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INSTITUTIONAL INVESTORS AND THEIR ROLE IN CORPORATE GOVERNANCE:
REFLECTIONS BY A "RECOVERING" CORPORATE GOVERNANCE LAWYER*

David P. Porter†

The Symposium's title question "Institutional Investors in Corporate Governance: Heroes or Villains?" is intentionally so broad that it leaves wide open the limits of discussion. In this Article, I will focus my remarks on my perceptions, based on my experiences over twenty-seven and one-half years of practice, about the intersection between institutional investors and corporate governance in the corporate, non-litigation setting.

To put my comments in perspective, I'll begin with some comments on the role of the corporate governance practitioner. I'll then discuss my views concerning "corporate governance," including the differences between what I term "procedural corporate governance" and "substantive corporate governance," and point out the fundamental difference in the corporate governance model here in Ohio, which is a "constituency state," from that of Delaware, which is not. I'll provide my thoughts on what good corporate governance is in practice, which necessarily includes some of my biases toward corporate control issues in general. With that background in place, I will then discuss how I believe institutional investors have influenced

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* This commentary is an extension of remarks made by the author at the George A. Leet Business Law Symposium "Institutional Investors in Corporate Governance: Heroes or Villains?" held under the auspices of the Center for Business Law and Regulation at Case Western Reserve University's School of Law on April 17, 2009.

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corporate governance, mostly for the good but sometimes for the bad, by examining:

- their role in establishing the current baseline of corporate governance practices in the primary U.S. public capital markets,
- their role in the Rule 14a-8 shareholder proposal process,
- the already large impact of proxy voting advisory services, and the potential game changing impact from the impending revocation of broker discretionary voting authority,
- the hidden world of shareholder “jawboning,”
- the somewhat recent emergence of “hedge fund attacks,” and
- the role of institutional investors in the ultimate battleground of corporate governance: takeover fights.

I. THE CORPORATE LAWYER’S ROLE IN CORPORATE GOVERNANCE

I come to this Symposium as a “recovering” corporate governance lawyer, someone who has only recently moved from active practice into the academic world. Until January 1, 2009, I was a partner in a major global law firm, representing numerous publicly-traded U.S. corporate clients, and advising management teams and boards about corporate matters across a broad spectrum of issues. Those issues frequently involved the relationships of corporate executives or Boards of Directors with the corporation’s shareholders and with each other—interactions commonly recognized today as corporate governance issues.

I am also an active participant in developing Ohio’s corporate governance law. As a member of the Corporation Law Committee of the Ohio State Bar Association, which monitors developments in corporate law and is the primary source for Ohio legislation in the corporation law field, I have led or participated in numerous drafting assignments and chaired various subcommittees, ultimately serving as Vice Chair (2005–2007) and Chair (2007–2009) of the Committee. In those capacities, I have testified numerous times before committees of the Ohio General Assembly on proposed corporate legislation,
including a number of measures directly affecting corporate governance.¹

Throughout my years of practice, and as I heard echoed in some of the remarks earlier in this Symposium, I have observed a tendency by some observers of corporate governance to view corporate lawyers, especially those at large firms, as primarily "defenders of management" and presumptive enemies of good corporate governance. I vehemently disagree. I'll start off by discussing what I see as the proper role of corporate governance lawyers.

My perspective is that of a corporate lawyer, a non-litigator. In the corporate governance arena, the corporate lawyer serves primarily as an "advisor."² Under the Model Rule of Professional Conduct (the "Model Rules"),² and their Ohio analog ("Ohio Rules"),³ an advisor is one who "provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications."⁴ While at times a corporate governance lawyer may also be an advocate, negotiator, or evaluator,⁵ the corporate governance lawyer's principal role is to counsel the Board of Directors and officers about corporate governance laws, rules, and related matters, their implications for the corporation's behavior, and the relationships among various corporate constituencies. As a counselor, the primary task is to propose practical, workable solutions to relational issues, and to minimize litigation risks for the client.

But in the lawyer's role as an advisor on corporate governance matters, who is the client? The short answer, under ethics rules⁶ and

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the securities regulations that are often applicable to corporate governance lawyers,\(^7\) is the entity—the corporation itself. Of course, in representing an entity, there must be some human representatives to whom the lawyer reports and from whom the lawyer receives instructions.\(^8\) In a corporate setting, the representative will sometimes be a member of the Board of Directors, especially in special counsel assignments. More typically, however, the relationship is conducted primarily through the general counsel, the chief executive officer or another executive officer, or some combination of those officers. As is vitally important for both the lawyer and the officers to understand, the corporate lawyer is ultimately a servant of the Board of Directors, just as the officers are. The Board (the group of directors collectively, not individually) is legally recognized to be the highest day-to-day decision-making authority for the entity.\(^9\) Therefore, in a fight between the Board and the officers, or the Board and individual shareholders, the corporate lawyer must take his instructions from, and owes his allegiance to, the Board.\(^10\)

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> An attorney appearing and practicing before the Commission in the representation of an issuer owes his or her professional and ethical duties to the issuer as an organization. That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer does not make such individuals the attorney's clients.

Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205.3 (2008). Because the so-called "up-the-ladder reporting requirements" contained in those rules apply to a broad group of lawyers involved in the preparation of disclosure documents filed with the SEC, and attach to breaches of "fiduciary duty" as well as to violations of the securities laws, many corporate governance activities will be captured by those rules.

8 See Ohio Rules of Prof'L Conduct R. 1.13 cmt. 1 (2007), available at http://www.supremecourt.ohio.gov/LegalResources/Rules/ProfConduct/profConductRules.pdf ("An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders, and other constituents.").


10 Lawyers representing corporate clients do not have fiduciary duties to shareholders. As was well-summarized by the SEC, "Decisions in a number of states recognize that, under state law, an attorney for an issuer does not owe a fiduciary duty to shareholders." Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, Exchange Act Release No. 47276, Investment Company Act Release No. 25,919, 68 Fed. Reg. 6,296,
In most corporate work, such as corporate finance or mergers and acquisitions, there is no tension between management and the Board, because they are working together to achieve a common corporate goal. But conflicts can, and do, arise whenever the interests of the officers conflict with those of the entity. The greatest ethical test for the corporate governance lawyer is to recognize when a conflict exists between the interests of individual officers or individual directors and the interests of the entity. It is then that the lawyer must understand that his duty is to the entity, and be prepared to give his best advice to the Board. Such a scenario is almost always the situation when one speaks of corporate governance.

II. WHAT IS "CORPORATE GOVERNANCE"?: PROCEDURE VS. SUBSTANCE

It has been accurately stated that "[until the 1990s the phrase] corporate governance was rarely uttered outside the arcane world of law school texts and academic treatises." Although I practiced what we today call “corporate governance law” in the 1980s, we then called it “corporate counseling.” Surprisingly, given all of the attention that has been given to “corporate governance” during the last two decades, the term itself is still not well-defined. It has been variously described as “the system by which companies are directed..."
and controlled"14 or more fulsomely as "the set of processes, customs, policies, laws, and institutions affecting the way a corporation is directed, administered, or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed."15 Robert A.G. Monks and Nell Minow, in their excellent treatise entitled Corporate Governance, now in its fourth edition,16 define corporate governance aspirationally, as "the structure that is intended to make sure that the right questions get asked and that checks and balances are in place to make sure that the answers reflect what is best for the creation of long-term, sustainable value."17 While closer to the mark, even this fails to capture what I think people mean when they refer to "corporate governance."

A broader, more complete, definition is simply how a corporation is run. I see corporate governance as actually constituting two vastly different matters. The first is procedural in nature—that is, what is the system by which the corporation makes fundamental decisions? The second is substantive—who makes the decisions and did what they decide actually result in a good outcome for the corporation? The process is readily measurable by third parties against objective standards, while the substance is largely immeasurable, at least in real time. This is because the true outcome of the decision-making cannot actually be known until sometime in the future, and any present day evaluation requires at least some degree of crystal-ball ing as well as a high degree of subjectivity. Process also yields itself readily to lawyer intervention (we are architects and engineers of a sort, quite able to design and implement systems, policies, and procedures).18 Substance, on the other hand, does not. Nevertheless, some Boards or management may choose to involve lawyers in matters of substance, although in such cases the lawyer is acting more in the capacity of a

15 Wikipedia.org, Corporate Governance, http://en.wikipedia.org/wiki/Corporate governance (last visited Apr. 15, 2009). To similar effect is Margaret Blair's definition: "the whole set of legal, cultural, and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated." BLAIR, supra note 12, at 3.
17 Id. at 3.
18 See George W. Dent, Jr., Business Lawyers as Enterprise Architects, 64 BUS. LAW. 279, 326 (2009), in which the author aptly describes corporate lawyers as castle architects and litigators as soldiers in battle. In my own view, it is important to add to Professor Dent's metaphor of corporate lawyer as architect the idea of "engineer," as corporate lawyers must also implement designs (their own or others) to actually build the corporate castle's ramparts and waterworks.
sophisticated business counselor or wise man (i.e., someone who can intelligently tell a Board or CEO that what they plan to do is stupid).\textsuperscript{19} This is not the normal role of most corporate lawyers, though many may aspire to become so regarded by their clients.

Certainly, when lawyers speak of corporate governance, they mostly mean procedural corporate governance. And as I'll discuss, many of the activities of institutional shareholders are focused primarily on procedure as well. Yet what I think most shareholders really care about, and really mean by corporate governance, is not "how does the corporation make its decisions?" but "do the people running my corporation produce good outcomes?"\textsuperscript{20} The answer to "is it well run?" is best measured by financial results, not process. To use the vernacular, "what's important is the bottom line, stupid." And I believe that substance is, at root, what matters in both the hedge fund attack and takeover situations I discuss below.

Yet lawyers know that process can be important to outcome. Having a checklist is one of the first things young lawyers learn about

\textsuperscript{19} Though a tough thing to do, this sort of advice falls squarely within the lawyer's ethical obligations. Rule 2.1 of both the Model Rules and the Ohio Rules provides the standard by which a lawyer acting as a counselor or advisor must work: "In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social, and political factors, that may be relevant to the client's situation." \textit{MODEL RULES OF PROF'L CONDUCT R. 2.1} (2008); \textit{OHIO RULES OF PROF'L CONDUCT R. 2.1} (2007), available at http://www.supremecourt.ohio.gov/LegalResources/Rules/ProfConduct/ProfConductRules.pdf. As stated in comment [1] to both rules:

[a] client is entitled to straightforward advice expressing the lawyer's honest assessment. Legal advice often involves unpleasant facts and alternatives that a client may be disinclined to confront. In presenting advice, a lawyer endeavors to sustain the client's morale and may put advice in as acceptable a form as honesty permits. However, a lawyer should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client.


\textsuperscript{20} See, for example, the comments of Jeffrey Bronchick of investment advisory service firm Reed, Conner & Birdwell, in a letter to the board of directors of Chesapeake Energy Corp. regarding the CEO's reported $112 million compensation package: "If I could reduce it to one page, I would frame and hang it on my office wall as a near perfect illustration of the complete collapse of appropriate corporate governance." Ben Casselman, \textit{Chesapeake Holders Denounce CEO's Pay}, \textit{WALL ST. J.}, Apr. 28, 2009, at B1 (quoting Letter from Jeffrey Bronchick, principal and Chief Investment Officer, Reed, Conner & Birdwell, to the board of directors of Chesapeake Energy Corp.). I think it unlikely Mr. Bronchick is commenting merely on the process of determining executive compensation, which is detailed in the company's preliminary proxy statement for its 2009 annual meeting. \textit{See Chesapeake Energy Corp., 2009 Preliminary Proxy Statement} (Schedule 14A), at 41-44 (Apr. 30, 2009), available at http://www.sec.gov/Archives//edgar/data/895126/000119312509082663/dpre14a.htm#toc38309_44 (detailing the changes in CEO compensation and the rationale used by the Compensation Committee to support them).
completing transactions; she who lacks a checklist (or fails to follow it) may find herself without a key document at a closing, causing the deal to fail. Checklists, policies, and procedures do play a role in ensuring, as Monks and Minow put it, that "the right questions get asked."\(^{21}\) So I am not denigrating procedural corporate governance, merely acknowledging that it is substantive corporate governance that actually matters the most to most non-lawyers. The best procedural corporate governance in the world may still lead to calamitous results, and the "worst" procedural corporate governance may nonetheless create great returns.

This procedural/substantive dichotomy finds a useful parallel in the liability of directors: we punish directors not for making the wrong decision but for not working hard enough in making their decision. Procedural corporate governance is a major component of a director's duty of due care, and failures of governance process can be so grossly negligent\(^{22}\) that they form the basis for a viable complaint against the director for breach of the duty of due care.\(^{23}\) In contrast, poor substantive corporate governance, that is, poor judgment, is unlikely to result in a viable claim against a director absent bad faith.

This is certainly true for Delaware corporations. Because of the business judgment rule, Delaware courts have said "in the absence of facts showing self-dealing or improper motive, a corporate officer or director is not legally responsible to the corporation for losses that may be suffered as a result of a decision that an officer made or that directors authorized in good faith."\(^{24}\) This deference to Board decision-making is supportable because corporate business decisions are inherently all about risk and risk-taking,\(^{25}\) which are matters not

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\(^{21}\) Monks & Minow, supra note 16, at 3.

\(^{22}\) Gross negligence is the applicable standard for personal liability of directors for breaches of the duty of care under the Delaware case law. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("[U]nder the business judgment rule director liability is predicated on concepts of gross negligence."), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

\(^{23}\) For example, an audit committee that neither meets with outside auditors nor questions the financial statements presented by insiders would appear to have failed to meet the standard of "care that an ordinarily prudent person in a like position would use under similar circumstances." Ohio Rev. Code Ann. § 1701.59(B) (West Supp. 2009).


\(^{25}\) See, e.g., In re J.P. Stevens & Co., Inc. S'holders Litig., 542 A.2d 770 (Del. Ch. 1988). Chancellor Allen wrote:

"Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith."
only beyond a court's capacity to adequately analyze and assess, but could, if judged, discourage directors from taking business risks, thereby reducing the efficiency of the corporate model.

Put another way, "directors are not guarantors of the success of the corporation's endeavors." The courts will not penalize directors for their decisions, no matter how poor they seem in hindsight, so long as they acted in good faith and followed good procedures in getting to their "best business judgment" decision. And many Delaware corporations have further shielded their directors from liability even for grossly negligent procedures by adopting the charter provisions authorized by Delaware General Corporation Law § 102(b)(7), a statutory amendment adopted following the "surprise" finding of director liability in Smith v. Van Gorkom. The Delaware Supreme Court has recently further bolstered the protections for Delaware directors by its March 2009 decision in Lyondell Chemical Co. v. Ryan. In reversing the Chancery Court decision that had denied defendant directors summary judgment despite existence of a § 102(b)(7) exculpation clause, the Supreme Court said the inquiry was properly limited to one of whether the directors acted in good faith. The court said that an "extreme set of facts [is] required to sustain a disloyalty claim." Only if [the directors] knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty.

In Ohio, where the business judgment rule has been codified and strengthened, it is even less likely that a director will be held
culpable for a bad corporate outcome. The statutory standard for a
director's personal liability is limited to those acts or omissions that
are "undertaken with deliberate intent to cause injury to the
corporation or undertaken with reckless disregard for the best
interests of the corporation."\(^3\) Moreover, Ohio requires proof of any
such claim to be proved "by clear and convincing evidence,"\(^3\) a
higher standard than Delaware's preponderance of the evidence.\(^5\) So
in both Delaware and Ohio, and other states that follow similar rules,
directors may make decisions that are catastrophic to the corporation
with virtual impunity, provided that they employ proper process in
doing so.

An illustration of this point can be made by looking at whether
General Motors has displayed good corporate governance during the
past decade. From a purely procedural perspective, GM probably
more than meets the standard of having good procedural governance
practices in place. GM's Board has long been represented by Weil,
Gotshal & Manges LLP,\(^3\) which could call on the services of Ira
Millstein, now considered a dean of corporate governance law,\(^3\) to

The relevant statutory provisions are found in OHIO REV. CODE ANN. § 1701.59(C), (D) (West Supp. 2009), which were adopted in 1986 as part of a package of legislation resulting from an abortive takeover attempt against Goodyear Corporation by Sir James Goldsmith. See Michael Ryngaert & Jeffry M. Netter, Shareholder Wealth Effects of the Ohio Antitakeover Law, 4 J.L. ECON. & ORG. 373, 373 (1988); Morgan Shipman, The Case for Reasonable State Regulation of Corporate Takeovers: Some Observations Concerning the Ohio Experience, 57 U. CIN. L. REV. 507, 531-34. The Corporation Law Committee's comments on these sections include the statement that:

The changes in division (C) are intended to make it clear that a director has the benefit of a presumption that he is acting in good faith and in a manner he reasonably believes is in (or not opposed to) the best interests of the corporation in all cases, including those affecting or involving a change in control or a termination of his services. It is believed that the changes are necessary because of the adoption by some courts, notably those of Delaware, of the view that, in such cases, the director becomes an interested party and, as a result, loses the benefit of the business judgment rule.

OHIO GENERAL CORPORATION LAW 105 (Michael A. Ellis ed., Bowne 2009) [hereinafter Ellis].

\(^{33}\) OHIO REV. CODE ANN. § 1701.59(D).

\(^{34}\) Id.; see also id. § 1701.59(C)(1).

\(^{35}\) See 1 LOU. R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS 4-19 n.34 (2005) (discussing that while Delaware chancellors had yet to explicitly articulate the appropriate standard, the preponderance of the evidence standard has been recognized in dicta and most likely applies).

\(^{36}\) MONKS & MINOW, supra note 16, at 440.

\(^{37}\) See, e.g., An Architect of Governance, DIRECTORSHIP MAG., Oct.–Nov. 2007, at 26, 26 ("Ira Millstein is arguably the top lawyer in America in the practice of corporate governance. As a senior partner at the law firm of Weil, Gotshal & Manges, where Millstein has worked since 1951, he has been so influential on the topic that not only did he rank number eight on The Directorship 100, a listing of the most influential people in corporate governance, but Yale Law School named its Center on Corporate Governance after him.").
advise it and help it refine and improve its practices before the Sarbanes-Oxley Act and its progeny made such practices required practices for exchange-listed companies. As early as 1993—albeit after a long period of turmoil and shareholder unrest\(^{38}\)—the GM Board understood it needed a majority of outside directors and a lead director, and that independent directors needed to meet in executive session and oversee board practices.\(^{39}\) A look at its corporate proxy statements shows the GM Board of recent years has had all the bells and whistles of a solid board, including diversity, a majority of independent directors,\(^{40}\) and other good corporate governance practices.\(^{41}\) By these standards, GM appears to be a model of good procedural corporate governance.

Yet with GM's recent bankruptcy,\(^{42}\) how can the GM directors say that their corporate governance was substantively effective? Has the company been well-run? I think many people would say that managing an automotive company into bankruptcy, or a major bank into TARP and billions of dollars of tax dollar infusions, is prima facie evidence of an ineffective Board, and therefore we can't commend their corporate governance from a substantive viewpoint. But is this a correct view?

Challenging the GM Board's substantive corporate governance means assessing the quality of both the decisions and the GM

\(^{38}\) See generally MONKS & MINOW, supra note 16, at 412–50, for a fascinating case study of General Motors's corporate governance history.

\(^{39}\) Id. at 445.

\(^{40}\) For example, the last pre-Sarbanes-Oxley Act proxy statement (2002) names twelve nominees for director. Of these, one (Karen Katen) is female, one (Nobuyuki Idei) Japanese, at least one (Stanley O'Neal) is African-American, one (Armando Codina) is a probable Hispanic, another (Percy Barnevik) a European. Only two are insiders. The outside directors show diversity of industry groups with relevance to a company that manufactures and sells consumer products, including executives or former executives of Compaq, Eastman Kodak, Pfizer, Procter & Gamble, Sara Lee, and Sony. See Gen. Motors Corp., Proxy Statement (Form DEF 14A), at 2–4 (Apr. 18, 2002). And director Stan O'Neal of Merrill Lynch would presumptively have brought financial industry savvy; no one could then predict his later troubles at Merrill Lynch, where he was forced to resign under pressure following that company's record losses. See Bradley Keoun, Merrill CEO Under Pressure to Resign on Record Loss, BLOOMBERG.COM, Oct. 27, 2007, http://www.bloomberg.com/apps/news?pid=20601087&sid=aU9M2CggIrVw&refer=home; Merrill Lynch chief leaves firm, BBC NEWS, Oct. 30, 2007, http://news.bbc.co.uk/2/hi/business/7069383.stm.

\(^{41}\) For example, in response to a shareholder proposal at the last pre-Sarbanes Oxley Act annual meeting in 2002, which asked that a bylaw be adopted to require that all members of the audit, nominating, and compensation committees be independent, the Board was able to respond that all members of those committees (and several others) were already required to be independent directors under corporate governance guidelines adopted in 1994. Id. at 26–27.

\(^{42}\) See the July 14, 2009 filing by Motors Liquidation Company, formerly General Motors Corporation, which describes the sale of all or substantially all of the assets of the former General Motors Corporation in a sale utilizing § 363 of the Federal Bankruptcy Code. Motors Liquidation Company, Current Report (Form 8-K) (July 14, 2009), available at http://www.sec.gov/Archives/edgar/data/40730/000119312509148748/d8k.htm.
leadership. Who really can do that objectively and fairly, other than those who actually were there at the time, knew what the directors knew, and had the same opportunity to make decisions? I think today’s critics of the GM management are simply commenting on an outcome now discernable with 20/20 hindsight, and are not in a position to challenge the actual quality of the decision-making itself, as opposed to the quality of the decision-making process.

There seems no reason to believe that the GM board process was deficient, or that directors were negligent in their due care. I am sure they were not blind to the competition’s strength, the risks attendant to the unfunded post-retirement liabilities, or the costs of North American unionized labor. Maybe the directors then in place were incapable of making the right decisions, or maybe they were capable of making correct decisions, but made poor ones. Maybe there were no possible correct decisions, or possibly, just possibly, the directors made correct decisions but things just didn’t work out to the corporation’s advantage (“sh*t happens”). Regardless of which was the case, there is probably no director liability for any of these outcomes. Only if a director is shown to be self-interested or having an improper motive would there be a viable breach of fiduciary duty claim against the director for a failure of substantive corporate governance.

Having identified the division between procedural and substantive corporate governance, where do the shareholders come in? As we’ll see, shareholders, especially institutional investors, can play a role in each type of corporate governance. Shareholders were key participants in creating our modern governance procedures, and continue to lobby for changes at specific companies, including petitioning for changes in governing documents such as articles of incorporation and regulations/bylaws. On the substantive side, shareholders can influence—or in extreme circumstances compel—directors to change corporate direction, toss out managers who don’t manage well, or even sell the company. But we’ll also see that most

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43 Selecting leaders is not an easy task. Consider President Lincoln’s difficulties in selecting his top general. Ask yourself if you would have chosen George A. McClellan—who dressed impeccably, was a successful businessman, and was known for his skill in organizing and disciplining his armies—or Ulysses Grant—who wore a private’s blouse, was a business failure, and was reputed to be a drunkard. Of course, General McClellan failed in the acid test of “who can whip Bobby Lee?,” while General Grant did not.

44 Dwight D. Eisenhower performed brilliantly in overseeing Operation Overlord, the invasion of Normandy, but failed to guard against the German counteroffensive known as the Battle of the Bulge. Douglas MacArthur directed a brilliant counterattack at Inchon but blew it when chasing the North Koreans to the Yalu River.
investors, including most institutional investors, don’t take an active part in corporate governance.

III. WHO ARE THE DIRECTORS WORKING FOR? IN OHIO (AND OTHER “CONSTITUENCY STATES”), IT MAY SURPRISE YOU

Perhaps the most fundamental question in substantive corporate governance is for whom does the Board of Directors work? For many laymen and law professors, there is an assumption that the corporation, and in turn the Board, serve primarily, or even solely, to maximize shareholder wealth. That is, corporations exist to enrich the shareholders, and any deviation from that purpose is wrong.

What is fascinating to me as one who practiced in this area is that support for this seemingly simple economic premise, much beloved by academics like Milton Friedman, is largely lacking from our corporate statutes and modern case law. Indeed, the contrary position appears explicitly in the corporate codes of over thirty states that see both groups continue to rely on the case to support the faulty premise that the purpose of a corporation is to maximize shareholder wealth; see also Joel Bakan, The Corporation: The Pathological Pursuit of Profit and Power 35 (2004) (discussing the viewpoints of a number of prominent business people, all of whom assert that corporations are set up to maximize shareholder value, rather than advance social goals).

As Professor Stout identifies, this viewpoint derives from literature dating back to the famous 1919 Dodge v. Ford Motor Co. case, in which the court, finding against Henry Ford in his plan to retain earnings, increase production, and reduce the price of cars in place of paying dividends, said, in what Stout argues is dicta, “[a] business corporation is organized and carried on primarily for the profit of the stockholders.” Stout, supra note 45, at 165 (quoting Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919)). The notion was also the conclusion in early writings such as those of Adolph Berle and Gardiner Means in their seminal 1933 work, Adolph A. Berle & Gardiner C. Means, The Modern Corporation and Private Property (Transaction Publishers 1991). See, e.g., id. at 293 (“It is traditional that a corporation should be run for the benefit of its owners, the stockholders . . .”); see also William W. Bratton & Michael L. Wachter, Shareholder Primacy’s Corporatist Origins: Adolf Berle and The Modern Corporation, 34 J. CORP. L. 99, 100 (2008) (“[S]hareholder primacy prevails today as the dominant view . . .”).

This view, taken to an extreme, causes some Americans to perceive corporations as inherently evil, “a pathological institution.” Bakan, supra note 45, at 2.

Those who support the shareholder wealth maximization doctrine echo the words of Nobel Laureate Professor Milton Friedman, who wrote in 1970 “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.” Milton Friedman, The Social Responsibility of Business Is to Increase Its Profits, N.Y. TIMES, Sept. 13, 1970, (Magazine), at 32 (quotation marks omitted).

contain so-called "constituency provisions." Even non-constituency states, such as Delaware, do not apply this approach to limit the broad discretion of directors except in the instance of the sale of the corporation, when so-called Revlon duties apply. As an illustration of how states have limited shareholder primacy, one would suppose that shareholders would like to have the power to determine when they will receive dividends and when they will sell the company as an entirety. But states have restricted those rights, for example, by providing for the declaration of dividends by the Board, and not the shareholders, and requiring that the Board approve any merger. Neither restriction is inherently required to support the corporate form, yet the restrictions exist.

I therefore view the "shareholder wealth maximization" premise to be fallacious as a statement of the law except in isolated circumstances, and then only in some states. What I believe instead is that shareholder wealth maximization is, indeed, a major, often predominant activity of corporations, but that states have expanded permissible corporate activities and goals far beyond shareholder wealth maximization either by the courts or by statute. Accordingly, corporate directors may appropriately pursue these court- or statutorily-sanctioned social responsibilities with no direct benefit to, and often at the expense of, shareholders. It is, thus, the Board that has the primary responsibility for determining the timeframe for shareholder wealth maximization, that is, how fast the corporation will grow, whether and when it will pay out dividends, and whether to

50 The term "constituency provision" refers to statutes, generally adopted in the 1980s in response to takeover bids, that provide, as does Ohio's statute, that directors, in fulfilling their duties to the corporation, may (and in Connecticut's case, must) consider interests other than those of the shareholder in making their decisions. CONN. GEN. STAT. ANN. § 33-756(d) (West 2005); OHIO REV. CODE ANN. § 1701.59(E) (West Supp. 2009).

51 See Stout, supra note 45, at 169-72 (discussing that except in the context of the corporation's sale, many modern Delaware cases suggest that Boards have a duty to consider constituents other than the shareholders and protect directors against claims that they failed to appropriately maximize shareholder wealth).

52 These "duties" require Delaware directors in situations involving the actual sale of the corporation to maximize the return to the shareholders. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). The Revlon duties are actually simply extensions of the normal fiduciary duties of loyalty and due care, but focused on a specific objective: maximizing the sale price. See Lyondell Chemical Co. v. Ryan, No. 401, 2008, 2009 WL 1024764, at *3 (Del. Apr. 16, 2009).


54 See, e.g., DEL. CODE ANN. tit. 8, § 251 (Supp. 2004); OHIO REV. CODE ANN. § 1701.78(D) (West 1994); MODEL BUS. CORP. ACT § 11.04 (2008).

55 See Stout, supra note 45, at 169 ("What about state corporation codes? Do they perhaps limit the corporate purpose to shareholder wealth maximization? To employ the common saying, the answer is 'not just "no," but "hell no."'").
sell, merge, or otherwise terminate the corporation's existence. Some shareholders may wish otherwise, and as I'll show later, shareholders may have real influence over the Board to make it so, but the law is not on their side, at least in this state.

Corporations are a creature of state law. There is of course no fundamental constitutional or common law right to incorporate under federal or state law. The right to incorporate (and thereby for shareholders to receive the benefits of limited liability) in a particular state is given by the state in order to induce economic activity that is expected to provide benefits to the state. The desired benefits vary from state to state.

Delaware, for example, has chosen to create a national market for incorporating because the state thereby receives a tremendous boost to its budget from the incorporation business. Delaware has no expectation that Delaware corporations actually reside or employ people in the state, or that they even have any business there. The

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56 This has been accepted since the earliest days of the Republic. See Head & Amory v. Providence Ins. Co., 6 U.S. (2 Cranch) 127 (1804), in which Chief Justice Marshall stated:

Without ascribing to this body, which in its corporate capacity, is the mere creature of the act to which it owes its existence, all the qualities and disabilities annexed by the common law to ancient institutions of this sort, it may correctly be said to be precisely what the incorporating act has made it, to derive all its powers from that act, and to be capable of exerting its faculties only in the manner which that act authorises.

Id. at 167. See also Home Ins. Co. v. New York, 134 U.S. 594 (1890), where the Court said:

The right or privilege to be a corporation, or to do business as such body, is one generally deemed of value to the corporators, or it would not be sought in such numbers as at present. It is a right or privilege by which several individuals may unite themselves under a common name and act as a single person, with a succession of members, without dissolution or suspension of business and with a limited individual liability[.]

The granting of such right or privilege rests entirely in the discretion of the State, and, of course, when granted, may be accompanied with such conditions as its legislature may judge most befitting to its interests and policy.

Id. at 599–600; see also Cort v. Ash, 422 U.S. 66, 84 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."); CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 91 (1987) ("It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.").

57 See, e.g., OHIO CONST art. XIII, § 2 ("Corporations may be formed under general laws; but all such laws may, from time to time, be altered or repealed.").

58 Revenue associated with granting charters and related income will approximate 21.7 percent of Delaware's state budget in 2010. DEL. OFFICE OF MGMT. AND BUDGET, FY 2010 GOVERNOR'S FINANCIAL SUMMARY, CHARTS, AND SCHEDULES 1 (2009), http://budget.delaware.gov/fy2010/operating/10opfinsumcharts.pdf. For additional discussion concerning the relative positions of Delaware and Ohio as states of incorporation, see Porter, supra note 1, at 176–78.

59 There are certainly ancillary employment benefits to people and entities that derive their
key benefit to the state is the taxes and other fees derived from corporations whose business is usually elsewhere (DuPont being an obvious exception). In my view, Delaware, like Nevada and North Dakota, two other states that seek foreign incorporators, are truly “flag of convenience” states.\(^{60}\)

In contrast, other states focus not on creating a convenient place for foreign incorporators, but to provide a solid foundation for local businesses. For example, my work with the Ohio Legislature has amply proved to me that the State of Ohio grants corporate charters not to compete with Delaware in the business of granting charters,\(^{61}\) but to further the State’s interests in creating and retaining jobs associated with the corporations that have significant business connections with our state.\(^{62}\) That is, the State of Ohio, in its desire to attract capital to businesses that create jobs within the state, is willing to extend the blessings of limited liability to investors (shareholders), but in exchange for that privilege has retained certain rights and privileges for itself. It retains those rights and privileges by adopting statutory provisions that prevent shareholders from having as much control over the corporation as perhaps those holders might like or

business from these incorporations, such as the employees of the secretary of state, the chancery court and various law firms, and the corporate service firms.

\(^{60}\) Similar to the maritime “flag of convenience” nations of Liberia and Panama that sell their flag to any ship that will wear it, there is no real state interest in the underlying economics of the business. That doesn’t mean Delaware doesn’t do a good job. On the contrary, its Chancery Court is a model for others to emulate. Porter, \textit{supra} note 1, at 185. Nevada is sometimes identified, especially in the western United States, as an alternative to Delaware. See, e.g., Karen Lange, \textit{Corporation Company, Selecting a State for Your Corporation or Limited Liability Company: Delaware, Nevada or the State Where Your Business is Operated?}, http://www.score.org/women/site/articles.html?article=16027 (last visited Aug. 4, 2009); see also LINN M. LOPUCKI, \textit{COURTING FAILURE: How Competition for Big Cases Is Corrupting the Bankruptcy Courts} 235–36 (2006). As to North Dakota, it recently adopted a corporate code for public companies specially tailored to the shareholder-primacy groups. A discussion of this statute is in Professor Steven Bainbridge’s commentary, Stephen M. Bainbridge, \textit{Why the North Dakota Publicly Traded Corporations Act Will Fail} (UCLA School of Law, Law-Econ Research Paper No. 09-07, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1364402.

\(^{61}\) That this is a long-standing Ohio policy can be seen from Professor Henry W. Ballantine’s 1927 comments on Ohio’s recently enacted corporate code:

\begin{quote}
The result is the most carefully drawn and comprehensive legislative effort as to corporations which this country has yet produced. The Act is not an attempt to go into competition for the business of issuing charters to doing business elsewhere as are the laws of Delaware and Nevada. It aims to facilitate business and remove useless impediments and at the same time safeguard the public . . . .
\end{quote}


\(^{62}\) Porter, \textit{supra} note 1, at 185. This view is supported by the advice I have received from legislators and others on how to present proposed legislation to the legislative committees: “It’s all about jobs.”
could theoretically enjoy. In fact, Ohio sometimes differentiates between corporations that have only nominal Ohio connections from those that are more closely related to the state: neither the Ohio Control Share Acquisition Act nor the Interested Shareholder Transactions Law (also known as the "merger moratorium" act) applies to Ohio corporations that lack a requisite presence in the state.

The key provision of Ohio law that refutes the shareholder wealth maximization doctrine is the constituency statute (Ohio Revised Code § 1701.59(E)), which provides that:

[A] director, in determining what the director reasonably believes to be in the best interests of the corporation, shall consider the interests of the corporation's shareholders and, in the director's discretion, may consider any of the following:

1. The interests of the corporation's employees, suppliers, creditors, and customers;
2. The economy of the state and nation;
3. Community and societal considerations;
4. The long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

63 For example, Board action is required to declare dividends, OHIO REV. CODE ANN. § 1701.33 (West Supp. 2009), sell all the corporate assets, id. § 1701.76, or accomplish a merger id. § 1701.78. And Boards may adopt "shareholder rights plans", or "poison pills," id. § 1701.16, and resist change-of-control transactions, id. § 1701.59, without alteration of the standard of care.
64 Id. § 1701.831.
66 In general, the anti-takeover legislation does not become applicable to a corporation simply because it incorporates itself in Ohio. Some greater nexus is required, such as having its principal place of business, principal executive offices, assets having substantial value, or a substantial percentage of its assets within the state. See, e.g., OHIO REV. CODE ANN. § 1701.01(Y) (West Supp. 2009) (defining an "issuing public corporation" as having such characteristics). The definition limits the companies subject to the control share acquisition provisions of Ohio Revised Code § 1701.831, as well as those subject to the interested shareholder provisions in Ohio Revised Code chapter 1704. See id. § 1701.831; OHIO REV. CODE ANN. §§ 1704.01--.07 (West 1994 & Supp. 2009). For a general discussion of Ohio's anti-takeover statutes, see Thomas E. Geyer, The Vitality of the Ohio Laws Designed to Encourage Negotiated Takeovers, 23 U. DAYTON L. REV. 515 (1998).
The comment to this legislation prepared by the Ohio State Bar Association’s Corporation Law Committee and adopted in 1984 states:

The Committee believes that Ohio law presently permits a director to take into account interests other than those of shareholders; however, the Committee believes that it is desirable to specify and clarify the breadth of the interests [that] a director may consider.

One scholar has challenged the statement that the constituency statute does not change the common law, suggesting that, “[o]ne possible explanation for these statements is legislative misunderstanding of the common law standards.” While I disagree with that viewpoint, as the Corporation Law Committee’s comments actually reflected the consensus view of the leading Ohio corporate law experts about Ohio law at that time, it hardly matters. The law today is what the statute says it is.

Under Ohio’s constituency statute, it is clear that directors must take into account the interests of shareholders. But it is also clear that directors may take into consideration competing interests of other constituencies. This has a major bearing on corporate governance. If the Board takes into account other constituencies, this means the shareholders’ voice is no longer the only voice listened to by the Board. A graphic representation of Ohio’s corporate governance looks like this:

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68 The Committee is the primary source of Ohio corporate legislation, and, as such, its comments are relevant to Ohio judges and cited in judicial decisions. See, e.g., Armstrong v. Marathon Oil Co., 513 N.E.2d 776, 785 (Ohio 1987) (relying on the Committee’s comments in order to interpret a particular corporate statute); see also Porter, supra note 1, at 176 (discussing the import of the Corporation Law Committee Comments).

69 Ellis, supra note 32, at 105.

70 Bainbridge, supra note 49, at 992.
In my illustration, I place the management below both the shareholders and the other constituencies in terms of the Board’s relationships. Shareholders will always be above management *qua* management, as managers owe fiduciary duties to the corporation\(^71\) that the shareholders theoretically may enforce through derivative actions. While other constituencies do not have this recourse, their influence on the Board would place them in a superior position to management in its officer roles. Yet, in Ohio and other constituency states, the Board may well take into consideration the interests of managers as employees on a co-equal basis with shareholders. Investors who don’t understand these fundamental relationships may be in for a surprise, especially in the takeover context.

As participants in the Symposium can see, this chart varies significantly from the corporate governance triangle presented by presenter John Wilcox, which in cursory form looks like the following:

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**Corporate Governance Triangle**

- Directors
- Management
- Shareholders

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One participant asked Mr. Wilcox where in his triangle one would place the “other constituencies,” his reply implied that the Board did not have a relationship with them.\(^73\) Accordingly, I do not think this triangle works well in constituency states.

\(^{71}\) See, e.g., MODEL BUS. CORP. ACT § 8.42 (2008) (detailing standards of conduct for corporate officers). Neither Delaware nor Ohio currently has a statutory statement of the duties of officers, but the Ohio State Bar Association Corporation Law Committee has proposed legislation under consideration.

\(^{72}\) See John Wilcox, The Corporate Governance Triangle (Apr. 17, 2009) (on file with The Case Western Reserve Law Review) (slide used during Mr. Wilcox’s presentation at the George A. Leet Business Law Symposium held under the auspices of the Center for Business Law and Regulation at Case Western Reserve University’s School of Law on April 17, 2009).

IV. MY VIEW OF WHAT CONSTITUTES “GOOD” CORPORATE GOVERNANCE

Before moving on to discuss institutional shareholders and their role in corporate governance, I will describe what, in my view, constitutes “good” corporate governance for public companies.

There are two sine qua nons to effective procedural corporate governance. First, the corporation must have at least a majority of its directors who are interested in having good governance procedures and who are open to discussion and change. It is not possible for lawyers to impose good procedures on directors who don’t want them! As a result, procedural corporate governance (the “how” of corporate governance) is inexorably entwined with substantive corporate governance (the “who and what”). Second, the corporation must have governance lawyers, whether in-house or from outside firms, who are committed to good corporate governance, have the necessary knowledge and skill sets, and have appropriate access to the Board. A CEO or general counsel who, in order to preserve her power in the boardroom, uses her gatekeeper powers to block off recommendations for change by governance lawyers is the natural enemy of good corporate governance. The governance lawyers should consider themselves extraordinarily lucky, as I was with so many clients, to have a general counsel or senior officer who is actually a strong advocate for governance, rather than people who view governance as, at best, a necessary evil. Where you lack such support, the task is so much harder.

Assuming such directors and corporate governance lawyers are in place, here’s my list of procedural corporate governance activities through which the lawyers can help ensure there are processes in place that create an environment that supports, to paraphrase Monks and Minow, asking the right questions and making sure the answers reflect what is best for the corporation.74

- The governance lawyers must routinely provide the client with state-of-the-art forms or updates of forms for governance policies, committee charters, and bylaws/regulations, as well as well-considered advice on the manner in which quality boards function (these each being appropriately tailored to the corporation after taking into consideration any peculiarities of the corporation, such as family control). In my view, there is

74 See supra notes 16–17 and accompanying text.
no "one size fits all" form suitable for every corporation. There are certainly good models, and one can start from there. But corporations have their own unique personalities and ultimately it is the lawyer's job to adapt the form to the client. The advent of the Internet and the requirement that many corporate governance documents be posted on the corporate website has greatly facilitated the ability of lawyers to find better models from which to work or ideas on how to improve their own forms. Prior to the Internet, lawyers were often hobbled in locating internal documents from non-clients to use as comparisons, and needed to use their personal networks, or join organizations, to find exemplars. Today, one can, for example, quickly locate and compare the audit committee charter of dozens of major corporations to look for ideas.

- The governance lawyers then must review these items with an alert set of independent directors who constitute a governance committee. These members must be willing to spend time at meetings with counsel at least annually to discuss governance issues. Based on these discussions, the governance committee should think about the advice, work with the lawyers to make any modifications or improvements to existing procedures that the committee thinks are appropriate, and, after due deliberation, come to a reasoned decision on recommending to the full Board their adoption.

- The full Board should consider the governance committee's recommendations and then adhere to the policies and procedures. The full Board should be briefed at least annually by the governance counsel on current governance issues, and have the opportunity to ask questions of counsel about the corporation's procedures and practices.

- The individual board members should routinely report to the governance committee and, through the committee or the corporate officers, should inform the governance counsel of any issues, problems, or ideas that arise during the course of the year.
Next, is the part of procedural corporate governance that lawyers can’t control: what actually goes on in the boardroom. We can lecture the directors on what they should do, but lawyers don’t control what they actually do. So all we can do is give the basic corporate law “duty of care” speech, which goes along the lines of the following:

“In making your decisions, you, as a director of [a Delaware/an Ohio] corporation, must act with due care. This means that you must receive appropriate briefings, read all the materials you are provided, seek out answers to your questions, take your time to think about what’s going on, stay alert to the risk that management is pulling a fast one by hiding salient facts from you, and consider the reasonableness of what you are being told and whether the source is reasonably reliable or not. You must work at your job. You must think.”

Giving such a speech could get you thrown out of some boardrooms. But those are boardrooms (and clients) that maybe you are better off avoiding anyway, if you value your reputation. One of the hallmarks of a good corporate governance lawyer—and given their gatekeeper status, even more so a good securities lawyer—is being prepared to be fired by a client or to fire a client who won’t follow appropriate advice.

What about substantive good governance? How can one ensure that the board makes good decisions that will lead to the best outcome? One can’t. All a participant in the governing process can do is give good advice, challenge assumptions, and suggest alternatives.

I will add that I have seen decisions made by boards that seemed prudent at the time, but later were shown to be poor decisions, and decisions that I initially thought unwise that turned out rather well. There were also a few decisions where my predicted poor outcome, unfortunately, was later proved correct. But, in all cases, the directors understood they were taking risks, and that was their job and their decision. Neither I nor a judge must agree with their action.

76 See discussion supra note 19 regarding Model and Ohio Rules of Professional Conduct Rule 2.1. Put bluntly, lawyers may not dodge unpleasant topics nor avoid battles that could result in the client’s firing the lawyer. One hopes that good diplomatic skills and tact will get you past any problems with your client, but one must not be afraid of being fired. Lawyers who are, and who dodge tough issues, or always side with the one who hires them, may well be viewed as “client friendly.” Although they will avoid being fired and may well be more successful for themselves or their firms financially, they ill-serve their client, and do so at the risk of bringing opprobrium on themselves or their firms for breaching their ethical duties.
But I do have some thoughts on issues that I believe a good Board does think about when it is considering the substance of decision-making:

- Make certain that suggested plans or programs have been looked at for long-term as well as short-term effects, not just one or the other. One of the most common failings of Boards is not asking for enough projections by either failing to adequately challenge the assumptions of the projections they do receive, or failing to play out enough scenarios about the future. As we’ve seen in the financial market turmoil, not playing out the potential effects from an upturn or downturn in the business can result in horrific results. A good role model for a director is the chess player, the best of whom map out moves, and likely responses, many turns in advance. There’s a reason generals learn to play war games, and directors would be well-served to follow that example. I understand the deference given to the officers who present the suggested plans or programs, but reliance on officers must be reasonable, and not questioning the underlying assumptions could be a major omission. Lawyers, especially the business counselor, sometimes can take on the same task of substantively vetting proposed plans or programs, but we’re not often given the opportunity, especially in larger corporations where lawyers are usually relegated to a lesser role. Not only do the directors have the opportunity to question and challenge, that’s their job.

- Consider how the decision, or lack of a decision, will play with constituents. It is a mistake to not always have investor relations in mind. The same goes for major creditors, customers, suppliers, employees, and other constituencies (whether you are in a constituency state or not). If need be, have due diligence done with these constituencies before the program is launched.

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77 See, for example, Ohio Rev. Code Ann. §1701.59(B)(1) (West Supp. 2009), which allows directors to fulfill their fiduciary duties by reliance on information prepared or presented by those officers "who the director reasonably believes are reliable and competent in the matters prepared or presented."
• Make certain the Board has savvy advisors. The law entitles directors to rely on experts and consultants, so Boards should employ them. Resist managers who say the Board doesn’t need to bring the gurus into the room—that is just management trying to look self-sufficient, and may in fact prevent you from hearing the consultants’ real advice, especially their hedges and assumptions. That doesn’t mean the Board must always hire extra people; it may be enough to establish one-on-one contact with the same advisors that management uses. They already have the facts in mind. But the Board needs to be aware that management’s advisers may not always be fully candid with the Board, so directors should consider the need for separate advisers in appropriate situations.

• As a corollary, always ask whether we have the right management team to implement our decision and protect the corporation. I have experienced situations where a Board doesn’t ask itself if the management team is up to the task, whether it is to carry out a merger/acquisition or handle an SEC investigation. CEOs loathe saying they and their team can’t handle something; therefore, the Board must always consider the potential need to seek additional help. Adding to the headcount to ease business integration of an acquisition is better than botching the integration through lack of resources. Help the CEO help herself.

• Directors should consider how they’ve seen similar problems handled elsewhere, but should not insist that their other experience should dominate the proposed plan of action. I have seen situations where directors wrongly import concepts that are either legally inappropriate (e.g., applying the wrong state law or ignoring a charter provision) or that don’t fit the culture or circumstances of the corporation. For example, a common failing of financially oriented directors is to think that flattening a corporate structure is a great idea (it saves costs). But flattening the structure may eliminate the value of subsidiary corporate veils, thereby exposing the “clean” assets of one business to the “dirty” tort claims of another.
Act collegially. Don’t be afraid to raise questions or suggestions, and don’t be too hasty in shooting down each others’ ideas. I have seen situations where “quiet” directors have better ideas than the “noisy” or “strong” ones. The fundamental strength of a Board is that a bunch of smart people are together in a room to make a decision. Everyone has an equal duty and equal vote and therefore should have an equal say.

Make a decision. Inaction or delay is usually worse than a wrong decision. But the Board should feel good about delaying a decision if it isn’t comfortable about its knowledge base. Get informed, and then act.

Against this backdrop, I’ll now respond to the Symposium’s main question.

V. INSTITUTIONAL INVESTORS: A NON-HOMOGENEOUS GROUP

The focus of this Symposium being “institutional investors,” I want to clarify that when I, and I think most other practitioners, use that term, it means a broad array of entities, including mutual funds, hedge funds, and other investment companies, bank trust departments, insurance companies, university and charitable endowment funds, pension funds, investment banks, investment advisors, and portfolio managers, among many others. Their common trait is that they actively deploy the pooled capital of third party beneficiaries in the equity securities markets. These players, who might also be called money managers, generally are at least partially compensated in the

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78 This is a refinement of commonly found definitions of “institutional investors.” For example, the first site identified on my April 6, 2009 GoogleTM search for “institutional investor definition” revealed the following: “Entity with large amounts to invest, such as investment companies, mutual funds, brokerages, insurance companies, pension funds, investment banks and endowment funds.” InvestorWords.com, Institutional Investor Definition, http://www.investorwords.com/2504/institutional_investor.html (last visited Apr. 6, 2009). Similarly, Monks and Minow, while not explicitly defining “institutional investor,” include in their discussion generally the entities I mention, but omit investment advisers and portfolio managers. See generally MONKS & MINOW, supra note 16, at 131-222 (providing an in depth description of institutional shareholders).

79 “Money manager” has also been defined more narrowly to only mean individual decision-makers, rather than institutions. See, e.g., InvestorWords.com, Money Manager Definition, http://www.investorwords.com/3105/money_manager.html (last visited Apr. 6, 2009) (defining “money manager” as “[a]n individual who is responsible for the entire financial portfolio of an individual or other entity”); BusinessDictionary.com, Money Manager Definition, http://www.businessdictionary.com/definition/money-manager.html (last visited Apr. 6, 2009) (defining “money manager” as a “[f]inance professional who advises his or her clients on investment opportunities and manages their portfolios on their behalf”). This distinction seems highly artificial. After all, institutions don’t make decisions, people do.
form of management fees, and so are distinguished from individuals or treasury arms of operating companies that make decisions for their own portfolio and profit solely from their market wins. But institutional investors are not homogeneous: some are long-term investors, some short-term investors, and some are speculators commonly known as arbitrageurs.

Some have broad discretion over the investments they make, while others are limited to specific industries, regions, or niches such as "socially responsible investing." Some are highly regulated, others less so. Some are faceless entities lacking in public recognition, while others are well-known through their actions or through a very visible fund manager. But faceless or famous, institutional investors today hold or at least control the purchase/sale/voting decision-making over most of the outstanding shares in most large public corporations, and certainly most of the shares that actively trade in the markets. It would be the very rare large public company that has

80 "Long-term" is another ill-defined term, but I intend for it to mean an investor with an anticipated holding period of at least a year. Some would assign this term only for anticipated holding periods of five years or more. See Campbell R. Harvey, Hypertextual Finance Glossary, http://www.duke.edu/~charvey/Classes/wpg/bfglosi.htm (last visited Apr. 6, 2009) (defining "long-term investor" as "[a] person who makes investments for a period of at least five years in order to finance his or her long-term goals"). In any case, it means a long time. See, e.g., Lawyers.com, Real Estate Investment Glossary, http://real-estate.lawyers.com/Real-Estate-Investment-Glossary.html#sectL (last visited Apr. 6, 2009) (defining "long-term investor" as one who is "interested in holding an investment for a long period of time").

81 As I use this term, "short-term investors" mean those who anticipate holding an investment for seconds, minutes, days, weeks, or any period of less than a year.

82 "Arbitrageur" customarily refers to short-term investors using a sophisticated trading strategy, for example, one:

who attempts to profit from price inefficiencies in the market by making simultaneous trades that offset each other and capturing risk-free profits. An arbitrageur would, for example, seek out price discrepancies between stocks listed on more than one exchange, and buy the undervalued shares on one exchange while short selling the same number of overvalued shares on another exchange, thus capturing risk-free profits as the prices on the two exchanges converge.

Investopedia.com, Arbitrageur, http://www.investopedia.com/terms/a/arbitrageur.asp (last visited Apr. 6, 2009). A common example of arbitrageur is in the merger arena, where risk arbitrageurs evaluate the risk that a pending merger will or will not occur, and make trading bets accordingly.

83 The voting rights to such shares may or may not accompany the purchase/sale decision-making power, but for purposes of this Article, I assume that most often the two powers remain combined.

84 MONKS & MINOW, supra note 16, at 132 (noting that as of 2002, institutional shareholders owned over 60 percent of the equity of the largest multinational corporations).

a majority of its equity voting power owned by individual shareholders.

Because institutional shareholders come in all shapes, sizes, and outlooks, it is not reasonable to expect that they all behave alike. One expects that the behavioral pattern of a union pension fund is unlikely to mirror a mutual fund that invests in an index portfolio, such as the S&P 500 or Russell 2000. And neither of these will act like the hedge funds led by activist-agitators Norman Peltz or Carl Icahn or Phil Falcone, nor do these gentlemen necessarily act like one another, or even exhibit the same behavior individually on a consistent basis. Reality bears this out: for every seller of shares there must be a buyer of those same shares, and given the concentration of ownership in institutional hands, there are institutions on both sides of many, and perhaps most, market transactions. So talking about "institutional investors" as a monolithic group is not possible. Nor, as we will see, is their impact on corporate governance uniform.

VI. SOME HEROES, SOME VILLAINS, BUT MAINLY NEITHER—SIX WAYS INSTITUTIONAL INVESTORS AFFECT CORPORATE GOVERNANCE

To answer the Symposium’s lead question, undoubtedly some institutional investors are a positive good (both for the corporation and for the American economy) all or nearly all of the time, and so are presumably “heroes” within the question’s meaning. Some would likely put Warren Buffet, the “Sage of Omaha,” in this category.
Other institutional investors may well be vicious, villainous scumbags—veritable Gordon Gekkos—that deserve our scorn at best, and a cell in a federal penitentiary at worst. But far more institutional investors—probably the vast majority—fall somewhere in the middle between hero and villain, and are no more than placid participants in the stock market with no active participation, and little interest, in corporate governance issues. Indeed, my mental image of most institutional investors is that of sheep chewing grass out in the pasture—mindless creatures, moving in a flock, sometimes urged on by the shepherd’s dog (in today’s environment, perhaps the government?), sometimes scared by a scent of wolf.

But I can attest through my twenty-seven years in the trenches that directors and officers of public companies do talk about and pay attention to at least some institutional investors, and those institutions have thereby separated themselves from the common flock. Moreover, in my experience, almost every corporation will at some point experience an interface with one or another institutional investor that significantly affects the behaviors or decisions of directors and officers as they go about their strategic and day-to-day management of the corporation. It is in this very small number of interactions that institutional investors have the opportunity to be either “heroes” or “villains.” Most institutional investors, however, are not visible in the boardroom or executive suite at any time, and so can’t even be nominated for the hero/villain roles. So “neither” is also an answer to the Symposium’s lead question.

So now let me comment on specific ways institutional investors affect corporate governance.

A. Institutional Investors Were Critical Players in Creating Today’s Procedural Corporate Governance System

Just as Willie Sutton famously targeted banks for his robberies “[b]ecause that’s where the money is,”90 corporations in need of money are attracted to the public markets, and so to institutional investors, because that’s where the vast bulk of the investing market’s

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90 WILLIE SUTTON & EDWARD LINN, WHERE THE MONEY WAS 119 (Viking Press 1976). Sutton denied he ever said this. Id. at 120.
money is. Given the massive growth in investment funds held for America’s retirement and healthcare plans, coupled with the tremendous efficiency of underwriters in tapping the institutional capital market devoted to publicly traded securities, the retail component of most public offerings has shrunk in size to be relatively small to virtually non-existent. Visits to large institutions holding vast pools of money are how you sell stock or bond offerings, not through encouraging a retail brokerage force to sell to individual investors. And the same is true of the secondary market; most equity securities of public companies remain in institutional hands. Thus, corporations that go to the public markets for equity capital inevitably focus the bulk of their investor relations efforts on these institutional investors or prospective investors. CEOs and CFOs travel around the world visiting institutions for one-on-one chats that help build bonds between investors and management. These perks are not available to ordinary investors. Yet, despite such efforts, this cozying up to the sources of capital will not, as we’ll see, prevent the investors voting against management.

To newcomers to the field like my students, the fact that institutions dominate the corporate finance world would seem to have little bearing on current procedural corporate governance, and therefore little direct impact on most of the “corporate governance” efforts of individual Boards and corporate governance lawyers. They would perceive instead, and quite correctly, that procedural corporate governance, especially the review, drafting, and disclosure work that will be in their future as young corporate lawyers, is driven primarily by well-defined requirements of the applicable stock exchange, the SEC, and state corporation law. But we teachers need to remind our students that the current systems and rules did not spring forth from Washington and New York by governmental or even divine inspiration, nor are they very old. Instead, it was over a long period during the span of my professional lifetime that institutional investors like CalPERS, TIAA-CREF, and others were instrumental in educating the SEC, NYSE, and others on the need for today’s better

91 See supra notes 84–85.
92 The California Public Employees’ Retirement System (CalPERS) is one of America’s largest institutional shareholders, and has been extremely active for several decades beginning in 1984. After a period in which it was only reactionary to others’ proposals, it developed its own highly public campaigns. See CAL. PUB. EMPLOYEES’ RETIREMENT SYS., CORE PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE 4 (2007), www.acga-asia.org/public/files/CalPERS_2007_6_15%20Core%20PofACG%20FINAL%20_TOC_.pdf.
93 TIAA-CREF was the first large institutional investor to run a proxy fight nominating its own candidates for election to a board, successfully challenging the incumbent members of the board of Furr’s/ Bishop’s, a restaurant chain. MONKS & MINOW, supra note 16, at 186–88.
procedural systems. Were it not for their efforts in laying the groundwork, followed by the impetus of corporate villains like Enron and others that accelerated the regulatory actions of Sarbanes-Oxley and its progeny, it is unlikely that we would have the present procedural corporate governance framework in place. Thus, there were certainly heroes among the activist institutions, and we should thank them for their efforts to have gotten us as far as we have.

But while the exchange rules themselves may have been created or greatly influenced by past lobbying efforts of activist institutional shareholders, today's students would be correct to believe that the identity or mix of a particular corporation's current investors has little impact on day-to-day procedural corporate governance. It really doesn't matter very much that shares are held by Fund A and not Fund B, so long as more than enough funds participate in the market. Far more relevant to procedural corporate governance are the exchange requirements, the makeup of the Board, the Board's relationship with the Chief Executive Officer, the SEC's disclosure requirements, and the effectiveness of counsel.

B. 14a-8 Shareholder Proposals: Populism in the Corporate Governance Market Place

The one time each year that shareholders become slightly more visible in corporate governance is the period leading up to the annual meeting of shareholders. It is then that many companies see at least some stirring of shareholder interest thanks to the SEC and its Rule 14a-8.

Under state corporation law, there is little or no methodology provided for shareholders to actively influence the strategy that the corporation follows or to set parameters for governing philosophies.

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94 The scandals surrounding Enron were famously depicted in the Oscar-nominated film ENRON: THE SMARTEST GUYS IN THE ROOM (Magnolia Pictures 2005), based on the 2003 book of the same title by Fortune Magazine reporters Bethany McLean and Peter Elkind, BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003). An interesting corporate governance or securities law course might well include this film, along with the earlier cited WALL STREET (Twentieth Century-Fox Film Corp. 1987), and the made-for-cable film about the leveraged buyout of RJR Nabisco, BARBARIANS AT THE GATE (HBO 1993), as discussion materials. To understand the importance of corporate activity towards constituencies other than shareholders, one might add Michael Moore's 1989 documentary, ROGER & ME (Warner Bros. Pictures 1989). Other films that might make the cut include THE SOLID GOLD CADILLAC (Columbia Pictures 1956), featuring Judy Holliday as a small shareholder who undoes a nest of corporate thieves, and OTHER PEOPLE'S MONEY (Warner Bros. Pictures 1991), in which a corporate raider played by Danny DeVito connives to take over an old family-run New England business. Just to remind students that not all businesspeople are crooks, heartless, or greedy, we must include Frank Capra's classic film, IT'S A WONDERFUL LIFE (Liberty Films 1946).
Shareholders have the right to vote at a meeting once it is called, and they may have a limited right to call meetings. But neither Delaware nor Ohio law provides a mechanism, or even an expressly identified shareholder right, to introduce a proposal before a meeting once it is called.

Companies, however, with securities registered pursuant to Section 12 of the Exchange Act become subject to a more complete set of procedural shareholder access rules favoring intervention by institutional investors trying to influence both Board practices (procedural governance) and corporate behavior and outcomes (substantive governance). The federal proxy rules, notably Rule 14a-8 under the 1934 Act, dictate the mechanics of bringing a shareholder proposal for public companies. Proposals brought under Rule 14a-8 must be differentiated from the efforts of shareholders who actually want to effect change in the strategic direction or control of the corporation by changing the members of the Board itself.

With the exception of the more aggressive binding (i.e., non-precatory) proposal form discussed below, I like to think of Rule 14a-8 proposals as generally being the corporate equivalent of citizens petitioning the legislature. Neither effort actually changes much of anything directly, but it does allow shareholders, in the corporate setting, and citizens, in the civic setting, to feel like they have a platform from which to influence the behavior of the

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95 See, e.g., OHIO REV. CODE ANN. § 1701.44 (West Supp. 2009) (entitling shareholders to one vote per share).
96 See, e.g., id. § 1701.40(A)(3) (limiting those who can call a meeting to the chairperson of the board, certain officers, directors, and some persons holding 25 percent or more of all outstanding shares).
97 Indeed, a credible argument can be made that in Ohio, there is no right to bring any shareholder proposals before an annual meeting of shareholders, absent permissive provisions in the corporation’s articles or regulations. OHIO REV. CODE ANN. § 1701.39 says only that “[a]n annual meeting of shareholders for the election of directors and the consideration of reports to be laid before such meeting shall be held...” OHIO REV. CODE ANN. § 1701.39 (West Supp. 2009) (providing for annual meetings of shareholders) (emphasis added). This statute does not identify any right of shareholders to bring other matters before the meeting. In the absence of inferring such a right into § 1701.39, Ohio shareholders hoping to bring matters before the shareholders would be forced to rely on their rights to call a special meeting under § 1701.40, which requires action by owners of 25 percent of all outstanding voting shares or such lesser or greater proportion (but not less than 50 percent) as may be provided by the articles or regulations. OHIO REV. CODE ANN. § 1701.40(A)(3) (West Supp. 2009). To my knowledge, this issue has never been raised in litigation or as an objection to a Rule 14a-8 proposal, and Ohio’s public corporations routinely acquiesce to shareholder proposals under Rule 14a-8.
100 See id. § 240.14a-8(i)(8) (excluding proposals relating to elections directly from the company’s proxy statement).
corporation or government. As corporate lawyers, we tend to think of these efforts as "attacks" on the Board (after all, our clients are obviously perfect in every way, and anyone trying to insert themselves into the boardroom must be the enemy!), but even using a "corporate threat scale" modeled on the Department of Homeland Security's terrorist threat scale, most Rule 14a-8 proposals would not warrant even a "yellow" or "elevated" warning to management and the Board.  

I view the vast majority of 14a-8 proposals, which are precatory in nature (mere recommendations that action be taken without imposing any obligations to do so), as being no more than a petition to redress grievances or address a concern, because, like the legislative petition, no positive action is required of the recipient. Corporations that receive precatory proposals that have the support of even the vast majority of shareholders are not thereby forced to take action; the Board may continue to apply its own judgment as to what course it should take on the matter. At the same time, a precatory proposal may well have an effect on corporate action: Boards often will listen to the vote and change policies or direction because of a strong expression of shareholder sentiment. But my point is, they don't have to.

The most powerful factor in this relationship between shareholders (who, after all, own the voting rights to elect directors) and directors (who manage the corporation) is the basic corporate governance construct of Delaware law (and of the Model Business Corporation Act, which has been implemented in many states). Both require the Board to act first before any amendments can be made to the corporation's charter, preventing shareholders from initiating charter revisions. These laws also place control of the management of the corporation's business and affairs in the hands of the directors. Once the state law takes these combined approaches to fundamental corporate governance, the shareholders lose the power to directly make meaningful changes in corporate direction. Only by

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102 See DEL. CODE ANN. tit. 8, § 242(b)(1) (2001) (requiring Board adoption of any amendment to articles following the issuance of shares before the amendment can be submitted to shareholders); MODEL BUS. CORP. ACT § 10.03(a) (2008) (requiring board approval for proposed amendments to the articles of incorporation).

103 See DEL. CODE ANN. tit. 8 § 141(a); MODEL BUS. CORP. ACT § 8.01(b).

104 See, e.g., CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227, 234–35 (Del. 2008) (discussing the balance between the shareholders' right to adopt procedural bylaws against the Board's right to manage the corporation).
persuading the directors to follow their will can the shareholders effect change in corporate behavior. As I'll discuss later with respect to Ohio, however, this construct is not the only way to arrange these relationships.

In my experience, precatory proposals fall into three main buckets. First, there are the common "social" proposals—sometimes by so-called “gadflies” like Evelyn Y. Davis or similar “frequent filers” who propose things like disclosure of a carbon principles policy, the creation of a corporate policy as to the human right to water, or more disclosure of executive compensation (though one would think the latter request should go to the SEC, which regulates disclosure requirements). In my experience, these sorts of proposals (which, if passed, would change corporate behavior, and so are largely substantive rather than procedural) are most often almost completely ignored at the Board level and normally cause only an attempt by the corporation’s lawyers to try to quash the proposal on technical grounds or, should that fail, inclusion in the proxy statement with a rather perfunctory reply from management (which is even more perfunctorily endorsed by the Board). In what I often consider a more enlightened corporate response, these proposals are sometimes simply allowed to go to the shareholders on a “why waste time and money arguing this point” basis. Of course, not every gadfly proposal is useless or silly. Sometimes they are forerunners to more thoughtful efforts in a similar vein, such as the “national campaigns” I will next describe. In any event, it is incumbent on corporations and their counsel to treat stockholders, even gadflies, fairly and with respect. On the corporate threat scale, I rate these in the Green (low) or at most Blue (guarded) range. Lawyers worry about them, but no one else really does.

Second, every proxy season sees more-organized “national campaign” proposals on “social” topics aimed at influencing governmental or popular pressure to effect corporate policies (these are typically substantive corporate governance, as they require behavioral changes by the corporation). Often these proposals have goals far beyond the subject corporation, and these too are often basically ignored by the Board and responded to by the corporation’s

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105 MONKS & MINOW, supra note 16, at 184.
lawyers either on technical grounds or with a brief management response. But sometimes social proposals are the cause for the corporation’s management, who want to defuse the potential fallout of governmental or public pressure, to negotiate with the proponent.\footnote{For example, in 1993, CalPERS had eleven of twelve companies they targeted prepared to make concessions, and United Shareholders Association (a creation of T. Boone Pickens) reported twenty-nine of fifty targets of shareholder proposals negotiated resolutions. \textit{Monks \& Minow, supra note} 16, at 186.} An example of a circumstance where negotiation might occur is in “glass ceiling” proposals. Few companies want public discussion of whether they, in fact, have failed to hire and retain minorities or females. On the corporate threat scale, I rate most of these proposals in the Green (low) or Blue (guarded) range. Only in fairly extreme circumstances involving especially noxious behaviors that could potentially excite Congress or regulators to focus special attention on the corporation will these proposals rise to the Yellow or higher range. An example of the latter might be proposals condemning the corporation’s dependence on a supplier’s reliance on child labor\footnote{See, e.g., Nike Inc., Definitive Proxy Statement (Form DEF 14A), at 23 (Aug. 12, 1996) (requesting “the Board of Directors to review compliance with the Nike Code of Conduct & ‘Memorandum of Understanding’ with contractors concerning the company’s ‘commitment to people, communities and the environment’”).} or corporate disregard of environmental issues that would result in bad publicity and reduced sales.\footnote{In 2007, Newmont Mining took what many viewed as a largely unprecedented step of endorsing a shareholder proposal that sought independent board committee review of the environmental and social impacts of the company’s global mining operations. See Ben Arnoldy, \textit{Mining Company Agrees to “Green” Review}, \textit{Christian Sci. Monitor}, Apr. 26, 2007, at 2.} The threat of adverse publicity that could affect sales shifts the proposal from being a lawyer’s issue to being a CEO’s issue.

My third category for proposals includes those aimed at changing corporate governance procedures. These procedural governance proposals—including calls for majority vote requirements in the election of directors, cumulative voting, board decategorization, limits on poison pills, etc.—are taken more seriously by management and Boards, regardless of whether the proponent is an institution or a gadfly, as the issues they raise may ultimately be important to the Board and to the corporation’s defensive posture against takeover attempts. I rate these as Yellow (elevated) or sometimes Orange (high) alerts on the corporate threat scale. When these measures are brought by gadflies like John Chevedden\footnote{According to an article in \textit{Crain’s New York Business}, Mr. Chevedden was responsible for 125 shareholder proposals to 85 companies in 2008, and about 15 percent of all resolutions filed by anyone between 1997 and 2006. Aaron Elstein, \textit{Harassed Companies Swat at Gadflies: AIG, Citigroup, Time Warner Seek to Silence Vocal Group of Investors}, \textit{Crain’s N.Y. Bus.}, Feb. 9–15, 2009, at 1.} or ordinary activist
institutions like CalPERS, typically as part of a broad initiative targeting many companies, they are treated with respect by the Board but evaluated in the context of whether it is indeed common to other companies. If so, there’s no reason to be worried, and we can wait and see how the shareholders vote. That leaves it pretty much as a lawyer’s issue initially; only if the vote is in favor of the proposal (or in the relatively rare instance where a particular proposal receives a violent reaction from one or more directors “on principle”) does the Board need to react. Occasionally, the general counsel or outside governance counsel for a corporation will recommend a negotiated resolution to the proposal because the approval trend is obvious and the lawyers want to be ahead of the curve.

If, instead, the measure is brought by a group or institution known as a hostile actor, such as by a hedge fund known to move from 14a-8 proposals to actual proxy contests, the corporation’s lawyers, management, and the Board will more likely see the proposal as a prelude to more serious attacks that could come through a call for a special meeting or at the next annual meeting, and will gird their loins for battle, putting together a corporate defense team of litigators, proxy solicitors, investment bankers, and other advisors. But given the cost of proxy contests, and the relative infrequency of the “hedge fund attacks” described below, this rarely occurs. Corporate governance proposals are far more likely to be of the common, seemingly benign, institutional type than the focus of a potential aggressor. But Boards beware: acquiescing to significant reductions in corporate defenses, like declassifying a board, could leave the corporation more open to takeover attempts or predatory hedge fund attacks.  

It is interesting to note that not all shareholder proposals need be precatory. There is at least one state—Ohio—that does not follow the Delaware General Corporation Law and Model Business Corporation Act construct that requires Board approval before shareholders can approve primary governance changes. Instead, Ohio allows shareholders to change charter provisions without prior Board action. This distinction is not well-known or understood, and Rule

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114 See OHIO REV. CODE ANN. § 1701.71(A) (West Supp. 2009), which specifies that shareholder approval (without mention of the Board) is required for amendments to the corporate articles, and id. § 1701.11(A), which has a similar rule with respect to the corporate regulations. That Ohio’s legislature knows how to require Board action in addition to shareholder approval is clear from other corporate statutes, such as the sale or other disposition of assets statute, id. § 1701.76(A)(1)(a), and the merger statute, id. § 1701.78(D) (West 1994).
14a-8 proposals are routinely brought as precatory proposals even with respect to Ohio corporations.

In my view, the potential to bring binding shareholder proposals in Ohio is a corporate outgrowth of the Progressive political movement, the wave of governmental reform that had its highpoint in the early 1900s as the backdrop behind the Ohio Constitutional Convention of 1912, which authorized Ohio's voter-driven initiative and referendum. Ohio's corporate code was modernized in 1926, and the current statutes maintain the fundamental philosophical approach of the earlier era. Despite the Ohio rule's uniqueness, I don't think it is strange at all that a state that allows its citizens to directly amend its constitution by initiative and override the legislature by referendum would have a corporate law that allows shareholders to directly amend the articles of incorporation. The possibility of non-precatory, binding proposals is equivalent to the power of citizens to bring direct proposals to the ballot.

Even so, there have been few, if any, binding proposals brought. Interestingly, this may be in part because most corporate practitioners and institutions may be ignorant of the law. But in a state where binding proposals are possible, the threat that such a proposal could happen should increase the impact at the Board level of those precatory proposals that are brought and that receive significant levels of support. If a majority of the shareholders support an institution's request that the Board consider de-classification of the Board, then the ability of a shareholder to change that request next time into a binding proposal may well cause a Board to be less able to simply ignore the shareholders' wishes. Corporate governance lawyers who recognize this threat counsel their clients accordingly.

Now let me illustrate, through two scenarios, the impact of Rule 14a-8 proposals on corporate behavior. In Scenario A, a religious-affiliated organization brings a substantive proposal that the Board take steps to cause the corporation to withdraw its business operations from a nation that is using police state methods to squash the freedom of religion and discriminate against a religious minority. This is a substantive corporate governance proposal, in that it would lead to a change in corporate activity. In Scenario B, a union pension fund

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116 Ohio Const. art. 2, § 1 (giving voters power to propose laws and constitutional amendments to the General Assembly, and allowing them to adopt or reject such proposals on a referendum vote).

117 Ballantine, supra note 61, at n.1; Shipman, supra note 32, at 518.
brings a procedural proposal that the Board take action to cause the charter/bylaws of the corporation to be amended to require that, except in contested elections, all director candidates receive a majority of the votes cast in order to be elected as a director, and that the term of any director not re-elected under that standard be ended. This is a procedural corporate governance proposal, not directly effecting any change in itself, but setting up an electoral process that could, in the future, result in a substantive change.

In my experience, the substantive governance proposal in Scenario A, despite the most fervent wishes of its proponents, is relatively unlikely to directly cause any significant change in corporate behavior. Even if many shareholders support the proposal, it is unlikely that the corporation will drop a profitable business to appease those shareholders. This does not mean that the corporation will not expend resources to quash the proposal. Rather, the corporate officers (and less commonly, the Board) may feel that they need to fight the shareholder proposal, even though they know it will have no direct impact on the corporation’s behavior, because the real war is to influence the governmental bodies that could actually affect the corporation’s activities through regulation on the issue.

So while every proxy season involves outside lawyers advising clients on how to respond to shareholder proposals, those of the Scenario A variety rarely result in any deep thinking at the Board level, and even more rarely cause serious debate in the boardroom, much less change corporate behavior. These largely symbolic proposals don’t hit Yellow on the corporate threat scale.

In contrast, the procedural proposal in Scenario B does not directly affect the corporation’s day-to-day operations or strategy, but is aimed squarely at the Board, potentially setting up a later change in Board membership, and therefore the corporation’s direction. It is obviously the kind of measure that could be viewed as extremely threatening by the directors. After all, notwithstanding that every director in the history of virtually every corporation in America has always received enough votes to be elected under the majority voting standard, there is the threat that, someday, one of the Board’s members will fail to get the necessary votes. As discussed below, this threat may be heightened through the changes in broker discretionary

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118 In 2007, only thirty-five directors received a majority “withhold” vote and only one director (at Gen-Probe, Inc.) failed to receive a required majority vote. Through October 2008 only thirty-seven directors had received a majority withhold vote. QUINTON HUCKEBY, PROXY GOVERNANCE, INC., ELECTIONS THAT MATTER: A REVIEW OF DIRECTOR VOTES IN 2008, at 1, 3 (2008), http://www.directorsandboards.com/DBeBRIEFING/November2008/AREviewofDirectorVotesin2008FINAL.pdf.
voting rules now underway at the New York Stock Exchange. As a result of this risk some corporations faced with such a proposal may fight the Scenario B proposal tooth-and-nail.

But many other corporations will acquiesce to the proposal, letting the matter go to the shareholders for a vote on the institutional proposal, or even going so far as adopting the proposal’s position and making it effective through Board-recommended proposals. This occurs when the Board and its advisors either do not see a viable argument against the logic behind majority voting standards, or do not see enough risk to the sitting directors to make them want to fight. As discussed further below, the likelihood of a negotiated settlement is increased if the Board is aware that proxy voting advisory services are likely to recommend a “yes” vote for the shareholder proposal. I rate these sorts of proposals as being a Yellow, and possibly even an Orange, on the corporate threat scale, since the Board, especially the Nominating/Corporate Governance Committee, will weigh in on the measures and debate them internally.

Some Rule 14a-8 shareholder proposals can actually have a profound effect on corporate governance and even corporate law. For example, consider the activity that led to Ohio’s recent statutory accommodation of majority voting standards for the election of directors of Ohio corporations. I had a major hand, through my work with the Ohio State Bar Association’s Corporation Law Committee, in pushing through the change to Ohio’s corporation law to clarify that the shareholders could decide that directors must receive a majority vote to be elected. The majority vote movement had gained steam throughout the United States, but here in Ohio we had a problem: at least some Ohio lawyers were of the view that the plurality standard then included in section 1701.55 of the Ohio Revised Code could not be interpreted as being subject to the provisions of section 1701.52 that enable shareholders to adopt a “different proportion” such as a majority. So clarification was appropriate, and a simple amendment to section 1701.55 was

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119 See Hearing on H.B. 134 Before the Subcomm. on Civil Justice of the S. Comm. on the Judiciary, 2007 Leg., 127th Sess. (Ohio 2007) (on file with The Case Western Reserve Law Review) [hereinafter Porter Testimony] (testimony of David Porter). For an interesting article discussing the majority voting reform movement and concluding that it is nothing more than “smoke and mirrors,” creating an image of reform but resulting in no real change, see William K. Sjostrom, Jr. & Young Sang Kim, Majority Voting for the Election of Directors, 40 Conn L. Rev. 459 (2007).

120 See, for example, Letter from Thompson Hine LLP to Mr. C. Thomas Harvie (Nov. 21, 2005) (attached to Letter from Goodyear Tire & Rubber Company to Securities and Exchange Commission (Nov. 30, 2005)), available at 2006 SEC No-Act. LEXIS 68, requesting no-action relief for Goodyear’s proposed exclusion of a shareholder proposal relating to majority voting.
processed in the ordinary course through the Ohio State Bar Association machinery and a sponsor found in the Legislature. As far as I know, there was no opposition to this amendment when it was introduced as House Bill 134 and enacted in 2007. 121 At that time, Ohio was the last state to clarify or adopt legislation to permit such election standards, and it was very easy, when testifying before legislative committees in Columbus, to give reasons to the legislators why they should support the bill. 122 I found that politicians, who are generally elected by plurality voting standards in contested elections, but who are also well aware how incredibly lucky they are if they can run unopposed, quickly grasped the absurdity that a director is, under the plurality voting systems in the uncontested elections that represent virtually all corporate elections, guaranteed election through voting his own shares for himself. Given the atmosphere created by Enron and its kin, legislators were not inclined to be overly sympathetic to entrenched directors, and they understood that there ought to be some way to oust a bad director short of a full-blown proxy fight. And the change was very appropriate given Ohio’s historically progressive past and our state’s general philosophy toward shareholder democracy as discussed above. 123

Our efforts to change Ohio’s law were given a gigantic boost by the Rule 14a-8 proposals being contemporaneously made by union pension funds, which asked Boards of nearly a dozen Ohio public companies to consider reincorporation to Delaware simply to enable adoption of majority voting standards by the shareholders. 124 Only three of these proposals actually went to the shareholders, 125 as the remaining corporations were easily able to dissuade the proponent from proceeding with their proposal by the corporation’s assurances that they supported, or at least did not oppose, our pending legislative efforts to clarify the statutes. Of the three proposals that went to

122 See Porter Testimony, supra note 119.
123 See supra text accompanying notes 115–16.
124 See Porter Testimony, supra note 119.
shareholders, one actually garnered majority support, which gave me particularly powerful ammunition in my testimony to the Legislative committees considering HB 134. Since I was already a proponent for the clarification, I viewed this particular use of Rule 14a-8 as a very positive application of shareholder power to facilitate shareholder democracy. Despite the fact that their actual proposal (to reincorporate to Delaware) was highly repugnant to me (and an unfair cost to the targeted companies, who after all were not the cause of the identified problem, but innocent victims of a quirk in how a statute had been drafted), I would call that institutional shareholder a “hero.”

While I support majority voting standards as a concept of good governance and shareholder democracy, I see a troubling dark side, which will be exacerbated by the points I discuss in the next topic. That dark side is that the real threat of removal of directors on an annual basis may create a dramatic shift from today’s world, in which directors, once elected, are virtually assured of a very long tenure. An important and good aspect of long tenure is that the director is motivated to take the long-term view, as she knows that she will be dealing with the fallout from any short-term actions that aren’t well thought through. It is my belief, shaped by my experiences in practice, that an undue focus on short-term strategies will usually result in poor strategies and outcome for the long-term. While the long-term view is more obviously protected by classified boards where board terms run for two or three years, which emphasizes a longer time horizon, today’s directors are, by dint of their relatively guaranteed re-election, encouraged to take the long-view even in corporations that have annual elections for all directors.

But once majority voting policies are put in place, if the directors perceive there to be a significant risk that the director can’t count on re-election, the director’s current long-term outlook may well switch to “how do I get re-elected next year?” Although I suspect that is exactly what some shareholders want to hear, it is, in my view, a very poor outcome. We all recognize this re-election campaign phenomenon from politics; the Founding Fathers sought to offset this

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risk to our national government by longer terms, especially for Senators.\textsuperscript{127} I must ask why we would ever want such short-term mentality to fill our boardrooms. Unfortunately, the combination of majority voting standards and annual board terms, when mixed with the unregulated clout of the proxy advisory services firms I discuss below, could lead to serious negative consequences for long-term thinking.

\textit{C. The Impact of ISS/RiskMetrics and the Potentially Huge Impact of the Elimination of Broker Discretionary Voting}

Before leaving the subject of Rule 14a-8 proposals, it is important to discuss the impact of proxy advisory services firms such as RiskMetrics Group, Inc. (which acquired Institutional Shareholder Services (ISS) in 2007),\textsuperscript{128} Glass Lewis & Co., LLC, and Proxy Governance, Inc. on Board receptivity and response to shareholder proposals. To sum it up, in my experience there is a \textit{huge} impact, and the rise in influence of these “advisors,” especially of RiskMetrics (the most prominent of the proxy advisory services firms), cannot be overstated. I place quotes about the word “advisor” as their real role in many cases is absolute and determinative, rather than merely advisory. That’s because, for many corporations, it is common wisdom that a majority of their institutional shareholders will follow the advisor’s recommendations slavishly, and so the outcome of the shareholder proposal may well be determined by what position RiskMetrics has taken on the matter.\textsuperscript{129} In the view of many

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\textsuperscript{127} As stated by Alexander Hamilton:

The mutability in the public councils, arising from a rapid succession of new members, however qualified they may be, points out, in the strongest manner, the necessity of some stable institution in the Government. Every new election in the States, is found to change one-half of the representatives. From this change of men must proceed a change of opinions; and from a change of opinions, a change of measures. But a continual change even of good measures is inconsistent with every rule of prudence, and every prospect of success. The remark is verified in private life, and becomes more just, as well as more important, in national transactions.


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practitioners, if the proxy advisory services firms have taken a “vote yes” position, it will pass, and a “vote no” position means it will fail. It’s a corporate equivalent of citizens voting the way a party or political advocacy group tells you to vote. Of course, there is another corporate example of voting the straight party line: voting as the directors suggest! I would suggest that neither approach is very thoughtful.

A key factor to understanding why advisory firms are so powerful is that, at least based on my clients’ experience, and as Mr. Wilcox confirmed to me during a break in the Symposium was also his experience, many ordinary institutions separate their voting decision making from their investment decision making. This means that the investment analysts that management so assiduously court through their investor relations efforts are most likely useless in affecting the outcome. It can be an almost schizophrenic behavior. On the one hand, the stock analyst rates the company (and presumably its management) a “buy,” while the investor votes against management because that’s what RiskMetrics said to do!

So the impact of RiskMetrics’s recommendations is already very significant. In Scenario B above, if the Board knows that the chance of a majority “yes” vote is almost certain due to the RiskMetrics position on the topic, it greatly increases the likelihood that the matter will be negotiated away through discussions with the proponent. Why fight a losing battle over something that is not an immediate threat to the Board?

This already significant power of proxy advisory services may be enormously increased as the New York Stock Exchange goes ahead with its plans to eliminate broker discretion. Currently, brokers are empowered by NYSE rules to vote proxies for the retail accounts that they oversee without receiving direction from the beneficial owners of those accounts. The rule change will, for shareholder meetings


131 Id.


held on or after January 1, 2010, terminate that authority and leave shares for which no direction is received as "broker non-votes." Objections to this proposal were well laid out in a comment letter from the Society of Corporate Secretaries & Governance Professionals and in commentary by David Katz and Laura McIntosh of Wachtell, Lipton, Rosen & Katz. In summary, brokers today vote heavily in favor of incumbent directors, but do so without receiving direction to do so from their customers, many of whom ignore requests for instruction. In contrast, most institutions—the shareholders most likely to be responsive to the proxy advisory services firm recommendations—do give directions on how to vote, using electronic voting systems. By removing the bulk of brokerage accounts from the votes cast column, institutions have more weight, which then increases the influence of the proxy advisory services.

Despite this impending rule change, we should not expect a change in shareholder voting behavior. Small holders will still not give directions on how to vote, and large holders will still rely on their proxy advisors and will give voting instructions to their nominee holders. This will magnify the voting power of the institutions and the impact of RiskMetrics and its competitors and could, for example, mean that "withhold the vote" campaigns against directors could

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137 Id. (noting that broker discretionary votes have historically been in favor of incumbent directors, which consequently appear to represent the views of retail shareholders despite their lack of input).

138 How much additional influence the services will have will depend heavily on the mix of ownership at the corporation and whether the institutional ownership do their own analyses or rely on the advisor. To use one example, statistics at Yahoo Finance on April 13, 2009 showed Procter & Gamble had a 60 percent institutional shareholder base (this is lower than many companies, probably because P&G has been a mainstay of retail accounts for decades). Assuming there was a majority vote election standard in place and a RiskMetrics supported "withhold the vote" campaign targeted a director, achieving 70 percent withheld at institutions but only 15 percent at retail, then under the current broker discretion rules, assuming 95 percent voting by both institutions and retail, the director would win election with 52 percent of the votes cast. If the brokers lack discretion, it requires only a tiny reduction in the votes cast to result in a loss of the necessary majority support. For a detailed examination of this issue, see the report published July 14, 2009 by the proxy solicitation firm Georgeson, Georgeson Report, SEC Approves Elimination of Broker Discretionary Voting in Uncontested Director Elections, July 14, 2009, http://www.georgesonshareholder.com/usa/download/georgeson_report0709.html.
greatly increase the risk that targeted directors are not re-elected under majority-vote standards.\textsuperscript{139} In extreme cases, the result may even be a failure of corporations to meet their quorum requirements, potentially costing money to hold a second meeting.\textsuperscript{140} These potential outcomes also heighten my earlier concern about directors taking on a short-term orientation.

The proxy advisory firms' clout is also seen on Board-generated proposals. Here, good planning requires the corporation and its counsel to reach out to RiskMetrics, and perhaps the two smaller firms, to vet management's own draft proposals before finalizing them. While this is most prevalent in executive compensation proposals that may require close analysis under RiskMetrics' guidelines, I have seen the same tactics used in broader corporate governance proposals, especially in potential takeover scenarios. By following this path, the corporation assures itself that the measure will be adopted, or, if adoption appears unlikely, it can make alternative plans.

\textit{D. The Institutional Investor as a Noodge: Jawboning Management}

Institutional shareholders do not limit themselves to making Rule 14a-8 proposals. Even those that don't plan to take any stronger measures know how to use the telephone or write letters to try to influence management. These "jawboning" contacts\textsuperscript{141} are different from the more common investment-oriented calls to check up on how business is doing.\textsuperscript{142} In many cases, such a letter (and less often a call) comes some months before the due date for Rule 14a-8 proposals, and is merely the groundwork that comes before a formal proposal. These communications fall within my discussion of those proposals above. But sometimes the shareholder crosses over from matters that are potential grist for the 14a-8 proposal mill to "suggestions" that clearly infringe on the Board's traditional turf, such as proposals recommending a change in dividend policy, or consideration of a stock buyback, or a mergers and acquisition opportunity. This sort of substantive approach by an institutional investor triggers a very

\textsuperscript{139} In 2008, an additional eighteen directors would likely have failed to receive majority support. HUCKEBY, \textit{supra} note 118, at 4.

\textsuperscript{140} See Letter from Neila B. Radin, Chair, Securities Law Comm., Soc'y of Corporate Secretaries and Governance Prof'ls, to Elizabeth M. Murphy, Sec'y, SEC, \textit{supra} note 135, at 3–4.

\textsuperscript{141} BLAIR, \textit{supra} note 12, at 75.

\textsuperscript{142} \textit{Id.} at 162–63 (discussing a particular fund manager's practice of closely following companies and calling management regularly).
different response by management and the Board than the more low-key Rule 14a-8-type activity.

The analysis begins with looking at the identity of the investor and how many shares he or she owns. I find that the company’s response to the approach differs greatly depending on the answers to those two questions. If the investor is a small holder, and not an obvious threat for greater activity (that is, not Carl Icahn, Phil Falcone, or another of that sort), management generally will be courteous and listen, say “thank you for your ideas,” and do no more. Rate this as still Green or Blue on the corporate threat scale. Corporate lawyers may never even hear about these calls, and the Board likewise probably isn’t informed.143

If, instead, the holder is one of the corporation’s largest long term holders, someone the corporation has courted for years, or most importantly, someone with holdings above the 5 percent ownership level that triggers reporting under sections 13(d)144 or 13(g)145 of the Securities Exchange Act, then in my experience the response will be taken much more seriously, rating at least a Yellow on the corporate threat scale. In these circumstances, corporate governance lawyers should be involved, the full Board should hear about the proposal and discuss responses, and the management should take great care to demonstrate their thoughtful consideration of the idea. Assuming the Board already had thought about the question, it may well want to say that to the holder, being ever mindful of Regulation FD146 strictures on selective disclosure as they do so. Will the Board ultimately do

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143 Although perhaps they should be at least kept apprised of the communications. Shareholders do not have a fundamental right to meet with or even communicate to directors. However, good corporate governance practices routinely include ways for directors to hear from all of their constituents. Public companies subject to the rules of the New York Stock Exchange are required to disclose a method for interested parties (not just shareholders) to communicate directly with the presiding director or with the non-management directors as a group. See NYSE LISTED COMPANY MANUAL §303A.03 (2009), available at http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp%5F1%5F4&manual=%2Fcm%2Fsections%2Fcm%2Dsections%2F.


what the large holder wants? Probably not, but at least they will have thought long and hard about it. And sometimes, circumstances later change so that the Board actually does adopt the action supported by the institutional investor, and perhaps does so a little faster than if the shareholder hadn't spoken up.

But what if the shareholder goes beyond jawboning? What if management and the Board don't appear to be acting in a thoughtful and informed manner? Cue the hedge fund attack.

**E. Aggressive Measures—"Hedge Fund Attacks"

It is every public company Board's nightmare that some aggressive-minded shareholder will decide their company is worthy of attention. Such action puts the directors on the hot seat more than anything short of a takeover battle (which at least has some fairly well-established rules) or the decision to enter into bankruptcy (which is usually so compelling a choice that there is, in the end, not as much trauma as might be supposed). Usually the aggressive shareholder's attention does not occur because of a failure in procedural corporate governance or because of a failure to treat a large holder with respect. Most aggressive shareholders do not go to war over such matters—meaning they don't spend a lot of their time and resources. Instead, the most aggressive shareholders choose their targets with a different goal: increasing the value of their investment portfolio through aggressive means.

When I speak of aggressive shareholders, I am speaking of hedge funds (another ill-defined term!) or other institutional investors that look at corporate governance as simply another of the tools that can be used along with other tactics, such as short selling, to maximize the value of their portfolio investments. These are not shareholders interested in globally maximizing good governance; you'll find no high-minded CalPERS or TIAA-CREF here.

It's my belief that aggressive shareholders, like predators hunting prey, usually target weakened companies, meaning companies that

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147 There is no limitation on the type or size of company that may draw the interest of an aggressive-minded shareholder. We know from assaults on companies such as Target, General Motors, and McDonald's that a marquee name or large size is no protection.

148 One writer says that a hedge fund "is generally described by what it is not. Generally a hedge fund is one of several categories of investment vehicles that holds a pool of securities and perhaps other assets, does not register its securities offerings under the Securities Act, and is not registered as an investment company under the Investment Company Act." MONKS & MINOW, supra note 16, at 197. Another writer says, "hedge funds resist one-line definition." William W. Bratton, Hedge Funds and Governance Target, 95 GEO. L.J. 1375, 1382 (2007).

149 The investor relations firm ICR published a white paper in May 2008 in which it divided shareholder activists into three categories: (1) "sharks," that are "primarily dedicated to
are perceived to have operational or strategic difficulties, and therefore have stock prices that lag their industry. Sample targets are companies that have suffered recurring declines in business or profits, companies that seem to have lost their way in an industry repositioning, companies that continue to operate a diversified conglomerate despite Wall Street’s preference for single industry stocks, and companies that hold onto stale businesses or failing business units that seemingly sap their energy. These targets are no different from most of the targets of the famed corporate raiders of the 1980s, and in many ways hedge funds are merely the twenty-first century version of T. Boone Pickens, Sir James Goldsmith, Robert Bass, Nelson Peltz, Carl Icahn, and their like. It should be no surprise then that those old-hands Peltz and Icahn today play in the new hedge fund game.

William Bratton, in his 2007 article Hedge Funds and Governance Targets, identifies four ways a hedge fund can direct its influence to get an immediate return on investment. First, get the target to sell itself at a premium to a third party, which hands immediate cash return to shareholders. Second, get the target to sell or spin off a significant asset, liberating cash or an asset for the shareholders. Third, get the target to pay out existing spare cash, which, again, provides instant return to the shareholders. Bratton identifies these three as the easy means. His fourth option, getting the target to change its long-term business plan, is clearly more difficult for the market to value.
Bratton’s list is consistent with my experience, save one additional form: some hedge funds may cross the hazily marked line between hedge fund and private equity fund, and actually intend to put the target together with other portfolio companies in order to flip both out as a larger, more valuable entity. So the hedge fund starts by looking for a target that will yield a fast return. Another factor that attracts hedge fund attacks is an existing base of disgruntled institutional shareholders, who, while they won’t start the attack themselves, are happy to tag along (and perhaps even instigate) the attacks. A corporation’s shareholder profile that holds the opportunity for a “wolf pack” approach increases the potential threat level of the jawboning investor described above.

Once the target is identified, the hedge fund looks for weaknesses that it can exploit in order to exert pressure on the target’s Board. Often, these are perceived procedural corporate governance weaknesses, such as having in place defensive bulwarks like staggered boards or poison pills, which are viewed negatively by proxy advisory services firms and many institutional shareholders as precluding takeover bids and thereby depressing stock market values. The hedge funds can then mount an attack on these perceived procedural corporate governance weaknesses as a prelude to a substantive corporate governance attack using the proxy rules to replace a minority of the directors. The plan normally is not to seize absolute control of the corporation, as that may trigger all sorts of corporate and state anti-takeover defenses, and, perhaps as importantly, cause investors to evaluate the bona fides of the insurgents. Rather, the aim is to make enough of a play so as to invade the boardroom and alter the corporation’s policies, or (more simply and cynically) to at least make it appear that this is their goal. And if a third party strategic bidder appears on the scene and offers a premium for control, so much the better. The hedge fund will gladly pocket its dollars and move on.

Why do I make this latter point? Because better corporate governance (procedural or substantive) is not really a goal of the exercise. Instead, the hedge fund’s goal is to persuade the market to increase the share price to a point that enriches the hedge fund. If that

159 In a “wolf pack” attack, first one hedge fund announces a position in a company, then others follow. Id. at 1379.

can be achieved without actually improving the target’s corporate governance, that’s okay for the hedge fund. Short-term dollar gains, not long-term governance, are what are at stake. The aggressive shareholder knows (as does the proxy advisor and counsel for the defense) that most institutional shareholders will be willing to support the insurgency so long as it doesn’t actually threaten a change in control. RiskMetrics and other proxy voting advisors usually will not oppose the “less than a majority change” that seemingly leaves any control premium in the hands of the current shareholders. Thus, the insurgent moves to replace all of the directors of a single class, or one-third of the full board, rather than all of the directors.

One phenomenon that adds mystery to these battles is the issue of who gets to vote. The hedge fund that brings the proposal is largely motivated, as I have said, by the prospect that the campaign will cause an uptick in the company’s share price. Rarely will the fund really want to be firmly committed to a long-term ownership position, unless it is with an eye to a subsequent change-in-control transaction that will yield a potentially even greater prize. But the short term uptick may well occur in advance of the vote actually being taken. At that point, as the campaign has achieved its goal and maximized the hedge fund’s investment and the fund faces risk from continued ownership, prudence would dictate that the hedge fund should sell its shares, take its profit, and move its investments elsewhere. This point may very well occur between the record date for the vote and the date of the shareholder meeting, in which case the fund might actually no longer own any shares, or have sold the economic interest in the shares and retained only the voting power! This “empty-voting” distorts the economic reality. A hit and run “investor” is, in my

161 See Bratton, supra note 148, at 1379 (discussing hedge funds’ bias toward short term gains); see also id. at 1383–84 (noting the short-term commitments of the hedge fund’s own investors).

162 In this respect, some hedge funds ape the greenmail tactics of the 1980s; the difference is that greenmail is today difficult to extract from wary directors, or even illegal under state law. See generally ThompsonHine.com, Hedge Funds: Greenmail Disgorgement Statutes and Corporate By-Law Provisions Could Trap Activist Hedge Funds (Mar. 12, 2009), http://www.thompsonhine.com/publications/publication1732.html.

163 For a fascinating example of hedge funds fighting one another, see High River L.P. v. Mylan Labs., Inc., 353 F. Supp. 2d 487 (M.D. Pa. 2005). Carl Icahn, who was involved in the battle, wrote a letter in which he excoriated another hedge fund for having hedged its position in Icahn’s target:

On Monday, Perry Capital disclosed in a filing with the Securities and Exchange Commission that it has hedged its Mylan shares, apparently confirming earlier reports that Perry may have had no economic interest in Mylan, merely the right to vote those shares. If this is true, in our opinion, this so-called innovative maneuver is co-opting the election process and robbing shareholders of the right to have a meaningful vote.
books, nothing more than a speculator, and, thus, it is hard for me to cast such a person as a "hero." Such a person is, for me, far more likely to be a "villain."

But many of these contests never make it as far as the actual proxy battle. Thus, Bratton reported a number of targets that have put themselves up for sale,\textsuperscript{14} unbundled "conglomerate" assets,\textsuperscript{15} or bought back shares using excess cash.\textsuperscript{16} As he demonstrated, Boards will often accede to the request of the insurgent by adopting the insurgent’s plan or putting some of the insurgent’s proposed members on the Board.\textsuperscript{17} Although some insurgents later become valued and trusted members of the Board, initially there is likely to be some disruption in Board dynamics and collegiality.

One facet of interest to the corporate lawyer is the lack of effective legal defenses to hedge fund attacks at the state law level. This is because the attacks take advantage of the modern nominee ownership system and so evade corporation statutes that focus on record ownership.\textsuperscript{18} The corporate takeover world, in contrast, has seen many effective statutory schemes developed to provide some level of protection against midnight raid tender offers or greenmail attempts.\textsuperscript{19} I have helped legislate and defend in litigation some of Ohio’s efforts in this regard,\textsuperscript{20} but to date I have not seen any state able to formulate effective protective legislation in the hedge fund attack area. The reason for this is not that the states, especially constituency states like Ohio, don’t care. The reason for inactivity is

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Corporate democracy is a cornerstone of our capitalist system. A few hedge funds should not be permitted to destroy it in order to make a few extra bucks.

\textsuperscript{14} Bratton, \textit{supra} note 148, at 1391.
\textsuperscript{15} \textit{Id.} at 1392–94.
\textsuperscript{16} \textit{Id.} at 1380.
\textsuperscript{17} \textit{Id.} at 1405–09.
\textsuperscript{18} For example, Ohio’s corporation law focuses entirely on shareholders of record; “shareholder” as used in chapter 1701 of the Ohio Revised Code means “a person whose name appears on the books of the corporation as the owner of the shares.” \textsc{Ohio Rev. Code Ann.} § 1701.01(F) (West Supp. 2009).
\textsuperscript{19} For a description of Ohio’s statutory defense scheme, see Geyer, \textit{supra} note 66.
\textsuperscript{20} For example, see the description of the 1996 battles over the constitutionality of Ohio’s Control Share Acquisition Act involving first Acme-Cleveland Corp. and later Commercial Intertech Corp. contained in Geyer, \textit{supra} note 66, at 533–40. As noted in that article, while the court upheld the statute’s constitutionality, the legislature nevertheless amended the statute to eliminate some of the provisions that the judge had struggled with in reaching his conclusion. Ohio’s legislature later adopted additional amendments to the Control Share Acquisition Act as a result of litigation in 2002 involving TRW Inc. Porter, \textit{supra} note 1, at 182.
that the basic ownership system for shares has developed beyond the
comprehension of state laws, through market derivatives and other
methods that, in effect, create the problems of "empty voting." Until new statutory schemes are developed, and so long as the
aggressors dot their current corporate law Is and cross their current
securities laws Ts, aggressive hedge fund tactics appear destined for
very little new legislative restrictions. The best that corporate defense
lawyers have come up with to take care of "empty voting" issues is
tightening their clients' notice bylaw requirements or creating record
dates for voting that are closer to the time of the actual vote. For
newly public companies, the best defense is dual class capitalization,
vesting majority voting control in the founding shareholder or his or
her family. Dual class capitalization is already in place at some family
or founder dominated companies, which is a huge advantage in
dealing with hedge funds. If one can ever look at these hedge fund attacks as a social
positive, it is because they in some cases do act like maggots that
doctors use to eat away diseased flesh, leaving a cleansed and
healthier corporation behind them. Of course the hedge fund raiders
would claim this is their goal in every attack. That would mean some
observers could rank these attackers in the "hero" category, at least
when the target is truly underperforming.

On the negative side, however, these attacks are dangerous threats
to any corporation, even well run ones, as there are relatively few real
defenses that the corporation can raise against them. Obviously, the
best way to avoid such hedge funds or other aggressive shareholders
is to outperform the market, or at least your peer group. But a

171 See generally Henry T.C. Hu & Bernard Black, Empty Voting and Hidden (Morphable)
Ownership: Taxonomy, Implications and Reform, 61 BUS. LAW. 1011 (2006) (discussing the
hedge fund practice of buying votes so as to have substantial voting power with little or no
economic ownership and its implications on corporate governance); Marcel Kahan & Edward
complicated nature of the U.S. corporate voting system and proposing ideas for reform).

172 Prominent examples of dual-class companies include Ford Motor Company, Google
14A) (Apr. 3, 2009); Google Inc., Proxy Statement (Schedule 14A) (Mar. 24, 2009); The New
York Times Co., Proxy Statement (Schedule 14A) (Mar. 11, 2009). In 2006, the Times's Board
was under attack by investors seeking to eliminate this protective device. See Jeremy W. Peters,
However, the company's proxy statement for its 2009 annual meeting shows that the Sulzberger
family trust continues to control 89 percent of the Class B shares, which are entitled to elect
ten of the fifteen directors. New York Times Co., Proxy Statement (Form DEF 14A), at

173 For interesting materials on maggot therapy, see University of California at Irvine,
Maggot Therapy Project, http://www.uciths.uci.edu/som/pathology/sherman/home_pg.htm (last
visited Apr. 7, 2009).
corporation that is in transition—that is migrating from underperforming to well-run—is at serious risk of attack even though there is nothing fundamentally wrong with its current governance or strategy. So long as the insurgents carefully read the corporate law and charter/bylaw provisions that govern nominations, they are a serious threat to win the contest. And in the Wall Street world where “greed is good,” you can be certain that abuses will occur, that good companies will be attacked, and that pirates will win. That’s villainy, in my book.

More importantly, as a lawyer in Ohio, I believe that regardless of whether there is actual villainy involved, the entire hedge fund approach to life violates the principles of our constituency statute and good corporate governance. By aggressively pushing Boards to generate short-term returns to shareholders, hedge funds pressure Boards to ignore the long-term and, especially, to favor the short-term interests of the shareholders versus the long-term interests of the corporation as a whole. There is no obligation for the Board to maximize short-term shareholder wealth, and yet that is precisely the goal of the hedge fund. Therefore, I believe that we should continue to explore defenses against such attacks.

F. Condition Red: Corporate Takeovers

The ultimate substantive corporate governance exercise is the takeover battle, be it in the form of a proxy battle to unseat a majority of the incumbent directors, a hostile tender offer, or initiation of a takeover battle through a bear hug letter. After all, what is more fundamental to substantive governance than the decision on who leads the company or whether to remain an independent company? Institutional investors—taken as a whole—play a significant role in corporate takeovers. First, some corporate raiders, while known

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174 See Bratton, supra note 148, at 1397–98 (describing attacks by Pershing Square on McDonald’s in 2006 and similar attacks in 2005 on Beverly Enterprises).

175 Targets have included such well-known companies as General Motors (fund: Tracinda Corp., led by Kirk Kerkorian), Heinz and Wendy’s (fund: Trian Fund Management, led by Nelson Peltz), Waste Management and Mattel (fund: Relational Investors, led by Ralph Whitworth). See Der Hovanesian, supra note 150, at 72 (describing the hedge fund pressure exerted on General Motors, Waste Management, and Mattel); Tully, supra note 152, at 84 (describing the Heinz and Wendy’s deals).

through their larger-than-life sized leaders (both Pickens and Icahn were using other peoples' money to make their raids in the 1980s),\textsuperscript{177} are institutional investors. Second, institutional shareholders typically hold more than a majority of the target's shares, and so have a large say in the outcome of the tender offer or merger vote.\textsuperscript{178} Third, fewer institutional investors than individual shareholders have emotional ties to the company and therefore are less likely to support management in a knee-jerk fashion, thereby becoming the swing vote necessary for both the bidder and the target to woo. This latter point is made more potent by the effect of the separation of investment and voting decisions discussed above.\textsuperscript{179}

But in the takeover context, as elsewhere, institutional shareholders are far from monolithic, and it is wrong to make any broad statements about their role as institutional investors, rather than individual shareholders. A few are the aggressors who start the battles, others serve as agent provocateurs who weaken the targets through hedge fund attacks, softening the targets up for a real bidder to come in and "help the shareholders." Some will support the takeover because they believe the short-term gain represented by the offer price to be greater than the long-term reward of holding on and following an alternative plan. Given the risks involved, others take the opposite view. Some are arbitrageurs, speculators who came into the stock precisely because it was in play and there is money to be made trading on the risk that the deal won't happen. Correspondingly, other, longer term investors may have sold them their shares because their fiduciary obligations forced them to liquidate shares rather than risk the loss of the takeover premium built into the current stock price should the offer terminate. Some will look at the issue through the eyes of RiskMetrics or its competitors; others make their own decision. And some (many companies hope it is someone like Warren Buffet) will ride to the beleaguered directors' aid as white squires to help fend off the attack. Bottom line, it doesn’t make a lot of sense to talk about them as a group.

I approach takeover battles from the point of view of an Ohio lawyer. As discussed above in Part III, in this state we have a fundamentally different view of corporations and their relationship with their shareholders than in Delaware. In Delaware, the Board's sole constituency (at least for solvent corporations) is the

\textsuperscript{177}BRUCE WASSERSTEIN, BIG DEAL: Mergers and Acquisitions in the Digital Age, 168 (2001).

\textsuperscript{178}See supra text accompanying notes 84–85.

\textsuperscript{179}See supra text accompanying notes 130–31.
shareholders.\textsuperscript{180} Here in Ohio, that's not the case. Ohio corporate Boards must consider the interests of the shareholders but are also free to consider—and make decisions based on—the interests of other constituencies.\textsuperscript{181} This makes takeovers in Ohio a rather different matter, philosophically, than in Delaware.

This fundamental difference in philosophy explains why, for example, \textit{Revlon} duties\textsuperscript{182} do not apply in Ohio—there is no obligation of directors, even once they start down the road of selling the company, to take on the role of an auctioneer whose duty is to extract the highest and best price for the shareholders. Instead, directors are free to consider the negative impact of a transaction on the corporation's other constituents, or to take the view that the interests of long-term shareholders outweigh those of short-term investors or speculators.\textsuperscript{184} Perhaps this is where the relationship of institutional investors toward an Ohio corporation is most at variance with their Delaware counterparts. In Delaware there is no difference between the interests of a Johnny-come-lately hedge fund, an arbitrageur hoping for a quick sale, and investors who want to be in the shares for a long time. In Ohio, on the other hand, the Board is free to differentiate between short-term interests and long-term interests, and distinguish between short-term shareholders and long-term shareholders (as our control share acquisition act explicitly does with regards to arbitrageurs).\textsuperscript{185} And an Ohio Board may, by statute, consider the impact of the transaction on employees, suppliers, customers, the municipalities in which plants are located, the economy of the state, and much more.\textsuperscript{186} Therefore, in an Ohio corporation, even in a takeover situation, shareholders may be viewed not as supreme, but as being at most first among equals. Of course, shareholders have the ultimate say in who serves as directors, so the shareholders are not completely powerless to persuade the directors to

\textsuperscript{180}See supra text accompanying notes 49–52.

\textsuperscript{181}See \textit{Ohio Rev. Code Ann.} § 1701.59(E) (West Supp. 2009) (stating that directors may also consider interests of employees, customers, creditors, suppliers, the state and national economy, society at large, and the interests of the corporation and its shareholders over varying periods of time).

\textsuperscript{182}See supra note 52.

\textsuperscript{183}Although the Ohio Supreme Court has not reached this holding, a statement to this effect was contained in the concurring opinion of Justice Holmes in the court's decision in \textit{Stepak v. Schey}, 553 N.E.2d 1072, 1077–78 (Ohio 1990).

\textsuperscript{184}See \textit{Ohio Rev. Code Ann.} § 1701.59(E)(4) (allowing consideration of "[t]he long-term as well as short-term interests of the corporation and its shareholders") (emphasis added).

\textsuperscript{185}See id. § 1701.59(E)(1) (requiring a second majority to approve any control share acquisition). This second majority excludes "interested shares," \textit{id.}, as defined in section 1701.01(CC), which includes shares acquired after first public disclosure of a control share bid, \textit{see id.} § 1701.01(CC)(1)(d).

\textsuperscript{186}See id. § 1701.59(E).
surrender control. But the shareholders can’t compel the directors to act simply by threat of lawsuits for breach of their fiduciary duties.

Under either an Ohio or Delaware analysis, those who seek to take over public company targets may be heroes in those circumstances where bad management is actually retarding the enterprise, or where the acquirer is able to productively consolidate the target with another portfolio investment to improve the value of both. In these cases, under the Delaware analysis, if shareholders of the public company are paid a price for their shares that exceeds their present value using any realistic growth scenarios, the institutional investor is indeed a hero. In Ohio, we’d perhaps want to add in consideration of other constituencies. If the cost is a net loss of jobs in Ohio or other bad effect on our economy, this may offset the benefits derived by shareholders and so reduce or eliminate the heroic stature of the attacker.

As I earlier said in the context of hedge fund attacks, there are times when bidders are villains, such as when hostile takeovers target a company that has started its recovery from a downturn, whether caused by poor management or otherwise, but that has not yet reached its optimal performance level. It is during this period that a corporation is most vulnerable. When it is in the trough of a downturn, it is often too damaged to attract buyers, other than liquidators, and when it is at the top of its performance cycle, it may be too costly for financial buyers to be interested. But when it has developed a plan to recover and is on its way up, buyers understand that if they can grab the company at that moment, they may well buy it at a depressed price, reaping rewards that the target’s shareholders would have enjoyed had the company remained independent. The risk of such a villainous attack is especially high if the buyer aligns itself with management to effect a management buyout-going private transaction, since management is a willing co-conspirator, or even promoter, of the transaction.

CONCLUSION

In my comments, I have tried to show how one “recovering” corporate governance lawyer thinks about corporate governance and the role of institutional investors. I have emphasized the framework that an Ohio practitioner uses in thinking about corporate governance issues, because it is so different than that used in Delaware. I will leave to another day any debate over the issue of whether Ohio’s approach is the correct one. There are many economists and academics who argue for shareholder primacy. But economists and
academics neither legislate nor vote in great numbers, and litigants who depend on their argument to sway a court, when that court has in front of it a clearly drafted statute to the contrary, will lose.

I have also outlined ways that I have seen institutional shareholders impact corporate governance. I will end as I began, by saying it is not really possible to view institutional investors as a monolithic group and that, under differing circumstances, they may be either heroes or villains, but more commonly are neither. Bottom line, they are essential parts of the corporate governance landscape, and lawyers cannot ignore their importance.