

University of Pennsylvania Carey Law School

Penn Law: Legal Scholarship Repository

Faculty Scholarship at Penn Law

2011

The Insignificance of Proxy Access

Marcel Kahan

New York University

Edward B. Rock

University of Pennsylvania Carey Law School

Follow this and additional works at: https://scholarship.law.upenn.edu/faculty_scholarship



Part of the [Business Administration, Management, and Operations Commons](#), [Business Organizations Law Commons](#), [Law and Economics Commons](#), [Other Economics Commons](#), and the [Securities Law Commons](#)

Repository Citation

Kahan, Marcel and Rock, Edward B., "The Insignificance of Proxy Access" (2011). *Faculty Scholarship at Penn Law*. 636.

https://scholarship.law.upenn.edu/faculty_scholarship/636

This Article is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship at Penn Law by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact PennlawIR@law.upenn.edu.

THE INSIGNIFICANCE OF PROXY ACCESS

Marcel Kahan and Edward Rock***

PROXY access is the right of shareholders to nominate directors and to have their nominees included in the company's proxy statement. Because proxy access is viewed as dramatically lowering the costs of an election contest, both proponents and opponents of proxy access predict that it will have a significant impact. Contrary to this conventional wisdom, we argue that proxy access will lead to few shareholder nominations, that most of these nominees will be defeated, and that the occasional nominee who may get elected will have little impact.

Based on past involvement in shareholder activism, we believe that neither mutual funds nor private pension funds would make significant use of proxy access. Certain large public pension funds have shown a modest interest in activism and may make some nominations. The entities with the greatest interests in activism—hedge funds and union-affiliated funds—would generally not satisfy the ownership and holding period requirements.

When compared to traditional proxy contests and to withhold campaigns, proxy access involves significant disadvantages while promising only modest advantages. The cost savings of proxy access compared to traditional contests are overstated because most proxy contest expenses are discretionary campaign expenses or relate to other expense items that are unaffected by the proxy access rule. By contrast, the limitations that come with proxy access are significant: the number of nominees a shareholder can propose is limited; the level of shareholder support required to gain a seat, as a practical matter, is increased; the company retains control over the design of

* George T. Lowy Professor of Law, New York University School of Law.

** Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania School of Law. We would like to thank Bill Allen, Jennifer Arlen, Marshall Babson, Michal Barzuza, Ryan Bubb, Emiliano Cattani, Jeff Gordon, Mike Levine, Mark Roe, and the participants at workshops at Columbia and NYU for helpful comments and Emily Schultz for her excellent research assistance. Marcel Kahan would like to thank the Milton and Miriam Handler Foundation for generous support. Edward Rock's research was supported by the University of Pennsylvania's Institute for Law and Economics and the Saul A. Fox Research Endowment.

the proxy cards; and the company retains exclusive access to preliminary voting information.

When compared to withhold-vote campaigns, proxy access has the advantage that, if it succeeds, it results in the election of a dissident director. But this benefit must be weighed against countervailing factors that reduce the likelihood of success: the higher level of shareholder support required for success, the greater challenge of positive versus negative campaigning, and the vulnerability of the dissident shareholders and their nominees to attacks by the company for lack of qualification or conflicts of interest. Such attacks will resonate especially for nominees by unions and public pension funds and may make it difficult to find qualified nominees.

Overall, we believe that proxy access would have some undesirable effects—it would result in some increase in company expenses and may, rarely, increase the leverage of shareholders whose interests conflict with those of shareholders at large—and some desirable effects—it may occasionally lead to the election of nominees to recalcitrant boards, where such nominees may have a modest impact on governance and a marginal impact on company value. None of these effects is likely to be very material, and the net effect is likely to be close to zero.

INTRODUCTION.....	1349
I. THE HISTORY OF PROXY ACCESS	1353
A. <i>History</i>	1353
B. <i>Other Developments</i>	1357
II. THE STATUS QUO: UNCONTESTED AND CONTESTED PROXY SOLICITATIONS	1362
A. <i>Uncontested Solicitations</i>	1363
B. <i>Contested Solicitations</i>	1364
C. <i>Contested Lite: Shareholder Proposals</i>	1371
D. <i>Withhold Votes: Activism Without Activists</i>	1374
E. <i>Who Will Use Proxy Access?</i>	1375
III. PROXY ACCESS VERSUS TRADITIONAL PROXY CONTESTS...	1383
A. <i>Plusses of Proxy Access: Cost Savings</i>	1384
1. <i>Cost of Preparing a Proxy Statement That Complies with Schedule 14A</i>	1384
2. <i>Cost of Distributing the Proxy Statement to All Solicited Shareholders</i>	1388

2011]	<i>Insignificance of Proxy Access</i>	1349
	3. <i>Costs of Collecting and Processing Votes</i>	1390
	4. <i>Campaign Expenses, Including Associated Legal and Regulatory Expenses</i>	1390
	5. <i>Assessment of Aggregate Cost Savings</i>	1392
	B. <i>Minuses of Proxy Access</i>	1394
	1. <i>Limitations on Nominees</i>	1394
	2. <i>Higher Voting Threshold</i>	1396
	3. <i>Design of the Proxy Card</i>	1399
	4. <i>Fighting in the Dark</i>	1401
	5. <i>Cumulative Voting</i>	1404
	6. <i>Adverse Signal</i>	1405
	C. <i>Empirical Assessment</i>	1406
	1. <i>Number of Nominees</i>	1406
	2. <i>Success Rates and Margins</i>	1406
	3. <i>Dissident Stakes and Savings</i>	1408
	D. <i>Summary and Evaluation</i>	1409
	IV. PROXY ACCESS VERSUS WITHHOLD VOTES.....	1409
	A. <i>Plusses of Proxy Access: Effect of Winning</i>	1410
	B. <i>Minuses of Proxy Access</i>	1413
	1. <i>Higher Voting Threshold</i>	1414
	2. <i>Negative Versus Positive Campaigning</i>	1414
	3. <i>Finding a Nominee</i>	1418
	4. <i>Effect of “Losing”</i>	1419
	C. <i>Empirical Assessment</i>	1420
	D. <i>Summary and Evaluation</i>	1425
	V. MUCH ADO ABOUT LITTLE: THE MARGINAL IMPACT OF PROXY ACCESS.....	1426
	A. <i>Costs</i>	1426
	B. <i>Unholy Alliance</i>	1427
	C. <i>Recalcitrant Companies</i>	1428
	D. <i>Emergence of New Activist</i>	1430
	CONCLUSION.....	1431

INTRODUCTION

Should shareholders in publicly traded corporations have the right to have their nominees to the corporate board included in the proxy statement and ballots mailed out by the company and at the company's expense? The highly controversial question has long

been at the forefront of the corporate governance debate. The Securities and Exchange Commission (“SEC”) first considered passing rules 60 years ago, and has since released several proposals.¹

But although there is significant disagreement among observers over whether such “proxy access” is desirable, there appears to be a widespread expectation that proxy access would have major effects on corporate governance. Thus, John G. Finley, formerly a partner at Simpson Thatcher & Bartlett and now Senior Managing Director and Chief Legal Officer at Blackstone, remarked that proxy access is “the biggest change relating to corporate governance ever proposed by the SEC.”² John Greenwald, in *Corporate Board Member* magazine, opined that “few things make boards more nervous” than proxy access.³ The Chamber of Commerce viewed proxy access as “extremely significant” and having “enormous impacts”⁴ and included killing it among its top 5 priorities.⁵ David Katz and Laura McIntosh, two lawyers at Wachtell, Lipton, Rosen & Katz, see proxy access as having the “potential to wreak havoc with American business”⁶ and an SEC adoption as “unwise and unnecessary.”⁷ Michael Garland of CtW Investment Group, a proxy advisory firm, called proxy access a “new and powerful tool.”⁸ *The Deal Magazine* notes that proxy access would make it “dramatically less expensive[] for shareholders to nominate direc-

¹ See Yin Wilczek, In Historic Rulemaking, SEC Allows Investors to Access Proxies to Nominate Directors, 42 Sec. Reg. & L. Rep. (BNA), 1617, 1621 (Aug. 30, 2010).

² John Greenwald, Hang On, 13 Corp. Bd. Member, First Quarter 2010, at 22, 24.

³ Id.

⁴ Sarah N. Lynch, Business Groups Gear Up To Fight SEC Proxy Access Proposal, Dow Jones Newswires, Aug. 18, 2009, available at Factiva, Doc. No. DJ00000020090818e58i000aq (quoting Tom Quaadman, Executive Director at the U.S. Chamber of Commerce).

⁵ Kara Scannell, Proxy Plan Roils Talks on Finance Rules, Wall St. J., Mar. 17, 2010, at A2.

⁶ David A. Katz & Laura A. McIntosh, Senate Bill Adversely Affects the Landscape, N.Y. L.J., May 27, 2010, at 5.

⁷ David A. Katz & Laura A. McIntosh, Populists’ Wish Lists Offer Legislative Parade of Horribles, N.Y. L.J., July 23, 2009, at 5; see also David A. Katz & Laura A. McIntosh, Proxy Access: Not Then, Not Now, N.Y. L.J., Sept. 28, 2006, at 5; David A. Katz & Laura A. McIntosh, SEC Revisits Shareholder Access to Director Nominations, N.Y. L.J., Aug. 30, 2007, at 5.

⁸ Joann S. Lublin, New Rule on Proxies Puts Heat on Firms, Wall St. J., Aug. 23, 2010, at B1.

tors.”⁹ Brian Cartwright, the former general counsel of the SEC, regards proxy access as a “grand experiment in politicizing the leadership” of U.S. corporations.¹⁰ *The Wall Street Journal* has called it a “high-stakes issue”¹¹ and headlined that proxy access would “put[] heat on firms.”¹² Others call proxy access either “groundbreaking”¹³ and “historic,”¹⁴ or “fatally flawed”¹⁵ and “a giant step backwards.”¹⁶ Some predict that proxy access would result in a “profound effect on the boardroom”¹⁷ and help “restore shareholder confidence”;¹⁸ others predict that it would “handcuff boards,”¹⁹ generate a “fair amount of litigation,”²⁰ and occupy the SEC for “years to come.”²¹

On August 25, 2010, it looked like proxy access was about to become a reality. The Securities and Exchange Commission, over heavy opposition by corporations and after a close vote along partisan lines, finally adopted a rule granting shareholders proxy access.²² But the Business Roundtable and the Chamber of Commerce promptly filed suit to enjoin and invalidate the rule.²³ On

⁹ Steven Epstein & Matthew Soran, Uncle Sam: A Most Effective Shareholder Activist?, *TheDeal.com* (July 13, 2009, 2:24 PM), <http://www.thedeal.com/newsweekly/community/uncle-sam-a-most-effective-shareholder-activist.php>.

¹⁰ Editorial, *Alinsky Wins at the SEC*, *Wall St. J.*, Aug. 30, 2010, at A14.

¹¹ Scannell, *supra* note 5, at A2 (discussing Congressional response to the proxy access legislation).

¹² Lublin, *supra* note 8, at B1.

¹³ Wilczek, *supra* note 1, at 1623.

¹⁴ *Id.* at 1621.

¹⁵ *Id.* at 1622 (quoting SEC Commissioner Kathleen Casey).

¹⁶ *Id.* at 1623 (quoting U.S. Chamber of Commerce).

¹⁷ David Calusdian, *Proxy Access: Time to Get Ready for Profound Changes*, *The Podium* (Nov. 18, 2009, 1:16 PM), <http://blog.investorrelations.com/2009/11/18/proxy-access-time-to-get-ready-for-profound-changes>.

¹⁸ *Walter Calls for Action on Proxy Access, Disclosure, Other Governance Topics*, *Corporate Law Daily (BNA)* (Feb. 19, 2009), http://0-news.bna.com.pacman.law.du.edu/cldn/display/batch_print_display.adp?searchid=14113940 (attributing phrase to SEC Commissioner Elisse Walter).

¹⁹ Wilczek, *supra* note 1, at 1623 (quoting Business Roundtable).

²⁰ *Id.* at 1622 (quoting John Olson, a partner at Gibson, Dunn & Crutcher LLP).

²¹ *Id.* (quoting SEC Commissioner Kathleen Casey).

²² See Wilczek, *supra* note 1, at 1621.

²³ *Petition for Review at 2, Bus. Roundtable v. SEC*, No. 10-1305 (D.C. Cir. Sept. 29, 2010). The SEC agreed to stay the effectiveness of the proxy access rules pending resolution of the lawsuit. See U.S. Chamber and Business Roundtable Commend SEC’s Decision to Grant Stay on Proxy Access Rule, U.S. Chamber of Commerce

July 22, 2011, the U.S. Court of Appeals for the D.C. Circuit vacated the proxy access rule due to the SEC's failure to assess its economic effects adequately.²⁴ As of this writing, the SEC has yet to determine whether to appeal the court decision, revise or reissue the rule after performing the missing analysis, or drop its effort to grant proxy access.

In this Article, we will argue that, contrary to the views expressed by the commentators, proxy access would have little impact on corporate governance. Even if the SEC's rule is ultimately validated or a different rule is adopted, few shareholders would use proxy access to make nominations, very few of the nominees would succeed in getting elected to boards, and the rare nominee who does get elected would make little difference on the way companies are run and would have even less of an effect on company value. While the specifics of our analysis consider the rule adopted by the SEC in 2010, our general arguments apply to any revised rule that may be adopted by the SEC, which is likely to be narrower than the 2010 rule, as well as to the prior proposals, some of which were broader than the 2010 rule.

Rather, the whole concept of proxy access, in our view, is based on a fallacy: the erroneous belief that it is the costs associated with distributing a proxy statement that accounts for the failure of shareholders to wage more successful proxy contests. Accordingly, all the effort that shareholder activists have poured into proxy access, even if they ultimately succeed in getting a valid rule adopted, will be wasted.

In Part I of this Article, we discuss the history of the proxy access rule, describe the rule adopted by the SEC in greater detail, and place it in the context of some other recent developments related to the shareholder franchise. Part II analyzes the status quo of contested and uncontested shareholder votes and examines what type of shareholders are likely both to satisfy the qualifications for making proxy access nominations and to be interested in engaging in activism via proxy access. Parts III and IV assess the advantages and disadvantages of proxy access relative to, respectively, tradi-

(Oct. 4, 2010), <http://www.uschamber.com/press/releases/2010/october/us-chamber-and-business-roundtable-commend-secs-decision-grant-stay-prox>.

²⁴ *Bus. Roundtable v. SEC*, No. 10-1305, 2011 U.S. App. LEXIS 14988 (D.C. Cir. July 22, 2011).

tional proxy contests and withhold votes. In Part V, we discuss the marginal impact proxy access would have on corporate governance. We close with a brief conclusion.

I. THE HISTORY OF PROXY ACCESS

A. History

The recently enacted, and for the time being vacated, rules on proxy access are the product of a long and tortured history. In 1942,²⁵ and then again in 1977,²⁶ the SEC expressed some interest in giving shareholders the opportunity to use the company's proxy materials to solicit votes in director elections, but ended up taking no action. Things started heating up in 2003, when the SEC again issued a proposal on proxy access for comments. Under the 2003 proposal, shareholders would obtain proxy access for the two years following a triggering event—either a 35% or more “withhold” vote in a director election or a majority vote by shareholders electing to make the company subject to proxy access.²⁷ Under that proposal, shareholders who held at least 5% of the company's stock for a minimum of 2 years would have been able to make nominations for some of the board seats.²⁸

From its beginning, the 2003 proposal was highly controversial. It was initially adopted by a vote of 3-2, with the Republican

²⁵ See Security and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the H. Comm. on Interstate and Foreign Commerce, 78th Cong. 17–19 (1943) (testimony of Chairman Ganson Purcell that the SEC solicited comments on staff proposal); Securities Act Release No. 2887, Exchange Act Release No. 3347, Holding Company Act Release No. 3988, Investment Company Act Release No. 417 (Dec. 18, 1942) (stating that “[a] number of the suggestions proposed by the staff were not adopted,” including the suggestion related to shareholder access to the company's proxy material). No action was taken.

²⁶ Staff of U.S. Securities and Exchange Commission Rep.: Review of the Proxy Process Regarding the Nomination and Election of Directors 3 (July 15, 2003), available at <http://www.sec.gov/news/studies/proxyreport.pdf>.

²⁷ Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,790, 60,791 (Oct. 23, 2003), *reprinted in* [2003–2004 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,101, at 88,409, 88,410 (Oct. 14, 2003).

²⁸ Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,794 (Oct. 23, 2003), *reprinted in* [2003–2004 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,101, at 88,413–88,414 (Oct. 14, 2003).

Chairman Donaldson siding with the two Democratic commissioners.²⁹ The Business Roundtable (an association of CEOs of leading U.S. companies) and the Chamber of Commerce were strongly opposed.³⁰ Donaldson ended up not pushing for an adoption of the proxy rules and resigned in 2005.³¹ His successor, Christopher Cox, was not regarded as a champion of proxy access, and proxy access was considered dead.

Dissatisfied champions of proxy access therefore decided to adopt an alternative strategy. In 2005, the American Federation of State, County and Municipal Employees (AFSCME) made a shareholder proposal under Rule 14a-8 to American International Group (AIG) seeking to implement a homemade proxy access regime through a bylaw amendment.³² The SEC's Division of Corporate Finance took the position that AIG could omit this proposal under Rule 14a-8(i)(8).³³ AIG did, and AFSCME sued. In 2006, the U.S. Court of Appeals for the Second Circuit ruled that the proposal could not be excluded.³⁴ In its opinion, the court was highly critical of the SEC, berating it for changing its position on the meaning of its rules without either acknowledging so or explaining the reasons for it.³⁵ The Court of Appeals's ruling meant that the SEC had to act, both to clarify its rules and to remedy the shortcomings the court had noted.

And act it did—sort of. In July 2007, the SEC released for comment two alternative proposals. One resembled the 2003 proxy access proposal. The other would have provided a reasoned basis for the position that a shareholder proposal trying to implement proxy

²⁹ See Jonathan Peterson, *SEC Offers Conflicting Shareholder Proposals*, L.A. Times, July 26, 2007, at C3 (stating that Chairman Donaldson and the SEC's Democratic commissioners supported the SEC's 2003 proposal).

³⁰ See Bill Baue, *Opening Up Pandora's Box: SEC Proxy Roundtable Questions Role of Non-Binding Resolutions*, SocialFunds (May 15, 2007), <http://www.socialfunds.com/news/article.cgi/2293.html> ("The SEC allowed the rule it proposed in October 2003, allowing shareowners proxy access to nominate directors in certain circumstances, to die on the vine due to opposition by the Business Roundtable and the US Chamber of Commerce, which threatened a lawsuit.").

³¹ Stephen Labaton, *S.E.C.'s Chairman is Stepping Down from Split Panel*, N.Y. Times, June 2, 2005, at A1.

³² *AFSCME v. AIG, Inc.*, 462 F.3d 121, 123–24 (2d Cir. 2006).

³³ *Id.* at 124.

³⁴ *Id.* at 129–30.

³⁵ *Id.* at 129.

2011]

Insignificance of Proxy Access

1355

access for a single company can be excluded under Rule 14a-8. Each proposal was supported by only 3 of the 5 commissioners—the first by the 2 Democratic commissioners and Chairman Cox, the second by Cox and the 2 other Republican commissioners.³⁶ In November 2007, the 3 Republican commissioners adopted the second proposal.³⁷

A year later, Barack Obama was elected President. Cox resigned and was succeeded by Mary Schapiro.³⁸ With Cox having been replaced by an Obama nominee, the SEC, in June 2009, released another variant of a proposed proxy access rule—again in a 3-2 vote.³⁹ The 2009 proposal was broader than the 2003 proposal: it removed the requirement of a triggering event, it lowered the percentage ownership requirement for making a nomination to 1%–5%, depending on company size, and it shortened the required holding period to 1 year.⁴⁰ Predictably, reactions were mixed, with some groups strongly opposed and others strongly in favor. But even some of the market participants who favored proxy access in general suggested that the 2009 proposal be made more restrictive.⁴¹ For example, in its comment letter to the SEC, Barclays Global Investors, a major institutional holder that manages \$1.5 trillion in assets, favored both the reintroduction of the triggers in the 2003

³⁶ See Nicholas Rummell, SEC Splits Proxy Access Votes as Cox Says ‘Yea’ to Two Proposals, *Fin. Wk.* (July 25, 2007, 6:11 PM), <http://www.financialweek.com/apps/pbcs.dll/article?AID=/20070725/REG/70725013/1036> (describing how the first proposal would allow shareholders to put forth proxy proposals calling for bylaw changes to allow shareholder-approved directors during corporate elections and how the second would restate the SEC’s position prior to the Second Circuit’s invalidation).

³⁷ L. Reed Walton, *The SEC Denies Proxy Access*, RiskMetrics Group Blog (Nov. 30, 2007, 10:33 AM), <http://blog.riskmetrics.com/gov/2007/11/the-sec-denies-proxy-accesssubmitted-by-l-reed-walton-publications.html>.

³⁸ See Randall Smith & Kara Scannell, *Regulator Schapiro to Run SEC for Obama*, *Wall St. J.*, Dec. 18, 2008, at A1.

³⁹ *Georgeson Inc. & Latham & Watkins LLP, Proxy Access Proposed Rules Published by SEC, Corp. Governance Comment.* (June 15, 2009), http://www.georgeson.com/usa/download/corp_gov_commentary.html.

⁴⁰ *Facilitating Shareholder Director Nominations*, Securities Act Release No. 9046, Exchange Act Release No. 60,089, Investment Company Act Release No. 28,765, 74 Fed. Reg. 29,032, 29,037, 29,063 (June 18, 2009).

⁴¹ See generally *Corporate Law Daily (BNA)* (Aug. 20, 2010), available at http://news.bna.com/cldn/CLDNWB/split_display.adp?fedfid=17646623&vname=ccdbulallissues&fn=17646623&jd=a0c4a1c0v3&split=0 (noting that institutional investors favor a 3% threshold).

proposal and an increase in the ownership threshold needed to make a nomination to 5%–15%, depending on the company's market capitalization.⁴² T. Rowe Price Associates, a mutual fund complex with about \$190 billion in assets, favored a 5% ownership threshold for all companies, noting that it owned more than 5% of the stock in more than 350 U.S. operating companies.⁴³ Moreover, managerial interests raised the argument that the proposed rule exceeded the SEC's rulemaking authority.⁴⁴

To insulate any rule against such a legal attack, the SEC delayed action until Congress, as part of the financial reform bill, granted the disputed authority to the SEC.⁴⁵ President Obama signed the finance reform bill on July 21, 2010, and the SEC adopted the proxy access rule on August 25, 2010. Under the adopted rule, the ownership requirement was set at a uniform level of 3% for all companies.⁴⁶ Shareholders can pool their shares to form a group that satisfies the ownership threshold. If more than 10 other shareholders are solicited in the effort to form such a group, the soliciting shareholder must file a disclosure statement with the SEC. The 3% ownership requirement must be satisfied as of the date the nomination is made and for the preceding 3 years.⁴⁷ Since nominations must be made no later than 120 days before the anniversary of the company's mailing of the previous year's proxy statement,⁴⁸ and the nominating shareholders must intend to maintain their

⁴² Annette L. Nazareth, *SEC Urged to Defer Adopting Proxy Access Rules*, Harv. L. Sch. F. on Corp. Governance and Fin. Reg. (Oct. 6, 2009, 9:01 AM), <http://blogs.law.harvard.edu/corpgov/2009/10/06/sec-urged-to-defer-adopting-proxy-access-rules>.

⁴³ *Id.*

⁴⁴ See Kevin Drawbaugh, *US CEO Lobby Doubts SEC Authority on Proxy Access*, Reuters, Jan. 16, 2004; Rachele Younglai, *SEC Aims for Proxy Access Rules in 2nd Quarter*, Reuters, Apr. 27, 2010, available at <http://www.reuters.com/article/idUSTRE63Q47T20100427>.

⁴⁵ See Jeff Morgan, *SEC Proxy Access Vote Delayed Until Early 2010*, National Investor Relations Institute (Oct. 6, 2009), <http://www.niri.org/Main-Menu-Category/advocate/Presidents-Note/SEC-Proxy-Access-Vote-Delayed-Until-Early-2010.aspx>.

⁴⁶ 17 C.F.R. § 240.14a-11(b)(1) (2010). However, for very small issues (with a public float of less than \$75 million), the effective date of the rule was delayed for 3 years. *Facilitating Shareholder Director Nominations*, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29,384, 75 Fed. Reg. 56,668 (Sept. 16, 2010).

⁴⁷ 17 C.F.R. § 240.14a-11(b)(2) (2010).

⁴⁸ *Id.* § 240.14a-11(b)(10).

2011]

Insignificance of Proxy Access

1357

ownership until the date of the meeting,⁴⁹ the rule effectively imposes a 3-and-1/3-year holding period on nominating shareholders. As in the proposed rule, nominations may only be made for up to 25% of the board seats. No nominations may be made by a shareholder who seeks to change control of the company or to gain a number of seats in excess of the maximum permitted by the rule.⁵⁰ A nominee's candidacy may not violate the law or any stock exchange rules, the nominee must meet stock exchange rule independence criteria, and the nominating shareholder must file a new Schedule N containing certain disclosures.⁵¹

Promptly after the proxy access rule was adopted, the Business Roundtable and the Chamber of Commerce filed suit to enjoin and invalidate it.⁵² On July 22, 2011, the Court of Appeals for the D.C. Circuit vacated the proxy access rule, holding that the rule was "arbitrary and capricious" due to the SEC's failure to assess its economic effects adequately.⁵³ As of this writing, the SEC has yet to determine whether to appeal the ruling, revise or reissue the rule after performing the missing analysis, or drop its effort to grant proxy access. But given the checkered history of proxy access, we would be surprised if the Court of Appeals opinion presented the last word in this long saga.

B. Other Developments

Between 2003, when the Donaldson commission released its proxy access proposal, and 2010, when the Schapiro commission adopted its variant of proxy access, several notable developments occurred. Shareholders realized the power they can wield by "just voting no." Many companies switched their election regime from

⁴⁹ Id. § 240.14a-11(b)(5).

⁵⁰ Id. § 240.14a-11(b)(6).

⁵¹ Id. § 240.14a-11(b)(8)–(10). The requirements of Schedule N are further discussed at Table 4, *infra*.

⁵² Petition for Review at 2, *Bus. Roundtable v. SEC*, No. 10-1305 (D.C. Cir. Sept. 29, 2010). The SEC has agreed to stay the effectiveness of the proxy access rules pending resolution of the lawsuit. See U.S. Chamber and Business Roundtable Commend SEC's Decision to Grant Stay on Proxy Access Rule, U.S. Chamber of Commerce (Oct. 4, 2010), <http://www.uschamber.com/press/releases/2010/october/us-chamber-and-business-roundtable-commend-secs-decision-grant-stay-prox>.

⁵³ *Bus. Roundtable v. SEC*, No. 10-1305, 2011 U.S. App. LEXIS 14988 (D.C. Cir. July 22, 2011).

plurality voting to some form of majority voting. Discretionary broker voting in director elections was eliminated. And finally, Delaware law was clarified to permit shareholders to adopt tailor-made, firm-specific proxy access rules. These developments have reduced—in our view, significantly—the impact, usefulness, and need for a federal rule on proxy access. In this Section, we describe these developments in greater detail.

In uncontested director elections—and the overwhelming majority of elections are uncontested—the only choice for shareholders who do not want to vote for a board nominee is to mark their proxy card (or voting instruction form) to withhold authority to vote for the director at issue. Shareholders have long had the ability to return a proxy card but withhold the vote for a director. Until recently, however, shareholders have taken little note of it.

The intellectual origin of shareholders withholding their votes lies in a 1990 presentation to large institutional investors by former SEC Commissioner, and then-professor at Stanford law, Joe Grundfest. Grundfest proposed that shareholders “just vote no” in director elections.⁵⁴ Though under the plurality voting system that prevailed at the time, withhold votes would have no legal effect no matter how many were cast,⁵⁵ he argued that the symbolic impact of withhold votes, especially when coupled with shareholder communications with management, could act as an annual referendum on managerial performance and “be a catalyst for improved oversight that would benefit all corporate constituencies, as well as the economy at large.”⁵⁶ In particular, Grundfest expected that

[a] successful “just vote no” campaign can induce internal reforms as a result of social pressures that lead board members to engage in more effective monitoring. Alternatively, a substantial “just vote no” turnout can increase the probability of a hostile proxy contest or tender offer that will be treated more kindly by

⁵⁴ Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 *Stan. L. Rev.* 857, 867 (1993).

⁵⁵ As discussed below, in an uncontested election under plurality voting, each nominee is elected as long as she receives a single affirmative vote. See *infra* text accompanying note 190.

⁵⁶ Grundfest, *supra* note 54, at 866.

the courts precisely because it follows a significant “just vote no” turnout.⁵⁷

Although there was some early enthusiasm for the initiative,⁵⁸ it took a number of years before Grundfest’s proposal caught on. The turning point probably was in the 2004 Disney board election,⁵⁹ when 45% of the shares were withheld from Disney CEO Michael Eisner.⁶⁰ This campaign was highly publicized for a variety of reasons: it involved a large entertainment company; it pitted Eisner against Roy Disney, the nephew of the legendary founder of the company; and Roy Disney spent more than \$2 million in campaigning for shareholders to vote “no.”⁶¹ Even though Eisner received a majority of the votes cast, the board of Disney immediately stripped him of his position as chairman⁶² and Eisner resigned as CEO the following year.⁶³ The Disney withhold campaign showed shareholders that, in the right circumstances, a high withhold vote is both achievable and effective in inducing governance changes.

In the wake of the rise of withhold campaigns, it also dawned on shareholders that there is something wrong with an election system in which a director can be elected even if a large majority of shareholders is opposed. As a result, shareholders began pushing for some form of majority voting. It seems that the arguments against plurality voting struck a chord. Within a short span, most large companies discarded the old plurality voting regime and adopted

⁵⁷ Id. at 927.

⁵⁸ Id. at 866–67 & n.33 (citing press reports commenting on the increased popularity of the initiative).

⁵⁹ See Andrew Countryman, Shareholders Renewing “Just Vote No” Campaigns, Chi. Trib., Feb. 11, 2005, § 3, at 4 (quoting Patrick McGurn, a corporate governance expert at Institutional Shareholders Service, as saying “[w]ithhold-vote campaigns came of age in 2004, and they emerged as the dominant tactic for shareholder activists . . .”).

⁶⁰ See Laura M. Holson & Geraldine Fabrikant, Disney Chief to Leave, Setting Off Race for Job, N.Y. Times, Sept. 11, 2004, at C3.

⁶¹ See Matt Kelly, Proxy Access Update: A Review of Likelihood, Costs, Compliance Wk. (Oct. 12, 2004), <http://www.complianceweek.com/article/1219/proxy-access-update-a-review-of-likelihood-costs>.

⁶² See Steven J. Spencer & Young J. Woo, Considerations for “Just Vote No” Campaigns, Activist Investment Developments, Schulte, Roth & Zabel, LLP 1 (Fall 2006), <http://www.srz.com/files/News/5333c42b-1659-4caf-9540-c10b4a6a038c/Presentation/NewsAttachment/26d52d60-ac91-404e-8bbd-67bfae1332d0/filesfilesArticle%20-%20AI%20-%20fall06%20-%20Considerations.pdf>.

⁶³ See Exit Eisner, L.A. Times, Sept. 30, 2005, at B10.

some form of majority voting. Thus, the percentage of S&P 500 companies with some form of majority voting increased from 16% in February 2006 and 66% in November 2007⁶⁴ to about 80% in 2010.⁶⁵ S&P 500 companies account for about 75% of the aggregate capitalization of the U.S. stock market.⁶⁶ Among smaller companies, majority voting so far remains much less prevalent: of 5930 companies outside the S&P 500 that are followed by RiskMetrics, only 17% had adopted some form of majority voting by 2009.⁶⁷ But still, it is clear that majority voting has been a big success, is already in effect for a majority of U.S. companies when weighted by capitalization, and is likely to be adopted by many more companies in future years.

A third change occurred with respect to the ability of brokers to vote shares held in their customers' brokerage accounts. Most individual shareholders in the U.S. hold their shares through brokers and are not the record holders of those shares.⁶⁸ When a company solicits proxies, it sends proxy materials to the brokers, which then forward them to their customers together with a form on which the customers can mark voting instructions.⁶⁹ If the customer does not return these instructions, and the issue is designated as "routine" by the NYSE, the broker can vote the uninstructed shares in its discretion—which usually means in accordance with management recommendations.⁷⁰

⁶⁴ Claudia H. Allen, Study of Majority Voting in Director Elections, Neal, Gerber & Eisenberg, LLP i (Nov. 12, 2007), <http://www.ngelaw.com/files/upload/majoritystudy111207.pdf>.

⁶⁵ See Press Release, California Public Employees' Retirement System, CalPERS 2010 Majority Vote Initiative Successful at Top Companies (Dec. 22, 2010), <http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-archive/pr-2010/dec/2010-majority-vote.xml>.

⁶⁶ See Data Series: SP500, S&P 500 Index, Federal Reserve Bank of St. Louis (Jul. 26, 2010, 10:01 AM), available at <http://research.stlouisfed.org/fred2/series/SP500>.

⁶⁷ See Lucian Bebchuk & Scott Hirst, Private Ordering and the Proxy Access Debate, 65 *Bus. Law.* 329, 343 (2010) (citing figures supplied to the authors by RiskMetrics).

⁶⁸ Marcel Kahan & Edward Rock, The Hanging Chads of Corporate Voting, 96 *Geo. L.J.* 1227, 1237 (2008) [hereinafter Kahan & Rock, *Hanging Chads*].

⁶⁹ *Id.* at 1243–48 (describing the process of how nominee shares are voted).

⁷⁰ *Id.* at 1250.

Until 2010, all uncontested director elections were treated as routine⁷¹—including the Disney board election in 2004 and subsequent elections in which active withhold campaigns were waged. As of January 1, 2010, the NYSE no longer treats *any* director election as routine.⁷² As a result, when a shareholder does not return voting instructions to the broker, these shares are not voted in the election of directors.

Finally, while proxy access was waxing and waning at the SEC, Delaware law made clear that shareholders had broad powers to adopt bylaws governing proxy access. In 2008, the Delaware Supreme Court held in *CA, Inc. v. AFSCME Employees Pension Plan*⁷³ that provisions facilitating the nomination of director candidates by shareholders can be included in bylaws—which can be adopted by shareholders without board approval⁷⁴—and need not be included in the certificate of incorporation (which can only be changed upon a board recommendation).⁷⁵ The following year, the Delaware legislature adopted a new Section 112 that explicitly allows corporations to adopt proxy access via bylaw.⁷⁶ Under that section, the bylaws may provide that individuals nominated by a stockholder will be included in the corporation's proxy solicitation materials and its form of proxy, subject to the procedures and con-

⁷¹ NYSE Rule 451, 2 N.Y.S.E. Guide (CCH) ¶ 2451 (Dec. 2009); NYSE Rule 452, 2 N.Y.S.E. Guide (CCH) ¶ 2452 (Dec. 2009). Since NYSE exchange rules effectively govern all brokers, this rule applies to all publicly traded companies, regardless of where their stock is listed for trading.

⁷² See Julie Connelly, What the Amended Rule 452 Means to You, Corp. Bd. Member, Third Quarter 2009, available at http://www.boardmember.com/MagazineArticle_Details.aspx?id=3880 (explaining the change in NYSE Rule 452 and ramifications for director elections).

⁷³ 953 A.2d 227, 237 (Del. 2008).

⁷⁴ Del. Code Ann. tit. 8, § 109(a) (Supp. 2010).

⁷⁵ See generally Marcel Kahan & Edward B. Rock, Corporate Constitutionalism: Antitakeover Charter Provisions as Precommitment, 152 U. Pa. L. Rev. 473, 495–96 (2003) (distinguishing between unilateral and bilateral governance changes).

⁷⁶ H.R. 19, 145th Gen. Assemb., Reg. Sess. (Del. 2009); see also Comment Letter from James L. Holzman, Chair, Council of the Corp. L. Section of the Del. Bar Ass'n, to Elizabeth M. Murphy, Secretary, Sec. & Exchange Commission 4 (July 24, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-65.pdf>. For an analysis of the jurisdictional interaction between Delaware and the federal government regarding proxy access, see Mark J. Roe, The Corporate Shareholder's Vote and its Political Economy, in Delaware and in Washington (Paolo Baffi Centre Research Paper No. 2011-94, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1884110.

ditions provided in the bylaw. These conditions may include a minimum level or duration of ownership, submission of specified information, and limitations on parties seeking control. In principle, therefore, if a majority of shareholders of a company want proxy access, they have the power to adopt a proxy access bylaw, at least in most Delaware companies.⁷⁷ Unlike the SEC's proxy access rule, Section 112 embodies an "enabling" approach to corporate governance, as it permits each company to determine for itself whether to have proxy access, and if so, which shareholders should be eligible to make nominations, rather than imposing the same "one size fits all" approach on all companies.⁷⁸

II. THE STATUS QUO: UNCONTESTED AND CONTESTED PROXY SOLICITATIONS

Before considering how proxy access may change the existing system, we need to describe briefly how the existing system works.

⁷⁷ Though Section 112 became effective in August 2009, we are not aware of any shareholder proposal during the 2010 proxy season that tried to use Section 112 to opt into a homemade proxy access rule. While this may indicate a lack of demand, it could also be due to the fact that shareholders' rights advocates were awaiting the likely adoption of the SEC proxy access rule. Moreover, without changes in federal law, a proxy access rule under Section 112 would have created some tensions with the anti-fraud provision in the proxy rules: to the extent that the company's proxy statement includes information provided by a nominating shareholder, and that information is materially false or misleading, the company would have violated Rule 14a-9. The new federal proxy access rule makes it a violation for a nominating shareholder to cause a company to include materially false or misleading information regarding a proxy access nomination under federal or state law, see 17 C.F.R. § 240.14a-9 (2010), and exculpates the company from any liability for false or misleading statements supplied by a nominating shareholder in Schedule 14N or otherwise, see 17 C.F.R. § 240.14a-11(f) (2010). It is not entirely clear whether this exculpation applies to information furnished under Section 112. However, prior to the adoption of the federal proxy access rule, the clear lack of any exculpation may have made a company wary of adopting proxy access under Section 112.

⁷⁸ The lack of any ability of companies to opt out of proxy access formed part of the basis for Commissioner Paredes's opposition to the SEC's approach. See, e.g., Troy A. Paredes, Comm'r, Securities and Exchange Comm'n, Speech at the 22nd Annual Tulane Corporate Law Institute (April 15, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch041510tap.htm>).

A. Uncontested Solicitations

There are approximately 6000 firms listed on the NYSE, the AMEX, and the NASDAQ, including foreign issuers.⁷⁹ The Wilshire 5000 index, which now includes around 4000 companies,⁸⁰ endeavors to cover the entire U.S. equity market and includes every equity security with its primary market listing in the U.S. It drops issues which stop trading for 10 consecutive days (which then are typically listed, if at all, on the “Pink Sheets”).⁸¹ Most of these companies hold shareholder meetings once a year and solicit proxies for these meetings⁸² under the federal proxy rules.⁸³

All but a handful of these meetings are utterly routine. As one would predict, the solicitation of proxies for the uncontested an-

⁷⁹ NYSE: 2600 listed operating companies, including 450 from outside the U.S. See A Guide to the NYSE Marketplace, NYSE Group 3 (2006), available at http://www.nyse.com/pdfs/nyse_bluebook.pdf. AMEX: 539 listed companies, including closed-end funds and non-U.S. issuers. See NYSE and NYSE AMEX Equities Membership, NYSE Euronext, Inc., <http://www.nyse.com/membership/equities/nyse> (last visited Sept. 2, 2011). NASDAQ: 2852 listed companies as of December 31, 2009. See NASDAQ OMX Group, Inc., Annual Report (Form 10-K), at 2 (Feb. 18, 2010). Total: 6009 companies.

⁸⁰ Wilshire Fundamental Characteristics, Wilshire Indexes (April 29, 2011), <http://web.wilshire.com/Indexes/Broad/Wilshire5000/Characteristics.html>.

⁸¹ See Description of Wilshire 5000 Total Market Index, Wilshire Indexes, <http://web.wilshire.com/Indexes/Broad/Wilshire5000/> (last visited May 17, 2011). The “Pink Quotations” or “Pink Sheets”—an electronic quotation system that displays quotes for typically inactively traded over-the-counter securities—are so called because the quotes were originally published on pink colored paper by the National Quotation Bureau (NQB). They are currently published by NQB’s successor, OTC Markets Group, Inc., which recently changed its name from Pink OTC Markets, Inc. See History of OTC Markets Group, OTC Markets, <http://www.otcm Markets.com/about/otc-markets-history> (last visited May 17, 2011).

⁸² We have described this complex system previously. See Kahan & Rock, *Hanging Chads*, supra note 68 at 1233–47. It is also the subject of a recent SEC release. See Concept Release on the U.S. Proxy System, Exchange Act Release No. 62,495, Investment Advisers Act Release No. 3052, Investment Company Act Release No. 29,340, 75 Fed. Reg. 42,982, 42,984 (July 22, 2010).

⁸³ Other estimates indicate that there are somewhere around 13,000 shareholder meetings for public companies per year at which around 600 billion shares are voted. 2009 Proxy Season: Key Statistics & Performance Ratings, Broadridge Investor Communication Solutions 2 (2009), available at <http://www.broadridge.com/investor-communications/us/2009ProxyStats.pdf>. The difference between the 13,000 estimate of meetings and the 6000–7000 estimate of public companies is probably due to (1) the fact that companies sometimes hold more than one meeting per year, (2) the inclusion of companies that trade only on pink sheets, and (3) the inclusion of investment companies in the former figure.

nual meeting is likewise fairly routine. Counsel for the company must produce a proxy statement that complies with the requirements of Schedule 14A. That proxy statement along with a proxy card—or, in the case of indirect holding, a request for instructions (a VIF or “voting instruction form”)—is then distributed to the shareholders, proxies and instructions are collected, votes are tabulated, and the results are reported.

Total costs of the annual proxy solicitation usually fall in the \$10,000 to \$100,000 range. For example, at Air Products & Chemicals (market capitalization \$15.4 billion), the 2010 annual proxy solicitation cost around \$80,000, of which \$35,700 was paid to Broadridge⁸⁴ (covering the distribution to street holders, registered holders, and employee plan participants as well as hosting meeting materials on their website); \$14,000 was paid to Morrow & Co. (for acting as proxy solicitor); and \$30,000 was paid to RR Donnelley (for proxy printing and EDGAR preparation).⁸⁵ The proxy statement itself was produced in house.

B. Contested Solicitations

In contrast to the routine uncontested proxy solicitation for the annual meeting, a proxy contest for control, or even a “short slate” contest in which the dissidents seek to elect only a minority of directors, is much closer to a political campaign. It typically involves telephone solicitations, presentations to institutional investors, multiple mailings to shareholders, and sometimes newspaper advertisements and litigation.

Contested solicitations are relatively infrequent. According to data compiled by Georgeson, a proxy solicitation firm, the number of contested solicitations from 1981 to 2009 has ranged from a low of 3 (in 1993) to a high of 57 (in 2009), with a general trend upwards beginning in the mid 1990s. Since there are over 6,000 publicly traded companies, this means that over 99% of all votes are uncontested. In Table 1, we present data on the cost to dissidents

⁸⁴ Broadridge Financial Solutions, Inc. (“Broadridge”), formerly a unit of Automatic Data Processing, Inc. (“ADP”), is the market’s leading provider of investor communications, including proxy mailing and vote processing services.

⁸⁵ Email from John Stanley, General Counsel, Air Products & Chemicals, Inc., to Marcel Kahan (July 30, 2010) (on file with the Virginia Law Review Association).

2011]

Insignificance of Proxy Access

1365

and companies of waging a contest in 2009.⁸⁶ Dissident costs varied widely, from a low of \$30,000 to a high of \$9 million for Ackman's (unsuccessful) contested solicitation at Target. Unsurprisingly, costs tended to be higher for larger companies (as measured by their market capitalization) than for smaller ones. For companies with a capitalization of less than \$300 million, the average (median) costs amounted to \$267,000 (\$200,000); for companies with a capitalization between \$300 million and \$1 billion, the average (median) costs amounted to \$643,000 (\$275,000); and for companies with a capitalization of above \$1 billion, the average (median) costs were \$2.17 million (\$1.15 million).

Table 1: 2009 Contested Solicitations (Source: Georgeson and Independent Research)

Company	Dissident	Market Cap \$mil	Issue	Co. Costs \$1000	Diss. Costs \$1000	Diss. Stake	Outcome
Online Resources	Tennenbaum Cap Part	2	Directors	650	550	21.90%	Dissidents
Rancher Energy	Andrei Stytsenko	4	Directors	*	30	1.30%	Dissidents
Asure Software	Red Oak/Pinnacle	9	Directors	*	100	10.30%	Dissidents
Wilshire Enterprises	Full Value Part.	9	Directors	150	30	18.60%	Settled
Advocat Inc.	Bristol Inv. Fund	15	Directors	175	150	7.40%	Mgmt
Whitney Inf. Network	Kingstown Part.	17	Directors	*	50	11.50%	Dissidents
Hooper Holmes, Inc.	R. V. Aprahamian	18	Directors	160	150	4.40%	Dissidents
VaxGen	VaxGen Full Value Comm.	23	Directors	*	*	*	Mgmt
Premier Exhibitions	Sellers Cap.	35	Consent to Elect Directors	350	500	16.30%	Dissidents
Fauquier Bankshares	D. M. Van Roijen	43	Directors	200	75-100	7.30%	Mgmt

⁸⁶ We use the cost estimates provided by companies and challengers in their proxy statements, as required by Schedule 14A. 17 C.F.R. § 240.14a-101, Item 4 (2010).

1366

Virginia Law Review

[Vol. 97:1347]

Company	Dissident	Market Cap \$mil	Issue	Co. Costs \$1000	Diss. Costs \$1000	Diss. Stake	Outcome
Neuberger Berman Dividend Adv. Fd.	Western Investment	53	Directors; Opp. Mgmt Agr.	250	150	9.90%	Settled
ORBCOMM, Inc.	John C. Levinson	58	Directors	475	495	1.10%	Withdrawn
Trico Marine Services	Kistefos AS	59	Directors	1200	1700	21.00%	Mgmt
iPass Inc.	Foxhill Opp. Master Fd	62.5	Directors	750	300	7.00%	Settled
California Micro Devices	Dialectic Cap. Mgmt	64	Directors	350	375	8.80%	Dissidents
Penwest Pharmaceuticals	Tang Cap. Part.	64	Directors	875	450	21.10%	Dissidents
Tollgrade Comm.	Ramius LLC	67	Directors	400	200	15.50%	Dissidents
Mac-Gray Corp.	Fairview Cap. Inv.	71	Directors	250	350	6.30%	Split
Quigley Corp.	Ted Karkus	77	Directors	*	250	*	Dissidents
DWS RREEF Real Estate Fund	Susan L. Ciciora Trust	95	Vote Against Liquidation	330	55	16.50%	Dissidents/ Settled
Avigen Inc.	Biotechnology Value Fund	<100	Remove/ Replace Directors	*	150	30.00%	Mgmt
BellaVista Capital	MacKenzie Patterson Fuller	<100	Remove/ Replace Directors	79.5	20	12.40%	Mgmt
Cavalier Homes Inc	Cavalier Homes Comm. for Change	<100	Directors	*	225	9.60%	Settled
Charlotte Russe Holding	KarpReilly Cap. Partners	<100	Directors	*	295	8.90%	Withdrawn
CNS Response	Leonard J Brandt	<100	Remove/ Replace Directors	*	*	32.00%	Mgmt
Concord Milestone Plus	Everest Mgmt	<100	Remove Gen. Partner	*	10	11.30%	Dissidents

2011]

Insignificance of Proxy Access

1367

Company	Dissident	Market Cap \$mil	Issue	Co. Costs \$1000	Diss. Costs \$1000	Diss. Stake	Outcome
Insured Municipal Income Fund	Bulldog Investors	<100	Directors/Inv. Policies	*	100	10.80%	Dissidents
IPC Holdings	Validus Holdings	<100	Opp. to Amalgamation	*	*	*	Dissidents
IPC Holdings	Validus Holdings	<100	Call Sp. Meeting	*	*	*	Dissidents
LCA Vision, Inc.	The LCA-Vision Full Value Comm.	<100	Remove/Replace Directors	*	*	*	Withdrawn
Specialty Underwriters' Alliance	Hallmark Fin. Services	<100	Directors	275	250	9.90%	Split
Sun-Times Media Group	Davidson Kempner Cap. Mgmt	<100	Consent to Replace Directors	445	415	5.90%	Dissidents
TM Ent. and Media	Opportunity Part.	<100	Expand Bd; Directors	*	25	18.50%	Settled
Agilysys Inc.	Ramius LLC	100	Directors	*	250	12.50%	Settled
Tier Technologies	Discovery Equity Part.	119	Directors	*	162.5	9.90%	Dissidents
CPI Corp	Ramius LLC	122	Directors	*	200	23.00%	Mgmt
Providence Service Corp.	Prov Comm	128	Directors	445	250	17.90%	Mgmt
Tecumseh Products	Herrick Found.	171	Directors	*	700	15.20%	Dissidents
Consolidated-Tomoka Land Co.	Wintergreen Fund	204	Directors	*	100	25.90%	Split
Conseco	Otter Green Mgmt	233	Director	245	225	0.80%	Dissidents
Myers Industries	GAMCO Asset Mgmt	304	Directors	*	25	9.60%	Mgmt
Orthofix International	Ramius LLC	308	Directors	650	250	5.50%	Mgmt
Orthofix International	Ramius LLC	308	Consent to Call Meeting	*	*	5.50%	Dissidents
Adaptec, Inc.	Steel Part.	389	Remove/Replace Directors	700	275	10.90%	Dissidents

1368

Virginia Law Review

[Vol. 97:1347]

Company	Dissident	Market Cap \$mil	Issue	Co. Costs \$1000	Diss. Costs \$1000	Diss. Stake	Outcome
Federal Signal Corp.	W. B. Kanders	399	Directors	1800	750	2.60%	Withdrawn
Saks Inc.	P. Schoenfeld Asset Mgmt	781	W/hold on Directors/ Repeal Class Bd	*	575	1.50%	Mgmt/Dissident
Children's Place Retail Stores	E. Dabah & Comm.	908	Directors	1500	2350	21.80%	Settled
Emulex Corp.	Broadcom Corp.	922	Call Sp. Meeting	900	*	0.00%	Withdrawn
Chemed Corp.	MMI Investments	960	Directors	1500	275	3.60%	Mgmt
PHH Corp.	Pennant Cap. Mgmt	1000	Directors	325	600	9.90%	Dissidents
Texas Industries	Shamrock Activist Value Fund	1108	Directors	600	1000	10.20%	Dissidents
Amylin	Icahn	1619	Directors/ Reincorp	7000	650	9.20%	Split/Mgmt
Amylin	Eastbourne Cap.	1619	Directors	7000	2500	12.20%	Split
CF Industries Holdings	Agrium Inc.	4968	Withhold on Directors	250	1300	2.60%	Mgmt
NRG Energy	Exelon	6227	Dir.; Exp. Board	3000	1300	0.00%	Settled
Biogen Idec	Carl Icahn	14137	Directors	9200	1000	5.60%	Split
Target Corp.	Pershing Square	34909	Directors	11100	9000	7.80%	Mgmt

* Not disclosed.

Market capitalization "<100" is authors' estimate.

To examine contested solicitations more closely, we collected detailed information about all the contests waged between 2005 and 2009 as listed by Georgeson,⁸⁷ excluding contests that did not primarily involve the election of directors upon expiration of their terms, contests waged in connection with hostile takeover at-

⁸⁷ See Georgeson, 2009 Annual Corporate Governance Review (2009), available at www.georgeson.com/usa/download/acgr/acgr2009.pdf.

2011]

Insignificance of Proxy Access

1369

tempts, and contests involving closed-end mutual funds.⁸⁸ Our list consists of 129 contests. In about half of these contests (66), the dissidents obtained some board representation, either as a result of a ballot success or pursuant to a settlement.⁸⁹

Our analysis shows that most of the target companies involved in these proxy contests are small. Only 8 companies (6%) had a market capitalization of more than \$10 billion (a typical definition of large-cap), 9 had a capitalization of between \$2 billion and \$10 billion (mid-cap),⁹⁰ and another 40 had a capitalization of between \$300 million and \$2 billion, a standard range for small-cap companies.⁹¹ About 60% of the companies (72) were micro-cap companies, with a capitalization of less than \$300 million. The average and median capitalizations of these micro-caps were \$93 and \$66 million. Though micro-cap companies also constitute a large fraction of publicly traded companies, they account for less than 2.5% of the market capitalization of U.S. companies.⁹²

That proxy contests are overwhelmingly a phenomenon of small and very small publicly-held firms is important, but rarely noted in the extensive literature on proxy contests. Corporate law scholars often seem to think of publicly held firms as a unitary phenomenon and focus mainly on the larger capitalization firms. But when a company falls below the \$300 million market cap, it is extremely difficult to attract attention from analysts or investors.⁹³ These

⁸⁸ Contests about mergers, bylaw amendments, and director removal were excluded because proxy access would not be a vehicle through which such contests could be waged. Contests involving closed-end mutual funds were excluded because of the special nature of these contests, which usually relate to the opening or liquidation of a fund.

⁸⁹ In 3 contests, no election was held for reasons such as a lack of quorum or the acquisition of the company prior to the scheduled vote.

⁹⁰ Mid Cap, Investopedia, <http://www.investopedia.com/terms/m/midcapstock.asp> (last visited May 17, 2011).

⁹¹ Small Cap, Investopedia, <http://www.investopedia.com/terms/s/small-cap.asp> (last visited May 17, 2011).

⁹² See Russell 3000 Index, Russell Investments (Feb. 28, 2011), http://www.russell.com/indexes/data/fact_sheets/us/russell_3000_index.asp (stating that Russell 3000 companies account for 98% of the investible U.S. equities market).

⁹³ Justin Canivet, Small Cap Analyst Coverage: An "Under-the-Radar" Dilemma, Focus, Apr. 2009, at 4, available at www.world-exchanges.org/files/file/Focus%200409.pdf. As Demiroglu & Ryngaert describe,

[i]n a press release dated July 7, 2005, Bob Greifeld, president and CEO of NASDAQ, noted that 35% of all publicly traded US firms had no analyst cov-

firms are lucky if a single analyst follows them.⁹⁴ With so little attention, the market for such companies' shares is far less informationally efficient than for mid-cap or large-cap companies.⁹⁵ Similarly, micro-cap companies present distinctive governance challenges. With most of the normal levers of accountability missing, many of them may be badly governed.

In terms of dissidents, of the 129 contests, 86 were waged by hedge funds; of the rest, most were waged by an individual or a group of individual investors. Mutual funds, public pension funds, and private pension funds did not wage *any* of these contests. Dissidents held on average 8.9% of the target company's outstanding shares. In 100 of the 129 contests, the dissidents held more than 5% of the shares of the respective target company. Only 13 dissidents held less than 1% of the shares. This group includes 9 dissidents that held stakes with a dollar value below \$150,000, all of whom lost. We regard such low percentage and dollar value contests as nuisance contests. Outside of nuisance contests, there is no strong correlation between dissident stakes and success. Thus, in the 15 contests in which dissident stakes exceeded 15%, the dissidents won only 6 (40%), a success rate well below the sample average.

Segregating the sample into micro-cap and regular-sized (that is, non-micro-cap) companies yields some further insights. Among regular-sized companies, hedge funds constituted 82% of the dissi-

erage. Additionally, he cited estimates by Reuters that from January 2002 to June 2005, 691 publicly traded US companies had lost all analysts' coverage. Almost all of these companies had market capitalizations under \$1 billion. Greifeld also noted "a lack of research coverage impacts company valuation, liquidity, and ultimately the welfare and growth of public companies."

Cem Demiroglu & Michael Ryngaert, *The First Analyst Coverage of Neglected Stocks*, 39 *Fin. Mgmt.* 555, 555 (2010) (quoting Press Release, NASDAQ, NASDAQ and Reuters Launch New Venture to Help Companies Obtain Independent Analyst Coverage (June 7, 2005), available at http://www.nasdaq.com/newsroom/news/pr2005/ne_section05_056.stm).

⁹⁴ Indeed, one concern with the 2003 analyst settlement was that the new rules would mean that many of the smaller firms would go from one analyst to zero. See Susanne Craig, *Firm to Research Stock "Orphans,"* *Wall St. J.*, June 7, 2005, at C3 ("Reuters found that since 2002, 691 companies have lost analyst coverage altogether. The hardest hit sector: Almost 99% of the companies that have lost coverage are smaller companies with a stock market value of less than \$1 billion.").

⁹⁵ See Demiroglu & Ryngaert, *supra* note 93, at 555, 567-69, 581 (documenting the price effects from the announcement of analyst coverage of a previously uncovered company).

2011]

Insignificance of Proxy Access

1371

dents, former insiders constituted 7%, and other dissidents constituted 11%. Among micro-caps, hedge funds accounted for only 54% of the dissidents, former insiders for 18%, and other dissidents for 28%.

Table 2: Proxy Contests 2005-2009*

	Contests	Hedge Funds	Former Insiders	Success Rate	Success Rate HF	Success Rate Insiders	Success Rate Others
All Companies	129	86	17	52%	60%	59%	21%
Microcaps (capitalization < \$300m)	72	39	13	51%	63%	69%	28%
Regular (capitalization > \$300m)	57	47	4	54%	56%	25%	0%

*Derived from Georgeson, Annual Corporate Governance Review, 2005 to 2009

As Table 2 shows, the overall success rate of the dissidents was similar in both groups. But this similarity masks important differences. Dissidents other than hedge funds had substantially higher success rates among micro-caps than among regular-sized companies, with former insiders doing better than other non-hedge fund dissidents. Hedge funds had high success rates in both groups, but accounted for a much larger fraction of the contests among regular-sized companies. Dissident stakes averaged 7.8% in regular and 9.7% in micro-cap companies. In both sets of companies, former insiders had the highest average stake (9.2% and 16.6%, respectively), followed by hedge funds (8.1% and 11%, respectively), and other dissidents (0.2% and 7.5%, respectively).

In sum, only two types of dissidents showed meaningful success in waging proxy contests: hedge funds and, for micro-cap companies, former insiders. Other investors—including institutional investors other than hedge funds and individual investors other than former insiders—either never tried or rarely succeeded.

C. Contested Lite: Shareholder Proposals

Under Rule 14a-8, any shareholder who holds a mere \$2,000 worth of stock for one year can place a shareholder proposal in the

company's proxy statement.⁹⁶ Rule 14a-8 proposals may relate to many important corporate governance matters, but they cannot be used as a vehicle to make a nomination for a directorship.⁹⁷ Given the trivial share ownership requirements and the short holding period, especially compared to the (adopted as well as proposed) thresholds for proxy access, a large number of shareholders are eligible to make Rule 14a-8 proposals. But most of them do not.

Georgeson publishes an annual list of all corporate governance-related proposals submitted at S&P 1500 companies. We examined the sponsors of the proposals for the five-year period 2005 to 2009 to determine what shareholder types make the most use of Rule 14a-8. In the 2005 to 2009 period, 1844 governance proposals were submitted. Of these, 47% were made by individual shareholders, 39% by labor-affiliated groups (unions, union funds, and employee organizations), and 5% by public pension funds.

Table 3: Governance Shareholder Proposal at S&P 1500*

Sponsor	2005	2006	2007	2008	2009	Combined
Total	375	384	375	339	371	1844
Individuals	158	180	177	163	181	859
Labor and Employee Groups	164	155	154	13	128	714
AFL-CIO	20	4	16	13	17	70
AFSCME	9	15	20	20	17	81
UBCJA	49	64	43	20	27	203
Public Pension Funds	15	19	19	19	25	97
CalPERS	3	2	5	6	5	21
NYC Pension Funds	0	9	10	10	11	40
Hedge Funds	3	7	0	3	2	15
Social Responsibility Funds	3	2	4	19	6	34
Charities and Religious Groups	24	16	15	9	13	77
Investment Managers	6	4	4	7	9	30
TIAA-CREF	0	0	0	2	4	6

*Derived from Georgeson, Annual Corporate Governance Review, 2005 to 2009

What is notable about this listing is, again, the absence of any private pension fund and the virtual absence (with the partial ex-

⁹⁶ 17 C.F.R. § 240.14a-8(b) (2010).

⁹⁷ *Id.* § 240.14a-8(i)(8).

ception of TIAA-CREF, which manages both retirement and mutual funds) of any mutual fund. Even public pension funds are underrepresented, and virtually all of the proposals in that category are sponsored by a handful of funds: New York City Pension Funds (40); CalPERS (21); Connecticut Retirement Plans (11); Massachusetts Laborers' Pension Fund (11); and New York State Retirement Fund (9).

By contrast, entities with economic or ideological interests that may deviate from maximization of company value—labor affiliated groups, religious and other charities, and social-responsibility oriented entities—are vastly overrepresented relative to their percentage shareholdings. As to the individual sponsors, a large percentage of proposals were made by a handful of individuals (such as John Chevedden, Gerald Armstrong, the Rossi family, and Evelyn Davis) with usually minimal ownership stakes.⁹⁸

For most of these shareholder proposals, the proponent relies on the description of the proposal but engages in no outside campaigning. Institutional shareholders are familiar with most types of proposals and often have developed policies on how they vote on them. Indeed, the proposals that receive majority shareholder approval tend to fall into a narrow set, which includes recommendations to destagger the board, establish majority voting, or eliminate supermajority voting. Occasionally, shareholder sponsors may campaign through public speeches, press releases, and advertisements, which they can do without having to make any filings.⁹⁹ Very rarely, a sponsor also engages in a so-called exempt solicitation under Rule 14a-2(b), which permits a shareholder to mail materials to other shareholders without filing a proxy statement as long as that shareholder does not furnish a proxy form and does not seek to act as a proxy, but it requires the filing of the mailed materials if the sponsor holds more than \$5 million in shares.¹⁰⁰

⁹⁸ See, e.g., FedEx Corp., Definitive Proxy Statement (Form DEF 14A), at 85–87 (Aug. 16, 2010) (identifying shareholder John Chevedden as owner of 100 shares of FedEx stock); Bill Barrett Corp., Definitive Proxy Statement (Form DEF 14A), at 46–47 (Apr. 9, 2010) (identifying shareholder Gerald Armstrong as owner of 100 shares).

⁹⁹ 17 C.F.R. § 240.14a-1(l) (2010).

¹⁰⁰ Id. §§ 240.14a-2(b)(1), 240.14a-6(g). In 2009, 15 shareholders engaged in such campaigns in favor of shareholder proposals. Seven of these campaigns were led by CalPERS. Most consisted of a single short mailing to shareholders.

Under that rule, shareholders may also engage in oral solicitations of other shareholders. Since most oral solicitations require no filings with the SEC,¹⁰¹ the exact number and scope of such solicitations are unclear. We doubt, however, that many proponents, with the possible exception of TIAA-CREF and public pension funds, engage in widespread oral solicitations.

D. Withhold Votes: Activism Without Activists

A final, more recent form of election “contests” relates to withhold votes in director elections. According to Georgeson’s survey of S&P 1500 companies, there were 41 directors in 2010 who received a majority withhold vote and 317 directors who received a withhold vote in excess of 30% of the votes cast.¹⁰² As described below,¹⁰³ many boards care about the percentage of withhold votes even if it does not affect the outcome of an election, and significant withhold votes often induce governance changes. Withhold votes thus represent an important form of shareholder activism.

Peculiarly, however, it is unclear who the activists behind withhold votes are. Most large withhold votes occur in companies in which no filings were made by backers of a withhold vote.¹⁰⁴ Thus, most large withhold votes are cast without any open campaigning. And, while it is true that most directors who receive large withhold votes received a withhold vote recommendation from ISS, the leading proxy advisor, it is equally true that most withhold recommendations by ISS do not result in large withhold votes.¹⁰⁵ Moreover, it is unclear whether an ISS withhold recommendation is the

¹⁰¹ Moreover, under 17 C.F.R. § 240.14a-2(b), shareholders are exempt from the rules requiring filing, except as provided under § 240.14a-6(g):

[N]o . . . submission need be made with respect to oral solicitations (other than with respect to scripts used in connection with such oral solicitations), speeches delivered in a public forum, press releases, published or broadcast opinions, statements, and advertisements appearing in a broadcast media, or a newspaper, magazine or other bona fide publication disseminated on a regular basis.

¹⁰² Georgeson, 2010 Annual Corporate Governance Review 8 (2010), available at <http://www.georgeson.com/usa/download/acgr/acgr2010.pdf>.

¹⁰³ See *infra* Subsection IV.B.4.

¹⁰⁴ In 2009, only 5 proxy statements or notices of exempt solicitations were filed in relation to withhold votes. See Georgeson, 2009 Annual Corporate Governance Review 48–49 (2009), available at www.georgeson.com/usa/download/acgr/acgr2009.pdf.

¹⁰⁵ See Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 *Emory L.J.* 869 (2010).

2011]

Insignificance of Proxy Access

1375

direct cause of withhold votes or whether an ISS withhold recommendation and withhold votes have the same underlying cause. A recent paper co-authored by one of us estimates that the ISS recommendation independently shifts only 6%–10% of the shareholder vote.¹⁰⁶ Large withhold votes may thus come about either spontaneously or from low-level coordination among institutional investors through oral communications and aided by recommendations by proxy advisors.

E. Who Will Use Proxy Access?

Predicting at this point what type of shareholders would use the proxy access rule to make nominations and how frequently they would do so is somewhat speculative. However, at least a good tentative sense of who would use proxy access can be obtained by looking at the activists who initiated full-fledged proxy contests and shareholder proposals under Rule 14a-8. Each of these types of activism bears some similarity to proxy access: full-fledged (or traditional) proxy contests share with proxy access the feature that they concern the election of directors; Rule 14a-8 proposals share with proxy access the feature that they entail low costs unless the proponent engages in outside campaigning.

Past participation in these forms of activism may be a predictor of future inclination to use proxy access for several reasons. First, proxy access may become a substitute for the other forms of activism: instead of, say, conducting a traditional proxy contest or making a shareholder proposal, a shareholder may make a nomination using proxy access. Second, participation in these other forms of activism indicates an interest in being and willingness to be an activist shareholder. Shareholders who, in the past, have remained passive when it came to voting are not likely to become active merely because—in addition to the existing avenues—a new way to become active presents itself. Relatedly, while proxy access represents a new, relatively cheap mode of activism, which may in principle be attractive to highly cost-conscious investors, making a Rule 14a-8 proposal is an equally cheap, and widely available,

¹⁰⁶ Id. at 906.

mode of activism.¹⁰⁷ Shareholders who have not made Rule 14a-8 proposals are thus unlikely to make proxy access nominations merely because it involves low expenses.

As discussed below,¹⁰⁸ the third type of activism, withhold votes, also resembles proxy access. However, since the activists behind large withhold votes, to the extent any exist, are unknown, and since any such activists seem to prefer to stay out of the limelight, we cannot and probably should not look at large withhold votes to predict who would use proxy access.

We start with proxy contests. As discussed, most (and most successful) proxy contests are initiated by hedge funds and former insiders. None were initiated by pension funds or mutual funds.¹⁰⁹ 85% of the dissidents in these proxy contests had a stake of more than 3% of the company when the contest commenced. However, under the rule adopted by the SEC, shareholders must also have held a 3% stake for the prior 3 years to qualify for proxy access.

A 3-year holding period is a particular problem for hedge funds, given their intense focus on internal rates of return. If a hedge fund buys a \$100 million stake and, within 1 year, changes things enough to increase the share price by 20%, it has a gross annual return of 20%. If, to take advantage of the costs savings of proxy access, the hedge fund holds the position for 3 years, earns a “normal” return of 5% in the first 3 years and then gets the same outcome with a 20% return in the fourth, the gross annual return goes from 20% per year to 8.6% per year. The cost savings would have to be huge to justify the much longer holding period, far higher than is reasonable to expect. Indeed, a spot check of 12 hedge funds that initiated proxy contests, based on 13F and other filings, showed that only 1 fund satisfied the 3-year holding period. Former insiders, by contrast, were more likely to satisfy both the 3% threshold and the holding period.

Turning next to shareholders who submitted Rule 14a-8 proposals, the largest institutional investors, who are most likely to satisfy a 3% ownership threshold for proxy access, rarely made such submis-

¹⁰⁷ As discussed below, a dissident shareholder has to make extensive disclosures to become eligible for proxy access and satisfy high minimum holding period and ownership thresholds. See *infra* text accompanying notes 109–12 and 130–31.

¹⁰⁸ See *infra* Part IV.

¹⁰⁹ See *supra* Section II.B.

sions. Rather, most proposals were submitted by individual investors who hold trivial stakes in the respective companies.¹¹⁰

Labor-affiliated groups, which also frequently sponsor shareholder proposals, present a more mixed picture. Some labor groups that have been very active in submitting shareholder proposals have few investment assets. For example, the AFL-CIO sponsored 70 resolutions through its \$28 million “Reserve Fund.”¹¹¹ In comparison, a 3% stake in the median S&P 600 SmallCap company would have a value of about \$18 million. These smaller funds will thus generally hold stakes far below the threshold for proxy access.¹¹²

The real union money is in joint union-employer pension funds subject to the Taft-Hartley Act (and thus known as “Taft-Hartley Plans” or “THPs”). THPs face two problems in utilizing proxy access: collective action and fiduciary duties.

There are approximately 1500 THPs¹¹³ that collectively manage approximately \$400 billion in assets,¹¹⁴ of which approximately \$100

¹¹⁰ See supra note 98. Similarly, charities and social issue funds appear not to have assets that are likely to be significant enough to qualify them for proxy access. For example, the Unitarian Universalist Common Endowment Fund had an ending market value of \$111.8 million as of June 30, 2010, and \$21.8 million in domestic equity holdings. See Investment Performance Summary, Unitarian Universalist Common Endowment Fund (June 30, 2010), http://www.uua.org/documents/finance/uucef/100630_summary.pdf.

¹¹¹ See Georgeson, 2009 Annual Corporate Governance Review 15 (2009), available at www.georgeson.com/usa/download/acgr/acgr2009.pdf; see also AFL-CIO, AFL-CIO 2009 Financial Report (2009), available at http://www.aflcio.org/aboutus/thisistheaficio/convention/2009/upload/ec_finreport.pdf (stating \$28 million of investments by the Reserve Fund at 2008 year end).

¹¹² In addition, a few of the social responsibility-oriented funds have assets of above \$1 billion. See Press Release, The Children’s Investment Fund Foundation, The Children’s Investment Fund Foundation Files Accounts for 2008/9 (May 28, 2010), available at http://www.ciff.org/assets/financial/CIFF_Financial_Statement_27_May_2010.pdf (stating 2009 year-end assets of £1,445 million, equivalent to over \$2 billion).

¹¹³ Private Pensions: Long-standing Challenges Remain for Multiemployer Pensions Plans, Testimony Before the S. Comm. on Health, Educ., Labor, and Pensions, 111th Cong. 1 (2010) (statement of Charles Jeszeck, Acting Director, Education, Workforce, and Income Security Issues, U.S. Gov’t Accountability Office), available at <http://www.gao.gov/new.items/d10708t.pdf> (noting that there were approximately 1500 multiemployer plans in 2009); Pension Benefit Guar. Corp., 2010 PBGC Annual Report 2 (2010), available at http://www.pbgc.gov/Documents/2010_annual_report.pdf (“[The PBGC] multiemployer program protects about 10.4 million works and retirees in about 1,460 pension plans.”).

¹¹⁴ Pension Benefit Guar. Corp., Pension Insurance Data Book 2009, at 105 (2010), available at <http://www.pbgc.gov/docs/2009databook.pdf> (reporting total assets of \$434.9 billion at the beginning of 2007).

billion is in common stock.¹¹⁵ For comparison, TIAA-CREF alone controls approximately \$420 billion. If all the assets of the activist \$40 billion United Brotherhood of Carpenters and Joiners of America, which sponsored 203 Rule 14a-8 proposals, were spread proportionally over the S&P 1500 companies, the fund would only hold about 0.35% in each company. Accordingly, with the current, diversified asset allocation, THPs face a monstrous collective action problem in satisfying the proxy access thresholds.

Although, in principle, individual THPs or a small group could change their investment choices to build up stakes large enough to satisfy a 3 year/3% proxy access threshold, doing so would expose the plans and their fiduciaries to legal risk. THPs are subject to strict fiduciary standards under both the Taft-Hartley Act and ERISA, including ERISA § 404(a), which mandates that fiduciaries must discharge their duties “solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan.”¹¹⁶ In addition, fiduciaries must act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”¹¹⁷

In order to satisfy these mandates, many THPs hire outside money managers to manage their assets and delegate full authority to invest and vote. So long as this delegation is made prudently, THP trustees face minimal prospects of being sued.

But suppose that, to satisfy the eligibility requirement for proxy access, a large and active THP chose to override the investment discretion of its outside money managers and invested an outsized portion of its pension assets in a specific company for 3 years. In making the investment decision, the plan fiduciaries, and anyone else exercising discretion, would take on the fiduciary duties out-

¹¹⁵ Emp. Benefits Sec. Admin., U.S. Dep’t of Labor, Private Pension Plan Bulletin: Abstract of 2008 Form 5500 Annual Reports 27 (2010), available at <http://www.dol.gov/ebsa/pdf/2008pensionplanbulletin.pdf> (multiemployer pension plans with 100 or more participants had \$107,637,000,000 in common stock in 2008).

¹¹⁶ 29 U.S.C. § 1104(a)(1) (2006).

¹¹⁷ *Id.* § 1104(a)(1)(B).

lined above,¹¹⁸ and in doing so, would incur significant legal risk. Indeed, the resulting firm-specific investment risk is significant enough that it is considered highly unlikely that any THPs will change their investment policies in order to qualify for proxy access.¹¹⁹ So long as the THPs remain widely diversified, the collective action problems are sufficiently severe that they are unlikely to qualify for proxy access under a 3% eligibility threshold.

By contrast, the few public funds that have sponsored more than a handful of shareholder proposals tend to be among the largest institutional investors. The New York City Pension Funds, CalPERS, and the New York State Retirement Fund—which, together, sponsored 70 proposals—have assets of \$98 billion, \$202 billion, and \$134 billion, respectively.¹²⁰ Of course, only a portion of these assets are invested in U.S. equities, and, of those, some are managed by external managers. Thus, for example, CalPERS claims to have voting authority only for about \$30 billion of equities that are publicly traded in the U.S.¹²¹ TIAA-CREF has \$415 billion in assets

¹¹⁸ Id. § 1002(21)(A) (“[A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets . . .”).

¹¹⁹ Personal communication with Damon A. Silvers, Director of Policy and Special Counsel, AFL-CIO (Jan. 27, 2011).

¹²⁰ See CalPERS, 2010 Comprehensive Annual Financial Report 2 (2010) (valuing CalPERS at \$201.6 billion as of June 30, 2010); Ciara Linnane, New York Comptroller Unveils Pension Fund Reform Plan, Reuters, Feb. 18, 2010, available at <http://www.reuters.com/article/idUSTRE61H3SD20100218> (valuing New York City’s pension fund at \$98 billion); N.Y. State and Local Retirement System, 2010 Comprehensive Annual Financial Report 21 (2010) (valuing pension funds at \$134.2 billion as of March 31, 2010).

¹²¹ See CalPERS, Quarterly Report Filed by Institutional Managers (Form 13F-HR) (Jul. 22, 2010), <http://www.sec.gov/Archives/edgar/data/919079/000114036110029935/form13fhr.txt>. On its website, CalPERS claims to have \$119 billion invested in global equities (which includes U.S. and international equities as well as alternative investments and hedge funds), and that 40% of its U.S. equities are managed externally. See Facts at a Glance: Investments, CalPERS, <http://www.calpers.ca.gov/eip-docs/about/facts/investments.pdf> (last visited May 18, 2011); U.S. Equities, CalPERS (Nov. 15, 2010), <http://www.calpers.ca.gov/index.jsp?bc=/investments/assets/equities/usequities.xml>. The discrepancy between these figures is likely due to the fact that outside money managers exercise voting authority over a portion of the CalPERS equity investments. The rule is not entirely clear as to whether shareholders like CalPERS can use all their shares in a company to meet the eligibility requirements even if some of these shares are managed by an outside money manager who has voting authority. The key is whether CalPERS has the “power” to vote the shares. If

under management¹²² and voting authority for over \$92 billion of equities that are publicly traded in the U.S.¹²³ Given their substantial asset size, the larger public pension funds and especially TIAA-CREF may well qualify for proxy access for several of their portfolio companies outright. As large institutional investors, these entities are also relatively well positioned to assemble a group of shareholders that so qualifies.

Of course, even these large institutional investors will not necessarily own the requisite shares in the specific company for which they would want to use proxy access. Thus, for example, CalPERS held between 0.4% and 1.3% of the shares in the 6 S&P 1500 companies to which it submitted a shareholder proposal in 2008.¹²⁴ In

CalPERS can at any time revoke the delegation of voting authority, one could argue that it either does have such authority already or that it could easily amend its contracts prospectively to give it the power, when it chooses, to vote shares held on its behalf by outside money managers. The practicability of such contracts may depend on the type of outside money manager that CalPERS employs. To the extent that equity is held via mutual funds or hedge funds, rather than in managed accounts, it may be difficult for CalPERS to obtain the requisite voting power.

¹²² TIAA CREF, 2009 Annual Report 2 (2009), available at http://www.tiaa-cref.org/ucm/groups/content/@ap_ucm_p_tcp/documents/document/tiaa04018030.pdf.

¹²³ TIAA CREF Investment Management, LLC, Quarterly Report Filed By Institutional Managers (Form 13F-HR) (Aug. 10, 2010), available at <http://www.sec.gov/Archives/edgar/data/887793/000088779310000005/r30-0630.txt>.

¹²⁴ CalPERS owned 0.4% of Dollar Tree. See Dollar Tree, Definitive Additional Materials (Form DEFA 14A), at 2 (May 29, 2008), available at <http://www.sec.gov/Archives/edgar/data/935703/000093570308000057/a.htm>; California Public Employees Retirement System, Notice of Exempt Solicitation (Form PX 14A6G), at 1 (May 29, 2008), available at http://www.sec.gov/Archives/edgar/data/919079/000119380508001433/e603890_px14a6g-dollar.htm. CalPERS owned 1.3% of Tech Data Corporation. See CalPERS, Notice of Exempt Solicitation (Form PX14A6G), at 1 (May 15, 2008), available at http://www.sec.gov/Archives/edgar/data/790703/000118811208001684/t62731_px14a6g.htm. CalPERS owned 0.7% of Interpublic Group. See Interpublic Group, Definitive Proxy Statement (Form DEF 14A), at 2 (Apr. 18, 2008), available at <http://www.sec.gov/Archives/edgar/data/51644/000104746908004848/a2184688zdef14a.htm>; CalPERS, Notice of Exempt Solicitation (Form PX 14A6G), at 1 (Apr. 28, 2008), available at http://www.sec.gov/Archives/edgar/data/51644/000118811208001447/t62529_px14a6g.htm. CalPERS owned 0.4% of Hilb Rogal & Hobbs. See Hilb Rogal & Hobbs, Definitive Proxy Statement (Form DEF 14A), at 1 (Mar. 31, 2008), available at <http://www.sec.gov/Archives/edgar/data/814898/000119312508070921/ddef14a.htm>; CalPERS, Notice of Exempt Solicitation (Form PX 14A6G), at 1 (Apr. 23, 2008), available at http://www.sec.gov/Archives/edgar/data/814898/000091907908000007/hrh_filing.htm. CalPERS owned 0.5% of Standard Pacific. See Standard Pacific Corp., Definitive Proxy Statement (Form DEF 14A), at 1 (Apr. 2, 2008), available at <http://www.sec.gov/Archives/edgar/data/878560/000119312508072676/ddef14a.htm>; CalPERS, Notice of Exempt Solicitation (Form

the 3 companies for which CalPERS made an exempt solicitation in support of a shareholder proposal in 2010, it held, respectively, 0.2%, 0.4%, and 0.6% of the shares.¹²⁵ TIAA-CREF held slightly above 1% of the shares in the two companies in which it made proposals in 2008.¹²⁶ Presumably, the number of shares in these companies that has been held for the requisite 3-year period is even lower, perhaps substantially so. And the holdings of CalPERS are of a magnitude that suggests that even a group of several large public pension funds may not satisfy a 3% ownership threshold for a given company. Finally, both the large pension funds and, even more so, TIAA-CREF have been relatively restrained in offering shareholder resolutions under Rule 14a-8. In 2010, for example, TIAA-CREF did not make a single Rule 14a-8 shareholder proposal in an S&P 1500 company, even though it would have been qualified to do so for most if not all of the companies in the index.

PX 14A6G), at 1 (Apr. 17, 2008), available at <http://www.sec.gov/Archives/edgar/data/878560/000117152008000224/eps2936.htm>. CalPERS owned 0.4% of Eli Lilly & Co. See Eli Lilly & Co, Definitive Proxy Statement (Form DEF 14A), at 3 (Mar. 10, 2008), available at <http://www.sec.gov/Archives/edgar/data/59478/000095013708003475/c22930ddef14a.htm>; CalPERS, Notice of Exempt Solicitation (Form PX 14A6G), at 1 (Mar. 28, 2008), available at http://www.sec.gov/Archives/edgar/data/59478/000119380508000951/e603562_pxa146g-calpers.htm.

¹²⁵ CalPERS owned 0.2% of Health Net. See Health Net, Definitive Proxy Statement (Form DEF 14A), at 5 (2010), available at <http://www.sec.gov/Archives/edgar/data/916085/000119312510088007/ddef14a.htm>; CalPERS, Notice of Exempt Solicitation (Form PX14A6G), at 1 (May 3, 2010), available at <http://www.sec.gov/Archives/edgar/data/916085/000117152010000282/eps3791.htm>. CalPERS owned 0.4% of Graco. See Graco, Inc., Definitive Proxy Statement (Form DEF 14A), at 6 (2010), available at <http://www.sec.gov/Archives/edgar/data/42888/000095012310023365/c56457ddef14a.htm>; CalPERS (Form PX14A6G), at 1 (Mar. 30, 2010), available at <http://www.sec.gov/Archives/edgar/data/42888/000117152010000236/eps3761.htm>. CalPERS owned 0.6% of Hospitality Properties Trust. See Hospitality Properties Trust, Definitive Proxy Statement (Form DEF 14A), at 5 (2010), available at <http://www.sec.gov/Archives/edgar/data/945394/000104746910001257/a2196573zdef14a.htm>; CalPERS, Notice of Exempt Solicitation (Form PX14A6G), at 1 (Mar. 25, 2010), available at <http://www.sec.gov/Archives/edgar/data/919079/000117152010000222/eps3755.htm>.

¹²⁶ See Johnson & Johnson, Definitive Proxy Statement (Form DEF 14A), at 2, 58 (Mar. 12, 2008), available at <http://google.brand.edgar-online.com/DisplayFiling.aspx?TabIndex=2&FilingID=5794786&companyid=10313&ppu=%252fdefault.aspx%253fcompanyid%253d10313%2526amp%253bformtypeId%253d148> (Johnson & Johnson, 1%); PepsiCo, Definitive Proxy Statement (Form DEF 14A), at 1, 49 (Mar. 24, 2008), available at <http://sec.edgar-online.com/pepsico-inc/def-14a-proxy-statement-definitive/2008/03/24/section2.aspx> (PepsiCo, 1.4%).

This, of course, raises substantial doubt about their proclivity to make proxy access nominations. Still, on occasion, these investors may both have an interest in becoming active in a company and either meet the qualifications for proxy access for that company or be able to assemble a group of investors that does.

In sum, judging from their past actions, the set of shareholders that have shown both an interest in activism and have some potential to be eligible for proxy access is fairly limited. Select public pension funds and, to a lesser extent, TIAA-CREF, have shown a modest interest in activism and may qualify for proxy access for some of their portfolio companies. Labor affiliated groups have shown a more significant interest in activism, but would be less likely to qualify due to the percentage ownership requirement. Hedge funds have been active in full-fledged contests, but would usually not satisfy a 3-year holding period. Former insiders may satisfy both the ownership threshold and the holding period requirement for micro-cap companies (albeit generally not for larger companies).

Of course, if the SEC releases a revised rule on proxy access in an effort to cure the deficiencies noted in the Court of Appeals, it may adopt different eligibility thresholds. We would anticipate that such thresholds would make eligibility more restrictive than the 2010 rules. But even if the SEC decided to relax the eligibility standard and revert to the 1%/1-year standard applicable to larger accelerated filers under its 2009 proposal, the general thrust of our argument would remain: most large institutional investors have shown no interest in or inclination to types of activism similar to proxy access; and labor affiliated groups, which have shown themselves most interested in activism, would often fail to satisfy even a 1% threshold.

A remaining possibility is that some new player would emerge or an existing player would become a catalyst to organize the longer term shareholders such as mutual funds into a group large enough to meet the threshold for taking advantage of proxy access, similar to the way hedge funds have played a catalyst role in other areas of

2011]

Insignificance of Proxy Access

1383

corporate governance and corporate control.¹²⁷ For reasons we discuss below,¹²⁸ we think this is unlikely.

Interest in activism and qualification for proxy access, of course, is just the beginning of the inquiry. The next steps are to determine whether it would make sense for these shareholders to pursue proxy access, as opposed to either a traditional proxy contest or a withhold campaign, and whether, if they were to pursue proxy access, they would have a significant chance of succeeding. These issues are taken up in the following Parts.

III. PROXY ACCESS VERSUS TRADITIONAL PROXY CONTESTS

In examining the impact of proxy access, one has to compare proxy access to the existing alternatives for shareholder activism to see what advantages it offers and what disadvantages it entails. The closest alternatives to proxy access are either the waging of a traditional proxy contest—in which a dissident submits its own proxy statement—or to withhold the vote for company nominees. In this Part, we will compare proxy access to a traditional proxy contest. In the next Part, we will compare it to withholding one's vote.

Before we commence our substantive discussion, we want to clarify the terminology we will be using. We will use the terms “dissident” and “dissident shareholder” to refer to the party who initiates (and pays for) a campaign and the terms “dissident nominee” and “company nominee” to refer to the persons running for seats on the board of directors nominated by the dissident or the board, respectively. We will use the terms “traditional proxy contest” and “proxy access contest” to distinguish between election contests in which the dissident, respectively, does not or does make use of proxy access. Finally, we will use the terms “withhold” or “just say no” campaign to refer to elections in which there is a large percentage of withhold votes, even if there is little or no observable campaigning.

¹²⁷ Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. Pa. L. Rev. 1021, 1045 (2007).

¹²⁸ See *infra* Section IV.D.

A. Plusses of Proxy Access: Cost Savings

The principal direct effect of proxy access is to reduce the costs of conducting a contested election. This is achieved by forcing companies to include, under certain circumstances, shareholder nominees in the company's proxy statement. In this Section, we will discuss how significant these cost savings are. For purposes of this analysis, we will take as a starting point the costs of a traditional proxy contest and then analyze the extent to which these costs decline as a result of proxy access. As background, it is worth recalling the wide range of cost estimates for contested solicitations, from about \$30,000 to approximately \$9 million.¹²⁹

1. Cost of Preparing a Proxy Statement That Complies with Schedule 14A

Proxy access obviously has the result of removing the requirement for a dissident to prepare her own proxy statement. Instead, however, under the rule adopted by the SEC, a dissident would have to prepare and submit to the company a newly established Schedule 14N.¹³⁰ But as we show, the net cost savings from having to prepare a Schedule 14N instead of a proxy statement are minimal.

The actual content of proxy statements can roughly be divided into 4 parts: required substantive information about the dissident and her nominees, certain technical information that identifies the issues and explains the basic ground rules, disclosures related to the company that duplicates the information provided by the company in its proxy statement, and additional information not required by the proxy rules.

Table 4 below contains our analysis of Schedule 14A, which governs the required contents of proxy statements. As to each item or sub-item, we categorized the information required as substantive, technical, or unnecessarily duplicative. Items that do not relate to the election of directors, or only to uncontested elections, or that generally require disclosure only by the company, are omitted.

¹²⁹ See *supra* Table 1.

¹³⁰ 17 C.F.R. § 240.14n-1 (2010). We believe that any revised rule would contain equivalent requirements. Otherwise, shareholders would have less information about dissidents and their nominees in proxy access contests than in regular contests.

2011]

Insignificance of Proxy Access

1385

Table 4: Schedule 14A Items

Item	Description	Category	14N
1a, b	Date, time, place of meeting; registrant's address; mailing date	Technical	
1c	Deadline for stockholder proposals for following year	Duplicative	
2	Proxy revocability	Technical	
4b	Solicitation methods, use of employees, contracts with other solicitation agents, total costs and costs to date, who pays/reimbursement, terms of any settlement	Substantive	Yes
5b	Interest and security holdings of any participant; name, address, convictions, share transactions in prior 2 years, source of funds, contracts re securities; ownership, related transactions, future employment or transactions by associates of participants	Substantive	Yes
6a-c	Share info: outstanding, votes, record date, cumulative voting	Technical	
6d	Ownership by management and 5% holders	Duplicative	
6e	Information regarding change of control	Duplicative	
7b	Only re nominees: bio, related transactions, 16(a)	Substantive	Yes
7c	Only re nominees: independence	Substantive	Yes
10-20	Other items	Duplicative	
21	Voting: required vote, abstentions and broker non-votes	Technical	
23	Documents where security holders share address	Technical	

Substantive information includes biographical information about the nominees, information about other “participants” (for example, the dissident entity) and their interest in the solicitation, and

information about solicitation methods and expenses. Unlike technical and duplicative information, substantive information must be prepared from scratch by the dissident. Moreover, the information that must be disclosed, in particular with respect to items 5 and 7, can be extensive. The preparation of substantive information, therefore, entails the greatest regulatory compliance costs. The proxy access rule would do nothing to reduce these costs, however, since a dissident and her nominees must provide the same substantive information to the SEC and to the company on a newly created Schedule 14N.¹³¹

Technical information includes the name and address of the company, time and place of the annual meeting, information on how to vote, the record date, the effect of abstentions and broker no-votes, proxy revocability, the required vote, the number of shares outstanding, and some additional disclosure where one set of materials is sent to holders who share an address. Proxy access would save the costs associated with including this information in a proxy statement. But because technical information is of limited scope and basically copied from the company's proxy statement, these cost savings would be trivial.

Duplicative information includes information about shareholdings by 5% owners and by management, information about any issue for which the dissident does not engage in a counter-solicitation, as well as information as to whether a change of control has occurred and by what deadline shareholder proposals must be submitted for the annual meeting in the following year. Since all of this information is already included in the company's proxy statement, and as long as dissidents do not have private information indicating that the information provided by the company is incorrect, it is not clear why the SEC requires the disclosure of this duplicative information.¹³² But since duplicative information can be

¹³¹ *Id.* § 240.14n-101.

¹³² As to agenda items other than the election of directors, as long as dissidents make no recommendation about how to vote or the same recommendation as the company, they also should be permitted to refer to the company's proxy statement for further information on these items. To be sure, this would mean that shareholders have to access the company's proxy statement to get such information. But the same is true whenever a company uses notice and access, where shareholders are given a voting form and told where they can get additional information on the item at issue. As to the other items, the SEC should not require their disclosure in dissident proxy state-

2011]

Insignificance of Proxy Access

1387

copied from the company's proxy statement, the regulatory compliance burden is minimal.

A significant portion of the proxy statement is taken up by information that is not required by SEC rules.¹³³ Such information is usually intended to influence shareholder votes. As such, it resembles other campaign expenses. Campaign information included in a proxy statement often consists of additional information about the dissident and her nominees,¹³⁴ the reasons for the solicitations,¹³⁵ and any business strategies that the dissident would want the company to explore;¹³⁶ the address of the proxy solicitor who can provide further information and assistance in voting;¹³⁷ and several boldfaced recommendations on how to vote.¹³⁸ Obviously, since these information items are provided voluntarily and serve a campaigning rather than a regulatory compliance function, proxy access does not result in any cost savings as to these items.

In sum then, the proxy access rule only reduces the costs associated with the preparation of a proxy statement that satisfies the regulatory requirements by eliminating the costs associated with the preparation of duplicative and technical information. As to substantive and campaign information, the dissident must either prepare a statement containing the same information even under proxy access or it does not have to provide the information to start with. The technical and duplicative information spans only a few pages and is copied from the company's proxy statement. The resulting cost savings will therefore be minimal.

ments (as it did, for example, for information in Item 8 of Regulation 14A) unless the dissident has access to information not available to the company which indicates that the information in the company's proxy statement is incorrect.

¹³³ See, e.g., Metropolitan Capital Advisors, Definitive Proxy Statement Filed by Non-Registrant (Form DEFN 14A), at 3–10 (Jan. 4, 2007) [hereinafter Metropolitan Proxy Statement], available at <http://www.sec.gov/Archives/edgar/data/864683/000119312507001082/ddefn14a.htm>.

¹³⁴ See id. at 10–11.

¹³⁵ See id. at 4–10.

¹³⁶ See Trian Fund Management, Definitive Additional Proxy Materials Filed by Non-Registrant (Form DFAN 14A) (May 23, 2006), available at <http://www.sec.gov/Archives/edgar/data/46640/000095011706002372/ex1.htm> (showing dissident Trian Group offering new business strategies for H.J. Heinz Company).

¹³⁷ See Metropolitan Proxy Statement, *supra* note 133, at 3.

¹³⁸ See id. at 3, 12.

2. *Cost of Distributing the Proxy Statement to All Solicited Shareholders*

Proxy access also eliminates the requirement for dissidents to distribute the proxy statement to all solicited shareholders. As a result, nominations under proxy access will save the costs of printing, mailing and distributing the proxy statement.

Printing and mailing expenses for a proxy statement depend on the length of the statement and the number of shareholders that are being solicited. A dissident proxy statement that contains only the required disclosures would typically be 10–15 pages long.

Printing and mailing expenses are further reduced in two ways. First, many shareholders do not receive printed proxy statements, either because they have signed up for internet delivery, because they participate in ProxyEdge (an electronic delivery system for institutional shareholders set up by Broadridge), or because a single statement is sent to a financial advisor for a managed account or to a household with multiple shareholders. In uncontested 2010 elections, these “suppressed” accounts total about 54% of all distributed proxy statements, and their percentage has been rising.¹³⁹ As to suppressed mailings, dissidents have no printing and mailing expenses, and instead just pay an incentive fee of 25 or 50 cents per account, depending on the size of the distribution.¹⁴⁰

Second, the proxy rules do not require a dissident to provide a proxy statement to each shareholder. A dissident could, if it opted to do so, forego soliciting small shareholders and not send them a proxy statement either.¹⁴¹ Data compiled by Broadridge suggest

¹³⁹ See Broadridge Financial Solutions, Inc., 2010 Proxy Season: Key Statistics & Performance Ratings 2 (2010) [hereinafter Key Statistics], available at http://www.broadridge.com/investor-communications/us/Broadridge_Proxy_Stats_2010.pdf (54.4% suppression in 2010); Compass Lexecon, An Analysis of Beneficial Proxy Delivery Services 14 (May 11, 2010) [hereinafter Beneficial Proxy Delivery Services], available at <http://www.broadridgeinfo.com/ADPFiles/Compass%20Lexecon%20Report%20Final%2005-14-10.pdf> (showing steadily increasing suppression percentages from 7.7% in 1998 to 53.2% in 2009).

¹⁴⁰ NYSE Rule 465, 2 N.Y.S.E. Guide (CCH) ¶ 2465 (June 2010).

¹⁴¹ The recently enacted rules on internet availability of proxy materials offer dissidents another option. Under these rules, a dissident does not have to mail paper proxy statements to shareholders as long as they provide shareholders with a short (typically half-page) notice at least 10 days before a proxy form or other solicitation materials are sent to shareholders regarding the internet availability of the information, post the proxy statement on a website, and supply paper and email copies on re-

that accounts containing fewer than 1000 shares constitute about 90% of all accounts, but that the shares in these accounts constitute only 3.7% of the votes cast.¹⁴² Moreover, over half of the shares voted that are held in such small accounts are voted through ProxyEdge, an electronic system established by Broadridge for institutional investors and investment advisors that permits the voting of shares held in different accounts on a consolidated basis.¹⁴³ ProxyEdge enables an investor or advisor to vote shares held in all accounts, whether or not the holder received a proxy statement for any particular account, at least as long as that holder also has shares in a different account for which it received a proxy statement. As a result, printing and mailing expenses can be dramatically reduced, with a minimal impact on the voting outcome, by not mailing proxy statements to holders of small accounts.

In addition to printing and mailing expenses, any person who distributes a proxy statement (or another mailing) to beneficial owners has to pay a unit fee to the securities intermediary through which the shares are held. In a contested election, this fee is \$1 for the mailing of the proxy statement.¹⁴⁴ The unit fee is payable for accounts that receive hard copies of the proxy statement as well as for suppressed accounts, but is not payable for accounts that are excluded from a distribution (for example, because the number of shares held in the account is too small).

quest. 17 C.F.R. § 240.14a-16 (2010). Typically, less than 5% of the shareholders request paper copies. Personal communication with Charles V. Callan, Chief Regulatory Officer, Broadridge Financial Solutions, Inc. (Oct. 25, 2010). Thus, notice and access reduce the costs for printing and mailing the proxy statement. Notice and access, however, require the dissident to make one mailing (of the notice) without any campaign literature and impose a 10-day delay for the distribution of campaign materials. For that reason, most dissidents do not avail themselves of notice and access.

¹⁴² See Key Statistics, *supra* note 139, at 3 (providing 3.7% of votes cast figure). That such small accounts constitute about 90% of all accounts is our estimate derived from the data on ballot share amounts and total shares processed in the Key Statistics and estimates of the total number of accounts derived from these statistics.

¹⁴³ *Id.*

¹⁴⁴ NYSE Rule 465, 2 N.Y.S.E. Guide (CCH) ¶ 2465 (June 2010). It is somewhat ironic that the largest expense component obviated by proxy access is a fee imposed by New York Stock Exchange Rules and sanctioned by the SEC. Much of the effect of proxy access thus could have been achieved by merely lowering this fee.

3. Costs of Collecting and Processing Votes

A third saving associated with proxy access relates to the costs of mailing separate proxy forms to shareholders and the costs of return postage and of processing the returned forms. In a traditional proxy contest, both the company and a dissident prepare their own proxy forms and forms of voting instructions. Proxy forms are sent to shareholders who are also listed as record holders in the company's register. These proxy forms are then typically returned to, respectively, the company's or the dissident's proxy solicitor. For shareholders who hold their shares through brokers and banks, Broadridge distributes voting instruction forms which are then returned to Broadridge, tabulated, and presented to the company's vote tabulator.¹⁴⁵ Under proxy access, however, there is only one form of proxy and one form of voting instructions that contains both the company's and the dissident's nominees. These forms are distributed to shareholders at the company's expense and, if mailed, returned at the company's expense. The dissident pays nothing.

In traditional proxy contests, the proxy statement and the voting forms are mailed out together. Compared to traditional contests, proxy access thus generates savings for the printing costs of voting forms and the costs associated with the return of the voting forms. In traditional contests, the latter costs obviously arise only (and the cost savings generated by proxy access thus extend only) with respect to the portion of the dissident's forms that are used to cast votes for the dissident.

4. Campaign Expenses, Including Associated Legal and Regulatory Expenses

Campaign expenses are, in most contests, by far the largest expense item. They include all campaign materials and information provided to shareholders that go beyond the required disclosures made in the proxy statement. While the proxy statement serves also as a regulatory compliance document with a lot of fine print, the other mailings to shareholders (so-called "fight letters") tend to be more catchy and reader friendly and to focus on the issues and

¹⁴⁵ Shareholders are also given the option to vote by phone or via the internet.

information likely to influence shareholders, rather than on disclosures required by the SEC.¹⁴⁶ In addition to drafting and sending fight letters, solicitors make personal phone calls to record holders, beneficial holders who have not objected to the disclosure of their names (so-called NOBOs), and other institutions who are known (as a result of their public filings or industry rumors) to hold shares in the company. For larger holders and proxy advisors, dissidents sometimes make detailed presentations of their future strategic plans for the company and the benefits they expect to reap. Other campaign expenses include the cost of strategic advice provided by proxy solicitors, the cost of legal advice related to campaign materials (for example, review of these materials for compliance with the anti-fraud rules), and litigation expenses concerning these materials. Proxy access has virtually no impact on these cost items and any associated legal and regulatory expenses. Even under proxy access, to the extent that a dissident engages in any such campaigning, all these expenses must still be borne by the dissident.

The only exception is that the dissident may include a supporting statement of up to 500 words in the company's proxy statement.¹⁴⁷ While the dissident bears the cost of preparing that statement, the costs of distributing it fall on the company. For a dissident who does not otherwise campaign, the supporting statement is the only campaign material that is provided to shareholders and the dissident is limited to the 500-word statement in explaining why shareholders should vote for the dissident nominee instead of a company nominee.

We doubt, however, that this supporting statement will be effective. First, a 500-word statement is very short to make both the negative case that the management nominees should not all be re-elected and the affirmative case that the dissident nominee deserves election instead. While a 500-word statement in support of a shareholder proposal can be enough to identify a proposal as one of a standard type (for example, to declassify the board), director elections are a much more complex decision. Second, many share-

¹⁴⁶ See, e.g., The Committee for Concerned Cyberonics, Inc. Shareholders, Definitive Additional Proxy Materials Filed by Non-Registrant (Form DFAN 14A) (Jan. 12, 2007), available at <http://www.sec.gov/Archives/edgar/data/864683/000119312507005900/ddfan14a.htm>.

¹⁴⁷ 17 C.F.R. § 240.14a-11(c) (2010).

holders may never read the dissident's supporting statement. Company proxy statements are significantly longer than dissident proxy statements because of additional disclosure requirements imposed only on the company.¹⁴⁸ The company can thus easily bury the supporting statement somewhere in the long compliance document where it is unlikely to be noticed even by shareholders who receive a paper copy. Moreover, the company can use "notice and access" for distributing its proxy statement.¹⁴⁹ Under notice and access, the company mails a short notice to shareholders informing them how to receive a paper or electronic copy of the proxy statement.¹⁵⁰ Shareholders who do nothing thus never receive a copy of the proxy statement. But, while the proxy statement itself is mailed out only on request, the company can distribute its own fight letters, which will not contain the dissident's supporting statement, to all shareholders. For dissidents who do not otherwise campaign, this means that many shareholders will never read the supporting statement, though they may receive plenty of campaign materials from the company.

5. Assessment of Aggregate Cost Savings

Data on distribution size, total solicitation costs, and printing and postage expenses compiled by the former parent company of Broadridge for proxy contests from 2003 to 2005 enable us to evaluate the aggregate cost savings that would have been generated in these contests if the dissident had used proxy access.¹⁵¹ We

¹⁴⁸ See, e.g., *Id.* § 240.14a-101, Items 8 and 9.

¹⁴⁹ *Id.* § 240.14a-16; Amendments to Rules Requiring Internet Availability of Proxy Materials, Securities Act Release No. 9108, Exchange Act Release No. 61,560, Investment Company Act Release No. 29,131, 75 Fed. Reg. 9073 (Feb. 26, 2010), *reprinted in* [2009-2010 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 88,866, at 84,708 (Feb. 22, 2010); Shareholder Choice Regarding Proxy Materials, Exchange Act Release No. 56,135, Investment Company Act Release No. 27,911, 72 Fed. Reg. 422,221 (Aug. 1, 2007).

¹⁵⁰ 17 C.F.R. § 240.14a-16 (2010); Shareholder Choice Regarding Proxy Materials, Exchange Act Release No. 56,135, Investment Company Act Release No. 27,911, 72 Fed. Reg. 422,221 (Aug. 1, 2007). In addition, the Commission has adopted the notice-and-access model that permits issuers to send shareholders a Notice of Internet Availability of Proxy Materials in lieu of the traditional paper packages.

¹⁵¹ These data are contained in a letter from Richard J. Daly, Group Co-President, Automatic Data Processing, Inc., to Nancy M. Morris, Sec'y, U.S. Sec. & Exch.

used these data as input to a regression to estimate both the total solicitation expenses and the printing and postage expenses associated with the mailing of the proxy statement as a function of the size of the initial distribution and of any subsequent fight letters,¹⁵² and calculated total cost savings as the sum of the saved printing and mailing costs, the \$1 unit fee per account, and an additional estimate of \$0.50 per account for the costs associated with the printing and collection of voting forms and other expenses. Reflecting the fact that many companies involved in proxy contests are small and that dissidents decide not to mail statements to shareholders who hold few shares, the 25th percentile, median, and 75th percentile of the actual distribution sizes were, respectively, about 1,600; 2,500; and 5,600. The largest distribution was made to 203,000 shareholders and the second largest to 32,000.

In dollar terms, the estimated cost savings for the 25th percentile, median, and 75th percentile distributions amounted to \$7,000; \$9,800; and \$17,700, respectively.¹⁵³ Even for significantly larger distribution sizes of 20,000 and 50,000, the estimated cost savings are modest, \$47,000 and \$100,000, respectively. In percentage terms, the cost savings for the 25th percentile, median, and 75th percentile distributions account for 3.4%, 4.3%, and 5.8%, respectively, of solicitation expense estimates provided by dissidents in their proxy statements. For distributions above 10,000, percentage cost savings stabilize at around 6.6%.

Comm'n (Apr. 20, 2006), available at <http://www.sec.gov/rules/proposed/s71005/ccallan1565.pdf>.

¹⁵² We removed one outlier in running this regression.

¹⁵³ These cost measures are not adjusted for inflation. Nevertheless, we believe that they reflect an overestimate of actual cost savings for several reasons. First, the percentage of suppressed accounts that do not receive hard copies of the proxy statement increased from 32.4% to 40.9% in the years 2003–2005 to 54.4% for 2010. See Key Statistics, *supra* note 139, at 1; Beneficial Proxy Delivery Services, *supra* note 139, at 14. Second, we believe that our allowance of \$0.50 for the costs associated with voting is conservative, especially for larger contests and in light of the fact that only 82% of the shares are voted through ProxyEdge and 10% through the internet. See Key Statistics, *supra* note 139, at 3. Third, the Broadridge estimate concerned the cost of printing and mailing the actual proxy statements used by the dissident, rather than a minimal statement containing only the required disclosures and a 500-word supporting statement. Fourth, one large cost item, the unit fee payable to intermediaries, is based on 2010 cost levels. Note that the issuer's printing and mailing expenses are substantially higher since issuers often mail glossy (both expensive to print and to mail) annual reports to shareholders with their proxy statements.

*B. Minuses of Proxy Access**1. Limitations on Nominees*

In traditional contests, dissidents can make as many nominations as there are board seats up for election. For companies without a staggered board, this means that they can run nominees for the entire board and take over control in one proxy contest. In companies with staggered boards, this typically means that they can run nominees for the one-third of the board up for election each year.

Under proxy access, the number of nominees would be more confined. Only one shareholder dissident may use proxy access for any given election, and that shareholder may nominate directors for no more than 25% of the board seats.¹⁵⁴ Thus, for example, if the board has 7 members, the dissident may nominate one candidate; if the board has 12 members, the dissident may nominate up to 3 candidates. Any previously elected dissident candidates who remain on the board count towards that maximum.¹⁵⁵

The limitations imposed by the proxy access rule would clearly be problematic for any dissident who, but for these limitations, would have wanted to nominate candidates for more than 25% of the board seats. Such a dissident may therefore prefer to run a traditional contest instead of a proxy access contest.

In our sample of contested elections, dissidents in 59% of the contests involving former insiders sought board control¹⁵⁶ and, in another 29% sought more than the 25% of the seats obtainable via proxy access. Particularly for former insiders, proxy access would probably not be a useful alternative to a full-fledged proxy contest.

But many dissidents run so-called “short slate” contests. In short slate contests, the dissident nominates fewer candidates than there are seats up for election and fills the remaining spots with company nominees. By definition, in short slate contests, a dissident does not nominate the maximum number of candidates possible. Short slate

¹⁵⁴ 17 C.F.R. § 240.14a-11(d) (2010).

¹⁵⁵ *Id.* § 240.14a-11(d)(2).

¹⁵⁶ We characterized dissidents as seeking board control if they contested more than a majority of the board seats. Hedge funds sought control in only 17% of the contests. For companies with staggered boards, even a dissident who contests all the board seats up for election will usually contest less than a majority of the seats. If such contests are redefined as control contests, the percentage of former insiders seeking control rises to 76%.

2011]

Insignificance of Proxy Access

1395

contests are often run by hedge funds that seek board representation but, intentionally, do not seek board control. Even though short slate contests sometimes involve more than 25% of the seats, the limitation on the number of candidates would seem to be less severe for short slate contests than for other contests.

However, even for short slate contests, and even for the subset of short slate contests involving no more than 25% of the seats, the limitation on nominees is significant. While a dissident in a short slate contest does not seek immediate control, the power of any elected dissident nominees depends on the *future* threat of a control contest. As discussed below,¹⁵⁷ minority representation on the board not coupled with such a threat may not amount to much. The minority can always be outvoted and even shut-out completely from the decision-making process by the delegation of decision-making power to board committees on which the minority is not represented. The power of a minority board member depends on her ability to persuade other directors and on the ability of the dissident to take over control if the majority is recalcitrant.

In a typical short slate contest in which dissident nominees are elected, the dissident has shown her ability to mount a successful contest and the shareholders have indicated that they want the dissident nominees' views to be taken into account. A majority that ignores the dissident acts at its peril.

In a proxy access contest, the situation is less stark. To be sure, the shareholders have shown support for the dissident. But the dissident cannot obtain board control via proxy access. The dissident may try to gain control through a traditional proxy contest in the year following the proxy access contest. But the threat of doing so would be undermined by the requirement in the proxy access rule that a dissident *not have the purpose* of changing control or gaining more board seats than the 25% threshold available via proxy access.¹⁵⁸ A dissident who, at the time of a proxy access nomination, claimed not to seek control and made nominations for less than 25% of the board and then, a year later, changed her tune arguing that her intentions had changed because the board majority ig-

¹⁵⁷ See *infra* Section IV.A.

¹⁵⁸ 17 C.F.R. § 240.14a-11(b)(6) (2010).

nored the dissident nominees' views would run significant litigation risk.

Even if this obstacle is overcome, the mere fact that a dissident used proxy access would make the threat of running a traditional proxy contest in the following year less credible. By using proxy access, a dissident signals that she is highly cost-conscious and willing, as we will show below,¹⁵⁹ to accept a significantly lower chance of winning in exchange for a small reduction in proxy contest expenditures. This is not a message of shock and awe and is much less likely than a successful short slate contest to induce cooperation by the majority.

2. *Higher Voting Threshold*

The practical effect of proxy access, and the way it is likely to be implemented, will raise the level of shareholder support that is required for dissident nominees to succeed. To see this effect, we have to delve deeper into the board election system and the design of voting forms. In contested board elections, the candidates with the most votes fill the available seats. Moreover, shareholders normally can vote for as many candidates as there are seats to be filled.¹⁶⁰

In traditional contests, it generally takes the support of a majority of the shares that are voted to get a dissident nominee elected. In these contests, both sides—the company and the dissident—distribute separate voting forms listing the respective sides' nominees. In traditional short slate contests, the dissident completes the slate by listing specific company nominees in addition to the dissident nominees.¹⁶¹ While a shareholder may decide not to vote for all of the dissident's or for all of the company's nominees listed on the respective form, it is very difficult for a shareholder to vote for some of the dissident's nominees and some of the company's nominees *not* listed on the dissident form.¹⁶² Given this design of

¹⁵⁹ See *infra* Subsections III.B.2–6.

¹⁶⁰ We focus here on elections without cumulative voting. Cumulative voting is addressed *infra* Subsection III.B.5.

¹⁶¹ See 17 C.F.R. § 240.14a-4(d)(4) (2010).

¹⁶² To do that, the shareholder would have to show up in person at the meeting and, if the shareholder were not a record holder, would in addition have to get a proxy from the record holder before the meeting.

2011]

Insignificance of Proxy Access

1397

the voting forms, most shareholders vote either for all the company nominees or for all the dissident nominees (including, in a short slate contest, the company nominees listed on the dissident's proxy form). Some shareholders vote for a subset of the respective nominees. But, we believe, it is extremely rare for shareholders to split their votes. In this structure, if holders of a majority of voted shares—and occasionally even fewer—support a dissident nominee, the nominee will get elected.

By contrast, under proxy access, it may take substantially more votes to be elected. The reason is that both the dissident and the company nominees appear on a single ballot form. Consider a hypothetical election with 7 candidates for 5 seats to the board of a company with 1 million voting shares. The table below gives the votes received by each nominee. Even though Fred received the votes of holders of 69% of the voting shares, he is not elected.

Nominee	Votes
Alice	790,000
Bill	770,000
Claire	750,000
David	730,000
Emily	710,000
Fred	690,000
Gillian	560,000
Total	5,000,000

The difference in required votes between traditional contests and proxy access contests is due to the fact that, in traditional contests, shareholders cannot split their votes between dissident nominees and those company nominees that do not appear on the dissident ballot. In traditional short slate contests, the company nominee who is also named on the dissident ballot is virtually assured election. From the dissident's perspective, votes for this company nominee are harmless. The dissident only cares about the votes received by its nominees and by the company nominees who do *not* appear on the dissident's ballot, and the ballot design assures that supporters of the dissident do not vote for those nomi-

nees. In effect, the ballot design enables the dissident to coordinate the votes by its supporters and to assure that they do not cast any votes for the “wrong” company nominee. Under proxy access, a single voting form does not afford such coordination. Shareholders can vote for a dissident nominee and *any* company nominee and may not even know which company nominee the dissident is trying to defeat.¹⁶³ The likely result is that many shareholders who vote for dissident nominees will spread their remaining votes among *different* company nominees.

To see the effect of this feature of proxy access on the required vote, take the extreme case in which all shareholders vote for the maximum permissible number of nominees and in which shareholders who support the dissident vote for all dissident nominees and distribute their remaining votes evenly among the company nominees. Let S be the number of board seats up for election and V be the number of dissident nominees. To get elected, a dissident nominee must receive a fraction of votes $d > S/(S+V)$. The reason is that each company nominee will get the vote of the fraction $(1-d)$ of the shares that did not support the dissident, and, in addition, a fraction equal to $d*(S-V)/S$ from supporters of the dissident who distribute their remaining votes $(S-V)$ evenly among the S company nominees.

If a dissident makes nominations for all open seats (if $V=S$), it just takes the support of more than half of the voting shares to get the dissident nominees election. However, as the proxy access rule limits the number of nominees to 25% of the board, most proxy access contests would be for less than all of the open seats. If the whole board is up for election, V would be at most $(S/4)$, and the support required to get elected would be 80% of the voting shares (or more if the number of open board seats is not divisible by 4). For companies with a staggered board and classes of equal size, V would be at most $(3S/4)$, and the support required to get elected would be 57% (or more if the number of open board seats is not

¹⁶³ The 500-word limit on the supporting statement and the fact that it may not be read by all shareholders make it a rather ineffective vehicle for effecting such coordination. To be sure, to the extent that a dissident engages in additional campaigning, it can ask shareholders not to vote for specific (or any) company nominees. But the fact that such targeting is not automatically induced by the design of the voting forms is likely to make it much less effective.

divisible by 4). Most such staggered boards have 9 members, in which case the required support threshold would be 60%.

Admittedly, the assumptions we used to make these calculations represent an extreme case. Some dissident supporters may cast votes only in favor of the dissident nominees, even though they have additional votes they are permitted to cast. To the extent that dissident supporters also cast votes for board nominees, they may not do so evenly but rather based on factors such as the description of the board nominee in the proxy statement, the order in which the nominees are listed, or voting recommendations received by a proxy advisor. Thus, in reality, the effect of the ballot design under proxy access will be less strong than as presented in our calculations.

3. Design of the Proxy Card

Under proxy access, the single ballot forms sent to shareholders are prepared by the company. This, by itself, entails significant advantages for the company and disadvantages for the dissident. First, the adopting release for the proxy access rule makes clear that the company is permitted to note on these forms that it recommends that shareholders vote for its nominees and against the dissident's nominees.¹⁶⁴

Second, if the proxy form is signed but no specific instructions are marked, the shares to which the proxy relates can be voted for the company's nominees.¹⁶⁵

Third, when dissidents mail fight letters or other campaign materials to shareholders, they will not be able to include a ballot form with their materials. Inclusion of a proxy or voting instruction form would result in the dissident losing the exemption under Rule 14a-

¹⁶⁴ See Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29,384, 75 Fed. Reg. 56,668, 56,723–24 (Sept. 16, 2010).

¹⁶⁵ See 17 C.F.R. § 240.14a-4(c) (2010); see also Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29,384, 75 Fed. Reg. 56,668, 56,724 n.609 (Sept. 16, 2010) (“We anticipate that companies would continue to be able to solicit discretionary authority to vote a shareholder’s shares for the company nominees . . .”). Rule 14a-4(c) as amended prohibits proxy “slate voting” (on the grounds that it would unduly favor management) but anticipates the continuation of discretionary voting by management when authorized by shareholders. 17 C.F.R. § 240.14a-4(c) (2010).

2(b)(1) that would otherwise apply to the fight letters and would thus require the dissident to furnish its own proxy statement to all solicited holders.¹⁶⁶ Moreover, even if the SEC expands the exemption under Rule 14a-2(b)(1) to include solicitations where a dissident distributes only the *company's* proxy and voting instruction form, inclusion of such forms is not practical for beneficial holders. Voting instructions supplied to beneficial holders are not generic but carry unique, holder-specific control numbers.¹⁶⁷ The holder-specific numbers on the company's voting instruction form would ordinarily not be available to the dissident, and a shareholder who returns a form with the incorrect control number would not validly vote her shares.

Campaign materials not accompanied by a proxy or voting instruction form are less effective. Any shareholder who, after reading the materials, decides to vote for the dissident has to search for the ballot form sent to her by the company or, if that form has been lost or has already been mailed back, has to request a new form. If the shareholder neglects to do so, or changes her mind in the interim, the vote for the dissident is lost.

Finally, the design of the proxy card may result in a disproportionately large number of invalid votes from shareholders who support the dissident nominees. In a director election, the maximum number of votes is equal to the number of available board seats. As explained above, in a traditional proxy contest both the company's and the dissident's forms are designed to assure that shareholders do not overvote. In proxy access contests, however, a shareholder may mark "for" for more nominees than there are seats to fill. By definition, a shareholder who overvotes must have voted for at least some dissident nominees. Moreover, most of them presumably did so conscious of the fact that the company recommended a vote "against" all the dissident nominees. Dissidents will thus effectively lose the support from these shareholders.

¹⁶⁶ That rule exempts from the requirement to furnish a proxy statement certain solicitations where the person making the solicitation does not "seek . . . the power to act as proxy . . . and does not furnish . . . a form of revocation, abstention, consent or authorization." 17 C.F.R. § 240.14a-2(b)(1) (2010).

¹⁶⁷ Personal communication with Charles V. Callan, Chief Regulatory Officer, Broadridge Financial Solutions, Inc. (Oct. 25, 2010).

2011]

Insignificance of Proxy Access

1401

4. Fighting in the Dark

When shareholders submit their votes, they do not go into a black ballot box that is left unopened until the shareholder meeting, when the votes are counted and the winner is declared. Rather, information about who casts votes for whom becomes available throughout the duration of the contest.

In traditional contests, shareholders who hold their shares directly on the company's books ("registered holders") receive proxy forms directly from the company and from a dissident and return the proxy they execute to the company or the dissident, as the case may be. As to these proxies, each side will know who returned the proxy form to it and how they voted, but neither side will know—except by inference—who returned the proxy form to the other side and how they voted. That is, the company, for example, will see the proxies it receives, which will appoint some member of management as proxy and, for the most part, authorize that person to vote the shares as recommended by the company.¹⁶⁸ From the fact that certain proxies have not been returned, the company can deduce that these shares have either not been voted yet or that proxies were given to dissidents. Dissidents are in an analogous position.

Shareholders who hold shares through brokerage or bank accounts ("beneficial holders")—a category that includes holders of most of the outstanding shares—receive voting instruction forms mailed to them by Broadridge on behalf of the company and the dissident, with both sides using different forms, and return one of the forms to Broadridge. In traditional contests, Broadridge provides both sides with daily vote tallies and weekly reports showing, for each broker, how many shares have been voted and for whom they have voted.¹⁶⁹ We will refer to this information provided by Broadridge, together with the information obtained from directly returned proxies, as "preliminary voting information."

¹⁶⁸ In traditional contests, a shareholder may withhold authority to vote the shares in a certain way but cannot require the proxy to vote the shares for a director nominee not recommended by management.

¹⁶⁹ Personal communication with Charles V. Callan, Chief Regulatory Officer, Broadridge Financial Solutions, Inc. (Oct. 25, 2010).

Access to preliminary voting information is very important. Proxy solicitors and their clients use it for several purposes.¹⁷⁰ First, most generally, they use it to determine whether their overall strategy is successful. If the results are close, the client may decide to expend additional resources. If results indicate that the outcome is clear, management or dissidents may decide to settle or fold rather than spend more money on a hopeless campaign. Second, solicitors can use the information to figure out whether major institutional holders have voted their shares and how they voted. Even though these holders usually hold their shares through banks or brokerages and no direct information on their voting is provided, solicitors have some general ideas about how many shares an institution holds and which intermediary it uses. Thus, changes in the vote tallies provide a good indication of how certain institutions are voting. Solicitors can accordingly engage in more effective solicitations of these institutions. Third, solicitors can estimate how retail shareholders are voting and adjust their campaign message to this group of holders. Fourth, as to registered holders, solicitors can engage in targeted campaigns for holders who have not returned their proxy forms. Finally, proxy solicitors can police for mistakes. As we have discussed in an earlier article, the proxy voting system is prone to administrative and clerical errors that can easily—and, under applicable law, irreversibly—affect the ultimate outcome of close contests.¹⁷¹ And, as discussed above,¹⁷² mistakes involving overvoting may easily occur in proxy access contests.

In traditional contests, access to preliminary voting information is roughly symmetrical: Broadridge provides the same information to both sides, and, as to proxies directly returned by registered holders, each side sees the proxies it gets but not those the other

¹⁷⁰ Personal communication with Alan Miller, Co-chairman, Innisfree M&A, Inc. (June 4, 2010).

¹⁷¹ See Kahan & Rock, *Hanging Chads*, *supra* note 68, at 1249–55, 1267–70. A recent, if extreme, example of such a mistake occurred in a proxy contest waged by Terra Industries on the board election for CF Industries Holdings. The night before the vote, a proxy solicitor noted that a vote by a large institutional holder who had indicated support for its client had not been tallied. After inquiries, the solicitor determined that RiskMetrics, who had been hired by the institutional holder to deal with the mechanics of voting, had mistakenly failed to vote the shares. RiskMetrics was alerted to the mistake and managed to cast the vote before the ballot closed.

¹⁷² See *supra* Subsection III.B.3.

side gets. In proxy access contests, by contrast, information is likely to be completely one-sided. As to proxies sent directly to registered holders, shareholders can vote either for the company's or for the dissident's nominees, but either way these proxies are returned to, *and seen only by*, the company. The dissident sees nothing. As to beneficial holders, Broadridge generally provides preliminary voting information only to clients who mail out their own proxy forms. Dissidents who make no mailing to shareholders receive no information. Dissidents who mail fight letters and other campaign materials but who do not mail a separate proxy statement and voting form receive preliminary information on the aggregate votes cast with respect to the director or issue they target but no broker-specific voting information.¹⁷³ Unless Broadridge were to make significant changes in these policies, dissidents in proxy access would receive substantially less preliminary voting information than companies do or than dissidents would receive in traditional proxy contests.

That such disparate access to preliminary voting information is a material disadvantage is corroborated by Professor Yair Listokin's study of the voting outcome of management-sponsored proposals.¹⁷⁴ In these proposals, as under proxy access, shareholders can vote for or against the proposal on the company's proxy card, and shareholders can campaign without having to file a proxy statement.¹⁷⁵ As Listokin has shown, the voting outcome on these resolutions is highly skewed: management is overwhelmingly more likely to win votes by a small margin than to lose by a small margin. The most likely explanation is that management uses information about the votes cast prior to the close of balloting and, when it appears that the vote is close, makes enhanced efforts to obtain additional votes for its side. The data presented by Listokin suggest that these efforts are rather successful: of 68 "close" votes (with a final voting result of between 47% and 53% for the management proposal), management won 61 votes.¹⁷⁶ If one assumes that, with-

¹⁷³ Personal communication with Charles V. Callan, Chief Regulatory Officer, Broadridge Financial Solutions, Inc. (Oct. 25, 2010).

¹⁷⁴ Yair Listokin, *Management Always Wins the Close Ones*, 10 *Am. L. & Econ. Rev.* 159, 175–78 (2008).

¹⁷⁵ See 17 C.F.R. § 240.14a-2(b) (2010).

¹⁷⁶ See Listokin, *supra* note 174, at 179 tbl. 5.

out the strategic advantage conferred on management by unilateral access to preliminary voting results, management would have lost half (or 34) of the close votes, then the effect of the strategic advantage is that 27 of these 34 losses—or 79%—turned into management wins. Even this 79% estimate understates the significance of superior preliminary voting information since it assumes that there were no contests which were close but which ended up, due to enhanced efforts, not being close after all. Moreover, we believe that Listokin's study picks up mostly the effect of some last-minute use of preliminary voting information and thus understates the benefits of disparate access to such information.

5. *Cumulative Voting*

Proxy access involves a special disadvantage for the few companies that permit shareholders to use cumulative voting in the election of directors. In cumulative voting, a shareholder is given as many votes per share as there are board positions to be filled and is allowed to cast those votes for one nominee or to distribute them in any way among the nominees. Cumulative voting, if used strategically, permits a minority of shareholders to secure minority board representation by cumulating all their votes on a single nominee. Consider a company with 1 million shares and a 9-member, annually elected board. Under regular voting, each shareholder can cast 1 vote per share for up to 9 nominees. In such a system, a shareholder group that controls 500,001 of the shares can secure the election of all 9 nominees. Thus, even a group that controls 499,999 votes is not assured of getting even a single nominee elected. Under cumulative voting, a nominee who gets 900,001 votes is assured election.¹⁷⁷ Since any shareholder can cast all 9 of her votes for a single nominee, it takes only 100,001 shares—roughly 10%—to be assured of electing 1 nominee to the board.

To employ cumulative voting strategically, a dissident must ideally get proxies that give the dissident discretion to decide how to cast the votes after the dissident knows the approximate level of shareholder support for its nominees. In proxy contests in compa-

¹⁷⁷ There are a total of 9 million votes to be cast, and the nominees with the 9 highest vote levels are elected. If a nominee gets 900,001 votes, it is thus impossible that 9 other nominees each get more votes. Thus, that nominee is assured of being elected.

2011]

Insignificance of Proxy Access

1405

nies with cumulative voting, proxies and voting instructions are designed to provide such discretion. Under proxy access, this is unlikely to occur. The specific design of proxies and voting instructions for board elections involving cumulative voting is unclear. Most likely, however, the proxies and voting instructions would resemble those distributed in elections not involving cumulative voting, meaning that 1—and only 1—vote will be cast for each nominee marked on the ballot. After all, if votes are to be cumulated, then someone has to decide how to cumulate them, and there is no likely candidate for doing so in proxy access.¹⁷⁸ This means, in effect, that by using proxy access, a dissident would forego the significant advantage conferred by cumulative voting on dissidents seeking minority representation.

6. Adverse Signal

A final adverse effect of proxy access is that its use would convey a negative signal about the dissident. As discussed,¹⁷⁹ proxy access would generate modest cost savings but entail substantial strategic disadvantages. For larger holders, the only ones eligible to use proxy access under the SEC-adopted rule, these cost savings would represent a trivial percentage of the value of their stakes. Take a typical midcap company, with a capitalization of about \$5 billion. A 3% stake in that company would amount to \$150 million. According to our estimates, the cost savings from proxy access would amount to 1 or 2 hundredths of 1% of that stake.

Now suppose that a dissident has a 3% stake, that the cost savings from proxy access are 0.03% of the dissident's stake, and that using proxy access would reduce the dissident's chances of winning by 10%. What would using proxy access signal about the dissident's view of the expected gains from winning a contest? If the dissident believed that winning the contest would increase the stock price by 0.3% or more, the dissident should forego proxy access and wage a traditional contest, because the benefits of using a traditional con-

¹⁷⁸ Normally the person who solicits the proxies or the appointed proxy decides how to cumulate the votes, but in proxy access this person has interests adverse to those of the dissident shareholder.

¹⁷⁹ See *supra* Section III.A; Subsections III.B.1–5.

test would outweigh the cost savings from proxy access. In such a case, a dissident's decision to opt *for* proxy access would convey a signal that the dissident does not believe that winning the contest would have a material effect on the stock price. Such a signal, of course, would be unlikely to attract votes.

C. Empirical Assessment

1. Number of Nominees

One important limitation of the proxy access rule is that a dissident may not nominate more than 25% of the board.¹⁸⁰ To assess the importance of that limitation, we examined the seats sought in traditional proxy contests. In our sample of 129 contests, the dissident sought a majority of the total seats in 23% of the contests and more than 25% of the seats in 91% of the contests. Hedge funds were less likely to seek control, or more than 25%, of the seats (13% and 88%, respectively), but dissidents other than hedge funds were substantially more likely to do so (44% and 95%, respectively). In sum, judging from traditional campaigns, the limitation on the numbers of seats sought is an important disadvantage, especially for dissidents other than hedge funds who often seek control.

2. Success Rates and Margins

As discussed, using proxy access rather than waging a traditional proxy contest entails several significant disadvantages that render it more difficult to gain the requisite shareholder support.¹⁸¹ To estimate the size of these disadvantages and their impact on the outcome of proxy contests, we performed a number of calculations. First, for our sample of traditional proxy contests, we calculated the increase in the implicit vote threshold assuming (i) that the dissident nominates the maximum number of candidates permissible by the proxy access rule and (ii) that shareholders who support the dissident will cast their remaining votes for company nominees and spread these votes evenly among the nominees. Under these assumptions, the average level of support required to win increased

¹⁸⁰ See 17 C.F.R. § 240.14a-11(d) (2010).

¹⁸¹ See *supra* Section III.B.

2011]

Insignificance of Proxy Access

1407

from a majority to 71% of the shares voted for a nominee. As discussed, the second of these assumptions is extreme.¹⁸² More reasonably, the implicit vote threshold would rise by about half that amount to roughly 60% of the shares voted for a nominee. In addition, we estimate that not having one's own proxy card, having to fight in the dark, and sending an adverse signal, together would cost a dissident another 5% of the votes.

In our sample of proxy contests in which a vote was held, dissidents won outright in 35 contests, dissidents won some seats in 9 contests, and management won in 52 contests. In the 44 contests in which dissidents won some seats, 3 involved cumulative voting. In these contests, proxy access entails even more severe disadvantages. For the 41 other contests, we calculated the swing—that is, the percentage shift in votes from the dissident to the management nominees—necessary for a dissident nominee to lose.¹⁸³

Table 5: Results of Proxy Contests

Swing Range	Number of Contests with Dissident Victories	Percentage of Total Dissident Victories—All Companies	Percentage of Total Dissident Victories—Capitalization > \$500 million	Percentage of Total Dissident Victories—Capitalization < \$500 million
< 1%	4	9.8	15.4	7.1
1% - 2%	4	9.8	23.1	3.6
2% - 5%	5	12.2	15.4	10.7
5% - 7.5%	5	12.2	7.7	14.3
7.5% - 10%	12	29.3	15.4	35.7
10% - 15%	3	7.3	7.7	7.1
15% - 20%	2	4.9	0	7.1
20% - 30%	5	12.2	15.4	10.7
30% - 35%	1	2.4	0	3.6

If our quantification of the disadvantages of proxy access is correct, these data indicate that dissidents would have lost 33 of the 41

¹⁸² See supra Subsection III.B.2.

¹⁸³ The swing was calculated by taking half of the difference between the votes for the dissident nominee who got the lowest number of votes but still got elected (the marginal dissident winner) and the votes for the management nominee who received the highest number of votes but did not get elected (the marginal management loser) and then dividing the difference by the number of the outstanding votes.

contests that they won as a result of these disadvantages. Moreover, elections tend to be closer for regular-sized than for micro-cap companies.¹⁸⁴ For regular-sized companies, 50% of the dissidents who won would have lost had 5% of the votes swung the other way. And of the 4 contests in large companies (with a capitalization of more than \$5 billion) in which dissidents gained board representation, 3 would have been lost had as little as 2% of the votes swung the other way. Thus, the disadvantages of proxy access are relatively more important for larger companies.

The data on success rates and margins also indicate the difficulty, if not futility, of winning a proxy access contest without actively campaigning. The level of campaigning varied greatly within the sample of traditional proxy contests, with some dissidents mailing several fight letters to all shareholders and making presentations to large holders and others relying mostly on the proxy statement. However, in each serious contest, the campaign material distributed went substantially beyond the 500-word supporting statement permitted by the proxy access rule. Judging by the results of traditional contests, and taking into account the other disadvantages of proxy access, the chances of victory for a dissident who uses proxy access and does not campaign would be remote.

3. Dissident Stakes and Savings

These limited costs savings resulting from proxy access have to be evaluated not only in relation to the effect on winning the contests but also in relation to the dollar value of the dissident stakes. As noted, these savings would normally amount to a few hundredths of 1% of the value of a 3% stake. Moreover, successful dissidents in traditional contests often seek and receive reimbursement of their costs for waging a proxy contest. As between, on the one hand, waging a traditional contest, expending some more resources, but having a material likelihood of succeeding and then possibly also getting the costs reimbursed; and, on the other hand,

¹⁸⁴ Just looking at the swing margins of prior contests probably understates the adverse impact of proxy access. In contests which dissidents won by a large margin, it is likely that management—looking at the preliminary voting results—realized that it had no chance to win and stopped campaigning. But if the dissidents in these contests had been burdened by the disadvantages of proxy access, the preliminary results would have been much closer, and management might well have campaigned harder.

waging a proxy access contest, expending fewer resources, and having a significantly reduced chance of succeeding and a correspondingly reduced chance of receiving reimbursement for any additional campaign expenditures,¹⁸⁵ the choice, we believe, would be an easy one.

D. Summary and Evaluation

Overall, for most dissidents, proxy access would not represent an attractive alternative. The reduced chances of winning associated with proxy access would generally outweigh the cost savings generated by it. For dissidents serious about winning, and who are considering significant outside campaigning (and spending the money on it), using proxy access makes little sense.

IV. PROXY ACCESS VERSUS WITHHOLD VOTES

Proxy access may be attractive for dissidents who do not plan to engage in outside campaigning and who are not really serious about winning. For these types of dissidents, the major advantage of proxy access is not merely a cost reduction but the virtual absence of any expenses. This has two implications: first, because the costs of making a proxy access nomination are very low, it may make sense to make a nomination even if the chances of success are low. As a result, we would expect many of these nominations to be unsuccessful. Second, some nominations may be made by dissidents who are virtually certain that they will not win for reasons other than getting one's nominee elected. These reasons may include trying to propagate certain ideas through the supporting

¹⁸⁵ Dissidents in traditional contests state whether they will seek reimbursement in their proxy statement, the granting of which is within the discretion of the board. If dissidents obtain control, they have the power to award themselves the reimbursement. See Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 Calif. L. Rev. 1071, 1108–09 (1990). If they settle, the agreement sometimes provides for a reimbursement of expenses. If they obtain minority representation, they have at least an argument that shareholders wanted them to get reimbursed. Dissidents in proxy access contests can also seek reimbursement but, in our view, are less likely to obtain reimbursement since (i) they will never have board control, (ii) they will never have stated in the proxy statement that they will seek reimbursement, and (iii) the board may take the position that the company already subsidized the proxy contest by providing proxy access and that no further reimbursement is warranted.

statement and gaining publicity for the shareholder and/or the nominee.

But even for highly cost-conscious dissidents, another alternative presents itself. Instead of starting a proxy access contest, these dissidents could use another, equally low-cost strategy: withhold their votes from some of the company nominees and perhaps engage in low-cost efforts to induce other shareholders to withhold their votes.¹⁸⁶ In this Part, we examine this alternative. As we will show, even for highly cost-conscious dissidents, a withhold campaign will often be a better option than a proxy access contest.

A. Plusses of Proxy Access: Effect of Winning

A proxy access nomination entails one major plus over a withhold campaign: if the contest is successful, its effects are stronger, and more certain, than those of a withhold vote. The technical legal effect of a director receiving less than a majority of the votes cast in a withhold campaign depends on the voting rules in place at the corporation. Most companies subscribe to one of three different voting rules:¹⁸⁷ the old, unmodified plurality regime that remains the default rule in Delaware and most other states;¹⁸⁸ an official by-law (or charter provision) that changes the default rule for uncontested elections to a majority standard; or a “policy” adopted by the corporation to require each nominee to submit an irrevocable offer to resign from the board should she receive less than the majority of the votes cast in an uncontested election.¹⁸⁹

In companies with a plurality regime, in an uncontested election, a nominee who receives less than a majority of the votes is elected to the board just like a nominee who receives more than a major-

¹⁸⁶ Such low-cost efforts may take the form of a press release explaining why the dissident is withholding its votes, an amendment to the dissident’s Schedule 13D or 13G making such points, or a letter to proxy advisors urging them to recommend a withhold vote. Most dissidents who qualify for proxy access would be subscribing to the services of proxy advisors and would have sufficient financial clout to have their press releases picked up by wire services.

¹⁸⁷ See, e.g., Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 *Tex. L. Rev.* 987, 1010 n.152 (2010).

¹⁸⁸ Del. Code Ann. tit. 8, § 216(3) (Supp. 2010).

¹⁸⁹ See id. § 141(b).

ity.¹⁹⁰ In companies with a board policy, such a nominee is also elected, but the other board members have to decide whether to accept her resignation. Under a majority vote bylaw, the nominee who receives less than a majority is not elected. Nor, of course, is anyone else. But under Section 141(b) of the Delaware General Corporation Law, each director remains in office until her “successor is elected and qualified or until such director’s earlier resignation or removal.”¹⁹¹ Thus, if the nominee who receives less than a majority is a member of the incumbent board,¹⁹² she will remain in office until the vacancy created by her non-election is filled. Generally, the resulting vacancy can be filled by the board, and at least in theory nothing prevents the board from appointing that non-elected nominee to the vacancy created by her non-election.¹⁹³

¹⁹⁰ In uncontested elections, the number of nominees is the same as the number of board seats to fill, so it technically takes just a single vote to get the requisite plurality.

¹⁹¹ See Del. Code Ann. tit. 8, § 141(b).

¹⁹² The nominee would not remain on the board as a holdover if she had not been an incumbent. Also, the statute is not clear as to who would remain as a holdover if two of the incumbent directors are not re-elected and a single vacancy is created. This can occur, for example, where one of the incumbents does not run for re-election and the other runs but fails to receive the requisite majority. Since directors run for the board as a whole, rather than for specific seats, there is no a priori way to distinguish between these two potential holdover directors. The latter hypothetical raises the issue of whether the statute ought to be applied at all to a situation where some nominees are elected and others are not. Though phrased in terms of an individual director (“[e]ach director shall hold office”), it may make more sense to view the provision as applying to the whole board; that is, a board remains in place until a successor board is elected. See *id.* An election where some, but not all, nominees fail to get a majority would then produce a vacancy without any holdover directors, which does not generate much of a problem. Moreover, such an interpretation would avoid several problematic scenarios, for example, one where several board members fail to get a majority, remain as holdover directors, and then appoint themselves to the vacancies over the objection of board members who were properly elected.

¹⁹³ For a recent Delaware opinion on majority vote bylaws, see *City of Westland Police & Fire Retirement System v. Axcelis Technologies, Inc.*, 1 A.3d 281 (Del. 2010). *Axcelis* involved a board-adopted bylaw that mandated that a director who did not receive a majority of the votes tender her resignation but which also gave the board discretion whether to accept the resignation. See *id.* at 283–84. In determining whether plaintiffs had established “proper purpose” to inspect books and records under Delaware General Corporation Law, tit. 8, § 220(b), the Delaware Supreme Court upheld the Chancery Court’s finding that a board decision not to accept the resignation did not by itself establish a credible basis to infer wrongdoing. *Id.* at 291. In so holding, the Delaware Supreme Court held that such board decisions, without additional evidence showing an entrenchment motive, are to be analyzed under the business judgment rule and not the *Unocal* or *Blasius* tests, even if they take place

Moreover, independent of the technical effect, a nominee (and the company on the board of which he serves) who receives less than a majority without having an opponent, or even a substantial withhold percentage short of a majority, suffers substantial embarrassment. Shareholders are sending a message to such companies, and companies may respond to these messages regardless of the technical effect of the withhold vote. In addition, the threatened infliction of such embarrassment gives shareholders leverage.¹⁹⁴

Compare these effects to the effect of a successful proxy access contest. Should the shareholder nominee receive more votes than one of the company nominees, the shareholder nominee would be elected and the company nominee who received fewest votes would not be elected.¹⁹⁵ How important this is in practice depends to a large degree on the level of recalcitrance of the board majority and on the person elected. Proxy access would not afford shareholders the opportunity to elect a majority of the board. By intention and design, shareholder nominees elected via proxy access would thus be a minority. Since board decisions are generally taken

during a battle for control. *Id.* at 288–91. The narrow ruling, however, may well not apply to shareholder-adopted majority voting bylaws or to better-crafted Section 220 requests that focus on investigating the suitability of directors whose resignations were rejected.

¹⁹⁴ It also deserves mention that, under the law of Delaware and some other states, shareholders can adopt a majority bylaw which could not then be amended by the board. See Del. Code Ann. tit. 8, § 216(b) (Supp. 2010) (codifying amendment adopted in 2006 to provide binding bylaws adopted by shareholders that prescribe vote requirements for director elections). Other states that have adopted legislation to enable shareholders to provide for forms of majority voting include California, Nevada, North Dakota, Ohio, Utah, Virginia, and Washington. See Claudia H. Allen, *Majority Voting in Director Elections—An Activist Success Story*, Neal, Gerber & Eisenberg LLP (Nov. 13 2007), http://www.ngelaw.com/news/pubs_detail.aspx?ID=777. Such a bylaw could be proposed via a binding shareholder resolution under Rule 14a-8. See Del. Code Ann. tit. 8, § 216 (“A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.”). Thus, to the extent that the plurality regime or a resignation policy is not sufficiently effective, in most companies shareholders can take action to adopt a more effective majority voting bylaw.

¹⁹⁵ In many instances, the board could place the non-elected company nominee on the board by expanding the board size and filling the resulting vacancy with the company nominee.

2011]

Insignificance of Proxy Access

1413

by majority vote,¹⁹⁶ the elected board nominees, if voting together, could always outvote the elected shareholder nominee.

Even having a seat at the table where decisions are made is, upon final analysis, contingent. The board could, at its first meeting, create a board committee—consisting of all board members except the shareholder nominee—and delegate to this committee most board powers, effectively shutting the shareholder nominee out of the discussion and information process.¹⁹⁷ While such an extreme measure may be unlikely, boards have significant discretion over what matters are primarily decided in committee and over who sits on which committee. Thus, through the proper work division and committee membership designation, the participation of the shareholder nominee in the discussion and information process could be reduced.¹⁹⁸

B. Minuses of Proxy Access

While proxy access has an advantage over a withhold campaign, it also entails substantial disadvantages: the likelihood of winning a withhold vote is significantly higher than the likelihood of winning a proxy access contest, and a good showing short of victory in a withhold vote may have a greater effect than a close loss in a proxy access campaign.

¹⁹⁶ It is possible to change this by bylaw, but it would probably require an active solicitation.

¹⁹⁷ See Del. Code Ann. tit. 8, § 141(c)(2) (Supp. 2010) (permitting delegation of any power to such a committee other than the power to approve or recommend any action that requires shareholder approval and the power to amend bylaws).

¹⁹⁸ This could be done in a subtle and discreet manner so that the sidelining of the shareholder nominee would be less apparent. All of this, of course, presupposes that the shareholder nominee would differ significantly from the board nominees along dimensions other than the fact that she was selected by shareholders and that the other board members, for that reason, would want to sideline her. On this issue, as well, there are some doubts. Also note that directors have information rights under state law and thus cannot be shut out completely from the information process. *Id.* § 220(d). In public companies, however, the additional information that comes from these information rights, and the capacity to use it, are very limited.

1. Higher Voting Threshold

As explained in the preceding Part,¹⁹⁹ it takes more votes to succeed in the proxy access contest than in a traditional proxy contest. This is equally true when comparing a proxy access contest to a withhold vote. To generate a majority withhold vote that results in a nominee not being elected or triggers her resignation, shareholders must cast more “withhold” than “for” votes for a specific nominee, with abstentions and non-votes being ignored. As a result, it just takes a majority of the voting shares to generate a majority withhold vote. But, as discussed above, it will likely take a substantially greater fraction of the voting shares to get a nominee elected via proxy access.

2. Negative Versus Positive Campaigning

A further disadvantage of a proxy access campaign compared to a withhold vote is that it would be more difficult to get shareholder support for a proxy access campaign. First, and most fundamentally, it is easier to get other shareholders to agree to be against something than to be in favor of something. In a withhold campaign, other shareholders just have to agree to oppose a specific company nominee. By contrast, in a proxy access campaign, they are asked to put the dissident nominee on the board instead of a company nominee. Even if these other shareholders believe that the present board or a certain director has not done a good job and would thus want either to send a general message to the board to mend its ways or to remove a specific director, they may not necessarily agree that putting the dissident nominee on the board would lead to an improvement.

The purely negative structure of withhold votes also means that they involve little downside risk. So what if a qualified company nominee receives a majority withhold vote? Unless the nominee is the company’s CEO, she can probably be replaced by another similarly qualified director. This may generate some work, but has no material impact on the company. Moreover, as explained below, a majority withhold vote may not result in the removal of the director from the board, but instead generate other sought-after

¹⁹⁹ See *supra* Subsection III.B.2.

changes.²⁰⁰ In comparison, placing a dissident nominee who does not deserve election on the board is potentially more serious business. Put differently, the very advantage of a proxy access contest—that, if it succeeds, it is certain to replace a board member with a dissident nominee—may lead shareholders to be more guarded in voting for a dissident nominee than in withholding their vote from a company nominee.

It will be especially difficult to make the affirmative case for voting for the dissident nominee without significant campaigning. While dissidents would get to include a 500-word supporting statement in the company's proxy materials,²⁰¹ this is very limited space to make such an affirmative case. At the very minimum, we believe, the dissident would ordinarily have to supplement the supporting statement with low-level campaign efforts, such as press releases and letters soliciting the support from proxy advisors.²⁰² But even with such supplements, it will not be easy to explain convincingly to other shareholders why electing the dissident nominee would be in their interest.

Moreover, proxy access opens the door to more effective campaigning by the company. In withhold contests, the ability of the company to campaign is somewhat limited by the nature of the contest. The company nominee targeted for a withhold vote is running against no one. To campaign, the company has to argue, in effect, that the company nominee is doing a good enough job to deserve being elected. This positive campaigning can be difficult—usually nominees targeted for a withhold vote have been so targeted for a reason—and implicitly draws attention to the nominee's shortcomings. By contrast, in a proxy access campaign, the company could attack the dissident's nominees via negative campaigning. Even casual observation of political campaigns suggests that

²⁰⁰ See *infra* Section IV.C.

²⁰¹ See *supra* text accompanying note 147.

²⁰² If the dissident goes much beyond such efforts and makes a mailing to shareholders, it will probably pay to wage a traditional contest rather than a proxy access contest.

this is much easier than positive campaigning.²⁰³ In fact, in traditional proxy contests, such attacks are common.²⁰⁴

The company may not merely attack the dissident nominee. It may also attack the dissident shareholder who made the nomination. Such attacks are particularly likely to be credible and effective if the dissident shareholder has arguable conflicts of interest. Most evidently, allegations of conflicts can be made for dissident shareholders who are affiliated with labor and employee interests. Other shareholders, who are interested predominantly in maximizing the economic value of the stakes, may worry that a nominee put forth by such groups will push the company to pursue the labor interests at the expense of profit maximization or that lending support to such a candidate will provide leverage to labor groups to extract concessions in exchange for withdrawing the nomination. In addition, public pension funds and hedge funds are vulnerable to being attacked for alleged conflicts. The boards of trustees of public pension funds typically consist of political appointees, politicians serving *ex officio*, or beneficiary representatives.²⁰⁵ Beneficiary representatives often have ties to organized labor.²⁰⁶ Thus, public pension fund trustees, who have little personal financial stake in maximizing the returns of the funds, may plausibly pursue other interests. Politicians and political appointees may pursue political

²⁰³ See, e.g., Eric Ferkenhoff, Icahn Appears to Fall Short at Motorola, N.Y. Times, May 8, 2007, at C1 (detailing personal criticisms by Icahn of Motorola's board).

²⁰⁴ See, e.g., The Committee for Concerned Cyberonics, Inc. Shareholders, Definitive Additional Proxy Materials Filed by Non-Registrant (Form DFAN 14A) (Jan. 18, 2007) [hereinafter The Committee for Concerned Cyberonics, Inc. Shareholders], available at <http://www.sec.gov/Archives/edgar/data/864683/000119312507008489/ddfan14a.htm> (containing a fight letter by dissidents citing to and refuting attacks by company).

²⁰⁵ See, e.g., Board Members, CalPERS (Jan. 25, 2011), <http://www.calpers.ca.gov/index.jsp?bc=/about/organization/board/members/home.xml>; Structure and Responsibilities, CalPERS (Aug. 27, 2008), <http://www.calpers.ca.gov/index.jsp?bc=/about/organization/board/structure-responsibilities.xml>.

²⁰⁶ See, e.g., Benn Steil, California's Sovereign Wealth Fund, Wall St. J., Mar. 7, 2008, at A14 ("Calpers is a political entity in every sense of the word. Its board is comprised of . . . six elected members—all six of whom have long ties to organized labor, including the board president . . . who is also executive vice president of the California Labor Federation. Calpers's investment policies are politically driven, often dictated by the legislature, and even involve foreign policy goals.").

goals such as increasing in-state investment,²⁰⁷ getting favorable PR, or benefiting significant donors.²⁰⁸ Beneficiary representatives may pursue labor goals.

These issues have particular salience for some of the most activist public pension funds. CalPERS, the New York State Retirement Fund, and the New York City Pension Funds have all been involved in “pay to play” scandals.²⁰⁹ CalPERS has been criticized for the presence of union representatives on its board and the pro-union stance it has taken in various labor disputes.²¹⁰ The New York City Pension Funds, though making a fair number of governance proposals, make more than twice as many social and environmental proposals and tout the engagement of (former) Comptroller William Thompson—the *ex officio* chief investment advisor of the funds—on climate change.²¹¹ Former New York State and

²⁰⁷ See Roberta Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 Colum. L. Rev. 795, 796–98 (1993).

²⁰⁸ See, e.g., Danny Hakim, Cuomo Issues 100 Subpoenas in Pension Fund Inquiry, N.Y. Times, May 2, 2009, at A17.

²⁰⁹ See *id.* (discussing investigation by Attorney General Cuomo into pay to play in New York pension funds); Craig Karmin & Peter Lattman, Calpers Rocked By ‘Pay to Play,’ Wall St. J., Oct. 15, 2009, at A1 (discussing pay to play at CalPERS).

²¹⁰ See Calpers and Cronyism, Wall St. J., Oct. 18, 2004, at A18 (noting political and union ties of CalPERS board members and accusing board of basing investment decision on political goals of labor and the Democratic Party); Jim Carlton & Jonathan Weil, Ouster Isn’t Expected to Alter Calpers Policy, Wall St. J., Dec. 2, 2004, at C3 (noting that CalPERS has been criticized for “meddling in political and labor-union issues with little connection to improving shareholder returns”); Jonathan Weil & Joann S. Lublin, Gadfly Activism at Calpers Leads to Possible Ouster of President, Wall St. J., Dec. 1, 2004, at A1 (noting controversial CalPERS actions in interceding on behalf of striking employees of a portfolio company).

²¹¹ The New York City Pension Funds’ 2006 Shareholder Proposals, The New York City Pension Funds 4–17 (2006), http://www.comptroller.nyc.gov/bureaus/bam/corp_gover_pdf/2006-shareholder-report.pdf; see also *id.* at 4 (“Comptroller Thompson has played a leading role in the efforts of the Investor Network on Climate Risk (INCR) . . . INCR has taken steps to pressure Wall Street firms, securities regulators and companies to provide deeper analysis and disclosure on the business risks and opportunities of climate change. In June 2006, Comptroller Thompson joined with 27 members of INCR in a letter to SEC Chairman Cox expressing concern that climate change poses material risks to companies in which INCR members are invested On September 20, 2006, the New York City Comptroller’s Office participated in a meeting between INCR members and SEC Commissioner Roel Campos in an effort to push the SEC towards the adoption of an SEC rule that would require companies to disclose climate change risks in their financial reports. Commissioner Campos expressed deep interest in the issue and offered his active participation in advancing the initiative.”); Postseason Report 2007 Shareholder Proposal Programs & Other Share-

New York City Comptroller Alan Hevesi (and the head of the respective pension systems) pled guilty to charges of defrauding the government²¹² and to more serious felony corruption charges for awarding pension investment business in exchange for gifts.²¹³ The current New York City Comptroller John Liu has been criticized for using a trip to Ireland to gain political, rather than investment, returns.²¹⁴

3. *Finding a Nominee*

Given the possibility of highly one-sided campaigning and of getting attacked and not defended, one wonders who would agree to become a dissident nominee. The dissident would want to nominate a person with experience, a good track record, independence, and an unimpeachable character to minimize susceptibility to negative campaigning against the nominee or the dissident herself. Warren Buffet, to use an extreme example, may not have to worry much about negative ads and, even if nominated by a union pension fund, may receive a lot of shareholder support. The Warren Buffets of this world, of course, usually have better things to do than run as dissident nominees. Someone less famous and accomplished than Buffet may well have second thoughts about entering a campaign in which she can expect to be attacked and have her record presented in the least favorable light by a company with significant campaign funds, while the dissident who nominated her

ownership Initiatives of the New York City Pension Funds & Retirement Systems, *The New York City Pension Funds & Retirement Systems* 4 (2007), http://www.comptroller.nyc.gov/bureaus/bam/corp_gover_pdf/2007-Shareholder-report.pdf (“On March 19, 2007, Comptroller Thompson joined with Ceres, dozens of institutional investors, and a dozen leading U.S. companies and called on U.S. lawmakers to enact strong federal legislation to address global climate change The investors and companies emphasized their concerns that the uncertainty surrounding climate policy and the lack of federal regulations may be undermining the long-term competitiveness of companies by discouraging new investments in clean energy and energy-efficient technologies.”).

²¹² See Michael Cooper, *Hevesi Pleads Guilty to a Felony and Resigns*, N.Y. Times, Dec. 23, 2006, at B1.

²¹³ Danny Hakim & William K. Rashbaum, *Hevesi Pleads Guilty in Pension Case*, N.Y. Times, Oct. 7, 2010, at A19.

²¹⁴ See Michael Corkery & Michael Howard Saul, *Comptroller’s Ireland Trip Questioned*, Wall St. J., Oct. 9, 2010, at A17.

will make little effort, and expend minimal funds, to defend her.²¹⁵ To be sure, for the right price, nominees can be found or the dissident can simply nominate one of its own officials. But this involves expense (if the dissident ends up paying the nominee), and, more importantly, it reduces the independence of the nominee from the dissident shareholder (if the nominee is paid or is an official with the dissident) and increases the credibility of accusations of conflict.

4. Effect of “Losing”

The final drawback of proxy access compared to a withhold campaign relates to the effect of losing. In a proxy access campaign, if the dissident nominees are not elected, the company can claim victory and vindication: shareholders have been offered a real choice between two live candidates and rejected the candidate nominated by the dissident.

In a withhold vote, by contrast, the company may be the de facto loser even if its candidate receives more “for” than “withhold” votes. Getting a substantial, but less than a majority, withhold vote is still an embarrassment and often induces board actions. Having, say, 40% of the shareholders withhold their vote from you in order to vote for no one is quite different from having an opponent in a contested election get 40% to your 60%. In the mother-of-all withhold campaigns—the 2004 campaign against Disney CEO Michael Eisner—Eisner received a majority “for” vote but was nevertheless ousted shortly thereafter.²¹⁶ This experience is not singular. For example, after some directors received a 25% withhold vote, International Paper decided to heed shareholder requests to dismantle its staggered board.²¹⁷ According to proxy solicitors, some companies regard withhold percentages of as low as 15-20% as problematic

²¹⁵ See The Committee for Concerned Cyberonics, Inc. Shareholders, *supra* note 204 (containing a dissident mailing defending the record of its nominees against attacks from company).

²¹⁶ See *supra* text accompanying notes 59–63.

²¹⁷ News Release, International Paper, International Paper Board of Directors Announces Annual Director Elections (Oct. 17, 2007), http://investor.internationalpaper.com/phoenix.zhtml?c=73062&p=irol-newsArticle_Print&ID=1064053&highlight=.

and will make additional solicitation efforts to increase the “for” votes.²¹⁸

C. Empirical Assessment

Among Russell 3000 companies, 82 director nominees in 2009 and 31 directors nominees in 2008 received a majority withhold vote in uncontested elections.²¹⁹ Of these nominees, 7 were running for board seats at companies that had adopted a resignation policy, and one was running at a company that had implemented a majority standard for election to the board.

Of the 113 nominees with majority withholds, 4 (the director subject to a majority standard and 3 subject to a regular plurality standard) were not elected or resigned, and one director died within a year.²²⁰ However, even for most of the other 108 directors, the majority withhold votes had a substantial impact that appears to have satisfied the concerns that triggered the withhold votes in the first instance.

To determine the basis for the withhold vote, we examined the voting recommendations by ISS, the most influential proxy advisor, which state the reason for any withhold recommendation.²²¹ These reasons fell into 6 categories: failure to attend at least 75% of the board meetings, membership on an excessive number of boards, lack of independence (often coupled with service on certain committees, adoption of a poison pill without shareholder approval, failure to implement shareholder proposal that received majority support, and compensation-related issues. This listing suggests that

²¹⁸ Personal communication with Alan Miller, Co-chairman, Innisfree M&A, Inc. (June 4, 2010).

²¹⁹ Gretchen Morgenson, Too Many ‘No’ Votes To Be Ignored, N.Y. Times, Sept. 20, 2009, at BU1. There were 84 directors in 2009 and 32 in 2008, but two of these directors (of Zapata Corp.) were not elected because different director candidates received a higher vote than they did, and for one further (of Alico), the company had agreed to support a different nominee in his stead. We thus disregarded these 3 directors.

²²⁰ The respective companies with directors subject to a resignation policy did not accept any of the 7 resignations.

²²¹ See Choi, Fisch & Kahan, *supra* note 105, at 869, 871. We caution that the ISS rationale is not necessarily the only reason why directors receive withhold votes. In fact, many directors for whom ISS issues a withhold recommendation for the same reason, and sometimes at the same company and the same year as the nominees who received majority withholds, receive a majority “for” vote.

2011]

Insignificance of Proxy Access

1421

often the main aim of the withhold recommendation is to induce corporate changes, rather than to remove the director at issue from the board. The reaction of companies and shareholders we discuss below suggests that this is indeed the case.

For the nominees who did not leave the board within one year and whose companies were not acquired or about to be acquired by the next annual meeting (98 nominees), we considered whether they were re-nominated, whether the company had taken any steps to address the shareholder concern, and how the nominees at issue fared in the 2010 board elections. Specifically, for those nominees who were re-nominated, we judged whether the company had adequately addressed the issue by the percentage of withhold votes they received the following year. Generally, if the nominee received less than 10% withholds, we considered the company as having addressed the issue to the satisfaction of shareholders and if the nominee received more than 40% withholds, we considered the company as not having addressed the issue to the satisfaction of shareholders.²²² When the board was staggered and the nominee was not up for reelection the following year, or when the nominee received between 10% and 40% withholds, we considered several factors, including (i) our own evaluation of the company's response to the ISS basis for a withhold recommendation, (ii) the presence of a secondary reason that may have accounted for the majority withhold vote and whether the company addressed that reason, and (iii) the withhold percentage received by other board nominees. For nominees who received withhold votes in 2008, we further judged whether that reason was addressed in the second year following the withhold vote. Based on our evaluation, 67 of the 98 withhold votes resulted in a company response that was satisfactory (including 2 in which the nominee was not re-nominated and 7 relating to a 2008 withhold vote that were addressed in the second year following the vote);²²³ 28 did not result in a satisfactory response (including 2 in which the nominee received another majority withhold vote in the following year); and in 3 instances, it was unclear whether the response was satisfactory or not.

²²² Note that for 2010 results, unlike for 2009 and 2008, shares voted by brokers without instructions from the beneficial owner are not included in the "for" vote count.

²²³ 2 of these 7 directors received a second withhold vote in 2009.

Note that the cases in which the response was not satisfactory were concentrated among smaller companies. Of the 28 nominees in companies with unsatisfactory responses, none were directors at an S&P 500 large-cap company, 3 were directors at an S&P 400 mid-cap company, and 24 were directors at an S&P 600 small-cap company. By comparison, for the 10 nominees at S&P 500 companies, every company addressed the concerns that gave rise to the withhold vote. Another notable aspect of the data is the rarity of majority withhold votes at companies that had adopted a majority standard for the election of directors and, to a lesser extent, at companies with a resignation policy. This may be due to any of the following factors: companies with a majority standard for election or with resignation policies may be more successful in avoiding majority withhold votes because they campaign more heavily for “for” votes; shareholders at companies with a majority standard for election or with resignation policies may be more careful in voting “withhold” if this may result in a majority withhold vote since their real aim is to induce the company or the director to make changes, rather than remove the director from the board; companies with a majority standard for election or with resignation policies may address the shareholder concerns before they result in a majority withhold vote; or withhold campaigns may be used to pressure companies to adopt majority voting. To the extent that either of the first 2 reasons account for the scarcity of majority withhold votes, they would result, to an even greater extent, in a scarcity of successful proxy access contests.

When a withhold vote did occur, the margin tended to be narrow. The average (median) percentages of the shares voting withhold, relative to the shares voting either “for” or “withhold,” were 56.25% (54.89%) in 2009 and were 55.11% (55.57%) in 2008. The withhold percentage exceeded 60% in only 24 votes and never exceeded 70%.²²⁴

²²⁴ These figures, however, somewhat understate the degree of shareholder opposition. In 2008 and 2009, uninstructed shares held through brokers could still be voted for the company nominees. To estimate the degree to which such shares may have reduced the withhold vote margin, we considered whether another issue (such as a shareholder proposal) was on the ballot for which uninstructed shares could not be voted. This permitted us to estimate the number of uninstructed shares. We then assumed, conservatively, that all these shares had been voted for the board nominees. (During 2009, about one-half of uninstructed shares were voted, by each broker, in

2011]

Insignificance of Proxy Access

1423

The set of nominees who received majority withhold votes may represent a potentially fertile set of targets for proxy access. Obviously, these nominees already face substantial opposition from shareholders. Nevertheless, we do not believe that dissident nominees would have had an easy time prevailing against most of these nominees.

First, the principal reason for the withhold nominations may not be known by the time a dissident has to make a proxy access nomination. For example, the company discloses whether directors attended at least 75% of the meetings only when it files its proxy statement. At that point, however, it would be too late for a dissident to nominate someone else to defeat a director who had missed many meetings.

Second, as later developments indicate, many if not most of these withhold votes were aimed at achieving a corporate change other than the removal of the director at issue. Regardless of the reason for the ISS withhold recommendation, the nominees seem to be able to receive a large majority in the next board election as long as the company takes proper rectifying measures. Take, for example, Syniverse Holdings, where all 8 directors received majority withhold votes in 2009. The reason for the ISS withhold recommendation was that the company adopted a poison pill without shareholder approval. The company then promised that the pill would either be terminated or submitted to a shareholder vote in 2011, and the directors were reelected in 2010 with a 94% “for” vote margin.²²⁵ Or take Sir Peter Bonfield, who attended fewer than 75% of the board meetings of Mentor Graphics and received a ma-

the same proportion as the actual instructions received by that broker. See Broadridge Financial Solutions, Inc., Broadridge Report on Rule 452: The Elimination of the Broker Vote for Director Elections—Analysis of the Impact During the First Proxy Season 25–31 (2010), available at www.broadridgeinfo.com/.%20.%20./MASTER%20Steering%20Comm%2010-19-10%20FINAL.pdf. We subtracted the respective number from the “for” votes received by the nominee and recalculated the withhold vote margin. Using this methodology for the 2009 withhold votes, the average and median withhold vote margins rose by about 6.5%.

Note, however, that once uninstructed broker shares may no longer be voted, the company may make enhanced efforts to induce holders to submit voting instructions. As a result, our methodology may result in an overestimate of the withhold vote margin.

²²⁵ Syniverse Holdings, Inc., Current Report (Form 8-K) (May 6, 2010), available at <http://www.sec.gov/Archives/edgar/data/1169264/000119312510112812/d8k.htm>.

jority withhold vote in 2009. His attendance record improved in the following year and he was reelected in 2010 with 93% of the vote.²²⁶ As a result, we do not believe that a majority withhold vote generally translates to majority support for a dissident nominee.

Third, even shareholders who would ideally like to oust a certain director from the board may not vote for a dissident nominee because they consider the dissident nominee to be even worse. This may be the case because the dissident nominee lacks the proper professional qualifications, because shareholders distrust the dissident shareholder who made the nomination, or because they believe that election of a dissident would reduce board effectiveness.

Fourth, as discussed, it is likely that a company would campaign more heavily—and more effectively—against a dissident nominee than it presently does when faced with a large withhold vote. At present, companies where nominees received a majority withhold vote engaged in little open campaigning.²²⁷ A small minority of companies mailed an additional letter to shareholders explaining why they should vote for certain nominees, and a few more mailed reminders to shareholders to vote, but most engaged in no open campaigning at all. If faced with a dissident nominee, we believe that this would be likely to change.

In rare instances, however, a dissident nominee may succeed. Take Ralph Atkin, a director of Skywest who received a 63% withhold vote in 2009, presumably because of concerns about his independence. Apparently nothing was done, and in 2010 he received a 68% withhold vote.²²⁸ Repeated ineffective withhold votes may eventually induce frustrated shareholders to support a dissident nominee. But then take Ralf Boer, a director of Plexus who received majority withhold votes in 2008 and 2009. Boer was a partner in a law firm that billed Plexus \$500,000 in 2008, and, the following year, Plexus adopted a poison pill without shareholder

²²⁶ Mentor Graphics Corp., Current Report (Form 8-K) (July 1, 2010), available at <http://www.sec.gov/Archives/edgar/data/701811/000119312510153532/d8k.htm>.

²²⁷ By open campaigning, we mean campaigning that requires the company to make additional filings with the SEC.

²²⁸ Skywest, Inc., Current Report (Form 8-K) (May 4, 2010), available at http://www.sec.gov/Archives/edgar/data/793733/000110465910027128/a10-6140_38k.htm. Though the withhold margin in 2010 appeared to have been higher, the withhold margin in 2009, when uninstructed broker votes are filtered out, as discussed *supra* note 222 and accompanying text, was 69%.

2011]

Insignificance of Proxy Access

1425

approval.²²⁹ By the time of the 2010 annual meeting, Boer's law firm's billings had dropped to \$5,000, and, although the poison pill appears to have remained in place, Boer was reelected in 2010 with 90% of the vote.²³⁰ Even repeated majority withhold votes thus may generate no hard feelings if the company shapes up.

D. Summary and Evaluation

A proxy access nomination, without significant outside campaigning, may be a plausible alternative to a withhold campaign. In both cases, the costs are low, and success in a proxy access campaign assures a change in board composition. Moreover, the fact that a majority of shareholders sometimes withholds its votes without any open campaign shows that a proxy access nomination without campaigning is not necessarily doomed to fail.

Nevertheless, we believe that successful proxy access nominations will be extremely rare. It will be harder to obtain the requisite majority because proxy access involves an implicitly higher voting threshold. It will be harder to obtain shareholder support because of the affirmative nature of the support required and concern over the dissident's goals. It will be hard to find qualified nominees due to the lack of support they are receiving from the dissident. Finally, by the time proxy access nominations are due, it may not yet be clear which companies or company nominees would be most vulnerable to a proxy access campaign.

And even as to companies or nominees who are clearly vulnerable, there may not be a shareholder (or group of shareholders) who is both qualified to make a proxy access nomination and interested in doing so. As discussed, to be eligible to make a proxy access nomination, a shareholder (or a group of shareholders) must have a sizeable equity stake of 3% and must satisfy a lengthy holding period of 3 years. No such requirements apply to a shareholder who wants to withhold its votes or encourage others to do so. Moreover, most large institutional investors, who would most easily satisfy these requirements, have been reluctant to become openly active but are perfectly willing to withhold votes from com-

²²⁹ Other Plexus directors did not receive a majority withhold vote.

²³⁰ Plexus Corp., Current Report (Form 8-K) (Feb. 10, 2010), available at <http://www.sec.gov/Archives/edgar/data/785786/000095012310012127/c56287e8vk.htm>.

pany nominees. We thus predict that withhold votes will remain the preferred method for shareholders to signal dissatisfaction to the company.

V. MUCH ADO ABOUT LITTLE: THE MARGINAL IMPACT OF PROXY ACCESS

We would expect proxy access to result in few nominations. Of the nominations made, few would result in the election of dissident directors. And the dissident directors elected would have little impact on the companies. Thus, in our view, proxy access does not amount to much, and the statements made by the supporters and detractors of proxy access are greatly overblown.

This being said, proxy access would have some marginal consequences. In this Part, we discuss these effects: some positive, others negative. On the whole, the net effect of proxy access is likely to be close to zero and surely is not high enough to get very excited about.

A. Costs

Dissident nominations generate costs. Faced with the possibility that a dissident nominee will get elected to a board, the company may campaign against the nominee. In doing so, the company will, in effect, spend shareholders' money.

As we have argued before, we do not believe that proxy access would generate a slew of nominees. However, given the low costs of making a nomination and the possibility of goals other than getting the nominee elected, nominations might be made even if the chances of success are highly remote. In fact, as discussed, we would expect that more serious dissidents would opt for a withhold campaign or a traditional proxy contest rather than for proxy access and that proxy access would predominantly be used by dissidents with low chances of success.

On the other hand, the marginal cost to the company of including the nominee and the supporting statement in its material is trivial. For dissident nominees who stand virtually no chance of getting elected, the company would not need to expend material resources in assuring their defeat. As it is, companies already incur some—although, we believe, lower—expenses to generate a high percent-

2011]

Insignificance of Proxy Access

1427

age of “for” votes or to defeat shareholder proposals. This being said, any increase in campaign expenses generated by proxy access would be a downside that has to be weighed against any benefits produced by proxy access and companies, being risk averse, may end up spending a lot more than needed to defeat a marginal shareholder nominee.

B. Unholy Alliance

A second potential downside of proxy access relates to the possibility of dissident nominations by shareholder groups who pursue interests that diverge from the interests of shareholders as a whole. *The Wall Street Journal*, for example, editorialized that proxy access will empower unions to threaten to run opposition candidates to extract political concessions, such as support for health care reform.²³¹ Other groups, such as public pension funds, social-issue oriented funds, hedge funds, and former insiders, may have divergent interests and may be tempted to use proxy access to advance their personal agendas. This is the “proxy access” equivalent of greenmail—and leaves shareholders worse off.

While there is a possibility that proxy access may be abused by some shareholder groups, we do not think that any abuse would be likely to have a serious impact. First, any single union or union-affiliated fund would very rarely own the requisite amount of stock to make nominations, and hedge funds would rarely satisfy the 3-year holding period requirement. Thus, these shareholders would have to assemble groups of like-minded investors and even then would not easily be able to satisfy the thresholds. The same would be true, albeit to a lesser degree, for public pension funds.

If these shareholders succeed in forming a group that meets the proxy access threshold requirements, they will have difficulty succeeding in extracting political concessions. As we argued above, the presence of, or even the suspicion of, divergent interests by the dissident makes it unlikely that nominees will succeed. Efforts to extract political concessions, or otherwise pursue personal interests, would be unlikely to stay secret for long. First, the company asked to make concessions would have a strong interest in revealing any request in order to discredit the dissident group. Second, if

²³¹ See Editorial, *Alinsky Wins at the SEC*, *Wall St. J.*, Aug. 30, 2010, at A14.

several shareholders must join the dissident group to satisfy the ownership threshold requirements, the likelihood of a leak from some member of the dissident group would increase. Third, the formation of a shareholder group would become public knowledge.²³² Once it becomes known that such a shareholder group was formed, that it threatened to make, but never did make, a proxy access nomination (or that it made one and withdrew it), and that around the same time the company changed its position on some matter of public policy or took some other action to benefit the special interests of these shareholders, then other market participants could deduce the link between these events. And once a shareholder has been publicly exposed, any future nominations by that shareholder would lack credibility.

Put differently, it is exactly because market participants would be attuned to the danger that some shareholders could abuse proxy access that it is unlikely that such abuse would result in more than sporadic harm.

C. Recalcitrant Companies

As we argued in Parts III and IV, we believe that withhold campaigns and traditional proxy contests are generally more effective ways for activists to achieve their goals than proxy access contests. Some companies, however, may lose a withhold campaign and still not mend their ways: the director at issue stays on the board and is re-nominated, and the board does not address the issue that prompted the high withhold vote or otherwise shape up. In these situations, the shareholders' only recourse will be to withhold their votes again or to start a traditional proxy contest. For these recalcitrant companies—which will overwhelmingly be micro-cap and small-cap companies—giving shareholders the additional option of proxy access may have some beneficial effects. Having snubbed shareholders once, the company stands an increased chance of losing in a proxy access contest. The case for the nominee is relatively simple and has some inherent appeal: the board ignored shareholder wishes expressed in a majority withhold vote and thus

²³² The knowledge will become public either because the attempt to form a group triggers filing requirements under Rules 14a-b(1) or (7) or because of the large number of persons who will become aware of the attempts to form a group.

2011]

Insignificance of Proxy Access

1429

stronger steps are needed. The threat of a specific board nominee generating such intense opposition from shareholders may induce the company to replace that nominee with a more acceptable candidate.

This being said, one should not overstate the resulting benefits of proxy access. First, the number of recalcitrant companies is small. For 2009, there were only 11 companies in the Russell 3000 in which one or more director received a majority withhold vote and the company failed to make a satisfactory response.

Second, for some recalcitrant companies, it may be difficult to satisfy the shareholder requirements for a proxy access nomination. The activist public pension funds and labor funds may not have sufficient shares, and mutual funds and other institutions may not be willing to make a nomination. Instead, it may be both easier and more promising to make a Rule 14a-8 proposal forcing these companies to adopt a majority standard for director election.

Third, it is not at all certain that recalcitrant companies would respond positively to the possible or actual election of a dissident director. Truly recalcitrant companies may just ignore the dissident director and push her to the sidelines by not putting her on any important board committee. Other companies may campaign heavily against the election of such a director.

Fourth, even if a minority of dissident directors were to be elected to the boards of some of these companies and succeeded in inducing some changes, it is unclear whether they will have major effects on company value. To be sure, such companies may make some actual or perceived improvements in their corporate governance such as destaggering the board, increasing the number of independent directors, or reducing excessive management compensation. But even to the extent that such changes are desirable, their effect on company value may be marginal.

As to changes that are likely to have a more significant impact on company value—such as agreeing to a hostile takeover offer, replacing management, substantially increasing payouts to shareholders, or making fundamental changes in operations or strategy—we doubt that a proxy access contest would be sufficient to induce them. Rather, for such changes, especially in recalcitrant companies, it takes a traditional proxy contest.

D. Emergence of New Activist

Another possibility is that proxy access would spur a new type of activism by a new type of activist. Maybe once proxy access is available, mutual funds and other large institutional holders who have credibility in the market place and are free of conflicts will finally use the power they have as large shareholders and come together to improve the way companies are run. Maybe proxy access would lead the Vanguards and Fidelities of the investment world to add respected and truly independent directors to the boards of their portfolio companies and to intervene quickly and aggressively when management fails. Maybe a group of professional independent directors would be assembled who are unaffiliated with dissident shareholders but have strong reputational reasons to act effectively as shareholder representatives and could easily be nominated by dissidents via proxy access. Maybe. But we think this is unlikely.

First, proxy access does not fundamentally change the corporate governance structure. Even without proxy access, mutual funds can sponsor shareholder resolutions, campaign for withhold votes, run an election contest, or ask a company and its nominating committee to place a certain person on the board. Many nominating committees will be perfectly happy to nominate a well-qualified and willing director candidate suggested by a Vanguard or Fidelity. Proxy access affords just one more option for activism. Though different from the existing options, we do not see why this option would induce activism by groups of shareholders who, in the past, have only become active in very limited circumstances where the activism had an immediate and material effect on the share price—such as pressuring boards not to block a hostile bid or to seek a higher price in a friendly merger.

Second, we do not think that most mutual funds are structured to become activists. Mutual funds largely compete on the basis of offering diversification, low expenses, and superior stock selection ability. They do not specialize in improving operations. Mutual funds like Third Avenue, which are more activist, behave like activist hedge funds: they identify companies with operational or strategic problems, take a significant equity stake, and then work to make improvements. But those mutual funds that specialize in

2011]

Insignificance of Proxy Access

1431

activism will, just like hedge funds, prefer to pursue more expensive routes which offer higher chances of success.

Third, mutual funds have been, and will remain, reluctant to put their own portfolio managers or other employees on the board of portfolio companies. Having such directors would arguably give the fund access to non-public information, which would greatly impede its ability to trade in the company's stock. Mutual funds, of course, could nominate an unaffiliated outsider to the board. But even if a competent outsider could be found, it is unclear how much difference her presence on the board would make. If the presence of the dissident nominee makes little difference, why even bother nominating one?

Finally, the notion that mutual funds would commence waging successful proxy access contests requires significant leaps of faith. As discussed in Part II, mutual funds led not a single traditional contest between 2005 and 2009. Moreover, hedge funds and individuals who have started contests would have had a much lower success rate had they used proxy access rather than traditional contests. The notion that mutual funds will now wage successful contests via proxy access requires one to believe that (i) mutual funds would have been highly successful in the past had they waged traditional contests (and will thus remain reasonably successful even if they wage proxy access contests); (ii) funds nevertheless did not wage any traditional contests because the costs outweighed the benefits for every single fund and every single portfolio company; and (iii) the small reduction in costs generated by proxy access will change this calculus even though proxy access contests entail a lower likelihood of success. We are skeptical that anyone seriously holds these views.

In sum, we are highly doubtful that proxy access would be the start of a new dawn in mutual fund activism. If proxy access does anything, it would be an additional, but largely ineffective weapon in the toolbox of those investors who were already engaged in activism before the passage of proxy access.

CONCLUSION

There is something seductive about "ballot access" for shareholders. After all, as Chancellor Allen noted over 20 years ago, "[t]he shareholder franchise is the ideological underpinning upon

which the legitimacy of directorial power rests.”²³³ Perhaps the ideological status of shareholder voting explains the vehemence of the battle over proxy access and has clouded the views of the partisans on both sides to the fact that proxy access would have minimal practical significance.

Any incremental reform to increase shareholder access to the corporate proxy must be evaluated against the backdrop of the existing structures and players in corporate governance. The impact of proxy access can only be understood in comparison to traditional proxy fights and other modes of shareholder involvement, including “just vote no” campaigns and shareholder proposals.

When one takes account of institutional detail, it becomes clear that, for multiple reasons, neither the proxy access rule adopted by the SEC nor any revised rule is likely to be important. Very few shareholders will qualify for proxy access. Of those who would qualify, the most important ones—mutual funds, private pension funds, and many public pension funds—have shown no taste for this type of activism. Even for those shareholders interested in activism, and even if shareholders not presently interested were to develop an interest, proxy access entails severe disadvantages. Thus, traditional proxy fights and other modes of shareholder involvement would often represent far better options for challenging incumbent management. Shareholders who *do* use proxy access would thus reveal themselves as busybodies, unserious about winning elections but all too happy to stir up publicity and controversy. What then, fellow shareholders may wonder, is their motivation? A union-affiliated fund may be seeking to advance labor interests. A social responsibility fund may be seeking publicity for its causes. Public pension funds may be pursuing political goals and publicity for board members who are elected officials or may be acting at the behest of union representatives on the fund’s board. The inherent strategic disadvantages of proxy access, coupled with these concerns, mean that the few initiated contests would likely fail. As long as companies understand this, the threat of using proxy access would not be an effective tool to extract concessions.

But ultimately, the insignificance of proxy access turns on a more fundamental issue. According to urban legend, the famous

²³³ *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 652, 659 (Del. Ch. 1988).

bank robber Willie Sutton, when asked why he was robbing banks, answered: “Because that’s where the money is.”²³⁴ Willie Sutton has a lot to teach to proponents of proxy access. Even if all the other problems of proxy access could be magically overcome, it would still have a limited impact for one simple reason: *the cost savings targeted by proxy access are not where the money is*. Director election contests involve complex issues, much more than shareholder proposals and withhold campaigns. The cost savings entailed by proxy access involve such a small part of the expenses it takes to wage a serious contest, and such a small fraction of the stake of any dissident who would be taken seriously, that it is implausible that they would generate large effects.

Shareholder activists who support proxy access are barking up the wrong tree if they think that a proxy access rule is a useful way to energize board governance. At best, it is symbolic politics in a world in which there are already easier, cheaper, and more effective measures such as targeted “withhold vote” campaigns.

A more serious means to invigorate shareholder voting would provide a mechanism to reimburse successful dissidents—and perhaps even those who gain high levels, but less than a majority of, shareholder support—for all or part of their reasonable *campaign expenses*. That’s where the money is. The recently enacted Section 113 of the Delaware General Corporate Law provides a roadmap for shareholders who want to adopt bylaws to provide for such reimbursement.²³⁵ Rather than waste their time and energy on proxy access, shareholder activists could have developed model bylaw provisions and pushed boards to adopt them. The SEC, in turn, could have taken the much less controversial step of revising its rules to make sure that such bylaw amendments could be introduced as Rule 14a-8 shareholder proposals without violating the various procedural limitations (such as the 500-word limit of such proposals). Reimbursement that is contingent on success, but that covers a much greater share of expenses than those avoided by proxy access, would encourage those shareholders who have a real shot yet hold the publicity seekers at bay. Whether such a rule

²³⁴ See generally, Willie Sutton, Wikipedia, http://en.wikipedia.org/wiki/Willie_Sutton (last visited Aug. 29, 2011).

²³⁵ Del. Code Ann. tit. 8, § 113 (Supp. 2010).

1434

Virginia Law Review

[Vol. 97:1347]

would improve corporate governance or increase the value of firms is beyond the scope of this Article, but at least such a rule could make a real difference in getting shareholder nominees elected to corporate boards.