THE POLITICS OF SHAREHOLDER VOTING

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Economic theory that suggests underperforming boards of directors should be fearful of an ouster vote by shareholders underappreciates the complexity of shareholder voting decisions. Skill at enhancing firm value has less to do with whether directors win votes and stay at the helm of public companies than previous commentators have presumed. Instead, like incumbent politicians, managers of some of the largest U.S. firms tend to stay in charge of firms because they understand—and take advantage of—the political dynamics of corporate voting. This Article presents a competing theory of shareholder voting decisions, one that suggests that shareholder voting in corporate elections is not dissimilar from citizen voting in political elections. Next, the Article presents the evidence. Using a hand-collected dataset from recent board elections, the Article compares the explanatory power of a standard economic variable (long-term stock price returns) and a political variable (money budgeted for campaigning) on election outcomes. Based on the data, directors' ability to enhance firm value (as measured by stock price returns) is not significantly related to whether they win reelection. Rather, the likelihood of being returned to office appears to be a function of typical election politics—how much was spent by challengers to persuade shareholder voters. These findings have at least two implications. First, the theory that shareholder voting may be politicized helps point the way to how the SEC ought to craft reforms—and, just as important, how not to craft them. Recent SEC reform efforts have the laudable goals of creating new conduits for shareholders to participate in firm affairs, increasing shareholder-nominated candidate success, and disciplining incumbent managers. The results of this study suggest that these reforms will not achieve the stated goals. Even with these reforms, the board continues to have an important political advantage, which likely translates into real votes. As the research here shows, the outcome of elections depends on persuasion and, not simply, as the SEC contends, on shareholders' director nominees being presented alongside those of management. Second, the evidence and theory about shareholder voting presented here has significant implications for understanding mergers and acquisitions, particularly hostile acquisitions. The theory is that acquirers have steep incentives to target firms with poor performance. In most cases, however, such acquisitions depend on winning a vote from shareholders. Thus, if there is any disciplinary effect created by the prospect of takeovers, it depends crucially on understanding what motivates shareholder voting behavior. If voting shareholders respond to political motivations, not economic ones, then the performance of target board members might not be as relevant as takeover theorists had previously surmised.

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Introduction

Economic theory that suggests an underperforming board of directors should fear an ouster vote by shareholders underappreciates the complexity of shareholder voting decisions.[1] In fact, whether

[1] *See, e.g.*, Harry DeAngelo & Linda DeAngelo, *Proxy Contests and the Governance of Publicly Held Corporations*, 23 J. Fin. Econ. 29, 29 (1989) (noting the widely held view that contested corporate elections give shareholders a way "to discipline incumbent managers who fail to maximize firm value"); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & Econ. 395, 403 (1983) ("[M]anagers' knowledge that they are being monitored by those who have the right incentives . . . tends to cause managers to act in shareholders' interest in order to advance their own careers and to avoid being ousted."); Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. Chi. L. Rev. 119, 136 (1987) (noting that the shareholder right to vote incentivizes managers to maximize shareholder value); Stuart L. Gillan & Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors*, 57 J. Fin. Econ. 275, 276 (2000) (arguing that the shareholder voting process is about corporate governance and performance and that "[t]he primary emphasis of activist shareholders has been to focus on the poorly performing firms in their portfolio and to pressure the management of such firms for improved performance, thus enhancing shareholder value").

directors stay at the helm of public companies has less to do with their skill at enhancing firm value. Rather, like incumbent politicians, directors of large U.S. firms tend to stay in charge because they understand—and take advantage of—the political dynamics of corporate voting. Indeed, the process of shareholder voting in corporate elections is not dissimilar to citizen voting in elections for public office.

At least once per year shareholders vote, or, more precisely, cast a proxy,[2] on significant issues affecting the firm.[3] Most significantly, shareholders may vote on whether or not to oust the current directors of the board.[4] Standard economic theory predicts that shareholders will vote for or against directors based on those directors' expected performance or ability to maximize firm value. For instance, shareholders might reelect directors when firm value has improved during those board members' tenure and vote "no"[5] when firm growth has stalled.[6] In this world of rational *homines economici*, shareholders decide whether to vote to keep directors based on a combination of economic considerations.[7] These may include whether firm leaders have made good decisions about what businesses to enter or exit, whether they offer a compelling vision for the firm's future, and, of

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2 Typically, shareholders do not physically show up at firm meetings to cast their vote. Rather, prior to the start of the meeting, the firm mails shareholders a proxy statement, which contains important details and instructions, along with a proxy card that shareholders can use as a ballot to register their votes. Shareholders mail these proxy cards to the firm and the firm tallies them in advance of the shareholder meeting. *See* R. Franklin Balotti et al., Meetings of Stockholders §§ 7.1, 14.8 (2011); *see also, e.g.*, Del. Code Ann. tit. 8, §§ 212(c), 231 (2010).

3 *See, e.g.*, tit. 8, § 211(b) (providing for the shareholder right to vote).

4 *See, e.g.*, *id.* § 141(k) (providing for the removal of directors by a majority of shareholder votes). Shareholders also vote on other fundamental transactions, such as statutory mergers and dissolutions. *Id.* §§ 251(c), 275(c).

5 Technically, in an uncontested election, the best shareholders can do is to withhold their votes. Directors could then still be elected with a single vote, because many jurisdictions use the plurality voting system as the default rule. *See, e.g.*, *id.* § 216(3) (authorizing a plurality voting system). Nonetheless, votes to withhold ("no votes") do have some expressive value. *See* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 Stan. L. Rev. 857, 866 (1993) (explaining that shareholders employing "just vote no" strategies might send a message to management and other shareholders that they are unhappy with the firm's performance). In a contested election over board seats, by contrast, shareholders may vote for a competing slate. If the competing slate receives more votes, it is elected and the incumbents are ousted. Balotti et al., *supra* note 2, § 12.6.

6 *See* Easterbrook & Fischel, *supra* note 1, at 403 (explaining the importance of voting as a way to monitor manager conduct).

7 *See, e.g.*, Richard M. Duvall & Douglas V. Austin, *Predicting the Results of Proxy Contests*, 20 J. Fin. 464, 464 (1965) (noting that the outcome of proxy contests "depend[s] on the performance of several economic variables that are normally utilized to measure managerial performance").

course, whether the share price has held up relative to the market and industry competitors.

Shareholders also typically vote on various proposals put forth by other shareholders or by management regarding firm governance, conflict of interest transactions, and even social and ideological issues.[8] Similar to voting behavior in director elections, proponents of economic orthodoxy would expect shareholders to vote down proposals that reward bad behavior and approve proposals that encourage good performance.[9] Shareholders might, for example, vote down a proposal to create a lavish salary plan for executives if the plan did not create incentives for managers to enhance firm value. They might vote to approve a proposal to destagger director terms, which would give shareholders a chance to vote out the entire board in a single election and, as a consequence, enhance shareholder voting and monitoring power.[10] Shareholders might vote to redeem takeover defenses, like the so-called poison pill.[11] Antitakeover tactics, after all, may entrench managers and stymie takeovers and the rich premiums that often accompany them.[12]

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8 *See* 17 C.F.R. § 240.14a-8 (2011) (providing exclusionary rules for shareholder proposals); *see also infra* notes 53–54, 60 and accompanying text (explaining the standard economic rationale that shareholders will vote for proposals that are predicted to enhance firm value).

9 *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 850 (2005) ("Without adequate constraints and incentives, management might divert resources through excessive constraints and incentives . . . . Adequate governance arrangements, however, can provide constraints and incentives that reduce deviations from shareholder-value maximization."); Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368, 376 (2007) (finding that proposals that have a questionable relationship to firm value receive low levels of shareholder support).

10 *See* Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 70–71 (2008) (discussing increased support for declassified boards, also called destaggered boards); Paul Rose, *Common Agency and the Public Corporation*, 63 VAND. L. REV. 1355, 1366–67 (2010) (describing shareholders' recent success in voting to repeal staggered boards); *see also* Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. REG. 174, 185 (2001) (noting that institutional shareholders "are hypothesized to vote for proposals enhancing shareholders' ability to monitor management with greater frequency than other outside investors").

11 *See* Thomas & Cotter, *supra* note 9, at 377–78 (finding that boards took action on votes to redeem takeover defenses and alter executive compensation); *see also* Fischel, *supra* note 1, at 148–49 (noting the wealth loss associated with antitakeover tactics). The term poison pill "has no precise definition. It generically denotes a range of defensive techniques, usually adopted by boards of directors as amendments to company bylaws." Charles M. Yablon, *Poison Pills and Litigation Uncertainty*, 1989 DUKE L.J. 54, 58.

12 *See* Randall S. Thomas, *Judicial Review of Defensive Tactics in Proxy Contests: When Is Using a Rights Plan Right?*, 46 VAND. L. REV. 503, 543 (1993) (noting that large premiums are associated with tender offers).

Political scientists, meanwhile, take a more nuanced approach to analyzing voting decisions, an approach that contrasts sharply with the accepted wisdom of economics.[13] Experts do not believe challengers are elected or incumbents reelected only because they will maximize constituents' individual welfare.[14] It would be unusual to suggest that voters in political elections will support a challenger based exclusively on her potential to lead their community or will support an incumbent based only on her past performance.[15] In fact, if political scientists offered a model that relied too heavily on indicators of official performance, they might be ridiculed as being shortsighted naïfs.[16] Rather, observers expect that poor performers can be, and are, elected to lead government.[17]

The same voting oddities may exist in corporate elections, which share many characteristics with political elections. Just as the law protects the right to vote in political elections,[18] it also protects the right to vote in corporate elections. For instance, courts have suggested that shareholder voting in corporate elections is a hallowed right,[19] that it is of "central importance,"[20] that it is a "supreme right,"[21] and that

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13 *See generally* Harvey J. Tucker & Ronald E. Weber, *State Legislative Election Outcomes: Contextual Effects and Legislative Performance Effects*, 12 Legis. Stud. Q. 537 (1987) (studying several variables in order to explain election outcomes in state races, including party strength, campaign spending, incumbency, and legislative performance).

14 *See, e.g.*, Randall W. Partin, *Assessing the Impact of Campaign Spending in Governors' Races*, 55 Pol. Res. Q. 213, 213–14 (2002) (noting the near-uniform belief in the importance of money in elections).

15 Of course, some voters do cast their votes strictly based on expected performance. The point is that for the vast majority of voters, it is more complicated.

16 In fact, political scientists have concluded that campaign spending, not past performance, is among the most important factors to a political candidate's success. *See* Peverill Squire, *Candidates, Money, and Voters—Assessing the State of Congressional Elections Research*, 48 Pol. Res. Q. 891, 900 (1995) (explaining a consensus in political science literature that challenger spending "powerfully influences [political] election outcomes").

17 *See, e.g.*, Tucker & Weber, *supra* note 13, at 551 (finding that measures of legislative performance "were weak and inconsistent correlates of election outcomes" and that party strength, campaign spending, and incumbency were "the most important factors affecting state legislative election outcomes").

18 In political contests, the right to vote is constitutionally guaranteed. Reynolds v. Sims, 377 U.S. 533, 554 (1964) ("Undeniably the Constitution of the United States protects the right of all qualified citizens to vote, in state as well as in federal elections.").

19 *See* Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 Iowa L. Rev. 485, 533 (1994) (commenting on the broad, rhetorical language courts have used in connection with shareholder voting rights); *see also* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) (rejecting a change in the date of a shareholder meeting as an impermissible attempt to interfere with a shareholder vote).

20 Blasius Indus., Inc. v. Atlas, 564 A.2d 651, 659 (Del. Ch. 1988) (noting the "central importance" of the shareholder right to vote).

21 Stokes v. Cont'l Trust Co., 78 N.E. 1090, 1093 (N.Y. 1906) (stating that a stockholder "has the right to vote for directors and upon all propositions subject by law to the control of the stockholders, and this is his supreme right and main protection").

obstacles to its proper exercise should be reviewed under a heightened standard of judicial review.[22] The careful treatment courts have extended to the right to vote suggests that this right is grounded in more than economic considerations alone.[23] Moreover, voters in some corporate elections, like the voters in political elections, are courted extensively by candidates.[24] Voters in corporate elections receive campaign-like pledges from the contenders, much like the kind of promises that are associated with political elections.[25] Those running for board seats advertise in newspapers, phone potential voters, and send out mailers and marketing materials[26]—all traditional hallmarks of a political contest.[27] Of course, the analogy should not be taken too far, but there is at least reason to believe that the same dynamics at play in political contests might explain shareholder voting behavior. Put differently, given the shared characteristics between corporate and political elections, it is reasonable to suppose that voters in corporate elections might approach their decisions in a way similar to voters in political elections.

This Article argues that shareholder voting is significantly more complex than standard economic theory assumes. In this regard, polit-

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22 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (establishing an "enhanced duty" of "judicial examination at the threshold before the protections of the business judgment rule may be conferred"). For a discussion of court opinions holding that management has overreached, including cases where board action was seen as interfering with shareholder voting, see Oesterle & Palmiter, *supra* note 19, at 526, 528–37.

23 *See* Oesterle & Palmiter, *supra* note 19, at 576 (suggesting similarities between regulation of interference with voting in corporate and political contests).

24 *See* Thomas, *supra* note 12, at 536 (discussing the prevalence of persuasive materials in proxy contests). For a review of the type and frequency of arguments that challengers use, see DeAngelo & DeAngelo, *supra* note 1, at 33–36.

25 *See* John Pound, *Proxy Contests and the Efficiency of Shareholder Oversight*, 20 J. FIN. ECON. 237, 245 (1988) (describing dissident promises to purchase significant stakes in a firm after a successful proxy contest).

26 *See* BALOTTI ET AL., *supra* note 2, § 12.8 (describing various forms of shareholder communication).

27 In both political and corporate elections, the content of communications to voters is lightly regulated. Candidates for public office typically can disseminate information to potential voters without any significant oversight by the FEC or comparable public authority. The FEC's principal concern is the money's source, which candidates disclose in periodic reports. *See* FEC, THE FEC AND THE FEDERAL CAMPAIGN FINANCE LAW (Feb. 2004), http://www.fec.gov/pages/brochures/fecfeca.shtml (describing the Federal Election Campaign Act requirement that candidates submit periodic reports disclosing the money they raise and spend). Light regulation is also, in some ways, a hallmark of corporate elections. No regulatory agency monitors the content of marketing materials. The SEC requires contestants to send in a proxy statement; once that is done, however, contestants are free to send out supplementary materials without significant oversight. *See* Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681, 687 (2007) (noting that while proxy statements are monitored, other communications are not).

ical science research on voting could be a rich treasure trove. For instance, previous researchers have found that in political elections, voter decisions are driven by factors not necessarily related to performance, including paid media, campaign expenditures, and name identification.[28] When it comes to campaign expenditures, political scientists have consistently found that challenger spending on persuasive advertising influences electoral outcomes.[29] As discussed below, these same political variables might help explain and predict voting patterns in corporate elections.

Part I gives the standard wealth maximization account of shareholder voting and then compares it to the evidence. It concludes that the already available empirical research offers, at best, uneven support for the economic account. Part II presents a competing narrative, in which shareholder voting decisions are more complex and not driven—or entirely explained—by economic considerations. Shareholder voting in corporate elections is not dissimilar from voting in political elections. Political considerations, including name identification, reputation, media access, and money spent on the campaign, likely drive shareholder voting decisions in the same way they help determine candidates' success in political elections.

Part III presents the evidence for this counterstory. While controlling for a host of other variables, it compares the explanatory power of a standard economic variable (long term stock price return) and a political variable (money budgeted on campaigning) on director election outcomes. The importance of persuasive campaign spending has been repeatedly chronicled in the political sphere. In a similar mode, the evidence presented here suggests that money in corporate elections can be significant, even more important than directors' ability to enhance firm value (as measured by stock price returns). The likelihood of being returned to office appears to be a function of typical election politics—how much was spent by contestants to put on a campaign to market and persuade the shareholder-electorate.

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[28] *See, e.g.*, Gary C. Jacobson, *The Effects of Campaign Spending in Congressional Elections*, 72 AM. POL. SCI. REV. 469, 479 (1978) (discussing how name identification and "voter recognition" are key to electoral success); David C. Nice, Research Note, *Campaign Spending & Presidential Election Results*, 19 POLITY 464, 464 (1987) (analyzing whether campaign expenditures are related to presidential election outcomes for presidential elections from 1860 through 1980).

[29] *See* Squire, *supra* note 16, at 900 (suggesting that, among political scientists, "[t]here is little dispute about the power of challenger spending" to influence congressional elections). Meanwhile, incumbent spending is not necessarily related to electoral outcomes. *See* GARY C. JACOBSON, MONEY IN CONGRESSIONAL ELECTIONS 42 (1980) (showing a "weaker, although properly negative impact on the challenger's vote" associated with incumbent spending).

Part IV sketches the considerable implications of this argument. First, the theory that shareholder voting is highly politicized helps point the way to how to—and, just as importantly, how not to—craft reforms. In particular, a political theory of shareholder voting might help us better understand the recent proxy access debate. This is because the debate about proxy access reforms fails to take into account the political dynamics that attend to shareholder voting. Most importantly, these types of reform do not account for the importance of marketing or political-style persuasion on shareholder voting. Second, and relatedly, if political variables matter more than—or at least as much as—economic ones, that fact should affect our understanding of takeover law. Because hostile acquisitions are preceded by a shareholder vote,[30] takeover artists should adjust their strategies if shareholder voting is more complex than previously suspected.

I
THE ECONOMICS OF SHAREHOLDER VOTING

Corporate law scholarship is dominated by the law and economics perspective.[31] When it comes to shareholder voting, the standard bearers of the economic view, Chief Judge Frank Easterbrook, Daniel Fischel, and Henry Manne, to name a few, argue that shareholder-voters are not misled by rhetoric, incumbent promises, and political dribble, like voters in political elections.[32] Shareholders, unlike voters in political elections, are single-minded and only care about the bottom line.[33] Thus, in the two most common instances of

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30 *See infra* notes 215–21, 227–28 and accompanying text (explaining that achieving hostile acquisitions depends on shareholder voting and suggesting that takeover artists should consider additional criteria in identifying their targets).

31 *See, e.g.*, Kent Greenfield & Peter C. Kostant, *An Experimental Test of Fairness Under Agency and Profit-Maximization Constraints (With Notes on Implications for Corporate Governance)*, 71 GEO. WASH. L. REV. 983, 985 (2003) ("One of the remaining bastions of traditional law and economics is much of corporate-law scholarship, which views the corporation as a nexus of express and implied contracts entered into by rational, utility-maximizing constituencies."); Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 276 (1967) (stating that law and economics "were at work in the development of mid-19th century corporation law").

32 *See* Easterbrook & Fischel, *supra* note 1, at 420–21 (arguing that shareholder-voters are not easily swayed by "campaign propaganda" or "misled by rhetoric"); *see also id.* at 420 ("In those rare situations where a proxy contest for control develops, the insurgent's chance for success [in getting votes] is likely determined by the amount of shares he owns rather than by the force of his arguments."); Henry G. Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399, 411 (1962) (noting that shareholders are single-issue voters, unlike voters in political elections).

33 Fischel, *supra* note 1, at 140–41 (arguing that shareholders in corporations are single-minded, while political voters have "broader goals than wealth maximization"); Manne, *supra* note 32, at 411 ("[Shareholders are] attempting to maximize only one type of utility

shareholder voting—votes on shareholder proposals and on board of director positions—the orthodox view suggests that these are merely opportunities to endorse or disapprove of the performance of firm leadership with regard to generating firm value.[34] In Section A, I briefly consider the law and economics view of how voters react to proposals submitted by shareholders for consideration at shareholder meetings. Section B applies the precepts of economics to shareholder voting in director elections. Section C then compares the standard wealth maximization account of shareholder voting to the available evidence with respect to both proposals and director elections.

A. Proposals

Prior to an annual or special meeting, the firm sends shareholders a disclosure document known as a proxy (or voting) statement, which notifies the shareholder-voter of the time and location of the vote and the items to be voted on.[35] The statement also includes suggestions (called proposals) by shareholders about the direction of the firm.[36] For decades, in fact, shareholders have used the firm's proxy statement to communicate with other shareholders and bring proposals to the shareholder community.[37] A proposal is submitted to the board and, if compliant with various exclusionary rules, is included in the firm's statement for a vote. These shareholder proposals may concern any number of subjects from social policy to corporate governance, including plans that: establish a shareholder advisory committee, ratify an executive compensation plan,[38] approve the selection of the firm auditor, repeal poison pills and other antitakeover measures,[39]

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or value, and that is financial. Company loyalty, respect, pride, and other values that could be enumerated count for little, if anything, in the share investor's equation.").

[34] These votes take place at an annual or special meeting for that purpose. *See, e.g.*, DEL. CODE ANN. tit. 8, § 211(a)–(b) (2005) (providing for annual stockholder meetings to elect directors).

[35] *See* BALOTTI ET AL., *supra* note 2, § 4.8 (describing the process of proxy statement distribution).

[36] *See* 17 C.F.R. § 240.14a-8 (2011) (describing procedures to have shareholder proposals included on proxy cards).

[37] *See* Lilli A. Gordon & John Pound, *Information, Ownership Structure, and Shareholder Voting: Evidence from Shareholder-Sponsored Corporate Governance Proposals*, 48 J. FIN. 697, 700 (1993) (describing the establishment of shareholder proposal rules in 1942).

[38] *See* Romano, *supra* note 10, at 201 (finding in a study that proposals related to executive compensation represent approximately 10% of proposals).

[39] *See id.* at 195–96 (noting that the elimination of takeover defenses is the most popular proposal type sponsored by institutional investors and represents approximately one-third to one-half of all institutional proposals).

call for an independent board chairman,[40] destagger director terms, switch the voting process from straight to cumulative or confidential voting,[41] and cover other issues.[42] Other shareholder proposals track broader social and ideological issues. In one famous case for example, shareholders proposed that the firm respect animal rights and exit the geese-feeding business.[43] In another, shareholders proposed that the firm push for national health care reform.[44] In still another, shareholders proposed that the firm divest from certain countries in protest of those countries' human rights abuses.[45] Shareholders, in certain limited circumstances, can piggyback the firm's proxy statement at virtually no cost to the shareholder and present a proposal to the other members of the shareholder community. These proposals appear in the firm's proxy statement and are normally sent to all shareholders, along with a proxy card, and the ballot that shareholders use to register their votes.[46] In any given election, more than one shareholder proposal can be included on a ballot.[47]

Proposals can come from shareholders or managers, but shareholder-initiated proposals can be distinguished from manager-initiated proposals in important ways. First, shareholder-initiated proposals are subject to exclusionary rules that give the board of directors the ability to leave many proposals out of the firm's proxy statement:[48] Among other reasons, the board of directors can exclude proposals from the proxy statement if the proposal sponsor fails to strictly adhere to securities regulations, if the proposal violates state law, or,

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40 *See id.* at 191–92 (noting that from 9 to 16% of proxy proposals in studies were related to board independence).

41 *See id.* at 205–06 (noting that 18 to 44% of proposals by institutional investors were related to confidential voting reforms).

42 *See* Stephen J. Choi, *Proxy Issue Proposals: Impact of the 1992 SEC Proxy Reforms*, 16 J.L. ECON. & ORG. 233, 237–42 (2000) (breaking down the types of proposals and their frequency by proponent and target type); Gillan & Starks, *supra* note 1, at 286–87 (breaking down types of proposals and their frequency by issue type); Deon Strickland et al., *A Requiem for the USA: Is Small Shareholder Monitoring Effective?*, 40 J. FIN. ECON. 319, 329–30 (1996) (summarizing proposals by type and success); Thomas & Cotter, *supra* note 9, at 375–76 (breaking down types of proposals and their frequency by sponsor type).

43 *See* Lovenheim v. Iroquois Brands, Ltd., 618 F. Supp. 554, 562 (D.D.C. 1985) (holding that a firm cannot exclude a proposal related to force-feeding geese).

44 *See* New York City Emps.' Ret. Sys. v. Dole Food Co., 795 F. Supp. 95, 103 (S.D.N.Y. 1992) (directing a firm to include in its proxy materials a proposal related to creating a national health care program).

45 *See* Fairfax, *supra* note 10, at 86–87 (discussing the proposal from the Episcopal Church that General Motors divest from apartheid South Africa).

46 For a recent example of a shareholder proposal at a large, public company, see Target Corp., Definitive Proxy Statement (Schedule 14A) (Apr. 21, 2009).

47 Thomas & Cotter, *supra* note 9, at 386 (reporting that proxy statements contained, on average, 1.9 proposals).

48 17 C.F.R. § 240.14a-8 (2011) (detailing the ways in which proposals can be excluded).

importantly, if the proposal concerns a director election.[49] Because of this last exclusion, shareholders who want to nominate a candidate for the board of directors cannot use a shareholder proposal as a method of nominating their preferred candidate.[50] Second, binding proposals can be excluded, so the vast majority of proposals are merely recommendations to the incumbent board.[51] If shareholder proposals make it through the thicket of exclusionary rules and into the proxy statement, shareholders have only 500 words to convince other shareholders to vote for each proposal.[52]

Standard economic theory suggests that shareholders vote strategically on shareholder-initiated proposals to maximize their profits.[53] According to this theory, individual and institutional investors vote to approve proposals that tend to reduce agency costs and preserve firm wealth for shareholders, and vote against proposals that entrench directors or do not incentivize good performance.[54] The theory would, for instance, expect shareholders to vote for proposals to separate the CEO and board chair positions on the theory that an independent board chairman enhances oversight of CEO decisions. Likewise,

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[49] *Id.* For a discussion of the exclusion process and the issuance of no-action letters, see Robert B. Ahdieh, *The Dialectical Regulation of Rule 14a-8: Intersystemic Governance in Corporate Law*, 2 J. Bus. & Tech. L. 165, 171–73 (2007).

[50] *See* AFSCME v. AIG, 462 F.3d 121, 127 (2d Cir. 2006) ("A proxy solicitation nominating a candidate for a specific election . . . made 'for the purpose of opposing' the company's proxy solicitation . . . would be excludable . . . ." (quoting 17 C.F.R. § 240.14a-12(c))). *But see id.* at 128 (noting that a proposal is not "excludable under Rule 14a-8(i)(8) if it would simply establish a process for shareholders to wage a future election contest").

[51] *See* Choi, *supra* note 42, at 241 (using a study of shareholder proposals to determine that proposals were almost always advisory). Even if the majority of shareholders support a proposal, boards do not always take action. In their sample of shareholder proposals, Thomas and Cotter found that boards took action in only around 25% of cases of majority-supported shareholder proposals on internal corporate governance. Thomas & Cotter, *supra* note 9, at 379 (examining corporate announcements within one year of successful proposals to determine if the firm had taken action relevant to a shareholder proposal). For a brief discussion of the conditions that can lead to board action on shareholder proposals, see *id.*, *supra* note 9, at 371.

[52] 17 C.F.R. § 240.14a-8(d) (2011).

[53] *See* Grundfest, *supra* note 5, at 902 (suggesting that shareholder proposals reflect shareholder dissatisfaction with performance); Romano, *supra* note 10, at 224 (noting that voting reflects share value); Thomas & Cotter, *supra* note 9, at 372 ("Shareholders will generally vote to maximize shareholder wealth so that they will support proposals that they believe increase shareholder wealth, while fewer shareholders will vote in favor of those proposals that do not create value.").

[54] *See* Jonathan M. Karpoff et al., *Corporate Governance and Shareholder Initiatives: Empirical Evidence*, 42 J. Fin. Econ. 365, 366 (1996) ("A central tenet of shareholder activism holds that shareholder proposals ameliorate the shareholder-manager agency conflict and pressure managers to adopt value-increasing policies."); *see also* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 Harv. L. Rev. 1735, 1752 (2006) ("Most institutional investors are profit maximizers who will not engage in activities whose costs exceed their benefits.").

shareholder-voters might be expected to vote against proposals to stagger director elections in order to amplify the threat of an ouster campaign for underperforming managers.[55]

Management, on the other hand, can be expected to oppose virtually all shareholder proposals, regardless of their perceived impact on profits. Management typically seeks to avoid the oversight and limitations on discretion that are the hallmarks of shareholder proposals.[56] Also, management inaction prior to the shareholder proposal can be interpreted as a signal that management opposes the proposal, presumably because if management supported the change, they would have already implemented it.[57] Because many shareholder-voters take their cue on how to vote from management,[58] shareholder proposals can often be expected to fail.[59]

Economic theory puts little stock in factors not obviously related to value maximization. For example, economic theory does not causally connect voting outcomes to the identity of the proposal's proponent. Under these lights, it is the content of the proposal, not the identity of the proponent, that informs the value of the proposal. Under traditional economic theory, shareholders judge proposals sponsored by institutional shareholders and individual shareholders similarly; they evaluate both by their potential for profit-maximization. According to this theory, shareholders are more likely to approve proposals related to corporate governance issues (e.g., separating the board chairman and CEO positions) than ideological proposals (e.g., terminating animal testing), regardless of whether the proposal sponsor is an institutional shareholder or an individual shareholder.[60] Another example is the 500-word limit on shareholder pro-

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55 *See generally* Thomas, *supra* note 12, at 529–30 (arguing that strong defensive tactics decrease management's responsiveness to shareholders).

56 *See* Thomas & Cotter, *supra* note 9, at 381 (explaining management opposition to shareholder proposals); *see also* Gordon & Pound, *supra* note 37, at 713 (finding that as insider ownership goes up, votes for shareholder proposals go down).

57 Thomas & Cotter, *supra* note 9, at 381 ("Management [opposes] almost all shareholder initiatives that come to a vote for the simple reason that if they agreed with the proposal, they could either propose it themselves or easily negotiate to get it off the ballot without a vote.").

58 Easterbrook & Fischel, *supra* note 1, at 402–03 (noting that shareholders routinely endorse manager decisions).

59 *See* Karpoff et al., *supra* note 54, at 368 (noting that, in a sample of shareholder proposals, only 2.5% received a majority of votes); *see also* Thomas & Cotter, *supra* note 9, at 371 (noting a history of low support for proposals).

60 *See* Romano, *supra* note 10, at 176–77 (noting that voting results for corporate governance proposals appear unlikely to differ based on whether the proponent is from a union or public pension fund). Perhaps with this in mind, some firms do not even identify the sponsors of some proposals. *See id.* at 177 n.7 (explaining that sponsors of the proposal in an Eastman Kodak proxy statement were not identified). *But see* Thomas & Cotter,

posals. Economic theory predicts that word limits on shareholder proposals should have little effect on corporate voting decisions. The word allotment seems sufficient to put corporate voters on notice of the proposal's content. Shareholders should, then, vote for the option they expect to maximize firm value. In fact, even if the word limit is insufficient to truly inform shareholders, one would expect that many shareholder voting outcomes would be largely unchanged: If the word limit is insufficient to make an informed judgment on which choice maximizes share value, larger shareholders have sufficient incentives to learn the necessary information in some other way.[61]

B. Director Elections

Perhaps the most important power shareholders have is the power to vote for (or against) directors. In director elections, just as in shareholder proposals, managers make their various disclosures in the firm's proxy materials. If a shareholder or group of shareholders wishes to compete against the corporate proxy statement, they launch a proxy contest to pitch their candidate to the other shareholder-voters.[62] On these rare occasions,[63] the proxy contesters hire their own lawyers, draft their own proxy statement, and submit the statement to shareholders directly.[64] These shareholders need not request permission from the board and, as a notable consequence, are not subject to the same restrictions: Challengers in a proxy contest are not subject to a word limit, nor to the various exclusionary rules.[65] Thus, unlike in the shareholder proposal context, activist-investors who win proxy contests do not merely have a mandate for change, they also

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supra note 9, at 373 (noting that the identity of the sponsor could affect shareholder votes since "[s]hareholders may perceive that some types of sponsors are more aligned with their wealth-maximization interests than others").

61 *See* Gordon & Pound, *supra* note 37, at 715 (finding that despite the paucity of information supplied to shareholder-voters by proposal sponsors, shareholders seem to make informed decisions about how to vote).

62 The terms "proxy contest" and "contested director elections" are used fairly interchangeably throughout this Article. Although not a term used here, proxy contests are also variously referred to in the literature and in court opinions as "proxy fights." *See, e.g.*, Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 34 (1977) ("The experience of the SEC with proxy fights offers ample evidence that this type of situation can best be controlled, and shareholders most adequately informed, if both sides to the argument are subject to the full and fair disclosure rules of the Federal securities laws." (citing 113 Cong. Rec. 855–56 (1967))).

63 *See* Lee Harris, *Missing in Activism: Retail Investor Absence in Corporate Elections*, 2010 Colum. Bus. L. Rev. 104, 173 (finding that shareholders launch free-standing proxy contests, on average, only thirty-two times per year).

64 For an example of a proxy contest statement, see *supra* note 46.

65 Shareholders do, however, need to make the various disclosures required under the Rule 14a schedule. *See* 17 C.F.R. § 240.14a-101 (2011).

have the power to effectuate change. Though a proxy contest can technically be about any number of subjects, the vast majority of proxy contests are director elections.[66] Unlike low-cost shareholder proposals, proxy contests are expensive for the shareholder-challenger.[67] As mentioned, contestants usually have to pay for lawyers to make various disclosures and for the dissemination of their proxy statements to eligible shareholder-voters. In addition, contestants typically spend a great deal of time and money persuading voting shareholders. The upfront costs for these contests are usually borne by the challenger, not the company.

As with proposals, standard economic theory suggests shareholders vote to maximize expected firm value in director elections.[68] Thus, in a contested director election, standard economic orthodoxy predicts that shareholders use their vote to reward good directors by voting to keep them in office and punish bad directors by voting for their replacement with the challenger's nominees.[69] Firms should, then, keep good managers and encourage them to perform well, lest they become the target of the next ouster campaign.[70] Under this view, the shareholder-voter uses the company's stock price, dividend policy, or another economic consideration as an indicator of managerial performance.[71] The standard economic analysis of director elections also predicts that successful challenger campaigns enhance firm

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66 *See* DeAngelo & DeAngelo, *supra* note 1, at 31 (noting that in a sample of seventy proxy contests, sixty were contests over board seats). Recall that directors cannot normally be nominated through a shareholder proposal. *See supra* notes 49–52 and accompanying text.

67 Harris, *supra* note 63, at 146 (finding that proxy contests can cost over one million dollars).

68 *See, e.g.*, David Ikenberry & Josef Lakonishok, *Corporate Governance Through the Proxy Contest: Evidence and Implications*, 66 J. BUS. 405, 406 (1993) (using this economic theory to discuss how shareholders approach voting).

69 *See* DeAngelo & DeAngelo, *supra* note 1, at 29 ("The proxy contest is widely viewed as the ultimate vehicle enabling stockholders of publicly held corporations to discipline incumbent managers who fail to maximize firm value."); Duvall & Austin, *supra* note 7, at 464 ("[I]f owners become dissatisfied with the current management one of the most effective and drastic means of expressing this dissatisfaction is the proxy contest."); Ikenberry & Lakonishok, *supra* note 68, at 406 (predicting that shareholders are less likely to support challengers if incumbent directors have not performed poorly).

70 Easterbrook & Fischel, *supra* note 1, at 403 (noting the disciplinary effect voting has on firm managers).

71 Henry G. Manne, *Some Theoretical Aspects of Share Voting*, 64 COLUM. L. REV. 1427, 1440 (1964) (theorizing that if a shareholder learns "other companies are doing much better than his own, either in terms of capital gains or dividends, it may be quite rational to vote for any group willing to incur the expense of a fight for control").

value because they operate as a mechanism to transfer firm assets to managers who are best able to maximize their value.[72]

Proponents of this view go further by making similar claims with respect to uncontested director elections and unsuccessful contested director elections. Economists speculate that even unsuccessful challenges to board seats add value and enhance share price.[73] In some contests, challengers do not win control of the board, but do win some seats.[74] Theoretically, these partial victories still result in changes to firm policies and more efficient use of firm resources,[75] and, even if challengers win no seats, the very challenge to the board has a disciplinary effect on incumbents.[76] In order to avoid future challenges, incumbents may cut self-indulgent policies and retrain their attention on shareholder interests.[77] Additionally, proponents of economic theory also argue that the mere threat of a director election is enough to keep incumbent managers in line and maximize firm value, regardless of whether an ouster vote is ever actually orchestrated. Put another way, the mere threat of an ouster is enough to make managers pursue shareholder interests.[78] Unlike in the case of shareholder proposals, the identity of the challenger in a director election fits into the standard economic analysis because shareholders in director elections do not usually have the content of a final plan or proposal to evaluate. Instead, shareholder-voters must evaluate the ability of the challenger to lead the firm based on the challenger's skill set, credibility, industry experience, and other characteristics of the challenger

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72 *See* Peter Dodd & Jerold B. Warner, *On Corporate Governance: A Study of Proxy Contests*, 11 J. FIN. ECON. 401, 405 (1983) (noting that "standard economic analysis" suggests that "shareholders' claims will be permanently revalued upward at the time of a proxy contest"); *see also* Manne, *supra* note 32, at 412 (noting that director elections hold the "key to higher capital gains through better management by others").

73 Dodd & Warner, *supra* note 72, at 405 (noting that "standard economic analysis" suggests that "shareholders' claims will be permanently revalued upward at the time of a proxy contest").

74 *See id.* at 409 (discussing partial proxy victories and finding that challengers won at least one seat in 58% of the cases under study).

75 *See, e.g.*, *id.* at 406 ("If minority representation is expected to have a positive impact on the cash flows accruing to (non-management) shareholders, then it alone is sufficient for an increase in share prices to take place.").

76 Ikenberry & Lakonishok, *supra* note 68, at 407 ("[W]hen dissidents fail to acquire any seats, the fact that the incumbent board and executive management may still be threatened by takeover attempts in the future suggests that operating performance in these firms should also improve.").

77 *See* Dodd & Warner, *supra* note 72, at 406 (characterizing the possibility of dissident challenge as creating a disciplinary effect on management).

78 *See* Easterbrook & Fischel, *supra* note 1, at 412 ("It is true that in public corporations directors are rarely evicted in mid-term, but the possibility of ouster may be sufficient to ensure that directors act as faithful agents of the residual claimants.").

or his nominee.[79] Shareholder-voters cannot simply read the content of the challenger's platform and decide whether the platform, on its face, has a good chance of enhancing value.[80]

C. Evidence and Implications

1. Shareholder Proposals

Commentators who analyze shareholder voting behavior in proposals have explored the importance of the identity of the proposal sponsor, the type of proposal, and prior firm performance on shareholder voting.[81] The available research tends to bear out many of the predictions of economic theorists. For instance, much of the current scholarship backs up the notion that shareholders tend to vote for proposals that are expected to enhance firm value and vote against value-decreasing proposals.[82] Randall Thomas and James Cotter in their 2007 study of proposals found that shareholders are more likely to vote for corporate governance proposals than social policy proposals,[83] which commentators generally have found are less likely to improve firm value.[84] In fact, these two commentators find that social responsibility proposals receive less than half of the average votes cast for shareholder proposals.[85] In their study of 403 proposals, no social responsibility proposal passed.[86] They found that shareholders vote in the highest proportions for proposals to repeal takeover defenses.[87] In a similar, earlier study, Lilli Gordon and John Pound found relatively high levels of support for shareholder proposals to rescind poison pills

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79 *See* DeAngelo & DeAngelo, *supra* note 1, at 36 (noting the importance of the dissident challenger's industry experience in persuading corporate voters in proxy contests).

80 *See* Pound, *supra* note 25, at 244 ("Dissidents and incumbents usually present information to shareholders about the value of their alternative business plans, but this information is difficult for outside shareholders to judge and is also liable to distortion.").

81 *See generally* Thomas & Cotter, *supra* note 9 (discussing voting patterns on proposals by sponsor and proposal type).

82 Gillan & Starks, *supra* note 1, at 291–92 (breaking out voter support by issue type and reporting that repealing takeover defenses receive the highest average vote in support).

83 *See* Thomas & Cotter, *supra* note 9, at 381 (describing their study results and finding that auditor independence, compensation, external governance, and internal governance proposals receive more votes than social responsibility proposals). See also *supra* notes 43–45 and accompanying text for examples of proposals which are oriented toward social goals.

84 *See* Strickland et al., *supra* note 42, at 332–33 (finding that the shareholder vote increases for proposals to eliminate poison pills and noting that the presence of poison pills leads to shareholder wealth losses).

85 Thomas & Cotter, *supra* note 9, at 376.

86 *Id.* at 377.

87 *Id.* at 376.

or expand shareholder voting rights.[88] These findings are consistent with the economic theory of shareholder voting, since takeover defenses tend to reduce the rich premiums that shareholders might expect to receive from a takeover attempt.[89]

Also consistent with the economic theory of shareholder voting, other research has shown that proposal sponsors tend to target underperforming firms, and that the target firm's prior performance is negatively correlated with voting outcomes.[90] Again, consider the recent research of Thomas and Cotter. After controlling for overall market performance, Thomas and Cotter found that targeted firms had, on average, dismal stock returns of 22.14%.[91] An earlier study suggested that shareholders may be more likely to vote in support of proposals at firms with poor performance.[92] Gordon and Pound similarly found a relatively high level of shareholder support in favor of proposals at firms with relatively poor long-term performance as measured by stock returns from one to five years prior to proposal.[93] Both of these findings are consistent with an economic theory: One would expect firms with indicators of poor performance to face more proposals. These findings are also consistent with the standard law and economics prediction that shareholders will be more inclined to vote

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88 Gordon & Pound, *supra* note 37, at 712 (summarizing the types of proposals that shareholders support).

89 *See supra* notes 53–55 and accompanying text (explaining that economic theory would predict rational, value-maximizing shareholders to vote for share price–maximizing proposals).

90 *See* Gillan & Starks, *supra* note 1, at 278 (discussing the trend toward the targeting of underperforming firms); Ikenberry & Lakonishok, *supra* note 68, at 423 (referring to prior findings that suggest that more than two-thirds of "dissident proxy materials claim that incumbents' operating performance is unsatisfactory"); Romano, *supra* note 10, at 183 (citing studies that show that "the targets of shareholder activism are, indeed, poor performers (compared to market or industry peers) on a variety of stock and accounting measures"); Thomas & Cotter, *supra* note 9, at 375 (concluding that during the period, targeted firms were underperformers); Sunil Wahal, *Pension Fund Activism and Firm Performance*, 31 J. FIN. & QUAN. ANALYSIS 1, 3 (1996) (reporting that sponsors of proposals target poor performers and industry poor performance). *But see* Jun Yang et al., An Empirical Analysis of Canadian Shareholder Proposals 5, 13 (July 2009) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1510248 (arguing that for Canadian companies, proposal proponents seem to target "large, highly visible companies . . . instead of underperforming firms").

91 Thomas & Cotter, *supra* note 9, at 375.

92 Strickland et al., *supra* note 42, at 332 (noting that votes received on proxy proposals increase "if the target firm's market-adjusted stock returns and book return on equity are lower" and "its market-to-book value of equity ratio is larger").

93 Gordon & Pound, *supra* note 37, at 712; *see also* Gillan & Starks, *supra* note 1, at 295 (finding a statistically significant relationship between vote share for proposals and firm performance as measured by five-year stock price returns).

for shareholder proposals at firms that are not well managed and have underperformed the market.[94]

In some other respects, however, the economic theory of shareholder voting behavior proves hard to square with the available empirical research. Indeed, some of the available evidence suggests that shareholders frequently seem to vote against what appears to be their own economic interests. For instance, shareholders have voted to preserve executive compensation schemes that are not tied to performance.[95] Additionally, though the vast majority of social or ideological proposals may fail, a group of researchers in Canada has reported a very high percentage of such proposals, which suggests that proponents expect to receive a high number of votes.[96] In short, many types of proposals that likely have a very low probability of improving firm value or a high probability of entrenching management received unusually high numbers of votes.[97]

Prior studies of shareholder proposals have also shown that a contestant's identity influences shareholder voting patterns.[98] Along these lines, Stuart Gillan and Laura Starks, in one of the most widely cited studies of shareholder proposals, found that institutional sponsors tend to receive significantly higher percentages of votes in support of their proposals than non-institutional sponsors.[99] They further claim that "prominent" individual sponsors, like Carl Icahn, receive more support for their shareholder proposals than other individuals, such as corporate gadflies who routinely challenge incumbents in corporate elections.[100] On the one hand, these findings can be massaged to fit standard economic analysis. One might argue, for instance, that

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[94] *See supra* notes 54–55 and accompanying text (remarking that shareholders might use proposals to reduce agency costs).

[95] *See* Oesterle & Palmiter, *supra* note 19, at 514 (noting MIPS Computers Systems' shareholders' approval of a plan to grant executives 2.5 million shares in stock options with no performance standards, after five years of underperformance).

[96] *See* Yang et al., *supra* note 90, at 5, 13 (finding a stronger tradition of proposals on social, ethical, and environmental issues in Canada as compared to the United States).

[97] *See id.*

[98] *See* Thomas & Cotter, *supra* note 9, at 381 (finding that proposals sponsored by individuals and private institutions received greater support than those sponsored by social activists); Wahal, *supra* note 90, at 2, 11 (noting the high success rates of nine major pension funds as proposal sponsors); Yang et al., *supra* note 90, at 5, 15–16 (reporting that institutional sponsors and coordinated groups receive higher support than individual activists and religious groups even when controlling for firm performance, issue type, ownership structure, and management ownership).

[99] *See* Gillan & Starks, *supra* note 1, at 289 tbl.5 (finding that institutional sponsors and coordinated groups each received 33% of votes for corporate governance proposals over an eight-year period, compared to an average vote of 18.5% for proposals sponsored by individuals over the same period).

[100] *Id.* at 281–82, 288.

shareholders may tend to support proposals sponsored by institutions because these institutions have fiduciary responsibilities to their own constituencies that operate as a credible signal that they would only sponsor value-enhancing proposals.[101] On the other hand, studies have found that individual sponsors of shareholder proposals have fared relatively well in support rates, exactly the opposite of the pattern observed by Gillan and Starks.[102] As shareholder activism seems to have gone more mainstream, Thomas and Cotter report that individuals who sponsored proposals received some of the highest levels of support compared to other sponsor types, besting even institutional investors (by a small margin).[103]

Furthermore, proponents of an economic theory cannot convincingly explain why identical proposals would receive significantly lower levels of support if submitted by an individual as opposed to an institutional shareholder. To take one example, in the Thomas and Cotter study, the researchers found that individuals who sponsored proposals on auditor independence garnered 8.71% of the vote on average, compared to 23.54% garnered by institutions that sponsored similar proposals.[104] It is strange that proposals on identical topics could generate such dissimilar levels of support based seemingly on the identity of the sponsor.

Finally, and arguably most damaging to the standard economic analysis of shareholder voting, the available research has suggested that, when measured by market reaction, shareholders support proposals that might not enhance firm value.[105] One would expect that shareholders would vote for value-enhancing proposals. However, the evidence shows that they do not.[106] Thomas and Cotter have found

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[101] *See* Thomas & Cotter, *supra* note 9, at 373 ("Shareholders may perceive that some types of sponsors are more aligned with their wealth-maximization interests than others.").

[102] *See id.* at 375–76 (finding that proposals sponsored by individuals received the most votes of any proposer group).

[103] *Id.*

[104] *Id.* at 375 tbl.2.

[105] Gillan & Starks, *supra* note 1, at 277, 298–300 (finding very little positive market reaction to proposals to repeal poison pills, and even negative market reaction to announcements of such proposals); Karpoff et al., *supra* note 54, at 384 (finding little evidence of positive returns associated with shareholder proposals); Romano, *supra* note 10, at 177, 188 tbl.1 (reviewing literature and reporting that the effect of shareholder activism is insignificant and, at times, negative to firm performance); Thomas & Cotter, *supra* note 9, at 389 (finding insignificant wealth effects from shareholder proposals); Wahal, *supra* note 90, at 3 (reporting that pension fund activism does not improve long-term stock price performance of targets); Yang et al., *supra* note 90, at 24 (summarizing prior findings of negative returns associated with proxy proposals). For a brief summary of studies that show that proposals might have "positive valuation effects," see *id.* at 369.

[106] *See* Wahal, *supra* note 90, at 2 (summarizing literature and reporting only weak evidence that shareholder proposals improve returns).

that shareholder support for proposals does not result in a positive market reaction.[107] In her review of all available studies, Roberta Romano reports that the evidence of any positive effect is, at best, mixed.[108] In fact, according to Romano, some of the available data suggest that shareholder activism may harm the firm.[109] Given the divergence between the evidence and the theory, the question is raised as to whether another theory can better explain shareholder voting patterns in this context.

2. *Director Elections*

In the case of board elections, an honest reading of the current research tends to support traditional economic theory. As with shareholder proposals, for instance, studies suggest that challenges are initiated on the basis of firm performance.[110] In their study of proxy contests, David Ikenberry and Josef Lakonishok found that targeted firms had lower returns than industry peers.[111] As for voting behavior, their findings suggest that challengers in proxy contests seem to believe that firm performance is a good indicator of whether their challenge will succeed and whether they will marshal a majority of shareholders to vote in support. Indeed, similar to shareholder proposals, some researchers have found that shareholders are more likely to vote in support of challengers in director elections if the performance of the target firm has been poor.[112]

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107 Thomas & Cotter, *supra* note 9, at 389 ("[W]e examine market reaction to shareholder proposals to see if they have measurable effects on shareholder wealth. We find that, consistent with earlier studies, these effects are generally insignificant . . . ."); *see also* Wahal, *supra* note 90, at 12–14 (finding no credible evidence of abnormal returns associated with shareholder proposals among nine major funds, with CalPERS as the only exception).

108 *See* Romano, *supra* note 10, at 177 (noting that few studies find positive effects resulting from shareholder activism).

109 *Id.* (noting that some studies "find a significant negative stock price effect from activism").

110 *See supra* notes 70–72 and accompanying text (discussing how shareholders may be willing to incur proxy fight costs if the firm is underperforming peers, as measured by capital gains and dividends).

111 Ikenberry & Lakonishok, *supra* note 68, at 432 (reporting that "5-year growth in the operating income of contest targets is 75% below that of control firms"); *see also* DeAngelo & DeAngelo, *supra* note 1, at 33–36 (summarizing dissident criticisms in a sample of proxy contests between 1978 and 1985, and finding that poor operating performance was the most frequent complaint); *supra* note 53–55, 68 and accompanying text (explaining that shareholders should vote to maximize share value, according to standard economic theory).

112 *See, e.g.*, Duvall & Austin, *supra* note 7, at 471 (noting that there is support for the view that "the worse the performance of management in terms of earnings the more likely stockholders are to give their support to insurgents").

Most significantly, however, the law and economics hypothesis that successful proxy contests enhance firm value, as standard economic analysis would predict, is not consistently borne out in the available data.[113] If shareholders were rational actors motivated only by the bottom line, one would expect shareholders to only support challengers expected to enhance firm value.[114] Thus, one would expect that successful challenges would have a positive effect on traditional market indicators, such as the firm's stock price.[115] Other researchers, however, have suggested that challenges to incumbents have little effect on a firm's stock price. For instance, Ikenberry and Lakonishok found that, where challengers obtain seats on the board of directors after a proxy contest, the market returns are significantly negative.[116] Negative results are particularly pronounced, according to these researchers, when challengers win a majority of seats.[117] Ikenberry and Lakonishok postulate, based on their findings, that "shareholders are not rational when they cast their proxies."[118] In short, a straight economic theory of corporate voting may not do a good job of explaining the empirical findings of voting patterns in director elections.

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[113] *See, e.g.*, Ikenberry & Lakonishok, *supra* note 68, at 421, 423 (reporting negative market returns after dissident victory); Rose, *supra* note 10, at 1381–85 (summarizing studies on performance and activism and concluding that there is mixed evidence of positive stock price improvement associated with activism). However, some researchers have found just the opposite. Dodd and Warner's study—one of the earliest and most important studies of proxy contests—found that in ninety-six proxy contests for board seats between 1962 and 1978, challengers won at least one board seat 58% of the time. Dodd & Warner, *supra* note 72, at 401, 409. Dodd and Warner found that these contests were associated with positive share price performance, regardless of whether the challengers actually win the contest. *Id.* at 434–35 (noting that evidence of positive share price performance around the time of proxy contests supports the standard economic analysis of proxy contests found in textbooks).

[114] *See* Ikenberry & Lakonishok, *supra* note 68, at 407 (theorizing that because the proxy contest is a method for shareholders to discipline management, proxy contests should improve firm performance—even if dissidents fail to gain any seats).

[115] For an alternative explanation of the poor performance of firms after proxy contests, see Thomas, *supra* note 12, at 542. Thomas speculates that some targets in proxy contests are in particularly bad shape prior to dissident victory.

[116] Ikenberry & Lakonishok, *supra* note 68, at 407 (noting short-term negative stock price returns and declines of more than 20% two years after contests in which dissidents gained one or more seats).

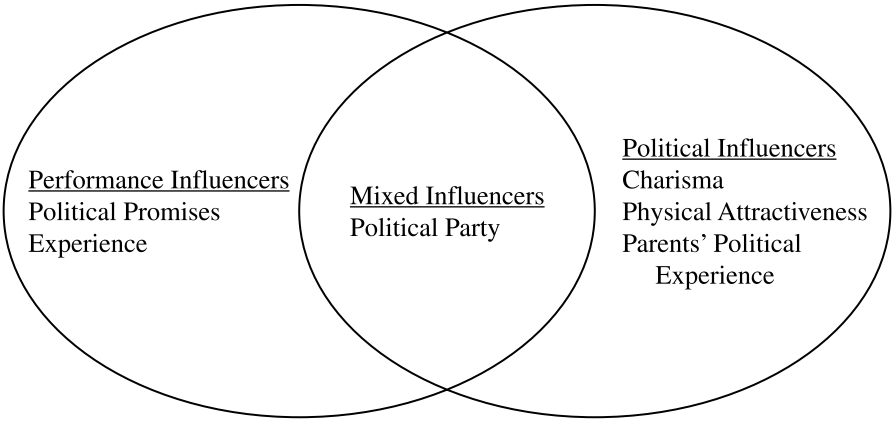
[117] *Id.* at 433 (reporting the "most severe" negative returns when dissidents gain majority control).

[118] *Id.*

II
The Politics of Shareholder Voting

In political elections, voters cast their votes with any number of objectives in mind. To be sure, some voters may be exemplars of the rational consumer of microeconomic theory. They may, in other words, be self-interested and able to discern what choices serve their own ends. Such voters make their voting decisions based on the incumbent's prior performance at managing government or expectations about the challenger's future performance. Even in these cases, however, permutations abound. For illustration, consider how different voters might approach their decisions to support a challenger. Perhaps a voter has cast her vote because a candidate promises to reduce taxes, extend unemployment benefits, or work to overturn an unpopular court decision through legislation. A voter may be influenced by any one of these considerations or some combination of all three. Similarly, for the incumbent, voters may refuse to reelect based on any number of indicators of poor prior performance. Perhaps the incumbent failed to deliver on important public policy objectives or political promises.

Diagram 1: Dynamics of Political Voting



As Diagram 1 suggests, however, some influences on voter decision making in political elections are not exclusively performance-based. The middle of the diagram illustrates the notion that voters in political elections also make their decisions based on mixed indicators—considerations that may be partly hinged on performance and partly tied to other values. As illustrated on the right-hand side of the diagram, voters in political elections may make up their minds based on criteria that have little at all to do with the potential (or prior) performance of the candidates. Voters may support a challenger because she exhibits the most charisma or other attractive personal characteristics; the challenger and the voter share a similar background; the challenger's political consulting agency put together a funny television commercial; the challenger is a snappy dresser; or the challenger simply energizes voter excitement.[119] Incumbents in political elections may be reelected by their constituents based on non-performance criteria, including name recognition and high visibility. Thus, in political elections, neither challengers nor incumbents would presuppose that their performance will be the decisive issue for all voters, in all elections, all of the time.

DIAGRAM 2: DYNAMICS OF CORPORATE VOTING

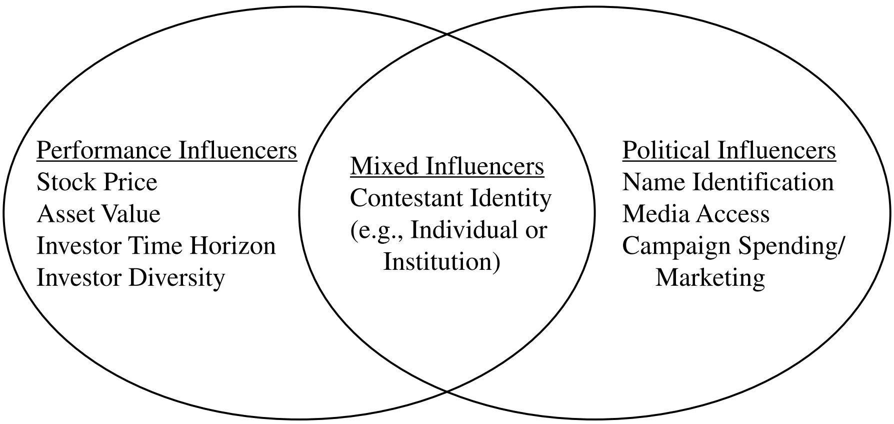


Diagram 2 illustrates that a similar set of complex dynamics may be at work in corporate elections as well. Shareholders, like political voters, may not be exclusively driven by a cold, hard calculation about whether the current officeholder has performed well or whether the challenger can be expected to perform well, as other commentators have suggested.[120] Instead, other, non-performance-based factors seem to influence election results.[121] Like voters in political elections,

[119] *See* Squire, *supra* note 16, at 893 (noting that candidates with appealing personal characteristics, such as physical attractiveness, oratorical skill, and "telegenic appeal" tend to run competitive campaigns).

[120] *See, e.g.*, Easterbrook & Fischel, *supra* note 1, at 405–06 ("[T]he shareholders of a given firm at a given time are a reasonably homogeneous group with respect to their desires for the firm. . . . This suggests . . . why the law makes no effort to require firms to adhere to any objective other than profit maximization . . . ."); Manne, *supra* note 71, at 1442 (arguing that the commonality of interests among shareholders of a corporation "sharply differentiates the politics of the corporation from the politics of government").

[121] It should be mentioned that shareholder-voters, particularly institutional shareholders, may also be influenced by proxy advisory firms. Since the 1980s, firms like

voters in corporate elections have varying objectives when casting their votes.[122]

To be sure, shareholders may cast their vote in corporate elections solely based on whether they are satisfied with managerial performance. Even then, just as in political elections, there are endless scenarios. Shareholders may have varied economic interests based on different investment time horizons or portfolio diversification, as an emerging line of scholarship by this author and others demonstrate.[123] Some shareholders may have a fully diversified set of investments that would make them more willing to take on risk with respect to a particular firm, while other shareholders may have more of their investment capital tied up in a handful of firms, which would make them more likely to want to avoid unnecessary risk.[124] The varying appetites for risks would also spill into how these shareholders vote, for whom they

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Institutional Shareholder Services, Glass, Lewis & Company, and Egan-Jones have provided recommendations to institutional shareholders about how to vote their shares. Although the impact of these advisors is beyond the scope of this Article, the effect of their influence remains an open question. For instance, in an effort to confront speculation that some advisors can shift 30% of a given vote, Professors Stephen Choi, Jill Fisch, and Marcel Kahan recently conducted an empirical evaluation and found that, while important, the influence of proxy advisors is likely overblown. They estimate that the most prominent proxy advisor shifts, at most, 10% of votes. Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 906 (2010) [hereinafter Choi et al., *Myth or Reality*]. Furthermore, recommendations from proxy advisors may themselves be influenced by a range of factors that are not based on performance. For instance, commentators have criticized some proxy advisors for providing both consulting services to firms and advice to shareholders of those same firms. These critics have alleged that proxy advisors' dependence on consulting revenue creates conflicts of interest that may taint their voting advice. *See* Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 657–58 (2009) [hereinafter Choi et al., *Director Elections*] (summarizing the criticism of proxy advisors).

122 *See* Paul H. Edelman & Randall S. Thomas, *Corporate Voting and the Takeover Debate*, 58 VAND. L. REV. 453, 463 (2005) (criticizing the view that "all shareholders are homogenous, so that they respond to the same signal—the company's stock price as set by omniscient market-makers—in deciding how to vote"). According to Edelman and Thomas, shareholders have heterogeneous interests based on (1) different values ascribed to shares; (2) number of shares owned, which affects shareholder view on the power of voting and thus participation; and (3) whether the shareholder has a fiduciary duty, which affects whether the shareholder will listen to advisors. *Id*.

123 *See, e.g.*, Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564–65 (2006) (discussing heterogeneous interests among shareholders); Edelman & Thomas, *supra* note 122, at 456 (identifying six core shareholder groups and noting differences in voting behavior); Christopher Gulinello, *The Retail-Investor Vote: Mobilizing Rationally Apathetic Shareholders To Preserve or Challenge the Board's Presumption of Authority*, 2010 UTAH L. REV. 547, 566–71 (describing fragmented shareholder interests); Harris, *supra* note 63, at 128–35 (discussing the different interests of hedge funds and retail investors).

124 *See generally* HARRY M. MARKOWITZ, PORTFOLIO SELECTION: EFFICIENT DIVERSIFICATION OF INVESTMENTS (1959) (discussing efficient risk-taking as a function of portfolio diversity).

vote, and which proposals they support. Complicating the matter even further, Diagram 2 attempts to illustrate that many shareholder-voters may not be greatly influenced by economic considerations. For example, many shareholders do not use the stock price as shorthand for whether to keep incumbent managers in place or replace them in contests for director positions. Nor do they only look at a basket of similar investments when evaluating proposals. Instead, shareholder-voters are motivated by the same broad range of considerations that motivate participants in political elections.

A. Proposals

A political theory of corporate voting suggests that shareholders do not exclusively base their proposal votes on whether the proposal will enhance firm value. Instead, shareholders evaluate proposals based on an array of economic and political considerations. Consider how proponents of the competing theories would analyze shareholder voting on proposals to raise executive compensation, a proposal routinely submitted by managers. An economic theory of shareholder voting would interpret shareholder opposition to these plans as consistent with shareholder preference for strategies that enhance firm value. By comparison, a political theory of shareholder voting behavior might conclude that shareholder rejection of executive compensation plans could be about the packaging and sensationalism of such plans. That is, shareholders might reject such plans, not because of a review of the plans on the merits, but because such plans have been vilified in the press, creating a negative public impression of them.[125]

Now, consider how a proponent of the political theory would interpret the empirical findings. Recall, for instance, that the available empirical research has shown that the identity of a proposal's proponent seems to be an important consideration to shareholder-voters.[126] Economists would interpret this finding to mean that shareholders use proponent identity as a ready heuristic for distinguishing frivolous proposals from those that are more likely to enhance firm value.[127] The explanations offered by economists do not explain why a shareholder would vote against a proposal submitted by an individual, but vote in favor of the identical proposal when submitted by an institutional investor. In any event, the vast majority of shareholder-voters

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[125] *See* Devin Leonard, *Bargains in the Boardroom?: As Congress Hovers, C.E.O. Pay Slips*, N.Y. Times, Apr. 4, 2010, at BU1 (reporting that C.E.O. compensation decreased in 2008 and 2009 amid the financial crisis and calls for executive compensation reform).

[126] *See supra* notes 98–100 and accompanying text.

[127] *See supra* note 101 and accompanying text.

are institutional investors. These entities do not need shorthand to sort through information that may be expensive, or otherwise difficult, to procure. Rather, these institutions have the resources, the ability, and the duty to stay apprised of the content of shareholder proposals. Thus, a theory of shareholder voting that takes into account other considerations has more interpretative appeal. In political elections, after all, voters routinely care about the identity of the proponent.[128] In politics, perennial candidates who may be qualified for office may have a poor reputation because of their frequent runs and, thus, very little chance of generating high levels of support. The same may be true in corporate elections. In the corporate sphere, several challengers routinely make challenges to the board's leadership at once. These gadfly challengers generally get lower levels of support than others.[129] A political theory of shareholder voting, therefore, can better account for the voting results that correlate with sponsor identity.

B. Director Elections

Similarly, a political theory of corporate voting would suggest that director elections—contests over who shall control and lead U.S. public companies on the board of directors—are not exclusively about the director's performance (or the challenger's expected performance, as the case may be). In fact, proponents of a political theory of corporate voting would argue that shareholder votes for incumbent directors do not represent a true endorsement of firm strategy per se, and as such, may do very little to discipline underperforming managers. The political theory complicates the traditional law and economics understanding of how managers respond to a contested director election. The accepted wisdom of economists is that the managers respond to challenges (or even the threat of challenges) by adjusting their conduct to meet shareholder economic interests. But if director election outcomes are a function of something else, then politically savvy managers at underperforming firms may have little to fear regarding a potential director election.

Furthermore, a political theory of corporate voting does a better job of explaining and predicting outcomes in contested director elections. Based on the available evidence, challengers in proxy contests have not fared well. For instance, as this author found in an earlier

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[128] *See supra* note 119 and accompanying text (noting non-performance criteria routinely considered by voters in political elections).

[129] Gillan & Starks, *supra* note 1, at 288, 290 tbl.6 (finding that "gadfly investors" typically received voting percentages significantly lower than "prominent individuals").

study, challengers rarely launch proxy contests for control and, when they do, they lose more than half of these voting contests to incumbents.[130] Furthermore, somewhat similar to shareholder proposals, the evidence suggests that proxy contests do not necessarily improve firm value. An economic approach to analyzing contested director elections argues that challenger success is strongly correlated with the challenger's prospects for improving firm value relative to incumbents. In this view, a challenger's loss in these contests might be attributable to its failure to offer a credible vision for how to improve firm performance. However, as the argument here has suggested, challenger success or loss during contested director elections might be as much a function of political skill as it is a function of potential to improve firm performance. In this view, shareholders may be casting their votes to support the most politically skilled contestants just as often as they throw their support behind the contestant with skill to enhance value.

Finally, the complexity of shareholder voting may explain why studies have reported that shareholder support for proposals or challengers in contested director elections does not necessarily improve firm value, as predicted by economists. As discussed previously, an economic theory would predict that shareholder-voters would be singly motivated to vote for whichever choice is likely to maximize firm value. If true, one can expect that, more often than not, shareholder support for proposals or challenger nominees would likely lead to a positive market reaction or other indications of improvement to firm value. Of course, the available empirical research tends not to back up this prediction.[131] However, a political theory of shareholder voting is deft enough to deal with these findings. Under a political theory, shareholder support may not necessarily translate into improvements in firm value. Since the shareholder-voter is not necessarily motivated by economic interests, how she will vote may be indeterminate. The number of influences on shareholder-voters is varied and not necessarily amenable to simple (economic) interpretation.

III
Evidence of the Politics of Shareholder Voting: Contested Corporate Elections

In this Part, the author's purely theoretical claims are put to the test. Using a hand-collected data set of contested corporate election results from recent years (2006–2009), this Part lends empirical sup-

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130 Harris, *supra* note 63, at 126, 141–44.

131 *See* text accompanying notes 105–09 and 115–17.

port to the central thesis of this Article: Like voters in political elections, voters in corporate elections are influenced by political interests. This Part focuses on the outcome of elections in contested corporate contests, which are typically contests over seats on the firm's board of directors.[132] The author compares the explanatory power of a standard economic variable (long-term stock price returns) and a political variable (money spent on campaigning) on election outcomes. Based on the data, directors' ability to enhance firm value (as measured by stock price returns) is not significantly related to whether they win reelection. Rather, the likelihood of being reelected to office appears to be a function of typical election politics—how much the contestant spent on the campaign.

In the typical contested director election,[133] shareholders vote on whether to return the incumbent directors to the board or to replace the directors with the challenger's slate of one or more director nominees. Shareholder-voters, in these cases, will have an option of ousting the current director(s) and electing their replacement(s). Why analyze contested director elections? Since firm decision making is reposed in the hands of the board,[134] the particular slate of nominees that shareholders vote for in director elections matters a great deal. Although they occur rarely, contested director elections are arguably one of the most significant voting events for the firm.[135] The results of these elections are significantly more consequential than the results of the typical, ho-hum uncontested director election or elections over shareholder proposals.

According to a pure economic theory of shareholder voting, contested director elections give the rational shareholder (if such a person

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132 Although these proxy contests are usually over seats on the board of directors, this is not always the case. *See, e.g.*, Harris, *supra* note 63, at 117 n.40 (suggesting that 83% of contested corporate elections involved board seats).

133 In some ways, no contested director election is "typical," since directors typically run unopposed and many firms still use plurality voting schemes. Thus, in typical elections for director seats, incumbent directors are guaranteed to return to office so long as they receive one vote. *See, e.g.*, *id.* at 140 n.117. This Article considers the small sample of cases in which directors face opposition for their board seats.

134 *See* DEL. CODE ANN. tit. 8, § 141(a) (2010) (stating that a corporation shall be managed by its board of directors); MODEL BUS. CORP. ACT § 8.01(b) (2005) (providing that power is centralized in the board of directors); *see also* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 41–42 (Del. 1994) ("[A] fundamental principle [of Delaware corporate law is] that the management of the business and affairs of a Delaware corporation is entrusted to its directors . . . .").

135 *See* Choi et al., *Director Elections*, *supra* note 121, at 660–61 (remarking on the importance of director election votes, since the votes determine who will manage the corporation).

exists) a chance to reward effective boards and punish bad ones.[136] But if shareholder-voters, like voters in political elections, make decisions based on a hodgepodge of various economic and political interests, directors might be reelected or ousted regardless of their prior performance. This Part presents empirical findings showing that how shareholders cast their votes defies the tidy narrative of classic economics.

A. Preliminary Evidence

Before getting to this study's results, some of the research findings in prior studies seem to offer some basic support for the claim that shareholder-voters have varied economic and political interests. For one thing, consider the frequency of shareholder proposals unrelated to issues that are likely to maximize firm value. Although some may be strictly seeking publicity, the number of campaigns driven by non-economic considerations suggests that at least some activist shareholders believe that there are plenty of other shareholder-voters that might be motivated by considerations other than those that are strictly economic.[137] In Canada, 15% of shareholder proposals submitted concern social, ethical, or environmental issues.[138] In the United States, Thomas and Cotter reported that in their sample of 1454 proposals, more than a quarter of the proposals submitted (27.7%) were related to social responsibility, the environment, or social issues.[139] In fact, their research shows more proposals were submitted on these types of issues than proposals that aim to have an effect on firm value, like proposals related to external corporate con-

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[136] *See supra* notes 68–78 and accompanying text (explaining that the standard economic account depicts contested director elections as a shareholder referendum on director performance).

[137] For instance, in the now famous case of *Pillsbury v. Honeywell*, activist shareholder Charles Pillsbury began a campaign for shareholder votes with social, rather than economic, objectives in mind. *See* State *ex rel.* Pillsbury v. Honeywell, Inc., 191 N.W.2d 406, 408–09 (Minn. 1971). In that famous case, Pillsbury challenged Honeywell to reveal its shareholder ledger, so that he could contact his fellow shareholders and begin a campaign to end Honeywell's involvement in the Vietnam War. Pillsbury admitted he intended to vote without an eye toward profitability and that he wanted to encourage other shareholders to do the same. *Id. Pillsbury* was not an aberrant case. Many other shareholders have also invested with an eye toward the social consequences of firm decision making. *See* Fairfax, *supra* note 10, at 84–85 (noting that socially responsible investment funds, faith-based organizations, and both union- and public-sponsored pension funds have all invested with an eye toward social concerns).

[138] Yang et al., *supra* note 90, at 13.

[139] *See* Thomas & Cotter, *supra* note 9, at 373–74 (counting 106 "environmental/social proposals" and 297 "other social responsibility proposals").

trol (22.6%), internal corporate control (18.6%), and compensation issues (27.3%).[140]

Shareholders who submit proposals with an eye toward social consequences are sometimes correct to suppose that other shareholders will vote in favor of such proposals.[141] In a recent paper, one scholar, Lisa Fairfax, notes several instances where a significant portion of shareholders voted for proposals plainly aimed at social goals.[142] Fairfax notes that in recent years, social proposals have garnered, on average, close to 27% of the vote.[143] Additionally, researchers have suggested that some institutional investors may have conflicts of interest that may drive their voting decisions.[144] In many cases, these conflicts turn out to be political in nature. Notably, Roberta Romano has carefully chronicled the political pressures on trustees and other overseers of public institutional investments (pension funds).[145] Typically, researchers have suggested that these conflicts may push some institutional voters to side with management, since the firms targeted by such proposals may be customers of one of the institution's other lines of business.[146] For instance, an investment bank acting in its capacity as a fund manager might vote to support management in order to maintain its underwriting and transactional business with the target firm. More than twenty years ago, Harvard's John Pound gave this example: "[A]n insurance company may hold a significant portion of a corporation's stock and concurrently act as its primary insurer. Voting against management may significantly affect

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140 *See id.* (noting 329 external corporate control proposals, 271 internal corporate control proposals, and 397 compensation proposals); *see also* Fairfax, *supra* note 10, at 88 (noting that in 2006, social proposals outnumbered proposals "on every corporate governance issue other than majority vote and pay-for-performance proposals").

141 For an early example of shareholders voting against their direct financial interests, including a discussion about how shareholders of Endicott Johnson—who were also residents of Endicott, New York—voted to keep the firm local, see Manne, *supra* note 32, at 417 & n.54.

142 *See* Fairfax, *supra* note 10, at 87–88 (arguing that "traditional shareholders can be counted on to use their increased [voting] power to support social investors who advance stakeholder issues").

143 *Id.* at 88 ("[T]he average shareholder support for social proposals went from 18% in 2005 to close to 27% in 2006.").

144 *See, e.g.*, Pound, *supra* note 25, at 242–43 (discussing the possible conflicts of interest for institutional voters in director elections at firms where such institutional investors have other business interests).

145 *See* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 814–20 (1993) (providing several examples in which the pursuit of shareholder activism by public pension funds was influenced by state politicians and interest groups).

146 George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 904 (discussing conflicts of interest as reasons for voting with management).

the firm's business relationship with this incumbent management and perhaps others as well, whereas voting with management results in no obvious penalty."[147]

To some degree, institutional shareholder voting synchronizes snugly with the basic economic theory in which institutional voting decisions can be understood to be a function of institutional shareholders looking out for their best economic interests. On the other hand, the lens of politics helps explain observed institutional voting behavior that cuts in the other direction. In her earlier research, Romano noted that some elected and appointed overseers of public pension fund resources seemed to make pension fund decisions based upon whether the decisions would generate positive media attention for the fund manager and perhaps in order to put themselves in a position to run for higher public office.[148] In these cases, it appears that the political ambitions of some of those in control of institutional votes may push them to oppose management and side with shareholders. The point is that the available evidence on shareholder conflicts of interest suggests that shareholder voting behavior—even institutional shareholder behavior—may be a function of a broader set of influences than simply an appraisal of whether the item voted on can be expected to maximize shareholder value.

B. Descriptive Evidence

Almost all of the data in this study is hand-collected and comes from proxy statements. Publicly traded firms are required to file these proxy statements prior to initiating a corporate election.[149] The statements are long,[150] heavily regulated documents. They include various disclosures, including the meeting date, location of the meeting where a vote will take place, and voting instructions for shareholder-voters.[151] The initial sample includes every proxy statement for pub-

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147 Pound, *supra* note 25, at 243.

148 *See* Romano, *supra* note 145, at 822 (discussing Elizabeth Holtzman, New York City Comptroller, and candidate for U.S. Senate); *see also* Joseph A. Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 Bus. L. 361, 381 (2010) (speculating that politicians serving on pension boards have political incentives to support certain candidates for the board).

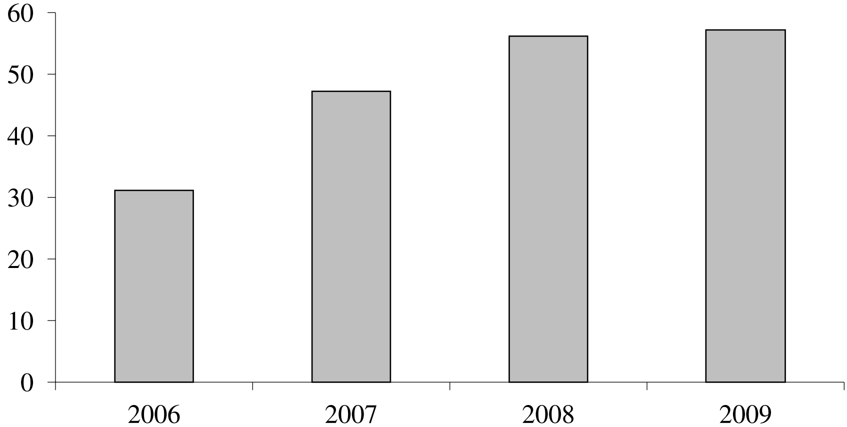
149 *See* Schedule 14A, 17 C.F.R. § 240.14a-6(b) (2011). Proxy statements are publicly available at the SEC's database, EDGAR. *Filings and Forms*, SEC, http://www.sec.gov/edgar.shtml (last visited Mar. 3, 2011).

150 *See, e.g.*, Christopher Cox, Chairman, SEC, Closing Remarks to the Second Annual Corporate Governance Summit (Mar. 23, 2007), *available at* http://www.sec.gov/news/speech/2007/spch032307cc.htm.

151 17 C.F.R. § 240.14a-101.

licly traded firms that had a contested election in 2006, 2007, 2008, and 2009.[152] During this period, there were 190 contested elections.[153]

DIAGRAM 3: CONTESTED DIRECTOR ELECTIONS BY YEAR



In addition to the proxy statement, other firm-specific information is taken from Compustat, a popular provider of firm, industry, and market data.[154] Other data on proxy contest characteristics, like election outcomes, comes from Georgeson, a leading industry consultant.[155] Table 1 (below) summarizes the variables used in the remainder of this Part. The most important variables used in this study are stock price return—an indicator of director performance—and campaign expenses—an indicator of the importance of political interests to shareholder-voters.

152 Several observations were dropped because of missing data.

153 Out of more than 11,000 public companies, only approximately thirty-five firms have experienced an election contest each year in recent years. Harris, *supra* note 63, at 120–21. Because of the rarity of these contests, there is good reason to be careful not to extrapolate too much about shareholder voting behavior generally, given that most of the time, most shareholders never get a chance to vote in these types of contested corporate elections. Furthermore, the small number of cases may also reduce the robustness of the results.

154 CAPITAL IQ COMPUSTAT, http://www.compustat.com/ (last visited Mar. 3, 2011).

155 GEORGESON, http://www.georgeson.com/ (last visited Mar. 3, 2011).

TABLE 1: VARIABLES

Contestant Expenses	**Description**	**Source of Data**
Challenger Expenditures	Challenger estimated expenditures on corporate election	Challenger Proxy Statement
Incumbent Expenditures	Incumbent estimated expenditures on corporate election	Incumbent Proxy Statement
Incumbent Performance		
Long Term Prior Performance	5 year total stock price return (less S&P 500 return)	Compustat
Short Term Prior Performance	1 year total stock price return (less S&P 500 return)	Compustat
Firm Ownership Structure		
Market Value of Outstanding Stock	Market price of shares at the end of the calendar year (preceding the contest) multiplied by the number of shares outstanding	Compustat
Incumbent Ownership Percentage	Percent of outstanding shares held by target firm executives and officers	Incumbent Proxy Statement
Challenger Ownership Percentage	Percent of outstanding shares held by challenger contestant	Challenger Proxy Statement
Challenger Identity		
Individual or Institutional Challenger	Whether challenger is an individual or institutional investor (1=Individual Challenger)	Georgeson
Outcome		
Contest Results	Dummy variable capturing the outcome of contested corporate elections (2006–2009) (1=Challenger Won Dispute)	Georgeson

1. Campaign Expenses

In an attempt to capture some of the influence of political indicators on contested director elections, the results include a control for the amount of money that contestants spent on director elections. In political elections, the importance of money to election results is a well-worn topic.[156] Yet, no previous study of voting behavior in corpo-

156 *See, e.g.*, Spencer Overton, *The Donor Class: Campaign Finance, Democracy, and Participation*, 153 U. PA. L. REV. 73, 77 (2004) (noting that wealthy donors "effectively

rate elections has tested the impact of persuasive spending by the contestants on shareholder voting behavior.[157] Of course, campaign expense estimates are not a perfect indicator of the presence of a politicized environment. However, campaign expense is still a useful political variable for at least two reasons. First, other "political" variables—candidate charisma, for example—are difficult to quantify and record.[158] Second, money spent on campaigning is related to other political indicators and is a useful indicator for their presence. In political elections, for instance, campaign fundraising can be used to purchase media, enhance visibility and name identification, and even to hire a consultant to help with charm and charisma.[159] The same dynamic may be present in corporate elections: The hypothesis is that the more money a contestant spends on a corporate election, the more likely they are to win it, regardless of indicators of performance. Thus, throughout the study, the results include estimates of campaign expenses as a potential determinant of outcomes of director elections. As can be seen in Table 2, challengers estimated that they would spend, on average, close to $600,000 to participate in firm elections. Meanwhile, incumbents budgeted nearly twice this amount.

2. *Firm Performance*

Similar to other studies of shareholder voting behavior, this study controls for firm performance.[160] For economists, the predicted effect

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select[ ] which candidates will be viable"); Jamin Raskin & John Bonifaz, *The Constitutional Imperative and Practical Superiority of Democratically Financed Elections*, 94 COLUM. L. REV. 1160, 1174 (1994) (arguing that campaign-related spending means that only individuals of substantial means can put on viable campaigns); *see also* McConnell v. FEC, 540 U.S. 93, 147–49 (2003) (noting that both wealthy donors and fundraising politicians understand that campaign donations are intended to serve the purpose of securing influence), *overruled on other grounds*, Citizens United v. FEC, 130 S. Ct. 876, 913 (2010).

[157] In a prior study by this author, the possibility of a relationship between campaign spending, shareholder voting, and election outcomes is noted. *See* Harris, *supra* note 63, at 145–46, 151.

[158] *See, e.g.*, John G. Matsusaka & Filip Palda, *Voter Turnout: How Much Can We Explain?*, 98 PUB. CHOICE 431, 432 (1999) (noting the difficulty of measuring certain variables, such as "sense of citizen duty," in explaining voter turnout).

[159] *See* Nice, *supra* note 28, at 466 (suggesting that money matters more for challengers because it builds their name identification and visibility); Partin, *supra* note 14, at 215 (mentioning the name recognition advantage of incumbents).

[160] *See, e.g.*, Gillan & Starks, *supra* note 1, at 293 (discussing the use of five-year buy-and-hold returns as a measure of firm performance); Gordon & Pound, *supra* note 37, at 707 (noting the use of stock price returns as a measure of firm performance); Strickland et al., *supra* note 42, at 327 (using two-year buy-and-hold returns in their study of shareholder proposals); Wahal, *supra* note 90, at 15 (arguing that buy-and-hold returns are a good measure of firm performance); Yang et al., *supra* note 90, at 19 (using five-year relative return as a firm performance measure in a study of shareholder proposals). In addition to long-term stock price returns, some authors have used returns from shorter periods. *See,*

of stock price returns would be negative.[161] Economists would surmise that directors of relatively poor performing firms (as measured by stock price returns) would be unlikely to be reelected to the board of directors. Here, firm performance is measured over both the short– and long-term, prior to the director elections. Specifically, the study uses the one-year/five-year buy-and-hold return on stock in the target company less than return on investment in the S&P 500. The average returns of target firms are consistent with the empirical findings of other studies. That is, in terms of short-term and long-term performance, it appears that targets that experienced a contested corporate election were underperformers overall. For instance, Table 2 suggests that the short-term performance for targets was, on average, 7.65% less than the market. The long-term performance, on average, for targets was nearly two percentage points (-1.82) below the average.

3. *Other Variables*

In addition to stock price return and campaign expense, the following study controls for several other variables typically examined by other investigators of shareholder voting behavior. These indicators include: (1) firm size, (2) share ownership structure, and (3) challenger identity.[162] First, firm size is measured as the market value of all outstanding common shares in the year in which the director election took place.[163] The expectation is that firm size is negatively related to challenger success in director elections.[164] That is, it is probably tougher to organize the ouster of directors at larger, more sophisticated firms.[165] Based on size, a wide range of firms experienced a con-

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e.g., Thomas & Cotter, *supra* note 9, at 380 (using one-year stock price returns). Shareholder voters should not, however, rely on stock price returns for shorter periods in the same way as long-term returns. A single poor annual return, for instance, may not be indicative of problems with a firm's management. *See* Gordon & Pound, *supra* note 37, at 712 (discussing the limitations of short-term stock price returns in a study of shareholder voting behavior).

161 *See supra* note 90 and accompanying text (describing studies which suggest that shareholder activism is more often directed at underperforming firms).

162 *See, e.g.*, Yang et al., *supra* note 90, at 18 (describing controls for their study of shareholder proposals at large Canadian companies).

163 *Cf*. Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1595 (2002) (measuring firm size as the market value of the firm's outstanding shares); Gordon & Pound, *supra* note 37, at 709 (describing the use of firm size as an independent predictor of vote share in proposal elections); Karpoff et al., *supra* note 54, at 375 (describing logistic regression to include the market value of equity).

164 *See* Thomas & Cotter, *supra* note 9, at 381 (discussing the negative effect of firm size on support for shareholder proposals).

165 A counterargument might be that proponents of change might actually target larger firms. In some instances, shareholders are likely to realize more gains from bringing proposals at larger firms, where the gains from any resulting improvements would be more

tested corporate election during the sample period—from huge behemoths, like Motorola (market valuation of approximately $36 billion) and CVS (market valuation of approximately $58 billion), to tiny firms, like Team Financial, Inc. (market valuation of approximately $1 million).[166]

Second, like previous studies, this study controls for share ownership structure, including controls for insider ownership and challenger ownership.[167] The impact of insider ownership on election outcomes is straightforward. The expectation is that insiders—incumbents or management—will not support a change in the board,[168] because they will not want to lose their lucrative posts. To the extent that incumbents own shares, they will vote those shares against the challenger. Thus, one would expect insider ownership to be negatively related to votes to approve director ouster. As a consequence, this study includes controls for shares owned by directors and executives as reported in the firm's proxy statements. The reverse is also true. Obviously, challengers can be expected to vote their shares in favor of the challenge. The more shares the challenger owns the greater the probability that the challenger will win the election contest. Thus, this study also includes controls for both challenger ownership and incumbent ownership. On average, challengers in contested corporate elections control nearly 9% of target shares, compared with incumbents who control nearly 9.5% of target shares.

Third, in order to ascertain the influence of challenger identity on proxy contest outcomes, the author has broken out lead contestants into two types, individual investors and institutional investors, using information reported in the annual compilation of Georgeson.[169] Because of the large expense involved in mounting a challenge to incumbents, the vast majority of challengers are institutional investors. Table 2, below, reports summary statistics for each of the variables used in this study.

pronounced. In fact, some research has shown that proposals are more likely to be brought at larger firms. *See* Karpoff et al., *supra* note 54, at 380 (finding that the probability of receiving a proposal increases with firm size).

166 Market valuation information is pulled from Compustat, a database maintained by Standard and Poor's. The dates for maket valuation information reflect the year of the proxy contest.

167 *See* Choi, *supra* note 42, at 234 (noting that high insider ownership can affect voting outcomes); Yang et al., *supra* note 90, at 20 (including management ownership as a control in a study of shareholder proposals).

168 Ikenberry & Lakonishok, *supra* note 68, at 407 (discussing incumbent and challenger ownership as a factor in proxy contest outcomes).

169 *See supra* notes 98–100 and accompanying text (discussing previous studies that have found that identity matters to shareholder-voters).

TABLE 2: SUMMARY STATISTICS (AS OF MAR. 7, 2011)

	Obs.	Mean	S.D.	Min.	Max.
Contestant Expenses					
Challenger Expenditures (in thous.)	181	$594.47	$1,187.72	$0.35	$9,000
Incumbent Expenditures (in thous.)	161	$1,195.23	$3,005.30	$6	$22,000
Incumbent Performance					
Long Term Prior Performance	142	-1.82	25.32	-81.83	117.03
Short Term Prior Performance	166	-7.65	60.67	-94.38	491.36
Firm Ownership Structure					
Market Value of Outstanding Stock Issue (in hundred thous.)	141	$1,866	$6,456	$0.71	$56,733
Challenger Ownership Percentage	179	8.71	6.76	0	46.39
Incumbent Ownership Percentage	166	9.46	12.04	0	80.98
Challenger Identity					
Individual or Institutional Challenger (1=Individual)	189	0.25	0.44	0	1
Outcome					
Contest Results (1=Challenger Wins)	117	0.36	0.48	0	1
Contest Results (1=Challenger Wins or Splits)	127	0.41	0.49	0	1

C. Inferential Evidence

Table 3 compares winners and losers in director election contests over the last four years in terms of campaign budget, long-term performance, short-term performance, size, and insider/challenger ownership. For instance, consider two of the chart's points of comparison—challenger campaign budget and challenger ownership stake. Consistent with an economic theory of shareholder voting, one would expect challengers to win contested director elections when firm performance has been weak.[170] The reported findings seem to match intuition. Though not statistically significant, the chart shows that winning challengers had higher ownership percentages at target firms than challengers who ultimately lost their campaigns. Additionally, compared to losing challengers, winning challengers targeted firms where both long-term and short-term performance was lower relative to the market. This is consistent with what most economic theorists would predict. In fact, Table 3 provides that the five-year relative return on

[170] *See supra* note 69 and accompanying text (explaining that economic theory predicts shareholders will vote against directors who perform poorly).

investment at firms where challengers won the contests was abysmal (-10.40%) compared with firms where challengers lost their campaigns (4.77%). The difference in long-term performance was statistically significant, but the difference in short-term performance was not.

What is also striking in Table 3, is that it shows a statistically significant difference in terms of the amount budgeted for campaign expenses. Successful challengers spent more on their campaigns than unsuccessful challengers. This difference in amount budgeted to put on a campaign for board seats is consistent with a political theory of shareholder voting. This finding signals, but does not prove, that persuasive spending seems to matter to the outcomes in contested director elections. Like in political campaigns, challengers who won contested director elections rely more on campaign spending to persuade shareholder-voters than those who lost these elections.[171] To give this difference some perspective, consider the raw numbers: Challengers in successful campaigns spent, on average, $730,912, compared to $468,969 spent, on average, in unsuccessful campaigns.[172] The difference in persuasive spending, however, does not take into account controls, the subject of the next section.

Reported above are t-statistics on paired differences at statistically significant levels of 1% (***), 5% (**), or 10% (*). Data is pulled from proxy statements for 2006, 2007, 2008, and 2009 and/or Compustat. In order to achieve a normal distribution, the following variables have been transformed: "Challenger Expense" is the natural log of challenger expense estimates, "Incumbent Expense" is the natural log of incumbent expense estimates, "Market Value of Outstanding Stock" is the natural log of the market price of shares at the end of the calendar year multiplied by the number of shares outstanding. All other variables are previously defined and unchanged. Data is pulled from proxy statements for 2006, 2007, 2008, and 2009, Compustat, and Georgeson. Wilcoxon-Mann-Whitney tests are also

171 These findings are consistent with an earlier, preliminary study by the author. *See* Harris, *supra* note 63, at 148–50. The earlier study reports findings over a three-year period and did not include one of the central variables in this study, relative return. *Id.*

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Challenger Spending (in thous.) in Director Election When Challenger Wins					
Percentile	10	25	Median	75	90
Amount	$55	$125	$250	$500	$700

Challenger Spending (in thous.) in Director Election When Challenger Loses					
Percentile	10	25	Median	75	90
Amount	$10	$70	$150	$350	$1300

TABLE 3: DIFFERENCE IN MEANS FOR SELECTED VARIABLES (AS OF MAR. 7, 2011)

Contested Director Elections Results	**Challenger Wins (Challenger wins=1)**	**Challenger Loses**		
	Mean	**Mean**	**Significant Difference?**	
			t-test	**Wilcoxon-Mann-Whitney**
Campaign Spending				
Challenger Expenses	12.45	11.75	Yes**	Yes*
Incumbent Expenses	12.10	12.02	No	No
Incumbent Performance				
5-Year Stock Price Returns	-10.40	4.77	Yes**	Yes***
1-Year Stock Price Returns	-13.19	-6.65	No	No
Firm Ownership Structure				
Market Value of Outstanding Stock	18.69	19.19	No	No
Insider Ownership Percentage	7.35	11.34	No	No
Challenger Ownership Percentage	8.80	8.02	No	No

reported for confirmation purposes only.[173] No data was transformed for Wilcoxon-Mann-Whitney tests.

The final set of findings further chips away at the classic economics approach to shareholder voting. The author conducts six logistic regressions.[174] The dependent variable is the outcome of recent contested director elections.[175] The results suggest that the prior performance of the incumbents is not related to contest outcome. This finding is consistent with other studies. For instance,

[173] "The Wilcoxon-Mann-Whitney rank test . . . can detect the difference between the medians of two samples from independent populations." RONALD DEEP, PROBABILITY AND STATISTICS WITH INTEGRATED SOFTWARE ROUTINES 618 (2006).

[174] *See infra* Appendix (discussing results).

[175] Outcomes of director elections come from Georgeson. The author did not include director elections that ended in a settlement or a split decision.

Thomas and Cotter's recent study of shareholder proposals did not report a statistically significant relationship between vote-share on shareholder proposals and short-term stock price returns.[176]

The only variables to show any statistically significant relationship to corporate election outcomes were incumbent ownership percentage, firm size, challenger identity, and challenger estimated expense. Of those variables, challenger estimated spending and firm size had a consistent, statistically significant relationship to election results. The nature of the relationship matches intuition. For challenger estimated expense, the data suggest that challenger expense was positively related to challenger success in contested director elections. The higher the level of challenger expense, the higher the odds that the challenger would win the contest. At the same time, it is worth noting that incumbent spending does not appear correlated with election outcomes. That is, while the relationship between challenger spending and proxy contest outcomes is statistically related, the relationship between incumbent spending and these outcomes is not. These findings are similar to the dynamics of political elections long discussed by political scientists. At least since 1978, political scientists have offered empirical evidence that electoral outcomes are influenced heavily by challenger spending.[177] Meanwhile, political scientists have found evidence that incumbent spending levels are a weak and inconsistent predictor of electoral outcomes.[178]

For firm size, the relationship was negative, as expected. Contestants, in other words, had a tougher time scoring a victory at larger firms. The other variables with a statistically significant relationship to election outcome—challenger identity and incumbent ownership percentage—were also negatively related to corporate election outcomes. As expected, incumbent ownership cuts against challenger success. Thus, the larger the incumbent's stake in the target firm, the less likely the challenger can be expected to win a contested corporate election. This finding makes sense, since one would expect that incumbents would vote their shares against the challenger.[179] Similarly, the findings suggest a negative relationship between electoral success and a challenger's status as an individual. Individual challengers seem to

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176 *See* Thomas & Cotter, *supra* note 9, at 382–83 (presenting the results from seven regression models).

177 Gary Jacobson's groundbreaking article was published in 1978. *See* Jacobson, *supra* note 28, at 488–89 (concluding that election outcomes are influenced by campaign spending).

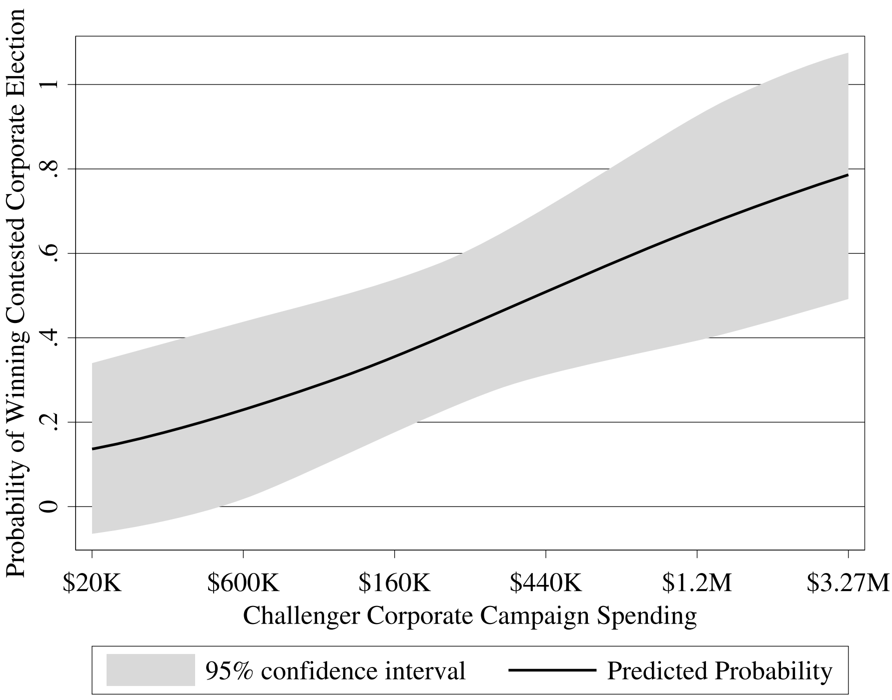
178 *See, e.g.*, JACOBSON, *supra* note 29, at 42 ("Incumbent spending has a much weaker, although properly negative impact on the challenger's vote . . . .").

179 For further explanation of this point, see *supra* text accompanying notes 56–59.

have lower odds of succeeding in a contested corporate election than institutional challengers.

Unlike linear regressions, the results of this study—a binary logistic regression—are difficult to interpret.[180] To give these findings some context, consider the following two figures that illustrate the effects of changes in challenger spending and firm size, respectively, on the probability of winning a contested election. The first figure shows the change in the predicted probability of winning a contested corporate election given the amount of money budgeted for the campaign. The shaded area is the 95% confidence interval. The first figure reveals that as the amount spent on director elections goes up, the probability of winning the contest also increases. The second figure charts the same relationship, but for firm size. It shows that as the firm increases in size, the probability of winning a contested corporate election decreases.

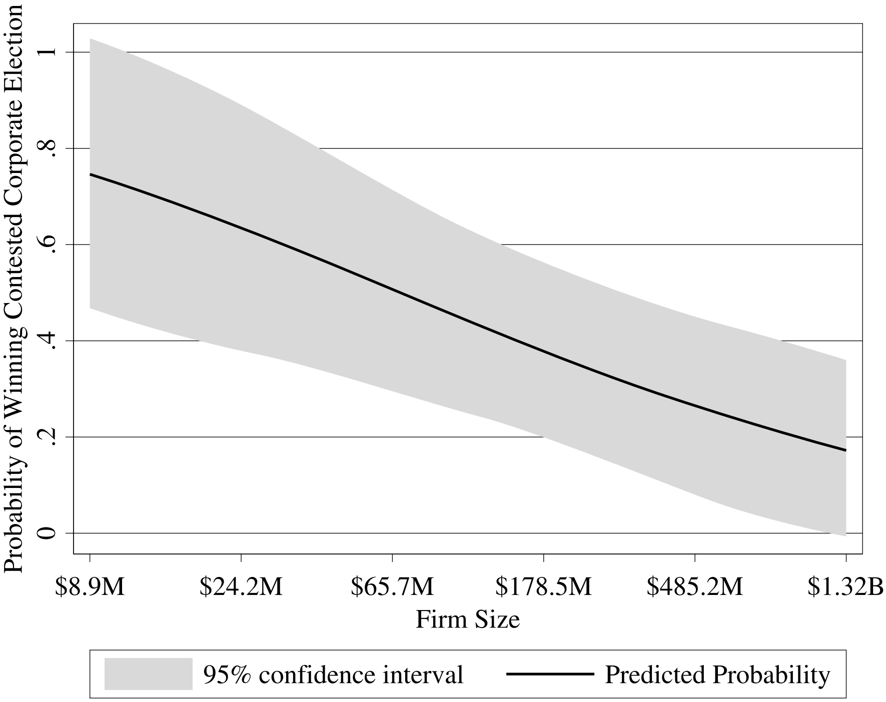
FIGURE 1: CAMPAIGN SPENDING AND ELECTION OUTCOMES



[180] *See* J. SCOTT LONG & JEREMY FREESE, REGRESSION MODELS FOR CATEGORICAL DEPENDENT VARIABLES USING STATA 3 (2d ed. 2006) (noting that non-linear models cannot be easily or fully interpreted because the effects of each variable depends on the level of all the other variables); D. James Greiner, *Causal Inference in Civil Rights Litigation*, 122 HARV. L. REV. 533, 554 (2008) (noting that a logistic regression is not as intuitive as other statistical techniques).

The figures report the predicted probability (based on Model Three in the Appendix) that a challenger will win a contested corporate election based on the amount of money the challenger estimates it will spend on the corporate campaign and firm size, respectively. Variables not illustrated in the graphic are fixed at their mean or modal value.

FIGURE 2: FIRM SIZE AND ELECTION OUTCOMES



At this point, a qualification is in order. The Model includes controls for factors that may influence the outcomes of these elections. However, as others have bluntly put it, "No social science study can control for all variables that might have influenced an outcome."[181] This is the problem of omitted variable(s) or "omitted variable bias." Although this study controls for all the traditional factors that might influence shareholder voting, it is nonetheless possible that the model omits some important variables. This may undermine the results. For instance, consider candidate quality, a variable not directly measured in this model. It is conceivable that campaign budgets are just a stand-in for candidate quality. In this view, it is not campaign budgets that

181 Deborah Jones Merritt & Barbara F. Reskin, *Sex, Race, and Credentials: The Truth About Affirmative Action in Law Faculty Hiring*, 97 COLUM. L. REV. 199, 225 (1997).

explain election results, as the findings suggest. Instead, shareholder-voters are simply supporting the most highly qualified contestant. If an omitted variable, like candidate quality, is significantly correlated with one or more of the independent variables, like campaign expenditure estimates, the results may be rendered questionable. It is possible that statistical significance may be erroneously attributed to the included variables (campaign expenditure), when the real influencer is the omitted variable (contestant quality).

Unlike in political elections, however, there is ample reason to believe that campaign budgets are not necessarily a sign of contestant quality. In political elections, campaign budgets may be a reasonable proxy for quality because candidates generally fundraise. Thus, candidates have to make appeals to potential donors, and whether they are able to raise large amounts of money may be a signal for how persuasive their campaign messages are. In corporate elections, by contrast, contestants do not fundraise and the expense of the proxy contest is borne by the contestant.[182] Thus, levels of spending are not an indication of approval from outside observers (such as a donor class).[183]

IV
Implications of the Politics of Shareholder Voting

The notion that voters in corporate elections are swayed by political considerations has significant implications in at least two respects: (1) shareholder voting reforms (particularly proxy access) and (2) the economic analysis of the market for corporate control.[184]

A. Proxy Access

First, in the area of shareholder voting reform, one of the most significant debates is about whether firms should help facilitate shareholder nominations.[185] Known as "proxy access," advocates argue that

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[182] *See* Harris, *supra* note 63, at 153–58 (explaining that challengers bear their own expenses in proxy contests).

[183] *Cf.* Squire, *supra* note 16, at 894 (noting that in political elections, it is difficult to infer anything about candidate quality from candidates that rely on their own financial resources).

[184] This phrasing—"the market for corporate control"—was coined and made famous by Henry Manne. *See generally* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. Pol. Econ. 110 (1965).

[185] *See* Cynthia J. Campbell et al., *Current Perspectives on Shareholder Proposals: Lessons from the 1997 Proxy Season*, 28 Fin. Mgmt. 89, 90 (1999) (noting that the SEC received 2000 comments in response to one of its proposals to change proxy access rules); Jeffrey N. Gordon, *Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy*, 61 Vand. L. Rev. 475, 475 (2008) (discussing

shareholders should be able to use the firm's proxy statement for more than just making proposals. Shareholders should also be able to use the firm's proxy to nominate directors to the board. If shareholders are able to nominate directors to the board by way of the firm's proxy statement, they will be able to make director nominations at little cost.[186] Whether to permit proxy access and at what level are key questions that have sparked clashes between regulators at the SEC, corporate law academics, and shareholder activists for at least the last decade.[187] In 2003, for example, the SEC proposed limited proxy access.[188] The SEC's proposal would have allowed shareholders, in very limited circumstances, to make director nominations using the firm proxy statement.[189] Under the proposal, shareholders who continuously held at least a 5% stake in the target for at least two years could make nominations to the board of directors.[190] Further, the SEC limited the number of nominations that could be made, such that proxy access would not lead to a change in control.[191] Also, the SEC proposed that shareholders would only have access if a large enough number of shareholders would withhold support on incum-

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the "debate over shareholder access to the issuer's proxy statement for the purpose of making director nominations"); Grundfest, *supra* note 148, at 386–87 (noting the thousands of comments received by the SEC regarding proposed proxy access rules).

186 *See* Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1264–69 (2009) (arguing in favor of proxy access).

187 *See, e.g.*, AFSCME v. AIG, 462 F.3d 121, 123 (2d Cir. 2006) ("[T]he Securities Exchange Commission . . . has ascribed two different interpretations to [Rule 14a-8(i)(8)]."); *see also* Fairfax, *supra* note 10, at 74 ("[T]he SEC staff initially took the position that such proposals could not be excluded from a corporation's proxy statement. However . . . the SEC staff eventually changed course and reversed this stance."); Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access* 3 (Univ. of Pa. Law Sch. Inst. for Law and Econ., Research Paper No. 11-05, 2011), *available at* http://ssrn.com/abstract=1769061 (calling proxy access "the SEC's most controversial rule-making initiative"). For a historical overview of SEC efforts to provide proxy access beginning in 1942, see generally *id.* at 5–12.

188 *See* Security Holder Director Nominations, 68 Fed. Reg. 60,784, 60,803 (proposed Oct. 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, 274) ("[W]e are proposing a limited exemption from certain of the proxy rules that would enable security holders to communicate for the limited purpose of forming a nominating security holder group without filing and disseminating a proxy statement."); *see also* Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. L. 43, 43 (2003) (noting that the SEC "last spring began a process of considering changes in the proxy rules that would require companies, under certain circumstances, to include in their proxy materials shareholder-nominated candidates for the board").

189 *See* Security Holder Director Nominations, 68 Fed. Reg. at 60,803.

190 *See* Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L.J. 205, 211–12 (2005) (describing the requirements of SEC Rule 14a-11).

191 *See id.* at 212 ("Shareholders could only nominate between one and three directors . . . .").

bent board members.[192] Ultimately, however, the proposal died a slow, lonesome death.[193] The SEC tried again in 2007.[194] In a similar proposal, which was later also abandoned by the agency, the SEC proposed that shareholders be able to amend a firm's bylaws in order to create a mechanism for shareholders to nominate candidates directly on the firm's proxy statement.[195] Finally, in 2010, the SEC proposed Rule 14a-11.[196] The proposed rule would require firms to permit shareholders to make director nominations through the firm's proxy statement.[197] The rule would limit proxy access to long-term holders who own a significant stake in the firm.[198] In this way, the shareholders incur no (or very few) costs to solicit votes for their proposed nominees.[199] According to the SEC, this latest effort at reform will create conduits for shareholders to compete for board seats, get more shareholder-nominated candidates elected to the board, and discipline incumbent managers.[200] Almost immediately, the Business

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192 *See* Security Holder Director Nominations, 68 Fed. Reg. at 60,790 (proposing a requirement of a "more than 35% security holder withhold vote, based on votes cast"); *see also* McDonnell, *supra* note 190, at 211–12 (describing the 35% withhold vote trigger).

193 *See* Gordon, *supra* note 185, at 484 (remarking that the 2003 proposal was never adopted by the SEC and "it ultimately faded away despite never being formally withdrawn"); McDonnell, *supra* note 190, at 212 (noting that the 2003 proposal appeared "to be dead"). For a summary of the 2003 proposal, see generally Gulinello, *supra* note 123, at 557–58.

194 *See* Shareholder Proposals, 72 Fed. Reg. 43,466, 43,466 (proposed Aug. 3, 2007) (to be codified at 17 C.F.R. pt. 240) ("Proposed amendments to Exchange Act Rule 14a-8 would enable shareholders to include in company proxy materials their proposals for bylaw amendments regarding the procedures for nominating candidates to the board of directors.").

195 *See id.*

196 Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,668 (proposed Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249) ("The new rules will require, under certain circumstances, a company's proxy materials to provide shareholders with information about, and the ability to vote for, a shareholder's, or group of shareholders', nominees for director.").

197 *See id.* The proposed rule excludes control contests. *See id.* at 56,669 (providing that a shareholder-challenger shall "not hold the securities with the purpose, or with the effect, of changing the control of the company or gaining more than a limited number of seats on the board").

198 Facilitating Shareholder Director Nominations, Exchange Act Rel. No. 62,764, at 108 (Aug. 25, 2010) (limiting shareholder nominations rights to shareholders that control 3% of outstanding shares and have continuously held their stake for the previous three years).

199 *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,073 (proposed June 18, 2009) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249, 274) ("Proposed new Rule 14a-11 would reduce both the direct and indirect costs of the proxy solicitation process."). In "2003, 2004, and 2005 the average cost to a soliciting shareholder of a proxy contest [was] $368,000. The costs included those associated with proxy advisors and solicitors, processing fees, legal fees, public relations, advertising, and printing and mailing." *Id.*

200 *See* Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,669 (noting the disciplinary effect of proxy access); *id.* at 56,670 (noting comment letters suggesting that proxy access would facilitate incumbent ouster and change in a board's composition);

Roundtable filed suit.[201] As a consequence, the SEC delayed implementation of the rule until the suit was resolved.[202] As it stands currently, a three judge panel for the D.C. Circuit Court of Appeals has ruled that the latest proxy access rules violate the Administrative Procedure Act.[203] The SEC has not yet disclosed its next steps, though an appeal to the U.S. Supreme Court may be next.[204]

Regardless of how the case is resolved, the point is that the debate about proxy access reforms fails to take into account the political dynamics that attend to shareholder voting.[205] Most importantly, these types of reform do not account for the importance of marketing or political-style persuasion on shareholder voting.[206] Under the SEC's current approach, the board of directors is not required to

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id. at 56,762 (assuming shareholder victory in election contests if shareholders are permitted proxy access).

201 *See* Fisch, *supra* note 187, at 16 (summarizing the claims in the Business Roundtable lawsuit).

202 *See* Grundfest, *supra* note 148, at 367–68, 377 (discussing the SEC's decision to delay Rule 14a-11 and noting the associated challenges from the Administrative Procedure Act). The unexpected turn of events and delay in implementation has created a natural experiment—specifically, an opportunity for researchers to investigate whether proxy access, as proposed by the SEC's new rule, improved firm value. *See, e.g.*, Bo Becker et al., *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge* 1 (Harvard Bus. Sch., Working Paper No. 11-052, 2010), *available at* http://www.hbs.edu/research/pdf/11-052.pdf (finding that "financial markets placed a positive value on shareholder access").

203 *See* Bus. Roundtable v. SEC, No. 10-1305, slip op. at 7 (D.C. Cir. July 22, 2011) (vacating the SEC's proposed rule on the grounds that "the Commission acted arbitrarily and capriciously for having failed once again . . . adequately to assess the economic effects of a new rule").

204 *See* Edward Wyatt, *Appeals Court Rejects S.E.C. Rule on Access to Proxy Materials*, N.Y. TIMES, July 23, 2011, at B3 (reporting that the SEC has several legal options after the ruling, including an appeal to the U.S. Supreme Court).

205 In addition to Rule 14a-11, the SEC has also proposed changes to Rule 14a-8, which would permit shareholders to make proposals about the circumstances under which shareholders could make director nominations using the firm's proxy statement. *See* Gulinello, *supra* note 123, at 560–61 (describing the SEC's changes to Rule 14a-8).

206 In fact, the SEC acknowledges that its reforms may create incentives for shareholders to reduce expenditures on political-style campaigning. The SEC suggests that, because of proxy access reforms, challengers "may see less need for additional soliciting efforts, such as the hiring of proxy solicitors, public relations advisors, or advertising." Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,758 (proposed Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249). The reforms, according to the SEC, will create heightened participation and "make director elections more competitive." *Id.* at 56,761; *see also id.* at 56,758 ("The result may be a greater degree of participation by shareholders through the proxy process in the governance of their companies."); *id.* at 56,761 ("[O]ur new rules may make director elections more competitive by facilitating shareholders' ability to nominate and elect their own director candidate . . . .").

create a budget for marketing a shareholder proposal.[207] Instead, shareholders who nominate a slate of directors are only entitled to make a short, 500-word statement in support of their nominations.[208] Meanwhile, the board continues to be permitted to spend corporate treasury dollars to campaign against the shareholder's proposal.[209] Thus, even when shareholders have access to the firm's proxy statement, the board continues to have an important political advantage, which likely translates into real votes.[210] As the research here shows, the outcome of elections depends crucially on persuasion and not simply, as the SEC contends, on shareholder nominees being "presented alongside those of management."[211] Based on the findings here, without persuasive campaign spending, shareholder-nominated candidates might not have a realistic chance of competing for board seats. Without acknowledging the significant political handicaps that shareholder proponents face, the SEC's approach to reform is unlikely to achieve its stated goals.[212] If firms and observers are really interested in grappling with the political dynamics of shareholder voting, it may mean coming up with a scheme to subsidize challenger expenses.[213]

B. *The Market for Corporate Control*

Second, the evidence and theory about shareholder voting presented here have significant implications for mergers and acquisi-

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[207] *See* Lee Harris, *Shareholder Campaign Funds: A Campaign Subsidy Scheme for Corporate Elections*, 58 UCLA L. Rev. 167, 176–78 (2010) (describing the difficulties of challenger financing).

[208] *See supra* note 52 and accompanying text (describing the 500-word limit on supportive statements for shareholder proposals).

[209] *See, e.g.*, Steinberg v. Adams, 90 F. Supp. 604, 608 (S.D.N.Y. 1950) ("[I]ncumbent directors may employ corporate funds in policy contests to advocate their views to the stockholders . . . ."); Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291, 293 (N.Y. 1955) (holding that a corporation can compensate the incumbent board when the proxy contest is in good faith); Grodetsky v. McCrory Corp., 267 N.Y.S.2d 356, 358–59 (Sup. Ct. 1966) (same); *see also* Oesterle & Palmiter, *supra* note 19, at 511 (noting the elaborate and expensive public relations campaign that challengers have to put on in order to match incumbents' spending on marketing).

[210] The available empirical research here (and elsewhere) tends to bear this out. In fact, in previous research, the author has shown that low-cost shareholder campaigns have been almost uniformly unsuccessful. *See, e.g.*, Harris, *supra* note 63, at 140–53 (noting the lower success rates of challengers in proxy contests); *see also* Oesterle & Palmiter, *supra* note 19, at 509 ("[T]he information that accompanies the proxy form is carefully written advocacy, drafted by public relations specialists working in conjunction with lawyers.").

[211] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,758.

[212] In a related paper, the author discusses a proxy reform that resolves the problem of shareholder under-funding. *See* Harris, *supra* note 207, at 192–99 (describing a subsidy scheme for eligible shareholder activists).

[213] *See generally id.*

tions, particularly hostile acquisitions. If voting shareholders respond to political motivations, not solely economic ones, then the performance of board members for the target might not be as relevant as takeover theorists had previously surmised. Whether an unsolicited bid or hostile acquisition is ultimately achieved will depend, in many cases, on a proxy contest and accompanying vote of the shareholders.[214] The boards of directors of many firms have increasingly turned to takeover defenses, like the poison pill, staggered elections, and other antitakeover tactics that, in effect, prevent an acquirer from taking their offer directly to shareholders.[215] Firm defenses require a potential takeover artist to negotiate with the board for their repeal or attempt to replace the board by contesting the next director election.[216] That is, if the takeover artist is unable to negotiate with the incumbent directors, shareholders would normally have to vote to oust the current board and install a new board that would repeal any takeover defenses.[217] Thus, antitakeover tactics, like the poison pill, require the takeover artist to win the vote of shareholders in order to diffuse such tactics.[218] Furthermore, according to Guhan Subramanian, in most states, shareholders would get a chance to vote on takeovers as a requirement of

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214 *See* DeAngelo & DeAngelo, *supra* note 1, at 32 (noting the link between proxy contests and acquisition transactions); Easterbrook & Fischel, *supra* note 1, at 406 (noting that voting facilitates takeovers); Edelman & Thomas, *supra* note 122, at 460 (describing voting as "central to takeovers").

215 *See* Grundfest, *supra* note 5, at 858 ("The takeover wars are over. Management won. Although hostile tender offers remain technically possible . . . . [I]t will be difficult for hostile bidders to prevail in takeover battles, even if shareholders support the insurgents' efforts."); *see also* Paramount Commc'ns Inc. v. Time Inc., 571 A.2d 1140, 1144 n.5, 1153–55 (Del. 1989) (approving the poison pill as a defensive tactic if a board of directors believes an offer is too low and a valid threat); Moran v. Household Int'l, Inc., 490 A.2d 1059, 1083 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985) (approving the poison pill and noting that a poison pill will increase the board's bargaining power). Boards do not need shareholder approval to approve a defensive measure, like a poison pill, that can be instituted quickly. Rights associated with poison pills are distributed to shareholders through a dividend. The right of the board to issue a dividend at its discretion is sacrosanct. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 170(a), 173 (2005) (allowing a board of directors the ability to declare and pay dividends); *see also* Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L.J. 621, 625 (2003) (noting that a board of directors faces no restrictions on its ability to deploy a poison pill and noting that a board of directors may adopt a poison pill "in a matter of hours if necessary").

216 Of course, if there are staggered elections for board seats, it might actually take more than one election.

217 *See* DeAngelo & DeAngelo, *supra* note 1, at 38–39 (noting the high frequency of takeover defenses at target firms in a sample of proxy contests); Edelman & Thomas, *supra* note 122, at 454 (noting the importance of shareholder voting in "almost all . . . takeover settings").

218 *See* Subramanian, *supra* note 215, at 627 (discussing the proxy contest as a method of redeeming a poison pill); *see also* Thomas, *supra* note 12, at 510 (noting the prevalence of poison pills).

state law.[219] In states with control share acquisition statutes, shareholders would vote on whether a large shareholder gets voting rights for their shares.[220] In effect, in such cases, whether takeover artists will be able to orchestrate their plan of an ouster and turnaround depends on whether shareholders approve of these plans in the first place. To be sure, in the takeover context, recall that usually a takeover artist will amass a relatively large position in target firms. However, because of takeover defenses and share acquisition statutes, this stake is usually insufficient to establish control. Shareholder voting is therefore critical. Typically, shareholders would have to vote to elect a new slate of directors to the firm and repeal takeover defense measures before a takeover artist could acquire the firm.

Beginning with Henry Manne's pioneering work, it has become virtually gospel among corporate scholars that underperforming managers face some discipline for their incompetence or misbehavior in the form of potential takeover attempts and ousters by outside acquirers.[221] The theory is that acquirers have steep incentives to target firms with poor performance.[222] These acquirers bet that poor-performing companies can be turned around, and their firm value enhanced.[223] When that happens, the acquirers will make a large profit.[224] Some economic theorists would go even further, suggesting that the market for corporate control (i.e., the takeover market) is the

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219 Subramanian, *supra* note 215, at 631–32 (noting that the majority of states—not including Delaware—have some statutory protection against coercive offers, including share acquisition statutes); *see also, e.g.*, OHIO REV. CODE ANN. § 1701.83 (West 2009) (exemplifying a control share acquisition statute).

220 *See* Edelman & Thomas, *supra* note 122, at 461 (describing control share acquisition statutes).

221 *See* Easterbrook & Fischel, *supra* note 1, at 414 n.48 (noting the connection between a lower share price and an increased likelihood of a takeover bid); Manne, *supra* note 32, at 410–11 (discussing the economic aspects of share voting and concluding that dissatisfied, selling shareholders create buying opportunities for outsiders who "are attracted to the potential gain they may make by buying the shares *and* managing the company efficiently"); *see also* William J. Carney, *The Legacy of "The Market for Corporate Control" and the Origins of the Theory of the Firm*, 50 CASE W. RES. L. REV. 215, 233–34 (1999) (summarizing the view of Henry Manne that weak management leads to profit and share price declines, "which would in turn attract outsiders as buyers"); Gulinello, *supra* note 123, at 574 ("[T]he more harm the current board inflicts on the corporation, the lower the company's stock price will drop, and the more vulnerable the board will be to a takeover.").

222 Another assertion made by Manne and others is that the poor performance of incumbent managers and the accompanying sell-off by dissatisfied shareholders increase the costs of capital to the firm. Put differently, as share price declines, the firm will have to sell more shares to raise the same amount of capital. This dynamic will eventually, as Manne puts it, mean that "the corporation will not survive." Manne, *supra* note 32, at 410.

223 *See generally* Dent, *supra* note 146, at 889 (noting that high premiums associated with takeover attempts suggest "slack in target management").

224 *See id.*

only method of disciplining managerial behavior.[225] Thus, economic theory suggests that the takeover artist is likely to replace the board of directors, when shareholders are fed up with the sagging stock price.

In the case of a hostile acquisition, the performance of managers may not be a good predictor as to whether we can expect an outsider to be successful in a takeover attempt, since such acquisitions depend on winning a vote from shareholders. In other words, if there is any disciplinary effect created by the prospect of takeovers, it depends crucially on understanding what motivates shareholder voting behavior. If voting shareholders respond to political motivations, not economic ones, then the performance of board members for the target might not be as relevant as takeover specialists had previously surmised. If shareholders, as argued here, are motivated by factors usually discussed only in the political realm—like name identification, charisma, and money spent on campaigning—then the disciplinary effect of the takeover may have been overstated. Shareholders might ignore a sagging stock price and vote to keep in place a board of directors that has been in office over a long period, solidifying its relationship with the shareholder community. Some incumbent managers may be shrewd enough to recognize these dynamics and take advantage. On the other hand, incumbent managers may have good reason to be significantly more fearful of a takeover attempt from a well-known, charismatic, wealthy takeover artist than an attempt from a challenger with industry experience, leadership ability, and a clear strategy to improve firm share price.

Takeover artists, if they want to be successful, cannot take the complexities of shareholder voting lightly. The findings and argument here suggest that takeover artists may have reason to redirect their takeover strategies to compete in the politicized atmosphere of shareholder voting. If they do not, takeover artists may fail to identify the best targets and, once identified, fail to achieve a takeover (when, by all economic accounts, one should have occurred).

First, without coming to terms with the political dynamics of shareholder voting, takeover artists will continue to be prone to misidentifying potential targets.[226] Firms that specialize in takeovers are hardly clairvoyant and immune from making mistakes.[227] For instance,

225 *See* Manne, *supra* note 184, at 113 ("Only the take-over scheme provides some assurance of competitive efficiency among corporate managers . . . ."). For a firsthand account of the intellectual contribution of Henry Manne to corporate law, see generally Carney, *supra* note 221.

226 *See* Dent, *supra* note 146, at 887–88 (noting that takeover artists make errors and sometimes attempt to take over well-managed firms).

227 For a description of the imperfections in takeover markets, see *id*.

previous researchers have argued that takeover artists fail, from time to time, to identify poor performing firms, based on available economic indicators of performance.[228] The theory of shareholder voting presented here suggests that takeover artists must take into account additional criteria as they attempt to identify possible targets. The takeover artists may fail to take into account the political-type advantages of incumbent directors in potential targets. The takeover artist should anticipate, for instance, that the shareholder community may avoid an ouster and replacement vote because it admires its high profile—although objectively ineffective—CEO.

Second, takeover artists who have identified a potential target must be willing to understand and engage in the political theater of shareholder voting. If they do not, for example, spend lavishly on their corporate election campaigns, their chance of success in a hostile approach begins to dim. If they misunderstand the dynamics of shareholder voting, takeover artists may underperform—that is, fail to achieve a takeover when one could have occurred.

Conclusion

Economic theory has led to a raft of research that has sought, with only mixed results, to tie shareholder voting to managerial performance. Scholars have tried to show that corporate election outcomes can be explained as a function of firm dividend policy, earned income, appreciation in shares, growth, or other traditional measures of managerial and firm performance. A political theory of corporate voting confronts the presumptions inherent in such an approach. In this view, voters in corporate elections behave very much like voters in political elections. Of course, the theory presented—that corporate election outcomes are better explained by the politics of the process than by the performance of firm managers—calls for more than just theory and discourse. It calls for new research and evidence on the predominance of political factors, like money, over economic motivators, like performance. This Article represents the opening salvo.

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228 *Id.* at 887–88.

Appendix

Table 4: Logistic Regression Results for Contested Corporate Elections (2006–2009)

	Wins Only (Challenger wins=1; Challenger loses=0)			**Wins and Partial Wins (Challenger wins and partial wins =1; Challenger loses=0)**		
Director Election Campaign Expenses	**Model One**	**Model Two**	**Model Three**	**Model Four**	**Model Five**	**Model Six**
Challenger Expenses	0.64** (0.29)	0.55** (0.24)	0.63** (0.29)	0.46** (0.23)	0.47** (0.21)	0.45* (0.23)
Incumbent Expenses	-0.04 (0.25)	-0.01 (0.21)	-0.03 (0.24)	0.05 (0.21)	0.07 (0.19)	0.06 (0.21)
Incumbent Performance						
5-Year Stock Price Returns (less S&P 500 returns)	-0.01 (0.16)		-0.01 (0.02)	-0.002 (0.013)		-0.01 (0.02)
1-Year Stock Price Returns (less S&P 500 returns)		0.004 (0.007)	0.003 (0.008)		0.005 (0.004)	0.006 (0.005)
Firm Ownership Structure						
Market Value of Outstanding Stock Issue	-0.52** (0.21)	-0.49** (0.21)	-0.53** (0.22)	-0.38** (0.18)	-0.38** (0.16)	-0.37** (0.18)
Challenger Ownership Percentage	-0.07 (0.07)	-0.04 (0.05)	-0.07 (0.07)	-0.008 (0.070)	0.007 (0.062)	-0.01 (0.07)
Incumbent Ownership Percentage	-0.08 (0.06)	-0.09* (0.05)	-0.09 (0.06)	-0.08* (0.04)	-0.07** (0.04)	-0.07* (0.04)
Challenger Identity						
Individual or Institutional Challenger (1=Individual)	-1.65** (0.80)	-1.25 (0.77)	-1.63** (0.82)	-0.78 (0.75)	-0.32 (0.71)	-0.72 (0.79)
Pseudo R-squared	0.26	0.21	0.26	0.18	0.17	0.20
Number of Observations	61	66	61	69	75	69
Log-Likelihood	-30.02	-34.33	-29.97	-38.76	-42.65	-37.94

Reported above are results from six logistic regressions, clustered by firm. Robust standard errors are in parentheses. The dependent variable is whether the challenger has success in a contested corporate election. "Challenger Wins" are cases where the challenger wins a majority of shareholder votes on each of the contested issues. "Partial Wins" are cases where the challenger wins a majority of shareholder votes on at least one of the contested issues, though loses at least one other contested issue. A positive coefficient indicates that that the variable is associated with a higher probability of challenger success. The statistically significant levels of 1% (***), 5% (**) or 10% (*) are noted. The following variables have been transformed: (i) "Challenger Expenses" is the natural log of challenger expense estimates; (ii) "Incumbent Expenses" is the natural log of incumbent expense estimates; and (iii) "Market Value of Outstanding Stock Issue" is the natural log of the market price of shares at the end of the calendar year multiplied by the number of shares outstanding. All other variables are previously defined and unchanged here. Data are pulled from proxy statements for 2006, 2007, 2008, and 2009; Compustat; and Georgeson. Collinearity diagnostics, including variable inflation factor (VIF) and tolerance tests, were run to measure the interrelationships among the independent variables. The results present no obvious evidence of collinearity problems, and the results of these diagnostics are unreported. Constant value is not reported.