The Corporate Shareholder’s Vote and its Political Economy, in Delaware and in Washington

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Abstract  

Shareholder power to effectively nominate, contest, and elect the company’s board of  
directors became core to the modern corporate governance reform agenda after the Enron and  
WorldCom scandals of 2002. As is well-known to corporate analysts, the incentive structure in  
corporate elections typically drives shareholders to be passive, and the incumbent board thereby  
largely controls the process. But shareholders’ authority to directly place nominations in the  
company-paid-for voting documents could revolutionize American corporate governance, by shifting  
authority from boards to activist shareholders. Because the standard election mechanism requires  
insurgents to pay their own election expenses, while incumbents’ election bills are paid by the  
company, these expense and incentive mismatches have made contested corporate elections rare and  
located power in the incumbent boards, not in the shareholder body, for upwards of a century.  
During the past decade, however, shareholder voting reform moved onto, off of, and then back onto  
the SEC agenda. The last three major moves were: Delaware’s surprise 2009 authorization of  
shareholder access — a move that business interests after having opposed access, surprisingly  
supported; the SEC promulgation of expanded access in August 2010; and, lastly, the SEC’s  
surprising staying of its own rule’s application as soon as the Business Roundtable and the Chamber  
of Commerce sued in September 2010 to overturn the SEC rule.  

This Delaware-Washington interaction on access concretely demonstrates a new theory of  
competitive federalism in lawmaking that sees federal-state interaction to be as, or more, important  
as the traditional, well-analyzed state-to-state competitive interaction. The latter is the usual mode for  
analysis — one of state competition for corporate charters and the concomitant revenue they bring.  
The former, though, is as or more important, but is new to our understanding of corporate  
lawmaking. First, it’s hard to understand Delaware passing its shareholder access statute without the  
issue having been on the national agenda for nearly a decade. Second, Delaware’s access is real but  
minimal and its passage has strategic uses, and perhaps strategic motivations, for the affected.  
Although the Delaware law could not in fact be used effectively by any insurgent when it passed, it  
both had the aura of serious access in action and gave rhetorical cover to those opposing the SEC  
rule. Why do we need an SEC rule, influential corporate players asked, if Delaware has one already?  
Third is the parallel federal-state litigation setting that the Delaware law made vivid: If states had  
been silent on access, the picture of the SEC wiping out state corporate law would have been blurry,  
as there would have been no state law for federal authorities to explicitly preempt. But with access,  
albeit weak access, on Delaware’s books, the preemptive picture of the SEC rule came into focus for  
federal courts, as it created a real federal-state conflict in an area long-governed by state law. Hence,  
the Delaware rule could deter courts from upholding the SEC action. Influential corporate actors  
presured that view of improper preemption. Overall, that kind of interaction, cooperation, and conflict  
in dividing corporate governance responsibilities is core to the understanding of American corporate  
lawmaking.
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Table of Contents

Introduction ................................................................................................................. 1
I. Delaware’s Reaction ........................................................................................................ 4
   A. The Buildup to Access During the Decade’s Scandals and Financial Failures ............... 4
   B. Access If and Only If Provided in the Bylaws .......................................................... 5
   C. From Where Do Bylaws Come? ............................................................................... 6
      1. The board ............................................................................................................... 8
      2. The shareholders, but via a proxy fight ................................................................. 9
      3. The Delaware solution ........................................................................................... 9
      4. The SEC solution: Rule 14a-8 ................................................................................. 10
II. SEC Action and Inaction, After Enron and During the Financial Crisis ....................... 10
   A. Back and Forth ....................................................................................................... 11
      1. A done deal .......................................................................................................... 11
      2. Political economy contrasts ................................................................................ 12
      3. AFSCME v. AIG: Cox’s access renewal and its subsequent demise ..................... 15
      4. Schapiro re-starts shareholder access .................................................................. 16
   B. Delaware Reacts .................................................................................................... 17
   C. The SEC Assesses .................................................................................................. 18
III. Concrete Public Choice, Federal-State Explanations .................................................. 19
   A. To Be Relevant ..................................................................................................... 19
   B. To Clarify Delaware’s Corporate Law .................................................................. 20
   C. To Craft a Compromise ....................................................................................... 20
   D. To Facilitate the Business Roundtable’s Challenge .............................................. 22
   E. To Keep the Federal Dogs at Bay .......................................................................... 25
   F. Contractual Parallels? .......................................................................................... 27
IV. The Political Economy Abstractions .......................................................................... 28
Conclusion ................................................................................................................ 35

Figure 1. Delaware moves from no access to modest access ............................................ 6
Figure 2. Activism of the influential shareholder: Reducing vertical agency costs vs. raising horizontal influence costs ................................................................. 13
Figure 3. Costs and coalitions: The financial shareholder as swing player in access .......... 14
Figure 4. The array of interests ...................................................................................... 32
Figure 5. State-federal preferences, circa 2000 .............................................................. 33
Figure 6. Action in Washington ................................................................................... 33
Figure 7. Delaware enacts limited shareholder access, which could minimize action in Washington ........................................................................................................... 34
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INTRODUCTION

Understanding the structural dynamics of state-based corporate lawmaking has been a long-standing task for corporate law academics. Central to the original thinking was that states compete for corporate chartering revenues, with each state seeking that firms “buy” their charter from that state. Some saw the competitive race as one to the top — making for more efficient corporate law; others saw it as one to the bottom — as states made insider-friendly corporate law. New, disruptive thinking sees that competition to be weak, with few if any states actively competing with the corporate champion, Delaware, and sees the deepest jurisdictional divide that needs analyzing not being competition between the states but rather the interaction between Delaware and Washington.

Here I examine the past decade’s shareholder voting rule moves — central to the corporate reform agenda during the past decade — to better understand that last and controversial dimension, of Delaware-Washington vertical interaction. It is possible to ignore horizontal state competition in understanding why and when Delaware, where most large American public firms are chartered, passed a shareholder voting law to make it easier for shareholders to oppose the incumbent board’s director nominations — a move that, if effective, could radically alter the balance of authority in the American corporation. But it is not possible to understand the Delaware statute, the timing of its passage, and even core particulars of the federal positioning on access without analyzing the state-federal interaction.

There’s a dynamic political economy structural to corporate lawmaking that’s vital to understanding corporate law outcomes in Delaware and in Washington. The analytic focus for the new shareholder voting mechanism has been on whether it will enhance or degrade corporate governance, and what form it should take — should it be permissive or mandatory? what shape should

* Professor of Law, Harvard Law School. Thanks for comments on a prior draft go to Michal Barzuza, John Coffee, Jeffrey Gordon, Kate Judd, Brett McDonnell, Curtis Milhaupt, Holger Spamann, Guhan Subramanian, and participants in workshops at the law schools at Columbia and Virginia.
the statutory default rules take? But to understand the law that emerges, the political economy of corporate lawmaking also needs attention. For example, important Delaware actions can often be better explained as Delaware positioning itself in relation to the potential outcomes in Washington than in reacting to, or in leading, state-to-state competition for chartering revenues, as the classic analysis has had it. Differences between the Delaware rules and the Washington rules map to the interest groups that have the most influence at each level.

One should not look at Delaware’s corporate law outputs as solely, and often not even as primarily, honed in state competition or as springing from the cogitation of local lawmakers. Rather, Delaware’s output is also often enough a result of the state’s lawmakers interacting with, reacting to, and even positioning themselves in relation to corporate discussions and potential rules emanating from Washington. Shareholder access provides a sharp study of the Delaware legislature interacting with Washington in making American corporate law and shows influential corporate players using the Delaware result to affect the Washington outcome, thus far successfully. Delaware is not reacting to state competitors here and the other states are not reacting to Delaware. The jurisdictional interaction is vertical, not horizontal.

Hence, here I examine Delaware’s new shareholder voting statute, in order to evaluate, I believe for the first time, two related questions: First, is Delaware’s statute best understood as a reaction to Washington or as a manifestation of state competition? Second, can we find major political economy inputs into Delaware lawmaking here as seeking to affect the shareholder access action in Washington and in the federal courts?

Both questions yield us interesting answers: it’s hard to see interstate, horizontal, competitive pressure as anywhere nearly as strong as Washington’s vertical pressure on Delaware. There’s considerable evidence to support the idea that some influential Delaware players wanted to provide an alternative to

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the mandatory voting rules that were emerging — and did emerge — in Washington and to generally slow Washington down as the SEC and elements in Congress pushed to authorize strong forms of shareholder voting authority.

True, not everyone was acting strategically. Many surely came to their own judgment of what was best for corporate structures. But political pressures and interests can affect which rules are selected among several that are plausible, can affect the thinking even of the public-spirited, and can be used for self-interested purposes even if they passed a legislature of outstanding public servants acting for fully the public-spirited reasons.

Enhanced shareholder voting has been the key corporate governance reform on the SEC agenda for much of the past decade. To understand the new Delaware statute fully, we must analyze not just its direct, raw impact on corporate voting rules, but also how Delaware’s effort interacts with Washington’s authority and actions, and its underlying political economy. While it can hardly be true that high-road views of the merits were unimportant, the converse is true as well: we cannot fully understand the results thus far without understanding the interests in play. The state-federal interaction in corporate lawmaking has a political economy dimension to analyze, and I analyze that dimension here.

* * *

A roadmap for this article: In Part I, I scrutinize the new Delaware shareholder voting statute for its mechanical limits to shareholders really obtaining cost-effective influence in electing directors. Those limits are substantial. In Part II, I show the SEC and congressional activity vis-à-vis shareholder access during the past decade. In Part III, I hypothesize several nuanced explanations for Delaware’s movement during the decade — from simple clarification of the state of Delaware law, to a public-spirited hunt to recapture the corporate high ground from other corporate lawmakers, to raw interest group capture with a deeply clever constitutional litigation strategy — and bring forward supporting evidence for each explanation. In Part IV, I reanimate the Delaware-SEC political economy story in terms with which political scientists would be comfortable. I provide a straight-forward spatial model of the type that political scientists have used in other settings of interacting governmental bodies. The spatial model explains and illustrates the pressures on Delaware corporate lawmaking at least as well as does the state-to-state competitive model. Then, lastly, I conclude.
I. DELAWARE’S REACTION

A. The Buildup to Access During the Decade’s Scandals and Financial Failures

Consider shareholder voting to elect the company’s board of directors. As is well known in the public corporation world, the incumbent board solicits proxies for votes from shareholders in the annual board election, and it does so at the company’s expense. Solicitation costs are not trivial. Although shareholders who want to nominate their own directors separately, and run them against the incumbent-endorsed nominees, are fully free to solicit votes from the company’s other shareholders, they must pay for their own solicitations. That expense, and the legal risk entailed, typically deters most shareholders from contesting board elections, even to elect new boards for troubled companies. They bear the expense, cannot be sure they will be reimbursed by the company, and, if they succeed, the benefits of the new directors are divided among all shareholders and not captured solely by the activist shareholder.

This sharp asymmetry in expense-bearing is at the core of the power allocation in the American public corporation. It puts power disproportionately in the hands on the incumbent directors, not stockholders.4

After the Enron scandals, Washington enacted the Sarbanes-Oxley Act and the Securities and Exchange Commission examined whether to revise its rules to permit activist shareholders easy, cheap access to the company’s proxy statement so as to lower the costs of shareholder activism, toward the end of making managers and boards more accountable to shareholders. SEC Chair William Donaldson put access on the modern SEC agenda in 2003, when it was seen as a major and inevitable post-scandal reform. But easy shareholder access proved controversial, scandals faded from memory and the media, and it failed to become law, dropping off the SEC agenda until the next SEC Chair, Christopher Cox, put it back on in 2005. But his Commission also decided not to promulgate access. The subsequent and current SEC Chair, Mary Schapiro, quickly announced after assuming her position that shareholder proxy access was high on her Commission’s agenda.5 The economic and political atmosphere

4 This is the long-received wisdom, set forth in basic corporate analytic materials. E.g., WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 169-70 (3d ed. 2009). The paucity of true proxy contests has been confirmed recently in Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 VA. L. REV. 675 (2007).

of a national economic recession and Wall Street financial deterioration made it plausible again that the SEC would act.

During the same 2003 to 2009 time span, Delaware law was seen as barring activists from either seeking such access to the company’s proxy statement directly or getting a clean shareholder vote to permit such company-paid access for outside activist shareholders. Activist shareholders sought bylaws that would enable shareholder access, and Delaware lawyers opined that Delaware law barred access, so boards could readily refuse — and did readily refuse — to include such proposals to unseat themselves in the companies’ proxy statements. Hence, shareholder activists saw Delaware law as a problem and SEC rulemaking as a solution. Corporate, mostly managerial, interests vigorously opposed SEC action on access, largely successfully.

B. Access If and Only If Provided in the Bylaws

Then, in March 2009, the Delaware legislature changed the state’s corporate law direction on access, by amending the state’s corporate law to allow shareholders access to the company’s proxy solicitation after the Delaware Corporate Law Council — the body that initiates the state’s corporate law reforms — recommended that the legislature authorize access. The business press reported that “the [year’s] most significant change [for Delaware corporate law] … is the amendment allowing investors to include their director nominees in the same proxy document mailed by companies to shareholders, making it easier for them and less expensive.” The provision was the lead section in the Delaware March 2009 bill to amend Delaware corporate law, which Delaware’s legislature passed and which its Governor signed into law.

The law was simple: the decade of uncertainty as to whether Delaware corporate law allowed shareholder access ended. The state’s corporate law would now permit shareholder access to the company’s proxy solicitation, if and only if the corporate by-laws provided for that access. Section 112 of the Delaware Corporate Code now provides that:

The bylaws [of a Delaware corporation] may provide that if the corporation solicits proxies with respect to an election of directors, it may be required … to

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include in its proxy solicitation materials ... in addition to individuals nominated by the board of directors, one or more individuals nominated by a stockholder.8

Why did Delaware enact access? And why did it enact the less than straightforward access statute that it did, one that on its surface seems to favor corporate governance insurgents — but, as we shall see shortly, does not? Why did Delaware, unfriendly to access at the beginning of the decade, and often thought to be board-friendly (which easy shareholder access is not), come to enact an access statute at the end of the decade, despite that boards and their organizations, like the Business Roundtable, the Chamber of Commerce, and their law firms had strongly opposed shareholder access for board elections for most of the decade? That question can be diagrammed, as it is in Figure 1. The diagram, although simple, helps set us up for more substantial political economy abstractions, analyzed below in Part IV.

Figure 1. Delaware moves from no access to modest access.

C. From Where Do Bylaws Come?

First: how much access does the Delaware statute provide? The business press reported that the new Delaware law made shareholder voting access power real.9 Managerial proponents said, in a widely-distributed memorandum in the business world, that Delaware access via § 112 was more than enough for governance activists and thereby made SEC action superfluous:

Importantly, the states have proven themselves responsive to legitimate calls for reform. Delaware has recently amended its corporate statute to permit

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9 See, e.g., Giannone, supra note 7.
corporate boards or stockholders to provide for stockholder access to the company's proxy materials for director elections. …10

Yet, despite the board advisors’ assertion that the states have proven themselves responsive, the Delaware access rule is rather weak and possibly incapable of bringing real access to shareholders. The statute permitted access, but only if authorized in the firm’s by-laws.

That limit at first seems merely mechanical, not an actual allocation of power — for shareholders to get access, they just need to make the bylaws authorize access. But that bylaw proviso sharply allocates power between shareholders and boards, and it does so in the traditional, board-friendly way.

Consider the realpolitik of a proxy fight for control of a corporate board. Insurgent shareholders are unhappy with the incumbent board and want to change the company’s strategic direction. They want to elect an alternate board. But the cost of mounting a real, contested proxy fight is, as is well-known, prohibitive. The insurgent shareholders must hire lawyers, pay proxy solicitation firms to pull out the vote, and advertise in the business press. The investor’s time and energy spent on the insurgency is taken away from the investor’s other business. Shareholder coordination to share the expense is possible but complex. Even if every shareholder wants a boardroom change, each shareholder wants the other shareholders to pay for that change.11

Even for a large shareholder, the cost of pursuing a contested proxy fight can be prohibitive. And the individual stockholder’s costs can dwarf the stockholder’s portion of the potential gains in stock price from changing the company’s strategic direction. While an insurgent could solicit other small holders to join the contest and bear a proportionate amount of the expense, free-rider problems and the cost of organizing that cost-sharing effort, which would itself be a regulated proxy solicitation, make such organizational efforts rarely attempted and more rarely successful.

Expense-bearing in a proxy fight for insurgents and incumbents is sharply asymmetrical, as is well-known.12 While the insurgents are stymied by expense and coordination issues, the incumbents on the board make the company pay for

11 This cost and free-rider analysis is the standard view on proxy contests. E.g., ALLEN, KRAAKMAN & SUBRAMANIAN, supra note 4, at 169-70. Information technology may eventually lower the cost of shareholder voting and organizing and thereby make proxy contests cheap to pull off. But for now, it hasn’t.
12 E.g., ALLEN, KRAAKMAN & SUBRAMANIAN, supra note 4.
the proxy solicitation for their own re-election. They pay nothing out-of-pocket, as the company’s lawyers prepare the solicitation, the printing, the distribution, and, if there’s a contest, the company also pays the additional costs of legal, advertising, and other expensive professional advice.

Hence, reformers’ goals here have been for insurgents to have access to the company paid-for proxy statement: insurgents would nominate directors, have their statement of support included in the company’s proxy statement, and have their solicitation costs paid not from their own pockets, but from the corporate coffers. While reformers would presumably like to make a full-scale proxy fight via access to the company’s solicitation materials, the federal reform process has focused solely on access for a short-slate of a minority of directors.

This is not to say that shareholders will never make proxy proposals and that proposals once made will never succeed. But the playing field is tilted against successful proxy proposals, especially of the contested variety.

1. The board. How far does the new Delaware statute go? It authorizes shareholder access, if and only if the company’s bylaws allow it.

And that is where the Delaware access mechanism becomes useless to most shareholder activists. The typical way to get a bylaw is that the board of directors re-writes the company’s bylaws. But expecting the target board to freely write an access bylaw when requested to do so is unrealistic: the insurgents are targeting the board itself for change. Yet, under the Delaware statute, it’s the targeted board that would first be asked to authorize the mechanism for its own demise.

While it’s possible that there are such directors, such is not the usual working of human nature. True, if the board comes under shareholder pressure via other means for shareholders to assert authority, the board might accede to an access bylaw. Boards do compromise and compromises can involve such corporate governance rules. In recent years, boards under pressure have ended self-entrenchment mechanisms such as staggered boards. But if a board-promulgated access bylaw would be a convenient compromise, with shareholder power to press for it coming from elsewhere. Delaware’s access law would not here be a new, independent source of shareholder muscle, but an authorized compromise point if activist shareholder have other means to pressure the target board into allowing access.13

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Delaware also authorized company bylaws to govern how and when insurgents would be reimbursed expenses. To get a bylaw that authorized reimbursing insurgents who challenge incumbents, the first way to do so is for the targeted incumbents to write such a bylaw. Again, not ordinarily likely.

2. The shareholders, but via a proxy fight. There’s another way to amend the company’s bylaws. Shareholders can themselves vote to change the bylaws. But how do they get to vote? The insurgents solicit votes from the other shareholders. If a majority of the shareholders vote in their favor, the bylaw authorizing access becomes part of the company’s governing rules.

That is, to obtain a structure that would allow a cheap proxy contest, the insurgents need first to launch, pay for, and win an expensive proxy contest or approximately the same sort that they are seeking to avoid. An earlier generation would recognize this as a “Catch-22.”

Hence, Delaware’s proxy access was thus not an immediately useful reform for the insurgents. This dead-end has not, as far as I am aware, been a focus of analysis of the Delaware change. Indeed, one might ask whether many shareholders would want to use the expensive contest to facilitate a cheap one. If the shareholder is willing to pay for the expensive contest for a governing rule, it might just as well do a full-scale proxy fight for control of the board.

3. The Delaware solution. The Delaware legislature could have set up means for insurgent shareholders to get an access bylaw put in place without their having to launch a full-scale proxy contest, because that kind of full-scale proxy fight is the very thing that access is constructed to avoid. The new sections 112 and 113 could have had a simple provision, along these lines:

In any solicitation of proxies by the company, the company must include for shareholder vote any bylaw proposed by 10% of shareholders 60 days prior to the solicitation. Shareholders, but not the board acting alone, may alter the

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14 Cf. Sullivan & Cromwell, Memorandum to Clients, Delaware Adopts Amendments to the Delaware General Corporation Law Relating to Corporate Governance, Apr. 28, 2009; Lipton, Lorsch & Mirvis, supra note 10.

To be sure here, a process-by-law could be cheaper for activists to get if governance associations endorse it as a good, across-the-board, general governance reform. Insurgents may have trouble persuading some stockholders that the insurgents’ directors are able enough, or that the situation is dire enough to require replacing the incumbent board. On the other hand, the benefits to shareholders of a process-by-law may be low enough to dissuade them from trying.
necessary percentage and timing in the foregoing sentence, via the company bylaws.

That is, Delaware lawmakers could have required companies to give shareholders access to the company’s proxy solicitation for bylaw proposals of this nature — those affecting election rules, or at least those affecting access rules, an “access for access” rule. Or, Delaware lawmakers could have made access the default rule, unless access was eliminated in a shareholder-approved opt-out bylaw. But they did not. They left the procedural hurdles to access in place, and those hurdles resembled the very hurdles access is designed to lower for shareholders.16

In the first proxy season after the Delaware access enactment, no shareholder seems to have solicited shareholder to approve a § 112 access bylaw.17 The statutory analytics above suggest one major reason why.

4. The SEC solution: Rule 14a-8. The SEC regulates proxy solicitations under Section 14 of the Securities Exchange Act of 1934. It could have its proxy rules provide for insurgent shareholder access to the company’s proxy solicitation for bylaw change proposals. As it interpreted its rules in 2008 following then-recent litigation, the SEC clarified that the relevant rule, which allows shareholder access to the company’s proxy statement for recommendations to management, did not contemplate cheap shareholder access for shareholder bylaw proposals.18 Eventually, in August 2010, it reversed course and amended 14a-8 to allow access for the purpose of shareholder votes on bylaw amendments.

II. SEC ACTION AND INACTION, AFTER ENRON AND DURING THE FINANCIAL CRISIS

Since Delaware’s statute is, as of now, a weak vessel, why did the state bother to launch an access rule at all?

After nearly a decade of access being near the top of the corporate activist reformers’ agenda, perhaps Delaware thought it needed to act. Whether it just

16 While I focus here on managers’ and shareholders’ interests, corporate lawyers’ interests should not be ignored. We lawyers, who are quite influential in the making of Delaware corporate law, do better with tailor-made access rules, which typically require serious lawyering, than with one-size-fits-all generic rules.

17 Kahan & Rock, supra note 15 (MS at 16 n.71).

18 SEC Release No. 34-599-14, Jan. 10, 2008, amending Rule 14a-8 (clarifying that election format proposals are not proper for shareholder proposals); AFSCME v. AIG, 462 F.3d 121 (2d Cir. 2006) (inducing SEC clarification of prior 14a-8 rule).
wanted to clarify its law on access bylaws, whether it in the end became convinced that shareholder access was a good idea, whether it wanted to run ahead of the SEC, whether it needed to be active a core corporate governance issue, or whether it strategically wanted to slow the SEC down all need to be considered, as we shall. Surely many players solely had high-road motivations on the value of access, even if a few might have been acting strategically. But even public-spirited players may be subject to pressure from the interested, as the interested bring forth public-spirited arguments that favor their own interests. Consider first the prominence in corporate circles outside Delaware of the access reform proposal in the years just prior to the Delaware passage.

A. Back and Forth

1. A done deal. The Enron, WorldCom, and related scandals dominated the business law reform agenda in the early years of the decade. Congress enacted Sarbanes-Oxley in the summer of 2002, thereby making the most substantial piece of corporate law legislation in decades an act of Congress, not a Delaware state corporate law statute. Simultaneously, the SEC announced that shareholder access would be a core reform for it to pursue. In the wake of the Enron scandal early in the decade, the media initially saw the proposal as a done deal, likely to be in place by the 2004 proxy season.19

But that heady corporate reform atmosphere subsided. Corporate, particularly managerial, spokespeople argued against access to the SEC and elsewhere.20 In time, the views of the SEC’s chair, Donaldson, softened, White House pressure against access was said to have been brought to bear, and he eventually concluded that he would not go forward without a consensus on the commission — a consensus that was lacking.21

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2. Political economy contrasts. There was a political economy contrast in the access debate in 2002 and 2003, one that later maps onto Washington-Delaware differences. Proponents of shareholder access wanted it as a means to reduce managerial agency costs. With ownership in large American firms diffuse, and with shareholder power weak, access could raise shareholders’ voice in the boardroom and lower board and managerial drift from shareholder value. It arguably could better than the status quo cabin managerial self-interest in their own compensation and accountability.

But critics of access put forward the downside that special interest shareholders would be the primary activists and would push firms to a corporate agenda that favored their, or their allies’, interests, with those interests likely to often be at odds with financial shareholders’ goals. As two opponents of access stated in a prominent attack on access, access would yield an “influx of special interest directors,” would raise “the risk of balkanized and dysfunctional boards,” and raised serious doubt as to whether institutional shareholders, public pension funds, and labor unions — the parties most likely to qualify for the right to include director nominees in a company’s proxy statement under most proposals — are well-suited to the role of nominating directors. Each has duties to its own constituencies; each has its own agenda…. 22

Think of the interest group split in this way: Activist shareholders sought a rule that would reduce managerial agency costs, focusing on the vertical problem of the large public firm, illustrated in Figure 2. But opponents of access instead saw the analytic in terms of influential activist shareholders, such as public pension funds, obtaining benefits from influence for themselves and their allies, not to all shareholders generally, also illustrated in Figure 2.

Caught in the middle were financial shareholders (think: mutual funds, hedge funds, individual owners) who wanted better corporate management, but could not capture any of the expected special influence benefits. Figure 3 illustrates their dilemma. They’d want greater managerial accountability, but didn’t want other influential shareholders to capture side benefits, benefits that would not be shared among all shareholders.

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22 Lipton & Rosenblum, supra note 1, at 67.
The managerial anti-access rhetoric (which I exemplify supra and infra) could be seen as an effort to turn financial shareholders (i.e., those who weren’t politicized state pension funds or labor-oriented funds) against access. The message from the managerial quarter was, when translated: yes, you financial shareholders will lose some value because of managerial agency costs if there’s no access, but you’ll lose as much or more value from enhanced shareholder influence of the “wrong” kind, i.e., influence that isn’t for shareholders’ across-the-board, general benefit. Figure 3 illustrates this appeal to financial shareholders. It could be seen an effort to peel off an influential interest group from supporting access.

23 Cf. E.E. Schattschneider, The Semisoverign People: A Realist’s View of Democracy in America (1960) (political scientists maps how politicians seek to define the most salient issue in a way the breaks or makes coalitions, to the politician’s electoral benefit).
The official comments made to the SEC during its rulemaking period divided along parallel lines. The staff summarized the 500 comments into the groups that favored, that opposed, and that had mixed views on the SEC’s 2003 shareholder access proposal:

A significant majority of the commentators, comprising virtually all of the unions; pension funds; social, environmental, and religious funds; a majority of institutional investors and institutional investor associations; a majority of investment advisers and managers; and a majority of individuals, supported the proposed rules. The exceptions were corporations, corporate executives, and corporate directors; law firms and attorneys; and most of the associations (primarily business associations), which were nearly unanimous in their opposition to the proposed rules.  

The special-interest activists were all for the rule; boards and their lawyers were against it. Financial investors were split, with a majority in favor. See Figure 3.

A major corporate cause célèbre in 2003 and 2004 made these managerial conceptual negatives vivid and real. Much attention from managers and the business media was given to CalPers corporate governance involvement in a

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bitter union strike Safeway. CalPers — the huge, at the time labor-influenced, California state pension fund — encouraged Safeway, the supermarket chain, to settle the strike on terms favorable to the strikers, with CalPers using corporate governance weapons to push its view. It became prominent as a cautionary tale among managers and their allies on the perils they faced if stockholders like CalPers had easier access to the company’s director election proxy statement.

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Why the SEC turned around on access in 2003 and 2004 is hard to know — perhaps the merits, perhaps eventual perceptions that its rule as drafted was cumbersome, perhaps they bought into managerial story of enhanced influence of nonshareholder-focused interests, perhaps the vividness of the Safeway fight, or perhaps raw influence channeled through the White House. Whatever the reason, in little more than a single post-Enron year, shareholder access went from being widely seen as a done deal at the SEC in the immediate wake of Enron’s failure and Sarbanes-Oxley’s passage to dead.

Delaware during this period did nothing on shareholder access.

3. AFSCME v. AIG: Cox’s access renewal and its subsequent demise.

Donaldson left the SEC, then Christopher Cox came in as its new chair and promptly put access back on the SEC agenda. As it percolated at the SEC, the Second Circuit Court of Appeals forced the SEC’s hand.

In AFSCME v. AIG, the Second Circuit held that the SEC’s election exclusion in its Rule 14a-8 (which allowed company management to exclude

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26 Jonathan Weil & Joann S. Lublin, Gaudly Activism at Calpers Leads to Possible Ouster of President, WALL ST. J., Dec. 1, 2004, at A1. The union activist pension president was indeed later ousted. Canned at CalPERS, supra note 25. For an example of the relevant activism, see the pension fund’s Letter, dated Dec. 17, 2003, from CalPERS to the Chairman, President & CEO of Safeway Inc., dated Dec. 17, 2003, re United Food and Commercial Workers Labor Negotiations (“[Y]our company is currently engaged in negotiations with the UFCW regarding issues, among others, over basic health benefits. We wish to express our deep concern regarding the status of these negotiations and we encourage you to resolve them fairly and expeditiously.”).


28 Kahan & Rock, supra note 2, at 1574.

29 462 F.3d 121 (2d Cir. 2006).
from the company’s proxy statement any shareholder proposal that “relates to an election”) did not allow management to exclude bylaw proposals that would govern elections procedures generally. SEC interpretations of its own rule were contradictory, said the court, and the most straight-forward interpretation of the regulatory language itself did not demand that a board could exclude a shareholder-proposed bylaw that would govern the general procedures in election contests. The most straight-forward application of the regulation’s language was that the board could exclude actual nominations, said the court, but not proposals for rules to govern future corporate elections.

The court’s decision prompted the Cox SEC in mid-2007 to propose and consider two contradictory rules. The first would be a blow to the insurgents, clarifying that election rules and bylaws were excluded under Rule 14a-8 from being entitled to access to the company’s proxy solicitation. The second would have been a blow to managerial opponents of access, by authorizing that shareholder access. Eventually, in November 2007, the Cox SEC promulgated the exclusion, not the expansion. Access was once again dead.

During this period, Delaware did nothing on shareholder access.31

4. Schapiro re-starts shareholder access. After the 2008 election, Mary Schapiro became chair of the SEC and put shareholder access back onto its agenda. Access looked likely to be promulgated quickly. “Chairman Schapiro has made clear her interest in empowering shareholders to improve corporate governance[.] … That Schapiro acted so quickly on proxy access, less than two months into her chairmanship did not come as a surprise.” The SEC simplified its earlier cumbersome and intricate 2003 proposal into something more workable. The financial crisis had put business reform back on the agenda (even

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31 Formally, that is. Under Rule 14a-8, shareholder proposals are excludable if they are not proper matters for shareholder action under state law. Delaware lawyers had been opining that access rules were not a proper matter for shareholder action under Delaware law. The Delaware court opened up the possibility of access rules, when answering SEC-certified questions, although oddly indicated that the bylaw could not confine board fiduciary discretion. Computer Associates v. AFSCME, 953 A.2d 227 (Del. 2008). Odd, because every contract confines future fiduciary discretion, but is an exercise of that discretion when the board agrees to that contract. The analog is corporate board’s fiduciary duty to shop their company when they agree to a merger. But this setting differs from access. Boards and managers can readily be conflicted in the sale by the terms of the sale and how well they do in the sale; the duty to shop reduces the impact of their conflicts.


though proxy access issues did little to directly explain the financial crisis). And the sharpest political critique of access — that it particularly helped state pension funds and other shareholder activists who were Democratic constituents — was not a compelling counterargument in a Democratic administration in Washington.34

**B. Delaware Reacts**

In that context of repeated but aborted SEC efforts to implement proxy access, and with an atmospheric that access was something that the states had authority to enact, Delaware in 2009 passed its access statute. As we saw, it granted little real access, because access first required the target board to change the bylaw to facilitate their own removal or required shareholders to go through the difficult proxy solicitation that simple access is meant to make unnecessary.

Ascertaining Delaware’s motives is not possible through the usual technique of parsing legislative history, because there is no formal legislative history. The Delaware Corporate Law Council recommended that the legislature amend the state’s corporate law, but it did not issue a report, just a draft statute. The legislature did not hold hearings or write a legislative report, but passed that proposed statute. There is no record of a legislative debate.

Intentions of some players though can be divined, by looking at the contemporary “testimony” of Delaware players, by interacting that testimony with construction of the statute, and by examining incentives and motives. The merits, statutory clarity, and interests seem to have been in play, presumably in different degrees for different players. I focus primarily on the latter — interests — but that does not mean that other motivations were absent or even, for many players, dominant.

The interests: The Delaware corporate bar stated to the SEC that, given the existence of Delaware’s § 112, the SEC need not promulgate an access rule, that Delaware-based flexibility was superior to a Washington-made rule, and that an SEC-promulgated rule would “undermine … the state system of [American] corporate governance.”35 Moreover, both Delaware players and savvy corporate lawyers stated that Washington’s efforts motivated Delaware’s:

34 Cf. Grundfest, supra note 25.


Letter, from Delaware Council of the Corp. Law Section, Delaware State Bar Ass’n, to the SEC, July 24, 2009, re Facilitating Shareholder Director Nominations, SEC Rel. No. 34-60089 (June 10, 2009).
“The [access] amendments to the Delaware General Corporate Law respond[ed] to … SEC rule-making initiatives relating to stockholder access…,” said a corporate law authority and an influential former chief justice of the Delaware Supreme Court. A leader in the corporate bar, Ted Mirvis, went further in interpreting the Delaware law: “[T]o forestall these attempts [at the SEC and in Congress] to further federalize corporate law, Delaware last month enacted legislation which expressly enables the adoption by Delaware companies of bylaws permitting access to company proxy materials.” And that, one might add for the Delaware players, is more than enough to satisfy shareholders. Washington should do no more.

C. The SEC Assesses

It’s not trivial that the SEC’s new chair signaled that that was how she saw the situation — that Delaware was enacting weak, not strong, access. After the Delaware statute passed, Commissioner Schapiro addressed the Council of Institutional Investors, a council populated by some shareholder activists, saying that:

Next month, the Commission will consider a proposal to ensure that a company’s owners have a meaningful opportunity to nominate directors.

We are looking at what the Commission considered in both 2003 and 2007; and we’re also considering the potential impact of proposed changes to Delaware’s corporate law.

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But it should not surprise anyone in this room that we are viewing these issues with fresh eyes. We want to ensure that any procedural requirements for access are rational, and not a means to thwart effective investor participation.38

III. CONCRETE PUBLIC CHOICE, FEDERAL-STATE EXPLANATIONS

Fully understanding why Delaware acted is speculative. A simple, high-road interpretation is that over time Delaware became convinced that access was a good idea, that enough boards and managers might need the wake-up call that shareholder proxy access could give them, and that any downside of access could be contained. Other Delaware players may have long thought that non-mandatory access was good policy and saw their moment to push forward their view.39 In the financial crisis atmosphere prevailing when the statute passed, Delaware’s corporate players may have decided they had to act, if only to stay relevant. And, if access was coming anyway, responsible Delaware lawmakers could have concluded that they would implement it better than would federal regulators. Perhaps also in the back of some actors’ minds was the risk that a backlash against corporate and financial interests during the then-ongoing economic and financial crisis could even have turned against Delaware if the state remained passive.

A set of less sympathetic public-choice-based hypotheses is also available. We assess them all, from innocuous, to high-road and public-spirited, to Machiavellian.

A. To Be Relevant

More than a few commentators noted during the past decade that Delaware in key dimensions was becoming decreasingly relevant in corporate lawmaking. Securities law academics saw the state’s core corporate legal structure — fiduciary duties and their interpretation — moving into federal courts, pendant to securities law claims.40 Delaware was not the preferred venue

38 Mary L. Schapiro, Transcript: SEC Chairman Addresses Council of Institutional Investors’ Spring Meeting, April 13, 2009 (emphasis supplied).
39 Leo Strine, for example, has consistently pushed forward a 14a-8 rule as the best way to go. See Strine, supra note 37; cf. Leo Strine, Comments, SEC Proxy Rule roundtable, may 7, 2007, at 34, available at www.sec.gov/spotlight/proxyprocess/proxy-transcript050707.pdf.
for merger litigation or, worse, firms were exiting from the Delaware judicial venue even when it was the most natural locus for the lawsuit.\textsuperscript{41}

Said a prominent corporate lawyer about Delaware’s access statute: “There is speculation that Delaware adopted this amendment to maintain its importance as the pre-eminent state for company incorporation and corporate law.”\textsuperscript{42} Delaware lawyers prefer to be involved in drafting tailor-made access bylaws and their leaders are prominent in the Delaware Corporate Law Council, which advises the Delaware legislature on corporate law matters.

Similarly, and in a more positive spirit, if shareholder access was coming anyway, public-spirited Delaware players could well have concluded that they would implement access better than the SEC both initially and over time. The Delaware Bar Association’s comments to the SEC are in that positive spirit.\textsuperscript{43} Delaware players are proud of their state’s corporate law mechanisms and see their work as likely to be superior to Washington’s.\textsuperscript{44}

B. To Clarify Delaware’s Corporate Law

The permitted range for Delaware corporate bylaws became muddied in the half-dozen years before the legislature passed § 112. Delaware lawyers had opined that shareholder authority to push for election-controlling bylaws was limited.\textsuperscript{45} One major 2008 Delaware Supreme Court opinion, that in Computer


\textsuperscript{42} Charles M. Nathan, Delaware Law Changes to Facilitate Voluntary Adoption of Proxy Access (July 7, 2009) (law firm memo). Cf. Robert A. Thompson, \textit{Corporate Federalism in the Administrative State: The SEC’s Discretion to Move the Line Between the State and Federal Realms of Corporate Governance}, 82 NOTRE DAME L. REV. 1143, 1144 (state, i.e., Delaware, law largely unchanged after Enron and WorldCom scandals of 2002).

\textsuperscript{43} Cf. Leo E. Strine, \textit{The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face}, 30 DEL. J. CORP. L. 673 (2005) (“the potential threat to economic efficiency that might result if the federal government further expands its role in corporate governance”); E. Norman Veasey, \textit{Musings on the Dynamics of Corporate Governance Issues, Director Liability Concerns, Corporate Control Transactions, Ethics and Federalism}, 152 U. PA. L. REV. 1007, 1017-18 (2003) (although “Sarbanes-Oxley trumps [aspects] of state internal affairs law,” the state should not despair, but “[r]ather … should inspire [it] to be a part of the solution.”).

\textsuperscript{44} See McDonnell, supra note 6.
Associates, controversially indicated that some bylaw provisions need always be subject to the board’s fiduciary duty to judge what was best for the company, forestalling boards from fully being bound in advance.\textsuperscript{46} Hence, a simple interpretation is that some Delaware leaders wanted to affirm an enabling approach, albeit one that started with the default power in the hands of the incumbent board.\textsuperscript{47}

C. To Craft a Compromise

The Delaware law has an aura of compromise. Access could be obtained, but not the open-ended, largely mandatory, one-size-fits-all access of the SEC’s Rule 14a-11 proposal. (That rule, which the SEC subsequently promulgated, but quickly stayed, mandated that all public firms have shareholder access; neither corporations, nor their boards, nor their shareholders could opt out of Rule 14a-11’s mandated but minimal access. Its mandatory nature has a contradictory, circular quality, as Joseph Grundfest has pointed out: shareholder choice in electing directors is permitted, but shareholders cannot choose to bar small shareholders from nominating directors at company expense.\textsuperscript{48})

In this spirit, Delaware could be seen as responding to the increasing empowerment of its institutional investor constituency by formally providing shareholders with some access immediately, and with the necessary bylaw access switch to be turned on later at a propitious moment.

And, if federal authorities’ enthusiasm for access ended (because of a change of some minds at the SEC or because future elections brought about a

\textsuperscript{46} Computer Associates, supra note 32.


\textsuperscript{48} See Grundfest, supra note 25. If the reader needs to know my view on the merits, here they are: Access via the Rule 14a-8 mechanisms that allow shareholders to cheaply set the bylaws is the place to begin. A default rule such as that in §§112 & 113 is unwise in giving too much authority to the incumbent board; Delaware ought to have incorporated a 14a-8-type rule into its legislation. But barring shareholders from contracting away from shareholder access, as the SEC’s Rule 14a-11 bars them from doing, is also unwise. The law could, and should, start from a default different from no-access at all, but shareholders should be able to tie their hands if it seems wise to them to give their board more discretion. Jill Fisch analyzes how the SEC proposal itself cannot effectively be used by many of its intended beneficiaries. Jill E. Fisch, The Destructive Ambiguity of Federal Proxy Access (Feb. 2011), available at www.ssrn.com/abstract=1769061.
change in the Commission’s composition), then the state would control how access would be modulated in the future. Perhaps Delaware would in time turn on the bylaw switch, if the SEC did not, but in a partial way, and would modulate access in the future, by repairing problems quickly and, perhaps, by expanding access as it appeared warranted, as the players became comfortable with access, or as institutional investors became a louder but more effective Delaware constituency.

D. To Facilitate the Business Roundtable’s Challenge

Less charitable, tactical interpretations of the statute’s impact are possible. When Delaware passed § 112, a court challenge to any SEC-promulgated access was as likely as such things can be before they happen. Mary Schapiro, the SEC chair, said she expected a lawsuit. “The U.S. Chamber of Commerce … wrote to Schapiro … saying it does not believe the SEC has the power to expand shareholders’ ability to nominate directors. Oversight of director elections has been under the purview of state law since the 19th century and should stay that way, the group said.”

Said Gibson Dunn partner John Olson in the summer before the SEC acted: “If the commission ultimately adopts a mandatory federal access scheme, attempting to preempt state law in the area, a lawsuit is a certainty…” An American Bar Association securities law Task Force of securities bar leaders put forward reasons why the task force thought that the SEC lacked authority to issue access rules. In an earlier era, the SEC promulgated rules barring dual

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50. Martha Graybow, Schapiro braces for fight over proxy access, REUTERS, Apr. 29, 2009.


class common stock; the Business Roundtable challenged the SEC’s authority to do so and won in the D.C. Circuit. Expectations were that the same kind of challenge to an SEC access rule would arise and corporate groups said as much.

Doubts about SEC authority were high enough to put that authority onto the congressional financial reform agenda during the 2008-2009 financial crisis, despite that shareholder access had little to do directly with the financial crisis. Indeed, the SEC’s authority was sufficiently uncertain that Congress formally authorized the SEC to promulgate an access rule in the Dodd-Frank summer of 2010 financial overhaul.54

Maybe litigation strategy considerations were not upper-most in the minds of the actual drafters of the law. Without a legislative report, it’s hard to know. But prominent players see the Delaware statute as helping the Business Roundtable attack federally-mandated access. They applaud the Delaware law for having that effect.

Even after Congress explicitly authorized the SEC to promulgate access to allay doubts about SEC authority, the Business Roundtable and the Chamber of Commerce challenged the SEC’s August 2010 rule on analogous grounds — arguing that the SEC was arbitrary and capricious in ignoring state access rules — and persuaded the SEC to stay its own rule.56 And the state of Delaware participated in that litigation, with the state’s Solicitor filing an amicus brief supporting the Roundtable. The SEC’s Rule 14a-11, Delaware’s state solicitor said in the amicus brief, “would fundamentally alter the policy of stockholder choice embodied in [the 2009 Delaware law, in] Section 112.”57 “SEC Rule 14a-11, rather than furthering the Delaware nomination right, flouts an important decision recently made by the Delaware legislature and signed into law by Delaware’s Governor.”58 The Delaware solicitor presented to the D.C. Circuit the interpretation that the SEC rulemaking was running roughshod over state rules, embodied in the recently-passed Delaware access provision, § 112.

53 Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990). The SEC in time induced the stock exchanges to bar listing of dual class common stock issues, thereby indirectly achieving its substantive goal.
58 Id. at 9.
So, with the Delaware solicitor’s brief in mind, consider the preemption atmospherics first and formal doctrine later. The federal judicial atmospherics differ if states have or do not have rules on shareholder access. The actual, ongoing, real existence of a Delaware access rule makes regulatory preemption and federal-state comity issues both real and vivid, in contrast to the theoretical, abstract bases if there were no major state statutory pronouncements on access.

It would have been easier in terms of atmospherics for the D.C. Circuit Court of Appeals to allow the SEC to act freely if no state had such a statute. It would be easier for the court to interpret that the SEC had authority, if states were silent and the SEC was entering an empty room. It would similarly be easier to ignore an arbitrary and capricious attack, along the lines that the SEC failed to adequately consider how its rule interacted with state law, if there were no state law with which the SEC rules would interact. But now it will be harder for the D.C. Circuit than it otherwise would have been to uphold the SEC rules as not being arbitrary and capricious, as there is a concrete state statute that the SEC rule, if it’s implemented, would eviscerate. Under Delaware law, in the absence of an authorizing bylaw, shareholders cannot get access. Federal authorities now seek to rip these provisions out from the state corporate code, mandating access via 14a-11 and mandating the mechanisms of determining the overall rules for access via Rule 14a-8. A court might well hesitate more now, as there’s a live Delaware statute on the books that the SEC’s rules would displace.

The Business Roundtable’s brief appeals to such a view, transforming the original, SEC lack-of-authority attack in an area traditionally committed to state lawmaking argument into a parallel arbitrary and capricious one:

The [SEC’s] adopting release is arbitrary and capricious in its treatment of state law. The rules’ stated purpose is to effectuate shareholders’ “state law rights” to nominate directors. … [But] Delaware, where more than half of U.S. public companies are incorporated … , has a law that specifically addresses shareholder access to the proxy for director nominates and provides that an access mechanism may be established by a company’s shareholders through a bylaw amendment… While claiming to effectuate state law rights, the [SEC’s] Proxy Access Rules effectively moot them....

59 Brief of Business Roundtable, supra note 55 (numbered paragraph 3). Joseph Grundfest had similarly argued that Delaware access law eviscerates the SEC’s view that the SEC, via Rule 14a-11, is replicating the state-based annual meeting, but through the proxy solicitation process. Delaware’s more limited access rules define the state-based process, he shows, and hence the SEC is going further than creating a proxy-oriented state-based meeting. Grundfest, supra note 25.
More vivid for the court is the contrast with one state, North Dakota, that has an expansive access rule. In this setting, of two real statutes being in play — one expansive on access and the other not — the federalism choice is harder than if there were no state statute to preempt.

E. To Keep the Federal Dogs at Bay

Consistent with the less charitable possibilities, some corporate players could have wanted to reduce the odds that the SEC in the end would act — and they might still harbor such hopes. After the Business Roundtable lawsuit was filed, the SEC stayed effectiveness of its new rule, suggesting that it may back down. And a new Commission (the August 2010 vote on access was 3-2) after another national election may decide not to revive the suspended rule, or the same Commission fighting for congressional budgetary support from a new Congress elected in November 2010 may defer to new congressional priorities, which may not include access. Some corporate players may have wanted Delaware to pass a rule that had limited impact, because even a weak Delaware rule might slake the Washington appetite for a strong federal access rule. After the 2008 election (and before the 2010 one), those corporate players that were influential in Delaware, like the corporate bar, may have assessed that the likelihood of SEC action was high and, in the context of the 2008-2009 financial crisis, would be widely supported in that Congress.

Congress at the time Delaware acted was considering lifting any doubt about the SEC’s authority to promulgate access by passing an explicit statute and eventually did. Delaware officials understood the potential consequence: The Dodd-Frank bill’s corporate governance provisions, like Sarbanes-Oxley’s earlier federal inroads into corporate lawmaking, “some [Delaware] officials say[,] could … erode Delaware’s corporate leadership role, and eventually the

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60 Publicly Traded Corporations Act, ch. 102, 2007 N.D. Laws 497, codified at North Dakota Cent. Code § 10-35-08. North Dakota’s access rule is mandatory, available to 5% shareholders holding stock for at least two years before seeking access. Cf. Reincorporation in N.D. Has Advantages and Disadvantages, CORP. COUNS. WEEKLY, May 13, 2009 (corporate “law panelists commented that the recent changes to the Delaware corporate law were probably prompted, in part, by the enactment of the North Dakota Act”).


62 Senator Schumer proposed such a statute and a provision is in the eventually-enacted omnibus financial reform bill. U.S. Senate, The 2009 Shareholder Bill of Rights Act, S. 1074, 111th Cong. 2d Sess.
revenue the state gets from companies incorporating there. But if Delaware enacted access, Congress might have been less willing to so authorize the SEC. Said one astute corporate lawyer: “the Delaware General Assembly may have thought that by enacting a specific proxy access bylaw before a federal proxy access law or rule was enacted, the federal legislators and regulators would find it, legally and politically, more difficult to supersede the new Delaware law.”

The Delaware statute, while not providing meaningful shareholder access to the ballot, could still have been good enough to satisfy some SEC commissioners such that they put their reform energies elsewhere. More importantly, the Delaware statute could have satisfied a busy Congress that the states were “on it” and that, hence, Congress could focus its financial reform attention elsewhere. Congress, with budgetary control of the SEC, can influence where the SEC puts its efforts. A weak but plausible Delaware statute could have induced (and may still yet induce) Congress to realign the SEC’s priorities. One can think of the moves in chess terms: director-friendly players sacrificed a pawn of weak access for positional advantage on the chessboard in Washington where strong access was in play.

Said one SEC commissioner (who was not disposed to favor required access to begin with): “[S]tates are in the midst of promoting a tailored company-by-company approach to shareholder director nominations…. Consider … [Delaware’s] new section 112….” Said a major law firm

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64 Nathan, supra note 42 (emphasis added). Cf. Wachtell, Lipton, Rosen & Katz, Proxy Access Revisited (law firm memorandum, Mar. 29, 2010):

[T]he best way to conduct an experiment of the costs and benefits [of access] is not to usurp the traditional role of state corporate law …, but rather to permit proxy access on a state-by-state, case-by-case, company-by-company basis.

65 Cf. supra note 38 & accompanying text (implications of Chair Shapiro’s speech).

66 For generalizations, see Mario Bergara, Barak Richman & Pablo T. Spiller, Modeling Supreme Court Strategic Decision Making: The Congressional Constraint, 28 LEG. STUD. Q. 247 (2003) (Supreme Court moves from its preferred position to slake Congress’s appetite to act); Roe, supra note 3 (Delaware moves to thwart federal action). See also Anna Harvey & Barry Friedman, Ducking Trouble: Congressionally-Induced Selection Bias in the Supreme Court’s Agenda (June 1, 2008), available at http://politics.as.nyu.edu/docs/IO/2787/HarveyFriedman Cert.pdf; William N. Eskridge, Overriding Supreme Court Statutory Interpretive Decisions, 101 YALE L.J. 331 (1991); John Ferejohn & Barry Weingast, A Positive Theory of Statutory Interpretation, 12 Int’l J.L. & ECON. 263 (1992).

67 Troy Paredes, Commissioner, SEC, The Proper Limits of Shareholder Proxy Access, Remarks at the Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, June 23,
substitution to the SEC, one in which the law firms opposed full-scale, SEC-mandated access: “Indeed, Delaware expressly contemplates that proxy access provisions will be included in the by-laws [citing to Delaware, § 112]. … [The better approach is to] address[ the issue] at the company or state level, and in any event, not as part of the debate on [SEC-inspired] proxy access.” 68

As one prominent corporate lawyer said when Delaware was on the verge of passing its access rule, Delaware will pass access and “[a]t that point, … there isn’t much reason for the SEC to try to create a whole new proxy access scheme that would preempt state law when state law had already provided for access,” he said. 69 That savvy corporate players think in these terms — of shielding their law and their constituents with concessions to the Feds — is not to be disputed. A century of thinking on the race among states to make corporate law has states in general and Delaware in particular thought to regularly act strategically in keeping state coffers filled with franchise fee revenues. Chief Justice Myron Steel of the Delaware Supreme Court, when complaining about a “populist frenzy” in Congress on corporate issues, indicated that Delaware and its allies “concede proxy access as a way to blunt calls for shareholder say-on-pay.” 70

F. Contractual Parallels?

Parallel private efforts occurred. A law firm representing boards and senior managers recognized that the decade’s pressure for shareholder access might be met by boards acquiescing and adopting shareholder access bylaws. 71
Their model access bylaw for boards, however, would not be substantively useful to shareholders wanting cost-effective access. Each shareholder could nominate only a single director, and only shareholders owning at least 5% of the company’s stock could nominate a director — an ownership level uncommon in American public firm stockholding. Worse yet for the shareholder activist, the single nomination could not be made by shareholders aggregating their stock to a 5% holding — a roadblock seriously impeding shareholders at the many companies that lack a single 5% shareholder, and which are the very companies where the distance between shareholders is greatest. 72 It’s those diffusely-owned firms where managerial and board insulation is likely to be highest that could most benefit from shareholder access. Hence, the appearance was that companies could use the law firm’s bylaw to indicate that they facilitated access, but without actually facilitating meaningful shareholder access. The strategic intent is clear, as the drafting law firm said that their purpose was to recommend “the preemptive adoption of a reasonable and … tailored bylaw, in part to deter, or discourage adoption of, more extreme … shareholder access....” 73

Delaware’s access statute, whose barriers to meaningful access are substantial but not as high as the law firm’s model managerial bylaw is, in its effect, regardless of the legislators’ intent, in the same spirit. It has the aura of access, but given the “Catch-22” effect of no cheap access to the proxy statement without shareholders first succeeding in a typically expensive proxy fight, it does little to reallocate authority between boards and shareholders.

**IV. THE POLITICAL ECONOMY ABSTRACTIONS**

These Delaware-Washington differences can be mistakenly dismissed as mere local maneuvers, without general implications for the making of American corporate law. But they are better seen as manifesting a big picture, political economy conceptualization of American corporate lawmaker: two jurisdictions make American corporate law and each has differing private inputs, differing aggregation mechanisms for decisionmaking, differing philosophies, and differing public policy goals. The Washington-Delaware shareholder access differences reflect fundamental differences in inputs, in philosophy, and in goals between the two lawmakers jurisdictions. And how the two jurisdictions

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72 Bebchuk & Hirst, supra note 20.
73 Mirvis, supra note 37.
interact is fundamental to understanding the crucible of American corporate
lawmaking.

Delaware we know gets a hefty fraction of its state budget from corporate
franchise fees and related charges. The immediate players who bestow these
benefits on Delaware are corporate boards and shareholders, each of which has
to approve reincorporation into Delaware for a non-Delaware company to
become a Delaware company that pays Delaware franchise fees. The direct
direct political salience of interests (such as corporate employees, citizens affected by
corporate behavior, and public policymakers looking at how best to organize the
economy), is not vivid in Delaware. Those other interests neither vote in
Delaware elections nor do they directly provide franchise fees. The absence in
Delaware of a constituency statute (common in other states, formally allowing
the board to take into account non-shareholder interests in decisionmaking,
particularly in merger decisions) symbolizes the narrow scope of influential
interests in Delaware — boards and shareholders, with the typical statutory
mechanisms being enabling for the two groups, not mandatory. 74 Delaware’s
philosophy is that corporate law ought to be enabling, with decisionmaking
authority generally resting in the first instance in the boardroom. 75

Washington’s political inputs, like those in other larger states, are broader
than those in Delaware. On the public-spirited plane, SEC officials have a
vision of how the American economy would be run best; some at the SEC see a
need for greater managerial accountability, many will be oriented more toward
capital markets efficiency than to Delaware’s philosophy of boardroom
autonomy. And general American popular opinion, which is often anti-
corporate, will count more in Washington than in Delaware. On the interest
group plane, the labor and political shareholder activists — state pension funds
are often politically-influenced and the AFL-CIO and other labor shareholder
funds are small but active — can have more weight in Washington, particularly
during a Democratic administration. The low-road view would see shareholder
access, particularly as embodied in the SEC’s Rule 14a-11, 76 as primarily

74 And corporate lawyers like tailor-made deals, which require more legal skill. Corporate
dealmaking lawyers are influential in Delaware, typically drafting up the legislation; they are less
influential in Washington.

75 From where it typically does not migrate. See Hansmann, supra note 13.

76 The now-stayed rule mandates that access be permitted for shareholders with ownership
aggregating to 3% of the company’s stock, if the shareholders owned the stock for at least three
years and do not seek control of the target. Hence, hedge funds and financial activists who have
bought into a company recently and are considering seeking control, cannot readily use 14a-11
access. State pension funds with indexed, long-term portfolios can. If the Delaware rhetoric
indicates capture by, or at least the influence of boards and their allies, 14a-11 is evocative of SEC
capture by the public pension funds and their allies.
benefiting these constituencies. But even a charitable view of the SEC’s political economy in this dimension is largely consistent: Corporate governance reformers want to make managers more accountable. They may indeed see agenda-driven activists as having pernicious and costly side-agendas, but could consider the costs of their influencing corporate agendas in their own favor as, given the reformers’ perception that there’s a major need for more managerial accountability in the American corporation, not so bad (or, depending on the reformers’ other political views, as not even costs). In this lower-road view, we get corporate governance rules at the federal level that tilt toward shareholder activists with a nonfinancial agenda, while we get corporate rules at the state level that tilt toward corporate insiders, with neither level politically well-suited to produce the most economically efficient corporate law possible.

The contrasting inputs can paint a political economy paradigm. Delaware seeks a rule that is satisfactory to its prime constituencies — directors and many shareholders — and doesn’t seek to satisfy others, such as activist interests wanting the corporation to be more accommodating to social claims on the firm or public-spirited corporate policymakers seeking to minimize managerial agency costs for efficiency reasons. It could have better satisfied the latter by enabling shareholders to put on the company’s proxy solicitation bylaw proposals that would define the terms of company-paid elections. It did not.

At the same time, Washington is either too busy to act or, when it does act, is overly motivated by political interests with electoral influence. Financial shareholders, with neither ties to management nor non-financial goals, have reason to find Delaware and Washington each to come up with rules that they, financial shareholders, find imperfect.

In this view, Delaware is the place where directors’ representatives (via their lawyers) meet with some shareholders’ representatives to draft corporate law that will be seen as satisfactory enough to Washington actors in Congress, the federal agencies, and the federal courts, such that those national actors leave the Delaware result alone. Or it can be seen as the place where directors and their lawyers make a counteroffer to the SEC and the activist, public pension fund shareholders.

One can abstract this Washington-Delaware political economy contrast even further by seeing the firm as consisting only of three players: managers, activist public pension fund shareholders, and financial shareholders. Financial shareholders are the “swing” group, in that they could consider activist shareholders as their allies in reducing managerial drift. Or they could see

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77 See Grundfest, supra note 25. For example, 14a-11’s 3-year holding period requirement is one that public pension funds — influential now in Washington — could often meet, but one that activist hedge funds could not.
managers as their allies in suppressing the quasi-political voices of the most likely activists. The rhetoric around shareholder access has more than a little of this kind of coalition formation and cycling, as Figures 2 and 3 illustrate. Director-oriented groups (such as the Business Roundtable and the Chamber of Commerce) appeal to financial shareholders to (implicitly) tolerate some managerial drift in exchange for shutting out interests — pushed by public pension funds and labor-oriented shareholders — that would be less likely to maximize shareholder profits. The Delaware arena, because it, unlike Washington, allows no direct representative input for these other interests, is then put forward by managers and their organizations, such as the Business Roundtable and the Chamber of Commerce, as the better arena not just for managers and boards, but also for financial shareholders.

The submission letters to the SEC on its proposed rules are consistent, with the managerial letters opposing, the state pension funds and similar players supporting, and the financial shareholders (like mutual funds) divided. In this view, Delaware made a bid to control proxy access rules, via §§112 and 113. It tilted authority toward incumbent boards. At first Washington rejected its bid, as the SEC promulgated its access rules anyway. But the SEC

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78 See supra note 25 & accompanying text (Safeway controversy). The earlier perception that the trade-off was between managerial agency costs and influential shareholders with a conflicted, often nonshareholder agenda, arose again during the 2010 effort. Consider the statements of two SEC commissioners. Said Commissioner Casey:

I believe many [investor] activists will concede that their interests in proxy access do not lie solely in the ability to successfully place a nominee on a company’s board of directors; instead, the proxy access right is also an important means of obtaining leverage to seek outcomes outside of the boardroom that may not otherwise be achievable — outcomes that are often unrelated to shareholder value maximization.


It’s no coincidence that only unions and cause-driven, minority shareholders want this coveted access. They would use it to advance their own labor, social and environmental agendas instead of the corporation’s goal of maximizing long-term shareholder wealth. The rule will give them pressure points with which to hold companies hostage until their pet issues are addressed.

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Unions and special-interest groups successfully lobbied Congress to include a provision in the recent Dodd-Frank Act to empower the SEC to make rules regarding proxy access. Paul Atkins, The SEC’s Sop to Unions, WALL ST. J., Aug. 27, 2010, at A15. The special interests he identified are “politically powerful trade-union activists, self-nominated shareholder-rights advocates, [and] trial lawyers.” Id.

79 See supra note 24.
Shareholder Access, in Delaware and in Washington

afterwards stayed its own rules in the face of the Business Roundtable lawsuit in the D.C. Circuit; Delaware, in this strategic view, may still get its way.

Spatial models, which many political scientists favor, facilitate our understanding. Begin with the interests: managers, activist investors and financial investors, as in Figure 4. Managers prefer that no shareholder have access to the company’s proxy statement, as access would intrude on managerial autonomy. Activist investors seek easy access, with minimal prerequisites to access. Financial shareholders do not seek broad access but do want to limit some types of managerial autonomy. Figure 4 illustrates the range of interests in their preference for more, or less, shareholder access.

Next, we need to locate the original positions of the main government bodies in this spectrum. We position the SEC, an agency that has investor protection as its raison d’être and in recent years has had public pension fund influence, between the preferences of financial and activist investors. Delaware is at first positioned between managers’ and investors’ preferences. The SEC prefers access, but that preference is not initially strong at the beginning of the decade. It is not active in promoting access in the year 2000.

Consider this as the play of interests and positions of government authorities, circa 2000. Figure 5 illustrates, with the gray circles indicating position but the gray indicating inaction.

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80 The most analogous political scientists’ work is in Bergara, Richman & Spiller, supra note 66, on Supreme Court labor-relations decisions. They model and bring forward evidence that the Court comes down in the space between its own preferences and that of the relevant congressional committee. Cf. Anna Harvey & Barry Friedman, Ducking Trouble: Congressionally Induced Selection Bias in the Supreme Court’s Agenda, 71 J. POLITICS 574 (2009).
After scandals (Enron, WorldCom in 2002 to 2003) and then again after the 2008 financial crisis, the SEC actively promotes shareholder access and Congress considers expanding SEC statutory authority to promulgate access rules. In normal times, access is neither on the congressional agenda nor high on the SEC’s. Crisis and scandal motivate each toward action. Figure 6 illustrates, with the dark circles indicating position and activity.

Pulled along by the activity in Washington, Delaware moves from opposing access to favoring mild access, as Figure 7 illustrates. Delaware, in this view, is nimble, and is more nimble than the Washington players. It can position itself more quickly and, in 2008 and 2009, is able to assess where Congress stands and what the likelihood is that the SEC would move. So, it moves quickly in order to stay relevant when Washington is in motion, to reduce the chance that either Congress or the SEC act (because, although Delaware’s new position is not at either Washington player’s ideal point, its new position might be good enough for one or the other in Washington to decide not to go any farther), and perhaps to set up political and judicial federalism challenges to SEC shareholder access action.81 Or its moves have those effects.

81 One might ask why Delaware did not act similarly in 2003 and 2005. Possibly the relevant players just did not think of the maneuver. Another is that it took awhile, after a half-dozen years of federal percolation, for Delaware to interest itself in the issue. Another, less charitable explanation is that those opposing access in 2003 thought the best strategy was to take it head-on at the federal level, by using political muscle and influence in Congress and on the White House to influence the SEC. A Delaware foray might have helped, but could have split, and thereby weakened, the better effort. After the 2008 elections, the muscle in Congress and the White diminished, calling forth different tactics.
Figure 7. Delaware enacts limited shareholder access, which could minimize action in Washington.

This spatial analysis for federal-state interaction gives us a conceptual array of the forces and pressures in making corporate law in America. It doesn’t tell us whether lawmaking results are more efficient at one level or another. But with the spatial arrays in mind, we are better positioned than before to measure the impact. Delaware proponents are in effect arguing that by weakening the corporate governance impact of shareholders lacking a pure shareholder agenda (as CalPers and the AFL-CIO lack), firms will do better overall for shareholders even if some price is paid in managerial agency costs, by allowing boards to be less accountable to the actual, real-world nonfinancial shareholders that we have. Access proponents are in effect saying that the trade-offs come out the other way — greater managerial and board accountability will produce more value, even if at the expense of greater voice for shareholders lacking a purely financial agenda.

When the SEC unexpectedly stayed effectiveness of its own access rules in September 2010, these trade-offs were in theory available to be measured by the stock market. If SEC-mandated access was superior to the status quo for shareholders overall, then the removal of SEC access should have hurt stock price for firms in which shareholders had more opportunity to use access more than the stock price of firms in which shareholders were less likely to use access. Initial data suggests that this was so, although at a low level.82

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Notice now what we have done. We now have a governmental interaction explanation for Delaware’s moves on a critical corporate law issue, an explanation that does not depend on the traditional state competition motivator, and one that is both nuanced and potentially complete in explaining Delaware’s movement on shareholder access in the past decade.

CONCLUSION

The merits of shareholder access have been extensively analyzed. But access has a political economy, federalism dimension as well, and that dimension may determine the regulatory outcome as much as, or more than, views of the merits.

Shareholder access has been core for corporate activist reformers during the past decade. The early action was at the SEC, as the scandals of the early part of the decade allowed and induced reformers to put a broad access rule onto the SEC agenda. For most of the decade the Delaware players did nothing to advance shareholder access. When the state players acted, they impeded it.

Then, in 2009, Delaware unexpectedly passed an access statute. The access statute’s passage vividly illustrates an underappreciated but foundational aspect in understanding the governmental structure of American corporate lawmaking — namely that Delaware operates not just in relation to the other states but in relation to Washington. Indeed, it’s plausible that its main constraints come as much from Washington as from the other states. Although another state had authorized shareholder access, the shareholder access action and pressure on Delaware mainly emanated from action in Washington, not from strong state-to-state competition.

Some responsible Delaware corporate lawmakers and legislators became convinced by the ongoing Washington debate that access was a good idea whose time had come, and some lawmakers surely wanted to clarify a long-standing Delaware conceptualization of board centrality and shareholder authority in the corporation. But it’s as plausible that the legislative result also reflected anti-access thinking from some, with the Delaware legislature passing what its board-centered corporate constituency clearly saw to be a minimally-acceptable access rule that would slow down and maybe stymie federal shareholder access rules. Surely managerial players have used the statute to press such views.

Despite that the Delaware rule would not give immediate meaningful access (and perhaps no access at all), it had the aura of real access, it enables the rhetoric of shareholder choice as an alternative to the SEC rules, and that aura
and those rhetorical moves could have been thought likely to slow down Washington from acting to implement full access. With the rule self-stayed by the SEC, with no transactional impact for now, and with the state-federal issue in play in the D.C. Circuit, it may still impede federally-mandated access.

It would be wrong to attribute a single, stained view to all Delaware players, especially one with such a strongly Machiavellian strain. Some players thought that following *Computer Associates*, the legislature needed only to clarify that bylaws could allow access. Other players always thought shareholder access to be a good idea but are indifferent to where the default rule lies; the federal action on access could just have brought forward a long-held view for action, but not have influenced the substance of that view. And surely some players preferred on merits that there be an expansive access rule. But even public-spirited views will tend to be selected, emphasized, and highlighted when there are interests in the political environment that do better if such views become law. Even those interested in the outcome will push views that they sincerely believe to properly allocate power among shareholders and directors in the American corporation.

It’s not necessary for the Delaware players to have been as Machiavellian for the action to have been self-interested. While Delaware has long been thought to have its eye on the cash register for franchise fees when it makes corporate law, this level of capture and calculation is not needed to make out the strategic interaction story in this article. Concepts of cognitive capture have already moved from psychology to finance to help to explain government decisionmaking during the recent financial crisis.83 Similar concepts can well apply to Delaware players. Ideas emerge. The ideas can capture the imaginations of lawmakers and those who influence lawmakers. Sometimes those ideas also map onto self-interest of those who promote the ideas, even if the ultimate public decisionmakers are free from that stain of self-interest.

83 Cf. RAGHURAM G. RAJAN, FAULT LINES (2010). Consider his analytic of the relationship between Henry Paulson, the Secretary of Treasury at the beginning of the crisis, and the financial firm he previously led, Goldman Sachs, said to benefit from the Secretary’s decisions:

I don’t think for a moment that Paulson, for example, was doing this because he was benefiting Goldman Sachs. … [O]ne of the things you learn when you read his book is the extent of [his] cognitive capture, the extent to which he doesn’t seem to be worried about the picture of the secretary of the Treasury calling GE, in one case, or Goldman Sachs to ask for their opinions. But what does come out is a person who thinks he is doing the right thing by the United States.

… [T]hese people were doing their best, but in an environment where they were getting filtered information.

Delaware and Washington interact in making American corporate law. Delaware cannot go farther than Washington would allow in making corporate law. And sometimes it is pulled along in the undertow of a federal wave, either pulled to where it did not otherwise want to go or repositioning itself while hoping to slow down that wave by moving along but not going as far as Washington would. That kind of conflict, positioning, and at times cooperation is core to the understanding of American corporate lawmaking. The shareholder access statute in Delaware when interpreted in light of the activity and pressure originating in Washington well illustrates that concept of federal-state interaction as often being more important than state competition in understanding the shape, pressure, and structure of state-made corporate law. How the two polities interact defines a good part of the terrain for the politics of shareholder and managerial power in the large American corporation.