything, shareholders may have an incentive to focus on a corporation's long-term well-being and directors will still have a fiduciary duty to act in the corporation's best interests.<sup>263</sup> Pressure in favor of short-termism may be an inevitable problem of corporate governance and the best way to deal with it might be satiating shareholders by giving them limited proxy access without allowing them to engage in more substantial interference with the governance process.<sup>264</sup> Finally, even if shareholders suffer from short-termism, the ability to nominate directors may correct that tendency by providing a mechanism for expressing their dissatisfaction with management in a manner that is more consistent with a long-term approach than their current remedy—selling their shares.<sup>265</sup>

#### 4. Corporate Social Responsibility

Lastly, some scholars argue shareholder empowerment interferes with the interests of non-shareholder stakeholders.<sup>266</sup> There are a few responses to this. First, shareholder proxy access may cause a shift in shareholder focus towards long-term concerns.<sup>267</sup> Second, proxy access may empower institutional shareholders that represent the interests of constituents who have been ignored by boards of directors in the past, such as environmental stakeholders and employees.<sup>268</sup> Shareholders consist of diverse groups and some of them may have interests, beyond short-term financial gain, that may align with those of non-shareholder stakeholders.<sup>269</sup> International experience has borne out this argument to some extent.<sup>270</sup> In Germany and France, employee stakeholders use their power to elect board representatives, which may be roughly analogous to employee pension funds that hold stock in a corporation.<sup>271</sup>

### **IV. SHAREHOLDER PRIMACY AND THE BUSINESS JUDGMENT RULE TOGETHER REQUIRE MORE SHAREHOLDER DEMOCRACY**

The current financial crisis naturally causes one to question whether the United States corporate governance structure needs revising. The financial crisis has served as the impetus for regulatory and Congressional attempts to enhance shareholder proxy access.<sup>272</sup> The shareholder primacy norm remains the “bedrock principle of U.S. corporate law.”<sup>273</sup> And under the business judgment rule, unless shareholders can rebut the presumption directors were not acting in the best interests of the corporation, those shareholders have no legal recourse against those directors no matter how stupid, egregious, or irrational board decisions may be.<sup>274</sup> Shareholders not only lack recourse in the courts, they lack recourse in the selection and retention of directors.<sup>275</sup>

This leaves only four choices: (1) abandon the shareholder primacy norm—i.e., reverse centuries-old attitudes towards the role of corporations; (2) modify the business judgment rule—which recent court decisions indicate is not being contemplated; (3) let shareholders sell their shares—which is of little consequence if share values have dropped dramatically due to director misfeasance; or (4) grant shareholders greater power in determining the make-up of the board of directors, particularly through access to the proxy to nominate board candidates. It is interesting how controversial this last option has proven to be.<sup>276</sup>

It is true the moniker “shareholder democracy”—used to describe shareholder empowerment techniques such as proxy access—is a misnomer. After all, voting in a democracy is based on one-person, one-vote, whereas those shareholders who are entitled to vote do so in proportion to the number of shares they own.<sup>277</sup> In other words, shareholder voting is more akin to a plutocracy.<sup>278</sup> And this has caused some of the debate to focus more on the concepts of “democracy” as a metaphor rather than the true role of shareholders within the modern publicly-traded corporation.<sup>279</sup>

Shareholder democracy is fundamentally an issue of the role of shareholders within the corporation, and their consequent power. But even this notion is not without some debate. For example, Joo asserts that beginning in the 1930s, theorists, such as Berle and Means,<sup>280</sup> and policymakers shifted the debate from the role of the corporation in society to the internal control hierarchy within the corporation between shareholders and management.<sup>281</sup> The helped assuage concerns over concentration of power within corporations because the “owners” did not control those corporations.<sup>282</sup> This precipitates the entire debate of the role of shareholders and exactly what they “own.”

Are shareholders merely investors looking for a return on their investment, or are they entitled to participate in determining the direction of the corporation?<sup>283</sup> If shareholders are the former only, then there is very little need for them to participate in the management of the corporation. They can minimize their financial risk by owning a diversified collection of stocks, in which case the “Wall Street Walk” is a practical solution for an underperforming investment.<sup>284</sup>

Lipton and Rosenblum describe the debate regarding the shareholder as an owner who is entitled to control the direction of the corporation.<sup>285</sup> If the shareholders own the corporation just as any others own private property—with all the attendant rights associated with private property ownership—then the wishes of the shareholders must be the paramount focus of the corporation.<sup>286</sup> But Lipton and Rosenblum find two fundamental flaws in this argument. First, harking back to the original public-service origins of the corporation,<sup>287</sup> they argue corporations play too important a role in the economy to be subject to the personal interests of shareholders.<sup>288</sup> They assert passage of general incorporation statutes reflects a policy choice that the role of shareholders is simply to aggregate capital, with the promise of limited liability in return.<sup>289</sup> It should be left to management to best determine how to deploy that capital for the good of society.<sup>290</sup> Second, Lipton and Rosenblum argue that ownership of corporate stock is not analogous to ownership of ordinary property, in that ownership of stock is

merely “a financial investment granting no direct control over the properties, equipment, contract rights, organizational structure, and other elements that make up the corporation itself.”<sup>291</sup> They claim shareholders do not care about the corporation any more than the holder of a betting slip cares about the racehorse bet upon.<sup>292</sup>

Although Bainbridge offers differing views as to the role of shareholders, his conclusions are similar. Bainbridge adopts Arrow’s delineation of decisions between consensus and authority.<sup>293</sup> Shareholders are a divergent group that, although they all want wealth maximization, will usually disagree as to how best to achieve it.<sup>294</sup> In addition, shareholders lack incentives to gather the information necessary to participate actively in decisionmaking, resulting in rational apathy.<sup>295</sup> As a result, corporate management is more effective at authoritative decisionmaking rather than at consensus building.<sup>296</sup>

Regardless of the degree of power shareholders should theoretically have, they have nonetheless entrusted their money to the board of directors. A “love-it-or-leave-it” blind trust in corporate management ignores the notion that with trust comes accountability. As discussed earlier,<sup>297</sup> absent fraud or gross negligence, directors have no legal accountability. But even when the corporation is viewed as merely an investment vehicle, there are still arguments supporting some degree of shareholders’ right to control the corporation’s direction.<sup>298</sup>

Corporate directors were initially considered trustees of the corporation and its shareholders.<sup>299</sup> Although directors are no longer considered trustees,<sup>300</sup> the trust concept was the foundation for the shareholder primacy norm.<sup>301</sup> When these initial doctrines regarding the role of directors were first being established, directors were members of the shareholding body, selected by the other shareholders to protect their mutual interests, usually on a purely voluntary basis.<sup>302</sup> In tracing the history of corporate boards, Gevurtz concludes the use of boards arose out of problems with direct governance by groups with large numbers of members.<sup>303</sup>

It is within this framework the first doctrines of director liability arose. The courts resisted holding directors to too high a standard, for fear the potential liability would dissuade qualified shareholders from serving as directors.<sup>304</sup> As such, courts were reluctant to hold directors liable for honest mistakes, regardless of how “absurd” or “ridiculous.”<sup>305</sup> Over the past 130 years, this reluctance has evolved into the business judgment rule that holds directors legally blameless as long as they did not consciously ignore their duties or engage in self-dealing.<sup>306</sup> And the business judgment rule retained an historic assumption that has proved false in modern times—dissatisfied shareholders can vote out incompetent directors.<sup>307</sup>

In the meantime, a recognized transfer of control in large publicly traded corporations from shareholders to management has occurred. While directors are still expected to maximize shareholder wealth, shareholders have no direct practical control over management. This control gap could have been alleviated by restrictions on the business judgment rule—holding directors to a higher standard of care to protect shareholder interests—but instead the business judgment rule did not evolve in the same manner as corporate control. It continued from precedents established long before the separation of management and control.

As a result, the most practical option remaining to protect shareholder interests is to give shareholders at least some additional management powers—specifically through access to the proxy to nominate directors. This will not result in shareholders becoming substantively involved in the management of the corporation. It is not a proposal to return to the early days of corporations when the shareholders were also the directors, looking after their own interests. But the law is stuck in those early days. Shareholder proxy access merely provides shareholders some modicum of protection when the law otherwise will not.

## V. CONCLUSION

Despite the fact the shareholder primacy norm places shareholder value first and foremost, a number of constituencies have linked the current financial crisis with current corporate governance practices—to the financial detriment of shareholders and society as a whole. When shareholder primacy backfires, shareholders are left with substantial losses and minimal legal recourse due to the business judgment rule. The most viable possible revision to corporate governance in the United States is to allow shareholders access to proxies to nominate alternative directors. There is a strong argument that if there is a real chance directors can be replaced, they will exercise much greater care in protecting shareholder interests. While it is doubtful shareholder proxy access revisions alone will prevent the next financial crisis, it is at least a step forward in corporate democracy—providing shareholders a meaningful voice in controlling their financial future.

### Footnotes

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<sup>1</sup> See, e.g., Grant M. Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2081 (2010) (forthcoming), available at <http://ssrn.com/abstract=1590274> (last visited May 7, 2010); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423-25 (1993); Kenneth B. Davis, Jr., *Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain: A Survey of, and Commentary on, the U.S. Corporate Law*, 13 CAN.-U.S. L.J. 7, 8 (1988).

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<sup>2</sup> See, e.g., *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (1919). The goal of maximizing shareholder wealth is a given when examining corporate board conduct. See, e.g., *Basic, Inc. v. Levinson*, 485 U.S. 224, 235 (1988); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 139 (Del. Ch. 2009).

<sup>3</sup> Hayden & Bodie, *supra* note 1, at 2078.

<sup>4</sup> Courts will not second-guess the substance of a board decision that leads to a corporate loss “apart from consideration of the good faith or rationality of the process employed.” *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (accord, *In re Citigroup*, 964 A.2d at 122; *In re The Dow Chemical Co. Derivative Litig.*, No. 4349, 2010 Del. Ch. Lexis 2, at \*37 n.55 (Del. Ch. Jan. 11, 2010)).

<sup>5</sup> This strategy is sometimes referred to as the “Wall Street Walk.” See, e.g., *Ending the Wall Street Walk: Why Corporate Governance Now?* (Commentary), CORP. GOV., <http://www.corpgov.net/forums/commentary/ending.html> (last visited May 7, 2010); Constance E. Bagley & Karen L. Page, *The Devil Made Me Do It: Replacing Corporate Directors' Veil of Secrecy with the Mantle of Stewardship*, 36 SAN DIEGO L. REV. 897, 909 (1999) (describing the “Wall Street Walk” from an ethical standpoint—i.e., if a company’s actions do not comport with a shareholder’s ethical values, the shareholder can sell that company’s stock and buy stock in another company that better exemplifies the shareholder’s ethical values).

<sup>6</sup> See, e.g., *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 959 (Del. 1985) (“If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.”) (citing *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984); DEL. CODE ANN. tit. 8, § 141(k) (2007)).

<sup>7</sup> For example, a group of Citigroup shareholders sued its directors alleging one reason Citigroup’s share price dropped below its book value in 2008 was due to the directors failing to properly monitor the risks incurred by Citigroup in the sub-prime mortgage market. *In re Citigroup*, 964 A.2d at 111, 114. Some shareholders take umbrage at the notion that if they don’t like the way the corporation is managed they should just sell their stock. According to T. Boone Pickens, “That’s like the gardener telling the estate owner, ‘If you don’t like the way I take care of your property, sell it and move out.’ . . .” Steven Flax, *Just What You Wanted: Another Shareholder Activist*, CORP. BD. MEMBER (2d Q. 2009), [http://www.boardmember.com/MagazineArticle\\_Details.aspx?id=3551](http://www.boardmember.com/MagazineArticle_Details.aspx?id=3551) (last visited May 7, 2010).

<sup>8</sup> This article focuses on rights of shareholders and liabilities of directors of large, publicly traded corporations. Most of the issues presented in this article do not apply to closely held corporations in which the majority, if not all, of the shareholders are active in the management of the corporation. In addition, Delaware corporate law is predominantly cited, as Delaware is the home of a majority of large, publicly traded corporations (see *infra* note 18) and Delaware is considered to be the most popular state for incorporation (see S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1, 1 (1976)).

<sup>9</sup> Adolph A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (arguing all powers granted to a corporation or its managers are exercisable only for the benefit of the shareholders); Theodore Levitt, *The Dangers of Social Responsibility*, 36 HARV. BUS. REV. 41, 49 (Sept.-Oct. 1958) (“Business will have a much better chance of surviving if there is no nonsense about its goals—that is, if long-run profit maximization is the one dominant objective in practice as well as in theory.”).

<sup>10</sup> MILTON FRIEDMAN, *CAPITALISM & FREEDOM* 133 (2d ed. 1963) (“[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.”).

<sup>11</sup> Courts often evaluate management’s conduct from the perspective of maximizing shareholder wealth. See, e.g., *Basic, Inc. v. Levinson*, 485 U.S. 224, 235 (1988); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 139 (Del. Ch. 2009).

<sup>12</sup> D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 278 (1998). See also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (holding “corporate directors have a fiduciary duty to act in the best interests of the corporation’s stockholders[.]”) (citation omitted); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 181-82 (Del. 1986) (holding a board may consider stakeholder interests in attempting to prevent a hostile takeover, but has a fiduciary duty to act in the stockholders’ best interests).

<sup>13</sup> 170 N.W. 668 (Mich. 1919). See also, Bainbridge, *supra* note 1, at 1423-24; Smith, *supra* note 12, at 278; Jonathan D. Springer, *Corporate Law Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85, 87 (1999).

<sup>14</sup> *Dodge*, 170 N.W. at 683.

<sup>15</sup> *Id.* at 684. The Michigan Supreme Court also held that when the directors act for the “incidental benefit of shareholders and for the primary purpose of benefiting others,” that is the point at which a court has a duty to interfere.” *Id.* The court upheld the lower court’s decree specifying an amount to be distributed to shareholders as dividends. *Id.* at 685.

<sup>16</sup> Springer, *supra* note 13, at 88 (“At the end of the day, it appears that the shareholder primacy norm has been relatively unchallenged throughout much of the Twentieth Century.”) (footnote omitted); Bainbridge, *supra* note 1, at 1423 (“Shareholder wealth maximization long has been the fundamental norm which guides U.S. corporate decisionmakers.”); David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1374 (1993) (“[S]hareholder primacy has served as corporate law’s governing norm for much of this century.”).

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<sup>17</sup> See Bainbridge, *supra* note 1, at 1424.

<sup>18</sup> The Delaware Division of Corporations has boasted that Delaware is the corporate home of 64% of the Fortune 500 companies. 2008 Ann. Rep., Del. Dep't of St. Division of Corps., available at <http://corp.delaware.gov/2008AR.pdf> (last visited May 7, 2010).

<sup>19</sup> Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 880 (1990) (footnote omitted).

<sup>20</sup> Hayden & Bodie, *supra* note 1, at 2082. See also FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 38 (1996) (arguing a successful firm provides jobs for workers and better products and services for consumers; that prosperity for stockholders, workers and communities goes hand in hand).

<sup>21</sup> Smith, *supra* note 12, at 291. Corporate charters were granted only through legislative acts until the mid-1800s. Kenneth K. Luce, *Trends in Modern Corporation Legislation*, 50 MICH. L. REV. 1291, 1294 (1952). Most corporate charters prior to the nineteenth century were related to public works, such as building toll roads and digging canals. JOSEPH STANCLIFFE DAVIS, 2 *ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS* 26 (1917). See also David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 207 (1990) (noting until the mid-nineteenth century most corporate charters were to pursue some form of public function). Incorporations for purely private profits were rare prior to the nineteenth century. *Id.*; Simeon E. Baldwin, *Private Corporations 1701-1901*, in *TWO CENTURIES' GROWTH OF AMERICAN LAW 1701-1901* 261, 268, 276 (1901) (estimating no more than 250 business-related corporations in America through the eighteenth century, two-thirds of which were of a quasi-public character).

<sup>22</sup> JOSEPH K. ANGEL & SAMUEL AMES, *TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE* 7 (1832). Historically, corporations were categorized as either sole or aggregate. Corporations sole were formed to perpetuate the succession of a single position, such as a king or archbishop, whereas corporations aggregate were formed to perpetuate the succession of multiple individuals, such as shareholders. See HARRY G. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* 11 (2nd ed. 1970); STEWART KYD, *I A TREATISE ON THE LAW OF CORPORATIONS* 20 (1793). With the possible exception of church parsons in Massachusetts, there has never been a corporation sole in the United States. JOHN P. DAVIS, *I CORPORATIONS: A STUDY OF THE ORIGIN AND DEVELOPMENT OF GREAT BUSINESS COMBINATIONS AND OF THEIR RELATION TO THE AUTHORITY OF THE STATE* 14 (1905).

<sup>23</sup> ANGEL & AMES, *supra* note 22, at 24 (“The public, therefore, gain by acts incorporating trading associations, as by such means persons are induced to hazard a certain amount of property for the purposes of trade and public improvement, who would abstain from doing so, were not their liability thus limited.”).

<sup>24</sup> See, e.g., *Gray v. Portland Bank*, 3 Mass. (3 Tyng) 364, 379 (Mass. 1807) (holding “the corporation is the trustee for the management of the property, and each stockholder a *cestui que* trust according to his interest and shares[.]”); *Verplanck v. Mercantile Ins. Co. of N.Y.*, 1 Edw. Ch. 83, 87 (N.Y. Ch. 1831) (holding “when a corporation aggregate is formed, and the persons composing it . . . place the management and control of its affairs in the hands of a select few, . . . then such directors become the agents and trustees of the corporators. . . .”); *Robinson v. Smith*, 3 Paige Ch. 222, 232 (N.Y. Ch. 1832) (holding “directors are the trustees or managing partners, and the stockholders are the *cestui que* trusts. . . .”); *Hodges v. New England Screw Co.*, 1 R.I. 312, 340 (R.I. 1850) (holding the directors of a corporation “liable in equity, as trustees, for a fraudulent breach of trust[.]”); *Butts v. Wood*, 37 N.Y. 317, 318 (N.Y. 1867) (holding the relationship between a director and a corporation is that of trustee and *cestui que* trust).

<sup>25</sup> 59 U.S. 331 (1856).

<sup>26</sup> *Id.* at 341.

<sup>27</sup> *Id.* at 336-39.

<sup>28</sup> *Id.* at 345. Woolsey, the plaintiff shareholder, claimed “the tax is so onerous upon the bank, that it will compel a suspension and final cessation of its business.” *Id.* at 339.

<sup>29</sup> See, e.g., *Detroit v. Dean*, 106 U.S. 537, 541-42 (1883); *Norman v. Consol. Edison Co. of N.Y.*, 89 F.2d 619, 622-24 (2nd Cir. 1937) (reviewing Supreme Court cases addressing the ability of shareholders to bring actions when faced with irreparable harm).

<sup>30</sup> See, e.g., *Tower Hill-Connellsville Coke Co. of W. Va. v. Piedmont Coal Co.*, 64 F.2d 817, 826 (4th Cir. 1933) (holding majority shareholders become the corporation, and, as such, assume the trust relation occupied by the corporation towards its stockholders and may not impair the value of the minority shareholders’ interest).

<sup>31</sup> Smith, *supra* note 12, at 319-20. See also *supra* notes 13-15 and accompanying text (discussing *Dodge v. Ford Motor Co.*). But see Johnson, *supra* note 19, at 874 n.41 (using *Dodge v. Ford Motor Co.* as an example of a court asserting a “self-evident” proposition).

<sup>32</sup> Report of Anton R. Valukas, Examiner, at 4, *In re Lehman Brothers Holdings Inc.*, No. 08-13555 (Bankr. S.D. N.Y. filed Mar. 11, 2010) (footnote omitted).

<sup>33</sup> *Id.* (footnote omitted).

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 2.

<sup>36</sup> *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 114 (Del. Ch. 2009).

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<sup>37</sup> See Adrian Blundell-Wignall, Paul Atkinson & Se Hoon Lee, *The Current Financial Crisis: Causes and Policy Issues*, OECD FIN. MARKET TRENDS (2008), available at <http://www.oecd.org/dataoecd/47/26/41942872.pdf> (last visited May 7, 2010); Editorial, *The Crisis, a Year Later*, N.Y. TIMES, Sept. 9, 2009, at A28.

<sup>38</sup> Estimates, in 2009 alone, of how much the federal government may have to spend to “solve” the current financial crisis have ranged from \$9.7 trillion to \$23 trillion. See Mark Pittman & Bob Ivry, *U.S. Taxpayers Risk \$9.7 Trillion on Bailout Programs (Update1)*, BLOOMBERG.COM, Feb. 9, 2009, at <http://www.bloomberg.com/apps/news?pid=washingtontory&sid=aGq2B3XeGKok>; Eamon Javers, *Bailouts Could Cost U.S. \$23 Trillion*, POLITICO, July 20, 2009, at <http://www.politico.com/news/stories/0709/25164.html>.

<sup>39</sup> *Corporate Apocalypse*, MGMT. TODAY, Jan. 1, 2009, at 50. See also Grant Kirkpatrick, *The Corporate Governance Lessons from the Financial Crisis*, 2009/1 FIN. MARKET TRENDS 1, 2 (May/June 2009), available at <http://www.oecd.org/dataoecd/32/1/42229620.pdf> (concluding “the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements[]”).

<sup>40</sup> *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (alterations in original removed) (cited by *In re Citigroup*, 964 A.2d at 122).

<sup>41</sup> David Rosenberg, *Galactic Stupidity and the Business Judgment Rule*, 32 J. CORP. L. 301, 303 (2007) (footnote omitted). This same sentiment was echoed by the Delaware Court of Chancery—when directors make poor decisions, redress “must come from the markets, through the action of shareholders and the free flow of capital, and not from this Court.” *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 698 (Del. Ch. 2005), *aff’d*, 906 A.2d 27 (Del. 2006).

<sup>42</sup> 8 Mart. (n.s.) 68, 68-69 (La. 1829).

<sup>43</sup> *Id.* at 73. The court was most likely referring to mandataries, persons to whom a legal mandate is given. WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 1373 (1965).

<sup>44</sup> *Percy*, 8 Mart. (n.s.) at 74.

<sup>45</sup> *Id.* at 75.

<sup>46</sup> *Id.* at 79-80 (noting, though, that if proof of a loss had been sustained, the directors would have been liable).

<sup>47</sup> *Spering’s Appeal*, 71 Pa. 11, 20 (Pa. 1872). The Pennsylvania Supreme Court did briefly address director liability earlier in *Bank of Washington against Barrington et al.*, 2 Pen. & W. 27 (Pa. 1830), in which a bank temporarily lost its incorporation due to a cashier failing to pay required payments to the state Treasurer. “The directors were bound not only to know the law, but to take all proper precautions; and if they failed to do so, the consequences are attributable to them....” *Id.* at 48.

<sup>48</sup> *Spering’s Appeal*, 71 Pa. at 21. “[G]entlemen elected by the stockholders from their own body ought not to be judged by the same strict standard as the agent or trustee of a private estate. Were such a rule applied, no gentlemen of character and responsibility would be found willing to accept such places.” *Id.* The fact that directors were stockholders who served without compensation was also noted earlier by the Rhode Island Supreme Court in 1850, which held that it would be unjust to hold directors liable for innocent mistakes. *Hodges v. New England Screw Co.*, 1 R.I. 312, 348 (R.I. 1850) (“The law requires of [directors] care and discretion, such as a man of ordinary prudence exercises in his own affairs; and if they practice this, and nevertheless make a mistake, the law does not hold them answerable.”) The U.S. Supreme Court regarded corporate directors in a similar light, as unpaid “gentlemen” selected from the body of stockholders, who also should not be held accountable short of fraud. *Briggs v. Spaulding*, 141 U.S. 132, 149 (1891). *Briggs v. Spaulding* also reflected the current sentiment in English jurisprudence, that too high of a threat of liability would deter “all men of property” from becoming directors. *Id.* (quoting *In re Forest of Dean Coal Mining Co.*, 10 Ch. D. 450, 451). See also Frederick Dwight, *Liability of Corporate Directors*, 17 YALE L.J. 33, 36 (1907).

<sup>49</sup> *Spering’s Appeal*, 71 Pa. at 24.

<sup>50</sup> The first reported instance of a U.S. court referring to a “business judgment rule” is in *Marony v. Applegate*, 266 A.D. 412, 422, 42 N.Y.S.2d 768, 779 (N.Y. App. Div. 1943) (holding if the directors showed they were guided by the financial necessities of the situation, and not by any ulterior motive, and were attempting to serve faithfully the interests of their company, they should be protected in their actions and decisions). See also *Weinberger v. Quinn*, 264 A.D. 405, 408, 35 N.Y.S.2d 567, 570-71 (N.Y. App. Div. 1942) (“[T]he courts do not pass on or assume to pass on questions of mere business judgment or expediency. Facts showing bad faith or other breach of duty must be alleged before a court will interfere.”) (citation omitted).

<sup>51</sup> *Bayer v. Beran*, 49 N.Y.S.2d 2, 6 (N.Y. Sp. Term 1944).

The director of a business corporation is given a wide latitude of action. The law does not seek to deprive him of initiative and daring and vision. Business has its adventures, its bold adventures; and those who in good faith, and in the interests of the corporation they serve, embark upon them, are not to be penalized if failure, rather than success, results from their efforts. The law will not permit a course of conduct by directors, which would be applauded if it succeeded, to be condemned with a riot of adjectives simply because it failed. Directors of a commercial corporation may take chances, the same kind of chances that a man would take in his own business. Because they are given this wide latitude, the law will not hold directors liable for honest errors, for mistakes of judgment. The law will not interfere with the

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internal affairs of a corporation so long as it is managed by its directors pursuant to a free, honest exercise of judgment uninfluenced by personal, or by any considerations other than the welfare of the corporation.

*Id.* at 5-6.

<sup>52</sup> *Casey v. Woodruff*, 49 N.Y.S.2d 625, 643 (N.Y. Sp. Term 1944).

<sup>53</sup> *See, e.g., Whitmer v. Whitmer & Sons, Inc.*, 99 A. 428, 431 (Del. Ch. 1916) (holding a past error in business judgment did not support the appointment of a receiver); *Scully v. Auto. Fin. Co.*, 101 A. 908, 909 (Del. Ch. 1917) (holding transfer of common stock in exchange for a valueless business idea illegal because it was supported by “no pretended exercise of business judgment” by the directors); *Atlantic Refining Co. v. Hodgman*, 13 F.2d 781, 788 (3d Cir. 1926) (holding the sale of the same issue of stock at different prices to different persons will be sustained if based on the exercise of fair business judgment) (applying Delaware law).

<sup>54</sup> 126 A. 46 (Del. Ch. 1924).

<sup>55</sup> *Id.* at 48.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 49.

<sup>58</sup> *Bodell v. Gen. Gas & Elec. Corp.*, 140 A. 264, 267 (Del. 1927) (holding the discretion of directors in their selling stock “should not be interfered with, except for fraud, actual or constructive, such as improper motive or personal gain or arbitrary action or conscious disregard of the interests of the corporation and the rights of its stockholders[ ]”).

<sup>59</sup> *Perrine v. Pennroad Corp.*, 47 A.2d 479 (Del. 1946), *cert. denied*, 329 U.S. 808.

In the settlement of disputes in which corporations are interested, the directors of the corporation, who are its duly accredited managers, are called upon to exercise honest business discretion. If it appears that they acted honestly, they are not responsible for mere mistakes, and under such circumstances courts will not interfere with their action or attempt to assume their authority to act. This must necessarily be so, otherwise, the courts will be called upon to settle many business disagreements between the stockholders of corporations, which should be disposed of by the directors who, as a general rule, are chosen by a majority of the stockholders for that purpose.

*Id.* at 487-88. This principle was referred to as the “business judgment rule” in the subsequent case, *Sneider v. Transcontinental & Western Air, Inc.*, 79 F. Supp. 339, 341 n.2 (Dist. Del. 1948).

<sup>60</sup> *Beard v. Elster*, 160 A.2d 731, 738-39 (Del. 1960) (holding a stock option plan, which allowed for exercising of options only while an optionee was employed by the company, was valid as adopted by an independent and disinterested board of directors). There were earlier indirect references to the business judgment rule by Delaware courts. For example, in *Nadler v. Bethlehem Steel Corp.*, 154 A.2d 146, 149 (Del. Ch. 1959), the Delaware Court of Chancery stated that executive compensation plans fell within the “business judgment rule” (citing *Lieberman v. Koppers Co., Inc.*, 149 A.2d 756, 759 (Del. Ch. 1959) (noting the adoption of a stock distribution plan by the directors was an exercise in their best business judgment)). *See also* *Gottlieb v. Heyden Chemical Corp.*, 90 A.2d 660, 663 (Del. 1952) (refusing to defer to the “sound business judgment of the directors” where a majority of the directors were conferring benefits upon themselves out of the assets of the corporation).

<sup>61</sup> F.M. Scherer, *Corporate Takeovers: The Efficiency Arguments*, 2 J. ECON. PERSP. 69, 69-70 (1988).

<sup>62</sup> *Id.*; Robin Marris, *A Model of the “Managerial” Enterprise*, 77 Q. J. OF ECON. 185, 189 (1963).

<sup>63</sup> Scherer, *supra* note 61, at 69-70.

<sup>64</sup> *Id.*

<sup>65</sup> Allen Boyer, *For the Love of Money*, 23 GA. L. REV. 827, 829-33 (1989) (book review) (quoting one corporate insider who worried about phone taps, electronic beams, and hidden cameras).

<sup>66</sup> Carol B. Swanson, *The Turn in Takeovers: A Study in Public Appeasement and Unstoppable Capitalism*, 30 GA. L. REV. 943, 969 (1996) (noting the public’s perception of popular books and movies on the subject of takeovers and the negative effects that takeovers had on labor).

<sup>67</sup> Matthew Winkler, David V. Hilder & James A. White, *The Party’s Over: Mounting Losses are Watershed Event for Era of Junk Bonds*, WALL ST. J., Sept. 18, 1989, at A1; Andrew Leckey, *Tune From Junk Heap Was Too Good To Be True*, CHIC. TRIB., Dec. 2, 1990, at C5.

<sup>68</sup> Springer, *supra* note 13, at 92-94.

<sup>69</sup> *Id.* at 94; Jeffrey N. Gordon, *Corporations, Markets, and Courts*, 91 COLUM. L. REV. 1931, 1938-39 n.21 (1991) (explaining defensive measures, including the poison pill and the flip-over); Swanson, *supra* note 66, at 977 (discussing poison pills, shark repellent amendments, and studies showing the negative economic effects of such mechanisms); Jeffrey N. Gordon, “Just Say Never?” *Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett*, 19 CARDOZO L. REV. 511, 511-13 (1997) (discussing poison pills, deadhand pills, and corporate bylaws).

<sup>70</sup> Swanson, *supra* note 66, at 978.

<sup>71</sup> *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458, 473 (D. Del. 1988).

<sup>72</sup> Swanson, *supra* note 66, at 978.

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<sup>73</sup> Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954, 955 (Del. 1985) (applying the business judgment rule and imposing the two conditions on Unocal’s attempt to resist a tender offer by Mesa Petroleum); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180, 182 (Del. 1986) (applying the business judgment rule to Revlon’s attempt to block a hostile takeover by Pantry Pride and allowing directors to consider non-shareholder constituencies if “there are rationally related benefits accruing to the stockholders[.]”); *BNS, Inc.*, 683 F. Supp. at 473-74.

<sup>74</sup> Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *BNS, Inc.*, 683 F. Supp. at 474.

<sup>75</sup> *BNS, Inc.*, 683 F. Supp. at 474.

<sup>76</sup> *Id.* at 474 (finding directors’ poison pill threat did not breach their fiduciary duty).

<sup>77</sup> Paramount Commc’ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

<sup>78</sup> *Id.* at 1147.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 1148.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* at 1149.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 1152.

<sup>85</sup> *Id.* at 1153-55.

<sup>86</sup> In re Citigroup Inc. S’holder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009).

<sup>87</sup> *Id.* at 124.

<sup>88</sup> *Id.* (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)) (internal quotation marks omitted).

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* See also Gantler v. Stephens, 965 A.2d 695, 705-06 (Del. 2009) (holding same).

<sup>91</sup> In re Citigroup, 964 A.2d at 139.

<sup>92</sup> No. 4349, 2010 Del. Ch. LEXIS 2 (Del. Ch. Jan. 11, 2010) (unpublished opinion).

<sup>93</sup> *Id.* at \*37 (“[S]ubstantive second-guessing of the merits of a business decision... is precisely the kind of inquiry that the business judgment rule prohibits.”) (citing In re Citigroup, 964 A.2d at 122).

<sup>94</sup> 970 A.2d 235, 239 (Del. 2009) (summarizing the plaintiffs’ claims as alleging the directors failed to obtain the best available price in selling the company).

<sup>95</sup> See DEL. CODE ANN. tit. 8, § 102(b)(7) (1999); *Lyondell*, 970 A.2d at 239.

<sup>96</sup> *Lyondell*, 970 A.2d at 239.

<sup>97</sup> See *id.* at 239-40.

<sup>98</sup> In re The Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006) (citing In re The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005)).

<sup>99</sup> *Lyondell*, 970 A.2d at 240 n.8.

<sup>100</sup> *Id.* at 243 (quoting In re The Walt Disney Co., 906 A.2d at 67) (internal quotations omitted).

<sup>101</sup> *Id.*

<sup>102</sup> In re Lear Corp. S’holder Litig., 967 A.2d 640, 654-55 (Del. Ch. 2008) (emphasis added; footnote omitted) (quoted with approval, *Lyondell*, 970 A.2d at 243).

<sup>103</sup> See, e.g., Dwight, *supra* note 48, at 34 (noting shareholder safeguards had “become either dead letters or the merest farce[.]”).

<sup>104</sup> William J. Carney, *The ALI’s Corporate Governance Project: The Death of Property Rights?*, 61 GEO. WASH. L. REV. 898, 922 n.126 (1993) (excluding financial institutions). See also Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968) (“The search for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack.”); Stuart R. Cohn, *Demise of the Director’s Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 591 n.1 (1983) (identifying seven “successful shareholder cases not dominated by elements of fraud or self-dealing[.]”).

<sup>105</sup> 765 A.2d 910 (Del. 2000).

<sup>106</sup> *Id.* at 922. See also In re Bridgeport Holdings, Inc., 388 B.R. 548, 569 (Bankr. D. Del. 2008) (denying defendants’ motions to dismiss the claims against the directors for breaches of fiduciary duties where the defendants allegedly “approved an uninformed fire-sale of the Company’s most valuable assets on the eve of bankruptcy[.]” (applying Delaware law); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 367 (Del. 1993) (holding the defendant directors, as a board, breached their duty of care by reaching an uninformed decision to approve the sale of the company).

<sup>107</sup> 914 A.2d 647 (Del. Ch. 2007). See also Teachers’ Retirement Sys. of La. v. Aidinoff, 900 A.2d 654, 675 (Del. Ch. 2006) (denying defendants’ motion to dismiss claims alleging self-dealing); In re LNR Property Corp., 896 A.2d 169, 176 (Del. Ch. 2005) (holding when a controlling shareholder stands on both sides of a transaction that shareholder has the

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burden of establishing the entire fairness of the transaction due to the inapplicability of the business judgment rule where self-interest may have colored directors' actions) (citing *Thorpe v. CERBCO*, 676 A.2d 436, 443 n.9 (Del. 1996)).

<sup>108</sup> 864 A.2d 80, 86 (Del. Ch. 2004). See also *Selheimer v. Manganese Corp. of Am.*, 423 Pa. 563, 580-81 (Pa. 1966) (implying directors who have been imprudent, wasteful, careless and negligent will be personally liable where such actions have resulted in corporate losses resulting in the insolvency of the corporation).

<sup>109</sup> See, e.g., Eric Dash & Julie Creswell, *Citigroup Pays for a Rush to Risk*, N.Y. TIMES, Nov. 23, 2008, at A1 (reporting Citigroup risk managers charged with overseeing deal makers eager to increase short-term earnings—and executives' multimillion-dollar bonuses—failed to rein them in).

<sup>110</sup> See, e.g., ROGER LOWENSTEIN, *ORIGINS OF THE CRASH: THE GREAT BUBBLE AND ITS UNDOING* 7 (2004); MARY O'SULLIVAN, *CONTESTS FOR CORPORATE CONTROL* 70 (2000) (“[The] alignment of the interests of the strategic managers of US public corporations with the demands of the stock market is now typically regarded as a defining feature of the market-oriented US system of corporate governance.”); Robert H. Hayes & William J. Abernathy, *Managing Our Way to Economic Decline*, 58 HARV. BUS. REV. 67, 67-68 (July-Aug. 1980) (arguing lower post-WWII productivity growth in the United States, compared to Germany and Japan, was due in part to management's focus on short-term cost reduction rather than long-term development of technological competitiveness); Michael E. Porter, *Capital Disadvantage: America's Failing Capital Investment System*, 70 HARV. BUS. REV. 65, 65 (Sept.-Oct. 1992) (concluding the innovative shortcomings of American businesses were the result of short time horizons, ineffective corporate governance, and high costs of capital—all symptoms of larger problems within the United States' capital investment system).

<sup>111</sup> Leslie Wayne, *Focus On: Stock Prices; A Look at New Corporate Tactics to Bolster the Value of Shares*, N.Y. TIMES, Feb. 26, 1984, § 3, at 6.

<sup>112</sup> See, e.g., In re Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009). (“This doctrine [the business judgment rule] also means, however, that when the company suffers losses, shareholders may not be able to hold the directors personally liable.”).

<sup>113</sup> See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 959 (Del. 1985).

<sup>114</sup> Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 680 (2007).

<sup>115</sup> *Id.* at 688 (concluding even when shareholder dissatisfaction with board actions and decisions is substantial, the evidence indicates challengers face considerable impediments to replacing boards). See also Rose A. Zukin, Comment, *We Talk, You Listen: Should Shareholders' Voices Be Heard or Stifled when Nominating Directors? How the Proposed Shareholder Director Rule Will Contribute to Restoring Proper Corporate Governance*, 33 PEPP. L. REV. 937, 941 (2006); *Facilitating Shareholder Director Nominations*, 74 Fed. Reg. 29,024, 29,026 (June 18, 2009) (proposed rule; to be codified at 17 CFR pts. 200, 232, 240, 249 & 274) (“[A]bsent an effective way for shareholders to exercise rights to nominate and elect directors . . . , the election of directors is a self-sustaining process of the board determining its members, with little actual input from shareholders[,] leaving directors “effectively unaccountable to shareholders . . . .” (footnote omitted).

<sup>116</sup> William K. Sjoström, Jr. & Young Sang Kim, *Majority Voting for the Election of Directors*, 40 CONN. L. REV. 459, 461 (2007).

<sup>117</sup> Arthur Levitt, Jr., *Stocks Populi*, WALL ST. J., Oct. 27, 2006, at A14.

<sup>118</sup> Sjoström, Jr. & Kim, *supra* note 116, at 461-62. Sjoström, Jr. and Kim conclude that despite 52% of S&P 500 and 45% of Fortune 500 corporations adopting majority voting as of February 2007, it has not provided shareholders any effective veto power over director candidates. *Id.* at 462-63.

<sup>119</sup> William K. Sjoström, Jr., *The Case Against Mandatory Annual Director Elections and Shareholders' Meetings*, 74 TENN. L. REV. 199, 216 (2007). Berle and Means reached a similar conclusion for companies with widely disbursed stock. Shareholder votes won't be meaningful unless voted in a block, through proxies; and the proxy committee is appointed by existing management. ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 81-82 (Harcourt, Brace & World, Inc. 1967) (1932). See also Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1260 (2009) (concluding same).

<sup>120</sup> See Elizabeth Cosenza, *The Holy Grail of Corporate Governance Reform*, 2007 B.Y.U.L. REV. 1, 49-54 (2007) (pointing to the corporate scandals of 2000 and 2001 and suggesting heightened shareholder oversight); *supra* notes 32-39 and accompanying text.

<sup>121</sup> Fairfax, *supra* note 119, at 1260-61.

<sup>122</sup> Jeff Kominsky, Note, *Access Granted: Proxies and the SEC*, 2 ENTREPEN. BUS. L.J. 573, 574 (2007).

<sup>123</sup> *Id.*

<sup>124</sup> *Id.* at 574-75.

<sup>125</sup> Securities Exchange Act § 14(a), 15 U.S.C. § 78n(a) (1934).

<sup>126</sup> 17 C.F.R. § 240.14a-8.

<sup>127</sup> *Id.* § 240.14a-8(i)(8).

<sup>128</sup> Bebchuk, *supra* note 114, at 688-91 (reviewing proxy-related costs associated with challenging incumbent directors).

<sup>129</sup> See, e.g., SCI Systems, Inc., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 875 (Aug. 14, 1992) (stating the SEC would not recommend action against a company that refused to allow a shareholder to include nominations to the board of directors in the company's proxy materials because it related "to an election to office"); Tylan Corp., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2530 (Sept. 25, 1987).

<sup>130</sup> Jeffrey N. Gordon, *Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy*, 61 VAND. L. REV. 475, 481 (2008).

<sup>131</sup> *Id.* at 481-82.

<sup>132</sup> *Id.* at 482.

<sup>133</sup> *Id.* at 483.

<sup>134</sup> *Id.* at 485 (footnote omitted).

<sup>135</sup> *Id.*; *Am. Fed'n State, County & Mun. Employees (AFSCME) v. Am. Int'l Group, Inc.*, 462 F.3d 121, 123 (2d Cir. 1998).

<sup>136</sup> *AFSCME*, 462 F.3d at 124.

<sup>137</sup> *Id.* at 125.

<sup>138</sup> *Id.* at 126.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*; Proposed Amendments to Rule 14a-8, Exchange Act Release No. 34-12598, 41 Fed. Reg. 29,982, 29,9845 (proposed July 7, 1976).

<sup>142</sup> *AFSCME*, 462 F.3d at 127-29.

<sup>143</sup> *Id.* at 129.

<sup>144</sup> *Id.* at 129-30.

<sup>145</sup> J. Robert Brown, Jr., *The SEC, Corporate Governance and Shareholder Access to the Board Room*, 2008 UTAH L. REV. 1339, 1369 (2008); Broc Romanek & Dave Lynn, *Monday's Conference: A Last Few Points*, Sept. 8 2006, <http://www.thecorporatecounsel.net/blog/archive/001221.html>; see also Commission Calendars Proposed Amendment to Rule 14a-8 Governing Director Nominations by Shareholders, Sept. 7, 2006, <http://www.sec.gov/news/press/2006/2006-150.htm>.

<sup>146</sup> Marilyn B. Cane & Stacey L. Silva, *Shareholder Democracy and the SEC's Proxy Rules: In the Boardroom*, 15 FORDHAM J. CORP. & FIN. L. 241, 243-44 (2009).

<sup>147</sup> *Id.*; Brown, Jr., *supra* note 145, at 1369-72.

<sup>148</sup> Press Release, Securities and Exchange Commission, SEC Votes to Propose Amendment to Facilitate Rights of Shareholders to Nominate Directors, May 20, 2009, <http://www.sec.gov/news/press/2009/2009-116.htm>; Cane & Silva, *supra* note 146, at 244.

<sup>149</sup> Facilitating Shareholder Director Nominations, *supra* note 115. The proposed rule would permit owners of between 1%-5% of an exchange-traded corporation's voting stock, who have held the stock at least one year, to be able to include their nominees for director in the company's proxy materials unless the shareholders are otherwise prohibited—either by applicable state law or a company's charter/bylaws—from nominating a candidate for election as a director. *Id.*, 74 Fed. Reg. at 29,025; Press Release, Securities and Exchange Commission, *supra* note 148. The proposed rule would not apply to contests for control of the board—shareholders would be limited to nominating just one director or nominees that represent 25% of the board, whichever is greater. Facilitating Shareholder Director Nominations, *supra* note 115, 74 Fed. Reg. at 29,043. In addition, the SEC has proposed a revision to Rule 14a-8(i)(8) so it would not restrict the types of amendments a shareholder could propose to a company's governing documents to address the company's provisions regarding nomination procedures or disclosures related to shareholder nominations (as long as any such proposals do not conflict with proposed Rule 14a-11 or state law). *Id.* at 29,056.

<sup>150</sup> S. 3217, 111th Cong. § 972(b) (Apr. 15, 2010) (amending 15 U.S.C. § 78n(a)). The bill leaves it to the discretion of the SEC to determine the terms and conditions for the proxy access. *Id.*

<sup>151</sup> S. 1074, 111th Cong. (May 19, 2009).

<sup>152</sup> *Id.* at § 4. The Act would also require issuers, to remain listed on stock exchanges, to elect a Chairperson of the Board of Directors who is not currently serving, and has not previously served, as an executive officer of the issuer, eliminate staggered boards, elect board members only by a majority of shareholder votes cast, and maintain a risk committee comprised entirely of independent directors, responsible for the risk management practices of the issuer. *Id.* at § 5.

<sup>153</sup> H.R. 2861, 111th Cong. § 16A(b) (June 12, 2009).

<sup>154</sup> <http://www.govtrack.us/congress/bill.xpd?bill=s111-1074> (Shareholder Bill of Rights Act of 2009) (last visited May 7, 2010); <http://www.govtrack.us/congress/bill.xpd?bill=h111-2861> (Shareholder Empowerment Act of 2009) (last visited May 7, 2010).

<sup>155</sup> 77 Del. Laws 14 (2009); DEL. CODE ANN. tit. 8, §§ 112 & 113 (2009).

<sup>156</sup> See, e.g., Eliot Spitzer, *Seize Power, Shareholders*, SLATE.COM (March 16, 2010 2:53 EST), <http://www.slate.com/id/2247592/>.

<sup>157</sup> Regarding the SEC's 2007 shareholder proxy access proposal, see Cane & Silva, *supra* note 146, at 249 (“[S]ome commentators observed ‘the regulatory approach taken in the Proposal [was] unnecessarily complex and in some aspects poorly aligned with shareholder interests.’” (quoting Comment Letter from John C. Wilcox, Sr. Vice President, Head of Corporate Governance & Hye-Wo Choi, Vice President and Assoc. Gen. Counsel, Corporate Governance, Teachers Ins. and Annuity Ass’n of Am., to Nancy M. Morris, Secretary, SEC (Sept. 20, 2007), available at <http://www.sec.gov/comments/s7-16-07/s71607-199.pdf>)). See also *infra* Section III.B.

<sup>158</sup> See Comments by Professor Michael Bradley, in *Edited Transcript of Proceedings of the Business Roundtable—Emory University Law and Economics Center Conference on Remedies Under the ALI Proposals: Law and Economics*, 71 CORNELL L. REV. 357, 361 (1986) (“Comments were made about the ravages in the market for corporate control and all of the abuses, but there has been no articulation of the problems at hand.”).

<sup>159</sup> Craig Owen White, *Corporate Governance: Directors vs. Shareholders?*, 55 CASE W. RES. L. REV. 569, 574 (2005).

<sup>160</sup> *Id.* at 576.

<sup>161</sup> Lucian Ayre Bebchuk, *The Case for Shareholder Access: A Response to the Business Roundtable*, 55 CASE W. RES. L. REV. 557, 561 (2005) (providing an example of why selling shares in response to poor board performance is an inadequate remedy).

<sup>162</sup> White, *supra* note 159, at 576. But see *supra* notes 32-35 and accompanying text; *infra* Section III.C.1.

<sup>163</sup> White, *supra* note 159, at 576.

<sup>164</sup> *Id.* at 578-79. “The monopoly of communicating with shareholders through the formal proxy mechanism once held by corporations has been left in tatters by the Internet, web pages, e-mail, group mail, and now ‘blogs.’” *Id.* at 579.

<sup>165</sup> Gordon, *supra* note 130, at 475-76 (citing Shareholder Choice Regarding Proxy Materials, Exchange Act Release No. 56,135, Investment Company Act Release No. 27,911, 72 Fed. Reg. 42,222 (Aug. 1, 2007)).

<sup>166</sup> *Id.* at 487-91.

<sup>167</sup> See *infra* Section III.C.3.

<sup>168</sup> William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 658-60 (2010).

<sup>169</sup> *Id.*

<sup>170</sup> *Id.* at 660.

<sup>171</sup> *Id.* at 720-23. Bratton and Wachter conclude “[s]hareholder power was a part of the problem and is not a part of the solution.” *Id.* at 723.

<sup>172</sup> See *supra* note 169 and accompanying text.

<sup>173</sup> Michael E. Porter & Rebecca Wayland, *Capital Disadvantage: America's Failing Capital Investment System*, 70 HARV. BUS. REV. 65, 76 (Sept.-Oct. 1992); Charles W.L. Hill, Michael A. Hitt, & Robert E. Hoskisson, *Declining U.S. Competitiveness: Reflections on a Crisis*, 2 ACAD. MGMT. EXECUTIVE 51, 51, 56 (1988).

<sup>174</sup> Lewis J. Sundquist III, Comment, *Proposal to Allow Shareholder Nomination of Corporate Directors: Overreaction in Times of Corporate Scandal*, 30 WM. MITCHELL L. REV. 1471, 1494-95 (2004). See also Comments of Wachtell, Lipton, Rosen, & Katz (June 11, 2003), <http://www.sec.gov/rules/other/s71003/wachtell061103.htm>; Facilitating Shareholder Director Nominations, *supra* note 115, 74 Fed. Reg. at 29,026 (noting concerns that shareholder-nominated directors may act on behalf of a small number of shareholders and that such directors may disrupt the functioning of the board).

<sup>175</sup> Sundquist III, *supra* note 174, at 1495.

<sup>176</sup> See Stephen M. Bainbridge, Response, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1757 n.113 (2006); Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 1, 43 (1988) (arguing shareholders may be “rationally apathetic[.]” in that the “cost of informing oneself sufficiently to cast an intelligent vote on a management proposal frequently exceeds the expected payoff[.]”).

<sup>177</sup> William J. Feis, *Is Shareholder Democracy Attainable?*, 31 BUS. LAW. 621, 640 (1976); Posting of Charles M. Nathan to Harv. Law School Forum on Corp. Gov. & Fin. Reg. (Jan. 13, 2010, 09:14), <http://blogs.law.harvard.edu/corpgov/2010/01/13/pros-and-cons-of-voluntarily-implementing-proxy-access/>.

<sup>178</sup> See Robert J. Haft, *Business Decisions by the New Board: Behavioral Science and Corporate Law*, 80 MICH. L. REV. 1, 22-24 (1981); Facilitating Shareholder Director Nominations, *supra* note 115, 74 Fed. Reg. at 29,026 (citing comment letters on 2007 Proposals from Thomas Wilson, President, The Allstate Corporation (Oct. 2, 2007), David T. Hirschmann, Senior Vice President, U.S. Chamber of Commerce (Oct. 2, 2007), and Anne M. Mulcahy, Chairman, Business Roundtable Corporate Governance Task Force, Business Roundtable (Oct. 1, 2007)).

<sup>179</sup> Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 743-48 (2007) (arguing this point, in addition to shareholder myopia, weakened board decisionmaking, and deterrence of qualified directors from serving on boards); Comment Letter on 2007 Proposals from Anne M. Mulcahy, *supra* note 178.

<sup>180</sup> Latham & Watkins LLP, Corporate Governance Commentary, Proxy Access Analysis No. 5, at 2 (Dec. 7, 2009), available at [http://www.georgeson.com/usa/download/reports/CorpGovCommentary\\_120709.pdf](http://www.georgeson.com/usa/download/reports/CorpGovCommentary_120709.pdf); see also ABA's Federal

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*Regulation of Securities Panel Opposes Proposed Direct Shareholder Access*, 36 Sec. Reg. & L. Rep. (BNA) 99 (Jan. 19, 2004) (arguing access risks damaging contests, discourages impartial consideration by nominating committees, and allows activist shareholders to dominate the process).

<sup>181</sup> White, *supra* note 159, at 572-73.

<sup>182</sup> *Id.* at 572 (speculating corporations could be held hostage by special interest shareholders).

<sup>183</sup> *Id.* at 578.

<sup>184</sup> Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 289 (1980); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982).

<sup>185</sup> Homer Kripke, *The SEC, Corporate Governance and the Real Issues*, 36 BUS. LAW. 173, 175-78 (1981).

<sup>186</sup> White, *supra* note 159, at 572.

<sup>187</sup> *Id.*; Comments of Task Force on Shareholder Proposals, Section of Business Law of the American Bar Association (June 13, 2003), at <http://www.sec.gov/rules/other/s71003/aba061303.htm> (arguing corporations are not political entities); Comments of American Society of Corporate Secretaries (June 13, 2003), at <http://www.sec.gov/rules/other/s71003/ascs061303.htm> (arguing the different duties stemming from corporate and state elections show they are not analogous).

<sup>188</sup> Lipton & Savitt, *supra* note 179, at 744-45; White, *supra* note 159, at 572-73; Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 575 (2006).

<sup>189</sup> Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1257-58, 1281-83, 1294-96 (2008) (arguing shareholder empowerment must be accompanied by new shareholder duties to prevent abuse); Sundquist III, *supra* note 174, at 1494 (noting access may give power to a few special-interest investors, hurting democracy); Comment Letter from Keith F. Higgins, Committee Chair, Comm. on Fed. Reg. of Sec. of A.B.A., Sec. of Bus. L., to Nancy M. Morris, Secretary, U.S. Sec. & Exch. Comm'n, on Shareholder Proposals in Release Nos. 34-56160 and 34-56161 (Oct. 2, 2007), available at <http://www.sec.gov/comments/s7-17-07/s71707-126.pdf> (arguing access hurts the rights of other shareholders who are also entitled to management time and focus).

<sup>190</sup> Posting of Charles M. Nathan, *supra* note 177.

<sup>191</sup> See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 304-05 (1999).

<sup>192</sup> See *id.* at 253-54, 286; John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443, 1446 (1994); Lynn Stout & Iman Anabtawi, *Sometimes Democracy Isn't Desirable*, WALL ST. J., Aug. 10, 2004, at B2.

<sup>193</sup> White, *supra* note 159, at 577 (2005).

<sup>194</sup> Sundquist III, *supra* note 174, at 1497 (“A [federal] rule that allows shareholders direct access to a proxy statement for nomination purposes arguably could violate state law because state law grants nominations to the board.”) (footnote omitted).

<sup>195</sup> *Id.* at 1497-98.

<sup>196</sup> Letter from Jeffrey W. Rubin, Chair of the ABA Committee on Federal Regulation of Securities, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, at 7-8 (Aug. 31, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-456.pdf>.

<sup>197</sup> Latham & Watkins LLP, *Corporate Governance Commentary, Proxy Access Analysis No.4*, at 5-6 (Nov. 3, 2009), available at [http://www.georgeson.com/usa/download/reports/CorpGovCommentary\\_110309.pdf](http://www.georgeson.com/usa/download/reports/CorpGovCommentary_110309.pdf).

<sup>198</sup> *Id.*; Letter from Jeffrey W. Rubin, *supra* note 196, at 4-5 (arguing the SEC should defer prescriptive access in response to flexibility concerns).

<sup>199</sup> Latham & Watkins LLP, *supra* note 197, at 5.

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

<sup>204</sup> Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488, 43,490-93 (Aug. 3, 2007).

<sup>205</sup> Latham & Watkins LLP, *supra* note 197, at 6.

<sup>206</sup> Letter from Jeffrey W. Rubin, *supra* note 196, at 4-5; Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L.J. 205, 260-63 (2005); Posting of Charles M. Nathan, *supra* note 177.

<sup>207</sup> McDonnell, *supra* note 206, at 260-61. See also *id.* at 261-62 (noting—but dismissing—problems with the optional approach, including the possibilities the bylaws may not be binding under state law, companies could avoid implementing a proposal by requiring the board to approve shareholder nominees, and the rule would result in a confusing number of company-specific rules); STAFF REPORT: REVIEW OF THE PROXY PROCESS REGARDING THE NOMINATION AND ELECTION OF DIRECTORS 26, 30 (July 15, 2003), available at <http://www.sec.gov/news/studies/proxyrpt.htm> (discussing advantages and disadvantages of a bylaw approach).

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<sup>208</sup> Blake Smith, Note, *Proxy Access and the Internet Age: Using Electronic Shareholder Forums to Improve Corporate Governance*, 2008 COLUM. BUS. L. REV. 1111, 1133-40 (2008).

<sup>209</sup> For general defenses of shareholder democracy, see Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43 (2003); Bebchuk, *supra* note 161; Letter from James E. Heard, Chief Executive Officer in Institutional Shareholder Services, to Jonathan G. Katz, Secretary of U.S. Securities and Exchange Commission (June 13, 2003), available at <http://www.sec.gov/rules/other/s71003/iss061303.htm>; 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 (1994).

<sup>210</sup> Goforth, *supra* note 209, at 448-50.

<sup>211</sup> Fairfax, *supra* note 119, at 1260 (“Shareholder advocates have long considered proxy access to be the ‘holy grail’ of shareholder democracy.”) (quoting Karey Wutkowski, *SEC to Look Outside Ballot on Proxy Access*, REUTERS, Jan. 4, 2008, <http://www.reuters.com/articlePrint?articleId=USN1741224720080104>); Lisa M. Fairfax, *Shareholder Democracy on Trial: International Perspective on the Effectiveness of Increased Shareholder Power*, 3 VA. L. & BUS. REV. 1, 7-8 (2008). For broader discussions of the concept of corporate democracy, see Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1509-10 (2006); Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1390 (2006); Thomas W. Joo, Comment, *Corporate Governance and the “D-Word,”* 63 WASH. & LEE L. REV. 1579, 1587 (2006).

<sup>212</sup> See Fairfax, *supra* note 119, at 1260-61; Jayne W. Barnard, *Shareholder Access to the Proxy Revisited*, 40 CATH. U. L. REV. 37, 39 & n.12 (1990) (quoting E. EPSTEIN, WHO OWNS THE CORPORATION 13 (1986) (“[Corporate elections] are procedurally much more akin to the elections held by the Communist party of North Korea than those held in Western democracies.”)); Melvin Aron Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1504 (1970).

<sup>213</sup> Facilitating Shareholder Director Nominations, *supra* note 115, 74 Fed. Reg. at 29,025-26.

<sup>214</sup> Goforth, *supra* note 209, at 434-37.

<sup>215</sup> Fairfax, *supra* note 119, at 1267-68.

<sup>216</sup> See Bebchuk, *supra* note 161, at 561.

<sup>217</sup> Brown, Jr., *supra* note 145, at 1380-82.

<sup>218</sup> Fairfax, *supra* note 119, at 1305-06 (arguing E-proxy, majority voting, electronic shareholder forums, and board declassification fail). See also Comment Letter from Michelle Edkins, Acting Chairman, ICGN S’holder Rights Comm., to Nancy M. Morris, Secretary, U.S. Sec. & Exch. Comm’n, on Shareholder Proposals in Release Nos. 34-56160 and 34-56161 (Oct. 2, 2007), available at <http://www.sec.gov/comments/s7-16-07/s71607-462.pdf> (“[Electronic shareholder forums are] an enhancement to rather than a replacement for more formal channels of communication between shareholders and companies, such as the general meeting and the proxy process.”).

<sup>219</sup> Goforth, *supra* note 209, at 447; Barnard, *supra* note 212, at 84-85.

<sup>220</sup> Fairfax, *supra* note 119, at 1305.

<sup>221</sup> *Id.* at 1305-06.

<sup>222</sup> Goforth, *supra* note 209, at 438-40.

<sup>223</sup> Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 842-43 (2005).

<sup>224</sup> Cane & Stacey, *supra* note 146, at 241-42.

<sup>225</sup> *Id.* at 242; Comment Letter from Knut Kjer, CEO, Norges Bank Inv. Mgmt., et al., to Christopher Cox, Chairman, U.S. Sec. & Exch. Comm’n (Sept. 28, 2007), available at <http://www.sec.gov/comments/s7-16-07/s71607-499.pdf>; accord Finlay on Governance, Question for Lehman Brothers Board: Why Are You Still There? (June 10, 2008), <http://www.finlayongovernance.com/?p=485>.

<sup>226</sup> Brown, Jr., *supra* note 145, at 1339-42.

<sup>227</sup> Barnard, *supra* note 212, at 37-41.

<sup>228</sup> Goforth, *supra* note 209, at 414-30.

<sup>229</sup> *Id.* at 432-34.

<sup>230</sup> See Comm. on Capital Mkts. Regulation, Interim Report 93 (Nov. 30, 2006), available at [http://www.capmksreg.org/pdfs/11.30Committee\\_Interim\\_ReportREV2.pdf](http://www.capmksreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf) (arguing shareholder empowerment will provide accountability, which lowers agency costs, raise share value, improve competitive equity, require more market discipline on the part of managers, and allow for less regulation and litigation); Barnard, *supra* note 212, at 90-92 (arguing competition for directorial positions energizes board decisionmaking, stops incumbent entrenchment, allows institutions to apply their expertise to troubled companies, allows shareholders to take action to stop harm from mismanagement before it occurs, and increases share value); Peter Dodd & Jerold B. Warner, *On Corporate Governance: A Study of Proxy Contests*, 11 J. FIN. ECON. 401, 435 (1983) (arguing proxy contests have a positive effect on share prices).

<sup>231</sup> See Fairfax, *supra* note 211, at 25 (noting international evidence from the United Kingdom, as well as possible limitations to the applicability of the study) (citing MARCO BECHT ET AL., RETURNS TO SHAREHOLDER ACTIVISM: EVIDENCE FROM A CLINICAL STUDY OF THE HERMES U.K. FOCUS FUND 6-7 (Eur. Corp. Governance Inst., Finance Working Paper No. 138, 2006), available at <http://homepage.univie.ac.at/Klaus.Gugler/public/SSRN-id934712.pdf>) (last visited May 7, 2010).

<sup>232</sup> See Bratton & Wachter, *supra* note 168, at 656-57.

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<sup>233</sup> *Id.* (citing The Causes and Effects of the Lehman Brothers Bankruptcy: Hearing Before the H. Comm. on Oversight and Gov't Reform, 110th Cong. 4 (2008) (statement of Nell Minow, Editor, The Corporate Library); Luigi Zingales, *The Future of Securities Regulation*, at 24-27 (Chi. Booth Sch. of Bus., Working Paper No. 08-27, 2009), available at <http://ssrn.com/abstract=1319648>) (last visited May 7, 2010).

<sup>234</sup> Arthur Levitt, Jr., *How to Boost Shareholder Democracy*, WALL. ST. J., July 1, 2008, at A17.

<sup>235</sup> See Roger Lowenstein, *A Seat at the Table*, N.Y. TIMES MAGAZINE, June 7, 2009, at 11; Goforth, *supra* note 209, at 440-41.

<sup>236</sup> See *supra* Section III.B.3.

<sup>237</sup> See, e.g., Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of the New Corporate Governance in Theory and Practice*, 34 DEL. J. CORP. L. 139, 175-79 (2009) (responding to a series of objections leveled against shareholder proxy access by Professor Bainbridge).

<sup>238</sup> *Id.* at 176.

<sup>239</sup> Goforth, *supra* note 209, at 450-53. "The simplest approach would be to limit the total number of nominations that a corporation must include in the proxy materials." *Id.* at 452. The current SEC proxy access proposal limits shareholder nominations to just one director or nominees that represent 25% of the board, whichever is greater. Facilitating Shareholder Director Nominations, *supra* note 115, 74 Fed. Reg. at 29,043.

<sup>240</sup> Barnard, *supra* note 212, at 88-89.

<sup>241</sup> McDonnell, *supra* note 237, at 177.

<sup>242</sup> *Id.* at 176-77.

<sup>243</sup> *Id.* at 178-79. See also Fairfax, *supra* note 211, at 28-29 (acknowledging the problems of hedge fund influence, but arguing other institutional investors that are interested in corporate democracy may check them; citing evidence of that effect from Germany).

<sup>244</sup> See *supra* Section III.B.3.

<sup>245</sup> Henry G. Manne, *Some Theoretical Aspects of Share Voting*, 64 COLUM. L. REV. 1427, 1440-41 (1964); Goforth, *supra* note 209, at 442; Gordon, *supra* note 176, at 43; Bainbridge, *supra* note 176.

<sup>246</sup> Goforth, *supra* note 209, at 443.

<sup>247</sup> *Id.* at 442-43.

<sup>248</sup> *Id.* at 443.

<sup>249</sup> Barnard, *supra* note 212, at 79-84 (noting factors, including the end of the junk bond market and the rise of institutional investors investing in equity, regulatory oversight of the voting behavior of institutional investors, and mechanisms for lowering the cost of information gathering and voting).

<sup>250</sup> Fairfax, *supra* note 211, at 23.

<sup>251</sup> *Id.* at 23-24.

<sup>252</sup> See Haft, *supra* note 178, at 22-24 (citing empirical evidence that outside voices can cause board disagreement, causing ineffective decisionmaking).

<sup>253</sup> Goforth, *supra* note 209, at 443-44.

<sup>254</sup> See, e.g., New York Stock Exchange Rule 303A.01 which requires listed companies to have a majority of independent directors (Nov. 29, 2009), available at [http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?searched=1&selectednode=chp\\_1\\_4\\_3\\_1&CiRestriction=303A&manual=%2Ffcm%2Fsections%2Ffcm-sections%2F](http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?searched=1&selectednode=chp_1_4_3_1&CiRestriction=303A&manual=%2Ffcm%2Fsections%2Ffcm-sections%2F).

<sup>255</sup> Goforth, *supra* note 209, at 444-45.

<sup>256</sup> See, e.g., I. JANIS, GROUPTHINK: PSYCHOLOGICAL STUDIES OF POLICY DECISIONS AND FIASCOES 9 (2d ed. 1982).

<sup>257</sup> Barnard, *supra* note 212, at 78-79.

<sup>258</sup> *Id.* at 75.

<sup>259</sup> Goforth, *supra* note 209, at 450-53 (suggesting shareholders be allowed to nominate no more than one-fourth of directors at a meeting and that short-term investors be barred from nominating directors); Facilitating Shareholder Director Nominations, *supra* note 115, 74 Fed. Reg. at 29,043 (proposing shareholder nominations be limited to just one director or nominees that represent 25% of the board, whichever is greater).

<sup>260</sup> Barnard, *supra* note 212, at 76.

<sup>261</sup> See *supra* Section III.B.3.; Samuel B. Graves & Sandra A. Waddock, *Institutional Ownership and Control: Implications for Long-Term Corporate Strategy*, 4 ACAD. MGMT. EXECUTIVE 75, 76, 78 (1990).

<sup>262</sup> Goforth, *supra* note 209, at 446; see also Rahul Kochhar & Parthiban David, *Institutional Investors and Firm Innovation: A Test of Competing Hypotheses*, 17 STRATEGIC MGMT. J. 73, 81-82 (1996) (arguing institutional investors are able to reward long-term company performance).

<sup>263</sup> Goforth, *supra* note 209, at 446.

<sup>264</sup> Brown, Jr., *supra* note 145, at 1380. See also Barnard, *supra* note 212, at 86-88 (arguing having some shareholder-nominated directors will not pose any more risk of short-termism than pure incumbent boards and that staggered boards may solve the problem).

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<sup>265</sup> Lowenstein, *supra* note 235; Zingales, *supra* note 233, at 24-27 (arguing shareholder nominations will channel shareholder interests into long-term values); Goforth, *supra* note 209, at 440-41 (arguing proxy access solves the “Wall Street Effect” problem of high investor turnover and short-term investing by providing an alternate remedy to selling stock).

<sup>266</sup> See *supra* Section III.B.5.

<sup>267</sup> See *supra* Section III.D.3.

<sup>268</sup> See McDonnell, *supra* note 237, at 176.

<sup>269</sup> Fairfax, *supra* note 211, at 31 (citing Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1459 (2006); Anabtawi, *supra* note 188, at 579-80; Matheson & Olson, *supra* note 192, at 1487)).

<sup>270</sup> *Id.* (discussing the United Kingdom, where institutional investors pressured managers to engage in socially responsible conduct).

<sup>271</sup> *Id.*

<sup>272</sup> See, e.g., Facilitating Shareholder Director Nominations, *supra* note 115.

The nation and the markets have recently experienced, and remain in the midst of, one of the most serious economic crises of the past century. This crisis has led many to raise serious concerns about the accountability and responsiveness of some companies and boards of directors to the interests of shareholders, and has resulted in a loss of investor confidence. These concerns have included questions about whether boards are exercising appropriate oversight of management, whether boards are appropriately focused on shareholder interests, and whether boards need to be more accountable for their decisions regarding such issues as compensation structures and risk management.

*Id.*, 74 Fed. Reg. at 29,025. See also Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. § 2 (May 19, 2009) (finding “among the central causes of the financial and economic crises that the United States faces today has been a widespread failure of corporate governance[,] ... [and] a key contributing factor to such failure was the lack of accountability of boards to their ultimate owners, the shareholders[.]...”).

<sup>273</sup> Davis, Jr., *supra* note 1, at 8.

<sup>274</sup> See *supra* note 40 and accompanying text.

<sup>275</sup> See *supra* notes 116-119 and accompanying text.

<sup>276</sup> Who knew corporate governance could be such a controversial subject? For example, commentators argue the American Law Institute’s final approval of its Principles of Corporate Governance in 1992 was the most controversial endeavor in the history of ALI, let alone corporate law. See, e.g., Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 461 (1992) (describing the undertaking as the most controversial in the Institute’s history); William J. Carney, *The ALI’s Corporate Governance Project: The Death of Property Rights*, 61 GEO. WASH. L. REV. 898, 898 (1993) (describing the approval of the ALI Principles of Corporate Governance as the most controversial event in the history of American corporate law). See also Lawrence E. Mitchell, *Private Law, Public Interest?*, 61 GEO. WASH. L. REV. 871, 872-73 (1993) (arguing since the ALI Principles of Corporate Governance lack a coherent theory of the corporation the “cannot, and do not, satisfy anyone[.]”) (footnote omitted). See generally AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994).

<sup>277</sup> See generally, Marco Becht & J. Bradford DeLong, *Why Has There Been So Little Block Holding in America?*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 653-57 (Randall K. Morck ed., 2005) (tracing the history of different classes of shares with different voting rights in U.S. corporations).

<sup>278</sup> See, e.g., Colleen A. Dunlavy, *From Citizens to Plutocrats: Nineteenth-century Shareholder Voting Rights and Theories of the Corporation*, in CONSTRUCTING CORPORATE AMERICA: HISTORY, POLITICS, CULTURE 66, 67 (Kenneth Lipartito & David B. Sicilia eds., 2004) (noting it was not until the middle of the nineteenth century that it was common for shareholder voting to be based on the number of shares owned); Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347 (2006) (contrasting voting rights between U.S. and European corporations).

<sup>279</sup> See, e.g., Mitchell, *supra* note 211, at 1506 (arguing the rhetoric of shareholder democracy has been used to champion broader goals than the role of the shareholder in the corporation).

<sup>280</sup> BERLE & MEANS, *supra* note 119, at 112-13.

<sup>281</sup> Joo, *supra* note 211, at 1584.

<sup>282</sup> *Id.* at 1585.

<sup>283</sup> See Lucas E. Morel, *The Separation of Ownership and Control in Modern Corporations: Shareholder Democracy or Shareholder Republic?*, 63 WASH. & LEE L. REV. 1593, 1593 (2006).

<sup>284</sup> See *supra* note 5; Sundquist III, *supra* note 174, at 1490-91 (using the “Wall Street Walk” as a distinguishing factor between shareholder democracy and governmental democracy in that participation in a corporation—i.e., owning shares—is voluntary).

<sup>285</sup> Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187 (1991).

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<sup>286</sup> *Id.* at 191-92.

<sup>287</sup> *See supra* notes 21-23 and accompanying text.

<sup>288</sup> Lipton & Rosenblum, *supra* note 285, at 192-93.

<sup>289</sup> *Id.* at 193. *See also supra* note 23 and accompanying text.

<sup>290</sup> Lipton & Rosenblum, *supra* note 285, at 192-93.

<sup>291</sup> *Id.*

<sup>292</sup> *Id.* at 194 (“Just as the bettor does not really care about the fate of the racehorse as long as it provides him a financial payoff, so too the stockholder/investor does not really care about the fate of the corporation as long as the stock generates a profit.”).

<sup>293</sup> Bainbridge, *supra* note 176, at 1745 (citing KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 68-70 (1974)).

<sup>294</sup> *Id.*

<sup>295</sup> *Id.* (explaining the opportunity cost entailed in making informed decisions is significant while the expected benefits of becoming informed are quite low, since most shareholders’ holdings are too small to have significant effects on a vote’s outcome).

<sup>296</sup> *Id.* at 1475-76.

<sup>297</sup> *See supra* Section II.B.

<sup>298</sup> *See, e.g.*, Comments of Task Force on Shareholder Proposals, Section of Business Law of the American Bar Association, *supra* note 187 (asserting “[t]he modern publicly held corporation is primarily an economic entity whose function is to create wealth for its owners (institutional or individual)[,]” yet stating “[t]he distribution among shareholders under corporate law of voting power and the right to receive dividends reflect . . .” that function); Lipton & Rosenblum, *supra* note 285, at 194 (stating “stockholders deserve a prominent voice in corporate governance[.]”) (footnote omitted). Lipton & Rosenblum argue that corporate governance systems must consider stockholders, the corporation, other stakeholders, and the health of the economy and society as a whole. *Id.* at 195.

<sup>299</sup> *See supra* note 24 and accompanying text.

<sup>300</sup> *Schoon v. Smith*, 953 A.2d 196, 206 (Del. 2008) (citing *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939)).

<sup>301</sup> *See supra* notes 26-29 and accompanying text.

<sup>302</sup> *See supra* note 48.

<sup>303</sup> Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *HOFSTRA L. REV.* 89, 167 (2004).

<sup>304</sup> *See supra* note 48.

<sup>305</sup> *See supra* note 49 and accompanying text.

<sup>306</sup> *See supra* Section II.B.

<sup>307</sup> *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 959 (Del. 1985).