Shareholder Voice in Corporate Charter Amendments

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State corporate laws require shareholder approval for corporate charter amendments, but only the board of directors has the power to propose how to amend charters. The directors' exclusive power over charter amendment proposals creates a potential for managerial opportunism by refusing to propose amendments that empower shareholders or by pursuing amendments that favor managers. While shareholder approval can theoretically serve as a check against such opportunism, dispersed shareholders' rational apathy and collective action problems, can also prevent them from being effective monitors. Prior scholarship has thus viewed charter amendments with suspicion, but there has been no systematic, empirical examination to confirm or refute the possibilities of managerial opportunism. Based on hand-collected data on charter amendments of the top 250 U.S. companies over the past twenty-one years, this Article demonstrates that the recent trend of shareholder engagement has enabled them not only to check management-initiated amendments, but also to pressure directors into proposing shareholder-initiated amendments. Concerns over managerial opportunism, however, remain valid, as the data reveal subtle ways in which directors have preempted shareholders' voice with compromised terms. This Article updates our theoretical understanding of corporate charter amendments by reflecting the new dynamic with shareholder engagement, as well as normatively claims that state and federal authorities should secure even-handed procedures so as to give both shareholders and managers a meaningful voice in the charter amendment process.

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I. INTRODUCTION

How has the recent rise of shareholder activism altered the dynamics of charter amendments? Can the new dynamic alleviate conventional concerns about managerial opportunism in charter amendment process? This Article tackles these two fundamental questions in corporate law and governance focusing on companies' most foundational governing documents: corporate charters.[1]

In 2009, the majority of the shareholders of Raytheon Company ("Raytheon") approved a shareholder proposal asking the company to grant the right to call a special shareholders' meeting to holders of 10% or more of the company's stock.[2] During the following year, although the outcome of the vote had no legally binding effect on the company, Raytheon's board responded by making its own proposal to amend its corporate

1. Distinguishing corporate charters from bylaws is an important premise of the Article. Corporate charters, formally referred to as a "Certificate of Incorporation" or "Articles of Incorporation", are most distinctive from bylaws for their rigorous amendment process. In contrast to a charter amendment that requires the approval of both directors and shareholders, for most companies, either directors or shareholders can unilaterally amend bylaws.

2. Raytheon Co., Quarterly Report (Form 10-Q) (July 23, 2009).

charter to grant such right, and the charter was amended accordingly.[3] Back in 2005, the company was in a similar situation. After shareholders passed a proposal demanding the declassification of the board in 2004, a management-sponsored proposal to declassify the board was approved by the majority of its shareholders.[4]

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.

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 observations. First, directors' exclusive right to initiate a charter amendment allows directors to pursue an amendment only when it favors them.[6] Second, once the initial charter provisions are set, shareholder approval requirements cannot effectively check directors' opportunistic amendments. Dispersed shareholders often lack requisite information to properly evaluate the proposals and face a collective action problem since they feel their votes will not be likely to influence the voting outcome.[7] Due to such structural impediments, prior literature has argued that midstream charter amendments tend to favor directors over shareholders.

Notwithstanding extensive theoretical literature, there has been no systematic empirical analysis to validate how such theories measure up to the current practice of corporate charter amendments. This Article 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, which is comprised of mostly

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3. Raytheon Co., Current Report (Form 8-K) (June 2, 2010).

4. Raytheon Co., Current Report (Form 8-K) (May 6, 2005); Raytheon Co., Quarterly Report (Form 10-Q) (July 29, 2004).

5. *See* Lucian A. Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1825–29 (1989) (discussing the differences when opting out in the initial charter versus the charter amendment stage) [hereinafter Bebchuk, *Limiting Contractual Freedom*]; Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1443 (1989) (noting that changes among corporations share something: "they are all proposed by the existing managers"); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1573–80 (1989) (claiming that managers have more opportunity to tilt the midstream charter in its favor because the shareholders' investment is already sunk); John C. Coffee Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1691 (1989) (emphasizing the importance of judicial role in midstream charter amendments); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 862–65 (2005) (proposing a new regime that requires shareholder-initiated midstream charter amendment proposals to be adopted under certain circumstances in midstream charter amendments) [hereinafter Bebchuk, *Increasing Shareholder Power*]; Michael Klausner, *Fact and Fictions in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1346 (2013) (discussing contractarian analysis of the governance adjustment after a company goes public).

6. Bebchuk, *Increasing Shareholder Power*, *supra* note 5, at 865 ("Management's control over charter amendments, as we have seen, 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.").

7. Gordon*, supra* note 5, at 1574–75. 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 disseminating information among shareholders, and strategic behavior by insiders that amounts to economic coercion.

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, and contrary to the concerns expressed in the prior literature, the Article shows that recent charter amendments tend to empower shareholders.[8]

Since 2000, changes in the corporate governance environment including the rise of shareholder activism in general and the increase of institutional investor ownership in large companies in particular,[9] do not fully explain why the shift in charter amendments was sudden, rather than gradual. Based on the data and interviews with practitioners, this Article shows that the SEC's new rule-making became the epicenter of the changes in charter amendments. The Commission promulgated a new rule in 2003 imposing fiduciary duty on mutual funds in proxy voting.[10] Further, two no-action letters in 2004, the SEC staff confirmed that relying on proxy advisory firms' recommendations would likely cleanse mutual fund of conflicts of interest and satisfy their fiduciary duty of loyalty to their investors.[11] 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 voting recommendations.[12]

At the same time, however, shareholder activism and the consequent charter amendments have not always produced the sought-after effects. In the Raytheon episode above, the management proposal made one modification to the minimum ownership threshold of the shareholder proposal: the right was given to those who owned 25% of the stock, rather than 10%.[13] Furthermore, another shareholder proposal with the 10% threshold, concurrently submitted in 2010, was excluded from the proxy ballot because it *conflicted with company's proposal*.[14] Regardless of this threshold increase, shareholders approved 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' power to challenge

8. *See infra* Part II.B.2 (discussing the failure of shareholder right to veto charter amendments).

9. *See* David A. Katz & Laura A. McIntosh, *The Changing Dynamics of Governance and Engagement*, N.Y.L.J. (July 23, 2015), http://www.newyorklawjournal.com/id=1202732808380/The-Changing-Dynamics-of-Governance-and-Engagement?slreturn=20160516005713 (discussing the increases in activism by part owners); 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, 886 (2013) ("[B]y any measure, mutual funds have the right to be a significant force in the governance of large U.S. corporations.").

10. 17 C.F.R. § 275.206(4)-6(a) (2003); Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585, 6585 (Feb 7. 2003) (to be codified at 17 C.F.R. pt. 275).

11. Egan-Jones Proxy Services, SEC No-Action Letter, 2004 WL 1201240 (May 27, 2004); Institutional Sharehold Servs. Inc., SEC No-Action Letter, 2004 WL 2093360 (Sept. 15, 2004).

12. James Cotter et al., *ISS Recommendations and Mutual Fund Voting on Proxy Proposals*, 55 VILL. L. REV. 1 (2010) (finding that mutual funds vote more consistently with ISS recommendations rather than management recommendations.); Daniel M. Gallagher, *Outsized Power and Influence: The Role of Proxy Advisers* 4–5 (Wash. Legal Foundation Critical Legal Issues Working Paper Series, Paper No. 187, 2014), http://www.wlf.org/upload/legalstudies/workingpaper/GallagherWP8-14.pdf ("In 2004, a proxy advisory firm requested – and received –'no action' relief from the SEC staff that significantly expanded investment advisers' incentive to use these firms.").

13. Raytheon Co., Current Report (Form 8-K) (May 27, 2010).

14. Raytheon Co., SEC No-Action Letter, 2010 WL 387511 (Mar. 29, 2010).

compromised proposals.[15]

The popularity of compromised implementation 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 which place onerous restrictions on that right. For instance, ISS, by far the most influential proxy advisory firm, consistently recommends voting for management-modified proposals.[16] 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 Article suggests practical implications for compromised implementation. I argue that the SEC should allow shareholders to challenge managements' preemptively compromised implementation by granting no-action letters restrictively, in order to secure a more transparent bargaining dynamic between shareholders and directors. Additionally, an adoption of state "opt-in" default law provision making a shareholder proposal binding in two specific cases would mitigate the distortion created by a competing shareholder proposal when it receives sufficient votes to amend charters.

This Article is organized in four parts. Part I introduces current state and federal laws on the charter amendment process, and theoretical concerns over managers' opportunistic behavior in midstream charter amendments. Part II provides the first systematic analysis of the new trend in charter amendments, using new, hand-collected data, and explains how the SEC's new rule and subsequent no-action letters have played an important role in substantially facilitating charter amendments that generally empower shareholders. Part III highlights managements' compromised implementation of shareholder requests. Finally, Part IV explores the normative implications on compromised implementation based on the foregoing theoretical and empirical analysis.

II. Existing Theories on Charter Amendments

A corporate charter is the most foundational document that governs how a company is organized and managed.[17] A corporate charter is the primary document because the charter supersedes other documents of the company, including its bylaws, which are invalid to the extent that they conflict with its charter.[18] Once a company files its charter with a

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15. Bebchuk, *Increasing Shareholder Power*, *supra* note 5, at 863 ("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.").

16. *Memo Series-The 2015 Proxy Season: Special Meeting Proposals*, SIMPSON, THACHER, & BARTLETT 2–3 (2015), http://www.stblaw.com/docs/default-source/memos/firmmemo_07_30_15_special-meeting-proposals.pdf [hereinafter *2015 Proxy Series*].

17. 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 (2016) (exemplifying the use of the term "certificate of incorporation"). The term for "corporate charter" is "articles of incorporation" in the California Corporations Code. *See* CAL. CORP. CODE § 200(a) (West 1983) (exemplifying the use of the term "corporate charter" in California) .

18. *See, e.g.*, Model Business Corporation Act (hereinafter "MBCA"), § 2.06(b) ("The bylaws . . . may

state, the corporate law 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 ample discretion to customize its corporate charter. Particularly with a midstream charter amendment, which occurs after companies have gone public, there have been questions 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 these 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 the corporate law of all 50 states, including the Delaware General Corporation Law, amending a corporate charter requires both directors' and shareholders' approvals.[19] After the directors first agree on whether a certain amendment proposal will be put up for a 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.[20] 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 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 it. 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 13 grounds under which the management can exclude shareholder proposals from the proxy ballot.[21]

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contain any provision . . . that is not inconsistent with law or the articles of incorporation."); DEL. CODE ANN. tit. 8, §109(b) (2015) ("The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation . . . .").

19. MBCA § 10.03.

20. *E.g.*, DEL. CODE ANN. tit. 8, § 242(b)(1) (2014).

21. 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) Irrelevance; (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).

Once a company receives a shareholder proposal, the company cannot simply ignore it. When a company wants to exclude the proposal from the voting agenda, the company must request the SEC to issue a no-action letter, which permits the exclusion on the grounds listed in Rule 14a-8(i).

What happens when a shareholder proposal gets voted on and receives support from a majority of shareholders? Since the federal rules does not impose any legal obligations on shareholder resolutions that receive at least majority approval, most shareholder proposals are only advisory.[22] In that sense, shareholder proposals are designed like referenda because they only demonstrate shareholders' preference on certain issues and do not legally bind management. It is worth noting that a proposal can be made even when a shareholder owns a small fraction of the company,[23] because Rule 14a-8(b) indicates that a shareholder who continuously owns at least $2,000 in market value or one percent of voting shares for at least for one year is eligible to submit a shareholder proposal.[24]

B. Theoretical Concerns over Midstream Amendments

Notwithstanding the intent of state corporate law to balance the power between shareholders and directors in the charter amendment process, whether shareholders can effectively monitor charter amendments has remained an important question. Shareholders' checks on opportunistic amendments by the board 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 amendments that destroy shareholder value from being adopted due to the problems of information asymmetry and collective action.

1. Board's Exclusive Right to Propose Charter Amendments

Under existing state corporate law, the first major structural hurdle is that the shareholders cannot initiate the charter amendment process. Only directors have the right to determine whether an amendment proposal will be put forward for a shareholder vote.[25] Although the shareholders can submit a proposal to amend the charter under the federal proxy rules, this is merely advisory even when a majority of shareholders vote in favor.[26] Prior literature has emphasized the fact that shareholders cannot adopt what they want in the charter unless managers expressly agree to do so first,[27] pointing to the past trend of managers exerting both *de facto* and *de jure* veto power over charter amendments. This

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22. 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 the required shareholder votes, the shareholder proposal becomes legally binding and bylaws would be changed as such.

23. Ross Kerber, *Special Report: Economy-class activist investor crashes the corporate party*, REUTERS (Oct. 23, 2013), http://www.reuters.com/article/2013/10/23/us-activist-chevedden-special-report-idUSBRE99M0LE20131023.

24. 17 C.F.R. § 240.14a-8(b) (2015).

25. *E.g.*, DEL. CODE ANN. tit. 8, §242 (b)(1) (2014).

26. 17 C.F.R. § 240.14a-8 (2015). For a detailed discussion on shareholder proposals, *see* Part II.B.1.

27. Klausner, *supra* note 5, at 1346 ("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.").

trend continued until the recent rise of shareholder engagement. This Article focuses on how shareholders have wrested some *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 weakening the checks and balances of the amendment process because of 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 management's discretion. Depending on the terms attached or modified by the directors, the true nature and 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 to them.[28]

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 their power over a new charter provision by modifying the required vote threshold or adding more stringent procedural requirements.

2. Failure of Shareholder Right to Veto Charter Amendments

If shareholders have not had the power to propose the 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 a voting system that traditionally favors management, most amendment proposals by management have received shareholder approval even when they favored management.[29]

First, shareholders do not always have enough information to tell whether a new amendment enhances shareholder value or not. A shareholder approval requirement may deter obviously opportunistic charter amendments, but the consequences of an amendment are ambiguous in many cases, at least at the time of voting.[30] 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. The supporting argument from shareholder proponents stated:

> 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.[31]

By contrast, its board of directors recommended voting "against" the proposal on the following reasons:

28. For examples of modified amendments, *see infra* Parts III.A and B (describing the data set and the changes in Charter amendment trends).

29. Gordon, *supra* note 5, at 1574–75.

30. Bebchuk, *Limiting Contractual Freedom*, *supra* note 5, at 1836–39.

31. AT&T Inc., Proxy Statement (Def. 14a) (Apr. 29, 2011) (*cf.* "excluded" shareholder proposals can be found at SEC no-action letters disclosures).

> [Taking action by written consent] would deprive stockholders of the right to be heard and to vote on proposed actions. Under our Bylaws, stockholders may introduce and vote on matters at annual meetings or special meetings. Stockholder meetings are open to all AT&T stockholders and allow every AT&T stockholder the opportunity to discuss and deliberate the proposed action. This proposal would allow stockholders that solicit written consents from a minimum number of shares to adopt binding proposals through written consents without a stockholders' meeting. By permitting action to be taken without a meeting, the proposal denies stockholders the opportunity to debate and hear the views of other stockholders.[32]

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 surmise 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 they actually will vote 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.[33]

Second, the tallying system that counts shareholders' votes may favor management proposals.[34] In a company's proxy statement, management indicates its voting recommendations for the agenda. In most cases, management recommends voting "for" management proposals and "against" shareholder proposals.[35] 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.[36]

This system of counting votes in favor of 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.[37] Under the stock exchange listing rules, when beneficial owners do not give specific voting instructions to their brokers, which is not uncommon,

32. *Id.*

33. Bebchuk, *Limiting Contractual Freedom*, *supra* note 5, at 1837 (noting the lack of incentive for shareholders to vote); Yair Listokin, *If You Give Shareholders Power, Do They Use It? An Empirical Analysis*, 166 J. INSTITUTIONAL & THEORETICAL ECON. 38, 52–53 (2010).

34. *See, e.g.*, Yair Listokin, *Management Always Wins the Close Ones*, 10 AM. L. & ECON. REV. 159,173 (2008) (finding that in close votes, management proposals tend to receive just over 50% of votes more often than they receive just under 50% of votes).

35. Fabrizio Ferri & David Oesch, *Management Influence on Investors: Evidence from Shareholder Votes on the Frequency of Say on Pay*, (Columbia Bus. Sch. Research, Working Paper No. 13-17) (2017).

36. Wal-Mart Stores' proxy ballot for the 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 Stores' Proxy Ballot Used for 2015 Annual Shareholders' Meeting*, WAL-MART STORE, INC. (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. BUS. L. REV. 1, 16 (2013).

brokers are able to vote on "routine" matters in their discretion.[38] Since brokers do not have sufficient incentive to make informed decisions, they tend to follow management's recommendations when they are allowed to exercise their discretion in voting. The practice has been unfairly advantageous to management, and the stock exchange listing rules have gradually narrowed the scope of brokers' discretionary voting over the years. In 2010, the New York Stock Exchange ("NYSE") amended Rule 452 to ban broker discretionary voting on executive compensation and uncontested director elections.[39] More related to charter amendments, in 2012, the NYSE and NASDAQ excluded important corporate governance issues from being "routine" matters.[40] Consequently, brokers can no longer engage in discretionary voting without instructions from beneficial owners on specific corporate governance proposals.[41]

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.[42] Even managers have an incentive to secure core corporate governance arrangements through charters rather than through bylaws. After all, once a corporate governance arrangement is stipulated in the charter, the shareholder approval requirement to amend it can function as a shield from future challenges.

III. NEW EMPIRICAL EVIDENCE OF CHARTER AMENDMENTS

This part presents and analyzes the original data on corporate charter amendments among the largest public companies in the U.S. Followed by data description in Section A, Section B presents the recent trend of charter amendments towards shareholder empowerment. Section C argues that the SEC's new rule in 2003 and subsequent no-action

38. N.Y.S.E. Manual Rule 452 (CCH) ¶ 2452 (2013); NASDAQ Stock Market Rule (CCH) ¶ 2251 (2010); Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 78f(b) (2015).

39. The SEC noted that NYSE Rule 452 is a member rule, and the amendment applied also to brokers licensed by NYSE but hold NASDAQ listed companies' shares. SEC Release No. 34-60215, 2009 WL 1897466 fn. 69 (July 1, 2009), https://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf.

40. *Information Memo*, NYSE REG. (Jan. 25, 2012), http://www.lexissecuritiesmosaic.com/gateway/nyse/info-memos/12-4.pdf ("Accordingly, proposals that the Exchange previously ruled as "Broker May Vote" including, for example, proposals to de-stagger the board of directors, majority voting in the election of directors, eliminating supermajority voting requirements, providing for the use of consents, providing rights to call a special meeting, and certain types of anti-takeover provision overrides, that are included on proxy statements going forward will be treated as "Broker May Not Vote" matters.").

41. The broker discretionary votes which used to be counted in favor of management are now categorized as "broker-non-votes" and they are counted only for the purposes of satisfying quorum. Contrary to the expectations of rule makers, recent empirical studies have shown that the change has not affected voting results much. Scott Hirst, *Frozen Charters*, 34 YALE J. REG. 91, 91 (2017); Becker & Subramanian, *supra* note 37, at 17–18 (In the context of director election, "[Since] the margin of victory in corporate elections is so large that the broker non-votes could not have made much of difference").

42. 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.").

letters in 2004 on institutional shareholders' proxy voting have played an important role in substantially increasing charter amendments since 2005.

A. Data Description

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.[43] Most empirical studies on corporate governance arrangements examine both charters and bylaws,[44] 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.

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. This Article is confined to the publicly traded companies only, which narrows the list to 221 companies.[45]

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. The sample companies are incorporated in 25 different states, but 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.[46] I did not exclude financial institutions from the sample companies because there are no additional, unique regulations for financial institutions in regard to corporate charters. 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, which are publicly available via the SEC's EDGAR database.[47]

To count only the substantive charter amendments, I excluded one relatively common but unsubstantial type of amendment: increasing the authorized number of shares. In order

43. A recent study has shown systematic analysis of corporate governance arrangements in a broader sense by looking at both corporate charters and bylaws combined. Klausner, *supra* note 5, at 1326.

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. *See generally* Paul A. Gompers et al., *Corporate Governance and Equity Prices*, 118 Q. J. ECON. 107 (2003); Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783 (2009); Martijn Cremers & Allen Ferrell, *Thirty Years of Shareholder Rights and Firm Value*, 69 J. FIN. 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 Fortune 500 2012*, FORTUNE (2012), 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 Aug. 2015)).

46. But, there is also a small number of initial 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 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.

to count the number of amendments consistently across companies, I counted the number of instances where the shareholders' votes were taken rather than the number of amended charter provisions. Typically, a proposal by management to eliminate the supermajority voting requirement is bundled. For instance, a management proposes to eliminate "all" supermajority voting requirements in the company's charter at the same time. Once approved by the shareholders, different sections in the charter containing a supermajority voting requirement will be eliminated simultaneously, thereby producing multiple amendments.[48] It would be misleading to count them separately for the purposes of estimating the amendment frequency. A more traditional type of bundling has also taken place wherein management puts different subject matters to one shareholder vote.[49] Seventy-one out of 432 voting agendas were bundled ones, and 60 of them proposed to eliminate supermajority voting requirements on different subject matters. Management bundled more than one unrelated subject matter 11 times, despite the SEC's rule against bundling.[50] 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 was created 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. Then I checked the company's current filing (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.[51] 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 approval. 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.[52]

48. 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 supermajority 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. AmerisourceBergen Corp., Proxy Statement (Def. 14a) (Jan. 22, 2010).

49. To understand the bundling problem, *see generally* Lucian A. Bebchuk & Ehud Kamar, *Bundling and Entrenchment*, 123 HARV. L. REV. 1549 (2010); James D. Cox et al., *Quieting the Shareholders' Voice: Empirical Evidence of Pervasive Bundling in Proxy Solicitations*, 89 S. CAL. L. REV. 1175 (2016). 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&DIs") to guide certain limited examples of permissible bundling. *Exchange Act Rule 14a-4(a)(3)*, SEC (Jan 24, 2014), http://www.sec.gov/divisions/corpfin/guidance/14a-interps.htm.

50. *Id.*

51. *See generally* Hirst*, supra* note 41 (detailing when proposals do not receive shareholder approval).

52. *See* Lucian Bebchuk & Ehud Kamar, *supra* note 49, at 1551 (detailing shareholder approval of mergers).

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

Table 1: Description of Data

Number of Sample Companies	221
Total Number of Amendments	432
Average Number of Charter Amendments per Company	1.95
Median Number of Charter Amendments per Company	2
Minimum Number of Charter Amendments per Company	0
Maximum Number of Charter Amendments per Company	8
Standard Deviation on Number of Charter Amendments per Company	1.79

I combined this original data with four other data sources: ISS Shareholder Proposals, SharkRepellent.net, the SEC no-action letter archive, and ISS Voting Analytics. The details of shareholder proposals between 1997–2015 for the sample companies were collected from the ISS Shareholder Proposals S&P 1500 data available at Wharton Research Data Services (WRDS). I also used SharkRepellent.net for the data on shareholder proposals that are submitted but excluded from the proxy ballot after the SEC no-action relief between 2005–2015. The details of each SEC no-action letter are available on the SEC Webpage.[53] Lastly, for the data on proxy advisor's voting recommendations, I used the ISS Voting Analytics.

Before I move on to charter amendments, it is crucial to clarify the terms that will be used throughout the Article. In corporate law and governance literature, terms such as "pro-shareholders," "shareholder-friendly," and "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 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 Article, 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 used to be composed of more director empowering provisions. These observations are consistent with previous academic literature, as discussed before that raised concerns over managerial opportunism in charter

53. *No Action Letters*, SEC, https://www.sec.gov/answers/noaction.htm (last visited Nov. 16, 2017).

amendments.[54] Charter amendments, however, have faced an unprecedented stimulus: shareholder activism.

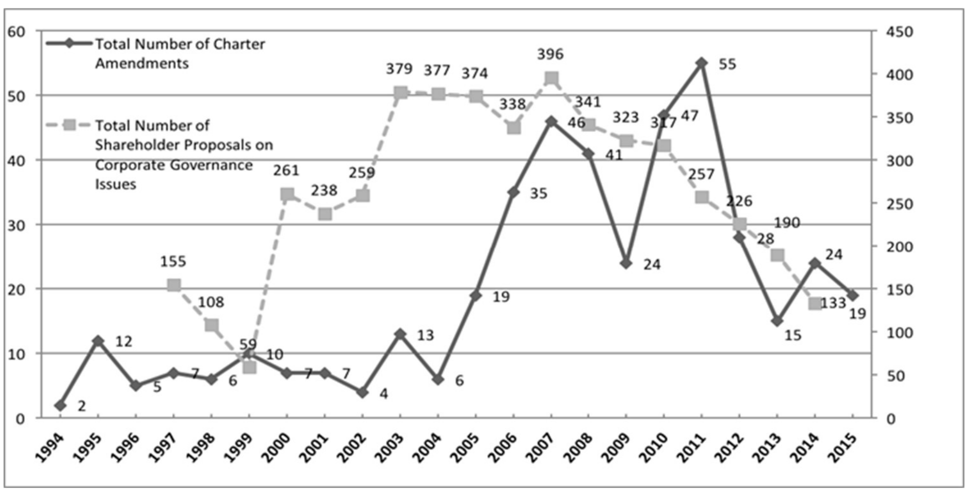
B. The Change in Charter Amendment Trends

The actual pattern of corporate charter amendments diverges from what was expected in prior literature both in frequency and substance.

1. The Change in Frequency

I compared the number of charter amendment incidences with the number of shareholder proposals submitted on governance issues ("governance shareholder proposals")[55] for the purpose of examining the trend of shareholders' pressure on governance. As Figure 1 below demonstrates, both the number of shareholder proposals pertaining to governance 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



The dotted line in 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 continued to decrease. 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, eliminating one of the main

54. *See supra* Part II.B (discussing managerial opportunism in charter amendments).

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.

issues on which shareholder proposals previously focused.[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 the mandatory disclosure of corporate political spending, which is rarely addressed in corporate charters.[57]

In comparison, the solid line shows that the number of charter amendments has substantially increased since 2004, peaking around 2011 and decreasing since then. Shareholders of the sample companies have approved 432 management proposals to amend corporate charters from 1994–2015.[58] Before 2005, the total number of charter amendments each year hovered around ten.[59] The temporary drop in charter amendments in 2009 is likely due to the financial crisis that began in 2008. During the crisis, companies and shareholders were presumably focused 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 amendments starting around 2011 is largely correlated with the decrease in the numbers of shareholder proposals on charter amendments. Recently, the focus of shareholder activism and proposals has shifted to issues such as corporate, political spending and the independence of the chairman of the board, neither of which requires a charter amendment.[60] After the companies have implemented popular, shareholder-empowering arrangements, they have not voluntarily moved to amend their charters. Thus, both the rise of the 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, the reasons for the low frequencies of amendments before and after the peak differ substantially. Before 2005, shareholders seemed to lack the power to induce management to initiate a charter amendment, and thus companies could sustain management-empowering charter provisions since the late 1980s. In contrast, after 2011, while the shareholders have the power to influence management, charter amendments are

56. Rajeev Kumar et al., *2014 Annual Corporate Governance Review*, GEORGESON 4 (2014), http://www.georgeson.com/us/Documents/agcr/agcr2014.pdf ("The number of shareholder proposals continued to decline during the 2014 proxy season. This trend began four years ago, when say on pay proposals became mandatory and replaced their shareholder proposal counterparts."). The SEC issued the final rule of "say-on-pay" on January 25, 2011 and the effective date was April 4, 2011. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Fed. Reg. 66590 (Oct. 28, 2010) (to be codified at 17 C.F.R. pts. 229, 240, 249).

57. For instance, the three most common shareholder proposal topics in 2015 were on (1) corporate political activities; (2) proxy access; and (3) independent chair. In 2014, they were on (1) corporate political activities; (2) independent chair; and (3) climate change. *Shareholder Proposal Development During the 2015 Proxy Season*, GIBSON, DUNN & CRUTCHER LLP (July 15, 2015), http://www.gibsondunn.com/publications/pages/Shareholder-Proposal-Developments-During-the-2015-Proxy-Season.aspx.

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.

60. Kumar, *supra* note 56.

temporarily in remission largely because shareholders have not come up with a new initiative that requires charter amendments.

2. The 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 governance-related.[61] There was not a coherent subject matter that 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.[62] More importantly, recent amendments have empowered shareholders like never before. All of the top five most frequently amended charter provisions shown in 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

Content of Provision	Frequency	Delaware Default	Amendment Gives More Power to
Eliminate Supermajority Voting Requirement	102	Simple Majority	Shareholders
Declassify Board	95	Single Class	Shareholders
Adopt Majority Voting Standard for Uncontested Director Election	36	Plurality	Shareholders
Grant Shareholders a Right to Call a Special Meeting	39	Shareholders Cannot Call a Special Meeting	Shareholders
Eliminate or Relax State Anti-Takeover Statutes	27	Require Super Majority Voting	Shareholders

The most frequently amended charter provision was to eliminate the supermajority voting requirements. Although the supermajority voting requirement will generally affect many different aspects of corporate governance, it also used to be a prevalent defensive tool against hostile takeovers. Returning to the default, simple majority voting standard, it

61. Klausner, *supra* note 5, at 1358 ("[T]he governance changes that were adopted [from the mid-1980s to the mid-2000s] were not contractual. They were made as a matter of practice, with no commitment in firm charters to maintain them.") (*emphasis added*).

62. American Express is a good example illustrating the differences in the trend in charter amendments before versus after the mid-2000s. The company amended its charter seven times during the sample period but the first two amendments in 1997 were in order to delete obsolete provisions and to change the address of its agent. The American Express Company, Proxy Statement (Def. 14a) (Mar. 11, 1997). 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 elections and to eliminate the supermajority voting standard for four different issues. The American Express Co., Proxy Statement (Def. 14a) (Mar. 14, 2008). *See* 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.").

becomes less difficult for shareholders to exercise their control over corporate charters and for a hostile takeover to take place. Especially for large companies, such as those in the sample, requiring 66 2/3%, 75% or 80% of shareholders' votes on a corporate matter could make it difficult if not impracticable for the shareholders to exercise control over the charter and other governance arrangements.

In order to better understand the role of the supermajority voting requirement, we need to distinguish between two distinct types of supermajority requirements. One is with respect to 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 supermajority voting requirements are different. For instance, DGCL section 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."[63] On the other hand, DGCL section 242(b)(4) stipulates that:

> Whenever the certificate of incorporation shall require . . . 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 repealed except by such greater vote.[64]

The latter section, therefore, ensures that if there is a supermajority voting requirement on a certain corporate action, that same level of approval will be required to amend or repeal that voting requirement.[65] It also clearly indicates that there are two different types of supermajority voting requirements.[66]

These two different types of supermajority voting requirements are often treated equally in the corporate governance literature. Furthermore, the supermajority voting

63. DEL. CODE. ANN. tit. 8, § 102(b)(4) (2015).

64. DEL. CODE ANN. tit. 8, § 242(b)(4) (2015) is a codification of Sellers v. Joseph Bancroft & Sons, 2A.2d 108, 111 (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 provisions of the charter which therefore were exempt from alteration except by majorities equaling at least the theretofore stipulated percentages").

65. MBCA § 7.27(b) has a counterpart provision. ("An amendment to the articles of incorporation 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.").

66. 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 supermajority 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 supermajority voting requirements allows companies to protect charter provisions 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 5. Removal of Directors & Fifth 8. Amendment, Repeal, etc. Available as Exhibit 3.1. to Hess' 10-Q filed on August 8, 2006. Hess Corp., Quarterly Report (Form 10-Q) (Aug. 8, 2006).

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 supermajority voting requirement enables shareholders to more easily amend the charter. The elimination of the supermajority voting requirement has been one of the top items on the agenda for activist shareholders.[67]

a. Declassification of The Board

The default duration and election of the board of directors in all states stipulates that the entire board is to be elected annually. However, when corporate charter or bylaws allow, the board of directors can be classified in order to enable some members to not run for election every year. Classification is usually carried out with three groups that have a similar number of directors so that each group is elected for a three-year term and only one group is up for election or reelection in a given year.[68] Consequently, the board of directors becomes more immune to shareholders' attempts to replace the board. With classification, shareholders have to wait two more years to replace an unwanted director. It therefore grants power to the directors and strips it from the shareholders.

Classified board also used to be widely adopted as an anti-takeover mechanism. When there are three classes, 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 a takeover context, a classified board gives more control (over whether to acquiesce to a hostile takeover attempt) to the directors and the management.[69]

Ninety-five charter amendments during the sample period were to declassify the board in order to allow all of its members to be eligible for election every year. In all of these cases, companies amended the contents of the charter rather than simply eliminating the 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 entire board.

b. Majority Voting Requirement in Uncontested Director Election

In my sample, all thirty-nine charter amendments to adopt a majority voting requirement in uncontested director elections were made between 2006 and 2013, following the 2005 spike.[70] Most default state laws on shareholder voting for director

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67. The elimination of Super Majority Voting has been the sixth most common corporate governance proposal voted on from 2010–2014. Kumar et al., *supra* note 56.

68. For example, MBCA, § 8.06 articulates that charters may provide for a staggered board; DEL. CODE ANN. tit. 8, §141(d) (2015) states that a company can stagger its board only when its charter or initial bylaws approved by shareholders enable such an arrangement.

69. Empirical evidence on whether a classified board enhances shareholder value is mixed. On the negative association between classified boards and firm value, see Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409 (2005), Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501 (2007); Lucian A. Bebchuk et al., *What Matters in Corporate Governance*, 22 REV. FIN. STUD. 783 (2009). *But see* K.J. Martijn Cremers et al., *Staggered Boards and Long-Term Firm Value, Revisited*, 126 J. FIN. ECON. 422 (2017) (discussing a classified board's positive association with firm value).

70. In terms of the distribution, there were one in 2006, eleven in 2007, thirteen in 2008, two in 2009, six

elections use the plurality standard. Under the plurality voting rule, director nominees with the most votes cast in their favor are elected to the board, regardless of the number of votes withheld against them.[71] Particularly in an uncontested election, a director nominee can still be re-elected so long as she receives a single "for" vote. Under the majority voting rule, by contrast, a candidate must receive more "for" votes than "withhold" votes. Hence, even in an uncontested election, "withhold" votes matter, and if the candidate were to receive more "withhold" 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. The adoption of the majority voting rule, especially in uncontested elections, functions as a mechanism to empower shareholders, because it allows them to easily remove an unwanted director by casting more "against" votes. Accordingly, companies with this mechanism are more vulnerable to proxy advisory firms' recommendation to withhold votes in director elections.

c. 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 shareholders' meeting to receive an approval for her takeover attempt. With respect to the right, state laws differ. 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 ten percent 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 bylaws. Thus, unless a Delaware company explicitly grants the right, shareholders of the company cannot call a special meeting. Shareholder control is enhanced when this right is granted to the shareholders in the charter.

In the sample, 36 charter amendments were made to grant shareholders the right to call a special meeting. Except for a sole incident in 2003, the other 35 amendments took place after 2008.[72]

d. 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, ranging from control share acquisition laws, to fair price laws, to control share cash-out laws, and freeze-out fair price laws.[73] As an example, under DGCL Section 203, a "business

in 2010, three in 2011, one in 2012, and two in 2013. These are sizable numbers but they constitute less than 1% to 30% of respective years' amendments. Thus the majority voting requirement in uncontested director elections is not the determinative factor of the charter amendment trend.

71. *See* MBCA, § 7.28 cmt. 7-186–7-187 (3d ed. 2002)
("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.").

72. Aetna, incorporated in Pennsylvania, adopted 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%.

73. EDWARD P. WELCH ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW 29 (2015).

combination" between a company and its shareholder owning over 15% of voting stock and her affiliation ("Interested Stockholder")[74] is prohibited for three years unless the approval of the directors and of at least 66 2/3% of voting stocks not owned by interested shareholders are secured.[75] Indiana's control share acquisition provisions require shareholder approval to expand control shares' voting rights.[76] 27 charter amendments in the sample companies either expressly opt-out of these state anti-takeover statutes or lower the supermajority voting requirement to a majority voting requirement. By making it easier for the target shareholders to bypass the state anti-takeover statutes, these amendments empower shareholders. This is because, similar to the board classification provision, when a company opts out of a state anti-takeover statute, the shareholders can more easily determine whether to acquiesce to a hostile takeover attempt.

C. The New Dynamics in Charter Amendments

Multiple factors simultaneously contributed to the new environment for shareholder activism.[77] 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?[78] What explains the delay between the increase in shareholder proposals and the increase in actual charter amendments? This Article argues that the SEC's new rule in 2003 and its interpretation of the rule in 2004 are previously under-appreciated epicenters for the change.

1. Institutional Shareholders as Pivotal Voters

A charter amendment requires an express shareholder approval through proxy voting, which has traditionally been an important mechanism for shareholder engagement.[79] Proxy voting is a unique device in the shareholder activism landscape, where different types of shareholders collaborate closely with one another.[80]

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74. DEL. CODE ANN. tit. 8, § 203(c)(5) (2017).

75. DEL. CODE ANN. tit. 8, § 203(a) (2017).

76. IND. BUS. CORP. LAW § 23-1-42-5, 23-1-42-9.

77. 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.

78. Another commentator pointed out a drastic change in the balance between shareholders and management starting in 2005. Klausner, *supra* note 5, at 1361–62 ("Developments since the mid-2000s are surprising in two respects. First, management has responded to shareholder demands as never before. Second, an innovation occurred . . . at the midstream stage, not the IPO stage.").

79. K.J. Martijn Cremers & Roberta Romano, *Institutional Investors and Proxy Voting on Compensation Plans: The Impact of the 2003 Mutual Fund Voting Disclosure Rule*, 13 AM. L. & ECON. REV. 220, 221 (2011).

80. 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

At the outset, institutional investors, such as mutual funds and pension funds, rarely submit their own proposals.[81] In their stead, individual activist shareholders have been the most frequent players in submitting shareholder proposals.[82] In 2014, for instance, three quarters of the initiators of shareholder proposals were individual shareholders.[83] At the same time, a single activist shareholder tends to circulate the same corporate governance proposal to multiple companies.[84]

Once the agenda has been set, however, given their sheer voting power, institutional investors play a crucial role.[85] Along with the significant concentration of institutional ownership in publicly traded companies,[86] their reactive activism has become an important

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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, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231 (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.

81. 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*, 121 J. FIN. ECON. 111 (2016); Gilson & Gordon, *supra* note 9, at 888 ("[D]espite the urging of academics and regulators, [institutions] remain stubbornly responsive but not proactive.").

82. 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 market value or 1% of voting shares for at least one year. It is not difficult to imagine an individual activist shareholder with small stakes submitting proposals to companies.

83. 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 proponent was the New York State Common Retirement Fund. *See* James R. Copland, *Frequent Filers: Shareholder Activism by Corporate Gadflies,* PROXY MONITOR (2014) http://www.proxymonitor.org/Forms/2014Finding5.aspx# (detailing how the majority of individual sponsored shareholder proposals have been proposed by three people).

84. 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 on adoption of proxy access.

85. *See* Gilson & Gordon, *supra* note 9, 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); *id.* at 887 ("[W]hile mutual funds are not proactive, they are not passive in the Berle-Means sense: They very frequently oppose management on core corporate governance issues.").

86. 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 a few of the companies where institutional investors own less than majority shares.

determinant in voting outcomes.[87] Because institutional investors are decisive voters,[88] hedge fund activists necessarily need the support of institutional investors to achieve their goal in proxy fights.[89] The dynamic of institutional investors' activism inherently differs from that of hedge fund activists and institutional investors' influence does not always rely on hedge fund activists.

In particular, the new dynamic in the charter amendment process reveals the largely discounted role of institutional investors in shareholder activism, particularly in mutual funds.[90] This Article's main focus lies on shareholder activism by institutional investors through proxy voting.

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 mutual funds.[91] Rule 206(4)-6, under the Investment Company Act of 1940, identified advisers' fiduciary duty of care and loyalty obligations in proxy voting.[92] 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.[93] Furthermore, Rule 30b1-4, under the Investment Company Act of 1940, mandates those companies to file Form N-PX with the SEC, disclosing how they voted their proxies.[94]

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87. Kahan & Rock, *supra* note 62, at 995–1022 (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, SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION 48 (2011) ("The amount and concentration of institutional ownership . . . makes it easier for institutions to coordinate their activities across major companies in a manner that influences corporate governance at particular companies and within the corporate community more generally.").

88. Appel et al., *supra* note 81 (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).

89. Cooperation between hedge fund activists and institutional investors in proxy fights. However, this explains only a small portion of institutional investors' role in shareholder engagement. After all, the number of companies targeted by hedge fund activists is much smaller than the number of companies not targeted. Gilson & Gordon, *supra* note 9, at 897.

90. Given their influence in voting outcomes, institutional investors' actions should be seen as a part of shareholder activism in a broader sense, 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.

91. Stephen J. Choi et al., *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 653 (2009) ("The rule [206(4)-6] focused increased attention on mutual fund voting policies.") [hereinafter Choi et al., *Director Elections*].

92. *See* 17 C.F.R. § 275.206(4)-6(a) (2003); Proxy Voting by Investment Advisers, 68 Fed. Reg.6585, 6585-01 (Feb. 7, 2003) (to be codified as 17 C.F.R. pt. 275).

93. The new rule, however, does not mandate investment advisers to vote on every proxy voting. Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585, 6585-01 (Feb. 7, 2003) (to be codified as 17 C.F.R. pt. 275) ("We do not suggest that an adviser that fails to vote every proxy would necessarily violate its 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.").

94. 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

How the institutional shareholders could satisfy the fiduciary duty in proxy voting was not entirely clear to them. Prior to the promulgation of the new rule, these shareholders tended to be largely passive in the proxy voting process. In particular, resolving 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.[95] In the first no-action letter provided to Egan-Jones Proxy Services, dated May 27, 2004, the SEC staff explained, "the recommendations of a third party that is in fact independent of an investment adviser may cleanse the vote of the adviser's conflict."[96] 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 the relationship between shareholders and management in proxy voting, proxy advisory firms working for both sides experience 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."[97]

The letter, in short, blessed the institutional shareholder's use of proxy advisory firms' recommendations 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 voting firm depends upon all of the relevant facts and circumstances."[98] Furthermore, the SEC stated: "[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."[99]

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 firms.[100] The proxy advisory industry expanded dramatically and, in conjunction with the increased ownership by institutional investors, their recommendations have been largely affecting the voting outcome.[101] Furthermore, as

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.

95. 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*, SEC, https://www.sec.gov/fast-answers/answersnoactionhtm.html (last visited Nov. 16, 2017).

96. Egan-Jones Proxy Services, SEC No-Action Letter, 2004 WL 1201240 (May 27, 2004).

97. *Id.*

98. Institutional Shareholder Services, Inc., SEC No-Action Letter, 2004 WL 2093360 (Sept. 15, 2004).

99. *Id.*

100. 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. SEC Staff Legal Bulletin No. 20, 2014 WL 2965312. It did not vacate the SEC's views in the no-action letters issued in 2004. *SEC Guidance on Use of Proxy Advisory Firms for Voting Proxies,* DAVIS POLK 1 (July 1, 2014), https://www.davispolk.com/files/07.01.14.SEC_.Guidance.on_.Use_.of_.Proxy_.Advisory.Firms_.for_.Voting.Proxies.pdf ("[SLB 20] does not revoke prior no-action letters . . . that investment advisers could demonstrate their proxy voting was free of conflicts if they voted in accordance with a pre-determined policy based on the recommendations of an independent third party.").

101. Choi et al., *Director Elections*, *supra* note 91, at 653–54.

a result of these developments, companies have become less likely to ignore shareholder proposals since proxy advisory firms can easily use any company's non-responsiveness against it. In the next part I will examine in detail how shareholder pressure has originated from both 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 categories: 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.[102] When a shareholder requests that management include a 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 is under more pressure to respond to them.[103]

From the sample companies, 198 out of 432 charter amendments (45.8%) received shareholder proposals on the same subject matter within a two-year period before the amendment. Among the companies that amended their charters more than once, 23% of companies did so only after shareholders proposed to do so, and 38% of companies made all their amendments without any shareholder proposal. As Table 3 below shows, the most frequent case is management proposals to amend the charter provision at issue in the following year after a shareholder proposal was voted on. Each year between 1994 and 2015, the number of charter amendments with shareholder proposals is less than charter amendments without shareholder proposals.[104]

102. 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. § 240.14a-8(b) (2015).

103. *See* Martin Lipton et al., *Some Thoughts for Boards of Directors in 2015*, WACHTELL, LIPTON, ROSEN & KATZ 5 (Dec. 1, 2014), 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 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."); Bebchuk, *Increasing Shareholder* Power, *supra* note 5, at 878 ("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.").

104. To determine whether a charter amendment has shareholder proposals voted at issue, this paper counted only two previous years because ISS's policy counts no further than past two years. *See ISS U.S. Corporate Governance Policy 2006 Updates*, INSTITUTIONAL SHAREHOLDER SERVS. 7 http://www.gibsondunn.com/fstore/documents/pubs/2006_US_Policy_Update_1117051.pdf (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 3. Shareholder Proposals on Charter Amendments

Shareholder Proposal Submitted Two Years Before	Shareholder Proposal Submitted One Year Before	Shareholder Proposal Submitted Same Year	Number of Charter Amendments
Voted	-	-	12
-	Voted	-	111
Voted	Voted	-	36
-	-	Voted	11
-	-	Excluded	28
-	-	-	234
Total			432

The following 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, it received approximately 58% of shareholders' favorable votes. In the following year, the board proposed to adopt board declassification with the following statement:

> 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.[105]

Proxy advisory firms' recommendations are the most significant determinants of voting results.[106] While the degree of mutual funds' reliance on proxy advisory firms' recommendation varies depending on the size of the mutual fund, subject matter, or rationale behind recommendations, a large portion of investors have been criticized for mindlessly following proxy advisory firms' recommendations.[107]

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105. Huntsman Corp., Proxy Statement (Def.14a) (Mar. 28, 2014).

106. Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?,* 59 EMORY L. J. 869, 871 (2010); James Cotter et al., *ISS Recommendations and Mutual Fund Voting on Proxy Proposals*, 55 VILL. L. REV. 1 (2010) (finding that mutual funds vote more consistently with ISS recommendations rather than management recommendations.).

107. Peter Iliev & Michelle Lowry, *Are Mutual Funds Active Voters?*, 28 REV. FIN. STUD. 446 (2014) ("Over 25% of [mutual] funds rely almost entirely on Institutional Shareholder Services (ISS) recommendations . . . .");

Proxy advisory firms can intensify the magnitude of internal shareholder pressure in two ways. The firms can provide 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 proposed by shareholders in its charter or bylaws. Additionally, the firm can also make recommendations on how to vote on 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.[108] It creates an indirect, yet powerful, enforcement mechanism to induce the implementation of shareholder proposals.[109]

It is worth noting that the first type of voting recommendations on governance choice is likely more vulnerable to the "one-size-fits-all" recommendations. Voting recommendations on executive compensation (say-on-pay) and the election of directors are more firm-specific in nature. Whether to elect a certain individual as a director or to approve compensation to a specific executive, a recommendation is supposed to be based on firm-specific facts and circumstances. In that sense, the 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 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.[110]

Stephen Choi et al., *Voting Through Agents: How Mutual Funds Vote on Director Election*, (N.Y. U. L. & Econ Res. Paper No.11–29, 2011) (shows that the influence of the ISS recommendations varies according to the reasons behind the recommendations.); Editorial, *Dimon vs. 'Lazy' Investors*, WALL ST. J., May 29, 2015, at A12. (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 as "lazy" and "irresponsible."); Daniel M. Gallagher, Comm'r, SEC, Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Directors' College (June 23, 2015), https://www.sec.gov/news/speech/activism-short-termism-and-the-sec.html. ("some [investment] advisers, particularly smaller ones, are still rotely 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.").

108. *United States Summary Proxy Guidelines*, ISS 15 (Mar. 14, 2017), https://www.issgovernance.com/file/policy/2017-us-summary-voting-guidelines.pdf (recommending that generally shareholders should vote for director nominees except in certain circumstances such as when "[T]he board failed to act on a shareholder proposal that received the support of a majority the votes cast in the previous year"). ISS adopted the policy of board responsiveness back in 2000 but it did not have much impact until around 2005; *Memo Series-The 2016 Proxy Season: Special Meeting Proposals*,SIMPSON, THACHER, & BARTLETT 13 (2016), http://www.stblaw.com/docs/default-source/memos/firmmemo_08_08_16_special-meeting-proposal.pdf [hereinafter *2016 Proxy Season*] ("issuers should take into account the possibility that failure to substantially implement a special meeting shareholder proposal that received majority support can yield negative vote recommendations from the proxy advisory firms against one or more of the company's directors.").

109. Colin Diamond & Irina Yevmenenko, *Who is Overseeing 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.").

110. *E.g.*, ISS recommended a vote "against" a Morgans Hotel Group's shareholder proposal asking for the right to call a shareholder meeting to 25% of shareholders, which is widely perceived as in favor of shareholders.

b. External Pressure: Market Forces

Along with the internal pressure from existing shareholders, the prevalence and influence of proxy advisory firms has created pressure coming from outside of companies. Whether or not it was their intention, proxy advisory firms have contributed to a system of "black or 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 categorizations seem to have produced a one-size-fits-all application. Accordingly, the company is likely to amend its charter provision to conform to such a categorization, even when a company's existing shareholders are silent on an issue, in order to avoid any negative recommendations from proxy advisory firms in the future.

IV. COMPROMISED IMPLEMENTATION AS THE NEW BATTLEGROUND

As discussed so far, the recent trend in charter amendments empowering shareholders conflicts with the prior theoretical discussions on directors' opportunistic charter amendments.[111] Does it mean that shareholder pressure, intensified through proxy advisory firms, has fundamentally shifted control over charter amendments from the directors to shareholders? In the following section, I claim that notwithstanding the large shift in favor of shareholders, through various subtle means, directors have still managed to retain 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 these given rights.

A. The Implementation of Compromised Proposals

While companies can adopt shareholder proposals without any conditions, they 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. The method of compromised implementation is a recent trend, which had led companies to amend their charters in a binary way: the transition from zero to one. The binary quality of these amendments stems from the fact that some cannot be compromised. For instance, there is no middle ground in adopting either a classified or declassified board. Accordingly, the discussion of compromised implementation is not applicable to all charter amendments. One can argue, however, that most binary charter amendments, with a few exceptions, can also be compromised. An implementation of a majority voting standard in uncontested director elections does not have to be a binary one, for example. Therefore, the transition from plurality standard to majority standard may rely on how the terms to deal with a board member who fails to receive a majority vote are set. In that sense, the recent trend of compromised implementations is not limited to specific provisions and has

ISS's rationale behind the recommendation was that the right would give a single shareholder the power to call a special meeting unilaterally might not align with the best interests of entire shareholders. *2015 Proxy Series*, *supra* note 16.

111. *See supra* Part II.B.

potential to spread out broadly in a very innovative and subtle form.

When a company preempts a shareholder proposal through its own modification, and such modification substantially deviates from what the shareholders initially intended, it creates a potential problem. Consequently, it raises the question as to what extent a company's implementation in a charter amendment should be regarded as being faithful to the shareholders' demands. Whether a compromised management proposal increases shareholder value is not only an empirical question but is also unclear and less consequential at the time of its adoption. While some companies adopt exactly what shareholders request, others do with subtle, yet important changes. [112] The most representative examples are those that alter required thresholds, or that add stricter procedural requirements to exercise newly granted shareholder rights.

1. Increase of Minimum Ownership Threshold

A threshold increase is most prevalent in cases that alter shareholders' right to call a special meeting. As Table 4 indicates below, among the 36 charter amendments to adopt shareholders' right to call a special meeting between 1994 and 2015, 29 amendments increased the eligibility ownership threshold from what was contained in the shareholders' proposals. Only 2 out of 36 charter amendments to grant shareholders the right to call a special meeting had not received any shareholder proposal requesting such right. Ironically, while most of the charter amendments occurred under shareholder pressure, more than 80% of the new charter provisions are in the compromised forms that erode the given shareholder right.

112. *See* Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1600 (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.").

Table 4. Compromised Shareholder Right to Call a Special Meeting Provision

Year	Number of Charter Amendments	Number of Amendments with Shareholder Proposals on the Issue	% of Amendments with Shareholder Proposals on the Issue	Number of Compromised Ownership Threshold	% of Compromised Ownership Threshold
2003	1	0	0%	0	0%
2008	1	1	100%	1	100%
2009	4	3	75.0%	0	0%
2010	9	9	100%	9	100%
2011	6	6	100%	6	100%
2012	7	7	100%	5	71.4%
2013	2	2	100%	2	100%
2014	3	3	100%	3	100%
2015	3	3	100%	3	100%
Total	36	34	94.4%	29	80.6%

As described in Table 5, a minimum ownership threshold in the shareholder proposals was usually 10%, but the managements increased it to 25% when they amended the charter provision. In some recent cases, the battle over the degree of compromise has become subtler, and the disparity between a shareholder proposal and a management proposal has become narrower. The shareholders in four companies proposed a 15% or even 20% ownership threshold for the right but managements increased it to 25%. In other instances, the managements in three companies proposed 20% threshold in reaction to shareholders' 10% threshold.

Table 5. Degree of Compromise in the Shareholders' Right to Call a Special Meeting

Increase in Minimum Ownership Threshold	Number of Amendments	Companies (Year of Amendment)
10% to 25%	22	CVS Caremark (2010), Dow Chemical (2010), Safeway (2010), Honeywell International (2008), Northrop Grumman (2010), Home Depot (2009), Raytheon (2010), Baker Hughes (2010), Bristol-Myers Squibb (2010), Goldman Sachs (2010), Danaher (2011), Textron (2011), Yum Brands (2011), Fluor (2012), Devon Energy (2012), Praxair (2012), McDonald's (2012), eBay (2012), Alcoa (2013), Baxter (2013), AmerisourceBergen (2014), Walt Disney (2014)
10% to 20%	3	NextEra Energy (2015), FedEx (2011), Allstate (2011)
15% to 25%	2	PPL (2015), Aetna (2014)

One might argue that the difference in thresholds is immaterial and a management-sponsored compromised proposal does not significantly harm shareholders. However, in large companies, such as those in my sample, the differences in eligibility requirements are much more likely to materially alter the rights of shareholders. Also, the fact that the companies persistently endeavor to obtain or retain the terms they prefer is revealing. If the impact of the compromise were trivial, why wouldn't management simply adopt the shareholders' terms without modifications? For example, shareholders of Home Depot did not have the right to call a special meeting until the management of the company proposed a charter amendment to grant the right to holders of 25% of shares in 2009.[113] Since then, the company's shareholders have submitted eight separate proposals to decrease the minimum ownership threshold to 10% or 15%.[114] All of the shareholder proposals were supported by more than 40% of the shareholder votes cast, and the proposal submitted in 2011 to lower the threshold to 15% was even approved.[115] The management, however, has not responded to the shareholders' continuing demand and still abides by the 25% threshold.

Sometimes, increasing the required threshold can render the right useless or ineffectual due to a collective action problem stemming from dispersed ownership. Although it is not easy to determine the optimal level of shareholder rights to maximize both the shareholders' interests and those of the firm, the direct benefit of granting such a

113. The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr. 15, 2009).

114. In 2009, 2010, 2015 and 2016, shareholder proposals attempt to decrease the ownership threshold to 10%. In 2011, 2012, 2014, and 2017, shareholders proposed 15% of ownership threshold instead. The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr. 15, 2009); The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr. 7, 2010); The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr.15, 2011); The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr. 2, 2012); The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr. 7, 2014); The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr.6, 2015), The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr. 4, 2016); The Home Depot, Inc., Proxy Statement (Def. 14a) (Apr. 3, 2017).

115. Home Depot, Current Report (Form 8-K) (June 7, 2011).

right through charter amendment but with a higher threshold seems to shield companies from adverse recommendations by proxy advisory firms.[116] Thus, in future director elections, companies can demonstrate that they are at least responsive to shareholders' demands. The proxy advisory firms' equal treatment of these different types of amendments can be problematic because it condones the management's unilateral modification of shareholders' proposals.

At the same time, threshold modification is relatively salient and the SEC has taken a somewhat robust position in favor of 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.[117]

2. Addition of Procedural Requirements

Another subtle way of restricting the shareholders' rights rests on adding more stringent procedural requirements to the shareholders' proposals. The adoption of the shareholders' right to act with written consent instead of having to request a shareholder meeting provides a great illustration. Generally, under state corporate laws, any shareholder action required to be taken at a shareholder meeting may be taken by shareholders' written consent in lieu of a meeting.[118] Companies can opt out of this state law through their charters. Having such a right can significantly enhance shareholders' control, as they can unilaterally remove directors or change bylaws 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.[119]

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.[120] All of these charter amendments were made between 2011 and 2014, and, at least superficially, all grant shareholders the right to

116. *2016 Proxy Season*, *supra* note 108 ("ISS recommend a vote "for" nearly all shareholder proposals in 2016, even those that proposed a threshold greater than 10%.").

117. Letter from Matt S. McNair, Attorney-Adviser, Div. of Corp. Fin., SEC, to Alan L. Dye, Hogan Lovells (Jan. 24, 2011), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/johnchevedden012411-14a8.pdf ("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(i)(10)"). *Id.*

118. MBCA § 7.04 ("Action without meeting"); DEL. CODE ANN. tit. 8, § 228 ("Consent of stockholders or members in lieu of meeting.").

119. In my 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).

120. *Action by Written Consent: A New Focus for Shareholder Activism*, CLEARY GOTTLIEB STEEN & HAMILTON LLP (June 22, 2010), https://www.clearygottlieb.com/news-and-insights/publication-listing/action-by-written-consent-a-new-focus-for-shareholder-activism29.

act by written consent.[121] At the same time, nearly all of the management proposals share innovative boilerplate language[122] 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, <u>in accordance with the by-laws</u>, (a) record holders of shares representing at least 25% of the outstanding common stock of the Corporation have <u>submitted a written request to the Secretary of the Corporation asking that the Board of Directors establish a record date</u> 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 <u>from *all* holders of shares</u> 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.[123] (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. There has to be a fixed record date to determine shareholders' consent because companies' shares are easily transferable in order to make a valid written consent. State laws, on the other hand, provide a statutory (default) record date in case the board has not fixed one.[124] 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 just the necessary number of shareholders 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.[125] In contrast, having to solicit all shareholders can be quite costly, which discourages the use of the written consent mechanism.

The procedural requirements are not as visible as the threshold modification discussed

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121. 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.

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

123. Amended and Restated Certificate of Incorporation Article SIXTH 5, HOME DEPOT (2011), http://ir.homedepot.com/~/media/Files/H/HomeDepot-IR/documents/governance-documents/amended-and-restated-certificate-of-incorporation.pdf.

124. *E.g.*, DEL. CODE ANN. tit. 8, §213 (b) (1953).

125. *E.g.*, DEL. CODE ANN. tit. 8, §228 (c) (1953).

above but could, in fact, significantly impair the newly granted shareholder's right. It potentially also turns the charter amendment into a superficial document. Unlike the visible threshold modifications, procedural requirements can take many different and creative forms, which makes it 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 shareholders initially wanted.

B. Managements' Preemption by Compromised Terms

So far, I have discussed whether and how managements respond to shareholder demands reflected in shareholder proposals.[126] In contrast to these amendments executed in response to the specific shareholder proposals, 234 out of 432 (54.2%) charter amendments were made without receiving any shareholder proposals on the issue.[127]It is difficult to identify the original intent behind these voluntary charter amendments, but from the directors' perspective, one clear benefit of voluntarily amending a charter provision is that directors can easily preempt the issue before shareholder pressure arises.

When companies amend their charters in response to shareholder proposals, the terms of the amendments must, at least partially, be guided by and faithful to the contents of the proposals. Specifically, when management waters down the terms in shareholder proposals, it needs to provide compelling justifications to highlight why the compromised terms are better than those offered by shareholders. On the other hand, when management voluntarily implements a charter provision without any previous shareholder proposal, they will have more freedom to choose the terms and dictate the arrangements they favor. Furthermore, when a shareholder proposal is subsequently submitted on the same issue, the voluntary implementation provides the legal grounds for companies to request from the SEC for a no-action letter granting permission to exclude the shareholder's proposal. More specifically, as long as the subject matter is the same and already has been voluntarily implemented, management can request the SEC's no-action letter approve the exclusion of the shareholder proposal on the grounds that the subject matter has already been "substantially implemented" under Rule14a-8(i)(10).[128]

126. The issue has also been addressed in the financial economics literature. *See, e.g.*, Yonca Ertimur et al., *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53 (2010) (using a sample of 620 shareholder proposals requesting an adoption of majority voting standard in uncontested director election between 1997 and 2004, the authors found that the main determinants of boards' responsiveness to shareholder proposals are the voting outcome and the influence of proponent); Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368 (2007) (using data from the 2002–2004 proxy seasons, the authors found that shareholder proposals "have an emerging role in reducing agency costs by increasing director responsiveness to shareholder concerns to open the market more fully to corporate control").

127. I acknowledge that 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 author's interviews with practitioners, many of these amendments were initiated in response to informal communication with hedge fund activists requesting certain governance changes. As the data on those informal communications are not publicly available, however, I had to count them as charter amendments without shareholder proposals.

128. 17 C.F.R. § 240.14a-8(i)(10) (2015).

In fact, recent practices by management in response to shareholder proposals raises a red flag indicating potential managerial opportunism in charter amendments. The timeline of AmerisourceBergen Corporation's charter amendment in 2014 is a vivid illustration of the dynamics of preemption.[129] As Table 6 shows, only after a shareholder submits a proposal, management comes up with a compromised proposal and tries to exclude a shareholder proposal on the ground that it "directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting" under Rule 14a-8(i)(9).[130]

Table 6. Timeline of Exclusion of the AmerisourceBergen Shareholder Proposal[131]

Date	Event (% of proposed minimum ownership threshold)
9/19/2013	A shareholder proposal was submitted (10%).
10/16/2013	Management requested from the SEC for a no-action letter to exclude the shareholder proposal.
Nov 2013	Board decided to propose a management proposal to initiate the charter provision (25%).[132]
11/8/2013	The SEC no-action letter was granted under Rule 14a-8(i)(9), and the shareholder proposal was excluded.
3/6/2014	Shareholder voted only on the management-sponsored compromised implementation (25%).

It is possible that a board could have coincidently submitted a compromised proposal the same year. Yet, as illustrated in Table 7, the fact that 22 out of all 29 compromised charter amendments (75.9%) reflected the terms in the management proposal submitted in the same year when the shareholder proposal was submitted portrays a systematic pattern. Among these 22 cases of concurrent management proposals, management excluded shareholder proposals in 19 cases (86.4%). The shareholder proposals appeared on the proxy statement only three times and were voted on along with the compromised management proposals at the same shareholder meeting.[133] Management tends to take

129. All the documents at each stage are compiled in one PDF file at the SEC website. For this specific example, the documents are available at AmerisourceBergen Corp., SEC No-Action Letter, 2013 WL 5720193 (Oct. 16, 2013).

130. 17 C.F.R. § 240.14a-8(i)(9) (2015).

131. All the documents at each stage are compiled in one PDF file at the SEC website. For this specific example, the documents are available at AmerisourceBergen Corp., SEC No-Action Letter, 2013 WL 5720193 (Oct. 16, 2013).

132. The company did not provide the exact date of the board resolution and it's not certain whether the resolution was made before or after the SEC granted no-action relief. *See* AmerisourceBergen, Proxy Statement (Def. 14a) (Jan 24, 2014) ("[T]he Board of Directors in November 2013 unanimously approved an amendment to our certificate of incorporation to provide stockholders with the right to call special meetings of stockholders as set forth in our bylaws, subject to stockholder approval at the 2014 Annual Meeting, and recommends that the stockholders vote in favor of the amendment. With this amendment, our stockholders will be empowered to act between annual meetings of stockholders.").

133. The three cases were from Home Depot in 2009, Capital One Financial Corporation ("Capital One"), and NextEra Energy, Inc. ("NextEra") in 2015. In those three cases, no-action relief was requested by management but not granted by the SEC.

advantage of the opportunity to preempt the compromised provisions.

Table 7. Management Same-Year Responses to Shareholder Proposals

Year	Number of Shareholder Proposals Excluded by Compromised Implementations	Number of Shareholder Proposals Voted on with Compromised Implementations
2009	-	1
2010	5	-
2011	4	-
2012	5	-
2013	2	-
2014	3	-
2015	-	2
Total	19	3

These preemptive proposals under Rule 14a-8(i)(9) spread out rapidly across companies, generating some controversy. In most of these cases, the SEC granted no-action letters and directors could simply preempt shareholder proposals with the terms they preferred. In fact, certain law firms advised such tactics to their clients that are corporate boards of directors. [134] The rationale behind the management's compromised implementation is to balance the benefits from empowered shareholder rights and the costs

134. Lipton et al., *supra* note 103, at 5

> 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 STEEN & HAMILTON LLP, *supra* note 120.

> 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.

from abuse of the rights.[135] While I agree on the need to balance the two, the particular way of how managements executed their preemptive proposals seemed to be opportunistic.

One milestone case has stopped the controversial managerial preemptions of compromised terms. For Whole Foods' 2015 shareholder meeting, individual activist Jim McRitchie submitted a shareholder proposal asking the company to allow shareholders that collectively own 3% of outstanding shares for more than three years to nominate directors for up to 20% of the board ("proxy access").[136] The management proposal, however, significantly compromised what shareholders proposed in four respects: (1) a higher eligibility ownership threshold (3% to 9%), (2) a longer holding period (three years to five years), (3) a stricter aggregation limit ("individual or group" to individual shareholder only), and (4) a lower cap on shareholder nominee (20% to 10%).[137] Based on this conflict, Whole Foods asked the SEC for a no-action letter.[138] The SEC initially granted the no-action relief on the grounds that the shareholder proposal conflicted with the management proposal under Rule 14a-8(i)(9).[139] Soon after, about two-dozen other companies also asked the SEC for no-action relief to exclude respective shareholder proposals on the same grounds citing the Whole Foods no-action letter.[140] A month later, SEC Chair Mary Jo White ordered SEC staff to review the exclusion rule, and the SEC's Division of Corporation Finance subsequently withdrew the relief and expressed no view on the issue during the 2015 proxy season.[141] The impetus behind this decision is telling.

On October 22, 2015, the SEC finally issued much-awaited guidance, using hypothetical examples to illustrate when shareholder proposals "directly conflict with management proposals" and thus can be excluded from the company's proxy under Rule

135. *See, e.g.*, AmerisourceBergen, Proxy Statement (Def 14a) (Jan 24, 2014) at 63 ("Our Board of Directors believes that establishing an ownership threshold of at least 25% strikes an appropriate balance between enhancing the rights of stockholders and protecting against the risk that a small minority of stockholders could trigger a special meeting (and the resulting significant financial and administrative expense of holding a special meeting). This threshold will allow special meetings to be called in special or extraordinary circumstances, while maintaining stockholders' ability to have general matters considered during our annual meetings.").

136. Whole Foods Market Inc., SEC No-Action Letter (Dec. 1, 2014), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/jamesmcritchie120114.pdf. In large companies like Whole Foods, the difference in terms between a shareholder proposal and a competing management proposal is significant enough to substantially alter the shareholders' rights.

137. *Id.*

138. *Id.*

139. *Id.*

140. Ross Kerber & Tanvi Mehta, *Update 1-U.S. SEC steps back after challenge on Whole Foods proxy access*, REUTERS, (Jan. 16, 2015), http://www.reuters.com/article/2015/01/17/whole-foods-mrkt-sec-idUSL1N0UW01120150117.

141. Whole Foods Market, Inc., SEC No-Action Letter (Jan. 16, 2015) http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/jamesmcritchiecheveddenrecon011615-14a8.pdf. *See also* Mary Jo White, Chair, SEC, Statement from Chair White Directing Staff to Review Commission Rule for Excluding Conflicting Proxy Proposals (Jan. 16, 2015), http://www.sec.gov/news/statement/statement-on-conflicting-proxy-proposals.html ("In light of Chair White's direction to the staff to review Rule 14a-8(i)(9) and report to the Commission on its review, the Division of Corporation Finance will express no views on the application of Rule 14a-8(i)(9) during the current proxy season."); Keith F. Higgins, Director, Div. of Corp. Fin., SEC, Speech at the Practising Law Institute Program on Corporate Governance: Rule 14a-8: Conflicting Proposals, Conflicting Views, Speech at Practicing Law Institute on Corporate Governance (Feb. 10, 2015) http://www.sec.gov/news/speech/rule-14a-8-conflicting-proposals-conflicting-views-.html#_edn15.

14a-8(i)(9).[142] According to the guidance, the SEC evaluates "whether a reasonable shareholder could logically vote for both proposals."[143] The guidance limits the use of the Rule 14a-8(i)(9) ground to exclude shareholder proposals, which opens the possibility for shareholders to challenge the compromised portion of the proposals. However, the guidance only clarifies the issue in cases where proposals from both shareholders and management are submitted for the same meeting.

C. The Desirability of Compromised Implementation in Charters

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 than a company that does not. Perhaps based on such rationale, 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.[144] Table 8 below shows that ISS, the most influential proxy advisory firm, recommended "for" votes when a management proposal heightened the minimum ownership threshold to trigger the right to call a special meeting, except in one sole case.[145]

Table 8. ISS Recommendations on Compromised Right to Call a Special Meeting

142. SEC Shareholder Proposals: Staff Legal Bulletin No. 14H (Oct. 22, 2015), https://www.sec.gov/interps/legal/cfslb14h.htm [hereinafter SLB 14H].

143. *Id.*

144. *2015 Proxy Series*, *supra* note 16, at 2–3 ("Presumably, ISS takes the position that some right is better than no right.").

145. The only exception was at the 2009 Home Depot Annual Shareholder Meeting. At the meeting, both a management proposal with a 25% threshold and a shareholder proposal with a 10% threshold were concurrently up for vote and ISS recommended to vote "against" the management proposal and vote "for" the shareholder proposal. The sole management proposal was passed with 67.2% "for" votes of the outstanding shares entitled to vote. *See* The Home Depot Inc., Quarterly Filing (Form 10-Q) (June 4, 2009) (citing the U.S. SEC quarterly report for The Home Depot).

Year	Number of Compromised Implementations	% of ISS Voting "For" Recommendation on Compromised Implementations
2003	0	100 %
2008	1	100 %
2009	0	75.0%
2010	9	100 %
2011	6	100 %
2012	5	100%
2013	2	100 %
2014	3	100 %
2015	3	100 %

Whether a compromised implementation is beneficial for the shareholders is an issue that requires a more rigorous systematic and empirical analysis. For those who support shareholder empowerment to minimize agency problems, directors' modification limiting shareholders' rights would constitute a problematic entrenchment. [146] Although management has become more responsive to shareholders on certain issues, directors' ex-post unilateral change in implementing the shareholder proposal, submitted in a year before, could be indicative of managerial opportunism. Furthermore, a compromise may satisfy neither party and could be harmful to the corporation as a whole.[147]

On the other hand, for those who believe a management-centric model is best suited to maximize firm value, shareholders' interventions are an unnecessary distraction. Thus, when management cannot reject a shareholder's request, a compromised provision would be the rational reaction to minimize the potentially harmful consequences of shareholder intervention.[148] Both groups are taking 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

146. *See, e.g.*, Bebchuk, *Increasing Shareholder Power*, *supra* note 5 (considering the levels of power between boards and shareholders in publicly traded companies and advocating for an increase in shareholder power); Lucian A. Bebchuk, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006); Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013).

147. 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) ("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.").

148. *See, e.g.*, Theodore N. Mirvis et al., *Bebchuk's "Case for Increasing Shareholder Power": An Opposition*, 121 HARV. L. REV. 43 (2007) (responding to Bebchuk's *The Case for Increasing Shareholder Power*); 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]ptimists might say [compromise] is positive because it shows that the market is working, and that boards 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.").

evaluated based on the issue, each firm's characteristics, and the degree of modification.

The phenomenon of compromised implementation has not been confined to charter amendments, but has also been actively adopted in bylaws. The desirability discussion, however, should be treated differently because of the fundamental difference in the amendment process of these two governing documents. While shareholders have the power to initiate bylaw amendments to challenge the compromised terms, they cannot amend charters in order to challenge terms unless either management or the SEC allows them to do so. If a management submits a no-action request to the SEC and the Commission grants the company no-action relief in excluding a shareholder proposal from the ballot, the shareholder proposal cannot be voted on. It limits shareholders' capability to challenge the compromised charter provision. In that sense, a compromised implementation is a potentially more severe impediment against shareholders. Accordingly, the desirability of a compromised charter amendment should be evaluated under a stricter lens.

V. Policy Implications for Compromised Implementations

The foregoing analysis of the recent trend in corporate charter amendments helps us gain a fuller understanding of how shareholder activism alters the corporate governance landscape. Notwithstanding the general rise of shareholder control over corporate charters and other governance arrangements, at least with respect to certain issues, conventional concerns about managerial opportunism are still valid. As I have shown in the Article, while it is true that most of the recent charter amendments tend to grant more power to shareholders, management has been able to retain substantial control over corporate charters and governance arrangements by implementing compromised versions of shareholders' demands.

A. Why do Compromised Implementations Deserve More Attention?

Compromised implementations, with higher ownership thresholds or highly stringent procedural requirements, have become increasingly prevalent. In such cases, while corporations are facially responding to the demands of shareholders, directors are able to alter the rights given to shareholders through creative modifications. In some cases, it is even doubtful whether shareholders are getting an additional right at all. While it is true that directors are responsive to the market and shareholder pressure, they nonetheless have myriad ways to exercise and retain 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.

Given shareholders' increased bargaining power, a better approach may rest on the disclosure and analysis of 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 written consent, the proxy advisory firms' "for" recommendations did not change. Relying on the SEC's rule and the no-action letters, institutional investors largely followed the proxy advisory firms' recommendations approving the modified management proposals. Consequently, the practice has allowed management to retain more control over the charter amendment process.

It is difficult to determine whether managements' modifications are in fact detrimental to shareholder value as it also depends on other factors including various firm-specific characteristics. In either case, this Article argues that it is important to acknowledge management's new responses, rather than letting them fly 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 limitations through a bylaw provision. Moreover, approval of a subsequent charter amendment 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.[149]

The so-called "careful preparation," referred to by the legal counsel, can be quite innovative and sometimes obfuscated from the view of shareholders and other market participants. In response to management's innovation in constraining shareholder rights, proxy advisory firms and institutional investors are in the best position to conduct more careful and sophisticated analysis and provide an informed voting guidance. More importantly, however, the current legal regime needs to secure the procedural right to question the compromised implementations.

B. Shareholders' Chance to Challenge Compromised Implementations

After the SEC's new guidance in 2015, managements rarely ask for no-action letters invoking Rule 14a-8(i)(9).[150] Now, the issue lies with whether and how to open a platform for shareholders to reconsider the compromised terms. As I have alluded to earlier, the optimal amount of rights that the shareholders should retain is not entirely clear. Depending on factors, such as ownership structure and market environment, the optimal allocation of power between shareholders and managements may also be subject to change over time.[151] Accordingly, the better legal solution is not to let management find the optimal level, but to retain open communication between shareholders and management through proposals and voting. Following suit, the next question is how to minimize potential legal impediments and facilitate shareholder engagement. For that purpose, I first argue that the SEC should interpret the "substantially implemented" element under Rule 14a-8(i)(10) restrictively, so that this Rule does not become a new venue that harbors the managerial preemption. Second, in case shareholders vote on competing, but not conflicting, proposals from both shareholders and managements, I suggest state law provide a legal ground to reflect shareholder voices in charter amendments more effectively, without distortion.

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149. CLEARY GOTTLIEB STEEN & HAMILTON, *supra* note 120, at 1, 3.

150. *See supra* Part III.B. *2016 Proxy Season*, *supra* note 108, at 5 ("2016 was the first year since 2008 that no companies submitted no-action requests to the SEC on the basis of Rule 14a-8(i)(9) with respect to special meeting shareholder proposals.").

151. Bebchuk, *Increasing Shareholder Power*, *supra* note 5, at 869 ("[w]ith respect to many issues in corporate law, deciding which arrangement is optimal is highly contestable."). *Id.* at 865 ("the optimal set of corporate governance arrangements is likely to change over time as new problems arise . . .").

1. The SEC's Restrictive Application of Rule 14a-8(i)(10)

Whenever a management wants to exclude a shareholder proposal from its proxy materials, the company must file its reasons with the SEC.[152] Often times, companies request no-action relief from the SEC, and the SEC's staff determines if 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 enforcement actions against the requestor—are meant to be non-formal statements by the Commission.[153] However, they often have had a stronger, sometimes even virtually binding effect, in practice. A single no-action letter can create a ripple effect and cause a substantial transformation in the corporate governance landscape.[154]

More comprehensive ground for exclusion is whether compromised and preemptive implementation can be regarded as "substantially implemented" under Rule 14a-8(i)(10).[155] The area where the SEC's no-action relief most actively evaluates such implementation is on proxy access proposals. In 2012, the SEC declined to grant a no-action letter to KSW, Inc., on the reasoning that the increase of ownership threshold to 5% by KSW management from the 2% proposed by shareholders cannot be viewed as substantial implementation of the shareholder's proposal.[156] Since then, and until very recently, companies could receive no-action relief as long as they impose a 3% ownership

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152. 17 C.F.R. § 240.14a-8(j)(1) (2011).

153. *Informal Procedures Regarding Shareholder Proposals*, SEC (Nov. 2, 2011), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8-informal-procedures.htm ("[i]t 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 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.").

154. 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, *Outsized Power and Influence: The Role of Proxy Advisers*, (Wash. Legal Found. Critical Legal Issues Working Paper Series, No. 187, (Aug. 2014)), http://www.wlf.org/upload/legalstudies/workingpaper/GallagherWP8-14.pdf. ("SLB 20 cautions against misguided 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").

155. SLB 14H will increase the use of 14a-8(i)(10) in requesting no-action letters. *New Staff Legal Bulletin and Proxy Voting Guidelines Released Ahead of the 2016 Proxy Season*, MORRISON FOERSTER LLP (Dec. 11, 2015), https://media2.mofo.com/documents/151204proxyseason.pdf ("SLB 14H could impose "a higher burden for some companies seeking 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) if they seek to exclude a shareholder proposal that is very similar to a management proposal of action").

156. KSW Inc., SEC No-Action Letter (Mar. 7, 2012), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/furlongfundnew030712-14a8.pdf ("[g]iven the differences between KSW's bylaw and the [shareholder] proposal, including the difference in ownership levels required for eligibility to include a shareholder nomination for director in KSW's proxy materials, we are unable to concur that the bylaw adopted by KSW substantially implements the proposal."). This no-action letter dealt with a bylaw amendment, but the same discussion can apply to examine whether a new charter provision substantially implemented a shareholder proposal.

threshold and a three-year holding period.[157] On July 21, 2016, however, the SEC changed its course and declined to grant no-action relief even when 3% ownership and 3 year holding period were satisfied, particularly when other differences were present.[158] It is encouraging that the SEC has acknowledged the importance of giving shareholders the opportunity to challenge preemptive implementations by management.[159]

Outside the context of proxy access of shareholder proposals, however, the SEC has usually not rejected no-action reliefs to companies wishing to exclude shareholder proposals against a compromised preemption by management. The practice may impair shareholders' bargaining power in the charter amendment process because it acts as an advanced blockade that prevents shareholders from further discussing the compromised implementation. Given the prevalence of compromised and preemptive implementations, the SEC should not allow either party to preempt the other's proposal and should expand the stance it has adopted with respect to proxy access to other contexts.

I argue that the SEC should restrictively apply Rule 14a-8(i)(10). Specifically, the SEC should allow shareholders to challenge the compromised charter amendment preempted under Rule 14a-8(i)(9) before 2015. In those cases, the way managements preempted the terms was particularly invasive towards shareholders. Shareholder voting will show what they think of the proposal, which challenges the management-sponsored compromised implementation. Shareholder voting on a shareholder proposal at a shareholder meeting is the most traditional method of shareholder activism and engagement. As the first step to achieve the optimal allocation of power in each company, shareholder voice needs to be heard through a shareholder proposal. Once a shareholder proposal is up for vote, even identical shareholder proposals may encounter different voting outcomes. The effect of such change is normatively desirable because it would encourage deviation from the current trend of "one-size-fits-all" corporate governance.

2. *State "Opt-in" Default Law to Resolve Issues with Competing Proposals*

Since managements are not able to exclude a competing shareholder proposal under Rule 14a-8(i)(9) any more, the phenomenon of shareholder voting on two competing proposals submitted respectively by management and shareholders has emerged. Shareholders' voting on the competing proposals leads to four possible combinations of voting outcomes as described below in Table 9.

Table 9. Matrix of Voting Outcomes of Competing Proposals

	Compromised Management Proposal	
	Not-Approved	Approved

157. SIMPSON THATCHER, *SEC Staff Issues No-Action Reponses*, SIMPSON, THACHER, & BARTLETT (Mar. 1, 2016) http://www.stblaw.com/docs/default-source/memos/firmmemo_03_01_16.pdf .

158. H&R Block, SEC No-Action Letter, 2016 WL2642253 (July 21, 2016) (stating that "[w]e [The SEC Staffs] are unable to conclude that H&R Block has met its burden of establishing that it may exclude the proposal under 14a-8(i)(10).").

159. The necessity of shareholders' right to revise company's implementation is well elaborated in the letter from James McRitchie on behalf of the proponent of proxy access proposal, John Chevedden to the SEC Staff. *See Id.*

Shareholder Proposal	Not-Approved	No Charter Amendment	Charter Amendment as Management Proposed
	Approved	No Charter Amendment Q 1. What if the majority of outstanding stocks entitled to vote approve the shareholder proposal?	Charter Amendment as Management Proposed Q 2. What if the higher % of outstanding stocks entitled to vote approve the shareholder proposal?

Under the current legal regime, corporate charters will be amended whenever shareholders approve managements' proposal regardless of whether a shareholder's competing proposal is approved. Thus, in the case where a competing shareholder proposal is defeated, the result reflects shareholders' preferences and seems sensible.[160]

On the other hand, in the case where a competing shareholder proposal receives more than a majority of "outstanding stock entitled to vote" demands careful analysis. It is crucial to point out the difference in required votes for approval. In order to approve a management proposal, state law requires support from a majority of "outstanding stock entitled to vote."[161] In comparison, a shareholder proposal approved only by a majority of votes "cast" is regarded as passed. Thus, in cases where a competing shareholder proposal receives more votes than a compromised management proposal, and the number of votes is high enough to satisfy the requirement for charter amendments set in state corporate law and in the company's charters as indicated by Q1 and Q2 in Table 9 above, it is clear that the shareholders strongly prefer the terms in the shareholder proposal. Even in these cases, however, under current legal regime, the resulting charter amendment will not reflect the terms of a shareholder proposal.[162] The most feasible option for shareholders might be to resubmit a proposal in the following year, which may incur significant costs and the same voting outcomes may repeat.

This denial of shareholders' representation in charter amendments is not normatively desirable. After all, in both cases, management already initiated a charter amendment on the issue, and a competing shareholder proposal varies not in subject matter but in shareholder favoring terms. In order to reflect shareholders' voices in corporate charters and to reduce the unnecessary costs associated with a successful shareholder proposal's

160. In 2015, NextEra Energy and Capital One Financial Corporation had these competing proposals voted on. In both cases, only management proposals are approved and the companies' corporate charters were amended accordingly.

161. *E.g.*, DEL. CODE ANN. tit. 8, § 242(b)(1) (2017).

162. NextEra Energy and Capital One Financial Corporation showed different views on how they amend their charters when both management proposal and shareholder proposal are approved. *See* NextEra Energy, Inc., Proxy Statement (Def. 14a) (Mar. 31, 2015) ("the Company intends to implement Proposal (management proposal) if Proposal 8 is approved and if Proposal 10 (shareholder proposal) is properly presented at the shareholder meeting and also approved."); Capital One Fin. Corp., Proxy Statement (Def. 14a) (Mar. 17, 2015) ("Although the Stockholder Proposal is not binding, as a matter of good corporate governance, if the Stockholder Proposal is approved, the Board expects to consider and to direct the Company to engage with stockholders regarding the Stockholder Proposal, regardless of whether the Proposed Certificate Amendment (management proposal) is approved by the stockholders.").

failure to amend charters, I suggest the adoption of a state "opt-in" default law provision imposing the obligation on management to implement a competing shareholder proposal in two exceptional cases. First, when a management proposal is not approved, a competing shareholder proposal that received enough votes to constitute charter amendment requirement under state law and charters becomes binding. Second, if both competing proposals are approved, the competing shareholder proposal that received higher votes than the management proposal becomes binding.[163]

The reform would considerably reduce the distortion in voting on competing proposals. Simultaneously, by taking the form of "opt-in" default, the new state law provision would not thwart the fundamental mechanism designed in the charter amendment process. As an "opt-in" default, the new state law provision applies only to the companies that adopted the provision to their charter in advance. It suggests that these companies' shareholders are vocal enough to adopt this provision and it is more likely for them to face an exceptional win of a competing shareholder proposal. Additionally, companies that would benefit the most by the provision have the capacity to adopt the new law, which consequently also lessens the concern for the reform.

VI. Conclusion

How shareholder activism has affected corporate governance is one of the most pressing current corporate law and governance issues. This Article sheds light on the issue through the lens of corporate charters and charter amendments. It argues that the recent rise of shareholder engagement, spurred by the SEC's new rule on mutual funds' fiduciary duty in proxy voting, has activated charters by restoring shareholders' power to check self-serving charter amendments by management. Although shareholders have gained more control over the amendment process than ever before, concerns remain.

Since current state corporate law endows boards with the exclusive right to initiate the amendment process, management has often been able to undermine shareholder control and make substantial alterations to shareholders' proposals for charter amendment. Accordingly, given that 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 rights, these compromised implementations deserve closer examination by the SEC and proxy advisory firms.

This Article not only updates our theoretical understanding of corporate charters by reflecting the new dynamic caused by shareholder engagement, but also normatively claims that the SEC should allow shareholders to challenge managements' preemptively compromised implementation in order to secure a more transparent bargaining dynamic between shareholders and managers.

163. The proper location of this new state law provision would be the place equivalent to DGCL Section 242(b).