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Introduction

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INTRODUCTION

CONFRONTING NEW MARKET REALITIES: IMPLICATIONS FOR STOCKHOLDER RIGHTS TO VOTE, SELL, AND SUE

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A defining characteristic of the corporation is its allocation of rights, responsibilities, and power among three groups—the board of directors, officers, and stockholders.[1] By statute, the board is tasked with managing the business and affairs of the corporation.[2] Recognizing that managing the day-to-day operations of a corporation is not always feasible for a board of directors, corporate law allows the board to delegate its authority and, most often, this authority is delegated to the officers.[3] In the typical public

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1. *See Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee on Delineation of Governance Roles and Responsibilities*, 65 BUS. LAW. 107, 111 (2009) ("The corporate form is defined by the way it distributes decision rights and responsibilities among shareholders, the board and management."); *see also* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 6-7 (Transaction Publishers 1991) (1932); Larry E. Ribstein, *Why Corporations?*, 1 BERKELEY BUS. L.J. 183, 196-98 (2004) (describing the corporate governance structure and decision-making hierarchy).

2. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2014) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . ."); MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR. ASS'N 2016) ("[A]ll corporate powers shall be exercised by or under the authority of the board . . . and the business and affairs of the corporation shall be managed by or under the direction . . . of its board of directors."); *see also* Kaplan v. Peat, Marwick, Mitchell & Co., 540 A.2d 726, 729 (Del. 1988) (stating that it is a "basic principal of [Delaware law] that the business and affairs of a corporation shall be managed by the board of directors").

3. *See* DEL. CODE ANN. tit. 8, §§ 141(a), 142(a); Grimes v. Donald, No. CIV.A.13358, 1995 WL 54441, at *8 (Del. Ch. Jan. 11, 1995) ("Of course, given the large, complex organizations through which modern, multi-function business corporations often operate, the law recognizes that corporate boards, comprised as they traditionally have been of persons dedicating less than all of their attention to that role, cannot themselves manage the operations of the firm, but may satisfy their obligations by thoughtfully appointing officers, establishing or approving goals and plans and monitoring performance. Thus section 141(a) of DGCL expressly permits a board of directors to delegate managerial duties to officers of the corporation, except to the extent that the corporation's certificate of incorporation or bylaws may limit or prohibit such a delegation." (citations omitted)), *aff'd*, 673 A.2d 1207 (Del. 1996); MODEL BUS. CORP. ACT §§ 8.01(b), 8.41. The board's ability to delegate to

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corporation, it is the officers who are given vast amounts of power and responsibility for running the business of the corporation.[4] In contrast to the board and officers, stockholders play a much more limited role in the management of the corporation. Stockholders are able to participate in corporate governance primarily through their rights to (1) vote, (2) sell, and (3) sue.[5] These rights may be used alone or in combination to influence corporate management and decision making, directly and indirectly.

The following excerpt provides a description of each of these stockholder governance rights:

> *1. Vote.* The shareholder franchise is a key part of corporate law, but that does not mean that shareholders vote on very many things. Most business decisions are left entirely to the board of directors or those to whom they delegate such authority. Shareholders participate only infrequently in a limited set of decisions, including the election of directors, fundamental corporate changes, and ratification.
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> *a. Election of directors.* Directors are usually elected annually, but this pattern can be varied by the corporation's articles of incorporation or other private ordering. Shareholders also have the power to remove directors in some circumstances.
>
> *b. Fundamental corporate changes.* Mergers and similar transactions require the approval of shareholders as well as directors and, thus, are an exception to the usual rule that leaves corporate decisions entirely in the hands of the directors. Of course, even here the directors act as gatekeepers: The shareholders can vote only on those transactions that are recommended to them by the directors.

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others is not, however, limited to just the officers of the corporation. *See Grimes*, 1995 WL 54441, at *8-9.

4. *See* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.10[B] (3d ed. 2014) (stating that "normally it is the officers to whom the primary functions of management are delegated"); Ribstein, *supra* note 1, at 188 ("[T]he corporate form of centralized management involves dividing management between professional full-time executives who manage the firm day-to-day and directors who oversee the board and set policy.").

5. *See* CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 157 (6th ed. 2010). Stated differently, "[a]ny action by [stockholders] relating to the details of the corporate business is necessarily in the form of an assent, request, or recommendation." Cont'l Sec. Co. v. Belmont, 206 N.Y. 7, 16-17 (1912).

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c. Ratification. Shareholders occasionally vote on the ratification of self-dealing transactions by interested directors. The vote can cleanse the transaction of any taint or shift the burden of proof in a legal challenge.

2. Sell. The ability to sell one's shares is a core right for shareholders and one that corporate law has, for the most part, left to the market. Appraisal—or dissenter's rights—is a rare exception where corporate law guarantees shareholders the right to sell their shares. Ordinarily, under corporate norms, a shareholder must obtain liquidity not from the corporation but from the market, if there is one. That is not to say that corporate law does not assume an important role for the ability to exit. Free transferability of shares and limited liability—both core characteristics of the corporate form—facilitate liquidity through the market. Many corporate rules take their specific shape because they exist in the shadow of a market for shares.

3. Sue. In addition to voting and selling, a shareholder's ability to sue serves as a constraint on the actions of managers and is a regular part of the governance matrix. Litigation rights of shareholders include derivative suits, direct suits and class actions, and inspection and other ancillary rights.

a. Derivative suits. In particular circumstances, such as breaches of fiduciary duty by those in control of the corporation, all states permit a shareholder to bring a suit in the name of, and on behalf of, the corporate entity. This type of suit is an exception to the usual rule that directors act for the corporation. It occurs when directors are disabled by conflict or are otherwise unable to meet their fiduciary duty. In response to the fear that a self-appointed shareholder would bring a "strike suit" to harass the corporation or its directors, various procedural rules developed to balance the potential for abuse against the monitoring value of such lawsuits.

b. Direct suits and class actions. Shareholders can also bring direct suits, which may be class actions if numerous shareholders are affected by common questions. In contrast to derivative suits, in which the loss to the shareholder is derivative of the harm to the collective enterprise, direct suits may be brought for an injury that the shareholder feels individually, such

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> as deprivation of a right to vote or a contract right. Such suits under state corporate law have increased in recent years. They may be based on fraud under state common law or on statutory remedies.
>
> *c. Inspection and other ancillary rights.* Shareholders also have ancillary rights at state law, such as the right to inspect the books and records of the corporation, including the list of shareholders. Such inspection may be the first salvo in a litigation battle, an effort to sell shares, or a voting campaign.[6]

The traditional portrayal of stockholders in the modern American public corporation has been one of geographically dispersed, small stakes, mom-and-pop holders.[7] Stockholders were largely passive individual investors, deferring to the decisions of corporate managers and relying heavily on market forces to serve as a check on management's power.[8] Accordingly, the problems of collective action and rational apathy among stockholder populations were central in corporate governance discussions.

Today, however, corporate commentators have observed a movement away from the traditional account of stockholders, in particular at public corporations. Professors Gilson and Gordon have observed that the distribution of shareholdings of U.S. public corporations has migrated from household ownership to largely institutional investors.[9] The emergence of institutional and activist stockholders has compensated for some of the problems identified with the traditional public corporation stockholder base (e.g., collective action, rational apathy). However, as Gilson and Gordon explain in their research, this shift presents its own set of unique

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6. Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, LAW & CONTEMP. PROBS., Summer 1999, at 215, 216-18 (footnotes omitted).

7. *See* BERLE & MEANS, *supra* note 1, at 6-7, 47-65; *see also* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 523-24 (1990) (describing the "passivity story" of stockholders in public corporations).

8. *See* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007); D. Gordon Smith, *The Role of Stockholders in the Modern American Corporation*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW (Claire A. Hill & Brett H. McDonnell eds., 2011).

9. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 863 (2013) ("Equity ownership in the United States no longer reflects the dispersed share ownership of the canonical Berle-Means firm."); *see also* Black, *supra* note 7, at 570-75 (describing in 1990 the beginning of changes in institutional equity ownership and stockholder activism).

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governance challenges.[10] In addition to the dramatic change in the composition of a public corporation's stockholder base, many new realities—technological advancements,[11] regulations providing for new ways to invest in corporations,[12] evolving transaction structures,[13] changing litigation strategies,[14] and amendments to federal securities laws,[15] to name

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10. Gilson & Gordon, *supra* note 9, at 889-902 (discussing the problems related to today's "agency capitalism"). Institutional investors in particular are well-suited to solve collective action problems:

> Institutional investors, because of their large ownership percentages, can overcome the problem of collective action in influencing corporate governance. Further, institutional investors tend to be more knowledgeable than individual stockholders and are less likely to be able to take advantage of selling their stock when they become frustrated with corporate management. This means that institutional stockholders tend to be better positioned and have more of an incentive to carry out the traditional role envisioned for stockholders — monitoring and enforcing board and officer conduct and engaging management in a conversation about how the corporation should be run. There are of course concerns that arise when you begin to talk about the role of institutional stockholders.

Megan W. Shaner, *The (Un)Enforcement of Corporate Officers' Duties*, 48 U.C. DAVIS L. REV. 271, 316 n.196 (2014) (internal citations omitted); *see also* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 862 (1992) (discussing institutional myopia); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1352-53 (1991) (stating that institutional investors will remain passive); Leo E. Strine, *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 689-90 (2005) (discussing the rise of institutional investors and stating that "we face a world in which stockholders of operating companies are both more active and more conflicted").

11. *See, e.g.*, Tom C.W. Lin, *Financial Weapons of War*, 100 MINN. L. REV. 1377 (2016).

12. *See, e.g.*, Joan MacLeod Heminway, *Business Lawyering in the Crowdfunding Era*, 3 AM. U. BUS. L. Rev. 149 (2012); Joan MacLeod Heminway, *What Is a Security in the Crowdfunding Era?*, 7 OHIO ST. ENTREPRENEURIAL BUS. L.J. 335 (2012); Andrew Schwartz, *The Digital Shareholder*, 100 MINN. L. REV. 609 (2015).

13. *See, e.g.*, Megan Wischmeier Shaner, *Deal Protection Devices: The Negotiation, Protection, and Enforcement of M&A Transactions*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 216 (Claire A. Hill & Steven Davidoff Solomon eds., 2016) (outlining the evolution of deal protection devices).

14. *See, e.g.*, Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U.L. REV. 1551 (2015) (discussing the increase in the appraisal action and impact on merger and acquisitions); Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133 (2004) (describing the decline in the use of derivative actions and the rise in the use of federal securities class actions and acquisition-oriented class actions); Matthew

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a few—have impacted the ability of stockholders to meaningfully participate in corporate governance. Similar to the shift in the composition of public corporations' stockholder bases from individual to institutional holders, these changes to the business and legal environment in which stockholders and their corporations operate pose new questions and challenges for corporate governance.

In this symposium issue, the authors use stockholders' rights to vote, sell, and sue as a platform for discussion of these new market realities for public corporations.[16] Professors Randall S. Thomas and Afra Afsharipour begin the issue by focusing on the right to vote. Professor Thomas and co-author Patrick C. Tricker explore the exercise and effectiveness of the stockholder franchise in two areas—the election of directors and approval of management proposals—and provide recommendations for further areas of investigation and research.[17] Meanwhile, Professor Afsharipour examines how stockholder approval intersects with the bidder overpayment problem in merger and acquisition transactions.[18]

Next, Professors James J. Park, Joan MacLeod Heminway, and Charles R. Korsmo focus on different aspects of a stockholder's right to sell his/her/its interest in the corporate enterprise. Professor Park analyzes how federal regulation of corporate governance can serve to counter limitations on the efficacy of stockholders' right to sell as a means of protecting

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D. Cain & Steven Davidoff Solomon, Takeover Litigation in 2015 (Preliminary Figures) (Jan. 14, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfmabstract_id=2715890 (observing changes in M&A litigation rates, multi-jurisdictional litigation, disclosure-only settlements, and enforcement of forum selection provisions); Alison Frankel, *How Corporations Can Game Their Own Forum Selection Clauses*, REUTERS: ANALYSIS & OPINION (Nov. 17, 2015), http://blogs.reuters.com/alison-frankel/2015/11/17/how-corporations-can-game-their-own-forum-selection-clauses/ (discussing a corporation's enforcement, or lack thereof, of its forum selection provisions as a litigation strategy).

15. *See, e.g.*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); *see also* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337 (2013).

16. In addition to the authors in this symposium issue, I would also like to thank Vice Chancellor J. Travis Laster, Dean D. Gordon Smith, and John Mark Zeberkiewicz for taking the time to participate in, and make insightful presentations at, the symposium.

17. Randall S. Thomas & Patrick C. Tricker, *Shareholder Voting in Proxy Contests for Corporate Control, Uncontested Director Elections and Management Proposals: A Review of the Empirical Literature*, 70 OKLA. L. REV. 9 (2017).

18. Afra Afsharipour, *Reevaluating Shareholder Voting Rights in M&A Transactions*, 70 OKLA. L. REV. 127 (2017).

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themselves from poor corporate governance.[19] Professor Heminway's article takes a closer look at the right to sell in the developing area of crowdfunded equity securities. In particular, she offers insight into how the transfer restrictions inherent in this type of investment affect stockholders' financial and governance rights.[20] Professor Korsmo then discusses how the right to sell has expanded from the classic view of selling one's shares of stock to include stockholders' ability to sell the legal claims attendant to their shares and the implications for combatting managerial opportunism.[21]

Finally, Professors Jessica M. Erickson and Sean J. Griffith examine the ability of stockholders to sue the corporation and its management. Professor Erickson looks at the initial stages of stockholder litigation, specifically the need for gatekeepers in stockholder litigation in order to maintain the right to sue as a tool to control managerial costs.[22] Further, she analyzes the need to tailor the use and type of gatekeeper to the particular type of stockholder litigation.[23] Addressing a later phase of stockholder litigation, Professor Griffith and co-author Anthony A. Rickey focus on the settlement of merger class actions. Pointing out how current formulations of the settlement process in merger class actions—in particular, the recent proliferation of disclosure settlements—undermine the right to sue in corporate governance, Griffith and Rickey offer insight into how stockholder objections to settlements can correct some of the shortcomings in the settlement approval process and reinvigorate the proceeding with a more adversarial posture.[24]

While individually the contributions to this issue focus on different areas of stockholders' governance rights, each article also highlights broader issues related to the changing dynamics surrounding public corporations. In particular, the articles in this issue raise important questions such as (1) whether a stockholder governance right functions differently today (for better or worse) than what corporate doctrine originally envisioned, (2) what are the emerging issues related to prominence of institutional

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19. James J. Park, *The Limits of the Right to Sell and the Rise of Federal Corporate Law*, 70 OKLA. L. REV. 159 (2017).

20. Joan MacLeod Heminway, *Selling Crowdfunded Equity: A New Frontier*, 70 OKLA. L. REV. 189 (2017).

21. Charles R. Korsmo, *Selling Stock and Selling Legal Claims: Alienability as a Constraint on Managerial Opportunism*, 70 OKLA. L. REV. 215 (2017).

22. Jessica Erickson, *The Gatekeepers of Shareholder Litigation*, 70 OKLA. L. REV. 237 (2017).

23. *Id.*

24. Sean J. Griffith & Anthony A. Rickey, *Objections to Disclosure Settlements: A How-To Guide*, 70 OKLA. L. REV. 281 (2017).

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stockholders, and (3) what areas of the law still need to adapt to new market realities. To that end, the articles in this issue serve as a reminder of the necessity for corporate governance structures to be continually reevaluated and refined to account for the ever-changing legal and economic conditions under which corporations operate.

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