

## DELAWARE'S NEW PROXY ACCESS: MUCH ADO ABOUT NOTHING?

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Over the past few years, there have been considerable changes at the federal and state levels with respect to shareholders' voting rights, and those changes could have a profound impact on director elections and corporate governance.<sup>1</sup> These changes include a significant increase in the number of public companies that have embraced a majority voting regime for director elections in lieu of a plurality voting standard,<sup>2</sup> a shift away from classified boards and towards annual director elections,<sup>3</sup> and the implementation of "e-proxy" rules enabling shareholders in public corporations to submit their proxies electronically.<sup>4</sup> These changes also have spurred much debate about the relative benefits and drawbacks of increasing shareholder power, particularly in the context of director elections.<sup>5</sup> While opponents contend that such increased power may harm the long-term interests of the corporation and

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<sup>1</sup> See, e.g., Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259 (2009) (discussing some of those changes).

<sup>2</sup> See *id.* at 1288-92 ("[S]ixty-six percent of S&P 500 companies and fifty-seven percent of Fortune 500 companies had adopted a form of majority voting" by the end of 2007) (citing Claudia H. Allen, *Study of Majority Voting in Director Elections*, Nov. 12, 2007, at 1, <http://www.ngelaw.com/files/upload/majoritystudy111207.pdf>).

<sup>3</sup> See Fairfax, *supra* note 1, at 1303-04. According to one study, at the end of fiscal year 2007, 73 of the top 100 companies had a declassified board. See Shearman & Sterling LLP, *2008 Trends in Corporate Governance of the Largest U.S. Public Companies: General Governance Practices* 30-31 (2008), available at <http://www.shearman.com/corpgovsurvey>. By June 2008, some 50 percent of S&P 500 companies had adopted some form of majority voting. See RiskMetrics Group, *2008 Postseason Report Summary: Weathering the Storm: Investors Respond to the Global Credit Crisis* 3 (Oct. 16, 2008), available at <http://www.riskmetrics.com> (search "2008 Postseason Report Summary").

<sup>4</sup> See Internet Availability of Proxy Materials, 72 Fed. Reg. 4148, 4148-49 (Jan. 29, 2007) (to be codified at 17 C.F.R. pts. 240, 249, and 274); Fairfax, *supra* note 1, at 1279-80.

<sup>5</sup> See e.g., Stephen M. Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1745-46 (2006) (offering an "explanation for why limited shareholder voting rights is corporate law's majoritarian default."); Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 624 (2006) (pinpointing an increase in shareholder power, and identifying reasons why such an increase is inappropriate); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 851 (2005) (discussing shareholder power with regard to director elections).

its shareholders,<sup>6</sup> proponents contend that augmenting shareholder power could increase shareholders' ability to influence director elections, and, by extension, could enhance shareholders' ability to influence corporate affairs and reduce managerial misconduct.<sup>7</sup>

Recently, Delaware, the incorporation home of a majority of public companies,<sup>8</sup> amended its general corporation code in a manner that appears to have important implications not only for shareholders' voting rights, but also for Delaware's role in the corporate governance landscape.<sup>9</sup> Delaware enacted a provision related to shareholders' ability to access the corporation's proxy statement for the purpose of nominating director candidates of their choice, often referred to as "proxy access," as well as a provision related to reimbursement of shareholders' proxy expenses.<sup>10</sup> Both provisions appear to have significant implications for shareholders. Indeed, shareholders have long viewed access to the corporation's

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<sup>6</sup> See Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, *supra* note 5, at 1752-54.

<sup>7</sup> See Bebhuk, *supra* note 5, at 856-57.

<sup>8</sup> According to the website for Delaware's Division of Corporations, "[m]ore than [half a million] business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 63% of the Fortune 500." See Delaware Division of Corporations, *Why Choose Delaware as Your Corporate Home?*, <http://corp.delaware.gov> (last visited Aug. 24, 2009).

<sup>9</sup> On April 10, 2009, Delaware signed into law several changes to its corporate code. See An Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law, H.R. 19, 145th Gen. Assem., Reg. Sess. (Del. 2009), [hereinafter *Delaware Amendments*] (providing a complete list of the changes). In June 2009, the Corporate Laws Committee of the American Bar Association ("ABA") proposed amendments to the Model Business Corporation Act ("MBCA") related to proxy access and proxy expense reimbursement. See News Release, American Bar Association, *Corporate Laws Committee Takes Steps to Provide for Shareholder Access to the Nomination Process* (June 29, 2009), <http://www.abanet.org> (search "Corporate Laws Committee"; then follow hyperlink). The amendments favor private ordering and hence provide a vehicle for directors or shareholders to establish their own procedures to allow for proxy access and reimbursement of expenses. *Id.* Because over 30 state corporate codes are based on the MBCA, such amendments, if enacted, could usher in major changes for most states. In addition to these recent changes, North Dakota's corporate code specifically allows proxy access for shareholders owning more than five percent of the outstanding shares of a public company for at least two years and enables shareholders to be reimbursed for certain proxy-related expenses. See North Dakota Publicly Traded Corporation Act, N.D. CENT. CODE § 10-35-02, -08, -10 (2007). While this essay acknowledges the importance of these and other changes at the state level, it focuses on Delaware's actions, particularly in light of Delaware's prominence in the corporate law arena.

<sup>10</sup> Delaware enacted new Section 112 granting companies the option to adopt bylaw provisions permitting shareholders access to a company's proxy statement in order to nominate director candidates, subject to certain conditions. See DEL. CODE ANN. tit. 8, § 112 (Supp. 2009). Delaware also provided for a new Section 113, which permits companies to adopt bylaw provisions to reimburse shareholders for expenses incurred in connection with proxy solicitations for director elections. See *id.* at § 113; see also *supra* note 9 and accompanying text.

proxy statement as pivotal to effectuating their rights within the corporation and ensuring managerial accountability.<sup>11</sup> Then too, some consider expense reimbursement bylaws to represent a form of proxy access because they allow shareholders to nominate directors without incurring costs associated with preparing and distributing a proxy statement.<sup>12</sup> By paving the way for greater access to the proxy statement, Delaware's recent legislative changes appear to have a vital impact on shareholders' ability to participate in elections and influence corporate conduct.

Beyond this impact on shareholder rights, many speculate that Delaware adopted such changes in order to "maintain its importance as the pre-eminent state" for corporate law and thus to head off federal regulation in this area.<sup>13</sup> In the wake of the recent financial meltdown and economic recession, the federal government has adopted several corporate governance initiatives that impact areas traditionally the province of state regulation.<sup>14</sup> Then too, the Securities and Exchange Commission ("SEC") once again has proposed a rule that would grant proxy access to shareholders of all public companies.<sup>15</sup> The current economic crisis has generated considerable momentum for adoption of such a proposal or some other provision that reforms the current proxy regime.<sup>16</sup> These federal initiatives impinge on

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<sup>11</sup> Upon proposing its proxy access rules, the SEC noted: "[r]efining the proxy process so that it replicates, as nearly as possible, the annual meeting is particularly important given that the proxy process has become the primary way for shareholders to know about the matters to be decided by the shareholders and to make their views known to company management." See Press Release, U.S. Sec. & Exch. Comm'n, SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors (May 20, 2009), available at <http://www.sec.gov/news/press/2009/2009-116.htm> [hereinafter *SEC Statement on 2009 Proxy Access Proposal*].

<sup>12</sup> See Posting of Charles Nathan to The Harvard Law School Forum on Corporate Governance and Financial Regulation, <http://blogs.law.harvard.edu/corpgov/2009/07/07/delaware-law-changes-to-facilitate-voluntary-adoption-of-proxy-access> (July 7, 2009, 9:27 EST).

<sup>13</sup> See *id.*

<sup>14</sup> This includes initiatives related to executive compensation, as well as those requiring that certain corporations enable their shareholders to cast an advisory vote on executive compensation. See generally American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) (providing for "say-on-pay" votes and other corporate governance guidelines); Emergency Economic Stabilization Act, Pub. L. No. 110-343, 122 Stat. 3765 (2008) (imposing corporate governance and executive compensation guidelines for companies receiving federal funds); U.S. Treasury Dep't, Interim Final Rule: TARP Standards for Compensation and Corporate Governance, 74 Fed. Reg. 28,394 (June 15, 2009) (to be codified at 31 C.F.R. pt. 30) (Treasury Department Rules on executive compensation).

<sup>15</sup> See Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024 (June 18, 2009) (to be codified at 7 C.F.R. pts. 200, 232, 240, 249, 274) [hereinafter *2009 Proxy Access Proposal*].

<sup>16</sup> In its overview of the 2009 Proxy Access Proposal, the SEC noted:

The nation and the markets have recently experienced, and remain in the midst of, one of the most serious economic crises of the past century. This crisis has led

corporate governance matters traditionally regulated by state law.<sup>17</sup> As a result, given that Delaware traditionally has played a prominent, if not dominant, role in shaping corporate law, these federal initiatives appear to undercut Delaware's dominance and authority in this area.<sup>18</sup> Hence, some speculate that Delaware took these actions not only to confirm or otherwise reassert its role as leader in the corporate governance arena, but also to prevent or curtail further federal encroachment into this area, since such encroachment necessarily undercuts that role.<sup>19</sup> The observation that the most significant threat to Delaware's corporate governance authority likely stems from the federal government is not a novel one.<sup>20</sup> In this regard, Delaware's attempt to

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many to raise serious concerns about the accountability and responsiveness of some companies and boards of directors to the interests of shareholders, and has resulted in a loss of investor confidence. These concerns have included questions about whether boards are exercising appropriate oversight of management, whether boards are appropriately focused on shareholder interests, and whether boards need to be more accountable for their decisions regarding such issues as compensation structures and risk management. In light of the current economic crisis and these continuing concerns, the Commission has determined to revisit whether and how the federal proxy rules may be impeding the ability of shareholders to hold boards accountable through the exercise of their fundamental right [under state law] to nominate and elect members to company boards of directors.

*Id.* at 29,025.

<sup>17</sup> To be sure, states traditionally regulate corporate governance matters as well as matters involving the voting rights of shareholders. *See, e.g., 2009 Proxy Access Proposal, supra* note 15, at 29,025; *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987) (“No principle of corporation law and practice is more firmly established than a State’s authority to regulate domestic corporations, including the authority to define the voting rights of shareholders.”). However, regulation of the proxy proposal and proxy disclosure process is a “core” federal function and one in which the SEC has long been engaged. *See 2009 Proxy Access Proposal, supra* note 15, at 29,025. *See* Alan R. Palmiter, *Securities Regulation: The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 886 (1994); Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1135 (1993). Hence, it is likely more accurate to refer to regulation in this area as one of shareholder responsibilities.

<sup>18</sup> *See* Lawrence A. Hamermesh, *Litigation Reform Since the PSLRA: A Ten-Year Retrospective: Panel Three: Sarbanes-Oxley Governance Issues: The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1749 (2006) (noting that “Delaware occupies an outsized place in the formation of business entities.”); Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 625 (2004); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1210 (2001); Brett H. McDonnell, *Two Cheers for Corporate Law Federalism*, 30 J. CORP. L. 99, 99 (2005); Mark J. Roe, *Delaware’s Competition*, 117 HARV. L. REV. 588, 601 (2003) (noting the “totality” of Delaware’s influence on corporate law).

<sup>19</sup> *See* Charles Nathan, *supra* note 12.

<sup>20</sup> *See* Roe, *supra* note 18, at 600 (titling an entire section “Delaware’s Main Competitor in Making Corporate Law: Washington, D.C.”); McDonnell, *supra* note 18, at 101 (noting “the threat of federal intervention limits what Delaware can do.”).

undermine that threat is not surprising. Delaware's recent actions thus may be viewed as having the twin goals of buttressing shareholders' voting rights and reaffirming Delaware's position in the corporate governance lexicon.

This essay examines whether such actions have been or can be successful in achieving either of these two goals. Critical examination of the new legislation's impact suggests that, while the new Delaware amendments may do very little in the way of directly advancing shareholder rights, they may play an indirect role in such advancement, and that role could prove significant in enhancing shareholder access to the proxy. Moreover, Delaware may be successful in forestalling federal intervention in this area, a result that may prove unsatisfactory for many shareholder advocates.

Part I of this Essay not only details the new Delaware legislation, but also highlights recent federal actions related to proxy access and shareholder rights. Part II explores the impact of the Delaware legislation on enhancing shareholder rights with respect to proxy access, while Part III examines whether and to what extent Delaware's actions served or can serve as a catalyst for curtailing increased federal intrusion into this sphere. Part IV offers some conclusions.

## I. PROXY ACCESS AND SHAREHOLDER VOTING RIGHTS

Shareholder advocates have long viewed access to the corporation's proxy statement as the "holy grail" of shareholder rights because, in providing them a channel for nominating candidates of their choice, such access enables shareholders a more robust role in director elections, thus increasing the likelihood that shareholders can impact election outcomes and board governance.<sup>21</sup> Indeed, because shareholders in public corporations vote by proxy, the proxy statement, which identifies the candidates for whom shareholders may cast a vote, is the primary vehicle through which shareholders can nominate and thereafter vote on director candidates of their choice.<sup>22</sup> This means that shareholders either must prepare and distribute their own proxy statement or be granted access to the proxy statement distributed by the corporation. The expense associated with preparing and distributing a proxy statement makes such an action prohibitive for most shareholders.<sup>23</sup> Granting shareholders access to the corporate proxy statement

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<sup>21</sup> See Karey Wutkowski, *SEC to Look Outside Ballot on Proxy Access*, REUTERS, Jan. 4, 2008, <http://www.reuters.com> (search "SEC to Look Outside").

<sup>22</sup> See Fairfax, *supra* note 1, at 1263-64.

<sup>23</sup> See *id.* at 1265; Lucian A. Bebchuk, Essay, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 682-83 (2007).

eliminates this expense,<sup>24</sup> and thus represents one of the few ways in which most shareholders can have a role in the director nomination process.<sup>25</sup> Without such access, most director elections feature candidates nominated solely by corporate managers and directors.<sup>26</sup>

There is debate about the importance and efficacy of proxy access. Indeed, there are other avenues for shareholders to impact director conduct,<sup>27</sup> as well as other, albeit expensive, means for shareholders to put forward candidates of their choice.<sup>28</sup> Also, it is not clear that proxy access can alter managerial behavior or otherwise prevent managerial misconduct, particularly the misconduct that triggered the current financial crisis and recession. In this respect, proxy access is not a panacea. Furthermore, granting all shareholders access to the proxy statement could increase the influence of shareholders with narrow or special interests in a manner that could have negative repercussions for corporations and shareholders as a

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<sup>24</sup> To be sure, proxy access does not eliminate the cost entirely, but instead shifts that cost so that it is borne by the corporation. While some view this shift as problematic, it also may be viewed as more equitable because it ensures that the corporation covers the proxy expense of both managerial and shareholder candidates, rather than only supporting the campaigns of management-supported nominees. See Comment Letter from American Bar Association, Business Law Section, Committee on the Federal Regulation of Securities to U.S. Sec. & Exch. Comm'n, 5 (Aug. 31, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-456.pdf> [hereinafter *Federal Securities Regulation Comment Letter*] (expressing the view that proxy access and shifting costs to the corporation are problematic).

<sup>25</sup> Some shareholders do run their own proxy contests, and while the costs of proxy distribution have made the number of such contests relatively small, such contests have increased over the last few years, though the relative number still appears to be low. See Bebchuk, *supra* note 5, at 856 (noting the considerable expense of proxy distribution to shareholders); RiskMetrics Group, 2008 U.S. Proxy Postseason Review 28 (updated Oct. 10, 2008) (pinpointing a 57-percent increase in the number of proxy contests from 2007 to 2008, which amounts to 40 in 2008, compared to 30 in the previous year). Shareholders also may recommend candidates to the board's nominating committee, though apparently boards rarely respond to such recommendations. See Security Holder Director Nominations, 68 Fed. Reg. 60,784, 60,786 (Oct. 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, 274) (indicating that shareholder recommendations to nominating committees rarely have any effect).

<sup>26</sup> According to some, this system essentially transforming the director election process is a pro-forma exercise. See Melvin Aron Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1503-04 (1970).

<sup>27</sup> See Bebchuk, *supra* note 5, at 851 (“[T]he power to replace directors is sufficient to ensure that value-enhancing changes in governance arrangements will occur . . . although actual replacement of incumbent directors does not occur frequently . . .”). Shareholders may also bring a derivative action, and some evidence suggests that “withhold-the-vote” or “just-say-no” campaigns influence board behavior. See Joseph A. Grundfest, *Internal Contradictions in the SEC's Proposed Proxy Access Rules* 13-14 (Rook Ctr. for Corp. Governance at Stan. Univ., Working Paper No. 60, 2009), available at <http://ssrn.com/abstract=1438308>.

<sup>28</sup> See Fairfax, *supra* note 1, at 1265.

whole.<sup>29</sup> Nevertheless, advocates of proxy access as well as the SEC contend that such access gives shareholders the ability to participate more fully in the nomination and director process, thereby protecting their fundamental voting right.<sup>30</sup> Advocates further maintain that “the presence of shareholder-nominated directors would make boards more accountable to the shareholders who own the company and that this accountability would improve corporate governance and make companies more responsive to shareholder concerns.”<sup>31</sup> By contrast, the lack of proxy access reduces the extent to which the director election process ensures that directors are accountable to shareholders. Hence, proponents of a proxy access rule insist that such a rule could have a significant impact on public corporations and their boards; thus, such proponents have long lobbied for access to the corporation’s proxy statement.<sup>32</sup> In 2009, their efforts culminated in reaction from Delaware and the federal government.

#### A. *Delaware and Proxy Access*

In April 2009, the Delaware governor signed into law several provisions related to shareholder voting, which took effect on August 1, 2009.<sup>33</sup> New section 112 of the Delaware Code, entitled “Access to Proxy Solicitation Materials,” gives companies the option to adopt bylaw provisions that grant shareholders access to the

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<sup>29</sup> See Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, *supra* note 5, at 1754; Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 811-12 (1993); see also *Federal Securities Regulation Comment Letter*, *supra* note 24, at 5 (noting that a federal proxy access rule, as proposed by the SEC, among other things could (i) “encourage proxy contests, creating costs, burdens and distractions for the companies and their shareholders,” (ii) “discourage qualified directors from serving,” and (iii) “increase the costs borne by corporations.”).

<sup>30</sup> See *2009 Proxy Access Proposal*, *supra* note 15, at 29,025-26. In fact, one survey found that some 82 percent of American investors agreed that shareholders should have the ability to nominate and elect directors of their choice. See *Comment Letter from Shareowners Educ. Net. Bd. of Dirs. to U.S. Sec. & Exch. Comm’n*, (Aug. 17, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-496.pdf>.

<sup>31</sup> See *2009 Proxy Access Proposal*, *supra* note 15, at 29,026, n.34 (citing comment letters).

<sup>32</sup> See *Bebchuk*, *supra* note 5, at 851.

<sup>33</sup> See *Delaware Amendments*, *supra* note 9. In addition to proxy access and expense reimbursement, the new Delaware amendments provide that a right to indemnification or advancement of expenses cannot be altered or eliminated after the occurrence of the act or omission for which such indemnification or expense relates, unless such alteration or elimination was already explicitly authorized. See *id.*; *contra* *Schoon v. Troy Corp.*, 948 A.2d 1157 (Del. Ch. 2008) (demonstrating how a case was decided prior to the 2009 amendment). The amendments also implement various changes allowing for a separate record and notice date for stockholder meetings, and allow the corporation, as well as the shareholders in a derivative suit, to seek removal of directors under special circumstances by application to the Chancery Court. See *Delaware Amendments*, *supra* note 9.

corporate proxy statement in order to nominate directorial candidates of their choice.<sup>34</sup> In particular, that section states:

The bylaws may provide that if the corporation solicits proxies with respect to an election of directors, it may be required, to the extent and subject to such procedures or conditions as may be provided in the bylaws, to include in its proxy solicitation materials (including any form of proxy it distributes), in addition to individuals nominated by the board of directors, one or more individuals nominated by a stockholder.<sup>35</sup>

Section 112 then pinpoints the various procedures or conditions that companies may consider imposing:

- (1) A provision requiring a minimum record or beneficial ownership, or duration of ownership, of shares of the corporation's capital stock, by the nominating stockholder, and defining beneficial ownership to take into account options or other rights in respect of or related to such stock;
- (2) A provision requiring the nominating stockholder to submit specified information concerning the stockholder and the stockholder's nominees, including information concerning ownership by such persons of shares of the corporation's capital stock, or options or other rights in respect of or related to such stock;
- (3) A provision conditioning eligibility to require inclusion in the corporation's proxy solicitation materials upon the number or proportion of directors nominated by stockholders or whether the stockholder previously sought to require such inclusion;
- (4) A provision precluding nominations by any person if such person, any nominee of such person, or any affiliate or associate of such person or nominee, has acquired or publicly proposed to acquire shares constituting a specified percentage of the voting power of the corporation's outstanding voting stock within a specified period before the election of directors;
- (5) A provision requiring that the nominating stockholder undertake to indemnify the corporation in respect of any loss arising as a result of any false or misleading information or statement submitted by the nominating stockholder in connection with a nomination; and

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<sup>34</sup> *Delaware Amendments*, *supra* note 9.

<sup>35</sup> *Id.*

(6) Any other lawful condition.<sup>36</sup>

New section 113 of the Delaware Code, entitled “Proxy Expense Reimbursement,” states that a corporation’s bylaws “may provide for the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors, subject to such procedures or conditions as the bylaws may prescribe.”<sup>37</sup> Like section 112, section 113 pinpoints a list of non-exclusive procedures and conditions that corporations may adopt when implementing an expense reimbursement bylaw:

(1) Conditioning eligibility for reimbursement upon the number or proportion of persons nominated by the stockholder seeking reimbursement or whether such stockholder previously sought reimbursement for similar expenses;

(2) Limitations on the amount of reimbursement based upon the proportion of votes cast in favor of one or more of the persons nominated by the stockholder seeking reimbursement, or upon the amount spent by the corporation in soliciting proxies in connection with the election;

(3) Limitations concerning elections of directors by cumulative voting . . . ; or

(4) Any other lawful condition.<sup>38</sup>

Both sections 112 and 113 rely on private ordering. Hence, both sections not only grant corporations the option of adopting bylaws to allow for proxy access or reimbursement of proxy expenses, but also give corporations the discretion to determine how such bylaws will be crafted.<sup>39</sup>

#### B. *The Federal Response*

On June 10, 2009, for the fifth time in its history, the SEC proposed a rule that would grant shareholders access to the corporation’s proxy statement to nominate directorial candidates of their choice.<sup>40</sup> Under the new Rule 14a-11 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”),<sup>41</sup> shareholders

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<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *See id.*

<sup>40</sup> *2009 Proxy Access Proposal*, *supra* note 15; *see Fairfax*, *supra* note 1, at 1273-77 (explaining previous efforts to implement proxy access).

<sup>41</sup> *See 2009 Proxy Access Proposal*, *supra* note 15, at 29,031.

would be eligible to have their nominee included on the corporation's proxy materials if they (1) own a certain percentage of the corporation's securities;<sup>42</sup> (2) have held the securities for at least one year and intend to do so through the annual meeting; and (3) are not holding the shares in order to change control of the company or gain more than minority representation on the board.<sup>43</sup> New Rule 14a-11 also provides that shareholders only would be able to nominate one candidate or the number of candidates that would represent up to 25 percent of the company's board, whichever is greater.<sup>44</sup>

Unlike the Delaware law, the federal law would *require* public corporations to provide proxy access as long as certain conditions were met.<sup>45</sup> As currently drafted, the federal proxy access rule does not enable corporations to opt out of such access, even if shareholders desire such an option.<sup>46</sup> In this regard, the federal law can be viewed as mandating proxy access. While some commentators maintain that the proposed rule represents an "appropriate compromise in establishing minimum disclosure requirements,"<sup>47</sup> others argue that a federally-mandated proxy access rule poses "[i]ssues of [w]orkability, [c]omplexity, and [f]lexibility."<sup>48</sup>

In addition to its proxy access proposal, the SEC has proposed to amend Exchange Act Rule 14a-8(i)(8) to require companies to include on their proxy statements shareholder proposals regarding the company's nomination procedures as long as they do not conflict with new Rule 14a-11.<sup>49</sup> Currently, federal law requires corporations to include bylaw amendments and other proposals from shareholders in

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<sup>42</sup> *Id.* at 29,035. Shareholders would be eligible to have their nominee included in the proxy materials if they: (a) own at least one percent of the voting securities of a "large accelerated filer" (a company with a worldwide market value of \$700 million or more) or of a registered investment company with net assets of \$700 million or more; (b) own at least three percent of the voting securities of an "accelerated filer" (a company with a worldwide market value of \$75 million or more but less than \$700 million) or of a registered investment company with net assets of \$75 million or more but less than \$700 million; or (c) own at least five percent of the voting securities of a "non-accelerated filer" (a company with a worldwide market value of less than \$75 million) or of a registered investment company with net assets of less than \$75 million. *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *See id.* at 29,084.

<sup>45</sup> *See id.* at 29,024.

<sup>46</sup> *See generally id.* (providing shareholders with proxy access as long as certain requirements are met).

<sup>47</sup> *See* Comment Letter from Nine Securities and Governance Law Firms to U.S. Sec. & Exch. Comm'n 4 (Aug. 25, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-508.pdf> [hereinafter *Comment Letter of Securities and Governance Firms*].

<sup>48</sup> *See, e.g., Federal Securities Regulation Comment Letter, supra* note 24, at 9-14.

<sup>49</sup> *See 2009 Proxy Access Proposal, supra* note 15, at 29,056.

their proxy statement, subject to certain exclusions.<sup>50</sup> One such exclusion is the so-called “election exclusion” contained in Rule 14a-8(i)(8), which enables corporations to exclude shareholder proposals that relate to a nomination or an election for membership on a corporation’s board.<sup>51</sup> In 2007, the SEC amended Rule 14a-8(i)(8) to allow exclusion of proposals related to election procedures, as well as those relating to actual elections or nominations.<sup>52</sup> The amendment was aimed at preventing shareholders from using the shareholder proposal process to propose proxy access bylaws that would establish procedures requiring corporations to grant shareholders access to a company’s proxy statement in future elections.<sup>53</sup> Hence, the current SEC proposal reverses the SEC’s course, essentially repealing the provision adopted by the SEC two years ago.<sup>54</sup> As a result, new Rule 14a-8 would enable shareholders to propose bylaws containing procedures for instituting proxy access, thereby enabling such procedures to be submitted for shareholder vote.

While new Rule 14a-11 would require all public corporations to adopt some form of proxy access,<sup>55</sup> new Rule 14a-8(i)(8) reflects a relatively more modest proposal because it permits shareholders to propose proxy access bylaws that can be approved or defeated by shareholders.<sup>56</sup> In that regard, new Rule 14a-8(i)(8) reflects a form of private ordering similar to the Delaware approach. Interestingly, many commentators who opposed the adoption of Rule 14a-11 supported Rule 14a-8(i)(8), noting that it “strikes the proper balance between permitting shareholders access to issuers’ proxy materials without the intrusion and problems raised by the proposed Rule 14a-11.”<sup>57</sup> Supporters of Rule 14a-8(i)(8) include many prominent

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<sup>50</sup> See 17 C.F.R. § 240.14a-8 (2009).

<sup>51</sup> See *id.* at § 240.14a-8(i)(8).

<sup>52</sup> See Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. 70,450, 70,453-54 (Dec. 6, 2007) (to be codified at 17 C.F.R pt. 240).

<sup>53</sup> See *id.*

<sup>54</sup> See 2009 Proxy Access Proposal, *supra* note 15, at 29,056.

<sup>55</sup> See *id.* at 29,031-32.

<sup>56</sup> See *id.* at 29,056.

<sup>57</sup> See Comment Letter from Arden Phillips, Chair, Association of Corporate Counsel: Corporate and Securities Committee to U.S. Sec. & Exch. Comm’n 1 (Aug. 17, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-337.pdf> [hereinafter *Comment Letter of ACC*]; see also *Federal Securities Regulation Comment Letter*, *supra* note 24, at 39 (noting support of Rule 14a-8(i)(8) as long as certain revisions are made); Comment Letter from W. Derrick Britt and Samuel C. Dibble, Co-Chairs, State Bar of California Business Law Section: Corporations Committee to U.S. Sec. & Exch. Comm’n, 7 (Aug. 18, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-495.pdf> [hereinafter *Comment Letter of California Bar Corporations Committee*] (supporting the simple proposed change to Rule 14a-8(i)(8)); Comment Letter from Edward J. Durkin, Director, United Brotherhood of Carpenters: Corporate Affairs Department 1-2 (Aug. 17, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-492.pdf> [hereinafter *Comment Letter of UBC*] (urging

organizations, law firms, and individuals, including the Delaware State Bar Association's Council of the Corporation Law Section, the Corporate and Securities Committee of the Association of Corporate Counsel, 26 corporate secretaries and governance professionals, the United Brotherhood of Carpenters, the Corporations Committee of the Business Law Section of the California State Bar, and the Committee on Federal Regulation of Securities of the American Bar Association.<sup>58</sup>

Of course, both Rule 14a-11 and Rule 14a-8 are merely proposals. Thus, there is no guarantee that the SEC will adopt them, or, if adopted, that they will remain in their current form. Indeed, the SEC has sought comments on both proposals, and while some comments express support for both rules, many others identify flaws in their current formulation.<sup>59</sup> Then too, the SEC has proposed proxy access rules in the past, and none of those proposals have culminated in adoption of a proxy access rule.<sup>60</sup> Moreover, although the SEC had stated an intention to vote on its proxy access rule in November 2009, on October 2, 2009, the SEC announced that it would delay any decision on its new proxy access rule until 2010.<sup>61</sup> To be sure, not only has the new SEC Chair, Mary Schapiro, expressed a commitment to proxy

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rejection of Rule 14a-11 and adoption of Rule 14a-8(i)(8) to facilitate important debate); Comment Letter from Corporate Secretaries and Governance Professionals to U.S. Sec. & Exch. Comm'n 2 (Aug. 17, 2009), *available at* <http://www.sec.gov/comments/s7-10-09/s71009-472.pdf> [hereinafter *Comment Letter of Corporate Secretaries*] (opining that Rule 14a-11 goes too far in curtailing shareholders' state-law rights); Comment Letter from Seven Law Firms to U.S. Sec. & Exch. Comm'n 6-7 (Aug. 17, 2009), *available at* <http://www.sec.gov/comments/s7-10-09/s71009-212.pdf> [hereinafter *Comment Letter of Seven Law Firms*] (comments from Cravath, Davis Polk, Latham & Watkins, Skadden Arps, Simpson Thatcher, Sullivan & Cromwell, and Wachtell Lipton) (stating that, in lieu of Rule 14a-11, Rule 14a-8(i)(8) would provide needed flexibility); Comment Letter from James L. Holzman, Chair, Delaware State Bar Association: Council of the Corporation Law Section to U.S. Sec. & Exch. Comm'n 11 (July 24, 2009), *available at* <http://www.sec.gov/comments/s7-10-09/s71009-65.pdf> [hereinafter *Delaware State Bar Comment Letter*] (expressing that, under Rule 14a-8(i)(8), stockholders' proposal of proxy access bylaws would not be prohibitively expensive).

<sup>58</sup> See *Comment Letter of ACC*, *supra* note 57; *Federal Securities Regulation Comment Letter*, *supra* note 24; *Comment Letter of California Bar Corporations Committee*, *supra* note 57; *Comment Letter of UBC*, *supra* note 57; *Comment Letter of Corporate Secretaries*, *supra* note 57; *Comment Letter of Seven Law Firms*, *supra* note 57; *Delaware State Bar Comment Letter*, *supra* note 57.

<sup>59</sup> See *Comment Letter of ACC*, *supra* note 57; *Federal Securities Regulation Comment Letter*, *supra* note 24; *Comment Letter of California Bar Corporations Committee*, *supra* note 57; *Comment Letter of UBC*, *supra* note 57; *Comment Letter of Corporate Secretaries*, *supra* note 57; *Comment Letter of Seven Law Firms*, *supra* note 57; *Delaware State Bar Comment Letter*, *supra* note 57.

<sup>60</sup> See *Fairfax*, *supra* note 1, at 1273-78.

<sup>61</sup> See Elisse B. Walter, Comm'r, U.S. Sec. & Exch. Comm'n, Address at the 48<sup>th</sup> Annual Corporate Counsel Institute: SEC Rulemaking – 'Advancing the Law' to Protect Investors (Oct. 2, 2009), *available at* <http://www.sec.gov/news/speech/2009/spch100209ebw.htm> (noting that the SEC would "likely move forward and consider an adopting release sometime in early 2010," which would mean that the final rules would likely not be in place at the beginning of the next proxy season).

access, but the current economic environment appears to enhance the probability that the SEC will be compelled to adopt some form of access law.<sup>62</sup> This commitment, coupled with the fact that even those who reject a prescriptive proxy access rule indicate support for amended Rule 14a-8, increases the potential that the SEC will adopt some form of proxy access rule.

Along with these proxy proposals, the SEC voted to eliminate broker discretionary voting for both contested and uncontested director elections in July 2009.<sup>63</sup> Under New York Stock Exchange (“NYSE”) Rule 452, brokers are permitted to vote shares in their control for “‘routine’ matters”<sup>64</sup> if brokers do not receive voting instructions from the beneficial holders by the tenth day preceding a shareholder meeting.<sup>65</sup> The SEC voted to eliminate uncontested elections from those matters classified as “routine,” and thus brokers cannot cast votes for uninstructed shares in such elections.<sup>66</sup>

This rule, which likely impacts most public companies because it applies to the actions of NYSE-registered brokers, could have a significant effect on shareholders and their activist campaigns. In 2006, a NYSE working group noted that brokers’ voting overwhelmingly follows the recommendation of incumbent boards, thus influencing election outcomes, particularly in cases where there is an organized “vote-no” or “withhold-the-vote” campaign.<sup>67</sup> An example is Walt Disney Company’s 2004 director election, the target of one of the most well-known “withhold-the-vote” campaigns.<sup>68</sup> If broker votes had not been counted, then CEO and board chair Michael Eisner would have received only 45 percent of the votes in favor of his reelection, while the majority of votes cast would have been withheld from him.<sup>69</sup> Instead, Eisner was reelected to the board with 55 percent of the votes

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<sup>62</sup> See Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm’n, Address to the Council of Institutional Investors (Apr. 6, 2009), *available at* <http://www.sec.gov/news/speech/2009/spch040609mls.htm> (noting that proxy access represents a critical response to the current crisis because it is “about making boards more accountable for the risks undertaken by the companies they manage”).

<sup>63</sup> See Self-Regulatory Organizations, 74 Fed. Reg. 33,293, 33,305 (July 10, 2009) (order approving the proposed changes to NYSE Rule 452).

<sup>64</sup> See *id.* at 33,293 n.7.

<sup>65</sup> See NYSE Rule 452 (2009).

<sup>66</sup> See Self-Regulatory Organizations, *supra* note 63, at 33,304-05.

<sup>67</sup> See Report and Recommendations of the Proxy Working Group to the New York Stock Exchange 13-14 (June 5, 2006) *available at* [http://www.nyse.com/pdfs/PWG\\_REPORT.pdf](http://www.nyse.com/pdfs/PWG_REPORT.pdf).

<sup>68</sup> *Id.* at 9.

<sup>69</sup> See *id.* Of course, because directors at Disney only needed a plurality of the vote to be elected, Eisner’s failure to receive a majority of the vote would not have impacted his ability to get reelected to the board. See *id.* n.12.

cast.<sup>70</sup> This example shows that discretionary broker votes not only have a real impact on election outcomes, but also have a real impact on withhold-the-vote campaigns.<sup>71</sup> The adoption of a majority voting standard by many public companies makes this rule even more significant because it could make it more difficult for directors to receive a majority vote, especially when those directors are targeted by shareholders.<sup>72</sup> In this respect, changes to NYSE Rule 452 could enhance shareholders' power related to campaigns that fall short of a full-blown proxy contest.

In adopting changes to Rule 452, SEC Chair Schapiro noted that despite logistical concerns as to the new rule's implementation, the amended rule was based on the recommendation of a diverse and sophisticated group convened by the NYSE and had been awaiting SEC approval for nearly three years.<sup>73</sup> As she stated, "[k]eeping hard decisions on hold indefinitely does not solve problems."<sup>74</sup>

As the foregoing discussion illuminates, both the federal government and Delaware have responded to the call for increased shareholder voice in director elections and corporate governance. According to the SEC, the economic crisis underscored the need for proxy reform because it raised "serious concerns about the accountability and responsiveness of some companies and boards of directors to the interests of shareholders," as well as concerns regarding how the proxy structure may be "impeding the ability of shareholders to hold boards accountable."<sup>75</sup> Like the federal government, Delaware's actions reflect an attempt to respond to these concerns. However, unlike the federal government, Delaware's actions favor a private ordering solution aimed at enabling corporations and shareholders to structure their own proxy access regime. Delaware's actions also reflect an effort to ensure the state's continued prominence in shaping the corporate governance landscape. The next sections explore whether Delaware's response facilitates the achievement of these twin goals.

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<sup>70</sup> *See id.*

<sup>71</sup> *See id.*

<sup>72</sup> *See id.* at 13. The rule could also make it difficult for some corporations to meet the quorum requirements. *See id.* at 12.

<sup>73</sup> Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Statement at SEC Open Meeting (July 1, 2009), available at <http://www.sec.gov/news/speech/2009/spch070109mls.htm>.

<sup>74</sup> *Id.*

<sup>75</sup> *See 2009 Proxy Access Proposal, supra* note 15, at 7.

## II. THE MORE THINGS CHANGE

### A. *Proxy Access*

An analysis of existing Delaware law reveals that the new amendments do relatively little to directly alter the substantive rights of directors and shareholders. Section 109 of the Delaware Code enables both stockholders and the board to amend or repeal the corporation's bylaws.<sup>76</sup> Section 109 further provides that a bylaw may address any issue relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers, or employees.<sup>77</sup> This broad provision seems to permit boards to adopt the type of proxy access provision addressed under the new section 112.<sup>78</sup> Section 109 certainly does not appear to prohibit proxy access bylaws.<sup>79</sup> Moreover, in 2008, the Delaware Supreme Court seemed to make clear that shareholder sponsored bylaws aimed at encouraging "candidates other than board-sponsored nominees for election" were valid under Delaware state law.<sup>80</sup> The Delaware legislature's synopsis of section 112 notes that it "clarifies" the corporation's ability to enable stockholder nominees to be included in a proxy solicitation.<sup>81</sup> Similarly, the Corporate Law Section of the Delaware State Bar Association indicated that the new law emerged from the group's effort to "clarify further the validity and flexibility of bylaws establishing . . . proxy access."<sup>82</sup> Referring to the new section as a "clarification" acknowledges that the law does not expand the rights previously afforded to directors or shareholders. Moreover, while such a clarification may be helpful by providing guidance with respect to the content of a proxy access bylaw, the clarification was unnecessary to secure the right under state law to adopt such a bylaw provision. In this regard, section 112 appears to confer a power that already exists.

Perhaps more importantly for shareholders, the new law does not remove the impediments at the federal level that prevent shareholders of public corporations from proposing proxy access bylaws on the corporation's proxy statement, and therefore the new law does not really empower shareholders to craft proxy access bylaws. Of course, at first glance, section 112 appears to permit shareholders to

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<sup>76</sup> DEL. CODE ANN. tit. 8, § 109 (Supp. 2009).

<sup>77</sup> *Id.*

<sup>78</sup> See *Delaware Amendments*, *supra* note 9.

<sup>79</sup> See tit. 8, § 109.

<sup>80</sup> See *CA, Inc. v. AFSCME Employee Pension Plan*, 953 A.2d 227, 236-37 (Del. 2008).

<sup>81</sup> See *Delaware Amendments*, *supra* note 9, at 5.

<sup>82</sup> See *Delaware State Bar Comment Letter*, *supra* note 57, at 4.

fashion and adopt proxy access bylaws.<sup>83</sup> This is because section 109 specifically enables shareholders to adopt, amend, or repeal bylaws.<sup>84</sup> Read together, sections 109 and 112 appear to permit shareholders to adopt, amend, or repeal bylaw provisions related to proxy access.<sup>85</sup> Unfortunately, current federal law specifically prohibits shareholders from proposing bylaws on the corporation's proxy statement that relate to a nomination or election for membership to the board or that relate to procedures for such nomination or election.<sup>86</sup> In this regard, despite Delaware's recent actions, shareholders may not propose proxy access bylaws unless federal law changes to permit such proposals. It could be that Delaware was seeking to anticipate the SEC's eventual adoption of a proxy access proposal, and thereby ensure that there were no state law impediments to the proposal. This is certainly a worthy endeavor in terms of enhancing shareholder power, but it is unnecessary in light of section 109. Ultimately, unless and until federal law changes, the Delaware law fails to grant any new rights to shareholders at all, and instead maintains the status quo pursuant to which only directors have the authority to recommend adoption of proxy access proposals.

It is possible that the new Delaware amendments could have an indirect impact. With respect to directors, perhaps it will encourage boards to adopt proxy access bylaw provisions. The Corporate Law Section of the Delaware State Bar Association noted that the new law reflects Delaware's view that a proxy access system may prove beneficial for the corporations that adopt it.<sup>87</sup> Along these lines, perhaps directors either needed the added clarification provided by the new law or, alternatively, needed the seeming sanction or tacit approval that the law seems to confer in order to spur their adoption of an access provision.<sup>88</sup> It is possible, therefore, that the new law, though redundant, could encourage directors to adopt proxy access proposals.

Of course, there is considerable reason to be skeptical about this possibility. Although the law just went into effect, no corporation has expressed a desire to adopt a proxy access proposal in its wake. Moreover, history suggests that such a grant will have no appreciable impact on expanding shareholders' access to the corporate proxy statement. Indeed, there are almost no examples of corporations

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<sup>83</sup> See *Delaware Amendments*, *supra* note 9.

<sup>84</sup> See tit. 8, § 109.

<sup>85</sup> See *id.*; see also *Delaware Amendments*, *supra* note 9.

<sup>86</sup> See *supra* notes 50-52 and accompanying text.

<sup>87</sup> See *Delaware State Bar Comment Letter*, *supra* note 57, at 2.

<sup>88</sup> See *id.* at 2-3.

that have voluntarily adopted proxy access bylaw provisions.<sup>89</sup> Instead, corporations tend to vigorously oppose such provisions.<sup>90</sup> As one group of law firms commented:

Corporations already have the ability to voluntarily adopt measures like those set out in the Proposal. Not only have corporations generally refused to do so (with very few exceptions), but entrenched corporate interests have fiercely opposed the implementation of any proxy access rule, voluntary or otherwise, for over twenty years. A rule that public corporations could choose to ignore would thus be no rule at all.<sup>91</sup>

These observations suggest that the new law is unlikely to have a direct or indirect impact on directors' propensity to embrace proxy access, leaving the landscape on this issue virtually unchanged.

For shareholders, Delaware's actions may have an indirect, but significant, effect on federal law, thereby finally granting shareholders the ability to introduce proxy access proposals on the corporation's proxy statement. Indeed, it is possible that Delaware's actions may have been designed to, or at least may in effect, emphasize the importance of removing the federal impediments to proxy access proposals. Accordingly, the Delaware law may serve an important signaling function, indicating to the federal government Delaware's willingness to look favorably on shareholder-submitted proxy access proposals, and hence Delaware's willingness to look favorably on a federal law that sanctions such proposals. The Delaware law may also serve an important signaling function for the business community. The fact that so many different organizations and individuals expressed their support for a rule that would allow shareholders to submit access proposals, and relied upon Delaware's actions to provide validity for their support, suggests that Delaware's actions have already encouraged many members of the business community to embrace at least some aspect of proxy reform. In other words, Delaware may have made such reform palatable to members of the business community. By decreasing opposition to some aspect of proxy reform, Delaware may have increased the likelihood that the SEC will adopt such reform.

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<sup>89</sup> However, after noting that very few examples exist of proxy access bylaw provisions, one law firm commentary managed to identify two companies with such provisions: Apria Healthcare Group, Inc. and RiskMetrics Group, Inc. See Latham & Watkins LLP & Georgeson Inc., Corporate Governance Commentary, *Proxy Access Analysis No. 2* (June 22, 2009), <http://www.lw.com> (search "Proxy Access Analysis No. 2).

<sup>90</sup> See Fairfax, *supra* note 1, at 1275-76 (describing litigation attempting to exclude various proxy access proposals).

<sup>91</sup> See *Comment Letter of Securities and Governance Firms*, *supra* note 47, at 3.

Ultimately, if Delaware's actions encourage the SEC to adopt Rule 14a-8(i)(8) and thus eliminate the restriction on shareholder submission of proxy access proposals, it could have a tremendous impact for shareholders and their ability to gain access to the proxy statement. Indeed, many of the changes in shareholder voting rights, from the increases in majority voting to the decrease in classified boards, have resulted from shareholders' use of the proposal process pursuant to which certain institutional and retail investors submitted proposals on a given issue and waged coordinated campaigns to encourage shareholder support.<sup>92</sup> These campaigns not only resulted in significant shareholder support, but also prompted both corporations and legislatures to alter the governance standards.<sup>93</sup> Notably, such changes occurred despite the non-binding nature of many shareholder proposals, suggesting that shareholder activism through the use of the proposal process has a significant impact on corporate decision-making. Currently, federal impediments undermine this activism with respect to proxy access by preventing shareholders from proposing proxy access changes. But shareholders' recent victories with respect to other issues suggest that if shareholders obtain the right to include access proposals on the corporation's proxy statement, they may be able to transform that right into the implementation of proxy access rules at targeted companies. If the new Delaware amendments influence the SEC's behavior, Delaware's actions could have a powerful, albeit indirect, impact on changing the landscape with respect to proxy access.

One note of caution for shareholders, however, is that even if the SEC amends Rule 14a-8(i)(8) to permit shareholder proxy access proposals, Delaware's preemptive strike may have implications for shareholders' ability to influence the type of proposal actually adopted. This is because unless and until such a federal amendment takes effect, only directors can submit proxy access proposals; hence they have a window of opportunity to submit proposals aimed at countering the shareholder-friendly proposals that can be expected from advocate groups. Directors may then be able to exclude any shareholder proposals on the same issue.<sup>94</sup> Therefore, Delaware may have inadvertently given directors an advantage over shareholders by enabling boards to control how proxy access is structured.

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<sup>92</sup> See Fairfax, *supra* note 1, 1288-93, 1303-04 (discussing proposal campaigns related to majority voting and board declassification).

<sup>93</sup> See *id.*

<sup>94</sup> See 17 C.F.R. § 240.14a-8(i)(11) (allowing corporations to exclude proposals that involve substantially the same issue).

B. *Proxy Reimbursement*

The proxy reimbursement provision also could be viewed as conferring a right that already existed under Delaware law. Indeed, the broad authority under section 109 appears to permit directors and shareholders to amend or adopt bylaws that provide for expense reimbursement.<sup>95</sup> To be sure, there may have been a need for additional clarification in this area. On the one hand, the 2008 Delaware Supreme Court decision in *CA, Inc. v. AFSCME Employees Pension Plan* found that a shareholder-proposed bylaw requiring proxy reimbursement was valid under state law.<sup>96</sup> On the other hand, that decision found that such a bylaw was invalid under Delaware law because it might require directors to violate their fiduciary duty.<sup>97</sup> While the decision seemed to leave open the possibility that such a bylaw would be valid if properly constructed, the legislation could be viewed as necessary clarification on the issue. In fact, the Delaware Supreme Court concluded its opinion by indicating that shareholder activists should seek recourse from the Delaware legislature to ensure the validity of broad proxy reimbursement bylaws.<sup>98</sup> In this regard, this new legislation could have more impact on the status quo, at least with regard to state law.

By contrast, the federal law question seems to be well-settled. Unlike proxy access, federal rules do not prevent shareholders from submitting proposals on this issue. Instead, in 2007, the SEC made clear that a shareholder bylaw provision that relates to the reimbursement of proxy expenses in contested elections may not be excluded under the general exclusion for director elections and procedures.<sup>99</sup> Since such access provisions were permitted under both state and federal law, section 113 does not extend a new right to directors or shareholders, and thus does not meaningfully alter the status quo.

Importantly, while a proxy reimbursement regime may facilitate shareholders' exercise of their voting right, it does not substitute for direct proxy access. This is because proxy access enables shareholders to avoid the expense associated with preparing and distributing a proxy statement altogether. By contrast, an expense reimbursement provision requires shareholders to incur such expense, albeit with the

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<sup>95</sup> DEL. CODE ANN. tit. 8, §109 (Supp. 2009).

<sup>96</sup> 953 A.2d 227, 237.

<sup>97</sup> *See id.* at 238.

<sup>98</sup> *See id.* at 240 (“Those who believe that CA’s shareholders should be permitted to make the proposed Bylaw [i.e. without a fiduciary out] as drafted part of CA’s governance scheme, have two alternatives. They may seek to amend the Certificate of Incorporation to include the substance of the Bylaw; or they may seek recourse from the Delaware General Assembly.”) (emphasis in original).

<sup>99</sup> *See* Shareholder Proposals Relating to the Election of Directors, *supra* note 52, at 70,454 n. 56.

promise of reimbursement under certain circumstances. To the extent shareholders do not have the up-front resources to wage a proxy contest, a reimbursement regime does not necessarily ameliorate the hurdles posed by the costs of waging a proxy battle. As a result, it is an inferior substitute for proxy access. This is underscored by the fact that, despite the ability to introduce bylaws on this issue, shareholders continue to advocate strongly for proxy access. Then too, regardless of the merits or efficacy of a reimbursement right, it is a right that already existed under Delaware law.

Taken together, this section reveals that, while the new Delaware amendments may have clarified and better defined the scope of proxy access and expense reimbursement rights, they did not actually confer any new rights on shareholders or directors. In terms of proxy reimbursement, at best this means that the new amendments simply reaffirm the ability to propose bylaws on this issue. In terms of proxy access, this means that the Delaware law did not, and could not, grant shareholders the right to propose access bylaw changes on the corporation's proxy statement. Instead, only the SEC has the power to grant such a right by removing impediments to the proxy proposal regime. On this point, there is some reason to believe that Delaware's actions may encourage the SEC to remove those impediments. If that occurs, then Delaware's new amendments will have played a major role in enhancing shareholder power.

### III. DELAWARE AND FEDERAL INTERVENTION

Recently several scholars have begun to recognize the important interaction between the federal government and Delaware on issues of corporate governance.<sup>100</sup> Such scholars note that instead of competition from other states, competition from the federal government represents the primary check on Delaware's behavior in the realm of corporate law.<sup>101</sup> While not necessarily a persistent check, Delaware nevertheless shapes its laws with the background understanding that its failure to protect sufficiently the interests of shareholders and the corporation could trigger federal intervention.<sup>102</sup> Arguably, the threat is augmented during times of turmoil involving corporations when concerns are raised regarding managerial accountability, the adequacy of directors' adherence to their fiduciary responsibilities, and safeguards against fraud or abuses of authority. Hence, Delaware becomes more cognizant of that threat and the need to protect its role in the corporate governance arena.

In this context, it should come as no surprise that the current recession and financial meltdown, the biggest since the Great Depression, would prompt federal

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<sup>100</sup> See *supra* note 18.

<sup>101</sup> See *id.*

<sup>102</sup> See *id.*

intervention and a resulting response from Delaware. Indeed, in addition to crafting the proposal eventually passed by the Delaware legislature, the Corporate Law Section of the Delaware State Bar Association submitted a formal written comment to the SEC's federal proxy access proposal.<sup>103</sup> The submission marked the first time in history that the Delaware State Bar Association, or any of its member groups, provided official comments to the SEC.<sup>104</sup> The group made the decision to submit comments because the SEC's proposal "significantly implicates . . . 'the traditional role of the states in regulating corporate governance.'"<sup>105</sup> The comment letter noted that a federal proxy access rule would steer disputes towards the federal court system and away from the courts of the corporation's state of incorporation, primarily Delaware.<sup>106</sup> It further stated that the Delaware courts had a "well-earned reputation for prompt, sophisticated and efficient resolution of specialized corporate law disputes."<sup>107</sup> The letter concluded by noting that Delaware state courts are "far more capable" than federal courts in resolving disputes.<sup>108</sup> In this regard, the letter pinpointed the jurisdictional issue that animates Delaware's response.

But will that response prove successful in ensuring that Delaware maintains its position of prominence by forestalling federal intrusion into the corporate governance arena? On the one hand, Delaware's actions did not prevent the SEC from proposing new rules covering the exact same ground as those covered by Delaware. Indeed, despite the fact that Delaware managed to pass legislation prior to any SEC action, the SEC nevertheless proceeded with a proposal of its own. Although the SEC acknowledged Delaware's actions in this area, Commissioner Schapiro noted that the SEC would view the issue with "fresh eyes."<sup>109</sup> Hence, Delaware's actions appear to have had no impact on the SEC's decision to move forward with a proxy access proposal. Moreover, those actions did not seem to minimize the breadth of that proposal. The SEC's proposal sweeps far more broadly than Delaware's amendments, even preempting Delaware law regarding proxy access with respect to public companies. Prior to issuing its proposed rule, the SEC Commissioner acknowledged the Delaware changes related to proxy access and

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<sup>103</sup> See *Delaware State Bar Comment Letter*, *supra* note 57.

<sup>104</sup> *Id.* at 2.

<sup>105</sup> See *id.*

<sup>106</sup> See *id.* at 13.

<sup>107</sup> See *id.* at 13-14.

<sup>108</sup> See *id.* at 14-15.

<sup>109</sup> See Schapiro, *supra* note 62.

noted that the SEC would consider those changes in fashioning their proposal.<sup>110</sup> Such consideration did not appear to translate into any curtailment of the SEC's intrusion in the proxy access arena. The fact that Delaware's actions neither prevented the new federal proposal, nor compelled the SEC to limit the reach of that proposal, does not appear to bode well for Delaware.

On the other hand, the SEC's express acknowledgement of Delaware's actions seems to confirm the state's importance and continued relevance. Indeed, not only did the SEC Chair specifically note the intention of considering Delaware's actions when shaping the SEC's proxy access proposal, but Delaware was the only state to which the SEC afforded such deference.<sup>111</sup> The very acknowledgement of the need to consider Delaware's actions highlights its preeminent status.

In addition, Delaware's actions may be sufficient to halt or at least delay enactment of a federally-mandated proxy access rule. Many comment letters insisted that a federal proxy access rule was inappropriate precisely because it failed to recognize and give proper weight to changes at the state level, particularly those implemented by Delaware.<sup>112</sup> Commentators insisted that regulators should assess the impact of those changes before intruding into state law.<sup>113</sup> In this respect, Delaware's amendments provided necessary fodder for commentators, potentially validating arguments against additional federal intervention. If the SEC chooses to reject federally-mandated proxy access, it is likely that Delaware's actions will have played a significant role in that choice. It is also possible that Delaware's actions enabled the SEC to feel more comfortable in its recent delay.

#### IV. CONCLUSION

A careful analysis of the new Delaware amendments reveals that such amendments purport to confer rights that already existed under Delaware state law, undermining the extent to which such amendments can be viewed as having any impact on the proxy access or proxy reimbursement landscape. However, those amendments may play an indirect role in encouraging the business community to

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<sup>110</sup> See *id.* (noting that in considering a proposal for proxy access, the SEC would consider its previous efforts on this issue, as well as the "potential impact of proposed changes to Delaware's corporate law.").

<sup>111</sup> See *id.*

<sup>112</sup> See *Federal Securities Regulation Comment Letter*, *supra* note 24, at 7-8; *Comment Letter of Corporate Secretaries*, *supra* note 57, at 2; see also *Comment Letter of California Bar Corporations Committee*, *supra* note 57, at 6 (noting that the proposed system would have a negative impact on the current corporate governance regime under state law).

<sup>113</sup> See *Federal Securities Regulation Comment Letter*, *supra* note 24, at 7-8; *Comment Letter of Corporate Secretaries*, *supra* note 57, at 2; see also *Comment Letter of California Bar Corporations Committee*, *supra* note 57, at 6.

embrace a more limited version of proxy access, and thus facilitating the SEC's adoption of such a version. While such a resolution may fall short of the kind of universal proxy access that some advocates may have desired, it certainly advances the campaign for access in important ways. The amendments may also serve the more subtle purpose of reinforcing Delaware's status as the preeminent body for regulating corporate affairs. On this point, there is reason to believe that the amendments either will serve to prevent the adoption of a federal proxy access rule or will lead to a significant curtailment of the nature of any rule eventually adopted. While this may prove disconcerting for shareholder advocates, it supports the budding thesis among several corporate scholars regarding the importance of the interplay between federal law and Delaware law, whereby one serves to balance and check the other.