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# THE MAJORITY-VOTING MOVEMENT: CURTAILING SHAREHOLDER DISENFRANCHISEMENT IN CORPORATE DIRECTOR ELECTIONS

## I. INTRODUCTION

The term “corporate governance” means simply “the system by which companies are directed and controlled.”<sup>1</sup> But the contours of the topic are much more complicated.<sup>2</sup> A fundamental debate among corporate-governance commentators is the extent to which shareholders should participate in the process.<sup>3</sup> This debate has continued since 1933, when Adolf A. Berle, Jr. and Gardinier C. Means’s famous book, *The Modern Corporation and Private Property*, predicted the problems inherent in the control structure of the corporation—where investors provide capital to corporations and get virtually no say in how that capital is employed.<sup>4</sup>

The inability of shareholders to dictate the corporate business decisions is a necessary feature of the modern publicly traded corporation.<sup>5</sup> The thousands of dispersed shareholders that make up the public corporation’s investing populace cannot come together to make its business decisions.<sup>6</sup> Therefore, its management must lie in a centralized group; that group is the board of directors.<sup>7</sup> Directors, acting as a board, are empowered under state law to make corporate decisions<sup>8</sup> and all the while must keep the interest of the corporation—and thereby also its shareholders—foremost in their collective mind.<sup>9</sup>

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1. Adrian Cadbury & Ira M. Millstein, *The New Agenda for ICGN*, in 3 ANNUAL DIRECTORS’ INSTITUTE ON CORPORATE GOVERNANCE 673, 686 (2005) (citation omitted). Corporate governance generally refers to “making sure the business is run well.” Judith Burns, *Everything You Wanted to Know About Corporate Governance . . . But Didn’t Know to Ask*, WALL ST. J., Oct. 27, 2003, at R6.

2. See, e.g., Deborah Solomon & Joann S. Lublin, *Voting Rights: Democracy Looks for an Opening*, WALL ST. J., Mar. 22, 2004, at A1.

3. Compare ADOLF A. BERLE, JR. & GARDINIER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 6–7 (Harcourt, Brace & World, Inc. 1968) (1932) (noting the concern that shareholders were unable to exercise control over corporate managers), with Stephen A. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 622–28 (2006) (arguing that limited shareholder involvement is necessary for public corporations to function).

4. See BERLE & MEANS, *supra* note 3, at 6–7.

5. Bainbridge, *supra* note 3, at 622–28.

6. See *id.* at 623. This Note discusses publicly traded corporations only. See *infra* note 34.

7. Bainbridge, *supra* note 3, at 624–25.

8. See, e.g., DEL. CODE ANN. tit. 8, § 141(b) (2006).

9. Brehm v. Eisner, 746 A.2d 244, 258–59 (Del. 2000); Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).

Nevertheless, individual directors can deviate from their legal duties.<sup>10</sup> Thus, in order to effectively safeguard their investment, shareholders must have access to an accountability mechanism.<sup>11</sup> The fundamental mechanism under state law is the power of shareholders to elect directors.<sup>12</sup> In reality, however, shareholders have had very limited say over who ultimately sits on the board.<sup>13</sup> Year after year, incumbent directors nominate themselves to run in the election, and shareholders, as a practical matter, find themselves unable to nominate anyone else.<sup>14</sup> The excessive cost and significant amount of time that goes into waging a proxy contest—one of very few ways of challenging the incumbent nominees under the SEC’s proxy rules—resign shareholders to accept the incumbent directors as the nominees for the election.<sup>15</sup>

The problem of shareholders’ lack of participation in the nomination of directors perhaps would not be as pronounced if shareholders could vote *against* those incumbents in the actual election.<sup>16</sup> Then the board might be more willing to nominate candidates who are more acceptable to the shareholders.<sup>17</sup> But, in the ordinary case, shareholders cannot vote against the board-imposed nominees either.<sup>18</sup> Instead, shareholders have the choice of either casting an affirmative vote for an incumbent director (a “for” vote) or withholding their authority to vote (a “withhold” or “withheld” vote).<sup>19</sup> Such withheld votes are not counted, however, under the current plurality-voting regime that exists in the majority of states, so a single vote received “for” an incumbent director ensures his or her election.<sup>20</sup>

The SEC took note of the interaction between the proxy rules and the state-law voting standards and found that the effect of the regulatory

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10. Patty M. DeGaetano, *The Shareholder Access Teeter-Totter: Will Increased Shareholder Voice in the Director Nomination Process Protect Investors?*, 41 CAL. W. L. REV. 361, 379–80 (2005) (providing examples of directors’ breaches of their fiduciary duties).

11. Bainbridge, *supra* note 3, at 627.

12. Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW 43, 44 (2003).

13. *Id.* at 45.

14. DeGaetano, *supra* note 10, at 391.

15. See Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 914–15 (1993).

16. Stephen Deane, Institutional Shareholder Services, *Majority Voting in Director Elections: From the Symbolic to the Democratic*, in WHAT ALL BUSINESS LAWYERS & LITIGATORS MUST KNOW ABOUT DELAWARE LAW DEVELOPMENTS 2006, at 331, 338 (2006).

17. See *id.* at 345.

18. *Id.* at 338.

19. *Id.* at 338–39.

20. See *id.*

regimes was to undermine shareholders' ability to elect board members.<sup>21</sup> In an attempt to fix the problems in the election process, the SEC proposed the Security Holder Director Nominations Rule, which would have allowed shareholders, without great cost, to nominate their own directors.<sup>22</sup> That rule, however, met significant opposition, and to this day the SEC has not adopted it.<sup>23</sup> Disappointed but undeterred, shareholder activists soon noted another way to fix the election process—this time by looking to state law.<sup>24</sup> They noted that, apart from the board's domination in the nominating process, the other major problem with director elections was the inability of shareholders to vote against incumbent directors in uncontested elections.<sup>25</sup> Thus began the majority-voting movement. If successful, the movement would cause the majority-voting standard to displace plurality voting as the dominant voting standard in uncontested director elections.<sup>26</sup>

This Note analyzes the origins and progress of, and issues surrounding, the majority-voting movement. Part II of the Note provides background information on the function of the board of directors in corporate governance and the distribution of power between the board and shareholders under corporate law, as well as a brief description of the operation of the federal proxy rules. Part III traces the evolution of the majority-voting movement in terms of significant trends in corporate governance, the recent legislation and regulation enacted to curb corporate fraud, and the SEC's controversial Security Holder Director Nominations Rule ("Shareholder Access Proposal" or "Proposed Rule"). Part IV discusses the majority-voting movement as it is unfolding today. Part IV compares and contrasts the dominant plurality-voting standard with that of majority voting, summarizes the corporate community's response to the movement, and discusses state legislative actions and recent amendments to the ABA's Revised Model Business Corporation Act (MBCA) made in response to majority voting. Part V analyzes the problems with the Shareholder Access Proposal and then proceeds to enumerate the advantages and disadvantages of a majority-voting standard. This Part also thoroughly describes the implementation problems that critics of majority

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21. See *infra* text accompanying notes 105–08.

22. See *infra* text accompanying note 108.

23. Posting of Gordon Smith to Conglomerate Blog, *Board Representation*, [http://www.theconglomerate.org/2006/02/board\\_represent.html](http://www.theconglomerate.org/2006/02/board_represent.html) (Feb. 5, 2006).

24. See Deane, *supra* note 16, at 338–39.

25. See *supra* text accompanying note 18; see *infra* note 107 and accompanying text (describing uncontested elections).

26. Deane, *supra* note 16, at 338, 342.

voting often say counsel against its adoption. Finally, Part VI concludes that majority voting—in its true form—is a positive corporate-governance development, despite detractors' arguments, and specifically shows how the implementation problems can be overcome.

## II. BACKGROUND

### A. *The Importance of the Director in the Corporate-Governance System*

The main actors in the corporate-governance<sup>27</sup> process are the corporation's board of directors and senior executives, or officers.<sup>28</sup> Arguably, the board of directors has the single most important role in the corporate-governance system.<sup>29</sup> Under the corporate laws of most states, including Delaware,<sup>30</sup> the board is entrusted with the management of the "business and affairs" of the corporation.<sup>31</sup> State law thus provides the board with the final legal say on most of the corporation's significant decisions and transactions.<sup>32</sup>

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27. "Corporate governance is the system by which we order the relations among—and functions of—members of a corporation's board of directors . . . to enhance the ability of directors to properly discharge their duties to the corporation and its shareholders." Felicia Smith, *Corporate Governance: Seasoned Companies*, in 33 ANNUAL INSTITUTE ON SECURITIES REGULATION 119, 125 (2001). Laws pertaining to the internal governance of a corporation—i.e., "corporate governance"—exist primarily at the state level. *Id.* at 128; *see also* *Business Roundtable v. Sec. & Exch. Comm'n*, 905 F.2d 406, 411–12 (D.C. Cir. 1990) (listing topics and issues often encountered in corporate governance and stating that these are "issues traditionally governed by state law").

28. Burns, *supra* note 1, at R6. Though the directors have the formal legal power to manage the corporation, it is the officers (e.g., the chief executive officer or president, secretary, and treasurer) who "actually run the corporation." ROBERT CHARLES CLARK, *CORPORATE LAW* § 3.2.1, at 105–06 (1986).

29. *See* Bebchuk, *supra* note 12, at 44.

30. Delaware is the state of incorporation of over half of all American publicly traded S&P 500 corporations. Deane, *supra* note 16, at 338. Because of its importance to state corporation law, the Delaware General Corporation Law (DGCL) will be considered throughout the Note. In addition, the MBCA, promulgated by the ABA, is the model for most of the other states, *id.*, so it will be analyzed throughout the Note as well.

31. DeGaetano, *supra* note 10, at 376 (citing DEL. CODE ANN. tit. 8, § 141(a) (2006)).

32. *See, e.g.*, CLARK, *supra* note 28, § 3.2.1, at 105–06 (listing the powers of the board and noting that "[a]s a formal legal matter, the directors . . . have extremely broad powers and responsibilities"). Among the board's important powers and duties are hiring the firm's CEO or president and other senior managers, setting the officers' compensation, and replacing them if necessary. *Id.* Directors also "advise management, assist in the decision making process, improve the business's operations, and assess promising business opportunities and other transactions." DeGaetano, *supra* note 10, at 376.

Directors have other broad powers as well. For example, they have the power to declare whether there will be a dividend; determine the amount of the dividend; adopt, amend, and repeal the company's bylaws; and make important operational decisions. CLARK, *supra* note 28, § 3.2.1, at 106. In practice, however, directors delegate most or all of these responsibilities to officers due to time, information, and budget constraints. *Id.* § 3.2.1, at 108. Directors may also delegate decisions to

The consequence of investing such significant power and discretion in the hands of the board is that shareholders have very limited rights.<sup>33</sup> To be sure, shareholders, consistent with their role as the “residual risk-takers in the capital structure,”<sup>34</sup> do retain certain rights, such as the right to vote on certain corporate transactions and decisions.<sup>35</sup> Still, these voting rights, which vary from state to state, are limited to only the most extraordinary corporate matters.<sup>36</sup>

Despite the paradigm of vesting shareholders with very little voting power, shareholders have always retained one voting right that was supposed to be absolute: a right to vote in the election of directors.<sup>37</sup> Since

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subcommittees of the board that they create. CLARK, *supra* note 28, § 3.2.1, at 106; *see also* Del. Code Ann. tit. 8, § 141(c) (2006).

Directors are responsible for initiating and approving certain “extraordinary” corporate actions, such as mergers, dissolutions, sales of all of the corporation’s assets, and amendments to the company’s charter; however, directors must also submit these important matters to the shareholders for their approval. CLARK, *supra* note 28, § 3.2.1, at 106.

33. *See, e.g.*, CLARK, *supra* note 28, § 3.1.1, at 94 (noting, in particular, that shareholders cannot “order the directors to follow particular business policies and practices”); Posting of Stephen Bainbridge to Pointoflaw.com, *Corporate Governance: In Praise of the Status Quo*, <http://www.pointoflaw.com/feature/archives/002939.php> (Sept. 13, 2006 16:48 EST) [hereinafter Bainbridge, *Corporate Governance*].

34. Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company’s Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW 67, 79 (2003). When this Note refers to “shareholders,” it is generally referring to common stockholders, who ordinarily have voting rights in public companies. *See, e.g.*, N.Y. Stock Exch., Inc., Listed Company Manual § 313.00 (2003). Further, this Note discusses director elections only in publicly traded corporations, and not in closely held or private corporations, as the issues surrounding shareholder voting in director elections are not as prevalent in the latter context. *See* ABA COMM. ON CORPORATE LAWS, ABA SECTION OF BUS. LAW, DISCUSSION PAPER ON VOTING BY SHAREHOLDERS FOR THE ELECTION OF DIRECTORS n.6 (2005), <http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20050621000000.pdf> [hereinafter ABA DISCUSSION PAPER].

35. *See, e.g.*, Lipton & Rosenblum, *supra* note 34, at 79.

36. CLARK, *supra* note 28, § 3.1.1, at 94. These extraordinary matters include sales of all the corporation’s assets, the decision to dissolve the corporation, and amendments to the corporate charter. *Id.* Shareholders have other voting rights (on nonoperating decisions) under state law as well, including: adopting, amending, or repealing the corporation’s bylaws; removing directors; and adopting shareholder resolutions, which may approve board actions or request that the board take certain actions. *Id.* § 3.1.1, at 94. For the general argument that vesting shareholders with limited power in favor of centralized management in the board of directors is necessary to the functioning of the public corporation, *see id.* § 3.1.1, at 94–95; Bainbridge, *Corporate Governance*, *supra* note 33.

37. *See* CLARK, *supra* note 28, § 3.1.1, at 95. Shareholders vote for directors, either in person or by proxy, at an annual meeting that all public corporations are required to hold. *Id.* § 9.1.1, at 358. In most companies, shareholders vote for the entire set, or slate, of directors every year at the annual meeting. *See id.* § 3.1.1, at 358. Some companies, however, have what is termed “classified” boards. In such companies, the board is split into different classes, and only certain classes participate in the shareholder vote each year. For example, Class A may be up for a shareholder vote in year 1, Class B in year 2, and Class C in year 3. *Id.* § 3.2.1, at 105. Board classification has the effect of allowing directors to serve for multiple years without having to face a vote each year. *See id.*; *see also* DEL. CODE ANN. tit. 8, § 141(d) (2006) (providing that corporations can have classified boards of directors).

directors are the central force in effective corporate governance, it seems logical to allow shareholders to vote on the election of those who “hold in the palms of their hands the broad trust and confidence of the shareholders.”<sup>38</sup> The theory behind giving shareholders the power to vote directors out of office is that directors will be accountable to shareholders and responsive to their concerns and requests, at the peril of being unseated otherwise.<sup>39</sup>

It may come as some surprise, then, to learn that in practice, shareholders have very little say in the nomination and election of directors. In fact, the notion that shareholders have the power to replace directors who disserve their interests is, in the words of Professor Lucian A. Bebchuk, “largely a myth.”<sup>40</sup> The election of directors at the annual meeting of shareholders each year has been labeled a “rubber-stamping” of a “yes vote” for the incumbent directors who essentially nominated themselves.<sup>41</sup>

### *B. The Federal Proxy Laws*

Before evaluating the efficacy of shareholder voting in director elections, however, it is necessary to understand how the federal proxy laws interact with the state laws on director elections. SEC Regulation 14A, implementing section 14(a) of the Securities and Exchange Act of 1934 (the Exchange Act), constitutes the federal proxy rules.<sup>42</sup> It provides, *inter alia*, that whenever someone (whether corporation’s management or a

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Generally, each shareholder receives one vote for each share of stock that he or she owns. CLARK, *supra* note 28, § 9.1.3, at 361. In the context of voting for directors, this means that each shareholder may cast that many votes (i.e., one vote times the number of shares owned) for each director. *Id.* On the other hand, cumulative voting—if it is allowed under the laws of the state of incorporation and authorized under the corporate charter—allows shareholders to take the total number of votes they have (the number of shares times the number of director positions for which the shareholder is entitled to vote) and cast them all for one or more directors. The purpose behind cumulative voting, supporters say, is that it gives minority shareholders a chance to have at least one director on the board when they may not have had such an opportunity in the absence of cumulative voting. *Id.* § 9.1.3, at 361–64.

38. DeGaetano, *supra* note 10, at 375.

39. *See, e.g.*, Bebchuk, *supra* note 12, at 44.

40. *Id.*

41. DeGaetano, *supra* note 10, at 391.

42. CLARK, *supra* note 28, § 9.2, at 366–68 (citing Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (2000)). Section 14(a) of the Exchange Act requires any security that is traded on any national securities exchange to be registered under that section. CLARK, *supra*, § 9.2, n.1. Such securities exchanges, including the New York Stock Exchange (NYSE), the American Stock Exchange, and the National Association of Securities Dealers Automated Quotations System (NASDAQ) are collectively referred to hereinafter as self-regulatory organizations (SROs). *See* DeGaetano, *supra* note 10, at 361.

shareholder) is soliciting a proxy<sup>43</sup> from a shareholder, that person must also provide, prior to or contemporaneously with the solicitation, and pursuant to Rule 14a-3 under the Exchange Act, a proxy statement that is in accord with Schedule 14A of Regulation 14A.<sup>44</sup> In addition, the person or corporation seeking the proxy must provide the shareholder with a proxy card on which to vote, and if the proxy card contains the names of director nominees up for election at the annual meeting, there must be a space in which shareholders can withhold authority to vote for them.<sup>45</sup> As will become apparent, these rules greatly influence director elections under state law. In particular, they prescribe the rules whereby shareholders may challenge the directors nominated by the board and thereby affect director nominations under state law.<sup>46</sup>

### III. THE EVOLUTION OF THE MAJORITY-VOTING MOVEMENT

The majority-voting movement is a recent phenomenon that quickly became *the* issue of the 2005 and 2006 proxy seasons and saw its greatest gains in the 2007 proxy season.<sup>47</sup> The movement for majority voting in the

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43. A proxy refers to a “document or other authorization by which the shareholder grants to another person the power to attend a shareholders’ meeting and exercise some or all of the shareholder’s voting rights.” Teresa Carnell & James J. Hanks, Jr., *Shareholder Voting and Proxy Solicitation: The Fundamentals*, 37 MD. B.J. 23, 24 (2004).

44. Securities Exchange Act Rule 14a-8, 17 C.F.R. § 240.14a-3(a) (2006); Securities Exchange Act Regulation 14A, Schedule A, 17 C.F.R. § 240.14a-101 (2006). Note, however, that on January 22, 2007, the SEC adopted Exchange Act Rule 14a-16, which will allow proxy solicitors to post their proxy materials on the internet after giving notice to the shareholders. Internet Availability of Proxy Materials, 72 Fed. Reg. 4148 (Jan. 29, 2007) (codified at 17 C.F.R. § 240.14a-16 (2007)).

45. Exchange Act Rule 14a-4(b)(2), 17 C.F.R. § 240.14a-4(b)(2) (2006). Also, the proxy card must, in boldface print, indicate whether management is soliciting the proxy. *Id.* § 240.14a-4(a).

The SEC mandated the inclusion of a “withhold” space on the proxy card in 1967. Grundfest, *supra* note 15, at 903. The SEC contemplated mandating an “against” option but decided against doing so since, in a majority of states, a plurality-voting standard was in place, and under a plurality-voting standard, a withhold vote had no effect. *See* N. Fork Bancorporation, Inc. v. Toal, 825 A.2d 860, 869 (Del. Ch. 2000). Thus, the SEC did not want to mislead shareholders into believing that they had a right to cast an affirmative vote against a particular candidate for a director when under state law they did not. *Id.* The subject of plurality voting is discussed more fully in Part IV. *See infra* notes 119–35.

46. *See, e.g., infra* Part III.A.3; *see also infra* text accompanying notes 108–12. The federal proxy rules also allow shareholders to make proposals to the board to implement decisions that are within the ambit of shareholder power under state law. *See infra* note 108.

47. *See, e.g.,* William Baue, *Majority-Vote Director Election Shareowner Resolutions to Top 100, Dominate Proxy Season*, SOCIAL FUNDS, Jan. 10, 2006, <http://www.socialfunds.com/news/article.cgi/1902.html> (“As the 2006 proxy season is taking shape, [the topic of] majority-vote director elections . . . is emerging as the one of the biggest issues on the corporate ballots.”); Paul S. Atkins, Comm’r, Sec. & Exch. Comm’n, Speech by SEC Comm’r: Remarks at the Corp. Dir. Forum 2007, <http://www.sec.gov/news/speech/2007/spch012207.psa.htm> (indicating that, for the 2007 proxy season, there are already 104 shareholder proposals pending for the adoption of majority voting); *see also infra* notes 147–50 and accompanying text.

election of corporate directors is a response to the noted lack of shareholder participation in the current system for voting in director elections.<sup>48</sup>

Before delving into the specifics of plurality and majority voting and why many view the plurality-voting model as defunct, it is necessary to understand the impetus for the majority-voting movement. To that end, I first provide a brief history of corporate governance and the events that lead to calls for increased shareholder voice in the direction of the corporation. I then discuss the major legislative and regulatory responses to the perceived dearth of shareholder participation in corporate affairs, including a rule proposed by the SEC in 2003 to deal with the problem.

A. *The History of Corporate Governance—The Failure of the Board of Directors to Look After Shareholders’ Interests*

1. *The Evolution of the Corporation and the Separation of Ownership from Control*

In 1932, Adolf A. Berle and Gardiner C. Means, the authors of *The Modern Corporation and Private Property*, expressed their concern over the extent to which ownership of the corporation by shareholders and control of the corporation had diverged.<sup>49</sup> They noted that ownership was becoming dispersed over many passive investors as corporations grew larger and became public, and executives, in place of the shareholders, were beginning to manage the corporation.<sup>50</sup> Commentators predicted that “agency costs” would arise from the need to oversee these executives.<sup>51</sup> Agency costs, in general, arise from the need to monitor agents.<sup>52</sup> The theory is that agents—in the absence of monitoring by the principals—will pursue their own self-interested goals rather than those of the principal.<sup>53</sup>

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48. See Bebchuk, *supra* note 12, at 45; Deane, *supra* note 16, at 346; COUNCIL OF INST. INVESTORS & NAT’L ASS’N OF CORP. DIRS. TASK FORCE, LOOKING BACK, LOOKING FORWARD: RECOMMENDATIONS ON MAJORITY VOTING, SECTION 404, AND EXECUTIVE COMPENSATION app. B at 1 (2007), <http://www.nacdonline.org/images/CII-NACD%20Task%20Force%20Report-Reforms-Final.pdf> [hereinafter CII-NACD REPORT].

49. Cadbury & Millstein, *supra* note 1, at 683.

50. *Id.*

51. DeGaetano, *supra* note 10, at 379–80.

52. Lipton & Rosenblum, *supra* note 34, at 74–75 (finding the “principal-agent” analogy, when applied in a corporate context, to be “flawed,” but noting nevertheless that “[m]uch of the academic literature on corporate governance uses a model of the shareholder as principal and the manager as agent”).

53. *Id.* at 75 nn.20–21.

Directors are supposed to be the solution to the agency problem, as they control the hiring, compensation, and firing of the corporation's management<sup>54</sup> and owe fiduciary duties to both the corporation and its shareholders.<sup>55</sup> Thus, when a manager acts contrary to the interest of the shareholders or the corporation by undertaking activities that reduce corporate value and enhance the principal's own self-interest, the board is supposed to sanction or replace that manager.<sup>56</sup> Directors are subject to liability for breaches of their fiduciary duties.<sup>57</sup>

Of course, directors themselves are agents of the shareholders, and as agents, they may produce the same agency costs as the managers. Directors may, for example, act in their own self-interest, ignoring the interest of the shareholders.<sup>58</sup> And though directors are subject to liability for breaches of their fiduciary duties, "[c]ourts will generally afford directors protection under the 'business judgment rule' when they have acted in an informed manner, in good faith and in the best interests of the corporation."<sup>59</sup>

Unfortunately, history shows that agency cost "theory," described ominously by Berle and Means, is more than just a theory; in many cases, it is the reality. "[T]he governance picture that developed through much of the twentieth century could be summarized as one of weak boards, powerful executives, and shareholders unable to hold either board or executives effectively to account."<sup>60</sup> Thus, the board was failing to adequately protect the interests of shareholders from the dereliction of self-interested managers.<sup>61</sup>

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54. See *supra* note 32 and accompanying text.

55. DeGaetano, *supra* note 10, at 376–77 (citing *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939)).

56. See Solomon & Lublin, *supra* note 2, at A1.

57. See, e.g., *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000) (fiduciary duty of care); *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939) (fiduciary duty of loyalty).

58. See DeGaetano, *supra* note 10, at 380.

59. *Id.* at 377 (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985)). The business judgment rule is a presumption that the corporate agents acted in good faith and in the best interest of the corporation. Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131, 1134 (2006). Thus, courts generally "defer to [the corporate agents'] decisions." Bebchuk, *supra* note 12, at 44.

60. Cadbury & Millstein, *supra* note 1, at 683.

61. See *id.*; see also *infra* notes 90–91 and accompanying text (describing the boards' hands-off approach, which facilitated the accomplishment of the massive financial frauds in the 2000s).

## 2. *The Market as the Disciplinarian: The Period of the Hostile Takeover*

As noted above, even as early as 1932, the agency problem associated with the separation of ownership and control permeated the discussion of the corporate form.<sup>62</sup> For the first part of the twentieth century, though, it seemed that there was a solution: the stock market.<sup>63</sup> If corporate managers and directors were unresponsive to shareholders, shareholders would sell the company's stock and force down the price of the shares.<sup>64</sup> This downward stock price movement had the effect of making the corporation more susceptible to a hostile takeover by a raider. These raiders, noting the depressed stock price and seeking to make a profit, would purchase large amounts of the stock and could then replace unresponsive management after taking control of the board.<sup>65</sup> Thus, the theory was that the threat of replacement kept incumbent management in line.<sup>66</sup>

But some commentators have noted that, during the two decades spanning the 1970s and the 1980s (the "takeover period"), the takeover mechanism started to get out of hand.<sup>67</sup> First, the hostile acquirer who purchased the shares in an effort to displace incumbent management did not always install better management.<sup>68</sup> Second, since these takeovers were financed primarily through debt, purchasers became mired in excessive levels of debt post acquisition.<sup>69</sup> Moreover, management soon learned how to circumvent hostile takeovers by developing antitakeover devices—e.g., the poison pill<sup>70</sup>—and by creating conglomerate organizations that were too large to take over.<sup>71</sup> In addition, states passed antitakeover statutes that helped to reduce the incidence of hostile takeovers.<sup>72</sup> Finally, and perhaps most devastatingly, the frequent hostile

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62. See *supra* text accompanying notes 51–53.

63. Edward S. Adams, *Corporate Governance After Enron and Global Crossing: Comparative Lessons for Cross-National Improvement*, 78 IND. L.J. 723, 726 (2003); see also Cadbury & Millstein, *supra* note 1, at 683.

64. Adams, *supra* note 63, at 726; Cadbury & Millstein, *supra* note 1, at 683.

65. Adams, *supra* note 63, at 726–27. The hostile raider hoped to install directors who would "make better use of the [corporate] assets," thereby increasing the value of the corporation as well as the value of the raider's investment. See Cadbury & Millstein, *supra* note 1, at 684.

66. See Cadbury & Millstein, *supra* note 1, at 684.

67. See Lipton & Rosenblum, *supra* note 34, at 85.

68. Cadbury & Millstein, *supra* note 1, at 684.

69. *Id.*

70. Poison pills are devices that make it more difficult for hostile bidders to acquire a company. See Grundfest, *supra* note 15, at 858 n.1 (summarizing the mechanics of the poison pill).

71. Cadbury & Millstein, *supra* note 1, at 684.

72. Grundfest, *supra* note 15, at 858.

takeover attempts worked to foster mistrust between shareholders and directors, further eroding the communication between them.<sup>73</sup>

### 3. *Shareholders' Last Resort: Expensive Proxy Contests*

With the “demise of the hostile takeover,” shareholders had only one weapon left to battle unyielding boards: the proxy contest.<sup>74</sup> A proxy contest occurs when shareholders attempt to solicit proxies from other shareholders for their *own*—not management’s—nominee or nominees for a director position.<sup>75</sup> If a shareholder mounts a successful proxy contest for one, multiple, or all of his or her director candidates by soliciting a sufficient number of votes from fellow shareholders, then some or all of the incumbent directors will be replaced.<sup>76</sup>

The problem with proxy contests, however, is that they are very costly to wage. The shareholder wishing to initiate one must pay for the cost of preparing and mailing out proxy statements to other shareholders,<sup>77</sup> and if the proxy contest is not successful, she does not recover those costs.<sup>78</sup> Additionally, even if the shareholder were reimbursed, she would still get only her proportional interest of the increased value in the share.<sup>79</sup> Thus, the problem is that the benefit of waging a proxy contest accrues to all shareholders, while the risk of loss (the costs) is borne only by the shareholder waging the contest.<sup>80</sup> It is not surprising, then, that proxy contests are a relatively rare phenomenon.<sup>81</sup>

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73. Lipton & Rosenblum, *supra* note 34, at 85.

74. See Grundfest, *supra* note 15, at 862. Though shareholders have had and continue to have the power to bring a derivative suit against the corporate directors and/or officers who they feel are not acting in the best interests of the corporation, these suits are very difficult to win because of the operation of the business judgment rule, which shields directors and managers from liability for having made poor business decisions. CLARK, *supra* note 28, § 9.5.4, at 396–97.

75. Lipton & Rosenblum, *supra* note 34, at 69. Proxy contests can also involve shareholder solicitations for proxies to vote on matters besides director elections, such as “proposed by-law amendments.” Bebchuk, *supra* note 12, at 45–46.

76. See, e.g., Bebchuk, *supra* note 12, at 45.

77. Grundfest, *supra* note 15, at 914 (stating that proxy contests can cost the shareholder soliciting the proxies millions of dollars); see also Bebchuk, *supra* note 12, at 65 n.64 (noting the legal expenses associated with drafting the proxy statement). But see Atkins, *supra* note 47 (describing the newly adopted Internet Availability of Proxy Materials rules, which should reduce the printing costs associated with mailing out proxy statements, but noting also that legal expenses and solicitation expenses still remain).

78. E.g., *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 128 N.E.2d 291, 293 (N.Y. 1955) (“The stockholders . . . have the right to reimburse *successful* [proxy] contestants for . . . expenses incurred by them.”) (emphasis added).

79. Grundfest, *supra* note 15, at 908–09.

80. *Id.* at 908. This phenomenon is often referred to as the free-rider problem because each shareholder “rationally prefers that her fellow shareholders bear the costs of monitoring while she

#### 4. *The Rise of the Institutional Investor*

The period beginning in the 1970s and extending through the 1990s saw a marked increase in the equity holdings of institutional investors.<sup>82</sup> Institutional investors include corporate pension funds, commercial banks, insurance companies, and investment banks, to name a few.<sup>83</sup> By the late 1990s, institutional investors owned more than sixty percent of the equity in publicly traded companies.<sup>84</sup> Many commentators stated that the marked increase in ownership of stock by institutional investors was the answer to the problem of lack of shareholder voice in corporate governance, perhaps in lieu of other unsuccessful governance devices such as takeovers and proxy contests.<sup>85</sup> The thinking was that such investors were large enough that, if they voiced their concerns to management, management would be more compelled to listen. In addition, they had the resources to monitor management, a practice which, it was hypothesized, would mitigate the agency problem.<sup>86</sup> However, it soon became clear that institutional investors observed what is known as the “‘Wall Street’ Rule;” they preferred to liquidate stock that became risky due to poor corporate governance, rather than engage in shareholder activism.<sup>87</sup> Thus, it appeared that institutional investors were not the answer after all.<sup>88</sup>

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reaps the benefits for free.” *Id.* By contrast, in a hostile takeover, though the shareholder is actually purchasing all (or a majority) of the shares, which can be a much more costly venture, the benefit accrues entirely to that shareholder (if he or she purchases all of the shares). Thus, all else equal, a shareholder would prefer to organize a takeover. CLARK, *supra* note 28, at § 9.5.4, 397–98, 399. However, hostile takeovers may be prevented by the antitakeover devices described above. *See supra* notes 70–71 and accompanying text.

81. *See* Bebchuk, *supra* note 12, at 45–46.

82. *See, e.g.*, Cadbury & Millstein, *supra* note 1, at 684.

83. Grundfest, *supra* note 15, at 919.

84. Roberta S. Karmel, *Should a Duty to the Corporation Be Imposed on Institutional Shareholders?*, 60 BUS. LAW. 1, 9–10 (2004). In 2002, institutional investors held approximately 49.8% of United States equities. DeGaetano, *supra* note 10, at 381.

85. *See, e.g.*, Cadbury & Millstein, *supra* note 1, at 684. The idea that shareholders should begin to look out for their own interests had also been expressed by Justice Brandeis, and institutional shareholders seemed capable of actually doing so. *Id.*

86. *See id.*

87. Bainbridge, *supra* note 3, at 619.

88. *See id.* Still, the votes of institutional investors are clearly important, as demonstrated by management’s hiring of proxy solicitors to specifically seek the proxies of institutional shareholders. *See* Carnell & Hanks, *supra* note 43, at 29. Moreover, institutional shareholders may be more likely to exhibit shareholder activism today, as private companies functioning as proxy advisory services (for example, Institutional Shareholder Services (ISS)) now exist which advise their institutional-shareholder clients on how to vote on corporate matters. Proxy solicitors often make pitches to ISS so that ISS will advise its client to vote a certain way. *See id.*; *see also* CII-NACD REPORT, *supra* note 48, app. B at 29.

### 5. *The 2000s: The Era of Corporate Scandals*

Following unprecedented growth in the stock market during the 1990s due to the technology boom and the cooling of concern over shareholder activism during that period,<sup>89</sup> the stock market experienced drastic changes. The year 2001 saw natural gas company Enron collapse upon exposure of massive financial fraud. In 2002, the trend continued with the collapse of WorldCom and the large losses suffered by Adelphia Communications Corporation and Tyco International Ltd.—all as a result of financial-reporting fraud. These massive frauds revealed “the systemic governance failures in America.”<sup>90</sup> The board of directors of each of these corporations was implicated for failing to prevent the perpetration of these massive financial frauds.<sup>91</sup> The entire investment community criticized the boards for failing to exercise one of their primary responsibilities: monitoring the senior executives to ensure that they were acting in the best interest of the company.<sup>92</sup> Even today, investors continue to lament the “systemic imbalance of power favoring corporate management and directors over shareowners.”<sup>93</sup>

#### *B. The Legislative and Regulatory Responses*

##### *1. Congress, Self-Regulatory Organizations, and the SEC Take Action*

Following the corporate frauds that obliterated “tens of billions of dollars of market capital,”<sup>94</sup> Congress, the self-regulatory organizations (SROs), and the SEC stepped in and undertook “the most far-reaching set

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89. DeGaetano, *supra* note 10, at 366.

90. *Id.* at 364–75.

91. *See id.* at 375 (noting that the observation learned from the corporate scandals was that “[a]n effective board of directors is central to good corporate governance”); *see also* Burns, *supra* note 1, at R6 (remarking that the recent scandals exposed that corporate managers were “acting like corporate monarchs—operating unchecked by boards, bankrupting their companies, and leaving shareholders with nearly worthless stock”).

92. *See, e.g.*, DeGaetano, *supra* note 10, at 370–71 (describing Enron’s officers’ perpetration of accounting frauds and the board’s allowing the officers to get away with it).

93. William Baue, *Binding Resolutions and Coordination Circumvent Structural Limitations of Shareowner Action*, SOCIAL FUNDS, Feb. 18, 2005, <http://www.socialfunds.com/news/article.cgi/1642.html>. Current corporate governance issues that continue to vex shareholder activists include corporate boards’ willingness to approve exorbitant executive compensation contracts, *see, e.g.*, Burns, *supra* note 1, at R6, and boards’ seeming acquiescence in the practices that have given rise to the recently exposed stock-option backdating schemes, *see, e.g.*, Carolyn Said, *Backdating Scandal Expands: Tougher Regulations Expected to Restrict How Stock Options Fit Within Executive Compensation*, S.F. CHRON., June 18, 2006, at F1.

94. DeGaetano, *supra* note 10, at 364.

of new corporate regulation since the Securities Act of 1933 and the Securities Exchange Act of 1934.”<sup>95</sup> First, Congress passed the Sarbanes-Oxley Act of 2002 to improve the quality of information disseminated by the financial reporting system.<sup>96</sup> Second, the New York Stock Exchange (NYSE) and the NASDAQ enacted several new rules, which the SEC approved on November 4, 2003,<sup>97</sup> requiring that a majority of the board consist of independent directors<sup>98</sup> and mandating the creation of certain key committees of the board.<sup>99</sup> The rationale behind requiring that directors be independent was to prevent conflicts of interest that might otherwise occur in the exercise of the directors’ duties to act on behalf of the shareholders.<sup>100</sup>

Finally, on November 24, 2003, the SEC passed a new rule requiring proxy-statement disclosure of the process whereby the board’s nominating committee<sup>101</sup> chooses the candidates for director positions.<sup>102</sup> The purpose of the rule was to increase the transparency to investors of the company’s process for nominating directors through disclosure and to allow shareholders to independently assess the adequacy of that process.<sup>103</sup>

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95. Lipton & Rosenblum, *supra* note 34, at 68.

96. *See, e.g.*, JOHN C. COFFEE, JR., JOEL SELIGMAN & HILLARY A. SALE, SECURITIES REGULATION: CASES AND MATERIALS, 53–54 (10th ed. 2007).

97. *See* DeGaetano, *supra* note 10, at 385.

98. *See, e.g.*, NYSE, INC., LISTED COMPANY MANUAL § 303A.01 (2003). The NYSE defines an independent director as one who “has no material relationship with the listed company.” An example of a material relationship is an employment relationship with the company or having a family member who was an executive officer of the company. *Id.* § 303A.02(a), (b).

99. *Id.* §§ 303A.04–.05, .07. These committees include the audit committee, the nominating/corporate-governance committee, and the compensation committee. *Id.*

100. *See id.* § 303A.01 cmt.

101. All companies listing on the NYSE must now have a nominating committee. *See id.* § 303A.04. Their primary function is “recommend[ing] candidates for inclusion on corporate proxy ballots.” Burns, *supra* note 1, at R6. Though the nominating committee recommends candidates as an initial matter, the board “has the final say in selecting [the actual] nominees.” *Id.* Prior to the SRO and SEC rules, companies were not required to have nominating committees. *See* DeGaetano, *supra* note 10, at 404. In 1977, the SEC adopted rules requiring companies to disclose whether they had a nominating committee and whether the committee would consider director nominees proposed by shareholders. *Id.* Those companies that did have nominating committees did not always require that the committee consist of a majority of independent directors. *See* CLARK, *supra* note 28, § 3.2.1, at 109 (pointing out that the nominating committees used to be staffed by management or friends of management and thus would be strongly inclined to nominate incumbent, management-friendly directors).

102. DeGaetano, *supra* note 10, at 387–89.

103. *See id.* at 387–88. Specifically, the rule required disclosure of the following: the nominating committee’s process for identifying and choosing between director nominees; whether the board would consider nominees suggested by shareholders (and if so, the procedure shareholders had to follow to have the board consider a nominee); the minimum qualifications a director nominee had to meet to be eligible; the company’s process whereby shareholders could communicate with directors; and certain other disclosures pertaining to directors. *Id.* at 388–90. The rule also required that the

## 2. *The Proposed Shareholder-Access Rule*

On October 14, 2003 the SEC issued for public comment Proposed Rule 14a-11, the Security Holder Director Nominations Rule (the “Proposed Rule”), which soon became one of the most controversial rules the SEC had ever proposed.<sup>104</sup> The purpose of the rule was to “improve the ability of security holders to participate meaningfully in the nomination and election of directors . . . without unduly burdening companies . . . where . . . the proxy process may be ineffective.”<sup>105</sup> The concern driving the proposal of the rule was that the operation of the proxy rules did not provide shareholders an adequate voice in the election of the directors who were to represent their interests.<sup>106</sup> The SEC observed that the current state of director elections was that the corporation—by way of the nominating committee—exclusively provided the slate of nominees on which shareholders were to vote.<sup>107</sup>

Taking plurality voting under state law as given, the SEC planned to use the Proposed Rule to dismantle the other force contributing to the lack of shareholder voice in the election of directors: the inability of shareholders to “bypass the nominating committee” and nominate their own directors in the company’s official proxy statement without having to wage a proxy contest and therefore without paying the associated expenses.<sup>108</sup> In order to foster this proxy statement access, the Proposed

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company disclose its policies pertaining to directors’ attendance at meetings and disclose the number of directors who attended the previous annual meeting. *Id.* at 389.

104. *Id.* at 393. Following publication of the rule, the SEC received over twelve thousand public comment letters. *Id.*

105. *Id.* at 393–94 (quoting Security Holder Director Nominations, 68 Fed. Reg. 60,784, 60,786 (proposed Oct. 23, 2003) (to be codified in 17 C.F.R. pts. 240, 249, 274)).

106. *See id.* at 390.

107. *See id.* Shortly after the SEC issued the Proposed Rule, the SROs promulgated rules requiring listed companies’ nominating committees to consist entirely of independent directors. *See supra* notes 97–100 and accompanying text. Despite this change, however, the SEC noted that “the presence of nominating committees [still had] not eliminated [shareholders’] concerns . . . with regard to the barriers to meaningful participation in the proxy process.” Security Holder Director Nominations, 68 Fed. Reg. 60,786.

In addition to the problems with the nomination process, the SEC observed that the small number of election contests due to the operation of the proxy rules, in conjunction with the state-law plurality-voting standard—which prevents shareholders from voting against the incumbent directors, *see infra* text accompanying note 124—meant that shareholders had no effective mechanism to elect someone other than an incumbent director. DeGaetano, *supra* note 10, at 390–91. A contested election is one in which a proxy contest has produced more nominees than there are seats for directors, creating competition among the incumbent (board-nominated) and nonincumbent (shareholder-nominated) director nominees. *See, e.g.*, CII-NACD REPORT, *supra* note 48, app. B at 4–5. The “vast majority” of director elections in public companies are uncontested. ABA DISCUSSION PAPER, *supra* note 34, at 6.

108. DeGaetano, *supra* note 10, at 390. Shareholders wishing to include voting proposals on the

Rule essentially allowed qualified shareholders<sup>109</sup>—upon the occurrence of certain triggering events<sup>110</sup>—to nominate less than a full slate of directors by placing his or her nominees directly into the company’s official proxy statement.<sup>111</sup> The effect of the rule was to allow shareholders to initiate an election contest without having to prepare and distribute a proxy statement, which, as noted previously, entails a substantial cost.<sup>112</sup>

Opponents of the Proposed Rule—including corporate directors, executives, law firms, and business groups—vociferously attacked it.<sup>113</sup> Their primary basis for opposition was that the rule would be costly and

company’s “official” proxy statement (i.e., the proxy statement that accompanies the proxy cards with which the incumbent directors intend to solicit votes for their reelection) currently have some limited access to that proxy statement under Rule 14a-8 of the Exchange Act. Rule 14a-8 is often called the Shareholder Proposal Rule. See *Shareholder Proposals: What You Need to Know*, COOLEY ALERT! (Cooley Godward LLP), Jan. 13, 2004, at 1, [http://www.cooley.com/files/tbl\\_s24News/PDFUpload152/780/ALERT\\_Shareholder\\_Proposal.pdf](http://www.cooley.com/files/tbl_s24News/PDFUpload152/780/ALERT_Shareholder_Proposal.pdf). Under this rule, certain shareholders may be able to include certain proposals on the company’s proxy statement. See *id.* Typically, such proposals are precatory (or nonbinding), meaning that they only recommend that the board take a particular action. *Id.* at 4. The reason that the shareholders submit only precatory proposals is that the rule allows the company to keep off the proxy statement any proposal that relates to an issue over which the shareholder has no say under the state’s corporate law. *Id.*; see also Exchange Act Rule 14a-8(i)(1), 17 C.F.R. § 240.14a-8(i)(1) (2006). And, as noted earlier, shareholders have very limited voting rights under most states’ corporate laws, including Delaware’s. See *supra* notes 33–35 and accompanying text. Precatory proposals, on the other hand, do not demand that the board take action on the topic, and therefore the company may not exclude such a proposal. *Shareholder Proposals: What You Need to Know*, *supra*, at 4; see also 17 C.F.R. § 240.14a-8(i)(1). Shareholder proposals often pertain to corporate-governance topics; common proposals include those calling for the elimination of poison-pill provisions and those requesting that the chairman of the board be someone other than the CEO. *Shareholder Proposals: What You Need to Know*, *supra*, at 2.

Whatever the range of topics permissible under Rule 14a-8, the company does not have to include any proposal that “relates to an election for membership on the company’s board of directors.” 17 C.F.R. § 240.14a-8(i)(8). Thus, under the rule, shareholders do not have access to the company’s proxy statement to place a nominee for a director candidate on the company’s proxy statement. See *Shareholder Proposals: What You Need to Know*, *supra*, at 3, 4. The Proposed Rule sought to allow shareholders to do precisely that. See *infra* text accompanying notes 109–12.

109. The Proposed Rule defined a qualifying shareholder as one who beneficially owned five percent or more of the issuer’s equity securities, in addition to satisfying other holding-period and filing requirements. DeGaetano, *supra* note 10, at 396–97.

110. The “triggering events” were designed to target those companies at which there existed “evidence of ineffectiveness or security holder dissatisfaction with [the] company’s proxy process.” *Id.* at 395 (quoting Security Holder Director Nominations, 68 Fed. Reg. at 60,789–90). The triggering events were the following: (1) any of the company’s directors’ receipt of thirty-five percent or more withhold votes of those cast in a director election; or (2) a shareholder proposal submitted under Rule 14a-8 asking for the invocation of the Proposed Rule at the next annual meeting of the company, where the proposal received a majority of the votes cast by shareholders at the annual meeting. *Id.* at 395.

111. DeGaetano, *supra* note 10, at 390–91, 394–99.

112. See Lipton & Rosenblum, *supra* note 34, at 83.

113. See, e.g., Corporate and Securities Law Blog, *SEC to Revisit Proxy Access*, <http://www.corporatesecuritieslawblog.com/46378-print.html> (Sept. 7, 2006).

was unnecessary.<sup>114</sup> Perhaps as a result of this fierce opposition, the SEC did not adopt the Proposed Rule.<sup>115</sup> On November 28, 2007, after several years of heated debate, the SEC finally put the issue to rest by adopting a clarifying amendment to Exchange Act Rule 14a-8(i)(8), which indicated that shareholders may not make shareholder proposals giving shareholders the power to propose director nominees in the company's proxy statement. This amendment effectively stripped shareholders of the power to use the proxy statement to do what the Proposed Rule would have otherwise allowed them to do.<sup>116</sup>

#### IV. THE MAJORITY-VOTING MOVEMENT

The death of the Proposed Rule was one of the most significant catalysts of the majority-voting movement.<sup>117</sup> Many shareholders were perturbed that they had so little voice in the election of directors. Following the corporate scandals, moreover, they felt this disability to be even more of a handicap.<sup>118</sup> Thus, shareholder activists, institutional investors, and their advisers turned to changing the state-law voting standard in director elections existing in nearly all the states—that is, the plurality-voting standard.<sup>119</sup>

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114. See DeGaetano, *supra* note 10, at 408–20. Opponents of the Rule espoused myriad arguments, some of which are described more fully at Part.IV.A. See *infra* notes 197–203 and accompanying text.

115. See, e.g., Deane, *supra* note 16, at 340.

116. See Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. 70,450, 70,450 (Dec. 11, 2007). The SEC took action in November 2007 as a result of the decision in *AFSCME v. American International Group, Inc.* at 70,451–53. In that case, the court refused to allow the company to exclude, under Exchange Act Rule 14a-8(i)(8), a shareholder proposal calling for a bylaw that would institute a procedure for shareholders to use the company's proxy statement to nominate directors. *Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group*, 462 F.3d 121, 125, 130–31 (2d Cir. 2006). The case was simply an interpretation of the SEC's own Rule 14a-8(i)(8), but the court's decision was in conflict with the SEC's asserted interpretation of the Rule. See *id.* at 126, 129. The SEC has now clarified its position with the amendment to Rule 14a-8(i)(8). Jane K. Storero, Jeffrey M. Taylor & Tifarah K. Roberts Allen, *SEC Adopts Rule Limiting Shareholder Access*, Blank Rome LLP Corporate and Securities Update (Jan. 2008), <http://www.blankrome.com/index.cfm?contentID=33>.

117. See Council of Institutional Investors, *Majority Voting Primer—Making Shareowners' Votes Count: Majority Voting in Director Elections 1* (Feb. 27, 2006), available at <http://www.cii.org/policies/MajorityVotingPrimer.pdf> [hereinafter CII, *Majority Voting Primer*].

118. See DeGaetano, *supra* note 10, at 375, 406.

119. See CII, MAJORITY VOTING PRIMER, *supra* note 117, at 1. The election of corporate directors is governed by state law. See *supra* text accompanying note 12. The SEC does not generally have the power to mandate internal governance standards and, as such, has not and probably will not become involved in the majority-voting debate. See *supra* note 27; see also *infra* note 198 and accompanying text; cf. Deane, *supra* note 16, at 345, 361 n.24 (indicating that some believe that “majority voting should be considered ‘as a supplement to, and not a replacement for, the right of shareholders to have

### A. *The Distinction Between Plurality and Majority Voting*

The concept of plurality voting is simple: the “‘plurality vote’ is well understood to mean the receipt of the most votes for a nominee or nominees without regard to the number of votes against or not cast.”<sup>120</sup> Plurality voting is the default voting standard in the election of corporate directors in most states.<sup>121</sup> However, in nearly all of the states, plurality voting is not mandatory, so corporations can provide in their organizational documents that a different voting standard (e.g., majority voting) applies.<sup>122</sup>

The consequence of plurality voting in an uncontested election is that each incumbent director is elected even when receiving only one affirmative vote “for” his or her election.<sup>123</sup> Withheld votes are

their director nominees included in company proxy materials [as per the Proposed Rule]” (quoting ISS Comment Letter, Re: Security Holder Director Nominations, Apr. 12, 2004). Thus, the majority-voting debate is likely to be waged at the state level, as it has been.

120. ABA DISCUSSION PAPER, *supra* note 34, at 2.

121. *Id.* The DGCL and MBCA, which “[a] substantial majority of the states follow . . . to a significant extent,” both use plurality voting as the default standard. *See id.* at 2–3 (citing MODEL BUS. CORP. ACT § 7.28(a) (2006) and DEL. CODE ANN. tit. 8, § 216 (2006)). Missouri and Illinois appear to be the only two states that mandate the use of majority voting. *See* MO. ANN. STAT. § 351.365(2) (2006); 805 ILL. COMP. STAT. ANN. 5/7.60 (West 2006); *see also* CHARLES I. COGUT ET AL., MAJORITY VOTING IN DIRECTOR ELECTIONS: A LOOK BACK AND A LOOK AHEAD 2 (Aug. 4, 2006), <http://www.stblaw.com/content/publications/pub560.pdf>. By contrast, Nevada is the only state which mandates plurality voting. Deane, *supra* note 16, at 338, 360 n.3 (citing NEV. REV. STAT. ANN. § 78.330(1) (West 2006)).

122. Deane, *supra* note 16, at 338, 360 n.3. Under Delaware law, the plurality-voting standard may be modified by “specification in the certificate of incorporation [i.e., charter] or bylaws of the corporation” of “the votes that shall be necessary for[] the transaction of any business.” DEL. CODE ANN. tit. 8, § 216 (2006). The “transaction of any business” includes the election of directors. *Id.*; *see also id.* § 216(3). “In the absence of such specification,” however, the plurality-voting standard applies. *Id.* § 216; *see also id.* § 216(3). The DGCL’s default plurality-voting provision states that “[d]irectors are elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors.” *Id.* (emphasis added).

The MBCA contains similar language, providing for a default plurality-voting standard. *See* ABA DISCUSSION PAPER, *supra* note 34, at 2 (citing MODEL BUS. CORP. ACT § 7.28(a) (2006)). As under Delaware law, the plurality-voting standard can be modified under the MBCA, but only in the articles of incorporation (equivalent to the charter). *Id.* at 2 n.2. Although the effectuation of a change to majority voting under the MBCA can be accomplished only through amendment of the articles of incorporation, which requires both board initiation and shareholder approval, the ABA recently added section 10.22 to the MBCA, which allows a corporation to adopt a bylaw provision that approximates a majority-voting standard. *See* MODEL BUS. CORP. ACT § 10.22 (2006). This amendment to the MBCA, as well as recent amendments to Delaware law, are explored more fully below. *See infra* notes 165–75 and accompanying text.

123. *See, e.g.*, Deane, *supra* note 16, at 338. In other words, in an uncontested election, incumbent directors are “certain to win.” *Id.* By way of example, suppose there are twelve directorship positions, which is the most common constituency of corporate boards. Burns, *supra* note 1, at R6. Suppose further that there are only twelve nominees. Those directors are ensured election because they necessarily will receive “the highest number of affirmative votes, up to the number of directors to be

disregarded under a plurality-voting system; only affirmative votes “for” the director are counted.<sup>124</sup> By contrast, in order to be elected under a majority-voting system, each director would need to receive an affirmative majority of the votes. In other words, fifty percent or more of the votes received by that director must be “for” the director, rather than withheld.<sup>125</sup> Majority voting, in giving effect to their withheld votes, provides shareholders an effective way to vote *against* a director.<sup>126</sup>

Plurality voting was not always the standard applicable to director elections. In fact, majority voting was the default standard in most states—including Delaware and those states having adopted the Model Business Corporation Act (MBCA)—until the 1980s.<sup>127</sup> The concern that precipitated the change to plurality voting was the risk that contested elections would give rise to *failed* elections.<sup>128</sup> In a contested election, there is a possibility that all of the candidates could fail to receive a majority of the votes and hence none would be elected, even though all the director seats could clearly be filled by those who received the most (i.e., a plurality) of the votes.<sup>129</sup> In order to prevent the occurrence of failed

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elected,” provided that they get at least one affirmative, or “for,” vote. See Corporate and Securities Law Blog, *Majority Vote in Director Elections: Alternate Standards*, <http://www.corporatesecuritieslawblog.com/9144-print.html> (Mar. 13, 2006). Further, since many directors are shareholders, they can simply cast their votes for themselves. See Deane, *supra*, at 345, 361 n.25.

124. See Deane, *supra* note 16, at 339, 360 nn.4–6. However, the withhold vote may still retain independent significance as a simple way for shareholders to express dissatisfaction with individual director candidates. See Grundfest, *supra* note 15, at 865–66. Still, the vote is only a “symbol” and has no legal effect. *Id.*

A related issue under the current voting system is whether giving the withhold vote legal significance would really make much of a difference in ousting ineffective incumbents, when considering the operation of the stock exchanges’ broker nonvote rules. See, e.g., ABA DISCUSSION PAPER, *supra* note 34, at 12. A “broker nonvote” occurs when a registered broker, the actual record holder of the shares for the beneficial owner, votes for the beneficial owner on some routine matter of corporate business because the broker has not received voting instructions from the beneficial owner on how to vote. See Carnell & Hanks, *supra* note 43, at 25; see also Julius J. Brecht, *Casting a Vote When You Miss the Meeting*, ALASKA J. COM., Mar. 29, 2004, available at [http://www.alaskajournal.com/stories/062804/wea\\_20040628024.shtml](http://www.alaskajournal.com/stories/062804/wea_20040628024.shtml). History has shown that brokers typically vote pro-management, and thus the broker nonvote rule has been called one which “transform[s] shareholder apathy and ignorance into votes of shareholder support.” Grundfest, *supra*, at 924. The purpose of allowing such votes is to ensure that the quorum requirements are satisfied. *Id.* However, as described below, the NYSE may amend the broker nonvote rules. See *infra* text accompanying notes 241–46.

125. COGUT ET AL., *supra* note 121, at 2. Alternatively, a majority-voting standard may require each director to receive a majority of affirmative votes out of all the votes that would have been cast had all shareholders entitled to vote voted—“a higher hurdle” than a simple majority of votes cast for or against that director at the meeting. See Deane, *supra* note 16, at 342.

126. See CII-NACD REPORT, *supra* note 48, app. B at 7.

127. ABA DISCUSSION PAPER, *supra* note 34, at 5–6 (noting that a plurality-voting provision was added to the MBCA in 1983, the DGCL in 1987, and Maryland’s corporate code in 1981).

128. See *id.* at 5.

129. *Id.* The ABA’s Discussion Paper quotes the official comment to the 1987 amendment to the

elections in this way, states chose to retain plurality voting as the default standard.<sup>130</sup> But, in giving a corporation the option to adopt a majority-voting standard, the states did not fully eliminate the risk of failed elections.<sup>131</sup> Therefore, the states also passed the so-called “holdover rules.”<sup>132</sup> These rules essentially states that a director who failed to be reelected would “hold over” in that position until certain events, such as the replacement of the director, occurred.<sup>133</sup>

Serious criticism of the plurality-voting system has arisen as of late. Critics of the plurality-voting standard claim that the rationale behind it is no longer applicable in director elections, as director elections are almost always uncontested.<sup>134</sup> Furthermore, critics argue that plurality voting deprives shareholders of meaningful participation in uncontested director elections, since the board-nominated incumbents are ensured election.<sup>135</sup>

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DGCL, which stated that though “[t]he Delaware rule [had] been that a vote of the majority of those present [was] required to take stockholder action . . . it was thought that at least in the case of the election of directors, the statute should only require a plurality vote.” *Id.*

130. *Id.* at 5–6.

131. See *supra* note 129 and accompanying text.

132. COGUT ET AL., *supra* note 121, at 2.

133. See, e.g., DEL. CODE ANN. tit. 8, § 141(b) (2006); MODEL BUS. CORP. ACT § 8.05(e) (2006).

The holdover rule in place in the DGCL, for example, mandates that if a director fails to be elected at an annual meeting of the shareholders, then that director will hold over until the first of several events occurs: (1) the holdover director resigns; (2) the holdover director is removed by a vote of the shareholders at a subsequently called meeting; or (3) a qualified replacement for the holdover director is nominated and elected by the shareholders under the voting standard applicable to director elections. DEL. CODE ANN., tit. 8, § 141(b). The operation of the holdover rule is explored more fully below. See *infra* notes 273–85 and accompanying text.

The MBCA’s holdover default rule may be modified or eliminated in the company’s articles of incorporation. MODEL BUS. CORP. ACT § 8.05(e). On the other hand, it does not appear that the company can modify the Delaware holdover rule either in its charter or bylaws. See DEL. CODE ANN., tit. 8, § 141(b).

One curious result of the holdover rule under a majority-voting standard and in a contested election is that if none of the director nominees received the requisite majority of the votes, but the nonincumbent nominees still received more votes than the incumbents (and hence, would have been elected under a plurality-voting system), the *incumbent* directors would continue to serve due to the holdover rule, even though they received fewer votes. CII-NACD REPORT, *supra* note 48, app. B at 5–6. For this reason, even proponents of majority voting do not contend that it should apply in *contested* elections—at least where the holdover rule is in place and at least one of the nonincumbent nominees is nominated by a shareholder (and not management). See ABA DISCUSSION PAPER, *supra* note 34, at 18–19 & nn.26–27 (explaining that there is no need for majority voting in a contested election because shareholders can, in effect, vote *against* incumbent management by casting a vote *for* a shareholder-nominated candidate); see also CII-NACD REPORT, *supra* note 48, app. B at 7 (though advocating majority voting, stating also that “the plurality vote standard is the appropriate vote standard for contested director elections as it provides for a fair and efficient outcome”). Thus, the discussion of the issues that majority voting creates are discussed throughout this Note in the context of *uncontested* elections.

134. See, e.g., Deane, *supra* note 16, at 338.

135. CII-NACD REPORT, *supra* note 48, app. B at 30.

### *B. The Momentum of the Majority-Voting Movement*

In light of the corporate scandals and the perceived lack of shareholder input in the director-election process, proponents of majority voting began pushing the new standard as a working alternative.<sup>136</sup> The impetus for the movement is the idea that the director-election process is broken—that it has become a mere formality resulting in the election of an incumbent slate of directors.<sup>137</sup> The stalling of the Proposed Rule, however, appears to be the most significant catalyst in the majority-voting movement.<sup>138</sup> Recognizing that the promulgation and subsequent nonenactment of the Proposed Rule meant that shareholders would continue to go without participation in director elections, several prominent institutions (including proxy advisory services and pension fund associations<sup>139</sup>) began to research majority voting and came to strongly support it as an alternative to the current director-election system.<sup>140</sup>

In addition, the institutional shareholders that the above institutions advised began to use the shareholder proposal process under Exchange Act Rule 14a-8 as a vehicle to put the standard to a vote at certain companies and generally to advertise the majority-voting standard.<sup>141</sup> During the 2006 proxy season, these institutional shareholders<sup>142</sup> submitted more than 140 shareholder proposals calling for the adoption of a majority-voting standard.<sup>143</sup> The proposals filed took either of two forms. The first was

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136. See, e.g., Baue, *supra* note 93 (“As long as [the Proposed Rule] is not enacted by the SEC, then there is going to be a reexamination of how the balance of power between shareholders and management can be leveled . . .”) (quoting Rich Ferlauto, the director of pension and benefit policy at the American Federation of State, County and Municipal Employees (AFSCME)).

137. See *supra* note 135.

138. ABA DISCUSSION PAPER, *supra* note 34, at 9 n.13; CII, MAJORITY VOTING PRIMER, *supra* note 117, at 1.

139. For example, Institutional Shareholder Services (ISS), a proxy advisory service; the International Corporate Governance Network (ICGN), an organization consisting of members representing private and institutional investors; and the Council of Institutional Investors (CII), an association of corporate, public, and union pension funds that control a significant amount (three trillion dollars) of pension assets, all took part in researching the majority-voting standard. See Baue, *supra* note 47; Deane, *supra* note 16, at 342.

140. See Deane, *supra* note 16, at 337. A shareholder effectively votes against a director nominee by casting a withhold vote. See *id.*; see also *infra* Part V.B.2.c (describing how the withhold vote interacts with a majority-voting standard).

141. See, e.g., CII, MAJORITY VOTING PRIMER, *supra* note 117, at 1–3.

142. Two of perhaps the most active institutional shareholders placing shareholder proposals for majority voting on the ballots over the past few proxy seasons have been AFSCME and the California Public Employees Retirement System (CalPERS). *Id.* at 3; see also Baue, *supra* note 47.

143. See, e.g., Henry Lesser, Mark F. Hoffman & William H. Bromfeld, *Majority Voting: Where Are We Now?*, DLA PIPER, Aug. 25, 2006, [http://www.dlapiper.com/majority\\_voting/](http://www.dlapiper.com/majority_voting/). Additionally, these numbers are up from the 2005 proxy season, when shareholders filed upwards of eighty such

binding shareholder proposals. In other words, if shareholders voted to adopt the proposal, the proposal would require the corporation to adopt an actual bylaw amendment.<sup>144</sup> The second was precatory proposals. These proposals merely recommended that the board consider adopting a majority-voting standard.<sup>145</sup>

To say that shareholders are submitting majority-voting proposals is one thing; their voting to adopt the proposals and the company's willingness to effectuate the proposal so adopted are another.<sup>146</sup> However, it has become clear over the 2005–07 proxy seasons that majority-voting proposals are receiving substantial support from shareholders and that companies are working to effectuate them.<sup>147</sup> The average rate of support for majority-voting shareholder proposals during the 2007 proxy season

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proposals. COGUT ET AL., *supra* note 121, at 3. And, by further contrast, in 2004, only twelve shareholder proposals calling for majority voting appeared on companies' ballots during the proxy season, with support for the proposals averaging around eighteen percent. Deane, *supra* note 16, at 354.

144. Under Delaware law, shareholders may unilaterally adopt bylaw amendments; no board approval is required. See ABA DISCUSSION PAPER, *supra* note 34, at 31 (citing DEL. CODE ANN. tit. 8, § 109 (2006)).

145. Lesser, *supra* note 143.

146. Notably, not all companies responded favorably to the receipt of these shareholder proposals in the first instance. In fact, twenty-seven companies during the 2006 proxy season petitioned the SEC with no-action letters, asking the SEC to allow the company to exclude the shareholder proposals calling for the adoption of majority voting from the proxy statement. See CII, MAJORITY VOTING PRIMER, *supra* note 117, at 2–3. A company may submit a no-action letter when it wishes to exclude a shareholder proposal submitted to it for inclusion in the proxy statement; the company must file a letter with the SEC's Division of Corporate Finance "explaining the legal basis for its decision" to exclude the proposal. *Am. Fed'n of State, County & Mun. Employees v. Am. Int'l. Group, Inc.*, 462 F.3d 121, 123 n.1 (2d Cir. 2006). If the Division's staff issues a no-action letter, the SEC will not file a civil suit against the company for violation of the proxy rules in excluding the proposal. *Id.*

However, the SEC has generally refused to issue no-action letters to companies trying to exclude majority-voting shareholder proposals. See, e.g., CII, MAJORITY VOTING PRIMER, *supra* note 117, at 3 (explaining how the SEC refused to issue a no-action letter for Hewlett-Packard's attempted exclusion of a majority-voting proposal on the basis that it had already "substantially implemented" the proposal under Exchange Act Rule 14a-8(i)(10)); see also COGUT ET AL., *supra* note 121, at 3. Apparently, majority-voting proposals do not "relate[] to an election for membership on the company's board of directors," within the meaning of Rule 14a-8(i)(8), which is one of the thirteen legal bases upon which companies can rely to exclude shareholder proposals; if they did so relate, they would be excludable. See Exchange Act Rule 14a-8(i), -8(i)(8), 17 C.F.R. § 240.14a-8(i), -8(i)(8) (2006). Yet, the SEC has allowed several companies—including Halliburton, Qwest, and Verizon—to exclude from their proxy statements shareholder proposals to allow shareholders to include their own director nominees on the proxy statement, as the Proposed Rule would have allowed. William Baue, *Mixed Messages and Flip-Flops as the SEC Director Nomination Rule Stagnates*, SOCIAL FUNDS, Feb. 11, 2005, <http://www.socialfunds.com/news/article.cgi/article1636.html>.

147. E.g., Claudia H. Allen, *Majority Voting in Director Elections—An Activist Success Story*, NEAL, GERBER & EISENBERG LLP, Nov. 13, 2007, at 1, available at <http://www.ngelaw.com/files/upload/surveyalert111307.pdf>; Deane, *supra* note 16, at 342–344; CII, MAJORITY VOTING PRIMER, *supra* note 117, at 2–3; COGUT ET AL., *supra* note 121, at 1; Lesser, *supra* note 143.

was in excess of 50%,<sup>148</sup> up from 47.8% during the 2006 proxy season.<sup>149</sup> Additionally, 66% of S&P 500 companies and more than 57% of companies in the Fortune 500 have instituted some form of majority voting, whether an informal corporate-governance policy or a bylaw amendment.<sup>150</sup>

Companies responding cooperatively to the majority-voting proposals have instituted director-election reforms but have done so in different ways. The most popular approach appears to be that first employed by Pfizer Inc., a Delaware corporation.<sup>151</sup> On June 23, 2005, Pfizer's board, though it actually retained a plurality-voting standard, nevertheless adopted a "corporate governance policy" which requires that directors receiving more withheld than "for" votes in an uncontested election "promptly tender [their] resignation[s]."<sup>152</sup> In this event, the board's corporate-governance committee makes a recommendation on whether to accept the nominee's tendered resignation.<sup>153</sup> The board of directors makes the final decision on the basis of the committee's recommendation and does so within ninety days of the vote.<sup>154</sup> Taking Pfizer's lead, over one hundred companies subsequently adopted Pfizer-styled "director resignation policies."<sup>155</sup>

On the other hand, the Intel Corporation (also incorporated in Delaware) embraced a different approach. Intel adopted an amendment to its bylaws.<sup>156</sup> The amendment expressly changed Intel's voting standard in

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148. Allen, *supra* note 147, at 2.

149. Lesser, *supra* note 143. Both of these figures have increased significantly since shareholders first began submitting majority-voting shareholder proposals in 2004. In 2004, the proposals ranged from 7% to 18% support. Deane, *supra* note 16, at 344. In 2005, 43.7% of the proposals received a majority of the votes. Lesser, *supra* note 143. Note, however, that even support in the 18% range is high for shareholder proposals, especially those which are proposed "in their first years; proposals typically gather increasing support in subsequent years." Deane, *supra* note 16, at 344.

150. Allen, *supra* note 147, at 1. These figures are up from 28% and 25%, respectively, in 2006. Claudia H. Allen, *May 17, 2006 Study Update Reveals 25% of Fortune 500 Companies and 28% of S&P 500 Companies Have Adopted Majority Voting Standards*, NEAL, GERBER & EISENBERG LLP, May 18, 2006, at 1, [http://www.ngelaw.com/files/upload/alert\\_survey\\_callen\\_051806.pdf](http://www.ngelaw.com/files/upload/alert_survey_callen_051806.pdf). See *infra* notes 151–54, 156–58, 160–64 and accompanying text (comparing corporate governance "policies" designed to approximate a majority-voting standard and bylaw amendments designed to implement actual majority-voting standards).

151. See COGUT ET AL., *supra* note 121, at 3.

152. *Id.*

153. *Id.* If the nominee at issue is also a member of the corporate governance committee, he or she would not participate in the decision. *Id.* In making the decision, the committee may consider what caused the nominee to receive the number of withheld votes he or she received. See *id.* at 3–4.

154. *Id.* at 3. The board publishes its decision and the reasons for the decision in a Form 8-K filed with the SEC. *Id.* at 3–4.

155. *Id.* at 4.

156. *Id.* at 5.

uncontested director elections from a plurality to a majority standard.<sup>157</sup> Thus, under Intel's approach, a director is *not elected* if that director fails to receive an affirmative majority of the votes cast at the meeting; by contrast, under the Pfizer approach, a director receiving more withheld votes than affirmative votes is still elected but must submit a resignation.<sup>158</sup> Other companies have followed Intel's example and adopted bylaws requiring majority voting in director elections.<sup>159</sup>

Though the end result of both the Pfizer and the Intel approach is similar,<sup>160</sup> majority-voting proponents view the Intel standard far more favorably.<sup>161</sup> They describe the Intel standard as a "true" majority-voting standard,<sup>162</sup> whereas the Pfizer standard is sometimes termed a "'modified' plurality standard."<sup>163</sup> In general, majority-voting proponents express that

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157. *Id.* The amendment specifically states that "each director shall be elected by the vote of the majority of the votes cast with respect to the director at any meeting for the election of directors . . . provided that if the number of nominees exceeds the number of directors to be elected, the directors shall be elected by the vote of a plurality." *Id.* at E-1 (emphases added).

158. Compare *id.* at D-1 (under Pfizer standard, director receiving more withheld votes tenders resignation but is still elected under plurality voting), with *id.* at E-1 (under Intel standard, director is elected only if he or she receives a majority of the votes cast). See also Charles Nathan, *Implementation of Majority Voting: The Devil in the Details*, 14 CORPORATE GOVERNANCE ADVISOR, May/June 2006, at 1-2, available at [http://www.lw.com/upload/pubcontent/\\_pdf/pub1561\\_1.pdf](http://www.lw.com/upload/pubcontent/_pdf/pub1561_1.pdf). The Intel standard allows shareholders to vote either "for" or "against" a particular director, and both options appear on the proxy card. COGUT ET AL., *supra* note 121, at 5. By contrast, the Pfizer approach retains the use of the "withhold" vote, since, under a plurality-voting standard, "against" votes are not counted. *Id.*

Further, even though under Intel's standard a director is not elected when he fails to receive an affirmative majority of the votes, due to the effect of the holdover rule, that director would still hold over in the director position until certain events occurred. See *supra* note 133. Therefore, Intel's bylaws also state that the director "shall offer to tender his or her resignation to the Board" if that director is "not elected." COGUT ET AL., *supra*, at E-1. The director resignation thus serves to cut off the holdover period by giving the board the power to accept a director's tendered resignation. *Id.* at 5.

159. See Allen, *supra* note 147, at 3 ("The percentage of companies adopting majority voting bylaws or charter provisions has steadily increased . . ."). Allen's 2007 study found that of the 534 companies included in the study that had initiated a majority-voting-styled corporate-governance change, 223 (42%) had adopted director-resignation policies in the style of Pfizer (as opposed to bylaw/charter amendments), 160 (30%) had adopted bylaw/charter amendments, and 151 (28%) adopted both. *Id.* at 3. The percentage of companies adopting Intel-styled policies has increased substantially from Allen's 2006 study, which found that only 17% of the companies surveyed had adopted bylaw/charter amendments. Allen, *supra* note 150, at 1.

160. The similarities and differences between the Pfizer and Intel approaches revolve around the operation of the holdover rule. See *infra* note 283 and accompanying text.

161. See, e.g., COGUT ET AL., *supra* note 121, at 5.

162. See Lesser, *supra* note 143. Proponents also refer to the Intel standard as the "gold standard" of majority-voting-type policies. COGUT ET AL., *supra* note 121, at 5 (quoting Pat McGurn, Executive Vice President of ISS).

163. Lesser, *supra* note 143. ISS has stated that it would recommend that its institutional-shareholder clients vote against shareholder proposals calling for majority voting only if the company has adopted its own "true" majority-voting policy or an equivalent alternative; ISS has already demonstrated its support for Intel-styled policies by recommending votes against director-resignation

Intel-styled standards fully empower shareholders to “elect or un-elect directors,” while Pfizer-styled policies do not.<sup>164</sup>

### C. Legislative Responses to Majority Voting

The key actors in state-law corporate legislation, namely the Delaware legislature and the American Bar Association (ABA) (which proposes and adopts amendments to the Model Business Corporation Act (MBCA))<sup>165</sup> have also responded to the majority-voting movement, but neither by mandating the implementation of majority voting nor by making it the default standard.<sup>166</sup> Rather, they generally altered certain provisions of the corporate codes that frustrated the majority-voting policies that companies were already adopting.<sup>167</sup>

The most glaring of these problems was the question of whether director resignations conditioned on the failure to receive a certain vote at the election were enforceable under Delaware law and the MBCA.<sup>168</sup> Another problem was that, under Delaware law, the board could unilaterally amend or repeal bylaws, which allowed the board to change shareholder-adopted majority-voting bylaw amendments.<sup>169</sup>

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policies which are not incorporated into the bylaws. See COGUT ET AL., *supra* note 121, at 4–5 (describing the criteria ISS uses to determine whether a voting standard equates with a “true” majority-voting policy and noting that director-resignation policies which are plurality-voting standards but are incorporated into the bylaws may be sufficient).

164. See CII-NACD REPORT, *supra* note 48, app. B at 32.

165. See *supra* note 30.

166. DEL. CODE ANN. tit. 8, §§ 141(b), 216 (2006); MODEL BUS. CORP. ACT § 10.22 (2006); see Celeste S. Ferber, Scott M. Stanton & Marshall L. Small, *Delaware Amends General Corporation Law to Address Issues Relating to Majority Voting for Director Elections*, MORRISON & FOERSTER LLP, July 2006, <http://www.mofo.com/news/updates/files/update02228.html>. In June 2005, the ABA’s Committee on Corporate Laws of the Section of Business Law began reviewing the MBCA’s provisions relating to director elections and evaluating alternatives to plurality voting. ABA DISCUSSION PAPER, *supra* note 34, at 1.

167. See DEL. CODE ANN. tit. 8, §§ 141(b), 216; MODEL BUS. CORP. ACT § 10.22.

168. See, e.g., Ferber et al., *supra* note 166. Addressing the enforceability (and revocability) of such resignations is necessary under both Pfizer- and Intel-styled policies due to the operation of the holdover rule. See *supra* note 133; see also *infra* note 170 and accompanying text. Still, even allowing for the enforceability and irrevocability of such resignations, there is another potential problem: the DGCL and MBCA do not specifically give directors or the company the power to, in the first instance, require the resignation of the director. See *infra* note 282 for a discussion of the problems created by the board’s inability to remove directors and for potential solutions.

169. See DEL. CODE ANN., tit. 8, § 109(a) (stating that shareholders have “the power to adopt, amend or repeal bylaws” but may also “confer [this] power . . . upon the directors”); MODEL BUS. CORP. ACT § 10.20(a), (b) (giving both shareholders and directors the power to amend or repeal bylaws subject to certain exceptions pertaining to directors); see also Posting of Gordon Smith to the Conglomerate Blog, *Delaware Bylaws*, [http://www.theconglomerate.org/2006/07/delaware\\_bylaws.html](http://www.theconglomerate.org/2006/07/delaware_bylaws.html) (July 21, 2006). The MBCA provision, however, also allows shareholders, in amending or repealing bylaws, to expressly indicate in the bylaw provisions that the board cannot amend or repeal

The Delaware legislature and the ABA sought to fix these holes by amending, respectively, the Delaware General Corporation Law (DGCL) and the MBCA. The amendments—effective August 1, 2006 for the DGCL and adopted June 20, 2006 for the MBCA—specifically provide for the enforceability of resignations whose tendering is made contingent on the occurrence of some future event (such as the failure to get a majority of the votes at a director election).<sup>170</sup> The amendment to the DGCL also stipulated that the board of directors can no longer amend a bylaw that is adopted by shareholders and that pertains to the election of directors.<sup>171</sup>

The ABA went a step further in adding section 10.22 to the MBCA.<sup>172</sup> Section 10.22 allows a company to voluntarily elect to adopt that statutory section in its bylaws.<sup>173</sup> This provision provides a framework for implementation of a majority-voting-like policy in uncontested elections only.<sup>174</sup> Essentially, in uncontested elections, director nominees must receive a plurality of the votes to be elected, provided that if the nominee receives “more votes against than for election,” the director will serve for a maximum ninety-day period.<sup>175</sup>

The California legislature also recently amended its Corporations Code to allow corporations to adopt a majority-voting standard in uncontested

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the bylaw. MODEL BUS. CORP. ACT § 10.20(b)(2).

170. DEL. CODE ANN. tit. 8, § 141(b) (2006); MODEL BUS. CORP. ACT § 8.07(b) (2006); COGUT ET AL., *supra* note 121, at 6. Resignations made conditional on failure to receive a specified vote may also be made irrevocable. DEL. CODE ANN. tit. 8, § 141(b); MODEL BUS. CORP. ACT § 8.07(b). The DGCL amendments involved no changes to the holdover rule. *See* DEL. CODE ANN. § 141(b); Ferber, *supra* note 166; *see also infra* notes 175 & 333 and accompanying text; *cf.* MODEL BUS. CORP. ACT § 10.22 (allowing company to adopt a shortened holdover period).

171. DEL. CODE ANN. tit. 8, § 216 (2006); COGUT ET AL., *supra* note 121, at 6. *See supra* note 168 for the MBCA’s approach.

172. Press Release, Am. Bar Ass’n, Committee on Corporate Laws Adopts Amendments to the Model Business Corporation Act Relating to Voting by Shareholders for the Election of Directors 2 (June 20, 2006), <http://www.abanet.org/buslaw/committees/CL270000pub/nosearch/mbca/amendments/release.pdf> [hereinafter ABA Press Release].

173. MODEL BUS. CORP. ACT § 10.22 (2006).

174. *See id.*

175. MODEL BUS. CORP. ACT § 10.22(a)–(b) (2006). In the ninety-day time period, the board may select another director to replace the nominee. *Id.* § 10.22(a)(2). If the board takes no action, the seat becomes vacant after ninety days. *Id.* § 10.22(a) cmt. Notably, the board may select “any qualified person, which could include a director who received more against than for votes” to fill the position. *Id.* § 10.22(a)(2)–(3) & cmt. (emphasis added). Thus, under section 10.22, a director not receiving a majority of the votes is elected but only for a ninety-day period, cutting short the otherwise-applicable holdover period. *See id.* § 10.22(a)(2). Finally, if the shareholders adopt the bylaw, only the shareholders can amend it, unless the bylaw is to the contrary. *Id.* § 10.22(c)(1).

elections.<sup>176</sup> Previously, the Code required that directors be elected by a plurality of the votes.<sup>177</sup> Effective on January 1, 2007, however, a corporation may amend its charter or bylaws to require that an incumbent director in an uncontested election must receive an affirmative majority of the shares voting at the meeting.<sup>178</sup>

The majority-voting movement has seen rapid progress since 2005 and shows no signs of slowing.<sup>179</sup> Still, there is still some opposition to the movement, albeit to a lesser extent than to the SEC's Proposed Rule.<sup>180</sup> And even to the extent that majority voting may, in fact, "become universal,"<sup>181</sup> significant legal questions pertaining to the implementation of a majority-voting standard and how to allay the problems that plurality voting was designed to eliminate still exist.<sup>182</sup> Debate on these issues between majority-voting proponents and skeptics persists even as the majority-voting movement continues to spread throughout corporate America.<sup>183</sup>

#### V. WEIGHING THE PROPOSED SOLUTIONS: THE SHAREHOLDER ACCESS PROPOSAL VERSUS MAJORITY VOTING

Since the vast majority of shareholder elections are uncontested and since, under a plurality-voting system, shareholders are unable to vote against incumbent directors, shareholders have virtually no say in the election of directors.<sup>184</sup> To alleviate this problem,<sup>185</sup> reformers have

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176. Act of Sept. 30, 2006, Ch. 871, §§ 1, 2, 2006 Cal. Stat. Ch. 871 (codified at CAL. CORP. CODE § 708, 708.5 (West 2006 & Supp. 2007) (effective Jan. 2007)); *see also* CAL. CORP. CODE § 108.5.

177. CAL. CORP. CODE §§ 708 (West 2006 & Supp. 2007).

178. CAL. CORP. CODE §§ 153, 708, 708.5.

179. *See* Baue, *supra* note 47. In fact, it is no longer implausible to say that majority voting will soon be the voting standard in place at all companies. *See id.* ("It appears that, given the high level of shareholder support, the strong commitment of influential institutional shareholders and institutional shareholder advisory services [such as ISS], and the lack of powerful opposition, majority voting will become universal."); *see also supra* Part IV.B.

180. *See id.*

181. *Id.*

182. *See* Deane, *supra* note 16, at 345 (noting that "the majority voting proposal raises a series of questions both substantive and technical"). In fact, the discrepancy between the number of companies using the Pfizer approach and the Intel approach is a demonstration of the diverging manners in which companies may attempt to institute changes facilitating shareholder participation in the director elections. *See supra* note 159 and accompanying text.

183. ISS PAPER, *supra* note 16, at 4.

184. *See supra* text accompanying notes 135 & 137.

185. Though not all commentators agree on the level of participation shareholders should have in the governance of the corporation generally, even those who argue that limited shareholder voting

stressed two particular solutions. The first is increasing the number of contested elections to foster competition in the director-election process by making it easier for shareholders to nominate their own directors. This is the precise solution that the Proposed Rule sought to accomplish.<sup>186</sup> The second is to give shareholders a way to vote against incumbents in uncontested elections—the goal of the majority-voting movement.<sup>187</sup> An assessment of the relative advantages and disadvantages of the two potential solutions reveals why the majority-voting movement continues to gain momentum, while the Proposed Rule has now been buried.<sup>188</sup>

*A. The Shareholder Access Proposal: Too Problematic to Be Adopted*

The primary argument underlying the support for the Proposed Rule is a simple one: shareholders have very little say in the election of directors, and they need more.<sup>189</sup> Essentially, supporters argue that input in the director-nomination process comes overwhelmingly from the nominating committee and very little from the shareholders.<sup>190</sup> Further, they argue, shareholders have no opportunity to vote against unresponsive, ineffective directors due to plurality voting.<sup>191</sup> Additionally, the alternative of mounting a proxy contest is generally infeasible due to prohibitive costs.<sup>192</sup> The result is that boards become “insulated”—feeling that they cannot be made to account for their actions.<sup>193</sup> Subject to little accountability for their actions and decisions, directors become more inclined to exhibit “managerial slack.”<sup>194</sup> Meanwhile, profits decline.<sup>195</sup> Proponents posit, however, that stronger accountability measures, such as allowing shareholders to nominate alternate directors, would make “[d]irectors

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rights are appropriate still admit that shareholder participation in director elections is necessary as an accountability measure. *See, e.g.,* Bainbridge, *supra* note 3, at 627.

186. Bebhuk, *supra* note 12, at 47.

187. *See* Deane, *supra* note 16, at 339, 346.

188. *See supra* note 116.

189. *See, e.g.,* Deane, *supra* note 16, at 337.

190. *See supra* text accompanying note 107.

191. *See supra* note 107 and accompanying text.

192. *See supra* text accompanying notes 77–79; *see also* Bebhuk, *supra* note 12, at 45. This argument may become less forceful in light of the SEC’s new internet proxy rules. *See supra* notes 43 & 77.

193. Bebhuk, *supra* note 12, at 61–62.

194. *Id.* at 62.

195. *Id.* at 62–63. If the directors feel invulnerable to being ousted by shareholders, they may, for example, take actions that result in wastefully “higher consumption of private benefits.” This occurs, for instance, when directors approve excessive, lavish compensation packages for executives. *Id.* at 62. Professor Bebhuk argues, moreover, that the rules requiring independent directors do not necessarily solve the problems that result from board insulation. *Id.* at 63.

more accountable to shareholders” because they would “face the real risk of losing the election and thus their seat on the board.”<sup>196</sup>

While the policy goal underlying the Proposed Rule—promoting democracy in shareholder elections—is laudable, if the rule creates more problems than it solves, then it is not worth adopting. Unfortunately, as opponents of the Proposed Rule have demonstrated, there are several compelling arguments against its adoption.<sup>197</sup> First, opponents argue that the Proposed Rule implicates significant federalism concerns, since it attempts to regulate the internal governance of corporations—an area of law for which governance has been traditionally reserved to the states—and thus may overstep the SEC’s rulemaking authority under Section 14(a) of the Exchange Act to promulgate proxy rules.<sup>198</sup> Thus, the Proposed Rule would have the effect of preempting state law on corporate-governance issues.<sup>199</sup> Second, opponents argue that, as a practical matter, only institutional investors can nominate directors under the Proposed Rule due to the five-percent-ownership requirement.<sup>200</sup> They further argue that allowing institutional investors to so easily nominate directors could be problematic.<sup>201</sup> Third, opponents state that the Proposed Rule will result

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196. Deane, *supra* note 16, at 337.

197. See, e.g., DeGaetano, *supra* note 10, at 406–19; Lipton & Rosenblum, *supra* note 34, at 76–94.

198. DeGaetano, *supra* note 10, at 411. The landmark case of *Business Roundtable v. SEC* held that the regulation of issues of corporate governance was beyond the scope of SEC regulation under the Exchange Act, and included attempts to regulate the process of electing directors as an example of a corporate governance issue. *Business Roundtable v. SEC*, 905 F.2d 406, 410–12 (D.C. Cir. 1990).

199. DeGaetano, *supra* note 10, at 410–11 (citing DEL. CODE ANN. tit. 8, §§ 141, 211–12 (2004)).

200. *Id.* at 412; Lipton & Rosenblum, *supra* note 34, at 67.

201. Lipton & Rosenblum, *supra* note 34, at 78–79; see also DeGaetano, *supra* note 10, at 417–18. For example, one problem with allowing institutional investors to nominate directors is that their interests may not be the same as those of the shareholders at large. Lipton & Rosenblum, *supra* note 34, at 78–79. For example, institutional investors may have a shorter investment horizon than other smaller shareholders (and thus may desire to elect directors who will undertake activities that are conducive to producing short-term profit), whereas other investors may have a more long-term perspective. See *id.* Another potentially divergent interest is that existing between certain institutional shareholders (such as public pension funds, labor unions, and other social activist organizations) with special-interest agendas pertaining to health care, global warming, and human rights issues, among others, and that of other shareholders, who would rather see the directors undertake profit-maximizing activities. Lipton & Rosenblum, *supra* note 34, at 78–79; Baue, *supra* note 93. Some opponents go so far as to say that the Proposed Rule could facilitate the election of special-interest directors catering to precisely those narrow interests. See DeGaetano, *supra* note 10, at 415–16 & n.303 (noting also the spate of special-interest shareholder proposals submitted to companies under Exchange Act Rule 14a-8 by “labor unions, grassroots organizations, and others traditionally categorized as gadflies” (internal citations omitted)). Another reason institutional investors should not be exclusively allowed to nominate directors is that their expertise is assessing financial returns, not running the company. Lipton & Rosenblum, *supra* note 34, at 77. Finally, it is argued, even if institutional shareholders were given the power to nominate individual shareholders, the “Wall Street Rule” suggests that they might not even exercise it. DeGaetano, *supra* note 10, at 413.

in the balkanization of boards and would thereby handicap their ability to effectively govern the corporation.<sup>202</sup> Finally, they argue that the Proposed Rule is overkill in light of the recent regulations, which were some of the most comprehensive in history and which need to be given time to have an effect.<sup>203</sup>

### *B. Majority Voting: Arguments For and Against*

Like the Proposed Rule, the majority-voting standard is a mechanism to make directors more accountable to shareholders.<sup>204</sup> Majority voting is different from the Proposed Rule, however, in that majority voting does not allow shareholders to nominate directors; it merely allows them to affirmatively vote against unpalatable directors nominated by the company.<sup>205</sup> Still, proponents argue that majority voting would represent a step toward engendering democracy in director elections by giving shareholders the power to cast out unresponsive directors—without the problems that the Proposed Rule creates.<sup>206</sup> On the other hand, the critics

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Thus, opponents argue that the nomination process is best left in the hands of directors, managers, and the nominating committee—all of whom know the business and are subject to a legally enforceable fiduciary duty of loyalty to the shareholders at large. In the exercise of their fiduciary duty to the shareholders, these constituents are forbidden from pursuing their own self-interested goals. Individual shareholders are not held to such a standard. *Id.* at 417–18. In the end, opponents argue that even if activism by large institutional investors is a positive development in the evolution of corporate governance, it is still not clear that institutional investors should have the power to nominate directors directly without first having to conduct a proxy contest. *See* Lipton & Rosenblum, *supra* note 34, at 76–79. Rather, they argue, there are distinct benefits to requiring shareholders who wish to nominate directors to wage a full-blown proxy contest. *See id.* at 88 (stating that requiring shareholders to conduct a proxy contest “allows [for] a level of scrutiny, disclosure and accountability that an insert in the company’s proxy statement is not able to provide”).

202. DeGaetano, *supra* note 10, at 417. A shareholder-nominated director who is ultimately elected will likely butt heads with the other directors, and the collegiality of the board may be compromised. *Id.* Still, proponents of the rule respond that one of the problems precipitating the SEC’s promulgation of the Proposed Rule was precisely that boards were already too “collegial” and were refusing to ask management the “hard” questions. *See* Lipton & Rosenblum, *supra* note 34, at 81. Opponents of the Proposed Rule respond that while it is true that an excess level of “collegiality” might be counterproductive to the board’s monitoring function, constant friction and inability to decide on important issues is equally damaging. *Id.* at 80–81.

203. DeGaetano, *supra* note 10, at 363–64, 407, 415. These rules—including the Nominating Committee Rule, the SROs’ independence rules, and the requirements under Sarbanes-Oxley—are already targeted to reduce the insulation of directors and thus to make them more accountable to shareholders. *Id.* at 415.

204. ABA DISCUSSION PAPER, *supra* note 34, at 9 & n.13.

205. Deane, *supra* note 16, at 340.

206. *See supra* text accompanying note 125; *see also infra* notes 208–20 and accompanying text. All references to the benefit of allowing shareholders to unelect unsatisfactory directors are qualified by the effects of the holdover rule. *See supra* note 133; *see also infra* note 275.

of majority voting argue primarily that majority voting presents implementation issues that proponents have not adequately addressed.<sup>207</sup>

### *1. Arguments in Favor of Majority Voting*

Proponents of majority voting argue that, while the standard may not engender as much shareholder participation in director elections as the Proposed Rule, it still increases shareholder participation and does so without implicating the substantial concerns associated with the Proposed Rule.<sup>208</sup> For example, majority-voting proponents argue that the majority-voting rule is much simpler than the Proposed Rule.<sup>209</sup> The dictate of majority voting is that if the votes that any director receives consist of fifty percent or more “for” votes, that director is reelected.<sup>210</sup> It avoids the more complex, two-step process<sup>211</sup> associated with the Proposed Rule and the issues surrounding which particular shareholders are “qualified” to place nominees on the proxy statement under the rule, as well as the propriety of allowing only certain large shareholders to nominate directors.<sup>212</sup>

Moreover, majority voting avoids the federalism problems associated with the Proposed Rule.<sup>213</sup> Whereas the Proposed Rule involves the federal government (via the SEC) stepping in to regulate matters of corporate governance, state law is the locus of the majority-voting movement.<sup>214</sup> State legislatures would be the ones to decide whether to discard the plurality-voting default rule and replace it with either a mandatory or default majority-voting rule, or, alternatively, to amend existing state law so as to make a majority-voting standard effective.<sup>215</sup> But, another distinct advantage of majority voting is that extensive regulation is not required at all; rather, private companies (through their shareholders) may decide for themselves whether to adopt majority voting, and such a decision is

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207. See *infra* Part V.B.3.

208. See Deane, *supra* note 16, at 345.

209. *Id.*

210. *Id.*

211. The Proposed Rule requires one annual meeting to determine whether the triggering events have been satisfied in the first instance and then, at the next annual meeting, the shareholders are able to nominate directors on the company’s proxy statement. DeGaetano, *supra* note 10, at 396. By contrast, majority voting allows shareholders to vote out unsatisfactory directors in “one fell swoop”—all within one election year, subject to the holdover rule. Deane, *supra* note 16, at 345.

212. See Deane, *supra* note 16, at 345. With majority voting, any shareholder who owns voting shares may register a vote “for” or “against” a director. See *id.*

213. *Id.* at 346.

214. *Id.* at 346–47.

215. *Id.* at 346.

possible because most states make plurality voting the default rule only.<sup>216</sup> The corporation then deals with the problems of implementation as it sees fit.<sup>217</sup> Thus, no “one-size-fits-all [federal] rule” is imposed on all corporations.<sup>218</sup>

A third point of differentiation between the controversial Proposed Rule and the majority-voting standard, proponents say, is that majority voting would be less likely to produce friction within the board of directors.<sup>219</sup> The majority-voting standard would not create the balkanization effect associated with the Proposed Rule because shareholders do not nominate directors who would be more likely to come into conflict with incumbent directors.<sup>220</sup>

In addition, advocates argue that majority voting—apart from its advantages over the Proposed Rule—is a desirable change in corporate governance because the policy underlying the plurality-voting standard is inapposite to the realities of today’s director elections.<sup>221</sup> The concern of failed elections is not significant since most director elections are uncontested.<sup>222</sup>

## 2. Arguments in Opposition to Majority Voting

Though it does not appear that the majority-voting standard has caused nearly as much contention as the Proposed Rule, opposition to the change does exist—in many cases for reasons similar to those offered in opposition to the Proposed Rule. The primary arguments offered against the movement for majority voting, as well as proponents’ counterarguments, are discussed below.

### a. Superiority of Plurality Voting

The first argument of majority-voting opponents is that plurality voting is a superior system.<sup>223</sup> Plurality voting, they argue, sidesteps the problem

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216. *See id.*

217. *Id.* (quoting Ira S. Millstein, a senior partner at Weil, Gotshal & Manges, LLP, who commented that he supports majority voting because it “puts the responsibility back on the board”).

218. *See id.* at 338.

219. *Id.* at 346.

220. *Id.* (pointing out that the majority voting rule “forces consultation . . . [and] cooperation” and that “it avoids . . . confrontation”). Instead, shareholders vote against directors they find to be unsatisfactory to them, and the board itself will, in most cases, determine who is to fill the seat. *See infra* note 283 and accompanying text; *see also infra* note 289.

221. *See Lesser, supra* note 143.

222. *Id.*

223. *See ABA DISCUSSION PAPER, supra* note 34, at 13.

of failed elections and therefore produces stability on the board.<sup>224</sup> In addition, the plurality-voting system is simple and intelligible; it mandates that those directors receiving the most votes out of all the directors win, up to the number of seats.<sup>225</sup> Further, the plurality-voting system is flexible and “works equally well with simple one-share-one-vote structures and with more complex capital structures, such as cumulative voting.”<sup>226</sup>

*b. Destabilization of the Board*

Beyond extolling the virtues of plurality voting, opponents also attempt to expose the vices of the majority-voting standard. The most significant problem, opponents say, is its potential to have a destabilizing effect on the board.<sup>227</sup> If a director fails to receive a majority of the votes, a directorship seat may remain vacant on the board for a long period of time, as it may take more than a year to find a director with the right fit.<sup>228</sup> It may also cause the board to fail to maintain certain stock-exchange listing requirements and regulatory mandates.<sup>229</sup> For example, the NYSE now requires the majority of the directors on the board to be independent of the company, and if shareholders vote out one of the independent directors,

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224. *Id.*

225. *Id.* at 13–14.

226. *Id.* at 14. Even some majority-voting *proponents* suggest that, where a company provides for cumulative voting in director elections, a majority-voting standard is unnecessary because cumulative voting “provides unique leverage to permit a minority of shareholders to have an influence on board composition.” *Id.* at 18. For example, newly enacted section 10.22 of the MBCA, *see supra* notes 172–75 and accompanying text, is only available to those companies that do not already provide for cumulative voting. MODEL BUS. CORP. ACT § 10.22(a) (2006). However, other majority-voting proponents argue that cumulative voting—though it does give minority shareholders greater voting power than they would have otherwise—does so only in contested elections, where majority voting is not applicable anyway. CII-NACD REPORT, *supra* note 48, app. B at 31. Thus, in uncontested elections, where cumulative voting either does not apply or does not give shareholders any greater power because they can only cumulate votes for incumbent directors, majority voting is still necessary to give shareholders an effective voice in the election. *Id.*; *see also* ED DURKIN, EFFECTS OF CONTESTED ELECTIONS AND CUMULATIVE VOTING ON COMPANIES ELECTING DIRECTORS BY MAJORITY VOTE 3 (2006), <http://cii.org/majority/> (click on “Ed Durkin’s answers to questions on majority voting, contested elections and cumulative voting”) (stating that the ABA’s assertion that majority voting should not be applied to companies with cumulative voting is faulty, as cumulative voting only applies in contested elections).

In addition, proponents of majority voting would probably respond that the arguments espousing the flexibility and simplicity of plurality voting are not persuasive in any case. Majority-voting proponents argue, for example, that the majority-voting rule is also “simple” and makes intuitive sense. Deane, *supra* note 16, at 345. Moreover, as described below, majority-voting proponents state that, although there may be some complexities involved in the implementation of the standard, these challenges can be addressed. *Id.*; *see also infra* text accompanying notes 276–80, 282–83.

227. Deane, *supra* note 16, at 348.

228. *Id.*

229. *Id.*

the ratio of independent to total directors may fall short of NYSE requirements and cause the company to risk being delisted from the exchange.<sup>230</sup>

Proponents respond to these arguments by stating that the majority-voting standard does not have to be so inflexible as to produce changes on the board that “range from disruptive to debilitating.”<sup>231</sup> For example, the Intel standard (a true majority-voting standard) gives the board the discretion to choose whether to accept a director’s resignation following his or her failure to receive a majority of the votes, providing the board with the requisite level of flexibility to avoid calamity.<sup>232</sup> If the board were to determine that a particular director, unelected due to his failure to receive a majority of votes, was indispensable to the functioning of the board,<sup>233</sup> the board could choose to reject the director’s tendered resignation.<sup>234</sup> Then, by operation of the holdover rule, which continues to exist under most state corporate laws—even those which have been recently amended to allow companies to more easily implement majority-voting standards—the director, though unelected, would continue to serve on the board.<sup>235</sup> Thus, the risk that a majority-voting standard would

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230. *Id.* New NYSE rules require that at least half of the directors on the board be independent. *See supra* notes 97–98 and accompanying text. In addition, the new SRO rules require fully independent nominating, audit, and compensation committees. *Id.* If one of the independent directors who serves on the committee fails to be reelected, the committee may fall short of having the requisite number of independent directors. *Id.* Also, the Sarbanes-Oxley Act requires audit committees to have at least one “financial expert.” Lipton & Rosenblum, *supra* note 34, at 90. If the director failing to receive a majority of the votes were the financial expert, the audit committee could not function. Deane, *supra* note 16, at 348.

231. Deane, *supra* note 16, at 348 (quoting Richard Alsop, First Vice President & General Counsel of Corporate Law at Merrill Lynch).

232. *See supra* note 158. In addition, though not representing a true majority-voting approach, the Pfizer-styled director-resignation policies also, of course, provide the board with sufficient flexibility. *See* Baue, *supra* note 47. Proponents of majority voting respond that such flexibility substantially reduces the force of detractors’ other arguments regarding the litany of devastating consequences that would attend adoption of majority voting. ABA DISCUSSION PAPER, *supra* note 34, at 7. Such cited consequences include breaches of executive employment agreements in place due to failure of the executives to be reelected as directors, thereby triggering costly severance payments; “changes of control” that might be triggered by failure to “elect a specified percentage of directors” under certain credit agreements; or the enlargement of a dissident shareholder’s representation on the board when a director representing another group fails to be elected. *See id.* (listing other adverse consequences as well). Proponents of majority voting state that directors will have the ability to consider these negative consequences when deciding whether to accept a nominee’s resignation under either the Pfizer or the Intel standard, thereby allaying the disasters opponents claim majority voting would produce. *See* COGUT ET AL., *supra* note 121, at 4–5.

233. *See supra* note 232 and accompanying text.

234. *See* COGUT ET AL., *supra* note 121, at 2.

235. *See id.* at 2, 5. For a more detailed analysis of the issues that the holdover rule creates through its interaction with the majority-voting standard, see *infra* notes 274–85 and accompanying text.

produce the myriad disruptions that attend board vacancies is not a significant one.<sup>236</sup>

*c. Stripping the Withhold Vote of its Significance*

Another point of opposition is that the majority-voting standard guts the force of the withhold vote to express shareholder dissatisfaction.<sup>237</sup> Assuming that the withhold vote on the proxy card of a company whose cards contain “for” or “withhold” options would function as an “against” vote under a majority-voting standard, withhold votes would no longer be the “powerful symbols that express shareholder dissatisfaction and drive governance reform.”<sup>238</sup> And, opponents argue, boards already take cues from withhold votes seriously—if not for the reason that the board wishes to restore the shareholders’ confidence in their ability to run the corporation then for the reason that the negative publicity associated with

236. CII-NACD REPORT, *supra* note 48, app. B at 8–10; *but see infra* notes 287–89 (describing how majority voting can lead to vacancies and therefore could, in certain instances, create some of the problems associated with vacancies). In addition, proponents state that, in any case, even under a majority-voting standard, it is not especially likely that any director will actually receive a majority of “against” votes. *See* Deane, *supra* note 16, at 341. As an example in practice, proponents point to Lockheed Martin Corp. *Id.* Lockheed Martin has a majority-voting standard in place—a rigorous one, in fact, requiring that directors earn not simply a majority of the votes cast for or against them but a majority of all votes outstanding, irrespective of whether they are voted in the election. *Id.* Proponents point out that a “vote-no” campaign waged by the AFL-CIO against one Lockheed Martin director, Frank Savage, still did not result in his removal even under the rigorous majority-voting standard, because the company’s board “persuaded shareholders that Savage made a real contribution to their board and was therefore worth keeping.” *Id.* Proponents of majority voting cite this event as an example of how majority voting can encourage directors and shareholders to work together to eliminate—rather than ignore—shareholder dissatisfaction. *See id.* They argue, therefore, that majority voting will not be the handicap on corporations that opponents make it out to be. *See id.* at 341–42.

Certain opponents respond to these counterarguments, stating that if the board retains such ample discretion to keep unelected directors on the board, majority voting is really just plurality voting “under a different name” and is not worth the effort expended debating it; the fact that the director was not technically “elected” is just semantics. *Id.* at 348. Proponents respond that when a director fails to be elected under a majority-voting system and the board chooses to allow the director to stay (by rejecting the resignation offer), the board must justify its decision to retain that unelected director. *Id.* at 346 (remarking that if a director fails to be elected due to receiving an insufficient number of votes, “the board then has to do something” and that “[a]ny board that didn’t do anything . . . would be idiotic”). The virtue of the majority-voting standard, then, is “the incentive [it provides for the board] to work with shareholders to find a mutually acceptable solution” to shareholders’ perceived problems with the board’s management of the corporation. *Id.* The standard puts substantial “pressure on boards to negotiate a solution with dissenting shareholders.” *Id.* Thus, the majority-voting standard is not just plurality voting under a different name. *See id.*

237. Deane, *supra* note 16, at 350–51.

238. *Id.* at 350. As Joseph Grundfest envisioned in his 1993 article, shareholders under a plurality-voting standard have the ability to inject power into the withhold vote by organizing “just vote no” campaigns, in which shareholders withhold votes en masse from unresponsive directors to signal their dissatisfaction. *See generally* Grundfest, *supra* note 15.

the board's receipt of a substantial number of withhold votes can be damaging to the company.<sup>239</sup> By taking away the possibility of exercising a withhold vote in uncontested elections, shareholders will be left with the stark choice between voting directly "for" or directly "against" a particular director, when shareholders may just want to use the withhold vote as a symbol that they are not happy with the current direction of the company.<sup>240</sup>

*d. Unintended Consequences*

Opponents further argue that the majority-voting standard may give rise to unintended consequences in light of a possible change in a NYSE rule pertaining to the voting of shares held of record by brokers.<sup>241</sup> Under the so-called "broker nonvote rule," a broker may vote the shares of the beneficial owner on routine, ordinary matters, such as director elections, if the beneficial owner provided the broker with no voting instructions.<sup>242</sup> Typically, brokers vote these shares (i.e., broker nonvotes) in favor of the incumbent directors.<sup>243</sup> However, the new rule being contemplated by the NYSE would prevent corporations from counting such uninstructed votes for director nominees.<sup>244</sup> Such a change could result in a substantially reduced number of "for" votes being cast for incumbents at the meeting.<sup>245</sup> Thus, the effects of this rule change, in conjunction with the possible increased use of the "against" vote by even those shareholders who are only marginally dissatisfied, could increase the incidence of directors' failing to be elected.<sup>246</sup>

An additional unintended consequence is that majority voting might deter directors from serving on corporate boards due to the risk of not

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239. See Grundfest, *supra* note 15, at 866.

240. Deane, *supra* note 16, at 350, 362 n.41. However, note that it may well be possible for a company adopting majority voting to have "for," "against," and "withhold" vote options on the proxy card. ABA DISCUSSION PAPER, *supra* note 34, at 18. The "for" and "against" votes would presumably be the only ones counted in determining whether the director received a majority vote. See *id.* at 18–19, 19 n.28. The withhold vote could still function as an abstention—and thus perhaps still a symbol of a shareholder's general dissatisfaction with a particular candidate. See *id.* at 18–19. If such voting options are possible, then the majority-voting system arguably allows shareholders to express an even wider range of opinions on the performance of the directors by way of the corporate vote. See *id.*

241. NYSE Group, Inc., NYSE Rule 452 (2007), available at [http://rules.nyse.com/NYSE/NYSE\\_Rules/](http://rules.nyse.com/NYSE/NYSE_Rules/) (click on "Operation of Member Organizations"); COGUT ET AL., *supra* note 121, at 6.

242. See *supra* note 124.

243. See *supra* note 124.

244. COGUT ET AL., *supra* note 121, at 7.

245. *Id.*

246. *Id.*

being elected, which all directors would face under a majority-voting standard.<sup>247</sup> Since the Enron, WorldCom, and other major corporate scandals during 2001–02, directors already must cope with a host of increased responsibilities and pressures and also face an increased risk of personal liability due to errors.<sup>248</sup> Thus, directors may be less willing to serve on boards if they feel as though they can be subject to an embarrassing removal at the whim of shareholders, who may vote against a particular director for any number of reasons not necessarily related to that director's effective management of the corporation.<sup>249</sup>

*e. Majority Voting Is Not Necessary*

An additional contention is that the majority-voting overhaul is unnecessary in light of the already-improving landscape of American corporate governance and the mechanisms already in place which allow shareholders to voice their opinions in an effective but nonintrusive manner.<sup>250</sup> First, opponents state that the legislation and regulations passed to deal with the corporate scandals have already sought to address several of the problems relating to directors and board nominations.<sup>251</sup> They further claim that these regulations need to be given a chance to prove their effectiveness before burdening the board with additional governance measures to implement.<sup>252</sup>

Second, they argue that shareholders already have multiple ways to express their dissatisfaction with company boards through methods they can and do use.<sup>253</sup> For example, shareholders may make precatory resolutions under Rule 14a-8,<sup>254</sup> vote against management's proposals at the annual meeting, make public statements that impugn the directors'

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247. Deane, *supra* note 16, at 348–49.

248. *Id.* at 348.

249. *See id.* at 348; *see also supra* note 201 (describing special-interest shareholders' votes).

250. *Id.* at 349–50; *see also supra* note 203 and accompanying text (arguing that the Proposed Rule was unnecessary for similar reasons).

251. *See, e.g.,* Lipton & Rosenblum, *supra* note 34, at 92–93. In particular, the newly enacted Nominating Committee Rule requires disclosures that increase the transparency of the process that a company's nominating committee uses to select director candidates, thereby "enhanc[ing] the ability of major shareholders to provide meaningful input into the nomination process." *Id.* at 92.

252. ABA DISCUSSION PAPER, *supra* note 34, at 14–15.

253. *See* Lipton & Rosenblum, *supra* note 34, at 69 (discussing arguments relating to Proposed Rule but applicable here as well).

254. Opponents further argue that directors already face significant consequences if they ignore precatory proposals that are passed by a majority vote. In so doing, the board is likely to receive significant criticism, and ISS may recommend to its institutional investor clients that those investors withhold their votes from the unyielding directors. *See Shareholder Proposals: What You Need to Know, supra* note 108.

management abilities, speak privately with management regarding their concerns, and suggest to the nominating committee a director candidate, whom the nominating committee must consider in accord with its fiduciary duty to act in the best interest of the company.<sup>255</sup> They may also withhold support for directors with whom they are dissatisfied.<sup>256</sup> Opponents state that shareholders have taken and continue to take advantage of each of these opportunities.<sup>257</sup>

Third, they argue that corporations have already made significant headway in improving the lines of communication between directors and shareholders.<sup>258</sup> Directors have seriously considered the issues that shareholders have found most bothersome and are generally working to resolve them.<sup>259</sup> For example, boards of many corporations have already begun to declassify their boards.<sup>260</sup> Shareholder activists observe that board classification, by allowing directors to escape reelection each year, leads to the entrenchment of the board and the managers, as well as reduced accountability to shareholders.<sup>261</sup> Notably, however, companies have been voluntarily moving to declassify boards in an effort to appease shareholders.<sup>262</sup> Some opponents argue that the move toward majority voting may stop the trend toward declassification of the boards, as the increased risk of failing to be reelected under a majority-voting standard would weigh heavily against the board's voluntary adoption of yet another insulation-reducing governance device.<sup>263</sup>

As a final argument, opponents cite the fact that dissatisfied shareholders may always sell their shares.<sup>264</sup> Thus, shareholders can bring market pressures to bear on a derelict board by driving down the stock price and subjecting the firm to the possibility of a hostile takeover.<sup>265</sup>

To these various arguments, proponents of majority voting would likely respond that the opponents' cited "solutions" have long existed and have not been effective in providing shareholders an active voice in the

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255. Lipton & Rosenblum, *supra* note 34, at 69.

256. ABA DISCUSSION PAPER, *supra* note 34, at 15–16.

257. Lipton & Rosenblum, *supra* note 34, at 69, 92–94.

258. *See* Deane, *supra* note 16, at 350–51.

259. *See id.*

260. *Id.* at 351. *See supra* note 37 for a description of board declassification.

261. *See supra* note 37. Classification is expressly allowed under certain states' corporate statutes, including Delaware's. *See* DEL. CODE ANN. tit. 8, § 141(d) (2006).

262. Deane, *supra* note 16, at 351.

263. *Id.*

264. ABA DISCUSSION PAPER, *supra* note 34, at 16.

265. *See supra* text accompanying notes 64–65. However, note the problems associated with hostile takeovers, described above. *See supra* text accompanying notes 70–73.

direction of their companies.<sup>266</sup> Many of the mechanisms cited as alternatives to majority voting have no legal force.<sup>267</sup> For example, precatory resolutions under Rule 14a-8 merely allow shareholders to *ask* that the board consider a certain proposal; even if the proposal receives a majority vote, the board may, without liability, decide not to implement it.<sup>268</sup> Moreover, though the nominating committee has a fiduciary duty to make decisions that are in the best interest of the corporation, the nominating committee routinely recommends incumbents for nomination, and the board itself still has the final say over who ultimately gets nominated.<sup>269</sup> Therefore, even post reform, shareholders still have no additional legal mechanisms (other than the proxy contest) to participate in director elections.

Proponents of the Intel-styled majority-voting standard also counterargue that while Pfizer-styled director-resignation policies are a step in the right direction, they insufficiently protect the voice of the shareholders in director elections.<sup>270</sup> Director-resignation policies are just that—policies. They are not binding bylaws, so the board may change them at any time.<sup>271</sup> Thus, the Intel standard, which is enshrined in a bylaw amendment, manifests a permanence that Pfizer’s informal “corporate governance policy” does not.<sup>272</sup>

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266. See, e.g., Deane, *supra* note 16, at 338, 342.

267. See, e.g., *Shareholder Proposals: What You Need to Know*, *supra* note 108. Further, though opponents glibly claim that shareholders can speak to management about their concerns, these “discussions” have no legal force, as it is the board that makes the company’s business decisions. See DEL. CODE ANN. tit. 8, § 141(a)(2006).

268. See *supra* note 108; see also Posting by Stephen Bainbridge on ProfessorBainbridge.com, *Today’s Shareholder Access Post: What About That Third Trigger?*, [http://www.businessassociationsblog.com/2003/11/todays\\_shareholder\\_access\\_post\\_what\\_about\\_that\\_third\\_trigger/](http://www.businessassociationsblog.com/2003/11/todays_shareholder_access_post_what_about_that_third_trigger/) (Nov. 11, 2003) (stating that the board’s decision not to implement a precatory resolution is protected by the business judgment rule).

269. See *supra* note 101. Further, the same agency problems discussed in connection with the divergent interests of managers and shareholders also apply to the interests between the directors on the nominating committee and shareholders. See Bebhuk, *supra* note 12, at 57.

270. CII-NACD REPORT, *supra* note 48, app. B at 32.

271. See Nathan, *supra* note 158, at 4–5. Moreover, with the recent amendments to Delaware law and the MBCA, ensuring that the board cannot unilaterally amend shareholder-adopted bylaw amendments pertaining to director elections, see *supra* note 171 and accompanying text, proponents are correct to assert that director-resignation policies “may be altered with relative ease” when compared with bylaw amendments. COGUT ET AL., *supra* note 121, at 4.

272. See COGUT ET AL., *supra* note 121, at 4–5.

### 3. *Implementation Problems Associated with Majority Voting: Dealing with the Holdover Rules and Preventing Board Vacancies*

Even granting that majority voting, in principle, is a positive step in terms of fostering more meaningful shareholder participation in director elections, skeptics cite various problems of implementation. Perhaps the greatest point of contention in the majority-voting movement is how to implement the voting standard so that it may be made effective under the existing statutory scheme of the state in which the company is incorporated.<sup>273</sup> In particular, the most difficult of these issues to resolve is how to square the majority-voting standard with the states' holdover rules.<sup>274</sup> Opponents of majority voting ask what the purpose of a majority-voting standard is if directors who fail to receive a majority of the votes still hold over as directors and serve at least until the next election anyway.<sup>275</sup>

There are several solutions, however, to dealing with the problems the holdover rule creates. First, and perhaps most obviously, states could eliminate the holdover rule to facilitate the implementation of majority-voting proposals.<sup>276</sup> However, eliminating the holdover rule may be imprudent.<sup>277</sup> The holdover rule serves a useful purpose; it ensures that directors who fail to win an election are not immediately removed from their positions and that the corporation will not be subject to immediate vacancies.<sup>278</sup> Moreover, if a majority of the directors failed to be elected, the directors' holding over might prevent an undesirable takeover.<sup>279</sup> Thus, wholesale elimination of the holdover rule does not seem appropriate.<sup>280</sup>

In keeping with these observations, it seems that most majority-voting proponents do not necessarily advocate the elimination of the holdover rule.<sup>281</sup> Instead, they argue that director-resignation policies adopted in

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273. See, e.g., Deane, *supra* note 16, at 345–46.

274. See, e.g., CII-NACD REPORT, *supra* note 48, app. B at 7–8. For a description of the “holdover rule,” see *supra* note 133.

275. See *supra* note 133 (explaining how state statutes provide that a director who is unelected continues to hold over in her position until she resigns, she is removed, or her successor is elected and is qualified).

276. CII-NACD REPORT, *supra* note 48, app. B at 8.

277. *Id.*

278. See *id.*

279. ABA DISCUSSION PAPER, *supra* note 34, at 22 (discussing how failed elections expose companies to hostile takeover).

280. CII-NACD REPORT, *supra* note 48, app. B at 8–9.

281. See, e.g., *id.* Some proponents, such as ISS, for example, do suggest sweeping modifications to the existing holdover rules. Letter from Stephen Deane, Vice President, Inst'l S'holder Serv., to the Honorable E. Norman Veasey, Chair, Comm. on Corp. Laws, Am. Bar Ass'n 4–5 (Aug. 15, 2005),

conjunction with majority voting will allow the corporation to give effect to the shareholders' vote without unduly handicapping the corporation's ability to deal with unexpected and possibly unwarranted shareholder votes and what would otherwise be immediate director vacancies.<sup>282</sup> Under

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<http://www.issproxy.com/pdf/ISSCommentLetteronABAMajorityElectionsPaper.pdf> [hereinafter ISS Letter]. ISS maintains that the holdover rule should keep unelected directors in office only in certain specific situations, such as when that director's leaving would cause the board to violate the SRO independence standards. *Id.*

282. See CII-NACD REPORT, *supra* note 48, app. B at 9–10. Director-resignation policies are essential to the operation of majority-voting standards because directors cannot remove other directors under either Delaware law or the MBCA; that power is specifically reserved to shareholders. See, e.g., DEL. CODE ANN. tit. 8, § 141(k) (2006) (stating that stockholders have the power to remove directors); MODEL BUS. CORP. ACT § 8.08 (2006) (same). Therefore, without a resignation policy in place, following a particular director's failure to receive a majority of the votes, the remaining directors would be powerless to unilaterally remove the holdover director if the holdover director refused to voluntarily resign. See, e.g., DEL. CODE ANN. tit. 8, § 141(k). Though the board (or shareholders, if authorized by the charter or bylaws) could call a special meeting to remove the director via a stockholder vote even without a resignation policy in place, enough shareholders would have to be present at the meeting or their votes represented by proxies in order to effectuate the removal, requiring shareholders to essentially vote again to remove the director they already voted not to elect. §§ 141(k), 211(a)(2), 211(d); CII-NACD REPORT, *supra* note 48, app. B at 8, 15, 18; see also MODEL BUS. CORP. ACT § 8.08. It is also true that, following an election in which one or more directors failed to be elected, the board may nominate another director candidate to replace the holdover director and call a special meeting where the shareholders may vote on the new candidate (who would replace the holdover director if the new nominee were elected by a majority of the outstanding votes). See DEL. CODE ANN. tit. 8, § 141(a). However, doing so is expensive, ABA DISCUSSION PAPER, *supra* note 34, at 21, and it takes time to find replacement directors. David Morrison & Elizabeth Cates, *Majority Versus Plurality Voting in the Election of Directors* (Fulbright & Jaworski LLP), Oct. 2005, at 4, [http://www.fulbright.com/index.cfm?fuseaction=publications.detail&pub\\_id=2018&site\\_id=494&detail=yes](http://www.fulbright.com/index.cfm?fuseaction=publications.detail&pub_id=2018&site_id=494&detail=yes) (click "view as PDF").

There is, however, another potential problem with the notion of using the director-resignation policy to cut off the holdover period for a holdover director. The problem is that the board also does not have the power to force directors to tender, before the annual meeting, a contingent resignation in the first instance. See DEL. CODE ANN. tit. 8, § 141(k); see also CII-NACD REPORT, *supra* note 48, app. B at 19 (noting that "guidelines or bylaw amendments" asking for resignations "would not create a legal right for a board to remove a director"). However, it is now clear that the DGCL and the MBCA, each as amended, make resignations conditioned on receipt of an insufficient number of "for" votes enforceable, meaning that such resignations could be tendered before the election but conditioned on the election results; still, they first must be voluntarily submitted. See DEL. CODE ANN. tit. 8, § 141(b); see also CII-NACD REPORT, *supra* note 48, app. B at 19. The board still has options, however, if a director refused to submit such a resignation in advance of the meeting. For example, the nominating committee could, at the urging of the board, choose not to nominate the obstinate director at the next annual meeting, forcing that director to wage an expensive proxy contest for his own election just as any other shareholder wishing to nominate a director would. See *supra* note 101 (describing the function of the nominating committee) and notes 107–10 and accompanying text (explaining how the Proposed Rule would have allowed shareholders whose candidates were not nominated by the nominating committee to wage a proxy contest within the company's proxy statement, but the Proposed Rule was not adopted). However, such an effort by that director would likely be in vain once the shareholders learned of the reason for his failure to be renominated. See CII-NACD REPORT, *supra* note 48, app. B at 19 (noting that these resignation "procedures might give a director a greater impetus to resign"). Thus, even though the board may not *force* all directors to

the Intel approach, for example, directors can apprise the reasons behind the shareholder vote, and if they conclude that the director is too valuable to the company and that the shareholders' voting decision was an unreasonable one, the board may allow the director to continue serving as a holdover director by rejecting his or her tendered resignation.<sup>283</sup> However, under a majority-voting standard, a board that chooses to retain an unelected director as a holdover director by rejecting his resignation

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submit contingent resignations in compliance with a director-resignation policy, it seems that the likelihood that a director would resist the submission of a contingent resignation is small. *See id.*

If the company did not require submissions of director resignations in advance of the election, and a certain director was not elected but refused to tender a resignation following the vote (and a special meeting to remove him or replace him would be too costly), the worst-case scenario might be to simply allow the director to hold over for the remainder of the period, which would be only one year, and then ask the nominating committee not to renominate him or her. *See id.* at 17–18.

283. CII-NACD REPORT, *supra* note 48, app. B at 19. If the board rejects the resignation, the director can always then submit an unconditional resignation, which the board must accept, if he really wants to leave his position. *Id.*

On the other hand, if the board after due consideration determines that the director should be removed, it can accept the resignation. *Id.* After acceptance of the resignation, the board can call a special meeting for the shareholders to elect a new director, it can eliminate the vacant seat, or it can simply permit a vacancy which may then be filled as explained below. *See id.* at 20–21; *see also infra* note 289.

Under the Pfizer approach, too, the board would be empowered to accept or reject the tendered resignation of a director who received more withhold votes than “for” votes. *See supra* text accompanying notes 152–54. However, because under the Pfizer approach plurality voting still applies, that director would still be elected (as only one vote is required to elect a director under plurality voting) and so would not be a holdover director. *See supra* note 158 and accompanying text. The distinction between an elected director holding office (the result under the Pfizer approach when the director fails to receive a majority of the votes) and a holdover director (the result under the Intel approach) with respect to powers, duties, and the ability to participate in decisions, however, appears to be nil. CII-NACD REPORT, *supra* note 48, app. B at 14–15 (noting that holdover directors can participate in board decisions to the same extent as elected directors).

This conclusion raises the question of what, then, is the difference between the Pfizer and Intel standards if, in either case, a director failing to receive a majority of the votes stays on after the election and, in either case, the decision to end the director's term (via accepting the resignation submitted) is within the discretion of the board. In truth, the differences are slight. *See Nathan, supra* note 158, at 2. Perhaps the most substantial difference is that Pfizer-styled standards are mere policy adoptions, whereas Intel-styled standards involve bylaw amendments. *Id.* at 4 (stating that “a decision to implement full-fledged majority voting cannot be made by board policy” and that “[i]t must be embedded in a by-law or certificate of incorporation”). Another distinction is that true majority-voting standards cause unsatisfactory directors to actually fail to be elected, giving the shareholders' votes a “stronger moral effect” and “legal effect” since the director was not legally elected. *Id.* at 2. Thus, if the board rejects the director's resignation, the board is actually allowing an unelected director to stay on the board whereas, under the Pfizer standard, rejecting the director's resignation amounts to simply ignoring the elected director's receipt of a majority of withhold votes, which are legally insignificant anyway. *See id.*; *see also supra* note 124 and accompanying text. A final difference is that true majority-voting standards will require that board-nominated candidates who had not previously served on the board obtain a majority of the votes or else not serve on the board at all, as the holdover rules do not apply to those who were not already incumbent directors. *See Nathan, supra* note 158, at 2.

presumably will have to justify that decision to the shareholders.<sup>284</sup> Thus, the majority-voting regime ensures that the board's decision whether or not to accept a director's resignation is subject to shareholder scrutiny.<sup>285</sup>

One final consideration in adopting the majority-voting standard is its potential to increase the incidence of board vacancies following elections.<sup>286</sup> Though, at first glance, it may seem that the operation of the holdover rule would protect the board from immediate and unexpected vacancies in all instances where certain directors failed to receive a majority of the votes, it will not do so in at least one instance: when one of the board-nominated candidates for a director position is not an incumbent and the director formerly filling the seat has already abdicated her position.<sup>287</sup> A nonincumbent candidate is not subject to the operation of

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284. CII-NACD Report, *supra* note 48, app. B at 27. If the elected directors on the board decide not to give the shareholders' vote due consideration, or (worse yet) ignore it completely and take no steps to find a new director to replace the unelected one, they will "likely exacerbate the underlying cause of shareholder dissent" and thereby possibly effect "a public struggle between the company and its shareholders." *Id.* Shareholders might as a result conduct a proxy contest to nominate a full new slate of directors to replace such unresponsive ones, *see supra* text accompanying note 76, or they might bring suit against the directors for breaches of their fiduciary duties of care and loyalty, *see supra* note 57 and accompanying text. And, even though proxy contests are costly and not frequently waged, one might surmise that a proxy contest would be more likely to erupt in the face of such blatant disregard of the shareholders' vote. *See* CII-NACD REPORT, *supra* note 48, app. B at 27. On the other hand, if the elected directors truly believed that the nonelected director was an invaluable asset to the corporation, then it would be likely that the directors would attempt to work out a deal with the shareholders rather than simply ignore their wishes. *See* Deane, *supra* note 16, at 354.

Were the board to fail to partake in such negotiations with the shareholders and to choose instead to reject the resignation without deliberation, it is unlikely that such a decision would be upheld under the business judgment rule. *See supra* note 59 and accompanying text. The business judgment rule protects only those decisions made "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (citation omitted) (internal quotation marks omitted). Such a decision would fail to meet that standard. Even if the board could produce sufficient evidence to show that its decision was reasonably informed, a shareholder plaintiff might still be able to show that the bad faith actuated the board's decision. Further, it is not entirely clear that the business judgment rule would automatically apply in this situation anyway. *Cf. Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659-60 (Del. Ch. 1988) (stating that "the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context"). *Blasius* distinguished ordinary business decisions, over which directors have discretion, from "matter[s] of internal corporate governance," suggesting that power over the latter may be constrained by the directors' agency duties to their principal, the shareholders. *See id.* This issue could be the subject of another note entirely. For present purposes, it is enough to say that a true majority-voting policy significantly constrains the board's discretion to whimsically ignore shareholder voting results under a majority-voting standard.

285. *Id.*

286. *See* CII REPORT, *supra* note 48, at 9-10.

287. *Id.* at 9. Such a condition can occur in an uncontested election when, for example, an incumbent director resigns before the election but where the resignation is effective as of the meeting date. The board may then nominate another candidate for the seat. Though that candidate is board nominated (and the election uncontested), the candidate is not an "incumbent" because the candidate

the holdover rule.<sup>288</sup> Therefore, if one or more of the nonincumbent director candidates failed to receive a majority of the votes, he or she would not be elected, the holdover rule would not apply, and there would be an immediate vacancy on the board.<sup>289</sup> Still, because board-nominated candidates are usually incumbents,<sup>290</sup> the holdover rule will operate to prevent vacancies in most instances. Thus, the possibility of increased vacancies due to majority voting is not an especially acute problem.<sup>291</sup>

## VI. PROPOSAL

A company's board of directors plays a pivotal role in a corporation's governance since state corporate laws vest directors with wide discretion to make decisions of fundamental importance to the functioning of the corporation.<sup>292</sup> The board decides the amount of compensation to be paid to the company's key executives, retains the authority to replace those executives, and has the ability to initiate or block (as the case may be)

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has not yet served on the board. *Cf.* ABA DISCUSSION PAPER, *supra* note 34, at 26 (applying the analysis to nonincumbent directors in a "modified plurality" context).

288. DEL. CODE ANN. tit. 8, § 141(b) (2006). The holdover rule states that "*director[s]* shall hold office" until resignation, removal, or appointment of a successor. *Id.* (emphasis added). A nonincumbent candidate is not a "director." *See* CII-NACD REPORT, *supra* note 48, app. B at 9–10 (distinguishing between the impact of the holdover rule on an incumbent nominee (i.e., resulting in a holdover) and a nonincumbent nominee (i.e., resulting in a vacancy)).

289. *See* CII-NACD REPORT, *supra* note 48, app. B at 9; *see also* Deane, *supra* note 16, at 348. Under the DGCL, a vacancy on the board is filled per the bylaws; if the bylaws are silent, the board fills the vacancy. DEL. CODE ANN. tit. 8, § 142(e) (2006); MODEL BUS. CORP. ACT § 8.10 (2006) (vacancy filled by board or shareholders, unless charter provides otherwise). Vacancies—especially multiple vacancies—can create problems in the functioning of the corporation, such as causing the corporation to fail to meet stock-exchange listing requirements, quorum requirements, SEC requirements pertaining to board committee constituency, and others. CII-NACD REPORT, *supra* note 48, app. B at 22. The Pfizer standard does not create a risk of vacancy because even a nonincumbent director will be legally elected so long as she receives one or more "for" votes. However, while not creating a risk of vacancy, the Pfizer standard is undesirable because it guarantees the election of nonincumbent candidates who may have no track record with the company or no experience in managing a corporation. *See* COGUT ET AL., *supra* note 121, at 5. The fact that the board may also hold a resignation of the majority-withheld director does not alleviate this problem, since the board has the discretion in deciding whether or not to accept the resignation. *Id.* at 3–4.

290. *See supra* text accompanying note 107.

291. *See* CII-NACD REPORT, *supra* note 48, app. B at 9. As explained above, a vacancy as an immediate result of the election occurs only when an incumbent has resigned on the day of (or effective as of) the election, leaving the seat vacant, and the nominee to replace the departed director is a nonincumbent. *See supra* note 287 and accompanying text. Such an occurrence is not especially likely. CII-NACD REPORT, *supra* note 48, app. B at 9–10. In addition, in order to avoid even this unlikely occurrence, the board can ask that the departing director resign before the date of the election, which creates a vacancy that the board can fill with the proposed new nominee. ABA DISCUSSION PAPER, *supra* note 34, at 26. Then the new nominee becomes an incumbent, and the holdover rule will apply if he is not elected. *Id.*

292. *See supra* text accompanying note 29; *supra* notes 31–32 and accompanying text.

significant corporate transactions such as mergers, dissolutions, and the payment of dividends.<sup>293</sup> Therefore, it is not difficult to see why shareholders, who surrender their capital to the firm and entrust its management to the board, should have some say over who sits on that board. In fact, while shareholders generally retain very little control over the individual decisions that the board and the officers of the corporation routinely make, the quintessential right attaching to the common shareholder's stock is voting in an election of the board of directors.<sup>294</sup> Such accountability on the part of directors is a necessary concomitant to the control paradigm of the corporation, which divests the equity owners of control over the "business and affairs" of the corporation.<sup>295</sup>

Though corporate governance has of late received increased attention, and though some of the recent laws and rules enacted to prevent future Enron-like frauds have targeted boards of public companies,<sup>296</sup> the process of electing directors of corporations under state law has remained the same. The typical director election process is a mere formality: the incumbent directors nominate themselves for board positions,<sup>297</sup> and the shareholders—rather than nominating their own candidates, which would require an expensive proxy contest—vote on whether to reelect the incumbents.<sup>298</sup>

The majority-voting standard serves as a partial fix to the marked imbalance of power between the board and shareholders in director elections. While not allowing shareholders to nominate their own candidates, majority voting allows shareholders to register an affirmative vote against unresponsive, ineffective directors.<sup>299</sup> Majority voting would displace the prevailing plurality-voting system, under which shareholders

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293. See *supra* note 32.

294. See *supra* text accompanying notes 33 & 37.

295. See *supra* text accompanying note 39.

296. See *supra* text accompanying notes 95–103.

297. See *supra* note 101; see also *supra* text accompanying note 107.

298. See *supra* note 135 and accompanying text. It might be argued that the costs of waging proxy contests may be substantially reduced in light of the SEC's recent adoption of its internet proxy rules, and therefore, shareholders may wage contests more frequently. See *supra* note 77. If shareholders can wage proxy contests with relative ease, there is less of a need for a change to majority voting. See *supra* notes 77–81 and accompanying text. Still, the internet proxy rules reduce only the costs of proxy distribution; the costs of solicitation and legal fees (e.g., in preparation of the proxy statement) remain the same. See *supra* note 77. Moreover, because there are still costs to waging proxy contests, the collective action problem described above may still work to inhibit the frequency of proxy contests. See *supra* note 80 and accompanying text. Finally, even if proxy contests do arise more frequently, such is not an argument against the principle of increasing shareholder participation that underlies majority voting, which would give shareholders at those companies not experiencing proxy contests an effective way to combat the collective action problem and let their voices be heard.

299. See *supra* text accompanying notes 125–26.

can tender withhold votes to signal their dissatisfaction but cannot legally vote against unsatisfactory directors.<sup>300</sup> This voting schematic also avoids the thorny issues associated with the SEC's Shareholder Access Proposal, which arguably would have vested shareholders with too much power and possibly have created balkanized boards mired in conflict, thereby rendering them unable to function effectively.<sup>301</sup> Thus, the virtue of the majority-voting movement is that it gives shareholders a concrete and effective way of making directors accountable and at the same time, due to the states' holdover rules, does not deprive the board of the flexibility and maneuverability it needs to run the corporation.

Majority voting is quickly becoming a widespread phenomenon,<sup>302</sup> but it still has its detractors.<sup>303</sup> At bottom, these opponents articulate two primary arguments against the movement.<sup>304</sup> The first is that a majority-voting standard is unnecessary because of recent corporate governance advances, including laws (such as the Sarbanes-Oxley Act) and new rules (such as the SEC's Nominating Committee Rule) which already provide shareholders additional protection against director malfeasance.<sup>305</sup> This argument, however, fails to appreciate the problem that majority voting attempts to address: the imbalance of power between shareholders and directors in *director elections*. Even presuming that the new rules and laws will generally prevent directors from breaching their fiduciary duties, “[t]he shareholder *franchise* is the ideological underpinning upon which the legitimacy of directorial power rests,”<sup>306</sup> and therefore shareholders should have a meaningful say in the director-election process.

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300. See *supra* text accompanying notes 123–24.

301. See *supra* text accompanying notes 213–20.

302. See *supra* text accompanying notes 147–50.

303. See, e.g., Keith Paul Bishop, *Majority Voting Could Harm Shareholder Interests*, L.A. DAILY JOURNAL, May 11, 2006, available at <http://www.buchalter.com/CM/Publications/051106-Majority-Voting-Could-Harm-Shareholder-Interests.pdf>.

304. Perhaps an additional argument warns of the possible “unintended consequences” of majority voting. The only concrete examples of such consequences that opponents provide are, first, the possibility that the contemplated changes to the NYSE broker nonvote rule might cause directors to receive fewer “for” votes than previously and thus cause failed elections more frequently than warranted, and, second, that majority voting will impede the movement to declassify boards. See *supra* notes 241–46, 260–63. As to the first, it could be argued that eliminating such uninstructed votes from the count makes elections more democratic. See ISS Letter, *supra* note 281, at 6–7. Further, the widespread adoption of majority voting may compel the NYSE to leave the broker nonvote rule as is. As to the second, the trend toward board declassification has continued to remain strong, and, in any event, a board’s attempts to “reclassify” the board itself will “require the approval of shareholders.” *Id.* at 5.

305. See *supra* text accompanying notes 250–63.

306. *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1998) (emphasis added).

The second argument against majority voting represents a more valid concern—that the switch from a plurality- to majority-voting standard presents daunting (and assertedly unanswerable) questions of implementation.<sup>307</sup> Though it certainly does raise questions of implementation, majority voting can be, and has been, implemented in many large, successful publicly traded corporations.<sup>308</sup> The three primary issues surrounding the implementation of majority voting are: (1) whether the state legislatures should mandate a majority-voting standard for director elections or at least provide that majority voting would be the default standard; (2) what kind of standard should ultimately be applied (e.g., a Pfizer- or Intel-styled standard); and (3) whether state holdover rules should be abolished or limited in order to make majority voting meaningful, or whether they can be retained as they stand.<sup>309</sup> Each of these issues is addressable.

First, although majority voting is a positive step in corporate-governance reform, it is not clear that the state legislatures need to step in to force the standard upon companies or even make majority voting the default voting standard.<sup>310</sup> The better option is to permit shareholders to move for the adoption of a majority-voting standard at their company in the first instance.<sup>311</sup> The majority-voting movement as it has already unfolded indicates that shareholders likely will not face significant opposition in at least getting the bylaw-amendment proposals (to require majority voting) on the company's proxy statement. The SEC has refused to issue no-action letters that would otherwise allow the company to exclude such proposals.<sup>312</sup> In addition, even to the extent that the shareholder proposals receive substantial support but do not pass,<sup>313</sup>

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307. See, e.g., *supra* text accompanying notes 273–74.

308. See *supra* note 159 and accompanying text.

309. Compare CII-NACD REPORT, *supra* note 48, app. B at 31 (endorsing majority voting but also calling for the “continued application of the holdover director rule[s]”), with ISS Letter, *supra* note 281, at 4–5 (arguing that the sweep of the holdover rule should be significantly reduced).

310. Plurality voting is the default in the majority of the states. See *supra* note 121.

311. See ABA Press Release, *supra* note 172, at 3 (stating that it would be “unwise to change the statutory plurality default rule because it would apply universally to all corporations governed [by the MBCA]” and that, instead of legislatively making plurality voting the default rule, “the statutory framework should facilitate *individual corporate action*”) (emphasis added).

312. See *supra* note 146.

313. If the proposal does pass, and the proposal calls for a binding bylaw amendment, the directors are not free to ignore it, as amendments to the bylaws pertaining to director elections are within the province of shareholder voting power under state corporate law. See DEL. CODE ANN. tit. 8, § 109(a) (2006) (shareholders may “adopt, amend or repeal bylaws”); § 109(b) (bylaws may contain any provision “relating to . . . the rights or powers of [the company’s] stockholders”). If the directors refuse to adopt or implement the policy or otherwise ignore its mandate, it appears that they would be violating section 109 of DGCL. See § 109.

companies may have little choice but to accommodate shareholders in some manner (whether by adoption of a true majority-voting standard or a director-resignation policy) as the tide turns toward universal majority voting.<sup>314</sup> If an unbending company finds itself as one of the only companies resisting the majority-voting trend, dissatisfied shareholders may sell the company's stock,<sup>315</sup> or institutional shareholders, at the urging of the proxy advisory services, may well undertake proxy contests to displace resistant boards.<sup>316</sup>

On the other hand, if the shareholders of a corporation are content with the plurality-voting system, they should be allowed to retain that standard. Shareholders and their companies are fully capable of weighing the risk of failed elections or sudden vacancies<sup>317</sup> against the value of increased participation in the election of directors—all inherent in the majority-voting standard. If the shareholders and the company decide that the benefits outweigh the costs, that company can implement majority voting. However, those companies that do not want to take the time or spend the money to undertake this calculus should be able to default to plurality voting. Therefore, state laws should not be amended insofar as they require majority voting or make it the default standard, even though the advantages of majority voting appear, on balance, to outweigh the disadvantages.

If shareholders or their companies decide that majority voting is desirable, the question then becomes what kind of standard to adopt: specifically, is a Pfizer-type standard sufficient, or must shareholders push for an Intel-type standard? First, as noted above, there is not a great deal of difference between the Pfizer (modified plurality) and Intel ("true majority") standard.<sup>318</sup> Under either standard, even if a director fails to receive a majority of affirmative votes, the director stays on the board, and

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314. See *supra* note 179 and accompanying text.

315. Massive selling might create a depression in the stock price and make the company more susceptible to takeover, in which case the resisting management would be promptly displaced. See *supra* text accompanying notes 64–65. Even though the board may employ antitakeover defenses, the business judgment rule will not protect their decisions if they are not made in good faith. See *supra* note 59.

316. See CII-NACD REPORT, *supra* note 48, app. B at 29 (noting that "[p]roxy advisory services . . . are increasingly playing a decisive role in shareholder voting" and that "[o]ften, these services vote or influence the vote of substantial blocks of institutionally owned shares of major companies"). In addition, though proxy contests are expensive, it does not seem unreasonable to require shareholders to conduct a contest in this one particular (and unlikely) instance in order to install a board that will be amenable to changing the voting standard to majority voting, as such a change should reduce the likelihood of shareholders' having to conduct proxy contests in the future.

317. See *supra* text accompanying notes 286–87.

318. See *supra* note 283.

the board cannot remove that director unless he submits a resignation.<sup>319</sup> And under both standards the board retains the discretion to decide whether to accept the director's resignation, thereby allowing the board to evaluate the impact that the director's departure would have on the functioning of the board.<sup>320</sup> Both the Pfizer and Intel standards, therefore, give the shareholders' withhold or "against" votes some significance. A director's receipt of a majority of withhold or against votes triggers board deliberation with respect to that director under both standards.

Despite its similarity to Pfizer's approach, however, Intel's standard seems preferable for two primary reasons. First, only the Intel approach entails a binding bylaw amendment, which mandates that directors who fail to receive the requisite vote are not elected.<sup>321</sup> In addition, recent amendments to state corporate laws provide that the board may not amend or repeal bylaws that "specif[y] the votes that shall be necessary for the election of directors."<sup>322</sup> By contrast, the board may amend a policy at any time.<sup>323</sup>

The second reason the Intel approach is preferable is that it actually changes the voting standard for the election of directors.<sup>324</sup> Even though there may be little practical difference between an elected director having received a majority of withheld votes and an unelected, holdover director having received a majority of "against" votes,<sup>325</sup> there is a stronger "legal' . . . and . . . moral effect" associated with the latter director's actual failure to be elected.<sup>326</sup> In the case of an unelected director who holds over, the board may be forced to offer a more compelling justification for retaining such a director—who was expressly unelected by the shareholders—in the face of the shareholders' clear vote for the board to do the opposite.<sup>327</sup>

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319. See *supra* note 282.

320. See *supra* text accompanying note 283.

321. See *supra* notes 271–72 and accompanying text. Though some companies that have adopted modified plurality approaches have incorporated the resignation policy into the bylaws, they appear to be in the minority. COGUT ET AL., *supra* note 121, at 4–5 (describing General Electric's and Time Warner's approaches).

322. DEL. CODE ANN. tit. 8, § 216 (2006); cf. MODEL BUS. CORP. ACT § 10.22(c)(1).

323. See *supra* text accompanying note 271. It would appear that the amendment to section 216 of the DGCL might not even apply to a bylaw incorporating a director-resignation policy in any event, since such a policy, while related to voting in director elections, still does not "specif[y] the votes that shall be necessary for the election of directors," DEL. CODE ANN. tit. 8, § 216 (2006) (emphasis added). In merely specifying the number of votes necessary to trigger deliberation with respect to the director's resignation, the policy fails to "specif[y] the votes" required to *elect* a director, as nominees under plurality voting are still elected by a single vote. See *id.*; see also *supra* note 158.

324. See *supra* note 158.

325. See *supra* note 283.

326. Nathan, *supra* note 158, at 2.

327. See *id.*

The final implementation issue regarding majority voting extends to the operation of the states' holdover rules. Opponents argue that majority voting is really no different than plurality voting if the director holds over notwithstanding the shareholders' vote.<sup>328</sup> Even some proponents of majority voting have argued similarly; though majority voting is a positive and necessary development to give shareholders more leverage in director elections, proponents state that the holdover rules prevent majority voting from doing so to its fullest extent.<sup>329</sup> The obvious question that arises, then, is whether states should discard the holdover rules in order to implement majority voting. Upon deliberation, the answer appears to be "no." Though it is true that the holdover rules do, to a degree, dilute the shareholders' power to "un-elect" directors, the rules are necessary in light of the disabling consequences that could ensue if unelected directors were immediately removed from the board.<sup>330</sup> Among other things, corporations would face delisting from stock exchanges, expensive severance payments for those insider directors whose compensation packages provide for them, and exposure to potentially harmful takeovers.<sup>331</sup>

Even though the holdover rules are necessary, there is a strong argument for reforming them so as to ensure that shareholders actually realize the benefits majority voting seeks to confer. The holdover rules as they currently stand allow for an unelected director to hold over indefinitely since, absent resignation or removal, directors hold over "until [their] successor[s] [are] elected and qualified."<sup>332</sup> Thus, there appears to

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328. See *supra* note 236.

329. See ISS Letter, *supra* note 281, at 4–5.

330. See *supra* note 232 (describing some of the adverse consequences). Some opponents also argue that the majority-voting standard may actually put shareholders in a worse position, since the board may decide to accept a director's resignation, thereby creating a vacancy that the board itself can fill. Bishop, *supra* note 303, at 2. However, this is not a strong argument against majority voting. First, the bylaws (or the charter) can provide shareholders with the power to fill vacancies, DEL. CODE ANN. tit. 8, § 223(a) (2006) (allowing the charter or bylaws to change the default rule that the directors fill vacancies), and the shareholders may always adopt a bylaw allowing them to do so, §§ 109(a), § 223(a). Second, even to the extent that the board can unilaterally fill the vacancy, majority voting is concerned with giving effect to shareholders' votes against unsatisfactory directors; it is not focused, as the Proposed Rule was, on giving shareholders the power to nominate directors. See *supra* text accompanying note 205. The board can unilaterally nominate its own replacement candidate at the next election anyway under either a majority- or plurality-voting standard, so its ability to do so before the election does not seem especially troubling. Shareholders may always vote against that director at the next annual meeting in any case. See *supra* note 101.

331. See *supra* note 232.

332. DEL. CODE ANN. tit. 8, § 141(b) (2006); cf. *Fork Bancorporation, Inc. v. Toal*, 825 A.2d 860, 871 & n.25 (Del. Ch. 2000) (holdover directors under majority-voting standard on a classified board were required to sit for election at the next meeting following their failure to be elected rather than being allowed to hold over for the rest of their three-year term; court never stated, however, that the holdover directors would abdicate their positions if they did not win at the next election). In theory,

be no cutoff period. For this reason, the state legislatures should consider limiting the holdover period to a certain timeframe.<sup>333</sup> A holdover period ending on the date of the next annual meeting would be reasonable and appropriate, since by that time a board should be able to find a qualified director.<sup>334</sup>

## VII. CONCLUSION

The control structure of the public corporation is such that the board of directors maintains nearly complete control over the management of the corporation. Such discretion is appropriate because in large, publicly traded corporations, it is infeasible that millions of dispersed shareholders could come together to manage “the business and affairs of . . . [the] corporation.”<sup>335</sup> But majority voting does not attempt to change the control structure of the corporation. It does not result in shareholders dictating the decisions that directors will make.<sup>336</sup> All majority voting does is provide shareholders a more meaningful role in voting in director elections—a key right that shareholders have always possessed.<sup>337</sup> In the end, majority voting is really a modest proposal designed to reenfranchise shareholders.

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then, even under a majority-voting standard, the board could reject an unelected director’s resignation, allowing him to hold over, then renominate him for the next election and continue to do so indefinitely; all the while, the director could hold over until his “successor [was] elected and qualified.” *See* DEL CODE ANN. tit. 8, § 141(b).

333. *See* MODEL BUS. CORP. ACT § 10.22 (2006). The newly enacted section 10.22 of the MBCA effectively allows the corporation to limit the holdover period to ninety days. *See id.* The problem with this holdover period, however, is that the time it allows the corporation to find a replacement director may be insufficient, and it leaves the board no flexibility, for even if the board cannot find a replacement in time, the director receiving a majority of withhold votes is unseated after ninety days, producing a vacancy. *See id.*

334. *See* Comac Partners, L.P. v. Ghaznavi, 793 A.2d 372, 379–80 (Del. Ch. 2001) (stressing the importance of the election of directors at an annual meeting). If the board believes that it is in the best interest of the corporation for the holdover director to continue to serve beyond the next annual election, the board may renominate that director but should have another director in queue in case the shareholders vote against the holdover director again.

Perhaps an even better solution would be to allow individual companies wishing to prevent or limit the application of the holdover rule to do so in their charters, as the MBCA (as amended) currently allows. *See* MODEL BUS. CORP. ACT § 8.05(e). Such a change would allow companies to assess on an individual basis how long it would take to find a replacement director when one fails to be elected at a meeting. If the legislatures are concerned that companies may eliminate the holdover period entirely, they could also mandate a minimum holdover period, such as ninety days (which could still be cut off by director resignations).

335. DEL CODE ANN. tit. 8, § 141(a) (2006); *see also supra* text accompanying notes 5–6.

336. In fact, majority voting is unlikely to affect in any capacity companies that maintain cordial relationships with their shareholders. Such companies respond actively to shareholder dissatisfaction by keeping open lines of communication between the board and the shareholders. *See supra* note 220 and accompanying text.

337. *See supra* text accompanying note 37.

It represents a happy medium between the problematic Shareholder Access Proposal and the alternative of giving shareholders only nominal say in board elections.<sup>338</sup>

Further, as demonstrated above, implementation problems cited by opponents are addressable. In the end, those companies planning to resist the rising tide of majority voting would be well advised to reconsider such resistance. Majority voting is here to stay.

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338. See, e.g., Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1467 (2006).

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