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CAN WE DO BETTER BY ORDINARY INVESTORS? A PRAGMATIC REACTION TO THE DUELING IDEOLOGICAL MYTHOLOGISTS OF CORPORATE LAW

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bothered to examine carefully the terms of the plan. Neither scenario reflects well on our corporate governance system, especially when that system gives stockholders an annual right to vote for directors. The strong empirical evidence that the most influential explanatory factor for the outcome of say on pay votes is the recommendation made by the most influential proxy advisory firm, instead of any factor directly related to the design of a pay plan,[110] suggests that the capacity of investors to think carefully about how to vote currently is overwhelmed by having annual say on pay votes at almost all listed companies. If the say on pay vote was really intended by its advocates to just be an outlet for stockholders to express generalized dismay, then they should say so and confess that they did not share their real motivations with Congress. By contrast, if the purpose of the say on pay vote was to provide stockholders with a powerful and reasoned voice about a key area of corporate decisionmaking that has an important incentive effect on corporate policy—the terms on which top managers are paid—its advocates should want a system of say on pay voting that optimizes the chances that compensation committees will develop sound long-term compensation plans for consideration by stockholders. These advocates should want stockholders themselves—and not just proxy advisory services—to give thoughtful feedback about them, both in advance of and in the form of a vote.

E. *Ensuring that Proponents of Corporate Action Share in the Costs They Impose on Other Stockholders*

Law and economics adherents like Bebchuk understand that when someone can take action that is personally beneficial and shifts the costs to others, he will tend to do so more than is optimal for anyone other

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recommendation from the proxy advisory service ISS, indicating that ISS's recommendations were more important than corporate total stock return or specific features of executive compensation in explaining stockholder votes); id. (suggesting that institutional investors rely upon ISS to identify compensation plans that should be voted down because corporations with performances and pay plans similar to those voted down receive affirmative support in the absence of an ISS negative recommendation). Another recent empirical study concludes that ISS is the most influential factor in the say on pay voting outcome, that corporations often change their compensation plans to avoid a negative ISS recommendation, that the stock market's reaction to the changed plans was "statistically *negative*," and that the "most parsimonious and plausible conclusion is that the [proprietary SOP policies] of proxy advisory firms . . . induce the boards of directors to make compensation decisions that *decrease* shareholder value." David F. Larcker, Allan L. McCall & Gaizka Ormazabal, Outsourcing Shareholder Voting to Proxy Advisory Firms 8–9, 44–45 (Rock Ctr. for Corporate Governance at Stanford Univ. Working Paper No. 119, 2013), available at http://ssrn.com/abstract=2101453 (on file with the *Columbia Law Review*).

110. See supra notes 107, 109 (citing empirical evidence which shows that the ISS recommendation is the most influential explanatory factor for the outcome of say on pay votes).

than himself.[111] Most investors would prefer that corporate managers not be distracted by the need to address shareholder votes unless those votes are about issues, such as a merger, that are economically meaningful to the corporation's bottom line. Under current law, however, a stockholder need only own $2,000 of a corporation's stock to put a nonbinding proposal on the ballot at the annual meeting of an American public corporation and need pay no filing fee.[112] By putting a proposal on the ballot in this way, a stockholder will necessarily require the corporation to spend hundreds of thousands of dollars on legal, administrative, and other costs,[113] and require all other investors to bear the costs of having to have their money manager agents spend time and money considering how to vote and ultimately casting a vote. And even a stockholder whose proposal has failed miserably can resubmit an identical proposal at the expense of the company's other stockholders.[114] The SEC requires the company to put a proposal that has failed once before on the ballot again unless it has been defeated within the past five calendar years by a vote of more than ninety-seven percent[115]—redolent of Ceausescu-style vote rigging.

These nonbinding votes, of course, come on top of the plethora of other votes shareholders are called upon to cast each year, including the annual vote on directors, the say on pay vote, votes to approve perfor-

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111. See Garret Hardin, The Tragedy of the Commons, 162 Science 1243, 1244 (1968) (explaining the tragedy of the commons with the classic example of herdsmen sharing a pasture, in which each will maximize his personal gain by increasing his herd until overgrazing depletes pasture); id. (observing that "[r]uin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in the freedom of the commons"); see also Romano, Less Is More, supra note 43, at 230 ("When a party does not bear the full cost of its activity, it will engage in more of the activity, for in equating the marginal benefits and costs of the enterprise, a lower level of benefit from the activity suffices to meet the reduced cost.").

112. 17 C.F.R. § 240.14a-8(b)(1) (2013); see also Leo E. Strine, Jr., Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward, 63 Bus. Law. 1079, 1100 (2008) (citing 17 C.F.R. § 240.14a-8(b)(1) (2008)).

113. For a thoughtful article that considers the inefficiencies and costs imposed by the current shareholder proposal regime, see Romano, Less Is More, supra note 43, at 182–219.

114. 17 C.F.R. § 240.14a-8(i)(12) (2013) (detailing requirements for resubmission).

115. Id. The SEC permits a company to exclude a submission from its proxy materials only in very limited circumstances. If the proposal has only been proposed once within the preceding five calendar years and received less than three percent of the vote, then it can be excluded. Id. § 240.14a-8(i)(12)(i). If the proposal has failed twice within the preceding five calendar years, and on its last submission received less than six percent of the vote, the company can exclude the proposal. Id. § 240.14a-8(i)(12)(ii). The company can also exclude a proposal that has failed three times within the preceding five calendar years if on its last submission it received less than ten percent of the vote. Id. § 240.14a-8(i)(12)(iii). No matter how many times a proposal has failed in the more distant past, a company cannot exclude a proposal if it has not been submitted within the preceding five calendar years. Id. § 240.14a-8(i)(12).

mance-based compensation required by federal tax law,[116] binding votes on certain equity issuances that are required by the stock exchanges,[117] votes to retain the company's auditors,[118] as well as state law requirements that stockholders approve certain key transactions, such as mergers[119] and very substantial asset sales.[120]

In many states, candidates for office are required to pay a filing fee tied to a percentage of the salary of the office they seek. In California, for example, a United States Senate candidate must pay a fee equal to two percent of the salary of a Senator, or $3,480, and a candidate for even the State Assembly must pay a filing fee equal to one percent of her salary, or nearly $1,000.[121] Given the economic motivation of investors and the absence of larger reasons that exist to foster candidacies in election in actual polities, requiring sponsors of economic proposals filed under Rule 14a-8 to pay a reasonable filing fee to bear a tiny fraction of the much larger costs their proposal will impose on the corporation (and therefore other stockholders) seems a responsible method to better recalibrate the benefit-cost ratio of Rule 14a-8.[122] For example, the SEC could impose a

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116. 26 U.S.C. § 162(m) (2012) (prohibiting public companies from deducting more than $1 million in compensation for the CEO and four highest-paid employees unless such compensation is performance-based and approved by shareholders).

117. E.g., N.Y. Stock Exch., supra note 61, § 312.03(c) (requiring a shareholder vote to approve an issuance of common stock equal to or in excess of twenty percent of the voting power outstanding before the issuance).

118. Although the SEC does not require shareholders to vote on the retention of the company's auditors, such a vote has become standard. See Ernst & Young, Audit Committee Reporting to Shareholders: Going Beyond the Minimum 1 (2013), available at http://www.ey.com/Publication/vwLUAssets/Audit_committee_reporting_to_shareholders:_going_beyond_the_minimum/$FILE/Audit_committee_reporting_CF0039.pdf (on file with the *Columbia Law Review*) (reporting that more than ninety percent of Fortune 100 companies seek annual shareholder ratification of the auditor chosen by the audit committee).

119. Del. Code Ann. tit. 8, § 251(c) (2011).

120. Id. § 271.

121. Frequently Asked Questions—2012 Candidate Filing, Cal. Sec'y of State, http://www.sos.ca.gov/elections/statewide-elections/2012-primary/faq-2012-candidate-filing.htm (on file with the *Columbia Law Review*) (last visited Feb. 2, 2014); see also Tex. Elec. Code Ann. § 172.024 (West 2010) (charging a filing fee of $5,000 to be a candidate for U.S. Senate, and $750 to be a candidate for state representative); 2014 Qualifying Fees, Div. of Elections, Fla. Dep't of State, available at https://doe.dos.state.fl.us/candidate/pdf/2014_Qualifying_fees.pdf (on file with the *Columbia Law Review*) (last visited Feb. 2, 2014) (charging a filing fee of $10,440 to be a candidate for U.S. representative, and $1,781.82 to be a candidate for state representative). It is common for a state to charge one percent of the salary of the office sought as a filing fee, as is done in Delaware, Kansas, Nebraska, North Carolina, and Washington. Del. Code. Ann. tit. 15, § 3103 (2007); Kan. Stat. Ann. § 25-206 (2000); Neb. Rev. Stat. § 32-608 (2008); N.C. Gen. Stat. § 163-107 (2011); Wash. Rev. Code Ann. § 29A.24.091 (West 2005 & Supp. 2013). In Virginia, the fee is two percent. Va. Code Ann. § 24.2-523 (2011).

122. Roberta Romano has also advanced well-reasoned arguments in support of a proposal that would recalibrate the benefit-cost ratio of Rule 14a-8. See Romano, Less Is More, supra note 43, at 230 (suggesting that "eliminat[ing] the subsidy of losing proposals

modest filing fee of $2,000, or even $5,000, for any stockholder proposal addressing economic issues and increase the holding requirement to a more sensible $2,000,000[123] while still allowing proposing stockholders to aggregate holdings if they make appropriate disclosures.[124] If the advocates of a proposal cannot put up $2,000 to $5,000 and find other investors with an ownership interest of at least $2,000,000, they have no right to force other stockholders to subsidize the cost of their desire for voice, when our free society gives them many other ways to exercise their free expression rights. Likewise, corporations should be permitted to exclude from the proxy Rule 14a-8 proposals in later years if they do not get at least twenty percent affirmative support in their first year, and if after the first year, they obtain less than thirty percent support.[125] None of these proposals, of course, would preclude proponents from using their own resources to fund a proxy contest to propose a bylaw, but it would reduce the ability of stockholders to use corporate funds (and thus indirectly the capital of other stockholders) on a subsidized basis to press initiatives that the electorate has soundly rejected and help to temper the proliferation of votes that overwhelm the institutional investor community's capacity for thoughtful deliberation.[126]

F. *Creating a More Credible and Responsible Director Election Process*

Stockholders now have considerable, undisputed authority to adopt reforms to the electoral processes of Delaware corporations.[127] These

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under the SEC's proxy proposal rules" could incentivize cost-effective activism because fund managers would "scrutinize . . . the fund's corporate governance program, to determine which proposals are most likely to attract voting support, because their cash position will be affected if they do not").

123. In reality, this number could be rationally increased to $20 million or higher so long as aggregation was permitted.

124. Strine, One Question, supra note 91, at 23 (suggesting this approach).

125. See supra note 115 (discussing the very limited circumstances in which companies are permitted to exclude submissions from their proxy materials).

126. Respected scholars have recommended even stronger medicine than what I have recommended here, including allowing investors to vote to have their funds opt out of the SEC shareholder proposal apparatus entirely. See Romano, Less Is More, supra note 43, at 238 (explaining a potential reform to the shareholder proposal system that would "permit firms, by shareholder vote, to choose their proxy proposal regime, opting from among full, partial, or no subsidy regimes, for all or some proposals or proposal sponsors").

127. E.g., Del. Code Ann. tit. 8, § 112 (2011) ("The bylaws may provide that if the corporation solicits proxies with respect to an election of directors, it may be required . . . to include in its proxy solicitation materials . . . , in addition to individuals nominated by the board of directors, 1 or more individuals nominated by a stockholder."); id. § 113 ("The 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 . . . ."); id. § 216 ("A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.").