LOOK TO YOUR LEFT, LOOK TO YOUR RIGHT: WHY THE SEC SHOULD RESERVE SEATS AT THE BOARDROOM TABLE FOR SHAREHOLDER NOMINEES

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INTRODUCTION

There has been no shortage of scholars, commentators, and government officials that have pushed for shareholder proxy access in corporate director nominations.[1] Despite their ownership rights,[2] shareholders lack representation on a vast majority of boards of directors ("BODs").[3] The shareholder's right to vote for directors is also limited to a slate chosen by sitting directors.[4] Various requirements to fill BODs' seats with a majority of independent directors have not provided adequate protection for shareholder interests and in some cases have even worked against those interests.[5] For unsatisfied shareholders, selling their shares or waging an expensive nominee campaign are the only options.[6] Many thought that access to proxy materials would help, namely to publicize shareholder nominees and apply pressure to mismanaging directors.[7] However, following the vacation of SEC Rule 14a-11 and a flurry of bylaw amendments,[8] the question worth asking now is whether proxy access is the solution. The answer is no.[9] In the middle of a

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1 *See infra* Part II.C (summarizing recent proxy access legislation and bylaw provisions).
2 *See infra* Part III.A (discussing how shareholders ultimately hold the right to nominate).
3 *See infra* Part II.C (discussing how few shareholder-backed nominees hold BOD positions).
4 *See infra* Part II.A (explaining how shareholders elect directors).
5 *See infra* Part II.B and Part II.C (discussing how the increased use of independent directors does not address director entrenchment and how BODs with majority independent directors may be less informed in their decision-making).
6 *See infra* Part I (explaining that shareholders have few options if they are displeased with a BOD's performance).
7 *See infra* Part II.C (summarizing recent proxy access legislation and bylaw provisions).
8 *Id*.
9 *See infra* Part IV.A (arguing for reserved seating on BODs on behalf of shareholder nominees).

sweeping proxy access movement,[10] few shareholder nominees hold a seat at the table,[11] relations between shareholders and BODs are hostile,[12] and the pull to maintain one's BOD seat is detracting from the directors' focus on corporate governance.[13]

The solution instead is an SEC-installed reservation system that allots shareholder nominees a minority of seats on BODs and potentially allots the remaining seats to director-chosen candidates, barring extenuating circumstances.[14] A new norm in the composition of BODs across the United States could create an environment of collaboration among shareholders, directors, and management.[15] A reservation system would offer shareholders reasonable representation and directors reasonable job security.[16] A registry of potential, SEC-vetted shareholder nominees would equip today's sophisticated institutional investors with a tool to contribute quality candidates.[17] This two-pronged initiative would meet shareholder expectations, and at the same time, capitalize on all the benefits of a "hybrid" BOD at the helm.[18]

I. WHAT HAPPENS IN THE KITCHEN: INVENTORYING THE ABCS OF AMERICA'S BODS

Though discussions abound about the proper role and composition of BODs, scholars and practitioners agree that their role is indispensable for operating an ethical, successful corporation. Often scholars state that "[a]n effective board of directors is central to good corporate governance; and good corporate governance, in turn, is central to good corporate performance."[19] The BOD springs from the unique structure of corporations. The basic structure of publicly held corporations

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10 *See infra* Part II.C (summarizing recent proxy access legislation and bylaw provisions).

11 *Id. See* infra Part II.C (discussing how few shareholder-backed nominees hold BOD positions).

12 *See infra* Part IV.A.1 (discussing how proxy access alone strains relations between directors and shareholders).

13 *See infra* Part III (explaining that directors often resist shareholder nominees attempting to join the BOD).

14 *See infra* Part IV (proposing the SEC install a reservation system for director nominations).

15 *See infra* Part IV.A.1 (explaining how a reservation system fosters an environment of collaboration).

16 *Id. See infra* Part IV.A.

17 *See infra* Part III (explaining how the shareholder demographic transitioned from physical persons to institutions).

18 *See infra* Part IV.A (proposing a reservation system for director nominations and showing the benefits of "hybrid" BODs).

19 Patty M. DeGaetano, *The Shareholder Direct Access Teeter-Totter*, 41 CAL. W. L. REV. 361, 375 (2005) (citing Troy A. Paredes, *Enron: The Board, Corporate Governance, and Some Thoughts on the Role of Congress*, in 11 Nancy B. Rapoport & Bala G. Dharan, *Enron: Corporate Fiascos and Their Implications* 495 (2004)).

is divided into two parts: ownership and control.[20] In many businesses, a single executive owns and controls, but control and ownership in corporations are split respectively between a BOD and shareholders.[21] These shareholders, as owners, elect the BOD with hopes it will lead the corporation effectively.[22]

The BOD often wears a number of hats. It directs resources and governs operations through managers who oversee day-to-day functions.[23] Among other responsibilities, the BOD selects and monitors the most senior managers (like the Chief Executive Officer ("CEO")), determines senior management compensation, assists in important decision-making processes, attempts to improve the company's operations, and analyzes prospective business opportunities.[24] Each corporation will decide for itself the extent to which its BOD directs these tasks.[25] In its most pared-down form, the BOD simply ensures that major transactions are the product of fair dealing and pricing.[26] Traditionally, a BOD's main goal is to maximize the value of common stock to reward shareholders for investing in the corporation.[27] The BOD acts as a trustee of the shareholder's shares; barring unethical activities, it is to do whatever is necessary to safeguard shareholder investments.[28] Though

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[20] Aristotle A. Butler, *Shareholder Nomination Restrictions: A Corporate Governance Mystery*, 82 MO. L. REV. 1141, 1147 (2017); Devan Grossblatt, *Boarded In: Counteracting the Consequences of Board Insularity by Legitimizing Director Elections*, 20 FORDHAM J. CORP. & FIN. L. 533, 539–40 (2015) ("This separation of ownership and control is a defining characteristic of the corporation.").

[21] Grossblatt, *supra* note 20, at 539–40.

[22] Butler, *supra* note 20, at 1147; Christopher Takeshi Napier, *Resurrecting Rule 14A-11: A Renewed Call for Federal Proxy Access Reform, Justifications and Suggested Revisions*, 67 RUTGERS U. L. REV. 843, 843 (2015).

[23] Butler, *supra* note 20, at 1147; Napier, *supra* note 22, at 843–44.

[24] DeGaetano, *supra* note 19, at 376; Lucian A. Bebchuk, *The Myth of Shareholder Franchise*, 93 VA. L. REV. 675, 680 (2007) [hereinafter *Shareholder Franchise*].

[25] Grossblatt, *supra* note 20, at 540 ("Investors stipulate their expectations of the board in the charter of incorporation, and state laws typically afford investors broad discretion to define the role of the board.").

[26] J. Robert Brown, Jr., *The Demythification of the Board of Directors*, 52 AM. BUS. L.J. 131, 157–58 (2015). For a discussion that questions the legitimacy of BODs' advisory role, see *id.* at 154.

[27] Grossblatt, *supra* note 20, at 541–42; Thompson v. Walker, 234 N.W. 144, 147 (Mich. 1931) ("It is the essence of this trust [that directors occupy in relation to stockholders] that it shall be so managed as to produce to each stockholder the best possible return for his investment."); Grossblatt, *supra* note 20, at 541–42. For more discussion of the role of shareholder wealth maximization in today's corporate governance, see Joan MacLeod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939 (2017).

[28] Guth v. Loft, Inc., 5 A. 2d 503, 510 (Del. 1939) ("While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders."); Grossblatt, *supra* note 20, at 541–42 ("[T]he corporate board can be conceptualized as a trustee of the corporation's shares, and a shareholder can be viewed as an owner of an alienable interest in the corporation's common stock." 23 Cel. Ch. 255, 270 (Del. 1939) ("While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders."). *Contra* Brian M. McCall, *The Corporation as Imperfect Society*, 36 DEL. J. CORP. L. 509 (2011).

some commentators have recently objected to this central tenet, this goal remains an unwavering expectation of BODs.[29]

In striving to maximize shareholder wealth, BODs generally enjoy broad authority to direct their corporations under state corporate laws (most commonly under Delaware law).[30] As a result, directors are mostly insulated from the consequences of their decisions, and they typically escape personal liability.[31] This privilege extends to election season,[32] during which directors may "entrench" themselves on a BOD.[33] Judicial standards designed to scrutinize directors also remain deferential to BODs.[34] Even so, BODs are subject to fiduciary duties, namely a duty of care and duty of loyalty.[35] The duty of care requires that each director acts under the reasonable belief that he or she is making decisions in the best interest of the corporation.[36] The duty of loyalty requires that each director prioritizes the best interests of the corporation and its shareholders over private interests of any director, officer, or shareholder.[37] Should shareholders disapprove of management or BOD decisions, more often than not, their only two options are to exercise the "Wall Street Rule"[38] by selling their shares or vote to replace the directors.[39]

A. Independent Directors: Saving Seats for A-List Celebrities

In the last several decades, independent directors have become en vogue additions to BODs.[40] Confusion persists, however, about what makes a director

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[29] Grossblatt, *supra* note 20, at 542–544 (citing Gantler v. Stephens, 965 A.2d 695, 706 (Del. 2009) ("[E]nhancing the corporation's long term share value" is a "distinctively corporate concern . . . .")).

[30] *Id.* at 576. Delaware General Corporation Law § 141(a) states that the "business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors." *Id.*

[31] *Id.* at 569–75 ("The Business Judgment Rule, exculpation for duty of care claims, indemnification, and insurance are some mechanisms that protect directors from liability in shareholder litigation.").

[32] *Id.* at 545.

[33] *Id.* at 547–48.

[34] *Id.* at 575–77.

[35] Guth v. Loft, Inc., 5 A. 2d 503, 510 (Del. 1939); Butler, *supra* note 20, at 1148; *Guth*, 23 Cel. Ch. at 270.

[36] *In re* ALH Holdings LLC, 675 F. Supp. 2d 462, 483 (D. Del. 2009).

[37] HCI Inv'rs, LLC v. Fox, 412 S.W.3d 424, 431 (Mo. Ct. App. 2013).

[38] Michael J. Goldberg, *Democracy in the Private Sector: The Rights of Shareholders and Union Members*, 17 U. PA. J. BUS. L. 393, 402 (2015).

[39] Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) ("They may sell their stock (which, if done in sufficient numbers, may so affect security prices as to create an incentive for altered managerial performance,) or they may vote to replace incumbent board members."); Napier, *supra* note 22, at 843–44.

[40] MAX PLANCK INSTITUTE FOR COMPARATIVE AND INTERNATIONAL PRIVATE LAW 2 (2017); Harold Baum, *The Rise of the Independent Director: A Historical and Comparative Perspective*, MAX PLANCK INSTITUTE FOR COMPARATIVE AND INTERNATIONAL PRIVATE LAW 2 (2017). This trend

independent.[41] In corporate law, independence is not a matter of whether a "director derives a benefit from the [disputed] transaction . . . . Rather, it involves an inquiry into whether the director's decision resulted from that director being controlled by another."[42] A director's relationship with a friend or family member, or even a competing business, may influence the director in his or her decision-making.[43] Independence comes down to whether the controller—family, friend, or competitor—has the unilateral power to take away a benefit on which the director depends.[44]

The independent director craze partly stems from the idea that they boost profit in corporations, despite empirical evidence that independence does not improve performance.[45] Stock exchange requirements have also pushed corporations to embrace them as preventative against future scandals like *Enron.*[46] As of the Sarbanes-Oxley Act passed in 2002, the New York Stock Exchange ("NYSE") and National Association of Securities Dealers Automated Quotations System ("NASDAQ") require that listed company BODs maintain a majority of independent directors.[47] By 2004, about 74% of directors serving on BODs in companies with more than $10 billion in revenue were independent.[48] Today, independent directors make up an average 85% of BODs for S&P 500 companies.[49]

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has spread to Asia, where the China Securities Regulatory Commission even issued a requirement that by 2003 at least one-third of directors overseeing a listed company must be independent directors. Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 75 (2007).

41 *See* Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002) (discussing the difference between "independent" directors and directors not "interested" in a particular transaction).

42 *Id.*

43 *Id.*

44 *Id.* By contrast, whether a director can gain unfair benefits from a transaction is a question of "interestedness." *Id.*

45 Clarke, *supra* note 40, at 73–75 ("Independent directors have long been viewed as a solution to many corporate governance problems . . . . [Nonetheless, t]he overall weight of the findings is that there is no solid evidence suggesting that independent directors improve corporate performance."); Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 447, 461–61 (2008).

46 Brown, *supra* note 26, at 131–32; *see* Lewis v. Fuqua, 502 A.2d 962, 966–67 (Del. Ch. 1985). *Contra In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 359 (Del. Ch. 1998).

47 NYSE, NYSE LISTED COMPANY MANUAL § 303A.01 (2018) [hereinafter NYSE MANUAL]; NASDAQ, INC. STOCK MARKETPLACE RULES § 5605 (2019) [hereinafter MARKETPLACE RULES]; Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors*, 5 BERKELEY BUS. L.J. 131, 148 (2008).

48 *Id.*

49 *Board Composition*, EY CENTER FOR BOARD MATTERS, (Mar. 24, 2019), https://www.ey.com/us/en/issues/governance-and-reporting/ey-corporate-governance-by-the-numbers#boardcomposition (last visited Mar. 24, 2019).

II. NOMINATING AND ELECTING THE BOD: DISHING OUT RIGHTS TO SELECT FUTURE DIRECTORS

While BOD decision-making processes are largely confidential and attempts to remove a director from the BOD are essentially pointless, annual elections have become the best opportunity for shareholders to influence BODs. This annual election process is divided into two stages: nomination and election.[50]

A. Election: A Taste of Shareholder Participation

Shareholder participation is generally limited to electing director candidates through votes, with little input in the nomination of those candidates.[51] The right of shareholders to participate in the election portion is a "sacrosanct" shareholder right and an "[i]nternationally accepted corporate governance principle."[52] To assist in shareholders' voting decisions, and per federal requirements, BODs provide shareholders with proxy materials prior to election containing information related to the director candidates.[53] Shareholders then exercise their right by casting votes for a slate of directors the sitting directors provide.[54]

B. Nomination: A Special Occasion for Incumbent Director Domination

The nomination starkly contrasts the shareholder election vote.[55] Different from electing, nominating is the act of "formally placing the name of a candidate for office before the electorate . . . to elect members of the governing body."[56] The nomination process is absolutely necessary to a well-ordered election.[57] It distills applicants qualified for election, lowers transactional costs, and restricts an otherwise fire hose of information disseminated to voters.[58] The main purpose of nominations is to alert voters of particular applicants, typically in a broadcasted slate, such that the voting base elects those nominees over other potential applicants.[59] The shareholders usually cast their votes on this nominee slate.[60] The

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50 *Id.*; *see infra* Part II.A–B (discussing the director nomination and election process).
51 DeGaetano, *supra* note 19, at 382–83.
52 Butler, *supra* note 20, at 1149–50.
53 Grossblatt, *supra* note 20, at 552–54.
54 *Id.*
55 *See* Butler, *supra* note 20, at 1150 (noting that the right to nominate is "conceptually and chronologically distinct from the right to vote on the election of such candidates").
56 *Id.*
57 Lawrence A. Hamermesh, *Director Nominations*, 39 DEL. J. CORP. L. 117, 130 (2014).
58 *Id.*
59 Butler, *supra* note 20, at 1150.
60 Grossblatt, *supra* note 20, at 552–54.

nomination is the most critical stage in director selection.[61] Compared to the power to nominate, the shareholder power to elect is "widely recognized as meaningless."[62]

Today, the right to nominate generally falls to a nominating committee of sitting directors.[63] Nominating committees, though prominent today, are not part of a long held tradition in director elections.[64] Most companies had no formal procedures for nominating directors until the late 1970s.[65] Under the theory that CEOs needed a team of directors they could work alongside effectively, CEOs often nominated BOD candidates.[66] The nominating committee entered the picture in the late 1970s.[67] In the last 20–25 years, it has become a "bona fide working unit" of BODs.[68] A 2006 Spencer Stuart survey reported that about 99% of S&P 500 companies use a nominating committee,[69] a percentage that remains the same today.[70]

Several rules govern the composition of nominating committees and encourage their use. The NYSE requires that all listed companies establish a nominating committee.[71] Similarly, the NASDAQ requires that all listed companies use nominating committees composed solely of independent directors to select candidates, or a majority of independent directors.[72] Various Securities and Exchange Commission ("SEC") disclosure requirements surrounding the nomination process also push corporations to form nominating committees.[73] Independent directors usually overwhelm them to prevent unfairness in director selection.[74] These independent directors essentially decide who will fill the next term's BOD.[75]

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61 *See* Hamermesh, *supra* note 57, at 117 ("I don't care who does the electing, so long as I get to do the nominating.").

62 Grossblatt, *supra* note 20, at 551.

63 Murphy, *supra* note 47, at 147.

64 *Id.* at 145.

65 *Id.*

66 *Id.* The stock exchanges no longer allow CEOs to vote on nominations. Brown, *supra* note 26, at 184.

67 Murphy, *supra* note 47, at 145.

68 *Id.* at 147.

69 *Id.* (citing *The Changing Profile of Directors,* SPENCER STUART 11 (2006)).

70 SPENCER STUART, 2018 U.S. SPENCER STUART BOARD INDEX, SPENCER STUART 25 (2018), https://www.spencerstuart.com/-/media/2018/october/ssbi_2018.pdf.

71 NYSE MANUAL § 303A.04(a), *supra* note 47.

72 MARKETPLACE RULES § 5605(e)(1), *supra* note 47.

73 CYNTHIA M. KRUS, CORP. SEC. ANSWER BOOK 11:04 (Supp. 2019).

74 *2018* SPENCER STUART, *supra* note 70; *see* Lewis v. Fuqua, 502 A.2d at 962, 966–67 (Del. Ch. 1985) (demonstrating an example of why independence is considered to prevent unfairness).

75 *See, e.g.*, Brown, *supra* note 26, at 140; DeGaetano, *supra* note 19, at 383; Grossblatt, *supra* note 20, at 539–40; DeGaetano, *supra* note 19, at 383.

Shareholders who disagree with a nominating committee's decision may sell their shares or otherwise instigate a proxy contest to recommend competing candidates.[76] Arguably, shareholders could recommend nominees to the committee or request their inclusion in proxy materials, but, according to the Council of Institutional Investors, these suggestions "are rarely given serious consideration."[77] Proxy contests are no better, though, because they are extremely expensive for nominating shareholders;[78] nominating committees use corporate funds to promote their candidates in proxy materials distributed to shareholders, but nominating shareholders must foot the bill to distribute information on competing nominees.[79]

C. SEC Initiatives and Bylaw Amendments: A Menu of Failed Reforms

A rising movement against shareholders' limited participation[80] recently culminated in two SEC reforms for greater shareholder influence in director nominations. One prevailed, and one did not. First, in 2011, the SEC amended Rule 14a-8 ("14a-8") to require that corporations allow shareholders to propose procedural changes to director nominations in the corporation's proxy materials.[81] Prior to the amendment, a corporation could exclude proposals that "relate[d] to elections" under 14a-8(8).[82] Fortunately for shareholders, this amendment has survived.[83]

In the same year, however, the SEC adopted the more groundbreaking Rule 14a-11 ("14a-11") to award shareholders proxy access. Proxy access is "the right of shareholders to nominate directors and to have their nominees included in the company's proxy statement."[84] Under 14a-11, the SEC required corporations give shareholders the same proxy access nominating committees had long enjoyed.[85] Access was restricted, though. A nominating shareholder needed to own at least

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[76] Napier, *supra* note 22, at 844 ("Shareholders initiating a proxy contest may either attempt a 'control contest' or a 'short-slate contest.' In a control contest, the dissident shareholder nominates sufficient directors to constitute a majority, and therefore control, over a company's board. In a short-slate contest, the dissident shareholder nominates only a few or one nominee in order to attempt to influence the existing board members.").

[77] Murphy, *supra* note 47, at 148–49; Brett McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L.J. 205, 211 (2005).

[78] *See infra* Part III.C (describing the costs for shareholders to nominate director candidates).

[79] *Id. See infra* Part III.C.

[80] *See infra* Part III (discussing a widespread increase in shareholder activism).

[81] Napier, *supra* note 22, at 864.

[82] HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, 2 GOING PUBLIC HANDBOOK § 15:36 (2018). Proposals included allowances for shareholders to nominate directors at shareholder meetings. Hamermesh, *supra* note 57, at 148–49.

[83] Napier, *supra* note 22, at 864.

[84] Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1347 (2011).

[85] THOMAS LEE HAZEN, 2 LAW SEC. REG. § 10:18 (2018).

3% of the corporation's securities, have held them for at least three years, and then continue to own them through the end of elections.[86] The SEC required corporations guarantee proxy access for a number of nominees equal to at least 25% of a given BOD.[87] With this rule, the SEC intended to benefit shareholders with substantial, long-term investments.[88] Shortly after its adoption, however, the D.C. Circuit Court of Appeals invalidated 14a-11 for failure to analyze adequately its economic impact on industry.[89]

Nonetheless, the movement for shareholder proxy access has been successful through use of bylaws. The most common shareholder proposal in 2016 called for proxy access,[90] and, as of 2019, about two-thirds of S&P 500 companies provide it.[91] Shareholder proposals for proxy access continue to pour into boardrooms.[92] These bylaw amendments, however, have come up short—these provisions *rarely* see any action.[93] With only two attempts at proxy access, "proxy access has never [actually] been used in the U.S.,"[94] partly because these bylaws contain requirements that make nominating a candidate impossible for the vast majority of shareholders.[95] Consequently, while the threat of shareholder nominees arguably pressures BODs to act according to their duty,[96] the proxy access movement has not translated into true shareholder representation on BODs.[97]

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86 *Id.*

87 *Id.*

88 Napier, *supra* note 22, at 862 ("Rule 14a-11 was adopted, as stated by the SEC, to 'facilitate the effective exercise of shareholders' traditional state law rights to nominate and elect directors to company boards of directors.'") (quoting 17 C.F.R. § 240.14a-11 (2010), invalidated by Business Roundtable v. SEC, 647 F.3d 1144 (2011)).

89 HAZEN, *supra* note 85.

90 Ronald O. Mueller et al., *Shareholder Proposal Developments During the 2017 Proxy Season*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND THE FINANCIAL REGULATION (July 12, 2017), https://corpgov.law.harvard.edu/2017/07/12/shareholder-proposal-developments-during-the-2017-proxy-season/.

91 *Board Composition*, *supra* note 49. About 20% of S&P MidCap 400 companies and 30% of S&P 1500 companies have provided proxy access. *Id.* Shareholders across the United States submitted about 60 proposals to adopt proxy access provisions in a corporation's bylaws in 2017. *Id.*

92 *Proxy Access—Now a Mainstream Governance Practice* SIDLEY AUSTIN LLP, SIDLEY CORPORATE GOVERNANCE REPORT 23 (2018), [hereinafter GOVERNANCE REPORT] https://www.sidley.com/-/media/update-pdfs/2018/02/20180201-corporate-governance-report.pdf?la=en.

93 SIDLEY AUSTIN LLP, THE LATEST ON PROXY ACCESS, Sidley Austin LLP 12–13 (2019), https://www.sidley.com/-/media/update-pdfs/2019/01/20190111-corporate-governance-update.pdf?la=en.

94 *Id.*

95 *See* GOVERNANCE REPORT, *supra* note 92, at 2; *infra* Part IV.A.3 (discussing the effects of the common 3% ownership requirement for nominating shareholders).

96 Napier, *supra* note 22, at 884.

97 For an in-depth discussion of the shortcomings of proxy access, see Kahan, *supra* note 84, at 1347, 1352, 1358, 1364 (2011) (discussing proxy access and noting that "the overwhelming majority of elections are uncontested," "few shareholders would use proxy access to make nominations," and

III. CALLING FOR A FRESH APPROACH TO DIRECTOR NOMINATIONS: "ORDER'S UP!"

The convergence of three features in today's corporate governance world necessitates the reform of director nominations: recently installed limits to shareholder rights, increased shareholder activism, and a growing number of institutional investors. First, despite recent bylaw amendments for proxy access, bylaw amendments are shaving down shareholders' right to nominate.[98] Without shareholder approval, many corporations have amended their bylaws to disqualify dissident nominees who receive payment from shareholders, even if the payment was to compensate the nominee "for taking the time and effort to seek election in a proxy fight."[99]

The use of excessive advance notice bylaw provisions is another example. Bylaws requiring that shareholders give corporations advance notice of nominations have become standard, and Delaware courts have thus far upheld them.[100] These bylaws have required up to 180 days' notice,[101] and until recently, at least one corporation required notice of nominations before its annual meeting was even typically scheduled.[102] Roughly 95% of S&P 500 companies require at least 60 days' notice[103]—and no official limit for this deadline exists.[104] Meanwhile, related shareholder nominee information requirements continue to

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"very few of the [shareholder] nominees would succeed in getting elected to boards"). The ability to win a proxy contest based solely on usage of proxy access, without extensive campaigning, is unlikely to succeed. *Id.* at 1408.

98 Hamermesh, *supra* note 57, at 137.

99 Carl Icahn & Icahn Enterprises, *Disqualifying Dissident Nominees: A New Trend in Incumbent Director Entrenchment*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Feb. 12, 2014), https://corpgov.law.harvard.edu/2014/02/12/disqualifying-dissident-nominees-a-new-trend-in-incumbent-director-entrenchment/; HOLLY J. GREGORY, *Using Board-Adopted By-Laws to Reduce Corporate Threats*, SIDLEY AUSTIN LLP, USING BOARD-ADOPTED BY-LAWS TO REDUCE CORPORATE THREATS 33 (2014), https://www.sidley.com/-/media/files/newsinsights/publications/2014/07/using-boardadopted-bylaws-to-reduce-corporate-th__/files/view-article/fileattachment/using-boardadopted-bylaws-to-reduce-corporate-th__.pdf.

100 R. FRANKLIN BALOTTI ET AL., DEL. L.DELAWARE LAW OF CORPORATIONS AND BUS. ORG. § 7.9 (2019); Butler, *supra* note 20, at 1159; Hamermesh, *supra* note 57, at 136–38.

101 BALOTTI, *supra* note 100; Butler, *supra* note 20, at 1160; *see* Hubbard v. Hollywood Park Realty Enterprises, Inc., 1991 WL 3151 (Del. Ch. Jan. 14, 1991) (allowing for a 90-day advance notice bylaw requirement for nominations); Nomad Acquisition Corp. v. Damon Corp., 1988 Del. Ch. LEXIS 133. (Del. Ch. Sept. 20, 1988) (finding no probability in proving invalid a 60-day advance notice of nomination requirement).

102 Alexandra Higgins, *JDSU bows to Sandell on board nominations*, CQ ROLL CALL CORP. CORPORATE GOVERNANCE BRIEFING (Jan. 30, 2015). In 2015, JDS Uniphase Corp. maintained bylaws that required shareholders nominate candidates 60–90 days in advance of the company's annual meetings, but the company set its annual meetings 60 days or less in advance, forcing shareholders to submit nominees before the corporation set its annual meeting time. *Id.*

103 ARTHUR FLEISCHER, JR. ET AL., TAKEOVER DEF. § 6.06 (8th ed. 2018).

104 Hamermesh, *supra* note 57, at 140–41 (discussing the ramifications of a 180-day advanced notice requirement).

expand, including: disclosures about a nominator and nominee's derivative securities holdings (not required under federal law), formal verification of information submitted, responses to questionnaires prepared by management, and others.[105] These bylaws only compound with shareholders' limited proxy access to restrict shareholders' right to nominate.[106]

Second, a recent surge in shareholder activism has exacerbated BODs' tendencies to resist shareholder participation in nominations.[107] During 2012, activist shareholders introduced fifty-eight proposals surrounding director elections.[108] This movement will only grow.[109] In an effort to maintain control of BODs, directors are resisting dissident nominees.[110]

Third, a decided rise in institutional investors has changed the dynamics between BODs and shareholders. Physical persons held about 84% of public stock in the 1960s,[111] but today institutional investors own about 80% of S&P 500 company stock.[112] These investors have "the resources and sophistication . . . to monitor and discipline [BODs]:"—and they "universally" want more involvement.[113] They go so far as to hire advisory services[114] and form groups

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105 *Id.* at 136–45; Butler, *supra* note 20, at 1160–61.

106 *See supra* Part II.C (defining "proxy access"); GOVERNANCE REPORT, *supra* note 92, at 2 (outlining the terms of proxy access bylaw provisions adopted from 2015 to 2018); *see also infra* Part III.C (explaining how shareholder proxy access is limited).

107 *See* Brandon R. Harper, *The Dupont Proxy Battle: Successful Defense Measures Against Shareholder Activism*, 41 DEL. J. CORP. L. 117, 117–18 (2016) (discussing the increase in shareholder activism and several incidents of director nomination "battles" between management-friendly nominators and hedge fund activist nominators); Kahan, *supra* note 84, at 1426 ("Faced with the possibility that a dissident nominee will get elected to a board, the company may campaign against the nominee.").

108 Peter A. Atkins et al., *Rethinking Director Nomination Requirements and Conduct in an Era of Shareholder Activism*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (July 1, 2013), https://www.skadden.com/insights/publications/2013/07/rethinking-director-nomination-requirements-and-co.

109 Harper, *supra* note 107, at 117.

110 *Id.* For instance, DuPont CEO Ellen Kullman successfully stopped an aggressive hedge fund from replacing four of DuPont's directors. After a hard-fought contest, DuPont's director nominees won all twelve BOD positions. *Id.*

111 Napier, *supra* note 22, at 848.

112 SUSAN R. HOLMBERG, ROOSEVELT INST., WHO ARE THE SHAREHOLDERS? 14 (2018), http://rooseveltinstitute.org/wp-content/uploads/2018/06/The-Shareholder-Myth.pdf.

113 Napier, *supra* note 22, at 848; GOVERNANCE REPORT, *supra* note 92, at 6 (discussing proxy access); *see* GEORGESON, 2018 ANNUAL CORPORATE GOVERNANCE REVIEW 50 (2018), http://www.georgeson-na.com/acgr/pdf/ACGR2018.pdf ("More institutional investors now place a greater emphasis on board composition and effectiveness when evaluating company performance and whether boards adequately represent the investors' long-term interests. In particular, investors are seeking more information on directors' backgrounds, skill sets and perspectives.").

114 George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 136–37 (2010).

among themselves to assist in making informed decisions.[115] This new generation is simply capable of more responsibility in director nominations, a process previously considered over the heads of the average shareholder.[116]

These factors justify an upgrade in the director nomination process with increased shareholder involvement. The longer corporate America denies shareholders their rights, the more likely these investors will choose to invest outside the United States[117] where many nations maintain more robust shareholder rights.[118] "The disempowerment of shareholders is . . . a threat to America's ability to attract investment capital."[119] BODs can no longer afford to ignore shareholders. Prioritizing shareholder interests, especially wealth maximization, is a strategy with "widespread acceptance" and an approach that yields the "highest overall utility and benefit" for shareholders, stakeholders, directors, and society.[120] Given that shareholder activism will likely rise in the foreseeable future,[121] society needs reform that will skillfully integrate this heightened shareholder involvement.[122]

A. The Power to Nominate: A Definitive Shareholder Right

Notwithstanding a prevailing norm that committees nominate directors, the power to nominate truly lies with shareholders.[123] Delaware courts have conceded this point, stating that the shareholder right to vote includes the right to nominate.[124] Unfortunately, state legislators have not declared who possesses this right (directors, shareholders, or both).[125] Corporate statutes rarely address the right to nominate at all,[126] and charters and bylaws are seldom more helpful, as they may limit the right but almost never *bestow* the right.[127] Three theories support the recognition of shareholders' right to nominate: nomination as a derivative power

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115 *Id.* at 133–34.

116 *See* Baum, *supra* note 40, at 17–20 (discussing the recent increase in institutional investors); Napier, *supra* note 22, at 848 (explaining that today's shareholders are capable of more involvement with BODs).

117 Dent, *supra* note 114, at 97.

118 *Id.* at 147.

119 *Id.*

120 Michael K. Molitor, *The Crucial Role of the Nominating Committee: Reinventing Nominating Committees in the Aftermath of Shareholder Access to the Proxy*, 11 U.C. DAVIS BUS. L.J. 97, 156 ("[I]t appears to be an accepted article of faith among the majority of academics and other commentators, businesspeople, and regulators that shareholder wealth maximization is the goal. I agree.").

121 *See supra* Part III (discussing the recent increase in shareholder activism).

122 Molitor, *supra* note 120, at 158.

123 *Contra* Butler, *supra* note 20, at 1157.

124 Linton v. Everett, No. 15219, 1997 WL 441189 at *9; (Del. Ch. July 31, 1997); Hubbard v. Hollywood Park Realty Enters., Inc., 1991 WL 3151 at *5 (Del. Ch. Jan. 14, 1991).

125 Hamermesh, *supra* note 57, at 133.

126 *Id.* at 127.

127 *Id.* at 128-29.

of voting;[128] nomination as a version of "business properly conducted";[129] and nomination as an "inherent right" of shareholder ownership.[130]

First, the Delaware Court of Chancery has found that the shareholder right to vote necessarily includes the right to nominate.[131] The court recognized the "common sense notion that the unadorned right to cast a ballot in a contest for office . . . is meaningless without the right to participate in selecting the contestants."[132] Other courts and scholars agree.[133] Commentators sometimes compare this concept to voting in political elections. An electoral system in which citizens may vote for their state governor but cannot vote in primaries appears absurd on its own, let alone a system that also allows those in charge to "hand-select the candidates."[134] Second, even when scholars and courts separate the voting power from the nominating power, they still come to the same conclusion: Shareholders hold the right to nominate. They consider nomination an item of business shareholders have the right to execute.[135] Generally, corporate "statutory 'policy. . . allow[s] *any business* at annual meetings. . . .'"[136] Therefore, from a business perspective, shareholders should have the right to nominate directors.

The final and most persuasive theory, however, might be that the shareholder right to nominate is part and parcel of shareholders' ownership in a

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128 *Id.* at 128, 130, 132.

129 Hamermesh, *supra* note 57, at 131–32 (citing Levitt Corp. v. Office Depot, Inc., 2008 WL 1724244, at *5 n.33 (Del. Ch. Apr. 14, 2008)) ("[A] nomination is a piece of "proper" meeting business, distinct from the vote . . . ."); Levitt Corp. v. Office Depot, Inc., 2008 WL 1724244, at *5 n.33 ("The act of nominating someone as a candidate for election as a director is an 'affair' or 'matter'—or . . . 'business'—to be considered . . . ."); Butler, *supra* note 20, at 1152–53 (citing Goldstein v. Lincoln National Convertible Securities Funds, Inc., 140 F. Supp. 2d 424, 439 (E.D. Pa. 2001), *vacated as moot*, No. 01-2259, 2003 WL 1846095 (3d Cir. 2003)).

130 Butler, *supra* note 20, at 1158–59.

131 Hamermesh, *supra* note 57, at 128 (citing Hubbard v. Hollywood Park Realty Enters., Inc., 1991 WL 3151 (Del. Ch. Jan. 14, 1991)).

132 *Id.*

133 AHI Metnall, LP by AHI Kan., Inc. v. J.C. Nichols Co., 891 F. Supp. 1352, 1358 (W.D. Mo. 1995) (finding that "the rights to nominate director candidates . . . are integral components of a shareholder's right to vote"); Durkin v. National Bank of Olyphant, 772 F.2d 55 (3d Cir. 1985) (holding national bank shareholders' voting right under the National Bank Act included the right to nominate directors); McDonnell, *supra* note 77, at 223 ("The fundamental power to elect would seem to carry with it the power to nominate . . . ."); Melvin Aron Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1505 (1970) ("As a corollary to their exclusive right to elect the board, the shareholders have the right to nominate candidates for directorships.").

134 Butler, *supra* note 20, at 1141. In the world of corporate elections, "those in charge" would be the BOD or nominating committee comprising directors sitting on the BOD.

135 Hamermesh, *supra* note 57, at 131–32. "[A] nomination is a piece of "proper" meeting business, distinct from the vote . . . ." *Id.*

136 Butler, *supra* note 20, at 1152–53 (citing Goldstein v. Lincoln National Convertible Securities Funds, Inc. 140 F. Supp. 2d 424, 439 (E.D. Pa. 2001), *vacated as moot*, No. 01-2259, 2003 WL 1846095 (3d Cir. 2003)) (emphasis added).

corporation.[137] As a corporate governance principle, shareholder ownership comes with the right to certain "investor protections" and a certain amount of "control [of] the firm." [138] The shareholders' right to nominate, therefore, is a byproduct of their ownership as a means to safeguard their investments and acknowledge their right to measured control over the corporation.[139] Combined, these three theories make a strong case that shareholders possess a resolute right to nominate directors.

B. The Director Nomination Process: There Are Winners and Shareholders

Despite support for shareholders' right to nominate, nominating committees manage the nomination process in a way that prevents shareholders from putting forth candidates. The directors of nominating committees frequently guarantee themselves future terms on BODs.[140] When they do consider a new candidate, they often pick candidates based on non-meritorious factors, such as opinions of the corporation's day-to-day management.[141] When shareholders attempt to work within this system to nominate competition, they meet costly hurdles.[142]

The fact of the matter is, a director who gains a position on a BOD can keep his or her position for many years.[143] The average tenure of an S&P 500 company director is 9 years.[144] Given directors occupy the nominating committee and have the capability to "entrench" themselves, it is difficult to replace BOD directors.[145] Even though nominating committees are often comprised of majority independent directors, this feature does not necessarily prevent entrenchment.[146] Even majority

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137 *Id.* at 1158–59.

138 *Id.* at 1158.

139 *Id.*

140 *See* Grossblatt, *supra* note 20, at 547, 590 ("The ability of directors to entrench themselves on a board provides the impetus for corporate boards to insulate themselves . . . . [T]he incumbent board's monopoly over director elections is intrinsic to the unrestrained insularity of publicly held corporations from shareholder involvement.").

141 *See* Dent, *supra* note 114, at 143–44 (discussing CEO influence on director nominations).

142 *See infra* Part III.C (discussing the costs associated with waging a shareholder nominee campaign).

143 *See* Grossblatt, *supra* note 20, at 547, 590 (discussing the ability of directors to "entrench themselves" on BODs); Goldberg, *supra* note 38, at 408 ("[S]hareholders in public corporations do not in any realistic sense elect boards. Rather, *boards elect themselves.*").

144 *Board Composition*, *supra* note 49.

145 Grossblatt, *supra* note 20, at 547.

146 *Id.* at 554.

independent director committees comprise sitting directors "who most likely [will] nominate themselves,"[147] as they usually run unopposed.[148]

When nominating committees do consider new applicants—many of whom meet the requisite qualifications—directors commonly consider factors outside of merit.[149] State law, charters, and bylaws generally contain few requirements that nominees must meet,[150] so nominating committees are free to base their decisions on applicants' social connections[151] or reputation within the corporation's management team.[152] Management understandably attempts to guide elections because directors interfere in corporate affairs, and even have the power to dismiss top officers.[153] Nomination committee decisions over the years suggest that management frequently pushes committees to reject institutional investor candidates despite the SEC's encouragement to consider them.[154] This process leaves shareholder investments vulnerable under directors chosen for reasons other than merit.

Even requirements that most BOD members be independent (based on questionnaires) leaves much discretion to the nominating committee.[155] In some cases, electing a majority of independent directors is more harmful than helpful.[156] Shareholders are generally satisfied with two-thirds independent directors on BODs, but an average of 85% of S&P 500 company BODs are independent directors.[157] This composition gives management an advantage. CEOs sitting on BODs (often as the chairperson) control the flow of information about the company

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147 *Id.*

148 *Id.* at 556. Many corporations now require sitting "zombie directors," who do not receive majority shareholder support in elections, to step down. Letter from the Council of Institutional Investors to the SEC (July 8, 2014), https://www.cii.org/files/issues_and_advocacy/correspondence/2014/07_08_14_CII_letter_to_SEC.pdf (commenting on the problem of "zombie directors"). This requirement in bylaws has yielded mixed results, as the majority of these "unelected" directors remain on BODs. *Id.*

149 Brown, *supra* note 26, at 133.

150 Grossblatt, *supra* note 20, at 554. For a list of ideal qualifications of director candidates, see WALTER A. EFFROSS, CORPORATE GOVERNANCE: PRINCIPLES & PRACTICES 278 (1st ed. 2010).

151 *See* DeGaetano, *supra* note 19*,* at 379–80 ("Hindsight has shown that many of the Enron outside directors had ties that made them arguably not independent at all: several directors were part of 'interlocking directorates' in which they served together on other common boards . . . .").

152 *See* Dent, *supra* note 114, at 143–44 (2010) (discussing CEO influence on director nominations).

153 Brown, *supra* note 26, at 133.

154 Murphy, *supra* note 47, at 164; Brown, *supra* note 26, at 133. Molitor, *supra* note 120, at 107 (Management-selected candidates "have, in the words of a former SEC Chairperson, 'a better chance of being struck by lightning than losing an election.'").

155 EFFROSS, *supra* note 150, at 282; *Shareholder Franchise*, *supra* note 24, at 681–82.

156 Rodrigues, *supra* note 45, at 447, 461 ("The data indicate that independence does not lead to improved firm performance and may even be associated with sub-optimal performance.").

157 *2018* STUART, *supra* note 70.

to the BOD,[158] including nominations for director.[159] Though stock exchanges exclude CEOs from nominating candidates,[160] CEOs may consult with the nominating committee, submit potential nominees, and even veto nominees.[161] Ultimately, the increased use of independent directors only *appears* to protect shareholders' investments.[162]

Holding BODs accountable in court for objectionable nominations is not a suitable alternative. Shareholders could attempt enjoining particularly egregious management-friendly nominations based on a good faith duty violation, but this claim requires proof that the nominating committee acted with a purpose not in the corporation's best interest.[163] Shareholders "rarely will succeed in marshaling the evidence needed."[164] Likewise, suing based on a fiduciary duty violation for nominating an unqualified candidate (who also is management-friendly) will likely fail because state laws have no standard against which to judge a nominee.[165]

C. The Dissident Nomination Process: There Are Still Winners and Shareholders

Shareholders not willing to sell off have only one option left to effect change: a dissident nominee campaign.[166] Unfortunately, "[f]or anyone who opposes a [nominating committee] candidate, the election is an exercise in futility"[167] for a number of reasons. First, the idea of putting forth a nominee can be intimidating for shareholders as they weigh the unknown against "the devil they know."[168] Second, if shareholders do choose to nominate a candidate, they will

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158 Brown, *supra* note 26, at 135, 173–75; *see* Dent, *supra* note 114, at 143–44 ("[Increased] director independence may actually be damaging to corporate governance by excluding 'informed and interested outside directors with significant equity stakes'" at a time when "firms are becoming more complex . . . and . . . more difficult to monitor.").

159 Brown, *supra* note 26, at 141–43.

160 NYSE MANUAL, *supra* note 47; MARKETPLACE RULES, *supra* note 47.

161 Dent, *supra* note 114, at 143–44; Brown, *supra* note 26, at 142. Even more, nominating committees' failure to provide shareholders with adequate information about nominees' management-friendly connections can make it difficult for shareholders to renounce biased candidates. *Id.* at 189.

162 *See id.* Brown, *supra* note 26, at 174 (discussing BOD dependence on CEOs for information if independent directors are in the majority).

163 *Id.* at 193–94.

164 *Id.* at 194.

165 *Id.*

166 Blasius Indus., Inc. v. Atlas Corp., 564 A.2d at 651 (Del. Ch. 1988).

167 Gretchen Morgenson, *Who's Afraid of Shareholder Democracy?*, N.Y. TIMES, (Oct. 2, 2005), https://www.nytimes.com/2005/10/02/business/whos-afraid-of-shareholder-democracy.html.

168 *Shareholder Franchise*, *supra* note 24, at 691–92; Napier, *supra* note 22, at 857. *See* Kahan, *supra* note 84, at 1424 ("[E]ven shareholders who would ideally like to oust a certain director from the board may not vote for a dissident nominee because they consider the dissident nominee to be even worse . . . because the dissident nominee lacks the proper professional qualifications, because

likely have to convince a large group of their co-shareholders to bet on the dissident nominee—that is, convince them the nominee is a common good for *all* shareholders; no small feat.[169]

Third, nominating shareholders will incur a litany of expenses the corporation covers for nominating committees.[170] Nominating shareholders must pay to disseminate basic information about their candidates to their co-shareholders.[171] "In the typical public corporation [there are] thousands of widely dispersed" shareholders.[172] Nominators likely will pay for extensive shareholder campaigning as well;[173] including presentations to investors and advertisements to gain support for their nominees.[174] Part of this expense may include payment to proxy solicitors and consultants to guide the nominators through the election.[175] In addition, they likely need to hire legal counsel to combat incumbent director suits in response to the dissident nomination.[176] "[I]ncumbents have excessive incentive to invest in opposing a challenge," driving up the cost for shareholders to nominate.[177] Even if the nominating shareholders are successful, they only reap their respective ownership fractions in any stock value increase post-election.[178] This broken structure discourages reasonable shareholders from pursuing representation, especially shareholders not interested in majority control.[179]

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shareholders distrust the dissident shareholder who made the nomination, or because they believe that election of a dissident would reduce board effectiveness."). For why mutual funds and money managers do not contest sitting directors, see *Shareholder Franchise*, *supra* note 24, at 691, 693.

169 *Shareholder Franchise*, *supra* note 24, at 692; *see* Part IV.A (discussing the need for substantial shareholder support to place a shareholder nominee on a BOD). For discussion on shareholders' hesitation to vote for a shareholder's nominee, see Molitor, *supra* note 120, at 151 ("[Voting shareholders] may be suspicious of the nominating shareholder's motives or good judgment, and the incumbent board certainly will advise shareholders to vote against the nominees . . . .").

170 Kahan, *supra* note 84, at 1365 (noting dissident nomination costs may range from $30,000 to $9 million).

171 *See supra* Part II.B (discussing shareholders' lack of proxy access). One alternative to distributing proxy materials ahead of voting is nominating candidates at annual shareholder meetings. These nominations, however, are "typically meaningless because proxies have already [cast their] votes" by that point. Goldberg, *supra* note 38, at 408.

172 Molitor, *supra* note 120, at 105.

173 Kahan, *supra* note 84, at 1391 (noting that campaigning is "by far the largest expense item").

174 *Id.* at 1364, 1391 ("[A] proxy contest for control, or even a 'short slate' contest in which the dissidents seek to elect only a minority of directors, is much closer to a political campaign.").

175 Napier, *supra* note 22, at 857; Molitor, *supra* note 120, at 105.

176 Napier, *supra* note 22, at 857-58. Red Zone LLC paid $2.4 million, $950,000, $850,000, and $600,000 in fees for investment banking fees; travel; proxy materials and their distribution; and proxy solicitor services, respectively, when it initiated a proxy contest with Six Flags, Inc. *Shareholder Franchise*, *supra* note 24, at 679–80.

177 *Id.*; *Shareholder Franchise*, *supra* note 24, at 690–91.

178 *Id.* at 690; Dent, *supra* note 114, at 137. This factor is often referred to as the "free-rider problem." *Shareholder Franchise*, *supra* note 24, at 689.

179 Molitor, *supra* note 120, at 106–107. The New York Times called "corporate elections a sham." *Id.*

IV. AN ELEGANT SOLUTION: PLACE CARDS ON THE BOARDROOM TABLE

To repair the director nomination structure, shareholders need more statutory protection to defend their right to nominate.[180] The extent to which BODs may limit shareholder participation in nominations remains "an unsettled area of the law" both statutorily and jurisprudentially.[181] Scholars agree that the power to nominate far outweighs the lesser power to vote.[182] Yet, statutes fail to safeguard this critical right.[183] Requirements that require nominating committees to be composed of independent directors do not fill the gap.[184] By tactfully establishing a new norm in BOD composition, however, corporations could boast a new generation of more functional boardrooms.

Two plausible, side-by-side federal-level initiatives in particular would bolster shareholder rights without long term backlash from sitting directors.[185] First, building on vacated 14a-11, the SEC should first consider a provision that reserves a minority of BOD seats for shareholder nominees.[186] By creating a new norm in BOD composition, shareholders could secure dependable representation and directors could avoid the fear of replacement that often triggers hostility and litigation.[187] Second, the SEC should consider an SEC-operated, applicant-funded registry of potential shareholder nominees.[188] These two initiatives would work in tandem, producing quality shareholder participation during elections—and after elections, a collaborative and diverse boardroom.

A. Shareholder Nominee Seats on BODs: "Reservation for Two (More or Less)"

Reserving BOD seats for shareholder nominees creates a setting for better communication and decision-making. Proposed in the 1950s by University of Virginia law professor Mortimer Caplin,[189] and later again in the 1980s by

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180 Hamermesh, *supra* note 57, at 129.

181 Butler, *supra* note 20, at 1154, 1156.

182 *See supra* Part II.B (comparing the power to nominate to the power to elect).

183 *See supra* Part II.A (discussing the statutory failure to address the power to nominate).

184 *See supra* Part III.B (explaining the current use of independent directors does not fully protect shareholders).

185 *See infra* Part IV (explaining why federal intervention is best to put in place the reservation system and registry).

186 *See infra* Part IV.A (explaining why the SEC should install a reservation system).

187 *See infra* Part IV.A.1 (discussing how a reservation system would improve director-shareholder relations).

188 *See infra* Part IV.B (explaining how the SEC should establish a registry of potential shareholder nominees).

189 Mortimer M. Caplin, *Shareholder Nominations of Directors: A Program for Fair Corporate Suffrage*, 39 VA. L. REV. 141, 152 (1953).

Columbia University law professor Louis Lowenstein,[190] the idea of reserving BOD seats for shareholder nominees is now picking up steam.[191] Investment circles are showing increasing support for shareholder nominees on BODs.[192] Investors find them attractive because they can give shareholders assurances that the BOD is using their investments wisely. "Such accountability and discipline provide incentives to avoid shirking, empire building, and other departures from shareholder interests that are costly . . . ."[193] Shareholder nominees could keep their counterparts in check.[194]

More than that, a small percentage of dissident nominees could improve the corporation's overall performance and operations. According to a 2008 study by the Investor Responsibility Research Center Institute, "hybrid" BODs lead corporations to outperform their peers on average.[195] About 60% of the 120 companies the IRRCI examined outperformed their peers, and they did so by an average of 21.5%.[196] Numerous 14a-11 commentators found that a minority of shareholder nominees effected positive change in their corporations' structure, strategy, and shareholder value "both in absolute returns and relative to peers."[197] Caplin, pioneer of the reserved shareholder nominee seat, suggested at least one shareholder nominee per BOD, and Lowenstein suggested two.[198] The SEC indirectly suggested up to 25% of the BOD through vacated 14a-11.[199] Following their lead would give shareholders adequate representation and could tangibly benefit the corporation.

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190 Murphy, *supra* note 47, at 181 (citing LOUIS LOWENSTEIN, WHAT'S WRONG WITH WALL STREET: SHORT-TERM GAIN AND THE ABSENTEE SHAREHOLDER 2010 (1988)).

191 *Id.*

192 Atkins, *supra* note 108.

193 Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1643 (2013) [hereinafter *Long-Term Value*].

194 *Id.*

195 Napier, *supra* note 22, at 867.

196 *Id.*

197 Facilitating Shareholder Director Nominations, Exchange Act Release No. 9136, 99 SEC Docket 439 at *152 (Aug. 25, 2010).

198 Murphy, *supra* note 47, at 181 (citing LOUIS LOWENSTEIN, WHAT'S WRONG WITH WALL STREET: SHORT-TERM GAIN AND THE ABSENTEE SHAREHOLDER 210 (1988)).

199 *See supra* Part II.C (explaining 14a-11 required shareholder proxy access for a number of nominees up to 25% of the BOD).

1. Less Extreme Alternatives to the Reservation System: "Something is Missing"

Though lesser strategies like adding more nominee requirements or threatening to sue over poor nominees seem sufficient, both fall flat.[200] Drafting requirements that force nominating committees to prioritize merits over favor with management would be difficult.[201] When Congress attempted to do so by encouraging financial expert nominees through the Sarbanes-Oxley Act, corporations did not conform.[202] Suing committees over nominations that allegedly violate their fiduciary duty is also unlikely to succeed because it is difficult to prove a committee acted outside the corporation's best interest or that a candidate is unqualified.[203]

Then, there is proxy access. Proxy access reforms under vacated 14a-11[204] or through 14a-8 could arguably pressure BODs to make responsible, shareholder-conscious decisions.[205] Proxy access, however, sparks hostility between directors and shareholder nominees ultimately yielding poor work products.[206] This hostility tends to produce expenses that discourage shareholders from nominating candidates in the first place.[207] Enmity between directors and shareholder nominees forces nominating shareholders to campaign harder; for example, they have to use devices like "fight letters" to counteract director letters to investors and pay more

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200 Goldberg, *supra* note 38, at 402 ("[E]lecting new directors, proposing resolutions, waging proxy fights, or bringing shareholder suits—is usually too expensive, too slow, or too much of a long shot to pursue.").

201 Brown, *supra* note 26, at 187.

202 *Id.* at 187–88.

203 *See supra* Part I (explaining the fiduciary duties of sitting directors); and Part III.B (discussing the difficulties involved when shareholders attempt to sue directors over candidates nominated).

204 *See supra* Part II.C (explaining the reforms adopted by the SEC under 14a-11).

205 Napier, *supra* note 22, at 879, 884.

206 Business Roundtable v. SEC, 647 F.3d 1144, 1150 (D.C. Cir. 2011); *see* Nicole L. Jones, *Shareholder Proposals, Director Elections, and Proxy Access: The History of the SEC's Impediments to Shareholder Franchise*, 93 DENV. L. REV. 233, 247–50 (2016) (depicting the ongoing battle between shareholders and directors over shareholder influence in BOD composition under Rule 14a-8); Murphy, *supra* note 47, at 143 (discussing how proxy access could strain director-shareholder relations).

207 *See* Kahan, *supra* note 84, at 1391 ("Campaign expenses are, in most contests, by far the largest expense item . . . . [which may include] 'fight letters' . . . . Other campaign expenses include the cost of strategic advice provided by proxy solicitors, the cost of legal advice related to campaign materials . . . , and litigation expenses concerning these materials. Proxy access has virtually no impact on these cost items and any associated legal and regulatory expenses."); *Business Roundtable*, 647 F.3d at 1150 (In considering 14a-11, "The Chamber of Commerce submitted a comment predicting boards would incur substantial expenditures opposing shareholder nominees through 'significant media and public relations efforts, advertising . . . , mass mailings, and other communication efforts, as well as the hiring of outside advisors and the expenditure of significant time and effort by . . . employees.'").

legal bills to meet director challenges over proxy statements.[208] Proxy access offers no solution for these costs, which far outweigh the savings that proxy access affords nominating shareholders.[209] This hostility only extends into the boardroom.[210] "Electing a shareholder-nominated director pursuant to 14a-11 or some other process will do little good if he or she will be promptly ignored as a heretic . . . ."[211] Proxy access rules simply maintain a win-lose mindset between directors and shareholders that generates unnecessary costs and stifles productivity.

By contrast, the reservation system brings about peace. Unlike proxy access alone, the reservation system creates a new scheme in which directors can comfortably adjust. "The shareholder-nominated directors would be an ongoing and predictable feature of the board," giving all directors "an incentive to make the system work by developing procedures and norms of conduct. . . to avoid conflict and foster dialogue."[212] In addition, the ability for shareholder directors to safeguard investments from inside the boardroom will likely make shareholders less compelled to take over, leaving the remaining directors to focus on goals besides maintaining their seats.[213]

An even more progressive version, though admittedly more complicated,[214] would allot nominating committee candidates whichever BOD seats are not

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208 *See* Kahan, *supra* note 84, at 1391 (discussing the cost of campaigning and corresponding legal services).

209 *Id.* at 1387, 1391.

210 *See* Napier, *supra* note 22, at 866 (discussing the concern that "dissident shareholder nominees" would hurt firm performance); Murphy, *supra* note 47, at 142 (discussing concerns about the ability of directors nominated by sitting directors and directors nominated by shareholders to work successfully as a team); Kahan, *supra* note 84, at 1413 ("The board could, at its first meeting, create a board committee—consisting of all board members except the shareholder nominee—and delegate to this committee most board powers, effectively shutting the shareholder nominee out of the discussion and information process.").

211 Molitor, *supra* note 120, at 160.

212 Murphy, *supra* note 47, at 182–83. Universal proxy cards could facilitate this norm. *See* Liana B. Baker & Michelle Price, *U.S. regulator shelves reform on voting in board fights: sources*, THOMSON REUTERS (July 11, 2018), https://www.reuters.com/article/us-sec-universalproxy/u-s-regulator-shelves-reform-on-voting-in-board-fights-sources-idUSKBN1K10FX (discussing how the SEC has considered universal proxy card requirements).

213 *See* Grossblatt, *supra* note 20, at 585 (discussing the need for measured director insulation in BODs). Requirements to include shareholder nominees are especially preferable to an increase in generalized shareholder oversight. *Id.* at 591, 620; Molitor, *supra* note 120, at 134–35. Increased shareholder oversight may make a corporation vulnerable to its competitors through disclosures of confidential information; discourage BOD involvement because of increased director liability; and lead to inefficient decision-making because of frequent shareholder input. Grossblatt, *supra* note 20, at 591, 620; Molitor, *supra* note 120, at 134–35.

214 *See* Kahan, *supra* note 84, at 1395 (explaining that, without other measures, shareholder representatives limited to a minority of BODs "can always be outvoted and even shut-out completely from the decision-making process by the delegation of decision-making power to board committees on which the minority is not represented").

reserved for shareholder nominees.[215] A set expectation of which seats belong to which nominees would make directors even less likely to resist shareholder participation and more willing to collaborate.[216] As a fail-safe, an outlined set of extenuating circumstances could trigger permission for shareholders to campaign for majority control.[217] This version of the reservation system has an added bonus for nominating committees and nominating shareholders alike: an easier time finding candidates. Many potential nominees are unwilling to risk their reputations in contested elections,[218] but under this system, candidates' seats would be waiting for them upon nomination.[219]

2. Economic Impact of the Reservation System: Electing on a Budget

Economically speaking, the reservation system is an opportunity to lower overall election costs. One major reason the Court of Appeals for the D.C. Circuit vacated 14a-11[220] was the potential for expensive incumbent lawsuits from directors opposing shareholder nominees.[221] Reserving BOD seats for shareholder nominees (and possibly director nominees) poses no comparable issue. Incumbent directors operating in the reservation system will likely expend less or no resources trying to box out candidates for seats allotted to shareholder nominees.[222]

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215 *See Long-Term Value*, *supra* note 193, at 1639 ("[W]hen corporate arrangements facilitate shareholders' ability to replace or influence directors, fear of activist intervention . . . produces pressure on management to focus excessively on the short term to the detriment of long-term value.").

216 *See id.* ("Insulating boards from short-term shareholder pressure, it is argued, enables them to focus on enhancing long-term value and thereby better serve the long-term interests of companies and their shareholders.").

217 Extreme cases may include a withhold vote by more than some percentage of shareholder voters in the course of a sitting director's reelection. *See* Kenneth N. Gilpin, *Disney Dissidents Rebuke Eisner, Denying Him 43% of Vote*, N.Y. TIMES (Mar. 3, 2004), https://www.nytimes.com/2004/03/03/business/media/disney-dissidents-rebuke-eisner-denying-him-43-of-vote.html (reporting that 43% of Walt Disney Co. shareholders withheld their votes during chairman and chief executive Michael D. Eisner's reelection).

218 *See* Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 54 (2003) [hereinafter *Shareholder Access*] (discussing the difficulties corporations face when searching for a qualified director).

219 *See* Kahan, *supra* note 84, at 1418 (discussing the difficulties of finding a suitable dissident nominee with "unimpeachable character" willing to endure criticism and attacks from nominating committees to secure a BOD seat).

220 *See supra* Part II.C (explaining the reforms adopted by the SEC under 14a-11).

221 Business Roundtable v. SEC 647 F.3d 1144, 1150 (D.C. Cir. 2011).

222 *See* Part IV.A.1 (discussing how the reservation system discourages resistance to shareholder participation).

3. Qualifying as a Nominating Shareholder: "Is My Name on the List?"

To operate an orderly election that safeguards the well-being of the corporation, not all shareholders should have the power to nominate.[223] Nominating shareholders need to have a significant financial stake in the corporation's success.[224] This restriction prevents nominations by shareholders free from the economic incentive to take elections seriously or shareholders motivated by private interests.[225] Restrictions can also help by removing nominees who unnecessarily crowd the ballot. "[T]he ballot is intended to facilitate challenges that might succeed, not to offer a mode of expression for all shareholders."[226] A financial stake requirement would help to remove "fringe investors" from the nominating pool.[227] Using studies of 14a-11 for comparison,[228] a 3% ownership threshold for nominating shareholders appears too high.[229] The 14a-11 requirement excluded "all but a small handful of investors."[230] As part of the reform, the SEC should consider installing a slightly lower ownership threshold.

In another departure from 14a-11,[231] the SEC should avoid any minimum shareholding period requirement.[232] The amount of time a shareholder has held a corporation's stocks does not necessarily indicate a level of interest in the corporation's long-term value.[233] Arguably, a holding period simply blocks new investors with changes for the corporation's long-term benefit.[234] The SEC should instead focus on shareholders' behavior post-election. The SEC could require nominating shareholders fill out a questionnaire in good faith explaining their post-election intentions,[235] inflict economic penalties for selling shares within a specified period following elections,[236] and/or enter agreements with shareholder directors that if their nominators sell their shares within a specified time period the directors will step down.[237] These strategies more effectively gauge a shareholder's

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223 *See* Napier, *supra* note 22, at 867–71, 885–86.
224 *Id.* at 865–66.
225 *Id.*
226 *Id*.
227 *Shareholder Franchise*, *supra* note 24, at 698.
228 *See supra* Part II.C (explaining the reforms adopted by the SEC under 14a-11).
229 Molitor, *supra* note 120, at 152.
230 *Id.*; Napier, *supra* note 22, at 869–70. For a proposal to lower the ownership threshold for nominating shareholders to .5%, with some exceptions, see Napier, *supra* note 22, at 891.
231 *See supra* Part II.C (explaining the reforms adopted by the SEC under 14a-11).
232 *See supra* Part II.C. *Contra* Molitor, *supra* note 120, at 170 (arguing corporations should have shareholding period requirements for shareholders to qualify to nominate).
233 Napier, *supra* note 22, at 894–95; Molitor, *supra* note 120, at 152.
234 *Shareholder Franchise*, *supra* note 24, at 697.
235 Molitor, *supra* note 120, at 170.
236 Napier, *supra* note 22, at 895–96.
237 Molitor, *supra* note 120, at 170.

level of interest in the corporation's future, and thus, whether they are suitable nominators.

If shareholders meet the proper criteria, they should have the full opportunity to nominate candidates, with access to proxy materials.[238] Proxy access could be in proportion to the percentage of seats on the BOD reserved for shareholder nominees.[239] Conducting a reservation system in this fashion can provide orderly director elections—and with them, a generation of more collaborative and productive BODs.

B. Developing a Shareholder Nominee Registry: The Advantages of Calling Ahead

This transition within BODs would not be feasible without the recent rise in institutional investors. Today's investors have the sophistication necessary to choose quality director candidates.[240] To help guarantee qualified shareholder nominees, however, a guide may be helpful. A registry of potential shareholder nominees would provide shareholders with assistance in choosing candidates and simplify an otherwise burdensome nomination process.[241]

The SEC could steer nominating shareholders toward quality nominees using the registry.[242] Applicants interested in holding a directorship at some point in the future would voluntarily register with the SEC for a small fee.[243] The SEC could test their knowledge in corporate law, finances, ethics and other relevant subjects to ensure they are qualified for a BOD position.[244] The application could require periodic disclosures of time commitments to ensure they have ample time

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238 *See supra* Part II.C (explaining the SEC's support for shareholder proxy access); Part III.B–C (discussing problems caused when shareholders are denied proxy access).

239 *See* Caplin, *supra* note 189, at 153 (discussing the need for proportional use of proxy materials during elections).

240 *See supra* Part III (discussing the recent increase in institutional investors and their attributes).

241 *See* DeGaetano, *supra* note 19, at 381 (discussing the possibility of "professional independent public directors").

242 *See* William S. Lerach, *Plundering America: How Investors Got Taken for Trillions by Corporate Insiders*, 8 STAN. J.L. BUS. & FIN. 69, 107–108 (2002) (suggesting the SEC station professional independent public directors, cleared by the SEC, with BODs to see that corporations are in compliance with the law). For concerns that shareholders may nominate unqualified candidates, see *Shareholder Access*, *supra* note 218, at 56.

243 *See* Lerach, *supra* note 242, at 107–108 (suggesting stationing professional independent public directors, cleared by the SEC, with BODs to see that corporations are in compliance with the law); Ronald J. Gilson, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 884 (1991) (also discussing the prospect of professional outside directors).

244 *See* Lerach, *supra* note 242, at 107 ("To qualify [as a professional independent public director the SEC will place on BODs], a person would have to meet minimum educational and experience qualifications and be registered with and licensed by the SEC, which would test applicants to assure sufficient financial and legal sophistication and knowledge of corporate ethical precepts.").

to devote to a directorship.[245] To guard against conflicts of interest,[246] the SEC could require disclosure of all financial, political, and relevant community ties, with periodic updates.[247] To encourage registry well before applicants pursue any particular directorship, the SEC could establish a waiting period of several months or more to prevent applicants from omitting contacts that would disqualify them from any specific BOD.

To address concerns that shareholder-backed directors may share confidential information with shareholders,[248] the SEC could emphasize confidentiality in its testing, require disclosure of any past ethical or confidentiality-related misconduct, and possibly inquire into the applicant's reputation with colleagues as a neutral third party.[249] In essence, the registry could help fence out shareholder nominees who prompt serious concerns for nominating committees.

This registry process may appear taxing, but this voluntary exercise could move an applicant's name to the top of a nominating shareholder's list. Shareholders likely would lean on this resource to find potential nominees. The registry would highlight qualified, vetted candidates without a cumbersome investigation.[250] In addition, listed applicants would likely garner broader shareholder support as un-biased nominees; these applicants will have registered

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245 *See* Elizabeth A. Nowicki, *Not in Good Faith*, 60 SMU L. REV. 441, 481–84 (2007) (discussing the possibility that time commitment issues not qualifications are what make directors incapable of properly fulfilling their duties).

246 *See* Murphy, *supra* note 47, at 183 (discussing confidentiality issues with shareholder-nominated directors).

247 Companies impose extra restrictions on shareholder nominees for proxy access because nominating committees cannot vet shareholder nominees in the same way they vet their own candidates. *See* Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29,384 (Aug. 25, 2010), available at http://www.sec.gov/rules/final/2010/33-9136.pdf ("[Companies worry], in particular, that a shareholder director nominee will be elected without undergoing the same extensive vetting process. . . applicable to other director nominees.").

248 Murphy, *supra* note 47, at 183 (discussing confidentiality issues with shareholder-nominated directors).

249 This process may resemble character and fitness investigations into law students, who wish to sit for a given state's bar exam, to protect the public from "unscrupulous" people who intend to practice law. *See* Timothy Dinan, *Bar Application Character and Fitness Background Check—Part 1*, THE NATIONAL JURISTS (Mar. 22, 2018, 9:47 AM), http://nationaljurist.com/national-jurist-magazine/bar-application-character-and-fitness-background-check-part-1. (explaining the nature of character fitness investigations of law students). An SEC registration process can similarly protect corporations from unwittingly electing objectionable shareholder nominees. This protection may put some nominating committees' concerns at ease.

250 *Shareholder Access*, *supra* note 218, at 56–58 (discussing the challenges nominating shareholders face to find qualified candidates that draw support from a majority of shareholders); Molitor, *supra* note 120, at 176–77 (also discussing the difficulties that nominating shareholders experience when searching for candidates).

ahead of time out of interest in representing shareholders broadly speaking, as opposed to any particular nominating shareholder.[251] Moreover, nominators could gain a layer of legal protection against incumbent directors protesting a shareholder nominee. If incumbent directors choose to sue over the nominee's lack of qualifications or conflicts of interest, the nominator could point to the candidate's registration as proof of otherwise.

An unrelated but significant benefit would be lower election costs. Institutional investors are often passive in director elections because they do not want to spend the money necessary to nominate a candidate.[252] The registry could eliminate or dramatically lower the cost of selecting and vetting a candidate, and it could repel expensive incumbent suits over nominees.[253] Together with savings from lower levels of director-shareholder hostility surrounding nominations and proxy access,[254] the registry could encourage institutional investors to participate. The benefit of establishing this registry, then, is two-fold: It can eliminate financial and time-consuming obstacles for investors interested in submitting nominees; and, more importantly, produce quality shareholder nominees.

C. Installing the Reservation System and Registry Through Federal Reforms: "Your Order Will Be Out in a SEC-ond"

An SEC regulation is the best route to establish the reservation system and registry. As a federal agency, the SEC is immune to the pressure state officials feel to cater to management in the nationwide competition to attract corporations.[255] Federal-level reforms also install new norms more effectively in large markets.[256] Though this federal regulation may appear to flout states' statutory authority, a

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[251] Ideally, an applicant will have registered well before he or she became aware of a directorship opportunity tied to a particular nominating shareholder; *see supra* Part IV.A (discussing the need for substantial shareholder support to place a shareholder nominee on a BOD).

[252] *Shareholder Access*, *supra* note 218, at 50, 64; *see* supra Part IV.A.1 (discussing extensive costs associated with shareholder nominee campaigns); Kahan, *supra* note 84, at 1376 (discussing the lack of institutional investor participation in director nominations).

[253] *See* Business Roundtable v. SEC, 647 F.3d 1144, 1150 (D.C. Cir. 2011) (In considering 14a-11, "The Chamber of Commerce submitted a comment predicting boards would incur substantial expenditures opposing shareholder nominees through 'significant media and public relations efforts, advertising . . . , mass mailings, and other communication efforts, as well as the hiring of outside advisors and the expenditure of significant time and effort by . . . employees.'").

[254] *See supra* Part III.B–C (explaining the SEC's support for shareholder proxy access); *see also* Part IV.A.1 (discussing the potential for extensive savings in campaign and litigation costs associated with shareholder nominee campaigns under the reservation system).

[255] Napier, *supra* note 22, at 877 n.202, 877–78.

[256] For a discussion of sweeping changes in corporate governance norms post-Sarbanes-Oxley Act of 2002, including increased federal government involvement, *s*ee Robert B. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 WAKE FOREST L. REV. 961, 965–66 (2003).

reservation requirement "would have as its immediate purpose no more than the establishment of reasonable nominating procedures, and . . . preservation of the shareholders' basic right of free voting."[257] For those who resist federal regulation because it stifles the market, this particular regulation does the opposite. Shareholders make up the free market, and corporate stock is the commodity they consume.[258] Therefore, "regulation [that] allows for greater shareholder influence is, in effect, a way to empower the market. . . ."[259] Given a reservation system and candidate registry indeed contribute to increased shareholder influence, these reforms *enable* the market.

V. ARGUMENTS AGAINST THE RESERVATION SYSTEM: BACKBURNER CONCERNS

Many of the legitimate arguments espoused in opposition to traditional proxy access do not necessarily apply in a reservation system. Unlike proxy access alone, the reservation system allows for a cohesive BOD, as well as director security against special interest shareholder nominees, short-termism, and shareholder activism.

A. Special Interest Directors: Turning Away Constituent Agents

The reservation system makes room for shareholder interests in the boardroom, but it does not swing the door open to special interest directors.[260] Special interest directors, or constituent directors, are "candidates who will serve the narrow interests of the nominating shareholder rather than the interests of the corporation itself."[261] To be elected, shareholder nominees need support from a large portion of shareholders.[262] Three rules govern voting in most companies: "the old, unmodified plurality regime"; a bylaw "that changes the default rule for uncontested elections to a majority standard"; or a policy that requires nominees resign if they receive less than majority support in elections.[263] Special interest nominees generally do not have the necessary support to be elected, especially if that interest clearly contradicts the interests of other shareholders. "[T]he presence of, or even the suspicion of, divergent interests by the [nominating shareholders] makes it unlikely that [their] nominees will succeed."[264] After all, special interest resolutions consistently fail to garner majority backing.[265]

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257 Caplin, *supra* note 189, at 158.
258 Napier, *supra* note 22, at 878–79.
259 *Id.* at 878.
260 Molitor, *supra* note 120, at 147.
261 *Id.*
262 *Id.*; *Shareholder Access*, *supra* note 218, at 55.
263 Kahan, *supra* note 84, at 1410.
264 *Id.* at 1427.
265 *Shareholder Access*, *supra* note 218, at 55.

As such, the ownership threshold for nominating shareholders serves as reinforcement against the prospect of special interest directors. Because of the threshold, decisions a nominee may make in favor of a nominator's private interest would disproportionately affect the nominator's investment and likely overshadow any benefits the nominator could reap lawfully.[266] Another measure to further deter special interest directors is a requirement that elected shareholder nominees reappear on the ballot in the following election.[267] Doing so "would ensure that the shareholder-backed director's re-election would depend solely on . . . his or her . . . assess[ment] by the majority of shareholders," as opposed to special interests in play during any given election.[268] Though no system can guarantee the BOD will repel all special interest directors, the reservation system deters them.

B. Short-Termism: The Proof Is Not in the Pudding

Critics argue that shareholder directors will focus unwisely on short-term goals, but they overstate this concern.[269] Detractors contend these directors "will move for abrupt changes in the company they target, which may boost the stock price and shareholder value in the short-term, but . . . will not account for any long-term financial stability."[270] Empirical study fails to show institutional investors, owning an overwhelming majority of S&P 500 company stocks,[271] are guilty of this approach—even short-term institutional investors.[272]

The reality is short-termism works against the private interests of institutional investors and their nominees. Investors often have their hands in multiple corporations,[273] and if an investor nominates directors who focus solely on the short-term, sitting directors at other corporations would deny their nominations elsewhere in the future.[274] This short-term approach is simply "detrimental to the institutional investor in the long run."[275] Similarly, nominees often have aspirations to fill other directorships in the future[276] and therefore want

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266 Napier, *supra* note 22, at 886.

267 *Shareholder Access*, *supra* note 218, at 55.

268 *Id.*

269 Dent, *supra* note 114, at 104–05.

270 Harper, *supra* note 107, at 120.

271 *See supra* Part III (discussing the rise of institutional investors).

272 Napier, *supra* note 22, at 868.

273 *See* Napier, *supra* note 22, at 869 (explaining that investors must consider how their decisions regarding one corporation will affect their relationships with other corporations).

274 *Id.*

275 *Id.*

276 Michal Barzuza & Quinn Curtis, *Board Interlocks and Corporate Governance*, 39 DEL. J. CORP. L. 669, 670 (2015); *see* Douglas M. Branson, *Initiatives to Place Women on Corporate Boards of Directors – A Global Snapshot*, 37 J. CORP. L. 793, 800 (2012) (pointing out that women in particular "may be serving on four, five, six, or seven boards of directors" at once).

to protect their reputations.[277] A nominee risks that future if sitting directors at other corporations can point to a track record of costly decision-making.[278] Nonetheless, penalties for nominators that withdraw shortly after elections could put the short-termism concern to rest, as these measures would lock nominators into the long-term consequences of their decisions.[279]

C. Shareholder Activist Takeovers: "How Many Are in Your Party?"

Another concern is that shareholder activists will take majority control, but a number of factors indicate that critics exaggerate this risk as well. First, this scenario is improbable given shareholders (often with little interest in corporate governance) generally do not invest to collaborate with fellow investors and seize control.[280] Second, investors are unlikely to garner enough support to gain a majority of BOD seats.[281] Of the 160 seats shareholder activists won in 2018, 40% of them were a single seat on a given BOD.[282] Shareholders with a political motive typically hold a small fraction of shares,[283] and social activist resolutions consistently fail to obtain majority support.[284]

Third, the decision for shareholders to take over is less compelling under the reservation system because the system allows for some level of guaranteed, in-person shareholder representation.[285] If the more progressive reservation system were put in place (meaning shareholders could nominate only a fraction of the BOD except in unusual circumstances),[286] directors would hold a concrete shield against

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277 *See* Napier, *supra* note 22, at 869 (discussing the consequences of an institutional investor's decision to nominate a candidate who acts on short-term interests at the expense of a corporation's long-term value).

278 *Id.*

279 *See supra* Part IV.A.3 (outlining options to penalize nominating shareholders who immediately sell their shares post-election).

280 Grossblatt, *supra* note 20, at 607–608; *see* Gail Weinstein, *The Road Ahead for Shareholder Activism*, HARVARD LAW SCHOOL FORUM CORPORATE GOVERNANCE & FINANCIAL REGULATION (Feb. 13, 2019), https://corpgov.law.harvard.edu/2019/02/13/the-road-ahead-for-shareholder-activism/ ("A small number of top activists, and a small number of campaigns, account for much of the activist activity . . . .").

281 *See* Weinstein, *supra* note 280 (explaining that the top five shareholder activists who won BOD seats accounted for 40% of all seats won from 2013–2018, noting "it is a small number of activists that has been driving most of the activity and having most of the success").

282 *Id.* (adding that "in most cases activism leads to a 'seat at the table'. . . not a sea change in corporate strategy").

283 Dent, *supra* note 114, at 106–07.

284 *Shareholder Access*, *supra* note 218, at 55.

285 *See* Part IV.A.1 (discussing the potential for collaboration between nominating committee candidates and shareholder nominees in the boardroom).

286 *See supra* Part IV.A.1 (explaining the progressive reservation system).

shareholder activist takeovers.[287] Finally, as is the case with special interest directors, the ownership threshold for nominating shareholders is a reinforcement against activist directors.[288] Due to their financial stake, nominating shareholders likely will not nominate activists whose decision-making could translate to lower value shares.[289] Thus, directors can be confident the reservation system provides reasonable security against shareholder activist takeovers.

D. Lack of Cohesion in the Boardroom: Operating a Successful BOD, Potluck Style

Many organizations have expressed the larger concern that integrated BODs lack cohesiveness,[290] but this problem fades in light of the reservation system. Whereas proxy access reforms spark hostility between shareholder directors and nominating committee directors,[291] the reservation system creates a collaborative boardroom environment.[292] During the selection process, shareholders would likely consider any candidate's ability to interact effectively with the sitting directors.[293] At the risk of sounding overly optimistic, the standardized reservation system may even bring shareholders and nominating committees together to find compatible candidates.[294] Numerous 14a-11 commentators and scholars have concluded that BODs with a minority of shareholder-backed directors improve internal operations and increase share value,[295] likely due to collaboration.

Rather than disjointedness, this integrated BOD actually has the potential to bring cohesiveness through a healthy dose of diversity in U.S. boardrooms.[296]

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[287] *See supra* Part IV.A.1 (explaining how a more progressive reservation system would limit the number of shareholder nominations unless unusual circumstances triggered permission for shareholders to nominate a majority).

[288] Napier, *supra* note 22, at 886.

[289] *Id.*

[290] Murphy, *supra* note 47, at 142–43; Napier, *supra* note 22, at 866.

[291] *See supra* Part IV.A.1 (discussing how 14a-8 and 14a-11 or other proxy access reforms alone exacerbate hostility between directors nominated by shareholders and those nominated by nominating committees).

[292] *Id.*; *see supra* Part IV.A.1 (discussing how the reservation system surpasses 14a-8 and 14a-11 by creating a collaborative dynamic between shareholder-chosen directors and nominee-committee-chosen directors).

[293] *See Shareholder Access*, *supra* note 218, at 58 (discussing how institutional investors may consider potential for disharmony between a nominee and sitting directors when selecting prospective shareholder nominees).

[294] *See supra* Part IV.A.1 (discussing how the reservation system fosters an environment for dialogue between shareholders, their chosen directors, and the rest of the BOD).

[295] *See supra* Part IV.A (explaining how "hybrid" BODs outperform BODs without any shareholder directors).

[296] *See* Murphy, *supra* note 47, at 143 ("[BODs] benefit from members' diverse perspectives and . . . experiences.").

"Exposing 'group think' to fresh perspectives, challenging directors to think outside of the box, questioning decisions being made at the board level—this is what a healthy board often looks like. Tension can be quite useful. . . ."[297] BODs can lack diversity because nominating committees often choose nominees from top management contacts or a defined circle of the sitting directors' acquaintances.[298] The nomination cycle presents the best occasion to infuse beneficial diversity.[299] Diversity may encompass a number of factors such as skillset;[300] level of day-to-day involvement with the corporation;[301] varied incentives;[302] gender;[303] and race.[304] At the nomination stage, shareholders could choose independent or non-independent candidates; candidates with specialized backgrounds like finance; women; and/or minorities. This variety can provide BODs with a wider breadth of knowledge and perspectives for informed decision-making,[305] and in the case of women and minority nominees, also meet popular moral demand.[306]

CONCLUSION

The movement for shareholder proxy access has revealed a number of its shortcomings with respect to shareholder representation in the boardroom. Shareholder nominees rarely receive BOD seats, and theoretical access only applies a certain amount of pressure for directors to handle investor money responsibly.[307] Proxy access alone simply does not allow shareholders to exercise

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297 Letter from the Social Investment Forum to the SEC (Dec. 22, 2003), https://www.sec.gov/rules/proposed/s71903/sif122203.htm; Murphy, *supra* note 47, at 143 (discussing the benefits of various viewpoints in the boardroom).

298 *See* Napier, *supra* note 22, at 845 ("The [Walt Disney Co.] board included [Chairman and CEO Michael] Eisner's personal lawyer, his friends, the principal of his children's school, his architect, and the president of a university Eisner had donated significant money to.").

299 Mary Parmeter, *The Fiduciary Duty to Gender Diversity Within Corporate Boards*, 32 WIS. J.L. GENDER & SOC'Y 85, 87, 101 (2017).

300 Brown, *supra* note 26, at 151–52.

301 *See supra* Part 1.A (discussing the difference between independent and non-independent directors).

302 *Access to the Ballot*, *supra* note 218, at 63.

303 Brown, *supra* note 26, at 163, 167.

304 *Id.*

305 *See supra* Part III.B (discussing how the flow of information is stemmed in BODs filled with independent directors); *see* Murphy, *supra* note 47, at 143 (discussing the benefits of various viewpoints in the boardroom); Brown, *supra* note 26, at 151 (discussing the need for financial expert directors to advise the BOD); *Access to the Ballot*, *supra* note 218, at 63 (discussing how shareholder access to BODs could introduce new incentives); *supra* Part III.B (discussing how the flow of information is stemmed in BODs filled with independent directors).

306 Deborah L. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?*, 39 DEL. J. CORP. L. 377, 401 (2014).

307 *See supra* Part II.C (discussing how proxy access has not translated into BOD representation for shareholders).

their full ownership rights.[308] It also sparks costly hostility between directors and shareholders.[309] Leaning on independent directors as an alternative for protecting shareholder interests only preserves an imbalanced status quo.[310] Reserving BOD seats for shareholder nominees is the best way forward—especially given "hybrid" BODs tend to outperform those without shareholder directors.[311] The SEC should install a mandatory reservation system that allots a minority of BOD seats to shareholder nominees and, potentially, allots the remaining seats to director-backed candidates.[312] By creating a new norm, the SEC could effect a collaborative atmosphere for productive corporate governance in boardrooms across the United States, starting with annual elections.

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[308] *See supra* Part III.A (discussing how shareholders truly hold the right to nominate, not nominating committees) and Part IV.A.1 (discussing how proxy access has not translated into in-person representation for shareholders on BODs).

[309] *See supra* Part IV.A.1 (explaining how proxy access sparks hostility between directors and shareholders).

[310] *See supra* Part II.B–C (discussing how the increased use of independent directors does not address director entrenchment and how BODs with majority independent directors may be less informed in their decision-making).

[311] *See supra* Part IV.A (explaining how "hybrid" BODs outperform BODs without any shareholder directors).

[312] *See supra* Part IV (proposing the SEC install a reservation system for corporate director nominations).