MAJORITY VOTING IN DIRECTOR ELECTIONS: A SIMPLE, DIRECT, AND SWIFT SOLUTION?

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I. INTRODUCTION

The shareholder franchise has often been described as a fundamental element of the corporate structure.[1] Although shareholders are the "owners" of the corporation, their ability to control corporate affairs is indirect. The traditional concept of the American corporation is that managerial authority is conferred to a board of directors that is elected by the shareholders.[2] Thus, it is has solemnly been stated that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[3]

In truth, however, shareholders have long lacked a meaningful voice in director elections. In 1932, Berle and Means declared, "For the most part the stockholder is able to play only the part of the rubber stamp."[4] Little has changed in the seventy-five years that have since elapsed. Legal and practical impediments have combined to ensure that shareholders are presented with only a single choice in the vast majority of elections: the candidate selected by the board. Shareholders may vote for the board's nominee or withhold their votes in a symbolic show of discontent; in

[1] Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 851 (2005).

[2] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2006) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . .").

[3] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988); *see also* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1127 (Del. 2003) ("Maintaining a proper balance in the allocation of power between the stockholders' right to elect directors and the board of directors' right to manage the corporation is dependent upon the stockholders' unimpeded right to vote effectively in an election of directors.").

[4] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 83 (Transaction Publishers 1991) (1932).

either case, however, the incumbent is assured reelection regardless of how many shareholders stand opposed to him or her.

Beginning in 2004, the majority voting movement set out to change this dynamic by empowering shareholders to oust directors that receive more votes "against" than "for" their election. Majority voting is a seemingly simple reform, and the corporate community has been unable to raise plausible objections to it—at least as a matter of principle. For this reason, activist shareholders have been able to persuade a substantial number of corporations to adopt majority voting, often on a voluntary basis. The unanticipated consequences of interjecting majority voting into director elections, however, have required the enactment of compromise provisions that bring majority voting's simplicity and viability into question.

This Note argues that difficulties inherent in formulating a workable majority voting standard have produced reform that is largely hollow and may well prove counterproductive. Part II discusses the traditional voting scheme in director elections, prior reform efforts, and the development of the majority voting movement. Part III explains the problems that failed elections and statutory safeguards present for majority voting. Part IV describes the various approaches that have been taken to implement majority voting, as well as statutory and regulatory efforts to facilitate its adoption. Part V argues that the majority voting movement has produced compromise provisions no more effective than "just vote no" initiatives, has created a system requiring costly and uncertain litigation to give effect to the shareholder vote, and has distracted shareholder activists from pursuing more meaningful reform. Part VI concludes by suggesting that reform directed at the underlying proxy system would serve shareholders more effectively than the interjection of majority voting into director elections.

II. THE MAJORITY VOTING MOVEMENT

This section discusses the origin and development of the majority voting movement. Part II.A considers the

traditional plurality voting regime and its interaction with the modern proxy voting system. Part II.B describes prior reform efforts that attempted to address the perceived inequities of director elections. Part II.C discusses the majority voting movement itself.

A. Plurality Voting

Director elections in the United States have traditionally been conducted by plurality voting. Under a plurality voting regime, a candidate for director must receive a greater number of the votes cast in an election than any other candidate in order to obtain a board seat, even if he or she does not receive an outright majority. Currently, thirty-three states, Puerto Rico, and the District of Columbia expressly provide for plurality voting in director elections,[5] as does the Model Business Corporation Act ("MBCA").[6] At least nine additional states have implicitly adopted plurality voting by providing for cumulative voting, which makes sense only under a plurality voting system.[7] In enacting plurality voting statutes, legislatures were apparently concerned about the possibility of failed elections, in which no candidate receives an outright majority of the votes cast.[8]

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[5] MODEL BUS. CORP. ACT ANN. § 7.28 statutory comparison (2006). Nevada mandates plurality voting. NEV. REV. STAT. § 78.330(1) (2006). The remaining thirty-four jurisdictions set plurality voting as the default in director elections. *See, e.g.*, DEL. CODE ANN. tit. 8, § 216(3) (2006) ("In the absence of [a] specification in the certificate of incorporation or bylaws of the corporation . . . [d]irectors shall be 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 . . . .").

[6] MODEL BUS. CORP. ACT ANN. § 7.28(a) (2006).

[7] Five states mandate cumulative voting and four make it the default in board elections. *Id.* statutory comparison.

[8] For example, legislative history suggests that plurality voting was adopted in Maryland because of the "bizarre occurrences" that would happen under an alternative scheme, including the possibility that "no nominees would receive a majority of the votes cast, in which case there would be no election and the current directors could continue to serve until the next annual meeting of stockholders." Explanation of Senate Bill 659, Vote Required to Elect Directors, *quoted in* Ideal Fed. Sav. Bank v.

Many have argued that plurality voting has aided in depriving shareholders of a meaningful voice in director elections. Few proxy contests are conducted annually in the United States.[9] Proxy contests have been aptly described as "the most expensive, the most uncertain, and the least used of the various techniques" for acquiring corporate control.[10] Shareholders, lacking the board's ready access to the corporation's proxy materials[11] and its treasury,[12] are frequently in no position to challenge incumbent directors by presenting alternative candidates in board elections. Collective action problems and state anti-takeover provisions

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Murphy, 663 A.2d 1272, 1277-78 (Md. 1995). Contemporaneous commentary indicates that the Delaware legislature adopted plurality voting for the same reason. ABA, COMM. ON CORPORATE LAWS, DISCUSSION PAPER ON VOTING BY SHAREHOLDERS FOR THE ELECTION OF DIRECTORS 5 (2005) [hereinafter ABA DISCUSSION PAPER], *available at* http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20050621000000.pdf. *See infra* Part III for a detailed discussion of failed elections.

[9] Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 862 (1993).

[10] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 114 (1965).

[11] While candidates nominated by the board are assured inclusion in the proxy statement, shareholder nominees are not entitled to the same benefit. Shareholders may propose candidates to the board's nominating committee, "which has a duty to consider bona fide candidates and to nominate directors they believe will best serve the interests of the company and all its shareholders." Martin Lipton & Steven Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67, 69 (2003). Despite this duty, it is far from guaranteed that shareholder candidates will make their way into the corporation's proxy materials.

[12] As a general rule, incumbent directors are reimbursed for expenses incurred in informing shareholders about their qualifications and persuading shareholders to vote in their favor, whether or not they are ultimately successful. An insurgent, however, may be reimbursed only if successful and only if the reimbursement is subsequently approved by the board and the other shareholders. Stephen M. Bainbridge, *Redirecting State Takeover Laws at Proxy Contests*, 1992 WIS. L. REV. 1071, 1078-79 (1992); *see also* Dale A. Oesterle & Alan A. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485, 547-48 (1994).

operate as further impediments to proxy contests.[13] Consequently, the vast majority of U.S. board elections are uncontested, with the number of candidates equaling the number of seats up for election.[14] Since plurality voting is the norm in director elections, the unopposed candidates—who have invariably been selected by the corporation—are guaranteed board seats even if more votes are withheld than are cast in their favor. Thus, the plurality standard and the limits of the American proxy voting system have combined to ensure that incumbent directors will be reelected even if only a single vote is cast in their favor and every other shareholder stands opposed.[15]

B. Prior Reform Efforts

1. "Just Vote No"

Shareholders have long been concerned with their lack of a meaningful voice in corporate affairs. In a 1990 speech to the Council of Institutional Investors ("CII") and a 1993 law review article, Professor Joseph Grundfest encouraged shareholders to register their discontent with a corporation by conducting so-called "just vote no" campaigns.[16] In a "just vote no" initiative, aggrieved shareholders "mark their proxy cards to 'withhold authority' from management's slate of directors which typically stands unopposed for election to the corporation's board."[17] In 1992, "just vote no" campaigns

[13] *See* Grundfest, *supra* note 9, at 862-63 n.18; *see also* Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1073, 1088-96 (1990); Bainbridge, *supra* note 12, at 1075-76, 1079-80.

[14] ISS INST. FOR CORPORATE GOVERNANCE, MAJORITY VOTING IN DIRECTOR ELECTIONS: FROM THE SYMBOLIC TO THE DEMOCRATIC 2 (2005) [hereinafter ISS, FROM THE SYMBOLIC TO THE DEMOCRATIC], *available at* http://www.issproxy.com/pdf/MVwhitepaper.pdf.

[15] *Id.*

[16] Grundfest, *supra* note 9, at 866.

[17] *Id.* at 903. The SEC requires registered corporations to afford shareholders the ability to withhold voting authority from a proxy holder. 17 C.F.R. § 240.14a-4(b) (2007).

received considerable assistance from changes in the Securities and Exchange Commission's ("SEC") disclosure rules.[18] The amendments created broad exemptions from the proxy rules for communications among shareholders that do not involve the actual solicitation of a proxy[19] and for public communications "stating how [a] security holder intends to vote and the reasons therefore."[20] Freed from costly disclosure requirements, "just vote no" campaigns began to gain traction as a relatively inexpensive alternative to other avenues of reform.[21]

"Just vote no" campaigns, however, are limited in their efficacy, being "a purely symbolic device that allows shareholders to cast a vote of no confidence in management."[22] Since plurality voting guarantees the election of a board-nominated director as long as there is at least one vote in favor of him or her, the board possesses the ultimate discretion whether or not to respond to the shareholder vote. Nevertheless, "just vote no" campaigns have often been successful in provoking board action, particularly when the Chief Executive Officer or another inside director is targeted.[23] Indeed, "sometimes even the

[18] Regulation of Communications among Shareholders, Exchange Act Release No. No. 31,326, 57 Fed. Reg. 48,276 (Oct. 16, 1992).

[19] 17 C.F.R. § 240.14a-2(b) (2007).

[20] *Id.* § 240.14a-1(l)(2)(iv).

[21] *See* Grundfest, *supra* note 9, at 911-12 (arguing that the costs of a "just vote no" campaign are negligible compared to pursuing Rule 14a-8 shareholder proposals).

[22] *Id.* at 905.

[23] *See* Diane Del Guercio et al., *Do Board Members Pay Attention When Institutional Investors 'Just Vote No'?: CEO and Director Turnover Associated with Shareholder Activism* 30 (Working Paper, June 2006) (study of ninety-two campaigns conducted between 1996 and 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=575242. The most notable example of a successful "just vote no" campaign is the 2004 initiative that led to Michael Eisner being stripped of his role as chairman and subsequently resigning as C.E.O. of Disney after he received approximately 45% "withhold" votes. *See* Bruce Orwall & Joann S. Lublin, *Eisner's Critics Now Like the Script; Roy Disney, Stanley Gold Suspend Bid to Oust CEO After Board Pledges Action*, WALL ST. J., Sept. 29, 2004,

mere threat of a . . . campaign may influence companies to adopt the requested changes."[24]

2. Proxy Access

More recently, shareholders and the SEC have turned their attention to remedying the proxy system itself, seeking "proxy access" for insurgents in board elections. Proxy access would require the board to include information on certain shareholder nominees as well as board-nominated candidates in the corporation's proxy materials. Eliminating the costs to insurgents of preparing and mailing their own proxy solicitations, proxy access was intended to be "a rather moderate step in a beneficial direction . . . constitut[ing] a significant departure from incumbents' long-standing control of the proxy machinery."[25]

On October 8, 2003, the SEC promulgated a proposed rule that would have required the board to include information on shareholder candidates in the corporation's proxy statement.[26] Under the SEC's proposal, proxy access would be limited to shareholders or groups of shareholders owning more than five percent of the corporation's voting securities[27] and would require that one of two "triggering events" occur.[28]

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at B3; Bruce Orwall & Joann S. Lublin, *Disney Dissidents Vow a Fight if Eisner Isn't Ousted by 2005*, WALL ST. J., Sept. 14, 2004, at B14.

[24] Andrew R. Brownstein & Igor Kirman, *Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 BUS. LAW. 23, 46-47 (2004).

[25] Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 48 (2003).

[26] Security Holder Director Nominations, 17 C.F.R. § 240.14a-11 (proposed Oct. 8, 2003).

[27] *See id.* § 240.14a-11(b).

[28] The proxy access requirement is "triggered" if within the two years preceding the meeting (1) a board-nominated candidate received more than 35% "withhold" votes or (2) a shareholder proposal that the corporation become subject to the proxy access rule is passed by a majority of shareholders. *Id.* § 240.14a-11(a)(2). The shareholder proposal mentioned in the second "trigger" may only be filed by a shareholder or group of shareholders holding more than 1% of the corporation's voting stock for at least one year. *Id.*

The proposed rule met with remarkably strong opposition from the business community.[29] Opponents claimed, among other things, that proxy access would be an unwarranted intrusion by the SEC into a matter traditionally left to state corporate law,[30] would deter otherwise qualified directors from serving,[31] and would produce balkanized and antagonistic boards.[32] Shareholder activists generally supported the proxy access rule but disagreed over its technical aspects.[33]

After languishing for nearly four years with neither adoption nor formal rejection by the SEC, proxy access was given new life by a Second Circuit decision. In *American Federation of State, County & Municipal Employees v. American International Group, Inc.* (*"AFSCME"*), the court held that a corporation may not exclude a shareholder-proposed bylaw allowing for proxy access from the corporation's proxy statement on the ground that such a

[29] *See* Deborah Solomon & Joann S. Lublin, *Voting Rights: Democracy Looks for an Opening—In the Boardroom*, WALL ST. J., Mar. 22, 2004, at A1.

[30] *See, e.g.*, Rose A. Zukin, Comment, *We Talk, You Listen: Should Shareholders' Voices be Heard or Stifled When Nominating Directors? How the Proposed Shareholder Director Nomination Rule Will Contribute to Restoring Proper Corporate Governance*, 33 PEPP. L. REV. 937, 981 (2006); Letter from Henry A. McKinnell, Chairman, The Business Roundtable, to Jonathan G. Katz, Secretary, SEC 11-13 (Dec. 22, 2003), *available at* http://www.sec.gov/rules/proposed/s71903/s71903-381.pdf.

[31] Zukin, *supra* note 30, at 987-88.

[32] *See, e.g., id.* at 986-87; Letter from John Wilcox, Vice Chairman, Georgeson Shareholder Communications, Inc., to SEC, at *8 (Dec. 12, 2003), *available at* http://www.sec.gov/rules/proposed/s71903/georgeson121203.htm.

[33] *See, e.g.*, Letter from Gerald McEntee, President, Am. Fed'n of State, County, and Mun. Employees, to Jonathan G. Katz, Secretary, SEC (Dec. 18, 2003) (favoring the proposal, but contending that the "triggers" should be modified and the 5% ownership requirement lowered), *available at* http://www.sec.gov/rules/proposed/s71903/s71903-396.pdf; Letter from James Heard, Chief Executive Officer, Institutional Shareholder Services, to Jonathan G. Katz, Secretary, SEC (Dec. 18, 2003) (supporting the proposed rule, but arguing for an "override" feature that would allow swifter action in egregious cases), *available at* http://www.sec.gov/rules/proposed/s71903/iss121803.htm.

proposal "relates to an election."[34] Following *AFSCME*, the SEC agreed to reconsider proxy access and ultimately decided to publish two alternative proposals for consideration. The first proposal would allow a shareholder (or group of shareholders) to submit a proposed bylaw setting forth proxy access procedures for inclusion in the corporation's proxy materials as long as the proponent (or group of proponents) has held at least five percent of the company's stock for more than a year;[35] the second would essentially reinstate the status quo that existed before *AFSCME* (i.e., the SEC's stance that corporations may properly exclude shareholder-proposed proxy access bylaws).[36] The SEC has not yet taken action on either proposal.

C. The Majority Voting Movement

Plurality voting has been sharply criticized for rendering boards unaccountable. Under the traditional plurality regime, opponents contend, incumbent directors "do not face elections with consequences, even if they fail to win a majority of votes cast."[37] Shareholder activists laud majority voting as a "simple, direct, and swift" solution to this problem, "draw[ing] a clear line in the sand—50 percent of

[34] 462 F.3d 121 (2d Cir. 2006).

[35] Shareholder Proposals, Exchange Act Release No. 56,160 (July 27, 2007).

[36] In *AFSCME*, the Second Circuit concluded that the SEC had not given an adequate reason for departing from its previous guidance that a shareholder proposal could only be excluded on the ground that it "relates to an election" when the proposal "would result in an immediate election contest." 462 F.2d at 127. The SEC's second proposal would cure the defect identified by the *AFSCME* court by amending Rule 14a-8 to make it clear that proposals may be excluded when they relate to either a specific "nomination or . . . election" or the general "procedure for such nomination or election." Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161 (July 27, 2007).

[37] Letter from Stephen Deane, Director, ISS Inst. for Corporate Governance, to E. Norman Veasey, Chair, Comm. on Corporate Laws, ABA (Aug. 15, 2005), *available at* http://www.issproxy.com/pdf/ISSComment LetteronABAMajorityElectionsPaper.pdf.

the votes cast—and set[ting] the timeframe as a single election."[38] Under the most basic form of majority voting, a candidate for director must receive a majority, rather than a mere plurality, of the votes cast in order to obtain a board seat. Majority voting is currently the norm in the United Kingdom, Germany, France, and other European nations.[39]

Impatient with the SEC's proxy access proposal and unsatisfied with "just vote no" campaigns, majority voting advocates sought a legally binding method to make their voices heard. Leading the way was "an unusual set of allies": a combination of unions seeking to rein executive pay and pension and hedge funds that saw "the majority-rule provision as a way to gain leverage to challenge managers and directors who aren't producing sufficient shareholder returns."[40]

Since its inception, the majority voting movement has grown with remarkable speed and met with considerable success. In 2004, twelve shareholder majority voting proposals were voted on, garnering an average vote of 12%.[41] In 2005, shareholders voted on sixty-seven proposals, receiving an average vote of 44.3%.[42] In 2006, eighty-four shareholder proposals came to a vote, with average approval

[38] ISS, FROM THE SYMBOLIC TO THE DEMOCRATIC, *supra* note 14, at 9. Likewise, Ed Durkin, a prominent shareholder activist, has described majority voting as "a very manageable, very straightforward reform." Gretchen Morgenson, *Who's Afraid of Shareholder Democracy*, N.Y. TIMES, Oct. 25, 2005, § 3 at 1; *see also* Louis Lavelle, *Commentary: A Simple Way to Make Boards Behave*, BUSINESSWEEK, Jan. 21, 2005 (describing majority voting as "a recipe for accountability if there ever was one").

[39] ISS, FROM THE SYMBOLIC TO THE DEMOCRATIC, *supra* note 14, at 4; *see also* INSTITUTIONAL S'HOLDER SERVS., 2006 POSTSEASON REPORT 18 (2006) [hereinafter ISS 2006 POSTSEASON REPORT], *available at* http://www.issproxy.com/pdf/2006PostSeasonReportFINAL.pdf.

[40] Dennis K. Berman, *Boardroom Defenestration*, WALL ST. J., Mar. 16, 2006, at B1.

[41] INSTITUTIONAL S'HOLDER SERVS., 2005 POSTSEASON REPORT 8 (2005), *available at* http://www.issproxy.com/pdf/2005PostSeasonReportFINAL.pdf.

[42] *Id.*

of 47.7%.[43] As of August 21, 2007, forty-six proposals have been voted on, averaging 49.4% shareholder approval.[44] In response to actual or anticipated shareholder proposals, more than 180 companies have adopted some form of majority voting,[45] including over 52% of the S&P 500 and 45% of Fortune 500 companies.[46] Furthermore, the Delaware, Washington, and California legislatures have adopted statutes facilitating the adoption of a majority voting standard, and the American Bar Association ("ABA") has amended the MBCA to the same end.[47]

III. OBSTACLES TO MAJORITY VOTING

Despite its apparent simplicity, majority voting raises several difficult issues, not all of which have been fully resolved. Opponents contend that "majority voting would open a Pandora's box of unintended consequences, from reducing the candidate pool to destabilizing the board."[48] Included among the potential adverse consequences of a majority voting regime are an increase in leverage for

[43] ISS 2006 POSTSEASON REPORT, *supra* note 39, at 3-4.

[44] Institutional S'holder Servs., 2007 Proxy Season Scorecard, http://www.issproxy.com/knowledge_center/proxy_season_watchlist/ (last visited Sept. 10, 2007). The nominal decrease in shareholder proposals in 2007 would seem to be not the result of decreased shareholder interest in the issue, but of an increased willingness on the part of companies to voluntarily adopt a majority voting standard. Melissa Klein-Aguilar, *Proxy Issues Will Return with a Vengeance in '08*, COMPLIANCE WEEK, June 7, 2007, *available at* http://www.complianceweek.com/index.cfm?fuseaction=article.viewArticle&article_ID=3428. *See infra* Part IV.A.1 for a discussion of the board's incentives to voluntarily adopt a majority voting standard.

[45] ISS 2006 POSTSEASON REPORT, *supra* note 39, at 2.

[46] CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS iii (2007), http://www.ngelaw.com/files/upload/majority_callen_020707.pdf.

[47] *See infra* Part IV.B.

[48] ISS, FROM THE SYMBOLIC TO THE DEMOCRATIC, *supra* note 14, at 12; *see also* Memorandum, Martin Lipton, Wachtell, Lipton, Rosen & Katz, *Majority Vote to Elect Directors* (Mar. 13, 2005), *available at* http://www.wlrk.com/docs/majorityvote.pdf (arguing that majority voting has "unintended and unforeseen consequences").

"special interest" shareholders, the inability of the capital markets to cope with a multitude of potential outcomes in director elections, and the loss of the symbolic effect of "withhold" votes.[49] However, the most persistent impediment to the implementation of majority voting has been the problem of failed elections, the focus of this section. Part III.A considers the harm to corporations that may arise from failed elections under a "true" majority voting standard. Part III.B discusses two common state law safeguards against failed elections that serve as additional impediments to the adoption of majority voting.

A. Failed Elections

In contrast to proxy access, majority voting is "essentially a *subtractive process*."[50] Providing no mechanism for shareholders to nominate their own candidates, majority voting leaves open the possibility of sudden board vacancies. A "true" majority voting standard means that any candidate receiving less than a majority of the votes cast would not obtain a board seat. If the incumbent in an uncontested election has received more votes "against" than "for" his or her reelection, the election would be said to have "failed," and the ousted director's seat would remain vacant—at least in theory—until another election could be held. The same would be true in a contested election if no candidate has received an outright majority of the votes cast.

Absent some sort of safeguard, the sudden removal of directors could result in substantial harm to the corporation. As an initial matter, a board left with multiple vacancies may simply be unable to function in an efficient matter. According to majority voting's detractors, directors with much needed expertise could be lost at the whim of shareholders, and locating replacements "with the right mix of skills to complement those of incumbent directors," already difficult in a post-Sarbanes Oxley world, may become

[49] ISS, FROM THE SYMBOLIC TO THE DEMOCRATIC, *supra* note 14, at 12-15.

[50] *Id.* at 4.

an even more formidable task.[51] In worst case scenarios, "unsuccessful elections could leave the board with a skeleton crew of directors, or perhaps no directors at all, and might cause the types of management crisis, exposure to hostile takeovers and the myriad other negative consequences of failed elections that the plurality rule . . . [is] meant to avoid."[52] Less obvious problems may also arise from failed elections, including:

i. If the ousted director is an independent director, inability to comply with listing standards;[53]

ii. If the ousted director is a senior executive, breach of his or her employment agreement;[54]

iii. The trigger of a "change of control" provision in a credit agreement, license, franchise agreement, or other corporate arrangement;[55]

iv. If a fixed number of directors are to be elected by holders of one class of securities, altering of the power relationship between shareholders of different classes;[56]

v. Altering the consequences of a staggered or classified board;[57] and

vi. Increasing the percentage of directors controlled by a dissident minority group.[58]

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[51] *Id.* at 12.

[52] ABA DISCUSSION PAPER, *supra* note 8, at 22.

[53] The New York Stock Exchange requires that boards of listed companies have a majority of independent directors, an independent audit committee with three or more members, an independent nominating/corporate governance committee, and an independent compensation committee. N.Y. STOCK EXCH. LISTING MANUAL § 303A.

[54] ABA DISCUSSION PAPER, *supra* note 8, at 6-7.

[55] *Id.* at 7.

[56] *Id.*

[57] *Id.*

[58] *Id.*

B. Existing State Law Safeguards

1. Holdover Rule

However, these dire predictions would probably not materialize in practice, even if a "true" majority voting standard were adopted, because state law provisions generally allow incumbent directors to maintain their board seats ("hold over") until a successor can be elected.[59] Although the holdover rule obviates the potential difficulties of failed elections, it is utterly incompatible with a majority voting regime. After being voted out of office by shareholders, the targeted director would remain on the board until another election could be held,[60] and if he or she is again ousted, the same result would follow. Thus, it has been argued that the adoption of a majority voting standard without modification of the holdover rule would "make for a hollow if not disingenuous reform, offering more the illusion than the reality of democratic and meaningful elections."[61]

2. Authority to Fill Vacancies

In addition to providing for the holding over of incumbent directors, state statutory schemes generally authorize a corporation's directors to immediately fill a board vacancy by nominating a successor.[62] As with the holdover rule, vacancy filling provisions are intended to prevent harm to the corporation but may operate to mitigate the impact of a majority voting regime. Since the directors' discretion in nominating a replacement is often extremely broad, an

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

[60] ABA DISCUSSION PAPER, *supra* note 8, at 7-8.

[61] Letter from Stephen Deane, Director, ISS Inst. for Corporate Governance, to E. Norman Veasey, Chair, ABA Comm. on Corporate Laws 4 (Aug. 15, 2005), *available at* http://www.issproxy.com/pdf/ISSComment LetteronABAMajorityElectionsPaper.pdf.

[62] *See, e.g.*, MODEL BUS. CORP. ACT ANN. § 8.10(a) (2006); DEL. CODE ANN. tit. 8, § 142(e) (2006).

obstinate board may select a candidate who shares the same undesirable characteristics as the ousted director or may simply fill the vacancy with the ousted director himself.

IV. IMPLEMENTATION OF MAJORITY VOTING

There are numerous means by which majority voting may be implemented, including amendment of the corporation's governance policy or bylaws, state or federal legislation, SEC regulations, and exchange rules. Legislation or rulemaking, in turn, may affirmatively alter the default rules by which elections are governed (e.g., by changing the default standard from plurality to majority voting) or may simply facilitate the adoption of majority voting by individual corporations. Each approach carries its own set of challenges.[63]

This section describes the various approaches to implementing majority voting that have been taken to date, with particular emphasis on attempts to resolve the difficulties associated with failed elections. Part IV.A considers majority voting provisions implemented by corporations on an individual basis through bylaw and corporate governance policy amendments. Part IV.B describes statutory and model code provisions adopted in response to the majority voting movement. Part IV.C discusses proposed revisions to the NYSE's discretionary broker voting rule that would significantly enhance the efficacy of majority voting.

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[63] *See, e.g.*, ISS, FROM THE SYMBOLIC TO THE DEMOCRATIC, *supra* note 14, at 10-11 (discussing potential federalism concerns with federal legislation or SEC rulemaking); ABA DISCUSSION PAPER, *supra* note 8, at 1 (noting that "[t]he substantive law relating to the election of directors of both public and private corporations is a matter governed by state corporation law"); ABA, COMM. ON CORPORATE LAWS, REPORT OF THE COMMITTEE ON CORPORATE LAWS ON VOTING BY SHAREHOLDERS FOR THE ELECTION OF DIRECTORS 14-16 (Mar. 13, 2006) [hereinafter ABA FINAL REPORT] (describing the difficulties of setting majority voting as a default rule), *available at* http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20060313000001.pdf.

A. Shareholder Proposals, Bylaw Amendments, and Resignation Policies

1. Generally

Since the inception of the majority voting movement in 2004, the primary means employed by shareholders to seek implementation of majority voting has been the filing of precatory proposals for inclusion in the proxy materials of individual corporations.[64] A smaller number of shareholders have submitted binding bylaw proposals that would *require* the implementation of majority voting.[65] Shareholder proposals were initially met with opposition from the corporate community, which expressed doubt as to whether the sudden implementation of majority voting would be a prudent course.[66] However, the increasing number of proposals and growing pressure from shareholder activists soon became too potent to ignore, and many boards came to view the adoption of majority voting in some form as inevitable.[67]

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[64] Shareholders may submit such proposals pursuant to SEC Rule 14a-8. 17 C.F.R. § 240.14a-8 (2007).

[65] A shareholder proposal may be excluded by the corporation if it is "not a proper subject for action by shareholders under [state law]." *Id.* § 240.14a-8(i)(1). Proposals must be "cast as [non-binding] recommendations or requests" to avoid exclusion when the proposal conflicts with the board's authority to manage corporate affairs. *Id.* note; *see also* Andrew R. Brownstein & Igor Kirman, *Can a Board Say No when Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 BUS. LAW. 23, 40-41 (2004); Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409, 428-433 (1998). The adoption of a bylaw regulating the electoral process, however, generally does not interfere with the board's discretion and may be the subject of a binding bylaw proposal.

[66] *See, e.g.*, Letter from Steve Odland, Chairman, Corporate Governance Task Force, The Business Roundtable, to E. Norman Veasey (May 26, 2005), *available at* http://64.203.97.43/pdf/20050527001LettertoABA-5.26.05-MajorityVotingFINAL.pdf.

[67] Dennis K. Berman, *Boardroom Defenestration*, WALL ST. J., Mar. 16, 2006, at B1.

Consequently, implementation of majority voting has overwhelmingly been effected on a voluntary basis by corporate boards faced with actual or potential shareholder proposals. From the board's point of view, there are several advantages to this course of action. By taking the ability to draft the implementing language away from shareholders, the board can craft a solution more favorable to management than may otherwise have been available and work out difficulties inherent in majority voting that investors may have failed to consider. At the same time, by actually adopting a majority voting standard—even one that is watered down—the board can avoid being labeled as unresponsive to investors and foreclose the possibility of adverse publicity from a heated battle.[68] Finally, unilateral adoption gives the board the ability to repeal or alter the majority voting provision at a later time without shareholder approval[69] and to exclude shareholder proposals from the corporation's proxy materials by claiming that majority voting has been "substantially implemented."[70]

2. The Pfizer Approach

Most corporations adopting a majority voting standard have chosen to follow the "director resignation policy" approach, pioneered by Pfizer in June 2005. Under Pfizer's corporate governance policy, "[i]n an uncontested election, any nominee for Director who receives a greater number of votes 'withheld' from his or her election than votes 'for' such election . . . shall promptly tender his or her resignation

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[68] *See* Memorandum, Wachtell, Lipton, Rosen & Katz, *Majority Voting—A Look Back at the 2006 Proxy Season* (June 12, 2006) (advising corporations to act "proactively" in light of "increased scrutiny from ISS and activist shareholders"), *available at* http://www.realcorporatelawyer.com/pdfs/wlrk061306_02.pdf.

[69] Bylaws or policies adopted by the board may generally be amended or revoked by the board alone. Under several recently enacted statutes, however, shareholder-adopted majority voting bylaws may not be repealed unilaterally by the board. *See, e.g.*, MODEL BUS. CORP. ACT ANN. § 10.22(a)(1) (2006); DEL. CODE ANN. tit. 8, § 216 (2006).

[70] *See* 17 C.F.R. § 240.14a-8(i)(10) (2007).

following certification of the shareholder vote."[71] Following the tender, "[t]he Corporate Governance Committee shall consider the resignation offer . . . and recommend to the Board whether to accept it."[72] Based on that recommendation, the entire board, excluding the tendering director, must then decide whether to accept or reject the resignation "within 90 days following certification of the shareholder vote."[73]

Shareholder activists were initially wary of the Pfizer approach. In December 2005, ISS indicated that it would take a case-by-case approach in deciding whether to recommend alternatives to "true" majority voting, based upon the proponent's "history of accountability to shareholders in its governance structure and in its actions" and its explanation of "why [the] alternative to a full majority voting threshold standard is the best structure . . . for demonstrating accountability to shareholders."[74] For a Pfizer-style resignation policy to be sufficient, ISS indicated that it would require incorporation of the following five elements:

i. Annual disclosure in the proxy statement of established guidelines concerning the process to be followed for nominees who receive majority withhold votes;

ii. A clear and reasonable timetable for all decision making regarding the nominee;

iii. A process for determining the nominee's status that is managed by the independent directors and that excludes the nominee in question;

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[71] Pfizer, Inc., Corporate Governance Principles § 7, *available at* http://www.pfizer.com/about/corporate_governance_principles.jsp.

[72] *Id.*

[73] *Id.*

[74] ISS U.S. CORPORATE GOVERNANCE POLICY 2006 UPDATES 4 (2005) [hereinafter ISS 2006 POLICY STATEMENT], *available at* http://www.issproxy.com/pdf/2006USPolicyUpdate.pdf.

iv. A range of remedies that can be considered concerning the nominee (acceptance of the resignation, maintaining the director but curing the underlying defect, and so on); and

v. Prompt disclosure via an SEC filing of the final decision regarding the nominee's status and a full explanation of how the decision was reached.[75]

CII went even further, categorically denouncing Pfizer-style policies as "fundamentally flawed" because the failure to adopt an actual majority voting standard "continues to deny shareholders a right to elect or unelect directors."[76]

The enforceability of majority voting resignation policies also came into question. Shareholder activists were uncertain, particularly under Delaware law, whether a director could irrevocably commit to resign without having an opportunity to consider whether his or her resignation would be in the best interests of the corporation.[77] Further complicating matters, the SEC denied the requests of Hewlett-Packard and Gannett for "no-action letters" related to the corporations' exclusion of shareholder majority voting proposals from their 2006 proxy materials based on the prior implementation of Pfizer-style resignation policies.[78]

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[75] *Id.* at 3-4.

[76] COUNCIL OF INSTITUTIONAL INVESTORS, MAJORITY VOTE WORK GROUP REPORT 32 (2006), *available at* http://www.cii.org/majority/pdf/MajorityVoteWorkGroupReport.pdf.

[77] Delaware common law is unclear on the extent to which directors may commit in advance to certain actions. *See, e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936-39 (Del. 2003) (finding an irrevocable agreement to support a merger without a "fiduciary out" clause to be invalid); Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1290-93 (Del. 1998) (finding a provision requiring directors to refrain from redeeming rights or terminating a rights plan for a specified period to be invalid).

[78] In the response to both requests, SEC staff disagreed that the companies had "substantially implemented" majority voting. Hewlett-Packard Co., SEC No-Action Letter, 2006 WL 39271, at *1 (Jan. 5, 2006); Gannett Co. Inc., SEC No-Action Letter, 2006 WL 89843, at *1 (Jan. 10, 2006).

3. The Intel Approach

In response to these concerns, the board of Intel decided to adopt a hybrid resignation policy/majority voting bylaw.[79] The basic procedure for ousting directors is the same under the Intel approach as under the Pfizer approach. If more votes are cast "against" than "for" a candidate in an uncontested election, he or she "shall offer to tender his or her resignation to the Board."[80] The independent Corporate Governance and Nominating Committee must then make a recommendation to the full board as to whether to accept or reject the resignation, with the tendering director being excluded from the deliberations.[81] The major difference between the Intel and Pfizer approaches is that Intel's board took the additional step of amending the bylaws to affirmatively provide that "each director shall be elected by the vote of a majority of the votes cast . . . ."[82] In effecting this change, Intel quelled a major shareholder criticism of Pfizer-style director resignation policies and simultaneously made it more likely that competing shareholder proposals or bylaws could be excluded as having already been "substantially implemented." ISS has come to embrace the Intel approach as a viable compromise that avoids the difficulties associated with failed elections, going so far as to state that "[c]ompanies are strongly encouraged to also adopt a post-election [director resignation] policy" if shareholders succeed in approving a binding majority voting resolution.[83]

Virtually every corporation that has implemented majority voting has done so by adopting a Pfizer-style director resignation policy or an Intel-style modified majority

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[79] Intel Corp., Bylaws, Art. III § 1, *available at* http://www.intel.com/intel/finance/docs/bylaws.pdf.

[80] *Id.*

[81] *Id.*

[82] *Id.*

[83] INSTITUTIONAL S'HOLDER SERVS., US CORPORATE GOVERNANCE POLICY 2007 UPDATES 11 (2006), *available at* http://www.issproxy.com/pdf/2007%20US%20Policy%20Update.pdf.

voting bylaw, sometimes with minor variations.[84] As of June 2006, at least 140 companies have adopted Pfizer-style director resignation policies, and at least forty have enacted Intel-style modified majority voting bylaws.[85] To date, no major corporation appears to have implemented a "true" majority voting standard.

B. Statutory Approaches

1. Model Business Corporation Act

On June 20, 2006, the Committee on Corporate Laws of the ABA ("Committee") adopted a series of amendments to the MBCA intended to facilitate the adoption of a majority voting standard for director elections. The substantive majority voting provision, section 10.22, allows either the shareholders or the board of directors of a corporation to unilaterally adopt a "carefully tailored majority voting bylaw standard,"[86] but does not alter plurality voting as the default

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[84] One common variation is the enumeration of factors to be considered in the acceptance or rejection of the director's tender of resignation. Berkshire Hathaway's policy, for example, provides:

> In reaching their decision, the Qualified Independent Directors shall consider all factors they deem relevant, including: (i) any stated reasons why shareholder withheld votes from such director, (ii) any alternatives for curing the underlying cause of the withheld votes, (iii) the director's tenure, (iv) the director's qualifications, (v) the director's past and expected future contributions to the Company, and (vi) the overall composition of the board, including whether accepting the resignation would cause the Company to fail to meet any applicable SEC or NYSE requirements.

Berkshire Hathaway, Inc., Corporate Governance Guidelines 2 (Feb. 27, 2006), *available at* http://www.berkshirehathaway.com/govern/corpgov.pdf. Another common variation of the Intel and Pfizer models would require a director who receives less than a majority of the shares *outstanding* (rather than voted) to tender his or her resignation. *See* ABA FINAL REPORT, *supra* note 63, at 33.

[85] ISS 2006 POSTSEASON REPORT, *supra* note 39, at 16.

[86] ABA FINAL REPORT, *supra* note 63, at 2.

standard in director elections. In deciding upon this restrained approach, the Committee was concerned primarily with the harm that may ensue from failed elections.[87] Among the options presented, the Committee was satisfied that maintaining plurality voting as the default rule, despite its flaws, was the most satisfactory approach because plurality voting "virtually assures the successful election of directors in every election," "delivers voting results in a certain, simple, efficient and transparent manner," and "is a 'one-size-fits-all' standard that works well with one-share-one-vote structures as well as more complex capital structures" (e.g., cumulative voting).[88] Accordingly, the Committee concluded that "[t]he risks of causing unforeseen consequences . . . would be significantly lessened if majority voting were adopted on an individual company basis," with each corporation assessing its needs and the potential for harm in its own specific case.[89]

A bylaw adopted pursuant to section 10.22 would allow shareholders of a public corporation to cast votes "for" or "against" candidates in director elections.[90] Although the receipt of a plurality of the votes cast is sufficient to obtain a board seat, any nominee failing to garner a majority vote serves for an abbreviated term that expires the earlier of "90 days from the date on which the voting results are determined" and "the date on which an individual is selected by the board of directors to fill the office held by such director."[91] The provision does not apply to contested elections,[92] and a bylaw adopted pursuant to section 10.22 by

[87] *See id.* at 14-16.

[88] *Id.* at 19.

[89] *Id.* at 19-20.

[90] MODEL BUS. CORP. ACT ANN. § 10.22(a)(1) (2006).

[91] *Id.* § 10.22(a)(2). In shortening the holdover period, the Committee recognized that "[i]f the holdover rule were maintained in its present form, a majority default rule would represent only a symbolic change . . . because directors who are not elected would nevertheless remain in office until a successor is elected and qualified." ABA FINAL REPORT, *supra* note 63, at 14.

[92] MODEL BUS. CORP. ACT ANN. § 10.22(b) (2006). For much of the comment period, the ABA maintained that "an exception that would

shareholders may not be unilaterally repealed or amended by the board.[93] Under the model bylaw, the board is authorized to "select any qualified individual to fill the office held by a director who received more votes against than for election."[94] The phrase "any qualified individual" is extremely broad, and the official comment to section 10.22 indicates that it "could include a director who received more against than for votes," i.e., the ousted director himself or herself.[95] The board is granted this power "to respond to the use of section 10.22(a)(2) as a takeover device or to prevent harm to the corporation resulting from a failed election."[96]

The Committee also amended two existing provisions of the MBCA to provide corporations with additional flexibility to craft their own majority voting solutions. Section 8.05 was amended to permit modification of the holdover period and directors' term of service through amendment to the corporation's articles of incorporation.[97] Likewise, section 8.07 was amended to provide for the enforceability of Pfizer-style resignation policies and Intel-style modified majority

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suspend the majority voting rule for contested elections . . . is not only unnecessary but could unduly complicate director elections." ABA FINAL REPORT, *supra* note 63, at 14. Ultimately, however, the ABA decided to include a carve-out for contested elections in section 10.22. Press Release, ABA, Comm. On Corporate Laws Adopts Amendments to the Model Bus. Corp. Act Relating to Voting By Shareholders For the Election of Dirs. 4 (June 20, 2006).

[93] MODEL BUS. CORP. ACT ANN. § 10.22(c)(1) (2006).

[94] *Id.* § 10.22(a)(3).

[95] *Id.* cmt.

[96] MODEL BUS. CORP. ACT ANN. § 10.22(a)(3) (2006). The commentary to section 10.22(a)(3) suggests that "[a]s a practical matter . . . and given the directors' consideration of their duties, boards are likely to be hesitant to select such director to fill the vacancy in other contexts." *Id.* cmt.

[97] *Id.* § 8.05(b)(ii), (e). In allowing this discretion, the Committee took into account that some corporations "facing little to no risk of [the] negative consequences [of a failed election] may prefer majority voting combined with a complete abolition of the holdover rule," others "with a complex capital structure and detailed director qualifications" may require maintenance of the plurality standard, and those in between "may prefer the type of compromise that a limited modification of the holdover rule would offer." ABA FINAL REPORT, *supra* note 63, at 19-20.

voting bylaws.[98] By giving corporations the ability to follow the Pfizer and Intel approaches, to enact a section 10.22 bylaw, or to craft their own solutions, the Committee sought to "encourage the continued development of different approaches . . . and avoid prematurely terminating that organic development by adopting a default rule that experience may prove is not the best standard available."[99]

2. California Corporations Code

On September 30, 2006, the California legislature enacted a majority voting statute sponsored by the California Public Employees' Retirement System, an influential public pension fund. Under the new provision, which is substantially similar to section 10.22 of the MBCA, listed corporations that have eliminated cumulative voting[100] may amend their articles of incorporation or bylaws to require "approval of the shareholders" in uncontested elections.[101] "Approval of the shareholders" is defined as "approv[al] or ratifi[cation] by the affirmative vote of a majority of the shares represented and voting at a duly held meeting at which a quorum is present."[102] If an incumbent director fails to obtain such approval, the director's term expires the earlier of "90 days

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[98] The amended portion of the provision states:

> A resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events. A resignation that is conditioned upon failing to receive a specified vote for election as a director may provide that it is irrevocable.

MODEL BUS. CORP. ACT ANN. § 8.07(b) (2006). The "specified events" may be "a majority withheld vote in a director election coupled with board acceptance of the resignation." ABA FINAL REPORT, *supra* note 63, at 34.

[99] *Id.* at 23.

[100] Cumulative voting is the default standard under California law. CAL. CORP. CODE § 708(a) (West 2006). Listed corporations may eliminate cumulative voting by amending their articles of incorporation or bylaws. *Id.* § 301.5.

[101] CAL. CORP. CODE § 708.5(B) (West 2007).

[102] CAL. CORP. CODE § 153 (West 2006).

after the date on which the voting results are determined . . . or the date on which the board of directors selects a person to fill the office held by that director."[103] No restriction is placed on who may be nominated as the ousted director's successor.[104]

3. Delaware General Corporation Law

In contrast to the approach taken by the California legislature, the Delaware General Assembly chose to adopt provisions indirectly facilitating majority voting rather than craft a substantive bylaw standard. New language was added to section 141 of the Delaware General Corporation Law to eliminate uncertainty as to the judicial enforceability of director resignation policies.[105] At the same time, the General Assembly prohibited boards from amending or repealing "[a] bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors."[106]

4. Washington Business Corporation Act

In May of 2007, Washington became the third state to adopt a statute facilitating the adoption of a majority voting standard.[107] Recent amendments to the Washington Business Corporation Act ("WBCA") grant boards and shareholders a great deal of flexibility to enact bylaws that alter "the number, percentage, or level of votes" necessary for the election of a director in uncontested elections,[108] as long as the corporation does not follow a cumulative voting

[103] *Id.* § 708.5(c).

[104] *See id.* § 305(a).

[105] DEL. CODE ANN. tit. 8, § 141(b) (2006). The amended portion of the statute is identical to MBCA § 8.07(b). *See supra* note 98.

[106] DEL. CODE ANN. tit. 8, § 216 (2006).

[107] H.R. 1041, 60th Leg., Reg. Sess. (Wash. 2007).

[108] *Id.* § 5(1)(ii).

standard.[109] Any director who fails to receive the requisite number of votes serves for a limited holdover term that may be adjusted by bylaw amendment (up to a maximum of ninety days).[110] The board retains the discretion to nominate "any qualified individual" to fill the ousted director's seat.[111] Additionally, Washington followed Delaware in expressly recognizing the enforceability of director resignation policies[112] and protecting shareholder-adopted majority voting bylaws from unilateral amendment or repeal by the board.[113]

C. Proposed Amendment to NYSE Rule 452

Presently, the NYSE permits a member organization to give a proxy to vote shares registered in its name, even if the beneficial owner has failed to instruct the member how to vote, as long as the member "has no knowledge of any contest as to the action to be taken at the meeting, and provided such action is adequately disclosed to stockholders and does not include authorization for . . . any . . . matter which may affect substantially the rights or privileges of such stock."[114] Under this provision, brokers may vote shares held for investors on certain "routine" matters, including uncontested director elections.[115] Elections are virtually never "contested" in a strict sense, even when there is a "just vote no" campaign or an attempted majority voting ouster. Accordingly, Rule 452 "has drawn the ire of some investor

[109] *Id.* § 5(1)(c). Washington sets cumulative voting as a default standard that may be altered by amendment to the corporation's articles of incorporation. WASH. REV. CODE § 23B.07.280(1) (2006).

[110] Wash. H.R. 1041 § 5(1)(ii).

[111] *Id.* § 5(1)(iv).

[112] *Id.* § 3.

[113] *Id.* § 5(2)(a).

[114] N.Y. STOCK EXCH. RULE 452 (2005).

[115] *See id.* 452.11(2) (defining "contest" as a matter that "is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management").

groups since generally brokers vote uninstructed shares in accordance with the incumbent board's recommendations."[116]

On October 24, 2006, the NYSE filed a proposal with the SEC to eliminate discretionary broker voting in director elections.[117] In practical terms, the proposed amendment would eliminate a significant number of votes that would almost certainly have been cast in favor of the incumbent board and thereby increase shareholders' chances of obtaining a majority vote.[118] If approved by the SEC, the changes will take effect on January 1, 2008.[119]

V. A SIMPLE, DIRECT, AND SWIFT SOLUTION?

The majority voting movement has often been called an unprecedented success, having swept through the corporate establishment "[w]ith astonishing speed."[120] Victory, however, may have been prematurely declared. This section contends that the attempt to simply interject majority voting into board elections has not provided a "simple, direct, and swift solution" to the problems of modern board elections. Part V.A considers the efficacy of majority voting as compared to "just vote no" campaigns, taking into account the discretion given to the board under virtually every

[116] Proposed Rule Change by New York Stock Exchange, SR 2006-92, 4 (Oct. 24, 2006), *available at* http://apps.nyse.com/commdata/pub19b4.nsf/docs/A2CC4C6807081506852572110058 9E90/$FILE/NYSE-2006-92.pdf.

[117] *Id.* at 3.

[118] The potential efficacy of the proposed amendment was limited to some extent when the NYSE modified its proposal in May 2007 in response to criticism from the mutual fund community. Proposed Rule Change by New York Stock Exchange, SR 2006-92, 5-7 (May 23, 2007), *available at* http://apps.nyse.com/commdata/pub19b4.nsf/docs/55715EE120D3281C852572E40076FF7D/$FILE/NYSE-2006-92%20A-1.pdf. The new proposal maintains discretionary broker voting for companies registered under the Investment Company Act of 1940. *Id.* at 7.

[119] *Id.* at 8.

[120] Eric J. Finseth & James B. Carlson, *Storming the Ramparts: The Ongoing Shift in the Balance of Power Between Shareholders and Incumbent Boards of Directors*, 26 BANKING & FIN. SERVS. POL'Y REP. 5, 6 (June 2007), *available at* 26 No. 6 BNKFSPR 5 (Westlaw).

majority voting provision adopted to date. Part V.B suggests that the board's discretion under current majority voting provisions may require costly and uncertain litigation, potentially rendering majority voting counterproductive. Part V.C argues that shareholder activists, by targeting plurality voting rather than the underlying proxy system, have focused on the wrong issue and diverted their attention from more meaningful reform efforts.

A. "Just Vote No" Under Another Name

Majority voting is not as simple a solution as it first appears. Despite plurality voting's inequitable operation in modern board elections, it was developed to address a legitimate concern: the possibility of failed elections. The same is true of the state holdover and vacancy-filling provisions that serve as additional obstacles to the adoption of a majority voting standard. On one side, there is merit to the argument that across-the-board elimination of these statutory safeguards and implementation of "true" majority voting would create an undue risk of harm to the corporation. Potential delisting and breach of credit and employment agreements from the sudden defenestration of directors, for example, are legitimate concerns that "true" majority voting does not adequately resolve.[121] More generally, a system contemplating multiple prolonged vacancies would seem to be less reliable and efficient than one ensuring that all board seats remain filled. On the other side, proponents of majority voting can persuasively argue the need for *some* reform, with the facial inequity of "one vote in favor of the incumbent, no matter how many against" working in their favor. Shareholder activists also correctly point out that wholesale maintenance of the statutory safeguards against failed elections will produce reform that is "hollow" at best.

Shareholder activists and the corporate community have largely agreed with both of these competing propositions, admitting that reform is necessary but acknowledging that a

[121] *See supra* Part III.A.

"true" majority voting system would do more harm than good. Accordingly, compromise solutions have dominated the majority voting landscape. Virtually every corporation that has adopted majority voting to date has done so through the enactment of a Pfizer-style director resignation policy, an Intel-style modified majority voting bylaw, or some variation on these models.[122] State legislation and the MBCA simply confirm the enforceability of these approaches, providing an even greater incentive for their continued use, or substitute model majority voting bylaws that largely emulate the Pfizer and Intel approaches in their operation.[123]

These compromise provisions are much less potent than a "true" majority voting standard because each effectively allows the board a discretionary check on the shareholder vote. Under the Pfizer and Intel approaches, the board may opt to reject the ousted director's tendered resignation. Similarly, the MBCA, Washington, and California model bylaws, while not providing for an express check, permit the board to nominate an ousted director as his or her own successor. Thus, a majority shareholder vote against the election of a candidate does not end the matter. An obstinate board may reject the ousted director's tendered resignation or nominate him or her to fill the seat to be vacated, and the targeted director may continue serving despite shareholders' wishes to the contrary.

Since boards are given the final say as to whether a targeted director should be ousted, it is questionable whether the majority voting movement will produce results that differ in any significant respect from those of its predecessor, the "just vote no" initiative. If the board wishes to remain obstinate in the face of shareholder activism, it is free to do so when faced with a "just vote no" campaign, and the check allowed the board under the compromise majority voting system that has developed permits corporations to cast aside shareholder wishes in much the same way. A recalcitrant board may utilize its discretion to keep a targeted director on

[122] *See supra* Part IV.A.2-3.

[123] *See supra* Part IV.B.

the board by asserting any number of facially permissible considerations, including the director's length of service, qualifications, and knowledge of the corporation; the lack of a suitable alternative; or the ability to resolve the dispute by other means.[124] Conversely, if the board is sympathetic to shareholder demands, it will likely accede to shareholder pressure whether the campaign is in the form of a "just vote no" initiative or a majority voting ouster. Thus, the present compromise majority voting system permits stubborn boards to remain as stubborn and accountable boards to act as accountably as they could when faced with a "just vote no" campaign.

B. The Problem of Enforcement

The much vaunted benefit of majority voting over "just vote no" campaigns is that the former is legally binding. Although the benefit of an enforceable mechanism to effect reform is indubitable, the discretionary check allowed boards under resignation policies, modified majority voting bylaws, and statutory model bylaws renders enforceability questionable and may produce a system that does more harm than good. Despite the ABA's prediction that "given the directors' consideration of their duties . . . boards are likely to be hesitant to select [the ousted] director to fill the vacancy,"[125] an obstinate board may well be willing to push the envelope.

Shareholders who believe that the board has acted unjustly in keeping a targeted director on the board have two potential courses of action available to them: (1) await the next election or (2) seek judicial relief. If shareholders choose the first option and the board remains recalcitrant, a subsequent election may well have the same result as the first, with the board simply declining to accept the director's

[124] These considerations are expressly enumerated as potential reasons for rejecting the ousted director's tender of resignation under some director resignation policies and modified majority voting bylaws. *See supra* note 84.

[125] MODEL BUS. CORP. ACT ANN. § 10.22(a)(3) cmt (2006).

resignation or re-nominating the director to his or her seat, just as it had done in the previous election. Dissident shareholders would be forced either to accept the board-nominated candidate or to mount a proxy contest at the second meeting. Given the cost and risk inherent in the latter course, it is unlikely that shareholders would pursue it.[126] Accordingly, the only practical avenue of recourse for shareholders to compel an obstinate board to oust a targeted director is to file an action for breach of the board's fiduciary duties under state law.

Difficult questions would then arise as to how the court should review the board's decision. The most likely candidate is business judgment review. Although the exact formulation varies from state to state, the business judgment rule is generally defined as a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."[127] Courts will defer to the board's decision unless the plaintiff can establish that

> the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.[128]

In the average majority voting case, it would be exceedingly difficult for a plaintiff to show irrationality, gross negligence, or bad faith.[129] The board may simply assert that it relied upon valid considerations in reaching its decision, such as the targeted director's qualifications, the lack of a suitable

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[126] *See* Part II.A *supra*.

[127] *In re* the Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

[128] Brehm v. Eisner, 746 A.2d 244, 264 n. 66 (Del. 2000).

[129] Bad faith in this context has been defined as "an intentional dereliction of duties, a conscious disregard of one's responsibilities." *Disney*, 906 A.2d at 64.

alternative, or an ability to resolve the shareholders' concerns by other means.

The critical question would likely be whether the board "lacks independence" under the particular facts of the case. Generally speaking, a board lacks independence if a majority of the board is dominated or controlled by an interested director.[130] When the other directors re-nominate or refuse to accept the resignation of the ousted director, the board may lack independence if a majority of the directors are somehow "beholden" to the targeted director, in which case more stringent "entire fairness" review would apply.[131] For most public corporations, however, it is unlikely that a majority of the board would be beholden to any single director, at least if that director is a senior executive, because exchange rules generally mandate a majority of independent directors.[132] To be sure, professional etiquette among board members may make it more difficult for the remaining directors to exercise "the independence necessary to consider the challenged transaction objectively"[133] in deciding whether to oust one of their brethren, but collegiality does not necessarily amount to "control" or "domination."[134]

Alternatively, the reviewing court may focus on the board's interference with the shareholder franchise. In *Blasius Industries, Inc. v. Atlas Corp.*, the Delaware Court of

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[130] Texlon Corp. v. Meyerson, 802 A.2d 257, 264 (Del. 2002).

[131] *See* Emerald Partners v. Berlin, 787 A.2d 85, 91 (Del. 2001) ("If the presumption of the business judgment rule is rebutted, however, the burden shifts to the director defendants to prove . . . that the challenged transaction was 'entirely fair' to the shareholder plaintiff.").

[132] *See, e.g.*, N.Y. STOCK EXCH. LISTING MANUAL § 303A.

[133] *Texlon*, 802 A.2d at 264.

[134] "Structural bias" arguments of this sort have repeatedly been rejected by the courts. *See, e.g.*, Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1050-52 (Del. 2004) (holding that "the professional and social relationships that naturally develop among members of a board" are insufficient, without more, to rebut the presumption of independence); Strougo v. Bassini, 112 F. Supp. 2d 355, 362 (S.D.N.Y. 2000) (following "[t]he majority view" that the "common experience" as directors is insufficient to bring the independence of a committee appointed by the board into question).

Chancery spoke at length about the need for credible corporate democracy:

> [T]he ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context. That is, a decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance. That, of course, is true in a very specific way in this case which deals with the question who should constitute the board of directors of the corporation, but it will be true in every instance in which an incumbent board seeks to thwart a shareholder majority.[135]

For this reason, the *Blasius* court held that "the board bears the heavy burden of demonstrating a compelling justification" for actions taken "for the primary purpose of impeding the exercise of shareholder voting power."[136]

At first glance, the *Blasius* standard appears to be ideally suited to the majority voting context. The board's refusal to oust a director who has received less than a majority of the votes cast in an election could easily be viewed as an "instance in which an incumbent board seeks to thwart a shareholder majority."[137] Despite the expansive language employed in portions of the *Blasius* opinion, however, subsequent Delaware courts have strictly maintained the "primary purpose" requirement[138] and have been fairly reluctant to subject board actions to "compelling justification" review as a general matter.[139]

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[135] 564 A.2d 651, 659-60 (Del. Ch. 1988) (footnote omitted).

[136] *Id.* at 661.

[137] *Id.* at 660.

[138] *See, e.g.*, Hill Stores Co. v. Bozic, 769 A.2d 88, 103 (Del. Ch. 2000).

[139] *See, e.g.*, Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996) ("*Blasius*' burden of demonstrating a 'compelling justification' is quite onerous, and is therefore applied rarely."); *In re* MONY Group, Inc. S'holder Litig., 853 A.2d 661, 674-75 (Del. Ch. 2004) ("[W]hen the matter to be voted on does not touch on issues of directorial control, courts will

In the majority voting context, unique problems surface that make strict judicial review of the board's decision even more improbable, particularly when the contest is about corporate policy rather than the personal characteristics of the targeted director. Shareholders are not a monolithic bloc, and determining exactly *what* they intended to signify by their vote may present a difficult factual question. Some shareholders, for example, may have desired a change in the corporation's environmental policy, while others may have believed that executive compensation was excessive. Additionally, the changes sought may relate to matters squarely within the board's authority (as in both examples set forth above). If that is the case, it is unlikely that a court would interfere with the decision to allow a director supporting existing policy to remain on the board, although shareholder opposition may be uniform and clear. When the corporation has adopted an Intel-style bylaw or a Pfizer-style resignation policy, courts may be unwilling to subject the board's decision to *Blasius* review, regardless of whether it is the director's personal characteristics or policy position that is at issue, because the board is given an *express* check under these approaches—not one merely incident to the board's vacancy-filling authority—that contemplates override of the shareholder vote when the justification is not necessarily "compelling."[140]

Accordingly, courts would almost certainly apply deferential business judgment review to the board's decision, allowing the board to prevail in all but the most obviously egregious cases. Regardless of whether the court would intervene in particular cases, however, it seems evident that

apply the exacting *Blasius* standard sparingly . . . ."); Stroud v. Grace, 606 A.2d 75, 91-92 (Del. 1992) (noting that he standard set forth in *Blasius* is "inextricably related to [its] specific facts"). *See generally* Oesterle & Palmiter, *supra* note 12 (arguing that, despite the broad rhetoric in *Blasius* and similar cases, courts have treated shareholder voting cases in a very inconsistent manner).

[140] Indeed, "compelling justification" review is nearly impossible to justify as a conceptual matter with regard to the Pfizer approach, which does not alter the plurality voting standard. *See supra* Part IV.A.2.

a system that grants the existing board discretion to keep a challenged director on the board and then requires shareholders to go to court when they feel that their vote has been improperly frustrated is inefficient in terms of potential costs to the litigants, the corporation, and the court system. One benefit of the plurality regime is that it does not, as a general matter, contemplate court intervention. Similarly, a "true" majority voting system requires judicial involvement only when the board refuses to abide by the majority's vote, an action that would be patently improper. By requiring costly and potentially futile litigation, the compromise that has developed between these two systems may well prove to be counterproductive.

C. Diverting Shareholder Attention from the Proxy System

By targeting plurality voting, the majority voting movement may have focused on the wrong issue. Despite the readily apparent inequity of a system that guarantees reelection when there is at least one vote in favor of the incumbent, no matter how many have been cast against him or her, plurality voting itself is not the issue. Rather, the problem is the way in which plurality voting functions in the present proxy voting environment, where elections are generally uncontested and the only available candidate is the incumbent.[141] If the proxy system allowed as a practical matter for elections with multiple candidates, plurality voting would operate much like the holdover rule, i.e., as a quite sensible safeguard against failed elections. Majority voting thus targets a statutory safeguard that, at best, merely aggravates the underlying inequity of the proxy environment.

In a larger sense, by failing to directly address the proxy system, majority voting leaves in place a regime under which the board maintains all of the real power. The board's discretionary check on the shareholder vote under current

[141] *See supra* Part II.A for a discussion of the interaction between plurality voting and the proxy voting system.

majority voting provisions allows it to retain ultimate authority only in an especially obvious manner. Even if the direct check were removed, shareholders would still be compelled to live with a successor nominated by the board pursuant to its vacancy-filling authority. In a dispute over corporate policy, there would be little to prevent the board from nominating a successor supporting the challenged policy. Indeed, it is questionable whether this objectionable successor problem could be resolved by majority voting alone, considering the fundamentally "subtractive" nature of the reform.[142]

Perhaps the most disconcerting aspect of the majority voting movement is that it has caused shareholder activists to focus on plurality voting to the detriment of proxy reform. Until recently, for example, proxy access was largely discarded by shareholders as they took up the banner of majority voting.[143] In contrast to majority voting, proxy

[142] To illustrate this point, consider the unique majority voting bylaw proposal submitted by Professor Bebchuk for inclusion in the proxy statement of General Dynamics: "In no event shall a director stand for election if that director was elected for an immediately preceding term in an uncontested election in which he or she received more 'withheld' votes than 'for' votes." General Dynamics Corp., Definitive Proxy Statement (Form 14A), at 40 (Mar. 31, 2006). The Bebchuk proposal has the advantage of largely resolving the failed elections issue without giving the board a check on the shareholder vote. At the same time, it guarantees the ouster of any personally objectionable director for at least an entire election period. In contests about policy, however, there is nothing in the Bebchuk proposal to prevent the board from selecting a successor who maintains the company line.

[143] Some commentators have argued that proxy access should be abandoned in favor of majority voting. Professor Grundfest has taken this view, contending that majority voting is simpler than proxy access, eliminates the latter's complicated and arbitrary "triggers," and facilitates consultation between the nominating committee and shareholders. Letter from Joseph Grundfest to Jonathan Katz, Secretary, SEC 2-3 (Apr. 7, 2004), *available at* http://www.sec.gov/rules/proposed/s71903/grundfest ascsbgi040704.pdf. Others have urged the adoption of majority voting as a "supplement to and not a replacement for" proxy access. *See, e.g.*, Letter from James E. Heard, Vice Chairman, ISS, to Jonathan Katz, Secretary, SEC 2 (Apr. 12, 2004), *available at* http://www.sec.gov/rules/proposed/s71903/iss041204.pdf. In any event, majority voting has clearly

access and other proxy reform measures would provide shareholders with an "additive" power to nominate their own candidates by facilitating meaningful election contests.[144] Proxy reform, in short, would simultaneously address the ills targeted by the majority voting movement, avoid the objectionable successor problem, and relegate plurality voting to its intended role as safeguard against failed elections.

VI. CONCLUSION

The difficulties inherent in crafting a workable majority voting solution suggest that attempting to bypass the proxy system through the implementation of a "quick fix" was perhaps ill advised. After a considerable amount of time and effort, shareholders are left with a system that ensures that majority voting ousters will be no more binding and no more effective than "just vote no" campaigns. Virtually every majority voting compromise enacted to date allows the board the ultimate discretion whether or not to give effect to the shareholder vote, providing no compulsion for a change of policy other than potential embarrassment. In the end, the majority voting movement may well turn out to have been counterproductive, a time-consuming diversion from more meaningful attempts at corporate democracy that establishes a system demanding costly and uncertain judicial intervention. Whatever its ultimate legacy, it is certain that

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eclipsed proxy access in terms of shareholder attention and number of proposals filed. *See* ISS 2006 POSTSEASON REPORT, *supra* note 39, at 3 (failing to list proxy access among "10 Key Governance Issues").

[144] *See supra* Part II.B.2 for a discussion of proxy access. In addition to proxy access, commentators have proposed various other ways to make the proxy system more equitable. *See, e.g.*, Bebchuk & Kahan, *supra* note 13 (discussing various alternative reimbursement schemes and arguing in favor of one in which incumbents would not be fully compensated and insurgents would be provided greater reimbursement in "issue" contests); Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, but Not Too Late*, 43 AM. U. L. REV. 379, 447-64 (1994) (proposing a series of amendments to proxy regulations intended to increase the voice of shareholders in corporate affairs).

the majority voting movement's promise of a "simple, direct, and swift solution" to the problems of modern director elections has gone unfulfilled.