

## **Columbia Law and Economics Working Paper No. 322**

### **Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy**

**Jeffrey N. Gordon**

*Columbia Law School, ECGI*

[jgordon@law.columbia.edu](mailto:jgordon@law.columbia.edu)

**FORTHCOMING 2008, VANDERBILT LAW REVIEW SYMPOSIUM**

*Draft of February 2008*

*available at <http://ssrn.com/abstract=1085356>*

#### *Abstract*

The current debate over shareholder access to the issuer's proxy for the purpose of making director nomination is both overstated in its importance and misses the serious issue in question. The Securities Exchange Commission's new e-proxy rules, which permit reliance on proxy materials posted on a website, should substantially reduce the production and distribution cost differences between a meaningful contest waged via issuer proxy access and a freestanding proxy solicitation. The serious question relates to the appropriate disclosure required of a shareholder nominator no matter which avenue is used. Institutional investors and other shareholder activists should focus their energies on working through the mechanics of waging short-slate proxy contests using e-proxy solicitations. Activist institutions need to work out the disclosure package required under the existing proxy rules. Such disclosure may be tested (and refined) through litigation, but a standardized package should emerge relatively quickly that the institution could use in proxy contests without a control motive. Institutional investors need to become facile with the e-proxy model (including coordinating a practice for opting-in to web-access) and should appreciate the extent to which proxy advisory services will do much of the actual solicitation work. If institutions are unwilling to make the relatively modest investment to master the mechanics of e-proxy contest, both in their initiation as well as voting in support of them, then their role in corporate governance will necessarily be limited.

Keywords: corporate governance, institutional investor, proxy contests, shareholders, directors, corporate reform, Securities Exchange Commission, e-proxy

JEL Classification: D70, G30, G34, G38, K22, M14

# Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy

Law Working Paper N°.92/2008

February 2008

Jeffrey N. Gordon  
Columbia Law School and ECGI

© Jeffrey N. Gordon, 2008. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

This paper can be downloaded without charge from:  
<http://ssrn.com/abstract=1085356>

[www.ecgi.org/wp](http://www.ecgi.org/wp)

ECGI Working Paper Series in Law

Proxy Contests in an Era of Increasing Shareholder Power:  
Forget Issuer Proxy Access and Focus on E-Proxy

Working Paper N°.92/2008

February 2008

Jeffrey N. Gordon

Forthcoming 2008, Vanderbilt Law Review Symposium

Many thanks for comments on an earlier draft to Jesse Fried, Jill Fisch, and Randall Thomas.

©Jeffrey N. Gordon, 2008. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

## Abstract

The current debate over shareholder access to the issuer's proxy for the purpose of making director nomination is both overstated in its importance and misses the serious issue in question. The Securities Exchange Commission's new e-proxy rules, which permit reliance on proxy materials posted on a website, should substantially reduce the production and distribution cost differences between a meaningful contest waged via issuer proxy access and a freestanding proxy solicitation. The serious question relates to the appropriate disclosure required of a shareholder nominator no matter which avenue is used. Institutional investors and other shareholder activists should focus their energies on working through the mechanics of waging short-slate proxy contests using e-proxy solicitations. Activist institutions need to work out the disclosure package required under the existing proxy rules. Such disclosure may be tested (and refined) through litigation, but a standardized package should emerge relatively quickly that the institution could use in proxy contests without a control motive. Institutional investors need to become facile with the e-proxy model (including coordinating a practice for opting-in to web-access) and should appreciate the extent to which proxy advisory services will do much of the actual solicitation work. If institutions are unwilling to make the relatively modest investment to master the mechanics of e-proxy contest, both in their initiation as well as voting in support of them, then their role in corporate governance will necessarily be limited.

---

Keywords: corporate governance, institutional investor, proxy contests, shareholders, directors, corporate reform, Securities Exchange Commission, e-proxy

JEL Classifications: D70, G30, G34, G38, K22, M14

Jeffrey N. Gordon  
Columbia Law School  
435 West 116th Street  
Ctr. for Law and Economic Studies  
New York, NY 10027  
United States  
phone: 212-854-2316, fax: 212-854-7946  
e-mail: [jgordon@law.columbia.edu](mailto:jgordon@law.columbia.edu)

|  |     |
|--|-----|
| I. SHAREHOLDER ACCESS TO THE ISSUER'S PROXY STATEMENT: A<br>BRIEF ACCOUNT.....               | 104 |
| II. OUR REGULATORY MOMENT .....  | 106 |
| III. E-PROXY AS A SUBSTITUTE FOR SHAREHOLDER ACCESS TO THE<br>ISSUER PROXY'S STATEMENT ..... | 112 |
| IV. THE DISCLOSURE DILEMMA.....  | 117 |
| V. CONCLUSION .....  | 120 |

The current debate over shareholder access to the issuer's proxy statement for the purpose of making director nominations is both overstated in its importance and misses the serious issue in question. The Securities and Exchange Commission's ("SEC's") new e-proxy rules, which permit reliance on proxy materials posted on a website, should substantially reduce the production and distribution cost differences between a meaningful contest waged via the issuer's proxy and a freestanding proxy solicitation. No matter which avenue is used, the serious question relates to the appropriate disclosure required of a shareholder nominator. Should the nominator be subject to the broad-ranging disclosure requirements now associated with the freestanding contest? Or should there be curtailed disclosure for a nominator (who disavows control motives) of a limited number of directors whose election will not change control? The inescapable costs lie in disclosure, not so much because of the drafting costs, but because of the liability standard associated with the current proxy solicitation rules. A party may be subject to a private suit for material misstatements or omissions in connection with a solicitation even without a showing of scienter. Disclosure under such a regime entails not only the up-front costs of precaution, but also the uncertain (and potentially high) costs of litigation. These costs—not the production, distribution, or other solicitation costs in an e-proxy-eligible world—will constrain director nominations made by a “good governance” activist without a large stake or a control motive. The current regulatory round associated with the SEC's side-stepping of the

Second Circuit's proxy access opinion in *AFSCME v. AIG*<sup>1</sup> is a sideshow, diverting attention from this important issue.<sup>2</sup>

Part I of this Essay briefly describes what shareholder access to the issuer's proxy statement entails. Part II summarizes how we have come to the present regulatory moment. Part III describes the e-proxy rules that should lead us to refocus the debate. Part IV sets up the key question: what is the appropriate disclosure (in content and liability risk) to require of a shareholder nominator? One obvious possible distinction is between nominators with and without control motives; another is between cases in which the election of shareholder nominees would or would not shift control of the board.

Packaged into the disclosure question are concerns about the rising influence of institutional investors and the newly fashionable issue of "agency capitalism," which focuses on the distinctive motives and incentives of the agents for these institutions.<sup>3</sup> The longstanding tradition in U.S. corporate law is that a shareholder "may vote as he pleases,"<sup>4</sup> subject to a set of constraints on controlling shareholders who use the corporate machinery for self-dealing or other potentially improper purposes.<sup>5</sup> This view was sustained over a long mid-twentieth century period, during which shareholder voting (outside of a contest for control) diminished in significance in favor of managerialist governance constrained (if at all) by control markets. This move to managerialism was, in important part, the result of increasingly diffuse share ownership, for which the free-rider and

---

1. 462 F.3d 121 (2d Cir. 2006).

2. The SEC recently resolved the matter, at least temporarily, by deciding to "codify" what it regarded as its "longstanding interpretation" of the applicable rules to permit exclusion of shareholder proposals purporting to grant issuer proxy access to nominate directors. Press Release, Sec. & Exch. Comm'n, SEC Votes to Codify Longstanding Policy on Shareholder Proposals on Election Procedures (Nov. 28, 2007), available at <http://www.sec.gov/news/press/2007/2007-246.htm>; see Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914, Investment Company Act Release No. 28,075, 72 Fed. Reg. 70,450 (Dec. 11, 2007) (effective Jan. 11, 2008).

3. See Ronald J. Gilson, *Leo Strine's Third Way: Responding to Agency Capitalism*, 33 J. CORP. L. 47, 52 (2007); Alex J. Pollock, *Will the Real Shareholders Please Stand Up? Principals and Agents in the Sarbanes-Oxley Era*, FIN. SERVICES OUTLOOK, July 19, 2007, [http://www.aei.org/publications/pubID.26512/pub\\_detail.asp](http://www.aei.org/publications/pubID.26512/pub_detail.asp) ("Under this system of agency capitalism, the ultimate principals—the real shareholders providing money at risk—have a lot of agents, capital market managers as well as corporate managers, all of whom they pay, directly or indirectly, and all of whom present principal-agent issues.")

4. Earl Sneed, *The Stockholder May Vote as He Pleases: Theory and Fact*, 22 U. PITT. L. REV. 23 (1960).

5. *E.g.*, *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 937 (Del. 2003) (Subjecting a controlling shareholder to fiduciary duty constraints in entering into a voting agreement where the disposition of control could be effected only through corporate action—here, a merger—rather than through sale of stock (because of transfer restrictions on super-voting shares)).

other collective action problems provoked “exit” rather than “voice” by the disgruntled shareholder.<sup>6</sup>

But with the rise of institutional investors, the diffusion of stock ownership has reversed course. The Berle-Means corporation of the twenty-first century exhibits the traditional separation of ownership from control, in that the owners still play no role in management.<sup>7</sup> But that separation has taken on a new form: instead of millions of dispersed retail investors, we have hundreds (perhaps thousands) of institutional investors who serve as financial intermediaries. The ability of these institutional actors to coordinate shareholder action at much lower cost changes the collective action equation and rejuvenates a shareholder activism that depends on voting as a credible mechanism for shareholder influence, even outside of a control contest. At the risk of some overstatement, shareholder voting now matters for the large U.S. public firm in ways it has not for seventy-five years. Accordingly, the ramshackle voting system itself needs reengineering.<sup>8</sup> But are we also in need of a new law of “shareholder duties” to offset potential pathologies? Perhaps a new set of disclosure obligations? More narrowly, in the director nomination context, should we be content with disclosure whose principal touchstone is control? And outside of contests for control, should we compel disclosure about the motives, objectives, and competence of the various actors?

Part V concludes with some advice to institutional investor activists. In particular, I suggest that preoccupation with access to the issuer proxy has been a diversion from the development of more effective shareholder activism. The e-proxy rules as now drafted permit low-cost waging of a proxy contest. Do not mourn the non-adoption of the SEC’s proxy access proposal. Celebrate it, for it well might have *raised* the cost to activist institutions of waging a proxy contest because it suggested that disclosures relevant to “agency capitalism” were necessarily material even in the case of an independent proxy solicitation. Shareholder activists should devote

---

6. See ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY: RESPONSE TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES 46 (1970) (“[A]ny resort to voice rather than to exit [is] unthinkable for any but the most committed stockholder.”).

7. See ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4 (1933) (noting the rise of the “quasi-public corporation: a corporation in which a large measure of separation of ownership and control has taken place through the multiplication of owners”). The text draws from John Armour & Jeffrey N. Gordon, *The Berle-Means Corporation of the 21<sup>st</sup> Century* (work-in-progress on file with author).

8. See Marcel Kahan & Edward B. Rock, *The Hanging Chads of Corporate Voting* 15-32 (Univ. of Pa., Inst. for Law & Econ. Research Paper No. 07-18, 2007), available at <http://ssrn.com/abstract=1007065>.

energy to working through the practical mechanics of undertaking e-proxy contests. Instead of “just vote no,” the next step should be “short slate” proxy contests via e-proxy: “Just vote for Joe [or someone].” First best choice for most institutional shareholders would be to work with an independent nominating committee, particularly where board changes seem appropriate. But to induce a fruitful negotiating climate, institutional investors need to make a short slate campaign a credible alternative.

The most significant e-proxy costs are the potential litigation and liability risks associated with allegedly faulty disclosure. But under the rules that are likely to emerge, those disclosure costs will not be much lower (if at all) in the case of a proxy contest run through the issuer’s proxy statement. Moreover, in many cases the issuer will contend that relevant material is materially misleading and will refuse to include it in the proxy statement, which will lead to protracted litigation in any event. Access to the issuer’s proxy statement (and the issuer’s proxy card) has symbolic value, but if the institutional investors, who collectively are majority stockholders in many firms, cannot figure out how to send in the contestant’s pink card rather than the issuer’s blue card (figuratively speaking), then shareholder activism is not ready for prime time.

#### I. SHAREHOLDER ACCESS TO THE ISSUER’S PROXY STATEMENT: A BRIEF ACCOUNT

The annual shareholders’ meeting is the governance crucible of the large public firm. Given the large number of shareholders in most public corporations, it is infeasible for the shareholders to assemble in a physical space; yet the validity of a vote depends on a large turnout, if only to satisfy quorum requirements. The practical solution is the corporation’s solicitation of proxies that designate corporate agents to vote on a shareholder’s behalf. The proxy solicitation process has become a kind of absentee voting system that gives shareholders the right to change their vote until the polls close on election day. The SEC’s use of its broad regulatory authority over the proxy solicitation process, granted by the 1934 Securities Exchange Act,<sup>9</sup> has had a major impact on U.S. corporate governance.<sup>10</sup> As demonstrated by the

---

9. 15 U.S.C. § 78n (2000).

10. For good discussions of the proxy process in American corporate governance on which some of the following discussion relies, see JESSE CHOPER ET AL., *CASES AND MATERIALS ON CORPORATIONS* (6th ed. 2004), MELVIN ARON EISENBERG, *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS* (10th ed. 2006), and 4 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION 1916-83* (3d ed. 1990).

new Compensation Discussion and Analysis requirement, the SEC has used its power to determine what information is material to the shareholder's proxy grant decision in order to serve the Commission's broad corporate governance objectives.<sup>11</sup> In addition to disclosure of issuer-specific information, the SEC has determined that the issuer's proxy statement must contain information about certain upcoming shareholder proposals. In particular, the issuer's proxy card must identify any qualifying shareholder proposal and must provide shareholders with an opportunity to vote on it.<sup>12</sup>

A shareholder may undertake an independent proxy solicitation on behalf of any matter to be voted on at the annual meeting, but access to the issuer's proxy statement is nevertheless highly prized. Through this access, shareholder proponents can avoid the costs of producing and distributing an independent proxy statement. Under SEC rules they also can avoid the disclosure obligations of a party who is formally soliciting proxies.<sup>13</sup> Moreover, the ownership requirements to make a shareholder proposal on the issuer's proxy statement are low—in some cases as little as \$2000 in shares held for one year.<sup>14</sup> Simply put, most shareholder proposals that find their way into the issuer's proxy statement would not be made otherwise.

Two groups have made extensive use of shareholder access to the issuer's proxy statement: corporate social responsibility ("CSR") activists and corporate governance activists. Since the 1970s, CSR activists have presented proposals on a wide range of public policy issues that corporate actions affect, including matters as diverse as apartheid in South Africa and global climate change. Since the 1980s, corporate governance activists have presented proposals relating to a wide range of internal governance issues, including board structure (e.g., classification), takeover defensive tactics (e.g., the "poison pill"), executive compensation (e.g., "golden parachutes"), and the vote required for director election (majority vs. plurality). Shareholder proposals have become so much a part of the customary practice in

---

11. See Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, Exchange Act Release No. 54,302A, Investment Company Act Release No. 27,444A, 71 Fed. Reg. 53,158 (Sept. 8, 2006) (mandating detailed compensation disclosure, especially about often "camouflaged" components, that would allow shareholders to evaluate compensation levels and board process).

12. See Rule 14a-4, 17 C.F.R. § 240.14a-4(a), (b)(1), (e) (2007) (specifying the form and content of a proxy statement); Rule 14a-101, 17 C.F.R. § 240.14a-101 (providing a sample proxy card). The proxy card need not include proposals that may be excluded from the issuer proxy.

13. Rule 14a-2, 17 C.F.R. § 240.14a-2(b)(1).

14. Rule 14a-8, 17 C.F.R. § 240.14a-8(b).

U.S. corporate governance as to create a market niche for governance service intermediaries, most notably Institutional Shareholder Services (“ISS”), which provide analysis, advice, and mechanical assistance in proxy voting.<sup>15</sup>

The terms and conditions of access to the issuer’s proxy statement have been a major corporate governance battleground for several decades. Picking up the general allocation of powers between shareholders and management in corporate law, the SEC permits an issuer to exclude a proposal if it “deals with a matter relating to the company’s ordinary business operations.”<sup>16</sup> Moreover, the SEC access rule forces most proposals to be framed as recommendations for corporate action—as “precatory” rather than obligatory. Thus, even a proposal approved by a majority of shareholders is typically not self-executing. Nevertheless, ballot access has been a potent mechanism in the hands of CSR and corporate governance activists. This is because management is often eager to avoid the publicity associated with the proponent’s campaign, which reaches not only other shareholders but also consumers (particularly important in CSR campaigns), legislators, and regulators. Management particularly may want to avoid the embarrassment of rejecting a recommendation that has substantial—or majority—shareholder support. Being visibly at odds with shareholders is never a good thing. Thus proxy access often opens the way to a negotiated settlement with the shareholder proponent on CSR and governance issues. The desirability of the agenda influence provided by proxy access and the meaningfulness of the negotiated concessions have been hotly debated.

## II. OUR REGULATORY MOMENT

The current regulatory debate is over shareholder access to the issuer proxy (and proxy card) in connection with the nomination of directors. One “red line” that the SEC has maintained throughout various formulations of the access conditions has been that the shareholder proposal cannot relate to a particular election of directors. Justifications for this constraint have varied over time, but the effect has been to rule out a low cost mechanism for a shareholder insurgent to reach fellow shareholders in a director election. The SEC rule is

---

15. For a description of the range of services, see the ISS website, ISS Governance Services, <http://www.issproxy.com/issgovernance.html> (last visited Feb. 1, 2008). ISS produces annual reports that summarize the year’s important proxy issues, including the degree of shareholder support, which are available at the ISS Governance Bookstore, <http://www.issproxy.com/bookstore/index.html> (last visited Feb. 1, 2008).

16. Rule 14a-8, 17 C.F.R. § 240.14a-8(i)(7).

thus in synch with the standard state law rules that produce reimbursement only if the insurgent wins control of the board; together these rules maintain a high cost barrier to waging a proxy contest. Critics would say that the state law rule is classic incumbent entrenchment, providing evidence that jurisdictional competition for incorporations is geared toward appealing to managerial interests. On this view, the SEC's position flows from similar managerial pressure, albeit applied in a different rulemaking venue. Defenders of the SEC's position would see the constraint as appreciating the potential disruption from an ever-present threat of a director election contest, and thus as legitimately avoiding a low cost workaround of the desirable barriers erected by state reimbursement rules. In its recent public pronouncements, the SEC has articulated a narrower policy claim, asserting that the constraint is necessary to assure that a nominator could not evade the disclosure requirements that are appropriate in an election contest.<sup>17</sup>

Over the past fifteen years corporate governance activists have paid increasing attention to the election of directors. Joe Grundfest's 1993 article, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*,<sup>18</sup> was an important intervention. Writing in the wake of judicial decisions and state statutes that appeared to permit management to "just say no" to a hostile bid, Grundfest proposed that institutional investors could signal their dismay with poor corporate performance by withholding their vote for the reelection of directors as a group: in other words, to "just vote no." Grundfest contemplated that this public display of disapproval would be symbolic only, but "[s]ymbols . . . have consequences."<sup>19</sup>

Over time, "just vote no" or "withhold vote" campaigns have become an important feature of the governance landscape. In an important evolutionary twist, the campaigns moved away from omnibus rejection of the entire board to targeted rejection of particular directors. This development was spurred by the governance failures that became apparent in the late 1990s and early 2000s. Governance troubles at the Walt Disney Company provide two instructive examples. Disney shareholders, distressed by the roughly \$100 million

---

17. Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488, 43,490-93 (Aug. 3, 2007) ("The purpose of [Rule 14a-8(i)(8)] is to prevent the circumvention of other proxy rules that are carefully crafted to ensure that investors receive adequate disclosure and an opportunity to make informed voting decisions in election contests.").

18. 45 STAN. L. REV. 857 (1993). The article is based on a proposal that Professor Grundfest first made to the Council of Institutional Investors in November 1990. *Id.* at 866 n.32.

19. *Id.* at 866.

severance payment received by short-time president Michael Ovitz, could “just vote no” against the members of the compensation committee. Shareholders who thought Disney’s flagging performance showed the declining effectiveness of long-time CEO Michael Eisner could also vote “no” on his reelection to the board. Shortly after receiving a substantial fraction of negative votes, Eisner did indeed depart.<sup>20</sup>

Similarly, following the wave of financial restatements that came after Enron-related reforms, angry shareholders turned on audit committee members who either had failed to oversee the audit process adequately or failed otherwise in their disclosure monitoring duties.<sup>21</sup> Specific audit committee members became the target of withhold vote campaigns. These targeted campaigns had more sting because of their *ad hominem* character; they could inflict reputational harm on the director in question. Withhold vote campaigns were also used to promote general corporate governance standards.<sup>22</sup> For example, an institutional investor might withhold its vote for a director who served on more boards than the institution believed consistent with good governance.

The limits of targeted withhold vote campaigns produced the next election-related governance reform. Under the charter or bylaw provisions of the typical firm, election of a director required only a plurality vote. As long as a quorum was present, a simple majority of those voting “for” or “against” was sufficient to elect a director, even if a large fraction of shareholders withheld its vote. Because these directors were not formally defeated, they could set aside the embarrassment of shareholder disapprobation and take their seats on the board. This led governance activists to push firms to adopt voting rules that required majority support (not just plurality) for director election. So, to provide a simple example, if one hundred shares were present and voting at the meeting, a withhold vote of fifty-one percent would defeat a candidate’s election. Some large public firms complied

---

20. Laura M. Holson & Geraldine Fabrikant, *Disney Chief to Leave, Setting Off Race for Job*, N.Y. TIMES, Sept. 11, 2004, at A1.

21. See Suraj Srinivasan, *Consequences of Financial Reporting Failure for Outside Directors: Evidence from Accounting Restatements*, 43 J. ACCT. RES. 291, 331 (2005) (“[F]or severe restatements the likelihood of departure is higher for audit committee members, who have direct responsibility for overseeing the financial reporting process, than for non-audit committee directors.”).

22. Descriptive evidence of the effects of withhold vote campaigns is provided by Diane Del Guercio et al., *Do Boards Pay Attention when Institutional Investors ‘Just Vote No’?: CEO and Director Turnover Associated with Shareholder Activism 13-32* (June 2006) (unpublished manuscript, on file with Vanderbilt Law Review), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=575242](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=575242).

with this request, formally changing their voting rules. Other firms adopted a variant, in which the failure to obtain majority support would oblige a director to tender a resignation. The board could then decide whether to accept the resignation.<sup>23</sup>

By the early 2000s, withhold vote campaigns—although by now an accepted governance tool—increasingly appeared too anemic a countermeasure for the governance abuses that seemed to unravel daily in the business press.<sup>24</sup> Even if a withhold vote campaign might force out particular directors, it could not install their successors. Governance activists (particularly institutional investors) wanted shareholders to have more power over director nominations as a way of ensuring the election of a group of directors who would be independent from management. Their goal was not a board majority; the institutions did not have a control motive. Yet the only available route, a regular proxy contest, was unpromising because of cost and free rider problems. A prior SEC reform adopted in 1992 to facilitate institutional investor nominations was commonly regarded as ineffective. Although a contestant could make a solicitation that filled out a “short slate” of its nominees with management’s nominees (even without the consent of those nominees),<sup>25</sup> the contestant’s solicitation was otherwise subject to the standard rules.

In response to the building sense of a governance crisis, the SEC in 2003 tabled a proposal designed to facilitate institutional voice

---

23. For a useful summary of the issue, see Council on Institutional Investors, *Majority Voting Primer: Making Shareowners' Votes Count: Majority Voting in Director Elections* (Feb. 27, 2006), <http://www.cii.org/policies/MajorityVotingPrimer.pdf>. See also CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS (2007), [http://www.ngelaw.com/files/upload/majority\\_callen\\_020707.pdf](http://www.ngelaw.com/files/upload/majority_callen_020707.pdf) (finding that as of February 2007 approximately 50% of the S&P 500 firms had adopted a majority vote policy, bylaw, and/or charter amendment, although only 40% made majority vote an absolute requirement for director election). For discussion of a recent amendment to Delaware corporate law that enables shareholders to adopt bylaw amendments relating to majority voting that cannot, in turn, be diluted by the board, see J.W. Verret, *Pandora's Ballot Box, or a Proxy with Moxie? Majority Voting, Corporate Ballot Access, and the Legend of Martin Lipton Re-Examined*, 62 BUS. LAW. 1007 (2007).

24. The evidence in Del Guercio et al., *supra* note 22 (manuscript at 27), finds that focused “vote no” campaigns are “effective in both pressuring the board to act and underperforming directors to resign,” suggesting that “withhold vote” campaigns may be more successful at forcing director turnover than institutional investors fully appreciated.

25. See Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, Investment Company Act Release No. 19,031, 57 Fed. Reg. 48,276 (Oct. 22, 1992) (amending Rule 14a-4(d), 17 C.F.R. § 240.14a-4(d), “to allow shareholders who seek minority representation on the board of directors to seek proxy authority to vote for one or more of management’s nominees, so long as the names of non-consenting nominees do not appear on the dissident’s form of proxy or in the dissident’s proxy statement”).

in the nomination of directors.<sup>26</sup> In a nutshell, the proposal would have given a five percent shareholder (or group) a right of “direct access” to the issuer proxy statement to make director nominations. This right was quite constrained, however. First, the access right was conditioned on certain “triggering events”—either a large (greater than thirty-five percent) withhold vote for a director nominee in the year immediately preceding the nomination, or majority shareholder approval of a direct access proposal made by a significant (greater than one percent) shareholder in a prior year. Second, direct access would be limited to longtime holders (more than one year) without a control motive. Third, the maximum number of nominees ranged from one (for a board of no more than eight) to three (for a board of at least twenty).

The proposal stirred intense debate.<sup>27</sup> Proponents saw the SEC’s proposal as a modest effort to inject director independence and accountability into the corporate governance system by empowering a class of long-term stakeholders in U.S. public equity markets. Opponents saw the proposal as SEC meddling in corporate governance that would have an unpredictable—and likely deleterious—effect on the efficient functioning of U.S. public firms and, thus, the U.S. economy. A divided SEC did not adopt the proposal, and it ultimately faded away despite never being formally withdrawn. After the 2004 election, when Chairman Cox replaced Chairman Donaldson, the proposal was taken off the table.<sup>28</sup>

The countermove by corporate governance activists was to look to self-help, pursuing shareholder adoption of bylaws that would open the issuer’s proxy to director nominations by shareholders—that is, direct access via bylaw amendment rather than by SEC rule.<sup>29</sup> The

---

26. See Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,784, 60,785 (Oct. 23, 2003) (“In the broad proxy revisions adopted in 1992, the Commission briefly revisited the security holder nominee issue . . . . [T]he Commission noted ‘the difficulty experienced by shareholders in gaining a voice in determining the composition of the board of directors . . . .’”).

27. For a sample, see *Symposium on Corporate Elections*, 59 Bus. Law. 43 (2003). Comment letters received by the SEC are posted at U.S. Securities and Exchange Commission, Comments on Proposed Rule: Security Holder Director Nominations, <http://www.sec.gov/rules/proposed/s71903.shtml> (last visited Feb. 1, 2008) and summarized at U.S. Securities and Exchange Commission, Summary of Comments, <http://www.sec.gov/rules/extra/s71903summary.htm> (last visited Feb. 1, 2008) and Div. of Corporate Fin., Supplemental Summary of Comments Received On or After February 6, 2004 (May 25, 2004), <http://www.sec.gov/rules/extra/s71903suppsumm.pdf>.

28. This is apparent from the 2007 issuer proxy access proposals discussed below, see *infra* text accompanying notes 36-44, which refer to the 2003 proposal but go off in different directions.

29. Shareholders ordinarily have concurrent power with the board to amend the corporation’s bylaws. *E.g.*, DEL. CODE ANN. tit. 8, §109 (2001). What happens if the board, in

*AFSCME v. AIG* litigation arose out of such a campaign. AFSCME, a public employees' union and established corporate governance activist, offered such an amendment for inclusion in AIG's proxy, pursuant to Rule 14a-8.<sup>30</sup> AIG sought SEC staff blessing to exclude the proposal, contending that the proposal fell within a provision that permits the exclusion of a proposal that "relates to an election for membership on the company's board of directors or analogous governing body."<sup>31</sup> AFSCME argued that its proposal was just a bylaw amendment—a governance change that did not relate to "an election" (meaning a *particular* election), unlike the nomination of an opposing director candidate. The SEC, joining AIG's cause through an amicus brief, argued that the exclusion meant to cover a shareholder proposal that "would result in contested elections."<sup>32</sup> After conducting a detailed review of the administrative history of the exclusionary language, the Second Circuit decided that the SEC's position conflicted with the Commission's 1976 adopting release, which had targeted *particular* elections, not election reform proposals like AFSCME's, which "would establish the procedural rules governing elections generally."<sup>33</sup>

The decision could have "opened the floodgates" to direct access to the issuer proxy for shareholder nominations on terms much broader than the failed 2003 SEC proposal.<sup>34</sup> Subject to shareholder approval, of course, the nominator ownership threshold might well be set lower than the five percent figure in the SEC's 2003 proposal, and the number of possible nominations would not necessarily be capped. Note how the process would work. In year one, assume that shareholders adopt a direct access bylaw. In year two, the issuer is *obliged*, per the bylaw, to include the shareholder nominations in its proxy statement. The exclusionary provisions of Rule 14a-8 are, after all, permissive: an issuer always can choose to include a proposal that

---

turn, amends the bylaws so as to undermine the shareholder initiative, a "battle of bylaw amendments," is not yet resolved. See Jeffrey N. Gordon, "*Just Say Never?*" *Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaw Amendments: An Essay for Warren Buffett*, 19 CARDOZO L. REV. 511, 550 n.150 (1997).

30. Am. Fed'n of State, County & Mun. Employees (AFSCME) v. Am. Int'l Group, Inc., 462 F.3d 121, 123-24 (2d Cir. 2006) (citing Rule 14a-8, 17 C.F.R. § 240.14a-8 (2007)).

31. *Id.* at 124 (citing Rule 14a-8(i)(8), 17 C.F.R. § 240.14a-8(i)(8)).

32. *Id.* at 126.

33. *Id.* at 130.

34. See, e.g., GEORGESON, 2006 ANNUAL CORPORATE GOVERNANCE REVIEW 2 (2006), [http://www.georgeson.com/usa/download/news/2006\\_ACGR\\_FINAL.pdf](http://www.georgeson.com/usa/download/news/2006_ACGR_FINAL.pdf) ("[A] recent court ruling is expected to open the floodgates in 2007 for shareholder proposals that would request boards of target companies to adopt proxy access for shareholders.").

it otherwise could exclude.<sup>35</sup> The bylaw would establish as a matter of corporate policy that proposals should be included.

The court made it clear, however, that it was not taking sides in the policy debate and that the SEC was free to amend or to clarify the rule through appropriate administrative action.<sup>36</sup> The SEC immediately faced conflicting pressure from both management and institutional investors. After nearly a year's cogitation, the SEC offered two proposals. The first followed the Second Circuit's invitation to adopt its preferred interpretation of the Rule 14a-8 election exclusion via reasoned administrative action.<sup>37</sup> The second would have permitted a five percent shareholder (or group) without a control motive to propose a proxy access bylaw similar to the AFSCME proposal. If shareholders adopted the bylaw, similar proponents would be permitted to nominate director candidates through the issuer's proxy.<sup>38</sup> As discussed below, the proposal would have required rather extraordinary disclosure from both the proponent of the election reform and the actual shareholder nominator. For this reason, the activist investor community and the business community rejected the direct access proposal. Instead, a divided SEC adopted the proposal that purported to codify its "longstanding policy" that blocked the Rule 14a-8 route to issuer proxy access.<sup>39</sup> Chairman Cox defended the action as merely "maintain[ing] the status quo of the past decade," while gamely promising "to move forward and re-open the discussion in 2008."<sup>40</sup> The encroaching political season makes the necessary consensus an unlikely prospect. Thus, it could be that possible entrée to the issuer's proxy statement for shareholder nominations raised by the 2003 proposal will be precluded by the 2007 determinations.

### III. E-PROXY AS A SUBSTITUTE FOR SHAREHOLDER ACCESS TO THE

---

35. See *AFSCME*, 462 F.3d at 130 n.9 ("Even if proxy access bylaw proposals were excludable under Rule 14a-8(i)(8), a company could nevertheless decide to include the proposal in its proxy statement . . .").

36. *Id.* at 130 n.9, 131.

37. Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488, 43,491 (Aug. 3, 2007).

38. Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466, 43,472 (Aug. 3, 2007).

39. Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914, Investment Company Act Release No. 28,075, 72 Fed. Reg. 70,450 (Dec. 11, 2007); Press Release, Sec. & Exch. Comm'n, *supra* note 2. Subsequent to *AFSCME v. AIG*, a unanimous Supreme Court reversed another Second Circuit case that had held an administrative agency to a prior interpretation of its rules. *Long Island Care at Home, Ltd. v. Coke*, 127 S. Ct. 2339 (2007). This makes it more likely that other circuits, including the Second Circuit itself, would refuse to follow *AFSCME v. AIG* in a subsequent case.

40. Press Release, Sec. & Exch. Comm'n, *supra* note 2.

## ISSUER'S PROXY STATEMENT

If the window to the issuer's proxy statement is slammed shut, does it matter? The answer, after the recent adoption of so-called "e-proxy rules" that permit an insurgent to post materials for internet access, is "not so much."

Effective as of the 2008 proxy season, the SEC has adopted rules that require issuers to post all proxy materials on a public website (in addition to the standard EDGAR postings on the SEC's site) and to provide shareholders with the option of "paper delivery" or "notice and access."<sup>41</sup> In terms of mechanics, the issuer sends a notice to all shareholders informing them of the availability of the web-posted proxy materials and of their right to receive a paper copy (via a request by mail, phone, email, or a web form). The notice must also give shareholders the opportunity to opt permanently into paper delivery. Web posting of proxy materials via the notice and access model must include a means to vote, which can be either a downloadable proxy card or direct electronic voting. The paper delivery model looks very much like the traditional proxy solicitation.<sup>42</sup>

A "soliciting person other than the issuer"—such as a shareholder nominator—also must comply with the notice and access model.<sup>43</sup> The model gives the nominator the flexibility to solicit some shareholders via notice and access and others via paper delivery.<sup>44</sup> One crucial difference is that the shareholder nominator, unlike the issuer, is not obliged to solicit *every* shareholder; the nominator need not supply a proxy statement to shareholders not being solicited. For example, the nominator "can choose to send Notices only to those shareholders who have not previously requested paper copies."<sup>45</sup> This

---

41. Shareholder Choice Regarding Proxy Materials, Exchange Act Release No. 56,135, Investment Company Act Release No. 27,911, 72 Fed. Reg. 42,222 (Aug. 1, 2007). Large public issuers (i.e., those with a public float of at least \$700 million who otherwise qualify as "accelerated filers") are subject to the rules for the 2008 season. Coverage for all other public companies begins in the 2009 season. *Id.* at 42,223 n.17. The rules replace a recently adopted program in which issuers could voluntarily opt into a regime that would give shareholders a choice of whether to receive proxy materials in paper form or electronically. Rule 14a-16, 17 C.F.R. § 240.14a-16(a)(1) (2007) (effective Jan. 1, 2008).

42. The principle difference is that the shareholder has opted into a paper delivery solicitation regime after having received a notice about the web-based alternative.

43. This account is based on the SEC release, Shareholder Choice Regarding Proxy Materials, 72 Fed. Reg. at 42,227-28.

44. The prior regime permitted solicitation of specific institutional investors—by paper—without undertaking an obligation to print and mail to every shareholder.

45. Shareholder Choice Regarding Proxy Materials, 72 Fed. Reg. at 42,228 & n.88. The footnote refers to the issuer's obligation to send out the notice to the tailored shareholder group

means that the nominator can simply post its proxy materials on a website and limit its solicitees to those for whom solicitation costs are probably low. To reach that group, the nominator's only initial costs are printing and postage for a one page notice. Although the notice must give the shareholder recipient the right to request paper delivery, the shareholder's initial selection of web access for the issuer's materials is likely to carry over to a proxy contest.<sup>46</sup> Additionally, institutional investors, who may generally request paper delivery to minimize their own printing costs, could agree to web delivery for such solicitations as a way to encourage them. A trade association, such as the Council of Institutional Investors, could help to create the practice. Further tailoring could come from a screening process for nominators run through the Council or through a proxy advisory service like ISS.

The avoided printing and mailing costs look substantial. The SEC cites the leading proxy services provider's estimate of average printing and mailing costs of \$5.64 per set of proxy materials in the 2006 proxy season.<sup>47</sup> By contrast, the SEC estimates that printing and mailing a notice costs \$0.42 per solicitee and that the costs of setting up a website are negligible.<sup>48</sup> For a nominator who wants to solicit 1,000 institutional investors via the notice and access method only, this can bring the distribution element of solicitation costs into the \$1,000 range—not much of a budgetary strain for any serious corporate governance activist. In any event, the SEC believes that the “flexibility” of the e-proxy system “ultimately may reduce the cost of engaging in proxy contests, thereby increasing the effectiveness and efficiency of proxy contests as a source of discipline in the corporate governance process.”<sup>49</sup>

---

that has not previously sought paper delivery, if the nominator so chooses, or to supply the tailored mailing list.

46. Under the original e-proxy proposal, such a nominator would have been able to condition a solicitation on the notice recipient opting for web-access, whereas the rule itself requires the nominator to offer paper delivery to anyone who receives the original notice. See Internet Availability of Proxy Materials, Exchange Act Release No. 55,146, Investment Company Act Release No. 27,671, 72 Fed. Reg. 4148, 4158 (Jan. 29, 2007).

47. Shareholder Choice Regarding Proxy Materials, 72 Fed. Reg. at 42,230-31 (estimate by ADP, the leading intermediary, now known as Broadridge Financial Solutions, Inc.).

48. *Id.* at 42,232.

49. *Id.* at 42,231. The SEC hastens to add that this particular rule change will nevertheless “not change significantly the number” of proxy contestants because the preexisting “voluntary” model already permitted use of an access and notice model for them. *Id.* This may be a cute way of deflecting objection that the mandatory e-proxy rule will, by design, lend aid and comfort to shareholder empowerment advocates. Yet one important difference under the mandatory “notice and access” model is that a firm will inevitably identify shareholders who are satisfied with website access only—that is, a pool of low cost solicitees.

So what is the difference to shareholder nominators in losing access to the issuer proxy but having resort to an independent solicitation waged via e-proxy? Is the symbolic difference a substantive one? If the principal consequence, aside from a relatively small cost differential, is only to exclude the gadfly nominator who cannot handle the additional complexity, then the difference cannot count for much, and may even be desirable from a policy perspective. There is, however, also the loss of a side-by-side comparison of the nominator's case (limited to 500 words)<sup>50</sup> and management's response; perhaps more importantly, there is the loss of a proxy card or e-form that shows competing candidates and looks more like a familiar ballot.<sup>51</sup> But realistically, the large firm that typically has been targeted by institutional investor activism will have a high percentage of institutional holders. Many of the institutions will look to ISS or other advisory firms for guidance on how to vote in a contested election. Other significant shareholders, who may rely on internal deliberation, should be able to put competing sets of materials side by side. If large shareholders or their intermediaries cannot manage to fill out and send back the "pink" card rather than the "blue" card or make similar adjustments in e-voting, then shareholder activism still has a long way to go.

One possible response to a "triviality" contention about issuer proxy access focuses on the other costs of free-standing proxy contests—in particular, the costs of drafting a proxy statement that meets the disclosure requirements under Rule 14a-9,<sup>52</sup> given the potential litigation risks of management pushback. By contrast, the only affirmative representation required of a shareholder proponent under 14a-8 concerns its ownership interest in the issuer's stock.<sup>53</sup> But this response rests on a faulty premise: it assumes that a direct access system might evolve in which a nominator could *avoid* a significant disclosure obligation. Why would shareholders vote for such a system? Even the proposed shareholder bylaw controverted in *AFSCME v. AIG* required the nominator to make disclosures that tracked and referenced important elements of a freestanding proxy statement and to assume "all liability of any violation of law or regulation arising out

---

50. Rule 14a-8(d), 17 C.F.R. § 240.14a-8(d) (2007).

51. Shareholder Choice Regarding Proxy Materials, 72 Fed. Reg. at 42,224.

52. 17 C.F.R. § 240.14a-9(a).

53. *Id.* § 240.14a-8(b)(2).

of the Nominator's communications with stockholders, including the Disclosure . . . ."<sup>54</sup>

Moreover, there is no reason to think that, for a shareholder-adopted direct access regime, the SEC would passively rely on an issuer bylaw to assure adequate disclosure. In this regard, the SEC's policy-based defense of the exclusion of the bylaw proposal in *AFSCME v. AIG*—that it could lead to an election contest without adequate disclosure—was disingenuous.<sup>55</sup> It is true that, under the current rules, a shareholder nominator would not have engaged in a “solicitation” merely by presenting a director alternative in the issuer's proxy statement (and on the issuer's proxy card) and thus would have assumed no additional disclosure obligation.<sup>56</sup> The current rules make the issuer the party who solicits the proxy; the nominator just wants to add another name.<sup>57</sup> Indeed, a nominator can engage in significant campaigning on behalf of the nominee without triggering a further disclosure obligation.<sup>58</sup> But the SEC could protect the important policy objective of assuring disclosure appropriate for director elections without constraining shareholder choice over direct access. In the simplest version, it could add a provision to Rule 14a-8 that made a direct access bylaw excludable unless it contained a disclosure undertaking like the proposed resolution in *AFSCME v. AIG*.<sup>59</sup> Alternatively, it could prescribe a form of disclosure that a shareholder nominator would prepare for inclusion in the issuer's proxy statement in the event that shareholders had adopted a direct access bylaw. So the key policy questions are: first, what kind of disclosure is appropriate in the case of a shareholder nomination, and

---

54. *Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc.*, 462 F.3d 121, 124 n.3 (2d Cir. 2006).

55. *Id.* at 130 n.9.

56. *See* 17 C.F.R. § 240.14a-1(l) (defining a solicitation).

57. This is spun out in the SEC's release “codifying” its “longstanding practice.” Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914, Investment Company Act Release No. 28,075, 72 Fed. Reg. 70,450, 70,450-51 (Dec. 11, 2007).

58. In general, efforts to persuade a shareholder to “execute or not to execute” a proxy count act as a “solicitation,” which could lead to a disclosure obligation. 17 C.F.R. § 240.14a-1(l)(1)(ii); *see* Rule 14a-3, 17 C.F.R. § 240.14a-3 (noting an obligation to file a proxy statement prior to making a solicitation). But the nominator publicizing its own voting intentions and its reasons for them would not be a “solicitation.” 17 C.F.R. § 240.14a-1(l)(2)(iv). Moreover, a nominator without a control motive *could* make a solicitation without incurring a disclosure obligation so long as the nominator did not seek “the power to act as proxy.” Rule 14a-2, 17 C.F.R. § 240.14a-2(b)(1).

59. This was pointed out by Commissioner Nazareth in her dissent to the SEC's “codification” rule. Annette L. Nazareth, Comm'r, Sec. & Exch. Comm'n, Speech by SEC Commissioner: Shareholder Proposals Relating to the Election of Directors (Nov. 28, 2007), available at <http://www.sec.gov/news/speech/2007/spch112807aln.htm>.

200x]

*DESKTOP PUBLISHING EXAMPLE*

117

second, should the answer be different for a shareholder using issuer proxy access versus a freestanding proxy contest?

## IV. THE DISCLOSURE DILEMMA

In the case of a shareholder nomination, there are two potential areas for disclosure: disclosure about the director nominee and disclosure about the nominator. That there should be extensive disclosure about the director nominee is not controversial. In its initial release responding to *AFSCME v. AIG*, the SEC described the salient items of nominee disclosure under a freestanding proxy contest as follows:

- Any arrangement or understanding between the nominee and any other person(s) (naming such person(s)) pursuant to which the nominee was or is selected as a nominee;
- Business experience of the nominee;
- Any other directorships held by the nominee in an Exchange Act reporting company;
- The nominee's involvement in certain legal proceedings;
- Certain transactions between the nominee and the company; and
- Whether the nominee complies with independence requirements.<sup>60</sup>

The shareholder resolution in *AFSCME v. AIG* called for disclosure of this information.<sup>61</sup>

A freestanding proxy contest also requires disclosure of certain nominator-specific information. In the same release, the SEC described the salient disclosure items as follows:

- By whom the solicitation is made;
- The methods to be employed to solicit;
- Total expenditures to date and anticipated in connection with the solicitation;
- By whom the cost of the solicitation will be borne;
- Any substantial interest of each participant in the solicitation;

---

60. Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488, 43,490 (Aug. 3, 2007) (footnotes omitted) (describing disclosure required by Schedule 14A, Items 7(a), (b), and (c)).

61. 462 F.3d at 124 n.3. The resolution called for the nominee disclosure required by Schedule 14A, Items 7(a), (b), and (c).

- The name, address, and principal occupation or principal business of each participant;
- Whether any participant has been convicted in a criminal proceeding within the past 10 years;
- The amount of each class of securities of the company owned by the participant and the participant's associates;
- Information concerning purchases and sales of the company's securities by each participant within the past two years;
- Whether any part of the purchase price or market value of each security is represented by fund borrowed;
- Whether a participant is a party to any contract, arrangements, or understandings with any person with respect to securities of the company;
- Certain related party transactions between the participant or its associates and the company;
- Whether the participant or any of its associates have any arrangement or understanding with any person with respect to any future employment with the company or its affiliates, or with respect to any future transactions to which the company or its affiliates will or may be a party; and
- With respect to any person who is a party to an arrangement or understanding pursuant to which a nominee is proposed to be elected, any substantial interest that such person has in any matter to be acted upon at a meeting.<sup>62</sup>

Nominator-specific information is more costly to provide because it offers more fertile ground for the exploration of possible disclosure violations. Extensive disclosure seems appropriate where the nominator may have a control motive—indeed, may solicit on behalf of a full slate of director nominees—and also where the nominator may have a strong economic interest in making good on a substantial investment in the issuer's stock, perhaps as the result of recent accumulation (or through derivative transactions). However, the shareholder resolution in *AFSCME v. AIG* did not call for disclosure of this information.<sup>63</sup>

---

62. Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. at 43,489-90 (footnotes omitted).

63. 462 F.3d at 124 n.3. The only required nominator-specific disclosure for access to the issuer proxy was with respect to the nominator's ownership stake in the issuer. *Id.* My surmise is that the proponents are counting on the proxy rules to block disclosure-free access by a control entrepreneur. Such parties are likely to want to engage in a "solicitation" to increase the chance of a success and will have crossed the five percent ownership threshold that will make them a

What disclosure should be required of a nominator seeking access to the issuer's proxy? One possible set of distinctions might be based on the nominator's disavowal of any control motive. Presumably this would distinguish between nominations by an investor and nominations by a control entrepreneur; it also would distinguish between elections where the nominator presented a "short slate" and those where control necessarily would be at stake because the nominator presented a majority slate. The SEC has tacitly approved this distinction by permitting five percent holders who disavow a control motive to submit a summary filing on a Form 13G rather than on a Form 13D, which has much more extensive shareholder-specific disclosure that is reminiscent of nominator-specific disclosure in a freestanding proxy contest.<sup>64</sup> Indeed, the current proxy rules apparently permit a Form 13G filer to make a "solicitation" without triggering a further disclosure obligation, so long as the filer does not seek "power to act as proxy for a security holder" and does not distribute proxy cards.<sup>65</sup>

It might also be reasonable to gear nominator disclosure to the number of board nominees (relative to board size) to reflect the potential for significant influence short of control. Nomination of one or two directors on a large board by a party without a control motive might reasonably trigger less nominator disclosure than nomination of a larger fraction of the board. Nominator disclosure also needs to take account of newly emerging possibilities for "empty voting" or "hidden voting" made possible by derivatives markets.<sup>66</sup>

As noted above, part of the SEC's response to *AFSCME v. AIG* was to propose a new version of issuer proxy access.<sup>67</sup> Qualifying shareholder proponents could use proxy access to propose a bylaw that would permit access for similarly qualifying proponents to make director nominations in a subsequent year.<sup>68</sup> The eligibility requirements were stiff: five percent share ownership for at least a year and no control motive.<sup>69</sup> Quite remarkable were the proposed disclosure requirements themselves, which appeared to encompass

---

13D filer, and thus subject to a disclosure obligation, if they solicit. See Rule 14a-2, 17 C.F.R. § 240.14a-2(b)(1)(vi) (broadening coverage for 13D filers); *cf. supra* note 58.

64. Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466, 43,472 (Aug. 3, 2007).

65. 17 C.F.R. § 240.14a-2(b)(1)(vi); *see supra* notes 56, 63 and accompanying text.

66. *See generally* Henry T. C. Hu & Bernard S. Black *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 Southern California Law Review 811 (2006).

67. *See supra* text accompanying notes 37-40.

68. Shareholder Proposals, 72 Fed. Reg. at 43,466.

69. *Id.* at 43,472.

matters extending beyond those subject to disclosure in a freestanding proxy contest—including contacts with a proxy advisory firm, detailed history as to when the shareholder formulated plans to make its proposal or nomination, and an account of contacts between the proponent and management (or directors) of the targeted issuer.<sup>70</sup> The proposal also called for extensive disclosure about natural persons who are the agents of shareholder proponents or nominators. This included how such persons are selected (for example, whether by election of the ultimate beneficiaries of the entity), the fiduciary duty of such agents to the beneficiaries, the “qualifications and background of such person or persons relevant to the plan or proposals,” and any interests not shared with other shareholders of the issuer.<sup>71</sup> The proposal would have required specific disclosure about contracts with the issuer, including “any employment agreement, collective bargaining agreement or consulting agreement.”<sup>72</sup>

As noted before, the costs to a proponent (or nominator) directly increase with the expanded scope and detail of disclosure because of heightened liability exposure.<sup>73</sup> Nominee disclosure seems highly relevant to a shareholder decision. Shareholders need to know the background, experience, and possible conflicts of any director candidate. Disclosure tailored to a proponent (or nominator) is much less straightforward. In significant measure such disclosure is premised on the view that the proposed action is less about the actual director election than about a bargaining game between proponent/nominator and the issuer over a side issue, including private interests, unrelated to the optimal governance of the firm. That concern seems attenuated where the proponent/nominator is, by hypothesis, a substantial long term holder without a control motive. It is ironic indeed to insist on more demanding disclosure criteria for access to the issuer proxy statement than in the case of a freestanding proxy contest. Is there any reason not to turn to e-proxy solicitations over a more costly alternative?

## V. CONCLUSION

Some of the implications of this analysis are straightforward. Institutional investors were right to line up en masse against the SEC’s issuer proxy access proposal. It was fools’ gold, and dangerous.

---

70. *Id.*

71. *Id.* at 43,473.

72. *Id.* at 43,472.

73. *See supra* text accompanying notes 3, 54 and 63-64.

The detailed disclosure called for by the SEC proposal was an invitation to litigation. Because some of the required disclosure pertained to the natural persons who control the institutional nominator, they would have faced personal litigation risk.<sup>74</sup> Given that an institution benefits from improved corporate performance only in proportion to its share ownership and the institution's officers hardly at all, the costs to the institutional and individual actors of pursuing or using issuer proxy access on these terms would easily outweigh the benefits. Also dangerous was the possibility that the "agency capitalism" disclosures of issuer proxy access would find their way into disclosure requirements in a freestanding proxy solicitation. This could have happened implicitly, through an expanded conception of "materiality," or through explicit rule changes as management (in particular) noticed the asymmetry between the disclosure regimes.

By contrast, it was no great loss that the SEC closed the door on shareholder bylaw proposals for issuer proxy access. Under any system of issuer proxy access the SEC will surely seek to regulate the disclosure associated with director nominations. To behave otherwise would be arguably inconsistent with the SEC's core mandate under section 14(a) of the 1934 Act. As the SEC's most recent proxy access proposal suggests, the disclosure requirements may be a poison pill. Even the more institutionally friendly SEC access proposals of 2003 were a cumbersome tangle borne of political compromise.<sup>75</sup> Moreover, because of the focus on "long term" investors, both the 2003 and 2007 proxy access proposals excluded by design activist shareholders who might run "short slate" campaigns with more focused economic objectives.<sup>76</sup> Nor does issuer proxy access address many of the longstanding sources of institutional investors' reluctance to nominate directors—for example, the threat of "short swing sale" liability under section 16(b) of the 1934 Securities and Exchange Act because of directors who they may have "deputized."<sup>77</sup>

Instead of investing further energy on issuer proxy access, institutional investors and other shareholder activists should focus on

---

74. See, e.g., Shareholder Proposals, 72 Fed. Reg. at 43,474 (describing personal liability faced by individuals).

75. See *supra* text accompanying notes 26-28.

76. See Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance* (European Corporate Governance Inst., Finance Working Paper No. 139/2006, 2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=948907](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=948907). April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors* (European Corporate Governance Inst., Finance Working Paper No. 140/2006, 2006), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=913362](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=913362).

77. See Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 545-48 (1990).

working through the mechanics of waging short-slate proxy contests using e-proxy solicitations.<sup>78</sup> The Council on Institutional Investors and public interest law firms could play a significant role in this regard. Activist institutions need to prepare the disclosure package required under the existing proxy rules. An institution's disclosure may be tested (and refined) through litigation, but a standardized package that institutions without a control motive could generally use in proxy contests should emerge relatively quickly. Activist institutions need to become adept with the web access model and appreciate the extent to which proxy advisory services will do much of the actual solicitation. It may be that few institutions will have sufficient incentive to make the relatively modest investment to master the mechanics necessary to undertake an e-proxy contest.<sup>79</sup> It also may be that few shareholders will take the trouble to engage with the substance of the proxy contest if it involves going beyond the four corners of the issuer's proxy. If so, the role of institutional investors in corporate governance necessarily will be limited.

Behind the SEC's response to *AFSCME v. AIG* is deep unease over "agency capitalism." We might be more concerned about the motives of agents of institutional investors precisely because those agents do not face high-powered economic incentives. When Carl Icahn makes the solicitation, we understand what he is about and the risks of which shareholders ought to be apprised. Institutional investors in this emerging world of "concentrated diffuse ownership"<sup>80</sup> do not fit the paradigm so easily. Their agents cannot earn enormous salaries or take profits from a successful investment. What exactly will they maximize? Thus begins the tough analysis of the consequences of shareholder empowerment, which seems, to me, inevitable.

---

78. Alternatively, or as a supplement, institutions should also consider waging e-proxy campaigns on behalf of shareholder bylaws that would mandate issuer proxy access, *see supra* text accompanying note 34, but should also appreciate that success will likely induce further (and appropriate) SEC response to protect its disclosure regime. On the other hand, the outcome of the 2008 election could affect any proposal that eventually emerges.

79. *See* Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 60 VAND. L. REV. – (2008) (finding little non-litigation institutional governance activity).

80. *See* Armour & Gordon, *supra* note 8 (describing ownership pattern in which shareholders of diffusely owned firms are typically institutional investors, rather than retail shareholders, such that the coordination costs for shareholder action are much lower).

## about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities*.

The ECGI will produce and disseminate high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It will draw on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

## ECGI Working Paper Series in Law

### Editorial Board

**Editor** Guido Ferrarini, Professor of Law, University of Genova & ECGI

**Consulting Editors**

Theodor Baums, Director of the Institute for Banking Law,  
Johann Wolfgang Goethe University, Frankfurt & ECGI

Paul Davies, Cassel Professor of Commercial Law,  
London School of Economics and Political Science & ECGI

Henry B Hansmann, Augustus E. Lines Professor of Law, Yale  
Law School & ECGI

Klaus J. Hopt, Director, Max Planck Institute for Foreign Private  
and Private International Law & ECGI

Roberta Romano, Allen Duffy/Class of 1960 Professor of Law,  
Yale Law School & ECGI

Eddy Wymeersch, Professor of Commercial Law, University  
of Ghent & ECGI

---

**Editorial Assistant :** Paolo Casini, "G.d'Annunzio" University, Chieti & ECARES,  
Lidia Tsyganok, ECARES, Université Libre De Bruxelles

Financial assistance for the services of the editorial assistant of these series is provided by the European Commission through its RTN Programme on European Corporate Governance Training Network (Contract no. MRTN-CT-2004-504799).

## **Electronic Access to the Working Paper Series**

The full set of ECGI working papers can be accessed through the Institute's Web-site ([www.ecgi.org/wp](http://www.ecgi.org/wp)) or SSRN:

|                             |   |
|-----------------------------|---|
| <b>Finance Paper Series</b> | <a href="http://www.ssrn.com/link/ECGI-Fin.html">http://www.ssrn.com/link/ECGI-Fin.html</a> |
|-----------------------------|---|

|                         |   |
|-------------------------|---|
| <b>Law Paper Series</b> | <a href="http://www.ssrn.com/link/ECGI-Law.html">http://www.ssrn.com/link/ECGI-Law.html</a> |
|-------------------------|---|