The Trajectory of American Corporate Governance: Shareholder Empowerment and Private Ordering

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Much of the research for this article was conducted while I was a Herbert Smith Freehills Visitor, Cambridge University Law School and Senior Global Research Fellow, Hauser Global Fellows Program, NYU Law School and thanks go.

Abstract

Shareholder power and activism are hot issues in the United States and around the world. Although some jurisdictions have welcomed greater shareholder involvement in corporate governance, this prospect has been met with widespread apprehension in the United States. There is a paradox here. Although the United States is generally regarded as the birthplace of shareholder activism, in fact, US shareholders have traditionally possessed far fewer corporate governance rights than shareholders in other common law jurisdictions. This article discusses the trajectory of corporate governance and evolving shareholder rights in the United States, in the context of the shareholder empowerment and proxy access debates. It considers recent corporate governance developments, including institutional activism and the phenomenon of 'private ordering combat' through bylaw amendments, which potentially readjust the balance of power between shareholders and the board of directors in US public corporations.

The article also explores the intriguing underlying question of why shareholder empowerment is such a controversial issue in the United States, compared to some other common law jurisdictions, such as the United Kingdom. To explain this puzzle, the article looks to legal history and to the fundamentally different organizational origins of US and UK corporate law. The article argues that organizational origins matter, and that the divergent origins of US and UK corporate law contribute to attitudinal differences in relation to shareholder power and the role of shareholders in corporate governance.

Keywords: Delaware general corporation law, shareholder activism, institutional investors, shareholder power, private ordering, proxy access, corporate charters and bylaws, bylaw amendment, US corporate law, UK company law, legal history, organizational origins

JEL Classifications: D70, G30, G34, G38, K22, K39, N0

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Introduction

Shareholder power and activism are topics of enormous current interest in the United States and around the world. The prospect of greater shareholder involvement in corporate governance has been welcomed and encouraged in some jurisdictions, such as the United Kingdom,[2] yet has been met with widespread apprehension in the United States. There is a paradox here. Although the United States is generally regarded as the birthplace of shareholder activism, in fact, US shareholders have traditionally possessed far fewer corporate governance rights than shareholders in other common law jurisdictions, such as the United Kingdom and Australia.

This article discusses the trajectory of corporate governance in the United States, with particular attention to the regulatory distinction between shareholder protection and participation in corporate governance. It examines evolving shareholder rights in the context of the US shareholder empowerment and proxy access debates, and considers recent corporate governance developments, which potentially readjust the balance of power between shareholders and the board of directors in US public corporations.

The article also explores the intriguing underlying question of why shareholder empowerment is such a hot button issue in the United States, compared to some other common law jurisdictions, such as the United Kingdom. In examining this issue, the

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[2] Both the United Kingdom and Japan, for example, recently introduced Shareholder Stewardship Codes, which are designed to encourage greater shareholder involvement in corporate governance. *See* Fin. Reporting Council, *The UK Stewardship Code* (Sept. 2012) *available at* https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf; The Council of Experts Concerning the Japanese Version of the Stewardship Code, *Principles for Responsible Institutional Investors, Japan's Stewardship Code, To Promote Sustainable Growth of Companies Through Investment & Dialogue* (Feb. 26 2014) *available at* http://www.fsa.go.jp/en/refer/councils/stewardship/01.pdf.

article looks to legal history. It considers the distinctively different origins and trajectories of corporate law in the United States and the United Kingdom, and the complex interplay between law and private ordering, and between mandatory and optional rules, in these two jurisdictions.

Organizational origins matter, and differences in those origins can lead to fundamental differences in the structure of legal regimes. The article argues that this insight is critical to understanding why shareholder participation in corporate governance is such a controversial issue in the United States compared to other common law jurisdictions.

1. Shareholder Power and Regulation: The Distinction Between Shareholder Protection and Participation in Corporate Governance

Power is deeply implicated in how we view shareholders and their role in the corporations. Various shareholder images have existed across time and jurisdictions.[3] Some of these images (such as shareholders as 'dispossessed owners' or 'beneficiaries under a trust') are constructed on the assumption that shareholders are powerless and need protection. Others (such as shareholders as 'participants in a political entity', 'gatekeepers' or 'stewards') presume that shareholders possess a certain level of power and ability, which can be used as a regulatory technique in its own right.[4]

Yet, the concept of power generally, and shareholder power in particular, is elusive and by no means easy to define.[5] Power can be held individually or collectively; can be used to influence both corporate controllers and lawmakers,[6] and is often most

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[3] Jennifer G. Hill, *Images of the Shareholder – Shareholder Power and Shareholder Powerlessness* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 53 (Jennifer G. Hill & Randall S. Thomas eds., 2015); Wolfgang Schön, *The Concept of the Shareholder in European Company Law*, 1 EUR. BUSINESS ORG. L. REV. 3 (2000).

[4] Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39 (2000).

[5] Marc T Moore, *Corporate Governance in the Shadow of the State* 17-18 (2013); Harwell Wells, *Shareholder Power in America: a Short History* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 13 (Jennifer G. Hill & Randall S. Thomas eds., 2015).

[6] *Id.*; Paul Davies, *Shareholders in the United Kingdom* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 355 (Jennifer G. Hill & Randall S. Thomas eds., 2015).

effective when invisible.[7] Although economic power and legal power are theoretically distinct, they are interrelated, since economic power can be used to lobby and leverage stronger legal rights, and to legimitize certain corporate actors. Shareholder empowerment through strong legal rights is closely connected to investor activism. The two are not, however, coterminous. Shareholder passivity can exist even when shareholders possess strong rights.[8]

Corporate regulation 'occurs in many rooms',[9] encompassing an array of techniques to control conflicts of interest and ensure corporate accountability.[10] These techniques lie across a regulatory spectrum that is closely linked to shareholder power. At one end of the spectrum are 'regulatory strategies', which are designed to safeguard shareholder interests and control agency problems, through use of prescriptive legal rules, such as fiduciary duties.[11] Regulatory strategies are protection-focused, and premised on the assumption that shareholders are vulnerable and incapable of safeguarding their own interests. At the other end of this spectrum lie 'governance strategies', which, by way of contrast, are generally focused on shareholder empowerment. Governance strategies seek to address the inherent power disparity between shareholders and the board of directors,[12] by granting shareholders specific legal rights, such as 'appointment rights' to control the composition of the board of directors and 'decision rights' to intervene in certain firm decisions.[13] Governance

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7 Marco Becht et. al., *Hedge Fund Activism in Europe: Does Privacy Matter?* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 116 (Jennifer G. Hill & Randall S. Thomas eds., 2015).

8 Gen Goto, *Legally "Strong" Shareholders of Japan*, 3 MICH. BUS. & ENTREPRENEURIAL L. REV. 125 (2014).

9 Marc Galanter, *Justice in Many Rooms: Courts, Private Ordering and Indigenous Law*, 19 J. OF LEGAL PLURALISM 1 (1981).

10 Henry Hansmann & Kraakman Reiner, *Agency Problems and Legal Strategies* in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 38 (Reiner Kraakman et. al., eds., 2d ed. 2009).

11 *Id.* at 39-41.

12 *Id.* at 42-43.

13 A third type of governance strategy, the so-called 'agent incentives' strategy, operates differently from the 'appointment rights' and 'decision rights' strategies. The 'agent incentives' strategy - of which perhaps the best-known example is pay for performance - provides incentives to motivate corporate managers to act in the best interests of shareholders, without the need for shareholder intervention or participation. *See* Hansmann & Reiner, *supra* note 10 at 42-43.

strategies promote shareholder participation, as a form of self-protection, and as an accountability mechanism in its own right.

The effectiveness of shareholder empowerment via governance strategies is context-specific and depends on corporate ownership structure. Where ownership is dispersed, shareholder empowerment represents a counterweight to centralized board power, and acts as a constraint on the board's discretion and autonomy. Its effectiveness in these circumstances will also depend on the sophistication of shareholders. However, in concentrated ownership settings, including state-owned enterprises, ultimate control will rest with the majority shareholder/s.[14] Here, shareholder empowerment will be irrelevant, or even counterproductive, as an accountability device.[15] Rather than providing a check and balance on another locus of power, in these circumstances, governance strategies involving shareholder power merely bolster the power status quo.

2. The Rise of 'Agency Capitalism' and its Regulatory Implications

Over the last century, there has been a major shift in the profile of shareholders of public corporations, which affects the use of regulatory strategies and governance strategies. *The Modern Corporation and Private Property* famously portrayed shareholders as dispersed and marginalized group, in need of legal protection due to their inability to act collectively.[16] By the 1990s, however, the rise of powerful institutional investors challenged that familiar picture of corporate law,[17] making shareholder participation and activism in corporate governance a real possibility.[18]

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[14] Lucian A. Bebchuk & Hamdani Assaf, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1269 (2009); Klaus J. Hopt, *American Corporate Governance Indices as Seen from a European Perspective* 158 U. PA. L. REV. 27 (2009).

[15] Luh Luh Lan & Varottil Umakanth, *Shareholder Empowerment in Controlled Companies: The Case of Singapore* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 572 (Jennifer G. Hill & Randall S. Thomas eds., 2015); Kon Sik Kim, *Dynamics of Shareholder Power in Korea* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 535 (Jennifer G. Hill & Randall S. Thomas eds., 2015).

[16] Adolf A. Berle Jnr. & Gardiner C. Means, *The Modern Corporation and Private Property* (1932).

[17] Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990).

[18] Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. APPLIED CORP. FIN. 55 (1991); Marco Becht et al., *Returns to Shareholder Activism:*

This activist theme continued the following decade with the emergence of hedge funds, which experimented with new activist techniques and strategies.[19]

Today, the dominant shareholders of public companies in many, but by no means all, jurisdictions are financial institutions broadly defined. In the United States, institutional investor shareholding in the top 1,000 American companies has risen from less than 10% in the early 1950s to over 70%.[20] In the United Kingdom, where institutional ownership has long been high, individual investors now hold only around 10% of listed UK equities. The remainder is in the hands of financial institutional investors, but significantly, approximately half of these institutions are now non-UK-based.[21] Financial intermediaries are increasingly important in jurisdictions, such as Australia, where the introduction of a mandatory private pension ('superannuation') system in the early 1990s has led to massive growth of financial intermediation.[22]

The dominance of financial institutions in the United States, coined by Professors Gilson and Gordon as 'agency capitalism', has profound regulatory implications.[23] These institutions are fundamentally different from individual investors, in terms of their structure, incentives and behavior. Economically powerful financial institutions can potentially use governance strategies, such as appointment rights and decision

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Evidence from a Clinical Study of the Hermes UK Focus Fund, 22 REV. OF FIN. STUD. 3093 (2009); Bernard S. Black & John C. Coffee Jnr., *Hail Britannia? Institutional Investor Behaviour under Limited Regulation*, 92 MICH. L. REV. 1997 (1994).

19 William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375 (2007); Brian R. Cheffins & John Armour, *The Past, Present and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L 51 (2011); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Control*, 155 U. PA. L. REV. 1021 (2007).

20 Robert B. Thompson, *The Power of Shareholders in the United States* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 441, 447 (Jennifer G. Hill & Randall S. Thomas eds., 2015); Conference Board, *The Conference Board Governance Center White Paper: What is the Optimal Balance in the Relative Roles of Management, Directors, and Investors in the Governance of Public Corporations?* 9 (2014).

21 Davies, *supra* note 6 at 356.

22 Australia's superannuation investment funds, which now stands at A$1.5 trillion, is the largest pool of funds under management in the Asia-Pacific region, and the fourth largest in the world. *See* Towers Watson, *Global Pension Assets Study, January* 13, 20 (2013). It has been predicted that these superannuation funds will eclipse those of the entire Australian banking system within 20 years. *See* Commonwealth of Austl., *Financial Systems Inquiry Final Report* § 2 (2014).

23 Ronald J. Gilson & Jeffrey N. Gordon, *Agency Capitalism: Further Implications of Equity Intermediation* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 32 (Jennifer G. Hill & Randall S. Thomas, eds., 2015).

rights, to protect their own, and other shareholders', interests vis-à-vis the board of directors and corporate management. However, one aspect of contemporary agency capitalism is that such financial institutions are 'sophisticated but reticent'. They are unlikely to be first movers, but have a deep understanding of underlying economic and financial issues, and can be prompted by other market players into supporting activism.[24]

Since the global financial crisis, some jurisdictions, such as the United Kingdom and Japan, have encouraged greater shareholder dialogue with management and activism through Shareholder Stewardship Codes.[25] The Codes are voluntary and adopt a principles-based, 'comply or explain' approach.[26] There have been analogous reforms in the broader European context.[27] These international developments are consistent with Gilson and Gordon's theory of agency capitalism.[28] They assume that institutional investors have a valuable role to play in corporate governance and that this role may, in appropriate circumstance, include activism.

However, an alternative, and fundamentally contradictory, image of shareholders pervades much contemporary US corporate law commentary. This is that shareholders

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24 *Id*.

25 *See* Fin. Reporting Council, *supra* note 2; The Council of Experts Concerning the Japanese Version of the Stewardship Code, *supra* note 2. Other jurisdictions, such as Hong Kong, have now followed suit. In March 2015, the Securities and Futures Commission ('SFC') released a consultation paper, which proposed introducing an analogous code, entitled The Principles of Responsible Ownership, in Hong Kong to encourage fund managers to be 'more aggressive in their ownership responsibilities. *See* Securities & Futures Commission, *Consultation Paper on the Principles of Responsible Ownership* (Mar. 2 2015) *available at* https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=15CP2; Enoch Yin, *SFC Rules of Engagement Touch Nerves of Executives*, S. CHINA MORNING POST Oct. 13 2015. Unlike the UK and Japanese Stewardship Codes, the Hong Kong version applies not only to institutional investors, but also to retail investors. *See* Lucy Newcombe, *Responsible Ownership: Hong Kong in the Global Context*, CSJ, June 2015, at 8.

26 Although 'comply or explain' regulation is a familiar part of the UK corporate governance landscape, it is entirely new to Japan. *See* The Council of Experts Concerning the Japanese Version of the Stewardship Code, *supra* note 2; Sadakazu Osaki, *Keys to Success to Japanese Stewardship Code*, LAKYARA, July 2014, at 2.

27 Recent revisions to the EU Shareholder Rights Directive are designed to enhance shareholder engagement in listed EU companies. *See* European Commission Press Release, *European Commission Proposes to Strengthen Shareholder Engagement and Introduce a 'Say on Pay' for Europe's Largest Companies* (Apr. 9 2014) *available at* http://europa.eu/rapid/press-release_IP-14-396_en.pdf.

28 Gilson & Gordon, *supra* note 23.

are predatory and/or disloyal to their ultimate beneficiaries.[29] Another concern is that rational apathy may lead institutional investors to delegate voting decisions to proxy advisers, which may themselves be ill-informed, biased or conflicted. From the perspective of regulatory diagnosis and prescription, such an image of shareholders provides policy justifications for restricting, rather than expanding, their corporate governance rights. It also potentially suggests a radical shift in corporate law, from a traditional focus of protecting shareholders to a new goal of protecting the corporation from its shareholders, and shareholders from each other.[30] This shift is encapsulated in Martin Lipton's 2015 recommendation that any new legislation/regulation should include protection for companies against shareholder pressure.[31]

These contradictory approaches to the role of shareholders in corporate governance have led to important policy and reform questions about shareholder rights, power and activism in recent times.

3. The US Shareholder Empowerment Debate

Nowhere is the tension between competing images of shareholders and their role in corporate governance - including the dichotomy between shareholder protection and participation - more evident than in the shareholder empowerment debate. This debate, which was essentially US-specific, emerged just prior to the global financial crisis, although its roots arguably go back several decades earlier.[32]

The shareholder empowerment debate related to whether US corporate law should make greater use of governance strategies involving appointment and decision rights,

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[29] Leo E. Strine, *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, U. PA. L. SCH. INST. FOR L. & ECON., 2015, at 38; Lawrence E. Mitchell, *Protect Industry from Predatory Speculators*, FIN. TIMES (London), July 9 2009 at 9.

[30] Hill, *supra* note 3 at 57.

[31] Martin Lipton, *Will a New Paradigm for Corporate Governance Bring Pease to the Thirty Years' Wear*, WACHTELL, LIPTON, ROSEN & KATZ, Oct. 2 2015.

[32] *E.g.* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 666 (1974).

to bolster the position of investors vis-à-vis the board of directors.[33] On one side of the debate, Professor Bebchuk advocated enhanced use of governance strategies in several key areas of US corporate law, including director elections and amendment of corporate constitutions.[34] In the director election context, Bebchuk proposed 'proxy access' reforms, which were designed to give US shareholders stronger rights in the director nomination process for contested board elections, via access to the corporation's own proxy material. Like shareholder empowerment itself, proxy access was not a new debate in US corporate law – it had simmered beneath the surface for at least fifty years.[35] Bebchuk argued that, without proxy access reforms, shareholders' notional power to replace directors in the United States was, in fact, illusory.[36]

The issue of shareholder proxy access became linked to another contentious topic relating to director elections, that of majority voting. Under Delaware law, majority voting is the default standard that applies for all shareholder decisions except the election of directors,[37] which, in contrast, falls under a plurality voting default rule.[38] Combined with proxy access restrictions, plurality voting can significantly undermine shareholder influence and choice in director elections. Under a plurality voting

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[33] *See* Jennifer G. Hill, *The Rising Tension Between Shareholder and Director Power in the Common Law World*, 18 CORP. GOVERNANCE: AN INT'L REV. 1 (2010) (discussing competing arguments in the US shareholder empowerment debate).

[34] *See* Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43 (2003) [hereinafter Bebchuk, *The Case for Shareholder Access*]; Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 696-7 (2007) [hereinafter Bebchuk, *The Myth of the Shareholder Franchise*] (discussing director elections); Lucian A. Bebchuk, *Letting Shareholders Settle the Rules*, 119 HARV. L. REV. 1784 (2006) [hereinafter Bebchuk, *Letting Shareholders Settle the Rules*]; Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) [hereinafter Bebchuk, *The Case for Increasing Shareholder Power*] (discussing amendment of the corporate constitution).

[35] Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329 (2010); Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CAL. L. REV. 1671 (1985); Lewis J. Sundquist III, Comment, *Proposal to Allow Shareholder Nomination of Corporate Directors: Overreaction in Times of Corporate Scandal*, 30 WM MITCHELL L. REV. 1471 (2004). *See e.g.,* Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CAL. L. REV. 1671, 1682-3 (1985) (noting the SEC's 'jawboning' on this issue).

[36] Bebchuk, *The Myth of the Shareholder Franchise*, *supra* note 34; Bebchuk, *The Myth of the Shareholder Franchise*, *supra* note 34; Leo E. Strine, *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759-82 (2006).

[37] DEL. CODE ANN. tit. 8, § 216(2).

[38] *Id*. at § 216(3).

system, board nominees that run unopposed can be elected, even if they receive far less than majority shareholder approval. Indeed, in an uncontested board election, a single vote can be sufficient to ensure success.[39]

Bebchuk's pro-empowerment stance relied on both efficiency and accountability rationales.[40] It envisaged increased shareholder participation in corporate decision-making as an alternative, and less intrusive, governance mechanism, to external intervention by legislators and regulators.[41] The 2006 Paulson Committee Report suggested that an independent justification for stronger shareholder rights was the fundamental power imbalance between management and shareholders under US corporate law.[42] Another possible justification is the practical insignificance of the duty of care as a regulatory strategy in the United States. This duty, which poses a real liability risk to directors in some common law jurisdictions such as Australia,[43] poses virtually no liability risk to US directors in the absence of fraud or self-dealing.[44]

The shareholder empowerment reform agenda encountered intense opposition. Anti-empowerment commentators asserted that, far from improving US economic competitiveness, reforms granting shareholders stronger legal powers would potentially destroy it. Commentators, such as Professor Stephen Bainbridge, claimed that shareholder disempowerment was not a defect of US corporate law, but rather its

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39 Note, however, that where a shareholder-adopted bylaw amendment specifies that a majority vote is necessary for the election of directors, the bylaw cannot be amended or repealed by the board of directors. *See id.* at 8, § 216.

40 Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 34; Bebchuk, *The Myth of the Shareholder Franchise*, *supra* note 34 at 678.

41 *Id*.; Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Markets Regulations*, COMM. ON CAP. MKTS. REG., 30 Nov. 2006 at xii-xiii, 93-14; Hal S. Scott, *What is the United States Doing About the Competitiveness of its Capital Markets*, 22 J. OF INT'L BANKING L. & REG. 487, 489-90 (2007).

42 Committee on Capital Markets Regulation, *supra* note 41 at 103. This approach essentially ignored the pressures of the market for corporate control. *See e.g.,* Henry Butler Manne, *Mergers and the Market for Corporate Control*, 73 J. OF POL. ECON. 110 (1965).

43 Matthew Conaglen & Jennifer G. Hill, *Directors' Duties and Legal Safe Harbours: A Comparative Analysis*, HANDBOOK ON FIDUCIARY DUTIES (D. Gordon Smith & Andrew Gold eds.) (forthcoming 2017); Michelle Welsh, *Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia*, 42 FED. L. REV. 217 (2014).

44 Bernard Black et al., *Outside Director Liability*, 58 Stan. L. Rev. 1055 (2006); Holger Spamann, *Monetary Liability for Breach of the Duty of Care?*, 8 J. LEGAL ANALYSIS 337 (2016).

hallmark and a natural corollary of centralized board authority.[45] They argued that shareholder protection was a more effective regulatory mechanism than participatory rights, and that shareholders already received adequate protection accorded by the market; the ability to exit and to diversify holdings; and by modern governance measures, such as performance-based pay.

A negative image of shareholders as predators or disloyal agents underpinned many anti-empowerment arguments. Justifications for restricting shareholder participation in corporate governance included, for example:- the risk of balkanized, politicized and dysfunctional boards;[46] board blackmail; abuse of power and opportunistic conduct by sectional shareholder interests;[47] impulsive and reckless conduct by majority shareholders; and an dangerous shareholder preference for short-termism.[48] Some commentators were sufficiently alarmed by the specter of stronger shareholder participation rights that they called for adoption of the 'precautionary principle', commonly used in environmental protection arena,[49] to assess any reforms that might shift the balance of power in shareholders' favor.[50]

An alternative strand of the anti-empowerment argument contended that shareholders themselves did not want stronger participatory rights in corporate governance. According to this hypothesis, if shareholder empowerment were indeed a valuable

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45 Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1736 (2006); Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 740; Strine, *Towards a True Corporate Republic*, *supra* note 36 at 1763; Martin Lipton, *Twenty-Five Years After Takeover Bids in the Target's Boardroom: Old Battles, New Attacks and the Continuing War*, 60 BUS. LAW. 1369, 1377 (2005).

46 Lipton & Savitt, *supra* note 45 at 748-9; Letter from Henry A. McKinnell, Chairman, Bus. Roundtable, to Jonathan G. Katz, Sec'y, SEC 4-6 (Dec. 22, 2003) *available at* https://www.sec.gov/rules/proposed/s71903/s71903-381.pdf.

47 *E.g.* unions and public employee pension funds.

48 *See generally* Hill, *supra* note 33.

49 *See e.g.*, U.N. Conference on Environment and Development, June 3-14, 1992, *Rio Declaration on Environment and Development*, princ. 15, U.N. Doc. A/CONF.151/26 (Vol. 1) (Aug. 12 1992) ("In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation").

50 Lipton & Savitt, *supra* note 45 at 747.

corporate governance attribute, it would already have evolved in the United States.[51] Recent US corporate governance developments, however, suggest otherwise. These developments show that, not only are institutional investors deeply interested in gaining stronger participation rights in corporate governance, but that, contrary to the claims of some anti-empowerment scholars,[52] they are also prepared to use those rights. Furthermore, institutional investors have become increasingly critical of restrictions on their legal rights effected by the adoption of governance structures, such as dual-class voting rights, which are common in the media and technology sectors.[53]

4. US Developments Regarding Shareholder Power

4.1 Post-Crisis Developments re Proxy Access Reform

The global financial crisis reactivated the issue of shareholder empowerment in the United States. The post-crisis goal of restoring investor trust provided new policy rationales for stronger shareholder rights and increased pressure for legislative change.[54]

In this novel setting, proxy access re-emerged as emblematic of the broader shareholder empowerment debate in the United States.[55] In 2009, the SEC, after vacillating on the issue for several years,[56] finally decided to propose a rule

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[51] Bainbridge, *supra* note 45 at 1736-7; Strine, *supra* note 36; Lipton & Savitt, *supra* note 45 at 743-44. This argument is closely related to the argument that charter competition between US states tends toward optimal legal systems for regulation of capital markets. *See* Ralph K. Jnr. Winter, *State Law, Shareholder Protection and the Theory of the Corporation*, 6 J. OF LEGAL STUD. 251, 276-7, 290 (1977).

[52] Bainbridge, *supra* note 45 at 1745, 1751-3; Yair Listokin, *If You Give Shareholders Power, Do They Use It? An Empirical Analysis*, 166 J. OF INSTITUTIONAL & THEORETICAL ECON. 38 (2010).

[53] Council of Institutional Investors: The Voice of Corporate Governance, *Proxy Access: Best Practices*, Aug. 2015; Stephen Foley & Matthew Garrahan, *Investors Challenge Murdoch Voting Rights: Dual-Class Voting Structure is Key to Family Control at News Corp*, FIN. TIMES (London), Nov. 18 2014, https://www.ft.com/content/09f209b0-6e91-11e4-a65a-00144feabdc0

[54] William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 656-7, 716 (2010).

[55] *See* David Skeel Jr., *The Bylaw Puzzle in Delaware Corporate Law*, 72 BUS. LAW. 1, 5-8 (2016-7) (providing an overview of the byzantine route to proxy access bylaws).

[56] Press Release, SEC, *Commission to Review Current Proxy Rules and Regulations to Improve Corporate Democracy* (Apr. 14 2003) *available at* https://www.sec.gov/news/press/2003-46.htm; DIV.

implementing proxy access.[57] Several other crisis-related reform proposals involving enhanced shareholder power surfaced during this period. These included a 2009 Shareholder Bill of Rights, which, according to its preamble, sought to 'provide shareholders with enhanced authority over the nomination, election and compensation of public company executives.'[58] The Shareholder Bill of Rights put forward numerous governance strategies designed to shift the balance of power within US public corporations in favor of shareholders.[59] These proposals elicited fierce opposition and intense political lobbying by corporations.

A range of corporate governance reforms were introduced under the *Dodd-Frank Act* of 2010, the future of which is uncertain following the 2016 Presidential election.[60] These reforms, although extremely controversial at the time,[61] were, in fact, far more modest than the Shareholder Bill of Rights proposals, which the Act superseded.

OF CORP. FIN., SEC, STAFF REPORT: REVIEW OF THE PROXY PROCESS REGARDING THE NOMINATION AND ELECTION OF DIRECTORS (2003) *available at* https://www.sec.gov/news/studies/proxyrpt.htm; Strine, *supra* note 36 at 1776-7.

57 Press Release, SEC, *SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors* (May 20 2009) *available at* https://www.sec.gov/news/press/2009/2009-116.htm; Hill, *supra* note 33 at 347-9.

58 Press Release, The Office of Senator Charles E. Schumer, *Schumer, Cantwell Announce 'Shareholder Bill of Rights' to Impose Greater Accountability on Corporate America* (May 18 2009) *available at* https://votesmart.org/public-statement/427143/schumer-cantwell-announce-shareholder-bill-of-rights-to-impose-greater-accountability-on-corporate-america#.WKLsIhJ95E4.

59 These governance strategies included (i) a requirement that the SEC enact proxy access rules; (ii) a mandatory annual non-binding shareholder vote on executive compensation; (iii) a prohibition on staggered boards; (iv) mandatory majority voting in uncontested board elections; (v) mandatory separation of the position of CEO and chair; (vi) mandatory board risk-management committees. *See* Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. §§ 3-5.

60 *See* Joseph A. Hall, *Predictions on Dodd-Frank's Executive Compensation Provisions*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 14 2016), https://corpgov.law.harvard.edu/2016/12/14/predictions-on-dodd-franks-executive-compensation-provisions/; Ben Protess & Julie Hirschfeld Davis, *Trump Moves to Roll Back Obama-Era Financial Regulations*, N. Y. TIMES DEALBOOK, Feb. 3 2017, https://www.nytimes.com/2017/02/03/business/dealbook/trump-congress-financial-regulations.html

61 A recurring criticism of the corporate governance provisions of the *Dodd-Frank Act*, related to its status as federal legislation, which, critics argued, encroached on traditional US state-based corporate law. *See* E. Norman Veasey, *What Would Madison Think? The Irony of the Twists and Turns of Federalism*, 34 DEL. J. CORP. L. 35 (2009); Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779 (2011); Troy Paredes, *The Proper Limits of Shareholder Proxy Access*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 30 2009), https://corpgov.law.harvard.edu/2009/06/30/the-proper-limits-of-shareholder-proxy-access/. According to Martin Lipton, a central battle in the corporate governance 'war' has been resistance to 'fast-marching federalization of corporate governance at the expense of traditional state law.' *See* Lipton, *supra* note 31 at 3.

Some of the most contentious provisions of the Shareholder Bill of Rights, such as those relating to staggered boards and majority voting, disappeared completely during the legislative reform process. Others were included in the *Dodd-Frank Act*, but in diluted form. Although Bainbridge has argued that the post-crisis legislative process in the United States was 'hijacked' by powerful institutional investor coalitions,[62] the weakening of shareholder governance rights during the reform process is more consistent with Professor Coffee's 'regulatory sine curve' hypothesis,[63] and shows that reform attrition due to political lobbying often begins prior to legislative enactment.

One apparently significant corporate governance provision of the *Dodd-Frank Act* was § 971.[64] This section laid the administrative groundwork for federal right of proxy access, by recognising the SEC's authority to make rules granting shareholders the right to nominate directors via the company's own proxy materials.[65] Like many other provisions of the Act, § 971 was weaker than the Shareholder Bill of Rights proposals in several ways. First, although § 971 merely authorized the SEC to make proxy access rules, the analogous provision in the Shareholder Bill of Rights *required* it to make such rules.[66] Secondly, whereas § 971 only provided the SEC with general rule-making authority, the Shareholder Bill of Rights included specific preconditions for proxy access, which were quite generous to shareholders. § 4 of the Shareholder Bill of Rights, for example, granted proxy access to a shareholder, or group of

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62 Stephen M. Bainbridge, *Corporate Governance After the Financial Crisis* 15 (2012).

63 John C. Coffee Jnr., *The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019 (2012).

64 *C.f.* Marcel Kahan & Edward B. Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347 (2011) (discussing proxy access as insignificant on the basis that mutual and pension funds are passive investors and would be unlikely to make use of it).

65 Delaware had in fact undertaken a 'preemptive strike' in this regard in 2009, when it introduced a new provision, DEL. G.C.L. § 112, which expressly permitted Delaware corporations to adopt bylaws granting shareholders proxy access rights. *See* Lisa M. Fairfax, *Delaware's New Proxy Access: Much Ado About Nothing?* 11 TRANSACTIONS: THE TENN. J. OF BUS. L. 87, 104 (2009); Skeel, *supra* note 55 at 7, 17-8. On its face, DEL. G.C.L. § 112, in combination with DEL. G.C.L. § 109, appeared to enable shareholders to adopt proxy access bylaws. This was, however, a phantom right only, under since federal law, only the board of directors had the ability to adopt this type of bylaw. *See* Lisa M. Fairfax, *Delaware's New Proxy Access: Much Ado About Nothing?* 11 TRANSACTIONS: THE TENN. J. OF BUS. L. 87, 101-3 (2009).

66 Bainbridge, *supra* note 62 at 15. Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. § 4 ("[t]he Commission *shall* establish rules relating to the use by shareholders of proxy solicitation materials supplied by the issuer for the purpose of nominating individuals to membership on the board of directors of an issuer" (emphasis added)).

shareholders, beneficially owning not less than 1% of voting shares for a continuous period of at least 2 years before the next scheduled annual meeting.

Following the passage of the *Dodd-Frank Act*, the SEC adopted Rule 14a-11 under the *Securities and Exchange Act* of 1934, granting shareholders proxy access in limited circumstances.[67] These circumstances were more restrictive than the preconditions in § 4 of the Shareholder Bill of Rights. Rule 14a-11 adopted a 3%/3 year/25% rule, which granted proxy access to a shareholder, or group of shareholders, holding at least 3% of the company's shares for the previous 3 years, with nominations restricted to 25% of the board of directors.

It has been said that the adoption of Rule 14a(11) caused financial institutions to rejoice, 'but only briefly'.[68] In 2011, soon after its adoption, but before it became operative, there was a successful challenge to the rule in *Business Roundtable v SEC*.[69] In that case, the U.S. Court of Appeals for the D.C. Circuit vacated Rule 14a(11) and reproached the SEC for acting 'arbitrarily and capriciously' by failing to make an adequate assessment of the rule's economic effects prior to adopting it.

Nonetheless, many global institutional investors, including CalPERS, regarded proxy access as 'unfinished business',[70] and, in the aftermath of the *Business Roundtable* case, lobbied the SEC to revive its proxy access rule making efforts. These lobbying attempts were, however, unsuccessful, and highlighted the difference in wording between the Shareholder Bill of Rights and the *Dodd-Frank Act.* § 971 of the *Dodd-Frank Act*, unlike the Shareholder Bill of Rights, merely authorized, but did not oblige, the SEC to make proxy access rules and the SEC, once bitten, was twice shy.[71]

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67 Press Release, SEC, *SEC Adopts New Measures to Facilitate Director Nominations by Shareholders* (Aug. 25 2010) *available at* https://www.sec.gov/news/press/2010/2010-155.htm.

68 James D. Cox & Benjamin J. C. Baucom, *The Emperor has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 TEX. L. REV. 1812 (2012).

69 Business Roundtable v. SEC 647 F.3d 1144 (D.C. Cir. 2011).

70 Media Release, CalPERS, *Institutional Investors Call on US Securities and Exchange Commission to Implement Financial Market Reforms* (Feb. 13 2012) *available at* http://www.institutionalassetmanager.co.uk/2012/02/14/162178/institutional-investors-call-sec-implement-financial-market-reforms.

71 Bainbridge, *supra* note 62 at 15.

4.2 Recent US Developments - Use of Private Ordering to Acquire Governance Rights

The *Business Roundtable* case did not ultimately prove to be a corporate governance showstopper. Although the decision obstructed the SEC's proposed proxy access rule, it left the door open to corporate governance change through private ordering by shareholders.[72] In spite of restrictions on shareholders' participatory rights under US corporate law, shareholders in public corporations have had considerable success with this strategy.

Private ordering can be used to change to the allocation of power between the board of directors and shareholders through either amendment to the corporate charter or the bylaws. The ability of shareholders to alter the charter is extremely limited in the United States.[73] Under Delaware law, only the board of directors can initiate charter amendments.[74] This contrasts sharply with UK and Australian company law, which permit shareholders to initiate and effect changes to the corporate constitution without board approval.[75] In spite of the restrictions on charter amendment under US law, the number of governance-related charter amendments in public corporations rose sharply during the last decade, with shareholder pressure an important contributing factor.[76] Nonetheless, the board's strategic superiority as gatekeeper of charter amendments necessarily affects the contents of such amendments.[77]

Bylaw amendment appears on its face to offer shareholders greater private ordering autonomy. Most US states permit either the board of directors or the shareholders to

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72 Some definitions of 'corporate governance' explicitly include private ordering within their compass. See for example, Butler, who defines corporate governance as 'the manner in which the relations between the parties to the corporate contract are restrained by government regulation or private ordering.' *See* Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV. 99, 101 (1989).

73 *See generally* Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129 (2009).

74 *See* DEL. CODE ANN. tit. 8, § 242(b)(1). *See also* MODEL BUS. CORP. ACT § 10.03 (2002).

75 *See* Hill, *supra* note 33 at 347.

76 Geeyong Min, *Shareholder Activism and Charter Amendments*, UNIV. OF VA. L. SCH. L. & ECON. RES. PAPER, Aug. 15 2016.

77 *Id*.

alter the bylaws independently of each other.[78] § 109(b) of the Delaware General Corporation Law ('Del. G.C.L.') seems to give shareholders broad latitude to amend the bylaws,[79] however, this power is limited by a qualification that the bylaws cannot be 'inconsistent with law or with the certificate of incorporation'. This creates a Catch-22 situation between §§ 109(b) and 141(a) of the Del. G.C.L.,[80] which vests management power in the board of directors unless otherwise provided by the statute or the charter,[81] and renders the bylaws subservient to the charter in terms of power allocation.

Although the *Business Roundtable* case vacated Rule 14a-11, it left intact an earlier SEC amendment to Rule 14a-8, which made it possible for shareholders to put forward their own proposals to adopt proxy access bylaws.[82] The introduction of § 112 of the Del. G.C.L. in 2009 also explicitly authorized the inclusion of proxy access-style rules, although the default rule was no proxy access.[83] In the wake of the SEC's failure to issue mandatory federal rules, institutional investors relied on this private ordering ability to acquire proxy access rights on a company-by-company basis.[84]

Shareholder proposals relating to general corporate governance issues have been in the spotlight in recent years. During the 2015 proxy season, there were 462 such proposals submitted (a 5.5% increase from 2014) and shareholders voted on 333 of

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78 Jill E. Fisch, *The New Governance and the Challenge of Litigation Bylaws*, 81 BROOK. L. REV. 1637, 1653 (2016); Skeel, *supra* note 55 at 5, 12. Under Delaware law, however, the board of directors will only have the power if it is explicitly conferred by the charter. *See* DEL. CODE ANN. tit. 8, § 109.

79 *E.g.*, DEL. CODE ANN. tit. 8, § 109(b) permits the bylaws to contain provisions relating, *inter alia*, to the business of the corporation, the conduct of its affairs, and the rights and powers of its stockholders and directors.

80 *See* Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street*, 73 TUL. L. REV. 409, 428-33 (1998).

81 *See generally* Hill, *supra* note 33 at 347; Fisch, *supra* note 78 at 1658-61; Gordon D. Smith et al., *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 140 (2011).

82 *See* Fisch, *supra* note 78 at 1649; Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 434 (2012) (discussing background to the SEC amendment to Rule 14a-8, which effectively reversed an earlier SEC amendment to Rule 14a-8 in 2007 that precluded such shareholder action).

83 *See* Skeel, *supra* note 55 at 8.

84 *See* Bebchuk & Hirst, *supra* note 35 (criticizing a private ordering approach, against the backdrop of a no-access default rule, compared to a mandatory proxy access solution).

those proposals (a 34% increase from 2014).[85] In the 2016 proxy season, there was a decline in the number of corporate governance shareholder proposals submitted (418 proposals) and voted on by shareholders (266 proposals), however, this was partially explained by greater board responsiveness to shareholder demands.[86]

Shareholder proposals during this period focused on an array of corporate governance matters, including board diversity, director qualifications, separation of the roles of chair and CEO,[87] and tenure reforms.[88] However, the clear stand-out issue was proxy access was.[89]

Shareholder proposals relating to proxy access rose from only 17 in 2014, to over 100 at US public corporations in the 2015 proxy season.[90] This was largely due to the efforts of New York City Comptroller, Scott Stringer, who filed 75 proposals on behalf of New York pension funds as part of the Boardroom Accountability Project.[91]

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85 *See* Rajeev Kumar, *Annual Corporate Governance Review*, GEORGESON, Oct. 27 2015 at 4.

86 *Id.* As discussed below, New York City pension funds were particularly active in 2015 in submitting proxy access shareholder proposals. In 2016, however, they withdrew their proxy access proposals after negotiating with issuers.

87 *Id*. at 4-9; Fisch, *supra* note 78 at 1651-2. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) § 972 requires an issuer to disclose why it has, or has not, decide to split the role of chair and CEO. In December 2016 Wells Fargo & Company announced that its board of directors had amended the bank's bylaws to require separation of these roles. *See* Press Release, Wells Fargo, *Wells Fargo Amends By-Laws to Require Separation of Chairman and CEO Roles* (Dec. 1 2016) *available at* https://www.wellsfargo.com/about/press/2016/separation-chairman-ceo-roles_1201/. This announcement came only two days after the State Treasurers of Connecticut and Illinois filed a shareholder resolution calling for a bylaw amendment to this effect. *See* Press Release, Office of Illinois State Treasurer Michael W. Frerichs, *Treasurer Frerichs Signs Resolutions Calling on Wells Fargo to Require Independent Board Chair* (Nov. 29 2016) *available at* http://illinoistreasurer.gov/TWOCMS/media/doc/November2016TMFWellsFargoResolution.pdf. In general, however, shareholders tend to have had less success in pushing for separation between the chair and CEO than for other types of corporate governance reform such as majority voting and declassification of staggered boards. Also, a number of US companies, such as Walt Disney and Bank of America, have at times split the roles of chair and CEO under pressure from shareholders, only to recombine them several years later. *See* David F. Larcker & Brian Tayan, *Chairman and CEO: The Controversy Over Board Leadership Structure*, STAN. CLOSER LOOK SERIES CORP. GOV. RES. INITIATIVE, June 2016, https://www.gsb.stanford.edu/faculty-research/publications/chairman-ceo-controversy-over-board-leadership-structure.

88 *Id.* at 4-9; *Fisch*, *supra* note 78 at 1651-2.

89 Rajeev Kumar, *Annual Corporate Governance Review*, GEORGESON, 2016 at 4-7.

90 By late October 2015, 110 proxy access shareholder proposals had been filed. *See* Kumar, *supra* note 85 at 5.

91 The Boardroom Accountability Project was launched in Nov. 2014. *See generally* New York City Comptroller Scott M. Stringer, *Overview*, Boardroom Accountability Project (Feb. 14 2017,

The Comptroller's proposals adopted a standardized 3%/3 year/25% proxy access matrix, in accordance with the SEC's vacated rule.[92] In 2016, approximately 200 proxy access shareholder proposals were submitted,[93] constituting almost half of the total number of shareholder proposals for that year.

Some boards, including those at Bank of America, Citigroup and General Electric ('GE') voluntarily adopted, or agreed to support, shareholder proxy access.[94] In February 2015, the GE board, voluntarily (or at least preemptively)[95] adopted 3%/3 year/20% bylaw, without submitting it to shareholder vote.[96] However, GE's board-adopted bylaw also included an aggregation limit of 20 shareholders.[97]

By late 2015, a total of 80 US corporations had adopted proxy access bylaws.[98] By mid-2016, this figure had risen to over 240,[99] and included approximately 39% of all

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11:37PM), http://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/overview/.

92 All proxy access proposals submitted to a vote in the first half of 2015 contained 3%/ 3 year thresholds, and 98% of these also capped nominees at 25% of the board. *See* Avrohom J. Kess, *Proxy Access Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 10 2015), https://corpgov.law.harvard.edu/2015/08/10/proxy-access-proposals/. In a small number of proposals, that percentage was 20%. There was generally no restriction on aggregation to meet the ownership threshold. *See* Sullivan & Cromwell LLP, *2015 Proxy Season Review*, SULLIVAN & CROMWELL LLP, 20 July 2015 at 5. 66 of the 75 resolutions submitted by Scott Stringer ultimately went to a vote, receiving an average of 56% of votes cast. *See* Yuka Hayashi & Joann S. Lublin, *Shareholders Notch Gain in SEC's New Ballot Guidelines: Agency's Position Reverses Earlier Decision on Exclusion of Shareholder Proposals*, WALL ST. J., Oct. 23 2015, https://www.wsj.com/articles/shareholders-notch-gain-in-secs-new-ballot-guidelines-1445551924.

93 Kumar, *supra* note 89 at 4.

94 *See generally*, Boardroom Accountability Project, *supra* note 91.

95 The voluntary adoption by the GE board of a proxy access bylaw enabled the company to exclude a proxy access shareholder proposal submitted by Kevin Mahar. GE obtained no-action relief from the SEC under Rule 14a-8(i)(10), which permits exclusion on the basis of 'substantial implementation', since the proxy access bylaw adopted by the board addressed the proposal's 'essential objective.' *See* Textron Inc., SEC No-Action Letter, 2015 WL 15005033 (Jan. 26 2015); General Electric Company, SEC No-Action Letter (Mar. 3 2015); Simpson Thatcher & Bartlett LLP, *Memo Series: The 2015 Proxy Season*, SIMPSON THATCHER & BARTLETT LLP, Jul. 30 2015 at 5 (discussing other substantive grounds on which companies have based no-action requests in relation to proxy access).

96 Ted Mann & Joann S. Lublin, *GE to Allow Proxy Access for Big Investors*, WALL ST. J. 11 Feb. 2015, https://www.wsj.com/articles/ge-amends-bylaws-to-allow-proxy-access-for-big-investors-1423698010.

97 General Electric, *By-Laws of General Electric Company*, GENERAL ELECTRIC COMPANY, 2015, https://www.ge.com/sites/default/files/GE_by_laws.pdf.

98 Sullivan & Cromwell LLP, *Proxy Access 2016: Market Trends and Shareholder Proposal Developments*, SULLIVAN & CROMWELL LLP, Nov. 10 2015 at 1.

S&P 500 companies.[100] Although most of the adopted bylaws followed the broad contours of the SEC's vacated Rule 14a-11 and the New York City Comptroller's proposals, [101] 95% of these bylaws introduced an aggregation limit of 20 shareholders,[102] similar to the bylaw adopted by GE.[103]

Aggregation limits pose particular problems for the nomination of board members, and the Council of Institutional Investors ('CII') has explicitly stated that it does not endorse such limits or caps. [104] In keeping with the implications of agency capitalism,[105] even though investment companies like Vanguard may vote for proxy access candidates, they are unlikely to nominate them in the first place. Thus aggregation limits make it far more difficult for shareholders to reach the proxy access ownership threshold in the first place.[106]

The stance of proxy advisory firms and institutional investors vis-à-vis proxy access proposals varies, and is still evolving.[107] Whereas Glass Lewis and institutional investors, such as BlackRock and State Street Global Advisers, adopt a case-by-case

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99 Cam C. Hoang, *SEC Denial of H&R Block's Request to Exclude Proxy Access Proposal*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 23 2016), https://corpgov.law.harvard.edu/2016/08/23/hr-block-no-action-letter/.

100 Peter Kimball & Alexandra Higgins, *The Finer Points of Proxy Access Bylaws Come Under the Microscope*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 12 2016), https://corpgov.law.harvard.edu/2016/09/12/the-finer-points-of-proxy-access-bylaws-come-under-the-microscope/.

101 95% of proxy access bylaws adopted between August and November 2015 included a 3% ownership threshold and 100% set a 3 year holding period. Also, 95% of these proxy access bylaws adopted some form of 20% maximum restriction on board membership, compared to the 25% maximum in the New York City Comptroller's proposals. *See* Sullivan & Cromwell LLP, *supra* note 98 at 2-3.

102 *Id*.

103 Kimball & Higgins, *supra* note 100 (suggesting that a '3/3/20/20 structure' has now become the standard currency for proxy access bylaws).

104 Letter from Ann Yerger, Exec. Dir., to Keith F. Higgins, Dir. SEC (Jan. 9 2015) *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/01_09_15_CII_to_SEC_re_Whole_foods.pdf.

105 Gilson & Gordon, *supra* note 23.

106 According to Mr McRitchie, the role of nominating proxy access candidates will usually fall to public pension funds. However, the aggregation of the six largest public pension funds in Whole Foods only amounts to 1.2% of stock. *See* James McRitchie, *Fixing Proxy Access Lite*, CORPGOV.NET, Sept. 24 2015, http://www.corpgov.net/2015/09/fixing-proxy-access-lite/.

107 Alliance Advisors, *2015 Proxy Season Preview (April 2015)*, ALLIANCE ADVISORS, Apr. 2015 at 2-3.

approach to these proposals, ISS has departed from this policy, by substituting a standard positive position for proposals that replicate the SEC's vacated Rule 14a-11. Vanguard has expressed a preference for a more demanding 5%/3 year threshold,[108] while Fidelity opposes, and generally votes against, proxy access proposals.[109]

At the same time that proxy access shareholder proposals have burgeoned, there has been a decline in the number of proposals relating to familiar corporate governance issues, such as majority voting, the right of shareholders to convene special meetings and declassification of staggered boards. This decline, however, is itself testament to shareholders' overall success in rewriting corporate governance rules through private ordering. These are no longer flashpoint issues, because these battles have now been largely won.

In recent times, for example, there has been a dramatic shift from plurality to majority voting. Between 2006 and 2014, the percentage of S&P 500 companies with majority voting rose from 16% to 90%,[110] and the percentage of S&P 100 companies with majority voting in the 2016 proxy season was 95%.[111] Shareholders have no right to convene a special meeting under Delaware law unless they are so authorized by the charter or bylaws.[112] However, as a result of bylaw amendment shareholder proposals, approximately 60% of S&P 500 companies now grant shareholders this right.[113] Finally, in the decade prior to 2014, the percentage of S&P 500 companies with declassified, or non-staggered, boards rose from 55% to 93.[114] As at 2016, staggered

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108 *Id.* at 3.

109 Kess, *supra* note 92.

110 Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Improve Board Accountability*, 83 U. CHI. L. REV. 1119, 1127 (2016).

111 *See* David A. Bell, *Corporate Governance: A Comparison of Large Public Companies & Silicon Valley Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 28 2016), https://corpgov.law.harvard.edu/2016/11/28/corporate-governance-a-comparison-of-large-public-companies-and-silicon-valley-companies/.

112 *See* DEL. CODE ANN. tit. 8, § 21.

113 As at June 30, 2016, 295 companies out of the S&P 500 granted their shareholders this right. *See* Yafit Cohn, *Special Meeting Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 2 2016), https://corpgov.law.harvard.edu/2016/09/02/special-meeting-proposals-2/.

114 SpencerStuart, *2016 Spencer Stuart Board Index: A Perspective on U.S. Boards*, SPENCER STUART BOARD SERV., 2016. Between 2012 and 2014, the boards of 98 S&P 500 and Fortune 500 companies were declassified as a result of work undertaken by the Shareholder Rights Project at Harvard Law School. *See* Harvard Law School Program on Institutional Investors, *Shareholder Rights*

boards were only present in 4% of S&P 100 companies,[115] although they remained popular in the technology sector.[116]

4.3 The Whole Foods Saga, Private Ordering Combat and Impoverished Consent

Not all US public corporations, faced with proxy access proposals, have voluntarily adopted, or agreed to support, them.[117] Predictably, many engaged in pushback by, for example, issuing an opposition statement to a proxy access proposal.[118] Some corporations went further by attempting to preempt a shareholder vote on the proposal altogether. Events at Whole Foods Market, Inc ('Whole Foods') during 2014-2015 provide a good case study of contemporary corporate governance dynamics regarding bylaw amendments, and exemplify what might be termed 'private ordering combat' between boards and shareholders.

The facts of the Whole Foods saga were as follows. Whole Foods claimed that it could rely on Securities and Exchange Act (SEC) Rule 14a-8(i)(9) to exclude a standard 3%/3 year/20% shareholder proposal submitted by James McRitchie, on the basis that it conflicted with the company's own proxy access bylaw provision proposal. Yet, the bylaw proposal offered by Whole Foods was far less generous to shareholders than McRitchie's. The Whole Foods' proposal introduced a stringent 9%/5 year/10% conditions. It also restricted proxy access to a single shareholder and prohibited any shareholder aggregation or coordination to reach the already high 9% stock ownership threshold.[119] Indeed, the Whole Foods proposal provided a good

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Project, SHAREHOLDER RIGHTS PROJECT (Feb. 11 2017, 1:20PM), http://www.srp.law.harvard.edu/index.shtml.

115 *See* Fisch, *supra* note 78 at 1647.

116 *E.g.*, approximately 50% of companies in the Silicon Valley (SV) 150 index have a staggered board. *See* Bell, *supra* note 111.

117 *See generally* Boardroom Accountability Project, *supra* note 91.

118 As at 26 July 2015, approximately 78 corporations, whose shareholder meetings had been held or were pending, had issued opposition statements. *See* Kess, *supra* note 92.

119 Letter from Matt S. McNair, Special Counsel, SEC, to A.J. Ericksen, Baker Botts LLP (Dec. 1 2014) *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/jamesmcritchie120114.pdf; Gretchen Morgenson, *Whole Foods' High Hurdle for Investors*, N. Y. TIMES, Jan. 3 2015, https://www.nytimes.com/2015/01/04/business/whole-foods-high-hurdle-for-

contemporary example of Professor Eisenberg's concept of 'impoverished consent', whereby shareholders are forced to vote for a management-proposed rule, in spite of preferring a different rule.[120]

Initially, the SEC legitimized the Whole Foods' exclusion of McRitchie's proposal, by granting the company no-action relief.[121] However, in January 2015, following a request by the CII for reconsideration of that decision,[122] the SEC retreated from its original position. Chair, Mary Jo White, announced that the SEC would conduct a review of the Rule 14a-8(i)(9) exemption in the light of questions concerning its 'proper scope and application'.[123] In a parallel move, the SEC announced that it would 'express no views on the application of Rule 14a-8(i)(9)' during the 2015 proxy season.[124] This meant that corporations, like Whole Foods, which sought to substitute company proposals for proxy access shareholder proposals now did so at their peril, and without the comfort of SEC no-action relief.[125] The SEC's

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investors-.html [hereinafter Morgenson, *Whole Foods*]. Whole Foods subsequently reduced the stock threshold from 9% to 5%. *See* Gretchen Morgenson, *At US Companies, Time to Coax the Directors Into Talking*, N. Y. Times, Mar. 28 2015, https://www.nytimes.com/2015/03/29/business/time-to-coax-the-directors-into-talking.html [hereinafter Morgenson, *US Companies*]. Even that lower threshold would amount to approximately US $1 billion in stock. *See* Paul Hodgson, *At Whole Foods, Chipotle, and Others, Shareholders Prepare for Battle*, FORTUNE, Feb. 3 2015, http://fortune.com/2015/02/03/whole-foods-chipotle-proxy-access/.

120 Melvin Aron Eisenberg, *The Structure of Corporate Law*, 89 COLUM. L. REV. 1461, 1477 (1989).

121 Letter from Evan S. Jacobson, Special Counsel, to Office of Chief Counsel, DIV. OF CORP. FIN., (Sept. 27 2016) *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchiecisco092716-14a8.pdf.

122 Council of Institutional Investors, *supra* note 53.

123 Public Statement, SEC, *Statement from Chair White Directing Staff to Review Commission Rule for Excluding Conflicting Proxy Proposals* (Jan. 16 2015) *available at* https://www.sec.gov/news/statement/statement-on-conflicting-proxy-proposals.html.

124 Announcement, SEC, *Division of Corporation Finance Will Express No Views under Exchange Act Rule 14a-8(i)(9) for Current Proxy Season* (Jan. 16 2015) *available at* https://www.sec.gov/corpfin/announcement/cf-announcement---rule-14a-8i9-no-views.html; Keith F. Higgins, *Rule 14a-8: Conflicting Proposals, Conflicting Views*, SEC, Feb. 10 2015, https://www.sec.gov/news/speech/rule-14a-8-conflicting-proposals-conflicting-views-.html.

125 Hodgson, *supra* note 119; Letter from John Engler, President, Bus. Roundtable to Gary Retelny, President & CEO, Institutional Shareholder Services & Katherine Rabin, CEO, Glass, Lewis & Co. (Jan. 23 2015) *available at* http://businessroundtable.org/resources/brt-letter-response-recent-sec-announcements-conflicting-proposals. *Cf.* however, the Business Roundtable's view that the SEC's announcement did not affect a company's ability to rely on Rule 14a-(8)(i)(8). *See* Letter from John Engler, President, Bus. Roundtable to Gary Retelny, President & CEO, Institutional Shareholder Services & Katherine Rabin, CEO, Glass, Lewis & Co. (Jan. 23 2015) *available at* http://businessroundtable.org/resources/brt-letter-response-recent-sec-announcements-conflicting-proposals.

announcement extended well beyond the narrow issue of proxy access. It also potentially obstructed a common mechanism used by corporations to exclude a variety of shareholder proposals, including those relating to special meeting rights; removal of supermajority provisions; and clawback proposals.[126]

In October 2015, the SEC effectively reversed its original grant of 'no action' relief to Whole Foods, with the release of new guidelines relating to shareholder proposals.[127] These guidelines narrowed the scope of legitimate exclusion to shareholder proposals that 'directly conflict' with a management proposal, in the sense of being mutually exclusive such that 'a reasonable shareholder could not logically vote in favor of both proposals.'[128] The SEC stated that proposals like those at Whole Foods, which 'seek a similar objective', did not meet this high standard of direct conflict such as to justify exclusion of the shareholder proposal. This virtually destroyed Rule 14a-8(i)(9)'s value as a managerial weapon in private ordering combat.

Ultimately, the Whole Foods board itself adopted a proxy access bylaw, which became effective in June 2015.[129] This bylaw was in the standard 3%/3 year/20% form, but contained various restrictions. These restrictions, which were contrary to CII's stated best practices for proxy access,[130] included, for example, an aggregation limit of 20 shareholders; a requirement that loaned shares must be recalled in order to be counted towards the ownership threshold; and a ban on any compensation arrangement (or 'golden leash')[131] between a nominee director and a third party.[132] In September 2015, McRitchie announced that he had filed a proposal, to be considered

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126 Alliance Advisors, *supra* note 107 at 3-4.

127 Hayashi & Lublin, *supra* note 92; DIV. OF CORP. FIN., SEC, STAFF LEGAL BULLETIN NO. 14H (CF) (2015) *available at* https://www.sec.gov/interps/legal/cfslb14h.htm.

128 DIV. OF CORP. FIN., SEC, STAFF LEGAL BULLETIN NO. 14H (CF) (2015) *available at* https://www.sec.gov/interps/legal/cfslb14h.htm.

129 Whole Foods Market Inc., *Amended and Restated Bylaws of Whole Foods Market, Inc. (A Texas Corporation) (Effective June 26, 2015)*, WHOLE FOODS MARKET, 2015, http://s21.q4cdn.com/118642233/files/doc_downloads/governance_documents/20150630-Whole-Foods-Market-Inc-Amended-and-Restated-Bylaws_6_26_2015.pdf.

130 Council of Institutional Investors, *supra* note 53 at 3-5.

131 Matthew D. Cain et al., *How Corporate Governance is Made: The Case of the Golden Leash*, 164 U. PA. L. REV. 649 (2016) (discussing corporate governance developments regarding golden leashes).

132 Sullivan & Cromwell LLP, *supra* note 98 at 3.

at Whole Foods' next annual meeting, seeking less onerous proxy access conditions.[133] In the lead-up to Whole Foods' annual meeting in March 2016, his new proposal received support from several large funds, as well as from ISS and Glass Lewis.[134]

Private ordering combat continues apace in US public corporations, although it is evolving into new forms since the Whole Foods saga. During 2016, many companies, attempted to exclude shareholder proposals to amend previously adopted proxy access bylaws, by relying on SEC Rule 14a8(i)(10), which permits exclusion of shareholder proposals where the company has already 'substantially implemented' a proposal. Between February and March 2016, the SEC granted approximately 30 companies no-action relief,[135] but the regulator signaled that there were limits to this relief, when it refused a request by H&R Block to exclude a bylaw amendment proposal by James McRitchie.[136] Mr McRitchie's proposal sought to amend the H&R Block's existing bylaws to be more shareholder-friendly in relation, for example, to the number of permitted nominee directors; limits on director re-nomination; shareholder aggregation prohibition and the relevant ownership threshold.[137] This proposal reflected a growing trend in 2016 towards more fine-tuned assessment by shareholders of restrictive secondary features of proxy bylaws.[138]

In refusing to issue a no-action letter for the benefit of H&R Block, the SEC stated that it was unable to conclude that the company had met its burden of demonstrating that it was entitled to omit McRitchie's proposal under Rule 14a8(i)(10) because there

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133 The new proposal permitted an unlimited number of eligible shareholders to aggregate their shares to appoint up to 25% of the board or two directors, whichever is greater. *See* McRitchie, *supra* note 106.

134 Barry B. Burr, *Pension Funds Line Up in Favour of Proxy-Access Bylaw Change at Whole Foods*, PENSIONS & INVESTMENTS, Mar. 4 2016, http://www.pionline.com/article/20160304/ONLINE/160309922/pension-funds-line-up-in-favor-of-proxy-access-bylaw-change-at-whole-foods

135 *See* Kumar, *supra* note 89 at 5 (noting that a total of 40 companies were able to exclude a proposal in 2016 on the basis of 'substantial implementation').

136 H&R Block, Inc., SEC No-Action Letter (May 5 2016). Mr McRitchie had withdrawn a proposal in 2015 to adopt proxy access after H&R Block agreed to adopt proxy access bylaws, but then lodged a proposal to amend those bylaws in 2016. *See* Hoang, *supra* note 99.

137 Hoang, *supra* note 99.

138 Kimball & Higgins, *supra* note 100.

was insufficient evidence to show that H&R Block's proxy access bylaw 'compared favorably' with the shareholder proposal.[139] The SEC came to the same conclusion in September 2016 in relation to a similar no-action relief application by Microsoft.[140]

4.4 Proxy Access and Private Ordering – Some Concluding Comments

Proxy access has become the litmus test for shifts in the corporate governance balance of power within US corporations.

Some of the dire predictions that marked original shareholder empowerment debate have resurfaced in this new context. Chief Justice Strine has stated, for example, that recent corporate governance developments have left boards increasingly subject to the 'immediate whims of stockholders.'[141] The reality of shareholder proxy access has also prompted concern about board dysfunction, including 'the risk of creating factions and a poisonous atmosphere.'[142]

The Business Roundtable has sought to depict the developments relating to private ordering by shareholders as fundamentally inconsistent with centralized board authority. For example, after the SEC's volte-face in relation to Whole Foods in January 2015, the Business Roundtable wrote to Glass Lewis and ISS, requesting that they refrain from making proxy voting recommendations if companies chose, without SEC authorization, to exclude shareholder proposals under Rule 14a-8(i)(9). The Business Roundtable justified its request on the basis that 'it would be inappropriate for ISS and Glass Lewis to apply their voting policies in a way that substitutes their own judgment as to the appropriate course of action in place of the Board's judgment'.[143] Proxy advisers and institutional investors, such as BlackRock, TIAA-

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139 H&R Block Inc., *supra* note 136. The SEC has previously stated that 'a determination that the company has substantially implemented the proposal depends upon whether [the company's] particular policies, practices and procedures are compare favourably with the guidelines of the proposal.' *See* Texaco, Inc. SEC No-Action Letter (Mar. 28 1991).

140 Letter from Matt S. McNair, Senior Special Counsel, SEC, to Ronald O. Mueller, Gilbson, Dunn & Crutcher LLP (Sept. 27 2016) *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchie092716-14a8.pdf.

141 Strine, *supra* note 29 at 40.

142 Yvon Allaire & François Dauphin, *Who Should Pick Board Members?* THE CLS BLUE SKY BLOG, 30 Nov. 2015, http://clsbluesky.law.columbia.edu/2015/11/30/who-should-pick-board-members/.

143 Letter from John Engler, President, Bus. Roundtable, *supra* note 125.

CREF and CalPERS, did not accede to this request, instead announcing that they would oppose the election of any directors, who were responsible for omitting shareholder proxy access resolutions without proper SEC authorization.[144]

Proxy access is merely the tip of the iceberg in relation to current US developments concerning allocation of power in corporate governance and shows that private ordering through bylaw amendment is definitely a two-way street.[145] As noted, some boards have engaged in private ordering combat, using their bylaw amendment powers to dilute the efficacy of shareholder proxy access by adding stringent preconditions, such as aggregation limits and prohibitions on golden leashes. The skirmishes at Whole Foods, H&R Block and Microsoft all raise the issue of 'impoverished consent' in this regard. Other recent governance disputes, such as the 2013 clash at Allergan, raise an additional problem of 'fragmented consent'. Although Allergan shareholders voted in favor of a charter amendment authorizing the holders of 25% of the company's shares to convene a special meeting, the Allergan board unilaterally adopted extremely broad bylaws, which interacted with, and effectively subverted, that right.[146]

Private ordering combat has also been evident in the context of shareholder litigation,[147] where directors adopted 'exclusive forum' bylaw provisions as an

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144 Alliance Advisors, *supra* note 107 at 2; ISS, *2015 Benchmark U.S. Proxy Voting Policies: Frequently Asked Questions*, ISS, Feb. 19 2015 at 5.

145 *See generally* Fisch, *supra* note 78 (describing private ordering governance innovations by both shareholders and boards as a form of 'new governance').

146 *See* Fisch, *supra* note 78 at 1655-6; Steven Davidoff Solomon, *In Botox Maker Fight, Focus on Clever Strategy Overshadows the Goals*, N. Y. TIMES DEALBOOK, Aug. 12 2014, https://dealbook.nytimes.com/2014/08/12/in-allergan-fight-a-focus-on-clever-strategy-overshadows-the-goal/ [hereinafter Davidoff Solomon, *In Botox Maker Fight*]; Steven Davidoff Solomon, *Allergan-Valeant Fight Holds Lessons for All Corporate Shareholders*, N. Y. TIMES DEALBOOK, Sept. 18 2014, https://dealbook.nytimes.com/2014/09/18/allergan-valeant-fight-holds-lessons-for-all-corporate-shareholders/ [hereinafter Davidoff Solomon, *Allergan-Valeant Fight*]. The bylaw dispute was settled in November 2014, when the Allergan board announced it was amending the bylaws to reduce the restrictions on shareholders convening a special meeting. *See* Business Wire, *Allergan Board of Directors Announces Approval of Amendments to Company's Bylaws*, BUSINESS WIRE, Nov. 12 2014, http://www.businesswire.com/news/home/20141112005381/en/Allergan-Board-Directors-Announces-Approval-Amendments-Company%E2%80%99s.

147 James D. Cox, *Whose Law Is It? Battling Over Turf in Shareholder Litigation* in RESEARCH HANDBOOK ON SHAREHOLDER POWER 333 (Jennifer G. Hill & Randall S. Thomas eds., 2015); Fisch, *supra* note 78 at 1665; Skeel, *supra* note 55 at 8-11.

antidote to multi-forum shareholder suits.[148] Following the 2013 *Boilermakers* decision,[149] which upheld exclusive forum bylaws that are unilaterally adopted by the directors, such provisions proliferated in US public companies,[150] particularly in the highly litigious context of M&A deals.[151] Finally, some boards attempted to introduce UK-style 'loser pays' rules by means of fee-shifting bylaws, which would have potentially inhibited shareholder litigation. Following the 2014 case, *ATP Tour Inc. v Deutscher Tennis Bund*,[152] in which the Delaware Supreme Court upheld the *prima facie* validity of fee-shifting bylaws, over 70 US public companies adopted such provisions.[153] A conception of the bylaws as a contract between the company and its shareholders (even though that contract had been drafted by the directors) was fundamental to the analysis of the courts in both the *Boilermakers*[154] and the *ATP Tour*[155] decisions.[156]

The board of directors and shareholders have not, however, been the only combatants in recent bylaw disputes. There have also been tussles between Delaware's courts and legislature regarding bylaw validity, which have sometimes resulted in different

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148 Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013); John Armour et al., *Is Delaware Losing Its Cases?* 9 EMPIRICAL L. STUD. 605 (2012); Skeel, *supra* note 55 at 8-9. Professors Roberta Romano and Sarath Sanga note that the first exclusive forum bylaw was adopted by Oracle Corp in 2006, and the first exclusive forum IPO charter provision was adopted by Netsuite Inc in 2007. *See* Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, EUR. CORP. GOV. INST. L. WORKING PAPER, 2015 at 2-3.

149 *Boilermakers,* 73 A.3d 934.

150 As at August 2014, 746 US public companies had adopted exclusive forum bylaws, 60% of which were adopted without a shareholder vote. See Fisch, *supra* note 78 at 1667.

151 Robert B. Little, *'Exclusive Forum' Bylaws Fast Becoming An Item in M&A Deals*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., May 13 2015, https://corpgov.law.harvard.edu/2015/05/13/exclusive-forum-bylaws-fast-becoming-an-item-in-ma-deals/.

152 ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014).

153 Laura D. Richman & Andrew J. Noreuil, *DGCL Amendments Authorize Exclusive Forum Provision & Prohibit Fee-Shifting Provisions*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., July 6 2015, https://corpgov.law.harvard.edu/2015/07/06/dgcl-amendments-authorize-exclusive-forum-provisions-and-prohibit-fee-shifting-provisions/. It appears that 30 of these companies were Delaware corporations. *See* Fisch, *supra* note 78 at 1674-5.

154 *Boilermakers*, 73 A.3d 934 at 956.

155 *ATP Tour Inc.*, 91 A.3d 554 at 558.

156 *See generally* Skeel, *supra* note 55 at 9.

outcomes.[157] For example, the Delaware legislature responded to the litigation bylaw developments by permitting the inclusion of forum-selection provisions in the charter or bylaws,[158] but prohibiting the inclusion of a fee-shifting ('loser pays') provision in either charter or bylaws.[159] These recent interventions of the Delaware legislature, though not unprecedented, are unusual.[160]

Proxy advisers have themselves recognized the broader corporate governance implications of the proxy access debate and private ordering. ISS has stated, for example, that it will oppose directors, who adopt charter or bylaw provisions that 'materially diminish shareholder rights', without shareholder consent.[161] This is no idle threat today, given the changes that have occurred to US share ownership and the corporate governance landscape that has left directors increasingly vulnerable to shareholder discontent.

5. Has There Been a Sea-Change in US Corporate Governance? Martin Lipton as Bellwether

Until recently, many anti-empowerment proponents adopted arguments presenting both institutional investors and activists in a negative light. In 2013, for example, Martin Lipton, who has been described as 'one of the leading warriors against activists,'[162] spoke scathingly of institutional investors. He warned that their voting power was being 'harnessed by a gaggle of activist hedge funds who troll through SEC filings', seeking short-term profit at the expense of both the company and the

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157 *See generally id*.

158 The legislature mandated, however, that Delaware must be one of the selected forums. DEL. CODE ANN. tit. 8, §115 (prohibits Delaware corporations from adopting charter or bylaw provisions that exclude Delaware as a forum for internal corporate claims). *See* Skeel, *supra* note 55 at 10 (describing this as a 'rather remarkable new provision').

159 DEL. CODE ANN. tit. 8, §§ 102(f) and 109(b). See Fisch, *supra* note 78 at 1669-71; Richman & Noreuil, *supra* note 153; Skeel, *supra* note 55 at 9-11.

160 *See* Skeel, *supra* note 55 at 10, 13-4.

161 ISS, *supra* note 144 at 5-6.

162 Ronald Barusch, *Dealpolitik: How Activism is Reshaping Directors' Roles*, WALL ST. J., Apr. 30 2015, http://blogs.wsj.com/moneybeat/2015/04/30/dealpolitik-whats-next-for-activism/.

economy.[163] This analysis depicted institutional investors as unfaithful servants that collaborate with predatory hedge funds.

Nonetheless, the corporate governance developments discussed above, together with recent high profile proxy battles, such as the activist campaign of Trian Management Fund ('Trian Fund') against DuPont,[164] had an interesting effect on anti-empowerment rhetoric. Only two weeks before DuPont's decisive annual shareholder meeting in May 2015 (and, perhaps more significantly, only two days after the announcement that ISS would recommend that shareholders vote in favor of two of Trian Management Fund's board nominees),[165] Mr Lipton departed from his familiar 'take no prisoners' rhetorical style.

Adopting a new, more conciliatory tone, he stated that 'Trian Fund and its founder, Nelson Peltz, have clearly established credibility and acceptability… They have

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[163] Martin Lipton, *Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., Feb. 26 2013, https://corpgov.law.harvard.edu/2013/02/26/bite-the-apple-poison-the-apple-paralyze-the-company-wreck-the-economy/.

[164] Steven Davidoff Solomon, *DuPont's Battle With Nelson Peltz May Confound Shareholders*, N.Y. TIMES DEALBOOK, May 1 2015, https://www.nytimes.com/2015/05/02/business/duponts-battle-with-nelson-peltz-may-confound-shareholders.html; Antoine Gara, *Trian Concedes Defeat in Proxy War with DuPoint's Ellen Kullman*, FORBES, 13 May 2015, http://www.forbes.com/sites/antoinegara/2015/05/13/trian-dupont-ellen-kullman-nelson-peltz/#26a990672a0d. In its long-running activist campaign against DuPont, Trian Management Fund sought to place four nominees, including founder Nelson Peltz, on DuPont's board of directors, with an eye to breaking up the company. Although the outcome was regarded as too close to call in the lead-up to DuPont's annual shareholder meeting on 13 May 2015, DuPont ultimately prevailed when its shareholders elected all twelve of DuPont's own nominees. *See* Steven Davidoff Solomon, *DuPont's Battle With Nelson Peltz May Confound Shareholders*, N.Y. TIMES DEALBOOK, May 1 2015, https://www.nytimes.com/2015/05/02/business/duponts-battle-with-nelson-peltz-may-confound-shareholders.html; DuPont, *DuPont Shareholders Elect All 12 DuPont Nominees at 2015 Annual Meeting Based on Preliminary Results*, DUPONT INVESTOR NEWS, May 13 2015, http://investors.dupont.com/investor-relations/investor-news/investor-news-details/2015/DuPont-Shareholders-Elect-All-12-DuPont-Nominees-at-2015-Annual-Meeting-Based-on-Preliminary-Results/default.aspx. DuPont's victory was by a narrow margin (ie 52%). Central to that victory was the fact that indexed investors, such as Vanguard Group, Black Rock and State Street, which collectively held 16.7% of shares, and CalPERS sided with DuPont's management. *See* John C. Coffee Jnr., *Lessons of DuPont: Corporate Governance for Dummies*, 253 N.Y. L. J. 5 (2015).

[165] *See* Business Wire, *Leady Proxy Advisory Firm ISS Recommends DuPont Stockholders Vote on Trian's Gold Card for Trian Nominees Nelson Peltz and Myers*, BUSINESS WIRE, Apr. 27 2015, http://www.businesswire.com/news/home/20150427006078/en/Leading-Proxy-Advisory-Firm-ISS-Recommends-DuPont. It also appears that on 29 April 2015, the same day on which Mr Lipton made his comments, Glass Lewis also decided to support Mr Peltz in his directorship bid. *See* David Benoit, *Glass Lewis Blacks Trian's Nelson Peltz for DuPont Board*, WALL ST. J., Apr. 30 2015, https://www.wsj.com/articles/glass-lewis-recommends-dupont-shareholders-elect-trians-nelson-peltz-1430365548.

become respected members of the financial community.'[166] Departing even further from his customary stance, Mr Lipton suggested that corporations facing activist campaigns would be 'well-advised to meet with the activist and discuss the activist's criticisms and proposals, which are frequently presented in the form of a well-researched white paper'. Finally, he commented that '[m]ajor institutional investors like BlackRock and Vanguard want direct contact with the independent directors of corporations.'[167]

Coming from Martin Lipton, these observations arguably bore the hallmark of a sea-change in the balance of power between US boards, activists and institutional investors.[168] They constituted recognition of the implications of agency capitalism, whereby 'sophisticated but reticent institutional investors' can, nonetheless, be prompted into supporting activism by other market players.[169]

Recent comments by the CEO of BlackRock, Larry Fink, also confirm this trend. Although previously critical of some activists for short-termist goals,[170] in 2016 Mr Fink confirmed that BlackRock had supported activists in 39% of the largest proxy contests the previous year.[171]

Martin Lipton's comments, combined with the rise of agency capitalism, suggest that US institutional investors have become the corporate equivalent of swing voters in politics – it seems all sides are now out to woo them in an increasingly globalized

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166 Martin Lipton, *Wachtell Lipton Explains Some Lessons from DuPont-Trian*, THE CLS BLUE SKY BLOG, Apr. 29 2015, http://clsbluesky.law.columbia.edu/2015/04/29/wachtell-lipton-explains-some-lessons-from-dupont-trian/.

167 *Id*.

168 Admittedly, Mr Lipton subsequently reverted to the language of conflict, comparing corporate governance developments in the United States with the religious Thirty Years' War of the 17th century. *See* Lipton, *supra* note 31 at 3 (describing proxy advisers, such as ISS, as a 'brigade of mercenaries'), 9-10 (noting conciliatory tone to major institutional investors).

169 Gilson & Gordon, *supra* note 23.

170 Larry Fink, *BlackRock CEO Larry Fink Tells The World's Biggest Business Leaders to Stop Worrying About Short-Term Results*, BUS. INSIDER, Apr. 14 2015, http://www.businessinsider.com/larry-fink-letter-to-ceos-2015-4?IR=T.

171 Matt Turner, *The World's Largest Investor Just Sent This Letter to CEOs Everywhere*, BUS. INSIDER, Feb. 3 2016, http://www.businessinsider.com.au/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2.

investment world.[172] Indeed, Mr Lipton has even presented institutional investors as the best hope for corporate governance peace and 'taming the activists.'[173]

6. Comparative Corporate Governance: Shareholder Participation and Engagement Around the World

The level of controversy generated in the United States by the shareholder empowerment debate and recent corporate governance developments is puzzling to foreign eyes. Is it even appropriate to regard the current trend towards private ordering by shareholders in US corporations as 'activism'?[174] After all, before the decision in *Business Roundtable v SEC*,[175] private ordering was the preferred regulatory solution of those who opposed mandatory federal proxy access rules. To describe private ordering as 'activism' once it becomes a reality suggests that its initial appeal to some opponents of mandatory proxy access may have been the likelihood of failure in practice. Terminology matters, and 'activism' tends to have negative connotations in the United States.[176] It is worth considering why private ordering by shareholders is described as 'activism', when private ordering by the board, through, for example, unilateral bylaw amendments, is not.

La Porta et al's influential 'law matters' hypothesis stressed the differences between common law and civil jurisdictions in terms of shareholder protection,[177] while obscuring important differences within the common law world itself.[178] Yet, the kind

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172 *See also* Fisch, *supra* note 78 at 1644 (noting the connection between agency capitalism and increased issuer responsiveness to shareholder interests generally).

173 Lipton, *supra* note 31 at 9-10.

174 *See e.g.,* Min, *supra* note 76 at 5 (arguing that institutional investor voting on shareholder proposals constitutes 'shareholder activism in a broader sense').

175 Business Roundtable v. SEC 647 F.3d 1144 (D.C. Cir. 2011).

176 Then SEC Chair, Mary Jo White criticized this tendency, stating that 'reflexively painting all activism negatively is, in my view, using too broad a brush and indeed is counterproductive.' *See* Mary Jo White, Chair, SEC, *A Few Observations on Shareholders in 2015*, SEC, Mar. 19 2015, https://www.sec.gov/news/speech/observations-on-shareholders-2015.html.

177 Rafael La Porta et al., *Law and Finance*, 106 J. OF POL. ECON. 1113 (1998); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. OF FIN. 471 (1999).

178 Jennifer G. Hill, *Subverting Shareholder Rights: Lessons from News Corp.'s Migration to Delaware*, 63 VAND. L. REV. 1, 8 (2010). *See* Brian R. Cheffins, *Corporate Ownership and Control*

of rights that have aroused controversy in the United States – for example, majority voting; the ability to convene shareholder meetings; nomination and removal of directors – are available to shareholders in numerous other common law jurisdictions, such as the United Kingdom, Australia, Singapore and Hong Kong. These shareholder rights are usually secured by mandatory rules. In the United Kingdom and Australia, for example, investors have an absolute statutory right to convene shareholder meetings[179] and to remove directors of public corporations from office at any time without cause.[180] This latter right precludes the operation of US-style staggered boards in the United Kingdom and Australia.[181] When News Corporation relocated from Australia to the United States more than a decade ago, it was the absence of such participation rights under Delaware corporate law that caused a revolt by Australian institutional investors.[182] Analogous rights are also available in some civil law jurisdictions, such as Japan, which has not traditionally been regarded as particularly protective of shareholder interests.[183]

In these various jurisdictions, shareholder participation rights are viewed as fundamental to corporate accountability.[184] The kind of engagement with corporate boards that, according to Martin Lipton, major US institutional investors now seek,[185]

33-40 (2008) (discussing La Porta et al.'s studies); Ron Harris & Naomi R. Lamoreaux, *Contractual Flexibility within the Common Law: Organising Private Companies in Britain and the United States*, Nov. 23 2016 *available at* https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2874780 (critiquing, from a historical perspective, the practice of treating British and US company law as indistinguishable).

179 *See* Companies Act c. 46 (2006) §§ 303-305 (U.K.); *Corporations Act* (2001) §§ 249D and 249F (Austl.). These provisions permit the holders of 5% of voting shares to requisition the board to convene a general meeting, or in the case of § 249F of the Australian Act, to convene such a meeting themselves.

180 See Corporations Act (2001) § 203D (Austl.); Companies Act c. 46 (2006) § 168(1) (U.K.).

181 Under Delaware corporate law, directors may be insulated from removal from office through the adoption of a staggered board structure, in conjunction with a norm of removal for cause in the case of a staggered board. See DEL. CODE ANN. tit. 8, § 141(k)(1).

182 Hill, *supra* note 178.

183 Goto, *supra* note 8.

184 *See e.g.*, Walker Review, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations*, NATIONAL ARCHIVES UK, Nov. 26 2009 at 5.6 ("[s]ome governance by owners is essential, at least in respect of the selection, composition an performance of boards, if boards and executives of listed companies are to be appropriately held to account in discharge of their agency roles to their principals").

185 Lipton, *supra* note 31.

is not contentious, for example, in the United Kingdom. Such engagement has a long history there and is regarded as increasingly important from a policy perspective.[186] The influential 2003 Higgs Report proposed a range of governance techniques, specifically designed to ensure open communication and engagement between boards and institutional investors,[187] which were subsequently incorporated into the UK Combined Code on Corporate Governance.[188] Also, one of the underlying premises of the UK Stewardship Code is that institutional shareholders have a non-delegable responsibility to engage with the companies in which they invest.[189] High-level engagement of this kind is also common in Scandinavian countries,[190] and encouraged under recent Japanese corporate governance reforms, which included the introduction of a UK-style Stewardship Code.[191]

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[186] R.C. Nolan, *The Continuing Evolution of Shareholder Governance*, 65 CAMBRIDGE L. J. 92, 93 (2006).

[187] The Higgs Report recommended, for example, the appointment of a senior independent director who should be available to resolve shareholder concerns 'that have not been resolved through the normal channels of contact with the chairman or chief executive,' *See* Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors*, DEP'T OF TRADE & INDUSTRY, Jan. 2003 at §§ 7.4-7.5. Other relevant provisions of the Higgs Report included proposals that the senior independent director should attend regular meetings with management and 'a range of major shareholders' to develop an understanding of shareholder concerns; that non-executive directors should be able to meet with major investors and should expect to do so if requested by those investors; that non-executive directors should meet with major investors as part of their induction into the company; that a company should state what steps it has taken 'to ensure that members of the board, and in particular the non-executive directors, develop a balanced understanding of the views of major investors'. *See* Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors*, DEP'T OF TRADE & INDUSTRY, Jan. 2003 at §§ 15.15-15.18.

[188] Fin. Reporting Council, *The Combined Code on Corporate Governance*, FIN. REPORTING COUNCIL, Jul. 2003 at E.1. *Cf.*, Fin. Reporting Council, *UK Corporate Governance Code*, FIN. REPORTING COUNCIL, Sept. 2014 at § E.

[189] Fin. Reporting Council, *supra* note 2; Jennifer Hughes, *FSA Chief Lambasts Uncritical Investors*, FIN. TIMES (London), Mar. 11 2009 at 1; Kate Burgess, *Myners Lashes Out at Landlord Shareholders*, FIN. TIMES (London), Apr. 22 2009, https://www.ft.com/content/c0217c20-2eaf-11de-b7d3-00144feabdc0.

[190] Richard Milne, *Norway Oil Fund Chief Jettisons Passivity*, FIN. TIMES (London), Aug. 10 2015, https://www.ft.com/content/4ea976d0-26d6-11e5-9c4e-a775d2b173ca; Gretchen Morgenson, *At US Companies, Time to Coax the Directors into Talking*, N.Y. TIMES, Mar. 28 2015, https://www.nytimes.com/2015/03/29/business/time-to-coax-the-directors-into-talking.html; Ruth Sullivan, *Traditional Investors Adopt Activism*, FIN. TIMES (London), May 5 2013, https://www.ft.com/content/62d5ea16-b253-11e2-a388-00144feabdc0.

[191] *See* The Council of Experts Concerning the Japanese Version of the Stewardship Code, *supra* note 2; The Council of Experts Concerning the Japanese Version of the Stewardship Code, *Japan's Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term*, JAPAN EXCHANGE GROUP, June 1 2015 at 33-4.

Also, some corporate governance matters, which are extremely controversial in the United States, such as whether to split the role of chairman and CEO,[192] are regarded as *de rigueur* in other common jurisdictions, even though they are not mandated by law, but merely recommended by non-binding corporate governance codes. In 2016, for example, 48% of S&P 500 companies in the United States split the role of chairman and CEO, but only 27% of S&P 500 companies had a chair that qualified as independent.[193] In the United Kingdom, on the other hand, 99% of FTSE 350 companies had a separate chair and CEO, and 93% of these companies had an independent chair, as recommended by the UK Corporate Governance Code.[194]

It seems that, in an era of globalized investment, US institutional investors are now becoming increasingly aware of the rights held by their counterparts in other jurisdictions, which at least partly explains current developments in the United States that have seen increasing use by investors private ordering techniques to acquire shareholder rights that are common in many other jurisdictions.

7. Divergent Approaches to Shareholder Power – The Role of Legal History

7.1 The Organizational Origins of US Corporate Law

Why is the current attitude to changes in the allocation of power and shareholder participation rights so different in the United States to many other jurisdictions, including the United Kingdom? Legal history provides some clues.

In spite of a similar common law heritage, there are major historical differences between US and UK company law.[195] Each had a fundamentally different organizational starting point. These divergent legal origins affected the internal allocation of power in corporations and the interplay between mandatory and optional

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192 *See generally* Larcker & Tayan, supra note 87.

193 SpencerStuart, *supra* note 114.

194 Fin. Reporting Council, *supra* note 2 at 10-11. Twenty four FTSE 350 companies reported that their chair did not satisfy the independence criteria in the UK Corporate Governance Code, which represented the third highest area of non-compliance with the Code. *See* Fin. Reporting Council, *supra* note 2 at 9, 11.

195 In comparing and contrasting the US and UK legal systems, Professor L.C.B. Gower once stated that 'if there are sufficient basic similarities to make a comparison possible, there are, equally, sufficient differences to make it fruitful.' *See* L.C.B. Gower, *Some Contrasts Between British and American Corporation Law*, 69 HARV. L. REV. 1369 (1956).

rules in corporate regulation in each jurisdiction. They also arguably contributed what has been described as US corporate law's 'exceptionalism.'[196]

US corporate law originated from early UK royal chartered corporations and therefore had quasi-public roots.[197] English chartered corporations included ecclesiastical bodies, guilds, municipal bodies and some trading companies. Famous examples were the East India Company, which was chartered in 1600, and the Bank of England, which received its first charter in 1694.[198] Prior to 1844, when the first UK general incorporation statute[199] was passed, the only legitimate means of acquiring corporate personality were by special Act of Parliament or by royal charter.[200]

This need for a charter from the monarch or Parliament reflected the idea that incorporation depended on 'the supreme power of the State,'[201] and contributed to the then-prevailing theory that the corporate form was a body, approved by the State to act in 'the national interest.'[202] Chartered corporations received delegated government authority and exerted authority through their bylaws. The bylaws could be enforced by various means, such as the imposition of fines. Indeed, in the early days of corporate law history, imprisonment was another enforcement option.[203] However,

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196 Naomi R. Lamoreaux, *Revisiting American Exceptionalism: Democracy and the Regulation of Corporate Governance: The Case of Nineteenth-Century Pennsylvania in Comparative Context* in ENTERPRISING AMERICA: BUSINESS, BANKS AND CREDIT MARKETS IN HISTORICAL PERSPECTIVE 25 (William J. Collins & Robert A. Margo eds., 2015).

197 Gower, *supra* note 195 at 1370; Lawrence M. Friedman, *A History of American Law* 188-195 (4th ed., 2005); Paul Redmond AM, *Corporations and Financial Markets Law* § 2.30-2.35 (2013).

198 In early chartered corporations, members traded with their own stock and at their own risk. Some chartered corporations, such as the East India Company, later moved to a permanent joint stock fund. *See* C.A. Cooke, *Corporation Trust and Company: An Essay in Legal History* 49-50 (1951); Samuel Williston, *History of the Law of Business Corporations Before 1800*, 2 HARV. L. REV. 105, 105-6, 111 (1888). It was not, however, until 1693 that the East India Company prohibited private trading by members. *See* Redmond, *supra* note 197 at § 2.30.

199 An Act for the Registration, Incorporation, and Regulation of Joint Stock Companies (Joint Stock Companies Act) 7 & 8 Vict. c 110 (1844). *See* Harris & Lamoreaux, *supra* note 178 at 6 (discussing background to early UK company legislation from the 1848 Act onwards).

200 Limited liability for registered joint stock companies followed in 1855 with the enactment of the *Limited Liability Act*. Before the passage of Limited Liability Act 18 & 19 Vict. C 133 (1855), special Act of Parliament and royal charter were also the only means of obtaining limited liability.

201 Williston, *supra* note 198 at 113-4.

202 Cooke, *supra* note 198 at 78.

203 Williston, *supra* note 198 at 121-2.

these bylaws were firmly under the control of the state – they were fixed by, and subservient to, the original charter.[204]

In the US context, virtually all chartered corporations prior to the American Revolution were 'bodies politic', such as towns, districts, and religious and educational institutions.[205] From the late 1780s on, however, this picture changed; chartered business corporations grew exponentially, ultimately dwarfing the number of bodies politic.[206] US law, however, made no distinction between these different types of corporations.

The majority of early business charter grants effectively involved private ownership of public utilities, such as mills, banks, bridges, toll roads and later, railroads.[207] True to their British roots and to their function in the early US business era, all such corporations, including those for profit, were regarded as 'public agencies' required to serve a public purpose.[208] The charters themselves were treated as analogous to political constitutions and contracts with the state,[209] which often included detailed specification of the grantee's obligations.[210] The bylaws were the equivalent of 'private statutes' and it was the ability of corporations, as an 'arm of the state',[211] to enforce these private statutes that distinguished them from unincorporated

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204 *See* Harris & Lamoreaux, *supra* note 178 at 8.

205 Pauline Maier, *The Revolutionary Origins of the American Corporation*, 50 WM. & MARY Q. 51, 53 (1993); Samuel Williston, *History of the Law of Business Corporations Before 1800*, 2 HARV. L. REV. 149, 165 (1888).

206 Although prior to 1787 there were only 6 chartered business corporations from 1830 to1860 state legislatures chartered 18,000 business corporations. *See* Wells, *supra* note 5 at 14; Robert E. Wright, *Corporation Nation* 62 (2014).

207 William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 5 AM. B. FOUND. RES. J. 69, 82 (1980).

208 Williston, *supra* note 198 at 105, 110-1; Maier, *supra* note 205 at 55-7.

209 Maier, *supra* note 205 at 79-80. *See e.g.,* Tr. of Dartmouth Coll. v. Woodward 17 U.S. 518 (1819); Charles River Bridge v. Warren Bridge (*The Charles River Bridge Case*), 36 U.S. 420 (1847) (concerning the nature of sovereign charters in the United States).

210 *E.g.*, charter grants for bridges, tollroads and railways often specified location, managerial responsibilities, such as keeping the operation in good repair and the maximum amount that could be charged to the public. *See* Carney, *supra* note 207 at 83.

211 Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1988*, 1 DEL. J. CORP. L. 249, 254 (1976).

associations.[212] Like their British predecessors, early American colonial corporations were essentially 'chips off the block of sovereignty'[213] and heavily restricted in their actions as a result of that fact.[214]

The transplantation of the UK chartered corporation model onto US soil came, however, with some distinctively American twists. First, a critical feature of modern US corporate law emerged during this period – US states, rather than the federal government, were empowered to charter corporations.[215] Secondly, there was populist backlash in the United States due to the fact that charters were originally granted selectively and usually involved monopoly privileges, which was viewed as anti-egalitarian and contrary to the ideals of the American republic.[216]

The problem of the 'monopolistic and scandalous' charter system was eventually solved by legislative means.[217] From the early 19th century onwards, US states began to make charters freely available under general incorporation statutes.[218] Even after their adoption, however, the view persisted throughout the 19th century that

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212 *Id.*

213 *Id*. at 255.

214 *Id*. at 254 (citing Professor Eugene Rostow, who described early American corporations as 'puny institutions', as a result of limitations in their charters as to their location and activities. *See* E. Rostow, *To Whom and for What End is Corporate Management Responsible?* In THE CORPORATION IN MODERN SOCIETY 50 (E.S. Mason ed., 1959)).

215 Maier, *supra* note 205 at 52. Although, of course, corporate law in the United States was state-based, and the political matrix varied from state to state, parallel general patterns can be discerned in its early development. *See* Lamoreaux, *supra* note 196 at 27, 30; Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 646 (2016) (discussing James Madison's failed proposal for U.S. federal incorporation in the Constitutional Convention of 1787). *Cf.* Morton J. Horwitz, *The Transformation of American Law, 1780-1860* ch. 4 (1992).

216 Maier, *supra* note 205 at 66-8, 71-2. Thomas Cooper, for example, was damning in his 1830 assessment of chartered corporations as 'founded on the right claimed by government, to confer privileges and immunities on one class of citizens, not only not enjoyed by the rest, but at the expense of the rest.' *See* Thomas Cooper, *Lectures on the Elements of Political Economy* 246 (1830).

217 Cary, *supra* note 32 at 663-4; *Citizens United v. FEC* 558 U.S. 310, 387 (2010). Some states had made early attempts to solve the problem by issuing charters to business rivals, and courts often refused to imply monopolistic privileges into special charter grants. *See Charles River Bridge* 36 U.S. 420, 546 (1847).

218 Cooke, *supra* note 198 at 93-4; Lamoreaux, *supra* note 196 at 31. New York was at the forefront of this trend. The first general incorporation law in relation to manufacturing was passed in New York in 1811. *See* Act Relative to Incorporations for Manufacturing Purposes 1811 N.Y. Laws 34. Connecticut adopted what is regarded as the first general corporation statute in 1837. *See* Carney, *supra* note 207 at 84. By 1860, 27 out of 32 US states and territories had adopted general incorporation statutes. *See* Lamoreaux, *supra* note 196 at 31.

corporations owed their existence to the state and involved public purposes.[219] It has recently been argued that restricted voting practices during this period reflected the fact that many US corporations essentially operated as public-regarding 'consumer cooperatives.'[220]

7.2 The Organizational Origins of UK Company Law

UK company law has fundamentally different organizational origins to US corporate law. By the time of their American ascent, chartered corporations were 'all-but-moribund' in Britain.[221] They had been eclipsed by unincorporated joint stock companies ('deed of settlement companies'), and it was these companies that ultimately provided the organizational blueprint for modern UK company law.[222]

Deed of settlement companies developed in a parallel universe to chartered corporations. Deed of settlement companies were unchartered associations 'on which the sun of royal or legislative favour did not shine'.[223] They were effectively large partnerships that made creative use of the trust concept to replicate certain features of chartered corporations, such as the ability to hold property and perpetual succession,[224] and had strong contractual elements.[225] Deed of settlement companies did not have a charter or Act of incorporation. Rather, their governing rules were found in articles of association in the form of a deed of settlement. All investors

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219 David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 206-7 (1990).

220 Henry Hansmann & Mariana Pargendler, *The Evolution of Shareholder Voting Rights: Separation Between Ownership and Consumption*, 123 YALE L.J. 948 (2014).

221 Maier, *supra* note 205 at 83.

222 Nonetheless, chartered corporations were not completely without influence on the development of UK company law; deed of settlement companies were, after all, trying to emulate certain aspects of chartered corporations. The legacy of chartered corporations is apparent, for example, in (i) the principle of voting according to the number of shares held, rather than on a 'one person, one vote basis'; (ii) the treatment of directors as fiduciaries; and (iii) recognition of the company as a separate legal entity. *See* Redmond, *supra* note 197 at § 2.35.

223 *Re Agriculturalist Cattle Insurance Company (Baird's Case*) (1870), 5 Ch. App. 725, 734. Often the denial of legislative favor was due to the ease with which parliamentary chartering Acts could be blocked by interested coalitions. *See* Timothy W. Guinnane et al., *Contractual Freedom and the Evolution of Corporate Control in Britain, 1862-1929*, NAT'L BUREAU OF ECON. RES., Sept. 2014 at 7.

224 Cooke, *supra* note 198 at 85-7.

225 Gower, *supra* note 195 at 1371-2, 1376.

('members') were required to sign the deed of settlement,[226] which constituted the central feature of the establishment and organizational structure of these organizations.[227]

Management of deed of settlement companies was almost invariably vested in trustees or a small management group.[228] Nonetheless, the articles of association represented the constitution of these companies, and it was well understood in the 18th century that members could protest if the company's management deviated from the provisions of the articles of association.[229] The deed of settlement could also provide members with specific supervisory and control powers, although in practice, members of these large unincorporated associations tended to remain passive.[230]

The famous Bubble Act of 1720 epitomized the differences and tensions between chartered corporations and deed of settlement companies in England.[231] The main purpose of this 'wordy and obscure' Act was to outlaw 'presuming to act as a corporation' without legal authority.[232] It was clear that this prohibition was designed to eradicate the growing number of unincorporated deed of settlement companies[233] from the trading arena, leaving it the exclusive domain of chartered corporations.[234]

The Bubble Act failed in its attempt to reassert governmental control over British business organizations, and constitutes a classic early example of the gap between

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226 Cooke, *supra* note 198 at 101; Redmond, *supra* note 197 at § 2.45.

227 *See* Cooke, *supra* note 198 at 95.

228 Austin, *supra* note 227 at 711; Cooke, *supra* note *198* at 95.

229 *See* Redmond, *supra* note 197 at § 2.45 (citing A.B. DuBois, *The English Business Corporation after the Bubble Act 1720-1800* 217 (1938)).

230 Austin, *supra* note 227 at 711.

231 Royal Exchange and London Assurance Corporation Act (Bubble Act) 6 Geo I, c 18 (1719). The Bubble Act derives its colloquial name from the South Sea Company Bubble in the early 18th century, a period of 'wild speculation and a great catastrophe.' *See* Cooke, *supra* note 198 at 80.

232 Gower, *supra* note 195 at 1370.

233 Of the more than two hundred companies that were formed around 1720, most were not incorporated by charter. *See* Williston, *supra* note 198 at 111-2.

234 Cooke, *supra* note 198 at 84; Redmond, *supra* note 197 at § 2.40. The Bubble Act also targeted chartered corporations operating beyond the purposes of charters or under expired charters. *See* Margeret Patterson & David Reiffen, *The Effect of the Bubble Act on the Market for Joint Stock Shares*, 50 J. OF ECON. HIST. 163, 170-1 (1990).

'law on the books' and 'law in action'. The Act was largely unenforced[235] between its enactment in 1720 and repeal in 1825,[236] and could, in any case, be circumvented by skillful drafting of deeds of settlement.[237] The result was that deed of settlement companies flourished, albeit in a 'legal grey area',[238] during the period when they were ostensibly banned. This species of company ultimately provided the blueprint for the UK's first general incorporation statute, the 1844 Joint Stock Companies Act.[239]

The close connection between UK company law and partnership law is reflected in legal history, terminology and doctrine. The first general UK incorporation statute,[240] the 1844 Joint Stock Companies Act, which was intended to differentiate between partnerships and companies, actually used the former to define the latter. Under this Act, a 'joint stock company' was described as a partnership with particular characteristics in terms of size and transferability of shares.[241] UK partnerships often included the term '& Co', and a particular company law doctrine, the 'just and equitable' shareholder remedy, is a direct transplant from partnership law.

The divergent origins of UK company law (from unincorporated deed of settlement companies) and US corporate law (from chartered corporations) explains many differences in legal terminology between the two jurisdictions. This includes use of the terms 'companies' and 'articles of association' in the United Kingdom, as opposed to 'corporations', 'charters', 'incorporated' and 'bylaws' in the United States.

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235 There was one prosecution in the 18th century and a smattering of cases in the early 19th century before its repeal in1825. *See* Cooke, *supra* note 198 at 84, 97-9, 105.

236 Hansard, *Joint-Stock Companies – Repeal of the Bubble Act*, HANSARD, Mar. 29 1825.

237 Cooke, *supra* note 198 at 99; Redmond, *supra* note 197 at § 2.45.

238 Guinnane et al., *supra* note 223 at 7.

239 Joint Stock Companies Act 7 & 8 Vict. c 110 (1844). *See generally* Cooke, *supra* note 198 at 109.

240 Joint Stock Companies Act 7 & 8 Vict. c 110 (1844).

241 *Id.* at § 2. A joint stock company was defined as a partnership either with shares that were transferable without the consent of the co-partners or with more than 25 members.

8. Implications of US and UK Organizational Origins for Allocation of Power and Shareholder Participation Rights

By the late 19th/early 20th century, there were striking differences between US and UK corporate law in relation to allocation of power and the dichotomy between shareholder protection and empowerment. These differences reflected the contrasting organization origins of corporate law in the two jurisdictions, and laid the groundwork for future divergence.

Many substantive legal differences between company law in the United Kingdom and the United States today can also be traced back to these different organizational origins. Whereas the starting point for US starting point was one of intense state control and regulation, the starting point for UK company law was a 'free contracting' model. UK and US corporate law developments during the 20th century (which often involved backlash against these respective starting points) involved complex interplay between mandatory and optional rules in each jurisdiction.

8.1 The United States

In the United States, as with UK chartered corporations, variation of governance structures was severely limited. A core feature of the American corporation was the need to accumulate capital from many small investors and then place it under 'firm central direction'.[242] Although the anti-egalitarian aspects of the early charter system had been obviated by general incorporation statutes,[243] a Jeffersonian fear of 'unbridled power' of corporations vis-à-vis the government persisted.[244] Early general incorporation statutes therefore vested managerial power in the board of directors but, at the same time, straightjacketed the board through a myriad of constraints, which mimicked, and often exceeded, the restrictions found in special charters.[245] These constraints were designed to ensure that the legislature retained ultimate control.[246]

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242 James Willard Hurst, *The Legitimacy of the Business Corporation in the Law of the United Stated 1780-1970* 47 (1970); Maier, *supra* note 205 at 58.

243 Seligman, *supra* 211 at 257-8.

244 Friedman, *supra* note 197.

245 Millon, *supra* note 219 at 208; Hurst, *supra* note 242 at 208. Statutory restrictions included limitations on corporate purposes and powers under the *ultra vires* doctrine; how much capital corporations could raise; how much they could borrow; and the extent of shareholder liability. There

Even if power could have been allocated differently between participants in early US corporations, the mechanism by which charters could be altered to achieve this would have made this difficult. The decision in *Trustees of Dartmouth College v Woodward*[247] interpreted a corporation's charter as a contract between its original parties, namely 'the donors, the trustees, and the crown',[248] which meant that *prima facie* alteration required the consent of all groups. Also, shareholder consent during this early period required unanimous consent.[249] The *Dartmouth College* decision shifted the corporation at least partly from the public to the private realm, by protecting corporate charters from unilateral alteration by the state.[250] However, Story J's famous concurring opinion in the case provided a means by which the state could assert such a right – namely if the power to alter the corporation's charter unilaterally were reserved to the state in the original grant. Reserved state powers became commonplace in the post-*Dartmouth College* era.[251] They could be beneficial and provide flexibility for industries undergoing great technological change. This was because vital charter amendments, such as to enable consolidation of railroads, could occur simply by means of state approval.[252]

Nonetheless, it appears that strong shareholder participation rights were embedded in both special charters and in the early American general corporate law statutes. A charter granted by New Jersey to the Society for Establishing Manufactures ('the SUM') in 1791 provides an interesting example of this phenomenon.[253] This charter

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were also restrictions involving corporate duration, and the state's power to amend or repeal charters, which were designed to ensure that the legislature retained ultimate control. *See* Maier, *supra* note 205 at 63, 76-7.

246 *See* Seligman, *supra* note 211 at 258.

247 Tr. of Dartmouth Coll. v. Woodward 17 U.S. 518 (1819)

248 *Id.* at 643-4.

249 Carney, *supra* note 207 at 85; Merrick E. Dodd, *Statutory Developments in Business Corporations Law*, 50 HARV. L. REV. 27, 33 (1936).

250 *See* Seligman, *supra* note 211 at 256.

251 Indeed, such reservations of power occurred even before the judgment in Tr. of Dartmouth Coll. v. Woodward 17 U.S. 518 (1819) was handed down. *See* Carney, *supra* note 207 at 83; Carney, *supra* note 207 at 83. These reservations still appear in MODEL BUS. CORP. ACT § 1.02 (2002)

252 Carney, *supra* note 207 at 85.

253 An Act to Incorporate the Contributors to the Society for Establishing Useful Manufactures, and for the Further Encouragement of the Said Society (SUM Act) 1791 N.J. Laws 1821. The SUM

accorded shareholders significant powers over management. Indeed, it has been suggested that apart these shareholder powers, the SUM's management was 'subject to practically no control.'[254]

Early general corporate law statutes also emphasized the power of shareholders to direct corporate policy and control the actions of the board. Although these statutes vested general management powers in the directors and officers, their powers were constrained by strong shareholder participatory rights.[255] The shareholders' meeting represented 'the critical decision-making forum'.[256] Any significant corporate changes required unanimous shareholder consent, and shareholders had the right to select directors annually by majority vote and remove them at will.[257] There were also early attempts to limit management's ability to use proxies to control the shareholders' meeting.[258] The conception of these early general statutes was that corporations were 'democratically controlled, in theory at least'.[259]

By the late 19th/early 20th century, however, the wind was blowing in a very different direction with regard to state control of corporations and shareholder rights. US corporate law was in the throes of an irrevocable shift, in the form of the well-documented rise of state competition for incorporation charters,[260] that would reshape it for modern times. Such competition had not been possible in an earlier era, when enterprises could only incorporate in their home state.[261] As localism[262] and state

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Act was New Jersey's first major industrial business corporation and a favorite enterprise of Alexander Hamilton. *See* Joseph Stancliffe Davis, *Essays in the Earlier Histories of American Corporations* 349 (1917).

254 Davis, *supra* note 253 at 387.

255 Dodd, *supra* note 249 at 33.

256 *See* Seligman, *supra* note 211 at 258.

257 *Id*.

258 *See* Dodd, *supra* note 249 at 33.

259 *Id*.

260 Charles Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey*, 32 J. CORP. L. 323 (2007) (discussing in detail the beginnings of the historical race for corporate charters, beginning with New Jersey in the 1880s).

261 Gerard C. Henderson, *The Position of Foreign Corporations in American Constitutional Law* (1918).

control over corporations receded, however, the community-based aspirations of corporations gave way to private organizational profit-seeking.[263]

State competition for corporate charters represented a massive backlash against US corporate law's restrictive past. New Jersey, an early leader in this race, introduced corporate law revisions,[264] which conferred 'breathtaking privileges'[265] on corporations, and were far more permissive than comparable legislation in other states at the time. It has also been said that New Jersey's General Revision Act of 1896 undermined shareholder control by, for example, permitting directors to amend the bylaws without shareholder approval.[266] This development laid the legislative groundwork for many contentious examples of private ordering combat today.

New Jersey cemented its dominance in 1888-1889, by introducing reforms that expressly permitted its corporations to hold stock in other companies, which had not previously been possible.[267] These reforms legitimized economic concentration and facilitated the first great wave of mergers in American history,[268] with New Jersey a

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[262] Historically, corporate citizenship had significant jurisdictional implications. In the early 19th century, for example, corporations were denied access to the federal courts' 'diversity of citizenship' jurisdiction. Because a corporation was at that time deemed to be a citizen of every state in which one of its shareholders lived, this limited the access of corporations with dispersed shareholding to the federal courts. Over time, however, the US Supreme Court introduced presumptions, which gave corporations greater access to federal courts. Thus, in Marshall v. Baltimore & O.R.R, 57 U.S. (16 How.) 314 (1853), the majority of Supreme Court introduced a conclusive, but fictional, presumption that all members of a corporation were citizens of the chartering state. *See generally* James W. Moore & Donald T. Weckstein, *Corporations and Diversity of Citizenship Jurisdiction: A Supreme Court Fiction Revisited*, 77 HARV. L. REV. 1426, 1427-9 (1964). In 1886, the decision in Santa Clara County v. Southern Pac. R.R,, 118 U.S. 394 (1886) held that a corporation was a citizen under the fourteenth amendment, and therefore entitled to protection of the privileges and immunities clause. *See also* Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173 (1985).

[263] Maier, *supra* note 205 at 81.

[264] *See* Hurst, *supra* note 242 at 69-70, 73; Pollman, *supra* note 215 at 649-51. Although many commentators date New Jersey's early dominance in the market for corporate charters as beginning with 1886 amendments to its corporate code, Professor Yablon argues that New Jersey's lead had already begun at least 15 years earlier, but was extended in 1888-9, when New Jersey passed legislation permitting a corporation to hold shares in another corporation. *See* Yablon, *supra* note 260 at 326-7.

[265] Seligman, *supra* note 211 at 265, 269-70 (describing the type of liberalization authorized by New Jersey and its imitators).

[266] *Id.* at 266.

[267] Yablon, *supra* note 260 at 326-7.

[268] *See id*. at 268 (citing Shaw Livermore, *The Success of Industrial Mergers*, 50 Quart. J. Econ. 68 (1935) for the proposition that between 1888 and 1905, 328 business combinations were effected,

major beneficiary of these developments.[269] It has been estimated that, by 1900, 95% of major US companies were incorporated in New Jersey.[270] The chartering business had proven so lucrative for New Jersey that, by 1902, fees associated with it were sufficient to pay off the entire state debt.[271]

It was hardly surprising that other states jumped on the lucrative corporate chartering bandwagon. Soon, states such as New York, West Virginia, Maine, Maryland and Kentucky, as well as Delaware were trying to emulate New Jersey's winning formula.[272] As the race for state charters gained momentum, a major selling point[273] was the promise by each state that it could provide more liberal incorporation laws, in terms of expanded corporate powers and shareholder immunity, than its competitors.[274] New Jersey's early success was short-lived. In 1913, the state handicapped itself in the race for corporate charters by adopting the restrictive 'Seven Sisters Acts', which were designed to control monopolies by reinstating restrictions on trusts and holding companies.[275] Although New Jersey repealed most of the 'Seven Sisters Acts' in 1917, the damage was done. The state never regained its ascendency over corporate charters;[276] Delaware took its place. Even though Delaware's 1899 Act merely replicated the New Jersey's legislation,[277] by 1915 the Delaware Act had acquired cachet as quintessentially modern and 'liberal.'[278] Major corporations, such

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which, by 1904, controlled approximately 40% of all manufacturing capital in America). *See also* Alfred Chandler, *The Beginning of 'Big Business' in American Industry*, 33 BUS. HIS. REV. 1, 10-4 (1959).

269 Yablon, *supra* note 260 at 324.

270 Seligman, *supra* note 211 at 267.

271 *Id.* at 268; Horwitz, *supra* note 215 at 83-4.

272 Seligman, *supra* note 211 at 269; Yablon, *supra* note 260 at 324; Harris & Lamoreaux, *supra* note 178 at 26-7.

273 *See e.g., Liggett Co. v Lee,* 288 U.S. 517, 53 S. Ct 481, 557 (1933) (discussing the competition for charters, in which '[t]he states joined in advertising their wares').

274 Yablon, *supra* note 260 at 324-5.

275 *See* Seligman, *supra* note 211at 270.

276 *Id*.

277 *Id*. at 327.

278 Yablon, *supra* note 260 at 327; Cary, *supra* note 34 at 664-5.

as DuPont and General Motors reincorporated in Delaware in 1916,[279] and the rest is history.[280]

The powerful image of US corporate law as 'enabling', rather than mandatory, dates from this time.[281] It reflects the fact that US state laws began to permit what had previously been forbidden under the strict rules associated with chartered corporations. This shift towards greater legislative flexibility in the race for corporate charters affected shareholder participation rights in US public corporations. Although there was a strong emphasis on shareholder protection in early 20th century Delaware case law, which frequently referred to directors as trustees for the stockholders,[282] Delaware's 'revolutionary general corporation law'[283] accorded few participatory rights to shareholders. The Act provided greater flexibility in the contents of the corporate charter and bylaws.[284] For example, under an important amendment to the Act in 1901,[285] the State effectively delegated its right to determine the intra-corporate structure and distribution of power to the incorporators themselves.[286] This 'self-determination provision' essentially flipped US corporate law history on its head, designating the corporation itself, rather than the state, as primary 'law-maker'.[287]

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279 *See* Yablon, *supra* note 260 at 325.

280 Delaware is still the dominant state in corporate law today. Approximately 60% of the largest US public corporations are incorporated in Delaware, as well as 80% of reincorporations. *See* Skeel, *supra* note 55 at 2.

281 The idea that corporate law was 'enabling' was an important feature of the nexus of contract theory of the corporation. *See* 89 COLUM. L. REV. 1395 (1989) (discussing in detail the mandatory/enabling debate in US corporate law).

282 *See* Samuel Arsht, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1, 9 (1976) (citing Lofland v. Cahall, 118 A. 1 (Del. 1922) & Bowen v. Imperial Theatres, Inc., 115 A. 918 (Del. Ch. 1922) as examples of judicial depictions of directors as trustees during this period).

283 *Id.* at 9. *See* Seligman, *supra* note 211 at 271 (discussing the DEL. G.C.L of 1899).

284 Pollman, *supra* note 215.

285 *See* Arsht, *supra* note 282 at 9 (noting that in 1901, that were amendments made to 48 of the 139 sections of the Delaware statute).

286 *See* Act of March 7, 1901, ch. 167, § 5, 22 DEL. LAWS 287-89, which permitted the certificate of incorporation to 'contain any provision which the incorporators may choose to insert for the regulation of the business and for the conduct of the affairs of the corporation, and any provisions creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders, or any classes of the stockholders, provided, such provisions are not contrary to the laws of this State.' This provision was the precursor of DEL. CODE ANN. tit. 8, § 102(b)(1). *See generally* Arsht, *supra* note 282 at 9.

However, because the Act, as originally passed, vested power to manage the business of the corporation in the board of directors,[288] which also acted as a gatekeeper to any charter amendments, this new-found flexibility, in fact, advantaged management and the board, rather than the shareholders.[289] The shift to liberal statutes, which Delaware's new Act exemplified, introduced default rules that gave the directors freedom to pass bylaws and to entrench themselves through staggered boards.[290] It has been argued that, during the 1920s promoters and managers of Delaware corporations used the self-determination provision to launch 'an assault on the last vestiges of shareholder control'.[291]

8.2 The United Kingdom

Whereas the original backdrop for US corporate law was one of strict state control and mandatory laws, the opposite was true for UK company law.

From the mid-19th century onwards, UK company law developed from a baseline of remarkable flexibility regarding allocation of power and participation rights for members/shareholders ('shareholders').[292] Unlike in the United States, the board's powers were derived, not from the state, but from the company's own constitution

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287 Seligman, *supra* note 211 at 273 (noting that this 'self-determination' provision was the diametric opposite of the first 100 years of US company law history, which was based on the rule that the only powers of the business corporation were those expressly or impliedly provided in its charter with the State).

288 Act of March 10, 1899, ch. 273, § 20, 21 DEL. LAWS 451-52.

289 *See* Seligman, *supra* note 211 at 251; Arsht, *supra* note 282 at 9 (suggesting that the 1901 amendments to the Delaware statute, and other amendments throughout the 20th century, were 'aimed solely at freeing management from restrictions at the expense of stockholder rights'). *See also* Arsht, *supra* note 282 at 11-2 (stating that many of the amendments to the DEL. G.C.L. between 1929 and a broad revision of the statute in 1967 'can fairly be described as protective provisions, intended to insulate officers and directors from liability in particular situations'). According to Arsht, these legislative developments to the Act 'obviously increased its attractiveness to management'. *See* Arsht, *supra* note 282 at 12.

290 Harris & Lamoreau, *supra* note 178 at 28.

291 Seligman, *supra* note 211 at 273. During this period, Delaware corporations began altering their charters to eliminate a range of shareholder rights including, for example, preemption rights and dividend rights. Seligman, *supra* note 211 at 273-4.

292 Although the term 'shareholder' was used in the Joint Stock Companies Act 7 & 8 Vict. c 110 (1844) (U.K.) and Joint Stock Companies Act 19 & 20 Vict. c 47 (1856) (U.K.), the Companies Act 25 & 26 Vict. c 89 (1862) (U.K.) and subsequent U.K. companies legislation, including the current Companies Act c. 46 (2006) (U.K.) use the term 'member'.

('articles of association' or 'articles').[293] These board powers could be 'as broad or as narrow…as desired.'[294] Significantly, decisions as to the breadth or narrowness of the board's powers were matters for the shareholders, who could alter the contents of the articles of association by special resolution, requiring a 75% majority.[295] Although some 19th century UK company cases interpreted shareholders' power in this regard to mean that directors were merely agents of shareholders,[296] this paradigm was overturned in *Cuninghame's* case.[297] This 1906 decision made it clear that the articles created separate and autonomous spheres of authority for both directors and shareholders.[298] Under the division of powers doctrine elucidated in *Cuninghame's* case, where the articles vested managerial power in the board, the board would be immune from interference by shareholders in its decision-making.[299] However, it was still possible for shareholders to give directions and advice to the board of directors of UK companies, if this power were specifically allocated to shareholders by the articles, which was commonly the case.

The ability of shareholders to alter the articles of association was a mandatory feature of UK company law,[300] conferred by statute.[301] Any provision attempting to contract out, or deprive, shareholders of this inherent power would be invalid, as contrary to

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293 *Cf.* Susan Watson, *The Significance of the Source of the Powers of Boards of Directors in UK Company Law*, 6 J. BUS. L. 597 (2011) (questioning the significance of the fact that directors in the UK obtained their powers from the article of association, rather than statute, given that the articles invariably vested managerial power in the board).

294 Robert R. Pennington, *Company Law* 481 (2nd ed., 1967).

295 *See e.g.* Companies Act 25 & 26 Vict. c 89 (1862) § 50 (U.K.).

296 Isle of Wight Rly v. Tahourdin (1883) Ch. D. 320.

297 Automatic Self-Cleansing Filter Syndicate Co Ltd v. Cuninghame [1906] 2 Ch 34.

298 *Id*. *See also* John Shaw & Sons (Salford) Ltd v. Shaw [1935] 2 K.B. 113, 134; Howard Smith Ltd. V. Ampol Petroleum Ltd. (1974) 3 ALR 448, 457.

299 For a recent example of the division of powers doctrine, see the Federal Court of Australia decision in *Australasian Centre for Corporate Responsibility (ACCR) v Commonwealth Bank of Australia* (CBA) [2015] FCA785, where Davies J held that the doctrine justified CBA's board of directors excluding ACCR's non-binding shareholder proposal from the CBA's annual general meeting. This decision was upheld on appeal by the Full Federal Court in *ACCR v CBA* [2016] FCAFC 80.

300 *See e.g.*, Walker v. London Tramways Co. (1879) 12 Ch. D. 705; Allen v. Gold Reefs of West Africa Ltd. [1900] 1 Ch. 656; Peters' American Delicacy Co. Ltd. v. Heath (1939) 61 CLR 457. Free alterability of the articles of association is today found in Companies Act c. 46 (2006) § 21 (U.K.).

301 *See e.g.*, Companies Act 25 & 26 Vict. c 89 (1862) §§ 50-1 (U.K.).

statute.[302] In contrast to contemporary Delaware law regarding amendments to the corporate charter,[303] UK shareholders could also initiate such constitutional changes without the need for board approval.

The articles of association therefore represented a contractual bargain between shareholders about how their company should be governed. Statutory recognition was given to this bargain, which explicitly bound the shareholders and the company, though not the directors.[304] It has been suggested that this inherent power of the shareholders to alter the articles according to their own wishes is the cornerstone of shareholder rights in the United Kingdom.[305] Although the United Kingdom had statutory law relating to companies from 1844 onwards, UK company law at the turn of the 20th century initially offered minimal statutory protection for outside investors.[306] Indeed, this 'free contracting' aspect of the articles meant that, during this period, at the turn of the 20th century, UK corporate governance was not dissimilar to some jurisdictions, such as Norway, which had no statutory corporate law whatsoever.[307]

UK companies were not required to devise their own constitutions from scratch. They could rely instead on model articles,[308] which were attached to the companies

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302 *See* Allen v. Gold Reefs of West Africa Ltd. [1900] 1 Ch. 656, 671; Peters' American Delicacy Co. Ltd. v. Heath (1939) 61 CLR 457, 479. *But see*, in limited circumstances, a company's articles may contain a 'provision of entrenchment' requiring more restrictive conditions to be met, or procedures complied with, in order to alter the articles. *See* Companies Act c. 46 (2006) § 22 (U.K.).

303 DEL. G.C.L. § 242.

304 Gower, *supra* note 195 at 1376. *See* Companies Act 25 & 26 Vict. c 89 (1862) § 16 (U.K.); Companies Act c. 46 (2006) § 33(1) (U.K.). *Cf. Corporations Act* (2001) § 140(1)(b) (Austl.) (embodies a contract between directors and company, though not between directors and members).

305 R.C. Nolan, *Shareholder Rights in Britain*, 7 EUR. BUS. ORG. L. REV. 549, 554-6 (2006). *Cf.* Watson, *supra* note 293.

306 *See* Cheffins, *supra* note 178 at 35, 194, 273.

307 Mike Burkart et al., *Why Do Boards Exist? Governance Design in the Absence of Corporate Law*, January 23 2017 *available at* https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2902617. *See also* Harris & Lamoreaux, *supra* note 178 (contrasting the high level of contractual freedom in small and medium size enterprises (SMEs) under British company law during the 19th century with the far more restrictive approach under US corporate law).

308 Companies House, *Model Articles of Association for Limited Companies*, GOV.UK, Mar. 3 2015. The earliest model articles of association for limited companies were found in Joint Stock Companies Act 19 & 20 Vict. c 47 (1856) § Table B (U.K.). The model articles were renamed 'Table A' in the Companies Act 25 & 26 Vict. c 89 (1862) (U.K.), and this terminology continued up to and

legislation and subject to amendment by the Board of Trade.[309] These constituted a set of default rules that companies could adopt in whole, in part, or not at all.[310]

It is interesting to note that, from the mid-19th century onwards, model articles in the United Kingdom contained robust participatory rights for shareholders. The model articles in the Joint Stock Companies Act 1856, for example, included provisions to the following effect:- any number of shareholders with an aggregate of not less than 20% of shares could requisition the directors to convene an extraordinary general meeting;[311] any shareholder could submit resolutions by giving at least 3 days notice[312]; shareholders could at any time remove a director from office by special resolution and appoint a replacement;[313] any two shareholders could summon an extraordinary general meeting at any time.[314]

Similar shareholder participatory rights were found in the model articles of the Companies Act 1862, which many regard as the first modern piece of UK company law.[315] These 'Table A 1862' articles vested managerial power in the board of directors, though subject to any powers that the Act or articles conferred on the shareholders in the general meeting.[316] Specific powers granted to shareholders by the articles included the ability to schedule 'ordinary' or annual general meetings[317] and the ability of 20% of members to requisition directors to convene an extraordinary general meeting.[318] Where the directors failed to comply with this requisition within

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including the Companies Act c 6 (1985) (U.K.). *See* Companies House, *Model Articles of Association for Limited Companies*, GOV.UK, Mar. 3 2015.

309 Companies Act 25 & 26 Vict. c 89 (1862) § 71 (U.K.)

310 *Id*. at §§ 14-5. *See* Harris & Lamoreaux, *supra* note 178 at 10 (discussing the structure and operation of these model articles).

311 Joint Stock Companies Act 19 & 20 Vict. c 47 (1856) § Table B, Art. 25 (U.K.).

312 *Id.* at § Table B, Art. 29.

313 *Id.* at § Table B, Art. 62.

314 *Id*, at § Form C, Memorandum of Association, 7th.

315 Nolan, *supra* note 186 at 98.

316 Joint Stock Companies Act 19 & 20 Vict. c 47 (1856) § Table B, Art. 55 (U.K.).

317 *Id.* at §§ Table B, Art. 30, 33 (U.K.).

318 *Id.* at §§ Table B, Art. 30, 32 (U.K.).

21 days, the same number of shareholders could convene an extraordinary general meeting themselves.[319] The 1862 Act provided a default rule permitting five members to summon meetings, in the absence of any articles dealing with the issue.[320] Several provisions of Table A 1862 limited directors' discretion by making their power to act conditional on shareholder approval. Shareholder consent was a necessary precondition to board action to increase capital[321] or declare a dividend.[322]

Table A 1862 provided for staggered board terms.[323] Staggered boards have a poor reputation in modern corporate governance literature due to their alleged ability to insulate directors,[324] because shareholders can only remove directors of staggered boards 'for cause' under Delaware law.[325] However, the staggered term in Table A 1862 would not operate in the same way, since shareholders could, under Article 65, remove any director from office by special resolution.[326] Later iterations of Table A articles would provide shareholders even stronger rights, by empowering them to remove a managing director from office.[327]

The Companies Act 1862 sent mixed messages with regard to shareholder voting.[328] The Act itself established a per capita voting blueprint – it provided that, absent a specific provision in the articles, 'every Member shall have One Vote.'[329] However, a

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319 Joint Stock Companies Act 19 & 20 Vict. c 47 (1856) § Table B, Art. 34 (U.K.).

320 *Id.* at § 52.

321 *Id.* at § Table B, Art. 26 (U.K.).

322 *Id.* at § Table B, Art. 72 (U.K.).

323 *Id*. at § Table B, Art. 58 (U.K.).

324 Lucian A. Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 STAN. L. REV. 887, 919 (2002) *cf.* Martijn Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 STAN. L. REV. 67 (2016).

325 Under Delaware corporate law, shareholders can only remove directors of staggered boards 'for cause'. *See* DEL. CODE ANN. tit. 8, § 141(k)(1).

326 Today, this is a statutory right, under both UK and Australian corporate law which cannot be altered in the constitution or by agreement. *See* Companies Act c 6 (1985) § 168(1) (U.K.); Corporations Act (2001) § 203D (Austl.)

327 *See e.g.*, Companies (Consolidation) Act (1908) § First Schedule, Table A, Art. 72 (U.K.).

328 Hansmann & Pargendler, *supra* note 220 (analyzing in detail early voting rights in the United States).

329 Companies Act 25 & 26 Vict. c 89 (1862) § 51 (U.K.)

different voting regime applied under the model articles. Article 44 of Table A 1862 adopted a graduated voting model.[330] The Companies (Consolidation) Act 1908 brought more consistency to shareholder voting, establishing a share/one vote default rule for a poll under both the Act[331] and the model articles.[332]

Of course, these model articles were default rules only. A fundamental question therefore arises – did UK public companies companies actually adopt them, thereby including strong shareholder participation rights in their own constitutions? There is mixed, and at times conflicting, historical scholarship on this issue. Some scholars argue that UK companies in the early 20th century voluntarily adopted robust shareholder rights.[333] Others argue, to the contrary, that the contractual freedom embodied in the articles of association was actually used over time to dilute shareholder rights and to shift the balance of power in UK companies in favor of directors.[334] Unlike the current US phenomenon of private ordering combat, this is essentially an argument of private ordering capture.[335] Private ordering capture was certainly possible during this period. In the early decades of the 20th century, shareholder voting was usually determined by proxy voting prior to the actual shareholders' meeting[336] and the directors had strategic superiority in this process. As Maugham J, stated in the 1934 case, *Re Dorman Long & Co Ltd*, '[i]n a sense, in all these cases, the dice are loaded in favour of the views of the directors'.[337]

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330 Hansmann & Pargendler, *supra* note 220 at 951-2. *See id*. at § Table A, Art. 44 (tiered voting model conferred one vote per share for the first ten shares held; with one vote for every five shares thereafter up to 100 shares; and beyond that, one vote for every ten shares).

331 Companies Act 25 & 26 Vict. c 89 (1862) § 67(iv) (U.K.)

332 Companies (Consolidation) Act (1908) §§ cl. 60, First Schedule, Table A, Art. 60 (U.K.).

333 *E.g.*, James Foreman-Peck & Leslie Hannah, *UK Corporate Law and Corporate Governance before 1914: A Re-Interpretation*, EUR. HIS. ECON. SOC'Y WORKING PAPER, Jan. 2015.

334 *E.g.* Guinnane et al., *supra* note 223.

335 *See* Cheffins, *supra* note 178 at 195. Professor Cheffins cites an 1899 complaint, which supports the existence of private ordering capture during this period ("[T]he shareholder is absolutely defenceless. Provided you do not commit downright larceny or embezzlement you can do anything under suitable Articles of Association").

336 *See* In re Dorman Long & Co Ltd; In re South Durham Steel & Iron Co. Ltd. [1934] Ch 635, 657-658.

337 *Id*. *See also* Cheffins, *supra* note 178 at 40 (citing a 1935 article by Cole which states "[I]n the ceaseless buying and selling of stocks and shares, and above all in the flotation and disposal of new capital issues, the insiders are obviously at an enormous advantage over the general investing public."

It is difficult to assess these competing claims, because, as noted by one group of authors,[338] the studies are based on completely different groups of companies. Nonetheless, both studies provide interesting and revealing insights. The study by Guinnane et al. suggests that at least for some rights, a high proportion of companies adopted Table A articles. It finds, for example, that a large majority (76.2%) of companies in its 1892 sample followed the Table A article granting shareholders power to remove directors by special resolution. Also, 12 out of 54 in the sample did not have any articles on file, which *prima facie* suggests wholesale adoption of the model articles.

Further incentives to comply with the model articles were created by revisions to 1908 UK Companies Act Table A articles. The revisions created a link between the model articles and London Stock Exchange Listing Rules.[339] Companies adopting the former would automatically comply with the latter.[340] The model articles therefore served as an important benchmark against which individual companies' articles could be assessed and evaluated.

However, it is also likely that there is at least some truth in Guinnane et al.'s allegation of private ordering capture during this early company law period. The authors cite an 1894 investment guide, which warned potential investors to review a company's articles of association carefully in advance to ensure that they did not deprive the shareholders of 'their just rights' by 'unrestrictedly vesting in the directors all the powers of the company'.[341] What is noteworthy about this investor warning is that it treated dilution of shareholder rights, not as an appropriate allocation of power, as a perversion of good governance.

Furthermore, because Guinnane et al.'s study is restricted to an examination of the articles of association, it ignores the broader UK company law context, in which there

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G.D.H. Cole, *The Evolution of Joint Stock Enterprise*, in STUDIES IN CAPITAL & INVESTMENT 51, 64 (G.D.H Cole ed., 1935).

338 Guinnane et al., *supra* note 223.

339 *See* Cheffins, *supra* note 178 at 40 (stating that UK stock exchange listing rules often imposed more stringent restrictions on insiders and greater investor protection than company law during this period.) *See also* Cheffins, *supra* note 178 at 196-7.

340 Guinnane et al., *supra* note 223 at 36.

341 *Id.* at 33.

were important developments relating to the interplay of voluntary and mandatory rules. From the early 20th century onwards, there was a shift towards juridification. This involved a series of reforms, which introduced mandatory statutory rules that either prohibited certain practices or accorded shareholders specific participation rights.[342] These mandatory rules were often introduced in response to market crises,[343] and on the recommendation of influential UK reform committees, which provided regular status reports on UK company law throughout the 20th century.[344] Many of the reforms introduced in response to the Greene Committee Report in 1926,[345] the Cohen Committee Report in 1945,[346] the Jenkins Committee Report in 1962[347] were mandatory rules designed to give shareholders a greater degree of control over directors.

These mandatory statutory rules operated against the traditional free contracting backdrop of UK company law. The statutory provisions both complemented and trumped the articles of association. The 1900 UK Companies Act, for example, introduced a mandatory statutory rule granting shareholders with 10% or more of the company's issued capital the right to convene a general meeting.[348] This suggests that a significant number of companies failed to include analogous Table A rights in their articles of association,[349] thereby prompting the legislature to introduce them as mandatory rules. These legislative gap fillers provided one-way flexibility – the

342 Nolan, *supra* note 186 at 103-5.

343 *See* Cheffins, *supra* note 178 at 275-8.

344 *See id*. at 328-31.

345 Board of Trade, U.K., *Report of the Company Law Amendment Committee 1925-26*, GREENE COMMITTEE, 1926.

346 Board of Trade, U.K., *Report of the Committee on Company Law Amendment (Cohen Report 1945)*, COHEN COMMITTEE, June 1945.

347 Board of Trade, U.K., *Report of the Company Law Committee*, JENKINS COMMITTEE, June 1962.

348 Companies Act 63 & 64 Vict. c 48 (1900) § 13 (U.K.).

349 Nolan, *supra* note 186 at 103.

articles of association could increase, but not decrease, the shareholder protection provided by the statutory rule.[350]

Another clear example of the impact of the divergent origins of UK and US corporate law relates to exculpation clauses.[351] US corporations required statutory permission to include exculpation clauses in relation to breach of the duty of care, including gross negligence, in their charters. That 'enabling' legislation appeared only in 1986, when Delaware enacted DGCL § 102(b)(7) as a rapid regulatory response to *Smith v Van Gorkom*.[352]

In the United Kingdom, on the other hand, exculpation (or exoneration) clauses were common in the articles of public companies from the early 20th century on as a result of its free contracting background. Their widespread use accords with a private ordering capture hypothesis. However, contrary to the approach of many US states in explicitly authorizing such clauses,[353] in 1928, the United Kingdom introduced reforms that prohibited and invalidated any provision exempting directors from liability for breach of duty, including negligence.[354] These reforms were based on the recommendations of the Greene Committee, which was scathing in its assessment of this type of article, stating that, in its view, it gave directors 'a quite unjustifiable protection'.[355]

9. Conclusion

350 *E.g.*, Companies Act 10 & 11 Geo. c 47 (1947) § 2 (U.K.) (default rules regarding the length of notice for general meetings became mandatory minimum rules, which could be increased, but not decreased in the company's articles). *See id.* at 104.

351 Conaglen & Hill, *supra* note 43.

352 *See generally*, James J. Hanks. Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1208-9 (1988). The enactment of DEL. CODE ANN. tit. 8, § 102(b)(7) was also in response to a directors' liability insurance crisis. *See* James J. Hanks. Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1209 (1988); Randy J. Holland, *Delaware Directors' Fiduciary Duties: The Focus on Loyalty*, 11 U. PA. J. BUS. L. 675, 691 (2009).

353 *See generally* Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935 (2012).

354 This reform was based on recommendation of the UK Greene Committee. *See* Board of Trade, *supra* note 345 at §§ 46-7.

355 *Id.* at § 46 (The Greene Committee continued by saying that under this type of article, "a director may with impunity be guilty of the grossest negligence provided that he does not consciously do anything which he recognises to be improper.") *See generally* Conaglen & Hill, *supra* note 43.

This article explores a range of contemporary US corporate governance developments, including shareholder empowerment and private ordering combat. It seeks to understand certain legal and attitudinal differences relating to shareholder power between the United States and other common law jurisdictions, such as the United Kingdom.

The article examines these issues from comparative and historical perspectives. It highlights the fact that US and UK corporate law have different organizational origins and, as a result of these dissimilar starting points, have followed quite different paths from the early 20th century onwards. US law shifted from a rigid corporate law system, which evolved from chartered corporations, to a far more liberal and flexible system, but a system in which corporate managers held the reins of corporate power and where the participatory role of shareholders in US corporate governance was diminished. The United Kingdom, on the other hand, shifted from a 'free contracting' position, which evolved from unincorporated deed of settlement companies, to a system where shareholders received stronger rights as a result of mandatory participatory rights and various statutory protections.

The distinctive trajectory of US corporate governance goes some way to explaining why activism first developed in the United States, why it continues to be such a controversial issue today, and why institutional investors are increasingly using private ordering remedies to acquire governance rights that are already available to shareholders in other common law jurisdictions.[356]

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[356] *See generally* Hill, *supra* note 178 (highlighting fundamental legal differences between Delaware and Australian corporate law at the time of News Corp.'s reincorporation in Delaware).

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