

2017

# Shareholder Voting in Proxy Contests for Corporate Control, Uncontested Director Elections and Management Proposals

Randall Thomas

Patrick C. Tricker

Follow this and additional works at: <https://scholarship.law.vanderbilt.edu/faculty-publications>



Part of the [Law Commons](#)

---

## Recommended Citation

Randall Thomas and Patrick C. Tricker, *Shareholder Voting in Proxy Contests for Corporate Control, Uncontested Director Elections and Management Proposals*, 70 *Oklahoma Law Review*. 9 (2017)

Available at: <https://scholarship.law.vanderbilt.edu/faculty-publications/959>

This Article is brought to you for free and open access by the Faculty Scholarship at Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Law School Faculty Publications by an authorized administrator of Scholarship@Vanderbilt Law. For more information, please contact [mark.j.williams@vanderbilt.edu](mailto:mark.j.williams@vanderbilt.edu).

# HEINONLINE

Citation:

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)

Provided by:

Vanderbilt University Law School

Content downloaded/printed from [HeinOnline](#)

Wed Feb 14 11:56:31 2018

-- Your use of this HeinOnline PDF indicates your acceptance  
of HeinOnline's Terms and Conditions of the license  
agreement available at <http://heinonline.org/HOL/License>

-- The search text of this PDF is generated from  
uncorrected OCR text.

-- To obtain permission to use this article beyond the scope  
of your HeinOnline license, please use:

[Copyright Information](#)



Use QR Code reader to send PDF to  
your smartphone or tablet device

SHAREHOLDER VOTING IN PROXY CONTESTS FOR  
CORPORATE CONTROL, UNCONTESTED DIRECTOR  
ELECTIONS AND MANAGEMENT PROPOSALS:  
A REVIEW OF THE EMPIRICAL LITERATURE

RANDALL S. THOMAS\* & PATRICK C. TRICKER\*\*

*Table of Contents*

Introduction.....	11
I. Theory of Corporate Voting .....	12
II. Proxy Contests for Corporate Control.....	15
A. The Impact of Contested Elections of Directors on Shareholder Value .....	18
1. Dissident Stock Ownership .....	18
2. Corporate Performance Effect on Targeting .....	19
3. Prior Target Stock Returns .....	20
4. Value of the Vote Hypothesis .....	22
5. Effect of Poor Corporate Performance.....	23
6. Liquidity Effects.....	25
7. Stock Price Effects During a Proxy Contest .....	25
8. Proxy Contest or Tender Offer? .....	28
9. Longer Term Performance Effects .....	29
10. Management and Director Effects.....	32
11. Post-Success Earnings “Baths” .....	34
12. Impact on Cash Holdings .....	35
13. Corporate Governance Effects .....	37
14. Hedge Fund Activism and Proxy Contests for Control or Representation.....	38
15. Summary .....	39
B. Determinants of Control Contests’ Outcome.....	40
1. Do Incumbents Have Systemic Advantages?.....	40
2. Dissident Spending Impact.....	44
3. Effect of Cumulative Voting .....	44

---

\* John S. Beasley II Professor of Law and Business, Vanderbilt Law School; Professor of Management, Owen Graduate School of Management, Vanderbilt University.

\*\* Associate, Davis & Harman LLP, Washington, D.C.

We thank the participants of the *Oklahoma Law Review*’s 2016 symposium, “Confronting New Market Realities: Implications for Stockholder Rights to Vote, Sell, and Sue,” for their helpful comments on this article.

4. Voting Recommendations .....	45
5. Earnings Management and Disclosure .....	46
6. Summary .....	48
III. Uncontested Director Elections .....	49
A. Determinants of Uncontested Election Outcomes .....	50
1. Vote No Campaigns .....	50
2. Corporate Governance Effects .....	51
3. Bad Director Performance .....	52
4. Impact of Weak Internal Controls .....	52
5. Executive Compensation's Role .....	53
B. Key Players in Uncontested Elections .....	55
1. Labor Union Voting Patterns .....	55
2. Mutual Fund Voting .....	59
3. ISS Recommendation Effect .....	60
C. The Effects of Uncontested Elections .....	61
1. Effect of Weak Shareholder Support .....	61
2. CEO Turnover .....	62
3. Corporate Governance and Takeover Defenses .....	65
4. Shift to Majority Voting .....	68
5. Summary .....	69
IV. Management Proposals .....	71
A. In General .....	71
1. Bundling .....	72
2. Use of Proxy Solicitors .....	73
3. Mutual Fund Voting .....	74
4. Confidential Voting .....	76
B. Antitakeover Amendments .....	78
1. Stock Price Effects .....	78
2. Impact of Institutional Investor Holdings .....	80
3. Management Stock Holdings .....	83
4. Proxy Solicitors' Effect .....	84
5. Impact of Counter Solicitations .....	85
6. Summary .....	86
C. Voting on Mergers and Acquisitions .....	87
1. Approval of Acquisitions .....	87
2. Impact of Stock Returns .....	89
3. Advisor Opinions .....	92
4. Deal Structure .....	95
5. Effect of Institutional Investors .....	96
6. Summary .....	97
D. Auditor Ratification .....	98

1. Non-Audit Fees ..... 99

2. Auditor Tenure ..... 101

3. Negative Reports ..... 102

4. Restatement’s Impact ..... 103

5. Adverse Internal Control Reports..... 103

6. Auditor Characteristics..... 105

7. Insider Ownership and Audit Committee Effects ..... 105

8. Effect of Seeking Auditor Ratification..... 106

9. Summary ..... 107

E. Compensation Proposals and Say on Pay ..... 108

1. Voting Support for Compensation Proposals..... 108

2. Effect of Company Performance..... 109

3. Effect of Dilution ..... 112

4. Shareholder Composition and Corporate Governance Impact..... 113

5. Type of Compensation Plans Matters ..... 114

6. Impact on CEO Compensation..... 116

7. Impact of SEC 2003 Rules ..... 117

8. Mutual Fund Voting After 2003..... 118

9. Dodd-Frank’s Say-on-Pay Vote ..... 118

10. Proxy Advisor Impact on Say-on-Pay Vote..... 119

11. ISS Effect on Board Behavior..... 121

12. Effect of Additional Disclosures on Say-on-Pay Vote..... 121

13. Frequency of Say-on-Pay Vote ..... 123

14. Summary ..... 124

V. Conclusions..... 124

*Introduction*

It is a central tenet of American corporate law that the board of directors of a corporation is entitled to manage and direct the business and affairs of the company. Shareholders have distinctly more limited powers within the corporation: they can sell their shares, vote them where allowed, or sue the company and its management to enforce its officers and directors’ fiduciary duties.<sup>1</sup> While suing and selling are important topics worthy of scholarly attention, this article focuses on shareholder voting rights.

As a routine matter, shareholders vote on a significant number of issues. For example, statutory, state corporate law requires that they vote annually to elect all, or at least a significant portion, of the members of the board of

---

1. Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 L. & CONTEMP. PROBS. 215, 216-18 (1999).

directors. A second major area for shareholder voting pertains to management and directors proposals, such as votes to approve a merger or sale of all or substantially all of the assets of the corporation, or a proposed amendment to the corporate charter. In more limited circumstances, shareholders have the right to place proposals on the corporate ballot using Rule 14a-8 of the 1934 Exchange Act, as well as the right to initiate bylaw amendments that are consistent with state law limitations.

In this article, we conduct an extensive review of empirical studies concerned with the most important areas for shareholder voting: elections of directors and management proposals.<sup>2</sup> We seek to inform the reader about which topics have been well-studied and which areas still require further investigation. Part I examines the various theories that have been proposed to explain the existence of shareholder voting at corporations. Part II looks at the evidence surrounding proxy contests for corporate control and whether it serves to discipline management or just provide a target for opportunistic investors. Part III looks at uncontested director elections and whether they have a meaningful role in keeping management accountable to shareholders. Part IV examines management proposals to understand which proposals play a meaningful role in corporate governance. We conclude with a brief summary and recommendations for future lines of potential research.

### *I. Theory of Corporate Voting*

What are the theoretical justifications for giving the shareholders voting rights?<sup>3</sup> Easterbrook and Fischel advance one of the first formal analyses of this question.<sup>4</sup> In their highly influential book, *The Economic Structure of Corporate Law*, they characterize shareholders as “gap fillers” in the incomplete contract that is the corporation.<sup>5</sup> The shareholders hold the residual interest in the corporation, and therefore have “the appropriate incentive[] . . . to make discretionary decisions. . . . The shareholders

---

2. There is a related, recent survey that covers research on shareholder proposals and some other selected areas of shareholder voting. See Matthew R. Denes et al., *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405 (2017).

3. For a discussion on the theory of corporate voting, see Randall S. Thomas & Paul H. Edelman, *The Theory and Practice of Corporate Voting at U.S. Public Companies*, in RESEARCH HANDBOOK ON SHAREHOLDER POWER 459 (Jennifer G. Hill & Randall S. Thomas eds., 2015).

4. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 63-65 (1991).

5. See *id.* at 21-22.

receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise discretion.”<sup>6</sup> In other words, shareholders have the right to exercise discretion through their voting rights because they have the claim on the residual value of the firm. For practical reasons, they can choose to delegate those voting rights to the board of the corporation, but “managers exercise authority at the sufferance of investors.”<sup>7</sup> Easterbrook and Fischel’s theory is subject to a number of critiques, which one of the authors has explored elsewhere but will not be repeated here.<sup>8</sup>

A second theoretical argument justifying shareholder voting can be derived from Berle and Means’ observation that in the modern corporation, there is generally a separation of ownership and control.<sup>9</sup> Jensen and Meckling build on this point to argue that there is a principal-agent relationship between the shareholders of the corporation and the board of directors.<sup>10</sup> In any principal-agent relationship, the agent will be tempted to try to extract private benefits, while the principal will take actions to minimize these costs.<sup>11</sup> In the corporate setting, shareholders can engage in monitoring as well as adjusting the price they charge for capital.<sup>12</sup> Monitoring activities include shareholder voting, which shareholders will use if it is cost effective to do so.<sup>13</sup> This model has also been subjected to various criticisms.<sup>14</sup>

More recently, Edelman and Thomas have proposed an alternative justification for shareholder voting.<sup>15</sup> They note that shareholders are the only corporate stakeholders whose only certainty of obtaining returns on

---

6. *Id.* at 68.

7. *Id.* at 67.

8. Thomas & Edelman, *supra* note 3, at 460; *see also* Paul H. Edelman et al., *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1371-72 (2014) [hereinafter Edelman et al., *Shareholder Voting*].

9. ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 119-25 (1932).

10. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 308-09 (1976).

11. *Id.* at 309-10.

12. *Id.* at 312-13.

13. *See id.*

14. Thomas & Edelman, *supra* note 3, at 460-64. For one thing, there is little evidence that the law requires boards to act on the shareholder’s behalf. *See* Margaret M. Blair, *OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY* 214-23 (1995); *see also* Edelman et al., *Shareholder Voting*, *supra* note 8, at 1372-74.

15. Thomas & Edelman, *supra* note 3, at 462.

their investment is tied directly to stock price changes.<sup>16</sup> In other words, shareholders can only be sure of getting any return on their stock by selling it “at market price to realize a capital gain (or loss).”<sup>17</sup> The other forms of returns they may receive—dividends or other payments from the company—are not guaranteed but are subject to the board of directors’ discretion.<sup>18</sup> By contrast, the other corporate stakeholders generally know what their returns will be, such as interest payments to creditors, subject to the enterprise’s financial viability.<sup>19</sup>

If the corporation’s stock price is positively correlated with the residual value of the firm and stock markets are given sufficient information about a public firm’s value so that its residual value accurately reflects their share price, then shareholders are the single corporate stakeholders whose return depends on both the firm’s residual value and the stock market’s accurate functioning.<sup>20</sup> Hence, shareholders can use the vote “to ensure that the residual value of the firm is maximized” (which therefore maximizes stock price).<sup>21</sup>

For example, shareholders “use the monitoring function of the vote” to remove boards that fail in maximizing share price by removing them in proxy contests.<sup>22</sup> When management proposes a value-decreasing merger, shareholders may use the vote to reject it or to force the acquirer to make a better offer.<sup>23</sup> Less dramatically, hedge funds may use the vote as part of a campaign to gain representation on the corporation’s board of directors and place pressure on the board to realize the full value of the stock.<sup>24</sup> More generally, the vote provides shareholders with a method of monitoring the board to ensure it protects their interests.<sup>25</sup>

Assuming that one can establish the legitimacy of shareholder voting rights using one of these theories, historically shareholders have been reluctant to exercise the vote vigorously.<sup>26</sup> The explanation for this

---

16. *Id.*

17. *Id.*

18. *See id.* at 462-63.

19. *Id.* at 463.

20. *Id.*

21. *Id.*

22. *Id.* For an extensive discussion of the legal rules and regulations affecting proxy contests for corporate control, see RANDALL S. THOMAS & CATHERINE T. DIXON, ARANOW & EINHORN ON PROXY CONTESTS FOR CORPORATE CONTROL (3d ed. 1998).

23. *See* Thomas & Edelman, *supra* note 3, at 463.

24. *See id.*

25. *Id.*

26. *See id.* at 474-75.



behavior generally focuses on the costs of voting.<sup>27</sup> Shareholders individually bear all the costs of voting, such as gathering information, preparing solicitation materials, distributing those materials, and soliciting support; yet, their successes benefit all of the shareholders.<sup>28</sup> In other words, there is a collective action problem: how can individual shareholders be incentivized to actually engage in monitoring activities?<sup>29</sup> Of course, there are a variety of ways to reduce these costs, such as using third-party voting advisors or permitted electronic proxies.<sup>30</sup> But even reduced costs will only be incurred if the benefits of voting to the share price are likely to exceed them.<sup>31</sup>

In recent years, activist shareholders have been more willing to incur the costs of voting and seek to gain representation on, and even control of, corporate boards.<sup>32</sup> Their aggressive use of the vote has brought proxy contests and voting on management proposals, such as mergers and acquisitions, to the forefront.<sup>33</sup> New regulatory developments have spurred the growth of third-party voting advisors and mandatory voting by pension funds and other institutional investors.<sup>34</sup> These developments underscore the importance of understanding corporate voting today and highlight the need for a review of the academic literature concerning shareholder voting.

## II. Proxy Contests for Corporate Control

In 1950, the first activist shareholders succeeded in gaining board representation at a public company through a proxy contest.<sup>35</sup> It happened at the Sparks-Withington Company, a New York Stock Exchange listed company that manufactured radio and television parts.<sup>36</sup> A shareholder and accountant, John Smith, submitted a full slate of directors seeking to correct the company's poor profits, nonexistent dividend, and inefficient

---

27. *Id.* at 468, 472.

28. *Id.* at 468.

29. *Id.*

30. *Id.*; Jeffrey N. Gordon, *Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy*, 61 VAND. L. REV. 475, 475-76 (2008).

31. See Thomas & Edelman, *supra* note 3, at 469.

32. See Alon Brav et al., *Hedge Fund Activism, Corporate Governance and Firm Performance*, 63 J. FIN. 1729, 1730 (2008).

33. Edelman et al., *Shareholder Voting*, *supra* note 8, at 1408-13.

34. Thomas & Edelman, *supra* note 3, at 474-75.

35. Frank D. Emerson & Franklin C. Latcham, *Further Insight into More Effective Stockholder Participation: The Sparks-Withington Proxy Contest*, 60 YALE L.J. 429, 430, 432-33 (1953) [hereinafter Emerson & Latcham, *Further Insight*].

36. *Id.* at 431-32.

management.<sup>37</sup> The contest quickly turned into an all-out mudslinging battle.<sup>38</sup> In a proxy statement, Smith asked shareholders if they could live on a dime of dividends.<sup>39</sup> The company's directors responded by holding cocktail parties for shareholders and offered shareholders radio and television sets at reduced prices.<sup>40</sup> Each side shot accusations at the other.<sup>41</sup> Smith accused the directors of engaging in self-dealing with other companies owned by family members.<sup>42</sup> The directors accused Smith of acting only out of self-interest, and they claimed his aim was to replace the company's auditing firm with his own, Smith & Skutt.<sup>43</sup> Management used company funds to employ a proxy solicitation firm, Georgeson & Co.<sup>44</sup> Smith used his second-hand Beechcraft Bonanza airplane to travel across the Midwest and rally other shareholders.<sup>45</sup> When the dust settled, Smith's Protest Committee won control of the board of directors by a margin of 2% of shares.<sup>46</sup> It was the first successful challenge to a NYSE-listed company's incumbent management by a grass-roots shareholder committee.<sup>47</sup>

Proxy contests' importance declined when the tender offer, a faster mechanism for bringing about a change-of-control transaction, became more popular in the 1970s.<sup>48</sup> During this time, hostile bidders were able to overcome a variety of management defensive tactics to gain control of publicly traded U.S. firms.<sup>49</sup> The tender offer's popularity peaked in the late 1980s<sup>50</sup> and began a rapid decline in the wake of the Delaware Supreme Court's decision in the Time/Warner litigation.<sup>51</sup> Time/Warner and subsequent Delaware case law upheld target companies' "Just Say No"

---

37. *Id.* at 432.

38. *Id.* at 433.

39. *Id.* at 441. Specifically, Smith asked, "Can you live on a dime a year? In dividends, we mean." *Id.*

40. *Id.* at 438-39.

41. *Id.* at 441.

42. *Id.*

43. *See id.* at 432, 443.

44. *Id.* at 445.

45. Frank D. Emerson & Franklin C. Latcham, *Proxy Contests: A Study in Shareholder Sovereignty*, 41 CALIF. L. REV. 393, 397 (1953) [hereinafter Emerson & Latcham, *Shareholder Sovereignty*].

46. *See* Emerson & Latcham, *Further Insight*, *supra* note 35, at 451 n.93.

47. *Id.* at 429-30.

48. THOMAS & DIXON, *supra* note 22, § 1.01[B].

49. *Id.*

50. *Id.*

51. *See* *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1141 (Del. 1989).

defenses.<sup>52</sup> This pushed bidders to bring joint tender offers and proxy contests where they would offer to buy the company if the target firm's shareholders would vote to turn out the incumbent board and allow the bidder to redeem the target firm's poison pill.<sup>53</sup>

Since the early 2000s, an important new player has emerged in corporate voting: the activist hedge fund.<sup>54</sup> These investors typically purchase stakes of 5% to 10% of the target company's stock and then push to bring about changes in the firm. Their strategies often lead them to seek seats on the target firm's board of directors, either through a short slate proxy contest or by a negotiated agreement with the incumbent board.<sup>55</sup> They are the most frequent sponsors of proxy contests: during the period 2003–2012, they sponsored 70% of all such contests, most of which were non-control contests where activists seek to influence or replace existing management, rather than to run the company.<sup>56</sup> While hedge fund activists have been carefully studied in the empirical literature, few papers have focused on their involvement in corporate voting contests.

Part A below summarizes the existing body of empirical research on proxy contests for corporate control. This work largely analyzes contests that occurred before hedge fund activism became significant. The first thirteen subsections draw on these earlier studies, while the next subsection focuses on the newer research that examines hedge fund activism. The final subsection summarizes the overall results and gives an overview of their important points. Part B examines the determinants of the outcome in proxy contests for corporate control.

---

52. Eduardo Gallardo, *Poison Pills Revisited*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 18, 2010), <https://corpgov.law.harvard.edu/2010/02/18/poison-pills-revisited/#4> (“[C]ommentators have suggested that the current state of Delaware law allows a target board to “just say no” to an inadequately priced tender offer by enacting a shareholder rights plan, effectively stopping shareholders from tendering their shares at the board’s discretion.”).

53. See THOMAS & DIXON, *supra* note 22, § 1.01[B].

54. Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, in NEW FINANCIAL INSTRUMENTS AND INSTITUTIONS: OPPORTUNITIES AND POLICY CHALLENGES 101, 101 (Yasuyuki Fuchita & Robert E. Litan eds., 2007).

55. Vyacheslav Fos, *The Disciplinary Effects of Proxy Contests*, 63 MGMT. SCI. 655, 656 (2017).

56. *Id.*

*A. The Impact of Contested Elections of Directors on Shareholder Value*

Researchers have tried to distinguish between two competing theories on how the proxy contest fits within corporate governance.<sup>57</sup> The first theory views proxy contests as a mechanism of corporate governance that increases shareholder value by replacing or disciplining management.<sup>58</sup> The second theory views proxy contests as a destructive competition between business tycoons that wastes shareholder wealth.<sup>59</sup> Distinguishing between these theories requires investigating the identity and power of the dissidents challenging the management incumbents, the conditions that lead to proxy contests, and their impact on shareholders' wealth.<sup>60</sup>

*1. Dissident Stock Ownership*

Looking at proxy contests in the early 1950s, Emerson and Latcham discover that dissidents own on average between 7% and 8% of the target company.<sup>61</sup> These results suggest that dissidents are motivated by the success of the company, rather than the private benefits of control.<sup>62</sup> Instead of being surprise raiders, dissidents tend to be shareholders with a significant ownership stake in the company who only resort to proxy contests after other measures have failed.<sup>63</sup>

Additionally, DeAngelo and DeAngelo uncover that dissidents publicly announced their disagreement with the company policies prior to announcing the proxy contest in 71% of cases, while many of the other cases had private signs of dissident activity before the contest.<sup>64</sup> This

---

57. See, e.g., Peter Dodd & Jerold B. Warner, *On Corporate Governance: A Study of Proxy Contests*, 11 J. FIN. ECON. 401, 405-06 (1983).

58. *Id.* at 405.

59. *Id.* at 406 (citing Adolf A. Berle, *Modern Functions of the Corporate System*, 62 COLUM. L. REV. 433, 439 (1962)).

60. See *id.* at 406-07.

61. See Emerson & Latcham, *Shareholder Sovereignty*, *supra* note 45, at 412; Frank D. Emerson & Franklin C. Latcham, *Proxy Contests: Competition for Management Through Proxy Solicitation*, 8 SW. L.J. 403, 411 (1954).

62. See David Ikenberry & Josef Lakonishok, *Corporate Governance Through the Proxy Contest: Evidence and Implications*, 66 J. BUS. 405, 413 (1993).

63. Harry DeAngelo & Linda DeAngelo, *Proxy Contests and the Governance of Publicly Held Corporations*, 23 J. FIN. ECON. 29, 32 (1989).

64. See *id.* at 32, 33 tbl.1. The announcement of the proxy contest was the first public "sign of dissident activity" in only seventeen of the sixty cases that they studied. *Id.* at 32. Of the remaining seventeen, seven involved a formal insider of the firm, and seven had evidence of prior contact between the management and the dissidents before the proxy contest announcement. *Id.*

suggests that dissidents are not surprise raiders but rather shareholders with a vested interest in the firm who use the proxy contest as a last resort.<sup>65</sup> In DeAngelo and DeAngelo's analysis, the dissident leader had prior experience in the industry in half of the contests, with one-third having prior experience at the target firm.<sup>66</sup>

Along the same lines, Ikenberry and Lakonishok demonstrate that dissidents tend to have a substantial ownership stake in the firm, suggesting that they are looking after their own investment.<sup>67</sup> They determine that the median dissidents own 10.62% of the company, twice the ownership stake in the company as the median incumbent directors.<sup>68</sup> Similarly, Harris finds that the dissidents own on average 8.7% of the company, a slightly lower percentage of ownership than the mean incumbent group.<sup>69</sup>

## 2. Corporate Performance Effect on Targeting

Firms targeted for proxy contests consistently performed worse than similarly situated firms based on accounting measures.<sup>70</sup> DeAngelo shows there are negative median returns on equity in the three years leading up to when dissidents announce their dissatisfaction with firm governance.<sup>71</sup> In a similar vein, Mukherjee and Varela find proxy contest firms have significantly lower returns on equity than other firms in their industry in the two years leading up to the election.<sup>72</sup>

---

65. *See id.*

66. *See id.* at 36, 37 tbl.3. Of the sixty contests, dissidents in twenty-nine had prior experience in the industry, including ten at the target firm. *Id.*

67. Ikenberry & Lakonishok, *supra* note 62, at 413.

68. *See id.* at 413, 414 tbl.2A. They find that the median dissident group owns 10.62% of the company, while the median incumbent group owns 4.61%. *Id.* Similarly, they find mean dissident ownership of 13.58% and mean management ownership of 8.94%. *Id.*

69. Lee Harris, *The Politics of Shareholder Voting*, 86 N.Y.U. L. REV. 1761, 1796, 1797 tbl.2 (2011). Harris's sample includes 190 contested elections at publicly traded firms from 2006 to 2009. *Id.* at 1791-92. He finds that the mean dissident owns 8.7% of the target company, while the mean incumbent directors own 9.5% of the company. *Id.* at 1797 tbl.2.

70. *See* Linda Elizabeth DeAngelo, *Managerial Competition, Information Costs, and Corporate Governance: The Use of Accounting Performance Measures in Proxy Contests*, 10 J. ACCT. & ECON. 3, 12-14 (1988).

71. *Id.* She finds market-adjusted returns on equity for the three years leading up to the dissident activity of -4.3%, -4.4%, and -5.8%, respectively, each significant at the 1% level using a Wilcoxon signed-rank test. *Id.* at 13-14, 13 tbl.3.

72. Turun K. Mukherjee & Oscar Varela, *Corporate Operating Performance Around the Proxy Contest*, 20 J. BUS. FIN. & ACCT. 417, 419-20 (1993). They examine return on equity using the Du Pont system and the statistical tests used "include the *t*-test, the

Duvall and Austin's analysis shows that targeted firms have significantly lower returns on equity relative to the industry in the seven years leading up to a proxy contest.<sup>73</sup> In Austin's study he discovers that 35% of proxy contests are associated with deficiencies in operating performance, another 25% resulted from disagreements over corporate policy, while the remaining contests resulted from social factors such as personality conflicts.<sup>74</sup> In a like fashion, Ikenberry and Lakonishok find that proxy contest firms did significantly worse than comparable firms in their industry in net sales, operating income before depreciation, cash flow, and dividends in the five prior years.<sup>75</sup> In sum, dissidents tend to target underperforming firms, supporting the view that proxy contests are useful corporate governance tools.<sup>76</sup>

### 3. Prior Target Stock Returns

The studies that focus on the target's prior stock returns paint a more confusing picture.<sup>77</sup> Generally speaking, studies tend to observe weak evidence of target firm negative cumulative abnormal returns ("CAR") in the years leading up to the election.<sup>78</sup> For instance, Ikenberry and Lakonishok are unable to reject the null hypothesis that the target firm's CAR equals zero for the five years leading up to the proxy contest.<sup>79</sup> Dodd and Warner similarly find weak evidence of negative returns.<sup>80</sup>

---

Wilcoxon Matched-Pair Signed-Rank test and the Mann-Whitney test." *Id.* They found the difference significant at the 5% level. *Id.* at 420.

73. See Richard M. Duvall & Douglas V. Austin, *Predicting the Results of Proxy Contests*, 20 J. FIN. 464, 464-65 (1965). They find rates of returns on equity capital average a -5.7% difference during the seven years leading up to the proxy contest. *Id.* This was statistically different from their respective industries. *Id.* at 465.

74. See DOUGLAS V. AUSTIN, PROXY CONTESTS AND CORPORATE REFORM 20 tbl.3, 33 tbl.4, 39 tbl.5 (1965).

75. Ikenberry & Lakonishok, *supra* note 62, at 417. They found that net sales (-26.2%) and operating income before depreciation (-39.3%) were significantly different at the 1% level, while cash flow (-37.2%) and dividends (-32.6%) were significantly different at the 5% level. *Id.* at 419 tbl.4B. During the three years leading up to the proxy contest, they also found that net income before extraordinary items (-80.8%) was significantly different at the 5% level. *Id.*

76. See, e.g., *id.* at 417.

77. See, e.g., *id.* at 414.

78. See *id.* at 414-15.

79. See *id.* at 414. In their sample, they find a CAR of 4.7% for months -60 to -24 and -8.6% for months -23 to -6. *Id.*

80. Dodd & Warner, *supra* note 57, at 414.

Yet, an interesting pattern emerges when stock return variations are examined over time.<sup>81</sup> Ikenberry and Lakonishok see significant negative returns from two years to six months before the contest announcement, but then significant positive returns during the two months leading up to the announcement.<sup>82</sup> Similarly, Dodd and Warner show weak negative returns from two years to six months before the contest but significant positive stock returns during the last six months.<sup>83</sup> The reported positive returns just prior to the proxy contest may have resulted from the stock market getting wind of the approaching contest, since the extensive preparations required for a proxy contest can be difficult to keep secret.<sup>84</sup> Consistent with this interpretation, DeAngelo also uncovers significant positive stock returns in the six months leading up to the contest.<sup>85</sup>

Using a portfolio method to measure stock returns, Mukherjee similarly shows that the contest firms outperform the S&P 500 in the six to nine months leading up to the contest, depending on which test he uses.<sup>86</sup> These returns, however, level off in the last two to four weeks before the contest.<sup>87</sup> In other words, the stock market may have fully priced the coming proxy contest weeks before it is even announced.<sup>88</sup>

Discordantly, Austin finds three trends in the period leading up to a contest, showing that about a third of firms' stock increases in value, a third

---

81. *See id.* at 418-19.

82. Ikenberry & Lakonishok, *supra* note 62, at 414-15 tbls.2 & 3. The negative returns in the two-years-to-six-months period are not statistically significant until they adjust for size and beta. *Id.* The positive returns in the two months before the announcement are statistically significant at the 5% level. *Id.* However, for Ikenberry and Lakonishok, the abnormal returns become negative after they adjust for size and beta. *Id.* at 415.

83. Dodd & Warner, *supra* note 57, at 414-15 tbl.2. Looking at univariate statistics in the months 60 to 24 before the contest, they find a cumulative residual of 0.054 with a z-statistic of 1.42. *Id.* at 414. In months 23 to 6 before the contest, Dodd and Warner find a mean cumulative residual of -0.087 with a z-statistic of -1.01. *Id.* Finally, "the mean cumulative residual for months -5 through 0 is 0.054, with a z-statistic of 2.72." *Id.* at 415.

84. *Id.* at 423-25.

85. DeAngelo, *supra* note 70, at 16. DeAngelo finds a mean cumulative prediction error of 6.6% for the five months before the contests ( $z = 2.60$ ) and 9.7% for the two months before the contest ( $z = 4.52$ ). *Id.*

86. See Tarun K. Mukherjee, *Stock Price Behavior Surrounding Proxy Fights for Control: A Non-Parametric Approach*, 21 REV. BUS. & ECON. RES. 85, 93 (1985). The sign test finds higher returns from six months to four weeks prior to the contest announcement, significant at the 5% level. *Id.* at 93, 94 tbl.2. The Wilcoxon test finds higher returns from nine months to one week before the contest announcement, significant at the 5% level. *Id.* at 93, 96 tbl.4.

87. *See id.* at 93.

88. *See id.*

decreases in value, and a third does not significantly change.<sup>89</sup> He suggests that the increases may be due to dissidents buying additional stock to gain more voting power before the contest.<sup>90</sup>

Finally, Mulherin and Poulsen find significantly positive stock returns from twenty days before the announcement until five days afterwards.<sup>91</sup> Summarizing, the bulk of these results suggest that proxy contests generally target firms with underperforming stock, but that this effect becomes obscured by the perceived benefits of the coming proxy contest.<sup>92</sup>

#### 4. Value of the Vote Hypothesis

Dodd and Warner propose an alternative theory, called the “value of the vote hypothesis,” attributing the increasing stock price to the value of each share’s vote leading up to the record date.<sup>93</sup> This hypothesis suggests that the price of the stock should decrease after the record date because only the record holder has the right to vote in the proxy contest.<sup>94</sup> As expected, Dodd and Warner find significant negative returns between the contest announcement and outcome, which usually encompasses the post-record date period.<sup>95</sup> To test this theory, they separate the sample between contests where the announcement occurs before and after the record date.<sup>96</sup> They find some evidence that stock prices drop more in contests with the record date after the announcement than in contests with the record date before the announcement.<sup>97</sup> This difference, however, does not fully explain the drop in price between the announcement and outcome.<sup>98</sup>

---

89. See AUSTIN, *supra* note 74, at 49-50, 50 tbl.6.

90. *Id.* at 49-50.

91. J. Harold Mulherin & Annette B. Poulsen, *Proxy Contests and Corporate Change: Implications for Shareholder Wealth*, 47 J. FIN. ECON. 279, 292-93, 292 tbl.4 (1998). Between twenty days before the contest announcement until five days afterwards, they find cumulative abnormal return of 8.04%, with a z-statistic of 10.7. *Id.* at 292 tbl.4.

92. See, e.g., Ikenberry & Lakonishok, *supra* note 62, at 414-15.

93. See Dodd & Warner, *supra* note 57, at 425-31.

94. See *id.* at 428-29.

95. *Id.* at 424-25. For the entire sample between these announcement and outcome, they find a mean cumulative residual of -0.043 ( $z = -2.63$ ), with only 32% of the sample having positive cumulative residuals. *Id.* at 425. “[W]here dissidents win a majority,” the “mean cumulative residual” is -0.053 ( $z = -1.71$ ). *Id.* “[W]here dissidents fail to win a majority,” the “mean cumulative residual” is -0.056 ( $z = -2.14$ ). *Id.* It appears that they did not design the study with the value of the vote hypothesis in mind and decided to improvise after they saw the unexpected results. See *id.*

96. See *id.* at 429.

97. *Id.* at 429-31. For the forty-two contests with data available and record dates after announcement dates, they find a mean residual for the day after the record date of -0.014



Mukherjee also shows that the company's stock loses value during the contest period relative to the S&P 500.<sup>99</sup> However, when he separates the sample between dissidents winning and losing, only dissident losses exhibit significantly worse returns between the announcement and outcome of the contest.<sup>100</sup>

Ghosh et al. further assess the value of the vote hypothesis.<sup>101</sup> They discover more pronounced positive abnormal returns leading up to a proxy contest for board control than with an issue proxy contest.<sup>102</sup> They fail to find statistically significant differences in the lead up to board control contests with the record date before and after the contest announcement and with and without cumulative voting.<sup>103</sup> They do, however, uncover significant negative returns following the record date of a proxy contest and larger negative abnormal returns for contests with cumulative voting than those without it.<sup>104</sup> They argue that this provides some support for the value of the vote hypothesis.<sup>105</sup> Overall, the value of the vote hypothesis appears to have significant support but cannot fully explain the pattern of stock prices during the proxy contest.<sup>106</sup>

#### 5. Effect of Poor Corporate Performance

Unsurprisingly, dissidents have a better chance of winning a proxy contest at poorly performing companies.<sup>107</sup> Duvall and Austin show that firms where dissidents succeeded in gaining control had significantly lower average rates of return on equity than firms where dissidents failed.<sup>108</sup>

---

( $z = -3.02$ ). *Id.* at 429-30. However, for contests with record dates before the announcement dates, they find an insignificant mean residual of -0.0003 ( $z = -0.49$ ). *Id.* at 430-31.

98. *Id.* at 431.

99. *See* Mukherjee, *supra* note 86, at 97.

100. *See id.*

101. Chinmoy Ghosh et al., *Proxy Contests: A Re-examination of the Value of the Vote Hypothesis*, 18 *MANAGERIAL FIN.* 3, 4 (1992).

102. *Id.* at 8.

103. *Id.* at 8-9. They expect that cumulative voting would have a more pronounced value of the vote effect because the dissidents need less votes to gain board representation. *Id.* at 5-6.

104. *Id.* at 10. The difference for cumulative and non-cumulative voting was significant at the 1% level. *Id.* at 15 tbl.5 (Panel A).

105. *Id.* at 11.

106. *See, e.g.* Dodd & Warner, *supra* note 57, at 429-31.

107. *See, e.g.*, Duvall & Austin, *supra* note 73, at 465-67.

108. *Id.* at 466. In their sample, forty-five contests were for control. *Id.* Of these, fifteen contests resulted in dissident victory, where the firms average rates of return relative to industry of -12%. *Id.* at 466, 466 tbl.2. At the thirty firms where dissidents lost, the firm had

Interestingly, representation contests where dissidents gained board seats had slightly higher rates of return on equity compared to firms where they failed to get any seats.<sup>109</sup> Using a multiple regression model, Duvall and Austin learn that dissidents are more likely to gain control at firms with lower returns on equity relative to industry and lower profit margins relative to industry.<sup>110</sup>

Similarly, Hancock and Mougoué show that return on equity, dividend payout, earnings per share, and price earnings ratio negatively correlate with dissidents' odds of victory.<sup>111</sup> Mukherjee and Varela find that successful contests had significantly lower returns on equity than an industry control group in the three years leading up to the contest, while unsuccessful contests had significantly lower returns on equity only in the year before the contest.<sup>112</sup>

Harris shows that there is a significant difference in the average stock returns during the five years preceding this contest where dissidents win and lose.<sup>113</sup> Yet, he fails to find a significant correlation with one-year or five-year stock returns and dissidents' chances of victory.<sup>114</sup> It seems based on these studies that shareholders are more willing to vote for new management when the company is performing poorly.<sup>115</sup>

---

average rates of return relative to industry of -4.8%. *Id.* Using a sum of squares test, they find these differences to be statistically significant at the .06 level. *Id.* at 467.

109. *Id.* at 467. For representation contests, they find rates of return to be slightly higher where the dissident was elected (-0.5%) compared to where he wasn't (-3.6%), but the difference wasn't statistically significant. *Id.*

110. *Id.* at 470-71.

111. G.D. Hancock & M. Mougoué, *The Impact of Financial Factors on Proxy Contest Outcomes*, 18 J. BUS. FIN. & ACCT. 541, 546-47 (1991) (computing statistical significance at the 5% level). They were unable to find a statistically significant correlation between dissidents' odds of victory and return on assets, average excess return, beta, degree of financial leverage, and the degree of operating leverage. *Id.*

112. Mukherjee & Varela, *supra* note 72, at 421, 422 tbl.1, 423 tbl.2 (computing statistical significance at the 10% level).

113. Harris, *supra* note 69, at 1797-99, 1799 tbl.3. He found average five years stock returns leading up to the contest of -10.4% where dissidents won and 4.77% where dissidents lost, significantly different at the 5% level with a *t*-test and at the 1% level with a Wilcoxon Mann-Whitney test. *Id.* at 1799 tbl.3.

114. *See id.* at 1799-800.

115. *See, e.g.,* Duvall & Austin, *supra* note 73, at 465-66.

### 6. Liquidity Effects

Liquidity facilitates the occurrence of a proxy contest.<sup>116</sup> Fos finds that proxy contests occur more often at companies with liquid stock.<sup>117</sup> Liquidity makes the proxy contest easier because dissidents can buy large blocks of stock without increasing the stock price.<sup>118</sup> Norli et al. find that stock liquidity facilitates shareholder activism.<sup>119</sup> They determine that liquidity positively correlates with instances of shareholder activism, including both proxy contests and shareholder proposals.<sup>120</sup> Using an interaction term between liquidity and past performance, Norli et al. discover that the probability of shareholder activism is more sensitive to past performance when the company has higher liquidity.<sup>121</sup> They further find that the liquidity negatively relates to the abnormal returns in the three days around the announcement of shareholder activism.<sup>122</sup> Since the market will price in the probability of shareholder activism, this shows that the market believes that shareholder activism is more likely at companies with more liquid stock.<sup>123</sup> They believe that liquidity facilitates shareholder activism by making it easier for dissidents to buy shares.<sup>124</sup>

### 7. Stock Price Effects During a Proxy Contest

Dodd and Warner show that the target company's stock price generally increases during the proxy contest, suggesting a potential increase in future value.<sup>125</sup> They uncover positive stock returns from approximately sixty days

---

116. Fos, *supra* note 55, at 655.

117. *Id.* at 656, 664-65 (using the Amihud illiquidity measure). For an in-depth analysis regarding the Amihud model of market illiquidity, see Yakov Amihud, *Illiquidity and Stock Returns: Cross-Section and Time-Series Effects*, 5 J. FIN. MARKETS 31 (2002).

118. Fos, *supra* note 55, at 656.

119. Øyvind Norli et al., *Liquidity and Shareholder Activism*, 28 REV. FIN. STUD. 486, 503 (2015) (using the Amihud trade impact measure). The authors define shareholder activism to include both proxy contests and shareholder proposals. *Id.* at 491-92. Their final sample identified 385 instances of shareholder activism between 1994 and 2007. *Id.* at 487.

120. *See id.* at 502-03. They use a probit regression with the probability of shareholder activism as the dependent variable and liquidity as an independent variable, yielding a positive relationship significant at the 1% level. *See id.*

121. *Id.* at 503. The interaction variable yields a negative coefficient that is statistically significant at the 1% level. *See id.*

122. *See id.* at 498-99, 498 fig.2. They find a coefficient of -0.105, which is statistically significant at the 1% level. *Id.*

123. *See id.* at 502-03.

124. *Id.* at 511, 515.

125. *See, e.g.,* Dodd & Warner, *supra* note 57, at 416. These results are different from the results relating to the value of the vote hypothesis because they include both the pre-contest

before the contest announcement up until the outcome.<sup>126</sup> Surprisingly, their results do not vary greatly depending on who ends up winning the proxy contest.<sup>127</sup> However, when examining the stock returns immediately surrounding the outcome of the contest, they find positive returns for dissident victories and negative returns for dissident defeats.<sup>128</sup>

Somewhat along the same lines, Borstadt and Zwirlein find positive abnormal returns in the period surrounding the proxy contest.<sup>129</sup> DeAngelo and DeAngelo also discover overall increases in stock value through the course of the proxy contest.<sup>130</sup> These returns, however, disappear when the forty days leading up to the contest are removed, which supports the notion that the stock market prices the value of the contest before it even begins.<sup>131</sup>

Alexander et al. find gains in stock value through the course of the contest.<sup>132</sup> Looking at the resolution of the contest, they report significant

---

period and the stock market reaction to the results of the contest. *See supra* notes 93-105 and accompanying text.

126. Dodd & Warner, *supra* note 57, at 416. Defined as the fifty-nine days before the announcement and going to when the election outcome results are announced, they find that the mean cumulative residual is 0.082, with a z-statistic of 2.78, and a median cumulative residual of 0.079. *Id.*

127. *Id.* For the period of fifty-nine days before the announcement up until the election outcomes are announced, they find a mean cumulative residual of 0.082 ( $z = 1.89$ ) for contests where dissidents win no seats, 0.081 ( $z = 2.05$ ) for contests where dissidents win at least one seat, and 0.128 ( $z = 1.43$ ) for contests where dissidents win a majority. *Id.*

128. *Id.* at 418. For the two-day period prior to and including the announcement, they find a mean cumulative residual of 0.011 ( $z = 2.38$ ) for contests where dissidents win at least one seat and -0.014 ( $z = -1.67$ ) for contests when dissidents win no seats. *See id.* They note that “[t]he relatively small size” of these returns indicates that the good and bad news from the contests has already been anticipated by the market. *Id.*

129. Lisa F. Borstadt & Thomas J. Zwirlein, *The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance*, 21 FIN. MGMT. 22, 28 (1992). They find an average abnormal return of 11.4% ( $z = 5.83$ ) during the proxy contest, defined as sixty days before the announcement until the contest resolution. *Id.*

130. DeAngelo & DeAngelo, *supra* note 63, at 40. From forty days before the initiation through the election, they find average abnormal stockholder wealth increases of 6.02% ( $z = 4.32$ ). *Id.*

131. *See id.* When the forty days before the initiation are taken out of the sample, they find negative but insignificant returns, with -12.47% ( $z = -0.77$ ) from initiation of dissident activity to the outcome and -6.32% ( $z = -1.14$ ) from contest announcement to outcome. *Id.* “These returns become significantly negative under the market-adjusted returns approach . . .” *Id.*

132. *See* Cindy R. Alexander et al., *Interim News and the Role of Proxy Voting Advice*, 23 REV. FIN. STUD. 4419, 4431, 4436 (2010) (using a sample of 255 proxy contests occurring between 1992 and 2005). For the period of twenty-five days before the proxy

positive returns for a dissident victory and insignificant negative returns for a management victory.<sup>133</sup> On balance, these studies support the claim that investors appear to view proxy contests positively regardless of who wins, although the announcement of dissident victories gains a more enthusiastic reaction.<sup>134</sup>

The stock gains associated with proxy contests may result from their link to takeovers of the company, which typically occur at a price per share that is significantly above the current market price.<sup>135</sup> When DeAngelo and DeAngelo break down the full period between contest outcomes, they find significant positive stock returns only for contests where dissidents gain some seats but not a majority.<sup>136</sup> Their data appear to indicate that the increased target firm value results from the sale or liquidation of the company, which mostly occurs where dissidents gain some but not a majority of seats.<sup>137</sup> Looking at the two days surrounding the contest outcome, they find that dissidents withdrawing from the contest results in significantly negative stock returns, further supporting their earlier mentioned conclusion.<sup>138</sup>

Mulherin and Poulsen also show that most of the stock price returns created by proxy contests actually result from takeovers.<sup>139</sup> Looking at proxy contests accompanied by a takeover bid, they find that firms that

---

contest filing date until the resolution of the contest, they find a CAR of 17.26%, significant at the 1% level. *Id.* at 4435 tbl.2, 4436. Even for contest won by management there is a positive CAR of 19.24%, significant at the 1% level. *Id.* at 4435 tbl.2.

133. *Id.* at 4436. In the days surrounding the completion of the contest, they find a CAR of 2.02% (*t*-statistic = 2.89) for dissident victory and a CAR of -1.07% (*t*-statistic = -1.56) for the management victory. *Id.*

134. *See, e.g.,* Dodd & Warner, *supra* note 57, at 416.

135. *See, e.g.,* DeAngelo & DeAngelo, *supra* note 63, at 44-45.

136. *See id.* at 41-43. Between forty days before the start of dissident activity up until the contest outcome, they find that contests resulting in some but not a majority seats had shareholder returns averaging 30.12% ( $z = 4.77$ ). *Id.* at 41 tbl.4.

137. *See id.* at 43-44. They count only those firms that have a sale or liquidation as resulting from the contest where the financial press reports a link. *See id.* They find fifteen contests result in sale or liquidation of the firm, of which seven had dissidents winning some but not a majority of seats. *Id.* at 44. Those fifteen contests saw wealth gains of 15.16% ( $z = 4.21$ ) for the full period of dissident activity. *Id.* The remaining sample had shareholder gains of 2.90% ( $z = 2.54$ ). *Id.* at 44-45.

138. *See id.* at 42. Overall where the dissidents gain no seats, they find shareholder losses of -5.45% ( $z = -7.56$ ) in the two days surrounding the contest outcome. *Id.* For the seven contests that ended with shareholder elections, they find insignificant outcomes of -1.73% ( $z = -1.51$ ). *Id.* For the sixteen contests that ended with dissidents withdrawing, they find stockholder returns of -7.19% ( $z = -8.13$ ). *Id.*

139. *See* Mulherin & Poulsen, *supra* note 91, at 308-09.

experience successful takeovers have significantly higher stock returns than firms with unsuccessful takeover bids.<sup>140</sup> Similarly, looking at contests without a takeover bid where dissidents obtain seats, they find that contests that result in the turnover of top management have significantly higher stock returns during the proxy contest and in the year following the proxy contest than contests without management turnover.<sup>141</sup> They further show that a turnover in top management and a restructuring of the company are not independent events, supporting the generalization that successful turnarounds require new management.<sup>142</sup> Mulherin and Poulsen conclude that much of the value created by proxy contests comes from either the acquisition of the company or the turnover of top management.<sup>143</sup> In sum, these papers suggest that the market benefits of proxy contests may have more to do with their role in company takeovers than their impact on corporate governance.<sup>144</sup>

#### 8. Proxy Contest or Tender Offer?

To view the issue from another angle, one could ask why someone would try to use a proxy contest rather than a tender offer to gain control of a company.<sup>145</sup> Sridharan and Reinganum find that proxy contest targets tend to be significantly more leveraged than tender-offer targets.<sup>146</sup> They have greater degrees of management control than tender-offer targets<sup>147</sup> and tend

---

140. *See id.* at 299. For firms with an unsuccessful takeover bid, they find insignificant abnormal returns from twenty days before the announcement up until the resolution and significantly abnormal returns of -23.7% ( $z = -4.18$ ) for the year after the resolution. *Id.* at 299, 299 tbl.7 (Panel A). For firms with successful takeover bids, they find positive abnormal returns of 20.1% ( $z = 9.49$ ) from twenty days before the announcement until the resolution and positive abnormal returns of 12.4% ( $z = 1.83$ ) in the year after the resolution. *Id.*

141. *Id.* at 301 tbl.7, 302 (noting  $t$ -statistics of 2.46 and 1.09 respectively).

142. *Id.* at 305, 307, 307 tbl.10 (Panel A) (resulting in a  $p$ -value of 0.000).

143. *Id.* at 303-05.

144. *See, e.g.,* DeAngelo & DeAngelo, *supra* note 63, at 51-52.

145. *See* Uma V. Sridharan & Marc R. Reinganum, *Determinants of the Choice of the Hostile Takeover Mechanism: An Empirical Analysis of Tender Offers and Proxy Contests*, 24 FIN. MGMT. 57, 57-59 (1995).

146. *Id.* at 62, 66. They find that the mean leverage ratio is 0.31 for proxy contest targets and 0.24 for tender offer targets, which is statistically significant at the 5% level. *See id.* at 62.

147. *Id.* Non-insiders hold larger blocks of shares greater than 5% in "tender offer targets (17.1%) than for proxy contest targets (12.9%)." *Id.* "[T]he average fraction of shares held by" outside directors is higher for "tender offers (5.32%) than for proxy contest targets

to be less profitable than tender-offer targets.<sup>148</sup> Interestingly, proxy contests and tender offers target firms with a similar proportion of staggered boards.<sup>149</sup> Using a logistic regression, they find that the dissident's decision to use a proxy contest is significantly positively related to the ratio of inside directors and the level of leverage and negatively related to the percentage of shares held in greater than 5% blocks.<sup>150</sup> More profitable firms are more likely to attract a tender offer.<sup>151</sup> These results, however, must be viewed with caution because the authors limit their sample of proxy contests to those linked to a takeover attempt.<sup>152</sup>

### 9. Longer Term Performance Effects

Mulherin and Poulsen offer evidence that shows proxy contest targets continue to underperform the stock market in the years after the contest, especially where dissidents win control.<sup>153</sup> They report nearly significant negative CARs in the year following the proxy contest.<sup>154</sup> By contrast, Mukherjee finds that these firms outperform the market for six to eight weeks after the contest.<sup>155</sup> However, when he separates his sample between contests where the dissidents succeed and those where they fail, he finds that dissident failures significantly outperform the market for four weeks, while dissident successes did not have a statistically distinguishable

---

(2.32%).” *Id.* Tender offer targets have fewer insiders sitting on the board (29.6%) than proxy contest targets (37.27%). *Id.*

148. *Id.* They find an ROA of 2.58% for proxy contest targets and 5.76% for tender offer targets, significantly different at the 1% level. *Id.* They find similar results with an “economy-wide adjusted ROA.” *Id.*

149. *Id.* They find that 28% of proxy contests have staggered boards compared to 26% of tender offers. *Id.*

150. *Id.* at 63-65 (noting statistical significance at the 5%, 10%, and 5% levels respectively). They are unable to find a relationship between staggered boards, changes in leverage, or the fraction of shares held by outside directors. *See id.* at 62-63.

151. *Id.* at 65. They find that adjusted ROA positively correlates with using a tender offer, significant at the 1% level. *Id.* Cumulative excess return is also positive but only marginally significant. *Id.*

152. *See id.* at 59-60. They include proxy contests that don't seek a majority of board seats because they still seek some degree of control and because eliminating them would shrink their small sample. *Id.* at 59.

153. *See, e.g.,* Mulherin & Poulsen, *supra* note 91, at 302-03.

154. *Id.* at 293. In the year after the proxy contest, they find CARs of -3.43% ( $z = -1.93$ ), falling just short of statistical significance at the 5% level. *Id.* at 292 tbl.4 (Panel A), 293. However, there is a downward bias because they do not include firms that are acquired just after the proxy contest. *Id.* at 294.

155. *See* Mukherjee, *supra* note 86, at 98 tbl.5, 99 tbl.6, 100 (noting statistical significance at the 5% level with both the Sign Test and Wilcoxon Test).

performance.<sup>156</sup> In sum, at least in the short term, the market appears to favor dissident failures when the proxy contest results are released.<sup>157</sup>

Ikenberry and Lakonishok determine that firms have negative stock returns in the twenty months after the resolution of the proxy contest.<sup>158</sup> When separated by outcome, they find that dissidents gaining some, or a majority of, seats is associated with significantly negative abnormal returns.<sup>159</sup> Where management keeps all of their seats, they observe only insignificant negative returns.<sup>160</sup> However, when they expand their analysis to examine the period four and a half years after the contest, all statistically significant results disappear.<sup>161</sup> This may indicate that dissidents run the company poorly, at least in their first twenty months on the board.<sup>162</sup> The market may also be correcting for over-optimism during the dissidents' initial victory.<sup>163</sup>

Ikenberry and Lakonishok further find that about a quarter of the negative returns occur in the day before and after an earnings report,<sup>164</sup> which indicates that information in the earnings report (and therefore, the performance of the company) caused the disappointing stock returns.<sup>165</sup> Finally, Ikenberry and Lakonishok show that in contests where dissidents gain at least one seat, companies without management turnover perform substantially worse than companies with management turnover.<sup>166</sup> In contrast, Borstadt and Zwirlein fail to find any abnormal returns in the three years after the proxy contest, which might suggest that the proxy contest has moved the company back on track.<sup>167</sup> Overall, in the short term, dissident victories are associated with poorer stock performance, while in the long run the two groups appear to be indistinguishable.<sup>168</sup>

---

156. *See id.* at 100.

157. *Id.* at 101.

158. *See* Ikenberry & Lakonishok, *supra* note 62, at 420-21, 420 tbl.5 (noting significance at the 5% level). They find a CAR of -17.24% for the period for five months to two years after the contest. *Id.*

159. *See id.* (noting significance at the 1% level).

160. *See id.*

161. *Id.*

162. *See id.* at 421, 423.

163. *Id.* at 433.

164. *See id.* at 422.

165. *Id.*

166. *See id.* at 424 (finding an insignificant result of -20.3% between months five and twenty-four for proxy contest with dissident victories and management turnover, compared to the CAR of -40.1% for dissident victories without management turnover).

167. *See* Borstadt & Zwirlein, *supra* note 129, at 28-29.

168. *See, e.g.,* Ikenberry & Lakonishok, *supra* note 62, at 421-23.



The target company's future operating performance reflects a similarly bleak picture.<sup>169</sup> Ikenberry and Lakonishok demonstrate that firms with dissident victories have significantly worse net sales, operating income before depreciation, cash flow, and dividends compared to industry peers, while firms with management victories are statistically indistinguishable from their industry peers.<sup>170</sup>

Mukherjee and Varela find that contest firms had worse performance in the three years following the proxy contest, as measured by return on equity, compared to an industry control group, particularly in the third year where the difference was statistically different at the 5% level.<sup>171</sup> When they divide the groups between dissident successes and failures, they find that the target firms with dissident successes had significantly lower rates of return on equity compared to a control group in the year after the contest, while dissident failures had lower rates of return on equity in years two and three after the contest.<sup>172</sup>

Austin observes that in his sample of proxy contests about a third of targeted firms failed or were taken over within three years.<sup>173</sup> This occurred twice as often after representation contests as contests for control.<sup>174</sup> He suggests that the tensions of a divided board may be too great for a company to withstand.<sup>175</sup> Of those that survived, about an equal number are doing better as are doing worse.<sup>176</sup>

The poor operating results of target firms where dissidents win a proxy contest may indicate that shareholders fail to vote rationally in the proxy contests.<sup>177</sup> The results may also be due to self-selection problems where

---

169. *See id.* at 427, 430.

170. *See id.* at 427, 428-29 tbl.9. For contests resulting in some dissident victory, they find over the subsequent five years negative net sales (-31.6%, at a 5% significance), operating income before depreciation (-79.2%, at a 5% significance), cash flow (-99.1%, at a 10% significance), and dividends (-72.5%, at a 1% significance). *Id.* at 428-29 tbl.9. Interestingly, these results become less statistically significant when dissidents win a majority of the board seats. *Id.* at 427.

171. Mukherjee & Varela, *supra* note 72, at 420-21. The authors defined return on equity as income before extraordinary items divided by total equity. *Id.* at 419.

172. *Id.* at 421 (each significant at the 5% level).

173. *See* AUSTIN, *supra* note 74, at 54-55.

174. *See id.*

175. *See id.* at 55.

176. *See id.* at 59-61.

177. *See* Ikenberry & Lakonishok, *supra* note 62, at 433-34.

dissidents win at the worst performing firms that are simply beyond saving.<sup>178</sup>

#### 10. Management and Director Effects

Proxy contests facilitate the turnover in management, even where dissidents fail to gain any seats.<sup>179</sup> DeAngelo and DeAngelo find that less than a fifth of the sample firms retain “the same incumbent management team” three years after the proxy contest.<sup>180</sup> Even where the dissidents did not win a majority of seats, about half of these firms experienced turnovers in top management, with three-quarters of these turnovers linked directly to the proxy contest.<sup>181</sup> They interpret this as support for the view that proxy contests are mechanisms to discipline management of a company even where they do not succeed.<sup>182</sup> Along those lines, Faleye finds that the likelihood of a forced executive turnover increases from 9.18% before the contest to 22.45% after the contest.<sup>183</sup>

Borstadt and Zwirlein learn that two-thirds of firms have a change in at least one top-level executive or board member in the three years after the proxy contest.<sup>184</sup> Using very recent data, Fos and Tsoutsoura find that only 43% of directors retain their board seats three years after the contest.<sup>185</sup> Their regression results show that 27% to 39% of directors will lose their seats as a result of the proxy contest.<sup>186</sup>

Ikenberry and Lakonishok show that top management turnover helps curb the negative stock returns after the contest.<sup>187</sup> In the year and a half

178. *See id.*

179. *See, e.g.,* DeAngelo & DeAngelo, *supra* note 63, at 50-51.

180. *Id.*

181. *Id.* at 46. Of the thirty-nine firms that did not experience a change of control, twenty experienced the resignation of a top manager within three years, of which fifteen resignations can be linked to the proxy contest. *Id.* at 46, 49. DeAngelo and DeAngelo used detailed case studies to establish a link. *See id.* at 46.

182. *Id.* at 50-52.

183. Olubunmi Faleye, *Cash and Corporate Control*, 59 J. FIN. 2041, 2056 (2004) (noting significance at the 1% level).

184. *See* Borstadt & Zwirlein, *supra* note 129, at 27. “A complete change in control occurred in 70 firms,” while thirty-one firms saw an external replacement of at least one “top-level executive or board position[.]” *Id.*

185. Vyacheslav Fos & Margarita Tsoutsoura, *Shareholder Democracy in Play: Career Consequences of Proxy Contests*, 114 J. FIN. ECON. 316, 321 (2014).

186. *Id.* at 322 tbl.4 (Panel B), 323 (noting significance at the 1% level).

187. *See* Ikenberry & Lakonishok, *supra* note 62, at 424-25, 427. They find management turnover in 24% of the cases where dissidents gain no seats, and turnover in 58% of cases where “dissidents gain at least one seat.” *Id.* at 424.

after a contest where dissidents gain at least one seat, they find significantly negative stock returns where there is no management turnover, but insignificant returns where there is a management turnover.<sup>188</sup> This is consistent with the claim that proxy contests help corporate governance by facilitating the turnover in top management.<sup>189</sup>

Proxy contests also hurt a director's tenure at other companies.<sup>190</sup> Using data from recent proxy contests, Fos and Tsoutsoura find that directors of target firms have on average 2.2 seats leading up to the contest, which drops to 1.8 seats five years later.<sup>191</sup> Using regression analysis, they claim that directors are likely to lose seats after a proxy contest.<sup>192</sup> Their regression predicts that a targeted director will lose in total 1.7 directorships, including those at the targeted company and other companies, leading to lost income of \$2.9 million over twelve years.<sup>193</sup> The authors take advantage of the presence of staggered boards to show that these results are caused by the proxy contest rather than the director's position at a poorly performing firm.<sup>194</sup> Looking at companies with staggered boards, they compare the future career paths of those directors that were standing for election at the time of the proxy contest ("nominated") directors with other directors on the board that were in board classes not being voted on ("non-nominated") directors.<sup>195</sup> Their analysis shows that nominated directors lose significantly more seats at other firms than non-nominated directors.<sup>196</sup>

---

188. *See id.* at 424. Where dissidents win one seat but don't cause a management turnover, they find a CAR of -40.1% ( $t = -2.74$ ) for the five to twenty-four months after the initiation of the contest. *Id.* Where dissidents gain at least one seat and cause a turnover in management, they find a CAR of -20.3% ( $t = -1.54$ ) for the same time period. *Id.*

189. *See, e.g., id.* at 424-25, 427.

190. *See* Fos & Tsoutsoura, *supra* note **Error! Bookmark not defined.**, at 333-35.

191. *See id.* at 324, 324 fig.2.

192. *Id.* at 325, 325 tbl.6 (noting significance at the 1% level).

193. *Id.* at 326. For being targeted with a proxy contest, a director can expect to lose 0.55 directorships at the targeted firm and 1.15 directorships at other firms. *Id.* They arrive at the compensation figures by starting with the fact that an average "director has 12 years until retirement . . . and is paid \$0.144 million per year." *Id.*

194. *See id.* at 327.

195. *Id.*

196. *Id.* at 328, 329 tbl.10 (noting significance at the 5% level). A regression shows that "nominated directors are expected to lose 0.67 directorships" in other companies, while non-nominated directors should lose 0.44 directorships, leaving nominated directors with a 60% higher career cost. *Id.* at 328.

They next investigate whether media coverage or the fact of being voted off the board attributes to the difference.<sup>197</sup> Both nominated and non-nominated directors have a higher chance of being covered by the media after a proxy contest,<sup>198</sup> but “nominated directors receive more media coverage than non-nominated directors.”<sup>199</sup> They next check if nominated directors who lose the proxy contest are more likely to lose seats on other boards than nominated directors who keep their seats.<sup>200</sup> As expected, they find that directors who lose their seats are more likely to lose seats on other boards as well.<sup>201</sup> Interestingly, independent directors appear to receive a bigger hit to their reputation and can expect to lose more board seats than inside directors.<sup>202</sup> Overall, this evidence supports the view that proxy contests impose significant career costs on incumbent directors.<sup>203</sup> These career costs likely act as a major incentive for directors to run the company properly and avoid proxy fights.

### *11. Post-Success Earnings “Baths”*

If dissidents win a proxy contest, they tend to take an earnings “bath” after they take control in order to make the firm appear less profitable, presumably because they know they can blame outgoing management and position themselves to make the company appear more profitable later on.<sup>204</sup> DeAngelo finds that more than half of the target firms with dissident victories reduced earnings through “discretionary non-cash writeoffs” in the year after the contest.<sup>205</sup> She detects insignificant unexpected earnings, significantly negative unexpected accruals, and significantly positive

---

197. *See id.* at 329.

198. *Id.* at 330 (noting significance at the 1% level). They find that “[t]he probability of being covered by the media increases from 28% before the proxy-contest announcement date to 37% after the proxy-contest announcement date.” *Id.*

199. *Id.* (noting significance at the 1% level). They find that a nominated director has a 40% probability of being covered in the news, while a non-nominated director has only a 31% probability of being covered in the news. *Id.*

200. *See id.* at 332.

201. *Id.* at 332, 332 tbl.13 (noting significance at the 10% level).

202. *Id.* at 333-34 (noting significance at the 1% level). Their regression suggests that an independent director will lose 0.21 more seats than an inside director. *Id.*

203. *See id.* at 334.

204. *See* Daniel W. Collins & Linda DeAngelo, *Accounting Information and Corporate Governance: Market and Analyst Reactions to Earnings of Firms Engaged in Proxy Contests*, 13 J. ACCT. & ECON. 213, 226 (1990).

205. DeAngelo, *supra* note 70, at 30. She finds that twelve of the twenty-two firms with dissident victories had writeoffs in the year after the proxy contest, while two more had writeoffs the following year. *Id.*

unexpected cash flows.<sup>206</sup> These results indicate that firms experiencing a control change typically experience an immediate increase in firm profitability but that this is not reflected in reported profitability, most likely because new management manage their earnings by taking a “bath.”<sup>207</sup>

Collins and DeAngelo find significantly negative unexpected accruals for firms where dissidents gain control, which are significantly lower than firms with unsuccessful contests and pre-contest unexpected accruals.<sup>208</sup> They also report significantly lower analysts’ earnings-forecast errors for successful contests compared to unsuccessful contests.<sup>209</sup> They examine the post-contest annual reports for the successful proxy contests and are able to find unusual income items for 95% of the companies.<sup>210</sup> Of these firms, 80% “report unusual items that are negative in the aggregate.”<sup>211</sup> This evidence suggests that new management takes an earnings “bath” to make the firm appear more profitable in the future.<sup>212</sup>

### 12. Impact on Cash Holdings

Proxy contests may help to reduce excess cash within corporations.<sup>213</sup> Management has a self-interested tendency to maintain high levels of cash within the corporation, even to the detriment of shareholders.<sup>214</sup> Paying out the excess liquidity as a dividend would reduce the resources under their control, restrict their ability to pursue corporate growth, and force them to raise funds to finance future projects.<sup>215</sup> As expected, Faleye finds that targets of proxy contests have significantly higher cash-to-asset ratios

---

206. *Id.* at 32-33. She finds a mean unexpected accrual of -0.0477 and a mean unexpected cash flow of 0.0241. *Id.* at 32 tbl.11.

207. *See id.* at 32-34.

208. *See* Collins & DeAngelo, *supra* note 204, at 226. For the successful contests, they find mean unexpected accruals of -2.78% and median unexpected accruals of -3.29%, which are different from zero at the 0.0265 and 0.0167 levels respectively and different from unsuccessful contests at the 0.0169 and 0.0300 levels respectively. *Id.* at 226-27.

209. *Id.* at 227-28. They find significantly lower analysts’ earnings forecast errors for successful contests compared to unsuccessful contests, with the mean significantly different at the 0.064 level and the median significantly different at the 0.0216 level. *Id.* at 228.

210. *Id.* at 228-29, 229 tbl.4.

211. *Id.* at 229. They find that “total unusual items comprise a negative 65.3% of reported income,” with a median of -96.2% “after a successful proxy contest.” *Id.* at 230.

212. *See id.* at 230, 232.

213. *See* Faleye, *supra* note 183, at 2041.

214. *Id.* at 2042-43 (citing Michael C. Jensen, *The Agency Cost of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323, 323-29 (1986)).

215. *Id.* at 2042.

compared to a control sample.<sup>216</sup> Also, contest targets have a mean and median excess cash that is significantly different from zero, while the control sample did not.<sup>217</sup> Faleye confirms that excess cash positively relates to being targeted in a proxy contest.<sup>218</sup> Excess cash also positively relates to abnormal stock price returns in the three-day period surrounding the announcement of the proxy contest.<sup>219</sup> This correlation suggests that investors view proxy contests as effective mechanisms to curb excess cash problems.<sup>220</sup>

Faleye discovers that, in the year after the proxy contest, companies experience a significant drop in their average cash ratio and average excess cash.<sup>221</sup> Money distributed to shareholders increases from \$5.9 million on average in the year before the contest to \$55.4 million in the year after.<sup>222</sup> Where dissidents campaigned on excess cash retention issues, targeted firms were significantly more likely to make a special cash distribution.<sup>223</sup>

Similarly, Hancock and Mougoué find that a dissident victory is negatively associated with the price-to-earnings ratio and dividend-payout ratio.<sup>224</sup> They also find that management success is significantly positively correlated with the dividend-payout ratio.<sup>225</sup> It appears that corporate directors use dividends to appease shareholders after a proxy contest.<sup>226</sup>

---

216. *Id.* at 2048. The cash-to-asset ratio of contest firms are a mean of 12.82% and a median of 8.56%, compared to 10.39% and 5.79% respectively for control firms, significant at the 10% and 1% levels. *Id.*

217. *Id.* at 2049 (showing a significant difference from zero at the 1% level). He finds a 0.0722 mean and 0.0367 median excess cash for target firms. *Id.*

218. *See id.* at 2049. The relationship is significant at the 5% level. *Id.* at 2050 tbl.2. The regression also controls for management ownership, outside block ownership, and market-adjusted returns. *Id.*

219. *Id.* at 2052 (noting a significance less than the 1% level).

220. *See id.*

221. *Id.* The average cash ratio falls from 12.82% to 9.15% between the start and finish of the contest, having a statistically significant difference at the 5% level. *Id.* The average excess cash goes down from 0.0722 to 0.0351, significant at the 1% level. *Id.*

222. *Id.* at 2054 (showing a significant difference at the 5% level).

223. *Id.* at 2058. Dissidents mentioned cash issues at fourteen firms, while the remaining eighty-four did not. *Id.* Where cash issues were raised in the campaign, 57.14% of firms made special cash distributions, compared to 13.01% in the campaigns without cash issues, significantly different at the 1% level. *Id.*

224. Hancock & Mougoué, *supra* note 111, at 548 tbl.4, 549 (showing significance at the 5% level).

225. *Id.* (showing significance at the 5% level).

226. *Id.* at 549.

Overall, it appears that proxy contests help to control excess cash within a company and prompt management to pay dividends to shareholders.<sup>227</sup>

### 13. Corporate Governance Effects

In principle, the mere threat of a proxy contest may positively impact corporate governance.<sup>228</sup> To assess this theory, Fos examines the effect that an increased probability of being targeted in a proxy contest has on corporate governance.<sup>229</sup> He does this by establishing a number of factors that make a proxy contest likely and then, using those factors, predicting the probability that a company will have a proxy contest in a given year.<sup>230</sup> He finds that companies that have an increased probability of a proxy contest are likely to have higher leverage, lower R&D, and lower capital expenditures.<sup>231</sup> He concludes that the threat of a proxy contest is sufficient to impact and assist corporate governance.<sup>232</sup> He also repeats his analysis to understand when these disciplinary effects take place.<sup>233</sup> His results show that targeted companies increase leverage, spend less on R&D, decrease capital expenditures, and increase dividend payouts in anticipation of, or in

---

227. Faley, *supra* note 183, at 2059.

228. *See* Fos, *supra* note 55, at 656. Fos's sample includes 1061 proxy contests that occur between 1994 and 2012. *Id.* at 657.

229. *See id.* at 656.

230. *See id.* at 664. He constructs a probit regression with the occurrence of a proxy contest as the dependent variable. *Id.* He finds that proxy contests are more likely to occur at firms that have a low market valuation, poor stock performance, higher institutional ownership, lower market capitalization, and higher liquidity. *Id.* Each of these factors had a statistically significant relationship at the 1% level, except for institutional ownership, which was statistically significant at the 5% level. *Id.* He constructs seven multiple regressions, with the occurrence of a proxy contest as the dependent variable. *See id.* at 664-65. All seven have variables for liquidity, market value, sales, institutional ownership, and book to market ratio. *See id.* Additionally, each has a corporate policy: leverage, cash, and dividends. *See id.* at 664-68. He then uses the equation produced by each respective regression to create a probability of a proxy contest for a given company in a given year. *Id.* He uses the respective probability as an independent variable in each of seven multiple regressions with each of the corporate policies as dependent variables. *See id.*

231. *Id.* at 669 (showing significance at the 1% level). He did not find a statistically significant relationship between the probability of receiving a proxy contest and cash holdings. *Id.*

232. *Id.* He demonstrates that correlation is due to causation by proving the identification assumption, which is that stock liquidity satisfies the exclusion restriction, and thus showing that his results are not endogenous. *Id.* at 668-69.

233. *Id.*

trying to avoid, a proxy contest.<sup>234</sup> He fails to find any correlation between changes in policy and the post-contest years.<sup>235</sup> He concludes that the threat of a proxy contest accounts for a significant part of its effect on corporate governance.<sup>236</sup>

#### *14. Hedge Fund Activism and Proxy Contests for Control or Representation*

Hedge funds have shaken up the U.S. corporate governance scene since the early 2000s by pushing for changes at targeted companies such as sales, restructurings, higher dividend payments, and changes to corporate management. Hedge funds frequently take substantial positions in targeted companies' stock, between 5% and 10%, and then begin lobbying for change.<sup>237</sup> Their activism "is backed up—implicitly or explicitly—by the threat of a proxy contest for corporate control."<sup>238</sup> Fos and Tsoutsoura find that hedge fund activism has caused an increase in the number of proxy contests.<sup>239</sup>

In another paper, Fos reports data on the number of control contests versus short slate contests: during the period 1994–2012, there were 199 control contests, but 708 contests involved short-slate contests to some extent.<sup>240</sup> He notes that in the same years, hedge funds sponsored 602 contested proxy contests of all sorts (control contests, short-slate contests, and issue contests), or approximately 57% of all such fights.<sup>241</sup> The hedge funds' sponsorship of proxy contests greatly increased in the latter part of this time period (2003–2012) so that they sponsored 70% of total proxy fights during that interval.<sup>242</sup> Fos suggests that hedge funds prefer non-control contests, such as running a short slate of candidates, because they seek to change the management of a firm, not to manage the firm

---

234. *Id.* He finds that the dummy variable for having a proxy contest within a year positively correlates with leverage (10% significance) and dividend payouts (5% significance) and negatively correlates with R&D spending (5% significance), capital expenditures (10% significance), and CEO compensation (5% significance). *Id.* at 668 tbl.8.

235. *Id.*

236. *See id.*

237. *See* Brav et al., *supra* note 32, at 1730-31.

238. Partnoy & Thomas, *supra* note 54, at 131.

239. Fos & Tsoutsoura, *supra* note 185, at 317.

240. Fos, *supra* note 55, at 660 tbl.2.

241. *Id.* at 660 tbl.3.

242. *Id.* The number of proxy contests sponsored by hedge funds increased by 170% in the 2003 to 2012 period compared to the 1994 to 2002 period, a difference that is statistically significant at the 1% level. *See id.*



themselves.<sup>243</sup> Fos also finds that the market has a more positive reaction to the announcement of a contest sponsored by hedge funds compared to other types of sponsors.<sup>244</sup> However, this difference in the firm's cumulative abnormal returns disappears eight months after the announcement, suggesting that hedge funds are no better at increasing a firm's value through proxy contests than other sponsors.<sup>245</sup>

There has been relatively little other academic research on hedge funds' use of proxy contests in elections of directors. We found one other study where the researchers separately identified hedge fund director contests and compared them with proxy contests brought by other types of activist investors.<sup>246</sup> However, the leading scholar in the area concludes that hedge fund-sponsored director election proxy contests are largely for representation or influence on the board of directors.<sup>247</sup> He argues that 81% of proxy contests are "non-control contests," so that "the current corporate governance environment therefore resembles the 'market for corporate influence' and not the 'market for corporate control.'"<sup>248</sup>

### 15. Summary

Proxy contests appear to function as a productive corporate governance mechanism, but a lot of questions and uncertainty still surround their utility. They provide many benefits to the corporation, including facilitating a change in management, reducing unnecessary liquidity, and prompting the payout of dividends.<sup>249</sup> The threat of a proxy contest alone may be sufficient to bring about these results.<sup>250</sup> The stock market appears to confirm the advantages of proxy contests and can even price the benefits of the contest before it begins.<sup>251</sup> The dissidents also have significant stakes in the targeted company and commence the contest usually after failed

---

243. *See id.* at 660.

244. *See id.* at 662.

245. *See id.*

246. The closest thing we found related to hedge fund sponsorship of contested shareholder proposals. Bonnie G. Buchanan et al., *Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and United Kingdom*, 49 AM. BUS. L.J. 739, 779-80 tbl.10 (2012). They found that hedge funds and private equity firms sponsored about 45% of U.S. contested proposals, held on average 8.9% of the targeted firm's stock, and spent on average more than \$400,000 on their solicitation costs. *Id.*

247. *See Fos, supra* note 55, at 660-64.

248. *Id.* at 660 & tbl.2.

249. *See supra* Sections II.A.10, II.A.12.

250. *See supra* Section II.A.13.

251. *See supra* Sections II.A.6, II.A.8.

negotiations, characteristics not normally associated with raiders.<sup>252</sup> The companies targeted in the contest also tend to be underperforming the market and generally in need of better management.<sup>253</sup>

Still other evidence raises doubts about the effectiveness of proxy contests and newly elected dissidents to help poorly performing corporations.<sup>254</sup> The stock gains associated with proxy contests may result from their impact on the likelihood of a corporate takeover.<sup>255</sup> Companies with dissident victories tend to have poor stock returns and weak operating performance after the proxy contest.<sup>256</sup> In these cases, it is possible that these companies were beyond saving to begin with, or perhaps the newly elected dissidents face a steep learning curve before they can move the company back on track.<sup>257</sup>

Hedge fund activism has been understudied with little academic research examining the differences between proxy contests brought by hedge funds and those initiated by other activist investors. Hedge funds, however, do appear to be the primary proponents of contested proxy solicitations and to have brought more short slate contests than control contests.<sup>258</sup>

#### *B. Determinants of Control Contests' Outcome*

##### *1. Do Incumbents Have Systemic Advantages?*

Another line of inquiry asks whether proxy contests go far enough in providing a fair opportunity for the challenging dissidents to gain control of the corporation.<sup>259</sup> Studies tend to show that incumbent directors have a significant advantage in winning proxy contests, due to a number of factors such as inefficiencies in the proxy system, the presence of blockholders, trust issues for stockholders, the stock's liquidity, and the ability of directors to manage earnings.<sup>260</sup> On the surface, studies find that challengers succeed in obtaining control of the firm in a quarter to a third of

---

252. See *supra* Section II.A.1.

253. See *supra* Sections II.A.2-4.

254. See *supra* Section II.A.9.

255. See *supra* notes 135-144 and accompanying text.

256. See *supra* Section II.A.9.

257. See *supra* Section II.A.9.

258. Fos, *supra* note 55, at 660 tbls. 2 & 3.

259. See, e.g., John Pound, *Proxy Contests and the Efficiency of Shareholder Oversight*, 20 J. FIN. ECON. 237, 258-59 (1988).

260. See, e.g., *id.* at 258-60.

proxy contests.<sup>261</sup> Such evidence suggests that incumbents have an advantage in proxy contests, but it fails to take into account the quality of the challenging candidates.<sup>262</sup> Researchers ask whether the proxy contest presents a fair fight in control over a firm and what factors advantage one side or the other.<sup>263</sup>

Director elections appear to favor the incumbent directors even where the dissidents would be as good or better candidates to run the company.<sup>264</sup> Listokin developed a novel and rather clever way to show that incumbent directors have a structural advantage in proxy contests.<sup>265</sup> He views a shareholder vote as a mechanism of information aggregation analogous to how the stock market aggregates information to determine value, but through different processes and with different results.<sup>266</sup> He runs a regression to see how the stock market reacts to dissident and management victories as the voting outcome gets closer and closer to a tied election.<sup>267</sup> Theoretically, a close vote implies that shareholders view the incumbents and dissidents as equally capable of running the company.<sup>268</sup> If the stock market assesses information in a similar manner, then it should have a minimal reaction to a close vote since it would also value either outcome as about equal.<sup>269</sup> If it assesses information differently, however, then its reaction to a close vote demonstrates a systematic bias in the shareholder vote's ability to assess the two outcomes of a proxy contest.<sup>270</sup> His regression predicts that a management victory after a close vote reduces the value of stock by 5.9% compared to a dissident victory.<sup>271</sup> This shows that

---

261. See, e.g., DeAngelo & DeAngelo, *supra* note 63, at 41 (showing success in 35% of the contests); Dodd & Warner, *supra* note 57, at 409 (showing success in 25.4% of control contests); Ikenberry & Lakonishok, *supra* note 62, at 413 (showing success in 28.4% of the contests).

262. See Yair Listokin, *Corporate Voting Versus Market Price Setting*, 11 AM. L. & ECON. REV. 608, 609-10 (2009). Listokin's sample includes ninety-seven proxy contests that occurred between 2000 and 2006. See *id.* at 615-16.

263. See *id.* at 609-10.

264. See *id.* at 610.

265. See *id.* at 608-09.

266. See *id.* at 609.

267. See *id.* at 610, 623.

268. See *id.* at 609.

269. See *id.* It helps that as the outcome of a proxy contest becomes even it becomes harder to predict who will win. See *id.* This means that the stock market will not be able to price in the value of either outcome vis-à-vis their relative probabilities of occurring prior to the outcome announcement. See *id.*

270. See *id.* at 609-10.

271. *Id.* at 623 (showing significance at the 10% level).

when a shareholder vote views both outcomes as fairly equal, it is actually overvaluing a management victory, demonstrating a systematic bias towards management in the proxy contest process that hurts shareholder value.<sup>272</sup> Other studies demonstrate a number of factors that might cause this disparity.<sup>273</sup>

Mechanical aspects of the proxy process give incumbent directors an inherent advantage.<sup>274</sup> Proxies are costly and difficult to solicit for dissidents.<sup>275</sup> Shares are usually held in nominee or street name, which means that votes have to be solicited through the nominee.<sup>276</sup> The record date occurs weeks before the vote, and so for companies with high share turnover, a large portion of voting rights will be separated from shareholder ownership.<sup>277</sup> These dynamics give incumbents a significant advantage due to their prior experience in dealing with these problems and their preexisting relationship with shareholders.<sup>278</sup> This background leads Pound to several testable hypotheses.<sup>279</sup> If it is more difficult for dissidents to solicit votes, then more shareholders should relate to a greater chance of management victory.<sup>280</sup> It should also mean that a shorter contest time or holding the vote at a special meeting also increases the chance of management victory.<sup>281</sup> As expected, Pound finds that more shareholders, shorter times between the announcement and outcome, and holding the vote at a special meeting rather than the usual meeting all indicate lower chances of dissident success.<sup>282</sup> He views this as evidence that structural aspects of the proxy process bias the contest toward management victory.<sup>283</sup>

---

272. *See id.* at 631. To phrase the conclusion differently, if the process of voting is biased towards management relative to the stock market's valuation then it will place a premium on dissident victory when the biased voter is indifferent to the results, as it does in this study. *See id.* However, this conclusion depends entirely on the assumption that the stock market reflects the "true" value of each outcome. *Id.* at 623. If the shareholder vote is viewed as the better valuation mechanism, then these results show a systematic bias in the stock market's valuation of each outcome. *Id.*

273. *See, e.g.,* Pound, *supra* note 259.

274. *Id.* at 258-59.

275. *Id.* at 239.

276. *Id.*

277. *Id.* at 239-40.

278. *Id.* at 240.

279. *See id.* at 241.

280. *Id.*

281. *Id.*

282. *Id.* at 258-59 (showing significance at the 1%, 10%, and 10% level respectively).

283. *See id.*

In some studies, the presence of institutional investors and large blockholders tend to favor the incumbent directors.<sup>284</sup> Pound finds that higher levels of institutional ownership relate to lower chances for dissident victory.<sup>285</sup> This correlation suggests that institutional investors have either conflicts of interest towards management or strategic alliances with management.<sup>286</sup> Schragger similarly finds that management is more likely to win where institutional investors own more shares and where more shares are held in blocks of 5% or more.<sup>287</sup> This may be because management exerts pressure on shareholders more effectively, which is a more important factor when there are fewer shareholders, or that management may place blocks of stock in friendly hand when they expect a proxy contest.<sup>288</sup>

Dissidents have a better chance of winning when they own a larger percentage of the company or seek only to replace a minority of the board.<sup>289</sup> In this way, the dissidents are able to gain the trust of the other shareholders.<sup>290</sup> As expected, Pound finds that dissidents who have larger holdings or make formal offers to buy the company have higher chances of success.<sup>291</sup> Dissidents that seek only minority representation on the board are also more successful than dissidents who want control of the board.<sup>292</sup> Shareholders naturally fear that dissidents may seek control of the board for the private benefits of control rather than to increase the profitability of the company.<sup>293</sup> Owning larger portions of the company or making a formal offer to buy the company dissipates shareholders' fears and helps dissidents to gain more votes.<sup>294</sup>

---

284. *Id.* at 242.

285. *Id.* at 259 (showing significance at the 10% level in two regressions and at the 5% level in the other three regressions).

286. *Id.* at 259-60 (showing dissident holdings are significant at the 1% level in three of the five regressions, while making an offer is statistically significant at the 1% level in three of the three regression).

287. RONALD D. SCHRAGER, CORPORATE CONFLICTS: PROXY FIGHTS IN THE 1980S, at 51 (1986) (showing *t*-statistics of 2.011 and 2.000 respectively).

288. *Id.*

289. Pound, *supra* note 259, at 260-61.

290. *See id.*

291. *Id.*; *see also id.* at 244-46 (explaining that, depending on the dissident's goals, a formal tender offer may serve their interests better than a proxy contest).

292. *Id.* at 251 tbl.1, 261 (showing significance at the 1% level in all three regressions).

293. *See id.*

294. *See id.*; *see also id.* at 244-46 (explaining that, depending on the dissident's goals, a formal tender offer may serve their interests better than a proxy contest).

### 2. *Dissident Spending Impact*

As conventional electioneering strategy suggests, dissidents' spending increases their chances of winning the proxy contest.<sup>295</sup> Harris finds that challengers who win board seats spend more on the elections than those that lose.<sup>296</sup> He confirms this with a logistic regression that shows that dissident spending positively relates to their chances of success.<sup>297</sup> Interestingly, he does not find a statistically significant relationship between incumbent spending and their chances of success, using either a difference of means test or a logistic regression.<sup>298</sup> This may be because the directors have access to the firm's resources and can spend as much as they feel necessary to win the election.<sup>299</sup> The fact that dissident spending plays a large role in determining proxy contests suggests that these contests may not be the most accurate mechanism for determining the best people to run the company.<sup>300</sup>

### 3. *Effect of Cumulative Voting*

The presence of cumulative voting greatly helps shareholders to gain some seats.<sup>301</sup> Looking at representation contests, Duvall and Austin find that straight voting significantly decreases the dissidents' chance of victory, compared to contests with cumulative voting.<sup>302</sup> Ikenberry and Lakonishok also find that dissidents are more likely to gain a seat in elections with cumulative voting than in elections with straight voting.<sup>303</sup> Austin finds that dissidents succeeded in approximately three-quarters of representation contests that involved cumulative voting.<sup>304</sup> Cumulative voting may not help to give dissidents control of the board but it will help to give them representation.<sup>305</sup>

---

295. Harris, *supra* note 69, at 1798.

296. *Id.* He finds that winners spend on average \$730,912, while losers spend on average \$468,969 on their election efforts. *Id.* A difference of means *t*-test finds a statistically significant difference at the 5% level. *Id.*

297. *Id.* at 1799-800 tbl.3 (showing significance at the 5% level).

298. *Id.*

299. *See id.* at 1807.

300. *See id.* at 1809-10.

301. *See, e.g.,* Duval & Austin, *supra* note 73, at 468-69.

302. *Id.* (showing significance at the 1% level). All of the contests in their sample where dissidents succeeded in gaining representation used cumulative voting. *Id.* at 468.

303. Ikenberry & Lakonishok, *supra* note 62, at 413. They find that dissidents gain at least one seat in 46.3% of straight voting contests and at least one seat in 71.9% of cumulative voting contests. *Id.*

304. *See* AUSTIN, *supra* note 74, at 44.

305. *See, e.g.,* Duval & Austin, *supra* note 73, at 468-69.

#### 4. Voting Recommendations

An Institutional Shareholder Services (“ISS”) recommendation has a major impact on who wins the proxy contest.<sup>306</sup> Alexander et al. find that a dissident wins the contest 55.06% of the time after receiving an ISS recommendation but only 41.28% after management receives a recommendation.<sup>307</sup> A multivariate probit regression predicts that an ISS recommendation for the dissidents will increase their chances of winning by 14.1 percentage points.<sup>308</sup> When they add in a series of controls known to predict proxy contest outcomes, their model predicts that an ISS recommendation for dissidents will increase their chances of winning by 29.5 percentage points.<sup>309</sup> These results suggest that an ISS recommendation is a good predictor of contest outcome.<sup>310</sup>

Alexander et al. also examine how an ISS recommendation affects the stock market’s valuation of each side.<sup>311</sup> The stock market has a statistically significant positive reaction to an ISS recommendation for a dissident but no reaction to a recommendation for management.<sup>312</sup> An ISS recommendation has a higher effect on the stock price of smaller companies.<sup>313</sup>

---

306. See Alexander et al., *supra* note 132, at 4420.

307. See *id.* at 4439. A chi-squared test shows an association between a recommendation and winning significant at the 10% level. *Id.* These numbers are higher than the general probability of a dissident winning a proxy contest probably because ISS issued a recommendation in only 77.6% of proxy contests, presumably where the dissidents had a significant chance of winning. See *id.* at 4434 tbl.1.

308. *Id.* at 4444 (showing significance at the 6% level, heteroscedasticity-robust *z*-statistic = 1.89).

309. *Id.* (showing significance at the 1% level, heteroscedasticity-robust *z*-statistic = 2.75).

310. *Id.*

311. See *id.* at 4420.

312. *Id.* at 4422. For ISS recommendations for dissidents, they find positive abnormal returns of 3.76%, significant at the 1% level. *Id.* They find insignificantly abnormal returns of -0.56% for ISS management recommendation. *Id.* A *t*-test shows that the difference in abnormal return recommendations for management and dissidents is statistically significant at the 1% level. *Id.*

313. *Id.* at 4438. Repeating the analysis on companies with asset values below the median, they find a CAR for endorsement of dissidents of 6.09% that is significantly greater at the 1% level than the CAR for endorsement of an incumbent of -0.82%. *Id.*

The enactment of Regulation Fair Disclosure (“Reg FD”) in October 2000 weakened the effect of an ISS recommendation.<sup>314</sup> Reg FD prohibits incumbent management from making selective disclosures to ISS and so decreases the information content of an ISS recommendation.<sup>315</sup> Alexander et al. suggest that part of the recommendation’s effect on stock value occurs through a shift in the probability of each outcome (“the prediction effect”) and part occurs through additional information about the value of each outcome (“the certification effect”).<sup>316</sup> They control for the prediction effect based on their earlier regression and reject the hypothesis of no certification effect.<sup>317</sup> Investors rely on ISS recommendations to determine the value of a management or dissident victory, rather than just the probability of each outcome.<sup>318</sup> An ISS recommendation affects the stock market’s valuation of a dissident’s victory but does not appear to affect the valuation of a management victory.<sup>319</sup> This difference may be due to the uncertainty surrounding how dissidents would manage a company, since they do not have an active track record.<sup>320</sup>

##### 5. *Earnings Management and Disclosure*

During a proxy contest, incumbent managers will manage the earnings of the company to make it appear more profitable.<sup>321</sup> Looking at earnings reports released during the proxy campaign, DeAngelo finds significant unexpected earnings and unexpected accruals but no unexpected cash flows.<sup>322</sup> If the unexpected earnings and accruals were the result of real increases in profitability, then one would also expect to see unexpected cash

---

314. *See id.* at 4439. When they divide the sample around that date, they only find a statistically significant difference between a management and dissident recommendation in the period before the regulation. *Id.*

315. *Id.*

316. *See id.* at 4420.

317. *Id.* at 4448 (showing significance at the 5% level). To do this, they use an OLS regression equation. *See id.*

318. *See id.*

319. *See id.* at 4449. A dissident recommendation increases the value associated with dissident victory by 8.4%, while a management recommendation decreases the value associated with a dissident victory by about 5.6%. *Id.* These figures are statistically significant using OLS standard errors at the 5% level but are not statistically significant using GMM standard errors. *See id.*

320. *See id.* at 4451.

321. DeAngelo, *supra* note 70, at 20.

322. *See id.* at 20-22. Using the random-walk model, she finds mean unexpected earnings of 0.01, significant at the 1% level, and mean unexpected accruals of 0.0195, significant at the 5% level. *Id.* at 21 tbl.5.



flow.<sup>323</sup> To bolster her argument, she examines firms that do not release an earnings report during the contest and does not find any statistically significant unexpected earnings, unexpected accruals, or unexpected cash flow.<sup>324</sup> She concludes that when an earnings report is released during a proxy contest, management takes the opportunity to manage earnings to make the firm appear more profitable.<sup>325</sup> Collins and DeAngelo similarly find that managers' accounting choices during the proxy contest artificially increase income.<sup>326</sup>

Baginski et al. report that managers increase the rate of forward-looking disclosures during the campaign.<sup>327</sup> They find no difference between the pre-contest and post-contest level of forward-looking disclosures.<sup>328</sup> This suggests that managers may be increasing disclosures during the proxy contest to explain away poor performance or reduce undervaluation of the company.<sup>329</sup> To judge whether the disclosures are more positive during the proxy contest, they examine how the stock market reacts to them.<sup>330</sup> They find significantly negative CARs in response to disclosures before the campaign and statistically neutral reactions during the campaign.<sup>331</sup> The

---

323. *See id.* at 22.

324. *See id.* at 22-23.

325. *See id.*

326. Collins & DeAngelo, *supra* note 204, at 218-20. Using a random-walk model, they find mean unexpected accruals of 1.38% of total assets, which has a *p*-value of 0.0155 using a standard *t*-test. *Id.* at 220. Using an alternative model, they find a mean unexpected accrual of 1.82% of total assets, significant at the 0.0003 level. *Id.*

327. Stephen P. Baginski et al., *Forward-Looking Voluntary Disclosure in Proxy Contests*, 31 CONTEMP. ACCT. RES. 1008, 1024-25 (2014). Baginski's sample includes seventy proxy contests that occur between 1994 and 1999. *See id.* at 1019-22. They find 0.2197 disclosures per month before the proxy contest compared to 0.4327 during it, significantly different at the 5% level. *Id.* at 1025 tbl.3. Using a smaller but more consistent sample of fifty-five firms, they find 0.3802 disclosures per month compared to 0.0970 after the contest, significantly different at the 1% level. *Id.* Using a multiple regression model, they find a strong positive correlation between being a proxy contest relative to the pre-contest period and the frequency of disclosures, significant at the 1% level. *Id.* at 1028. Similarly, they find a strong negative correlation between the post-contest period relative to the contest period and the frequency of disclosures, significant at the 1% level. *Id.*

328. *Id.* at 1030.

329. *Id.* at 1008-09 (citing Paul M. Healy & Krishna G. Palepu, *Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literatures*, 31 J. ACCT. & ECON. 405 (2001)).

330. *See id.* at 1033-34.

331. *See id.* at 1033. For the two years leading up to the contest, they find a mean CAR of -0.020, significant at the 1% level. *Id.* They find a mean CAR of 0.007 during the proxy contest, significant at the 1% level. *Id.*

disclosures may not have stock market reaction because investors understand that releases will be biased during the campaign.<sup>332</sup> A multiple regression analysis confirms that disclosures are more positive during the campaign than before or after it.<sup>333</sup> Another regression shows that the rate of positive forward-looking disclosures positively correlates the presence of a proxy contest.<sup>334</sup> They next examine how the disclosures change when management wins or loses the proxy contest.<sup>335</sup> They find that managers who won the contest temporarily increased their disclosures while the managers who lost did not.<sup>336</sup> The authors suggest that the increased disclosures may have helped the managers to win the contest.<sup>337</sup> Similarly, they rerun the multiple regressions examining stock market reaction and find that the disclosures were more positive for managers who won their contests.<sup>338</sup>

#### 6. Summary

Incumbent directors appear to have a systematic advantage in proxy contests.<sup>339</sup> Where the stock market would judge both sides as equal, the incumbent directors have a significantly higher chance of winning.<sup>340</sup> Their position as directors allows them to manage the earnings reports of the company and release positive information to help themselves win.<sup>341</sup> Other systematic factors give them a considerable advantage, such as the process

---

332. *Id.*

333. *Id.* at 1034. A multiple regression model finds a negative correlation between a disclosure released before rather than during a proxy contest and market reaction to the disclosure, significant at the 1% level. *Id.* Another regression finds a significant negative correlation between a disclosure released before rather than during a proxy contest and market reaction to the disclosure. *Id.*

334. *See id.* at 1038-41. They find that rate of issuing positive disclosures positively relates to being in a proxy contest, significant at the 5% level. *Id.*

335. *Id.* at 1038-41.

336. *Id.* at 1038. Using an interaction term between being in the contest and dissidents winning and being in the post contest and dissidents winning, they find a negative coefficient for the first variable and a positive coefficient for the second variable, both significant at the 5% level. *Id.*

337. *Id.* at 1041.

338. *Id.* Using interaction terms between the pre-proxy contest and dissidents winning and the post-contest and dissidents winning, they find positive coefficients, significant at the 10% and 1% levels respectively. *Id.*

339. *See supra* Section II.B.1.

340. *See supra* Section II.B.1.

341. *See supra* Section II.B.5.

of soliciting proxies and the presence of institutional investors.<sup>342</sup> While this may present a significant hurdle to dissidents, other factors can even the playing field.<sup>343</sup>

The previous section demonstrated that dissidents have higher chances of winning at worse performing firms.<sup>344</sup> Dissidents willing to spend their own money to invest in the company or run a better campaign may be able to ease the distrust of their fellow shareholders by demonstrating their dedication to the company.<sup>345</sup> Cumulative voting can also help dissidents to get representation on the board, even if it will not help them to gain control.<sup>346</sup> Finally, ISS can overcome collective action problems to effectively distinguish between dissidents likely to better manage the company from those who are not.<sup>347</sup> The system may not be perfectly fair, but it presents each side with a very real chance of proving themselves and gaining the opportunity to run the company.

### *III. Uncontested Director Elections*

The overwhelming majority of corporate elections are uncontested. Incumbents need not worry about losing their seats in these circumstances because state corporate law uses plurality voting, not majority voting, as the default rule for director elections. The combination of an uncontested election and a plurality voting system ensures that directors are almost guaranteed to get reelected.<sup>348</sup> Under plurality voting rules in an uncontested election, shareholders can choose between voting “for” the candidate or “withholding” their vote.<sup>349</sup> The director just needs a single vote, which can even be their own, to get reelected.<sup>350</sup> Indeed, most directors get elected with more than 95% support from shareholders.<sup>351</sup>

These concerns are compounded by the fact that free-rider problems may deter shareholders from taking the time and effort to seriously evaluate a

---

342. *See supra* notes 274-288 and accompanying text.

343. *See supra* Section II.A.5.

344. *See supra* Section II.A.5.

345. *See supra* Section II.B.2.

346. *See supra* Section II.B.3.

347. *See supra* Section II.B.4.

348. *See* Paul E. Fischer et al., *Investor Perceptions of Board Performance: Evidence from Uncontested Director Elections*, 48 J. ACCT. & ECON. 172, 172 (2009).

349. *See* Diane Del Guercio et al., *Do Boards Pay Attention When Institutional Investor Activists “Just Vote No”?*, 90 J. FIN. ECON. 84, 85 (2008).

350. *See id.*

351. *See* Fischer et al., *supra* note 348, at 175, 176 tbl.2. They find a mean of 96.4% of support for directors and a median of 98% support. *See id.* at 176 tbl.2.

director's performance.<sup>352</sup> Also, shareholders may choose to sell their shares when directors mismanage a company rather than "withhold" their votes.<sup>353</sup> Therefore, many commentators argue that uncontested director elections are a sham and an ineffective tool of corporate governance.<sup>354</sup> Others, however, contend that even minor drops in a director's support can act as signal of shareholder disapproval and effectively discipline the director.<sup>355</sup>

#### A. Determinants of Uncontested Election Outcomes

##### 1. Vote No Campaigns

With this theory in mind, some shareholders have begun launching "just vote no" campaigns.<sup>356</sup> Between 1990 and 2003, there were 112 such campaigns, mostly driven by institutional investors.<sup>357</sup> These campaigns resulted in an average of 5.8% withheld votes, with 21.2% of campaigns having a withheld vote of greater than 20%.<sup>358</sup> Studies evaluate whether director elections are a meaningful tool of corporate governance by examining what factors determine their results and how their results impact corporate governance.<sup>359</sup> These studies show that shareholders vote based on the actions of individual directors rather than the overall company performance.<sup>360</sup> While the evidence confirms that uncontested elections pose little threat to a director's tenure on the board, they can have a meaningful impact on other aspects of corporate governance.<sup>361</sup>

Cai et al. suggest that the results of a director election only weakly reflect the performance of the company.<sup>362</sup> They show that the percentage of "for" votes that a director receives in an uncontested election reflects the company's prior performance but has limited economic significance.<sup>363</sup> Cai et al. find that having a poor operating performance predicts there will be

---

352. *See id.* at 173 (citing ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY (1957)).

353. *See id.* (citing Robert Parrino et al., *Voting with Their Feet: Institutional Ownership Changes Around Forced CEO Turnover*, 68 J. FIN. ECON. 3 (2003)).

354. *See id.* at 172.

355. *See id.*

356. *See* Del Guercio et al., *supra* note 349, at 85.

357. *See id.*

358. *Id.* at 89.

359. *See, e.g., id.* at 85.

360. *See, e.g.,* Jie Cai et al., *Electing Directors*, 64 J. FIN. 2389, 2416-17 (2009).

361. *See, e.g., id.* at 2417.

362. *See, e.g., id.* at 2399.

363. *See id.*

fewer “for” votes, but a standard deviation decrease in the industry-adjusted EBITDA-to-assets ratio only predicts a 0.37% decrease in support.<sup>364</sup> Similarly, Del Guercio et al. find barely significant evidence that groups start “just vote no” campaigns at companies with worse operating return on assets compared to their industry peers.<sup>365</sup>

There is mixed evidence about the impact of stock returns on the results of a director election.<sup>366</sup> Cai et al. fail to find any significant relationship between stock returns and voting outcome.<sup>367</sup> Del Guercio et al., however, find stronger evidence that companies targeted for “just vote no” campaigns have negative market-adjusted stock returns over the previous year.<sup>368</sup>

Fischer et al. find that a lower percentage of “for” votes in a director election predicts a more positive stock market reaction to a change in the CEO.<sup>369</sup> This result suggests that shareholder votes in director elections are an accurate reflection of the management’s performance. While company performance has some role in director elections, shareholders appear to be looking at other factors in deciding whether to support a director or to withhold their vote.<sup>370</sup>

## 2. Corporate Governance Effects

The governance characteristics of the company have a strong relationship with the “for” votes cast for directors, albeit with small economic significance.<sup>371</sup> Cai et al. find that lower ratings on the governance index, entrenchment index, and having both staggered board and poison pill provisions all predict fewer “for” votes at a statistically significant but

---

364. *See id.* (showing significance at the 1% level).

365. *See* Del Guercio et al., *supra* note 349, at 93. In the third to second years before the start of the campaign, they find a difference of means of the operating performance significant at the 10% level but fail to find a significant difference of medians, compared to industry peers. *See id.* at 92 tbl.3. However, they fail to find a significant difference for mean or median in the year before the “just vote no” campaign. *See id.*

366. *Compare* Cai et al., *supra* note 360, at 2399, *with* Del Guercio et al., *supra* note 349, at 87 tbl.1.

367. *See* Cai et al., *supra* note 360, at 2399 (using two- and three-year excess returns to measure market performance).

368. *See* Del Guercio et al., *supra* note 349, at 87 tbl.1. They find that the mean and median market adjusted stock returns for the previous years for targeted companies are significantly different from zero at the 1%. *See id.* at 88.

369. *See* Fischer et al., *supra* note 348, at 177-79 (showing statistical significance at the 1% level).

370. *See* Cai et al., *supra* note 360, at 2416-17.

371. *See id.* at 2399.

economically insignificant level.<sup>372</sup> Their results reveal a similar relationship for the presence of a shareholder suit.<sup>373</sup>

Board characteristics also have an impact on director elections.<sup>374</sup> Larger boards, more outsiders on the boards, and higher ownership by directors predict more “for” votes.<sup>375</sup> These results suggest that the features of a company’s corporate governance system affect a shareholder’s opinion of directors.<sup>376</sup>

### *3. Bad Director Performance*

Evidence suggests that shareholders distinguish the actions of individual directors and hold directors accountable in specific instances for failing to perform their duties.<sup>377</sup> Cai et al. find that the biggest determinant of a direct election, outside of a negative ISS recommendation, is failing to attend board meetings.<sup>378</sup> In their study, directors that attended fewer than 75% of board meetings received 14% fewer “for” votes in an uncontested election.<sup>379</sup> Directors who abrogate their responsibilities will receive fewer “for” votes.<sup>380</sup> Shareholders appear to react less to overall performance of the company and more to specific failures of the directors.<sup>381</sup>

### *4. Impact of Weak Internal Controls*

Shareholders are more likely to “withhold” their votes for managing directors when there is a material weakness in the internal controls of a company.<sup>382</sup> Starting in 2004, the Sarbanes-Oxley Act requires that accelerated filers disclose the independent auditor’s opinion on the

---

372. *See id.* at 2399, 2400 tbl.II (finding all significant at the 1% level). A standard deviation increase in their governance and entrenchment index all predict a decreased “for” votes of 0.43% and 0.4% respectively. *Id.*

373. *See id.* at 2399. The presence of a shareholder lawsuit predicts 1% fewer “for” votes, statistically significant at the 10% level. *Id.*

374. *See id.*

375. *See id.* (showing significance at the 1% level).

376. *See id.*

377. *See, e.g., id.*

378. *See id.* at 2404.

379. *See id.* (finding statistical significance at the 1% level).

380. *See id.*

381. *See id.*

382. Zhongxia (Shelly) Ye et al., *Shareholder Voting in Director Elections and Initial SOX Section 404 Reports*, 28 J. ACCT., AUDITING & FIN. 103, 104 (2013). Ye et al. collect a sample of 370 companies that received an adverse or disclaimer opinion on the effectiveness of internal control in the first year of the SOX section 404 auditor reports, and a corresponding industry matched control firms. *See id.* at 110, 112.

effectiveness of internal controls and in particular whether there was a material weakness.<sup>383</sup> Studies suggest that internal control problems have negative consequences on the company including higher levels of debt, less accurate earnings forecasts, and a higher likelihood of receiving a modified audit opinion on financial statements.<sup>384</sup> Management directors at firms with a material weakness in their internal controls received fewer votes than management directors in firms of the same industry.<sup>385</sup>

Directors on the audit committee, however, did not receive significantly different voting results than their industry peers.<sup>386</sup> Nonetheless, a disclosure restatement predicted significantly fewer votes for an audit committee director, but not fewer votes for a management director.<sup>387</sup>

By contrast, Cai et al. fail to find a relationship between receiving an accounting restatement and the votes of an audit committee director.<sup>388</sup> Ye et al. find that the more material weaknesses a company has predicts a higher percentage of votes withheld in an uncontested director election.<sup>389</sup> Disclosing a material weakness or deficiency, however, correlates with an increase in votes for management directors.<sup>390</sup> These results suggest shareholders express their dissatisfaction with corporate management by withholding their vote.<sup>391</sup>

##### 5. Executive Compensation's Role

The ability of directors to ensure fair compensation of officers also significantly affects director elections.<sup>392</sup> Cai et al. find that excess CEO compensation predicts fewer “for” votes in director elections.<sup>393</sup> This is

---

383. *Id.* at 104.

384. *See id.* at 106.

385. *See id.* at 114. A difference of means *t*-test shows that the difference is statistically significant at the 10% level. *See id.* at 114 tbl.3. A regression also shows that the presence of a material weakness predicts fewer votes for management directors, significant at the 10% level. *Id.* When the split material weakness into two variables, account balance-level weakness and company-level weakness, they find that both predict lower votes for management directors, significant at the 10% level. *See id.* at 118.

386. *See id.* at 114 tbl.3.

387. *See id.* at 115. A nontechnical restatement disclosure predicts fewer votes for an audit committee director, statistically significant at the 1% level. *See id.*

388. *See* Cai et al., *supra* note 360, at 2407.

389. *See* Ye et al., *supra* note 382, at 119 (showing significance at the 1% level).

390. *See id.* (showing statistical significance at the 1% and 10% levels respectively).

391. *See id.*

392. *See* Cai et al., *supra* note 360, at 2399.

393. *See id.* (showing statistical significance at the 1% level).

particularly true when the director sits on the compensation committee.<sup>394</sup> Also, CEOs who serve as directors and receive excess compensation receive significantly fewer “for” votes than the other directors.<sup>395</sup>

Ertimur et al. take advantage of the backdating scandal in 2006 and 2007 to examine whether shareholders are more likely to cast “withhold” votes for directors that fail to properly oversee executive compensation.<sup>396</sup> Directors at firms caught up in the backdating scandal have more votes withheld than directors at other firms.<sup>397</sup> Because a decade passed between when the backdating occurred and when the scandal became public, many directors at the backdating firms had no connection to the controversy.<sup>398</sup> While shareholders are more likely to withhold their votes for both the backdating directors and the new directors, the shareholders withheld significantly more of their votes for backdating directors.<sup>399</sup> These results suggest that shareholders are able to distinguish between different degrees of responsibility.<sup>400</sup>

Shareholders blamed directors on the compensation committee more than directors on the auditing committee, and in turn, more than the other directors.<sup>401</sup> Again, shareholders blamed directors who were on the compensation committee at the time of the backdating more than those who were not.<sup>402</sup> This suggests that the directors who sat on the compensation

---

394. *See id.* at 2407 (showing statistical significance at the 10% level).

395. *See id.*

396. *See* Yonca Ertimur et al., *Reputation Penalties for Poor Monitor of Executive Pay: Evidence from Option Backdating*, 104 J. FIN. ECON. 118, 121 (2012). They collect a sample of 178 firms involved in the scandal and a sample of control firms. *See id.* at 122.

397. *See id.* at 123. For directors caught in the backdating scandal, they found a mean and median withheld votes of 9.8% and 4.9%, compared to 4.9% and 2.2% respectively for directors at other companies, significantly different at the 1% level. *Id.* A multiple regression confirms that shareholders are more likely to withhold their votes for directors at the backdating firms, significant and positive around the 5% level. *Id.*

398. *Id.*

399. *See id.* Both groups see a positive correlation between being on the board and receiving a “withhold” vote relative to directors on other boards, significant at the 1% level. *See id.* at 125 tbl.2. However, the directors who were on the board during the backdating received 3.77% higher “withhold” votes. *Id.* at 123.

400. *Id.*

401. *Id.* at 123-24. When they divided the director of the backdating firms between compensation committee membership, auditing committee membership, and other directors, they find coefficients of 8.41, 5.79, and 4.06 respectively, all significantly more likely to receive a “withhold” vote at the 1% level. *See id.* at 125 tbl.2.

402. *Id.* at 123-24. Although all groups of the compensation committee had a statistically significant correlation at the 1% level, those also on the compensation committee during the backdating had a *t*-statistic of 7.41, compared to a *t*-statistic of 4.59 and 4.99 for those not on



committee at the time of the backdating received the largest penalty in “withhold” votes.<sup>403</sup> It also suggests that shareholders view the backdating as a failure of the compensation committee rather than the auditing committee.<sup>404</sup>

Directors received more “withhold” votes at firms that had more severe backdating.<sup>405</sup> An ISS “withhold” recommendation based on the backdating correlated with higher percentage of “withhold” votes by shareholders.<sup>406</sup> This result may raise concerns that shareholders follow ISS recommendations too closely or mechanically.<sup>407</sup> The directors at backdating firms received more “withhold” votes at other firms where they served as directors, but the results were largely statistically insignificant.<sup>408</sup> Shareholders appear not to penalize directors for their failings at other firms.<sup>409</sup>

## *B. Key Players in Uncontested Elections*

### *1. Labor Union Voting Patterns*

In his paper, Agrawal claims that labor unions may use their votes to further their own interests, often at the expense of the company’s wellbeing.<sup>410</sup> Agrawal further examines the voting habits of the AFL-CIO before and after part of the organization split off to become the Change to

---

the compensation committee or not on the board at all during the backdating. *See id.* at 125 tbl.2.

403. *Id.* at 127.

404. *Id.*

405. *Id.* at 128. They divide directors between firms with backdating worth more than 6.5% of assets and firms with less. *Id.* While both groups had significantly more “withhold” votes, the top half had a *t*-statistic of 6.10 in the regression model compared to 4.08 for the bottom half. *See id.* at 127 tbl.2.

406. *See id.* at 129. Of the firms involved in the backdating scandal, firms with an ISS “withhold” recommendation based on the backdating had a *t*-statistic of 10.92, compared to a coefficient of 4.99 at firms without a “withhold” recommendation by ISS. *See id.* at 127 tbl.2.

407. *Id.* at 129.

408. *Id.* at 136. The directors of backdating firms received mean and median “withhold” votes at other firms of 5.8% and 2.6%, compared to 4.9% and 2.2% for directors who don’t serve at backdating firms. *Id.* However, the differences are economically small and don’t become statistically significant in multiple regressions. *Id.*

409. *See id.* at 139-41.

410. *See* Ashwini K. Agrawal, *Corporate Governance Objectives of Labor Union Shareholders: Evidence from Proxy Voting*, 25 *REV. FIN. STUD.* 187, 187 (2012).

Win (“CTW”) Coalition.<sup>411</sup> He shows that the AFL-CIO varied its voting patterns based on whether or not it represented the workers of that company, thus leading to the inference that it is using its voting power as a tool in their labor struggles.<sup>412</sup> The firms with AFL-CIO unions have similar characteristics as firms with CTW unions.<sup>413</sup> The AFL-CIO is more likely to vote against directors at companies with AFL-CIO unions than those with no union.<sup>414</sup> The difference suggests that the AFL-CIO’s votes are in part guided by its labor relations with the companies.<sup>415</sup> The organization became significantly less likely to vote against a firm’s directors after it went from being an AFL-CIO union to a CTW union.<sup>416</sup>

By comparison, mutual funds are more likely to vote for the directors at companies with unions and did not change their voting patterns after the move from AFL-CIO to CTW representation.<sup>417</sup> The mutual funds’ voting

---

411. *Id.* at 188-89. Specifically, he examines the AFL-CIO votes before and after part of the organization spun off in 2005 to form the Change to Win (“CTW”) Coalition, as well as the United Brotherhood of Carpenters and Joiners of America (“UBCJA”) before and after joining the CTW Coalition in 2005. *See id.* at 188-90. They collect 10,407 votes by the AFL-CIO between January 1, 2003 and December 31, 2006. *Id.* at 194-95. On average, the organization supported 65% of director nominees. *Id.* at 195.

412. *See id.* at 190, 203.

413. *See id.* at 201-03. The notable difference is that the AFL-CIO firms have an average market capitalization of \$32 billion, while the CTW firms have an average market capitalization of \$23 billion. *Id.* at 201-02. Otherwise, the two groups have similar capital intensity, number of employees, return on assets, and asset growth. *Id.* at 202.

414. *Id.* at 203. For these purposes, “AFL-CIO firms” are those that have a AFL-CIO union both before and after the 2005 split off. *See id.* The AFL-CIO voted against 31% of directors at nonunionized firms and 44% of AFL-CIO firms. *Id.* Agrawal confirms that these differences are statistically significant. *Id.* A multiple regression confirms that the AFL-CIO was 11% more likely to vote against directors of unionized firms, statistically significant at the 1% level. *Id.* at 205 tbl.5, 206.

415. *Id.* at 203.

416. *See id.* When the CTW firms were represented by the AFL-CIO, the AFL-CIO voted against their directors in 45% of elections. *Id.* After the firms moved to CTW unions, the AFL-CIO voted against their directors in only 29% of elections. *Id.* A multiple regression confirms that the AFL-CIO became 17.9% more supportive of firms’ directors after they moved to CTW unions, statistically significant at the 5% level. *Id.* at 205 tbl.5, 206. They find the same results when they repeat the regression with controls for governance characteristics and stock performance. *Id.* at 206.

417. *Id.* at 207. Agrawal examines the voting pattern of the Fidelity Spartan Total Market Index Fund, the Vanguard Institutional Total Stock Market Index Fund, and the TIAA-CREF Equity Index Fund. *Id.* Vanguard was more likely to vote for the director of a firm with unionized works, statistically significant at the 5% level, while the other two funds had no statistically different result. *See id.* at 208 tbl.6. None of the funds had a statistically

tendencies suggest that unionization is not associated with lower director quality, eliminating one alternative explanation of the AFL-CIO's voting pattern.<sup>418</sup> Similarly, CalPERS, "the world's largest public pension fund," was not more likely to vote for or against directors of unionized firms and did not change their voting pattern in response to the change in union representation.<sup>419</sup>

Agrawal suggests that the most reasonable explanation for AFL-CIO's voting pattern is that the organization bases its decisions on the labor relations with the companies that it represents.<sup>420</sup> Similarly, the United Brotherhood of Carpenters and Joiners of America ("UBCJA") became more likely to vote against the directors of CTW firms after it joined the CTW.<sup>421</sup> Agrawal claims that basing voting decisions on a union's labor relations may be a common practice to other union pension funds.<sup>422</sup>

The AFL-CIO is also more likely to vote against directors at firms experiencing management-union conflicts as compared to the other firms it represents.<sup>423</sup> Agrawal argues that the AFL-CIO appears to use its shareholder voting power to influence the directors of firms where there are ongoing labor disagreements.<sup>424</sup> Because the AFL-CIO pension fund controls \$100 billion in assets, its vote can significantly affect a director

---

different likelihood of voting against the director after changing from AFL-CIO representation to CTW representation. *See id.*

418. *See id.* at 207.

419. *See id.* at 207, 208 tbl.6.

420. *Id.* at 187, 212.

421. *Id.* at 209. Specifically, the UBJCA became 21.7% more likely to vote against the directors of CTW firms after they joined the CTW, statistically significant at the 10% level. *Id.* at 208 tbl.6, 209.

422. *Id.* at 209.

423. *Id.* at 210-11. They use two proxies to assess the presence of labor strife: (1) whether any unfair labor practice charges were raised by the firm for unlawful attempts at strengthening union membership; and (2) whether any unfair labor practice charges were filed by the labor union against the firm for refusing to bargain collectively. *Id.* at 210. A multiple regression finds that the AFL-CIO is 17.7% more likely to vote against a director at a firm with unionization conflict compared to other firms the organization represents, statistically significant at the 1% level, and 13.9% more likely to vote against firms with collective bargaining conflicts with the AFL-CIO. *See id.* at 211 tb.7, 212.

424. *See id.* at 210. An alternative explanation is that the AFL-CIO is simply trying to remove directors who have created potentially value-decreasing labor conflicts. *Id.* To eliminate this possibility, the authors examine how the AFL-CIO's voting pattern in response to labor strife changes at firms that move from AFL-CIO representation to CTW representation. *See id.* at 210, 211 tbl.7. They find that the pattern disappears and so eliminate the alternative explanation. *Id.*

election.<sup>425</sup> On its own, AFL-CIO opposition to a director predicts 2.57% less support.<sup>426</sup> The AFL-CIO's use of its voting power to assist labor disputes appears to hurt shareholder value.<sup>427</sup> When firms moved from representation by AFL-CIO to representation by CTW, their stock value increased.<sup>428</sup> The stock price increase is more pronounced at firms that previously experienced AFL-CIO opposition to their directors compared to where the AFL-CIO supported their directors.<sup>429</sup>

AFL-CIO appears to be an effective tool in benefiting labor unions.<sup>430</sup> Opposition to a firm's directors predicts a decrease in the number of unfair labor practice findings, with a more pronounced effect when the AFL-CIO opposed the entire slate of directors.<sup>431</sup> These results suggest that union pension funds vote with an eye to help the laborers, rather than just increase shareholder value, which appears to have a real benefit to the union at the expense of other shareholders.<sup>432</sup> More broadly, the results suggest that directors respond to the votes of individual shareholders rather than just the aggregate election outcomes.<sup>433</sup>

---

425. *Id.* at 215.

426. *See id.* at 215 tbl.8 (showing significance at the 1% level). They find that directors supported by the AFL-CIO receive on average 96.06% support, while directors opposed by the AFL-CIO receive on average 93.49% support. *Id.* at 214.

427. *See id.* at 216.

428. *Id.* The firms that move from AFL-CIO representation to CTW representation experience an average one-day abnormal return of 0.50%, statistically significant at the 1% level. *See id.* at 216, 217 tbl.9.

429. *See id.* at 216. Where the AFL-CIO previously opposed at least one director, the firm experienced a one-day abnormal return of 0.49%, statistically significant at the 1% level. *See id.* at 216, 217 tbl.9. Firms where the AFL-CIO did not oppose any directors do not have statistically significant abnormal returns. *See id.* at 216-18. Similarly, firms that experienced labor strife with the AFL-CIO had statistically significant abnormal returns, while the firms without labor strife had no statistically significant abnormal returns. *Id.* at 218.

430. *See id.* at 218-19.

431. *See id.* at 219. The AFL-CIO opposition to at least one director predicted a 2.5% decrease in unfair labor practice filings, significant at the 1% level. *Id.* at 219, 220 tbl.10. AFL-CIO opposition to the entire slate of directors predicted a 11.5% reduction in union conflicts. *Id.*

432. *See id.* at 219-20.

433. *Id.* at 220. Agrawal suggests that analogous results may be found with other entities such as public pension funds, family shareholders, and government owners. *Id.* at 221.

## 2. Mutual Fund Voting

Mutual funds are more likely to support management, perhaps also with an eye to self-interest.<sup>434</sup> In 2003, the SEC created a new rule that required mutual funds to report their votes in shareholder elections, allowing researchers to study their voting patterns.<sup>435</sup> Matvos and Ostrovsky find that some mutual funds have a greater propensity to vote for management than others, irrespective of company and director characteristics.<sup>436</sup> These mutual funds may be “trying to build a reputation for management friendliness.”<sup>437</sup> Mutual funds are also more likely to vote for directors when a higher percentage of other funds are voting for that director, which the authors call the “peer effect.”<sup>438</sup>

Similarly, Cai et al., find that brokers are more likely to vote for the directors than other shareholders.<sup>439</sup> This result is important because brokers vote on average 13.1% of outstanding shares.<sup>440</sup> In fact, eliminating the broker’s votes would reduce overall “for” votes by 2.5%, a significant portion considering that directors normally receive only 5% “withhold” votes.<sup>441</sup> Their regressions predict that a swing of this magnitude in election

---

434. See Gregor Matvos & Michael Ostrovsky, *Heterogeneity and Peer Effects in Mutual Fund Proxy Voting*, 98 J. FIN. ECON. 90, 90 (2010).

435. *Id.* Matvos and Ostrovsky construct a comprehensive data set of 2,058,788 votes by 2774 mutual funds in 13,588 director elections of 1388 companies that occurred from July 1, 2003 to June 30, 2005. *Id.* at 94. An average of 152 funds vote for each director. *Id.* Elections are made up of 16.7% of inside directors, 70.7% outside directors, and 12.6% outside related directors. *Id.*

436. *Id.* at 96-97. They note that if the fund’s voting decisions responded only to director characteristics, there would not be systematic differences in voting patterns. *Id.* A multiple regression shows that the percentage of “for” votes in a given year positively correlates with a “for” vote in a given election in the subsequent year. *Id.* at 97. Matvos and Ostrovsky rerun the regression while controlling for firm and director characteristics and see the same result. *Id.* They rerun the regression again with separate fixed effects for each shareholder meeting and fixed effects for each director election and find the same correlation. *Id.*

437. *Id.* at 97.

438. *Id.* Matvos and Ostrovsky avoid simply running a regression to see how the votes of other mutual funds predicts a given mutual fund’s vote because they don’t think they can control for every other factor that determines a fund’s vote. *Id.* Instead, they use the other mutual funds’ propensity to support management as an instrument for the other funds’ votes. *Id.* They find a statistically significant relationship between the other funds’ propensity to support management and the mutual fund’s vote with a linear probability model, statistically significant at the 1% level. *Id.* at 97, 100. They confirm this result by adding in controls and using alternative ways of instrumenting. See *id.* at 100.

439. See Cai et al., *supra* note 360, at 2415.

440. *Id.*

441. See *id.*

results would reduce CEO compensation by \$600,000, increase the odds of CEO turnover by 1.07, and increase the odds of removing a poison pill by 1.08, as examined in more detail below.<sup>442</sup>

### 3. ISS Recommendation Effect

The single biggest factor impacting a director election appears to be a recommendation from the ISS.<sup>443</sup> There is evidence that ISS issues a “withhold” recommendation in 0.8% of director elections.<sup>444</sup> Cai et al. find that an ISS “withhold” recommendation predicts that the director will receive 19% fewer “for” votes.<sup>445</sup> Choi et al. find that a “withhold” recommendation by ISS predicts 10.7% fewer “for” votes by institutional investors and thus an overall 6.4% fewer “for” votes.<sup>446</sup> The recommendation of Glass Lewis, another proxy advisor firm, also has a significant impact on the outcome of a director election, while the recommendations of Proxy Governance and Egan Jones do not.<sup>447</sup>

Because proxy advisors, especially ISS, play such a large role in director elections, it is important to understand what factors determine how they vote.<sup>448</sup> Choi et al. identify fourteen factors that have a statistically significant relationship with whether ISS issues a “for” or “withhold” recommendation.<sup>449</sup> Eight of the ten board-related factors are statistically

---

442. *See id.* at 2415-16.

443. Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 871 (2010).

444. *Id.* at 886.

445. *See* Cai et al., *supra* note 360, at 2404 (showing significance at the 1% level).

446. *See* Choi et al., *supra* note 443, at 903. They first use a multiple regression to show that an ISS recommendation has a significant correlation with the outcome of a director election. *See id.* at 894. They note that adding the variable for an ISS recommendation increased the predictive power of their regression from an R<sup>2</sup> of 0.109 to 0.185. *Id.* at 895. Attempting to differentiate causation from correlation, they work off the assumption that ISS influences the votes of institutional investors and not individuals. *See id.* at 894. They rerun the multiple regression with two interaction variables: one multiplying the voting recommendation by the fraction of shares held by institutional investors and the second multiplying the voting recommendation by the fraction of shares not held by either directors or institutional investors. *See id.* at 901. This essentially works off the assumption that, absent the ISS recommendation, the institutional investors would vote the same way as individuals, thus producing the predicted effect of an ISS recommendation. *See id.* at 901-02.

447. *Id.* at 905.

448. *See* Stephen J. Choi et al., *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 651 (2008).

449. *See id.* at 671-72 tbl.3. The factors that make ISS significantly more likely to issue a “withhold” recommendation are being a CEO, an SEC investigation within the past two

significant, with some also having economic significance, such as failing to act on a proxy issue proposal that received majority support, attending less than three-quarters of board meetings, being an employee of the company, and being an outside director linked to the company; each factor increases the probability of a “withhold” recommendation from ISS.<sup>450</sup> Interestingly, ISS was significantly less likely to issue a “withhold” recommendation for directors who had golden parachutes.<sup>451</sup> In addition, being a CEO, serving on the compensation committee, having a classified board, or having cumulative voting each increased the probability of a “withhold” recommendation.<sup>452</sup> Finally, new directors were less likely to receive a “withhold” recommendation.<sup>453</sup> Relative to other proxy advisor firms, ISS paid less attention to compensation-related factors and no attention to audit- or disclosure-related factors.<sup>454</sup>

### *C. The Effects of Uncontested Elections*

#### *1. Effect of Weak Shareholder Support*

Evidence is mixed on whether low shareholder support will affect a director’s chances to remain in office.<sup>455</sup> Cai et al. fail to find any relationship between director elections and subsequent director turnover.<sup>456</sup> They also fail to find a relationship between the election results and the director tenure at other firms.<sup>457</sup> This result tends to support the view of director elections as meaningless charades of shareholder democracy.<sup>458</sup>

Aggarwal et al., however, find that low shareholder support in an uncontested director election can have a meaningful impact on the

---

years, being on the compensation committee, having excess CEO compensation in the top 5% of the sample, attending less than 75% of board meetings, being on at least three other major boards, being on the nominating committee, being an employee of the company, being an outside director with affiliate link to the company, owning more than 20% of the company, failing to implement a proxy issue proposal that received majority support, having a classified board, and having cumulative voting. *See id.* Factors that make an ISS “for” recommendation significantly more likely are being a new director, being an interlocking director, being a chairman and not an employee, and having a golden parachute. *See id.*

450. *See id.* at 673.

451. *See id.* (demonstrating significance at the 1% level).

452. *See id.*

453. *See id.*

454. *See id.* at 675.

455. *See* Cai et al., *supra* note 360, at 2414.

456. *See id.*

457. *See id.*

458. *See id.*

director's career.<sup>459</sup> Directors that receive more "withhold" votes are more likely to leave within the next year.<sup>460</sup> Naturally, directors at firms with classified boards are less likely to leave within a year than directors at firms without classified boards.<sup>461</sup> This result is because directors on classified boards only face election every three years.<sup>462</sup> Additionally, a director that receives a higher percentage of votes withheld is likely to lose director positions at other firms.<sup>463</sup> The authors next look at directors who stay on the board despite receiving low support from shareholders.<sup>464</sup> A director who receives low support but still stays on the board is more likely to lose a committee position.<sup>465</sup> Overall, their results suggest that "withhold" votes still have a negative impact on directors, both at the at issue company and at other companies.<sup>466</sup>

## 2. CEO Turnover

The percentage of "withhold" votes at an uncontested director election can also significantly impact the firm's corporate governance.<sup>467</sup> Fischer et al. find that a lower percentage of "for" votes predicts a higher rate of CEO turnover.<sup>468</sup> Their results are also economically significant.<sup>469</sup> A CEO at a company with the lowest quintile of board approval is two and half times as likely to suffer a forced turnover as a CEO at a company in the top quintile.<sup>470</sup>

---

459. See Reena Aggarwal et al., *The Power of Shareholder Votes: Evidence from Uncontested Director Elections* 3-4 (Georgetown McDonough Sch. of Bus. Research Paper No. 2609532, 2017), <http://ssrn.com/abstract=2609532>. The authors limit their sample to outside directors. *See id.* at 12. They look at all director elections between 2003 and 2014. *See id.* Their final sample includes 83,496 director elections. *See id.* at 18.

460. *See id.* at 23 (showing significance at the 1% level). Their regression also shows that if ISS makes an "against" recommendation, then the director is more likely to leave within the next year. *See id.* (showing significance at the 1% level).

461. *See id.* at 25-26.

462. *See id.*

463. *See id.* at 27, 48 tbl.7 (showing significance at the 1% level).

464. *See id.* at 28.

465. *See id.* at 29.

466. *See id.* at 33.

467. *See, e.g.*, Fischer et al., *supra* note 348, at 173.

468. *See id.* at 180 (showing statistical significance at the 1% level).

469. *See id.*

470. *See id.* A CEO in the lowest quintile of board approval has a 1.9% chance of suffering a forced turnover, compared to a 5.1% chance for a CEO at a company in the lowest quintile of board approval. *Id.*



By contrast, however, Cai et al. find a negative but insignificant relationship between shareholder support for a director and the rate of subsequent CEO turnover.<sup>471</sup> This suggests that shareholder approval may be only a weak predictor of subsequent CEO turnover.<sup>472</sup> Interestingly, when Cai et al. distinguish between inside and independent directors, they find that the support for independent directors has a significant negative correlation with subsequent CEO turnover, while inside directors do not have a statistically significant relationship.<sup>473</sup> In their model, a standard deviation decrease in support for an independent director predicts a 20% greater likelihood of a CEO turnover.<sup>474</sup> These results suggest that inside directors are less likely than independent directors to respond to shareholder dissatisfaction and replace the company's CEO.<sup>475</sup>

Fischer et al. rerun their regressions for CEO turnover rate and market reaction with variables for both the percentage of voter support out of shares voted and for the percentage of shares voted out of all shares, a proxy for shareholder apathy.<sup>476</sup> Shareholder support has similar results as before, while the shareholder apathy has insignificant results.<sup>477</sup> These results suggest that the market reaction to a CEO turnover is driven by the percentage of shareholders who vote for a director, not by the percentage of shareholders who vote overall.<sup>478</sup> When there is a forced CEO turnover, the lower board approval predicts a higher likelihood that the CEO will be replaced by someone outside of the company.<sup>479</sup> Similarly, lower board

---

471. See Cai et al., *supra* note 360, at 2411.

472. See *id.* The different results may be explained by the different statistical procedures used. See *id.* at 2410. Cai et al. use a two-stage approach to control for the endogeneity of votes, such that they include firm performance to explain the director votes and use the residual to explain CEO turnover in the second stage. See *id.* Fischer et al. more simply use a multiple regression where they control for various measures of firm performance. See Fischer et al., *supra* note 348, at 180.

473. See Cai et al., *supra* note 360, at 2410-11.

474. See *id.* at 2410.

475. See *id.* at 2411.

476. See Fischer et al., *supra* note 348, at 186-87.

477. See *id.* at 187. The percentage of shareholder support out of votes cast had a significantly negative relationship with both CEO turnover rate and market reaction to the turnover rate, just as before. See *id.* The variable for apathy, the percentage of shares voted out of shares outstanding, did not have a significant correlation with the market reaction to CEO turnover but did have a significantly negative relationship to the likelihood of CEO turnover. See *id.*

478. See *id.*

479. See *id.* at 181-82.

approval predicts an increased likelihood that there will be a director turnover in the following year.<sup>480</sup>

Del Guercio et al. similarly report that “just vote no” campaigns increase the likelihood of CEO turnover.<sup>481</sup> They find that a “just vote no” campaign resulted in a CEO turnover 31% of the time and a forced CEO turnover 25% of the time.<sup>482</sup> These rates were significantly higher than similarly performing control firms.<sup>483</sup> Del Guercio et al. find that these companies have significantly negative abnormal returns in the 250 days leading up to the forced CEO turnover and significantly positive returns in the two days surrounding the announcement.<sup>484</sup> Their results suggest that director elections can have a meaningful impact on corporate elections, even if not by directly replacing the directors.<sup>485</sup>

The CEO turnover resulting from poor election results tends to increase the profitability of the company.<sup>486</sup> Del Guercio et al. find that companies targeted for “just vote no” campaigns tend to have higher operating returns on assets in the three years following the campaign compared to industry peers.<sup>487</sup> However, when they remove the firms with a forced CEO turnover in the year following the campaign, the results become insignificant.<sup>488</sup> In contrast, Cai et al. fail to find a relationship between election results and subsequent firm performance.<sup>489</sup>

---

480. *See id.* at 182 tbl.6 (showing significance at the 5% level).

481. *See* Del Guercio et al., *supra* note 349, at 97.

482. *See id.*

483. *See id.* at 97 tbl.5. They find that the target firms have higher rates of CEO turnover, with a difference of means and medians significant at the 5% level. *See id.* They find that the targeted firms have significantly higher rates of forced CEO turnover, with a difference of means and medians significant at the 1% level. *See id.*

484. *See id.* at 101 tbl.7. For the 250 days leading up to the forced CEO turnover, they find a mean negative abnormal return of -42.75% and a median of -40.28%, both significant at the 1% level. *See id.* For the two days surrounding the announcement, they find mean abnormal returns of 2.52%, significant at the 1% level, and a median of 2.88%, significant at the 5% level. *See id.*

485. *See, e.g.,* Fischer et al., *supra* note 348, at 180.

486. *See* Del Guercio et al., *supra* note 349, at 93.

487. *See id.* When they control for both industry and prior performance, they find a difference of means significant at the 5% level and a difference of medians significant at the 1% level. *See id.* at 92 tbl.2. When they control for only industry, they find a difference of means significant at the 10% level and no significant difference of medians. *See id.*

488. *See id.* at 101 tbl.7.

489. *See* Cai et al., *supra* note 360, at 2414.

Overall, these results provide some evidence that poor elections results increase the likelihood of CEO turnover, which in turn improves the performance of the company.<sup>490</sup>

### 3. Corporate Governance and Takeover Defenses

Director elections can help to bring the corporate governance practices of the company into line with shareholders' expectations<sup>491</sup> by, for example, reigning in excess CEO compensation.<sup>492</sup> Cai et al. find that director elections impact the subsequent change in excess CEO compensation, especially for directors on the compensation committee.<sup>493</sup> A 1% decrease in the votes for a compensation committee member predicts a reduction in unexplained CEO compensation of \$143,000 in the following year.<sup>494</sup> If the director is the chair of the compensation committee, then a 1% decrease in their votes predicts a decrease in excess CEO compensation of \$220,000 in the following year.<sup>495</sup> By contrast, election results for directors not on the compensation committee appear not to impact the subsequent CEO excess compensation.<sup>496</sup> Similarly, Fischer et al. find that higher shareholder support for directors predicts higher subsequent excess CEO compensation, although these results are statistically insignificant.<sup>497</sup>

The results of director elections can increase the likelihood of removing a poison pill.<sup>498</sup> Cai et al. find weak evidence that lower director support increases the likelihood of a company removing its poison pill.<sup>499</sup> Their initial results indicate a significant negative relationship between election results and removing the poison pill, but the relationship disappears when controls are added for firm characteristics.<sup>500</sup> However, lower support for a

---

490. See Del Guercio et al., *supra* note 349, at 93.

491. See, e.g., Cai et al., *supra* note 360, at 2408.

492. See *id.*

493. See *id.*

494. *Id.* at 2410 (showing a coefficient statistically significant at the 1% level).

495. See *id.* (showing a coefficient significant at the 1% level).

496. See *id.*

497. See Fischer et al., *supra* note 348, at 183, 184 tbl.7. They fail to find a correlation between board approval and CEO compensation, but they find a correlation between the quintile rank of board approval and CEO compensation, statistically significant at the 1% level, and a negative correlation between being in the lowest quintile and CEO excess compensation, statistically significant at the 5% level. See *id.* at 184 tbl.7.

498. See Cai et al., *supra* note 360, at 2411.

499. See *id.*

500. See *id.*

governance committee member significantly predicts a higher chance of removing the poison pill.<sup>501</sup>

Weak election results do not affect the odds of declassifying the board.<sup>502</sup> Interestingly, however, an increase in the dispersion of election results between the directors does significantly increase the likelihood of declassifying the board.<sup>503</sup>

The level of shareholder approval of the directors also impacts companies' acquisition activity.<sup>504</sup> Fischer et al. show that higher shareholder support for directors predicts a worse market reaction to a subsequent announcement that the company will be acquiring another firm.<sup>505</sup> They also find a weak correlation between director support in an election and subsequent acquisition activity.<sup>506</sup> External financiers or board members may be more likely to be careful in their analysis of proposed acquisitions when they are perceived to be poorly managing the company.<sup>507</sup> There is also a negative correlation between shareholder approval of directors and the average subsequent divestiture market return.<sup>508</sup> Lower support for directors also predicts more divestiture activity in the following year.<sup>509</sup> Fischer et al. suggest that firm assets are likely to be underperforming at firms with low board approval, which increases returns on divestitures and the probability of more divestitures since there should be more valuable divestiture opportunities.<sup>510</sup> Overall, their results suggest that uncontested director elections can play a meaningful role in reflecting investors' perceptions of board performance.<sup>511</sup>

The board's structure also determines whether the shareholders' votes will meaningfully impact corporate governance. Gal-Or et al. examine elections for directors on the audit committee to determine whether

---

501. *See id.* (showing significance at the 5% level both with and without controls).

502. *See id.* at 2414.

503. *See id.* at 2414 tbl.7 (showing significance between 5% and 1% levels).

504. *See* Fischer et al., *supra* note 348, at 184.

505. *See id.* (showing significance at the 1% level).

506. *See id.* at 185. They fail to find a correlation between board approval and later acquisition activity but find a correlation between the quintile of board approval and subsequent acquisition activity, significant at the 5% level. *See id.*

507. *See id.* at 184.

508. *See id.* at 185 (showing significance at the 1% level).

509. *See id.* at 185-86. They find the correlation between board approval and the number of divestitures is statistically significant at the 1% level, but using quintile measures is significant at the 5% level. *See id.* at 186.

510. *See id.* at 185.

511. *See id.* at 187.

staggered boards affect the impact of director elections.<sup>512</sup> They postulate that directors on staggered boards are more insulated from the opinion of shareholders because they are elected only once every three years and therefore may be less responsive to shareholder concerns.<sup>513</sup>

They find that accounting financial experts on the audit committee are more likely to be turned over following low shareholder support, but only if they sit on a non-staggered board.<sup>514</sup> Furthermore, weak shareholder approval increases the likelihood that the departing accounting financial expert will be replaced with another accounting financial expert on non-staggered boards, but is not significant for staggered boards.<sup>515</sup> Audit committees on non-staggered boards are more likely to increase the number of meetings following low support from shareholders, which the authors use as a proxy for diligence.<sup>516</sup>

Low shareholder support, however, does not lead to any change in meeting frequency for audit committees of staggered boards.<sup>517</sup> The low shareholder support also does not increase the number of board meetings or compensation committee meetings at companies with either staggered or non-staggered boards.<sup>518</sup> Low shareholder support in audit committee elections also reduces money spent on tax non-audit services, but only for non-staggered boards.<sup>519</sup> The non-staggered boards decreased discretionary accruals following low support from shareholders, while staggered boards remained insignificant.<sup>520</sup>

---

512. Ronen Gal-Or et al., *The Efficacy of Shareholder Voting in Staggered and Non-Staggered Boards: The Case of Audit Committee Elections*, 35 AUDITING: J. PRAC. & THEORY 73 (2016). Their sample includes more than 18,296 director elections in more than 6786 firm year observations between 2004 and 2010. *Id.* at 74.

513. *See id.*

514. *See id.* at 87 (showing significance at the 5% level). The authors found no relationship between the level of support for a director who is on the committee and is an accounting financial expert and the likelihood of that director's turnover. *See id.* For these directors on non-staggered boards, receiving low support increases the likelihood of turnover by 5.2%. *See id.*

515. *See id.* (showing significance at the 5% level).

516. *See id.* (showing significance at the 5% level). The regression suggests that the number of meetings increases by 3.7 meetings. *See id.*

517. *See id.*

518. *See id.* at 87-89.

519. *See id.* at 89 (showing significance at the 10% level). The authors acknowledge however that the economic significance of the reduction is small, only about 2.9 for firms with the highest spending. *See id.*

520. *See id.* at 91-92 (showing significance at the 5% level).

As a whole, their study suggests non-staggered boards are more responsive to shareholders than staggered boards.<sup>521</sup> The study also suggests that researchers should be cognizant of whether they are looking at staggered or non-staggered boards when studying the impact of uncontested director elections.<sup>522</sup>

#### 4. *Shift to Majority Voting*

Choi et al. argue that firms experienced a major shift from plurality voting to majority voting between 2005 and 2015 and that this shift has affected uncontested director elections.<sup>523</sup> If a director's election is uncontested, then that director needs only a single vote to win reelection under a plurality voting system.<sup>524</sup> Under a majority voting system, however, the director would still need support from a majority of shareholders.<sup>525</sup> Despite the increased accountability allegedly created by majority voting, directors are much less likely to fail to receive a majority of shareholder support in a majority voting system compared to a plurality voting system.<sup>526</sup>

Choi et al. find that this difference largely results from the self-selection of firms to move from plurality voting to majority voting.<sup>527</sup> The motivation for shifting from plurality to majority voting changed between the first half of the period, from 2007 to 2009, and the latter half of the period, from 2010 to 2012.<sup>528</sup> The early adopters self-selected, while the later adopters

---

521. *See id.*

522. *See id.*

523. *See* Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1120, 1120-24 (2016). Their data set includes 64,933 elections between 2007 and 2013. *Id.* at 1135. The number of firms with majority voting has grown from 16% of S&P 500 companies in 2006 to almost 90% in 2014. *See id.* at 1127.

524. *See id.* at 1121.

525. *See id.*

526. *See id.* at 1122. Between 2007 and 2013, 0.03% of directors at majority firms failed to receive majority support, compared to 0.6% at plurality firms. *See id.* at 1129 (showing a significant difference at the 1% level).

527. *See id.* Firms that decided to switch from plurality to majority voting in 2011 were less likely to have previously received a "withhold" recommendation or a significant number of "withhold" votes from shareholders compared to firms who did not switch. *See id.* at 1140. The authors confirm this result using a Cox proportional hazard model. *See id.* at 1141. Additionally, firms with a poison pill were less likely to adopt majority voting. *See id.* at 1142. Interestingly, companies with better stock performance were less likely to adopt majority voting. *See id.* Shareholders apparently seek more accountability from firms that are not performing as well. *See id.*

528. *See id.* at 1146.

were responding to shareholder pressure.<sup>529</sup> The adoption of majority voting results in a decreased likelihood of receiving a “withhold” vote of more than 30% by 2 to 3 percentage points.<sup>530</sup> When divided between early and late adopters, the decreased likelihood has a much higher magnitude and statistical significance for the late adopters compared to the early adopters.<sup>531</sup> Directors are much less likely to miss more than 25% of board meetings after the adoption of majority voting as compared to before.<sup>532</sup>

However, boards are no more likely to implement shareholder proposals after adopting majority voting.<sup>533</sup> Given that a director has committed certain “offensive” conduct, leading to them receiving a “withhold” recommendation from ISS, the odds of a majority of shareholders casting a “withhold” vote is higher at firms with plurality voting than at firms with majority voting.<sup>534</sup> These results suggest that directors engage in certain electioneering practices, but it is unclear exactly which practices.<sup>535</sup> Overall, majority voting adds a new dimension to director elections that deserves further study.

### 5. Summary

Empirical studies paint a picture of director elections that are more meaningful than the dearth of competition and uniformly high rate of “for” votes would suggest.<sup>536</sup> Simultaneously, however, the elections act less as a direct check on the directors’ ability to maintain profits and more to ensure

---

529. *See id.* When the authors split the sample between firms that adopted majority voting between 2007 and 2009 and those that adopted it between 2010 and 2012, the ISS “withhold” recommendation and the presence of the poison pill remain significant only for the early adopters, while abnormal returns remains significant only for the later adopters. *See id.*

530. *See id.* at 1150 (showing significance at the 1% level).

531. *See id.* at 1151. Additionally, firms that adopt majority voting are less likely to receive a high “withhold” vote relative to their industry matched peers. *See id.* at 1153 (showing significance at the 1% level). When split between early and later adopters, the difference from industry match peers remains statistically significant only for late adopters. *See id.* at 1156-57.

532. *See id.* at 1167, 1169 tbl.8 (showing significance at the 5% level).

533. *See id.* at 1164.

534. *See id.* at 1173. The other conduct that the authors considered to be “offensive” was to miss more than 25% of board meetings. *See id.* When the authors split the sample between early adopters and late adopters, they find evidence that early adopters are doing electioneering, while late adopters are not. *See id.*

535. *See id.* at 1166.

536. *See, e.g.,* Fischer et al., *supra* note 348, at 173.

that they continue to perform their responsibilities.<sup>537</sup> Company performance has only a limited impact on the outcome of a director election, with results ranging from a statistically but not economically significant relationship to no relationship at all.<sup>538</sup>

The ability of directors to perform their stated duties appears to have a larger effect on their election results, somewhat irrespective of how it impacts the company's bottom line.<sup>539</sup> Directors receive fewer "for" votes when they allow the CEO to receive excess compensation.<sup>540</sup> Shareholder can even distinguish between the failings of different directors.<sup>541</sup> When there is a material weakness in the internal controls of the company, shareholders are more likely to withhold their votes for management directors but not directors on the audit committee.<sup>542</sup> One of the biggest factors impacting election results is the director's neglect of responsibilities and failure to attend three-quarters of the board meetings.<sup>543</sup>

These results perhaps show that shareholders can distinguish between the performance of the company and the performance of its directors.<sup>544</sup> They may also show that free-rider problems prevent shareholders from assessing how the director's decisions affect the company's profitability and instead rely on heuristic cues to make voting decisions, such as board meeting attendance.<sup>545</sup> The strong impact of ISS decisions, even when performance is controlled for, points toward the latter interpretation.<sup>546</sup> Interestingly, while the specific failures of directors hurt the election results, poor election results have a greater impact on a company's management than specific directors.<sup>547</sup>

While some evidence suggests that low support for directors will lead to their resignation, often directors will replace the company's management and keep a tight hold on to their own seats. Thus, uncontested director elections can be understood as keeping corporate governance on track without passing judgment on the efficacy of corporate policies.

---

537. *See supra* Section III.A.1.

538. *See supra* Section III.A.1.

539. *See supra* Section III.A.2.

540. *See supra* Section III.A.5.

541. *See supra* Section III.A.3.

542. *See supra* Section III.A.4.

543. *See supra* Section III.A.3.

544. *See supra* Section III.A.3.

545. *See supra* Section III.A.3 and text accompanying note 352.

546. *See supra* Section III.B.3.

547. *See supra* Section III.C.1.



#### IV. Management Proposals

##### A. In General

Unlike director elections and proxy contests, management proposals often have a binding effect and give shareholders a direct say on directors' governance of the corporation.<sup>548</sup> These proposals also raise collective action concerns.<sup>549</sup> Most shareholders own too few shares to make a meaningful impact on the vote tally and so may maintain a rational ignorance of the corporation's affairs.<sup>550</sup> Some practical aspects of the proxy process may give managers an inherent advantage in receiving votes for their proposals.<sup>551</sup> Managers can bundle controversial proposals with favorable ones.<sup>552</sup> Managers can also hire proxy solicitors to help pass proposals.<sup>553</sup>

At first glance, shareholders appear to rubber stamp management proposals.<sup>554</sup> On average, about 80% of shareholders support the management proposal.<sup>555</sup> Less than 2% of management proposals fail to receive the necessary support from shareholders.<sup>556</sup>

Management appears to have a significant structural advantage in winning the necessary votes to pass their management proposals.<sup>557</sup> By examining the continuity of the distribution of close votes, Listokin finds significantly more management proposals that just barely pass than just barely fail to pass, suggesting that management is able to influence close votes to secure passage.<sup>558</sup> He rejects the possible explanation that

---

548. Jennifer E. Bethel & Stuart L. Gillan, *Corporate Voting and the Proxy Process: Managerial Control Versus Shareholder Oversight* 4-5 (paper presented at Tuck-JFE Contemporary Corp. Governance Conference, 2000), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=236099](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=236099).

549. Ernst Maug & Kristian Rydqvist, *Do Shareholders Vote Strategically? Voting Behavior, Proposal Screening, and Majority Rules*, 13 REV. FIN. 47, 47-48 (2008).

550. See Bethel & Gillan, *supra* note 548, at 4-5.

551. See *id.* at 5.

552. See *id.* at 7.

553. *Id.* at 8.

554. See *id.* at 2-3.

555. See Maug & Rydqvist, *supra* note 549, at 63 (finding that management proposals between 1994 and 2003 received 82.8% of shareholder support on average).

556. See *id.* (finding that management proposals pass 98.5% of the time); Bethel & Gillan, *supra* note 548, at 2-3.

557. See Yair Listokin, *Management Always Wins the Close Ones*, 10 AM. L. & ECON. REV. 159, 173-74 (2008).

558. See *id.* at 173. Listokin uses a "caliper test" to determine the probability that the discontinuity surrounding the 50% mark is due to random chance. *Id.* (using the caliper test

management works to get to the 50% mark and then stops because the votes follow simple majority rules where the total number of votes that will be cast is itself uncertain.<sup>559</sup>

As a comparison, he looks at the distribution of votes on shareholder-sponsored resolutions, which are nonbinding, and finds that the distribution can easily be attributed to chance.<sup>560</sup> He also finds that larger companies have a higher likelihood of winning a close election, while the level of institutional ownership and the score on the governance index has no significant association.<sup>561</sup> These numbers may reflect management's ability to track the results of the vote as they come in (accurate within a single percentage point) and intercede to shift the balance of close elections.<sup>562</sup>

### 1. Bundling

Another form of potential abuse is that managers can bundle separate issues together into a single management proposal in order to achieve the result that they want.<sup>563</sup> In 1992, the SEC implemented "Unbundling Rules" that prohibit companies from bundling together multiple voting items into a single box on the ballot.<sup>564</sup> Cox et al. discover that some form of bundling occurs in 28% of management proposals in their sample.<sup>565</sup> Bundled proposals include items that would increase shareholder rights in nearly three times as many cases as items relating to restricting shareholder rights.<sup>566</sup> However, many of the cases that would expand shareholder rights relate to board declassification, where there is no intrinsic need for the items to be bundled.<sup>567</sup>

---

suggested by Alan Gerber & Neil Malhotra, *Do Statistical Reporting Standards Affect What Is Published? Publication Bias in Two Leading Political Science Journals*, 3 Q.J. POL. SCI. 313 (2008)). The test shows that the odds that the distribution is a result of random chance is less than one in a billion. *Id.*

559. *See id.* at 173-74.

560. *See id.* at 174-75.

561. *Id.* at 175-76 (demonstrating significance at the 1% level).

562. *See id.* at 176-77.

563. James D. Cox et al., *Quieting the Shareholders' Voice: Empirical Evidence of Pervasive Bundling in Proxy Solicitations*, 89 S. CAL. L. REV. 1175, 1175 (2016). They collect a sample of 1349 management proposals between 2003 and 2012. *Id.* at 1220-21.

564. *Id.* at 1178.

565. *Id.* at 1220-21. More specifically, bundling with at least one material item occurs in 23% of cases. *Id.* at 1221. Finally, a bundling of two or more material issues occurs in 18% of cases. *Id.* at 1222.

566. *Id.* at 1228.

567. *Id.*

Proxy advisors, particularly ISS and Glass Lewis, make their voting recommendations for bundled proposals “based on the perceived net effect of the items in the bundle.”<sup>568</sup> ISS recommended an “against” vote for less than 10% of the items with some degree of bundling.<sup>569</sup> All of the proposals with the “against” recommendation tended to restrict shareholder rights.<sup>570</sup> Additionally, ISS only notes the bundling issue in 13% of bundled proposals.<sup>571</sup> These results suggest that shareholders cannot rely on proxy advisors to identify bundled proposals.<sup>572</sup>

On average, only 4.2% of shareholders vote against the bundled proposals.<sup>573</sup> The authors find similar results when looking at Glass Lewis’s recommendations and its impact on shareholder voting.<sup>574</sup> Overall, it appears that managers use bundling as a strategy to influence shareholder votes, and this tool is an effective one.

## 2. Use of Proxy Solicitors

According to Bethel and Gillan, managers’ use of proxy solicitors does not appear to have a major impact on the voting results.<sup>575</sup> They find no relationship between the amount of money spent on proxy solicitors and the voter turnout.<sup>576</sup> In fact, money spent on proxy solicitors was negatively correlated with votes cast in favor of management.<sup>577</sup> The most likely explanation for that result is that elections where the company spent more on a proxy solicitor were probably also more controversial and faced greater shareholder resistance.<sup>578</sup> They may also be nonroutine proposals where brokers are not able to vote uninstructed shares.<sup>579</sup>

---

568. *Id.* at 1230.

569. *See id.* at 1233.

570. *See id.* The thirty-one proposals with an “against” recommendation represented 37% of all the proposals that hurt shareholder rights. *See id.* The authors suggest that the reason that only thirty-one of the eighty-four proposals that hurt shareholder rights received an “against” recommendation is because those proposals also contained issues that would expand shareholder rights. *Id.*

571. *See id.*

572. *See id.* at 1234.

573. *Id.* However, voter dissent rises to 25.7% when ISS gives a “vote against” recommendation. *Id.* Only seven of the thirty-one proposals with an “against” recommendation failed to receive support from a majority of shareholders. *Id.*

574. *See id.* at 1234-36.

575. Bethel & Gillan, *supra* note 548, at 21.

576. *See id.*

577. *See id.* at 21, 40 tbl.8 (demonstrating significance at the 1% level).

578. *See id.* at 22.

579. *See id.*

Some other important results from their research include the finding that managers were more likely to use a proxy solicitor and spend more money on solicitors in votes on nonroutine management proposals than routine management proposals.<sup>580</sup> Higher insider and block ownership predicted less spending on a proxy solicitor and a lower likelihood of using a solicitor.<sup>581</sup> The presence of insiders and blockholders made the use of proxy solicitors less necessary.<sup>582</sup> However, higher institutional ownership predicted more money spent on proxy solicitors, suggesting that management uses proxy solicitors to interact with institutional investors.<sup>583</sup> The authors, however, fail to find any relationship between the amount of money spent on a proxy solicitor and the voting results, presumably because management spends more money on measures that have more shareholder resistance.<sup>584</sup>

Other characteristics of the company also influence voting results on management proposals.<sup>585</sup> Bethel and Gillan find that companies with management proposals tend to have higher market-to-book ratios, market-adjusted returns, price earnings ratios, insider holdings, and less debt.<sup>586</sup> A negative recommendation from ISS leads to significantly fewer votes in favor of the management proposal.<sup>587</sup> Higher levels of block ownership predict higher shareholder support for management proposals.<sup>588</sup>

### 3. Mutual Fund Voting

Mutual funds are major shareholders in most public companies, so the impact of their voting on management proposals is substantial, but studies disagree on whether their business ties or conflicts of interest influence how they vote.<sup>589</sup> By way of background, the equity assets owned by mutual funds increased from \$83 billion to \$4.49 trillion between 1984 and

---

580. *See id.* at 22, 42 tbl.9 (demonstrating significance at the 10% and 1% levels respectively).

581. *See id.* at 23, 42 tbl.9 (demonstrating significance at the 1% level).

582. *See id.* at 23.

583. *See id.* at 23, 42 tbl.9 (demonstrating significance at the 1% level).

584. *See id.* at 21-22.

585. *See id.* at 15.

586. *Id.* All results were different at the 1% level, except for the debt-to-asset ratio, which was different at the 5% level. *Id.* at 30 tbl.1.

587. *See id.* at 21.

588. *See id.* at 23, 42 tbl.9 (demonstrating significance at the 1% level).

589. *See* Burton Rothberg & Steven Lilien, *Mutual Funds and Proxy Voting: New Evidence on Corporate Governance*, 1 J. BUS. & TECH. L. 157, 157-58 (2006).

2004.<sup>590</sup> In 2004, mutual funds held about 24% of U.S. stock market capitalization.<sup>591</sup> To guide their voting on management proposals, the largest mutual funds have adopted voting guidelines, although many delegate the voting of their proxies to ISS in accordance with these guidelines.<sup>592</sup>

Rothberg and Lilien find that all of the ten largest funds had policies in 2004 of voting against at least one antitakeover defense, including eight against dual class stock, seven against supermajority voting and classified boards, and five supporting restricting poison pills.<sup>593</sup> They find that mutual funds rarely supported social or political activists, with some funds saying they would support management and others stating they would follow ISS or even abstain.<sup>594</sup> These authors interpret mutual funds' voting decisions as evidence that they are willing to confront management to increase shareholder value.<sup>595</sup>

Overall, mutual funds support management proposals about 80% of the time.<sup>596</sup> For proposals on takeover defenses, they voted against management 59% of the time, including 70% on poison pills.<sup>597</sup> They voted "no" on 47% of stock option compensation proposals but only voted "no" on 9% of bonus compensation proposals.<sup>598</sup> Funds within the same family tended to vote the same way on the same proposals.<sup>599</sup> For example, Fidelity's funds only voted differently from each other 0.8% of the time, mostly where one voted against and another abstained, presumably as a result of some sort of communications error.<sup>600</sup> Rothberg and Lilien note that the six funds that take long-term positions in companies were much more likely to vote with management than the five largest funds.<sup>601</sup> They find similar voting patterns between the four "mostly mutual fund" families

---

590. *Id.* at 159.

591. *Id.* at 160.

592. *See id.* at 163.

593. *Id.* at 164.

594. *Id.* at 165.

595. *Id.* at 164.

596. *Id.* at 167 (finding that the top five funds voted against management 17% of the time); *cf.* Lilian Ng et al., *Firm Performance and Mutual Fund Voting*, 33 J. BANKING FIN. 2207, 2210 (2009) (finding that mutual funds supported management between 65% and 98% of the time depending on the type of management proposal).

597. Rothberg & Lilien, *supra* note 589, at 167.

598. *Id.*

599. *Id.*

600. *Id.*

601. *Id.* at 169 (noting 95% versus 81% support of management).

and the four mutual funds that mostly get their business from another source.<sup>602</sup> This result suggests that business ties are not a major factor in mutual funds' observations.<sup>603</sup>

However, Ng et al. find evidence that mutual funds' voting is partly driven by conflicts of interest.<sup>604</sup> They compare mutual funds without business ties to those with business ties, which they define as those with banking, insurance, brokerage, or investment banking parents or large 401(k) business or large retirement accounts.<sup>605</sup> A difference of means test finds statistically significant differences between the two groups for eleven of the twenty proposal types.<sup>606</sup> This result shows that mutual funds with business ties vote differently than those without them.<sup>607</sup> They also find that strong company performance and an ISS recommendation increases the odds that the mutual fund will support the management proposal.<sup>608</sup>

#### 4. Confidential Voting

Confidential voting does not appear to eliminate management's advantage in voting on management proposals. Confidential voting prevents management from knowing how any individual shareholder voted.<sup>609</sup> Theory suggests that confidential voting would mitigate conflicts of interest, since shareholders, particularly institutional investors, could vote against management without losing their favor.<sup>610</sup> Romano, however, fails to find a relationship between having confidential voting and shareholder support for management proposals.<sup>611</sup> These results undermine the hypothesis that confidential voting will reduce the effects of conflicts of

---

602. *See id.* at 170-71.

603. *See id.* at 171.

604. *See* Ng et al., *supra* note 596, at 2215-16.

605. *Id.*

606. *Id.* (demonstrating significance at the 5% level ten times and the 10% level once).

607. *Id.* at 2216.

608. *See id.* at 2212-14 (varying significance between the 10% and 5% level depending on proposal type).

609. *See* Roberta Romano, *Does Confidential Proxy Voting Matter?*, 32 J. LEGAL STUD. 465, 466 (2003). She examines proxy proposal outcomes for firms that adopted confidential voting between 1988 and 1997, leading to a sample of 129 firms with 920 management proposals and 801 shareholder proposals. *Id.* at 472, 480. Of the 129 firms with confidential voting, only fifty-two firms had shareholder votes on a proposal to adopt confidential voting. *Id.* at 474. The proposals voted on before the adoption of confidential voting received an average support of 39.2%. *Id.* at 475. Of these, seven received majority support, leading management to adopt confidential voting in the following years. *See id.*

610. *See id.* at 466.

611. *See id.* at 493, 496.

interest in institutional investors.<sup>612</sup> It is, however, possible that managers submit more favorable plans in anticipation of the decreased support resulting from having confidential voting.<sup>613</sup> Romano also fails to find abnormal returns surrounding the announcement of plans to adopt confidential voting.<sup>614</sup> She argues that the insignificant stock market reaction suggests that confidential voting does not increase the value of the company.<sup>615</sup>

Shareholders may be able to vote strategically on management proposals.<sup>616</sup> Maug and Rydqvist develop a model where each shareholder has access to some private information and all the public information.<sup>617</sup> Shareholders do not know each other's private information but do know how they intend to vote.<sup>618</sup> If each shareholder uses "sincere voting," then they will vote based on their own private information but will disregard others' voting intentions.<sup>619</sup> Sincere voting creates a problem with supermajority requirements, where more than half of shareholders have information that the proposal will increase value but the vote still fails.<sup>620</sup> However, if voters engage in "strategic voting," then they will recognize how others intend to vote and adjust their votes to reflect the collective wisdom of the shareholders, allowing the supermajority proposal to pass.<sup>621</sup>

Maug and Rydqvist find that shareholder support increases when a proposal requires supermajority support, suggesting that shareholders vote strategically.<sup>622</sup> The impact of strategic voting changes 77 of the 510 supermajority proposals from fail to pass.<sup>623</sup> These results suggest that shareholders are able to take into account the information of other shareholders and overcome collective action problems.<sup>624</sup>

---

612. *See id.* at 496.

613. *See id.* at 496-97.

614. *See id.* at 502-04.

615. *Id.* at 504.

616. *See* Maug & Rydqvist, *supra* note 549, at 47.

617. *Id.* at 48.

618. *See id.* at 48-49.

619. *See id.* at 49.

620. *See id.*

621. *See id.*

622. *See id.* at 67.

623. *Id.*

624. *See id.* at 74. An alternative explanation may be that managers campaign harder when their proposal requires supermajority approval. *See id.* at 73-74. However, Maug and Rydqvist reject this explanation by looking at a matched sample of simple majority and supermajority provisions that were voted on at the same meeting and still found a higher approval for the supermajority provisions. *See id.* at 73.

To better understand management proposals, we next examine the evidence related to shareholder voting on four types of management proposals: antitakeover amendments, mergers and acquisitions, auditor ratification, and compensation proposals.

### *B. Antitakeover Amendments*

Scholars disagree on whether antitakeover amendments will help to increase the corporation's value.<sup>625</sup> Some argue that antitakeover amendments destroy shareholder value by exacerbating managerial agency costs and decreasing the odds of a takeover.<sup>626</sup> Others claim, however, that antitakeover amendments increase value by giving management negotiating leverage with bidders and providing managers with short-term job security.<sup>627</sup>

#### *1. Stock Price Effects*

Older studies have shown that shareholders generally vote to approve antitakeover amendments,<sup>628</sup> although this appears to no longer be the case. Between 1985 and 1988, however, Young et al. find that antitakeover amendments on average received the support of 80% of shareholders.<sup>629</sup> Data from this time period shows that more than 95% of amendments on average receive the needed majority support from shareholders to pass.<sup>630</sup>

By the 1990s, however, things had changed. Institutional investors held an ever-increasing percentage of most public companies' stock and began to engage in shareholder activism.<sup>631</sup> In particular, they began voting against antitakeover defenses proposed by corporate management based on

---

625. See Erin E. Smith, *The Value of Antitakeover Provisions in the Post-SOX Era 2* (last revised Mar. 16, 2017) (unpublished manuscript), <http://ssrn.com/abstract=2303921>.

626. *Id.*

627. *See id.*

628. See, e.g., James A. Brickley et al., *Corporate Voting: Evidence from Charter Amendment Proposals*, 1 J. CORP. FIN. 5, 8-9 (1994) [hereinafter Brickley et al., *Corporate Voting*].

629. See Philip J. Young et al., *Trading Volume, Management Solicitation, and Shareholder Voting*, 33 J. FIN. ECON. 57, 61 (1993).

630. See Brickley et al., *Corporate Voting*, *supra* note 628, at 8 (finding that about 5% of antitakeover amendments failed to pass); Sanjai Bhagat & Richard H. Jefferis, *Voting Power in the Proxy Process: The Case of Antitakeover Charter Amendments*, 30 J. FIN. ECON. 193, 223 (1991) (finding that only one antitakeover proposal failed to pass out of 187).

631. Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 827-29 (1992).



empirical studies such as the ones summarized below.<sup>632</sup> As a result, it became impossible for corporate management to win shareholder approval for charter amendments to insert classified boards and other antitakeover defenses.

Agrawal and Mandelker examine the stock returns surrounding the announcement of antitakeover amendments and find that the amendments appear to hurt the corporations' value.<sup>633</sup> They find significantly negative cumulative average abnormal returns ("CAARs") of -2.6% during the forty days leading up to and including the announcement of the proposed amendments.<sup>634</sup> Interestingly, when they shorten the period to the ten days leading up to the announcement, they find insignificant results, suggesting that news of the proposed amendment has already been incorporated into the stock market price.<sup>635</sup>

The authors find that the announcement of a proposal to add a supermajority voting provision with a board-out clause<sup>636</sup> resulted, on average, in significantly negative CARs, while votes on supermajority and authorized preferred stock provisions resulted, on average, in weakly negative returns.<sup>637</sup> The negative stock market reaction is probably due to the combination of a supermajority provision with a board-out clause, which gives enormous power to managers to prevent a takeover or to discriminate against bidders.<sup>638</sup>

Bhagat and Jefferis similarly report that firms that propose antitakeover amendments have significantly worse returns around the announcement

---

632. See James A. Brickley et al., *Ownership Structure and Voting on Antitakeover Amendments*, 20 J. FIN. ECON. 267, 273-74 (1988) [hereinafter Brickley et al., *Ownership Structure*].

633. See Anup Agrawal & Gershon N. Mandelker, *Large Shareholders and the Monitoring of Managers: The Case of Antitakeover Charter Amendments*, 25 J. FIN. & QUANTITATIVE ANALYSIS 143, 149-51 (1990).

634. See *id.* at 149 (demonstrating significance at the 1% level). Only 41.7% of their sample had positive cumulative abnormal returns during this period. *Id.*

635. See *id.*

636. A supermajority voting provision with a board-out clause requires support from a supermajority of shareholders, generally between 66% and 95%, in order for a merger to be approved, but allows the board to waive this requirement. See *id.* at 144.

637. See *id.* at 156, 157 tbl.6. The presence of a supermajority with a board-out clause predicts negative CARs, significant at the 1% level, for the forty- and twenty-day periods. See *id.* at 157 tbl.6. The presence of a supermajority provision predicts negative CARs, significant at the 5% level, for the twenty-day period. See *id.* The presence of an authorized preferred stock provisions predicts a negative CAR, significant at the 10% level, for the forty-day period. See *id.*

638. See *id.* at 156.

date than industry-matched control firms.<sup>639</sup> The result holds for each group of amendments: amendments that entrench the board, fair-price or supermajority amendments, anti-greenmail amendments, and blank-check preferred stock amendments.<sup>640</sup> They use weighted maximum likelihood estimates to show that antitakeover amendments destroy about 1% of a company's value.<sup>641</sup>

Smith, however, examines the stock market's reaction to close votes and claims that passing an antitakeover provision increases the value of the firm by 4.66%.<sup>642</sup> However, this same study finds that close proposals to repeal an antitakeover amendment did not have a statistically significant effect on company value.<sup>643</sup> The difference in results may be due to the different time periods examined.<sup>644</sup>

## 2. *Impact of Institutional Investor Holdings*

Institutional investors and blockholders actively monitor the adoption of antitakeover amendments and help to screen out those that would decrease the corporation's value.<sup>645</sup> Brickley et al. (1988) find that institutional investors are more likely to vote on, and more likely to vote against, the antitakeover amendments.<sup>646</sup> Their results show that institutional investors are active in the affairs of the firm and do not rubber stamp management.<sup>647</sup>

Agrawal and Mandelker conclude that corporations with higher levels of institutional ownership had better stock returns leading up to the announcement of the amendment.<sup>648</sup> They argue that their results are

---

639. See Bhagat and Jefferis, *supra* note 630, at 203. They fail to find significant returns for the antitakeover firms over the three-day announcement period. See *id.* However, the control group had positive returns over the same period, significant at the 1% level for all types of amendments, which were significantly different from the antitakeover firms at the 1% level. See *id.*

640. See *id.*

641. See *id.* at 215. The same results hold when they separate amendments that entrench the board from those that require a fair price or supermajority support in a takeover. See *id.*

642. See Smith, *supra* note 625, at 26, 54 tbl.2 (demonstrating significance at the 1% level).

643. See *id.*

644. Compare Bhagat & Jefferis, *supra* note 630, at 196 (using a sample period of 1984-1984) with Smith, *supra* note 625, at 1 (using a sample period of 2006-2010).

645. See Brickley et al., *Ownership Structure*, *supra* note 632, at 273-74.

646. *Id.* at 274 (finding both results statistically significant at the .01 level).

647. *Id.*

648. See Agrawal & Mandelker, *supra* note 633, at 151. They divide the firms into three groups based on the percentage of institutional ownership. *Id.* at 150-51. They find that the group with the lowest institutional ownership has significantly negative CAARs during the

consistent with the active monitoring hypothesis—that more sophisticated and well-informed shareholders, such as institutional investors, are more likely to vote in their economic interests.<sup>649</sup> Their results may underestimate the impact of institutional ownership because management knows about institutional opposition before they propose the amendment.<sup>650</sup> Similarly, the more investments by institutions, the more likely that the announcement of the amendment would receive a better stock market reaction.<sup>651</sup> The concentration of institutional ownership in the five largest institutional investors also positively relates to a better stock market reaction to the amendment announcement.<sup>652</sup>

Agrawal and Mandelker also show that firms with higher levels of block ownership are also more likely to receive better CARs leading up to the amendment announcement.<sup>653</sup> Using a multiple regression model, they find a significant relationship between institutional ownership and CARs around the announcement for fair-price provisions, supermajority provisions, and supermajority with board-out provisions, while finding no relationship with classified board provisions and authorized preferred stock.<sup>654</sup>

---

forty and twenty days leading up to the announcement, at the 1% and 5% levels respectively. *See id.* at 151 & tbl.3. The other two groups had CAARs indistinguishable from zero. *See id.* at 151. The CAARs of the groups with the largest and smallest institutional ownership during the forty-day period were significantly different at the 1% level. *See id.*

649. *See id.* For a discussion of the active and passive monitoring hypotheses, see *id.* at 143-44.

650. *See id.* at 151-52.

651. *See id.* at 152. As before, they divide the firms into three groups based on the dollar value of institutional ownership. *See id.* For the group with the smallest institutional ownership, they find significantly negative CAARs of -5.4% for the forty-day period ( $z$ -score = -3.09) and -3.09% ( $z$ -score = -1.89) for the twenty-day period. *See id.* The other two groups had insignificant results. *See id.*

652. *See id.* at 153. They use Herfindahl Index to measure the concentration of institutional investors. *Id.* After the dividing the firms between three groups based on the Herfindahl Index, the group with the lowest concentration had significantly negative CAARs of -3.8% over the forty-day period and -2.6% over the twenty-day period, significant at the 1% and 5% levels. *See id.* at 153, 154 tbl.4. The other two groups had insignificant returns. *Id.*

653. *See id.* at 153-54. The third of firms with the lowest 5% or greater ownership had a CAAR of -3.3% over the forty days leading up to the amendment announcement, significant at the 10% level. *See id.* at 154. The other two-thirds had insignificant results. *See id.*

654. *See id.* at 156. They use interaction variables to test the relationship of institutional ownership to CARs for specific types of antitakeover provisions. *See id.* For supermajority with a board-out clause, higher institutional ownership predicts better CARs at the 5% and 1% levels for the forty-day and twenty-day periods. *See id.* at 157 tbl.6. For a supermajority provision, higher institutional ownership predicted better CARs at the 10% and 5% levels for

Bhagat and Jefferis, however, fail to find a correlation between the level of institutional ownership and the likelihood of proposing an antitakeover amendment, suggesting that institutions increase the value of antitakeover amendments by some way other than deterring management from proposing them.<sup>655</sup> The type of institutional investor can also impact support for the antitakeover amendment.<sup>656</sup> Theory suggests that pressure-sensitive institutions, such as insurance companies, banks, and trusts, tend to be more susceptible to management coercion, while pressure-insensitive institutions, such as corporate pension funds, brokerage houses, and investment council firms, tend not to be susceptible to such pressure.<sup>657</sup> As expected, Brickley et al. (1988) find that the pressure-sensitive institutions correlated positively with the “voted for” while the pressure-resistant institutions correlated negatively, and vice versa for the “voted against” regression.<sup>658</sup>

Brickley et al. (1994) also report that higher ownership by pressure-sensitive institutions increases support for the proposal, while higher ownership by pressure-insensitive institutions decreases support for the proposal.<sup>659</sup> Similarly, they find that high ownership by blockholders increases the proportion of outstanding votes cast.<sup>660</sup> These results suggest that blockholders have greater incentive to overcome free-rider problems associated with voting.<sup>661</sup> The presence of more institutional owners either makes managers less likely to propose antitakeover amendments or moderates their negative effects through better monitoring or greater voting

---

the forty-day and twenty-day periods. *See id.* For fair price provisions, institutional ownership predicts better CARs at the 10% level in the forty-day and twenty-day periods. *See id.*

655. *See* Bhagat & Jefferis, *supra* note 630, at 214. They note that their data does not allow them to distinguish between institutional investors that might be biased towards management from those who are independent. *See id.*

656. *See* Brickley et al., *Ownership Structure*, *supra* note 632, at 277, 278 tbl.2.

657. *See id.* at 277.

658. *See id.* at 278 tbl.2. The hypothesis that the pressure-sensitive and pressure-resistant variables are equal can be rejected at the .05 significance level. *See id.* at 279 n.13.

659. *See* Brickley et al., *Corporate Voting*, *supra* note 628, at 21 tbl.3, 22. Pressure-sensitive institutions are those that are easily pressured by management, including insurance companies, banks, and non-bank trusts, while pressure-insensitive institutions include public pension funds, mutual funds, endowments, and foundations. *Id.* at 20 n.11.

660. *See id.* at 18-19, 19 tbl.2 (demonstrating significance at the 1% level). Their model predicts that every 1% increase in blockholder ownership will result in an increase of 0.1% of votes cast. *See id.*

661. *See id.* at 19.

power in the presence of a takeover bid.<sup>662</sup> However, institutional investors may just be better at identifying firms that are more likely to be successfully taken over or have management that would not propose a value-harming amendment.<sup>663</sup>

### 3. Management Stock Holdings

Studies find that managers who are also shareholders tend to vote in favor of antitakeover proposals.<sup>664</sup> Brickley et al. (1988) find that managerial stock ownership is not significantly related to the percentage of votes cast but is significantly related to the percentage of “for” votes, possibly because management ownership reduces other shareholders’ incentives to vote.<sup>665</sup>

Bhagat and Jefferis find that the CEOs of the firms proposing the amendments and all directors and officers as a group received higher compensation as a percentage of firm value than the control firms.<sup>666</sup> The CEO and the officers and directors at the amendment firms owned a lower percentage of the voting rights compared to the control firms.<sup>667</sup> They find no significant difference in earnings between the two groups.<sup>668</sup> The fraction of votes held by the CEOs, all officers and directors, or outside directors negatively correlated with the probability of proposing an antitakeover amendment.<sup>669</sup> Having officers who are also 5% blockholders decreases the likelihood of management proposing an antitakeover amendment when other ownership characteristics are controlled for.<sup>670</sup> The

---

662. See Agrawal & Mandelker, *supra* note 633, at 156-57.

663. See *id.* at 158.

664. See Brickley et al., *Ownership Structure*, *supra* note 632, at 273-74.

665. *Id.* at 274.

666. See Bhagat & Jefferis, *supra* note 630, at 205. CEOs at the amendment firms receive on average \$0.6 million (0.20% of firm value) compared to \$0.49 million (0.55% of firm value) at the control group. See *id.* The entire group of officers and directors at amendment firms receive \$3.19 million (0.83% of firm value) compared to \$2.29 million (1.26% of firm value) at control firms. See *id.* These results are significantly different. See *id.* at 205 tbl.4.

667. See *id.* at 205. CEOs at the amendment firms own on average 2.54% of the company, compared to 7.15% at the control firms. See *id.* The officers and directors as a group own 8.03% of the company at the amendment firms, compared to 14.86% of the control firms. See *id.* These results are significantly different. See *id.* at 205 tbl.4.

668. See *id.* at 208.

669. See *id.* at 213. Using a weighted probit analysis, they find *t*-statistics of 2.53 for CEOs, 1.01 for all officers and directors, and 1.19 for outside directors. See *id.* at 211 tbl.6. Using a LaGrange multiplier test, they find *t*-statistics of 3.47 for CEOs, 2.97 for all officers and directors, and 1.89 for outside directors. See *id.* at 212 tbl.7.

670. See *id.* at 214.

authors suggest that officers who are blockholders are usually part of the founding family of the company and face a decreased risk of hostile takeovers or management turnover.<sup>671</sup>

However, Brickley et al. (1994) find that management's ownership does not correlate with the percentage of votes cast.<sup>672</sup> One would expect that management votes their shares in favor of their own proposals, but this may not be the case.<sup>673</sup> Requiring a supermajority of votes outstanding also predicts higher shareholder support for the proposal.<sup>674</sup> This result suggests that management decides which amendments to propose with an eye toward the likely level of shareholder approval.<sup>675</sup> Management also has a variety of mechanisms to influence shareholder voting.<sup>676</sup>

#### 4. Proxy Solicitors' Effect

Young et al. find that increased money spent on proxy solicitation predicts a higher proportion of votes cast by shareholders.<sup>677</sup> However, the total number of days between the record date and the meeting date (which measures the amount of time for a solicitation to occur) did not relate to the proportion of votes cast.<sup>678</sup> More days between the record date and when the proxy is received predicts fewer votes cast, while more days between receiving the proxy and the meeting date predicts a higher proportion of votes cast.<sup>679</sup> These results suggest that a company can increase the proportion of shares voted by mailing the proxy as soon as possible after the record date.<sup>680</sup> When the proposal requires a certain percentage of votes outstanding for approval, there tend to be more days between when the shareholders receive the proxy and when the meeting date occurs.<sup>681</sup> This suggests that management is aware that the length of time between the record date, the proxy mailing date, and the meeting date influences the

---

671. *See id.*

672. *See* Brickley et al., *Corporate Voting*, *supra* note 628, at 18-19, 18 tbl.2. When they break up blockholders by type, they find that individual and corporate blockholders and institutional investors increase the percentage of votes cast, significant at the 1% level, but management does not. *See id.*

673. *See id.* at 19.

674. *See id.* at 24-25, 25 tbl.5 (demonstrating significance at the 1% level).

675. *See id.* at 24.

676. *See* Young et al., *supra* note 629, at 66-67 tbl.4.

677. *See id.* at 66-67 tbl.4, 69 (demonstrating significance at the 5% level).

678. *See id.*

679. *See id.* (finding both significant at the 1% level).

680. *Id.* at 69-70.

681. *See id.* at 68 tbl.4, 70 (demonstrating significance at the 1% level).

number of votes cast, so management uses this phenomenon to their advantage to secure passage of their proposals.<sup>682</sup>

Individuals, possibly due to collective action problems, appear more likely to support management than institutional shareholders.<sup>683</sup> Brickley et al. (1988) find that the size of the firm positively relates to support for management, which suggests that individual shareholders are more likely to vote with management.<sup>684</sup> Brickley et al. (1994) find that larger firms tend to receive more shareholder support for their antitakeover amendments.<sup>685</sup> Because larger firms tend to have more shareholders, the results suggest that management can more effectively control shareholders when there are more of them and each one owns a lower percentage of the company.<sup>686</sup> Interestingly, positive performance of the company, based on either stock performance or return on assets, does not significantly correlate with shareholder voting support for the proposed amendments.<sup>687</sup>

##### 5. Impact of Counter Solicitations

Counter-solicitation proxy fights help demonstrate the value-decreasing nature of antitakeover amendments.<sup>688</sup> Counter-solicitation campaigns are relatively rare compared to antitakeover amendment proposals, with only twenty campaigns occurring between 1979 and 1987 out of more than 600 charter provisions proposed and ratified in the same period.<sup>689</sup> Pound finds that the counter-solicitation campaign succeeded in preventing the amendment in 25% of cases.<sup>690</sup>

Management has significant advantages in passing antitakeover amendments because they can give as little as ten days' notice of a shareholders meeting and decide who is allowed to vote by judiciously

---

682. *See id.*

683. *See* Brickley et al., *Ownership Structure*, *supra* note 632, at 274.

684. *Id.* (finding statistically significant results for one regression at the .02 level and another at the .01 level). The relationship between firm size and percent of stock voted was not statistically significant, which would seem to cut against the free-rider hypothesis. *See id.*

685. *See* Brickley et al., *Corporate Voting*, *supra* note 628, at 21 tbl.3, 23 (demonstrating significance at the 1% level).

686. *See id.* at 23.

687. *See id.* at 21 tbl.3, 22.

688. John Pound, *Shareholder Activism and Share Values: The Causes and Consequences of Countersolicitations Against Management Antitakeover Proposals*, 32 J.L. & ECON. 357, 358 (1989).

689. *See id.* at 360-61. Of these, sixteen had sufficient information to be included in the study. *See id.* at 361.

690. *See id.* at 362.

setting the record date.<sup>691</sup> These advantages prevent dissidents from having the necessary time to buy additional shares.<sup>692</sup> Where the antitakeover amendments were ultimately approved, the firms experienced significant negative returns when the vote outcome became public.<sup>693</sup> Where the antitakeover amendment was defeated, the firms experienced significant positive returns.<sup>694</sup> These results are economically significant and suggest that antitakeover amendments hurt shareholder value.<sup>695</sup> When Pound examines the entire period of the counter-solicitation campaign, he finds similar results.<sup>696</sup> Looking at news articles, he finds that almost all of the dissident groups expressed intent to control the firm and had a record of control-oriented investment activity.<sup>697</sup> As a result, the shifts in shareholder value probably result from the changing probability of a successful takeover.<sup>698</sup>

#### 6. Summary

Despite the negative stock market reactions, shareholders have historically tended to overwhelmingly approve antitakeover amendments.<sup>699</sup> Today this is no longer the case, and corporate management is reluctant to propose such charter amendments as they are almost certain to fail. In fact, in recent years, shareholders have often succeeded in persuading corporate management to propose the removal of classified boards and then voted overwhelmingly to get rid of them.<sup>700</sup>

---

691. *See id.*

692. *See id.* at 363.

693. *See id.* at 366. Pound finds an average net-of-market stock return of -7.24%, statistically significant at the 1% level. *See id.* at 367 tbl.1.

694. *See id.* at 366. For the four firms where the antitakeover amendment was defeated, Pound finds an average net-of-market stock return of 4.60%, statistically significant at the 1% level. *See id.* at 367 tbl.1.

695. *See id.* at 366.

696. *See id.* For companies where the antitakeover amendment ultimately succeeded, he finds an average net-of-market return of -8.99%, significant at the 5% level. *See id.* at 367 tbl.1. For companies where the antitakeover amendment ultimately succeeded, he finds an average net-of-market increase of 8.11%, significant at the 5% level. *See id.*

697. *See id.* at 369. He finds that fourteen of the sixteen dissident groups expressed intent to control the firm. *Id.* Similarly, fifteen of the sixteen dissidents were individuals or firms with a record of control-oriented investment activity. *Id.*

698. *See id.*

699. *See supra* Section IV.A.1.

700. *102 Companies Declassified*, HARV. L. SCH.: SHAREHOLDER RTS. PROJECT, <http://www.srp.law.harvard.edu/declassifications.shtml> (last visited June 12, 2017).



Although it is not entirely clear why shareholders once offered such high levels of support, the historical evidence does help to illuminate the different roles that each group of shareholders play. Management holdings are not as directly related to the likelihood of proposing or adopting shareholder amendments as would be expected, possibly because larger holdings act as a takeover defense in themselves and remove the need to adopt other defenses.<sup>701</sup> Institutional investors with large stock ownership can effectively overcome collective action problems if they are organized to block value-decreasing antitakeover amendments.<sup>702</sup> Individuals, however, do not own enough shares to escape rational ignorance and therefore tend to support management in higher numbers.<sup>703</sup> As a result, institutional shareholders need to overcome collective action problems to stop antitakeover amendments.

### *C. Voting on Mergers and Acquisitions*

#### *1. Approval of Acquisitions*

Matvos and Ostrovsky demonstrate that shareholders consistently approve acquisitions despite their value-decreasing effect on the company.<sup>704</sup> From the perspective of management, the acquisitions can be explained by the overconfidence of managers, the pursuit of empire building, and the pressure effects on acquirers' stock prices around mergers.<sup>705</sup> However, little explanation exists for why shareholders would approve any merger, given their predominantly value-decreasing nature.<sup>706</sup>

Acquisitions generally receive the support of around 95% of votes cast and 70% of outstanding voting rights.<sup>707</sup> Examining the acquisition votes between 1990 and 2000, Burch et al. do not find a single instance of the

---

701. *See supra* Section IV.A.3.

702. *See supra* Section IV.A.2.

703. *See supra* text accompanying notes 683-684.

704. Gergor Matvos & Michael Ostrovsky, *Cross-Ownership, Returns, and Voting in Mergers*, 89 J. FIN. ECON. 391, 391 (2008).

705. *See id.*

706. *See id.*

707. *See, e.g.*, Jennifer E. Bethel et al., *The Market for Shareholder Voting Rights Around Mergers and Acquisitions: Evidence from Institutional Daily Trading and Voting*, 15 J. CORP. FIN. 129, 135 (2009) (finding an average approval of 95% of votes cast and 70% of votes outstanding for 350 mergers and acquisitions between 1999 and 2005); Timothy R. Burch et al., *Is Acquiring-Firm Shareholder Approval in Stock-for-Stock Mergers Perfunctory?*, FIN. MGMT., Winter 2004, at 45, 45-46 (finding an average approval rate of 98% of votes cast and 73% of votes outstanding for 209 acquisition votes between 1990 and 2000).

acquirer's shareholders failing to approve a merger.<sup>708</sup> Unsurprisingly, shareholders are much more likely to support a merger when ISS issues an "approve" recommendation.<sup>709</sup>

The rise of merger arbitrage provides new importance in shareholder voting on mergers.<sup>710</sup> In merger arbitrage, or more technically "activist risk arbitrage," "a shareholder attempts to change the course of an announced [merger and acquisition ("M&A")] deal through public campaigns."<sup>711</sup> Voting against a deal and persuading other investors to do the same provides leverage to the activists to negotiate better terms.<sup>712</sup> However, these activists are cognizant of the fact that they will only profit if some deal is eventually completed.<sup>713</sup> This type of activism has been an increasingly common aspect of the M&A landscape, with activism in 0.6% of deals in 2000 up to 13% and 6.5% of all deals in 2013 and 2014.<sup>714</sup> In total, Jiang et al. observe 343 instances of M&A activism between 2000 and 2014.<sup>715</sup> Even where activists intervene, the merger tends to receive a high level of support from the target's shareholders, with an average of 65% voting in favor of the deal.<sup>716</sup> These numbers, however, are much lower than in standard mergers and suggest a more controversial vote. Activists

---

708. See Burch et al., *supra* note 707, at 46.

709. See Laura Sophie Henning, *Shareholder Voting and Merger Returns*, 29 FIN. MKTS. & PORTFOLIO MGMT. 337, 348 (2015). The author's sample includes 141 firm votes that occur in target firms and 243 votes that occur in acquiring firms between 2003 and 2011, for a total of 384 votes over 367 transactions. See *id.* at 342. The reason for the low overlap is that private firms are not required to hold shareholder meetings or publicly release the results, and shareholder approval is required for acquirer firms only when more than 20% of outstanding shares will be issued. See *id.* at 342-43. An ISS recommendation was negatively related to dissent at the target firm at the 5% level and negatively related to acquirer recommendation at the 1% level. See *id.* at 349, 349 tbl.2. Henning also noted that the "free float" of the company, meaning the percentage of shares in the hands of ordinary investors, is positively associated with voter dissent for acquirers, and no statistically significant relationship for target shareholders exists. See *id.* at 348, 349 tbl.2 (demonstrating significance at the 1% level). Thus, ordinary investors at acquiring firms are more likely to dissent to the acquisition. See *id.* at 348.

710. See Wei Jiang et al., *Influencing Control: Jawboning in Risk Arbitrage 3* (Columbia Bus. Sch. Research Paper Series, Paper 15-41, 2016), <https://ssrn.com/abstract=2587925>. The author's sample covers 4278 deals between 2000 and 2014. *Id.* at 3.

711. *Id.* at 1.

712. See *id.* at 18-19.

713. See *id.* at 22.

714. *Id.* at 3.

715. See *id.* at 3-4. Because of incomplete data, they narrow down their final sample of M&A activism in targets to 255 instances. See *id.* at 9.

716. See *id.* at 11.

will use several techniques to influence other shareholders' votes, such as public criticism of the deal and proxy solicitation to veto the deal.<sup>717</sup> By far the most influential method is support from ISS, where dissidents gained support in 69% of the eighty-four ISS recommendations disclosed.<sup>718</sup> Overall, the activists attained better terms in 31% of deals, but failed to reach a completed deal in 21% of cases.<sup>719</sup> Of the deals withdrawn from the initial buyer, a failed shareholder vote was the cause in 25% of cases, including 7.89% where the activist's vote was pivotal and 5.26% where the negative vote followed a negative ISS recommendation.<sup>720</sup> By contrast, the authors find shareholders vote down the deal in 1.07% of all deals not involving shareholder activists.<sup>721</sup> These results suggest that shareholder voting on mergers provides activists with a meaningful tool to attain better terms for all of the company's shareholders. The rise in merger activism gives the merger vote a more meaningful role in corporate governance.

## 2. Impact of Stock Returns

Even if they do not vote down the acquisition, shareholders pay attention to the acquisition's value when casting their votes. Burch et al. find that the acquirer's stock returns around the announcement of the merger and around the shareholder vote both predict a higher rate of shareholder support.<sup>722</sup> The acquirer's change in return on the assets before and after the acquisition correlates with acquirer shareholder support for the acquisition.<sup>723</sup> The ratio of cash to assets predicts a worse reception of the merger by shareholders.<sup>724</sup> Shareholders may understand that acquisitions by cash-rich firms tend to destroy more value because they represent a way to waste cash.<sup>725</sup> Neither the acquirer's return on assets nor their stock

---

717. *See id.*

718. *See id.* These numbers suggest that ISS issued a recommendation in favor of the dissidents in 31% of cases. *Id.* at 12.

719. *See id.*

720. *See id.* at 52 tbl.5 (Panel C). Some of these deals were complete with other buyers, where the activist's efforts led to better terms for the shareholders. *See id.* For all deals, shareholders voted down the deal in 6.88% of cases. *See id.* However, it is not clear how many of these deals made it to a shareholder vote. *See id.*

721. *See id.* However, it is not clear how many of these deals came to a shareholder vote. *See id.*

722. *See* Burch et al., *supra* note 707, at 57 tbl.3, 58 (finding both significant at the 5% level).

723. *See id.* at 57 tbl.3, 59 (demonstrating significance at the 5% level).

724. *See id.* (demonstrating significance at the 5% level).

725. *See id.* at 58-59.

returns over the previous year significantly relate to the level of shareholder support.<sup>726</sup> This result suggests that shareholders are voting to approve the transaction based on the quality of the target and not based on their company's performance over the previous year.<sup>727</sup>

The relationship between stock market returns and shareholder approval presents a more complicated picture.<sup>728</sup> Hsieh and Wang find that requiring the shareholders of the acquiring company to vote on and approve the acquisition predicts higher gains to both the acquirer and the target.<sup>729</sup> On the other hand, Kamar fails to find a relationship between requiring shareholder approval and the stock market returns surrounding the announcement.<sup>730</sup> The lack of a correlation suggests that the shareholder voting requirement does not prevent harmful acquisitions or even discourage management from putting a harmful acquisition to a shareholder vote.<sup>731</sup> Shareholder approval is also unrelated to the premium over the stock price paid for the target company, although this is admittedly a crude proxy for acquisition value.<sup>732</sup>

However, Henning finds that abnormal announcement returns relate negatively to voting dissent by both target and acquirer firm shareholders.<sup>733</sup> This result suggests that shareholders take market reaction into account when deciding how to vote.<sup>734</sup> The relationship, however, is stronger for target shareholders than for acquirer shareholders.<sup>735</sup> Henning interprets this result to mean that the merger is more pivotal for the target

---

726. *See id.* at 57 tbl.3, 58.

727. *See id.* at 58.

728. *See* Jim Hsieh & Qinghai Wang, Shareholder Voting Rights in Mergers and Acquisitions 26 (Mar. 2008) (unpublished manuscript), [http://www1.american.edu/academic.depts/ksb/finance\\_realestate/rhauswald/seminar/vote\\_American.pdf](http://www1.american.edu/academic.depts/ksb/finance_realestate/rhauswald/seminar/vote_American.pdf).

729. *See id.* at 26, 49 tbl.6 (demonstrating significance at the 5% level). Gains are measured over the five-day event window as both a percentage increase in market equity of the acquirer and target and as dollar value of the increase in market equity. *See id.* at 24. Having voting rights for the acquirer's shareholders predicts an additional increase in market value of 1.1%. *See id.* at 26.

730. Ehud Kamar, Does Shareholder Voting on Acquisitions Matter? 14 (Mar. 2011) (unpublished manuscript), <http://www7.tau.ac.il/blogs/law/wp-content/uploads/2011/11/March-2011.pdf>.

731. *See id.* at 13-14.

732. *See id.* at 16-17.

733. *See* Henning, *supra* note 709, at 348.

734. *Id.*

735. *See id.* Abnormal returns are negatively related to target shareholder votes at the 1% level. *See id.* at 349 tbl.2. Abnormal returns are also negatively related to acquirer dissent but only marginally significant at the 10% level. *See id.*

company and, as a result, the target shareholders invest more energy in monitoring the transaction.<sup>736</sup>

Henning analyzes the effect of voting dissent on abnormal returns following the shareholder meeting.<sup>737</sup> Voting dissent has a strong positive relationship with the cumulative abnormal returns following the meeting for both target and acquiring firms.<sup>738</sup> Thus, meetings with higher voting dissent are followed by a more positive stock market reaction.<sup>739</sup> This counterintuitive result reflects the fact that the shareholder vote resolves part of the uncertainty around the completion of the deal.<sup>740</sup> Henning claims that the level of voting dissent reflects the uncertainty of deal completion, even if the deal as a whole increases shareholder value.<sup>741</sup> Thus, once the shareholders approve the deal, despite the high dissent, the company's share value increases.<sup>742</sup> Henning also looks at the relationship between voting dissent and long-run abnormal returns.<sup>743</sup> As expected, voting dissent is negatively related to long-run abnormal performance over the following two years.<sup>744</sup> Voting dissent, however, is only marginally significant when correlated with performance over a five-year period.<sup>745</sup> The amount of shareholder dissent predicts a large portion of subsequent performance of the merged company.<sup>746</sup>

---

736. *See id.* at 348.

737. *See id.* at 355.

738. *See id.* (finding both significant at the 1% level).

739. *See id.* at 355-56.

740. *See id.* at 356-57.

741. *See id.*

742. *See id.* at 355-56. To confirm this interpretation, Henning uses the length of the negotiations as a proxy for deal uncertainty and divides the deals into two groups with above and below median negotiation length. *See id.* at 357. As expected, for deals with shorter negotiation periods, there was no significant correlation between voting dissent and subsequent abnormal returns. *See id.* For deals with longer negotiation periods, higher voting dissent predicted higher abnormal returns. *See id.* (demonstrating significance at the 1% level for acquirers and the 5% level for target firms). Thus, the correlation between voting dissent and abnormal returns reflects the increased certainty in resolving the deal going forward. *See id.*

743. *See id.* She excludes firms that are not acquirers and creates separate samples for firms with at least two years of subsequent data (194 firm observations) and five years of subsequent data (79 firm observations). *Id.*

744. *Id.* (demonstrating significance at the 5% level).

745. *See id.*

746. *See id.* at 361.

### 3. Advisor Opinions

Becher et al. find that the acquirer's shareholders appear to pay more attention to the fairness opinion of the target's advisors than the acquirer's advisors.<sup>747</sup> They show that the presence of a target advisor's opinion increases shareholder support more than the presence of an acquirer advisor's opinion.<sup>748</sup> Receiving a positive equity valuation ("EV") ratio<sup>749</sup> from a target advisor also increases shareholder support, while one from an acquisition advisor does not.<sup>750</sup> Ouyang finds similar results.<sup>751</sup> A target advisor's opinion of target equity value leads to better support from acquirer shareholders than the acquirer advisor's opinion.<sup>752</sup> In fact, the

---

747. David Becher et al., *Do Shareholders Listen? M&A Advisor Opinions and Shareholder Voting 4* (July 2010) (unpublished manuscript), <http://www.rhsmith.umd.edu/files/Documents/Departments/Finance/Session6BecherDoShareholdersListen.pdf>.

748. *See id.* at 15-16. A target advisor increases shareholder support by 8.38 percentage points (significant at the 1% level), while an acquirer advisor increases shareholder support by 6.25 percentage points (significant at the 3% level). *See id.* at 34 tbl.2. More dramatically, a multiple regression finds that a target advisor's opinion significantly increases shareholder support for the acquisition, significant at the 5% level, while the presence of an acquirer advisor opinion has no significant effect. *See id.* at 16, 36 tbl.3.

749. The EV ratio is the difference between the average target equity valuation and the offer price divided by the offer price. *Id.* at 12. A positive EV ratio indicates that the target firm value is higher than the offer price, so that the offer is a good deal for the acquirer, while a negative EV ratio indicates that the acquisition is a bad deal. *Id.*

750. *See id.* at 15-16. An opinion with a positive EV ratio from the target's advisor increases the mean shareholder support by 6.92% ( $p$ -value = 0.11), with a median of 6.82% ( $p$ -value = 0.08), while the opinion from the acquirer's advisor had no statistically significant effect. *See id.* at 34 tbl.2. A multiple regression similarly finds that a positive opinion from a target's advisor significantly increases shareholder support, significant at the 10% level, while the acquirer's advisor had no impact. *See id.* at 36 tbl.3. Part of the reason for the lower statistical significance was because of the smaller sample size. *See id.* at 34 tbl.2, 35-36 tbl.3.

751. *See* Wenjing Ouyang, *The Effect of M&A Advisors' Opinions on Acquirer Shareholder Voting*, 57 Q. REV. ECON. & FIN. 175, 175-76 (2015). The author collects a sample of 136 friendly negotiated deals announced between 2000 and 2006. *Id.* at 178. The paper focuses on acquirer shareholders rather than target shareholders because target firms usually do not report voting results. *Id.* at 176 n.2. She limits the acquirer shareholder vote to outside shareholder approval to limit the impact of insiders. *See id.* at 178. Using this definition, she finds an average shareholder approval rate of 68.5%. *See id.* All of the mergers she studies are approved by the acquirer shareholders. *See id.*

752. *See id.* at 181. "[W]hen a target advisor provides an estimation of the target equity value, the average and median increases in acquirer shareholder support are 5.63% and 8.17% . . . respectively." *Id.* (demonstrating significance at the 2% and 1% levels respectively). A Probit model "shows that when the target advisor provides an estimation of target value, acquirer shareholder support significantly increases [by] 4.46%," significant at

acquirer advisor's estimated EV ratio does not appear to have any significant effect on shareholder voting.<sup>753</sup> As acquirer advisor opinions tend to be more optimistic, these results suggest that shareholders can see through the bias of acquirer advisors and focus on the less-biased opinions of target advisors.<sup>754</sup>

Becher et al. determine that shareholder support increases when the target advisor provides an earnings forecast, particularly when the forecast indicates that the merger is non-dilutive, and that an earnings forecast by the acquirer's advisor has no impact on shareholder approval, even where the opinion indicates that the merger is non-dilutive.<sup>755</sup> Ouyang also finds that the shareholder approval rate increases by an average of 6.34% when the target advisor provides forecasts of the deal's impact on the acquirer's earnings.<sup>756</sup> By contrast, when the acquirer advisors provide an earnings forecast, the voting results do not change significantly.<sup>757</sup> If target advisors forecast non-dilutive earnings, then the shareholder support increases by

---

the 7% level. *Id.* When an acquirer advisor provides the same estimation, however, it has no impact on shareholder voting. *Id.* When the offer price is less than the midpoint of the target advisor's valuation range, "the mean and median acquirer shareholder approval rates increase by 8.01% and 8.52%, respectively." *Id.* (demonstrating significance at the 5% level). Additionally, acquirer shareholders have significantly higher support for the deal "when target advisors issue higher target equity evaluations." *Id.* (demonstrating significance at the 5% level). A Probit model similarly shows that a one standard deviation increase in the target advisor's equity valuation estimate increases the acquirer shareholders' approval rate by 2.53%. *Id.*

753. *See id.* A Probit model similarly shows no significant relationship. *See id.*

754. *Id.*

755. *See* Becher et al., *supra* note 747, at 17-18. Univariate results indicate that the presence of an earnings opinion from the target's advisor increases shareholder support by 6.5%, significant at the 1% level, while a non-dilutive forecast increases shareholder support by 5.05%, significant at the 4% level. *See id.* at 37 tbl.4. Having an earnings forecast, even a non-dilutive forecast, from the acquirer's advisor did not relate to shareholder voting. *See id.* A multiple regression similarly finds that the presence of an earnings forecast from the target's advisor increases shareholder support, while one from the acquirer's advisor does not. *See id.* at 39 tb.5. Interestingly, having a non-dilutive earnings forecast has a similar impact from the acquirer's and target's advisor, each significant at the 10% level. *See id.*

756. Ouyang, *supra* note 751, at 182 (demonstrating significance at the 1% level). The median increase is 9.22%, significant at the 1% level. *Id.* A Probit model similarly "shows that the approval rate increases by 5.60% when the target advisors provide earnings forecasts." *Id.*

757. *See id.* A Probit model similarly fails to find a statistically significant relationship. *See id.*

4.53%.<sup>758</sup> Again, the shareholder approval rate does not significantly change when the acquirer advisors issue a similar opinion.<sup>759</sup>

The recommendation of an analyst who works for the same investment bank as an advisor to the target or acquirer may have an impact on shareholder voting.<sup>760</sup> Becher et al. find that shareholder support increased by 11% when the analyst affiliate of a target advisor provides a recommendation, and shareholder support increases even more when that analyst's recommendation provides a positive recommendation.<sup>761</sup> By contrast, the recommendation of an analyst affiliated with the acquirer advisor had no impact.<sup>762</sup> But shareholder support decreased by 14% when the acquirer advisor had prior business with the acquirer firm.<sup>763</sup> This suggests that shareholders respond negatively to potential conflicts of interest in their firm's advisor.<sup>764</sup>

Interestingly, the level of support from the acquirer's shareholders for the acquisition accurately predicts whether the acquirer will use the same advisor in a future acquisition.<sup>765</sup> This result suggests that managers believe that the choice of advisor significantly impacts shareholder support, even though the data suggests that their advisor's recommendation has little impact on the deal.<sup>766</sup> The acquirer's shareholders appear to recognize their firm's advisor faces an inherent conflict of interest and so look to the target's advisor.<sup>767</sup>

Overall, Burch et al. interpret these results to suggest that shareholders pay attention to the value of the acquisition when casting their vote, even if they do not overall reject the acquisition.<sup>768</sup> Although these approval rates suggest that shareholder voting does not directly block management's

---

758. *Id.* (demonstrating significance at the 4% level). Similarly, a Probit model shows that a non-dilutive forecast leads to increased shareholder support by 4.36%. *Id.*

759. *See id.* A Probit model also finds that a non-dilutive forecast by acquirer advisors does not impact shareholder support. *See id.*

760. *See* Becher et al., *supra* note 747, at 18.

761. *See id.* at 20, 42 tbl.7. The relationship between issuing an opinion and shareholder support was significant at the 4.2% level, while the relationship between issuing a positive opinion and shareholder support was significant at the 7% level. *See id.*

762. *See id.* at 20.

763. *Id.* at 20, 42 tbl.7 (demonstrating significance at the 1% level).

764. *See id.* at 20.

765. *See id.* at 22 (demonstrating significance at the 2% level). A standard deviation increase in shareholder support increases the odds that the same advisor will be used in a future deal by 13%. *Id.*

766. *See id.*

767. *Id.* at 24.

768. *See* Burch et al., *supra* note 707, at 46-47.



decisions on mergers, the shareholder vote may offer an indirect check.<sup>769</sup> The threat of shareholder rejection may prevent acquirer management from pursuing a bad merger long before a shareholder vote occurs.<sup>770</sup> Burch et al. postulate that disapproving shareholders may also prefer to sell their shares rather than vote down the acquisition, or may simply view voting against the acquisition as futile.<sup>771</sup>

#### 4. Deal Structure

If management fears that shareholders will vote down the deal, they may structure the deal to avoid the shareholder approval requirement.<sup>772</sup> Hsieh and Wang find that slightly more than half of acquirers proposed transactions that required shareholder approval.<sup>773</sup> They find that deals are less likely to be successful where the acquirer's shareholders have to vote on the deal.<sup>774</sup> Kamar, however, finds no correlation between the shareholder vote requirement and the odds of completing the stock acquisition once the registration statement was filed.<sup>775</sup> He interprets this lack of correlation to suggest that shareholder approval does not filter value-harming acquisitions,<sup>776</sup> although the advent of merger arbitrage (discussed in Jiang above) suggests that this may have changed today.<sup>777</sup>

A shareholder approval requirement makes the acquisition of a private company take longer to complete.<sup>778</sup> A shareholder approval requirement is less likely when the deal uses unregistered stock for a private company,

---

769. *Id.* at 46.

770. *Id.*

771. *See id.* at 51-52.

772. *See* Hsieh & Wang, *supra* note 728, at 3-4. Shareholder approval is required when "the acquirer issues new shares exceeding 20% of outstanding shares." *Id.* at 8-9. However, cash deals do not require approval of the acquirer's shareholders. *Id.* at 10.

773. *See id.* (finding that 53% of acquirers had shareholder approval).

774. *See id.* at 18, 46 tbl.4 (demonstrating significance at the 5% level). Their model predicts a 24.06% decrease in the probability of deal success if the acquirer's shareholders need to approve the deal. *Id.* at 18.

775. *See* Kamar, *supra* note 730, at 21. The author limits his sample to mergers that involve stock consideration because prior literature finds that mergers without stock consideration are treated differently by the markets and rarely require shareholder approval. *Id.* at 8.

776. *See id.* at 21.

777. *See supra* notes 710-718 and accompanying text.

778. *See* Kamar, *supra* note 730, at 25, 44 tbl.6 (demonstrating significance at the 1% level). A multiple regression predicted that a shareholder-approved acquisition of a private company would take ninety-five days longer than an acquisition without shareholder approval, which would take fifty days. *See id.*

suggesting that the acquirer will avoid a shareholder vote to save time.<sup>779</sup> However, shareholder approval does not increase the duration of an acquisition of a public company.<sup>780</sup>

Hsieh and Wang find that larger acquirers are less likely to seek shareholder approval of the acquisition.<sup>781</sup> Acquirers with more cash holdings were more likely to face shareholder approval, while acquirers with higher market-to-book ratios, more institutional investors, or worse stock performance were less likely to face shareholder votes.<sup>782</sup> On the other hand, shareholder votes were more common for the acquirer when the target had higher institutional holdings.<sup>783</sup> Kamar finds no relationship between the level of ownership by insiders and blockholders and having a shareholder voting requirement, suggesting that managers do not avoid the voting requirement for fear of shareholder resistance.<sup>784</sup> These results provide some support for the theory that voting rights serve as a screening method to prevent bad deals from going through.<sup>785</sup>

##### 5. *Effect of Institutional Investors*

Institutional investors may be facilitating approval of the acquisitions.<sup>786</sup> Matvos and Ostrovsky find that, on average, institutional investors owned 43% of acquiring companies and 30% of target companies.<sup>787</sup> Consistent with previous research, institutional investors who hold acquirer stock receive negative returns from the acquisition.<sup>788</sup> However, when the institutional investor's holdings in both the acquirer and the target are accounted for, their returns become statistically indistinguishable from zero.<sup>789</sup>

While an acquisition may hurt the acquirer's value, institutional investors still increase the value of their investments by investing in both the acquirer

---

779. *See id.* at 30, 47 tbl.9 (finding both significant at the 1% level).

780. *Id.* at 26.

781. Hsieh & Wang, *supra* note 728, at 16. They find that the logarithm of the book value of assets correlates negatively with having shareholder approval, significant at the 1% level. *See id.* at 16-17, 45 tbl.3.

782. *Id.* (demonstrating significance at the 1% level).

783. *Id.* at 16, 45 tbl.3 (demonstrating significance at the 1% level).

784. *See* Kamar, *supra* note 730, at 30.

785. *See* Hsieh & Wang, *supra* note 728, at 19.

786. *See* Matvos & Ostrovsky, *supra* note 704, at 393-94.

787. *Id.* at 393.

788. *Id.* at 394 (finding significantly different from 0 at the 1% level). However, the raw returns are not significantly different from zero. *See id.*

789. *Id.*

and the target.<sup>790</sup> Matvos and Ostrovsky find that institutional investors that only owned shares in the acquirer were more than twice as likely to disapprove of the merger as institutional investors that owned shares in both the acquirer and the target.<sup>791</sup> Interestingly, they report several instances of an institutional investor approving the merger on one side of the deal while rejecting it on the other.<sup>792</sup> When they limit the sample to acquisitions that received a positive stock market reaction, the difference in voting habits disappears.<sup>793</sup>

Institutional investors appear to buy additional shares leading up to the record date, the date that determines who can vote on the acquisition.<sup>794</sup> Bethel et al. show that institutions trade and buy more actively before and on the record dates for mergers than afterward, suggesting that they do so for the voting rights.<sup>795</sup> However, they find no statistically significant relationship between cross-ownership of the target and acquirer and institutional buying behavior.<sup>796</sup> These results provide some explanation for why shareholders approve acquisitions but fall short of completely solving the puzzle.

#### 6. Summary

Although shareholder voting may not prevent every bad acquisition, shareholders' decision-making process appears consistent with the goal of maximizing company value.<sup>797</sup> The shareholder vote closely follows the stock market's assessment of the acquisition and reflects how the acquisition will impact the company's operating performance.<sup>798</sup> Shareholders can even screen out conflicted and unreliable sources of

---

790. *See id.*

791. *See id.* at 399. They find that on average 0.82% of cross-over firms voted against the merger, while 2.17% of acquirer-only firms voted against it. *See id.* They use linear probability, logit, and conditional logit models to confirm that cross-over funds are more likely to vote for a merger than acquirer-only funds, significantly different at the 1% level. *Id.*

792. *Id.* at 398.

793. *See id.* at 400. They are unable to find a statistically significant difference in voting patterns between cross-over and acquirer-only firms during good mergers with linear, logit, and conditional logit probability models. *Id.*

794. *See* Bethel et al., *supra* note 707, at 135.

795. *Id.* They eliminate the explanation of merger arbitrage by constructing a multiple regression between trading around the record date and trading around the merger announcement and find no statistically significant correlation. *See id.* at 139.

796. *Id.* at 143.

797. *See supra* Sections IV.B.1-4.

798. *See supra* Section IV.B.2.

information when making their decision.<sup>799</sup> A binding shareholder vote, however, loses its bite when management can structure the transaction to avoid the requirement.<sup>800</sup> Still, the evidence suggests that the shareholder vote has some screening impact without resorting to an outright rejection, even if only as a soft deterrent or an implicit threat.<sup>801</sup> Other dynamics, such as cross-ownership in the target company, may create shareholder approval of an otherwise bad acquisition.<sup>802</sup>

#### *D. Auditor Ratification*

Auditor ratification allows shareholders, in a nonbinding vote, to approve or reject the company's outside auditor.<sup>803</sup> The goal is to keep the auditor independent so he or she can effectively check the company's books.<sup>804</sup> Despite the lack of a legal requirement of shareholder approval, around two-thirds of public companies hold a vote on auditor ratification.<sup>805</sup> In auditor ratification votes, auditors receive on average between 98% and 99% support from shareholders, as close to unanimous support as possible in any election.<sup>806</sup>

In studies examining data going back to 1976, there has been only one instance of shareholders failing to ratify the board-approved auditor.<sup>807</sup> In

---

799. *See supra* Section IV.B.3.

800. *See supra* Section IV.B.4.

801. *See supra* Section IV.B.4.

802. *See supra* Section IV.B.5.

803. *See* Mai Dao et al., *Shareholder Voting on Auditor Selection, Audit Fees, and Audit Quality*, 87 ACCT. REV. 149, 149-50 (2012) [hereinafter Dao et al., *Shareholder Voting*].

804. *See id.* at 150.

805. *See id.* at 156 (finding that 67% of firms had auditor ratification); Jagan Krishnan & Zhongxia (Shelly) Ye, *Why Some Companies Seek Shareholder Ratification on Auditor Selection*, 19 ACCT. HORIZONS 237, 238 (2005) (finding that 68% of public companies put their auditor up for ratification); K. Raghunandan & Dasaratha V. Rama, *Audit Committee Composition and Shareholder Actions: Evidence from Voting on Auditor Ratification*, 22 AUDITING: J. PRAC. & THEORY 253, 258 (2003) (finding that 64% of companies held auditor ratification votes).

806. *See* G. William Glezen & James A. Millar, *An Empirical Investigation of Stockholder Reaction to Disclosures Required by ASR No. 250*, 23 J. ACCT. RES. 859, 863 tbl.1 (1985) (finding an average of 99% shareholder support from 1976 to 1981); Barbara J. Sainty et al., *Investor Dissatisfaction Toward Auditors*, 17 J. ACCT. AUDITING & FIN. 111, 119 (2002) (finding an average of 1.177% disapproval, with a maximum of 21% disapproval). Both studies counted abstaining votes as voting against auditor ratification, although they are technically two different categories.

807. *See* Suchismita Mishra et al., *Do Investors' Perceptions Vary with Types of Nonaudit Fees? Evidence from Auditor Ratification Voting*, 24 AUDITING: J. PRAC. & THEORY 9, 10 (2005).

2002, the shareholders of Hershey Foods voted against ratifying Arthur Andersen LLP, a month after the accounting firm was indicted for its involvement in the Enron collapse as the company's outside auditors.<sup>808</sup>

Critics naturally question whether these votes have any impact on the auditor's independence and effectiveness.<sup>809</sup> Despite the high levels of shareholder support, auditor ratification votes help to keep auditors independent and provide insight into what shareholders view as a threat to auditor independence and effectiveness.<sup>810</sup>

### *1. Non-Audit Fees*

Theory suggests that the primary threat to auditor independence is the fees paid to auditors for non-auditing services.<sup>811</sup> Auditors may fear exposing problems with the company's books and risking management's wrath where they receive substantial business from the company in addition to their usual auditing fee.<sup>812</sup>

The evolution of the required disclosure of fees paid to auditors has allowed researchers to understand whether shareholders hold a similar concern. Between 1978 and 1982, ASR No. 250 "required public companies to disclose . . . the percentage of fees for nonaudit services in relation to the audit fee."<sup>813</sup> Glezen and Millar find no statistically significant difference in the percentage of "for" votes before and after the disclosure requirements.<sup>814</sup> Also, they did not find a correlation between auditor approval rating and the percentage of fees paid for non-auditing services.<sup>815</sup> This finding suggests that shareholders are not concerned that non-auditing services will undermine auditor independence.<sup>816</sup>

---

808. *Id.* (noting that 81% of shareholders rejected ratification).

809. *See id.*

810. K. Raghunandan, *Nonaudit Services and Shareholder Ratification of Auditors*, 22 *AUDITING: J. PRAC. & THEORY* 155, 155-56, 162 (2003).

811. *See id.* at 156-57.

812. *See id.*

813. Glezen & Millar, *supra* note 806, at 859. The requirement "was withdrawn because [the SEC] found few companies reporting 'sensitive' nonaudit services" and because the SEC Practice Section of the AICPA Division of Firms later required the release of similar information. *Id.*

814. *See id.* at 864. Separating the data by industry and firm size also failed to yield a statistically significant difference. *See id.* at 865.

815. *See id.*

816. *See id.* at 864.

In 2001, the SEC again began requiring the disclosure of audit and non-audit fees paid to the outside auditor.<sup>817</sup> The SEC's research suggests that the average non-audit fee ratio for Fortune 1000 companies is 269%.<sup>818</sup> Raghunandan finds that the non-audit ratio positively predicted the proportion of shareholders who vote against shareholder ratification.<sup>819</sup> The non-audit fee ratio also predicted a decrease in shareholder support for auditor ratification compared to before the new disclosure requirement.<sup>820</sup> The difference in ratification support suggests that the disclosure requirement has facilitated shareholders' ability to monitor their company's auditor.<sup>821</sup> Similarly, Raghunandan and Rama find that a higher non-audit fee to audit fee ratio predicted significantly more votes against auditor ratification.<sup>822</sup>

In 2003, the SEC updated the auditor disclosure rules by adding two new categories, "audit-related fees" and "tax fees," to the fee types.<sup>823</sup> Mishra et al. find that the audit-related fee ratio predicted increased support for auditor ratification.<sup>824</sup> The tax fee ratio and the "other" non-audit fee ratio predicted more shareholders voting against ratification.<sup>825</sup> These results suggest that shareholders do not view audit-related fees as creating a conflict for the auditor's independence.<sup>826</sup> However, tax fees are still perceived negatively as undermining the auditor's independence.<sup>827</sup>

---

817. Raghunandan, *supra* note 810, at 155, 157. Companies were required to start disclosing fees paid to the auditor after February 5, 2001. *Id.* at 159. "[T]otal nonaudit fees are defined as the sum of the 'Financial Information Systems Design and Implementation Fees' and 'Other Fees.'" *Id.* The non-audit fee ratio "is the ratio of total nonaudit fees to audit fees." *Id.*

818. *Id.* at 157.

819. *See id.* at 161. He finds a relationship between the non-audit fee ratio and both the percentage of shareholders voting against and the percentage of shareholders either voting against or abstaining, significant at the 1% level. *See id.* at 160 tbl.2 (Panel A).

820. *See id.* at 161 tbl.2, 162 (demonstrating significance at the 1% level).

821. *See id.* at 161-62.

822. *See* Raghunandan & Rama, *supra* note 805, at 259-60, 260 tbl.2 (demonstrating significance at the 5% level).

823. Mishra et al., *supra* note 807, at 10. The other available fee type is "other fees." *Id.* The SEC removed the financial information systems design and implementation fees because they were prohibited by the Sarbanes-Oxley Act. *Id.* The SEC has argued that audit-related fees and tax fees are viewed more favorably by shareholders and do not undermine an auditor's independence. *Id.*

824. *See id.* at 19, 21 tbl.5 (demonstrating significance at the 1% level).

825. *See id.* (finding each significant at the 1% level).

826. *See id.* at 20.

827. *See id.* at 21.

Although non-audit fees may reduce shareholder support for auditor ratification, shareholders' votes on auditor ratification do not appear to affect the level of non-audit fees. Neither Raghunandan nor Krishnan and Ye find any statistically significant relationship between allowing shareholders to vote on auditor ratification and the ratio of non-audit to audit fees.<sup>828</sup>

Overall, these results suggest that shareholders have viewed non-audit fees as a threat to auditor independence since 2001, but they did not view it as a threat in the late 1970s and early 1980s. The change in shareholder sentiment may be due to an increased willingness of shareholders to question the board's decision. It may also be due to a greater recognition of the need to have outside auditing after the scandals that took down Enron and WorldCom.

## 2. Auditor Tenure

The relationship between an auditor's tenure and its effectiveness presents another ongoing debate.<sup>829</sup> Some argue that longer tenure between an auditor and a client undermines the independence (and thereby, the quality) of the auditor.<sup>830</sup> Others argue that having a mandatory rotation of auditors would undermine their effectiveness "because of high audit start-up costs and increased risk of audit failures."<sup>831</sup>

Dao et al. show that longer tenure of an auditor predicts higher opposition to ratification from shareholders.<sup>832</sup> This result suggests that shareholders view auditors as less independent and less effective the longer that they have audited the company.<sup>833</sup> Sainty et al. find a more conflicted relationship between tenure and approval rates.<sup>834</sup> Univariate results suggest that longer experience with a client decreases ratification opposition.<sup>835</sup> However, multivariate results provide weak evidence that shareholders are more likely to oppose auditor ratification the longer the auditor has worked

---

828. See Krishnan & Ye, *supra* note 805, at 246; Raghunandan, *supra* note 810, at 159.

829. See Mai Dao et al., *Auditor Tenure and Shareholder Ratification of the Auditor*, 22 ACCT. HORIZONS 297, 297 (2008) [hereinafter Dao et al., *Auditor Tenure*].

830. *Id.*

831. *Id.*

832. *Id.* at 305 (demonstrating significance at the 1% level). The relationship holds true for both Big Four and non-Big Four auditing firms, when the data is split up. *Id.* at 307.

833. See *id.* at 309.

834. See Sainty et al., *supra* note 806, at 122, 129.

835. See *id.* at 122. They divide the sample between clients who have had their auditor for more (1.042% opposition) and less (1.338% opposition) than five years and find the result significantly different at the 5% level. *Id.* at 121 tbl.3 (Panel C).

with the company.<sup>836</sup> These results suggest that shareholders may be concerned that auditors who work for the company for a longer period of time will become too cozy with management and lose their independence.<sup>837</sup>

### 3. Negative Reports

When the outside auditor issues a negative report, the shareholders appear to respond with level-minded judgment by weighing the costs of the negative report against the severity of the problem.<sup>838</sup> The issuance of a going-concern audit opinion presents an opportunity for shareholders to judge the effectiveness of their company's auditor.<sup>839</sup> One might think that issuing such an opinion would increase the confidence of shareholders in the auditor, since it would provide evidence that the auditor is performing his or her monitoring function and is not beholden to management.<sup>840</sup> However, going-concern audit reports can also lead to a variety of negative consequences for the company, including "negative publicity, violation of debt covenants, higher costs of capital, [and] negative market reactions."<sup>841</sup> They can sometimes even be a "self-fulfilling prophecy," eliminating the company's chances of recovery.<sup>842</sup>

Sainty et al. find that issuing a going-concern audit opinion increases disapproval by shareholders.<sup>843</sup> Interestingly, a going-concern audit report receives more shareholder opposition when the company is showing fewer signs of financial distress.<sup>844</sup> The initial going-concern opinion increases

---

836. *See id.* at 128 tbl.5 & 129. An ordinary least-squared regression finds no correlation between audit tenure and voting results. *See id.* However, a logistic regression finds that longer tenure makes shareholders more likely to oppose auditor ratification, significant at the 5% level. *See id.*

837. *See* Dao et al., *Auditor Tenure*, *supra* note 829, at 309.

838. *See* Sainty et al., *supra* note 806, at 121 tbl.3 (Panel D).

839. *See id.* at 115.

840. *See id.*

841. *Id.*

842. *Id.*

843. *Id.* at 121 tbl.3, 122. Auditors that issued a going-concern audit report received on average 3.367% opposition, while auditors who did not received 1.007% opposition, which were significantly different at the 1% level. *Id.* A multiple regression confirms that issuing a going-concern audit report leads to more audit opposition. *See id.* at 128 tbl.5, 129.

844. *See id.* They rerun their multiple regression with an interaction variable between the issuing of a going-concern audit report and a composite measure of the inverse likelihood of financial distress. *See id.* at 126. The interaction variable is positive and statistically significant at the 1% level, suggesting that fewer signs of financial distress lead to more blame by shareholders on the auditor. *See id.* at 128 tbl.5, 129.



shareholder dissatisfaction with the auditor, while a reversal of the going-concern opinion decreases dissatisfaction back to normal levels.<sup>845</sup> These results suggest that shareholders can develop a nuanced understanding of the situation, punishing auditors more when they prematurely issue a going-concern opinion and returning to normal levels of support when the situation is resolved.<sup>846</sup>

#### 4. Restatement's Impact

Similarly, restatement disclosures also lead to lower support for auditor ratification.<sup>847</sup> In theory, restatements evidence failure on the auditor's part.<sup>848</sup> Having a restatement disclosure predicts a decrease in shareholder support for auditor ratification.<sup>849</sup> This suggests that a restatement announcement decreases the shareholders' perceptions of their auditor.<sup>850</sup> It also supports the idea that shareholders' perception of audit quality will influence their votes on audit ratification.<sup>851</sup>

#### 5. Adverse Internal Control Reports

Shareholders do not blame the auditors for issuing an adverse internal control opinion unless the opinion involves a non-company-level material weakness.<sup>852</sup> Section 404 of the Sarbanes-Oxley Act requires companies to disclose whether the auditor believes there are any material weaknesses in the company's internal controls, which is known as an adverse internal

---

845. See *id.* at 130 & tbl.6. They expand out their data from 1994 to 1998. *Id.* at 130. The initial going-concern leads to an average jump of shareholder opposition of 1.63%, significant at the 5% level. *Id.* at 130 & tbl.6. Reversing the going-concern opinion reduced opposition by 1.244%, significantly different from the year before at the 1% level. *Id.*

846. See *id.* at 130-31.

847. See Li-Lin Liu et al., *Financial Restatements and Shareholder Ratifications of the Auditor*, 28 *AUDITING: J. PRAC. & THEORY* 225, 234-35 (2009).

848. *Id.* at 226.

849. See *id.* at 233 tbl.4, 234 (demonstrating significance at the 1% level). Liu et al. find that, on average, 2.75% of shareholders, with a median of 1.59%, vote against auditor ratification for a restatement, compared to 1.45% average and 0.93% median for the control group. *Id.* at 233 & tbl.3.

850. See *id.* at 234-35. To ensure that the restatement firms did not simply always have lower auditor ratification rates, the authors compare the voting results before and after the restatement and find the differences to be statistically significant at the 1% level. *Id.* at 234 & tbl.5.

851. See *id.* at 237.

852. See Dana R. Hermanson et al., *Adverse Section 404 Opinions and Shareholder Dissatisfaction Toward Auditors*, 23 *ACCT. HORIZONS* 391, 391, 393 (2009).

control opinion.<sup>853</sup> The disclosure of an internal weakness can have negative effects such as higher debt costs, decreased stock price, and even a self-fulfilling prophesy of company failure.<sup>854</sup> The auditor may be partly responsible for any internal control problems, since the outside auditor often helps the company develop its internal controls.<sup>855</sup>

Hermanson et al. find no significant difference between the percentage of shareholders that vote against auditor ratification in companies with and without an adverse internal control opinion.<sup>856</sup> However, shareholders are more likely to vote against auditor ratification when the auditor issues an adverse opinion on an internal control that does not involve a company-level material weakness.<sup>857</sup> This result suggests that shareholders are punishing the auditor for being too conservative in issuing an adverse opinion against a company that has not experienced any significant misstatements.<sup>858</sup> An adverse opinion for a company-level material weakness only results in decreased shareholder support for the auditor when the company had a restatement.<sup>859</sup> These results suggest that shareholders blame auditors for not identifying and correcting material weaknesses in the past and thus providing low-quality auditing services.<sup>860</sup> It also suggests that, where an auditor issues a company-level adverse opinion before a restatement has been issued, shareholders reward or at least do not penalize

---

853. *See id.* at 392.

854. *Id.* at 395.

855. *See id.*

856. *See id.* at 400, 401 tbl.2. Companies with an adverse internal control opinion saw on average of 2.419% of shareholders voting against or abstaining from voting for auditor ratification, with a median of 0.968%, compared to an average of 1.828% and a median of 1.118% for the control sample. *Id.* at 401 tbl.2. These results were not statistically different. *See id.*

857. *See id.* at 403 tbl.4, 404. In the overall sample, they find a mildly significant relationship between a non-company level material weakness adverse opinion and increased votes against auditor ratification, significant at the 10% level. *See id.* at 403 tbl.4. When they split the sample between companies that disclosed restatements and those that did not and removed the interaction variables between restatements and adverse opinions, both samples resulted in a positive correlation between issuing a non-company level adverse opinion and increased votes against auditor ratification, significant at the 5% level. *See id.*

858. *See id.* at 404.

859. *See id.* at 403 tbl.4, 404. When the sample is limited to companies with a restatement, an adverse opinion for a company-level material weakness predicts decreased support for auditor ratification, significant at the 1% level. *See id.* at 403 tbl.4. The full sample and the sample of companies without a restatement does not result in a significant correlation between an adverse opinion for a company-level material weakness and shareholder voting on audit ratification. *See id.*

860. *See id.* at 404.

the auditor, because they believe that the auditor has identified an important problem that needs to be corrected.<sup>861</sup>

#### 6. Auditor Characteristics

Auditor characteristics impact how shareholders vote on auditor ratification.<sup>862</sup> Theoretical literature suggests shareholders can determine the quality of an auditor through proxies such as reputation, name brand recognition, client base, and accumulated capital wealth since the auditor is seen as a possible indemnifier if the investment goes bad.<sup>863</sup> Sainty et al. find that bigger auditing firms are likely to get more shareholder support.<sup>864</sup> However, they find no difference in shareholder support when the auditor is an industry leader for the specific industry.<sup>865</sup>

#### 7. Insider Ownership and Audit Committee Effects

Characteristics of the company and the audit committee can also impact shareholder voting on auditor ratification. Raghunandan and Rama find that higher share ownership by officers and directors and by blockholders predicted fewer votes against auditor ratification, while having the CEO as the chairman of the board predicted more votes against auditor ratification.<sup>866</sup> Similarly, Raghunandan finds that the percentage of insider ownership inversely predicts the proportion of shareholders voting against auditor ratification.<sup>867</sup>

Some evidence suggests that the composition of the audit committee also affects the auditor ratification results.<sup>868</sup> When Raghunandan and Rama

---

861. *See id.* at 406.

862. *See* Sainty et al., *supra* note 806, at 119-20.

863. *See id.* at 114.

864. *See id.* at 120. The then-Big Six firms received on average 0.519% opposition, while national firms received 0.876% opposition and local firms received 1.142% opposition. *Id.* at 121 tbl.3. The difference between these categories was significant at the 1% level. *See id.* at 120. A multiple regression confirms that the Big Six audit firms receive less opposition than the other firms, significant at the 1% level. *See id.* at 127, 128 tbl.5.

865. *See id.* at 120, 121 tbl.3. They define industry leadership as having clients with market share exceeding 20% in the specific industry. *See id.* at 120. Similarly, a multiple regression fails to find any relationship between market share and voting results. *See id.* at 128 tbl.5, 129.

866. *See* Raghunandan & Rama, *supra* note 805, at 259, 260 tbl.2. Blockholder ownership was significant at the 5% level, while officer and director ownership and CEO as chairman were significant at the 1% level. *Id.* at 260 tbl.2.

867. *See* Raghunandan, *supra* note 810, at 159, 160 tbl.2 (demonstrating significance at the 1% level).

868. *See* Raghunandan & Rama, *supra* note 805, at 260.

divide the sample in two based on the audit fee ratio, they find that the presence of a non-expert or non-independent audit committee predicted significantly higher “against” votes in the half of the sample with a higher non-audit fee ratio.<sup>869</sup> These results suggest that the composition of the audit committee affects shareholder perception of the audit when the non-audit fee ratio is high.<sup>870</sup>

#### 8. *Effect of Seeking Auditor Ratification*

An examination of which companies allow their shareholders to vote on auditor ratification suggests that auditor ratification is associated with better accounting practices.<sup>871</sup> Companies with auditor ratification tend to pay more in auditor ratification fees.<sup>872</sup> Krishnan and Ye found that higher total auditing fees predicted a higher chance that the company would seek auditor ratification.<sup>873</sup> This result suggests that auditors seek ratification when the auditor’s interest in the engagement is high.<sup>874</sup> Dao et al. also find that having shareholders vote on auditor ratification predicted higher audit ratification fees.<sup>875</sup> Their regression model predicts that having shareholders vote on auditor ratification is associated with 9% higher auditor fees.<sup>876</sup>

Krishnan and Ye report that auditing committees with greater financial expertise were more likely to seek auditor ratification.<sup>877</sup> Dao, Raghunandan, and Rama also find that companies with auditor ratification were less likely to receive a restatement for fiscal year 2006.<sup>878</sup> Their regression analysis predicts that having auditor ratification predicts a 32%

---

869. *See id.* (demonstrating significance at the 5% level). Interestingly, the dummy variable was not significant for the bottom half of the sample. *See id.*

870. *Id.*

871. *See* Krishnan & Ye, *supra* note 805, at 238.

872. *See id.* at 247-49.

873. *See id.* at 247, 248 tbl.3 (demonstrating significance at the 10% level).

874. *See id.* at 247, 250.

875. *See* Dao et al., *Shareholder Voting*, *supra* note 803, at 156, 159 tbl.2 (demonstrating significance at the 1% level). They limit their sample to firms that added or removed auditor ratification and again find a significant positive correlation between having auditor ratification and having higher auditor fees, significant at the 10% level. *See id.* at 160, 161 tbl.3. Their regression suggests that a firm that added auditor selection would have 8% higher fees than a firm that removed auditor selection. *See id.*

876. *See id.* at 156-58.

877. *See* Krishnan & Ye, *supra* note 805, at 248 tbl.3, 250 (demonstrating significance at the 10% level).

878. *See* Dao et al., *Shareholder Voting*, *supra* note 803, at 162 tbl.4, 165 (demonstrating significance at the 10% level).

reduction in the likelihood of having a restatement.<sup>879</sup> Companies with auditor ratification also have significantly lower abnormal current accruals.<sup>880</sup> The decreased likelihood of a restatement and the lower abnormal current accruals suggest that having shareholders vote on auditor ratification increases the quality of the auditor's work.<sup>881</sup> Raghunandan finds no statistical difference in company size between companies that do and do not submit their auditor for shareholder ratification.<sup>882</sup> Krishnan and Ye, however, find that larger companies are more likely to seek auditor ratification.<sup>883</sup>

Companies with better returns and where directors receive higher levels of shareholder support are also more likely to seek shareholder ratification of their auditor.<sup>884</sup> These results suggest that better performing companies tend to allow shareholder ratification of the auditor.<sup>885</sup> Beyond the difference in companies that do and do not have auditor ratification, there is little evidence of the impact of shareholder voting. Sainty et al., however, find that greater opposition to auditor ratification increases the chances that the firm will change auditors in the next two years.<sup>886</sup>

### 9. Summary

While shareholders give auditor ratification almost universally high support, the small variations in shareholder support appear to accurately reflect the auditor's ability to maintain independence and effectively perform the job. Shareholders understand the threat that non-audit fees, tax fees, and a longer relationship pose to an auditor's independence and respond by withholding their support.<sup>887</sup> Shareholders also appear to understand the importance of going-concern opinions, restatements, and adverse internal control opinions and only blame the auditor for the

---

879. *Id.* at 165.

880. *See id.* at 166, 167 tbl.5 (demonstrating significance at the 1% level).

881. *See id.* at 168.

882. Raghunandan, *supra* note 810, at 159.

883. *See* Krishnan & Ye, *supra* note 805, at 248 tbl.3, 250 (demonstrating significance at the 5% level).

884. *See id.* (each demonstrating significance at the 10% level).

885. *See id.*

886. *See* Sainty et al., *supra* note 806, at 132, 133 tbl.7. A firm that changed auditors received average ratification opposition of 2.67%, while firms that did not change auditors received ratification opposition of 1.01%, significantly different at the 1% level. *Id.* A multiple regression confirms that higher opposition to auditor ratification predicts a greater chance that the firm will be fired in the next two years, significant at the 1% level. *See id.*

887. *See supra* Sections IV.D.1-2.

associated problems when the auditor has gone too far prematurely.<sup>888</sup> Allowing shareholders to ratify the outside auditor is associated with an audit committee possessing greater financial expertise, lower abnormal current accruals, and a lower chance of having a restatement.<sup>889</sup> Although it is still unclear whether auditor ratification leads to a more effective and independent auditor, auditor ratification votes are at least associated with such results.<sup>890</sup>

#### *E. Compensation Proposals and Say on Pay*

Depending on how compensation is structured, it can increase shareholder value by properly incentivizing executives or it can dilute shareholder interest in the corporation.<sup>891</sup> When managers are compensated according to firm performance, they will work harder and take appropriate risks.<sup>892</sup> However, managers can make the plans overly beneficial to themselves and thereby undermine shareholder value.<sup>893</sup> As a result, a shareholder vote on compensation can theoretically represent an important check against management abuse.<sup>894</sup>

##### *1. Voting Support for Compensation Proposals*

Compensation proposals receive, on average, support from 80% of shareholders.<sup>895</sup> Shareholders almost always approve compensation proposals.<sup>896</sup> Thomas and Martin found only five proposals, less than 1% of

---

888. *See supra* Sections IV.D.3-5.

889. *See supra* Section IV.D.8.

890. *See supra* Section IV.D.8.

891. *See* Angela G. Morgan & Annette B. Poulsen, *Linking Pay to Performance — Compensation Proposals in the S&P 500*, 62 J. FIN. ECON. 489, 490-91 (2001).

892. *Id.* at 491.

893. *Id.* at 490.

894. *Id.*

895. *See, e.g.*, Angela Morgan et al., *The Evolution of Shareholder Voting for Executive Compensation Schemes*, 12 J. CORP. FIN. 715, 723-24 (2006) (finding average shareholder support for compensation proposals of 85% to 80.9% between 1992 and 2003); Randall S. Thomas & Kenneth J. Martin, *The Determinants of Shareholder Voting on Stock Option Plans*, 35 WAKE FOREST L. REV. 31, 58-59 (2000) (finding that stock option proposals in 1998 received on average only 18.6% opposition).

896. *See, e.g.*, Christopher S. Armstrong et al., *The Efficacy of Shareholder Voting: Evidence from Equity Compensation Plans*, 51 J. ACCT. RES. 909, 910-11 (2003) (finding that shareholders failed to approve 2% of equity compensation proposals between 2001 and 2010); Thomas & Martin, *supra* note 895, at 58 (finding less than 1% of stock proposals fail to receive shareholder support in 1998).

their sample, which failed to receive the necessary shareholder support.<sup>897</sup> From case studies of the defeats, they concluded that high levels of shareholder dilution caused the rejection, ranging from 20% to 44%.<sup>898</sup>

At least before 2003, management had some latitude to structure executive compensation to avoid the shareholder approval requirement, which they had been increasingly avoiding despite the expanding regulations requiring shareholder approval.<sup>899</sup> Between 1978 and 1997, companies adopted only 9% of plans without shareholder approval.<sup>900</sup> By contrast, between 1997 and 2002, companies adopted 27% of plans without shareholder approval.<sup>901</sup>

## 2. Effect of Company Performance

Managers appear more likely to submit compensation to a shareholder vote when the company is doing well, although shareholders seem unconcerned with company performance.<sup>902</sup> Balachandran et al. find that firms with better corporate governance tend to put their compensation plans up for a vote.<sup>903</sup> Firms with a lower return on assets (“ROA”) are less likely to put their compensation plans up for a vote.<sup>904</sup> Similarly, Morgan and

---

897. Thomas & Martin, *supra* note 895, at 58.

898. *Id.* at 57.

899. Sudhakar V. Balachandran et al., Do Voting Rights Matter: Evidence from the Adoption of Equity-Based Compensation Plans 1 (May 2004) (unpublished manuscript), <https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/1083/1083.pdf>. SEC rule 16b-3 has long required that compensation awarded to executives be subject to the short swing sale prohibition unless the plan was approved by shareholders. *Id.* at 9. In 1996, the SEC amended the rule by expanding the exemption to approval by directors or a board committee. *Id.* at 10. Also, in 1998, the NYSE created an exemption for requiring shareholder approval of plans where 20% of companies were eligible to participate, half of which must not be either officers nor directors. *Id.* They ended the exemption in 2002. *Id.* In 2003, NYSE and NASDAQ began requiring firms to obtain shareholder approval for equity-based compensation plans. *Id.* at 1.

900. *Id.* at 3-4.

901. *Id.* at 4. The increase in unapproved plans may be the result of regulatory changes. *See id.* at 9-10.

902. *Id.* at 22-23.

903. *Id.* at 23. They use the proportion of directors that are insiders, whether the CEO is also the chair of the board and whether the firm has a beneficial owner, defined as owning more than 10% of the company’s stock. *See id.* at 36 tbl.4. A CEO chairman and a higher proportion of inside directors make the firm less likely to submit the compensation plan to shareholders, both significant at the 5% level. *See id.* Having a beneficial owner made it more likely that the company would submit compensation for shareholder approval, significant at the 10% level. *See id.*

904. *Id.* at 22-23 (demonstrating significance at the 1% level).

Poulsen find that managers are more likely to submit compensation proposals after high stock-price performance, although sales did not make a difference.<sup>905</sup>

Executives may see periods of strong stock performance as opportune times to have their compensation tied to company performance.<sup>906</sup> The performance of the company, however, does not appear to affect shareholders' support for compensation plans.<sup>907</sup> Morgan et al. find that neither the prior one-year stock performance nor the book-to-market ratio had a statistically significant relationship to proposal support.<sup>908</sup> Cremers and Romano also find that company performance did not relate to support for equity compensation proposals.<sup>909</sup>

Poor company performance may also increase support for incentive-based executive compensation.<sup>910</sup> Thomas and Martin find that shareholders offer greater support for future stock option plans when the company has been performing poorly.<sup>911</sup> Perhaps shareholders are willing to create stronger incentives to attract better managers when their company performs poorly and needs top-notch management expertise.

However, while examining the first round of say-on-pay votes in 2011, Ertimur et al. find that poorly performing firms, based on abnormal returns and ROA, received less shareholder support.<sup>912</sup> Cotter et al. also find better stock performance over the previous two years resulted in more support on the say-on-pay proposals.<sup>913</sup> Ignoring the recent say-on-pay votes, managers

---

905. Morgan & Poulsen, *supra* note 891, at 512. The stock result was significant at the 5% level. *See id.* at 509 tbl.7.

906. *Id.* at 512.

907. *See* Morgan et al., *supra* note 895, at 726, 728.

908. *Id.* at 726, 727 tbl.5.

909. *See* K. J. Martijn Cremers & Roberta Romano, *Institutional Investors and Proxy Voting on Compensation Plans: The Impact of the 2003 Mutual Fund Voting Disclosure Rule*, 13 AM. L. ECON. REV. 220, 238 tbl.3, 242 (2011).

910. Thomas & Martin, *supra* note 895, at 61-62.

911. *Id.* They divide the sample in half based on the prior one-year, three-year, and five-year market returns. *Id.* at 61. They find no significant difference in shareholder opposition based on one-year returns. *Id.* However, lower three-year returns and five-year returns had significantly lower shareholder opposition. *Id.* at 61-62. These results are confirmed with a multiple regression, finding a significantly positive relationship between one-, three-, and five-year returns and shareholder opposition. *Id.* at 71-72.

912. Yonca Ertimur et al., *Shareholder Votes and Proxy Advisors: Evidence from Say on Pay*, 51 J. ACCT. RES. 951, 973, 975 tbl.6A (2013) (both measures significant at the 1% level).

913. James F. Cotter et al., *The First Year of Say-on-Pay Under Dodd-Frank: An Empirical Analysis and Look Forward*, 81 GEO. WASH. L. REV. 967, 985 (2013). They group



appear to incorrectly believe that shareholders vote on compensation proposals based on the company's recent performance.<sup>914</sup>

Allowing shareholders to approve compensation plans may also improve company performance.<sup>915</sup> In the year after the compensation proposal, Morgan and Poulsen find that companies had significantly higher stock performance, earnings divided by assets, and sales divided by assets than a control group.<sup>916</sup> Balachandran et al. similarly find that having shareholder approval of compensation plans predicts better ROA and better operating returns in the year after initiating the plan.<sup>917</sup> It may be that the compensation proposals lead to better company performance or that executives propose compensation proposals when they expect strong performance.<sup>918</sup>

Plans approved by shareholders tended to be larger and have a higher exercise price.<sup>919</sup> Plans covering directors were likely to be approved by shareholders, while plans covering officers were less likely to pass.<sup>920</sup> Also, Morgan and Poulsen find that firms with higher institutional holdings were more likely to let shareholders vote on the compensation plan, while insider ownership had an insignificant impact.<sup>921</sup> These results suggest that insiders are not able to propose these plans without support from institutional investors.<sup>922</sup> Overall, these papers indicate that firms with good corporate

---

companies into five groups based on total stock returns over the twenty-four months leading to Fiscal Year End 2010. *Id.* The group with the best stock returns received on average 68.9% support, while the group with the lowest support received on average 62.8% support; these were significantly different at the 1% level. *Id.* A multiple regression confirms that higher stock returns led to higher support, significant at the 1% level. *See id.* at 990, 991 tbl.6.

914. *See id.*

915. *See* Morgan & Poulsen, *supra* note 891, at 519-20.

916. *Id.* The CARs are significantly different at the 5% level, while earnings/assets and sales/assets are significantly different at the 10% level. *See id.* at 519.

917. Balachandran et al., *supra* note 899, at 25 (both significant at the 5% level).

918. *See* Morgan & Poulsen, *supra* note 891, at 520.

919. Balachandran et al., *supra* note 899, at 16. Plans approved by shareholders included an average of 5502 shares and an average exercise price of \$12.13. *Id.* at 31 tbl.1. Plans not approved by shareholders included an average of 3142 shares and an average exercise price of \$10.47. *Id.* A multiple regression finds that smaller plans were less likely to be put to a vote, significant at the 1% level. *Id.* at 23.

920. *Id.* (both demonstrating significance at the 5% level).

921. Morgan & Poulsen, *supra* note 891, at 510 (demonstrating significance at the 5% level).

922. *See id.*

governance and strong performance allow shareholders to approve their compensation plans.<sup>923</sup>

### 3. *Effect of Dilution*

The primary driver of shareholder support for compensation proposals appears to be their effect on the level of shareholder dilution.<sup>924</sup> Morgan and Poulsen find that the average dilution of the plans was 3.21%, with a median dilution of 2.35%, while 23% of the plans had a dilution effect greater than 5%.<sup>925</sup> Plans that resulted in less dilution of the company's stock saw a better stock market response than plans with more dilution.<sup>926</sup> Shareholders gave lower support to plans with higher dilution levels.<sup>927</sup> Similarly, Thomas and Martin find that the dilution of all plans proposed predicted significantly less shareholder support.<sup>928</sup> The total dilution of all the stock option proposals in the proxy statement had a greater impact on shareholder voting than the dilution of each individual proposal.<sup>929</sup>

Morgan et al. report that more dilutive plans received less shareholder support.<sup>930</sup> Armstrong et al. find that the dilution of the compensation plan predicted less support from shareholders.<sup>931</sup>

---

923. *See id.*

924. *See id.* at 499.

925. *Id.*

926. *See id.* at 514. Plans with dilution of less than or equal to 5% had average CARs of 0.46% ( $t = 2.70$ ), while plans with returns greater than 5% returns received CARs of 0.17% ( $t = 0.75$ ). *Id.* at 515. When the sample was limited to plans that affected executives, plans less than 5% received CARs of 0.62% ( $t = 3.04$ ), while plans with greater dilution saw CARs of 0.15% ( $t = 0.64$ ). *Id.*

927. *See id.* at 514-15.

928. *See* Thomas & Martin, *supra* note 895, at 69 (demonstrating significance at the 1% level). The result holds when they divide the sample between plans with more and less than 10% dilution. *See id.* at 69-70.

929. *Id.* at 60. They run a chi-squared analysis of total dilution of the proposals within a stock option proposal greater or less than 10% and the dilution of individual proposals of greater or less than 5%. *Id.* Naturally, shareholder disapproval is highest when the total of dilution is greater than 10% and the individual dilution is greater than 5%, receiving shareholder disapproval of 24.8% on average. *Id.* This disapproval rate is significantly different from when total dilution is high and individual dilution is low. *Id.* However, there is no significant difference between high and low individual dilution when total dilution is low. *Id.*

930. Morgan et al., *supra* note 895, at 726, 727 tbl.5 (demonstrating significance at the 1% level).

931. *See* Armstrong et al., *supra* note 896, at 929-30. The number of shares created by the plan as a proportion of shares outstanding, the number of stock options and restricted stock not yet granted as a proportion of shares outstanding, and the proportion of the CEO's

CEO compensation affects how shareholders vote on compensation proposals.<sup>932</sup> Armstrong et al. find that the shareholders' support for the equity compensation proposal correlates negatively with the CEO's option compensation, total compensation, proportion of equity compensation, and options granted.<sup>933</sup> Morgan et al. find that a higher ratio of CEO compensation to total assets predicted lower support for the compensation proposal.<sup>934</sup> These results indicate that higher CEO compensation led to less shareholder support.<sup>935</sup> Conyon also finds that higher levels of CEO pay are associated with higher levels of shareholder opposition to the firm's say-on-pay proposal.<sup>936</sup> Furthermore, firms with better economic performance see lower levels of shareholder dissent on the proposals.<sup>937</sup> Finally, the composition of the board also has a significant impact on the say-on-pay proposals.<sup>938</sup> Shareholders appear to pay attention to the dilution of the compensation plan and the current pay of the CEO when they vote on compensation proposals.

#### *4. Shareholder Composition and Corporate Governance Impact*

The company's shareholder profile affects support for compensation proposals.<sup>939</sup> Morgan et al. find that larger institutional holdings lead to less

---

compensation in equity all predict less shareholder support for the equity compensation plan, each statistically significant at the 1% level. *Id.* at 929 tbl.2.

932. *Id.* at 935.

933. *Id.* at 931 tbl.3, 935 (each significant at the 1% level, except for total compensation significant at the 10% level).

934. *See* Morgan et al., *supra* note 895, at 729, 730 tbl.7.

935. *See* Armstrong et al., *supra* note 896, at 935.

936. Martin J. Conyon, Shareholder Dissent on Say-on-Pay and CEO Compensation 17 (Mar. 16, 2016) (unpublished manuscript), <http://ssrn.com/abstract=2748645>. Their sample includes 3205 firm-year observations from 2010 to 2012 that includes 1264 unique firms. *Id.* at 10. Each of cash pay, total pay, realized pay (which includes ex post gains from the sales of options and restricted stock), and excess compensation predict higher levels of shareholder dissent, each significant at the 1% level. *See id.* at 29 tbl.6.

937. *Id.* at 18. Higher market performance and accounting performance result in higher levels of shareholder support for the say-on-pay proposals, significant at the 1% level. *See id.* at 29 tbl.6.

938. *See id.* at 18. A larger board leads to lower levels of support for say-on-pay proposals, at a marginal level of significance. *See id.* at 18, 29 tbl.6. Interestingly, Conyon finds no relationship between the percentage of independent directors and shareholder support for the say-on-pay proposals. *Id.* Shareholders are more likely to oppose the say-on-pay proposal when the CEO is also the chairman of the board. *See id.* at 18, 29 tbl.6 (demonstrating significance at the 1% level).

939. *See* Morgan et al., *supra* note 895, at 726.

support for the compensation proposals.<sup>940</sup> This result suggests that institutional shareholders are more critical of executive compensation plans than are individual shareholders.<sup>941</sup>

Morgan and Poulsen find that higher managerial holdings led to higher support for compensation proposals.<sup>942</sup> Similarly, being a larger firm predicts high shareholder support for a compensation proposal.<sup>943</sup> Cremers states that high stock turnover led to less support for the equity compensation proposals.<sup>944</sup> The presence of a poison pill is also correlated with significantly less support for the equity compensation proposals.<sup>945</sup>

### 5. Type of Compensation Plans Matters

Shareholders seem more inclined to support different types of plans.<sup>946</sup> Thomas and Martin find that stock option plans for all employees experience significantly higher opposition than plans for just executives or outside directors.<sup>947</sup> Evergreen plans face significantly more opposition than stock option plans generally.<sup>948</sup> Plans with discount options receive more opposition than fair market options.<sup>949</sup> Plans that allow for repricing underwater options receive significantly more opposition than plans without the option.<sup>950</sup> Plans with omnibus awards receive significantly more

940. *Id.* at 726, 727 tbl.5 (demonstrating significance at the 5% level).

941. *See id.*

942. Morgan & Poulsen, *supra* note 891, at 517.

943. *Id.* (demonstrating significance at the 5% level).

944. Cremers & Romano, *supra* note 909, at 238 tbl.3, 242 (demonstrating significance at the 5% level).

945. *Id.* (demonstrating significance at the 5% level).

946. *See* Thomas & Martin, *supra* note 895, at 62.

947. *Id.* at 61. They find that stock option plans for all employees have opposition of 22.1%, plans for executives of 18.1%, and plans for outside directors of 11.9%. *Id.* A chi-squared analysis shows that these differences are statistically significant. *See id.*

948. *See id.* at 62. On average, plans with evergreen or quasi-evergreen provisions receive 28.2%, which is higher than the opposition rate to plans without the provisions, significant at the 1% level. *Id.* at 62, 76 tbl.2. A multiple regression finds that evergreen plans are weakly correlated with shareholder opposition, significant at the 10% level. *See id.* at 71.

949. *See id.* at 63. Plans with discount options receive 24.2% opposition on average, which is higher than plans with the market options, significant at the 1% level. *Id.* A multiple regression shows that discount options are weakly correlated with shareholder opposition, significant at the 10% level. *See id.* at 71.

950. *See id.* at 65. An underwater repricing option allows the board to lower the exercise price of the option when the stock price has fallen below the original exercise price. *Id.* at 63. They find that plans that allow for repricing underwater options received on average 25.1% opposition, while options that did not have a repricing option received on average

opposition than plans without the feature.<sup>951</sup> Time-lapse restricted stock records greater opposition than other plans.<sup>952</sup> Thomas and Martin did not find a significant difference in opposition to reload options compared to other plans.<sup>953</sup> Plans with change in control provisions receive greater opposition than plans without the provisions.<sup>954</sup> Plans accompanied by preferential loans to executives to pay for the stock receive significantly more opposition than other plans.<sup>955</sup> They did not find a significant difference between plans with pyramiding of stock options compared to other plans.<sup>956</sup> Plans with acceleration provisions receive significantly more

---

16.1% opposition, significant at the 1% level. *Id.* at 65. These results are confirmed with a multiple regression. *See id.* at 71.

951. *See id.* at 65. Plans with an omnibus feature receive on average opposition of 21.1% while plans without the feature receive opposition of 17.1%, which is significantly different at the 1% level. *Id.* However, a multiple regression fails to find a significant correlation between an omnibus provision and shareholder opposition. *See id.* at 71.

952. *See id.* at 66. Time-lapsing restricted stock occurs where “company stock . . . is given or sold, at a deep discount, [but] . . . cannot be sold during a fixed period of time,” which made up 44% of their sample. *Id.* at 66. The time-lapsing restricted stock received 20.8% opposition compared to other plans that received 16.9% opposition, significantly different at the 1% level. *Id.* These results are confirmed with multiple regression analysis. *See id.* at 71.

953. *Id.* at 67. Reload options allow the executive to lock in gains on their existing stock options “without giving up the opportunity to realize further gains if the company’s stock price should continue to increase.” *Id.* at 66-67. They made up 10% of the sample. *Id.* at 67. The reload options received 20.4% opposition and other proposals received 18.4% opposition, which were not significantly different. *Id.* However, a multiple regression fails to find any significant relationship between a reload option and shareholder opposition. *See id.* at 71.

954. *Id.* Change in control provisions allow executives to exercise their options “upon a change in control of the company.” *Id.* They received opposition of 19.7%, while other plans received opposition of 14.9%, significantly different at the 1% level. *Id.* However, a multiple regression fails to find a significant relationship between a change in control provision and shareholder opposition. *See id.* at 71.

955. *See id.* at 68. Proposals that included “the possibility of using loans to pay the exercise price” made up 27% of the sample and received opposition of 24.8%, while other plans received opposition of 16.4%, which was significantly different at the 1% level. *Id.* These results are confirmed with a multiple regression. *See id.* at 71.

956. *Id.* at 68.

opposition than other plans.<sup>957</sup> Proposals that add shares to existing plans face significantly higher opposition than proposals that create new plans.<sup>958</sup>

Morgan and Poulsen find that proposing a new compensation plan predicted higher shareholder approval, while replacement plans and adding additional plans did not.<sup>959</sup> These results suggest that shareholder voting reflects the negative and positive aspects of a compensation plan, even if shareholders do not actually reject any of them.<sup>960</sup>

#### 6. Impact on CEO Compensation

Studies have found conflicting evidence on whether shareholder support affects a CEO's future compensation. Martin and Thomas find that shareholder support for a proposal correlated with changes in salary and total pay for the CEO in the following year.<sup>961</sup> Shareholder support, however, did not have a statistically significant relationship to salary plus bonus or to option pay.<sup>962</sup> These results suggest that CEO compensation is responsive to shareholder voting on compensation proposals.<sup>963</sup>

In contrast, Armstrong et al. fail to find a correlation between the shareholder vote and different measures of CEO compensation in the first and second year after the vote.<sup>964</sup> They also examine whether there was a relationship between approval of the equity compensation plan and the CEO's compensation in the next year.<sup>965</sup> They find no correlation between a failed vote on equity compensation and future compensation.<sup>966</sup> This is surprising because equity proposals are generally binding, so it suggests that boards are seeking additional shares for the CEO in the later years.<sup>967</sup>

---

957. *See id.* Plans with acceleration provisions received 21.2% opposition while other plans received opposition of 15.7%, significantly different at the 1% level. *Id.* However, a multiple regression fails to find any significant relationship between an acceleration provision and shareholder opposition. *See id.* at 71.

958. *See id.* (using a multiple regression, significant at the 1% level).

959. *See Morgan & Poulsen, supra* note 891, at 505 tbl.5, 506 (demonstrating significance at the 5% level).

960. *See id.* at 514, 515 tbl.9.

961. *See* Kenneth J. Martin & Randall S. Thomas, *When Is Enough, Enough? Market Reaction to Highly Dilutive Stock Option Plans and the Subsequent Impact on CEO Compensation*, 11 J. CORP. FIN. 61, 78 tbl.8 (2005) (demonstrating significance at the 10% level).

962. *Id.* at 78 tbl.8, 79.

963. *Id.* at 80.

964. *See* Armstrong et al., *supra* note 896, at 932-33 tbl.3, 935.

965. *See id.* at 943.

966. *See id.*

967. *Id.*

Conyon finds that firms with higher levels of dissent are less likely to increase their CEO's pay, but only at marginal levels of significance.<sup>968</sup> This result suggests that the say-on-pay votes provide some check on CEO compensation.<sup>969</sup>

### 7. Impact of SEC 2003 Rules

In 2003, the SEC adopted new rules that require shareholder approval for new equity compensation plans or material alterations to an existing equity compensation plan.<sup>970</sup> Ng et al. find that the percentage of firms with management-sponsored equity compensation proposals increased from 47.6% before the 2003 regulation to 53.4% after the regulation.<sup>971</sup> However, the increase in the percentage of firms with compensation proposals resulted mainly from firms that already had compensation approved by shareholders.<sup>972</sup> Interestingly, ISS gave positive recommendations to 80% of the equity compensation proposals in the two years leading up to the new rule compared to 90% in the two years after the new rule, suggesting that equity compensation proposals increased in quality.<sup>973</sup>

After, but not before the new rule, total compensation and equity compensation of the top five executives predicted significantly less support for the compensation proposals.<sup>974</sup> More entrenched directors and more institutional holdings also predicted significantly less support after, but not before, the new rule.<sup>975</sup> These results suggest that the new rule increased the quality of shareholder voting.<sup>976</sup> The new mandatory nature of equity proposals may have empowered shareholders to more critically examine the compensation proposals on which they vote.<sup>977</sup>

---

968. Conyon, *supra* note 936, at 19, 30 tbl.7.

969. *See id.* at 19-20.

970. Lilian Ng et al., *Does Shareholder Approval Requirement of Equity Compensation Plans Matter?*, 17 J. CORP. FIN. 1510, 1511 (2011). Prior to the new rule, about half of S&P 500 firms had equity-based compensation plans that weren't approved by shareholders. *Id.* Equity compensation proposals fall into three categories: stock options, restricted stock, and omnibus awards. *Id.* at 1515.

971. *Id.* at 1516. They find that 47.6% of firms have compensation proposals between 2001 and 2003 compared to 53.4% between 2003 and 2005. *Id.*

972. *Id.* at 1517.

973. *Id.* at 1520.

974. *Id.* at 1523, 1524 tbl.7 (both showing significance at the 5% level).

975. *See id.* (both significant at the 10% level).

976. *Id.* at 1523.

977. *Id.*

The average composition of executive compensation dropped from 60% equity and 40% cash to 50% equity and 50% cash after the new rule.<sup>978</sup> As expected, it appears that the 2003 rule motivated management to receive their compensation in cash instead of equity.<sup>979</sup>

#### 8. Mutual Fund Voting After 2003

Another part of the 2003 SEC reforms require that mutual funds disclose how they vote on proxy proposals.<sup>980</sup> The SEC hoped that such disclosure would reduce mutual fund support for management by making them more accountable to their investors.<sup>981</sup> Cremers and Romano find that mutual fund support for management did not decline after the disclosure rules.<sup>982</sup> In fact, mutual funds may have increased their support for management after the disclosure rules.<sup>983</sup> The added transparency may make mutual funds more vulnerable to management backlash, but this interpretation is unlikely since management would already have known how the mutual funds voted.<sup>984</sup> Management would not have already known about the mutual funds' votes if the corporation had confidential voting, but that characteristic did not correlate with proposal support.<sup>985</sup> Perhaps mutual funds may believe that their investors prefer them to vote with management and are now responding to that pressure.<sup>986</sup>

#### 9. Dodd-Frank's Say-on-Pay Vote

In 2011, the Dodd-Frank Act created a new mandatory, but non-binding, vote on executive compensation known as say on pay.<sup>987</sup> On average, 9.6%

---

978. *Id.* at 1525. The differences between the two periods are statistically significant at the 5% level. *See id.* at 1525 tbl.8.

979. *See id.*

980. Cremers & Romano, *supra* note 909, at 221.

981. *Id.* The SEC hoped that investors would pressure mutual funds into reducing their support for management. *See id.* at 226.

982. *Id.* at 239. Their results suggest that mutual fund holdings, both before and after, lead to decreased support for the EEIC proposals, significant at the 5% levels. *Id.* at 238 tbl.3. However, the correlation disappears as they add in additional control variables. *See id.* The interaction variable between mutual fund holdings and the "after" dummy correlates positively with EEIC support, significant at the 10% level, suggesting that mutual funds may have increased their support for management after the disclosure. *See id.* at 238 tbl.3, 239.

983. *See id.* at 238 tbl.3 (demonstrating significance at the 10% level).

984. *Id.* at 242.

985. *Id.* at 242-43.

986. *See id.* at 243.

987. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 951, 15 U.S.C. § 78n-1 (2012); Ertimur et al., *supra* note 912, at 951-52. They focus on the



of shareholders (median 4.6%) vote against the say-on-pay proposal.<sup>988</sup> Shareholders paid attention to the CEO's current compensation in voting on the say-on-pay proposals.<sup>989</sup> Cotter et al. find that higher excess CEO compensation predicted significantly less support for the say-on-pay proposal.<sup>990</sup> The growth in CEO pay, however, did not have a major effect on the say-on-pay vote.<sup>991</sup> Similarly, Ertimur et al. find that a higher level of and higher growth of CEO pay predicts less shareholder support for the say-on-pay proposal.<sup>992</sup>

#### 10. Proxy Advisor Impact on Say-on-Pay Vote

The recommendation of a proxy advisor had the greatest impact on shareholder voting on say-on-pay proposals.<sup>993</sup> ISS recommended "against" for 13% of the compensation packages in their sample.<sup>994</sup> Similarly, Glass Lewis recommended "against" for 21% of the compensation packages in their sample.<sup>995</sup> The two firms offer the same recommendation in

---

recommendations given by ISS and Glass Lewis in 2011 on say-on-pay votes, which are mandatory but nonbinding. *Id.* Both proxy advisors, ISS and Glass Lewis, provide a quantitative and qualitative analysis of the executive pay plan, assign a rating, and issue a final vote recommendation. *Id.* at 953. ISS issued an "against" recommendation for 11.3% of firms, while Glass Lewis issued an "against" recommendation for 21.7% of firms. *Id.*

988. Ertimur et al., *supra* note 912, at 973.

989. See Cotter et al., *supra* note 913, at 987-92.

990. *Id.* at 990, 991 tbl.6 (demonstrating significance at the 1% level). Excess CEO compensation is defined as CEO compensation minus the expected CEO compensation based on company performance and industry standards. See *id.* at 988-89 n.96.

991. See *id.* at 987-88. After dividing companies into five groups based on growth in CEO compensation, they find statistically significant differences between the groups when ISS issues a positive recommendation, significant at the 5% level, but not when it issues a negative recommendation. *Id.* A multiple regression also fails to find a significant relationship between the growth in CEO compensation and shareholder support. *Id.* at 990, 991 tbl.6.

992. See Ertimur et al., *supra* note 912, at 973, 975 tbl.6A (demonstrating significance at the 1% and 5% levels respectively).

993. See Cotter et al., *supra* note 913, at 990.

994. See David F. Larcker et al., *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J.L. & ECON. 173, 180 (2015). Their sample is based on 2008 firms from the Russell 3000 index that were required to have a say-on-pay vote in 2011 under the Dodd-Frank Act. See *id.* at 176.

995. *Id.* at 181. Glass Lewis does not publicly release their recommendations. As a result, the authors extrapolate Glass Lewis recommendations from the voting of four firms that follow Glass Lewis policies. The firms disagreed in only six instances, suggesting that this methodology has a high level of accuracy. See *id.* at 180.

approximately 79% of cases.<sup>996</sup> No firm that received a positive ISS recommendation failed to receive majority support, while one firm that received a positive recommendation from Glass Lewis failed to receive majority support.<sup>997</sup>

Cotter et al. find that an ISS recommendation in favor of the say-on-pay proposal resulted in significantly more shareholder support.<sup>998</sup> Out of all of the variables they studied, an ISS recommendation appeared to have the largest effect.<sup>999</sup> Ertimur et al. also find that a negative recommendation from ISS or Glass Lewis predicted significantly less shareholder support for the proposal.<sup>1000</sup> The ISS recommendation also had a significantly larger effect on shareholder votes compared to the Glass Lewis recommendation.<sup>1001</sup> These results confirm that ISS and Glass Lewis have a major impact on shareholder voting, with ISS playing the larger role.<sup>1002</sup>

Ertimur et al. further report that a negative ISS recommendation had a greater effect on non-blockholders than blockholders.<sup>1003</sup> This result suggests that institutional investors deviate more from the ISS recommendation when they own a greater share of the company, perhaps because a greater ownership share incentivizes them to overcome collective action problems.<sup>1004</sup>

---

996. *Id.* at 181. However, where one of the firms offers a “vote against” recommendation, the firms agree only in 23% of cases. *See id.*

997. *See id.*

998. *See* Cotter et al., *supra* note 913, at 982. Say-on-pay proposals with a positive ISS recommendation received on average 28.2% more shareholder support than say-on-pay proposals with a negative ISS recommendation. *See id.* A multiple regression confirmed that companies with a positive ISS recommendation received more support, significant at the 1% level. *See id.* at 990, 991 tbl.6.

999. *Id.* at 990.

1000. Ertimur et al., *supra* note 912, at 976 tbl.6B, 978 (both demonstrating significance at the 1% level). The *R*<sup>2</sup> is 43.8% in the model with Glass Lewis, 65.7% in the model with ISS, and 82.3% in the model with both, compared to 20.9% in the model with neither, suggesting that their recommendations explain a larger part of the variation in shareholder voting. *See id.*

1001. *See id.* at 978.

1002. *See id.*

1003. *See id.* at 979. Their results indicate that a negative recommendation from ISS results in 34.4% of nonblockholders voting no and 24.5% of blockholders voting no, while a negative recommendation from Glass Lewis resulted in 17.6% and 13.7% respectively. *Id.* at 979-80.

1004. *See id.*

Larcker et al. find that the recommendations of proxy advisors are more likely to shift votes at firms with more passive investors.<sup>1005</sup> This result reflects a free-rider problem among passive investors, who are happy to defer to the recommendations of a proxy advisor.<sup>1006</sup> An ISS “against” recommendation that results from multiple parts of the compensation plan being of high concern leads to more shareholders voting against the plan than when only a single part created high concern.<sup>1007</sup> This result suggests that some shareholders pay attention to the rationale for the negative recommendation and do not blindly follow the proxy advisor.<sup>1008</sup>

### *11. ISS Effect on Board Behavior*

Of the firms that received a negative ISS recommendation, 55% claimed to change their compensation the following year in response to the say-on-pay vote.<sup>1009</sup> The claim occurred in 72% of firms that received 30-35% dissent from shareholders, compared to 32% in firms that received 25-30% dissent from shareholders.<sup>1010</sup> These results suggest that firms will change their compensation policy in response to an ISS recommendation and shareholder votes.<sup>1011</sup> However, Ertimur et al. find no market reaction to these changes.<sup>1012</sup> Ertimur et al. interpret their results as showing that proxy advisors process significant amounts of information for institutional investors but fall short of identifying or promoting best practices in compensation proposals.<sup>1013</sup>

### *12. Effect of Additional Disclosures on Say-on-Pay Vote*

Mukhopadhyay and Shivakumar use the say-on-pay vote to understand how disclosures affect shareholder voting.<sup>1014</sup> A higher number of

---

1005. See Larcker et al., *supra* note 994, at 184. They define passive investors as firms that are “quasi indexers” and “transient institutions.” See *id.* at 183. An interaction term of ISS “against” and percentage of passive investors, as well as Glass Lewis “against” and percentage passive, is statistically significant at the 1% level. *Id.* at 184, 185 tbl.2.

1006. *Id.* at 201-02.

1007. See Ertimur et al., *supra* note 912, at 980-81.

1008. See *id.* at 981.

1009. *Id.* at 984. Dodd-Frank requires firms to disclose how they reacted to the previous say-on-pay vote. See *id.*

1010. *Id.* at 986.

1011. *Id.*

1012. See *id.* at 987.

1013. See *id.*

1014. See Tathagat Mukhopadhyay & Lakshmanan Shivakumar, Do Compensation Disclosures Matter for SoP Voting? 1 (Nov. 2015) (unpublished manuscript), <http://ssrn.com/abstract=2718438>. To examine the disclosures, the authors compute a score

performance-related disclosures decreases the likelihood of getting less than 70% support on a say-on-pay vote.<sup>1015</sup> A firm in the top decile of disclosures has about a 5% chance of missing the 70% threshold, compared to a 6.1% chance for a firm in the bottom decile.<sup>1016</sup> Thus, while not determinative of the vote, the increased disclosure has a significant impact relative to not disclosing.<sup>1017</sup> Additionally, firms become more forthcoming in their disclosures after receiving a low level of support for the say-on-pay vote.<sup>1018</sup> The low support prompts management to do more to justify its compensation.<sup>1019</sup> These increased disclosures also decrease the likelihood of receiving a low level of support on the next say-on-pay vote.<sup>1020</sup>

Finally, the authors look at whether the introduction of the say-on-pay voting requirement changed firms' behavior.<sup>1021</sup> As expected, firms that award their CEOs higher compensation also provide more disclosure, presumably in order to justify the higher compensation.<sup>1022</sup> This relationship, however, is significantly stronger in the post-say-on-pay period.<sup>1023</sup> This result suggests that boards view disclosure as a useful tool to gain approval of the say-on-pay vote.<sup>1024</sup> Additionally, the result shows that managers are responsive to investors' demands for compensation-related disclosures.<sup>1025</sup>

---

of textual disclosures of managerial performance. *See id.* at 2. Their sample includes 7973 say-on-pay votes that occurred between January 2011 and September 2014. *See id.* at 25.

1015. *See id.* at 27, 55 tbl.4 (demonstrating significance at the 1% level). The authors focus on the 70% support level because receiving less support begins to affect firm behavior and makes it more likely that ISS will issue a negative recommendation on subsequent say-on-pay votes. *Id.* at 20. The authors find similar results when they use a continuous variable of the resulting disapproval of the say-on-pay vote. *Id.* at 28.

1016. *Id.*

1017. *See id.*

1018. *Id.* at 30, 60 tbl.6 (demonstrating significance at the 5% level).

1019. *See id.* at 31.

1020. *See id.* at 32, 62 tbl.7 (demonstrating significance at the 10% level). However, the variable loses its significance when a control variable for ISS recommendation is added to the regression. *See id.* at 32. This result may be because an ISS recommendation already reflects the increases in textual disclosure. *See id.* at 32-33.

1021. *Id.* at 33. The authors look specifically at how the relationship between peer-adjusted executive pay and textual disclosures of performance changes around the introduction of mandatory say-on-pay voting. *See id.* The authors use peer-adjusted executive pay as a proxy for shareholder demand for compensation-related disclosure. *See id.*

1022. *See id.* at 35, 63 tbl.8 (demonstrating significance at the 1% level).

1023. *Id.* at 35.

1024. *Id.*

1025. *Id.* at 35-36.

### 13. Frequency of Say-on-Pay Vote

The say-on-pay provisions also created a vote on how often shareholders would vote on say on pay, with the ability to chose between every one, two, or three years, known as “say when on pay.”<sup>1026</sup> The say-when-on-pay vote created a unique situation where proxy advisors consistently recommended choosing every year, but managers’ recommendations varied between one and three years.<sup>1027</sup>

Ferri and Oesch find that a management recommendation for the triennial option significantly increased shareholder votes for that result.<sup>1028</sup> Their results suggest that a management recommendation increased shareholder support for the triennial option by 26%.<sup>1029</sup> Using four proxies of management credibility, they find that shareholders give less support to the triennial option in firms where management recommended the triennial option but had less credibility.<sup>1030</sup> In almost all cases, the board adopts the frequency voted highest by shareholders.<sup>1031</sup> In 2012, firms were requested to disclose if and how they took into account the 2011 say-on-pay vote.<sup>1032</sup>

Significantly, of those companies that received negative ISS recommendations on the say-on-pay vote, companies that adopted an annual say-on-pay vote were significantly more likely to change their compensation practices in 2012 because of the 2011 say-on-pay vote, compared to the companies that adopted the triennial vote.<sup>1033</sup> This result

---

1026. See Dodd-Frank Wall Street Reform and Consumer Protection Act § 951, 15 U.S.C. §78n-1(a)(3)(B) (2012); Fabrizio Ferri & David Oesch, *Management Influence on Investors: Evidence from Shareholder Votes on the Frequency of Say on Pay*, at 3-4 (Columbia Bus. Sch. Research Paper No. 13-17, Oct. 25, 2013), <http://ssrn.com/abstract=2238999>.

1027. Ferri & Oesch, *supra* note 1026, at 3. Management recommended an annual vote in 61.6% of cases. *Id.* On average, 75.5% of shareholders supported the annual option, compared to 1.7% for biennial and 21.3% for triennial. *Id.* at 8. The annual option received the most support in 90.8% of votes. *Id.*

1028. See *id.* at 11, 39 tbl.1 (demonstrating significance at the 1% level).

1029. See *id.* at 11. Including the management recommendation increased R2 from 35.2% to 74.4%, suggesting that the management recommendation had significant explanatory power. See *id.*

1030. See *id.* at 17-18, 43 tbl.3. In firms where management recommended the triennial option, high votes against say on pay, high votes withheld from directors, average high votes against management proposals, and management forecast error all predicted less support for the triennial option, significant at the 5% level. *Id.*

1031. See *id.* at 19 (only twelve companies adopt a different frequency than recommended by shareholders).

1032. See *id.*

1033. *Id.* at 20 (demonstrating significant differences at the 1% level). For the companies with annual votes and negative ISS recommendations, 67.5% made changes to their

suggests that a less frequent say-on-pay vote makes management less responsive to shareholders' concerns on compensation.<sup>1034</sup>

#### 14. Summary

Although the changing regulatory landscape for compensation proposals makes direct comparisons difficult, some lessons can be drawn from the evidence. The use of compensation proposals is clearly associated with stronger company performance.<sup>1035</sup> When they have a choice, managers are more likely to submit their compensation to shareholder approval when the company is doing well, but shareholders appear largely unconcerned with the company's performance when it comes to determining compensation.<sup>1036</sup> Thus, managers at less successful firms should be willing to submit their compensation to shareholder approval without fear of retribution. Also, submitting a proposal to a shareholder vote is associated with better company performance in the future, but this may only be because better performing firms submit compensation to shareholder approval.<sup>1037</sup>

The primary factor affecting shareholder support appears to be the level of dilution created by the plan.<sup>1038</sup> The 2003 reforms appear to result in higher quality compensation plans but appear to not affect mutual fund voting behavior.<sup>1039</sup> The new say-on-pay rules appear to give proxy advisors a more important role in executive compensation and appear to prompt many companies to reform their compensation practices.<sup>1040</sup>

#### V. Conclusions

A tremendous amount of empirical work has been done to document the different aspects of shareholder voting in proxy contests for corporate control, uncontested director elections, and management proposals. Proxy contests for corporate control, or even the threat of such a proxy contest, act as a productive corporate governance mechanism by providing several benefits, including facilitating a change in management, reducing

---

compensation plans in response to the 2011 vote, while only 14.3% of companies with triennial votes and negative ISS recommendation made such changes. *Id.*

1034. *Id.* at 23.

1035. *See supra* Section IV.E.2.

1036. *See supra* notes 902-905 and accompanying text.

1037. *See supra* Section IV.E.2.

1038. *See supra* Section IV.E.3.

1039. *See supra* Section IV.E.8.

1040. *See supra* Sections IV.E.12-13.

unnecessary liquidity, and prompting the payout of dividends. The stock market's reaction to their announcement appears to price the benefits of the contest before it begins. Dissident shareholders take significant stakes in the targeted company and target underperforming companies in need of better management.

However, some evidence raises doubts about the effectiveness of proxy contests and newly elected dissidents to help poorly performing corporations. The stock gains, apparently associated with proxy contests, may actually occur because of the market's revised perspective on the likelihood of a corporate takeover. Dissident victories are associated with poor future stock returns and weak subsequent operating performance.

Hedge fund activism has been understudied with little academic research examining the differences between proxy contests brought by hedge funds and those initiated by other activist investors. Hedge funds do, however, appear to be the primary proponents of contested proxy solicitations and to have brought more short-slate contests than control contests. The most pressing area for future research from a policy perspective relates to hedge fund activists' use of short-slate contests.

Uncontested director elections act less as a direct check on directors' ability to maintain profits and more to ensure directors continue to perform their responsibilities. Company performance appears to only slightly affect voting results. Directors' ability to perform their duties, however, has a larger effect on their election results. For example, directors receive fewer "for" votes when shareholders perceive that they have granted the company CEO excess compensation.

Shareholders distinguish between different directors in their voting. Thus, when there is a material weakness in the internal controls of the company, shareholders are more likely to withhold their votes for management directors than they are for directors on the audit committee. Similarly, if a director neglects his or her responsibilities and fails to attend board meetings, shareholders are more likely to vote against him or her in the next election. While some evidence suggests that low support for a director will lead to their resignation, directors will often replace the company's management and keep a tight hold on to their own seats. In sum, uncontested director elections can be understood as keeping directors focused on performing their individual jobs without passing judgment on the efficacy of corporate policies.

Management proposals no longer receive a free pass from shareholders: antitakeover charter amendments are suspect, and other proposals are scrutinized by ISS and its institutional investor clients. Institutional

investors with large stock ownership can effectively overcome collective action problems if they are organized to block value-decreasing antitakeover amendments.

For mergers and acquisitions, shareholder voting will not block all bad acquisitions, although increasingly shareholders' voting behavior focuses on maximizing company value. Shareholder votes track the stock market's assessment of the acquisition and how it will impact the company's performance. However, a binding shareholder vote loses its bite when management can structure the transaction to avoid the requirement. Furthermore, institutional cross-ownership in the target company and the acquiring firm may lead to shareholder approval of an otherwise bad acquisition.

Auditor ratification votes almost universally show high shareholder support with small variations reflecting the auditor's ability to maintain its independence and perform its work. Shareholders' votes reflect their understanding of the potential conflicts of interest posed for audit firms if they are receiving non-audit fees for performing other work (such as tax advisory services) and have a long-standing relationship with the firm. Shareholder ratification of the outside auditor is also associated with an audit committee with greater financial expertise, lower abnormal current accruals, and a lower chance of having a restatement.

For management compensation proposals, the dramatic changes in government regulations makes direct comparisons difficult. Shareholders appear largely unconcerned with the company's performance when it comes to determining compensation. The primary factor affecting shareholder support appears to be the level of dilution created by the plan. The new say-on-pay rules appear to have given proxy advisors a more important role in executive compensation and appear to have prompted many companies to reform their compensation practices. They have also led to greater shareholder management dialogue when management's proposals receive lower levels of shareholder support.

As evidenced by these conclusions, the power of the proxy contest can have dramatic impacts on corporate governance. This tremendous amount of empirical work offers terrific insight into the effects of proxy contests for corporate control, uncontested director elections, and management proposals.