

IMPROVING DIRECTOR ELECTIONS

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It is well known that U.S. director elections are largely a formality: incumbents typically nominate themselves, for elections that are almost always uncontested, and are re-elected with virtual certainty. The result, as illustrated by the recent debacle at J.P. Morgan Chase, is what one might expect: directors who are elected not for their qualifications but rather because shareholders simply have no other choice. In the aftermath of the 2008/2009 financial crisis, efforts were made to improve corporate democracy. The introduction of majority voting, the introduction of eProxy rules, and elimination of broker voting of uninstructed shares were predicted to dramatically improve the vibrancy of the director election process. Our analysis, based primarily on data from the 2007–2011 proxy seasons, indicates that these reforms have been ineffective in achieving their stated goals. Specifically, we find that: (1) only two incumbent directors who did not receive a majority of the votes cast have actually left their boards; (2) not a single insurgent candidate has made use of eProxy; and (3) only one director election outcome has changed due to the elimination of broker voting of uninstructed shares. We also find no evidence that these reforms have influenced the “shadow” negotiation between the board and major shareholders in favor of shareholders. In contrast to these reforms, our research suggests that a properly designed proxy access regime has the potential to meaningfully improve the director election process at U.S. corporations.

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INTRODUCTION

Among the Russell 3000 companies¹ in 2011, 16,822 candidates were nominated for 16,797 board seats.² 16,796 of these candidates were proposed by the incumbent directors, leaving 26 candidates proposed by shareholders. Among the candidates proposed by the incumbents, the candidates were almost always the incumbents themselves. The success rate for these incumbent candidates was 99.9%, compared to 46% for the candidates proposed by shareholders.³

Although these statistics will not surprise those who study or participate in corporate elections, they may startle those who study democracy generally. Only 69 director seats, or 0.4% of total director elections, presented a choice for shareholders of U.S. companies in 2011.⁴ Additionally, the challengers in these 0.4% of contests faced an uphill battle because of certain systematic biases in the corporate voting process that favor incumbents. As former SEC chairman Arthur Levitt, Jr. famously put it: “A director has a better chance of being struck by lightning than losing an election.”⁵

Lack of choice has consequences. One example is the recent debacle involving J.P. Morgan Chase (“JPM” or “JPMorgan”) and the “London Whale.” In May 2012, JPMorgan announced \$2 billion in trading losses that JPM CEO Jamie Dimon attributed to a “Risk 101” mistake.⁶ While there is plenty of blame to go around, starting with the individual trader and going all the way to Dimon, one question is why the JPM shareholders would have elected, by overwhelming majorities and for five consecutive years, the three directors on the JPM Risk Committee who lacked risk management expertise. The answer is that the JPM shareholders had no other choice.

A core tenet throughout the Western world is that a vibrant democracy leads to better governance. In the corporate law context, this means that more meaningful director elections lead to better directors and better corporate governance, either because the incumbent directors are more vigilant (i.e., *ex ante* effects) or the election process weeds out ineffective directors in favor of new blood (*ex post* effects). More than separation of Chairman and CEO, independent director requirements, “Say on Pay,” and other high

¹ The Russell 3000 includes the 3,000 largest U.S. public companies, as measured by market capitalization. The companies in the Russell 3000 account for approximately 98% of U.S. public equity.

² *Voting Analytics*, INST. S’HOLDER SERV., http://www.issgovernance.com/voting_analytics (last visited January 15, 2013) (statistics based on authors’ calculations).

³ *Id.* (statistics based on authors’ calculations).

⁴ *Id.* (statistics based on authors’ calculations).

⁵ Arthur Levitt, Jr., *Stocks Populi*, WALL ST. J., Oct. 27, 2006, at A14. To be clear, the phenomenon we are describing is by no means new. *See, e.g.*, Melvin Aron Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1503–1504 (1970) (noting the perfunctory nature of corporate elections).

⁶ Erik Schatzker, Dawn Kopecki & Bradley Keoun, *House of Dimon Marred by CEO Complacency Over Unit’s Risk*, BLOOMBERG (June 12, 2012), <http://www.bloomberg.com/news/2012-06-12/house-of-dimon-marred-by-ceo-complacency-over-unit-s-risk.html>.

profile corporate governance reforms that have been proposed and adopted over the past few years, we believe that improving director elections is likely to actually improve corporate governance because the causal mechanism is so clear.

In the aftermath of the 2008 financial crisis, efforts were made to improve director elections. Each one of these reforms, from majority voting to eProxy to elimination of broker voting of uninstructed shares, was heralded by its proponents as a game changer that would finally achieve meaningful director elections in the U.S.⁷ And yet with the benefit of three or four years of experience with each of these reforms, the evidence presented in this Article makes clear that they have had a modest effect, at best, both individually and taken together. In particular:

- *Only two incumbent directors* who did not receive a majority of the votes cast under a majority vote regime have actually left the board, and one of these two was mandated to leave under state law;
- *Not a single insurgent candidate* has made use of eProxy, at least in part because turnout among retail investors is thought to be lower when eProxy is used;
- *Only one director election outcome* has been changed due to the elimination of broker voting of uninstructed shares.

It might nevertheless be argued that the negotiations that take place in the “shadow” of these reforms have led to more vibrant corporate democracy, but there too our data shows that, if anything, shareholders’ leverage in their negotiations with management has weakened, not improved, over the past few years.

Our concurrent econometric research, co-authored with our colleague Dan Bergstresser and forthcoming in the *Journal of Law & Economics*, indicates that meaningful reform could be achieved through the dog that didn’t bark.⁸ Shareholder proxy access, in which significant, long-term shareholders would have the right to put their own candidates on the company’s own proxy statement, would meaningfully improve director elections. The power of proxy access can be seen not by adding up the dollars and cents saved in an election campaign on behalf of an insurgent candidate, as some commentators have suggested, but rather through the effect of having the potential for more candidates on the company’s own ballot than seats available on the

⁷ See Joann S. Lublin, *Theory & Practice: Directors Lose Elections, but Not Seats—Staying Power of Board Members Raises Questions About Investor Democracy*, WALL ST. J., Sept. 28, 2009, at B4 (discussing several options for improving director elections through the context of elections where directors did not receive 50% of the vote, but still retained seats).

⁸ Bo Becker, Dan Bergstresser & Guhan Subramanian, *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge*, 56 J. LAW & ECON. (forthcoming 2013).

board. That is, shareholder proxy access achieves the Holy Grail of meaningful corporate democracy by invading the “sacred space” of the company’s own proxy statement.

Despite the intuitive appeal of proxy access for improving director elections, or perhaps because of it, the SEC abandoned its comprehensive shareholder proxy access rule after a successful Business Roundtable challenge in mid-2011.⁹ As an alternative, the SEC invited a company-by-company approach, in which shareholders can propose proxy access at their specific companies.¹⁰ Twenty-three companies received proxy access proposals in the 2012 proxy season.¹¹ The success of these proposals ranged widely, depending on the specific design of the proposed access regime, certain legal technicalities, and shareholder sentiment at the targeted companies. Commentators predict that proxy access will continue to be an important issue going forward.¹² Our research points in favor of a properly designed proxy access regime, though we acknowledge that a company-by-company approach may have negative consequences for board recruitment relative to an across-the-board approach promulgated by the SEC.

The remainder of this Article proceeds as follows. Part I begins with a motivating case study on J.P. Morgan and the “London Whale.” Part II reviews other reforms to director elections over the past few years, and provides evidence on how these reforms have influenced the director election process. Part III focuses on shareholder proxy access as a potential tool for improving director elections. It reviews the theoretical and empirical evidence on both sides of the debate (including our own econometric evidence), clarifies the mechanism for value creation, and provides what we consider to be implications of this evidence for the future. Part IV concludes.

I. CASE STUDY: J.P. MORGAN AND THE “LONDON WHALE”

In 2010, Ina Drew, the respected head of JPM’s Chief Investment Office (CIO), contracted Lyme disease and was forced to step back from her

⁹ See *Oversight of the U.S. Securities and Exchange Commission: Hearing Before the Subcomm. on Capital Mkts. and Gov’t Sponsored Enter. of the H. Comm. on Fin. Serv.*, 112th Cong. 14 (2012) (testimony of Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm’n); see also *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1146 (D.C. Cir. 2011).

¹⁰ See 17 C.F.R. 240.14a-8 (2011).

¹¹ See SULLIVAN & CROMWELL LLP, PROXY ACCESS PROPOSALS—REVIEW OF 2012 RESULTS AND OUTLOOK FOR 2013 2 (2012), available at http://www.sullcrom.com/files/Publication/efef6acc-c684-42d5-a745-c2c106c6b794/Presentation/PublicationAttachment/7e64817d-0711-49c3-8584-0d6d3d457dd4/Proxy_Access_Proposals_Review_of_2012_Results_and_Outlook_for_2013-7-20-2012.pdf.

¹² Emily Chasan, *Companies May Be Inundated by Proxy Access Proposals*, WALL ST. J. CFO J. BLOG (Nov. 9, 2012), <http://mobile.blogs.wsj.com/cfo/2012/11/09/companies-may-be-inundated-by-proxy-access-proposals/>.

daily responsibilities.¹³ Drew's hands-on management style helped JPM steer clear of the worst of the financial crisis of 2008, but in her absence internal divisions began to surface in the CIO.¹⁴ In 2011, Achilles Macris, head of the CIO's London office, dropped caps on risk control that required traders to exit positions when their losses topped \$20 million.¹⁵ Althea Duersten, his counterpart in New York, raised objections, but she was "routinely shouted down" according to former CIO employees.¹⁶ In late 2011 Drew returned from sick leave, but she relocated to an executive office away from the trading floor and took a more hands-off approach to managing her team.¹⁷

On April 6, 2012, the *Wall Street Journal* reported that a CIO trader in the London office—later identified as Bruno Iksil, also known as the "London Whale"—was putting the bank at risk with his massive bets.¹⁸ The article prompted JPM CEO Jamie Dimon to take a closer look at the CIO's books, and the results "made him queasy."¹⁹ On May 10, 2012, JPM disclosed a \$2 billion loss, later reported to be closer to \$3 billion, and then nearly \$6 billion.²⁰ JPM CEO Jamie Dimon described the loss as a "Risk 101" mistake, caused by failure to adequately understand the true value-at-risk of the CIO's positions.²¹ JPM's stock price dropped approximately 19% with the announcement, wiping out approximately \$30 billion in JPM's market capitalization.²² Congressional hearings followed,²³ along with calls for greater regulation of financial institutions.²⁴ In October 2012 JPM announced that it was suing Iksil's supervisor, Javier Martin-Artajo, though the

¹³ Susan Adams, *JPMorgan's \$6 Billion Case of Lyme Disease*, FORBES (May 22, 2012, 1:33 PM), <http://www.forbes.com/sites/susanadams/2012/05/22/jpmorgans-6-billion-case-of-lyme-disease/>.

¹⁴ Jessica Silver-Greenberg & Nelson D. Schwartz, *Discord at Key JPMorgan Unit is Blamed in Bank's Huge Loss*, N.Y. TIMES, May 20, 2012, at A1.

¹⁵ Monica Langley, *Inside J.P. Morgan's Blunder*, WALL ST. J., May 18, 2012, at A1.

¹⁶ Silver-Greenberg & Schwartz, *supra* note 14.

¹⁷ Steve Denning, *The Perfect Storm at JPMorgan Chase*, FORBES (May 21, 2012, 8:47 AM), www.forbes.com/sites/stevedenning/2012/05/21/the-perfect-storm-at-jpmorgan-chase/.

¹⁸ Gregory Zuckerman & Katy Burne, *'London Whale' Rattles Debt Market*, WALL ST. J., Apr. 6, 2012, at A1. "London Whale" is a reference to the size of Iksil's trades.

¹⁹ Langley, *supra* note 15.

²⁰ Jessica Silver-Greenberg & Nelson D. Schwartz, *JPMorgan's Loss is Said to Rise at Least 50%*, N.Y. TIMES, May 16, 2012, at A1; Dan Fitzpatrick & Gregory Zuckerman, *J.P. Morgan 'Whale' Report Signals Deeper Problem*, WALL ST. J. ONLINE (July 14, 2012), <http://online.wsj.com/article/SB10001424052702303740704577524451161966894.html>.

²¹ Schatzker, Kopecki & Keoun, *supra* note 6.

²² *See id.*; *see also* Mark Gongloff, *Jamie Dimon Complains More, As JPMorgan Chase Losses Eclipse \$30 Billion*, HUFFINGTON POST (May 21, 2012, 12:23 PM), http://www.huffingtonpost.com/mark-gongloff/jamie-dimon-jpmorgan-chase_b_1533126.html.

²³ *See Live Blog: J.P. Morgan CEO Jamie Dimon on Capitol Hill*, WALL ST. J. ONLINE (June 13, 2012), <http://blogs.wsj.com/deals/2012/06/13/live-blogging-j-p-morgan-ceo-jamie-dimon-on-capitol-hill/>.

²⁴ *See, e.g.*, Ben Pross, *Lawmakers Clash on Regulation at JPMorgan Hearing*, N.Y. TIMES DEALBOOK (Jun. 19, 2012, 12:54 PM), <http://dealbook.nytimes.com/2012/06/19/lawmakers-clash-on-regulation-at-jpmorgan-hearing/>; Carol E. Lee & Damien Paletta, *White House Steps Up Push To Toughen Rules on Banks*, WALL ST. J., May 17, 2012, at A1.

filings declined to provide specific allegations.²⁵ In January 2013, JPM announced that Dimon's pay would be cut in half, largely as a consequence of the London Whale incident.²⁶

While the London Whale incident can be examined from many angles, we examine the corporate governance aspects here. JPM, like all U.S. financial institutions, has a Risk Committee. According to the JPM Risk Committee charter:

The Risk Policy Committee is responsible for oversight of the CEO's and senior management's responsibilities to assess and manage the corporation's credit risk, market risk, interest rate risk, investment risk, liquidity risk and reputational risk, and is also responsible for review of the corporation's fiduciary and asset management activities.²⁷

Since 2008, the three members of the JPM Risk Committee were James Crown (chair), Ellen Futter, and David Cote. Crown traded bonds at Salomon Brothers from 1980–1985, but had not worked on Wall Street since then.²⁸ His relevant experiences, according to JPM, were his directorships at General Dynamics Corp. and Sara Lee Corp, and presidency of Chicago-based Henry Crown & Co.²⁹ Jamie Dimon and Crown's father Lester were overseers together for the Harvard Business School Club of Chicago.³⁰

Futter was the President of the American Museum of Natural History in New York City and the former President of Barnard College.³¹ She chaired the audit committee of Bristol-Myers Squibb Co. during its 1999 accounting scandal, which led to a \$300 million settlement with the SEC.³² She also served on AIG's compliance and governance committees, resigning in July 2008 just before the \$180 billion bailout by the U.S. government.³³ Futter

²⁵ Dan Fitzpatrick, *J.P. Morgan Sues Whale's Ex-Boss*, WALL ST. J., Oct. 31, 2012, at C3.

²⁶ Dan Fitzpatrick, *Dimon Takes a 'Whale' of a Pay Cut*, WALL ST. J., Jan. 17, 2013, at C1.

²⁷ *Risk Committee Charter*, JP MORGAN CHASE & CO., <http://www.jpmorganchase.com/corporate/About-JPMC/risk-committee-charter.htm> (last visited Nov. 28, 2012).

²⁸ *Executive Profile: James S. Crown*, BLOOMBERG BUSINESSWEEK (Aug. 15, 2012, 8:12PM), <http://investing.businessweek.com/research/stocks/private/person.asp?personId=554619&privcapId=4304111&previousCapId=658776&previousTitle=JPMorgan%20Chase%20&%20Co.>

²⁹ Henry Crown & Co. is an investment firm that has interests in a variety of business assets. "These holdings include stakes in sports teams (the Chicago Bulls and the New York Yankees), leisure (Aspen Skiing Company), banking (JPMorgan Chase), and real estate (Rockefeller Center). The company also has a stake in General Dynamics; after once controlling the company outright, it still has a seat on the board. Affiliate CC Industries holds and manages some of the Crown family's investments." *Henry Crown and Company Company Profile*, YAHOO! FINANCE (Aug. 15, 2012), <http://biz.yahoo.com/ic/40/40214.html>.

³⁰ Dawn Kopecki & Max Abelson, *JPMorgan Gave Risk Oversight to Museum Head With AIG Role*, BLOOMBERG (May 25, 2012, 7:39 PM), <http://www.bloomberg.com/news/2012-05-25/jpmorgan-gave-risk-oversight-to-museum-head-who-sat-on-aig-board.html>.

³¹ *Id.*

³² *Id.*

³³ *Id.*

received corporate sponsorship for her museum from JPM as well as donations from Dimon's family foundation.³⁴

Cote was the Chairman & CEO of Honeywell International Inc., a conglomerate with operations in numerous industries (e.g., defense, automotive, home security, chemicals) but not finance.³⁵ Honeywell had received loans and financial advisory services from JPM.³⁶ In addition, JPM had purchased safety and security equipment as well as maintenance services from Honeywell.³⁷ All of these items were deemed immaterial by the board.³⁸

While these individuals are of course respected members of the business community, none of them have expertise in managing risk. CtW Investment Group (CtW), an advisor to union pension funds that held approximately 0.2% of JPM shares, highlighted the point in an April 2011 letter to the JPM board, more than a year before the London Whale incident: "[T]he current three-person risk policy committee, without a single expert in banking or financial regulation, is simply not up [to] the task of overseeing risk management at one of the world's largest and most complex financial institutions."³⁹

To be clear: all of this is not to say that the London Whale incident would not have occurred had the JPM Risk Committee included one or more directors with expertise in managing risk. It is well understood that JPM's operating committee on risk management, which consists of high-ranking JPM employees, bears primary frontline responsibility for managing risk exposure and therefore bears most of the blame for the London Whale incident. But certainly the odds of identifying the problem would have been higher if the board's Risk Committee included people who had expertise with risk management. Perhaps more importantly, the "optics" of the London Whale incident were not favorable to JPM when commentators after-the-fact highlighted the lack of risk expertise on the Risk Committee. A \$30 billion stock price drop in response to a \$2 billion trading loss can only be explained by the market's expectation that there was more to come (true, to some extent) and/or that there were deeper problems within JPM.⁴⁰

One apparent puzzle is why the JPM shareholders would repeatedly reelect the members of the JPM Risk Committee, by large margins, in the years leading up to the London Whale incident. Crown and Cole each received more than 96% of the votes cast in each of the five years they served on the JPM Risk Committee.⁴¹ Futter received similarly high approval rat-

³⁴ *Id.* Kristin Lemkau, a JP Morgan spokeswoman, stated the gifts did not create "a material relationship" that would supposedly impede Futter's performance on the JPM board. *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *See id.*

³⁹ Dan Fitzpatrick & Joann S. Lublin, *J.P. Morgan Plans Risk Panel Shift*, WALL ST. J., May 26, 2012, at B1.

⁴⁰ Gongloff, *supra* note 22.

⁴¹ *Voting Analytics*, *supra* note 2 (statistics based on authors' calculations).

ings until 2011, when Glass Lewis recommended against her because of her involvement on the boards of Bristol-Myers and AIG.⁴² In that year she was re-elected with 86% of the votes cast in her favor.⁴³ No candidate in a “normal” election could dream of such high levels of support from the electorate.

The explanation for the extremely high approvals, of course, is that shareholders had no other choice. In each year between 2009 and 2011, JPM nominated eleven candidates for the eleven seats on its board.⁴⁴ In each of those years, the eleven “candidates” were the incumbents themselves—that is, there was zero turnover.⁴⁵ In 2012, JPM nominated Timothy Flynn and James A. Bell to replace William H. Gray, III and David C. Novak, who were stepping down for reasons unrelated to the London Whale incident.⁴⁶ No JPM shareholders nominated candidates during this period, which meant that every election during this four-year period was uncontested. To its credit, in 2006 JPM replaced its plurality voting system with a majority vote rule, which then required directors to obtain a majority of the votes cast in order to be seated on the board.⁴⁷ But as we will demonstrate in this Article, this bar is not a meaningful one.

In May 2012, JPM announced that it would be adding one or two new directors to its Risk Committee.⁴⁸ The newly appointed Flynn, who had risk management experience during his tenure as KPMG International’s Chairman, was ultimately chosen as the new committee member.⁴⁹

Of course, it should not have to take a multi-billion dollar trading loss to put people with the right skillset on the JPM Risk Committee. If director elections had been more meaningful, it seems likely that incumbent directors would have been more responsive to shareholder concerns, or (if they were not) an insurgent director could have been nominated on the simple platform of putting someone with risk expertise on the Risk Committee. To reiterate, we do not claim that the London Whale problem could have been avoided if the JPM Risk Committee had directors with risk expertise. However, we do claim that structural flaws in corporate boards, such as the one at JPM, would be less likely to occur if director elections were more meaningful. In

⁴² Kopecki & Abelson, *supra* note 30.

⁴³ *Id.*

⁴⁴ *Voting Analytics*, *supra* note 2 (statistics based on authors’ calculations).

⁴⁵ *Id.* (statistics based on authors’ calculations).

⁴⁶ See NOTICE OF 2012 ANNUAL MEETING OF SHAREHOLDERS AND PROXY STATEMENT, JPMORGAN CHASE & Co. 1 (Apr. 4, 2012), available at http://files.shareholder.com/downloads/ONE/2144265866x0x556146/e8b56256-365c-45aa-bbdb-3aa82f0d07ea/JPMC_2012_proxy_statement.pdf. Mr. Bell was nominated in November 2011. *Id.* at 2.

⁴⁷ NOTICE OF 2007 ANNUAL MEETING OF SHAREHOLDERS AND PROXY STATEMENT, JP MORGAN CHASE & Co. 3 (Mar. 30, 2007), available at <http://files.shareholder.com/downloads/ONE/2144265866x0x87787/1a24f0ca-e25d-42cc-8ef7-b140c20cd5ef/Proxy2007.pdf>.

⁴⁸ See Dan Fitzpatrick & Joann S. Lublin, *J.P. Morgan Plans Risk-Panel Shift*, WALL ST. J., May 26, 2012, at B1; see also Nelson D. Schwartz & Jessica Silver-Greenberg, *JPMorgan Was Warned About Lax Risk Controls*, N.Y. TIMES, June 4, 2012, at B1.

⁴⁹ NOTICE OF 2012 ANNUAL JP MORGAN SHAREHOLDERS MEETING, *supra* note 46.

the next Part we describe and assess reforms that have been recently implemented to achieve this goal.

II. RECENT REFORMS IN DIRECTOR ELECTIONS

The corporate law of every U.S. jurisdiction requires that corporations hold an annual meeting to elect directors. In this election, the company will invariably nominate exactly the number of candidates to fill the available seats—for example, nine candidates for nine seats. The incumbents then use company funds to solicit the shareholders for their proxies, which give the incumbents the right to vote the shareholders' shares at the annual meeting in favor of the incumbent slate.⁵⁰

Any shareholder can propose a nominee to the board's nominating committee, but if the board refuses to put the shareholder's candidate on the company's slate, which is likely, the shareholder would have to engage in a time-consuming and expensive campaign in order to get their candidate seated. Specifically, a shareholder who wants to nominate a "short slate" (i.e., less than a full slate of candidates) or a full slate (i.e., one candidate for each available seat) would have to file Schedule 14A with the SEC, hire a proxy solicitor, and often engage in an expensive public campaign to support their nominee or nominees. In contrast to the incumbents' proxy solicitation expenses, which are paid for directly by the company, an insurgent's expenses are only reimbursed if the shareholder is successful in getting his or her candidate seated on the board.⁵¹ Even in this best-case scenario, the shareholder must then share the benefits of any improvement in corporate performance *pro rata* with the other shareholders. As a result of these obstacles, contested director elections outside the context of a hostile takeover bid have been exceedingly rare in corporate America.⁵²

Against this backdrop, three reforms have been implemented over the past few years, each with a different focus but all with either the direct or indirect objective of making corporate elections more meaningful. We discuss each of these in chronological order of their appearance: majority voting requirements, eProxy rules, and broker voting of uninstructed shares.

A. Majority Voting

The initial push for majority voting seems to have been a response among activist investors to the failure of the proxy access rule in 2003⁵³—

⁵⁰ See WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 162 (4th ed. 2012).

⁵¹ See *id.* at 161–62.

⁵² See Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 682–86 (2007).

⁵³ DLA Piper, *Majority Voting: Where Are We Now?* (2006), http://dlapiper.com/majority_voting/.

that is, majority voting was a second-best means for improving director elections after proxy access had failed. Under the traditional system of plurality voting, a director would simply need to receive a plurality of the votes cast—for example, if a director in an uncontested election received 1 affirmative vote and 999 votes were “withheld,” the director would still be seated on the board. Under a majority voting system, in contrast, the director must receive a majority of the votes cast in order to be seated on the board. So in the example above, the director would need to receive at least 501 affirmative votes out of the 1,000 votes cast.

Majority voting began appearing among U.S. companies in 2004, though a corporate law complication initially slowed its proliferation. Under the so-called “holdover rule,” a director continues in office until and unless a successor is elected, the director resigns, or the shareholders remove the director.⁵⁴ Some initial majority voting proposals did not make clear what would happen in the event that a director did not receive a majority of the votes cast. Companies exploited this ambiguity to argue against majority vote proposals, on the grounds that any director who did not receive a majority vote would holdover anyway, thus rendering a majority vote requirement meaningless.⁵⁵

Amendments to the Delaware General Corporation Law (DGCL) in 2006 clarified that “[a] resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable.”⁵⁶ This amendment permitted Delaware corporations to implement a majority vote regime by requiring its directors to submit an irrevocable resignation letter effective if the director does not receive a majority of the votes cast and the board accepts the resignation.⁵⁷ The Delaware legislature also adopted changes permitting shareholders to adopt a bylaw, not subject to further amendment or repeal by the board, proscribing the voting standard for director elections.⁵⁸ At approximately the same time the ABA Committee on Corporate Laws adopted changes to the Model Business Corporate Act (MBCA) similarly facilitating majority voting.⁵⁹

These amendments to the DGCL and MBCA gave shareholders a clear path to majority voting, which led to the rapid proliferation of majority vote requirements among U.S. companies. Table 1 shows the incidence of majority voting among the Russell 3000 and S&P 500 since 2006:

⁵⁴ See DEL. GEN. CORP. L. § 141(b).

⁵⁵ See, e.g., Carpenters’ Pension Fund Proposal and Supporting Statement, a Rule 14a-8 request to Hewlett-Packard (Oct. 7, 2005); Hewlett-Packard No-Action Letter Request to SEC (Nov. 4, 2005); Carpenters’ Response to Hewlett-Packard No-Action Letter Request to SEC (Dec. 8, 2005), reprinted in ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 50, at 196–99.

⁵⁶ DEL. GEN. CORP. L. § 141(b).

⁵⁷ See FREDERICK H. ALEXANDER & JAMES D. HONAKER, *THE NUTS AND BOLTS OF MAJORITY VOTING* 1, 3 (2006), available at <http://www.mnat.com/assets/attachments/113.pdf>.

⁵⁸ Del. Code Ann. tit. 8, § 216 (2006).

⁵⁹ S’holders for the Election of Directors, *Changes in the Model Business Corporation Act?*, 61 COMM. ON CORP. LAWS, ABA SECTION OF BUS. LAW 399 (2005).

TABLE 1:
INCIDENCE OF MAJORITY VOTING AT RUSSELL 3000 COMPANIES
(LIGHT GREY) AND S&P 500 COMPANIES
(DARK GREY), 2006–2011⁶⁰

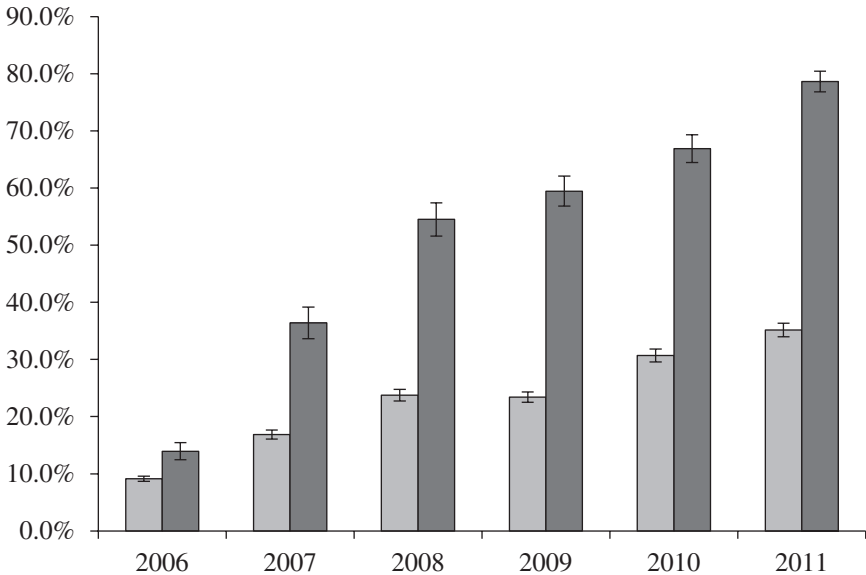


Table 1 shows that the incidence of majority voting increases substantially with company size. In 2011, for example, 78% of the S&P 500 had a majority voting requirement, compared to 43% of the S&P 1500, 34% of the S&P MidCap companies, and 15% of S&P SmallCap companies.⁶¹ When weighted by market capitalization, director elections are now, in effect, a majority vote regime.

At least in theory, majority vote requirements create a meaningful election process because every election, in effect, becomes a contest between the candidate and “not the candidate.” In doing so majority vote requirements may give bite to “withhold vote” campaigns, in which dissident shareholders do not propose an alternative candidate but simply advocate for withholding votes against a particular incumbent candidate.⁶²

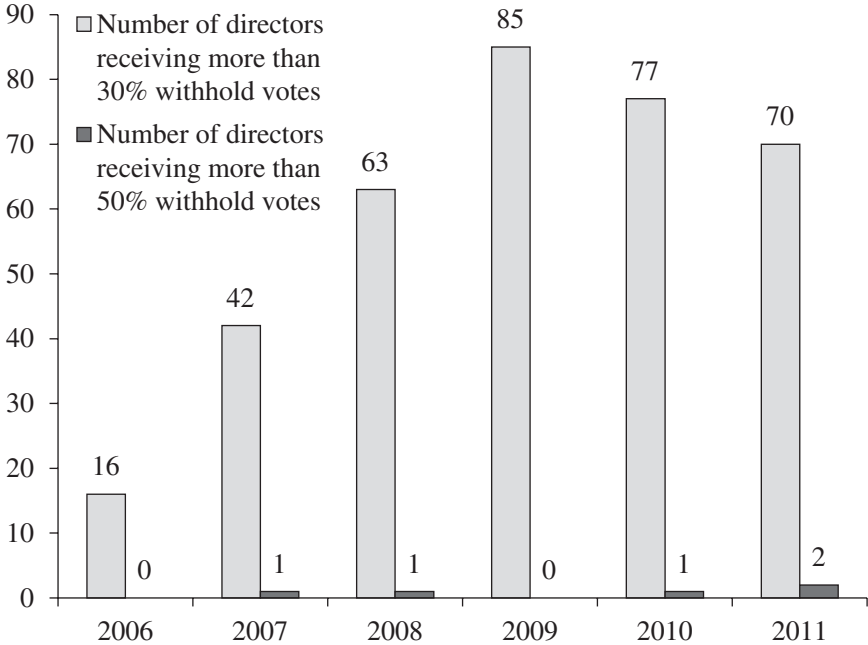
⁶⁰ Vertical bars indicate 99% confidence intervals for annual means. *Voting Analytics*, *supra* note 2. We adjust *Voting Analytics* data as follows to handle what appear to be occasional mislabeling of plurality as majority: when a firm changes its election format from plurality to majority twice (with a reversal in between), we classify all years from the initial change as majority votes, assuming double reversals are coding errors.

⁶¹ *Voting Analytics*, *supra* note 2.

⁶² Credit for first proposing withhold-vote campaigns goes to Joseph A. Grundfest. See Joseph A. Grundfest, “Just Vote No”: A Minimalist Strategy for Dealing with Barbarians Inside the Gates, 45 *STAN. L. REV.* 857 (1993).

The following chart shows the number of directors among the Russell 3000 companies who received less than a majority affirmative vote, in each year from 2006 to 2011, as well as the number of directors who received a withhold vote in excess of 30% of the votes cast:

TABLE 2:
NUMBER OF DIRECTORS RECEIVING A MAJORITY AND 30%
WITHHOLD VOTE, 2006–2011⁶³



An important feature of majority voting regimes is that the director must submit his or her resignation but in most states (including Delaware) the board is not required to accept it. We therefore examined the outcome in the five cases in which the Voting Analytics data indicate that a director nominated by management had received insufficient votes under a majority system.

The following table lists the five directors who did not receive a majority vote between 2007 and 2011, among companies that had a majority vote regime, and the consequences of that vote:

⁶³ *Voting Analytics*, *supra* note 2. Only firms using majority election and directors proposed by management.

TABLE 3:
THE FIVE DIRECTORS WHO DID NOT RECEIVE A MAJORITY
VOTE, 2007–2011

Company	Meeting Date	Name	Outcome
Gen-Probe, Inc.	5/31/2007	Mae C. Jemison	Board did not accept resignation. Did not seek reelection. ⁶⁴
Quest Software, Inc.	5/8/2008	Jerry Murdock, Jr.	Board accepted resignation. ⁶⁵
Global Crossing Ltd.	7/8/2010	Michael Rescoe	Board dissolved due to merger. ⁶⁶
Annaly Capital Management, Inc.	5/26/2011	Jonathan D. Green	Board did not accept resignation. Currently on board. ⁶⁷
Isramco, Inc.	12/30/2011	Marc E. Kalton	Board accepted resignation. ⁶⁸

Table 3 shows that in two of the cases, the board chose not to respect the majority vote results.⁶⁹ One of the cases involved the creation of a new

⁶⁴ See, e.g., Lois Gilman, *Majority Voting Now Has the Majority*, BOARDMEMBER (Mar.–Apr. 2008), https://www.boardmember.com/MagazineArticle_Details.aspx?id=450; Stephen Taub, *The Majority Doesn't Rule*, CFO.COM (Jul. 20, 2007), http://www.cfo.com/article.cfm/9533226/c_9531652?f=todayinfinance_next. Gen-Probe's Board did not accept Ms. Jemison's resignation, even after she received only 30% of the votes. Gilman, *supra*. The board determined that her two board meeting absences, which had been the bases for voters' rejection, were due to good reasons. Nevertheless, Ms. Jemison did not continue serving on the board after November 2007. Annalisa Barrett and Beth Young, *Majority of Votes Withheld: Shareholders Say "No," Boards Say "Yes"*, THE CORP. GOVERNANCE ADVISOR, Jul.–Aug. 2008, at 6, 8.

⁶⁵ See Joann S. Lublin, *Directors Lose Elections, but Not Seats*, WALL ST. J. (Sept. 28, 2009), <http://online.wsj.com/article/SB12540932057844429.html>; Elizabeth O'Sullivan, *Directors to Shareholders: I'm Outta Here*, BOARDMEMBER (Jan.–Feb. 2009), https://www.boardmember.com/MagazineArticle_Details.aspx?id=2948. In 2008, Mr. Murdock was the only board member who lost his seat during a nonbinding election as a direct result of a shareholder vote. See Lublin, *supra*. Mr. Murdock was bound to quit because Quest is incorporated in California, and California state law required directors' resignations upon failure to receive majority votes in corporations with majority-voting standard. *Id.* Additionally, Mr. Murdock was not invited to stay on the board after submitting his resignation, "possibly because he was the only director who'd been on Quest Software's board (and its compensation committee) between 1999 and 2004, a period when the company granted a number of options to various executives that an internal investigation later found were improperly backdated." O'Sullivan, *supra*.

⁶⁶ Press Release, Level 3, Level 3 Completes Acquisition of Global Crossing (Oct. 4, 2011), <http://level3.mediaroom.com/index.php?s=23600&item=66513>. Mr. Rescoe sat on Global Crossing's Board until Oct. 3, 2011, when Level 3 acquired Global Crossing. Mr. Rescoe was not on the new, combined Board. *Id.*

⁶⁷ See *2011 Director Rejection*, COUNCIL OF INSTITUTIONAL INVESTORS (Feb. 28, 2012), <http://www.cii.org/DirectorRejections2011>; see also *The Election of Corporate Directors: What Happens When Shareowners Withhold a Majority of Votes from Director Nominees?*, IRRC INST. (Aug. 2012), <http://www.irrcinstitute.org/pdf/Final%20Election%20of%20Directors%20GMI%20Aug%202012.pdf>. The Annaly Board decided to retain Mr. Green, despite failing attendance standards "on the grounds that the absences were justifiable." *Id.* at 6.

⁶⁸ Isramco, Inc., Form 8-K, (Jan 11, 2012). Isramco "determined to reduce the size of the board to six members rather than to add a director to replace [Marc Kalton,] a director who was not re-elected at the Annual Meeting of Shareholders." *Id.* at Item 8.01.

⁶⁹ See Gilman, *supra* note 64; *2011 Director Rejection*, *supra* note 63.

board due to an acquisition.⁷⁰ In two of the remaining cases, the director's resignation was accepted by the board. One of those cases was subject to state law that did not allow the board to refuse the resignation.⁷¹ Therefore, only one of the five cases represents a board accepting a director resignation by choice.⁷²

B. *eProxy*

In July 2007, the SEC promulgated its long awaited "eProxy" rules. Under the new Rule 14a-16, all public companies must post their proxy materials on a publicly available website, and may simply mail a "Notice of Internet Availability of Proxy Materials" to shareholders, no later than forty calendar days before the shareholder meeting.⁷³ According to many observers, the anachronism of 200+ page paper mailings would soon be a distant memory with eProxy.⁷⁴

Importantly, third parties could take advantage of the "Notice and Access" model as well, which could substantially reduce the costs of running a proxy contest.⁷⁵ With eProxy distribution, the cost of printing and mailing would fall from an estimated \$5-\$6 per set of proxy materials⁷⁶ to just the cost of a postage stamp (for the notice) and the minimal cost of establishing a website. SEC Commissioner Annette Nazareth stated that the cost savings generated by eProxy would "help level the playing field between management and dissenting shareholders."⁷⁷

Some commentators predicted that eProxy would lead to more contested director elections. Professor Jeffrey Gordon, for example, argued that shareholder activists should abandon their campaign for shareholder proxy access and dedicate their time instead to figuring out the nuts and bolts of conducting eProxy contests.⁷⁸ According to Professor Gordon, eProxy could provide a direct and effective substitute for shareholder proxy access.⁷⁹ eProxy could also provide a meaningful substitute for withhold-vote campaigns, which (as described above) are given bite through majority vote re-

⁷⁰ See Level 3, *supra* note 66.

⁷¹ See Lublin, *supra* note 65.

⁷² See Isramco, *supra* note 68.

⁷³ 17 C.F.R. § 240.14a-6 (2007).

⁷⁴ See, e.g., Broc Romanek, *The SEC's E-Proxy Comes to Life!*, DEAL LAWYERS (Dec. 18, 2006), <http://www.deallawyers.com/Blog/2006/12/the-secs-e-proxy-comes-to-life.html>.

⁷⁵ See Shareholder Choice Regarding Proxy Materials, 72 Fed. Reg. 42,222, 42,231-32 (Aug. 1, 2007).

⁷⁶ ADP, now called Broadridge Financial Solutions, Inc., estimates that the average cost of printing and mailing a paper copy of a set of proxy materials during the 2006 proxy season was \$5.64. *Id.* at 42,230-31.

⁷⁷ SEC Proposes to Modernize Rules Governing Proxy Solicitations, 37 SEC. REG. & L. REP. (BNA) No. 47, at 1958 (Dec. 5, 2005).

⁷⁸ 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 (2008).

⁷⁹ *Id.* at 487.

quirements. Gordon explains: “Instead of ‘just vote no,’ the next step should be ‘short slate’ proxy contests via e-proxy: ‘just vote for Joe [or someone].’”⁸⁰

Contrary to this recommendation, we find that out of the 148 insurgent candidates proposed at 41 different companies between 2009 and 2011, *none* made use of the eProxy method of solicitation.⁸¹ The reason for this sharp disconnect between prediction and reality can be found in retail investor behavior: investors are less likely to respond to proxy solicitations conducted via eProxy. According to Broadridge, the largest provider of brokerage processing services, 4.6% of retail accounts that received notice only via mail voted in 2010; 13% of retail accounts that received e-delivery voted; and 25.4% of retail accounts that received full packages voted.⁸² Although investors have gained more experience with eProxy and Internet voting in general, these trends have not changed meaningfully in 2011–2012.⁸³

The Broadridge findings explain why insurgents have not taken up eProxy to run proxy contests “on the cheap.” Insurgents already face an uphill battle in any campaign against the incumbents, with many shareholders defaulting to management, and eProxy only makes the task harder by reducing response rates. Insurgents have figured out what mail-order catalog retailers have known for decades: hard copies are less likely to be ignored. In economic terms, shareholders use the fact that someone has engaged in a costly mailing rather than a cheap email as a sorting mechanism to determine what they should pay attention to.⁸⁴

In considering whether to use eProxy, insurgents must weigh the benefits of lower proxy solicitation costs against the costs of reduced turnout. Our evidence suggests that the calculation has, without exception, not weighed in favor of using eProxy. This represents a substantial disconnect between the predictions of eProxy proponents and the practical realities of

⁸⁰ *Id.* at 478.

⁸¹ For the 148 candidates not proposed by management as reported in VotingAnalytics, we examined SEC filings to determine whether the insurgent candidate used the “notice and access” method.

⁸² BROADRIDGE, SUMMARY VOTING STATISTICS—RETAIL SHAREHOLDERS: THREE FISCAL YEARS (2008–2010) 1 (Apr. 7, 2011) (on file with author); *see also* Fabio Saccone, *E-Proxy Reform, Activism and the Decline In Retail Shareholder Voting* 6 (The Conference Board Director Notes No. DN-021, 2010), available at <http://ssrn.com/abstract=1731362> (“[T]he savings for companies opting for the ‘notice only’ method came at the price of a significant drop in retail shareholders participation.”).

⁸³ *See* BROADRIDGE, 2012 PROXY SEASON KEY STATISTICS & PERFORMANCE RATING 1 (2012) (on file with author).

⁸⁴ The decline in retail turnout also explains why incumbents have not made greater use of eProxy. Without a quorum, the shareholder meeting cannot be called to order, and the company must start the annual meeting process all over, this time (presumably) through a traditional proxy solicitation. In addition, and perhaps more importantly, a decline in retail turnout means that institutional investors have greater voice in director elections. Institutions, which typically follow the advice of proxy advisory firms such as Glass Lewis or ISS, are less likely than retail investors to vote for the incumbent slate. Indirectly, then, eProxy hands more power to institutional shareholders, who are less likely to vote with the incumbents.

eProxy as implemented. eProxy has not led to the sea change in director elections that some commentators predicted.

C. Broker Voting of Uninstructed Shares

One of the many arcane features of the corporate voting system is that most retail investors hold their shares in “street name,” through a broker such as Merrill Lynch or Charles Schwab. When a company wants to solicit proxies for its annual meeting, it sends its proxy materials to the broker, who then must send the materials on to the “beneficial owners” for their votes. If beneficial owners do not return their vote preferences in time (so-called “uninstructed shares”), the broker can vote the shares on behalf of the beneficial owner for “uncontested” issues.⁸⁵

Historically, the election of directors with no opposing candidates was considered to be an “uncontested” issue. Brokers would routinely vote the uninstructed shares, virtually always for the incumbents, thereby increasing turnout and boosting support for the incumbent slate.⁸⁶ In January 2010, however, the New York Stock Exchange (NYSE) amended Rule 452, such that director elections would no longer be considered an uncontested issue.⁸⁷ Because NYSE Rule 452 applies to all brokers that are members of the NYSE, this change will apply to virtually all public companies, not just companies listed on the NYSE.⁸⁸

The amended Rule 452 interacts in important ways with the other changes to the voting system noted above. With majority voting now the norm, Rule 452 reasonably reflects the fact that even ostensibly uncontested elections are now implicit contests. Rule 452 also gives companies more reason to be fearful of eProxy: with the loss of broker shares that could reliably be counted on to favor the incumbents, companies need to collect all the retail shares they can get.

Commentators predicted that Rule 452 would have a dramatic effect on director elections.⁸⁹ Corporate Board Member’s article *What the Amended Rule 452 Means to You* is typical:

⁸⁵ For a detailed and illuminating description of the mechanics of proxy voting, see Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L. J. 1227 (2008). Professors Kahan & Rock were writing before the changes to Rule 452 described in the text, though they noted that a NYSE working group had recommended such a change. *See id.* at 1250 n.94.

⁸⁶ *Id.* at 1250.

⁸⁷ Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08, 74 Fed. Reg. 33,293 (July 10, 2009).

⁸⁸ *E.g.*, CRAVATH SWAINE & MOORE LLP, SEC APPROVES AMENDMENT TO NYSE RULE 452 ELIMINATING BROKER DISCRETIONARY VOTING IN UNCONTESTED DIRECTOR ELECTIONS 1 (Jul. 1, 2009), available at www.cravath.com/files/Uploads/Documents/Publications/3154787_1.pdf.

⁸⁹ *See, e.g.*, AKIN GUMP STRAUSS HAUER & FELD LLP, SEC APPROVES RULE CHANGE ELIMINATING BROKER DISCRETIONARY VOTING FOR ELECTION OF DIRECTORS 2 (July 2, 2009),

The election of directors, once pretty much a breeze for anyone the nominating committee chose to put on the ballot, has become a lot less certain. . . . Not only has plurality voting given way to majority voting . . . but management has lost its ace in the hole, the uninstructed broker vote.⁹⁰

To test these predictions, we collected data on voting outcomes on all director elections among Russell 3000 companies between 2003 and 2012. The results are reported in the following table:

TABLE 4:
VOTING OUTCOMES 2003–2011⁹¹

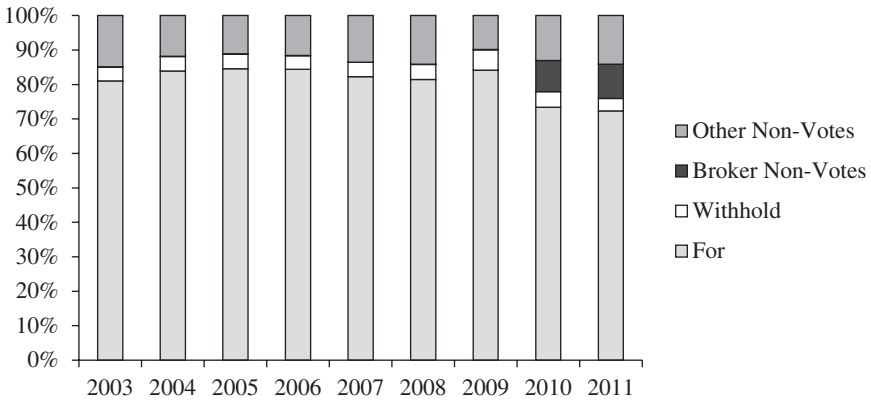


Table 4 shows the impact of Rule 452 beginning in 2010: uninstructed shares that previously would have gone to the incumbents are now broker non-votes. In each of 2010 and 2011, broker non-votes amounted to approximately 10% of outstanding shares overall, which means that overall turnout fell from approximately 85% to 75%. However, the margin of victory in

available at <http://www.akingump.com/communicationcenter/newsalertdetail.aspx?pub=2195>; FOX ROTHSCHILD LLP, SEC APPROVES AMENDMENTS TO NYSE RULE 452 ELIMINATING DISCRETIONARY VOTING BY BROKERS IN UNCONTESTED DIRECTOR ELECTIONS 3 (Aug. 2009), available at http://www.foxrothschild.com/uploadedFiles/newspublications/newsletter_aug09_smallBusinessSecurities.pdf (“Amended Rule 452 is expected to have a material impact on all public companies.”); LINDQUIST & VENNUM LLP, SEC APPROVES AMENDMENTS TO NYSE RULE 452 ELIMINATING DISCRETIONARY VOTING BY BROKERS IN DIRECTOR ELECTIONS 2, (July 2009), available at <http://www.lindquist.com/pubs/xprPubDetail.aspx?xpST=PubDetail&pub=86> (“The impact of the amended Rule 452 is that the number of votes in favor of each nominee will be much smaller because of the elimination of the broker vote traditionally cast for the election of a nominee.”)

⁹⁰ Julie Connelly, *What the Amended Rule 452 Means to You*, BOARDMEMBER.COM (2009), https://www.boardmember.com/MagazineArticle_Details.aspx?id=3880.

⁹¹ *Voting Analytics*, *supra* note 2.

corporate elections is so large that the broker non-votes could not have made much of a difference, at least at this aggregate level. If we make the conservative assumption that broker non-votes would have gone entirely to the incumbents, *only one* director election outcome would have been changed (at Annaly Capital Management Inc.) if broker non-votes had been included in 2011. A handful of other elections would have been rendered closer, but would not have been changed in their outcome.

These results are dramatically different from the “major impact” of Rule 452 that was predicted. However, the results are almost self-evident in view of the overall statistics presented in Table 4, showing that the baseline margin of victory for incumbent directors is very large. It would take a much larger broker non-vote to have a meaningful impact on typical corporate elections.

D. Negotiations in the Shadow of Recent Reforms

Thus far, we have presented empirical evidence demonstrating that the combined effects of majority voting, eProxy, and Rule 451 do not seem to have created truly meaningful director elections, as the proponents of these rules predicted. To summarize the findings presented thus far:

- *Only two incumbent directors* who did not receive a majority of the votes cast under a majority vote regime have actually left the board;
- *Not a single insurgent candidate* has made use of eProxy at least in part because turnout among retail investors is thought to be lower when eProxy is used; and ;
- *Only one director election outcome* has been changed because of the Rule 452 amendments.

It might nevertheless be argued that the direct effects of these reforms will never be observed, because sophisticated market participants will negotiate in the “shadow” of these rules.⁹² A director who is about to lose a majority vote, for example, will instead resign.

We cannot test this hypothesis directly. But if it were true, we would expect director turnover to increase over the past few years, as shareholders would wield more leverage in their negotiations with the incumbent directors over board composition. The following table presents average director turnover for each year between 2001 and 2012 using BoardEx for data. The vertical bars indicate 99% confidence intervals:

⁹² Cf. Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L. J. 950, 968 (1979).

TABLE 5:
DIRECTOR EXIT PROBABILITY 2001–2012

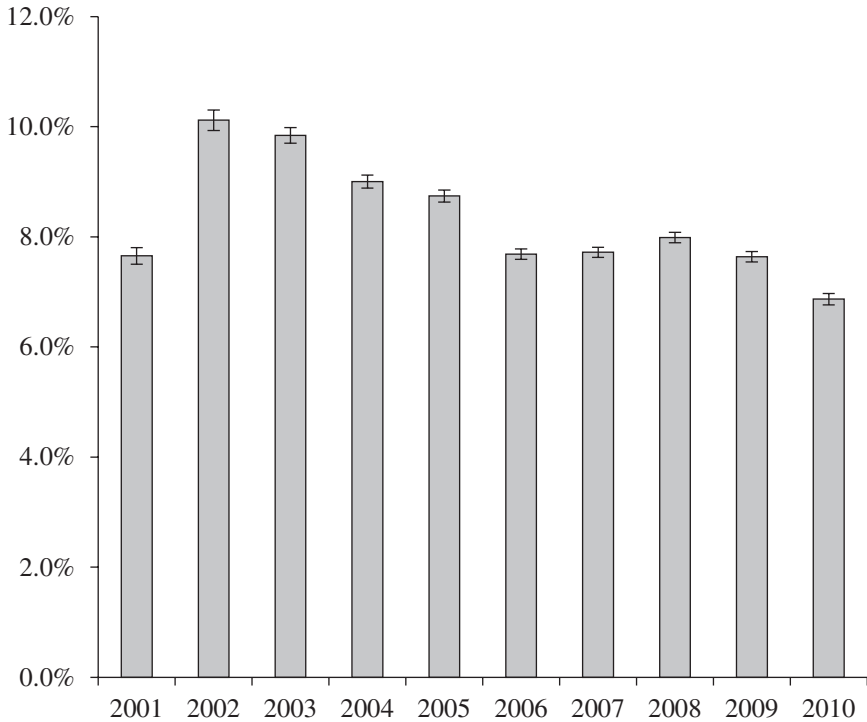


Table 5 shows that the likelihood of a director leaving the board has decreased, not increased, over the past ten years. If shareholders in fact wielded a larger club one would expect to see greater board turnover, not less, either because the board would voluntarily replace ineffective directors or because they would be forced to do so by shareholders threatening a withhold-vote campaign or an insurgent candidate via eProxy.

To get more precise on the question of negotiations that may have taken place in the shadow of the recent reforms, we examine sensitivity of board turnover to corporate performance. The risk of losing the job can be a big source of incentives for senior executives.⁹³ Indeed, corporate CEOs face increased turnover rates when their firms perform poorly (i.e., following low stock returns).⁹⁴ In fact we find some modest sensitivity of board turnover to corporate performance in the early years of our sample, in the sense that directors have slightly higher probability of exit when their firm has low

⁹³ Steven N. Kaplan, *Corporate Governance and Corporate Performance: A Comparison of Germany, Japan, and the U.S.*, 9 J. APP. CORP. FIN., no. 4, 1997, at 86–93.

⁹⁴ Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed?*, 12 INT'L REV. FIN. (SPECIAL ISSUE) 57 (2012).

stock returns. Directors whose firms are in the top quartile of previous year stock return have a 2–3 percentage point higher exit probability than those in the bottom quartile during the 2000–2002 period. However, this relationship has grown weaker with time. By 2009, there was no discernible difference in exit probabilities based on stock performance. As with the evidence on overall exit probabilities presented in Table 6, the lack of performance sensitivity is inconsistent with the idea that the reforms to the director election process have given shareholders more leverage in their negotiations with corporate boards.

Not only is the overall trend on director turnover negative, but the base rate is low too. U.S. CEOs faced annual turnover rates of 15.8% for the 1992 to 2007 period, implying a 6.5 year average tenure for a CEO.⁹⁵ In contrast, we find a 2010 turnover rate for corporate directors of 6.9%, implying an average tenure of almost 15 years. Considering that the average director is initially appointed in his or her early to mid-50s,⁹⁶ our evidence suggests that the average director among this group serves until retirement. Put differently, if we assume that a typical appointment age of mid-50s and a typical retirement age of approximately 70, board turnover *could not be any lower* than it currently is. Yet again, this evidence highlights the perfunctory nature of director elections.

III. SHAREHOLDER PROXY ACCESS

A. Background

Against this backdrop, many commentators have viewed shareholder access to the company's proxy statement as an essential step to make director elections more meaningful, and, by extension, to improve overall corporate governance. The idea is simple: significant, long-term shareholders should have the right to place one or more board candidates on the company's own proxy statement.

Shareholder proxy access (or just "proxy access") would have two effects. First, it would reduce the cost for shareholders in proposing candidates to the board, which presumably would lead to more contested elections or negotiations in the shadow of such a contest. Second, and far more important, it would present shareholders with a meaningful choice on the company's own proxy statement. That is, because proxy access intrudes on the "sacred space" of the company's proxy statement, it is fundamentally different than running a proxy contest with a separate candidate or separate slate.

⁹⁵ *Id.*

⁹⁶ See MATTEO TONELLO & JUDIT TOROK, THE 2011 U.S. DIRECTOR COMPENSATION AND BOARD PRACTICES REPORT 40 (2011); see also SPENCER STUART, 2011 SPENCER STUART BOARD INDEX 17 (2011) (reporting average age of newly-appointed independent directors of 56.7).

For the first time in the history of U.S. corporate governance, there would be more candidates on the company ballot than seats available on the board.

To disinterested observers, the idea that shareholders should be able to put their own nominees on the company's proxy statement might seem to require no explanation. (As one prominent Delaware lawyer put it to us, proxy access might even seem to be a property interest that comes with share ownership.) Yet proxy access has been one of the most controversial—if not *the* most controversial—issues in corporate governance over the past decade.⁹⁷ Opponents of proxy access argue that it would shift a dangerous amount of power to certain kinds of shareholders (for example, union pension funds) who could pursue objectives counter to shareholder wealth maximization.⁹⁸ They also argue that high-quality directors may be unwilling to serve on boards if they must face competition from shareholder-sponsored candidates.⁹⁹ Proponents of proxy access argue that competition in the director election process is desirable, and that giving institutional investors more influence in the director election process will likely benefit all shareholders.¹⁰⁰

Perhaps in part because neither side of this debate could deliver a knock-out blow at the level of theory, the implementation of a proxy access rule has had a dizzying back-and-forth over the past decade. In broad brush form the pattern has been as follows:

Step 1: Corporate governance crisis prompts popular demand for reform (see Enron/Worldcom in 2002/03; financial crisis in 2008/09).

⁹⁷ See, e.g., Motion for Stay of Proxy Access Rules by Business Round Table and Chamber of Commerce of the United States of America, 75 Fed. Reg. 56,668 (Sept. 29, 2010) (“Few issues in corporate governance have generated more disagreement or stronger passions.”); Memorandum from Wachtell, Lipton, Rosen & Katz 2 (Dec. 8, 2010) (on file with author) (“Proxy access is expected to significantly impact the dynamics of shareholder engagement, and, in some cases, the composition of boards.”); Jeffrey McCracken & Kara Scannell, *Fight Brews as Proxy Access Nears*, WALL ST. J., Aug. 26, 2009, at C1 (John Finley, Partner, Simpson Thacher & Bartlett referred to “the biggest change relating to corporate governance ever proposed by the SEC.”); John Greenwald, *Hang On*, BOARDMEMBER (2010), https://www.boardmember.com/MagazineArticle_Details.aspx?id=4502 (“Few things make boards more nervous than [proxy access].”); see also U.S. SEC. & EXCH. COMM’N DIV. CORP. FIN., STAFF REPORT: REVIEW OF THE PROXY PROCESS REGARDING THE NOMINATION AND ELECTION OF DIRECTORS 21 (2003), available at <http://www.sec.gov/news/studies/proxycomsum.pdf> (showing that approximately 700 different comment letters were submitted when proxy access was proposed in 2003); Steven M. Davidoff, *The Proxy Access Debate*, N.Y. TIMES DEALBOOK (Oct. 9, 2009, 9:00 PM), <http://dealbook.nytimes.com/2009/10/09/the-proxy-access-debate/?pagew> (“Since proposed on June 10, 2009, the rule has generated more than 500 comment letters and much hand-wringing among corporations.”); *Comments on Proposed Rule: Facilitating Shareholder Director Nominations*, U.S. SEC. & EXCH. COMM’N (Nov. 11, 2010), <http://www.sec.gov/comments/s7-10-09/s711009.shtml>.

⁹⁸ See, e.g., Stephen M. Bainbridge, *A Comment on the SEC Shareholder Access Proposal* 8 (UCLA Sch. of Law, Law-Econ. Research Paper No. 03-22, 2003).

⁹⁹ See, e.g., Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67, 86 (2003).

¹⁰⁰ See, e.g., Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 48–64 (2003).

Step 2: The SEC, in both Republican (2002/03) and Democratic (2008/09) administrations, moves forward with a proxy access rule, even getting so far as implementing the Rule in 2009.

Step 3: The Business Roundtable, joined by the U.S. Chamber of Commerce, engages in a ferocious media campaign (2002/03) and legal challenge (2008/09) that results in the repeal of the Rule and backpedalling by the SEC.

We provide a slightly more detailed and less tongue-in-cheek review of the most recent effort here. In May 2009, the SEC introduced a proxy access rule in the wake of the 2008/2009 financial crisis. The SEC explained: “The nation and the markets have recently experienced, and remain in the midst of, one of the most serious 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.”¹⁰¹ Under the proposed Rule 14a-11, a shareholder or shareholder group that owned more than 1% of a large U.S. public company (defined as market capitalization greater than \$700 million), more than 3% of a midsize public company (market capitalization \$75–\$700 million), or more than 5% of a small public company (market capitalization less than \$75 million) would have the ability to place nominees on the company’s proxy statement for up to one-quarter of the total board seats.

In an effort to preempt or at least shape the SEC’s consideration of the proposed federal rule, Delaware amended its corporate code to confirm that shareholders could amend the company’s bylaws to permit proxy access.¹⁰² Section 112 of the DGCL, enacted in May 2009, provides that: “The bylaws may provide that if the corporation solicits proxies with respect to an election of directors, it may be required . . . to include in its proxy solicitation materials . . . 1 or more individuals nominated by a stockholder.”¹⁰³ Section 112 reflects one application of the Delaware Supreme Court’s holding in *CA v. AFSCME*, handed down in July 2008, which permits shareholders to regulate procedural aspects of corporate governance (e.g., how decisions are made) but not substantive aspects, which are left to the board.¹⁰⁴ Thus Section 112 confirmed the shareholders’ right to opt-in to proxy access (a so-called “voluntary proxy access regime”).

In July 2010, the U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Notwithstanding Delaware’s efforts to preempt federal action, Section 971 of the Act amended Section 14(a) of the Securities Exchange Act to provide the SEC explicit authority to adopt

¹⁰¹ Facilitating Shareholder Director Nominations, 74 Fed. Reg. 67,144 (Dec. 18, 2009).

¹⁰² See Mark J. Roe, *The Corporate Shareholder’s Vote and its Political Economy in Delaware and in Washington*, 2 HARV. BUS. L. REV. 1 (2012).

¹⁰³ DEL. CODE ANN. tit. 8 § 112 (2009).

¹⁰⁴ See *CA Inc. v. AFSCME*, 953 A.2d 227 (Del. 2008).

proxy access rules.¹⁰⁵ By confirming that the SEC had the authority to issue a proxy access rule and signaling Congress's support for such a rule, Section 971 seemed to make proxy access inevitable.¹⁰⁶

On August 25, 2010, by a 3 to 2 vote, the SEC announced the adoption of a final Rule 14a-11, mandating proxy access at all U.S. public companies. Any shareholder or shareholder group that held more than 3% of a U.S. public company's shares for more than three years would be eligible to nominate candidates for up to 25% of the company's board seats.¹⁰⁷ The new Rule 14a-11 was planned to go in to effect on November 15, 2010, well in time for the April/May 2011 proxy season.¹⁰⁸

On September 29, however, the Business Roundtable, along with the U.S. Chamber of Commerce, filed a complaint in the D.C. Circuit Court of Appeals, alleging that the SEC's proxy access rules were unlawful under U.S. securities laws and "arbitrary and capricious."¹⁰⁹ The Business Roundtable complaint also asserted—but did not explain—that the SEC's proxy rules "do not promote efficiency, competition, and capital formation."¹¹⁰ The complaint was widely anticipated by the marketplace based on public statements, including in the comment letters submitted by these two groups to the SEC on the proxy access proposal. Nevertheless, Congress's authorization to the SEC under Section 971 of the Dodd-Frank Act was thought to shut down this kind of challenge; perhaps as a result, the filing of the Business Roundtable complaint did not attract significant media attention.

However, on October 4, the SEC unexpectedly announced that it would stay implementation of Rule 14a-11, pending resolution of the Business Roundtable litigation in the D.C. Circuit. The SEC explained: "Among other things, a stay avoids potentially unnecessary costs, regulatory uncertainty, and disruption that could occur if the rules were to become effective during the pendency of a challenge to their validity."¹¹¹ News accounts noted that the SEC's announcement was a surprise.¹¹² Commentators also noted that the

¹⁰⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 971, 124 Stat. 1376 (2010).

¹⁰⁶ See Stephen M. Bainbridge, *The Corporate Governance Provisions of Dodd-Frank* 9–10 (UCLA Sch. of Law, Law-Econ. Res. Paper No. 10-14, 2010).

¹⁰⁷ Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668 (Sept. 16, 2010)

¹⁰⁸ *Id.* The three-year rule excluded many investors with shorter holding periods. *Id.* However, the rule would have allowed investors with two-year holdings, for example, to qualify relatively soon. *Id.* Many activist institutional investors have typical holding periods above a year. Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1731 (2008).

¹⁰⁹ Complaint, *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (No. 10-1305).

¹¹⁰ Petition for Review at 2, *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (No. 10-1305). Complaint, *supra* note 109, at 2.

¹¹¹ In the Matter of the Motion of the Business Roundtable and the U.S. Chamber of Commerce for Stay of Effect of Commission's Facilitating Shareholder Director Nomination Rules, 75 Fed. Reg. 63,031 (Oct. 4, 2010).

¹¹² See, e.g., Memorandum from Wachtell, Lipton, Rosen & Katz 1 (Oct. 5, 2010) (on file with author) (noting "unexpected development").

SEC's stay meant that proxy access rules would not go into effect for the 2011 proxy season.¹¹³

On July 22, 2011, the U.S. Court of Appeals for the D.C. Circuit struck down Rule 14a-11 under the Administrative Procedure Act. The D.C. Circuit accepted the Business Roundtable's argument that the SEC's process in considering and adopting the new Rule was insufficiently deliberate and rational.¹¹⁴

In September 2011, the SEC announced that it would not appeal the D.C. Circuit's ruling, but instead would reinstate its amendments to Rule 14a-8, which would allow shareholders to vote on a resolution recommending or requiring the inclusion of shareholder-sponsored board candidates in the next year's corporate proxy statement.¹¹⁵ In April 2012 SEC Chairman Mary Schapiro confirmed that a comprehensive proxy access rule was "not on the Commission's immediate agenda," but that the SEC would "continue to look at [the issue] over time."¹¹⁶ The SEC thus moved away from comprehensive proxy access to a two-step, company-by-company approach. After a sprinkling of proposals in the 2012 proxy season, proxy access is predicted to be a hot-button issue in 2013.¹¹⁷

B. Literature Review

Academic commentators, including ourselves, have used the various twists and turns in the evolution of proxy access over the past decade as natural experiments to test the value of proxy access. The "Efficient Capital Market Hypothesis" (ECMH) predicts that stock prices should reflect all publicly available information.¹¹⁸ A natural corollary of the ECMH is that stock prices should move in response to the arrival of new information, in a way that reflects the market's assessment of that new information.¹¹⁹ An obvious example of new information is an earnings announcement: stock prices typically move within minutes depending on whether the company meets, exceeds, or falls short of the market's expectations.¹²⁰ In the context of

¹¹³ See, e.g., Jesse Westbrook, *SEC Delays Rules Easing Ouster of Directors Amid Review of Legal Challenge*, BLOOMBERG (Oct. 4, 2010), <http://www.bloomberg.com/news/2010-10-04/sec-delays-proxy-access-rules-pending-court-review-following-chamber-suit.html>.

¹¹⁴ Bus. Roundtable, 647 F.3d at 1150.

¹¹⁵ Facilitating Shareholder Director Nominations, 76 Fed. Reg. 58,100 (Sept. 20, 2011).

¹¹⁶ Schapiro, *supra* note 5.

¹¹⁷ See Joann S. Lublin & Ben Worthen, *H-P Activist Investors Score a Major Victory*, WALL ST. J., Feb. 6, 2012, at B4; Sean Quinn, *Midseason Update On Proxy Access*, ISS GOVERNANCE (May 10, 2012, 5:19 PM), <http://blog.issgovernance.com/gov/2012/05/mid-season-update-on-proxy-access.html>; SULLIVAN & CROMWELL, *supra* note 11.

¹¹⁸ See generally Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

¹¹⁹ The idea of empirically evaluating regulatory changes with stock market data was introduced by G. William Schwert. See G. William Schwert, *Using Financial Data to Measure Effects of Regulation*, 24 J. L. & ECON. 121, 122 (1981).

¹²⁰ See James M. Patell & Mark A. Wolfson, *Good News, Bad News, and the Intraday Timing of Corporate Disclosures*, 57 ACCT. REV. 509-27 (1982).

regulatory changes, this kind of “event study analysis” provides insight on whether the regulatory change is viewed by market participants as improving firm value, and, by extension, whether the regulatory change is desirable as a policy matter.

With proxy access, four event studies have exploited various developments in the likelihood of a comprehensive proxy access rule to empirically assess whether proxy access is desirable as a policy matter. If the four studies are simply tallied up, the results appear to be inconclusive: two studies find evidence suggesting that proxy access reduces firm value, while two other studies (including our own) find evidence suggesting that proxy access increases firm value. However, on a closer look we believe that there are methodological and temporal differences that make it inappropriate to give them all equal weight. In our view, the evidence suggests that proxy access, on average, improves firm value.

In the remainder of this Part we explain this point in more detail. The key to our assessment is the well-accepted fact that an event study analysis must use events that are *unexpected* (otherwise there is no new information contained in the actual event), *significant* (otherwise the effect is likely to be lost in general stock market noise), and *directionally clear* (otherwise the interpretation of the stock market reaction will be incorrect). In our view, most of the proxy access events that have been studied do not fit these three criteria. As a result, the results from these studies are ambiguous at best, and potentially misleading.

For example, Larcker, Ormazabal, and Taylor (2010) examine nine events between March 2007 and June 2009 that, in their view, increased the likelihood of shareholder proxy access,¹²¹ and five events that, in their view, decreased the likelihood of proxy access.¹²² The authors use the number of institutions with 1% or more ownership (*NLargeBlock*) and the number of possible coalitions that would control 1% or more of the shares outstanding (*NSmallCoalitions*) as proxies for a company’s exposure to a shareholder access rule.

¹²¹ David F. Larcker, Gaizka Ormazabal & Daniel J. Taylor, *The Market Reaction to Corporate Governance Regulation*, 101 J. FIN. ECON. 431 (2011). The nine events were: the Second Circuit’s holding in *AFSCME v. CA* (Sept. 5, 2006), the SEC announcement of a roundtable discussion on proxy access (April 24, 2007), the SEC’s disclosure of a proposed rule on proxy access (July 27, 2007), a speech by SEC Commissioner Elisse Walter on proxy access (Feb. 18, 2009), a speech by SEC Chairwoman Mary Schapiro on proxy access (April 6, 2009), the SEC’s announcement that it would vote on a proposed rule (May 12, 2009), the SEC’s announcement of the content of the proposed rule (May 14, 2009), the introduction of the Schumer Bill in the U.S. Senate (May 19, 2009), and the SEC’s vote in favor of the proposed rule on proxy access (May 20, 2009). *Id.*

¹²² *Id.* The five events were: the SEC’s publication of a final Rule 14a-8 with no substantial changes (Nov. 28, 2007), the SEC’s publication of a final Rule 14a-8(i)(8) with no substantial changes (Dec. 12, 2007), the introduction of an opt-in shareholder proxy access bill in the Delaware House of Representatives (Mar. 10, 2009), the passage of this bill in the Delaware House (March 18, 2009), the passage of the bill in the Delaware Senate (April 8, 2009), and the reopening of the comment period on the SEC proposed Rule on shareholder access (Dec. 14, 2009). *Id.*

For five out of the thirteen events, the authors find a statistically significant (at 95% confidence) negative correlation between *NLargeBlock* and events that increased the likelihood of shareholder proxy access. For a (somewhat different) five out of thirteen events, the authors find a statistically significant negative correlation between *NSmallCoalitions* and events that increased the likelihood of proxy access. The coefficients for both *NLargeBlock* and *NSmallCoalitions* become highly significant and inversely correlated with increased likelihood of shareholder access when all thirteen events are pooled. The authors conclude that their findings are consistent with the view that >1% shareholders “will use the privileges afforded to them by proxy access regulation to manipulate the governance process to make themselves better off at the expense of other shareholders.”¹²³ Larcker and Tayan (2010) further state that “regulation of corporate governance is viewed negatively by shareholders.”¹²⁴

Akyol, Lim and Verwijmeren (2012) examine eight events between September 2006 and December 2009 that, in their view, increased the likelihood,¹²⁵ and five events that, in their view, decreased the likelihood of proxy access.¹²⁶ For each event date, they compare the return of a portfolio of U.S. firms to the return of a global market portfolio (excluding U.S. firms) and to a Canadian market portfolio. They also isolate U.S. financial firms from other U.S. firms, on the theory that financial firms might be more likely to be targeted by shareholders for proxy access. Six of the events taken individually produce statistically significant abnormal returns around the event dates (at 95% confidence), and when the events are aggregated the returns are highly significant and inversely correlated with shareholder proxy access. Specifically, the authors find that an increased likelihood of shareholder access reduced returns to the U.S. portfolio relative to the non-U.S. portfolios, and for U.S. financial firms relative to non-financial U.S. firms.

¹²³ Larcker, Ormazabal & Taylor, *supra* note 121, at 447.

¹²⁴ David F. Larcker & Brian Tayan, *Proxy Access: A Sheep, or Wolf in Sheep's Clothing?* 3 (Stan. Graduate School of Bus. Closer Look Series: Topics, Issues, and Controversies in Corp. Governance, 2010).

¹²⁵ Ali C. Akyol, Wei Fen Lim & Patrick Verwijmeren, *Shareholders in the Boardroom: Wealth Effects of the SEC's Rule to Facilitate Director*, 47 J. FIN. QUANT. ANALYSIS 1029 (2012). The eight events are: first mention of the Schumer Bill in the press (April 25, 2009), introduction of the Schumer Bill in the U.S. Senate (May 19, 2009), first mention of the Shareholder Empowerment Act in the press (June 12, 2009), the SEC announcement of a roundtable discussion on proxy access (April 24, 2007), the SEC announcement of amendments to Rule 14a-8 14a-8(i)(8) (July 27, 2007), first mention of potential amendments to Rule 14a-11 (April 6, 2009), the SEC's vote in favor of the proposed rule on proxy access (May 20, 2009), and the publication of the SEC's draft proposal for Rule 14a-11 (June 10, 2009). *Id.*

¹²⁶ The five events are: the SEC's publication of a final Rule 14a-8 with no substantial changes (Nov. 28, 2007), the SEC's publication of a final Rule 14a-8(i)(8) with no substantial changes (Dec. 6, 2007), the introduction of an opt-in shareholder proxy access bill in the Delaware House of Representatives (Mar. 10, 2009), the passage of this bill in the Delaware House (Mar. 18, 2009), the passage of the bill in the Delaware Senate (April 8, 2009), and the reopening of the comment period on the SEC proposed Rule on shareholder access (Dec. 14, 2009). *Id.*

The authors conclude that “increasing shareholder rights . . . may actually be detrimental to shareholder wealth,” and that the results “question the role of shareholder empowerment in addressing agency problems and provide support for the case against shareholder empowerment.”¹²⁷

Taken together, the results from these two studies are strikingly consistent: events that increased the likelihood of proxy access reduced shareholder value, and events that decreased the likelihood of proxy access increased shareholder value. The studies have led some commentators to conclude that proxy access reduces shareholder wealth. For example, Professor Joseph Grundfest of Stanford Law School summarizes the “consistent conclusion” from the two studies as follows:

[P]roxy access, as currently proposed by the Commission, reduces shareholder wealth, and, even if preferred by vocal institutional investors, is inimical to the best interests of the shareholder community as a whole. . . . The best currently available empirical data indicate that, given a choice between the current regime and the Commission’s proxy access rules, shareholders seeking to maximize returns would prefer the status quo because the proposed rules appear to destroy shareholder wealth.¹²⁸

It should also be noted that both the Akyol and Larcker studies were submitted to the SEC as comment letters during the rulemaking process,¹²⁹ and were referenced by the SEC in the final Rule that it promulgated in September 2010.¹³⁰

We find the reliance on these prior event studies to be troubling because many of the events studied were widely anticipated, unimportant, and/or directionally unclear. For example, both the Akyol study and the Larcker study identify the announcement of a SEC roundtable discussion series on April 24, 2007 as an event that increased the likelihood of proxy access.¹³¹ With the SEC having considered proxy access off-and-on for most of the prior decade (and having already promised to take up proxy access after the *AFSCME* decision the prior year¹³²), it is not clear why the announcement of a roundtable discussion—with, of course, no prediction on what conclusions the discussants would reach—should convey meaningful information to the marketplace, much less increase the likelihood of proxy access.

¹²⁷ Akyol, Lim & Verwijmeren, *supra* note 125, at 1040.

¹²⁸ Joseph A. Grundfest, *Measurement Issues in the Proxy Access Debate 2* (Stan. L. & Econ. Olin, Working Paper No. 392, 2010).

¹²⁹ See Letter from Joseph A. Grundfest to Elizabeth M. Murphy, Sec’y, U.S. Sec. & Exch. Comm’n. (Jan. 18, 2010); Letter from David F. Larcker to Elizabeth M. Murphy, Sec’y U.S. Sec. & Exch. Comm’n. (Jan. 18, 2010); see generally 17 CFR §§ 200, 232, 240, and 249.

¹³⁰ See 74 Fed. Reg. 33,298 (July 10, 2009).

¹³¹ Akyol, *supra* note 125; Larcker et al., *supra* note 121, at 437, 443.

¹³² See *AFSCME v. AIG, Inc.*, 462 F.3d 121, 130 (2d Cir. 2006); see also Letter from Charles J. Kalil, Corp. Vice President & Gen. Counsel, Dow Chemical Co., to Chairman Cox and Comm’rs (Nov. 27, 2006) (on file with author).

In fact, the impact of the April 24th announcement on the likelihood of proxy access is not even directionally clear. At the time of the announcement, the Second Circuit's decision in *AFSCME* permitted proxy access on a company-by-company basis.¹³³ In the press release announcing the Roundtable series, SEC Chairman Christopher Cox noted generally: "This roundtable will explore the relationship between the federal proxy rules and state corporation law, and pose questions to the participants about whether this relationship can be improved."¹³⁴ After the Roundtable, the first move from the SEC, proposed in October 2007 and finalized in December 2007, was amendments to Rule 14a-8(i)(8) that overruled the *AFSCME* decision and eliminated proxy access.¹³⁵ To the extent that investors interpreted Cox's general statement to mean that *AFSCME* was vulnerable (which, in retrospect, would have been an accurate interpretation) the April 24 announcement should have decreased the likelihood of shareholder access, rather than increased it as the Akyol and Larcker studies predict.

A second problem with both studies is that many of the events were predicted in advance, at least in part, by the marketplace. For example, it is well known that the Corporate Law Section of the Delaware Bar Association, not the Delaware legislature, creates Delaware corporate law. Once the Corporate Law Section voted in favor of a shareholder access amendment on February 26, 2009,¹³⁶ its implementation in Delaware became virtually a foregone conclusion. Both the Akyol study and the Larcker study examine the introduction of the shareholder access bill in the Delaware House of Representatives (March 10, 2009), the passage of the bill in the House (March 18th), and the passage of the bill in the Delaware Senate (April 8th), but fail to examine the recommendation from the Corporate Law Council that occurred on February 26th.¹³⁷ Similarly, the promulgation of the final Rule on August 25th, 2010 was very accurately predicted in press reports ahead of its actual announcement.¹³⁸ If the marketplace fully anticipates an event, then wealth effects around the event date can be meaningless.

¹³³ *AFSCME v. AIG*, 462 F.3d 121; see ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 50, at 201.

¹³⁴ U.S. Sec. & Exch. Comm'n, SEC Announces Roundtable Discussions Regarding Proxy Access (Apr. 24, 2007) (on file with authors).

¹³⁵ Shareholder Proposals Relating to the Election of Directors Final Rule, 72 Fed Reg. 70,450 (Dec. 11, 2012)

¹³⁶ See Michael Tumas & John Grossbauer, *Morton, Anderson & Corroon, Amendments to the Delaware Corporation Code*, HLS FORUM ON CORP. GOVERNANCE & FIN. REG. (Feb. 28, 2009, 4:24 PM), <http://blogs.law.harvard.edu/corpgov/2009/02/28/proposed-amendments-to-the-delaware-general-corporation-law-2/>; DEL. CODE ANN. tit. 8; DEL. GEN. CORP. L. § 112 (2009).

¹³⁷ Akyol, Lim & Verwijmeren, *supra* note 125; Larcker, Ormazabal & Taylor, *supra* note 121, at 437.

¹³⁸ See, e.g., LATHAM & WATKINS LLP, PROXY ACCESS COMMENTARY NO. 1 6 (2009), available at <http://www.lw.com/thoughtLeadership/corporate-governance-commentary-proxy-access-analysis-no-1>; Bass, Berry & Sims Corp., *Delaware Adopts Proxy Access Amendment; SEC Expected to Adopt Proxy Access Rules Shortly*, SEC. & EXCH. COMM'N L. ALERT (May 15, 2009), <http://www.bassberry.com/files/Publication/e7ed792b-bfea-4c3c-818e-010ce76bb6>

In contrast to these prior studies, we (in conjunction with our colleague Dan Bergstresser) examine two events that we believe to be unanticipated, important, and directionally clear. The first is the SEC's unexpected stay of proxy access, announced on October 4, 2010. In our view, this was an unanticipated, important, and directionally clear event: proxy access went from 100% to 0% for the 2011 proxy season, and from 100% to some probability less than 100% (depending on one's views about the merits of the Business Roundtable challenge) for years beyond that. The second event is the D.C. Circuit's ruling on July 22, 2011, striking down Rule 14a-11 under the Administrative Procedure Act. Based on our conversations with administrative law scholars at the Harvard Law School and elsewhere during the pendency of the litigation, this outcome too was unexpected by the marketplace. The core of the reasoning was that the SEC had explicit authority to adopt a proxy access rule, under Section 971 of the Dodd-Frank Act of 2010.¹³⁹ To impose a stringent cost/benefit assessment on the SEC would therefore seem to subvert Congressional intent. At the very least, it seems clear that the D.C. Circuit's ruling was not completely anticipated by the marketplace. In our view, this was an unanticipated, important, and directionally clear event that substantially reduced the likelihood of proxy access.

Using a one-day event window around both event dates, we find that share prices of companies that would have been more vulnerable to proxy access (as measured by institutional ownership, among other things) declined compared to share prices of companies that would have been most insulated from the SEC's Rule.¹⁴⁰ This value loss was economically significant: on October 4th, for example, we estimate a value loss for the S&P 500 of approximately \$80 billion in value. Our findings received attention in the *Wall Street Journal*,¹⁴¹ the *New York Times*,¹⁴² and the *Deal* magazine,¹⁴³

ff/Presentation/PublicationAttachment/676bda50-5f2f-4467-ad0a-01bc83d85b25/Corporate Alert.

¹³⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 971, 124 Stat. 1376 (2010).

¹⁴⁰ We also use an intra-day window, using minute-by-minute stock price movements on October 4, 2010, and obtain directionally the same results. The intra-day findings respond to critics of an early version of our paper, who expressed skepticism about the validity of event study methodology in general and the causal inferences that can be drawn from such a methodology. See, e.g., David Marcus, *The Proxy Access Problem*, THE DEAL MAG. (NOV. 24, 2010), ("[R]eaders with little understanding of and less confidence in the black art of regression analysis may well be skeptical of a paper that claims to be able to assign a value measured in basis points to a single amorphous factor on a single trading day among the dozens that affect the value of stocks."). Contrary to Marcus's suggestion, event study analysis is one of the most well-established and commonly-used tools in all of finance. It is precisely the "little understanding of" event study analysis that causes "less confidence" in event study methodology (which, as an aside, does not make use of regression analysis as Marcus suggests). Having said that, event study methodology has to be used with care, and can be abused. See *infra* Part III.B.

¹⁴¹ *Overheard*, WALL ST. J., Feb. 3, 2012, at C8.

¹⁴² Steven M. Davidoff, *The Heated Debate Over Proxy Access*, N.Y. TIMES (NOV. 2, 2010), <http://dealbook.nytimes.com/2010/11/02/the-heated-debate-over-proxy-access/>.

¹⁴³ Marcus, *supra* note 140.

among other places. The *Journal* summarized the implications of our findings as follows:

Companies dislike the idea of giving investors more say over who runs for board seats. Among their arguments: It could shift power to shareholders, such as unions, which may have goals at odds with maximizing value. The stock market doesn't agree, according to economists Bo Becker, Daniel Bergstresser and Guhan Subramanian. . . . Making it easier for outsiders to slate board candidates might not be good for sitting board members, but it could be good for investors.¹⁴⁴

In contemporaneous work with ours, Cohn, Gillan, and Hartzell (2010) also study proxy access using an event study methodology, focusing on firms with activist investors (but using a classification scheme for investors that differs from ours).¹⁴⁵ They use three event dates, all more recent than the Larcker and Akyol studies: a refinement of the proxy access rule that clarified the position size requirements for proxy access (June 16–17, 2010); an additional refinement that led to the dropping of the 5% threshold from the Dodd-Frank bill (June 24–25, 2010); and the ultimate passage of the proxy access rule (August 25, 2010).¹⁴⁶ The authors argue that the 5% size requirement introduced on June 16–17 was a higher threshold than expected in the marketplace, and therefore should be interpreted as a negative event for proxy access. When this 5% requirement was dropped on June 24–25 this was, in turn, a positive event for proxy access. On August 25, when the final Rule was announced, the authors argue that the surprise event was the three-year holding period rather than two years expected by the marketplace; therefore this was a negative event for proxy access.

The Cohn study finds a positive correlation between proxy access and shareholder wealth, i.e., the two negative events reduced value for companies most vulnerable to proxy access, and the one positive event increased value for companies most vulnerable to proxy access. These findings are inconsistent with the findings from the Akyol and Larcker studies, but consistent with the findings from our study with Bergstresser.

So who is correct? One potential basis for explaining the difference among the various studies would be in the particular events that are studied. We believe that our study, unlike the Larcker and Akyol studies, uses events that were unanticipated, important, and directionally clear. It is well accepted that these three criteria must be met in order for event study analysis to be meaningful.

¹⁴⁴ *Overheard*, *supra* note 141.

¹⁴⁵ Jonathan B. Cohn, Stuart L. Gillan, & Jay C. Hartzell, On Enhancing Shareholder Control: A (Dodd-) Frank Assessment of Proxy Access (Jul. 14, 2011) (unpublished manuscript) (on file with authors).

¹⁴⁶ *Id.* at 16, 20–21.

Another potential basis for explaining the difference would be temporal: the two studies that use events from 2006–2009 (Larcker and Akyol) find evidence that proxy access reduces firm value, while the two studies that use events from 2010–2011 (Cohn and our study) find evidence that proxy access increases firm value. The different results, then, might be explained by learning in the marketplace, as investors became more comfortable with the idea of proxy access.

A third possible basis for explaining the difference, related to the second, is that the events we study were a response to a specific proxy access rule, which contained specific ownership thresholds (3%) and holding period requirements (3 years). The earlier events studied in the Larcker and Akyol studies involved hypothetical rules, because there was no specific rule that had been formally proposed by the SEC during their timeframe of analysis. In particular, it seems possible that the earlier event studies captured the market's reaction to a 1% ownership threshold for large U.S. public companies, as contained in the May 2009 proposed Rule. To the extent that a 1% ownership requirement was too low, the final Rule corrected this deficiency with a 3% ownership requirement. This explanation, if correct, would resolve the difference between our findings and the earlier studies; it would also be consistent with our experience in the 2012 proxy season (described in more detail below), in which proposed Rules with 1%/1-year hold requirements were systematically unsuccessful and proposed Rules with 3%/3-year hold requirements were systematically successful.

We return to the question of specific rule design below. For present purposes, it is sufficient to say that if the market viewed ownership thresholds and holding period requirements as desirable, and if there were some chance during the 2006–2009 period that the final proxy access rule would not have such features, or at least not at optimal levels, then the market might penalize the hypothetical rule on this basis.

C. *The Mechanism for Value Creation*

To the extent that we have persuaded the reader that proxy access creates value, on average, in this Part we discuss the likely mechanism for value creation. The starting point is the core tenet that more meaningful democracy leads to better governance. In the corporate law context, this means that more meaningful director elections leads to better directors and better corporate governance, either because the incumbent directors are more vigilant (i.e., *ex ante* effects) or the election process weeds out ineffective directors in favor of new blood (*ex post* effects). Incidents like the JPM “London Whale” become less likely, which directly influences share price. More than separation of Chairman/CEO, independent director requirements, “Say on Pay,” and other high-profile corporate governance reforms that have been proposed and adopted over the past few years, we believe that improving

director elections is likely to actually improve corporate governance because the causal mechanism is so clear.

In an important contribution, Professors Marcel Kahan and Edward Rock take a contrarian view. They argue that proxy access would be unlikely to yield a significant number of shareholder-nominated candidates, and would be unlikely to have a meaningful effect on corporate governance more generally.¹⁴⁷ Drawing inferences from past behavior, the authors argue that neither mutual funds nor private pension funds would make significant use of shareholder access.¹⁴⁸ Large public pension funds “may make some nominations,” but hedge funds and union-affiliated funds, which historically have been more activist, would generally not satisfy the ownership and holding period requirements under the Rule. In addition, Kahan and Rock argue that the proxy access rule would not substantially lower the costs of running a short slate contest, and that, in some respects, the costs of running a candidate using the company’s proxy statement would be greater than running a candidate in the traditional manner.

While we agree with Kahan and Rock that the number of actual candidates under a shareholder access regime may very well be small, we believe that Kahan and Rock give too little weight to the potential for more meaningful “constructive engagement” between large shareholders and the company under a proxy access regime. Moreover, Kahan and Rock’s predictions about shareholders’ willingness to use proxy access are based on past behavior, and do not account for the possibility that shareholder behavior would change in response to a new regime.¹⁴⁹

The analogy to proxy access should be apparent: a cost/benefit analysis ignores the possibility for behavior change due to the fact that a proxy access candidate goes to a “sacred space,” namely, the company’s own proxy statement. Proxy access creates the possibility of more candidates on the ballot than seats on the board. In our view, it is this simple point that distinguishes proxy access from majority voting, Rule 452, and eProxy, all of which, as we show in the prior Part, have had less of an impact on improving director elections than their proponents had predicted.

¹⁴⁷ Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347 (2011).

¹⁴⁸ *Id.* at 1370, 1432.

¹⁴⁹ On this last point, in a recent presentation of this paper at New York University alongside Kahan and Rock, one of us observed that their approach to proxy access could similarly be used to predict that texting is unlikely to be a significant mode of communication. Texting is just slightly less costly than email (e.g., no need for a header, as is the convention with email), and in some ways texting is more costly than email (e.g., you need to know the phone number rather than just the email address). Of course, this prediction would be highly inaccurate because behavior has in fact changed in response to the new technology, at least in part because text messages go to a space (the phone number) that is far more sacrosanct than the email inbox. A static cost/benefit analysis of texting versus email would not capture this critical difference.

D. Optimal Design of a Proxy Access Rule

After the SEC's announcement that it would abandon comprehensive proxy access and instead permit a company-by-company approach, shareholders put proxy access proposals on the ballot for 23 companies in the 2012 proxy season.¹⁵⁰ Of these 23 proposals, the SEC deemed that eight were excludable, either because they conflicted with another bylaw, because there were multiple proposals on the topic, and/or they were too vague. One more was withdrawn (at Pioneer Natural Resources) in response to governance improvements, and five others were not voted on for other reasons. Among the remaining nine proposals, two received a majority of the votes cast (60% at Chesapeake Energy and 56% at Nabors Industries), and seven received less than a majority.¹⁵¹

The results from the 2012 proxy season are likely the result of some idiosyncratic contextual features and should not be examined too closely for predictions about future proxy seasons. Shareholder proposals were rushed, yielding certain procedural challenges that will likely be resolved going forward; in addition the two successful proposals can almost certainly be explained in substantial part by corporate scandals revealed at both companies just weeks before the annual meetings.¹⁵²

One clear lesson for the future nevertheless emerges: shareholders will pay attention to the specifics of the access proposal in determining how to vote. The two successful proposals both imposed an ownership threshold/holding period requirement of 3%/3 years, identical to the abandoned Rule 14a-11, while *all* of the unsuccessful proposals had lower thresholds, typically 1%/1 year. Even with ISS recommendations in favor of 1%/1 year requirements at Charles Schwab, CME Group, Wells Fargo, and Western Union, the proposals did not pass. This evidence indicates that shareholders value ownership thresholds and holding periods, and are unwilling to give the powerful stick of proxy access to just any shareholder.

¹⁵⁰ SULLIVAN & CROMWELL LLP, PROXY ACCESS PROPOSALS – REVIEW OF 2012 RESULTS AND OUTLOOK FOR 2013 (2012).

¹⁵¹ The votes were: Charles Schwab (31% in favor), CME Group (38%), Wells Fargo (32%), Western Union (33%), Ferro Corp. (13%), Princeton National Bancorp (32%), KSW (21%).

¹⁵² At Chesapeake Energy Corp. the board revealed in April 2012 that CEO Aubrey McClendon was given certain rights to co-invest with the company that created potential conflicts of interest. Anna Driver & Brian Grow, *Special Report: Chesapeake CEO Took \$1.1 Billion in Shrouded Personal Loans*, REUTERS (Apr. 18, 2012), <http://www.reuters.com/article/2012/04/18/us-chesapeake-mcclendon-loans-idUSBRE83H0GA20120418>; at Nabors Industries it was revealed that CEO Eugene Isenberg had used the corporate jet for personal trips to Palm Beach and Martha's Vineyard, among other places, without disclosure. See Mark Maremont, *A Very Rich Adieu for Nabors CEO*, WALL ST. J., Oct. 31, 2011, at A1.

CONCLUSION

U.S. director elections have long been a formality. After the financial crisis of 2007/2008, there was a growing consensus that steps should be taken to make director elections more meaningful. In this Article, we have empirically assessed the three most important reforms that have been put in place over the past few years: majority voting, eProxy, and Rule 452 Amendments. We find that each of these changes has had a trivial impact. Even when taken together, they have barely moved the needle toward more vibrant director elections. This finding stands in stark contrast to the predictions made by proponents of these various changes when they were being proposed and considered by policymakers.

In our view, comprehensive shareholder proxy access is the single tool that provides the greatest chance of meaningful director elections. The causal mechanism for achieving change is clear. Our empirical evidence, conducted jointly with our colleague Daniel Bergstresser, indicates that the market, at least, believes that proxy access would have had a meaningful, positive impact on corporate governance. And in view of the evidence presented in this Article that other reforms have failed, we believe that the case for comprehensive shareholder proxy access becomes even stronger.

With the rise and fall of comprehensive proxy access, the battle has now shifted to a company-by-company approach for the 2013 proxy season and going forward. Our research points in favor of a properly designed proxy access regime. However, a company-by-company approach, unlike a comprehensive approach, raises countervailing concerns regarding the market for corporate directors. Proxy access at any particular company may be detrimental for that company because qualified directors would be less willing to serve on the boards of such companies, relative to companies that do not offer proxy access to their shareholders.

If proxy access became the norm, then the negative effects on director recruitment would be diminished. But if instead proxy access did not proliferate, then the negative effects on director recruitment may be significant and companies might reasonably reject proxy access in order to attract qualified individuals to serve on their boards. Ultimately this question cannot be resolved at the level of theory and will depend on our experience with a company-by-company approach over the next few years.