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ELEPHANT IN THE BOARDROOM?: COUNTING THE VOTE IN CORPORATE ELECTIONS

While corporate elections are not perfectly parallel to civic elections . . . notions of what a fair election means and entails do inescapably carry over It is troubling . . . if the side in control of the levers of power employs them . . . to coerce its opposition One need not assume bad faith on the part of incumbents to foresee . . . the prospects for unfairness; honest men seeking their (disputable) vision of what is best, if not bound-in by rules, are capable of gross impositions. Thus, it offers cold comfort that the law will assume that directors are acting in good faith. Where the franchise is involved a special obligation falls upon courts to review with care action that impinges upon legitimate election activities.¹

I. INTRODUCTION

After a tense proxy fight for control of Yahoo Inc., election results announced at the August 1, 2008, annual meeting showed the incumbent board of directors remained in control.² Yahoo announced that Chairman Roy Bostock received a 79.5% favorable vote, CEO Jerry Yang 85.4% favorable, and the next day the Wall Street Journal reported that “[s]hareholders overwhelmingly endorsed the board.”³ The six-month run-up to the annual meeting had been tumultuous: it began with an unsolicited buyout offer from Microsoft on February 1, followed by on-again, off-again negotiations with Microsoft, the unwelcome intervention of Carl Icahn, a “just vote no” proxy campaign mounted by dissident shareholders, and a share price that had roller-coastered from about \$20 to more than \$33 and back to \$20.⁴

The Yahoo board’s sense of relief was short-lived because an institutional investor asked Broadridge Financial Solutions, the

¹ Stahl v. Apple Bancorp, Inc., Civ. A. No. 11510, 1990 WL 114222 at *5 (Del. Ch. Aug. 9, 1990) (holding, despite the dicta quoted, that under *Unocal* analysis a board’s defenses against a takeover bid were reasonable in light of the threat). Chancellor Allen stated further that “assessment of the reasonably foreseeable consequences . . . on legitimate election activities, made as of the time that the board acted . . . is relevant for a determination whether the action was authorized and whether it constituted a breach of duty of loyalty.” *Id.* at *6.

² Jessica E. Vascellaro, *Yahoo Shareholders Endorse Board*, WALL ST. J., Aug. 2, 2008, at B6, available at <http://online.wsj.com/article/SB121761996994605499.html>.

³ *Id.*

⁴ See Jessica E. Vascellaro & Matthew Karnitschnig, *Yahoo Will Add Icahn to its Board*, WALL ST. J., July 22, 2008, at B2, available at <http://online.wsj.com/article/SB121664028755469981.html> (including a table that concisely summarizes the key events leading up to Yahoo’s annual meeting. *Id.*

independent vote-tabulator Yahoo had employed, to check the totals.⁵ The investor, who along with a related fund, controlled about 16% of Yahoo's outstanding stock, strongly doubted whether support for the incumbent board was as high as news reports indicated.⁶ After checking the totals, Broadridge and Yahoo announced a corrected vote count on August 5, revealing a miscount amounting to about 20% of the total vote, with roughly twice as many votes withheld from the chairman and CEO as first reported.⁷ The recount did not change the outcome of the election, but shareholders' view of the board's performance evidently fell short of overwhelming endorsement.⁸

The events at Yahoo were not unique.⁹ For two and one-half months after the June 2008 annual meeting of CSX Corp., the incumbent board

⁵ Jessica E. Vascellaro, *Yahoo Shareholder Questions Vote on CEO*, WALL ST. J., Aug. 5, 2008, at B6, available at <http://online.wsj.com/article/SB121788630096211373.html>.

⁶ *Id.*

⁷ Benjamin Pimentel & Dan Gallagher, *Yahoo Board Vote Count Sharply Revised*, MARKETWATCH, Aug. 5, 2008, http://www.marketwatch.com/news/story/votes-against-yahoo-board-much/story.aspx?guid={91D5D9F5-AC7B-4F60-9B08-69FF5A156875}&dist=msr_6; Jessica E. Vascellaro, *Yahoo Vote-Counting Error Overstated Support for Yang*, WALL ST. J., Aug. 6, 2008, at B6. Analysis revealed the source of the error was a truncated total on a computer-generated report. Scott M. Fulton III, *Huge Correction: More Opposition to Yahoo's Yang than First Tabulated*, BETA NEWS (Aug. 6, 2008), http://www.betanews.com/article/Huge_correction_More_opposition_to_Yahoos_Yang_than_first_tabulated/1218038502 (candidates who received votes totaling a nine-digit number "had votes removed from their 'against' column and moved to their 'for' column. . . . Shareholder votes were tabulated on paper").

⁸ Pimentel & Gallagher, *supra* note 7.

⁹ See *In re Waddell & Reed Financial, Inc.*, No. Civ. A. 4602-CC (Del. Ch., June 12, 2009) (ordering an inspector of election to reopen the vote and accept previously omitted votes of approximately 3.2 million shares of Waddell & Reed after a proxy advisory firm failed to transmit votes because of a technical error). See generally Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485, 510-11 (1994):

The leaky dam of proxy tabulation burst in the 1993 proxy season when various institutional investors blew the whistle on Automatic Data Processing (ADP) [now Broadridge], a tabulation firm that handles over seventy percent of all corporate proxy solicitations. Several investors claimed [Broadridge] had not tallied their proxies in a "just vote no" campaign against Paramount Communications. The Paramount miscount was only the tip of the iceberg. During the solicitation period before the 1993 spring annual meetings, [Broadridge] had experienced significant difficulties: Proxy materials were sent out late or not at all; [Broadridge] received proxy tabulations late or not at all, causing several firms to struggle to meet quorum requirements or to postpone meetings; electronic tabulation systems failed to function; and proxy solicitors had to solicit proxies several times.

Id.

battled two hedge funds, which together controlled about 20% of CSX's voting shares, before a court decision placed four insurgent director candidates on CSX's board.¹⁰ In the April 2008 election at Washington Mutual ("WaMu"), votes cast by brokers, rather than owners, determined the incumbent board's re-election.¹¹ In the 2005 merger of Transkaryotic Therapies, Inc. with Shire Pharmaceuticals Group PLC, some Transkaryotic shareholders, alleging inaccurate tabulation of votes, disputed whether the merger had been validly approved.¹²

The dirty secret is that when shareholders vote in a corporate election, nothing assures an accurate vote count—as one investment manager observed, “nobody is really penalized if they don't do their job.”¹³ The problem is this: corporate elections are supposed to

¹⁰ Alex Roth, *Vote '08: CSX vs. Activists*, WALL ST. J., June 25, 2008, at C3; Alex Roth, *In CSX Proxy, Funds Claim Victory in Close Board Vote*, WALL ST. J., June 26, 2008, at C1; Heidi N. Moore, *CSX, TCI Count Evokes a Classic*, WALL ST. J., July 24, 2008, at C3; *CSX Announces Final Voting Results for 2008 Annual Meeting of Shareholders*, company news release (July 31, 2008), available at <http://investors.csx.com/> (follow “News Releases,” then “2008” hyperlinks); David Glovin, *CSX Loses Appeal to Block TCI From Winning Two Seats (Update2)*, Sept. 15, 2008, <http://www.bloomberg.com/apps/news?pid=20601087&sid=a.LBL61SRPxe0&dbk>; *CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), *aff'd* 292 F. App'x 133 (2d Cir. 2008) (litigating whether irregularities in proxy disclosures and the differences between shares and equity swaps should disqualify the hedge funds' proxies). Less than a year later, the hedge funds had sold their CSX shares, which had lost about fifty percent of their value, and relinquished their board positions. Alex Roth & Cassell Bryan-Low, *Fund Sells CSX Shares in Wake of Proxy Fight*, WALL ST. J., Apr. 29, 2009, at A24.

¹¹ Jeff Nash, *Broker Vote Zaps Shareholder Might*, FINANCIAL WEEK (Apr. 28, 2008), <http://www.financialweek.com/apps/pbcs.dll/article?AID=/20080428/REG/694771377>. Financial Week reported “[n]one of WaMu's 13 directors received a majority of no votes, although shareholders withheld 40% or more of all votes from two of them . . .” and “broker votes [had] counted for more than 19% of the votes cast in WaMu's 2007 director election.” *Id.* The article noted that brokers usually vote for incumbent management and “these ‘phantom’ votes can provide management with a handicap of up to 20% in elections.” *Id.* Official vote totals allow an inference that the broker vote may have been one-fourth of the total vote. See *Washington Mutual, Inc., Quarterly Report (Form 10-Q)*, at 94 (Aug. 11, 2008). See also *Shamrock Holdings of Cal., Inc. v. Iger*, 2005 WL 5756479 at *1, n.7 (Del.Ch. June 6, 2005) (revealing that Disney's CEO Michael Eisner would not have been elected without “for” votes from brokers—counting broker votes, 45.4% were withheld, but 54.4% of shareholder-instructed shares were withheld from Eisner); *infra* note 100 (in uncontested director elections, brokers may vote their customers' shares if shareholders do not provide voting instructions).

¹² *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 355 (Del. Ch. 2008). Although the inspector of election certified that Transkaryotic shareholders had approved the merger by a margin of 2.6%, evidence showed genuine issues of material fact as to irregularities in validating and counting certain proxies, involving more votes than the margin by which the merger was approved. *Id.* at 375–76, 378.

¹³ Brandes Institute, *Proxy Voting: Making Sure the Vote Counts*, October 2003, <http://www.brandes.com/Institute/Documents/Proxy%20Voting%20092903.pdf>, at 5. See also Meagan Thompson-Mann, *Voting Integrity: Practices for Investors and the Proxy*

legitimate directors' power—and, by extension, the way our economic system works—but real legitimacy depends on a voting process that is fair and accurate.¹⁴

This Note focuses on the curious absence of accountability for accurately counting votes in corporate elections; it assumes—quite apart from the spirited debate concerning the proper role of shareholder voting in corporate governance—that any time an election is called, voters are entitled to nothing less than an accurate count of legitimately cast votes. Throughout, unless otherwise specified, the term “election” refers to any process in which shareholders vote—equally to the election of directors and to voting on a merger or charter amendment. Delaware corporation law, the most thoroughly developed body of law on rights of shareholders and the body of law applicable to more corporations than any other, provides the legal framework.¹⁵

Part II first reviews the Delaware corporation law germane to the discussion of counting the vote in corporate elections.¹⁶ Second, it examines the increasing incidence of contested and close corporate elections, which has exposed weaknesses in the mechanisms and governing law for counting the vote.¹⁷ Third, it reviews fiduciary duties under Delaware corporate law, which frame any question of accountability for conducting the voting process fairly.¹⁸ Fourth, it discusses how the modern practice of holding shares “in street name” complicates the mechanics of conducting a corporate election.¹⁹ Fifth, it

Industry 11 (Yale School of Management, Millstein Center for Corporate Governance and Performance, Policy Briefing No. 2, working draft, June 2008), available at <http://millstein.som.yale.edu/2008%2006%2005%20voting%20integrity2.pdf> (noting that consequences of miscast or lost votes to shareholders and intermediaries can be financial or reputational, including loss of clients).

¹⁴ *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (“The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”). An alternative view is that nowadays “voting by shareholders is best explained as error correction of managers rather than as an inherent shareholder right to participate.” Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 141 (2009). But accepting this alternative view *arguendo*, surely a vote could be efficacious to correct managers' errors only if it is counted accurately.

¹⁵ William T. Allen, Jack B. Jacobs & Leo E. Strine Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1288 (2001) (Delaware's law of business organization is of paramount importance in establishing U.S. pre-eminence in facilitating economic welfare).

¹⁶ See *infra* Part II.A.

¹⁷ See *infra* Part II.B.

¹⁸ See *infra* Part II.C.

¹⁹ See *infra* Part II.D-E.

briefly examines two possible ways to work around or reduce the complexity with technology.²⁰

Part III analyzes, first, the legal and economic reasons why both directors' and shareholders' governance powers deserve protection, and second, the inevitability of errors in the complex proxy-handling system that has evolved around existing legal presumptions and institutional economic interests.²¹ Third, it evaluates how much technology could alleviate errors and identifies obstacles to implementing technical solutions.²² Fourth, it examines biases inherent in current proxy-handling procedures and legal rules.²³ Part IV proposes a doctrine, consistent with established Delaware precedents, to strengthen fiduciary accountability for an accurate vote count in the corporate election process.²⁴

II. BACKGROUND

The expectation that votes legitimately cast in an election should be counted accurately is intrinsic to fundamental notions of democracy: "the elector's right . . . is not only that to cast his ballot but that to have it honestly counted."²⁵

This Part presents background information concerning the legal context of corporate elections. It begins with a summary of relevant Delaware statutes and case law, followed by an examination of reasons why contested corporate elections occur more frequently than in years past. Third, it catalogues the standards of review for corporate directors' fiduciary duties (where any accountability for more accurate elections

²⁰ See *infra* Part II.F.

²¹ See *infra* Part III.A-B.

²² See *infra* Part III.C.

²³ See *infra* Part III.D.

²⁴ See *infra* Part IV.

²⁵ *United States v. Saylor*, 322 U.S. 385, 388 (1944) (reversing lower court's ruling that stuffing a ballot-box in an election for a U.S. senator was not a criminal offense under federal law). Despite disagreement whether regulation of elections is a question of federal or state jurisdiction, justices agreed there is a close association between the right to cast votes and the expectation of fair and honest counting of votes cast. See Frank J. Obara, Jr., *The Counting and Reporting of the Vote, Including the Role of Inspectors of Elections*, 10-3 in R. FRANKLIN BALOTTI, JESSE A. FINKELSTEIN & GREGORY P. WILLIAMS, *MEETINGS OF STOCKHOLDERS* (1995 & Supp. 2008) (commenting that in a fair and honest corporate election someone should attest to accuracy of the tabulation). See also John H. Biggs, *Shareholder Democracy: The Roots of Activism and the Selection of Directors*, 39 *LOY. U. CHI. L.J.* 493, 501 (2008) ("The self-appointing character of how directors of public companies are elected has long been an awkward matter for boards to explain, in light of the perceived democratic process that shareholder ownership suggests. The single slate of directors to 'choose' from doesn't square with American ideas of democracy.").

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must lie). Fourth, it summarizes the practical realities of owning and trading shares in corporations, which is different today than it was when Delaware's corporation law established key presumptions. Fifth, it summarizes the procedures by which a corporation conducts an election and the attendant opportunities for errors. And sixth, it touches on technologies that could simplify the process and reduce errors.

A. *Corporate Elections under Delaware's General Corporation Law*

Delaware law affirms that directors hold the power to manage a Delaware corporation's business, counterbalanced by shareholders' power to elect the directors and to vote on the approval of fundamental proposals.²⁶ Although, in theory, shareholders can nominate and elect directors and amend bylaws without prior board approval, as a practical matter they can only ratify or veto the board's proposals.²⁷ Theory and reality are often at odds; as one scholar has noted, "[c]ourts often commence their opinions with the stern but tired maxims of fiduciary duties . . . only to subsequently invoke the purifying balm of the 'business judgment rule' . . . to preclude inquiry into the merits of directors' decisions."²⁸

²⁶ DEL. CODE tit. 8 § 141(a) (2009) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors."); § 211(b) (2009) (annual meeting and election of directors); § 242 (2009) (amending the articles of incorporation); § 251(c) (2009) (shareholder approval of mergers); § 271(a) (2009) (sale of substantially all corporate assets); § 275 (2009) (dissolution of corporation). *But cf.* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise* 155 (Harvard Law School Discussion Paper No. 567, March 2007), available at <http://ssrn.com/abstract=952078> (arguing that "[s]hareholders commonly do not have a viable power to replace the directors of public companies"); ADOLPH A. BERLE, JR., & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 139 (1932) (describing the proxy machinery as not providing shareholders power over management but rather as separating power from shareholders). In *Speiser v. Baker*, Chancellor Allen reviewed the history of the prohibition on directors voting corporately-held shares of stock, which dates from early nineteenth-century decisions. 525 A.2d 1001, 1009-10 (Del. Ch. 1987). At all times since, courts have been concerned that directors should not control the means of perpetuating their power, and later corporation law statutes uniformly embodied the prohibition. *Id.*

²⁷ DEL. CODE tit. 8 §§ 109(a), 211(b), 251(b)-(c), 271(a) (2009). Compare Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 U.C.L.A. L. REV. 601, 616-17 (2006) ("[O]nly the election of directors and amending the bylaws do not require board approval before shareholder action is possible. In practice . . . even the election of directors . . . is predetermined by the existing board nominating the next year's board."), with Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 660 (2007) (finding it "deeply unsettling" that corporate elections allow shareholders only to vote for the candidate or abstain but not to vote against a candidate, and proposing that the SEC should amend proxy rules to allow "against" votes).

²⁸ Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 593-94 (1983). Compare *In*

By statute, strict rules apply to corporate elections. Delaware corporations must call shareholder meetings annually, and may call special meetings according to circumstances that require a vote.²⁹ The board must comply with statutory requirements in setting the record date, on which the list of shareholders eligible to vote is determined, and must make the list available to registered shareholders.³⁰ In addition, the board must disclose information that is material to questions on which shareholders will vote.³¹ Registered record owners have the sole right to

re Transkaryotic Therapies, Inc., 954 A.2d 346, 360–61 and n.48 (Del. Ch. 2008) (discussing Delaware courts' consistent position that a breach of the board's duty of disclosure surrounding matters on which shareholders vote leads to irreparable harm that justifies injunctive relief), and *In re* J.P. Morgan Chase & Co. S'holders Litig., 906 A.2d 766, 772 (Del. 2006) (recognizing the stockholder's right to cast an informed vote), and *In re* Topps Co. S'holders Litig., 926 A.2d 58, 94–95 (Del. Ch. 2007) (enjoining a merger vote where a standstill agreement with a competing bidder effectively withheld from shareholders material information concerning a proposed merger), and *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) (if stockholders are displeased they have the power replace the board), and *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939) (referring to a "rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation"), with *San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc.*, 2009 WL 1337150 at *10 (Del. Ch. May 12, 2009) (upholding board's power to enter into contracts that trigger a "poison put" debt acceleration if shareholders vote to replace directors, and exonerating the board from a duty of care to be informed of contractual commitments that conflict with the board's fiduciary duties), and *McPadden v. Sidhu*, No. Civ. A. 3310-CC (Del. Ch. Aug. 29, 2008) (where directors countenanced egregious self-dealing by an officer in the spin-off of a subsidiary, the court found exculpable gross negligence rather than a breach of good faith or loyalty), and *In re* Bear Stearns Cos., Inc. S'holder Litig., 2008 WL 959992 (Del. Ch. Apr. 9, 2008) (staying action in Delaware court with effect to allow issuance of new stock to acquirer to determine outcome of merger vote), and *Moore Corp. Ltd. v. Wallace Computer Servs., Inc.*, 907 F. Supp. 1545, 1564 (D. Del. 1995) (directors had right to refuse to redeem the poison pill even though shareholders had tendered 73.4% of shares), and *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989) (approving Time board's merger decision that gave shareholders a lower price than a competing offer and was structured to deny shareholders a vote, because of the threat that shareholders might perceive their interest differently than the board did). In *The Control and Conflict of Interest Voting Systems*, Lynne L. Dallas argues that voting may co-opt shareholders, amounting to illusory participation that provides the mere appearance of accountability. 71 N.C. L. REV. 1, 33–35 (1992).

²⁹ DEL. CODE tit. 8 § 211(b)–(d) (2009) (specifying requirements for meetings of shareholders; annual meetings; special meetings).

³⁰ *Id.* § 213 (2009) (fixing date for determination of stockholders of record); § 219 (2009) (list of stockholders entitled to vote; penalty for refusal to produce; stock ledger).

³¹ SEC Rule 14A, 17 C.F.R. § 240.14a-13 (2007); *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) (when communicating about corporate matters, "the *sine qua non* of directors' fiduciary duty to shareholders is honesty"); *Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996) (directors' duty to disclose includes avoiding partial disclosures that may mislead); *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992) (when it seeks shareholder action, a board has a fiduciary duty to disclose fully and fairly all material information).

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cast votes, although beneficial owners have the right to direct voting of their shares.³²

At a meeting of shareholders, the inspector of election has statutory duties: to determine the number of shares eligible to vote and present at the meeting, either in person or by proxy; to receive proxies and ballots and to determine their validity (including hearing and resolving challenges); to count votes; and to provide a report certifying the vote totals as well as any challenges to voting rights.³³ If the inspector of election cannot resolve a dispute as to the validity of proxies, the parties have recourse in the Chancery Court, which can order and supervise a new election or grant other equitable relief as appropriate.³⁴

The board of directors exercises significant control over the voting process.³⁵ It nominates director candidates and sets the record date and meeting date; it has the exclusive right to formulate most proposals on which shareholders can vote; it appoints the proxy solicitors, tabulator, and inspector of election; and it controls the agenda and chairs the meeting.³⁶ Unlike a competing faction, if any, the board can spend

³² DEL. CODE tit. 8 § 219(c) (2009); SEC Rule 14A-4, 17 C.F.R. § 240.14a-4 (2007). See *Berlin v. Emerald Partners*, 552 A.2d 482, 494 (Del. 1989) (“from the perspective of the Delaware corporation, a broker who is the stockholder of record, has the legal authority to vote in person or by proxy on all matters. Nevertheless, the relationship between a broker, who is the ‘record owner,’ and the beneficial owner is governed by the rules of the various stock exchanges.”); *Enstar v. Senouf*, 535 A.2d 1351, 1356 (Del. 1987) (a Delaware corporation need not look beyond the registered owners). Commonly, the actual “beneficial” owner of shares is not the “record” owner shown on a corporation’s stock register; allowing a broker or bank to be the record owner facilitates trading and overall efficiency of stock markets. See *infra* Part II.D. Except on discretionary matters as defined by stock exchange rules, brokers are bound to vote according to beneficial owners’ voting instructions. *Berlin*, 552 A.2d at 493-94 and nn.14-15 (citing stock exchange rules); *Bay Nfld. Co., Ltd., v. Wilson & Co., Inc.*, 37 A.2d 59, 63 (Del. 1944) (registered holder would not be recognized in equity as entitled to vote shares against true owner’s wishes); *Hauth v. Giant Portland Cement Co.*, 96 A.2d 233, 235 (Del.Ch. 1953) (proxyholder has fiduciary obligation to carry out owner’s wishes); *In re Canal Const. Co.*, 182 A. 545, 548 (Del. Ch. 1936) (estate administrator who transferred shares but was still registered holder on record date may not exercise the voting right in defiance of the transferee’s wishes).

³³ DEL. CODE tit. 8 § 231(b) (2009). See also *Obara*, *supra* note 25, at 10-6.

³⁴ DEL. CODE tit. 8 §§ 225, 227 (2009); *Berlin*, 552 A.2d at 491 (inspectors’ determinations are presumed correct under law, but may be challenged in a suit).

³⁵ *In re MONY Group S’holder Litig.*, 853 A.2d 661, 675 (Del. Ch. 2004) (“[I]n the context of a stockholder vote a board of directors must perform a myriad of ministerial functions in order to ensure an orderly voting process which all, in some way, indirectly affect the vote.”). See also *Dallas*, *supra* note 28, at 19-20.

³⁶ DEL. CODE tit. 8 §§ 211(a), (d), 213, 231, 251(b)-(c), 271(a)-(b) (2009). See, e.g., *Portnoy v. Cryo-Cell Int’l, Inc.*, 940 A.2d 43 (Del. Ch. 2008) (setting aside a corporate election and holding that an incumbent board’s secret vote-buying arrangement and manipulative conduct of annual meeting were inequitable conduct); *State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, No. Civ. A. 17637, 2000 WL 1805376 at *12 (Del. Ch. Dec. 4, 2000) (declining

corporate funds to promote its candidates and proposals, and as the final vote count approaches, the board is better informed than any competing faction about how the vote is accumulating.³⁷

Delaware courts declare that boards have a duty of scrupulous fairness in conducting elections.³⁸ Any time incumbent board members' actions may be seen to promote board entrenchment, their good faith may be scrutinized.³⁹ In *Solomon v. Alexander*, the court asked

summary judgment against a board although it found none of the board's "plethora" of justifications adequate for adjourning the meeting in order to selectively solicit additional proxies).

³⁷ *Levin v. Metro-Goldwyn-Mayer, Inc.*, 264 F.Supp. 797, 803-04 (S.D.N.Y. 1967) (in a contest over policy, a board may make reasonable corporate expenditures to persuade shareholders). See *infra* text accompanying note 119; *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 68 (Del. Ch. 2007) (documenting how the Topps CEO and chairman, facing defeat in a contested 2006 election of directors, postponed the annual meeting long enough to negotiate a deal with insurgents to enlarge the board—and save his directorship). See also Yair Listokin, *Management Always Wins the Close Ones*, forthcoming in 10 AMER. L. & ECON. REV., available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=980695# at 29-30 ("The status quo allows management to obtain frequent vote updates, while shareholder opponents of management often have no comparable knowledge. . . . [I]f management sees that it is well behind, it can undertake an extraordinary effort, while its opponents have no obvious way of responding.").

In *Portnoy*, the Chancery Court found a board's exploitation of such advantage inequitable; since that decision, a new innovation, designed to assure that management will prevail, has appeared in proxy solicitations. 940 A.2d at 47. An example is found in the voting instruction form distributed on behalf of Foundry Networks, Inc. for its special meeting to be held on Dec. 17, 2008: the board asked shareholders to approve Proposal 2—"To approve the adjournment of the special meeting to permit further solicitation of proxies if there are not sufficient votes at the special meeting to approve the first proposal [a Plan of Merger] described above"—that is, management solicited an exculpatory ratification, in advance, of conduct the courts have found improper. Foundry Networks, Inc. Special Meeting to be Held on 12/17/08 at 10:00 a.m. PST for Holders as of 11/07/08 (voting instruction form distributed by or on behalf of UBS Financial Services, Inc. to beneficial owners) (on file with author).

³⁸ *Aprahamian v. HBO & Co.*, 531 A.2d 1204 (Del. Ch. 1987). The court was emphatic:

The corporate election process, if it is to have any validity, must be conducted with scrupulous fairness and without any advantage being conferred or denied to any candidate or slate of candidates . . . those in charge of the election machinery of a corporation must be held to the highest standards in providing for and conducting corporate elections.

Id. at 1206-07; see also *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) (stating that directors' fiduciary duties of due care, good faith, and loyalty are unremitting and include duty to deal with shareholders honestly).

³⁹ *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) (holding the board acted inequitably, with purpose to perpetuate itself in office, when it advanced the annual meeting date and thereby denied a dissident faction time to mount its proxy battle); *accord* *Lerman v. Diagnostic Data, Inc.*, 421 A.2d 906, 914 (Del. Ch. 1980) (invalidating board action when, faced with a known dissident, the board had called an annual meeting with only sixty-three days advance notice after passing a bylaw requiring alternative director candidates be nominated seventy days in advance of the annual meeting); *Giuricich v.*

rhetorically, “how should a court . . . conceive of the best way to protect shareholders’ valid expectation that they will be dealt with fairly?” and answered, “a fully-informed, non-coerced vote.”⁴⁰ Courts have found wrongful coercion where someone’s actions cause shareholders to vote for a reason other than the merits of the transaction.⁴¹ A board’s duty is not only to abstain from overtly and intentionally manipulating corporate elections, but also to be affirmatively fair to dissidents; a board may not passively take advantage of a bylaw that prevents dissident shareholders from conducting a timely proxy contest.⁴² However,

Emtrol Corp., 449 A.2d 232, 239 (Del. 1982) (willful perpetuation of a shareholder deadlock, resulting in board’s entrenchment, frustrated a 50% shareholder’s voting rights and justified court’s appointment of a custodian). On entrenchment in takeover battles, see *infra* Part II.C.4.

⁴⁰ Solomon v. Alexander, 747 A.2d 1098, 1127 (Del. Ch. 1999). The case involved a shareholder challenge to the division of assets and disentanglement of information technology operations when General Motors split off its Electronic Data Systems (EDS) subsidiary to holders of a “tracking stock” based on EDS’s operating performance. *Id.* at 1106–09. Although plaintiffs’ allegations might have rebutted the presumption of protection by the business judgment rule, the court found that an uncoerced vote of shareholders preserved the protection. *Id.* at 1111.

⁴¹ Williams v. Geier, 671 A.2d 1368, 1382–83 (Del. 1996) (vote by a majority of shareholders validly ratified a board-passed recapitalization involving an amendment to the certificate of incorporation that diminished the voting power of shares for three years after their sale to a new shareholder). A court may nullify an election if it finds coercion in proxy disclosures or in the terms of a proposed transaction or in surrounding circumstances. *Id.* at 1382.

⁴² See Moran v. Household Intern., Inc., 490 A.2d 1059, 1080 (Del. Ch. 1985) (subversion of corporate democracy by manipulation of corporate machinery will not be countenanced under Delaware law). *But cf.* Hubbard v. Hollywood Park Realty Enters., No. Civ. A. 11779, 1991 WL 3151 (Del. Ch. Jan. 14, 1991). In *Hubbard*, the board had enforced an advance-notice bylaw even though circumstances changed materially after the advance-notice deadline had passed, to the disadvantage of dissidents who wished to nominate alternative candidates. *Id.* at *2. The court required the board to waive the bylaw and allow dissident shareholders to nominate a slate of director candidates, reasoning that “occasions do arise where board inaction, even where not inequitable in purpose or design, may nonetheless operate inequitably.” *Id.* at *10. In *Blasius*, Chancellor Allen noted that “an unintended breach of the duty of loyalty is unusual but not novel.” 564 A.2d at 663 (citing *Lerman and AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103 (Del.Ch. 1986)). In *Linton v. Everett*, Vice Chancellor Jacobs set aside election results, noting “it is not required that *scienter*, *i.e.*, actual subjective intent to impede the voting process, be shown.” No. Civ. A. 15219, 1997 WL 441189, at *9 (Del. Ch. July 31, 1997); *accord* *Accipiter Life Sciences Fund, L.P. v. Helfer*, 905 A.2d 115, 127 (Del. Ch. 2006) (holding that the court’s “equitable powers can only be roused under *Schnell* where compelling circumstances . . . constitute an evident or grave incursion into the fabric of the corporate law”). *Cf. In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 757 (Del. Ch. 2005) (discussing the possibility of breaching fiduciary duty through inaction). But in *In re Transkaryotic Therapies, Inc.*, Chancellor Chandler stated that “a vote tabulation claim that fails to allege any wrongdoing . . . on the part of the individual defendants can only be asserted against the Company” and that a plaintiff asking a court to invalidate an election must present clear

despite frequent references in dicta to a board's fiduciary duties, the courts seldom, even in cases of wrongdoing, apply a remedy other than merely setting aside an unfair election and ordering a new one.⁴³

B. *Contested Elections*

For many years, shareholders' role in public companies was mostly passive.⁴⁴ But recently, activist investors, including pension plans and hedge funds, as well as so-called raiders like Carl Icahn, have contested director elections, compensation proposals, charter and bylaw amendments, merger and takeover transactions, and precatory

and convincing evidence that the election was in fact invalid. 954 A.2d 346, 374 nn.124–25 (Del. Ch. 2008).

⁴³ See, e.g., cases cited *supra* notes 36–42. But cf. *Rice & Hutchins, Inc. v. Triplex Shoe Co.*, 147 A. 317, 324 (Del. Ch. 1929) (reversing outcome of contested election of directors by court order). In striking contrast, tampering with union elections can result in criminal racketeering charges. In *United States v. DeFries*, union officials were charged with fraudulently procuring their election as well as approval by members of a merger with another union that triggered generous severance payments to the officials, who immediately assumed the same responsibilities for the successor merged union. 858 F. Supp. 1 (D.D.C. 1994), *order rev'd on other grounds*, 43 F.3d 707 (D.C. Cir. 1995), *and on remand*, 909 F. Supp. 13 (D.D.C. 1995), *rev'd on other grounds*, 129 F.3d 1293 (D.C. Cir. 1997). The trial court noted that:

[18 U.S.C.] § 1346 has expressly declared "honest services" to be an interest protected by the mail fraud statute, and it appears to the Court that the "honest services" any organization is entitled to expect of its officers includes, at a minimum, that *the officers*... refrain from corrupting the organization's election proceedings

858 F. Supp at 4. In reinstating mail fraud counts of the indictment, the appeal court stated that the improperly handled ballots were property covered by the mail fraud statute and that

even if it were actually proven at trial that the defendants tampered with fewer ballots than necessary to turn the election, the theft would nevertheless undermine the election's credibility—and thus the value of the union's entire investment in the process—if accompanied by evidence of a risk of broader wrongdoing.

43 F.3d at 710. A jury convicted the defendants of mail fraud and racketeering, 909 F. Supp. at 15, but procedural error and faulty jury instructions caused reversal on appeal. 129 F.3d at 1302, 1305, 1310, 1312.

⁴⁴ *Blasius*, 564 A.2d at 659 (Del. Ch. 1985) ("[i]t has, for a long time, been conventional to dismiss the stockholder vote as a vestige or ritual of little practical importance. It may be that we are now witnessing the emergence of new institutional voices and arrangements that will make the stockholder vote a less predictable affair than it has been."). See also Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders* 4–5, UCLA School of Law, Law & Economics Research Paper No. 08-02, available at <http://ssrn.com/abstract=1089606>.

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resolutions.⁴⁵ As a result, today shareholders' votes make a difference more than ever before.⁴⁶

In response to hostile corporate takeover battles that emerged during the 1980s, corporations adopted a variety of defenses, such as the stockholder rights plan, commonly known as the poison pill.⁴⁷ After Delaware courts legitimated the poison pill, it became a favored mechanism for boards to fend off unsolicited takeover bids.⁴⁸ A board

⁴⁵ NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 312.01 Shareholder Approval, available at http://www.nyse.com/Frameset.html?nyseref=http%3A//www.nyse.com/regulation/listed/1182508124422.html&displayPage=/lcm/lcm_section.html. The NYSE manual notes: "Shareholders' interest and participation in corporate affairs has greatly increased. Management has responded by providing more extensive and frequent reports on matters of interest to investors. In addition, an increasing number of important corporate decisions are being referred to shareholders for their approval." See *State of Wis. Inv. Bd.*, No. Civ. A. 17637, 2000 WL 1805376, at *19 (Del. Ch. Dec. 4, 2000) ("[s]ince the *Blasius* opinion was issued over a decade ago, several large institutional stockholders, including SWIB, have become increasingly proactive in challenging management proposals by asserting their rights as stockholders."); Marcel Kahan & Edward B. Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1229 (2008) (citing three mergers in recent years that were approved by slim margins: Compaq and Hewlett-Packard with 51.4% approval, AXA and MONY with 53.8% approval, and Transkaryotic Therapies with 52% approval); Listokin, *supra* note 37, at 14 (identifying over 16,000 resolutions presented for shareholder approval during the period from 1997 to 2004). See also Biggs, *supra* note 25 (arguing that shareholder activism results in large measure from the shift from defined-benefit to defined-contribution retirement plans prompted by the 1976 enactment of ERISA and resultant democratization of interest in corporate governance).

⁴⁶ Soc'y of Corp. Sec'ys & Governance Prof'ls, Comment Letter to the SEC Re: Roundtables Regarding Stockholder Rights and the Federal Proxy Rules, Proxy Voting Issues: Voting Integrity, Mar. 26, 2007, at 2, <http://www.governanceprofessionals.org/commentletters/flash20s.shtml> ("[w]ith closer elections and increasing shareholder activism, it is important that votes are counted accurately and fairly represent the long-term interests of all stockholders.").

⁴⁷ Lucian A. Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STANFORD L. REV. 887, 904 (2002).

Poison pills consist of stock warrants or rights that allow the holder to buy an acquirer's stock (a so-called "flip over" provision), the target's stock (a "flip in" provision), or both at a substantial discount from the market price. These rights only become exercisable in the event that a shareholder (the "acquiring person") buys more than a certain percentage of the target's stock (typically 10 or 15%) without the target board's approval. These rights are explicitly *not* exercisable by the acquiring person, so the resulting dilution in his voting power and economic stake may make the acquisition of the target through market purchases too expensive to pursue.

Id. (emphasis added).

⁴⁸ *Moran*, 500 A.2d 1346, 1352 (holding that a "poison pill" defense is legal under Delaware law). See Kahan & Rock, *supra* note 45, at 1229 ("In takeover contests, Delaware law, by upholding the poison pill, has channeled the decision into the annual meeting. The

equipped with a poison pill could force the bidder to negotiate with the board rather than offer to purchase shares from shareholders.⁴⁹ The only way for a bidder to overcome a poison pill is to oust the board, replacing it with a new board that will remove the pill; so, with the widespread adoption of poison pills, takeover bids were channeled into proxy contests for control of corporate boards.⁵⁰

C. *Fiduciary Duties – Standards of Review*

A keystone of corporate law is the separation of ownership and control of the modern corporation: managers manage,⁵¹ but shareholders have rights to elect directors, to approve “fundamental” changes (usually only proposals made by the board of directors), and to sell their shares.⁵² Deriving from the history of the corporate form, fiduciary rules of agency law underlie the relationship between owners (shareholders) and managers (directors and officers) of a corporation.⁵³

prevailing mode of hostile acquisitions has become a bid coupled with a proxy contest so as to replace the directors and remove the poison pill.”)

⁴⁹ R. Franklin Balotti & J. Travis Laster, *Professor Coates is Right. Now Please Study Stockholder Voting*, 54 U. MIAMI L. REV. 819, 819 (2000).

⁵⁰ See Allen et al., *supra* note 15, at 1313 (“Replacing the board became an essential part of a hostile offeror’s strategy, because that was the only way to circumvent the otherwise preclusive effect of the poison pill”). *But cf.* Velasco, *supra* note 27, at 675 (arguing that takeover bids are not about managing the business—directors’ domain—but about shareholder’s rights to sell their shares, a decision in which directors should not intrude).

⁵¹ DEL. CODE tit. 8 § 141(a) (2009). The code states the principle:

The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

Id.

⁵² See *supra* notes 26–27 (listing statutes that set out shareholders’ rights relating to fundamental changes).

⁵³ Dallas, *supra* note 28, at 5–12 (outlining the history of corporate law as it pertains to voting rights, from origins in partnership and contract to the entity theory to modern concepts involving the interaction of multiple constituencies). Dallas concludes the historical discussion with the observation that management is no longer an agent of shareholders. *Id.* at 11. Bainbridge describes the function of shareholder voting rights as a means of holding empowered directors accountable to tacit bargains, or at least to standards of reasonable performance, but also as “an accountability device of last resort to be used sparingly” Bainbridge, *supra* note 27, at 627. However, in Bainbridge’s view the board operates “within a pervasive web of accountability mechanisms that substitute for monitoring” by shareholders and shareholder voting is therefore all but superfluous. *Id.* at 625.

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Even though many decisions have narrowed the duties that directors owe to shareholders, Delaware courts maintain that directors of a corporation are in a fiduciary relation to the corporation and its shareholders, and that the fiduciary relation is relevant to the conduct of corporate elections.⁵⁴

Delaware decisions of the 1985–1995 takeover era shaped modern corporate law regarding the rights and duties of shareholders and directors.⁵⁵ Ex-Chancellor Allen, writing in 2001 with Vice Chancellors Jacobs and Strine, recounted the story of how:

⁵⁴ *Loft, Inc. v. Guth*, 2 A.2d 225, 238 (Del. Ch. 1938). The Chancery Court reaffirmed this principle in *Solomon*:

The nature and effect of the fiduciary relationship between directors and shareholders is the very bedrock of Delaware's corporate jurisprudence. A basic duty of fairness, *i.e.*, the requirement to treat shareholders and their equity interest in the corporation fairly, is the broadest notion of the duties directors owe to the corporation's shareholders.

747 A.2d at 1111. *But cf.* *Brehm v. Eisner*, 746 A.2d 244, 256 (Del.2000) (“Aspirational ideals of good corporate governance practices . . . are highly desirable, [and] often tend to benefit stockholders But they are not required by the corporation law and do not define standards of liability.”). A number of academic commentators argue that modern practice has, in effect, superseded the courts’ stated adherence to fiduciary duties. *See* Douglas G. Baird & M. Todd Henderson, *Other People’s Money (Fiduciary Duty to Shareholders)*, 60 STANFORD L. REV. 1309, 1317–20 (2008) (noting common board actions that violate the presumption of fiduciary duty to shareholders without objection from courts, such as filing bankruptcy, triangular mergers, mergers into a shell company that eliminate a class of stock, structuring a merger as an asset sale to eliminate shareholders’ appraisal rights, and declaring in-kind dividends without regard to tax consequences to shareholders); Daniel J. H. Greenwood, *Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1038–45 (199–6) (arguing that the shareholders whom directors represent are a fictional abstraction without the legal rights real principals have over real agents, being powerless, *e.g.*, to initiate actions, bind directors as agents, or terminate directors as agents); Ethan G. Stone, *Business Strategists and Election Commissioners: How the Meaning of Loyalty Varies with the Board’s Distinct Fiduciary Roles*, 31 J. CORP. L. 893, 922, 930 n.164 (2006) (describing the relationship between shareholders and directors as more accurately resembling beneficiary/trustee than principal/agent).

⁵⁵ Allen et al., *supra* note 15, at 1293. Written by three of the principal participants, this paper recounts how standards of review evolved in adjudication of particular cases. The key decisions that reshaped Delaware corporate law, discussed *infra*, were: *Smith v. Van Gorkom*, 488 A.2d 858, 880 (Del. 1985) (establishing a so-called gross negligence standard of review for directors’ duty of care—soon effectively removed by 65 Del. Laws ch. 28g, §§ 1–2 (1986) (current version 8 DEL. CODE tit.8 § 102(b)(7) (2009)), which allowed corporations to insulate directors from liability for damages); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957–58 (Del. 1985) (holding that in takeover cases directors must be reasonable in both perceiving a threat to the corporation and in crafting a defensive response—an intermediate standard); *Moran v. Household Int’l., Inc.*, 500 A.2d 1346, 1352 (Del. 1985) (holding that “poison pill” defense is legal under Delaware law); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 181 (Del. 1986) (holding that once a transfer of control is inevitable, directors’ duty is to obtain the best possible sale price for shareholders—a

[r]equired to develop a body of rules to impose legal order upon . . . (a dynamic revolution in corporate merger activity) . . . , the Delaware courts employed the fiduciary duty doctrine to evaluate the decisions of corporate directors in a multitude of circumstances The end result was the articulation by Delaware courts of new standards of review in cases such as *Unocal*, *Revlon*, and *Blasius*”⁵⁶

Before considering how fiduciary duties apply to corporate elections, the following sections briefly review the key decisions that shaped the law of fiduciary duties between corporate directors and shareholders: the duties of care and loyalty, special duties in the context of selling a company or defending against a hostile takeover bid, the duty of good faith, the duty of disclosure, and how context conditions the interpretation of fiduciary duties.

1. Duty of Care

Duty-of-care claims charge that directors acted without taking sufficient care to ensure that their decisions were good for the corporation; such claims are essentially about negligence.⁵⁷ Not wanting to deter risk-taking, Delaware courts long avoided finding liability so long as directors acted in subjective good faith, and set a lenient gross-

different intermediate standard); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 668 (Del. Ch. 1988) (holding that board action taken to thwart the shareholder vote will not be upheld absent a compelling justification); *Paramount Commc’ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153–54 (Del. 1990) (holding that under the *Unocal* standard the board may reasonably defend against substantive coercion, i.e., the threat that shareholders will disbelieve the board’s reasons for opposing an unsolicited bid); *Stroud v. Grace*, 606 A.2d 75, 78 (Del. 1992) (holding that *Unocal* analysis applies to any defensive measure involving issues of control, even if it implicates voting rights); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (holding that rebuttal of business judgment rule will subject directors to entire fairness review, i.e., the duty-of-loyalty standard); *Paramount Commc’ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 47 (Del. 1994) (holding that either a change-of-control transaction or defensive measures may trigger enhanced scrutiny, which includes judicial review of board’s decision-making and actions); and *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1372–73 (Del. 1995) (holding that board’s action under *Unocal* analysis must be proportionate, neither precluding nor coercing shareholders’ exercise of voting rights).

⁵⁶ Allen et al., *supra* note 15, at 1294.

⁵⁷ *Id.* at 1299–1300 (“[T]he Delaware supreme court, although purporting to apply the gross negligence standard of review, in reality applied an ordinary negligence standard . . . [It] withdrew much of the comfort and greater incentive for risk-taking promised by that more lenient standard.”)

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negligence standard for the duty of care.⁵⁸ However, the standard soon was interpreted more strictly in *Smith v. Van Gorkom*, in which the court found a board liable for damages because it did not investigate and deliberate sufficiently, even though the buyout offer it approved realized a 40% control premium for shareholders.⁵⁹ The Delaware legislature promptly provided for elimination of directors' duty-of-care liability.⁶⁰ Delaware statutes also afford broad protection to directors when they rely on reports or advice from persons with professional expertise.⁶¹ As in *Van Gorkom*, later duty-of-care cases focus on the sufficiency of a board's decision-making process.⁶²

2. Duty of Loyalty

In claimed breaches of the duty of loyalty, involving self-dealing, usurpation of a corporate opportunity, or other conflicts of interest, directors must satisfy a stringent "intrinsic fairness" standard.⁶³ If

⁵⁸ *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); see also *Allen et al.*, *supra* note 15, at 1299 (gross negligence is "a standard facially far more lenient than the simple 'negligence' standard of conduct.").

⁵⁹ 488 A.2d at 880 (Del. 1985) (holding directors liable for deciding to accept buyout offer after insufficient diligence in reviewing the offer and alternatives).

⁶⁰ The new provision enacted in 1986 enables a Delaware corporation to amend its certificate of incorporation to include "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty" in duty-of-care cases but not for breach of the duty of loyalty, bad-faith actions, or self-dealing transactions. 65 Del. Laws ch. 28g, §§ 1-2 (1986), codified as DEL. STAT. tit. 8 § 102(b)(7) (2009). Exculpatory provisions have since become nearly universal in Delaware corporations' articles of incorporation. See *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 65 (Del. 2006) ("Section 102(b)(7) of the DGCL . . . authorizes Delaware corporations, by a provision in the certificate of incorporation, to exculpate their directors from monetary damage liability for a breach of the duty of care.").

⁶¹ DEL. CODE tit. 8 § 141(e) (2009) provides:

[a] member of the board of directors . . . shall . . . be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.

⁶² *E.g.*, *Brehm*, 746 A.2d at 264 ("Due care in the decision[-]making context is *process* due care only."). Shareholders alleged breach of fiduciary duty after The Walt Disney Company's board of directors approved a \$140 million severance package for a dismissed former president; the court held that the board had relied in good faith on expert advice concerning the former president's employment agreement. *Id.* at 248, 261.

⁶³ *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (self-dealing, through a parent corporation's domination of a subsidiary, breaches the duty of loyalty to minority shareholders). In *In re eBay S'holders Litig.*, 2004 WL 253521 (Del. Ch. Feb. 11, 2004), the

directors' financial interests diverge from shareholders' interests, the protections of the business judgment rule and exculpatory provisions do not apply; in such cases, directors must show that both the process and the price in a financial transaction were fair to the corporation and shareholders, or obtain ratification of the challenged transaction by shareholders or disinterested directors.⁶⁴

When corporate takeover battles produced cases that fell between the straightforward duty-of-care and duty-of-loyalty standards, the Delaware courts developed intermediate standards of review to deal with them; over time, two intermediate standards came to control most decisions, depending on whether the issue was sale of the company or control of the board.⁶⁵

3. Best Price in Sale of Company

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. established a standard of review that applies when the sale of a company or substantially all of its assets is in process.⁶⁶ Reasoning that changed circumstances alter a board's fiduciary responsibilities, the Delaware Supreme Court held that once the Revlon board understood that sale of the corporation was inevitable, the directors' duty to shareholders "changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."⁶⁷ Post-*Revlon*, if sale of the company becomes inevitable, the board no longer enjoys managerial discretion in decision-making—its duty is to seek the best price for shareholders.⁶⁸

court refused to dismiss a suit claiming defendant directors of eBay usurped a corporate opportunity. *Id.* at 5. As "thanks" for directing eBay business to them, investment bankers had allocated to the individual directors dozens of IPO positions that afforded them many millions of dollars of quick profits; the court found grounds, sufficient to withstand a dismissal motion, that this gratuity was improperly diverted from the corporation, constituting a breach of the directors' duty of loyalty. *Id.* at 1.

⁶⁴ *Emerald Partners v. Berlin*, 787 A.2d 85, 92 (Del. 2001) ("unless there is a violation of the duty of loyalty or the duty of good faith, a trial on the issue of entire fairness is unnecessary because a Section 102(b)(7) provision will exculpate director defendants from paying monetary damages that are exclusively attributable to a violation of the duty of care.") *Accord* *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710–11 (Del. 1983) ("[W]here one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts The concept of fairness has two basic aspects: fair dealing and fair price.").

⁶⁵ *Allen et al.*, *supra* note 15, at 1312.

⁶⁶ 506 A.2d 173 (Del. 1986).

⁶⁷ *Id.* at 182. The Revlon board approved a merger and then enacted "lock-up" defensive measures against other bidders. *Id.* at 176–79.

⁶⁸ *Id.* at 182. The court held that, having decided on a transfer of control, directors were bound to seek the best price for shareholders and could not play favorites among

4. Anti-Takeover Defenses

The decision in *Unocal Corp. v. Mesa Petroleum Co.* determined a standard for reviewing a board's defensive actions in a contest for control: when a board adopts anti-takeover measures, it must show both that it reasonably perceived the bid as a threat to corporate effectiveness and policy, and that the defensive measures were a reasonable response to the threat.⁶⁹ Ten years later, in *Unitrin, Inc. v. American General Corp.*, the court further clarified the reasonableness of defensive measures: "if the board of directors' defensive response is not draconian (preclusive or coercive) and is within a 'range of reasonableness,' a court must not substitute its judgment for the board's."⁷⁰

In *Blasius Industries, Inc. v. Atlas Corp.*, the court directly addressed how shareholders' voting franchise relates to the board's legitimacy.⁷¹ The *Blasius* test requires that if the plaintiff can show the board acted with the primary purpose to thwart shareholders' voting rights, then the board must show a compelling justification for its action, even if it acted

competing bidders. *Id.* at 184. In further clarifying *Revlon* duties, the courts have held that directors may seek the best price by a variety of methods, including single-bidder negotiations supplemented by an effective market check as an alternative to conducting an auction. Allen et al., *supra* note 15, at 1321.

⁶⁹ 493 A.2d 946, 955 (Del. 1985). As part of its rationale, the *Unocal* court noted the inherent danger when a threat to control is involved; directors are necessarily confronted with a conflict of interest, making an objective decision difficult. *Id.*, quoting *Bennett v. Propp*, 187 A.2d 405, 409 (1962). *But cf. Solomon*, 747 A.2d at 1126 ("In most circumstances Delaware law . . . rejects the notion that a director's interest in maintaining his office, by itself, is a debilitating factor.").

⁷⁰ 651 A.2d 1361, 1388 (Del. 1995), quoting *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d at 45-46. In its reasoning about proportionate responses, the court also discussed its decision applying *Unocal* in *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1357 (Del. 1985), in which the board's response was proportionate because it did not "strip" the stockholders of their right to receive tender offers and did not fundamentally restrict proxy contests. *Unitrin*, 651 A.2d at 1387. In *Williams v. Geier*, the court stated that wrongful coercion may exist where a party takes actions that cause shareholders to vote for some reason other than the merits of the transaction. 671 A.2d 1368, 1382-83 (Del. 1996).

⁷¹ 564 A.2d 651, 669 (Del. Ch. 1988) (invalidating a board's actions to increase its size with friendly new directors when incumbent directors admitted they had acted to thwart the election of a new board majority and the board lacked a compelling justification). Even though directors, facing a shareholder consent proposal to reconstitute the board, had acted on their view of the corporation's best interest, their action was "an offense to the relationship between corporate directors and shareholders . . ." *Id.* at 652. Because of the intended effect on an impending vote of shareholders, Chancellor Allen saw the board's action not as exercising the corporation's power, rights or obligations, but as involving the legal and equitable obligations of an agent to a principal—a question that may not be left to the agent's sole business judgment. *Id.* at 660. Even if the board knew better than shareholders what was best for the company, only the shareholders have the right to determine who should be on the board, and therefore the board's action was a violation of its duty of loyalty to shareholders. *Id.* at 663.

in good faith.⁷² The courts have applied *Blasius* in cases that involve a board's overt manipulation of the voting process, for example, in setting the date of a shareholders' meeting, by enacting onerous notice requirements for shareholder-initiated proxy proposals, by limiting access to the list of registered shareholders, or by abuse of the power to chair the shareholders' meeting.⁷³

In *Stroud v. Grace* and further in *Unitrin*, the Delaware Supreme Court subsumed the *Blasius* standard within the second step of the *Unocal* analysis (reasonableness of defensive measures), applicable when the issue of control is present.⁷⁴ As a result, in the evolved *Unocal*-

⁷² *Id.* at 662–63. The decision drew on precedents where the board acted to tamper with the election process; see *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437, 437 (Del. 1971) (board advanced date of annual meeting to handicap dissident shareholders' proxy efforts); *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206 (Del. Ch. 1987) (board postponed annual meeting to disadvantage insurgent proxy holders). The *Blasius* decision added the "compelling justification" burden, to clarify that invalidation of board action was not a *per se* rule. *Blasius*, 564 A.2d at 662.

⁷³ Compare *Chesapeake Corp. v. Shore*, 771 A.2d 293, 296–97 (Del.Ch. 2000) (board unilaterally enacted a by-law requiring a super-majority to overcome an anti-takeover defense), and *State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, No. Civ. A. 17637, 2000 WL 1805376 at *3 (Del. Ch. Dec. 4, 2000) (despite having a quorum, board adjourned meeting to selectively solicit additional proxies favoring its proposal, which otherwise would have lost), and *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1121 (Del. 2003) (board increased its size to dilute voting power of directors elected by insurgent shareholders), and *Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43, 46–47 (Del. Ch. 2008) (where a threatened incumbent board had coordinated vote-buying and manipulated conduct of annual meeting, court ordered new election), with *Stroud v. Grace*, 606 A.2d 75, 91–92 (Del. 1992) (board's control was not threatened and 78 percent of shareholders approved a board proposal to amend bylaws; the Delaware Supreme Court held that the *Blasius* test did not apply), and *Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1117–18 (Del. Ch. 1990) (in response to a tender offer, a board delayed a meeting that had been contemplated but was not required; the court found no disenfranchisement that would invoke the *Blasius* test). Delaware courts appear less likely to apply *Blasius* in cases involving a board decision about a business transaction than when the dispute is purely a matter of board power. See David C. McBride & Danielle Gibbs, *Voting Rights: The Metaphysics of Blasius Industries v. Atlas Corp.*, 26 DEL. J. CORP. L. 927, 936 (2001) (reviewing consistency and usefulness of the *Blasius* doctrine); Velasco, *supra* note 27 at 657–59 (2007) (proposing expanding the application of *Blasius* whenever there is intent to interfere with shareholders' voting rights, not only where a plaintiff can prove interference was the primary purpose, arguing that corporation law specifically allocates voting rights to shareholders as a balance against broad powers allocated to boards of directors and any interference should therefore be subject to close scrutiny).

⁷⁴ *Stroud*, 606 A.2d at 92 n.3 (court must apply *Unocal* where the board adopts a defensive measure that touches on issues of control); *Unitrin*, 651 A.2d at 1379 (under *Unocal*, enhanced scrutiny of defensive measures means they must not preclude or coerce shareholder choices and must be in a range of reasonableness); accord *MM Cos.*, 813 A.2d at 1130 (court must protect shareholders' franchise within *Unocal's* requirement that defensive measures be proportionate and reasonable in relation to the threat); see also *Allen et al.*, *supra* note 15, at 1316 (Delaware courts gradually "folded" the *Blasius* standard into *Unocal*).

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Unitrin-Blasius standard, a court first determines whether the board's perception of a threat to the corporation and its response to the threat are reasonable; if so, it applies the business judgment rule. If not, and if the board's defensive response directly involves shareholders' voting rights, the *Unitrin* analysis (whether a defensive measure coerces or precludes effective voting by shareholders) examines also the *Blasius* question of the board's subjective intent in adopting the defensive measure.⁷⁵

5. Duty of Good Faith

In contrast to the better understood duties of care and loyalty, the legal meaning of the duty of good faith was foggy until 2005, when Chancellor Chandler gave it definition in *In re Walt Disney Company Derivative Litigation*, stating that "intentional dereliction of duty, a conscious disregard for one's responsibilities" is a valid (but not the exclusive) standard for determining good faith.⁷⁶ Breach of the duty of

⁷⁵ Allen et al., *supra* note 15, at 1312-16 (discussing how, once poison pills made replacement of the board essential to corporate takeover strategies, considerations of equity led the courts to evolve the *Blasius* doctrine to look much like the *Unocal/Unitrin* standard). Allen et al. opine that *Unocal/Unitrin* analysis is adequate so long as judges keep a "gimlet eye out for inequitably motivated electoral manipulations" and recommend that the Supreme Court should formally unify the *Unocal/Unitrin* and *Blasius* doctrines. *Id.* at 1316. See *Mercier v. Inter-Tel*, 929 A.2d 786 (Del. Ch. 2007) (discussing the evolved reasonableness standard and—uniquely—finding that a board had satisfied the *Blasius* "compelling justification" standard).

⁷⁶ 907 A.2d 693, 754-55 (Del. Ch. 2005), *aff'd* 906 A.2d 27 (Del. 2006). Acknowledging that the duty of good faith is "[s]hrouded in the fog of . . . hazy jurisprudence," Chancellor Chandler stated that:

[u]pon long and careful consideration, I am of the opinion that . . . intentional dereliction of duty, a conscious disregard for one's responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith. Deliberate indifference and inaction in the face of a duty to act is, in my mind, conduct that is clearly disloyal to the corporation.

Id.; accord *Stone v. Ritter*, 911 A.2d 362, 369, 372 (Del. 2006) (holding that test of oversight liability, sustained or systematic failure of board to exercise oversight, relies on the duty of good faith, as instance of failure to act in the face of a known duty to act). See generally Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006). In Eisenberg's formulation, the elements of the duty of good faith are subjective honesty or sincerity, conformity to generally accepted corporate norms and standards of business decency, and fidelity to office. *Id.* at 26. He notes that "intentional" and "conscious" should be interpreted as meaning "either that the manager was conscious that he was disregarding his duties or that a reasonable person in the manager's position would have known that he was disregarding his duties" so that denial of subjective intent or awareness is not an adequate defense. *Id.* at 72. Eisenberg discusses Vice Chancellor Strine's view that loyalty subsumes good faith, but rejects this view in favor of the three-way distinction. *Id.* at 12-13. The Delaware Supreme court has confusingly come down on both sides of the question, referring to the three primary fiduciary duties in *Cede & Co. v. Technicolor, Inc.*,

good faith is less often a basis for liability than a threshold condition to remove protection of the business judgment rule.⁷⁷ Delaware law does not allow exculpation or indemnification of bad faith actions.⁷⁸

6. Duty of Disclosure

When the board requests shareholder action, shareholders have the right to make an informed decision, and directors have a specific duty to disclose accurately all available material information, which Delaware courts consider an instance of the duties of care, loyalty, and good faith, rather than a distinct fiduciary duty.⁷⁹ The duties of care, loyalty, and good faith obligate directors to deal honestly with shareholders in any public or direct communication.⁸⁰ Further, SEC Rule 14a-9 imposes liability for false or misleading disclosures in proxy statements.⁸¹

7. Fiduciary Duties in Context

Professor Stone attempts to resolve apparent contradictions in key decisions on fiduciary duty by identifying two distinct sets of powers

634 A.2d 345, 361 (Del. 1994); *accord* Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001), but describing the requirement to act in good faith as a subsidiary element of the fundamental duty of loyalty in *Stone*, 911 A.2d at 370.

⁷⁷ Gilbert v. El Paso Co., 575 A.2d 1131, 1145 (Del. 1990) (requiring directors to demonstrate good faith before enjoying the presumption of the business judgment rule). *See also* Eisenberg, *supra* note 76, at 73.

⁷⁸ DEL. CODE tit. 8 § 102(b)(7) (2009) (allowing corporations to exculpate directors from monetary damages for breaches of the duty of care but explicitly excludes breaches of the duty of good faith and loyalty); § 145(a) (2009) (corporations may indemnify any person acting for the corporation if the person acted in good faith).

⁷⁹ Malone v. Brincat, 722 A.2d 5, 12 (Del. 1998) (disclosure duty is implicated when the board requests shareholder action, and the test applied is materiality of the information to the issue put before shareholders; the cause of action does not include reliance, causation, or actual damages). *Accord* Stroud, 606 A.2d at 85 (duty to disclose material facts that would significantly affect the shareholder vote).

⁸⁰ Malone, 722 A.2d at 10 (reversing dismissal of complaint with prejudice, where there was evidence that directors knowingly made false disclosures). The court held that directors violate their fiduciary duty if they “knowingly disseminate false information” that results in injury to the corporation or a shareholder, and stated that the director’s fiduciary duty is not intermittent but “the constant compass” to guide directors’ actions. *Id.* at 9–10. Even when the board is not seeking shareholder action, the duties of care, good faith, and loyalty apply; dissemination of false information could violate one of those duties. *Id.* at 13. *Accord* O’Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 916 (1999).

⁸¹ 17 C.F.R. 240.14a-9 (2007). Scierter is not required in proving a violation of Rule 14a-9: “a proxy solicitation that contains a misleading representation or omission violates the section even if the issuer believed in perfect good faith that there was nothing misleading in the proxy materials.” Beck v. Dobrowski, 559 F.3d 681, 682 (7th Cir. 2009). Pending rule changes to increase shareholders’ access to proxies will impose the same requirement on shareholders who nominate director candidates. 74 Fed. Reg. 29024 (June 18, 2009).

exercised by boards of directors—each having a distinct purpose that implies its own standard for fiduciary duty.⁸² He distinguishes a board's operating power, through which a board makes or delegates decisions about conducting the corporation's business affairs, from a coordinating power, the power to manage collective action by shareholders in voting or selling their shares.⁸³ Powers and duties vary with context: just as *Revlon* duties arise when it becomes clear a company is going to be sold, special board duties arise in the context of an election—these duties, such as the duty of disclosure, facilitate decisions that corporation law reserves for a shareholders' vote rather than for a board's judgment.⁸⁴

D. Holding Securities "in Street Name"

The following sections discuss complex arrangements that developed over the last four decades to enable the growth and efficiency of modern securities markets—arrangements that in many respects clash with presumptions embodied in corporation law.⁸⁵ First to be discussed

⁸² Stone, *supra* note 54, at 928. Stone analyzes apparent inconsistency in the courts' treatment of conflicts of interest and in whether fiduciary duty is owed to shareholders or to the corporate enterprise, especially in applying *Unocal* and *Blasius* doctrines, tracing differences between decisions to differences in the powers the board is exercising in each case. *Id.* at 912.

⁸³ *Id.* at 913–17. Citing various decisions of Delaware courts, Stone argues that the courts recognize this distinction, even if they have not articulated it clearly. Context alters a board's fiduciary duties, just as it does in a case controlled by the *Revlon* rule. See *supra* note 66 and accompanying text.

⁸⁴ Stone, *supra* note 54, at 900, 920. The board's role is to use its coordinating power to assist the shareholders to make their decision effectively, even if the board disagrees with the decision. *Id.* at 924. In short, the board's role is *ministerial*—"involv[ing] obedience to instructions or laws instead of discretion, judgment, or skill . . ." BLACK'S LAW DICTIONARY 457 (3d pocket ed. 2006). Chancellor Allen reasoned in *Blasius*:

[T]he ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context. . . . A board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of *the corporation's power* over its property, or with respect to *its* rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation.

Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 660 (Del. Ch. 1988).

⁸⁵ Considerable complexity results from the interaction of three legal principles:

The only persons entitled to vote are registered owners on the record date

A beneficial holder who permits his or her shares to be held by another in nominee or fiduciary capacity relinquishes the direct right to participate in corporate affairs

. . . [but] the record owner has no right to vote the shares contrary to the wishes of the beneficial owner.

is the arrangement by which the industry eliminated the transfer of paper share certificates. Second is the now-ubiquitous practice of custodial shareholding by intermediaries, which complicates voting. Third is the convoluted set of procedures by which a corporation conducts a vote of shareholders when a vote is required. Fourth is the procedure for counting the vote in corporate elections.

1. “Immobilization” of Shares

In times past, hundreds of messengers scurried around Wall Street transporting stock certificates and checks between offices; by the 1960s, this method of settling trades resulted in a back-office crisis that forestalled further growth of the markets and even forced the stock exchanges to severely cut back trading hours.⁸⁶ Beginning in the early 1970s, the industry developed a solution: by “immobilizing” physical stock certificates in a central depository and recording changes of ownership using book-entry accounting methods, they could eliminate the bottleneck attendant to paper-based transactions.⁸⁷

In the United States today, about 85% of shares are held in street name by brokers or banks, for themselves or as custodians for customers, rather than being registered with the issuing company.⁸⁸ These shares are deposited with The Depository Trust Company (“DTC”), which keeps track of who owns them by electronic bookkeeping entries; DTC’s affiliate Cede & Co. is the shareholder of record on the issuing

A. Gilchrist Sparks III & Michael Houghton, *The Mechanics of Stockholder Voting Under Delaware Law, and Conducting an Annual Stockholders’ Meeting of a Delaware Corporation*, in SHAREHOLDER MEETINGS AND SHAREOWNER CONTROL IN TODAY’S SECURITIES MARKETS, at 433, 435 (PLI Corp. L. and Practice, Course Handbook Series No. 507, 1985).

⁸⁶ David C. Donald, *The Rise and Effects of the Indirect Holding System: How Corporate America Ceded its Shareholders to Intermediaries*, Johann Wolfgang Goethe-Universität, Institute for Law and Finance, Working Paper No. 68, 9–10 (2007), http://publikationen.uni-frankfurt.de/volltexte/2007/4885/pdf/ILF_WP_068.pdf. From 1960 to 1968 trading volume quadrupled; the back-office crisis was brokers’ inability to settle the transactions. *Id.* at 10. In some brokerage firms, the backlog of transactions grew to exceed in value the firms’ total assets. *Id.* at 9. Over 100 firms failed or were acquired. *Id.* It took four years after one firm was liquidated to sort out its backlog of paper transactions. *Id.* at 12.

⁸⁷ 15 U.S.C. § 78q-1(e) (2000) (as amended in 1975, § 17A(e) of the Securities and Exchange Act requires all exchange-traded securities to be immobilized); *see also* Donald, *supra* note 86, at 17-19. Donald observes that intermediaries in effect replaced corporations as the “issuers” of the dematerialized “securities,” which were then transferred as claims against their custody accounts; they also replaced shareholders as the persons registered on corporations’ stockholders lists. *Id.*

⁸⁸ SEC, *Briefing Paper: Roundtable on Proxy Voting Mechanics* (May 23, 2007), <http://www.sec.gov/spotlight/proxyprocess/proxyvotingbrief.htm>.

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company's stock register.⁸⁹ When investors buy and sell shares in a brokerage account, DTC settles trades by calculating each day the net change in brokers' and banks' share balances; brokers and banks perform similar net accounting for purchases and sales in their customers' accounts through as many tiers of custodial relationship as necessary.⁹⁰

This "indirect holding system" streamlined the process of clearing trades at the cost of obscuring share ownership: under this system, the true beneficial owner who holds equitable title⁹¹ is not the record shareholder that state corporation laws recognize.⁹² Besides obscuring the owner's identity, indirect holding also obscures the quantity owned. Although corporation law (like the naïve investor) views a shareholder

⁸⁹ Donald, *supra* note 86, at 23. See also Depository Trust & Clearing Corp., *An Introduction to DTCC Services and Capabilities* 3 (April 2008), http://www.dtcc.com/downloads/about/Introduction_to_DTCC.pdf (DTC retains custody of 3.5 million securities issues, worth about \$40 trillion, including securities issued in the US and more than 110 other countries); Depository Trust & Clearing Corp., *2007 Transaction Statistics and Performance*, <http://www.dtcc.com/about/business/statistics.php> (In 2007, DTC's affiliate, National Securities Clearing Corp., settled 13.5 billion securities transactions valued at more than \$1.8 quadrillion).

⁹⁰ John C. Wilcox, John J. Purcell III, & Hye-Won Choi, "Street Name" Registration & The Proxy Solicitation Process, in *A PRACTICAL GUIDE TO SEC PROXY AND COMPENSATION RULES* 12-6 (Amy L. Goodman & John F. Olson eds., 3rd ed. Supp. 2007) (in most transactions, DTC legally owns shares both before and after the trade, merely shifting them between accounts of intermediaries). See also Prefatory Note to UCC § 8-101 (1994).

⁹¹ Prefatory Note to UCC § 8-101 (1994); UCC §§ 8-102(7), 8-102(17) and comment 17 (1994). The holder of shares in street name holds a *security entitlement*, effective when the intermediary (a broker, bank, or trustee) credits acquired shares to the shareholder's account. UCC § 8-501(b) (1994). This security entitlement is not a claim to specific property, but rather the right to enforce a claim against the intermediary to deliver all property rights associated with the shares. UCC § 8-503(b) and comment 2. The beneficial owner holds the entitlement in common with other entitlement holders, each having a pro rata claim against the intermediary's holdings of the security. *Id.* comment 1. Under the indirect holding rules, it is immaterial whether the intermediary actually owns sufficient shares that it can credit to the beneficial owners. *Id.*; UCC § 8-501(c) (1994). In those instances, now rare, where beneficial owners are also owners of record, the lack of an account record with an intermediary means traditional property law applies to the holding rather than the UCC Article 8 rules. See also Wilcox et al., *supra* note 90, at 12-3 (DTC is merely custodian and has no beneficial interest in shares). See generally Kahan & Rock, *supra* note 45, at 1240-43 (summarizing provisions of UCC Article 8 that are relevant to the indirect holding system).

⁹² DEL. CODE tit. 8 § 219(c) (2009) (stock ledger the only evidence as to who are the stockholders); § 262 (2009) (allowing only the record owner to claim appraisal rights); see *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 469-70 (Del. 1995) (continuing to recognize rule that a corporation may rely on its stock ledger to determine who is eligible to vote or exercise other rights of a stockholder); accord *Berlin v. Emerald Partners*, 552 A.2d 482, 494 (Del. 1989) (record ownership determines who may vote); *Williams v. Sterling Oil of Okla., Inc.*, 267 A.2d 630, 634 (Del. Ch. 1970) ("exclusive right of registered owners to vote"), *rev'd on other grounds*, 273 A.2d 264 (Del. 1971).

as owner of a determinate number of shares, under Article 8 of the Uniform Commercial Code, what the shareholder legally owns is a *pro rata* interest, in common with all other customers of the broker, in a fungible mass of like securities that the broker holds.⁹³ The fungible mass is a continually varying quantity of shares held by custodians, with no specific shares being attributed to specific customers.⁹⁴ As a result, the number of shares shown in a customer's account only *approximates* the number of shares that the customer is legally entitled to vote.

2. Assignment of Proxy

Assigning a proxy establishes a seemingly straightforward agency relationship, by which the owner of shares grants authority to another to vote the shares according to the owner's instructions.⁹⁵ But the

⁹³ UCC § 8-503 (1994); SEC, *supra* note 88. See also UCC § 8-511 (1994) (although the beneficial owner's claim to the financial asset is superior to claims of general creditors, purchasers of that security from the broker and creditors who obtained a security interest have claims superior to the beneficial owner's claim).

⁹⁴ *In re Appraisal of Transkaryotic Therapies, Inc.* No. Civ. A. 1554-CC, 2007 WL 1378345 (Del. Ch. May 2, 2007), at *2 (“[N]o investor who might ultimately have a beneficial interest in securities registered to Cede, has any ownership rights to any particular share of stock reflected on a certificate held by Cede.”). See *supra* note 91.

⁹⁵ DEL. CODE tit. 8 § 212(b) (2009) (authorizes shareholders to appoint a proxy); *Duffy v. Loft*, 151 A. 223, 227 (Del. Ch. 1930), *aff'd* 152 A. 849 (Del. 1930) (appointment of proxy creates agency relationship, of which proxy card is evidence); *McLain v. Lanova Corp.*, 39 A.2d 209, 212 (Del. Ch. 1944) (“[T]he holder of a proxy is an agent, and, within the scope of his authority, has a certain fiduciary relation toward his principal . . .”); *accord Parshalle v. Roy*, 567 A.2d 19, 27 (Del. Ch. 1989) (“A ‘proxy’ or ‘proxy card’ is merely written evidence of an agency relationship in which a principal [the shareholder of record entitled to vote] authorizes an agent . . . to vote the principal's shares with respect to the matters and in the manner specified in the proxy.”). The proxyholder's agency powers are limited by terms granted in the proxy:

A stockholder who is present in person *or* represented . . . by a *general* proxy is present for quorum purposes *and* is also voting power present on all matters. However, if the stockholder is represented by a *limited* proxy and does not empower its holder to vote on a particular proposal, then the shares represented by that proxy cannot be considered as part of the voting power present with respect to that proposal.

Berlin, 552 A.2d at 493. In *North Fork Bancorp. v. Toal* the court held (making a finer distinction than in *Berlin*) that a limited proxy that withholds authority to vote for a proposal does not withhold all voting power but only power to cast a particular vote on that question, and so is properly considered voting power present with respect to that proposal. 825 A.2d 860, 868-69 (Del. Ch. 2000), *aff'd* 781 A.2d 693 (Del. 2001).

It is apparent that recent cases treating proxy assignment powers either maintain the now-obsolete presumption that a legal owner with the power to assign a proxy is also the beneficial owner or use the term ‘proxy’ indiscriminately to denote either proxy or voting instructions.

discrepancy between legal and beneficial ownership, involving tiers of intermediaries, complicates matters.⁹⁶ Although the registered owner has the legal right to vote and to assign that right (a proxy), the beneficial owner has the right in equity to direct how proxyholders vote (through voting instructions, sometimes confusingly called assignment of proxy).⁹⁷ Assignment of proxy creates an elaborate agency relationship that runs in a chain from the legal owner (usually Cede & Co.) through intermediary brokers and banks and Broadridge to the beneficial owner.⁹⁸ Voting instructions create an elaborate agency relationship running in the reverse direction.⁹⁹ But—just as with directors' fiduciary duties in conducting elections fairly—proxyholders' fiduciary duties as agents are theoretical only, because the courts hold that the beneficial owner bears the risk of a proxyholder's errors in voting.¹⁰⁰

⁹⁶ See *supra* notes 90–92 and accompanying text.

⁹⁷ *Freeman v. Fabiniak*, No. Civ. A. 8035, 1985 WL 11583 (Del.Ch. Aug. 15, 1985) (holding it inequitable to allow a mere record holder to vote shares contrary to the true owner's wishes); SEC Rule 14A-4(e), 17 C.F.R. § 240.14a-4(e) (2007) (providing that shares be voted in accordance with beneficial owner's instructions). See NYSE Rule 452, http://rules.nyse.com/nysetools/Exchangeviewer.asp?SelectedNode=chp_1_2&manual=/nyse/nyse_rules/nyse-rules/ (last visited Aug. 11, 2009) (“A member organization shall give or authorize the giving of a proxy for stock registered in its name, or in the name of its nominee, at the direction of the beneficial owner[.]” and “[w]here a member organization gives a subsequent proxy, it should clearly indicate whether the proxy is in addition to, in substitution for or in revocation of any prior proxy.”). See also *Len v. Fuller*, No. Civ. A. 15352, 1997 WL 305833 at *3–5 (Del. Ch. May 30, 1997) (in a close election contest, court applied doctrine of equitable conversion to determine voting rights, ruling that an equitable owner of shares had the right to compel a proxy from the record owner, where the equitable owner had exercised a call option for the record owner's shares but the sale transaction had not yet closed).

⁹⁸ See *Wilcox et al.*, *supra* note 90, at 12-3, 12-7, 12-9 to 12-10 (outlining the “daisy-chain” of relationships). Only very rarely and on special request is proxy authority transferred all the way to the ultimate beneficial owners, who thus do not have any *legal* right to vote their shares; the legal right is retained by the broker or bank.

⁹⁹ *North Fork Bancorp.*, 825 A.2d at 868 (“[O]ne must look to the language on . . . the . . . proxy cards [i.e., voting instruction forms] to determine the nature and extent of the agency relationship created.”). See *supra* note 32; *infra* note 107.

¹⁰⁰ *Am. Hardware Corp. v. Savage Arms Corp.*, 136 A.2d 690, 692 (Del. 1957) (noting the NYSE rule approvingly, but determining that the shareholder bore the risk of any failure of a broker to fulfill voting instructions); *Enstar Corp. v. Senouf*, 535 A.2d 1351, 1354–55 (Del. 1987) (because street name registration is voluntary, shareholder must bear risks attendant on holding shares through nominees; intermediary's error in failing to make demand for appraisal in name of record owner disqualified demand); *Mainiero v. Microbyx Corp.*, 699 A.2d 320, 324 (Del. Ch. 1997) (investor choosing to hold shares other than as record owner assumes risk); see also *McLain v. Lanova Corp.*, 39 A.2d 209 (Del. Ch. 1944) (in the absence of inequitable circumstances, the record owner can vote the stock); *Duffy v. Loft, Inc.*, 151 A. 223 227 (Del. Ch. 1930) (authorized agents' failure to produce and file their proxies at stockholders meeting did not of itself destroy authority). *But cf.* *Allison v. Preston*, 651 A.2d 772 (Del. Ch. 1994), *aff'd sub nom.* *Preston v. Allison*, 650 A.2d 646, 649 (Del. 1994)

If a beneficial owner does not provide voting instructions, stock exchange rules have allowed the broker to vote the shares on routine matters, usually following the Wall Street Rule, which presumes that shareholders uniformly support management—and that if not, they would sell their shares.¹⁰¹ (Effective for annual meetings scheduled after January 1, 2010, the New York Stock Exchange abolished broker discretionary voting for the election of directors.)¹⁰²

If a beneficial owner withholds authority to vote for a director candidate, the effect can vary. Because default rules prescribe plurality voting, in an uncontested election of directors, a single favorable vote suffices to elect the board's candidate, and a shareholder's decision to cast votes for or withhold votes from an incumbent candidate makes no difference whatsoever.¹⁰³ On occasions when a majority vote is required, withholding authority means the shares are considered present and entitled to vote, but no vote will be recorded for them; because this increases the denominator but not the numerator, in effect it counts against the candidate.¹⁰⁴

(confirming the general rule that a beneficial stockholder is afforded no relief if the agent errs but enforcing the agent's duty to vote according to a beneficial owner's wishes because nominee holding of shares was obligatory rather than voluntary under federal ERISA law); *Instituform of N. Am., Inc. v. Chandler*, 534 A.2d 257, 271 (Del.Ch. 1987) (trustees and investment managers, as distinguished from pure nominees, are not bound to follow beneficial owner's wishes). In the risk-of-proxyholder-error cases, it is apparent that what the court calls a "proxy" is the voting instruction that the beneficial owner gave to the intermediary, rather than the legal proxy that Cede & Co. assigned as record owner.

¹⁰¹ NYSE Rule 452, *supra* note 97. In opposition to the Wall Street rule, Bebchuk argues that "for shareholders concerned that poor board performance is reducing the value of their investment, the freedom to sell their shares [at a depressed price] is hardly an adequate remedy." Bebchuk, *supra* note 26, at 141.

¹⁰² SEC Release No. 34-60215 (July 1, 2009) approved, with amendments, changes to NYSE Rule 452 that the NYSE first proposed in 2006.

¹⁰³ DEL. CODE tit. 8 § 216(3) (2009) (unless bylaws provide otherwise, directors will be elected by a plurality of votes of shares present and entitled to vote). *See generally* American Bar Association, Section of Business Law, Committee on Corporate Laws, *Discussion Paper on Voting by Shareholders for the Election of Directors*, June 22, 2005, <http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20050621000000.pdf> (discussing the historical fear of failed elections owing to insufficient votes to satisfy a majority standard). *See Velasco, supra* note 27, at 612 (noting that incumbent directors are effectively immune to a shareholder vote and considers it misleading to say there is an election or right to vote).

¹⁰⁴ *See* DEL. CODE tit. 8 § 216(2) (2009) (requires affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter for approval of proposals other than election of directors, unless otherwise stipulated in the company's charter or bylaws). *See generally* *Licht v. Storage Technology Corp.*, No. Civ. A. 524-N, 2005 WL 1252355 (Del. Ch. May 13, 2005) (summarizing the effect of voting instructions and abstentions in various kinds of contests); *Wilcox et al., supra* note 90, at 12-16 (presenting a summary table of vote-tabulation rules); Catherine T. Dixon, *The*

3. Proxy Statements

When a shareholder meeting approaches, state and federal laws require a board of directors to communicate to shareholders the substance of any matters subject to a vote.¹⁰⁵ Delaware corporation law envisions a simple process: *Step 1*, look in the official stockholders list for names and addresses; *Step 2*, send the materials to those persons at those addresses.¹⁰⁶ But this is of course unrealistic; under the “indirect holding system,” beneficial owners are traceable only through accounts on the books of a pyramid of intermediaries.¹⁰⁷ Even if communication with owners could be simplified, solicitation of proxy or voting instructions still must pass through each intermediary: to be legally valid, the power of agency must bind each intermediary in an unbroken chain between the record owner and the beneficial owner.¹⁰⁸

To eliminate the cost and delay that a series of one-to-one handoffs would entail, both issuers and intermediaries assign power of attorney to Broadridge Financial Solutions to distribute disclosure information to beneficial owners and to collect their voting instructions.¹⁰⁹ Acting as the

SEC's Expanded Requirements: Disclosure of Proxy Voting Tabulation Procedures and Results, 7 INSIGHTS 11, 16 (Dec. 1993) (including a table comparing rules for tabulating votes under various states' laws).

¹⁰⁵ SEC Rule 14(b), 17 C.F.R. § 240.14(b); DEL. CODE tit. 8 § 222 (2009).

¹⁰⁶ DEL. CODE tit. 8 § 219(a) (2009); *see also* Donald, *supra* note 86, at 27; Soc'y of Corporate Sec'y's & Governance Prof'ls, *supra* note 46, at 1 (current proxy system is based on obsolete assumptions that shareholders have a long-term economic interest, register their shares, and trade rarely; its defects had less impact in former conditions than today).

¹⁰⁷ *Supra* notes 88-90; *see also* Kahan & Rock, *supra* note 45, at 1242 (noting that the Delaware voting paradigm does not take account of the modern system of custodial ownership, particularly the indeterminacy of share ownership under UCC Article 8); *cf.* Donald, *supra* note 86, at 63 (although masking of the beneficial owner's identity was incidental to the indirect holding system, brokers treat their customer lists as proprietary information and resist sharing it with issuing companies); Soc'y of Corporate Sec'y's & Governance Prof'ls, *supra* note 46, at 5 (proxy communication and voting processes favor interests of brokers and banks rather than interest of beneficial owners).

¹⁰⁸ *See supra* notes 99-100 and accompanying text on establishing a relationship of agency by assigning proxy. The laws of agency apply to the proxy authority: the proxy, *qua* agent, consents to act on behalf of the beneficial owner and subject to the beneficial owner's control. RESTATEMENT (SECOND) OF AGENCY § 1 (1958). As the voting instructions pass through intermediaries to the record owner or proxyholder who will cast the actual votes, each intermediary is bound as a subagent (“a person appointed by an agent empowered to do so, to perform functions undertaken by the agent for the principal”). *Id.* § 5.

¹⁰⁹ Broadridge Financial Solutions, Inc., *ProxyEdge*®, <http://www.broadridge.com/investor-communications/us/institutions/proxyedge.asp> (Broadridge is the proxy agent for 97% of U.S. banks and brokers). Although some other providers compete for some of the services, because of Broadridge's dominant market position, this Note will refer to Broadridge as the provider of proxy distribution and tabulation services. *See also* Obara, *supra* note 25, at 10-2. *See also* Soc'y of Corporate Sec'y's & Governance Prof'ls, *supra* note

agent of both issuer and intermediaries, Broadridge can compile mailing lists and distribute proxy information and voting instruction forms (“VIFs”) on their behalf¹¹⁰ without compromising confidentiality required under Objecting Beneficial Owners rules that mask the identities of a custodian’s customers.¹¹¹

E. Conducting Corporate Meetings and Elections

The corporate election process is presented here step by step, somewhat simplified, followed by a discussion of factors that contribute to difficulty or confusion in counting the vote.

1. Corporate Elections, Step by Step

THE ELECTION PROCESS, STEP BY STEP¹¹²

1	When an issuer announces a corporate election, it must identify intermediaries holding its stock and ask them how many proxy material packages they require for beneficial owners. ¹¹³
2	The issuer issues an “omnibus proxy,” which confers voting authority to banks and brokers with respect to the shares in their DTC accounts on the record date. ¹¹⁴ Brokers and banks transfer

46, at 5 (commenting on lack of competition and lack of incentive to contain costs of proxy-related services because issuers pay for services that other parties price, procure, and perform).

¹¹⁰ SEC, *supra* note 88.

¹¹¹ SEC Rules 14b-1(b)(3) (beneficial owners may choose whether to be either Objecting Beneficial Owners [OBOs] or Non-Objecting Beneficial Owners [NOBOs], applying to brokers), 14b-2(b)(4)(ii)(B) (same, applying to banks). *See also* Donald, *supra* note 86, at 63 (although beneficial owners may have reasons to mask their identities from issuers, default OBO provisions in brokerage account agreements apparently serve brokers’ interest: about three fourths of beneficial owners are considered OBO, and brokers say releasing NOBO lists would endanger their customers’ privacy, even though 88% of shareholders would unconditionally provide the information to issuers). *Cf.* Bus. Roundtable, *Request for Rulemaking Concerning Shareholder Communications*, Letter to SEC dated April 12, 2004, at 11, http://www.sec.gov/rules/petitions/petn4-493.htm#P45_11983 (proposing that investors who care about anonymity should bear the cost rather than pass the costs on to all shareholders).

¹¹² *See* Obara, *supra* note 33; *see also* Donald, *supra* note 86, at 29–33 (summarizing customary procedures used in conducting corporate elections).

¹¹³ 17 C.F.R. §§ 240.14a-13(a)–(a)(1)(i)(A); 240.14a-13(a)(4)–(5); 240.14a-13, Note 1. Determining beneficial owners is an iterative process that may involve multiple layers of respondent banks and regional brokers. Donald, *supra* note 86, at 25.

¹¹⁴ Wilcox et al., *supra* note 90, at 12-7. The issuer ordinarily acts through custodian Cede & Co., which is the legal or record owner of shares. *Id.* at 12-10 to 12-11. Although banks and brokers are assigned voting rights, stock exchange rules deny brokers (and contractual

	their proxy authority, through power of attorney, to Broadridge. ¹¹⁵
3	The issuer sends proxy disclosure packets to Broadridge for distribution (on behalf of intermediaries) to beneficial owners. ¹¹⁶ Broadridge sends required disclosures concerning questions subject to a shareholder vote and a voting instruction form VIF. ¹¹⁷ (By contracting with intermediaries as well as issuers, Broadridge can reduce cost and delay.)
4	The beneficial owner returns to Broadridge a VIF – general (in favor of management’s proposals); limited (instructions to vote in some other indicated way); or none. ¹¹⁸ Until the polls close, the beneficial owner may change voting instructions.
5	Broadridge tabulates incoming VIFs, and reports the continuously updated master tabulation of voting results to intermediaries and the issuer (but generally not to the opposition). ¹¹⁹ It is not customary for any party in this process

provisions usually deny banks) the right to decide how to vote. *Id.* at 12-8. *Cf.* Kahan & Rock, *supra* note 45, at 1254 (no effort is made at this step to reconcile inconsistent records of share positions among the issuer’s stock register, the Cede & Co. list, and the internal records of custodians).

¹¹⁵ Wilcox et al., *supra* note 90, at 12-10; Broadridge Financial Solutions, Inc. Annual Report (Form 10-K), at 7 (Aug. 23, 2007).

¹¹⁶ 17 CFR § 240.14b-1(c)(2)(i) requires issuers to reimburse intermediaries for the cost of distributing proxy materials. Rule 14b-2 establishes a corresponding requirement for bank intermediaries. *Id.* § 240.14b-2(a)(5)(c)(2)(i).

¹¹⁷ Wilcox et al., *supra* note 90, at 12-10. It is significant that beneficial owners receive a voting instruction form rather than a proxy card. *Id.* The broker retains the legal right to vote shares or to grant proxy authority, and beneficial owners have the right only to instruct the proxyholder how to vote their shares. *Id.* See also Bus. Roundtable, *supra* note 111, at 5.

¹¹⁸ See Wilcox et al., *supra* note 90, at 12-12 to 12-13; SEC, *supra* note 88; Kahan & Rock, *supra* note 45, at 1247-48; Broadridge, *supra* note 109. In principle, the beneficial owner returns voting instructions to the broker or bank, but in practice most voting instructions are collected by Broadridge through ProxyEdge®, its proprietary web-based voting facility, or by mail. Broadridge, *supra* note 109. Broadridge acts for the intermediaries under power of attorney. *Id.* ProxyEdge® uses a unique tracking number (functionally comparable to a signature) for each beneficial owner, to authenticate instructions, reconcile multiple instructions from the same beneficial owner, and report on aggregated vote counts by categories of beneficial owners. *Id.* ProxyEdge® is a registered trademark of Broadridge Financial Solutions, Inc. *Id.*

¹¹⁹ *Cf.* Broadridge Financial Solutions, Inc., 2008 Corporate Issuer Services Guide 26, <http://www.broadridge.com/investor-communications/us/corporations/pdfs/Part%205%20Vote%20Proc%20Stp3.pdf>. Broadridge’s service description continues:

to issue written confirmation of voting instructions received (or of how a proxyholder actually voted a beneficial owner's shares).

- | |
|---|
| 6 The broker or bank sends Broadridge a proxy, or a series of incremental partial proxies, indicating aggregated shares voted for and against each proposal or candidate. ¹²⁰ Discrepancies often arise. ¹²¹ If an overvote develops, the intermediary should |
|---|

Broadridge issues voting results on behalf of our bank and broker clients based on the schedule [fifteen days before the meeting, ten days before the meeting, daily beginning on the ninth day before the meeting, 7:00 p.m. the day before the meeting, and morning of the meeting]. The voting results are issued on a "client proxy" and provided to you or your designated agent. The voting results reported reflect instructions received from beneficial shareholders and broker discretionary voting if applicable. All share amounts are provided to Broadridge by its bank and broker clients and are reflected on the client proxy without modification by Broadridge.

Id. at 25.

Access to these progress reports enables management to redouble its proxy solicitation efforts if votes received so far are not favorable with a comfortable margin. Sometimes the insurgent opposition is led by an institutional investor that can obtain reports direct from Broadridge or through its broker. However, institutional investors have complained that reporting available from intermediaries "was not sufficiently robust to guarantee that the information genuinely reflected their voting intentions [In one instance, perplexed about a reported split vote,] [t]he investor called Broadridge to investigate further, and was told there was no way of telling how the vote had been split." Thompson-Mann, *supra* note 13, at 11.

There is evidence that "[w]hen a retail shareowner using Broadridge's proxyvote.com platform votes for or against at least one item on a proxy but fails to vote on other items, each item they fail to vote is cast in favor of the company's recommended position." James McRitchie, SEC Petition 4-583 at 2 (May 15, 2009). This practice arguably does not comply with SEC Rule 14a-4(b)(1), which requires prominent notice to the beneficial owner how unspecified votes will be cast. *Id.* Representing Corporate Governance, McRitchie petitioned the SEC to amend the rule to require that voter information forms, as well as proxies, bind fiduciaries and warn security holders of the effect of their voting instructions. *Id.* at 1. Broadridge's defense relies on the technical distinction between a proxy and voting instructions. *Id.* at 2.

¹²⁰ Obara, *supra* note 33, at 10-13. See Kahan & Rock, *supra* note 45, at 1253-54; see also NYSE Rule 452, *supra* note 97, which has until now allowed a broker to vote on discretionary questions (including an uncontested election of directors) for all street name shares it holds for which it (or Broadridge) received no VIF, but may vote only in accordance with the beneficial owner's instructions on non-discretionary questions. For the new revision of Rule 452, see *supra* note 102 and accompanying text. Cf. Wilcox et al., *supra* note 90, at 12-8 to 12-9 (remarking that the NYSE appears to permit the practice of brokers assigning voting instructions received to any shares held [in the fungible mass], so long as there is no overvote).

¹²¹ Obara, *supra* note 33, at 10-13. See, e.g., *In re Deutsche Bank Securities Inc.*, Request for Review of Exchange Hearing Panel Decision 05-045, 2006 WL 760710 *1-*3 (NYSE Feb. 15,

amend its proxy to vote no more than the number of shares it is entitled to vote; Broadridge forwards the proxies collected in this way to the tabulator. ¹²²	
UNCONTESTED "ROUTINE" ELECTION	CONTESTED ELECTION OR PROXY FIGHT
7a The tabulator (often Broadridge) forwards collected proxies to the meeting of shareholders, with information about conflicting proxies, overvotes, etc. ¹²³	7b Each faction, having obtained its proxies from Broadridge, delivers them to the inspector of election, who takes them to a secure, neutral counting room.
8a The inspector of election oversees the validation and counting of proxies to verify legality of the	8b Proxies from registered owners are segregated from broker and bank proxies, and are sorted into the same order as the stockholder list. Each of the

2006) (NYSE fined Deutsche Bank for rule violations after investigation found overvotes in twelve of fifteen instances tested in 2002 and eleven of twelve in 2003). *See also* Soc'y of Corporate Sec'y's & Governance Prof'ls, *supra* note 46, at 3 (noting lack of verifiable audit trail for votes and lack of any guarantee that beneficial owners will receive proxy materials or have their votes counted).

¹²² SEC, *supra* note 88 ("If there is an over-vote, the broker-dealer will have to decrease the customers' vote but the customers will never know some or all of their votes did not count."). *See also* Kahan & Rock, *supra* note 45, at 1260 ("cutting down the number of voting instructions to the number of shares the broker is entitled to vote means that someone (who?) must decide whose votes count").

¹²³ Stock exchange enforcement decisions are revealing:

There are no standard industry procedures that govern Tabulators' approach to dealing with over-voting. Tabulators may respond to over-votes with a variety of vote-counting procedures, including counting votes on a "first in-first voted" or "last in-first voted" basis, or disregarding altogether a vote submitted by a broker-dealer. Depending upon the procedure implemented by the Tabulator, certain customers' voting instructions may not be represented as originally given. . . . The lack of any uniform procedure raises the possibility that Tabulators may employ procedures that cause votes to be lost.

NYSE Hearing Panel Decision 06-055 at *4, *6 (Apr. 18, 2006) (adjudication imposing censure and a \$600,000 fine where broker voted more shares than it was entitled to vote); *see also* NYSE Hearing Panel Decision 07-028 at *1 (Mar. 8, 2007) (assessing \$325,000 fine for a similar infraction). It is worth noting that to the offending firms fines of this magnitude are utterly insignificant, providing no incentive to alter their conduct.

election (that there was a quorum and the official vote count). ¹²⁴	inspector's assistants takes a group of proxies.
9a The inspector examines proxies, excluding those that were not properly executed (for instance, lacking a signature). Because the outcome is predetermined, little effort need be expended on validating proxies.	9b The inspector's staff examines registered owners' proxies and checks them against the stockholder list, sorting proxies into five categories: For management, For the opposition, Not on list (invalid), Set aside (missing signature, etc.), and Stand off (conflicting proxies). The assistants count proxies for each faction and check each other's work.
10a The inspector totals votes cast for the management slate of director candidates.	10b The staff attempts to resolve partial proxies and revocations for each intermediary. If the result is an overvote, the staff requests the intermediary's proxy clerk to bring the total number of votes in line with eligibility. If an overvote cannot be resolved, the inspector may disqualify some or all of the intermediary's shares. The assistants count proxies for each faction and check each other's work. ¹²⁵

¹²⁴ DEL. CODE tit. 8 § 231(a) (2009) (corporations that list shares on a national exchange or have more than 2,000 record shareholders must appoint inspectors of election for any shareholders meeting; there are no statutory requirements for inspectors' qualifications or independence); Obara, *supra* note 33, at 10-8.

¹²⁵ In the aggregation it is difficult to keep track of who has voted or changed a vote, causing the need to adjust the count for overvotes, revocations of proxies, errors by intermediaries, etc. See also Kahan & Rock, *supra* note 45, at 1262 (discussing alternative ways that intermediaries resolve overvotes and resulting distortions in the vote tally). Kahan & Rock report that it is "entirely opaque" how Broadridge and its customers handle these adjustments. *Id.* at 1253-54. Because VIFs are technically not proxies, Inspectors of

11 The inspector totals the votes and certifies, in a report to the meeting chair, the number of shares present and the votes cast for and withheld from the proposals and slate(s) of candidates. Then, the meeting chair reports the vote count and announces the outcome—for instance, that there was a quorum, that certain candidates were duly elected directors, or that the merger proposal was approved.

2. Factors That Confuse the Vote Count

The complexity occasioned by multiple layers of nominee ownership leads to such errors as unclear or lost voting instructions, with the possibility for proxyholders to cast votes inconsistent with the beneficial owner's intentions.¹²⁶ In addition, the fact that proxyholders aggregate the voting instructions of multiple beneficial owners (which arrive and are processed piecemeal) makes it difficult or impossible to verify votes.¹²⁷ Further, because key participants in this complex arrangement derive profits from their roles in the process, they have no incentive to streamline the layers.¹²⁸

In most elections, many beneficial owners, especially those who have small holdings, do not return voting instructions, resulting in an undervote.¹²⁹ Because shareholders have the right, but not the duty, to vote their shares, the undervote does not affect legitimacy of the election,

Election may not review these source documents in case of any dispute arising during the tabulation of voted proxies. Wilcox et al., *supra* note 90, at 12-10.

¹²⁶ Brandes Institute, *supra* note 13 at *7 (votes gone missing hampered investors' efforts to vote against excessive executive compensation); see also BALOTTI ET AL., *supra* note 25, at 9-10.1; *supra* note 106 and accompanying text. In *Blasius*, after reciting a virtual catalogue of proxy-handling and counting errors in a consent contest, Chancellor Allen observed that "[t]he multilevel system of beneficial ownership of stock and the interposition of other institutional players between investors and corporations . . . renders the process of corporate voting complex." *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 668 (Del. Ch. 1988). In deciding the case, he concluded that "[w]e cannot know, in these circumstances, what the outcome of this close contest would have been if the true wishes of all beneficial owners had been accurately measured. The parties must . . . be content with the result announced by the [inspectors]." *Id.* at 670.

¹²⁷ Thompson-Mann, *supra* note 13, at 11 (reporting an occasion when Broadridge was not able to account for how a split vote—92% for, 8% against—arose, contrary to the institutional investor's policy); Kahan & Rock, *supra* note 45, at 1253 (describing factors producing a "nightmare of verification"). Problems arise because intermediaries submit aggregated partial proxies, obscuring the voting instructions of individual beneficial owners. *Id.*

¹²⁸ Thompson-Mann, *supra* note 13, at 11.

¹²⁹ *Inv. Assoc. v. Standard Power & Light Corp.*, 48 A.2d 501, 507 (Del. Ch. 1946) (taking judicial notice of fact that many shareholders fail to vote). See also Bainbridge, *supra* note 27, at 635 n.89 (discussing rational apathy among small shareholders).

but it may mask overvoting elsewhere.¹³⁰ Under a soon-to-be obsolete part of NYSE Rule 452, if a broker did not receive a beneficial owner's voting instructions on a routine question by ten days before the shareholders' meeting, the broker could vote the customer's shares in its own discretion.¹³¹

Determining who has voting rights is often difficult because brokers lend shares from customers' margin accounts to short sellers who sell them at today's price in the hope of replacing the borrowed shares at a lower price later.¹³² When shares are lent, voting rights accompany them, even though the original owner thinks (and her brokerage statement will show) that the shares remain in her account.¹³³ But

¹³⁰ Cf. *Berlin v. Emerald Partners*, 552 A.2d 482, 493 (Del. 1989).

¹³¹ NYSE Rule 452, *supra* note 97. Routine questions include uncontested director elections and appointment of auditors. Broker discretionary voting in director elections is eliminated in a revision to Rule 452 effective at annual meetings scheduled after Jan. 1, 2010. SEC Release No. 34-60215 at 2 (July 1, 2009).

¹³² *In re Digex, Inc.*, No. Civ. A. 18336-NC, 2002 WL 749184 at *2 (Del. Ch. Apr. 16, 2002) (concisely describing mechanism of short selling and its implications). The court noted that:

[w]ith regard to the share borrowed, both the shareholder from whom it was borrowed and the third party to whom the share was sold are beneficial owners. It is probable, if not certain, that neither the issuer nor the beneficial owner from whom the stock was borrowed is aware of the short sale Additionally, the borrowed share could be borrowed from the account of the third-party buyer and sold to yet another buyer. This would create an additional, a third, beneficial owner for that one record share. Conceivably, this serial borrowing could create a number of beneficial owners that was a multiple of the number of shares actually issued.

Id. at *2 and n.9. A margin account allows the customer to purchase shares with funds borrowed from the broker. A typical brokerage account agreement states:

[Broker] can loan out (to itself or others) the securities that collateralize your margin borrowing. If it does, you may not be entitled to receive, with respect to securities that are lent, certain benefits that normally accrue to a securities owner, such as the ability to exercise voting rights, or to receive interest, dividends, or other distributions.

Fidelity Investments, *The Fidelity Account Customer Agreement* 8, http://personal.fidelity.com/accounts/pdf/trust_supplemental.pdf. It is evident how this practice can produce discrepancies in share counts and voting rights. A concise account of the use of borrowed shares to affect elections and manipulate share prices is Kara Scannell, *How Borrowed Shares Swing Company Votes*, WALL ST. J., Jan. 26, 2007, at A1, based on Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 832-35 (2006); *see also* William L. Tolbert, Jr., Leslie H. Lepow & John F. Cox, *Borrowed Voting* (American Enterprise Institute), 11 BRIEFLY . . . : PERSPECTIVES ON LEGISLATION, REGULATION, AND LITIGATION, No. 8, 1-21 2008.

¹³³ NYSE Information Memo No. 07-8, *Disclosure of Voting Loss and Dividend Status in Margin Accounts* (Jan. 23, 2007), [http://apps.nyse.com/commdata/PubInfoMemos.nsf/0/85256FCB005E19E88525726B00619047/\\$FILE/Microsoft%20Word%20-%20Document%20in%2007-8.pdf](http://apps.nyse.com/commdata/PubInfoMemos.nsf/0/85256FCB005E19E88525726B00619047/$FILE/Microsoft%20Word%20-%20Document%20in%2007-8.pdf). *See also* SEC, *supra* note 88; Kahan & Rock, *supra* note 45, at 1256-57 (the

because the broker holds its own and customers' shares in fungible bulk at DTC,¹³⁴ it does not decrement the lent shares from any particular customer's account, and there is no principled way to reconcile the number of shares to which any account owns voting rights.¹³⁵

Delaware courts have long been permissive in allowing the buying and selling of votes, and in today's markets it is possible to accumulate effective voting power in secret using complex financial derivatives to separate voting rights from economic interest.¹³⁶ An example, involving

loan is actually a transfer of full legal title under an agreement to repurchase the shares, and the possibly inadvertent lender thereby loses voting rights); Soc'y of Corporate Sec'y's & Governance Prof'ls, *supra* note 46, at 3 (in issuers' view, integrity of the vote is impaired by counting voting instructions for loaned shares and assigning them arbitrarily to unvoted shares: for this reason, some shares are voted multiple times, others not at all); Tolbert et al., *supra* note 132. Proxy solicitations typically disclose the possibility that the number of shares to be voted may be adjusted downward, but this notice is often far from conspicuous—for example, on the voting instruction form for the Foundry Networks, Inc. special meeting on Dec. 17, 2008, this information is printed in light grey ink in small print (eight-point small capitals) on the reverse side of the form. *See supra* note 37. Kahan & Rock comment that short selling raises doubt whether votes were cast by investors who actually owned shares, adducing the example that in 2004 the AXA/MONY merger was approved by a margin of 1.7 million shares although 6.2 million shares were out on loan. *Supra* note 45, at 1263.

¹³⁴ *See supra* notes 93–94 and accompanying text.

¹³⁵ SEC, *supra* note 88. *See* NYSE Information Memo No. 04-58, *Supervision of Proxy Activities and Over-Voting*, Nov. 5, 2004, [http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256F09007311B485256F3F00645587/\\$FILE/Microsof%20Word%20-%20Document%20in%202004-58.pdf](http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256F09007311B485256F3F00645587/$FILE/Microsof%20Word%20-%20Document%20in%202004-58.pdf) (evidence that overvoting arises from failures in accounting for lent shares); NYSE, *NYSE Regulation, Inc. Fines UBS Securities, Goldman Sachs Execution & Clearing, and Credit Suisse Securities (USA) \$1.35 Million for Proxy-Handling Violations in Corporate Elections*, NYSE News Release, June 13, 2006, <http://www.nyse.com/press/1150107128723.html>.

¹³⁶ Vote-buying arrangements, once considered a breach of shareholders' fiduciary duty to each other, have been allowed for over sixty years. *Schreiber v. Carney*, 447 A.2d 17, 25 (Del.Ch. 1982) ("an agreement involving the transfer of stock voting rights without the transfer of ownership is not necessarily illegal[.] . . . [t]o hold otherwise would be to exalt form over substance"), citing *Ringling Bros.-Barnum & Bailey Circus Combined Shows, Inc., v. Ringling*, 53 A.2d 441, 447 (Del. 1947) ("a shareholder may exercise wide liberality of judgment in the matter of voting . . . so long as he violates no duty owed his fellow shareholders."). Although shareholders may buy and sell votes, for management to use corporate assets to buy votes and tilt a close election is a breach of the duty of loyalty. *Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43, 74–75 (Del. Ch. 2008).

A modern case involving derivatives is *CSX Corp. v. The Children's Inv. Fund Mgmt. (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), *aff'd* 292 Fed. Appx. 133 (2d Cir. 2008) (in spite of disclosure violations, hedge funds seeking control of CSX Corp. won the right to vote four directors onto CSX's board; the incumbent board had sought to enjoin hedge funds' voting power because, to evade disclosure requirements, they had purchased derivatives rather than shares). The court found defendant hedge funds had amassed a large economic position in CSX through total return swaps rather than purchasing shares, in a scheme to avoid having to publicly disclose their large position until they were ready to mount a proxy fight. *Id.* at 549–50. A swap contract can be unwound at any time by

total return swaps, figured in the recent proxy fight at CSX Corp.¹³⁷ Routine hedging of the short swap positions vested a significant amount of voting power in parties who lacked the economic interest of bona fide shareholders.¹³⁸

agreement between the contracting parties; if settled in kind, rather than in cash, the long party obtains full ownership, including attached voting rights, of a large shareholding that has been accumulated in stealth. *Id.* at 522–24.

¹³⁷ CSX, 562 F. Supp. at 516. The swaps gave the hedge funds “substantially all of the indicia of stock ownership save the formal legal right to vote the shares.” *Id.* The court explained the total return swaps (TRSs) at issue:

For example, in a cash-settled TRS with reference to 100,000 shares of the stock of General Motors, the short party agrees to pay to the long party an amount equal to the sum of (1) any dividends and cash flow, and (2) any increase in the market value that the long party would have realized had it owned 100,000 shares of General Motors. The long party in turn agrees to pay to the short party the sum of (1) the amount equal to interest that would have been payable had it borrowed the notional amount from the short party, and (2) any depreciation in the market value that it would have suffered had it owned 100,000 shares of General Motors.

In practical economic terms, a TRS referenced to stock places the long party in substantially the same economic position that it would occupy if it owned the referenced stock or security. There are two notable exceptions. First, since it does not have record ownership of the referenced shares, it does not have the right to vote them. Second, the long party looks to the short party, rather than to the issuer of the referenced security for distributions and the marketplace for any appreciation in value.

The short party of course is in a different situation. It is entitled to have the long party place it in the same economic position it would have occupied had it advanced the long party an amount equal to the market value of the referenced security. But there are at least two salient distinctions, from the short party’s perspective, between a TRS and a loan. First, the short party does not actually advance the notional amount to the long party. Second, it is subject to the risk that the referenced asset will appreciate during the term of the TRS. . . .

. . . .
Institutions that hedge short TRS exposure by purchasing the referenced shares typically have no economic interest in the securities. They are, however, beneficial owners and thus have the right to vote the referenced shares.

Institutional voting practices appear to vary. As noted below, some take the position that they will not vote shares held to hedge TRS risk. Some may be influenced, at least in some cases, to vote as a counterparty desires. Some say they vote as they determine in their sole discretion. Of course, one may suppose that banks seeking to attract swap business well understand that activist investors will consider them to be more attractive counterparties if they vote in favor of the positions their clients advocate.

Id. at 520–21, 522 (footnotes omitted).

¹³⁸ *Id.* at 522. The court described how swaps misalign voting rights:

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A shareholder is allowed to revoke or supersede a previously submitted proxy at any time before the polls close.¹³⁹ In a contested election, especially a close one, beneficial owners commonly receive repeated proxy solicitations; either through confusion or because of a change of mind, some return voting instructions multiple times for the same shares.¹⁴⁰ When an overvote or obvious duplication of proxies occurs, the tabulator or inspector of election should eliminate prior proxies and count only the last one.¹⁴¹ Multiple proxies create confusion that, if not resolved, can disqualify all of them.¹⁴²

Adding to the confusion, brokers and banks commonly return partial proxies that represent only some of the shares they are entitled to vote, submitting them incrementally as they receive voting instructions from their customers; because they represent the voting instructions of many beneficial owners, these proxies typically include combinations of For, Against, and Abstain votes.¹⁴³ These proxies count cumulatively, but may include repetitive votes, or may, because of share lending, total more votes than the intermediary is entitled to vote.¹⁴⁴ An intermediary must reconcile any overvote with the tabulator by making adjustments that remove votes from the final aggregated proxy—but the beneficial

[T]he accumulation of substantial hedge positions *significantly alters the corporate electorate*. It does so by (1) eliminating the shares constituting the hedge positions from the universe of available votes, (2) subjecting the voting of the shares to the control or influence of a long party that does not own the shares, or (3) leaving the vote to be determined by an institution that has no economic interest in the fortunes of the issuer, holds nothing more than a formal interest, but is aware that future swap business from a particular client may depend upon voting in the “right” way.

Id. (emphasis added, footnotes omitted).

The court reviewed evidence that the hedge funds’ counterparties bought and sold CSX shares immediately before and after record dates in a pattern clearly calculated to secure dividend and voting rights *id.* at 544. Although legal, these transactions contributed to an overall impression of manipulative conduct. *Cf. id.*

¹³⁹ *Magill v. N. Am. Refractories Co.*, 128 A.2d 233, 237 (Del. 1956) (stockholder may change his vote until the polls close).

¹⁴⁰ *Obara*, *supra* note 33, at 10-14 to 10-15 (it is not unusual for five proxies to be returned for a single position in a contested corporate election).

¹⁴¹ *Id.* at 10-16.

¹⁴² *Williams v. Sterling Oil of Okla., Inc.*, 273 A.2d 264, 265 (Del. 1971) (“the inspectors of an election must reject all identical but conflicting proxies when the conflict cannot be resolved from the face of the proxies themselves or from the regular books and records of the corporation”). *Accord Concord Fin. Group, Inc. v. Tri-State Motor Transit Co.* 567 A.2d 1, 15-16 (Del. Ch. 1989).

¹⁴³ *Obara*, *supra* note 33, at 10-13. Where the total eligible vote is not exceeded, all such proxies are counted. *See also Schott v. Climax Molybdenum Co.*, 154 A.2d 221, 223 (Del. Ch. 1959) (stating same).

¹⁴⁴ *See supra* notes 120-123 and accompanying text.

owners will never know that some of their shares did not count, and if double-counting is offset by an undervote, it may go unremarked.¹⁴⁵

Although both the records at Cede & Co. and beneficial owners' account statements purport to track a definite number of shares, and although counting votes requires definite numbers of shares, the underlying reality is that custodial accounts hold *pro rata* interests in a fungible mass of shares—shares that are in continual motion, being bought, sold, lent, and borrowed without being traceable to particular accounts.¹⁴⁶ Reconciling vote counts to *pro rata* shares of a fungible mass is pointless, and nobody really tries.¹⁴⁷ Because the net settlement system creates intraday discrepancies between a broker's total holding at DTC and the sum of shares in its internal accounts, brokers have to adjust the number of shares their customers vote, in order to reconcile the total vote to whatever number of shares DTC held for the broker at the instant selected as the record date for the meeting.¹⁴⁸

Finally, ignoring the complex reality of voting, by law inspectors of election may examine only the legal proxy documents, as if they represented shareholders' actual votes rather than votes that one or more intermediaries have aggregated and adjusted.¹⁴⁹ Delaware law consistently considers inspectors' powers and duties "purely ministerial, not quasi-judicial," and emphasizes the value of an expeditious result over its accuracy.¹⁵⁰

These factors evidence a voting system and a process that is susceptible to both accidental and intentional miscounting of shareholders' votes.

¹⁴⁵ SEC, *supra* note 88 (in principle intermediaries are obliged to vote as instructed, but their diligence in doing so cannot be monitored). *See supra* note 127 (stating same). If a broker or bank fails to reconcile an overvote or conflicting proxies, the inspector of election may disqualify some or all of the associated proxies, in effect disenfranchising multiple beneficial owners whose voting instructions were aggregated by the broker or bank. *See supra* note 125 and accompanying text.

¹⁴⁶ *See supra* text accompanying notes 93–94.

¹⁴⁷ *See supra* note 94.

¹⁴⁸ *See supra* text accompanying notes 93–94, 121.

¹⁴⁹ *Cf.* DEL. CODE tit. 8 § 231(d) (2009). Inspectors may use only information on the face of the proxy or the envelope and must accept anything that reasonably purports to be a valid proxy; they may not consider extrinsic evidence as to a proxy's authority except to resolve broker overvotes. *Id.*

¹⁵⁰ *Williams v. Sterling Oil*, 273 A.2d at 265 (describing duties of inspectors); DEL. CODE tit. 8 § 225(a) (2009) (judicial inquiry into proxies and voting is reserved to the chancery court, upon suit by a shareholder with standing); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 668 (Del. Ch. 1988) (inspectors' duties are conditioned by administrative need for expedition and certainty).

F. *Direct Communication, Direct Registration*

In 2004, the Business Roundtable, in collaboration with Georgeson Shareholder Services, proposed changes to SEC rules, made possible by exploiting available technology that would alleviate problems in the current system of proxy communication.¹⁵¹ The proposed changes would enable proxy information and voting rights to move directly from issuers to beneficial owners, rather than “cascading down through successive layers of custodians” as is currently required for shares held “in street name.”¹⁵² Benefits to investors would include vote confirmation, an audit trail on votes cast, and eliminating the practice of brokers voting shares that they do not own; in addition, reducing complexity would eliminate some unnecessary costs.¹⁵³

An enabling infrastructure for eliminating (not merely immobilizing) paper stock certificates already exists and could be used to avoid the complexities of custodial relationships: the Direct Registration System

¹⁵¹ See Bus. Roundtable, *supra* note 111, at 3, 10 (proposing changes to SEC rules); Georgeson Shareholder Communications, Inc., *Re: Rule No. 4-493*, Letter to SEC, 1-4 (May 3, 2004), <http://www.sec.gov/rules/petitions/4-493/georgeson050304.pdf> (supporting the Business Roundtable’s request for rule changes). The proposal by the Business Roundtable and Georgeson related to a then-pending SEC rule change that would have enhanced shareholders’ access to the corporate proxy process. SEC Release No. 34-48628, 68 Fed. Reg. 60784, 2003 WL 22350515 (Oct. 14, 2003). This Rule 14a-11, not adopted then but newly re-proposed, would, under certain circumstances, require publicly traded companies to include shareholder nominees for director in the companies’ proxy materials unless state law or a company’s governing documents prohibit shareholders from nominating directors. SEC Release Nos. 33-9046, 34-60089 (June 10, 2009), <http://www.sec.gov/rules/proposed/2009/33-9046.pdf>. In a related development, Delaware revised its General Corporate Law, effective August 1, 2009, empowering Delaware corporations to limit through bylaws shareholders’ ability to nominate director candidates, reimbursement of proxy expenses, etc. DEL. CODE tit. 8 § 112 (2009).

See also Broadridge Financial Solutions, Inc., *2008 Proxy Season Key Statistics*, <http://www.broadridge.com/investor-communications/us/2008ProxyStats.pdf> (over 79% of shares voted in the 2008 proxy season were voted via the internet-based ProxyEdge® service, which attests to investors’ ability and willingness to use electronic infrastructure in communications and transactions related to their shareholdings).

¹⁵² Georgeson, *supra* note 151, at 1; Bus. Roundtable, *supra* note 111, at 12.

¹⁵³ Georgeson, *supra* note 151, at 3. Vote confirmation would provide a safeguard against mistakes and fraud, and would allow fiduciaries to document how they have voted shares held in trust. *Id.* Audit trails would enable sorting out complexities of voting stock that has been loaned, and are essential if voting results are challenged legally. *Id.* The justification for broker discretionary voting—companies need it to avoid failed quorums even though it is patently anti-democratic—would vanish with effective direct communication to shareholders. *Id.* Benefits to issuers include reduction in the cost and time that proxy communication requires, and transparency as to who the shareholders are (although it eliminates the OBO/NOBO mechanism, the proposal allows for beneficial owners who require privacy to arrange nominee ownership at their own expense.) *Id.* at 3-4.

("DRS"), operated by DTC, allows beneficial owners to register their shares electronically on the books of an issuer or its transfer agent, and to transfer them using DRS transactions.¹⁵⁴ Registration of the shares assures direct communication between issuers and beneficial owners, and eliminates broker voting as well as the need for "fungible mass" accounting of shareholdings that leads to errors, discrepancies, and adjustments to voting instructions.¹⁵⁵ However, for investors who trade frequently, or if prompt execution of trades is important, holding shares in DRS is less advantageous than holding "in street name"; brokers' internal systems better meet their needs.¹⁵⁶ DRS has been available since 1996; all states' laws now allow corporations to issue shares without paper certificates, and all U.S. stock exchanges require issuers to be capable of participating in the DRS; yet, despite the opportunity DRS offers to reduce complexity and errors, it is little used.¹⁵⁷

¹⁵⁴ See SEC, *Holding Your Securities – Get the Facts*, <http://www.sec.gov/investor/pubs/holdsec.htm>; Securities Industry & Financial Markets Assn., *Direct Registration System Educational Webinar*, June 24, 2008, <http://events.sifma.org/uploadedFiles/Events/2008/DRSwebinar/DRSEdWebinar6-24-08.pdf> ("DRS webinar"). See also Joseph Trezza, *Going Paperless in the Securities Industry: Benefitting Issuers and Investors*, CORP. SEC. & GOVERNANCE PROFESSIONAL 2-3 (newsletter, June 2007) (U.S. markets are catching up; dozens of countries' securities markets have eliminated paper certificates over the last twenty years). Even with the vast majority of share certificates now immobilized, the current volume of issuance and transfer of certificates costs the industry about \$350 million annually, including \$50 million to replace lost or stolen certificates; certificates worth \$16 billion were lost in the 9/11 World Trade Center disaster and had to be replaced at a cost of \$300 million, whereas electronic records were preserved. *Id.* at 3-4. Securities Indus. & Fin. Markets Ass'n [SIFMA], *Securities Industry Immobilization & Dematerialization Implementation Guide* 18-22 (2008), www.sifma.org/services/techops/pdf/SIFMA-Dematerialization-Guide.pdf-2008-10-27 (summarizing the costs of processing certificates and the benefits of DRS).

¹⁵⁵ See *supra* Part II.D.2 (indicating why DTC, owned by member firms in the securities industry, is unlikely ever to develop functionality in DRS that would compete effectively with brokerage firms' street-name shareholding arrangements); see also SIFMA, *Dematerialization Guide*, *supra* note 154, at 32 (noting that brokerage firms prefer their clients to hold shares in street name).

¹⁵⁶ SEC, *supra* note 154. Trading requires that shares first be transferred and re-registered to a broker, then traded; even though it is accomplished electronically, in a fast-moving market the time required by this extra step could have significant financial impact. *Id.* Although issuers can buy and sell shares held in DRS, timing and price of transactions is entirely outside the investor's control. *Id.*

¹⁵⁷ SEC Release No. 37931, Order Granting Approval to Establish DRS (Nov. 7, 1996), [File No. SR-DTC-96-15] (approving establishment of DRS to provide cost-efficient transfers, prompt settlement of trades, and reduction in problems related to lost or stolen certificates); SEC Release No. 34-54289, Order Granting Approval to Mandate Listed Companies Become Eligible to Participate in DRS (Aug. 8, 2006), 71 Fed. Reg. 47278 (Aug. 16, 2006) [File No. SR-NYSE-2006-29] (setting DRS implementation deadlines for issuers and exchanges, including final deadline for all listed stocks to achieve DRC compatibility by Jan. 2008, later extended to Mar. 2008). See also SIFMA, DRS webinar, *supra* note 154

This Part reviewed the increasing incidence of contested corporate elections and the legal rules that govern the conduct of those elections—rules based on presumptions about shareholding that clash in part with present-day realities. Complex arrangements arose to relate actual share ownership and trading practices to legal presumptions and to enhance the efficiency and liquidity of securities markets, but the multiplicity of players and handoffs of information increased susceptibility to errors when law requires a shareholder vote. Corporate directors have fiduciary duties to shareholders, but in relation to elections, those duties are enforced only by exception, to sanction blatant manipulation of the election process.

III. ANALYSIS

Delaware law presumes a form of corporate election that once was common but today is obsolete for all but the smallest corporations: an election with registered shareholders, simple proxy arrangements, in-person attendance at the annual meeting, and an ability for shareholders to hold directors accountable.¹⁵⁸ If the law's presumption matched reality, counting the vote fairly and accurately would be simple; however, because most shares are today held "in street name" (which is essential to the efficiency and liquidity of today's securities markets), the mechanisms provided under Delaware law are not conducive to an accurate vote count.¹⁵⁹

Part III.A focuses on the reasons why accurately counting shareholders' votes matters. Part III.B reviews how the street-name holding system's complexity opens it to errors in counting the vote. Part III.C reviews how technical solutions could reduce errors. Part III.D focuses on the governance issues that determine confidence in corporate

(detailing progress in dematerialization, cost savings, and the securities industry's further goals for DRS).

¹⁵⁸ Greenwood, *supra* note 54; Dallas, *supra* note 28.

¹⁵⁹ Kahan & Rock, *supra* note 45, at 1248–49.

The complexity of the custodial ownership system, combined with the pressure of numerous shareholder votes, creates a system that is far more complex and fragile than the one anticipated by the Delaware legal structure. There are somewhere around 17,000 reporting companies. Most of these companies are subject to the SEC proxy rules when they solicit proxies. Finally, annual meetings are seasonal, with most taking place during the second quarter of the calendar year. Broadridge delivers more than one billion communications to investors per year. It is an accident waiting to happen.

Id. [footnotes omitted]. See also Prefatory Note to UCC § 8-101 (summarizing concisely differences between current reality and the shareholding and trading environment presumed by corporation law).

enterprises and the extent to which the courts have found any enforceable duty to count the vote accurately in corporate elections.

A. *The Importance of the Shareholder Franchise*

In *Blasius*, Chancellor Allen stated that the shareholder franchise “is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own”¹⁶⁰ and that “the prospect of losing a validly conducted shareholder vote cannot . . . constitute a legitimate threat to a corporate interest, at least if one accepts the traditional model of the nature of the corporation that sees shareholders as ‘owners.’”¹⁶¹ Specifically, the shareholder franchise is crucial to a balance of power between the board of directors and shareholders.¹⁶² In theory, shareholders’ economic interest as owners (or as residual claimants on the corporation’s earnings and assets) assures that this allocation of governance power is appropriately placed, but this alignment is by no means assured.¹⁶³

¹⁶⁰ *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988); Allen et al., *supra* note 15, at 1311 (“[T]he shareholders’ right to elect the corporation’s governing body is a fundamental, cardinal foundation of Delaware corporation law.”).

¹⁶¹ *Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1124 (Del. Ch. 1990) (board’s deferral of annual meeting in response to shareholder’s intent to conduct a proxy contest was reasonable to allow time for informing shareholders of issues). The traditional view is that the law permits directors’ independence solely for the benefit of the true owners, shareholders, and limits directors’ autonomy by fiduciary duties, requirements that shareholders approve some decisions, and the right of shareholders to elect the directors. Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 442 (2006). In contrast, the contractarian view is that the law assigns legitimating governance power to shareholders (among all interested constituencies) because as the residual claimant the shareholder has most at risk and thus has the strongest interest in assuring that directors will perform to maximize the wealth of all constituencies. *Id.* at 446-47.

¹⁶² See *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1127 (Del. 2002) (discussing a proper balance in the allocation of power between the stockholders’ right to elect directors and the board of directors’ right to manage the corporation); Allen et al., *supra* note 15, at 1311 (“When directors intentionally act to thwart the right of the shareholders to remove them at the polls, they intrude upon basic statutory rights of the shareholders and upset the careful balance of power created by the Delaware General Corporation Law.”). Some commentators view the shareholder franchise as a mechanism for correcting errors. See *supra* note 14.

¹⁶³ *Unitrin v. Am. Gen. Corp.*, 651 A.2d 1361, 1380-81 (Del. 1995) (“[S]tockholders are presumed to act in their own best economic interests when they vote in a proxy contest.”). However, short selling, vote-buying, and derivative instruments and broker discretionary voting allow parties to vote shares without economic interest. See *supra* notes 136-38 and accompanying text; *supra* note 131 and accompanying text.

B. *The Current System Produces Errors*

Even though tabulation errors in corporate elections only rarely become the object of litigation, it is indisputable that the existing proxy system is error-prone—its complexity, the need for behind-the-scenes adjustment of the vote, and lack of verification assure a significant incidence of errors, and they create opportunities for abuse.¹⁶⁴

A number of key reasons follow:

- Complex custodial relationships require multi-layer communication of proxy information and voting instructions.¹⁶⁵
- The collection and aggregation of voting instructions proceeds with no verification or audit trail, and is subject to adjustment in any case; unconstrained by law, custodians' policies and practices differ.¹⁶⁶
- Over- and under-voting produce discrepancies that sometimes need to be resolved and sometimes mask disproportionate allocation of voting power.¹⁶⁷
- Because net settlement of transactions produces transient discrepancies in share counts, custodians assign and adjust votes (at least in part arbitrarily because verifiable facts are unavailable), and sometimes vote without instructions, to make the total vote count conform to the record total of shares they hold on behalf of various beneficial owners.¹⁶⁸
- Although common law obligates custodians to follow beneficial owners' voting instructions, the inability to verify execution of voting instructions renders enforcement of fiduciary duty mostly infeasible.¹⁶⁹
- Legal vote-buying arrangements, derivative instruments, and short selling separate voting rights from economic interest and obscure who has voting rights.¹⁷⁰
- Rules for inspectors of election favor expeditious determination of the result over accuracy; but in close elections accuracy is crucial to the outcome.¹⁷¹

¹⁶⁴ See *supra* notes 2–13 and accompanying text. See also Kahan & Rock, *supra* note 45, at 1249 (cataloguing three categories of voting “pathologies”—caused by complexity of the system, by confusions about ownership of shares, and by misalignment between voting rights and economic interests).

¹⁶⁵ *Supra* Part II.D.

¹⁶⁶ *Supra* note 119 and accompanying text.

¹⁶⁷ *Supra* notes 120–23, 139–42 and accompanying text.

¹⁶⁸ *Supra* notes 90, 122–23 and accompanying text.

¹⁶⁹ *Supra* notes 118–19 and accompanying text.

¹⁷⁰ *Supra* notes 132–38 and accompanying text.

¹⁷¹ *Supra* notes 149–50 and accompanying text.

The vote count that tabulators and inspectors report in corporate elections is the sum of *pro rata* shares of multiple fungible masses held by custodians, arbitrarily adjusted by the custodians, who may untraceably add or subtract votes to fill any gaps. In a close contest, could a reasonable person have confidence that such a tally accurately represents shareholders' intent? Delaware law does. Rather than assuring a fair and accurate election process, it seems the law disregards manifest flaws in the corporate voting process—tolerating systematic bias and gross miscounts as mere errors, regrettable but insignificant.

The dearth of case law concerning accuracy in counting the vote in corporate elections may relate to the presumption, noted above, that counting is a simple matter.¹⁷² Although errors in counting votes sometimes have figured in litigation, Delaware courts' decisions have yet to define how or whether directors' (or proxyholders') fiduciary duties apply to obtaining an accurate vote count; although it is possible to glean or infer some principles from dicta, cases have been decided on other issues.¹⁷³

It is fair to ask: how much accuracy is it reasonable to expect in elections conducted largely through proxies? No definitive answer is possible, but it is germane to observe that modern corporations have many millions of shares outstanding, often held by shareholders large and small, in widely scattered accounts. As in a civil election, every vote should count, but achieving perfect accuracy is neither feasible nor affordable.¹⁷⁴ Delaware courts explicitly recognize the need for expeditious conclusion of elections and finality of results, and weigh

¹⁷² *Supra* note 158. *But cf. In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 374–79 (Del. Ch. 2008) (plaintiff's claim that incorrect tabulation of votes meant shareholders had not validly approved a merger withstood defendants' motion for summary judgment).

¹⁷³ E.g., *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 663–67 (Del. Ch. 1988) (reciting problems counting consents and revocations, the court found inspectors made errors in counting, and concluded that both sides in the contest nevertheless must accept as final the totals the inspectors had announced); *In re Transkaryotic*, 954 A.2d at 355–56 (discussing problems in eliminating possible duplicate proxies, finding a question of material fact sufficient to defeat summary judgment motion).

¹⁷⁴ In a criminal prosecution of tampering with a union election, the court commented:

In any election, public or private, involving more than a minimal number of voters or ballots, a rule requiring the government to prove that an alternative outcome would have ensued had the election been untainted would render the victors' offices and emoluments virtually invulnerable . . . There are simply too many variables, and it would give the defendants the benefit of too many unknowns that are truly unknowables. Proof beyond a reasonable doubt has never required proof to a mathematical certainty.

United States v. DeFries, 909 F. Supp. 13, 17 (D.D.C. 1995), *rev'd on other grounds*, 129 F.3d 1293 (D.C. Cir. 1997).

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these goals against protection of the franchise—redounding usually to the advantage of incumbent directors and management.¹⁷⁵ Even allowing that some margin of error is unavoidable in practice, a system that can produce a miscount amounting to 20% of the total vote—as in the 2008 Yahoo annual meeting—intuitively is not sufficiently accurate.¹⁷⁶ And the view articulated in *In re Transkaryotic*, that a court can by definition offer no remedy once an irreparable harm has occurred, leaves shareholders without either equitable or legal relief.¹⁷⁷

C. *Technology Could Help – a Little*

Technology-enabled changes to the proxy voting process, along the lines proposed in 2004 by the Business Roundtable and Georgeson Shareholder Communications, could improve accuracy and streamline the process.¹⁷⁸

Transparency of ownership would open direct communication between issuers and beneficial owners, enabling issuers to better understand who the owners are.¹⁷⁹ Direct communication would eliminate most of the handoffs in proxy dissemination and voting, reducing delays.¹⁸⁰ Every handoff eliminated removes an opportunity to lose or distort information; the proposed change would significantly reduce errors.¹⁸¹ Reducing or eliminating handoffs that now occur between the beneficial owner and the inspector of election would enable confirmation of votes as well as direct validation of proxies, providing a safeguard against mistakes and fraud.¹⁸²

By eliminating intermediaries' aggregation and adjustment steps, the process of reconciling multiple proxies from the same beneficial owner

¹⁷⁵ *Supra* note 150 and accompanying text; *see, e.g.*, *Concord Fin. Group, Inc. v. Tri-State Motor Transit Co.* 567 A.2d 1, 6 (Del. Ch. Sept. 6, 1989) (policy against shareholder disenfranchisement is counterbalanced by need for finality in corporate elections). *But cf.* *Allison v. Preston*, 651 A.2d 772, 777 (Del. Ch. 1994) (upholding the policy against disenfranchising beneficial owners, for the benefit of incumbent directors whom election had ousted, by reversing election inspectors' routine proxy-counting decisions because obligatory rather than voluntary nominee ownership of pension fund's shares, required by ERISA, meant beneficial owners did not accept risk of agent's misfeasance ordinarily associated with nominee ownership).

¹⁷⁶ *See supra* note 25 (describing expectations surrounding a democratic vote).

¹⁷⁷ 954 A.2d at 361 (Del. Ch. 2008) (granting summary judgment to defendant directors where plaintiffs alleged disclosure violations tainted the vote that narrowly approved a merger).

¹⁷⁸ *Supra* Part II.F.

¹⁷⁹ Georgeson, *supra* note 151, at 2; Bus. Roundtable, *supra* note 111, at 7–9, 12.

¹⁸⁰ Georgeson, *supra* note 151, at 1–2; Bus. Roundtable, *supra* note 111, at 9.

¹⁸¹ Georgeson, *supra* note 151, at 3; Bus. Roundtable, *supra* note 111, at 12; Donald, *supra* note 85, at 33.

¹⁸² Georgeson, *supra* note 151, at 3; Bus. Roundtable, *supra* note 111, at 12.

(both partial proxies and proxies revoking earlier ones) would be simple, traceable, and verifiable—rather than being untraceable after being aggregated with others; voting would be auditable, although some adjustment to discrepancies in the fungible mass might still be required.¹⁸³

Discontinuation of discretionary broker voting, which the Business Round Table and Georgeson recommended and which soon will be in effect, means the vote count will better reflect the true wishes of voting shareholders who have a genuine economic interest.¹⁸⁴ The changes proposed by the Business Round Table and Georgeson would reduce overall system cost by allowing elimination of some back-office work at many intermediaries.¹⁸⁵ The changes also would allocate the cost burden of OBO confidentiality to those investors who desire and benefit from it.¹⁸⁶ The further step of linking beneficial owners' accounts to DRS (which might be accepted if implemented with powers of attorney for brokers) would simplify custodial relationships, but would remove share lending as a revenue source for brokerages.¹⁸⁷

Certain significant obstacles would need to be overcome. Various parties—brokers, Broadridge, and others—collect fees for performing the services that make the current complex system work, and stand to lose significant revenue.¹⁸⁸ Because custodians have no incentive to give up their control over account information or proxy voting, but exercise significant influence over rules set by self-regulating organizations like DTC and stock exchanges, there is little prospect of change to the *status quo ante*.¹⁸⁹ Finally, although applying technology could alleviate errors, could reduce opportunities to manipulate the vote, and could improve efficiency, it has no bearing on whether anyone has legal accountability for accurately counting the vote.

D. Suspect Motives and Biased Procedures

Plainly, in any contested election or change-of-control decision, and sometimes even in uncontested director elections, the board is an interested party for whom the temptation to exploit any advantage is

¹⁸³ Georgeson, *supra* note 151, at 3.

¹⁸⁴ Georgeson, *supra* note 151, at 3; Bus. Roundtable, *supra* note 111, at 7; SEC, *supra* note 101.

¹⁸⁵ Georgeson, *supra* note 151, at 2.

¹⁸⁶ *Id.*

¹⁸⁷ *Supra* notes 154–57 and accompanying text.

¹⁸⁸ Donald, *supra* note 86, at 63–64.

¹⁸⁹ *Supra* text accompanying note 128; note 155.

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present.¹⁹⁰ Regardless of whether we believe the shareholder franchise legitimates the separation of control from ownership, or merely acknowledge that statutes call for shareholders to vote, it is an unfortunate practical necessity that an interested party, the board of directors, conducts the process by which shareholders exercise their voting powers.¹⁹¹

Courts have nullified or formally rescinded legal board action when it was taken for an inequitable purpose.¹⁹² If board action effectively thwarts shareholders' right to vote, a court can apply *Blasius* scrutiny – but the plaintiff must first prove the board's primary purpose was to impede the vote, a difficult burden that plaintiffs seldom can overcome.¹⁹³ The courts set aside elections if overt intentional manipulation of election machinery is proven, but seldom have they held an individual accountable for having a role in such manipulation.¹⁹⁴

¹⁹⁰ *Supra* note 26. Short of purposeful manipulation of the vote, a contested election or change-of-control transaction allows directors' motives to be questioned but does not invoke conflict-of-interest treatment as in cases involving usurpation of corporate opportunity or freeze-out mergers.

¹⁹¹ *See supra* note 84; *see also* Velasco, *supra* note 27, at 659 (arguing that courts should respect the balance of power established in corporate law and disallow protection of the business judgment rule if board action impinges on shareholders' rights). Although DEL. CODE tit. 8 § 141(a) (2009) authorizes the board of directors to manage the corporation's business and affairs, the routine conduct of business affairs does not encompass the election of directors or fundamental decisions concerning disposition of shareholders' property; it seems incongruous that the board of directors, having a potential conflict of interest in such matters, should enjoy control over the voting mechanism.

¹⁹² *Lerman*, 421 A.2d 906 (Del. Ch. 1980) (inequitable conduct does not require an evil or selfish motive).

¹⁹³ *See supra* notes 71–75 and accompanying text on the *Blasius* standard and its relation to *Unocal* analysis. *See also* *Giuricich v. Emtrol Corp.*, 449 A.2d 232, 239 (Del. 1982) (willful perpetuation of a shareholder deadlock, resulting in board's entrenchment, frustrated a 50% shareholder's voting rights and justified court's appointment of a custodian); *accord* *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1127 (Del. 2003) (board that enlarged its membership to impede proxy fight for control was held to *Blasius* standard of compelling justification); Velasco, *supra* note 27, at 617 (noting the superficiality of the *Unocal* test in practice – nearly anything counts as a threat and nearly any response, if not preclusive or coercive of the vote, is deemed reasonable).

¹⁹⁴ *See supra* notes 71–72; *see also* *Williams v. Geier*, 671 A.2d 1368 (Del. 1996) (shareholder vote may be invalidated if wrongfully coerced, i.e., if shareholders were led to vote on some basis other than the merits of the transaction); *Linton v. Everett*, No. Civ. A. 15219, 1997 WL 441189 (Del. Ch. July 31, 1997) (setting aside election where directors issued new shares to themselves and effectively precluded opportunity for nomination of an alternative slate of board candidates). *But cf.* *Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43 (Del. Ch. 2008) (holding incumbent board's secret vote-buying arrangement and manipulative conduct of annual meeting were inequitable conduct, the court set aside corporate election and ordered a new election with expense to be borne by defendant incumbents). The newly-enacted amendment to § 225 grants the Court of Chancery power

Sometimes the courts shield management from the limited statutory power of shareholders in ways that seem to “upset the careful balance of power.”¹⁹⁵ Arguably, the fact that the law allocates to shareholders the power to vote on certain questions entails shareholders’ legal right to expect an accurate count of the vote, a right that should be enforceable on those who are entrusted with conducting the election and counting the vote.¹⁹⁶ In *In re MONY Group, Inc. Shareholder Litigation*, Vice Chancellor Lamb noted that in the context of elections, directors’ duties are largely ministerial, and in *Malone v. Brincat*, the Delaware Supreme Court emphasized that directors’ fiduciary duties include the duty to deal with shareholders honestly, not only in required disclosures but in all things—which presumably includes all aspects of conducting a corporate election.¹⁹⁷ Even when a court enforces shareholders’ unimpeded right to vote effectively, the decision means little without an assurance that shareholders’ votes will be counted accurately: without an accurate count, the vote is not effective.¹⁹⁸

to remove directors to avoid irreparable harm (but only after a felony conviction or breach-of-loyalty judgment related to directorial misconduct). 77 Del. Laws ch. 14 § 10 (2009).

¹⁹⁵ Allen et al., *supra* note 15, at 1311. See, e.g., *Paramount Commc’ns, Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1990) (upholding board’s action when, facing threat of a hostile tender offer, it restructured a pending merger as an acquisition to obviate need for shareholders’ approval); *Unitrin v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995) (the court found substantive coercion, essentially shareholders’ inability to recognize or understand their true economic interest, a sufficient reason to justify denying a vote to shareholders). A striking recent example is the Delaware Chancery Court’s decision to allow a New York court to rule on a question of Delaware law in *In re Bear Stearns Cos., Inc. S’holder Litig.*, No. Civ. A. 3643-VCP, 2008 WL 959992 (Del.Ch. Apr. 9, 2008) (allowing a merger to proceed where issuance of new stock to the acquirer transparently eliminated shareholders’ statutory right to an uncoerced vote on the merger); see Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 Emory L. J. 713 (2009) (arguing that allowing a New York court to decide left Delaware case law undisturbed and avoided a “showdown” with powerful federal government officials who had brokered the deal).

¹⁹⁶ See *supra* note 25 (discussing the expectation of an accurate vote count in any democratic process).

¹⁹⁷ *In re MONY Group, Inc. S’holder Litig.*, 853 A.2d 661, 675 (Del. Ch. 2004); *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998); *supra* note 38 and accompanying text. In *Malone* the court reasoned that “directors have definitive guidance in discharging their fiduciary duty [of disclosure] by an analysis of the factual circumstances relating to the specific shareholder action being requested and an inquiry into the potential for deception or misinformation.” *Id.* at 12. By similar reasoning, if fiduciary duties extend to fairness in the manner of conducting an election, directors could obtain definitive guidance by analyzing circumstances relating to the proxy-handling and voting process and inquiry into the potential for bias or error in counting the votes.

¹⁹⁸ *MM Cos.*, 813 A.2d at 1127 (Del. 2003); SEC, Unofficial Transcript of Roundtable on Proxy Voting Mechanics 3 (May 24, 2007), http://www.sec.gov/news/openmeetings/2007/openmtg_trans052407.pdf (in opening remarks, SEC Chairman Christopher Cox stated that voting is of little value if the vote is not counted accurately).

In a quantitative empirical study of corporate elections, Professor Yair Listokin found that proposals sponsored by management are “overwhelmingly more likely to win . . . by a very small amount than to lose by a very small amount—to a degree that cannot occur by chance.”¹⁹⁹ This pattern apparently results because management, using the significant advantage conferred by real-time information from Broadridge and its control over when to close the polls, is able to engage in last-minute proxy campaigning just sufficient to obtain the outcome it wants.²⁰⁰

This Note detailed the many ways in which customary practice and the law confer significant advantages to a corporation’s incumbent board of directors in any contest, and how meager are the means available to shareholders to assert or defend their statutory governance rights.²⁰¹ Because the frailties and design of the proxy communication and voting process tend to favor incumbent boards over other interests, built-in bias may impair the legitimacy of an election even in the absence of overt manipulation by the board.²⁰² As Chancellor Allen observed in a different situation of built-in bias, “it is hard to imagine that a valid corporate purpose is served by perpetuating a structure that removes from the public shareholders the practical power to elect directors other than those supported by management.”²⁰³

Ought the courts enforce a stricter standard of fiduciary duty when the integrity of the voting process is at stake, including the not-as-simple-as-it-seems counting of the vote? By judicial interpretation, the duty of care pertains to diligence in making business decisions and so is not germane to assuring integrity of the vote.²⁰⁴ The duty of loyalty is implicated only in overt self-dealing for pecuniary gain, and would not apply to conducting an election.²⁰⁵ Among the three primary fiduciary duties, the partly-defined duty of good faith remains as the only likely means of protecting the voting process.²⁰⁶ According to Professor Stone’s view of the context-dependency of the duty of good faith:

¹⁹⁹ Listokin, *supra* note 37, at 4.

²⁰⁰ *Id.* at 25–26, 29. For examples of such manipulation, see *supra* notes 36–37 and accompanying text.

²⁰¹ *Supra* Parts II.A, II.C.

²⁰² *Supra* Part III.B.

²⁰³ *Speiser v. Baker*, 525 A.2d 1001, 1012 (Del. Ch. 1987) (denying motion for judgment on the pleadings where plaintiff director sought to vote shares, held by a subsidiary, sufficient to control the parent corporation).

²⁰⁴ *Supra* Part II.C.1.

²⁰⁵ *Supra* Part II.C.2.

²⁰⁶ *Supra* Part II.C.5.

[T]he board subverts the purpose of its coordinating power if it uses that power to determine the outcome of decisions allocated to collective shareholder action. The board holds that power to facilitate decisions that express the shareholders' preferences, not to manipulate the voting to achieve predetermined results. Actions taken for the purpose of manipulating the outcome of a collective shareholder action are, in this context, taken in bad faith.²⁰⁷

In Delaware jurisprudence, a failure in the duty of good faith removes protection of the business judgment rule and other exculpatory provisions, exposing directors to potential liability.²⁰⁸ What is needed to protect the integrity of elections is an affirmative duty that—like the duty of disclosure—is triggered when a board requests shareholder action and has responsibility to administer the process by which shareholders' rights are exercised.

In some cases courts have focused attention on the *effectiveness* of the shareholder vote rather than inquire into the board's subjective purpose, subjecting even board inaction to judicial scrutiny.²⁰⁹ An effectiveness standard—a duty to assure that election mechanisms allow shareholders' votes to have full effect—would comport well with the statutory reservation of certain decisions to shareholders' vote and the view that directors have a duty to deal honestly and with scrupulous fairness toward shareholders.²¹⁰ If a court may nullify an otherwise valid vote because an overt purposeful action caused shareholders to vote in a certain way for reasons other than the merits of the issue, the court presumably may equally nullify a vote if something in the voting process

²⁰⁷ Stone, *supra* note 54, at 926. Cf. *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (“[M]atters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power.”).

²⁰⁸ See *supra* notes 76–78.

²⁰⁹ See *Lerman v. Diagnostic Data, Inc.*, 421 A.2d 906 (Del. Ch. 1980) (court held invalid a bylaw, otherwise lawful, that prevented a shareholder from waging a proxy contest); *Giuricich v. Emtrol Corp.*, 449 A.2d 232, 239 (Del. 1982) (willful perpetuation of a shareholder deadlock, resulting in board's entrenchment, frustrated a 50% shareholder's voting rights and justified court's appointment of a custodian); *Hubbard v. Hollywood Park Realty Enters., Inc.*, No. Civ. A. 11779, 1991 WL 3151 (Del. Ch., Jan. 14, 1991), (when an advance-notice bylaw kept a competing slate of director candidates off the election ballot, court ordered waiver of the bylaw, applying *Schnell* and *Lerman* rather than *Blasius*; the court equated inaction with action in the circumstances and commented “occasions do arise where board inaction, even where not inequitable in purpose or design, may nonetheless operate inequitably”). *Id.* at *10. See also *supra* note 42.

²¹⁰ *Supra* Part III.A.

has the effect of causing votes to be counted other than the way shareholders actually voted on the merits of the issue.²¹¹ In this context, where directors' contextually-defined role is (in contradistinction to making business decisions) solely to effectuate shareholders' governance rights, their passive acquiescence in an inequitable effect or result cannot properly fulfill an affirmative fiduciary duty.²¹² In conducting the election, it matters not at all what (disputable) vision the directors have of the corporation's best interest: the right to decide belongs to shareholders. And so it is reasonable to argue that if corporate directors fail to mitigate known faults in the election process—faults that foreseeably may, and sometimes do, produce an inaccurate and possibly inequitable result—a court could find they consciously disregard a known responsibility, they fail to act in the face of a known duty to act; that is, they breach their duty of good faith.²¹³

IV. CONTRIBUTION

This Part proposes an Effective Voting Rule—complementary to the business judgment rule—that would protect shareholders' statutory power to make informed decisions in specified circumstances. Like disclosure duties, the Effective Voting Rule would apply any time a board requests shareholder action.

First, this Part reviews the rationale and legislative intent of the corporate governance scheme embodied in Delaware's General Corporation Law, concluding that stronger protection for the powers allocated to shareholders would enhance legitimacy without weakening directors' allocated powers. Second, it describes the force of the Effective Voting Rule, the conditions that trigger its application, and its consistency with other rules of law. Third, it projects how the rule would stimulate development and implementation of methods for handling and counting proxies that would improve accuracy and perceived legitimacy of corporate elections. Fourth, it addresses

²¹¹ *Williams v. Geier*, 671 A.2d at 1382–83. See *supra* note 42, discussing decisions in which the court intervened to nullify boards' actions taken without specific manipulative intent or to enjoin board action where inaction produced an inequitable result.

²¹² *Hubbard*, 1991 WL 3151. See also *supra* notes 82–84 and accompanying text on the purpose of a board's coordinating powers.

²¹³ See *supra* notes 76–77. Following *Linton*, scienter need not be proved. *Linton v. Everett*, No. Civ. A. 15219, 1997 WL 441189, at *9 (Del. Ch. July 31, 1997). *Contra Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 1998) (holding that aspirational ideals of corporate governance are not required by law). This principle is recognized in New York law: “[A director] shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause . . . reliance [on officers, employees, outside experts, or board committees] to be unwarranted.” N.Y. Bus. Corp. Law § 717(a)(3) (2003).

corollary matters that would require attention to optimize potential benefits from the Effective Voting Rule.

Delaware's General Corporation Law reserves routine business decision-making exclusively to the board of directors, but reserves to shareholders collectively the power to elect directors and approve fundamental changes.²¹⁴ The evident legislative (or contractual) intent of this implied bargain, in which shareholders' power to elect or remove directors legitimates the directors' control over corporate resources, is that directors and shareholders should each exercise their respective powers without interference.²¹⁵ Case precedent promises to shareholders the "unimpeded right to vote effectively"; this right demands more comprehensive protection than merely sanctioning actions taken with the "primary purpose" to thwart the vote (with the burden placed on aggrieved shareholders to prove directors' subjective—and primary—intent).²¹⁶ Just as the business judgment rule protects directors' and managers' autonomy in exercising their allocated powers, a complementary legal doctrine should protect the power allocated to shareholders. Then-Vice Chancellor Jacobs observed in *Hubbard* that "[t]o allow for voting while maintaining a closed candidate selection process . . . renders the former an empty exercise";²¹⁷ if so, then surely it is likewise an empty exercise to allow for voting while maintaining a demonstrably unreliable vote-counting process.

Born of practical necessity, boards play a ministerial role when shareholders exercise their powers.²¹⁸ To protect shareholders' allocated powers, a proposed Effective Voting Rule would impose on directors an affirmative duty, when conducting a corporate election, to ensure the

²¹⁴ *Supra* section II.A.

²¹⁵ *See supra* section II.A. The statutes that allocate powers to shareholders and to directors presumably are of equal dignity and independent legal significance.

²¹⁶ Velasco, *supra* note 27, advocates applying *Blasius* scrutiny to any intent, not only a primary purpose, to interfere with voting rights. *See Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 652 (Del. Ch. 1988) (board action having "primary purpose" to impede shareholders' action breached fiduciary duty); *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1127 (Del. 2003) ("unimpeded right to vote effectively"). As noted *supra* note 81, enforcement of the disclosure duty under SEC Rule 14a-9, forbidding false or misleading information in proxy statements issued in anticipation of shareholder voting, does not require proof of knowledge or intent.

²¹⁷ *Hubbard*, 1991 WL 3151, at *6.

²¹⁸ The duty of arranging for and conducting meetings of shareholders is assigned to boards not because this function benefits from directors' discretionary judgment about the best interests of the corporation but because collective shareholder action cannot occur without coordination and nobody else is positioned to provide it. To apply the business judgment rule in these circumstances invites the board to intrude on shareholders' powers with a promise of impunity. *See supra* notes 84–86 and accompanying text.

unimpaired effectiveness of shareholders' voting power.²¹⁹ Effective voting is defined as voting that is (1) *informed* by appropriate disclosure of material information, (2) *fair* in providing a reasonable opportunity for competing candidates or proposals to be considered, and (3) *accurate* in tabulating votes rightfully cast by beneficial owners. Like the disclosure duty, the proposed Effective Voting Rule applies any time a board requests shareholder action. It obligates directors to arrange all procedures that are material to effective shareholder action with honesty and scrupulous fairness; because proxy tabulation procedures can determine the outcome of a close contest, their materiality is beyond dispute. The rule supplements the board's duty to disclose all available material information and partakes of the same rationale: that statutory shareholder action should be an *informed decision*—that is, both informed and a decision.²²⁰ Grounded in the duty of good faith—action or inaction that impairs the fairness and accuracy of the vote count would demonstrate conscious disregard of a board's responsibilities—the Effective Voting Rule removes from ministerial acts in conducting an election the protection of the business judgment rule and any exculpatory bylaw under section 102(b)(7).²²¹ Depending on factual circumstances, remedies could include injunctive relief or monetary damages.

The Effective Voting Rule doctrine would in no way diminish a board's ability (or duty) to inform or persuade shareholders in anticipation of the vote, but it would require due care and good faith in providing for a fair and accurate voting process—which shareholders cannot provide for themselves and which the board oversees as a ministerial duty.

The Effective Voting Rule significantly strengthens protection of shareholders' statutory powers, but is consistent with key decisions in

²¹⁹ The Delaware Supreme Court promised in 1982 that “careful judicial scrutiny will be given a situation in which the right to vote for the election of successor directors has been effectively frustrated and denied[.]” *Giuricich v. Entrol Corp.*, 449 A.2d 232, 239 (Del. 1982); *see also* *Stone*, *supra* note 54 at 924. The board needs flexibility for making business decisions, but conducting corporate elections is not part of business decision-making. In this context, strict enforcement of fiduciary duty is consistent with statutes that prevent abuse (for instance, strict rules regulating the frequency of calling annual meetings, determining eligibility to vote, and the timing and content of required disclosures). *Id.* at 919.

²²⁰ *See supra* section II.C.6 on the duty of disclosure.

²²¹ *Stone v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006) (if directors act not in good faith, protections of an exculpatory charter provision do not attach); *see* DEL. CODE tit. 8 § 102(b)(7) (2009) (allowing charter provisions exculpating directors for duty-of-care liability); *see also id.* § 145 (2009) (allowing indemnification of directors, officers, and others, but not if they act in bad faith).

which Delaware courts have analyzed directors' fiduciary duties to shareholders. The *Moran v. Household International, Inc.*, decision announced that Delaware Law would not countenance "subversion of corporate democracy by manipulation of corporate machinery."²²² In both *Aprahamian* and *Blasius*, the court declined to apply the business judgment rule where purposeful board action impaired shareholders' voting rights.²²³ In *In re Topps Co. Shareholder Litigation*, the court invalidated board actions that biased the voting process.²²⁴ In *Hubbard v. Hollywood Park Realty Enterprises*, the court did not allow a board to take passive advantage of a bylaw that operated inequitably against insurgent shareholders.²²⁵ In *In re Walt Disney Company Derivative Litigation* and in *Stone v. Ritter*, the courts stated that deliberate indifference and inaction in the face of a duty to act can constitute bad faith, removing protection of the business judgment rule.²²⁶ Finally, in *Mercier v. Inter-Tel* the court held that postponing an election to allow shareholders to consider new information and the board's advice was consistent with fiduciary duties so long as it did not impede or coerce the shareholders' vote.²²⁷

Implementing the Effective Voting Rule would create an incentive for directors to contract with Broadridge (or other providers) for verifiably fair and accurate proxy-handling and tabulation services. Even without difficult-to-measure damages, an increased risk of having to repeat the expensive proxy and election process would encourage accuracy; and courts could require directors who fail in their duty to assure a fair and accurate vote count to bear the cost of a new election, as the court did in *Portnoy v. Cryo-Cell International, Inc.*²²⁸ Under such pressure the securities industry undoubtedly would implement hitherto neglected technical and procedural improvements. And if Delaware implements the rule, its direct jurisdiction and indirect influence practically ensure that fair and accurate proxy voting will become the industry standard.

²²² 490 A.2d 1059, 1080 (Del. Ch. 1985); *see supra* note 42 and accompanying text.

²²³ *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206-07 (Del. Ch. 1987); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988). *See supra* Section II.C.4 on anti-takeover defenses.

²²⁴ 926 A.2d 58, 84-93 (Del. Ch. 2007). *See supra* Section II.A.

²²⁵ *Hubbard v. Hollywood Park Realty Enterprises*, No. Civ A. 11779, 1991 WL3151 (Del. Ch. Jan. 14, 1991).

²²⁶ 907 A.2d 693, 754-55 (Del. Ch. 2005); 911 A.2d 362, 369, 372 (Del. 2006). *See supra* note 76 and accompanying text; section II.C.5 on the duty of good faith.

²²⁷ 929 A.2d at 813.

²²⁸ *Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43 (Del. Ch. 2008) (holding incumbent board's secret vote-buying arrangement and manipulative conduct of annual meeting were inequitable conduct, the court set aside corporate election and ordered new election with expense to be borne by defendant incumbents).

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As a corollary matter, the Effective Voting Rule may require narrowing the application of section 141(e) of the General Corporation Law, which protects directors from liability when they rely on reports or information from persons they reasonably believe to have expert or professional competence.²²⁹ Although such protection is appropriate when directors make business decisions, a board should not escape accountability for ministerial acts merely by relying on outside service providers to administer portions of the election process.

A second corollary matter is the current unenforceability of the proxyholder's duty, as agent for the beneficial owner, to vote according to instructions. Current law affords no remedy for such failure, regardless of the reason, treating it as a voluntarily incurred risk. Because street-name shareholding is the predominant practice, courts should acknowledge that most beneficial owners must vote their shares through proxies. Given this factual reality, courts should enforce proxyholders' duty under agency law to vote according to the beneficial owner's instructions, reversing the voluntary-assumption-of-risk precedents. As with directors under the Effective Voting Rule, if proxyholders faced potential liability, the securities industry would promptly hold Broadridge accountable to provide verifiable and auditable proxy voting—or a competing service provider would emerge to satisfy the need.²³⁰

V. CONCLUSION

Until recent years close corporate elections were rare; voting usually was so lopsided that any errors in the count were of no consequence. But since the 1980s, defensive responses to hostile takeovers and shareholder activism have generated frequent proxy contests, often with close decisions. Boards are interested parties in proxy contests, and they are able to influence the vote through scheduling of elections, control of the annual meeting's agenda and chair, and other measures that disadvantage an opposing faction.

Intentional miscounting of proxy votes (or ballot box stuffing) by a board, if proven, would not be a reasonable or proportionate defensive measure under *Unocal/Unitrin* doctrine, and would not find a compelling justification under *Blasius*. However, despite the statutory allocation to

²²⁹ See *supra* note 61.

²³⁰ Because it is conducted through extensive use of mail and electronic communications, the proxy process obviously is within the purview of federal mail fraud and wire fraud statutes. In an extreme case it is conceivable that facts could arise that would support racketeering charges against directors or parties handling proxies on an "honest services" theory—as has occurred in the case of tampering with union elections. See *supra* note 43.

shareholders of governance power that legitimates a board's powers, Delaware courts have tolerated a system of voting that allows the outcome of corporate elections to be determined by means other than a fair and accurate count of shareholders' votes. First, the complex proxy system gives an advantage to incumbent boards and their proposals. Second, proxy tabulation is prone to errors—through which shareholders' votes may be rejected or even cast against their express instructions. Neither boards, nor their attorneys, nor the courts can credibly claim ignorance of the problems.

Troubling questions arise. How can a board claim legitimacy for its continuing control of the corporation, or for ratification of a transaction that requires shareholders' approval, if it has good reason to suspect serious flaws in the procedures by which it obtains shareholders' statutorily required approval? Do boards have an affirmative fiduciary duty to conduct fair elections, and is that duty breached when a board passively allows biased voting procedures to work in its favor? If so, should a board be able to escape its responsibility for conducting fair elections merely by the expedient of engaging outside providers for proxy communication and tabulation services?

This Note assumes that the expectation of accurate counting is fundamental to any kind of democratic election, and that the legitimacy of corporate elections is important to sustain trust in the public corporations that dominate economic life. Where the law grants shareholders a vote, assuring an accurate vote count is obligatory. Because boards conduct corporate elections even though they are interested in the outcome, the law should obligate them to use demonstrably fair and accurate election procedures.

The proposed Effective Voting Rule would impose an affirmative duty on boards to assure fair and accurate elections. When a board's role is to provide the mechanism for shareholders to exercise their statutory rights, rather than to exercise its own business discretion, the business judgment rule should not apply. The Effective Voting Rule proposed here builds on Delaware precedents but strengthens the interpretation of directors' fiduciary duties in the special context of facilitating a decision that the law allocates to shareholders. By doing so, it might strengthen the real and perceived legitimacy of corporate enterprises.

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