WHO CONTROLS CORPORATE CHARTERS?
SHAREHOLDER ACTIVISM AND CHARTER AMENDMENTS

Geeyoung Min

Abstract

Prior scholarship has characterized corporate charters as relatively static documents that, if ever amended, tend to serve the interests of managers over those of shareholders. This paper challenges the conventional accounts using newly constructed, original data on corporate charters of the 221 largest, publicly traded U.S. companies. The novel dataset shows that, starting around 2005, there was a substantial increase in charter amendment activity that tends to empower shareholders. This paper argues that a new rule from the U.S. Securities and Exchange Commission (“SEC”) in 2003 and its subsequent interpretation regarding mutual funds’ fiduciary duty in proxy voting have played an important role in this change by empowering proxy advisory firms, such as the Institutional Shareholder Services (“ISS”). The general rise of shareholder influence on charter amendments, however, has not completely shifted control from managers to shareholders. Directors’ exclusive right to dictate the final draft of charter provisions has enabled managers to make compromised implementations which impose limitations on how shareholders can exercise newly granted rights. This paper argues that the current practices of the SEC and proxy advisory firms tend to disregard such compromises and presents suggestions on how to better facilitate a more nuanced debate on charter amendments.

* Research Assistant Professor at University of Virginia School of Law and Postdoctoral Fellow in Corporate Law and Governance at Ira M. Millstein Center at Columbia Law School. I am grateful to Lisa Bernstein, Richard Brooks, Brian Cheffins, Stephen Choi, Jack Coffee, Luca Enriques, Ronald Gilson, Jeffrey Gordon, Zohar Goshen, Michelle Greenberg-Kobrin, Henry Hansmann, Michael Klausner, Robert Jackson, Curtis Milhaupt, Joshua Mitts, John Morley, Ed Morrison, Inho Andrew Mun, James Nelson, Nathan Park, Gabriel Rauterberg, Roberta Romano, Susan Rose-Ackerman, Greg Rustico, Sarath Sanga, Carol Sanger, and Eric Talley; as well as participants at the Chicago Legal Scholarship Workshop and the Columbia Associates and Fellows Workshop for their insightful comments.

DRAFT—Please do not cite without the author’s permission
6/16/16
# TABLE OF CONTENTS

I. INTRODUCTION .................................................................3

II. EXISTING THEORIES ON CHARTER AMENDMENTS ......................7
   A. Law: Checks and Balances in Charter Amendment Process .......7
   B. Theoretical Concerns over Midstream Amendments ..............9
      1. Board’s Exclusive Right to Propose Charter Amendments ...9
      2. Failure of Shareholder Right to Veto Charter Amendments 10

III. ACTUAL DYNAMICS OF CHARTER AMENDMENTS ..................13
   A. The Change in Charter Amendment Trends .......................13
      1. Description of Data ............................................14
      2. Change in Frequency .........................................17
      3. Change in Substance ..........................................19
   B. The New Dynamics in Charter Amendments ........................25
      1. Institutional Shareholders as Pivotal Voters .................26
      2. The SEC’s New Rule and No-Action Letters ..................28
      3. Proxy Advisory Firms and Shareholder Pressure .............30
   C. Compromised Implementation as the New Battleground ..........34
      1. The Implementation of Modified Shareholder Proposals ....34
      2. Managements’ Preemption by Compromised Terms ............38
      3. Desirability of Compromised Implementations ...............41

IV. IMPLICATIONS ...................................................................42
   A. Decreased Need for Mandatory State Corporate Law ..........42
   B. Policy Implications for Compromised Amendments ............43
      1. Proxy Advisory Firms’ Voting Recommendations ............45
      2. The SEC’s No-Action Letters ..................................45

CONCLUSION .........................................................................47
INTRODUCTION

For a shareholder meeting in 2009, a shareholder of Safeway Inc., one of the largest grocery chains in the country, submitted a proposal asking the company’s board of directors to give the holders of 10% or more of company’s stock the right to call a special meeting. The board was unable to exclude the proposal from the ballot,1 and the proposal was voted with the support of 60.3% of shares at the shareholder meeting.2 Although the outcome of the vote had no legally binding effect on the company, Safeway’s board responded by making its own proposal granting such right to the shareholders the following year.3

As this episode demonstrates, over the past decade, shareholders have actively expressed their preferences on corporate governance arrangements manifested in the companies’ charters and bylaws, and managers have become more responsive to their demands. In the process, corporate charters and bylaws have become an important battleground for shifting the relative rights of shareholders over those of managers. This paper tackles how the recent rise of shareholder activism has influenced companies’ most foundational governing documents: corporate charters.4

The existing literature on corporate charters has expressed concerns over managers’ opportunistic charter amendments, particularly with respect to midstream amendments that take place after a firm’s initial public offering.5 Such concerns are bolstered by two important ob-

1 Safeway requested the SEC’s no-action letter in order to exclude the shareholder proposal based on rule 14a-8(i)(2)(Violation of law), (3)(Violation of proxy rules) and (6)(Management functions) but the request was denied. https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/pdf/109029709-40.pdf For the detailed description of the process to exclude a shareholder proposal through the SEC no-action letter, see infra II. B. 2.
4 Corporate charters deserve distinction from bylaws especially because of the rigorous amendment process. While either directors or shareholders can unilaterally amend bylaws, both directors’ initiation and shareholders’ approval are necessary to amend corporate charters. Due to the flexibility, both directors and shareholders generally favor bylaws over charters for governance changes.
servations. First, directors’ exclusive right to initiate a charter amendment allows directors to pursue an amendment only when it favors them. Second, once initial charter provisions are set, shareholder approval requirements cannot effectively check directors’ opportunistic amendment. Shareholders often lack requisite information to properly evaluate the proposals and face the collective action problem since a single shareholder vote is unlikely to affect the outcome. Due to such structural impediments, prior literature has argued that midstream charter amendments tend to favor directors over shareholders.

Notwithstanding the extensive theories, there has been no systematic empirical analysis to validate how such theories measure up to the current corporate charter amendment practice. This paper offers the first comprehensive analysis of this issue, using an original dataset exclusively on corporate charters of the 221 largest publicly traded companies from 1994 to 2015. The new data, mostly on midstream charters, uncovers a dramatic change both in frequency and substance of charter amendments. Charters were much more actively amended starting around 2005, and the number of amendments between 2005-2015 was almost five times larger than that between 1994-2004. More importantly, contrary to the concerns expressed in the prior literature, the paper shows that recent charter amendments tend to empower shareholders.

The changes in the corporate governance environment since 2000, including the rise of shareholder activism and the increase of institutional investor ownership in large companies, however, do not fully

5 Lucian A. Bebchuk, The Case for Increasing Shareholder Rights, 118 Harv. L. Rev. 833, 865 (2005) (“Management’s control over charter amendments distorts the evolution of charter provisions in management’s favor. Changes that could increase shareholder value will not be adopted if they make management worse off.”)
6 Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 Colum. L. Rev. 1549, 15741575 (1989) (“Shareholder voting as a means of evaluating and consenting to a proposed charter amendment is fraught with severe problems, in particular, collective action problems in acquiring and dissemination information among shareholders, and strategic behavior by insiders that amounts to economic coercion.”)
7 Distinguishing corporate charters from bylaws is an important premise of the paper. In contrast to a charter amendment that requires approvals of both directors and shareholders, for most companies, either directors or shareholders can unilaterally amend bylaws. Furthermore, bylaws are subordinate to corporate charters, and a bylaw provision that conflicts with the charter is ineffective. Based on these differences, legal scholarship has clearly treated them separately, and my data provides the first systematic analysis of contents of charters, not bylaws.
8 See infra II. A. 3.
explain why the shift in charter amendments was not gradual over a period but sudden. Based on the data and interviews with practitioners, this paper claims that the SEC’s new rule-making was the epicenter of the change in charter amendments. The Commission promulgated a new rule in 2003 imposing fiduciary duty on mutual funds in proxy voting. Further, through two no-action letters in 2004, the SEC staff confirmed that relying on proxy advisory firms’ recommendations would likely cleanse mutual funds’ conflicts of interest and satisfy their fiduciary duty of loyalty to their own investors. The no-action letters significantly increased the influence of proxy advisory firms in proxy voting by giving mutual funds a strong incentive to rely on their recommendations.

At the same time, however, the shareholder activism and the consequent charter amendments have not always produced the sought-after effects. In the Safeway episode above, the directors proposed a charter amendment with the eligibility threshold of 25% or more of the ownership of the company’s stock, not 10% as initially proposed by the shareholders in the previous year. Regardless of this increase in threshold, shareholders approved the management’s proposal and the company’s charter was amended accordingly. The fact that the shareholders only have a choice of either approving or rejecting the management proposal significantly impedes shareholders’ bargaining power to challenge the compromised proposals.

This paper demonstrates that the popularity of compromised im-

COLUM. L. REV. 863, 886 (2013) (”[B]y any measure, mutual funds have the right to be a significant force in the governance of large U.S. corporations.”)

15 Safeway Inc., Current Report (Form 8-K) (May 24, 2010) at 2, http://www.sec.gov/Archives/edgar/data/86144/000119312510126942/d8k.htm. It is because Lucian A. Bebchuk, The Case for Increasing Shareholder Rights, 118 HARV. L. REV. 833, 865 (2005) (“Management also has the sole power to put proposals on the table, and shareholders have to vote up or down on these proposals without having the option to amend them. Bargaining theory indicates that... a party that has the sole option to make take-it-or-leave-it offers to the other will have a substantial advantage.”)
plementation has been magnified by proxy advisory firms’ voting recommendations and the no-action letters from the SEC. First, when it comes to the issue of granting a new right to shareholders, proxy advisory firms have not sufficiently alerted shareholders to vote against management proposals placing more onerous restrictions on the right. For instance, the ISS, by far the most influential proxy advisory firm, consistently recommends voting for management-modified proposals. Second, the SEC staff has also contributed to the spread of management’s compromised implementation by granting no-action relief to companies seeking to exclude shareholder proposals that challenge management’s modifications.

After laying out the institutional context and the analysis of the data, this paper explores the theoretical and practical implications of the recent charter amendments trend. First, our understanding of midstream charter amendments needs to be updated to reflect the new dynamic caused by shareholder activism. For the past thirty years, the theoretical foundation for corporate statutes and policies was based on the assumption of passive shareholders with weak bargaining power. My data and its analysis provide tangible evidence that this assumption is not valid any more, particularly with respect to charter amendments. The increase in shareholders’ bargaining power would diminish the need of protecting shareholders through mandatory and protective state law provisions. Second, at the same time, variations in the compromised charter amendments by managers may hinder shareholders from exercising their newly negotiated right. The SEC and proxy advisory firms should allow shareholders to challenge managements’ compromised implementation in order to secure a more transparent bargaining dynamic between shareholders and directors.

This paper is organized as follows. Part I introduces the current state and federal law on the charter amendment process and the theoretical concerns over managers’ opportunistic behavior in midstream charter amendments. Part II provides the first systematic analysis of the new trend in charters amendments, using new, hand-collected charter amendment data, and claims that the SEC’s new rule and subsequent no action letters have played an important role in substantially facilitating charter amendments that generally empower shareholders. This Part also highlights managers’ compromised implementation of shareholder requests. Part III explores the normative implications based on the foregoing theoretical and empirical analysis.

17 Simpson Thatcher Memo, Special Meeting Proposals (July 30, 2015) at 2-3
I. EXISTING THEORIES ON CHARTER AMENDMENTS

A corporate charter is the most foundational document that governs how a company is organized and managed.\(^{18}\) A corporate charter is the primary document because the charter supersedes other documents of the company, including its bylaws: they are invalid to the extent that they conflict with its charter.\(^{19}\) Once a company files its charter with a state, corporate laws of the chosen state will automatically fill the gaps in the company’s charter. Since state corporate laws are composed mostly of default rules, each company has an ample discretion to customize its corporate charter. Particularly as to a midstream charter amendment, which occurs after companies have gone public, there have been questions as to whether managers are enhancing their own agendas at the expense of shareholders by tailoring the charters in their favor. There has been little data to answer the questions. In order to better understand this debate as well as the recent trend in charter amendments, this Part first focuses on the procedural mechanics of the amendment process and discusses how the procedural requirements allocate power over corporate charters between managers and shareholders.

A. Law: Checks and Balances in Charter Amendment Process

Under both the Model Business Corporation Act and all fifty states’ corporate law, including the Delaware General Corporation Law, amending a corporate charter requires both directors’ and shareholders’ approvals.\(^{20}\) After the directors first agree on whether a certain amendment proposal will be put up for vote at a shareholder meeting, the proposal will be adopted and become effective only when the proposal is approved by at least the majority of outstanding stock entitled to vote on the proposal.\(^{21}\) Because the provision requires a majority of stock “entitled to vote thereon,” rather than a majority of “votes cast,” the requirement may not be so easy to satisfy especially for companies with dispersed share ownership. At least on its face, the current two-step mechanism under which one party (directors) proposes the change and the other

\(^{18}\) I use the term “corporate charter” to indicate a legal document filed with a U.S. state to incorporate a corporation. It is officially referred to as “certificate of incorporation” in Delaware General Corporation Law, see Del. Code Ann. tit. 8, § 104, or “articles of incorporation” in the California Corporations Code, see California Corporations Code, § 200 (a).

\(^{19}\) E.g., Model Business Corporation Law (“MBCA”), § 2.06 (“The bylaws may contain any provision...that is not inconsistent with law or the articles of incorporation.”); Del. Code Ann. tit. 8, §109(b) (“The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation . . . .”).

\(^{20}\) MODEL BUS. CORP. ACT Section 10.03.

\(^{21}\) E.g., DEL. CODE ANN. tit. 8, Section 242 (b)(1).
party (shareholders) decides whether to adopt the change seems to allocate the power fairly evenly for the purposes of creating checks and balances between the two constituents.

In addition to the state corporate law, another important source that influences charter amendments is the federal regulation of shareholder proposals. While shareholders can submit proposals on a broad range of issues, including concerns over environmental and international human rights violations, shareholder proposals on corporate governance issues receive the most amount of attention. After all, proposals on corporate governance matters are the ones that influence the allocation of power within companies, where the starkest tension between the managers and the shareholders resides.

The federal proxy rule regulates shareholder proposals, and unlike state corporate laws, companies that are subject to the federal rule cannot opt out of the rule. Rule 14a-8 under the Securities Exchange Act of 1934 defines how shareholders can include their resolutions in proxy ballots to be voted on. Also, more importantly, Rule 14a-8(i) lists thirteen grounds under which the management can exclude shareholder proposals from the proxy ballot. Once a company receives a shareholder proposal, the company cannot simply ignore the proposal. When a company wants to exclude the proposal from the voting agenda, the company must request the SEC to issue a no-action letter, permitting the exclusion on the grounds listed in Rule 14a-8 (i).

What happens when a shareholder proposal gets voted on and receives majority of shareholder support? Since the federal rules cannot impose any legal obligations on shareholder resolutions that receive at least majority approval, most shareholder proposals are only advisory. In that sense, shareholder proposals are designed like referenda because they only demonstrate shareholders’ preference on certain issues and do not legally bind the management. It is worth noting that a proposal can be made even when a shareholder owns a small fraction of the company. Rule 14a-8(b) indicates that a shareholder who continuously owns at

---

22 Thirteen grounds that allow management to exclude shareholder proposals are: (1) Improper under state law of incorporation (2) Violation of any state, federal, foreign law (3) Violation of proxy rules (4) Personal grievance or special interest (5) Relevance (6) Beyond company’s power/authority (7) Intervention of management function (8) Improper action on director elections (9) Conflicts with company’s proposal (10) Substantially implemented already (11) Duplication of other shareholder proposals (12) Resubmission (13) (Demand of) Specific amount of dividends. 17 C.F.R. § 240.14a-8(i) (2015).

23 Federal rule does not define whether majority means either majority of votes cast or votes entitled to vote. In practice, “votes cast” standard is used more often.

24 One exception would be the recent rise of binding shareholder proposal to adopt bylaws. In most states, shareholders can unilaterally adopt, amend or repeal bylaws. Thus, if a shareholder proposal regarding bylaws receives a required shareholder votes, the shareholder proposal becomes legally binding and bylaws would be changed as such.
least $2,000 in market value or 1% of voting shares for at least for one year is eligible to submit a shareholder proposal.25

B. Theoretical Concerns over Midstream Amendments

Notwithstanding state corporate law’s intent to balance the power between the shareholders and the directors in the charter amendment process, whether shareholders can effectively monitor opportunistic, self-interested amendments by directors has remained an important question. Shareholders’ checks on board’s opportunistic amendments could be undermined in at least two ways: first, shareholders cannot propose or initiate shareholder value-enhancing charter amendments; and second, shareholders cannot effectively prevent shareholder value-destroying amendments from being adopted due to the problems of lack of information and collective action.

1. Board’s Exclusive Right to Propose Charter Amendments

Under the existing state corporate laws, the first major structural hurdle is that the shareholders cannot initiate the charter amendment process. Only the directors have the right to determine whether any amendment proposal will be put forward for a shareholder vote.26 Although the shareholders can submit a proposal to amend the charter under the federal proxy rules, this is merely advisory even when the majority of the shareholders vote in favor.27 Prior literature has emphasized the fact that shareholders cannot adopt what they want in the charter unless managers expressly agree to do so first,28 and has pointed to the past trend of managers exerting both the de facto and the de jure veto power over charter amendments. This trend continued until the recent rise of shareholder engagement; this paper focuses on how the shareholders have wrestled some of the de facto power away from the management.

Furthermore, management’s exclusive power to initiate charter amendments has another, more subtle but rarely discussed, effect of

26 E.g., Del. Code Ann. tit. 8, §242 (b) (1).
27 Regulation 14a-8, for detailed discussion on shareholder proposals, see I.B.1.
28 Michael Klausner, Fact and Fictions in Corporate Law and Governance, 65 STAN. L. REV. 1325, 1346 (2013) (“Once a company goes public, the characterization of changes in the manager-shareholder relationship as “contractual” is weaker than at the IPO stage. A charter amendment requires, first, approval by the board of directors and then approval by shareholders. The board must initiate the amendment. Shareholders cannot.”)
weakening the checks and balances of the amendment process: the management’s exclusive right to draft the terms of an amendment. Even if a company were to embrace an amendment that reflects shareholders’ demands, the actual terms of the amendment are largely up to the management’s discretion. Depending on the terms attached or modified by the directors, the true nature and the effect of an adopted provision can vary widely. By making subtle changes to shareholder-sponsored amendment proposals, directors may “satisfy” the demand of the shareholders without actually handing power back to the shareholders.29

When a charter amendment proposal has no room for variation—for instance, in the case of the elimination of a staggered board—there is not much the directors can do to manipulate the language, or subtly undermine the power of the new provision. In many other cases, however, managers can exercise its power over a new charter provision by modifying the required vote threshold or by adding more stringent procedural requirements.

2. Failure of Shareholder Right to Veto Charter Amendments

If shareholders have not had a power to propose charter amendments they want, the next question would be whether the shareholder approval requirement has functioned as an effective check against managers’ self-serving charter amendments. Mainly due to shareholders’ lack of information and incentive to vote, as well as the traditionally management-favoring voting system, most managements’ amendment proposals have received shareholder approval even when the proposals were favoring the management over the shareholders.30

First, shareholders do not always have enough information to tell whether a new amendment is shareholder value enhancing or not. A shareholder approval requirement may deter an obviously opportunist charter amendment. In many cases, however, the consequences of an amendment are ambiguous, at least at the time of voting.31 Even for an identical corporate governance arrangement, there could be persuasive arguments on both sides. For instance, at an annual shareholder meeting in 2011, AT&T shareholders voted on a shareholder proposal to adopt a charter provision allowing shareholder action by written consent. Supporting argument from shareholder proponents stated:

29 For examples of modified amendments, see infra II. C. 1.
Taking action by written consent in lieu of a meeting is a means shareholders can use to raise important matters outside the normal annual meeting cycle. A study by Harvard Professor Paul Gompers supports the concept that shareholder dis-empowering governance features, including restrictions on shareholder ability to act by written consent, are significantly related to reduced shareholder value.\textsuperscript{32}

On the other hand, CVS Caremark’s board recommended voting against similar proposals:

Giving a bare majority of stockholders the right to act only by written consent would deprive other stockholders of the valuable opportunity to discuss matters that affect the Company and all stockholders as a whole and to influence the voting process. The Board believes that matters that are of sufficient importance to be subject to stockholder action should be communicated to all stockholders before the decision is taken, and that all stockholders should have an equal opportunity to consider and vote on proposed stockholder actions, as is currently provided for under our Charter and By-laws.\textsuperscript{33}

Each side offers arguments aimed at convincing shareholders that adopting the other side’s recommendation will undermine shareholder value. From the perspective of an individual shareholder, whether implementing the proposal will be beneficial is difficult to discern by looking only at the arguments. Furthermore, even when shareholders are well-informed and know which way to vote, this does not necessarily mean that shareholders will actually vote in that way. Because the dispersed ownership structure makes it difficult and quite costly to gather enough votes to defeat an amendment proposed by the management, it may not be in the interest of an informed shareholder to mount an effective resistance. Thus, either due to lack of information, cost, or other concerns, many shareholders do not exercise their voting rights or mount resistance against management-sponsored proposals.\textsuperscript{34}

\textsuperscript{32} CVS Caremark’s proxy statement filed for a 2011 annual shareholder meeting, p.66 http://www.sec.gov/Archives/edgar/data/732717/000119312511062175/ddef14a.htm#toc133812_15.

\textsuperscript{33} Id. at 67.

Second, the tallying system that counts shareholders’ votes could also favor management proposals. In a company’s proxy statement, a management indicates its voting recommendations for each voting agenda. In most cases, a management recommends voting “for” management proposals and “against” shareholder proposals. In addition to being a statement of advocacy, such recommendations also often function as a default: a shareholder’s vote is counted as being in accordance with management’s recommendations unless the shareholder clearly expresses her voting preferences against them.

This system of counting votes in favor of a management becomes more complicated due to the prevalence of brokers and broker-owned votes. Most retail investors utilize a broker service and remain passive beneficial owners. Brokers act as messengers between a company and its retail investors. Under the stock exchange listing rules, when beneficial owners do not give specific voting instructions to their brokers, which is not uncommon, brokers are able to vote on “routine” matters in their discretion. Since brokers do not have sufficient incentive to make informed decisions, when brokers are allowed to exercise their discretion in voting, they tend to follow the management’s recommendations. The scope of “routine” matters, however, has gradually narrowed over the years. In 2010, the New York Stock Exchange (“NYSE”) amended Rule 452 to ban broker discretionary voting on uncontested director elections and executive compensation. More relatedly to charter amendments, in 2012, the NYSE and NASDAQ excluded important corporate governance issues from being “routine” matters, and brokers cannot engage in discretionary voting without beneficial owners’ instructions on certain corporate governance proposals.

---

36 Wal-Mart Store’s proxy ballot at 2015 shareholder meeting indicates that “If you do not specify how the proxy should be voted, it will be voted “FOR” each of [director] nominees listed in Proposal 1, “FOR” Proposals 2,3, and 4 (management proposals), and “AGAINST” Proposals 5 through 9 (shareholder proposals).” Wal-Mart Store’s proxy ballot used for 2015 Annual Shareholders’ Meeting on June 5, 2015 http://stock.walmart.com/files/doc_financials/2015/annual/2015-sample-proxy-ballot.pdf.
37 Bo Becker & Guhan Subramanian, Improving Director Elections, 3 HARV. B. L. REV. 1, 16 (2013).
38 New York Stock Exchange Listing Rules Section 452; NASDAQ Stock Market Rules 2251; Section 957 of Dodd-Frank Act.
39 This amendment applied also to NASDAQ listed companies because NYSE listing rules affect to brokers licensed by NYSE and hold NASDAQ listed companies’ shares.
40 It includes declassifying board of directors, effectuating majority voting in the director election, eliminating supermajority voting requirements, providing for the use of written consents by stockholders, and providing right to call a special meeting of stockholders.
41 The broker discretionary votes that used to be counted in favor of the management are now categorized as “broker-non-votes” and they are counted only for the purposes of satisfying quorum.

DRAFT—Please do not cite without the author’s permission
Given these structural impediments, it is uncertain whether a shareholder approval requirement in the charter amendment process could effectively prevent directors’ opportunistic amendment attempts. Ironically, the shareholder approval requirement has often been used to protect charter provisions that are more in favor of managers. Even managers have incentive to secure core corporate governance arrangements through charters than through bylaws. After all, once a corporate governance arrangement is stipulated in the charter, shareholder approval requirement to amend it can function as a shield from future challenges to the arrangement.

II. ACTUAL DYNAMICS OF CHARTER AMENDMENTS

This Part presents and analyzes the original data on corporate charter amendments among the largest public companies in the U.S. Section A uncovers and presents the recent trend of charter amendments towards a shareholder empowerment that conflicts with the prior theoretical understanding of managements’ opportunistic charter amendments. Section B argues that the SEC’s new rule in 2003 and subsequent no action letters in 2004 on institutional shareholders’ proxy voting have played an important role in substantially increasing charter amendments since 2005. Section C examines how managers proactively fight back by implementing compromised and weakened versions of shareholder requests.

A. The Change in Charter Amendment Trends

As mentioned in the previous part, there have been extensive theoretical discussions on corporate charters. However, no systematic empirical analysis of actual corporate charters exists to test those theoretical propositions. Most empirical studies on corporate governance ar-

Contrary to the expectations of rule makers, recent empirical studies have shown that the change has not affected voting results much. Scott Hirst, Frozen Charter, 34 YALE J. ON REG. (forthcoming) (2017); Bo Becker & Guhan Subramanian, Improving Director Elections, 3 HARV. BUS. L. REV. 1, 17-18 (2013) (In the context of director election, “[Since] the margin of victory in corporate election is so large that broker non-votes could not have made much of difference.”).

Barry H. Genkin & Keith E. Gottfried, Ten Ways to Prevent a Company from Being Vulnerable to a Consent Solicitation, Blank Rome LLP (May 2008) http://www.blankrome.com/index.cfm?contentID=37&itemID=1559 (“As we have repeatedly mentioned, since shareholders generally have the right to unilaterally propose binding amendments to a company’s bylaws but not to the certificate of incorporation, the more secure place to provide for the size of the board would be in the certificate of incorporation.”).

A recent study has shown systematic analysis of corporate governance arrangements in a broader sense by looking at both corporate charters and bylaws combined. Michael Klausner, Fact and Fictions in Corporate Law and Governance, 65 STAN. L. REV. 1325, 1326 (2013)
rangements examine both charters and bylaws, but the datasets used in such studies are not suitable for examining the practice of charter amendment. This is the first study that relies and focuses exclusively on corporate charters and shows how they have evolved over the recent years.

1. Description of Data

My data sample consists of the top 250 of the Fortune 500 companies listed in its 2012 issue. The list consists of the 500 largest companies in terms of revenue that are incorporated in the U.S. The companies in the sample are influential not only because of their size, but also because they tend to be the ones most often targeted by activist shareholders. From the largest 250 companies of Fortune 500 list, this paper is confined to the publicly traded companies only, which narrows the list to 221 companies.

The sample companies are incorporated in 25 different states and 63% of them are incorporated in Delaware. The annual revenue of the firms in the sample ranges from $22.6 billion to $351.1 billion. The market value and book value of assets ranges from $3.3 billion to $425 billion, and from $7.7 billion to $1.9 trillion, respectively. Given that the top Fortune 250 firms are long-established and well-known companies, such as Wal-Mart, General Motors, and AT&T, most of the charters in the sample are midstream charters. I did not exclude financial institutions from the sample companies because there are no additional, unique regulations on financial institutions as far as corporate charters are concerned. All publicly traded companies are required to file their charters with the SEC, and the charters are filed as Exhibit 3.1 with a 10-K, 10-Q, 8-K, DEF 14, or S-3 filings, rather than as an independent filing. Those filings are publicly available via the SEC’s EDGAR database.

---

44 Ever since the G-index, which treats provisions in charters and bylaws on an equal basis, was introduced in 2003 as a proxy to evaluate the quality of each company’s corporate governance, combining charters and bylaws has become a norm in empirical finance literature on corporate governance issues. Paul Gompers et al., Corporate Governance and Equity Price, 118 Q. J. ECON. 107 (2003); Lucian A. Bebchuk et al., What Matters in Corporate Governance?, 22 REV. FINANC. STUD. 783 (2009); Martin Cremers and Allen Ferrell, Thirty Years of Shareholder Rights and Firm Value, 69 J. FINANCE 1167 (2014)

45 The Fortune 500 list is not confined to publicly traded companies, because it includes private companies and cooperatives that file a 10-K, as well as mutual insurance companies that file with state regulators. For the full list of companies, see http://fortune.com/fortune500/2012/. As I started collecting the data in 2012, I kept the list from the 2012 issue, but have incorporated all the amendments between 1994 and 2015. (As of August 2015).

46 But, there is also a small number of initial charters, charters used in the company’s IPO, such as that of Facebook.

47 For each company, I first confirmed the location of the most current charter from the most recent annual filings (10-K) Exhibit 3.1. In most cases, companies only refer to the previous filing
To count only the substantive charter amendments, I excluded one relatively common but not a substantive type of amendment: increasing the authorized number of shares. In order to count the number of amendments consistently across companies, I counted the number of incidences where the shareholders’ votes were taken rather than the number of amended charter provisions. Typically, a management’s proposal to eliminate the super-majority voting requirement is bundled. For instance, a management proposes to eliminate “all” super-majority voting requirements in the company’s charter at the same time. Once approved by the shareholders, different sections in the charter that contained a super-majority voting requirement will be eliminated at the same time, thereby producing multiple amendments. Counting them separately for the purposes of estimating the amendment frequency would be misleading. A more traditional type of bundling has also taken place wherein management puts different subject matters to one shareholder vote. Seventy-one (71) out of 430 voting agendas were bundled ones, and 60 of them proposed to eliminate super-majority voting requirements on different subject matters. Management bundled more than one unrelated subject matters 11 times, despite the SEC’s rule against bundling. To be consistent, I counted these bundled amendments to constitute a single amendment event.

I coded the charter amendment history of the 221 sample companies between 1994 and 2015 using two different sets of documents. The first set is created by using amendments proposed by management and their voting outcomes. I checked the annual proxy statements (DEF 14) to identify whether there was a management proposal and also the substance of the proposal, and then I checked the company’s current filing that first attached the charter, rather than attaching the current charter in their current annual filing, which sometimes required me to track down a much earlier filing to locate the company’s charter.

For instance, in 2010, Item 2 on the proxy ballot of AmerisourceBergen’s annual meeting was “To approve the amendment and restatement of AmerisourceBergen’s Amended and Restated Certificate of Incorporation to replace all super-majority vote requirements with a majority vote requirement.” And this one vote amended 10 distinct charter provisions including 1) undesignated preferred stock; 2) the classified board; 3) the removal of directors; 4) vacancies on the board of directors; 5) stockholder action by written consent; 6) the ability to call special meetings of stockholders; 7) advance notice of director nominations and stockholder proposals; 8) business combination; 9) the limitation of liability of directors, indemnification and advancement; and 10) the amendment of certain charter provisions. See AmerisourceBergen’s proxy statement for 2010 annual meeting at 16.

To understand the bundling problem, see generally, Lucian A. Bebchuck and Ehud Kamar, Bundling and Entrenchment, 123 HARV. L. REV. 1549 (2010); James D. Cox et al., Are Companies Impermissibly Bundling Proposals for Shareholder Votes?, working paper (2015) In general, bundling different subject matters in one vote violates the SEC Exchange Act Rule 14a-4(a)(3). Regarding the unbundling rule as a principle, the SEC issued several Compliance and Disclosure Interpretations (“C&DI s”) to guide certain limited examples of permissible bundling (Jan 24, 2014). http://www.sec.gov/divisions/corpfin/guidance/14a-interps.htm

Id. SEC Exchange Act Rule 14a-4(a)(3)
ing (8-K) or quarterly filing (10-Q) after the shareholder meeting to confirm whether shareholders approved these amendment proposals. It is important to check the voting outcomes because some management proposals fail to receive shareholder approval.\footnote{See Scott Hirst, \textit{Frozen Charter}, 34 YALE J. ON REG. (forthcoming) (2017)} Second, I cross-checked the voting outcomes with the annual filings’ references to charters. By doing so, I was able to capture charter amendments without shareholder approvals. It includes certain changes in capital structure, which do not require shareholder approval, if such power is granted in the company’s charter. Another source of charter amendments without shareholder approval on specific provisions is through mergers. When companies merge, shareholders’ approval of the mergers encompasses the adoption of new or amended charters.\footnote{See Lucian Bebchuk and Ehud Kamar, \textit{Bundling and Entrenchment}, 123 HARV. L. REV. 1551 (2010).}

Table 1 below presents the basic description of the sample corporate charter amendments.

<table>
<thead>
<tr>
<th>Table 1: Description of Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Sample Companies</td>
</tr>
<tr>
<td>Total Number of Amendments</td>
</tr>
<tr>
<td>Average Number of Charter Amendments per Company</td>
</tr>
<tr>
<td>Median Number of Charter Amendments per Company</td>
</tr>
<tr>
<td>Minimum Number of Charter Amendments per Company</td>
</tr>
<tr>
<td>Maximum Number of Charter Amendments per Company</td>
</tr>
<tr>
<td>Standard Deviation on Number of Charter Amendments per Company</td>
</tr>
</tbody>
</table>

Before I move on to charter amendments, I need to clarify the terms that will be used throughout the paper. In the corporate law and governance literature, the terms, such as “pro-shareholders”, “shareholder-friendly”, of “in favor of shareholders,” are generally used to indicate actions or mechanisms, including charter provisions, that enhance shareholder value. However, whether a corporate governance arrangement stipulated in a charter actually increases shareholder value is a much-
debated issue and often necessitates an empirical examination with much more sophisticated, detailed measurement and analysis. Because much more analysis is required to make such value statements, instead of using value-based terminology, I will use terminology that indicates whether a certain charter provision gives more power to the shareholders or the directors. In terms of the allocation of power between the shareholders and the directors, an increase in shareholder power would presumably result in a decrease of director power, and vice versa. At the same time, when a charter provision grants more power to the shareholders, this does not automatically imply that the provision increases shareholder value. Thus, in order to describe empirical observations throughout the paper, I use the terms, such as “shareholder empowering” and “director empowering.” Despite the distinction between shareholder empowerment and shareholder value enhancement, proxy advisory firms and shareholder activists generally exhibit a tendency to support shareholder empowering governance arrangements while managers resist them.

Overall, the corporate charters of sample companies still tend to be composed of director empowering provisions. These observations are consistent with the prior academic literature, as discussed before, that raised concerns over managerial opportunism in charter amendments. Charter amendments, however, have faced an unprecedented stimulus: shareholder activism.

2. Change in Frequency

I compared the number of charter amendment incidences with the number of shareholder proposals submitted on governance issues (“governance shareholder proposals”) for the purpose of examining the trend of shareholders’ pressure on governance. As Figure 1 below demonstrates, both the number of governance shareholder proposals and the number of charter amendments show a dramatic increase followed by a gradual decrease. Both lines show a similar pattern, except for the fact that there seems to be a time delay between the increase in the number of proposals and the increase in the number of amendments.

Figure 1. Time Trend of Charter Amendments and Shareholder Proposals on Corporate Governance Issues

---

54 See supra I.B.
55 For more accurate measurement between shareholder proposals and charter amendments, I excluded shareholder proposals on social issues because they do not ask for amendment of charters or bylaws.
The dotted line in the Figure 1 indicates that the number of submissions of governance shareholder proposals increased substantially around 2000 and kept rising. After the peak around 2007, the number of proposal submissions has been decreasing. One of the reasons behind the decrease is that shareholder voting on executive compensation (“say-on-pay”) was adopted as a mandatory rule by the SEC in 2011, and one of the main issues, that the shareholder proposals focused on prior, has been eliminated.\(^{56}\) In addition, as more companies have implemented the requested governance changes, the number of shareholder proposals on those issues naturally dropped. More frequent topics of shareholder proposals in recent years are on non-traditional and innovative matters, including mandatory disclosure of corporate political spending, which are rarely addressed through corporate charters.\(^{57}\)

In comparison, the solid line shows that the number of charter amendments has substantially increased since 2004, peaking around 2011, and thereafter decreasing. Shareholders of the sample companies have approved 430 management proposals to amend corporate charters.

\(^{56}\) 2014 Annual Corporate Governance Review, Georgeson p.4 (“The number of shareholder proposals continues to decline during the 2014 proxy season. This trend began four years ago, when “say on pay” proposals became mandatory and replaced their shareholder proposals counterparts.”)

\(^{57}\) For instance, the three most common shareholder proposal topics in 2015 were on 1) corporate political activities 2) proxy access 3) independent chair and in 2014 were on 1) corporate political activities 2) independent chair 3) climate change. Gibson, Dunn & Crutcher, Shareholder Development During the 2015 Proxy Season (July 15, 2015) http://www.gibsondunn.com/publications/pages/Shareholder-Proposal-Developments-During-the-2015-Proxy-Season.aspx
during 1994-2015. Before 2005, the total number of charter amendments each year stayed around ten. The temporary drop in charter amendments in 2009 is likely due to the financial crisis that began in 2008. Presumably during the crisis, companies and shareholders were focused much more on successfully weathering the crisis rather than on implementing better corporate governance arrangements. As the graph shows, the amendment frequency immediately recovers in 2010.

In addition, the drop in the numbers of amendment starting around 2011 is largely correlated with the decrease in the numbers of shareholder proposals on charter amendments. Recently, focus of shareholder activism and proposals has shifted to the issues such as corporate political spending and the independence of the chairman of the board, neither of which requires a charter amendment. After the companies have implemented popular, pro-shareholder arrangements, they have not voluntarily moved to amend their charters. Thus, both the rise of amendments in 2005 and the drop in 2011 show that shareholder activism has been the direct driver of charter amendments. Although the frequency of amendments has been relatively low since 2013, this is more due to the fact that shareholder activism’s focus has moved away from charter amendments and less due to the structural impediments that the shareholders faced in the pre-2005 period.

3. Change in Substance

Charter amendments before and after the mid-2000s are very different not only in frequency but also in substance. Before the mid-2000s, the contents of amendments were mostly firm-specific and not on governance-related matters. There was not a coherent subject matter that

58 Since I selected the sample companies from the 2012 issue of Fortune and tracked the relevant proposals and amendments between 1994 and 2015, some might question whether the increased amendments are by new companies, rather than by existing companies. In spite of the (insignificant) changes in the composition of sample companies, the newly added companies after 2005 have made only ten charter amendments and the spike starting in 2005 is mostly because the companies that existed before 2005 have increased their charter amendments.

59 The relatively high number of amendments in 1995 is largely due to seven amendments made by one company, CenturyLink. By comparison, thirteen amendments in 2003 were from twelve different companies.


61 Michael Klausner, Fact and Fictions in Corporate Law and Governance, 65 STAN. L. REV. 1325, 1358 (2013) (“the governance changes that were adopted [from the mid-1980s to the mid-2000s] were not contractual. They were as a matter of practice, with no commitment in firm charters to maintain them”) (emphasis added)
the amendments addressed during this early period. But after 2005, the topics of shareholder proposals across companies converge into a small number of popular initiatives. More importantly, the recent amendments have empowered shareholders like never before. All of the top five most frequently amended charter provisions shown Table 2 below conform with the most popular shareholder activism initiatives granting more control to the shareholders.

Table 2. The Most Frequently Amended Charter Provisions

<table>
<thead>
<tr>
<th>Charter Provision</th>
<th>Frequency</th>
<th>Delaware Default</th>
<th>More Control to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eliminate Supermajority Voting Requirement</td>
<td>102</td>
<td>Simple Majority Voting</td>
<td>Shareholders</td>
</tr>
<tr>
<td>Declassify Board</td>
<td>95</td>
<td>Single Class</td>
<td>Shareholders</td>
</tr>
<tr>
<td>Adopt Majority Voting Standard for Uncontested Director Election</td>
<td>39</td>
<td>Plurality</td>
<td>Shareholders</td>
</tr>
<tr>
<td>Grant Shareholders a Right to Call a Special Meeting</td>
<td>36</td>
<td>Board of Directors Only</td>
<td>Shareholders</td>
</tr>
<tr>
<td>Eliminate or Relax State Anti-Takeover Statutes</td>
<td>27</td>
<td>Require Supermajority Votes</td>
<td>Shareholders</td>
</tr>
</tbody>
</table>

a. Elimination of Supermajority Voting Requirement

The most frequently amended charter provisions were to eliminate the super-majority voting requirements. Although the super-majority voting requirement will generally affect many different aspects of corpo-

---

American Express is a good example illustrating the differences in the trend in charter amendments before versus after mid 2000s. The company amended its charter seven times but the first two amendments in 1997 were in order to delete obsolete provisions and to change the address of its agent. In 2008, in comparison, American Express made five charter amendments on key governance matters including one to adopt a majority voting standard for uncontested director election and to eliminate the supermajority voting standard for four different issues. Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1044 (2010) (“Shareholder resolutions often come in waves, with every year or so witnessing the emergence of a new “flavor of the year” type of precatory resolution and the decline of some prior types.”)
rate governance, the requirement also used to be a prevalent defensive
tool against hostile takeovers. Returning to the default, simple majority
voting standard, it becomes less difficult for shareholders to exercise
their control over corporate charters and also for a hostile takeover to
take place. Especially for the large companies, such as those in the sam-
ple, requiring 66 2/3%, 75% or 80% of shareholders’ votes on a corpo-
rate matter could make it quite difficult for the shareholders to exercise
control over the charter and other governance arrangements.

In order to better understand the role of the super-majority voting
requirement, we need to distinguish between two different types of su-
per-majority requirements. One is with respect to undertaking certain
corporate actions that do not involve a charter amendment (e.g., electing
a director), while the other is to amend the charter. The legal bases of the
two distinctive super-majority voting requirements are different. For in-
stance, DGCL § 102(b)(4) stipulates that companies may have provisions
“requiring for any corporate action, the vote of a larger portion of the
stock or of any class or series thereof, or of any other securities having
voting power, or a larger number of the directors, than is required by this
chapter.” On the other hand, DGCL § 242(b)(4) stipulates that:

“[w]henever the certificate of incorporation shall re-
quire...the vote of a greater number or proportion than is
required by any section of this title, the provision of the
certificate of incorporation requiring such greater vote
shall not be altered, amended or repeated except by such
greater vote.”63

The latter section, therefore, ensures that if there is a super-majority vot-
ing requirement on a certain corporate action, that same level of approval
will be required to amend or repeal that voting requirement.64 It also

63 Del. Code Ann. tit. 8, § 242(b)(4) is a codification of Sellers v. Joseph Bancroft & Sons, 2 A.
2d 108 (Del. Ch. 1938) (deciding that if bare statutory majority can amend the charter provision
regarding corporate action by supermajority voting requirement, it would be “always possible... for
a bare majority to eliminate those [supermajority] percentages entirely by appropriate amendment
and then by subsequent proceedings to proceed by a like bare majority to alter and change the pro-
visions of the charter which therefore were exempt from alteration except by majorities equaling at
least the theretofore stipulated percentages”) at 111.

64 MBCA Section 7.27 (b) has a counterpart provision, (“An amendment to the articles of in-
corporation that adds, changes, or deletes a greater quorum or voting requirement must meet the
same quorum requirement and be adopted by the same vote and voting groups required to take action
under the quorum and voting requirements then in effect or proposed to be adopted, whichever is
greater.”)
clearly indicates that there are two different types of super-majority voting requirements.\(^6^5\)

These two different types of super-majority voting requirements are often treated equally in the literature. Furthermore, the super-majority voting requirement to amend corporate charters has been largely overlooked, even though this is particularly important in the context of charter amendments, especially in light of the recent shareholder activism. Obviously, the elimination of the super-majority voting requirement enables shareholders to more easily amend the charter. The elimination of such super-majority voting requirement has been one of the top items on the agenda for the activist shareholders.\(^5^6\) According to the data, when super-majority voting requirements were eliminated, they were mostly with respect to approving certain corporate actions, such as a merger. Elimination of the super-majority voting requirement with respect to charter amendment has been much more infrequent.\(^6^7\)

---

\(^6^5\) As an illustration, as of June 2015, Hess Corporation (“Hess”), incorporated in Delaware, has a charter provision requiring an affirmative vote of at least 80% of the company’s outstanding shares of common stock to remove any of its directors. This is the first type of super-majority voting requirement. Furthermore, notwithstanding DGCL § 242(b)(4), Hess’s charter also requires an affirmative vote of at least 80% of the company’s outstanding shares of common stock to amend that specific provision. Although unnecessary for Delaware corporations, the second type of super-majority voting requirements allows companies to protect charter provisions that they deem important. For instance, had Hess’s charter not contained the second type and had DGCL § 242(b)(4) not become law, at least in theory, 50% or more of the shareholders could get together to amend the 80% voting requirement down to 50% in order to remove the directors and, subsequently, remove any directors they disfavor. In contrast, with the DGCL § 242(b)(4) and Hess’s supermajority voting protection on the provision, at least 80% of voting shares is required to amend the charter provision on director removal. Certificate of Incorporation of Hess Corporation, Article Fifth. Removal of Directors & Fifth 8. Amendment, Repeal, etc. Available as Exhibit 3.1. to Hess’ 10-Q filed on August 8, 2006.


\(^6^7\) Continuing with the Hess example, in 2013, an individual shareholder submitted a proposal to eliminate the super-majority voting requirement from Hess’s charter. The shareholder proposal was approved by 83.5% of shareholder votes cast, which, unfortunately, was only 68.7% of outstanding shares of voting stock. The following year, the management of Hess made two proposals regarding the super-majority voting requirements. Proposal 4A was to eliminate the 80% super-majority voting requirement imposed on certain provisions of the company’s Restated Certificate of Incorporation and By-Laws, and Proposal 4B was to eliminate two-thirds super-majority voting requirements, imposed on other provisions of the company’s Restated Certificate of Incorporation. On both proposals, because the company received the affirmative votes of more than two-thirds (66.6%), but less than 80%, of the outstanding shares, only the second proposal passed. Thus, while all the provisions requiring two-thirds or more super-majority vote have been removed, the 80% super-majority voting requirement remains in Hess’s charter. Hess, current report (8-K) filed on May 13, 2014 available at http://www.sec.gov/Archives/edgar/data/4447/000095012714000020/a14-34_8k.htm
b. Declassification of The Board

The default duration and election of the board of directors in all states is that the entire board is to be elected annually. When corporate charter or bylaws allow, on the other hand, the board of directors can be classified (or staggered), so that not everyone is up for election every year. Classification or staggering is done usually with three groups with similar or the same numbers of directors, so that each group is elected for a three-year term and, in any given year, only one group is up for election or reelection.68 In this way, the board of directors becomes more immune to shareholders’ attempt to replace the board. With classification, shareholders would have to wait two more years to replace an unwanted director. Classification, therefore, grants more power to the directors and away from the shareholders.

The classified board also used to be widely adopted as an anti-takeover mechanism. When there are three classes, since it takes at least two years to replace the majority of the board, a classified board effectively delays any hostile challenger’s attempt at a takeover, especially when taking control over the board is necessary to retract a poison pill. In the takeover context, therefore, a classified board gives more control (over whether to acquiesce to a hostile takeover attempt) to the directors and the management rather than to the shareholders.69

Ninety-five (95) charter amendments during the sample period were to declassify the board, so that the entire board will be up for election every year. In all of these cases, companies amended the contents of the charter rather than simply eliminating a provision, thereby moving back to the default status. The 95 companies that amended classified board provisions now have the charter provisions mandating annual elections of the whole board.

c. Majority Voting Requirement in Uncontested Director Election

Most default state laws on shareholder voting for director elections use the plurality standard. Under the plurality voting rule, director

---

68 E.g., MBCA Section 8.06 articulates that charters may provide for a staggered board; Del. Code Ann. tit. 8, §144 (d) states that a company can stagger its board only when its charter or bylaws approved by shareholders enables such an arrangement.

nominees with the most votes cast in their favor are elected to the board, regardless of the number of votes withheld or voted against them. Particularly in an uncontested election, a director nominee can still be re-elected so long as she receives a single “for” vote. The number of “against” or “withheld” votes in this setting is meaningless. Under the majority voting rule, by contrast, a candidate must receive more “for” votes than “against” votes. Hence, even in an uncontested election, “against” votes matter, and, if the candidate were to receive more “against” votes than “for” votes, she will not be re-elected. By adopting the majority voting rule, a company can presumably enhance its directors’ accountability to its shareholders. Especially with respect to uncontested elections, the adoption of the majority voting rule functions as a shareholder empowering mechanism, since now they can more easily remove an unwanted director by casting more “against” votes.

d. Shareholders’ Right to Call a Special Meeting

Depriving shareholders of the right to call a special meeting has been another frequently used tactic to defend against hostile takeovers. If a shareholder does not have the right to call a special meeting, an insurgent-shareholder must wait until the next annual shareholder’s meeting to receive an approval for her takeover attempt. With respect to the right, state laws differ. For instance, in addition to the directors and other persons authorized by the charter or the bylaws, MBCA Section 7.02(a) grants shareholders who own at least 10% of voting shares the right to call a special meeting. In comparison, DGCL Section 221(d) grants the right only to the directors and persons authorized by the charter or the bylaws. Thus, unless a Delaware company explicitly grants the right, shareholders of the company cannot call a special meeting. Obviously, granting such a right to the shareholders through the charter is a shareholder control enhancing amendment.

In the sample, 36 charter amendments were made to grant shareholders the right to call a special meeting. Except for only one incident in 2003, the other 35 amendments took place after 2008.71

---

70 See MOD. BUS. CORP. ACT ANN., Section 7.28 at 7-186 through 7-187 (Official Comment) ("A 'plurality' means that the individuals with the largest number of votes are elected as directors up to the maximum number of directors to be chosen at the election.") (3d ed. 2002)

71 Aetna, incorporated in Pennsylvania, adopted a charter provisions on the shareholders’ right to call a special meeting twice in 2003 and 2014. Since the 2003 amendment granted the right to shareholders who own at least 2/3 (66.6%) of shares, the provision was virtually nominal. In 2014, the company reduced the threshold to 25%.

DRAFT—Please do not cite without the author’s permission
e. Elimination or Relaxation of State Anti-Takeover Statutes

The fifth most frequently amended charter provision is to opt out of or relax the effect of a state anti-takeover statute. State anti-takeover statutes take different forms, such as control share acquisition laws, fair price laws, control share cash-out laws, and freeze-out fair price laws. For instance, under DGCL Section 203, a “business combination” between a company and its shareholder who owns more than 15% of voting stock is prohibited for three years unless, for instance, the approval of the directors and the approval of at least 66 2/3% of voting stocks owned by disinterested shareholders are secured. Indiana’s control share acquisition laws prohibit an acquirer from either buying or voting a control block in the target unless the acquirer is a disinterested shareholder. Twenty-seven (27) charter amendments in the sample either expressly opt-out of these state anti-takeover statutes or lower the supermajority voting requirement in the statutes to a majority voting requirement. By making it easier for the target shareholders to bypass the state anti-takeover statutes, we can also consider these amendments to be more shareholder empowering. This is because, similar to the board classification provision, when a company opts out of a state anti-takeover statute, the shareholders can more directly and more easily determine whether to acquiesce to a hostile takeover attempt.

B. The New Dynamics in Charter Amendments

Multiple factors simultaneously contributed to the new environment for shareholder activism. The number of governance proposals by shareholders significantly increased starting in 2000, but the number of charter amendments skyrocketed beginning in 2005. It is puzzling that the change in charter amendments has not been gradual but abrupt. More specifically, how do we explain the sharp increase in shareholder-empowering charter amendments starting around 2005 and not sooner, or later for that matter? What explains the delay between the increase in

72 Folk on the Delaware General Corporation Law (2015) at 29
73 Del. Code Ann. tit. 8, § 203 (a)
74 Indiana Bus. Corp. Law § 23-1-42
75 In 2002, the Sarbanes-Oxley Act was introduced in response to a series of corporate scandals, including Enron, WorldCom, and Tyco, which heightened compliance and disclosure requirements for registered companies. These corporate scandals and subsequent legislation made shareholders more attentive to corporate wrongdoing.
76 Another commentator pointed out a drastic change in the balance between shareholders and management starting in 2005. Michael Klausner, Fact and Fictions in Corporate Law and Governance, 65 STAN. L. REV. 1325, 1361-62 (2013) ("Developments since the mid-2000s are surprising in..."
shareholder proposals and the increase in actual charter amendments? This paper argues that the SEC’s new rule in 2003 and its interpretation of the rule in 2004 are previously under-appreciated epicenter for the change.

1. Institutional Shareholders as Pivotal Voters

A charter amendment requires an express shareholder approval through proxy voting, which is the traditional and important mechanism for shareholder engagement.77 Proxy voting is a unique device in the shareholder activism landscape, where different types of shareholders collaborate closely with one another.78

At the outset, institutional investors, such as mutual funds and pension funds, rarely submit their own proposals.79 In their stead, individual activist shareholders have been the most frequent players in submitting shareholder proposals.80 In 2014, for instance, three quarters of

---


78 Among major players in the shareholder activism landscape, hedge fund activists have long been at the center of attention. Hedge fund activists are better known for targeting a small number of companies and aggressively initiating proxy fights challenging the companies’ business strategies as well as their governance arrangements. When an activist hedge fund tackles a company’s governance, it tends to proactively attack a specific director or the management rather than to recommend a more general change of private ordering via shareholder proposals. Given their capacity to purchase significant shares in short term and aggressive intervention in the business strategy of target companies, hedge fund activists are still the most threatening and influential activists. Whether their allegedly short-term interests align with the long-term shareholders’ interests is a contentious issue. E.g., Lucian Bebchuk et al., The Long-Term Effects of Hedge Fund Activism, 115 COLUM. L. REV. 1085 (2015) (presenting a comprehensive empirical investigation that shows no evidence of short-term gains after intervention are at the expense of long-term performance). But see K.J. Martijn Cremers et al., Hedge Fund Activism and Long Term Firm Value, (working paper) (on file with author) (2016) (providing empirical evidence that shows short-term investors tend to reduce R&D expenditure and experience increase in firm value in the short term, which is reversed after the investors left the firms). Unlike hedge fund activists, institutional investors are considered to be relatively long-term shareholders and are unlikely to accumulate a block solely to wield their power.

79 Institutional investors, especially mutual funds, are known as being passive mainly because they have much more diversified portfolios of companies and it is too costly for them to delve into each company’s corporate governance arrangement and decide what to propose and how to vote on issues. In many cases, when institutional investors are not satisfied with the returns from a company, they tend to exercise the exit option by selling company stocks rather than demanding changes at the company to spur improvement. Ian R. Appel et al., Passive Investors, Not Passive Owners, working paper (2015), Ronald J. Gilson & Jeffrey N. Gordon, The Agency Costs of Agency Capitalism: Activists Investors and the Revaluation of Governance Rights, 113 COLUM. L. REV. 863, 888 (2013) (“[D]espite the urging of academics and regulators, [institutions] remain stubbornly responsive but not proactive”)

80 Under the current federal proxy rule, as briefly reviewed in the previous section, a shareholder is eligible to submit shareholder proposals if she continuously owned at least $2,000 in mar-
the initiators of shareholder proposals were individual shareholders.\textsuperscript{81} At the same time, a single activist shareholder tends to circulate the same corporate governance proposal to multiple companies simultaneously.\textsuperscript{82}

Once the agenda has been set, however, given their sheer voting power, institutional investors play a crucial role.\textsuperscript{83} Along with the significant concentration of institutional ownership in publicly traded companies,\textsuperscript{84} their reactive activism has become an important determinant in voting outcomes.\textsuperscript{85} While hedge fund activists necessarily need the support of institutional investors to achieve their goal in proxy fights,\textsuperscript{86} institutional investors are decisive voters independent from hedge fund activists.\textsuperscript{87} Institutional investors’ influence does not always rely on hedge fund activists, and the dynamic of institutional investors’ activism inherently differs from that of hedge fund activists.

In particular, the new dynamic in the charter amendment process reveals the largely discounted role of institutional investors, especially

\textsuperscript{81} Three individual activists were John Chevedden, William Steiner, and James McRitchie. These individual activists take the role of spreading out the agenda to many other companies. The other frequent proponents was the New York State Common Retirement Fund. See James R. Copland, \textit{Frequent Filers: Shareholder Activism by Corporate Gadflies}, Proxy Monitor (2014) \url{http://www.proxymonitor.org/Forms/2014Finding5.aspx#notes}.

\textsuperscript{82} Often times, a single activist spreads the same corporate governance agenda to multiple companies simultaneously. E.g., Harvard Shareholder Rights Projects run by Lucian Bebchuk have focused on declassification of board and New York City Comptroller led by Scott M. Stringer has pursued adoption of proxy access.

\textsuperscript{83} See Gilson & Gordon, at 867 (comparing that dispersed shareholders used to be “rationally apathetic” but institutional investors are “rationally reticent” in the sense that they are willing to vote); at 887 (“While mutual funds are not proactive, they are not passive in the Berle-Means sense; They very frequently oppose management on core corporate governance issues.”)

\textsuperscript{84} In 98\% of sample companies, institutional investors own more than 50\% of the company’s stock. This information was collected from NASDAQ’s Ownership Summary and Institutional Holdings sections. News Corp, 21st Century Fox, Viacom, Penske Automotive, and Kraft Heinz are the few companies where institutional investors own less than majority shares.

\textsuperscript{85} Marcel Kahan & Edward Rock, \textit{Embattled CEOs}, 88 Tex. L. Rev. 987, 995-1022 (2010) (arguing that changes in increased institutional investor ownership, changes in governance rules regarding board election, and the regulatory changes in voting and the solicitation of proxies resulted in the decline in CEO power); LISA FAIRFAX, \textit{SHAREHOLDER DEMOCRACY} (2011) at 48 (“[the amount and concentration of institutional ownership] makes it easier for institutions to coordinate their activities across major companies in a matter that influences corporate governance at particular companies and within the corporate community more generally.”)

\textsuperscript{86} See, e.g., Gilson & Gordon, at 863. The cooperation between hedge fund activists and institutional investors in proxy fights explains only a small portion of institutional investors’ role. After all, the number of companies targeted by hedge fund activists is much smaller compared to the number of companies not targeted.

\textsuperscript{87} Ian R. Appel et al., \textit{Passive Investors, Not Passive Owners}, (2015) (working paper) (on file with author) (providing empirical findings suggest that increase in passive institutional ownership is associated with increase in board independence, removal of takeover defenses, and less dual class share structure).
mutual funds, in shareholder activism. This type of shareholder activism by institutional investors through proxy voting is the main focus of this paper.

2. The SEC’s New Rule and No-Action Letters

In 2003, the SEC adopted new regulations on investment advisers, which includes most of the institutional shareholders. This new rule mainly applied to the mutual funds. Rule 206(4)-6, under the Investment Company Act of 1940, identified adviser’s fiduciary duty of care and loyalty obligations in proxy voting. Under the rule, mutual funds and other registered investment management companies are now required to disclose their policies and procedures regarding how they vote their proxies. Furthermore, Rule 30b1-4 under the Investment Company Act of 1940 mandated the companies to file Form N-PX, disclosing how they voted their proxies, with the SEC.

How the institutional shareholders could satisfy this fiduciary duty in proxy voting was not entirely clear to them, who tended to be largely passive in the proxy voting process prior to the promulgation of the new rule. In particular, how they could resolve potential conflicts of interest to avoid breach of fiduciary duty of loyalty in proxy voting was an issue. On request, the SEC issued two no-action letters giving guidance on the new rules. In the first no-action letter provided to Egan Jones Proxy Services, dated May 27, 2004, the SEC staff explained, “the recommendations of third party that is in fact independent of an invest-

---

88 Even if some institutional investors’ votes are strongly influenced by the recommendations of the proxy advisory firms and many times institutional investors are simply taking advantage of the voting opportunities proposed by activist individual shareholders, given their influence, institutional investors’ actions should be seen as a part of shareholder activism in a broader sense.


91 The new rule, however, does not mandate investment advisers to vote on every proxy voting. Id. (“We do not suggest that an adviser that fails to vote every proxy would necessarily violate it fiduciary obligations. There may even be times when refraining from voting a proxy is in the client’s best interest, such as when the adviser determines that the cost of voting the proxy exceeds the expected benefit to the client.”)

92 17 C.F.R. § 270. 30b1-4 (2015). In Form N-PX, mutual funds and other registered investment management companies are required to disclose information including whether the matter was proposed by the issuer or a security holder; whether the fund cast its vote on the matter; how the fund cast its vote (e.g., vote “for”, “against”, or “abstain”); and whether the fund cast its vote for or against management.

93 Upon an issuer’s request, the SEC staff decides whether to issue a no-action letter providing that the SEC staff would not recommend the SEC’s enforcement action against the issuer on the issue. No-Action Letters, U.S. SECURITIES AND EXCHANGE COMM’N, https://www.sec.gov/answers/noaction.htm (last visited Feb. 28, 2016).

DRAFT—Please do not cite without the author’s permission
ment adviser may cleanse the vote of the adviser’s conflict.”94 The main question here was whether proxy advisory firms are eligible to be an independent third party. Often times, proxy advisory firms, such as the ISS, provide consulting services on corporate governance issues to the issuer and recommend how institutional shareholders should vote their proxy. Given the confrontational nature of relationship between shareholders and management in proxy voting, proxy advisory firms working for both sides raise conflicts of interest. However, the SEC explicitly said in the no-action letter:

“We believe that the proxy voting firm provides advice on corporate governance issues and receives compensation from the Issuer for these services generally would not affect the firm’s independence from an investment adviser.”95

This no-action letter, in short, blessed the institutional shareholder’s use of proxy advisory firms’ recommendation to satisfy their fiduciary duty to their own investors. In the second no-action letter provided to the ISS on September 15, 2004, the SEC backpedaled a bit by stating “whether an investment adviser breaches or fulfills its fiduciary duty of care when employing a proxy advisory firms depends upon all the relevant facts and circumstances.”96 Furthermore, the SEC stated in the letter:

“[W]e take no position in this letter regarding whether ISS’ conflict procedures effectively ensure that its proxy voting recommendations to investment advisers are impartial. Nor do we take any position regarding whether an investment adviser should hire ISS as an independent third party to vote client proxies.”97

In sum, the new rule and subsequent two no-action letters now require institutional investors to participate in shareholder voting and implicitly endorse relying on the recommendations of proxy advisory

95 Id.
97 Id.
firms. The proxy advisory industry expanded dramatically and, in conjunction with the increased ownership by institutional investors, proxy advisory firms’ recommendations have become an important factor that affects the voting outcome. Furthermore, as a result of these developments, companies have become less likely to ignore shareholder proposals, since proxy advisory firms can easily use the company’s non-responsiveness against the company. In the next section, I will examine in detail how shareholder pressure has originated both from inside and outside of companies.

3. Proxy Advisory Firms and Shareholder Pressure

Depending on the presence of a specific shareholder proposal or demand, charter amendments can be divided into two types: the ones included with shareholder proposals and the ones without. Given the requirement of a shareholder vote on both types of amendments, the expanded role of proxy advisory firms has contributed to the increase of shareholder influence over both types of amendment.

a. Internal Pressure: Shareholder Proposals

As briefly discussed before, shareholders can submit a proposal requesting a specific charter amendment. When a shareholder requests management to include a certain proposal on the company’s proxy material, the management faces direct shareholder pressure on the amendment. The magnitude of shareholder pressure varies depending on the likelihood of securing the majority of shareholders’ support. When shareholder proposals are likely to receive majority support, management would be under more pressure to respond to them. From the sample

---

99 On June 30, 2014, the SEC issued Staff Legal Bulletin 20 (“SLB 20”) to provide guidance on proxy advisory firms. SLB 20 states an investment adviser’s duties and obligations when it hires proxy advisory firms. https://www.sec.gov/interp/legal/cfslb20.htm It did not vacate the SEC’s views in the no-action letters issued in 2004. Davis Polk Client Memorandum, SEC Guidance on Use of Proxy Advisory Firms for Voting Proxies (July 1, 2014) at 1 (“[SLB 20] does not revoke prior no-action letters...that investment advisers could demonstrate their proxy voting was free of conflict if they voted in accordance with a pre-determined policy based on the recommendations of an independent third party.”)

98 Stephen Choi et al., Director Elections and the Role of Proxy Advisors, 82 S. CAL. L. REV. 649, 654 (2009)

100 Under current federal proxy rules, a shareholder who “continuously held at least $2,000 in market value, or 1%, of the company’s securities entitled to be voted on the proposal at the meeting for at least one year by the date you submit the proposal” is eligible to submit a shareholder proposal. 17 C.F.R. Part 240 14a-8(b) (2015).

101 See Martin Lipton et al., Some Thoughts for Boards of Directors in 2015, WACHTELL, LIPTON, ROSEN & KATZ, 5 (Dec. 1, 2014) at http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.23674.14.pdf (“[A] key consideration is whether the proposal is likely to receive majority shareholder support. If the proposal receives the...
companies, 159 out of 430 charter amendments (37%) received shareholder proposals on the same subject matter within a two-year period before the amendment. As Table 3 below shows, the most frequent case is that management proposes to amend the charter provision at issue in the following year after a shareholder proposal was voted on. In each year between 1994 and 2015, the number of charter amendments with shareholder proposals is less than charter amendments without shareholder proposals.\footnote{To determine whether a charter amendment has shareholder proposals voted at issue, this paper only counted only two previous years because ISS’s policy counts no further than past two years. ISS U.S. Corporate Governance Policy 2006 Updates (on file with the author) page 7. (one prong of policy was whether director nominees “ignored a shareholder proposal that was approved by a majority of votes cast for two consecutive years.”)}

<table>
<thead>
<tr>
<th>Amendments with Shareholder Proposals</th>
<th>159</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposal voted on in two consecutive years</td>
<td>36</td>
</tr>
<tr>
<td>Proposal voted on once in a year before</td>
<td>111</td>
</tr>
<tr>
<td>Proposal voted on once in two years before</td>
<td>12</td>
</tr>
<tr>
<td>Amendments Without Shareholder Proposals</td>
<td>271</td>
</tr>
<tr>
<td>Total</td>
<td>430</td>
</tr>
</tbody>
</table>

Here is an example of a charter amendment triggered by a shareholder proposal. In 2013, shareholders of Huntsman submitted a shareholder proposal to declassify the board. Despite the board’s recommendation to vote against this proposal, the proposal received approximately 58% of shareholders’ favorable votes. In the following year, the board proposed to adopt board declassification with the following statement:

\begin{quote}

support of a majority of votes cast, proxy advisory firms such as ISS (as well as members of the investment community) will expect the board to be responsive to the proposal.”); Lucian A. Bebchuk, The Case for Increasing Shareholder Rights, 118 Harv. L. Rev. 833, 878 (2005) (“Incumbents prefer not to lose votes. Therefore, whenever they expect a proposal to have sufficiently strong [shareholders’] support, they will seek to avoid defeat in a vote by initiating the change themselves.”).\footnote{To determine whether a charter amendment has shareholder proposals voted at issue, this paper only counted only two previous years because ISS’s policy counts no further than past two years. ISS U.S. Corporate Governance Policy 2006 Updates (on file with the author) page 7. (one prong of policy was whether director nominees “ignored a shareholder proposal that was approved by a majority of votes cast for two consecutive years.”)}
\end{quote}
At last year’s annual meeting, a nonbinding stockholder proposal to declassify our Board received the favorable vote of approximately 58% of the shares voted at the meeting. Following this vote, the Governance Committee and the Board considered the merits of annually elected and classified boards. The Board believes that the classified Board structure has provided stability and continuity to the Board and reduced vulnerability to coercive takeover tactics, fostered director independence and reinforced a commitment to long-term goals. However, the Board acknowledges the preference expressed by our stockholders who voted in favor of annual elections.\

Proxy advisory firms’ recommendation is the most significant determinant of voting results. While the degree of mutual funds’ reliance on proxy advisory firms’ recommendation vary depending on the size of the mutual fund, subject matter, or rationale behind recommendations, a large portion of investors have previously been criticized for mindlessly following proxy advisory firms’ recommendations.

Proxy advisory firms can intensify the magnitude of internal shareholder pressure in two ways. The first is by providing recommendations on how to vote on governance issues: a proxy advisory firm’s recommendation on a governance issue directly addresses whether a company should adopt the change in its charter or bylaws proposed by shareholders. The second is by making recommendations on how to vote on

---

105 Peter Ilyev & Michelle Lowry, Are Mutual Funds Active Voters?, 28 REV. FINANC. STUD. 446 (2014) (“Over half of [mutual] funds rely almost entirely on Institutional Shareholder Services (ISS) recommendations.”); Stephen Choi et al., Voting Through Agents: How Mutual Funds Vote on Director Election, working paper, (2011) (showing that the influence of the ISS recommendations varies with the supporting reasons behind the recommendations.); Editorial, Dimon vs. ‘Lazy’ Investors, Wall Street Journal (May 28, 2015) (stating that ISS and Glass Lewis “have enjoyed far too much influence over companies they don’t own and been subject to far too little scrutiny given their potential conflicts of interest.” And quoting Jamie Dimon’s speech that criticizes shareholders who vote solely based on proxy advisory firms’ recommendations “lazy” and “irresponsible.”); Daniel M. Gallagher, Activism, Shorttermism, and the SEC: Remarks at the 21st Annual Stanford Directors’ College (June 23, 2015) (“Some [investment] advisers, particularly smaller ones, are still reticently relying on proxy advisory firm voting recommendations, rather than using a proxy advisor’s analysis as one input into the fund advisers’ own nuanced analysis.”) http://www.sec.gov/news/speech/activism-short-termism-and-the-sec.html

---

DRAFT—Please do not cite without the author’s permission
director elections. If a company does not implement a shareholder proposal supported by at least a majority of shareholders, ISS generally recommends a vote “against” one or more directors the following year.\textsuperscript{106} It creates an indirect, yet powerful, enforcement mechanism to induce the implementation of shareholder proposals.\textsuperscript{107}

It is worth noting that the first type of voting recommendations on governance choice is more vulnerable to the likelihood of the “one-size-fits-all” recommendations. Voting recommendations on director election and executive compensation (say-on-pay) are more firm-specific in nature. Whether to elect a certain individual as a director, or whether to approve compensation to a specific executive are supposed to be evaluated based on firm-specific facts and circumstances. In that sense, these recommendations are more costly for proxy advisory firms. In contrast, each corporate governance proposal is usually contentious from the beginning. In most cases, there is a widely accepted view on each governance proposal which influences whether directors will welcome the proposal or not. When a proxy advisory firm makes a voting recommendation in accordance with the widely accepted view on the governance proposal, the proxy advisory firm does not need to invest to justify its recommendation. Proxy advisory firms only need a convincing rationale behind the recommendation when they recommend against the widely accepted view on the proposal.\textsuperscript{108} In that sense, the submission of shareholder proposal on a corporate governance issue not only triggers shareholder pressure by proxy advisory firms’ vote “for” recommendations on the issue, but also triggers shareholder pressure by proxy advisory firms’ heightened scrutiny over the director elections of companies.

b. External Pressure: Market Forces

In addition to the internal pressure associated with the existing shareholders, the prevalence and influence of proxy advisory firms has also created shareholder pressure from the outside. Whether the proxy advisory firms intended, they have contributed to a system of “black or


\textsuperscript{107} Colin Diamond & Irina Yevmenenko, \textit{Who is Observing the Proxy Advisors?}, 3 BLOOMBERG CORP. L.J. 606, 617 (2008) (“[B]oards may do what they believe ISS wants them to in order to keep their seats, whether or not their belief is justified.”)

\textsuperscript{108} E.g., ISS recommended a vote “against” a Morgans Hotel Group’s shareholder proposal that asked for granting the right to call a shareholders’ meeting to 25% of shareholders, which is widely perceived as in favor of shareholders. ISS’s rationale behind the recommendation was that the right would give a single shareholder the power to call a special meeting unilaterally and that it, “introduces changes that might not be in the best interests of all shareholders.” Morgans Hotel Group Report, ISS Proxy Advisory Services, at 17

DRAFT—Please do not cite without the author’s permission
white labeling” on corporate governance choices. They generally express strong preference on proposals which empower shareholders and tend to make identical voting recommendations across companies. Each corporate governance choice is conspicuously categorized as being either a good or a bad practice, and such categorization seems to have produced a one-size-fits-all application. Accordingly, even when a company’s existing shareholders are silent on an issue, the company is likely to amend its charter provision to conform to such a categorization in order to avoid any negative recommendations from proxy advisory firms in the future.

C. Compromised Implementation as the New Battleground

As discussed so far, the recent trend of charter amendments towards shareholder empowerment conflicts with the prior theoretical discussions on directors’ opportunistic charter amendments.\textsuperscript{109} Does it mean that shareholder pressure, intensified through the proxy advisory firms, has fundamentally shifted control over charter amendments from the directors to the shareholders? In the following section, I claim that notwithstanding this large shift in favor of the shareholders, through various subtle means, in many cases, directors have still retained much control. The battleground over corporate charters has shifted from the issue of whether to grant certain rights to the shareholders to the issue of how to expand or constrain such given rights.

1. The Implementation of Modified Shareholder Proposals

Among the amendments, 165 out of 430 management proposals to amend charters are made within two years of shareholder proposals on the same issue. Among the companies that amended their charters more than once, 23% of companies amended their charters only after shareholders proposed to do so, and 38% of companies made all their amendments without any shareholder proposal.

While companies can adopt shareholder proposals as written, it can also “preempt” the specific provision with more director-centric conditions. As in the Safeway episode, mentioned in the introduction, when a shareholder proposal requests the right to call a special meeting for shareholders who own more than 10% of the outstanding shares, the company can “preempt” that proposal by implementing it but with a 25% threshold. Obviously, when a company preempts a shareholder proposal through its own modification and such modification substantially deviates from what the shareholders initially wanted, it creates a potential

\textsuperscript{109} See supra Section I.B.
problem. The question is to what extent a company’s implementation should be regarded as being faithful to the shareholders’ demands. While some companies adopt exactly what shareholders requested, others adopt what shareholders requested but with subtle yet important changes. The most representative examples are those that alter required thresholds or that add stricter procedural requirements to exercise newly granted shareholder rights.

a. Threshold Modification

A threshold modification is most prevalent with respect to altering shareholders’ right to call a special meeting. Between 1994 and 2015, 36 companies adopted shareholders’ right to call a special meeting in their corporate charters. In the process of implementing the shareholder proposals in subsequent years, sixteen of these companies increased the eligibility ownership threshold compared to the threshold contained in the shareholders proposals. In every case, the shareholder ownership required to exercise the right was 10% in the shareholder proposals, but all the companies adopted charter provisions requiring 25% ownership.

One can argue that it may be better for shareholders to have the right with management-imposed limitations rather than no right at all. Likewise, one could also argue that a company that implements the right is more attentive to shareholders compared to a company that does not provide any right to call a special meeting. Perhaps based on such rationale, the ISS recommended voting for on nearly all of the proposals, either by the shareholders or the managements, with a threshold greater than 10% in the 2015 proxy season.

Sometimes, however, increasing the required threshold can potentially make the right useless or ineffective due to the collective action problem that stems from dispersed ownership. Although it is not easy to determine what level of threshold is optimal to maximize the interests of the shareholders and of the firm, the direct benefit of granting such a right through charter amendment but with a higher threshold seems to be that the companies can avoid proxy advisory firms’ adverse recommendations with respect to director elections in the future by demonstrating that they are at least responsive to the demands of the shareholders. The proxy advisory firms’ equal treatment of these different types of amend-

---

110 See Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599 (1989) (“The rules that are identified as “mandatory” in practice have very little common with the understanding of that term. They are easily – and legally – side stepped, or they pose nonbinding constraints because there is no burning demand to deviate from them.”)

111 Simpson Thatcher Memo, Special Meeting Proposals (July 30, 2015) at 2-3 (“Presumably, ISS takes the position that some right is better than no right.”)
ments can be problematic because it also condones the management’s unilateral modification of shareholders’ proposals.

At the same time, this threshold modification tactic is relatively visible and at least the SEC has taken a somewhat more robust position in favor of the shareholders. When shareholders have made proposals to lower the eligibility threshold, companies have sought the SEC’s guidance on whether they could exclude such proposals based on the grounds that the subject matter has been “substantially implemented.” Through no-action letters, the SEC has consistently declined exclusion on the grounds that an implementation with a higher threshold than what the shareholders proposed is not “substantial” implementation.112

b. Addition of Procedural Requirements

Another subtle way of restricting the shareholders’ rights is by adding more stringent procedural requirements to the shareholders’ proposals. The adoption of the shareholders’ right to act without a shareholder meeting provides a great illustration. Generally, under the state corporate law, any shareholder action required to be taken at a shareholder meeting may be taken without a meeting when a required percentage of shareholders consent in writing.113 Companies can opt out of this state law through their charters. Having such right can significantly enhance shareholders’ control. With this right, for instance, shareholders can unilaterally remove directors or change bylaws even without any prior notification to the board or convening a shareholder meeting. In the dataset, 84% of the companies restrict such a right through the charter.114

In response to the recent wave of shareholder proposals requesting a more liberal right to act by written consent, fifteen companies in the sample adopted a charter provision allowing shareholder action without a meeting.115 All of these charter amendments were made between 2011

112 General Dynamics Corporation, SEC No-Action Letter (January 24, 2011) (“We note that the proposal specifically seeks to allow shareholders to call a special meeting if they own, in the aggregate, 10% of the company’s outstanding common stock, whereas General Dynamics’ bylaw requires a special meeting to be called at the request of a group of shareholders only if the group owns, in the aggregate, at least 25% of General Dynamics’ outstanding voting stock. We are therefore unable to conclude that the bylaw adopted by General Dynamics substantially implements the proposal. Accordingly, we do not believe that General Dynamics may omit the proposal from its proxy materials in reliance on rule 14a-8”) https://www.sec.gov/divisions/corpfin/cfnoaction/14a-8/2011/johnchevedden012411-14a8.pdf

113 MBCA Section 7.04 (Action without meeting); Del. Code Ann. tit. 8, §228 (Consent of stockholders or members in lieu of meeting)

114 In the sample, 104 companies have a charter provision about written consent. Eighty-seven of those companies (84%) restrict the use of written consent without meeting either by absolute prohibition (71 companies) or by requesting unanimous consents (15 companies).

115 Cleary Gottlieb Steen & Hamilton Client Memorandum, Action by Written Consent: A New Focus for Shareholder Activism (June 22, 2010) http://www.cgsh.com/action_by_written_consent_a_new_focus_for_shareholder_activism/
and 2014, and, on their face, all grant shareholders the right to act by written consent. At the same time, nearly all of the management proposals share innovative boilerplate language that imposes a substantial restriction on the right to act by written consent. The typical boilerplate of new charter provision states:

Any action required to be taken at any annual or special meeting of stockholders of the Corporation or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting and without a vote if, in accordance with the by-laws, (a) record holders of shares representing at least 25% of the outstanding common stock of the Corporation have submitted a written request to the Secretary of the Corporation asking that the Board of Directors establish a record date for the proposed action by stockholders and including the information with respect to such action and such holders as would be required by the by-laws if such holders were requesting the call of a special meeting, (b) the Board of Directors fixes such a record date or has failed to do so within ten (10) days after the date on which such request was received by the Secretary of the Corporation, (c) consents are solicited by the stockholders proposing to take such action from all holders of shares and (d) consents in writing, setting forth the action so taken, are delivered to the Corporation and not revoked, and are signed by the holders of outstanding stock on such record date having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voting. (emphasis added)

The provision thus imposes two important procedural hurdles. First, a soliciting shareholder must submit a request to the board (through the company’s secretary) to fix a record date. Because companies’ shares

116 Two in 2011 (Home Depot, Omnicom); Seven in 2012 (Alcoa, Allstate, Amgen, AT&T, CVS Caremark, Northrop Grumman, Staples); Three in 2013 (EMC, International Paper, J.P. Morgan Chase); 2014 (Duke Energy, Occidental Petroleum, Raytheon) All of these amendments with two exceptions (EMC, Omnicom) received shareholder proposals on this issue at the shareholder meeting in previous year.

117 Only two companies (Omnicom and AT&T) did not use the terms.

118 Home Depot, Amended and Restated Certificate of Incorporation, Article SIXTH 5.

DRAFT—Please do not cite without the author’s permission
are easily transferable, in order to make a valid written consent, there has to be a fixed record date to determine shareholders’ consent. State laws, on the other hand, provide a statutory (default) record date in case the board has not fixed one.\textsuperscript{119} Since the charter provision gives the board ten days to establish the record date, this procedural requirement enables the board to prepare a strategy against the shareholders’ written consent.

Second, under the provision, soliciting shareholders must send solicitations to all the shareholders. Without such a procedural requirement, under the default state law, soliciting shareholders could have contacted only as many other shareholders as they needed. Once they could accumulate enough shareholders to agree to the solicitation, action by written consent could take effect. With respect to unsolicited shareholders, they could have just sent an ex-post notice.\textsuperscript{120} By contrast, having to solicit all shareholders under the provision, especially with respect to large, publicly traded companies, can be quite costly, which could strongly discourage the use of the written consent mechanism.

The procedural requirements are not as visible as the threshold modification discussed above but could, in fact, significantly impair the newly granted shareholders’ right. It also potentially makes the charter amendment merely superficial. Unlike the visible threshold modifications, procedural requirements can take many different, creative forms, and it is difficult to ascertain their practical implications. The issues of how many and which procedural requirements should be permissible and which amendments with additional procedural requirements should constitute “substantial implementation” are thorny problems for the SEC. At the very least, however, adding such procedural requirements to shareholder proposals shows that managements can retain more control over charter amendments by implementing charter provisions that substantially deviate from what the shareholders initially wanted.

2. Managements’ Preemption by Compromised Terms

So far, I have discussed how and whether companies are responsive to shareholder proposals and demands.\textsuperscript{121} At the same time, 271 out of 430 (63\%) charter amendments were made without receiving any shareholder proposals on the issue.\textsuperscript{122}

\textsuperscript{119} E.g., Del. Code Ann. tit. 8, §213 (b)
\textsuperscript{120} E.g., Del. Code Ann. tit. 8, §228 (c)
\textsuperscript{121} The issue has also been addressed in other academic studies. See, e.g., Yonca Ertimur et al., Board of Directors’ Responsiveness to Shareholders: Evidence from Shareholder Proposals, 16 J. Corp. F. 53 (2010).
\textsuperscript{122} The fact that there were charter amendments without shareholder proposals in the previous years does not necessarily mean that there was no specific input from shareholders. Based on the
Although it is difficult to discern the fundamental intent behind these voluntary charter amendments, one clear benefit of voluntarily amending the charter from the directors’ perspective is that directors can more easily preempt the subject matter before the shareholder pressure (through shareholder proposals) rises. When companies amend their charters in response to shareholder proposals, the terms of the amendments must, at least partially, be guided by and be faithful to the contents of the shareholder proposals. On the other hand, when a management devises a charter provision without any previous shareholder proposal, the management will have much more freedom to choose the terms and devise the mechanism it favors: the management gets to dictate the arrangements. Furthermore, when a shareholder proposal is subsequently submitted on the same issue, the company may be more likely to be granted an SEC no-action letter allowing them to exclude the proposal. After all, as long as the subject matter is the same and has already been voluntarily implemented by the company, there is tenuous ground for the SEC to determine that the subject matter has not been “substantially implemented.”

The data show that almost all sample companies’ managements took advantage of the opportunity to preempt the compromised provisions whenever possible. For example, all fifteen companies that amended their charters to adopt a shareholders’ right to call a special meeting with no prior shareholder proposals have chosen the director-preferred 25% ownership threshold rather than the shareholder-preferred 10% threshold.

Also, when a shareholder proposal “directly conflicts with one of the company’s own proposals to be submitted to shareholders at the same meeting,” the management has grounds to exclude the proposal from the proxy material. The application of the rule has been subject to some controversy: what if a conflicting management proposal gives more control to the management? Without any limitation, directors can simply preempt any shareholder proposal with the terms they prefer. In fact, cer-

---

124 These 15 companies include Microsoft (in 2009), Dow Chemical (in 2010), DirecTV (in 2011), Textron (in 2011), Danaher (in 2011), McDonald’s (in 2012), Caterpillar (in 2012), Fluor (in 2012), eBay (in 2012), Devon Energy (in 2012), Praxair (in 2012), Alcoa (in 2013), Amerisource-Bergen (in 2014), Baxter (in 2013), and Aetna (in 2003 and 2014). It is interesting that all these preemption appeared after 2009. In 2003, Aetna implemented the right for the holders of at least 80% of shares and reduced the threshold to 25% in 2014.
tain law firms advise such a tactic to their clients, who are corporate boards of directors. The most representative examples are amendments to heighten or lower the voting threshold, or to add stricter procedural requirements to the exercise of newly adopted shareholder rights. In that sense, the exclusion right is facilitating opportunistic, management-friendly amendments.

One recent example shows how a company can take advantage of the exclusionary right. At the 2015 shareholder meeting, individual activist Jim McRitchie submitted a shareholder proposal to Whole Foods. His proposal asked the company to allow shareholders that collectively own 3% of stocks for more than three years to nominate directors for up to 20% of the board. The management’s counter-proposal stipulated that a shareholder who owns 9% of stocks for more than five years could nominate directors for up to 10% of the board. Based on this conflict, Whole Foods asked the SEC for a no-action letter. The SEC initially granted relief, but after the SEC Chair directed the SEC staff to review the exclusion rule, the SEC subsequently withdrew the relief and decided to express no view on the issue. In large companies like Whole Foods,

126 Martin Lipton et al., Some Thoughts for Boards of Directors in 2015, Wachtell, Lipton, Rosen & Katz, p.5 (December 1, 2014) at http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.23674.14.pdf (“Assuming that the company cannot exclude the proposal from its proxy statement under Rule 14a-8, the company’s options for responding to the proposal include the following: (1) submit the proposal to a shareholder vote and make a board recommendation as to how shareholders should vote, (2) preemptively adopt a proxy access bylaw or submit a competing proxy access proposal with more stringent requirements, or (3) attempt to negotiate a compromise or alternative outcome with the shareholder proponent. In weighing these options, a key consideration is whether the proposal is likely to receive majority shareholder support. If the proposal receives the support of a majority of votes cast, proxy advisory firms such as ISS (as well as members of the investment community) will expect the board to be responsive to the proposal.”); Cleary Gottlieb Alert Memo, Action by Written Consent: A New Focus for Shareholder Activism (June 22, 2010) at http://www.cgsh.com/action_by_written_consent_a_new_focus_for_shareholder_activism/ (“Delaware law permits a charter amendment to include parameters on the ability of shareholders to act by consent. Shareholders are unlikely to view some parameters – e.g., a special supermajority voting standard applicable only to actions by consent – as responsive to their demand for the right to act by consent. However, there are good arguments for why shareholders – even activist shareholders – should support a charter amendment authorizing action by consent that also includes procedures to assure that the board and all shareholders receive sufficient advance notice and information before action by consent may be taken. For example, the charter could provide that action by written consent would only be permitted if solicitations were obtained through a consent solicitation statement made available to all shareholders and would not be deemed adopted unless valid consents were delivered and not withdrawn as of a reasonable date after the first notice to the board of the intention to solicit consents. Such a provision would be designed to give both the shareholder proponent and the board a reasonable amount of time to communicate with all shareholders about the merits of their positions, including time needed to prepare consent solicitation statements.”).


the difference in eligibility requirements between a shareholder proposal and a competing management proposal is significant enough to substantially alter the shareholders’ rights.

3. Desirability of Compromised Implementation

Whether a compromised implementation is good for the shareholders is an issue that requires more systematic, empirical analysis. For those who support shareholder empowerment to minimize the agency problems, directors’ modification that limits shareholders’ rights would constitute a problematic entrenchment. Although the management has become more responsive to the shareholders on certain issues, a modification occurred in implementing a shareholder proposal in the previous year, directors’ ex-post, unilateral change can be seen as a breach of a mutual agreement. Also, in some cases, a compromise may satisfy neither party.

On the other hand, for those who believe a management-centric model is best suited to maximize firm value, shareholders’ intervention is an unnecessary distraction and thus, when management cannot reject a shareholder’s request, a compromised provision would be a rational reaction to minimize the potentially harmful consequences shareholder intervention. Both groups are taking the opposite views on how much control should be allocated to shareholders to achieve their common goal of shareholder-value maximization. Accordingly, the emergence of compromised adaptation needs to be more rigorously evaluated based on the issue, each firm’s characteristics, and the degree of modification.


130 Id. (“Wealth creation can decrease...if what companies pursue is neither the vision of their management teams or even the alternative vision of a hedge fund, but an admixture of both...not to upset important interest groups (such as ISS, Glass Lewis, or certain activist institutions) who might influence [independent directors’] ability to remain in the independent director game.”)

131 See, e.g., Theodore N. Mirvis et al., Bebchuk’s “Case for Increasing Shareholder Power”: Opposition, 121 Harv. L. Rev. 43 (2007); Lynn A. Stout, The Mythical Benefits of Shareholder Control, 93 Va. L. Rev. 789 (2007); Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, 119 Harv. L. Rev. 1735 (2006) See also, Leo E. Strine, Jr., Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law, 114 Colum. L. Rev. 449, 474 n.77 (2014) (“[O]ptimist might say [compromise] is positive because it shows that the market is working, and that the board and activists reach a sensible middle ground, balancing short-term reward and long-term risk, with solid center investors pushing both sides toward responsible alterations in corporate policy that produce durable gains.”)

DRAFT—Please do not cite without the author’s permission
III. IMPLICATIONS

The foregoing analysis of the charter amendments trend lead to several implications that challenge the conventional understanding of corporate charter amendments. Furthermore, because corporate charters function as the primary document that allocates power between the directors and the shareholders, the recent trend in corporate charter amendments helps us gain a fuller understanding of how shareholder activism alters the corporate governance landscape.

A. Decreased Need for Mandatory State Corporate Law

In a major departure from the prior scholarship that highlighted concern over directors’ opportunistic charter amendments, this paper has shown that, since 2005, corporate charters have been actively amended in a way that generally empowers shareholders. The novel findings about how often, in which direction, and when corporate charters have changed not only update the prior literature but also present an important implication for the state corporate law: the decreased need for mandatory state law.

Most of the mandatory state provisions tend to be protective of shareholders. For companies that are more prone to charter amendments, state default laws would become less consequential than for companies with more static charters that are more dependent on the default provisions of state law. Unless a provision is mandatory, shareholders now exercise more power to opt-in or opt-out of state default provisions than before. The prevalence of concentrated ownership through institutional investors seems to have substantially lowered the information costs and mitigated collective action problems, and this has increased shareholders’ control in the corporate governance landscape.

The resolution of collective action problems and the increase of shareholder control over charters have made it easier for companies to share the same or similar charter provisions, regardless of the state of incorporation. For instance, whether a company is incorporated in Delaware or New York, its shareholders can demand a certain governance arrangement in a charter amendment. This also implies that the decisive factor driving the distinction among state corporate laws is not the default provisions but the mandatory provisions. For instance, Massachu

---

132 See supra I.B
133 See supra II.A.

DRAFT—Please do not cite without the author’s permission
setts, Indiana, Oklahoma, and Iowa all mandate a staggered board for all publicly traded companies incorporated in those states.\textsuperscript{135} For those companies, the shareholders, no matter how active, cannot contract around that mandatory governance arrangement unless they can convince the managers to change the state of incorporation.

Therefore, the rationale behind using mandatory state rules to protect dispersed shareholders, who were presumed to have little power and little incentive to engage in governance changes, has become less compelling. On the contrary, as seen in mandatory staggered board provisions, mandatory state laws can be used to give managers more control to the detriment of the shareholders. The descriptive findings in this paper show that shareholders are recovering their bargaining power against managers over corporate charters and various governance arrangements, particularly through activism. The need for mandatory corporate legal provisions for the purpose of protecting dispersed and disempowered shareholders is diminishing.

B. Policy Implications for Compromised Amendments

Notwithstanding the general rise of shareholder control over corporate charters and other governance arrangements, at least with respect to certain issues, whether increased shareholder intervention has actually shifted more control to shareholders remains an open question. As I have shown in the paper, while it is true that most of the recent charter amendments tend to grant more power to the shareholders, management has been able to retain substantial control over corporate charters and governance arrangements by implementing compromised versions of shareholders’ demands.

Compromised implementations, with higher ownership thresholds or more stringent procedural requirements, have become increasingly prevalent. In such cases, while the corporations are facially responding to the demands made by shareholders, the directors are able to alter the rights given to shareholders through creative modifications. In some cases, it is even doubtful as to whether the shareholders are getting an additional right at all. While it is true that the directors are responsive to the market and the shareholder pressure, they nonetheless have myriad ways of retaining and exercising control. In other words, the balance of power seems to have shifted somewhat towards the shareholders but the degree of that shift depends on the context.

\textsuperscript{135} See IND. CODE ANN. Section 23-1-33-6(c) (LexisNexis 2014); IOWA CODE ANN. § 490.806(A) (2014); MASS. GEN. LAWS ANN. ch. 156B § 50A, ch. 156D, § 8.06(b)-(g) (West 2015); OKLA. STAT. ANN. tit. 18, § 027 (D) (West 2011).
Given shareholders’ increased bargaining power, a better approach may be to provide more disclosure and analysis to the institutional investors, especially through the proxy advisory firms. As shown in Part II, even when certain corporations decided to modify shareholders’ proposals and impose substantial procedural hurdles on how shareholders can execute a written consent, the proxy advisory firms’ “for” recommendations did not change. And the institutional investors, relying on the SEC’s rule and the no-action letters, largely followed the proxy advisory firms’ recommendations approving the modified management proposals. This, in turn, has allowed management to retain more control over the charter amendment process.

It is difficult to determine whether the managements’ modifications are in fact shareholder value-destroying and, at least in theory, this will depend on many other factors including various firm-specific characteristics. In either case, this paper argues that it is important to acknowledge these new responses from the management, rather than let them remain under the radar. For instance, one client memo on shareholder action by written consent demonstrated the necessity of adding procedural requirements:

If a board wants to implement meaningful advance notice requirements of this type, then those requirements should be included in the charter amendment that provides for action by consent. Under Delaware case law, there are significant limits on a board’s ability to implement similar that provides only for procedures that limit the right to act by consent may be much harder to achieve than one that combines a new right to act by consent with procedural safeguards. Careful preparation thus will be essential to enable boards and managements to respond thoughtfully and proactively to shareholder activism seeking the right to act by written consent.136

The so-called “careful preparation,” referred to by the legal counsel, can be quite innovative and sometimes obfuscated from the shareholders’ or other market participants’ view. What the current regime can do is impose an obligation to conduct more careful and detailed analysis of managements’ modifications.


DRAFT—Please do not cite without the author’s permission
1. Proxy Advisory Firms’ Voting Recommendations

One possibility is to induce proxy advisory firms to provide more analysis and comparison between shareholders’ and managements’ proposals: for instance, the reasons why their “for” recommendations stay the same despite the imposition of procedural hurdles by the management. The SEC could indirectly induce more enhanced analysis and disclosure by imposing stronger fiduciary duty obligations on institutional investors. The Commission could, for instance, consider adopting a rule that institutional shareholders’ reliance on proxy advisory firms’ recommendations on modified management proposals would be deemed to satisfy the duty only when the recommendations contain sufficient analysis and comparison between shareholders’ and managements’ proposals. Such an indirect influence will provide extra incentive for the proxy advisory firms to conduct a more nuanced analysis, which will become part of the discussion among the shareholders when deciding on an amendment proposal. As a result, proxy advisory firms’ recommendations on managements’ compromised proposals should be more varied, depending on each company’s circumstances.

2. The SEC’s No-Action Letters

Another implication that follows from the discussions presented in this paper is the increased influence of the SEC’s no-action letters on corporate charters.\textsuperscript{137} Whenever a company wants to exclude a shareholder proposal from its proxy material, the company must file its reasons with the SEC.\textsuperscript{138} Often times, companies request no-action relief from the SEC, and the SEC’s staff determines whether the shareholder proposal at issue can be excluded, based on whether the shareholder proposal falls under Rule 14a-8(i). No-action letters—which are given when the SEC staff decides not to recommend the SEC enforcement action against the requestor—are meant to be non-formal statements of the Commission,\textsuperscript{139} but they often have had a stronger, sometimes even virtually binding effect, in practice.

\textsuperscript{137} The SEC’s no action letters
\textsuperscript{138} 17 C.F.R. § 240. 14a-8(j) (1)
\textsuperscript{139} SEC Division of Finance, Informal Proceedings Regarding Shareholder Proposals, https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8-informal-procedures.htm ("It is important to note that the staff’s no-action responses to Rule 14a-8(j) submissions reflect only informal views. The determinations reached in these no-action letters do not and cannot adjudicate the merits of a company’s position with respect to the proposal. Only a court such as a U.S. District Court can decide whether a company is obligated to include shareholder proposals in its proxy materials. Accordingly, a discretionary determination not to recommend or take Commission enforcement action does

DRAFT—Please do not cite without the author’s permission
A single no-action letter can create a ripple effect and cause a substantial transformation in the corporate governance landscape.\(^ {140} \) For instance, on January 16, 2015, the SEC granted no-action relief to Whole Foods on the grounds that its shareholder proposal on proxy access could be excluded because the proposal conflicted with the management proposal of a significantly higher ownership threshold under Rule 14a-8(i)(9). Soon after the Whole Foods no-action letter, about two-dozen other companies also asked the SEC for no-action relief to exclude respective shareholder proposals on the same ground, citing and relying on the no-action letter issued to Whole Foods.\(^ {141} \) Perhaps fearing a widespread adoption of the practice, the Commission withdrew the Whole Foods no-action letter about a month later and is currently taking no position on the issue.\(^ {142} \)

On October 22, 2015, the SEC issued a guidance, using hypothetical examples, in which shareholder proposals directly conflict with management proposals and thus can be excluded under Rule 14a-8(i)(9).\(^ {143} \) According to the guidance, the SEC evaluates “whether a reasonable shareholder could logically vote for both proposals.”\(^ {144} \) This guidance is welcome, but it is useful only in cases when proposals from both the shareholders and the management are submitted at the same meeting. Rather, whether compromised and preemptive implementation can be regarded as “substantially implemented” shareholder proposal under Rule 14a-8(i)(10) is a more acute issue.\(^ {145} \) The SEC’s current prac-

---

not preclude a proponent, or any shareholder of a company, from pursuing any rights he or she may have against the company in court, should the company’s management omit the proposal from the company’s proxy materials.

\(^ {140} \) Although SEC staff reserves the right to change the Commission’s position reflected in a prior no-action letter, this has rarely happened. For instance, the SEC issued SLB 20 in 2014 in an effort to correct the unintended consequences of its 2004 no-action letters, but SLB 20 still did not completely reverse the course. Commissioner Daniel M. Gallagher, U.S. Securities and Exchange Commission, *Outsized Power and Influence: The Role of Proxy Advisers*, Washington Legal Foundation Critical Legal Issues Working Paper Series, No. 187, (Aug. 2014) at 14, http://www.wlf.org/upload/legalstudies/workingpaper/GallagherWP8-14.pdf (“SLB 20 cautions against misjudged reliance on the two 2004 staff no-action letters, which have been widely misinterpreted as permitting investment advisers to abdicate essentially all of their voting responsibilities to proxy advisers without a second thought.”).


\(^ {143} \) The SEC’s Staff Legal Bulletin 14H (“SLB 14H”).

\(^ {144} \) Id.

\(^ {145} \) SLB 14H will increase the use of 14a-8(i)(10) in requesting no action letters. Morrison Foerster, New Staff Legal Bulletin and Proxy Voting Guidelines Released Ahead of the 2016 Proxy Season, p. 3 (Dec. 4, 2015)”SLB 14H could impose “a higher burden for some companies seeking
tice of issuing no-action relief to exclude shareholder proposals challenging the compromised portion impairs shareholders’ bargaining power in the charter amendment process. Given the prevalence of compromised and preemptive implementations, the SEC should not allow either party to preempt the other’s proposal.

CONCLUSION

How has shareholder activism affected corporate governance? This important question has received a lot of attention from both scholars and practitioners. This paper sheds light on this issue through the lens of corporate charters and charter amendments. Overall, the paper shows that the recent rise of shareholder activism has restored shareholders’ power to check management’s self-serving charter amendments by giving shareholders more voice over the amendment process. At the same time, however, concerns remain. First, because current state corporate law dictates that the amendment process must be initiated through a board resolution, management has often been able to undermine shareholder control and make substantial alterations in their favor. Further, these compromised implementations of corporate charters have not yet received sufficient examination by the SEC and proxy advisory firms. The paper has argued that our understanding of corporate charter amendments needs to be updated to reflect the new dynamic caused by shareholder activism and the SEC and proxy advisory firms should allow shareholders to challenge managements’ compromised implementation in order to secure a more transparent bargaining dynamic between shareholders and directors.

---

to exclude a proposal to meet than had been the case under our previous formulation.” As a result, issuers may turn to Rule 14a-8(i)(10) in seeking to exclude a shareholder proposal that is very similar to a management proposal of action.”

DRAFT—Please do not cite without the author’s permission