

THE CASE AGAINST MANDATORY ANNUAL DIRECTOR ELECTIONS AND SHAREHOLDERS' MEETINGS

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Abstract

The article examines the mandatory requirement under state corporate law and stock exchange listing standards that public corporations hold annual shareholders' meetings for the election of directors. Specifically, I question the value of requiring corporations to (1) elect directors *annually*, and (2) hold shareholders' meetings *annually*. I critique the various justifications for these requirements and find none of them persuasive. I then explore a different approach taken by Minnesota with respect to the frequency of director elections and shareholders' meetings and conclude that the approach is superior to the current scheme. Recognizing, however, that any less strict state approach is overridden by exchange listing standards requiring annual elections and meetings, I propose that these listing standards be abolished. This would give effect to the Minnesota approach, but more importantly, it would allow state "laboratories" to experiment with alternative rules with respect to the frequency of elections and meetings. Consequently, it would add another variable for consideration in connection with the various proposed corporate governance reforms (e.g., shareholder proxy access, proxy contest reimbursement, majority voting) under debate, some of which may impact the propriety of annual director elections and shareholders' meetings.

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I. INTRODUCTION

In 1999, the United Brotherhood of Carpenters Pension Fund submitted a shareholder proposal to the J.C. Penney Company requesting that the company's board of directors take the necessary steps to provide for the election of directors once every three years instead of J.C. Penney's existing practice of annual director elections.¹ The fund reasoned that triennial director elections would better allow the board and senior management to focus on the long-term which would "best serve the interests of [J.C. Penney's] shareholders and other important constituents."² The fund's proposal seems like a sensible suggestion for addressing concerns that various market factors cause management to focus on short-term wealth maximization to the detriment of the corporation's long-term success.³ However, the proposal was never put to a vote of the shareholders or otherwise acted upon. The fund withdrew it in the face of a legal opinion from J.C. Penney counsel asserting that the proposal could not be validly implemented under Delaware law (J.C. Penney's state of incorporation) and a letter from the New York Stock Exchange (NYSE) (the exchange on which J.C. Penney's shares are listed) stating that triennial elections would violate NYSE listing standards.⁴ Delaware, like most states, requires shareholders to elect directors annually. Similarly, the listing standards of the NYSE, as well as those of Nasdaq and the American Stock Exchange (AMEX), require that listed corporations hold annual shareholders' meetings for the election of directors.⁵

Obviously, triennial elections do not meet these requirements, and hence the merits of the fund's proposal were never reached nor do I reach them in this article. Instead, I examine the mandatory requirement under state corporate law and stock exchange listing standards that public

¹ See J.C. Penney Co., SEC No-Action Letter, 2000 WL 348374 at *1.

² *Id.* at *4.

³ See, e.g., Thomas L. Hazen, *The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law*, 70 N.C. L. Rev. 137, 179 (1991) (noting that "[a]lthough not all observers agree, many have suggested that corporate managers' obsession with short-term shareholder wealth maximization has, in many cases, diverted their attention away from the efficient operation of their companies."); Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 210 (1991) (asserting that "[t]he focus on the short term has come at the expense of the long-term planning, investment and business development of the corporation.").

⁴ See J.C. Penney Co., SEC No-Action Letter, 2000 WL 348374 at *5 & *9.

⁵ See NYSE Listed Co. Manual § 302.00; NASD Manual § 4350(e); Amex Company Guide, § 704.

corporations hold annual shareholders' meetings for the election of directors. Specifically, I question the value of requiring corporations to (1) elect directors *annually*, and (2) hold shareholders' meetings *annually*. Although the origin of annual shareholders' meetings for the election of directors can be traced back to the twelfth century,⁶ surprisingly little has been written on these issues. Indeed, the 1996 Delaware Chancery Court opinion in *Hoschett v. TSI International Software, Ltd.*⁷ is the only U.S. authority directly on point. *Hoschett* maintains that the purpose of requiring annual director elections is to provide a check on management and an opportunity for the exercise of corporate democracy.⁸ *Hoschett* posits that the purpose of requiring annual shareholders' meetings is to provide an opportunity for deliberation and an occasion for shareholders "to bring matters before the shareholder body."⁹ Others have suggested that an additional purpose for requiring annual meetings is to give shareholders a chance to confront management.

While in the aggregate these justifications may support the concept of shareholders electing directors through the mechanism of a meeting, I argue that they do not support requiring director elections or shareholders' meetings annually. In fact, two states have done away with the annual requirement. Annual director elections and shareholders' meetings are now optional under Minnesota and North Dakota corporate law. For exchange listed corporations, however, relaxed state rules on these points are essentially irrelevant. Even if an exchange listed corporation were incorporated in Minnesota or North Dakota, it would still have to hold annual shareholders' meetings for the election of directors as required by exchange listing standards. Hence, I propose that these listing standards be abolished. This would give effect to the approaches taken by Minnesota and North Dakota, but, more importantly, it would allow state "laboratories" to experiment with alternative rules with respect to the frequency of elections and meetings. Consequently, it would add another variable for consideration in connection with the various proposed corporate governance reforms (e.g., shareholder proxy access, proxy contest reimbursement, majority voting) under debate, some of which may impact the propriety of annual elections and meetings.

⁶ See Cyril O'Donnell, *Origins of the Corporate Executive*, 26 BULL. OF THE BUS. HIST. SOC'Y 55, 57 (1952).

⁷ 683 A.2d 43 (Del. Ch. 1996).

⁸ See *id.* at 45-46.

⁹ See *id.*

The article proceeds as follows. Part II provides background on state law, exchange listing standards, and federal regulations relevant to annual director elections and shareholders' meetings of public corporations. Part III critiques the various justifications for requiring director elections and shareholders' meetings annually and finds none of them persuasive. Part IV explores Minnesota's approach, weighs its benefits and costs, and concludes that the approach is superior to the current scheme. Hence, Part V proposes abolishing the exchanges' annual director elections and shareholders' meeting requirements in order to fully expose the issue to corporate federalism. Part VI states a brief conclusion.

II. BACKGROUND

State law generally requires corporations to hold annual shareholders' meetings, the principal purpose of which is to elect directors.¹⁰ Likewise, exchange listing standards require listed corporations to hold annual shareholders' meetings for the election of directors. Finally, federal proxy rules dictate procedures for the solicitation of proxies, a critical component of director elections, and prescribe the form and content of the solicitation package. Hence, annual director elections and shareholders' meetings implicate three separate sets of regulations, each of which is described briefly below.

A. State Law

The corporate law of all but two states requires corporations to hold annual shareholders' meetings for the election of directors.¹¹ Typically, under a corporation's bylaws, details of the meeting such as location, date, record date, time, and agenda, are left to the board to determine.¹² Any proper business, in addition to the election of directors, may be transacted at an annual meeting.¹³ This commonly includes auditor ratification and

¹⁰ See 2 MODEL BUSINESS CORPORATION ACT ANNOTATED § 7.01 official cmt. (3d ed. 2000) [hereinafter MBCA ANN.].

¹¹ See, e.g., *id.* §§ 7.01(a) (“[a] corporation shall hold annually at a time stated in or fixed in accordance with the bylaws a meeting of shareholders.”) and 8.01(c) (“Directors are elected at the first annual shareholders’ meeting and at each meeting thereafter . . .”); DEL. CODE ANN. tit. 8, § 211(b) (2001) (“[A]n annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws.”).

¹² See 2 MBCA ANN., *supra* note --, §§ 7.01 & 7.07; DEL. CODE ANN. tit. 8, §§ __. See also See D. Craig Nordlund, *Planning and Conducting the Annual Shareholders’ Meeting*, in PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 2005 971, 991 (2005).

¹³ See DEL. CODE ANN. tit. 8, § 211(b).

approval of stock option plans. The corporation is required to provide written notice of the meeting to each shareholder entitled to vote as of the record date.¹⁴ Generally, each share of common stock is entitled to one vote.¹⁵

For a shareholder vote at an annual meeting to be valid, a quorum must be present at the meeting, either in person or by proxy.¹⁶ A proxy is a person appointed by shareholders to vote their shares at the meeting on their behalf and in accordance with their instructions.¹⁷ Generally, a majority of shares entitled to vote constitutes a quorum.¹⁸ Most public corporations elect directors through straight as opposed to cumulative voting and a plurality as opposed to a majority voting standard.¹⁹ Under straight voting, each shareholder casts the number of shares he or she owns for a nominee for each board seat up for election. Under a plurality standard, the nominees that receive the largest number of votes win, up to the number of board seats up for election, regardless of whether any of them receive a majority of votes cast.²⁰ For example, if there were seven board seats up for election and ten nominees running, the top seven vote getters would be elected.

B. Exchange Listing Standards

To list securities with the NYSE, Nasdaq, or AMEX, a corporation must comply with the applicable listing standards established by the exchange.²¹ These standards are imposed on a corporation pursuant to a

¹⁴ See *id.* § 222. See also *Bryan v. Western Pac. R.R. Corp.*, 35 A.2d 909, 913 (Del. Ch. 1944).

¹⁵ See 2 MBCA ANN., *supra* note --, § 7.21(a); DEL. CODE ANN. tit. 8, § 212(a). A corporation can vary the voting rights of common shares in its articles or certificate of incorporation.

¹⁶ See 2 MBCA ANN., *supra* note --, § ; DEL. CODE ANN. tit. 8, § 216.

¹⁷ See 2 MBCA ANN., *supra* note --, § 7.22(a); DEL. CODE ANN. tit. 8, § 212(b).

¹⁸ See *id.*

¹⁹ See 2 MBCA ANN., § 7.28(a) (“Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present.”); DEL. CODE ANN. tit. 8, § 216(3) (“Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors”).

²⁰ See 2 MODEL BUSINESS CORPORATION ACT ANNOTATED § 7.28(a); DEL. CODE ANN. tit. 8, § 216(3). See also 2 MBCA ANN., *supra* note --, § 7.28 at 7-186 through 7-187 (Official Comment) (“A ‘plurality’ means that the individuals with the largest number of votes are elected as directors up to the maximum number of directors to be chosen at the election.”).

²¹ See Special Study Group of the Committee on Federal Regulation of Securities, American Bar Association, Section of Business Law, *Special Study on Market Structure*,

contract between it and the exchange and therefore are not technically a part of federal or state law.²² However, the Securities Exchange Act of 1934 (Exchange Act) does require that any listing standard rules be approved by the SEC,²³ and the SEC can also abrogate, add to or delete from any such rules.²⁴ Additionally, the SEC has from time to time encouraged exchanges to voluntarily adopt certain corporate governance listing standards.²⁵

Given that most U.S. public companies list on one of these exchanges, listing standards have an important and substantial impact on public corporations.²⁶ These standards are designed to increase investor confidence in listed companies and the exchanges and have been vaunted as “a bastion of shareholder protection.”²⁷

Listing standards are comprised of both quantitative and corporate governance standards. Quantitative standards focus on financial criteria such as public float, market capitalization, revenues, cash flow and earnings.²⁸ Among the corporate governance standards of each exchange is the requirement that listed corporations hold annual shareholders’ meetings for the election of directors.²⁹ Other corporate governance listing standards include specific requirements with respect to independent directors, audit

Listing Standards and Corporate Governance, 57 BUS. LAW. 1487, 1489-90 (2002) [hereinafter *ABA Study*].

²² See *id.* at 1503. The Securities Exchange Act of 1934 does require that any listing standard rules be approved by the SEC. See 15 U.S.C. § 78(s)(b). And the SEC can also abrogate, add to or delete from any such rules. See *id.* § 78(s)(c). Additionally, the SEC has from time to time encouraged exchanges to voluntarily adopt certain corporate governance listing standards. This has been referred to as “regulation by raised eyebrow.” See *ABA Study*, *supra* note --, at 1503.

²³ See 15 U.S.C. § 78(s)(b)

²⁴ See *id.* § 78(s)(c).

²⁵ This has been referred to as “regulation by raised eyebrow.” See *ABA Study*, *supra* note --, at 1503.

²⁶ See Roberta S. Karmel, *The Future of Corporate Governance Listing Requirements*, 54 SMU L. REV. 325, 325 (2001).

²⁷ Douglas C. Michael, *Untenable Status of Corporate Governance Listing Standards Under the Securities Exchange Act*, 47 BUS. LAW. 1461, 1477 (1992). See also *ABA Study*, *supra* note --, at 1496-97.

²⁸ See NYSE Listed Company Manual § 102.01.

²⁹ Note that only the AMEX annual meeting listing standard specifically requires directors to be elected at the meeting. The analogous NYSE and Nasdaq standards simply require corporations to hold annual meetings but do not specify that directors are to be elected at the meetings. The NYSE has stated on several occasions, however, that its annual meeting requirement “is not simply a device to provide information to shareholders” but mandates the annual election of directors. See SEC No-Action Letter, 2000 WL 14160 at *4. See also SEC No-Action Letter, 2000 WL 348374 at *5. Presumably, Nasdaq would take a similar position.

and nominating committees, and shareholder voting.³⁰ Additionally, the NYSE and Nasdaq listing standards require listed corporations to solicit proxies for all shareholders' meetings.³¹

C. Federal Proxy Rules

As noted above, generally a majority of a corporation's shares must be present in person or by proxy to satisfy the state law quorum requirement for a valid shareholders' meeting. For most shareholders physical attendance at a shareholders' meeting is an inefficient use of time—either the site is geographically inconvenient, the shareholder's investment in the corporation represents a small percentage of a diversified portfolio, or both.³² Hence, quorum requirements necessitate (and the NYSE and Nasdaq require) that public corporations solicit shareholder proxies for their annual meetings.³³ As a result, the overwhelming majority of shareholders vote by proxy pursuant to the proxy materials furnished to them by the corporation, and hence, these proxy materials are of central importance to shareholder voting.³⁴

Appreciating this importance, Congress empowered the SEC through Section 14(a) of the Exchange Act to regulate the solicitation of proxies by public corporations.³⁵ The purpose of Section 14(a) "is to prevent

³⁰ See NYSE Listed Company Manual § 301.00.

³¹ See *id.* § 402.04; Amex Company Guide § 7.05; NASD Manual § 4350(g).

³² See MELVIN A. EISENBERG, *THE STRUCTURE OF THE CORPORATION* 98 (1976). See also ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 86 (The Macmillan Company 1940) (1932). As for who actually attends meetings:

Analysts and the business press attend only out of a sense of duty; sophisticated shareholders don't go at all. The audience is likely to be company employees and retirees looking to fill an otherwise quiet afternoon. At some annual meetings, the audience is made up almost exclusively of corporate executives, lawyers, p.r. people, auditors and the like. In effect, the stagehands have become the audience.

Philip R. Lochner & Richard H. Koppes, *Stop Us Before We Meet Again*, WALL ST. J., Mar. 18, 1994, at A10.

³³ See Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485, 507 (1994).

³⁴ See LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* § 6-C-1 (2004).

³⁵ Section 14(a) provides:

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules

management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation.³⁶ Thus, rules promulgated by the SEC require a public corporation to furnish its shareholders a detailed disclosure document called a proxy statement whenever it solicits proxies.³⁷ The proxy statement is designed to provide shareholders with relevant information with respect to the matters up for vote for which proxies are solicited.³⁸ Therefore, a proxy statement relating to the election of directors must include biographical information about the nominees, when they first became directors, their stock and option holdings in the corporation, and, with respect to incumbent directors, whether they failed to attend at least 75 percent of board and applicable committee meetings.³⁹ The proxy statement must also include detailed information about director compensation and transactions between any directors and the corporation during the past year.⁴⁰

SEC proxy regulations also specify requirements for the proxy card, the legal document pursuant to which a shareholder appoints the proxy to vote shares on the shareholder's behalf.⁴¹ The card resembles an absentee ballot in that it lists the nominees for election to the board and includes check-off boxes for granting authority to the proxy to vote the shareholder's shares in favor of each candidate. Consequently, voting by proxy entails little more than checking boxes on the card, signing it and dropping it in the mail. Among other things, SEC regulations require that the card set forth the name of the proxy and on whose behalf proxy appointments are solicited.⁴² SEC regulations also prohibit a proxy card from conferring authority to vote for a nominee not listed in the proxy statement or to vote at more than one annual meeting.⁴³

and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security [issued by a public corporation].

15 U.S.C. § 78n(a).

³⁶ J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964).

³⁷ See 17 C.F.R. § 240.14a-3(a).

³⁸ See ROBERT C. CLARK, CORPORATE LAW 366 (1986).

³⁹ See Schedule 14A, 17 C.F.R. § 240.14a-101 (2005).

⁴⁰ See *id.*, Items 7 & 8; see also 1 HAROLD S. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 17:6 at 969 (2005).

⁴¹ See 17 C.F.R. § 240.14a-4.

⁴² See *id.* § 240.14a-4(a)(1).

⁴³ *Id.* § 240.14a-4(d).

Additionally, if a proxy solicitation for the election of directors at an annual meeting is made by the corporation's management, the solicitation materials must be accompanied or preceded by an annual report to security holders.⁴⁴ As required by SEC regulations, the annual report provides detailed information about the corporation's performance, including audited year-end financial statements. Hence, it furnishes shareholders with a means to evaluate the corporation's performance under the stewardship of the incumbent board.

In a different vein, federal proxy rules require a public corporation to include in its proxy materials shareholder proposals meeting certain qualifications discussed below.⁴⁵ Common examples include proposals to repeal staggered boards, eliminate supermajority voting provisions, and rescind poison pills.⁴⁶ Shareholder proposals also frequently address social issues such as the inhumane treatment of animals.⁴⁷

A corporation is only required to include those proposals that meet various procedural and substantive requirements specified in Rule 14a-8. To be eligible to submit a proposal, the proponent must have continually held at least \$2,000 or 1% of the corporation's stock during the preceding year.⁴⁸ The length of the proposal is limited to 500 words and for annual meetings generally must be submitted at least four months prior to the anniversary of the mailing date of the previous year's proxy materials.⁴⁹

The rule provides thirteen substantive grounds under which a corporation may exclude a proposal from its proxy materials.⁵⁰ For example, a corporation can exclude a proposal that is not a proper subject for action by shareholders under state corporate law, relates to ordinary business operations, relates to the election of directors, or has already been substantially implemented by the corporation.⁵¹ If a corporation intends to exclude a proposal, it must file a no-action letter request with the SEC explaining why the corporation believes the proposal is excludable.⁵² The SEC will either grant or deny the request, and the corporation will generally

⁴⁴ See *id.* § 240.14a-3(b).

⁴⁵ See Shareholder Proposals, 17 C.F.R. § 240.14a-8.

⁴⁶ See MARK A. SARGENT & DENNIS R. HONABOCH, PROXY RULES HANDBOOK § 5:2 (2005).

⁴⁷ See I BLOOMENTHAL, *supra* note --, § 18:1 at 398.

⁴⁸ See 17 C.F.R. § 240.14a-8(b)(1).

⁴⁹ See *id.* § 240.14a-8(d) & (e)(1).

⁵⁰ See *id.* § 240.14a-8(i).

⁵¹ See *id.* § 240.14a-8(i)(1), (7), (8 & (10)).

⁵² See 17 C.F.R. § 240.14a-8(j).

include or exclude the proposal in conformance with the SEC's decision.⁵³ Infrequently, a proponent of a proposal that the corporation and the SEC deem excludable will thereafter seek a court order compelling the corporation to include the proposal.⁵⁴

III. JUSTIFICATIONS

As a result of state corporate laws and exchange listing standards, public corporations are required to elect directors and hold shareholders' meetings annually. As mentioned above, the 1996 Delaware Chancery Court opinion in *Hoschett v. TSI International Software, Ltd.*⁵⁵ sets forth various justifications for these requirements. This part briefly describes the facts of *Hoschett* and then explores the justifications. It also discusses an additional justification for the annual meeting requirement not mentioned in *Hoschett*. Finally, finding none of the justifications persuasive, it briefly explores why the annual director elections and shareholders' meeting requirements emerged.

A. *The Facts of Hoschett v. TSI International Software, Ltd.*

Hoschett involved a suit against TSI International Software, Ltd., a privately-held Delaware corporation, brought by Fred Hoschett, a TSI shareholder. The suit sought an order compelling TSI to hold an annual meeting for the election of directors as required by Delaware General Corporation Law (Delaware Code) Section 211.⁵⁶ TSI had never held an annual meeting for the election of directors during its several years of existence.⁵⁷ As a result, Hoschett moved for summary judgment under Delaware Code Section 211(c) which provides that the Court of Chancery may summarily order a meeting upon application of any shareholder if one has not been held for a period of 13 months.⁵⁸ TSI responded with its own motion for summary judgment asserting it had fulfilled Section 211's annual meeting requirement by electing directors through shareholder written consent in lieu of a meeting in accordance with Delaware Code Section 228(a).⁵⁹

⁵³ See 1 BLOOMENTHAL, *supra* note --, § 18:7 at 995.

⁵⁴ See *id.* See also Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 881 (1994).

⁵⁵ 683 A.2d 43 (Del. Ch. 1996).

⁵⁶ See *id.* at 43.

⁵⁷ See *id.* at 44.

⁵⁸ DEL. CODE ANN. tit. 8, § 211(c).

⁵⁹ See *Hoschett*, 683 A.2d at 44. Delaware Code Section 228(a) provides as follows:

Thus, the court had to reconcile the mandatory annual meeting language of Delaware Code Section 211(b) with Section 228(a) which allows any required shareholder action to be taken without a meeting through shareholder written consent. Noting that the annual meeting requirement is one of the few mandatory provisions of Delaware corporate law and that “Delaware courts have long recognized the central role of annual meetings in the scheme of corporate governance,”⁶⁰ the court concluded that the annual meeting requirement in Section 211(b) trumped Section 228(a) and thus could not be fulfilled by shareholder written consent.⁶¹ In reaching its conclusion, the court addressed both why corporations are required to elect directors annually and why corporations are required to hold shareholders’ meetings annually.

B. Annual Director Election Requirement

1. Check on Management

Providing a check on management is perhaps the most obvious justification for mandatory annual director elections. A central theme of corporate law is addressing the agency problem inherent in the separation of ownership from control. The typical public corporation is collectively “owned” by numerous and dispersed shareholders but controlled by management.⁶² Because management generally owns only a small percentage of the corporation’s stock but has a large human capital investment in the corporation, the interests of management and shareholders

Unless otherwise provided in the certificate of incorporation, any action required by this chapter to be taken at any annual or special meeting of stockholders of a corporation, or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock 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.

DEL. CODE ANN. tit. 8, § 228(a).

⁶⁰ Hoschett, 683 A.2d at 44.

⁶¹ See *id.*

⁶² See BERLE & MEANS, *supra* note --, at 3; ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1-2 (1993). Note that “owned” is in quotes because shareholders do not own the corporation in the traditional sense of the word. Instead they own the residual claim to the corporation’s income and assets.

diverge.⁶³ As a result, management may take action in its own best interest as opposed to the best interest of the shareholders.⁶⁴ Management may, for example, allocate itself excessive compensation or other perquisites, engage in empire building, or shirk responsibility.⁶⁵

To address this agency problem, the board of directors is charged with monitoring senior executives.⁶⁶ However, the board may become dominated by, or beholden to, the executive team and therefore shirk its monitoring responsibility.⁶⁷ Thus, annual director elections, at least in theory, provide shareholders with the ability to oust an ineffective board which thereby provides a check on management. As Chancellor Allen put it in *Hoschett*, “[t]he annual election of directors is a structured occasion that necessarily focuses attention on corporate performance. Knowing that such an occasion is necessarily to be faced annually may itself have a marginally beneficial effect on managerial attention and performance.”⁶⁸ Emphasis, however, should be placed on “marginally beneficial” because *annual* director elections provide at most a minimal check on management.

The reality is that the outcome of the vast majority of director elections is a foregone conclusion. This is because the board controls the size and composition of the slate of director nominees put to the shareholders for the vote. Consequently, it sets the slate size at the number of seats up for election and, absent a death or resignation, simply re-nominates incumbent directors.⁶⁹ Management then employs the “proxy machinery” to ensure

⁶³ See Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 566 (2006); See ROMANO, *supra* note --, at 2.

⁶⁴ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, _ (1976); FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 10 (1991).

⁶⁵ See Jensen & Meckling, *supra* note --, at _; EASTERBROOK & FISCHER, *supra* note --, at 10.

⁶⁶ See ROMANO, *supra* note --, at 2.

⁶⁷ See Barry Baysinger & Robert E. Hoskisson, *The Composition of Boards of Directors and Strategic Control: Effects of Corporate Strategy*, 15 ACAD. MGMT. REV. 72, 72-73 (1990) (noting that “managers dominate their boards by using their de facto power to select and compensate directors and by exploiting personal ties with them.”).

⁶⁸ *Id.* at 44-45. See also Leo E. Strine, Jr., *Towards a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1777 (2006) (“The right to elect directors is an important tool for stockholders, allowing them to hold centralized management accountable and thereby contributing to the creation of stockholder wealth by checking agency costs.”).

⁶⁹ See Jay Cai et al., “Electing Directors” (June 2006) at 3 (noting that 1748 out of 1750 of sampled director elections had a slate size equal to the number of seats up for election). Available at SSRN: <http://ssrn.com/abstract=910548>.

their election.⁷⁰ Specifically, management uses corporate funds, personnel, and facilities to prepare, print and distribute proxy materials.⁷¹ The materials list only the incumbent board's slate as up for election and a management selected individual (typically the CEO or other senior executive) as the proxy. Additionally, the proxy statement and proxy card specifically state that the board of directors recommends that shareholders vote for each candidate.⁷²

In order to empower the management selected proxy to vote the shareholder's shares at the annual meeting, a shareholder merely needs to mark the "For All" box to the right of the list of nominees, date, sign and mail the card. There is no state law, federal law, or exchange listing standard requirement that the proxy card include an "against" box. Nor is there a requirement to allow shareholders to write-in candidates.⁷³ Thus, few corporations provide these options, and therefore it is generally not possible for a shareholder to use the corporation's proxy card to instruct the proxy to vote against a nominee or to vote for someone other than a

⁷⁰ Berle and Means described voting by proxy and the "proxy machinery" as follows:

Designed probably as a convenience to the absent shareholder, [the proxy] was a century ago denied to the shareholder save where by special provision it was inserted, but its convenience speedily led to the inclusion of this right in every charter or in the appropriate section of the incorporation act. The growth of the corporations, the dispersion of shareholders, the manifest impossibility for the vast majority of shareholders to attend meetings, have made the right to vote, in reality, a right to delegate the voting power to someone else—and the proxy is almost invariably a dummy chosen either by the management, by the "control," or by a committee seeking to assume control. The proxy machinery has thus become one of the principal instruments not by which a stockholder exercises power over management of the enterprise, but by which his power is separated from him.

BERLE & MEANS, *supra* note --, at 139.

⁷¹ See EISENBERG, *supra* note --, at 98.

⁷² For a sample proxy statement see http://www.pg.com/content/pdf/02_investor/financial_reports/proxy/pg2005_proxy_statement.pdf. For a sample proxy card see http://www.pg.com/content/pdf/02_investor/financial_reports/proxy/pg2005_proxy_ballot.pdf.

⁷³ The proxy card for Intel Corporation's 2006 annual shareholders' meeting did include an "against" box. This is because Intel has adopted a majority of votes cast standard for the election of directors, so the against box was added to allow shareholders to cast a vote against. See Intel Corporation, 2006 Proxy Statement 4 (Mar. 28, 2006). Safeway Inc.'s proxy card for its 2006 annual shareholders' meeting also included an "against" box for the same reason. See Safeway Inc., 2006 Proxy Statement 2 (Apr. 12, 2006).

nominee listed on the card. Note that SEC regulations do require the card to also contain a box the shareholder can check to withhold authority to vote for any nominees and a means by which a shareholder can grant authority to vote for some nominees and withhold authority to vote for some nominees.⁷⁴

From the corporation's perspective, it does not even matter if a shareholder fails to mark any of the boxes on the proxy card. As allowed by SEC regulations, management specifies on the card that if no boxes are marked, the card will be considered as conferring power on the proxy to vote "for" the election of each nominee.⁷⁵ Further, the board's slate will be elected (assuming a quorum) regardless of whether the shareholders grant or withhold authority. This is because, as noted above, the voting standard for the election of directors at most corporations is plurality, and under a plurality standard, the candidates that receive the largest number of votes win.⁷⁶ In an uncontested election, the only individuals who receive any votes are those listed on the corporation's proxy card and ballot. Since the number of names listed will equal the number of seats up for election, each listed person is guaranteed to be among the top (and only) vote getters and therefore guaranteed to be elected.

Even if all non-management shareholders check the "withhold authority" box on the proxy card or abstain from voting at the annual meeting, management will vote the shares it controls in favor of the slate, and the slate will still be elected, even if management votes only a single share. The "vote no" campaigns launched from time to time by activist shareholders—campaigns encouraging shareholders to check the "withhold authority" box—are merely symbolic. They are used to send a message to the board but have no impact on the outcome of an uncontested election.⁷⁷

To be sure, a disgruntled shareholder (commonly referred to as an insurgent) can nominate additional candidates or an entire alternative slate. The corporation, however, has no obligation to include the insurgent's nominees on the corporation's proxy card. An insurgent can nonetheless

⁷⁴ See 17 C.F.R. § 240.14a-4(b).

⁷⁵ *Id.* § 240.14a-4(b)(1).

⁷⁶ See *supra* note __ and accompanying text.

⁷⁷ See, e.g., Laura M. Holson, *Criticism Mounting as Disney's Leader Faces Crucial Vote*, NEW YORK TIMES, Feb. 27, 2004, at A1 (describing vote-no campaign against Disney director Michael Eisner), and Laura M. Holson, *Defied in Vote, Disney Leader Loses One Post*, NEW YORK TIMES, Mar. 4, 2004, at A1 (noting that Eisner re-elected as director notwithstanding unprecedented success of vote-no campaign). In this particular campaign, the message was heard—Eisner was stripped of his chairman position.

launch a proxy contest whereby it independently solicits proxies from the corporation's shareholder. In such an event, shareholders would receive two sets of proxy materials—one set from the corporation and one set from the insurgent, thereby giving shareholders a choice of competing slates. However, proxy contests for the election of directors outside of the takeover context are extremely rare. During the period 1996-2004, insurgents launched proxy contests to install rival slates outside of the takeover context at only 108 companies, an average of 12 a year.⁷⁸

Several reasons have been put forth for the dearth of electoral proxy contests.⁷⁹ The first is cost. A proxy contest will typically run an insurgent from \$5 million to \$10 million.⁸⁰ While the board will use the corporate coffers to fund its proxy campaign, including fending off any insurgent challenge, an insurgent must fund its campaign out of its own pocket and will be reimbursed by the corporation only if it wins.⁸¹ The tab is so high because the insurgent will not only have to prepare and mail proxy materials, but, as discussed below, will have to overcome shareholder apathy and other impediments. As a result, the insurgent will find it necessary to retain attorneys, investment bankers, public relations advisors, proxy solicitors, and financial printers.⁸² The fees of these professionals quickly add up. And an incumbent board does not sit idly by in the face of a proxy contest. It may initiate litigation against the insurgent alleging

⁷⁸ See Lucian A. Bebchuk, "The Myth of the Shareholder Franchise" (October 2005) at 10. Available at SSRN: <http://ssrn.com/abstract=829804>. Most of these 108 companies were small. Only 17 had market capitalizations at the time of the proxy fight exceeding \$200 million, and 59 had market capitalizations at the time of the time of the proxy fight of \$50 million or less. See *Id.*

⁷⁹ See generally Bebchuk, *supra* note --, at 13-22.

⁸⁰ See Oesterle & Palmiter, *supra* note --, at 511. See also WILLIAM A. KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE* 179 (2000). Note that the successful consent solicitation undertaken by the insurgent Red Zone LLC in the fall of 2005 to oust three of Six Flags, Inc.'s six directors cost Red Zone \$11.6 million. The biggest single expense was \$5 million signing bonus to get a seasoned executive to join the insurgent slate adding credibility. Other expenses included \$813,000 in legal fees; \$2.4 million in investment banking fees; \$972,000 in travel expenses incurred to meet with stockholders during the solicitation period, \$36,000 for the cost of preparing, printing and mailing proxy materials and subsequent communications to stockholders; and \$580,935 in fees and expenses for professional proxy solicitors. See Six Flags Inc. Proxy Statement for Annual Meeting of Stockholders to be held on May 25, 2006 at 29-30 [hereinafter Six Flags 2006 Proxy Statement].

⁸¹ See Stephen M. Bainbridge, *Redirecting State Takeover Laws at Proxy Contests*, 1992 WIS. L. REV. 1071, 1074 (1992).

⁸² See Oesterle & Palmiter, *supra* note --, at 511; See Bebchuk, *supra* note --, at 14-15.

federal proxy rule violations.⁸³ At the same time, the insurgent may have to initiate litigation against the corporation or inspector of elections to, for example, obtain access to corporate records or challenge the invalidation of proxy cards. Any such litigation will add to the insurgent's costs.⁸⁴

Although an insurgent's costs will likely be reimbursed by the corporation if it prevails, only 37 of the 108 electoral proxy contests launched outside of the takeover context during the period of 1996-2004 were successful. Hence, an insurgent will have to consider the benefits of victory in light of the probability of failure. Also relevant is the insurgent's ownership percentage of the target corporation. If an insurgent owns 5% of the target, it will capture only 5% of the increase in firm value resulting from the successful proxy contest notwithstanding the fact that it will have incurred and risked 100% of the cost.⁸⁵ The other 95% of value will be conferred on the firms' other shareholders even though they funded none of the cost of the proxy contest. This "free-rider" problem discourages shareholders from launching proxy contests. Many shareholders will instead holdout for the opportunity to free ride on a fellow shareholder's proxy contest.⁸⁶

Interrelated with cost are collective action difficulties inherent in public corporation shareholder voting.⁸⁷ In the face of a proxy contest, a rational shareholder will choose to become informed about an insurgent's slate only if the benefits of doing so outweigh the costs. Most shareholders will conclude that the opportunity cost of reading the insurgent's proxy statement exceeds the expected benefit of an informed vote. Therefore, they will rationally remain uninformed and thus vote for the incumbents by default.⁸⁸ Even if a shareholder concludes that the expected benefit of becoming informed outweighs the cost, he is still unlikely to act because of a free-rider problem. Realizing that his vote is not likely to be outcome

⁸³ Claims alleging proxy rule violations are considered both derivative and direct. See *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964). Hence, the incumbent board will use the corporate coffers to finance any such litigation. See Bainbridge, *supra* note --, at 1075.

⁸⁴ See *id.*

⁸⁵ This is obviously an oversimplification—it does not take into account probability of success, estimation error risk, etc. For a more detailed example, see Bebchuk, *supra* note --, at 15-16.

⁸⁶ See *id.* See also Oesterle & Palmiter, *supra* note --, at 512; KLEIN & COFFEE, *supra* note --, at 177-78.

⁸⁷ See CLARK, *supra* note --, at 390.

⁸⁸ See *id.* at 390-91. See also Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1575 (1989); Oesterle & Palmiter, *supra* note --, at 512; Bainbridge, *supra* note --, at 1089; Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 402 (1983).

determinative, he will choose not to incur the cost of becoming informed.⁸⁹ Instead he will try to free ride on the efforts of other shareholders and nonetheless capture the benefits of informed collective action. Of course, other shareholders are likely to implement the same strategy and likewise remain uninformed. In such a case, no collective action will be taken and no benefits will be captured.⁹⁰

Additionally, even if informed, many shareholders will be reluctant to vote for the insurgents. They may be suspicious of the insurgent's motives,⁹¹ uncertain as to whether the corporation will perform better under the insurgent's team, or simply subscribe to the axiom "better the devil you know than the devil you don't."⁹² Incumbents also have an important psychological advantage in that they solicit proxies under the name of "the corporation" as opposed to their own names as an insurgent will have to do.⁹³ Further, some institutional investors may be reluctant to vote against the incumbents because of business concerns. For example, a vote by an insurance company against an incumbent board will likely jeopardize any existing and future business with that corporation and will be poorly received by incumbents at other companies.⁹⁴

As a result of the above factors, most shareholders are predisposed to vote for the incumbents. The insurgents will not necessarily even get the votes of disgruntled shareholders. These shareholders are more likely to instead follow the "Wall Street Rule," i.e., sell their shares prior to the vote. Doing so eliminates the need to incur information costs or assume risk with respect to the insurgent.⁹⁵

⁸⁹ See EASTERBROOK & FISCHER, *supra* note --, at 66.

⁹⁰ See CLARK, *supra* note --, at 392-93; Robert C. Pozen, *Institutional Perspective on Shareholder Nominations of Corporate Directors*, 59 BUS. L.J. 95, 99 (2003).

⁹¹ "[A] challenge could be motivated by a desire to obtain the private benefits associated with control. A decision to mount a challenge could be due, not to a belief in superior management ability, but to the challenger's adeptness in extracting private benefits." Bebchuk, *supra* note --, at 18.

⁹² See *id.* See also KLEIN & COFFEE, *supra* note --, at 177.

⁹³ See EISENBERG, *supra* note --, at 112.

⁹⁴ See Pozen, *supra* note --, at 97; John Pound, *Proxy Contests and the Efficiency of Shareholder Oversight*, 20 J. FIN. ECON. 237 (1988); Bebchuk, *supra* note --, at 20. See also Gretchen Morgenson, *Investors vs. Pfizer: Guess Who Has the Guns?*, NEW YORK TIMES, Apr. 23, 2006, at _ .

⁹⁵ See Pozen, *supra* note --, at 96 ("The Wall Street Rule is alive and well. In most cases when institutional investors are dissatisfied with the performance of a company's directors or executives, these investors simply sell the stock. Selling the stock sends a signal to the company, yet does not impose any costs (other than trading costs) on institutional investors."). See also Bainbridge, *supra* note --, at 1079; KLEIN & COFFEE, *supra* note --, at

At a majority of public companies, an insurgent will also have to deal with a staggered board.⁹⁶ With a staggered board, a corporation divides its directors into groups, typically three, and only one group comes up for election each year.⁹⁷ Thus, if a corporation has a three group staggered board, only one-third of its board seats would come up for election each year. Therefore, to win a majority of board seats, an insurgent would have to mount and win two electoral proxy contests in three years. This obviously increases an insurgent's costs as it doubles the number of required solicitations and stretches the insurgent's campaign over more than year.⁹⁸ Additionally, even shareholders who deem the insurgent's slate superior to that of the incumbents may be reluctant to vote for the insurgent because of the required two rounds of elections. Voting in the insurgent's slate in round one would put the board in limbo for a year. The incumbents will retain control but know they are on the way out. They will also have to deal with the internal division and friction caused by having a third of the board composed of a competing faction.⁹⁹

The bottom line is that an insurgent will face an expensive uphill battle in an electoral proxy contest. It will have to spend heavily to overcome rational shareholder apathy and other impediments, but based on the data cited above, its chance of success will be approximately one in three. Given an insurgent is only reimbursed if it prevails and then has to share the spoils with all other shareholders, it is likely that many would be insurgents do nothing or sell out instead of fighting. In this light, it is not surprising

177; EASTERBROOK & FISCHER, *supra* note --, at 83. Note that the "Wall Street Rule" may not be an option for some institutional shareholders. For example, the investment policies of index funds typically limit the funds' discretion to sell. Also, entirely unloading a large position in a corporation is difficult. See Securities and Exchange Commission, Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564, 6565 at *6565.

⁹⁶ See Bebchuk, *supra* note --, at 21. Staggered boards are not the only structural impediment to proxy fights. An even stronger structural impediment is provided by a dual class capitalization. Approximately six percent of public companies have dual class capitalizations. See Paul A. Gompers et. al., *Extreme Governance: An Analysis of Dual-Class Companies in the United States* (2006) at 3. Available at SSRN: <http://ssrn.com/abstract=562511>. Briefly, a company with a dual-class stock capitalization has two classes of common stock, typically Class A and Class B. Class A shares are publicly traded and provide one vote per share. Class B shares are not publicly traded, carry super voting rights (such as ten votes per share), and are mostly owned by management. Often management owns Class B shares equal to a majority of shareholder voting power. In such an event a proxy contest would be futile. Management would simply vote its controlling stake in favor of the incumbents' slate. See Bainbridge, *supra* note --, at 1075.

⁹⁷ See 2 MBCA ANN., *supra* note --, § 8.06; See DEL. CODE ANN. tit. 8, § 141(d).

⁹⁸ See Bebchuk, *supra* note --, at 21.

⁹⁹ See *id.* at 21-22.

that so few electoral proxy contests are launched and that even fewer are successful.

The end result is that in the vast majority of cases the election of directors is a charade—incumbent victory is a foregone conclusion. Hence, justifying *annual* director elections as a check on management is misplaced. An annual charade simply provides no meaningful check on management.

Characterizing the annual election of directors as a charade is nothing new,¹⁰⁰ and various proposals have been made over the years to make them more meaningful.¹⁰¹ Among those that have recently been pushed are allowing shareholders to include nominees in corporations' proxy materials,¹⁰² requiring corporations to reimburse insurgents' proxy contest expenses,¹⁰³ and implementing a majority voting standard for the election of directors.¹⁰⁴ Certainly director elections would be more meaningful if shareholders were able to include competing candidates in a corporation's proxy materials or corporations were required to reimburse an insurgent's expenses as doing either would result in more contested elections. Director elections would also be more meaningful with a majority voting standard as shareholders would have the power to block the election of one or more management nominees without having to launch a proxy fight.¹⁰⁵

¹⁰⁰ See, e.g., BERLE & MEANS, *supra* note --, at 88:

[C]ontrol will tend to be in the hands of those who select the [nominating] committee by whom, in turn, the election of directors for the ensuing period may be made. Since the [nominating] committee is appointed by existing management, the latter can virtually dictate their own successors. Where ownership is sufficiently sub-divided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible.

See also EASTERBROOK & FISCHER, *supra* note --, at 87.

¹⁰¹ See CLARK, *supra* note --, at 95.

¹⁰² See Security Holder Director Nominations, 34-48626, 2003 WL 22350515, *1 (Oct. 14, 2003).

¹⁰³ See Bebchuk, *supra* note --, at 24-26; Strine, *supra* note --, at 1778.

¹⁰⁴ See The ISS Institute for Corporate Governance, *Majority Voting in Director Elections* (2005). Available at <http://www.issproxy.com/pdf/MVwhitepaper.pdf>. See also Gretchen Morgenson, *The Shareholder Spring*, N.Y.T., Apr. 27, 2006, at B1.

¹⁰⁵ Note, however, that because of the so-called "holdover rule," an incumbent director that does not receive sufficient votes in an uncontested election to be reelected would not actually be ousted from the board. This rule, reflected in both the MBCA and Delaware Code, provides that an incumbent director remains on the board until his successor is elected and qualified. See 2 MBCA ANN., *supra* note --, at § 8.05(e); DEL. CODE ANN. tit. 8, §141(b). Because no successor will have been elected given that the number of nominees will equal the number of seats up for election, a losing incumbent will remain on the board.

Consequently, any of these measures would likely strengthen the check on management provided by annual director elections. Even a strengthened check, however, does not support the mandatory requirement of annual director elections. The check, strengthened or otherwise, flows not from the frequency of director elections but from the possibility that shareholders could rise up at any given time and oust an incumbent board, if warranted.¹⁰⁶

2. Corporate Democracy

Hoschett notes that annual elections serve as a “mechanisms of corporate democracy.”¹⁰⁷ Likewise, the NYSE Listed Company Manual describes the purpose of its corporate governance listing standards, among which is the annual election requirement, “to encourage high standards of corporate democracy.”¹⁰⁸ The phrase “corporate democracy” relates to the governance structure of a corporation. Shareholders as the residual claimants to the corporation’s income and assets elect the corporation’s board of directors which oversees its business and affairs.¹⁰⁹ Hence, at least in theory, a corporation is a representative democracy—shareholders elect representatives to make decisions in the best interests of the corporation. Periodic elections are certainly a critical feature of a representative democracy, but the concept of representative democracy is obviously not dependent on annual elections, whether through a meeting or otherwise. One need only consider that in our federal representative democracy no

The same would not be true for a non-incumbent candidate, but several companies who have adopted majority voting standards avoid the situation by filling board vacancies prior to the annual meeting, as allowed under the MBCA and Delaware Code, through board action thereby giving even “new” candidates incumbent status. See Thaddeus C. Kopinski, *Will Investors Choose Majority Vote or Pfizer?* (Mar. 3, 2006). Available at http://blog.issproxy.com/2006/03/will_investors_choose_majority.html#more. Some companies have addressed the holdover rule issue by adopting director resignation policies that, for example, require a directors who do not receive sufficient votes to be reelected to submit their resignations to the board. The board will then decide whether to accept the resignation. See, e.g., the policy of Dell Inc. available at <http://www.sec.gov/Archives/edgar/data/826083/000095013406001756/d32587exv99w1.htm>. The ABA Preliminary Report of the Committee on Corporate Laws on Voting by Shareholders of the Election of Directors includes proposals meant to address the holdover rule. See *Preliminary Report of the Committee on Corporate Laws on Voting by Shareholders for the Election of Directors*, January 17, 2006, at 27-35.

¹⁰⁶ See CLARK, *supra* note --, at 96; EASTERBROOK & FISCHER, *supra* note --, at 76. See also Bebchuk, *supra* note --, at 23 (“there is no reason to assume that the optimal frequency of scheduled elections for directors is once a year.”).

¹⁰⁷ Hoschett, 683 A.2d at 46.

¹⁰⁸ See *id.* § 301.00.

¹⁰⁹ See EASTERBROOK & FISCHER, *supra* note --, at 67.

governmental officials are elected annually. The founding fathers did in fact debate whether annual elections were appropriate for members of the House of Representatives but ultimately decided on biennial elections.¹¹⁰

Further, any assertion by the NYSE that annual director elections are important for corporate democracy is undercut by an exception for foreign companies. Specifically, non-U.S. companies can obtain a waiver from compliance with the annual election requirement and other corporate governance standards that are inconsistent with home country laws or practices.¹¹¹ All that is necessary is that the foreign company furnishes the NYSE a written certification from independent counsel in its home country that non-compliance with a particular standard is not prohibited by home country law.¹¹² The primary reason for the exception is global competition among exchanges for listings.¹¹³ It, however, demonstrates a less than full commitment to corporate democracy by the NYSE.

With that said, voter turnout for the annual elections of directors is excellent. "U.S. corporations routinely achieve participation at shareholder meetings in excess of 80% of outstanding shares -- far higher than in any other country."¹¹⁴ Such high turnout is surprising, at least at first blush. Rational shareholder apathy would seem to dictate that many, if not most, shareholders would not even take the time to fill out and send in their proxy

¹¹⁰ See *The Debates in the Federal Convention of 1787 reported by James Madison: June 21, 5-9* (Jun. 21, 1787).

¹¹¹ See NYSE Listed Company Manual § 103.00, Non-U.S. Companies. Nasdaq and AMEX have similar policies. The SEC release approving listing standard changes at the NYSE and AMEX to allow these waivers provided as follows:

The AMEX and NYSE have both identified the following areas in which an exception or waiver from otherwise applicable listing standards might be provided based on a home country practice: (1) Quarterly reporting of interim earnings; (2) composition and election of the Board of Directors; (3) shareholder approval requirements and voting rights; [FN5] and (4) quorum requirements for shareholder meetings.

Self-Regulatory Organizations, Order Approving Proposed Rule Changes by the American Stock Exchange, Inc. and the New York Stock Exchange, Inc. to Amend the Exchanges' Listing Standards for Foreign Companies, Exchange Act Release No. 24,634, 52 Fed. Reb. 24,230 (June 23, 1987).

¹¹² See NYSE Listed Company Manual § 103.00, Non-U.S. Companies.

¹¹³ See Karmel, *supra* note --, at 334.

¹¹⁴ See John C. Wilcox, *Shareholders Nominations of Corporate Directors--Unintended Consequences and the Case for Reform of the U.S. Proxy System*, in WHAT ALL BUSINESS LAWYERS & LITIGATORS MUST KNOW ABOUT DELAWARE LAW DEVELOPMENTS 1486 PLI/corp 1167, 1170 (2005).

cards. The fact that holders of over 80% of shares do would suggest that shareholders highly value the annual exercise of corporate democracy notwithstanding the shortcomings of director elections described above. This in turn would support the requirement of annual director elections.

Drawing this conclusion from the data, however, would be misguided. This is because institutional investors such as pension funds, mutual funds, insurance companies and bank trust departments hold more than 60% of the voting shares of major U.S. corporations,¹¹⁵ and these shareholders have several reasons unrelated to the annual exercise of corporate democracy for voting their shares. First, the portfolios of many institutional investors are managed by investment advisers subject to the Investment Advisers Act of 1940. The Act generally imposes fiduciary obligations on investment advisers to vote the shares in the portfolios they manage.¹¹⁶ Second, institutional investors for private sector employee benefit plans are subject to the Employee Retirement Income Security Act of 1974 which likewise generally imposes fiduciary obligations on the portfolio managers to vote their portfolio shares.¹¹⁷ Third, the Investment Company Act of 1940 requires mutual funds and other investment companies to disclose how they voted their portfolio shares, thereby providing investment companies with a strong incentive to vote to avoid unfavorable disclosure.¹¹⁸ Fourth, as mentioned above, many institutional investors have an economic incentive to vote (and to vote with management).¹¹⁹

Additionally, frequently shares held in street name with brokers are voted as determined by the broker and not the beneficial owners.¹²⁰

¹¹⁵ See Roberta S. Karmel, *Should a Duty to the Corporation be Imposed on Institutional Shareholders?*, 60 BUS. L.J. 1, 9 (2004).

¹¹⁶ See Proxy Voting by Investment Advisers, 68 FED. REG. 6585 (Feb. 7, 2003) (noting that “[t]he duty of care requires an adviser with proxy voting authority to monitor corporate events and to vote the proxies.”)

¹¹⁷ Interpretive Bulletin Relating to the Employee Retirement Security Act of 1974, 29 C.F.R. § 2509.94-2 (2003) (noting that portfolio managers are required to vote proxies on items that will affect the value of the plan).

¹¹⁸ Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 FED. REG. 6564 (Feb. 7, 2003).

¹¹⁹ See *supra* text accompanying note ____.

¹²⁰ See Jennifer E. Bethel & Stuart Gillan, *The Impact of the Institutional and Regulatory Environment on Shareholder Voting*, Oct. 2002, at 6. Available at SSRN: <http://ssrn.com/abstract=354820> (noting that 70% to 80% of shares trade on the NYSE in 1997 were owned in street name). “Street name” means that the shares are held of record in the name of a depository company used by the brokerage house (e.g., Cede & Co.) and not the name of the beneficial owner. Holding shares in street name is encouraged by brokers because it reduces formalities associated with transferring shares. See I Bloomenthal, *supra* note --, at § 17:9. See also Bethel & Gillan, *supra* note --, at 6 (noting that brokerage firms

Brokers are required to seek voting instructions from beneficial owners. With respect to routine matters, including uncontested elections, if a beneficial owner does not provide instructions at least ten days before the meeting, the broker is free to, and typically does, vote these “uninstructed shares” as it chooses.¹²¹ Data from the 2005 proxy season indicates that the voting rights relating to 56% of accounts with shares held in street name were not exercised by the account holders.¹²² Presumably, many of these shares were nonetheless voted by brokers. Typically broker votes of uninstructed shares represent five to ten percent of votes cast at an annual shareholders’ meeting.¹²³ Considering the legal obligations and economic incentives regarding institutional shareholder voting and permitted broker voting of uninstructed shares, it is unlikely that high voter turnout is indicative of shareholders placing a high value on the annual exercise of corporate democracy.

C. Annual Shareholders’ Meeting Requirement

1. Presenting Matters to the Shareholder Body

Hoschett asserts that requiring annual shareholders’ meetings is justified because they afford shareholders “an opportunity to bring matters before the shareholder body, as provided by the corporation’s charter and bylaws.”¹²⁴ Annual shareholders’ meetings do provide such an opportunity but not as a result of a corporation’s charter or bylaws. The charters of most public corporations simply do not address the issue and the bylaws typically make it more difficult for shareholders to bring forth matters. Specifically, most public corporations include within their bylaws an advance notice provision requiring a shareholder to notify the corporation in writing of a matter she wishes to present at the annual meeting a

routinely charge clients fees if they fail to hold their shares in street name). It is also favored by many shareholders because it allows them to keep their identities, securities positions, and votes confidential, even from the Issuers of the shares. See *id.*

¹²¹ See NYSE Rule 452, AMEX Rule 577, and NASD Rule 2260. See also Bethel & Gillan, *supra* note --, at 6-7. Note that the NYSE Proxy Working Group has recently proposed categorizing all director elections as non-routine thereby preventing brokers from voting uninstructed shares in uncontested director elections. See *Report and Recommendations of the Proxy Working Group to the New York Stock Exchange*, 21 (June 5, 2006). Available at http://www.nyse.com/pdfs/REVISED_NYSE_Report_6_5_06.pdf.

¹²² See Internet Availability of Proxy Materials Release, 2005 WL 3610280 (December 5, 2005) at 31.

¹²³ Bethel & Gillan, *supra* note --, at 3.

¹²⁴ *Hoschett*, 683 A.2d at 45.

prescribed number of days (typically 45 days) before the meeting.¹²⁵ If a shareholder fails to provide the requisite notice, he or she will not be allowed to present a matter at the meeting. In some sense, however, it is irrelevant because, as mentioned above, very few shareholders attend annual meetings. So even if a corporation were properly noticed of a matter to be presented, there would be little of the “shareholder body” around to hear the presentation.

The real way to get a matter before the shareholder body is to have it included in the corporation’s proxy materials. As mentioned above, Rule 14a-8 under the Exchange Act provides shareholders with a mechanism to do so.¹²⁶ The rule has been on the books since 1942, has been revised on numerous occasions, and has always been controversial.¹²⁷ Commentators have long asserted that the costs of the rule outweigh its benefits.¹²⁸ They complained that the rule was used “chiefly by timeworn gadflies or religious or political groups unable to achieve their ends through legitimate political mechanisms.”¹²⁹ As of 1981, the cost-benefit analysis looked to be accurate—a lot of money had been spent on including thousands of shareholder proposals in corporations’ proxy materials but only two of these proposals passed over management opposition.¹³⁰ However, with the rise of institutional activism the rule is now viewed by many as an important corporate governance tool.¹³¹ “Institutional investors have found Rule 14a-8 useful both in their efforts to affect change directly through the share voting process and as a bargaining tool in negotiating with management for governance changes.”¹³²

During the period of 2001 through 2005, 3,099 corporate governance related shareholder proposals were submitted, and 1,730 were voted on, many of which received a majority of votes cast.¹³³ Submitted proposals

¹²⁵ See Oesterle & Palmiter, *supra* note --, at 511. See also 2 MBCA ANN., *supra* note --, § 7.07 Official Comment.

¹²⁶ See SARGENT & HONABOCH, *supra* note --, at § 5:2 (“Rule 14a-8 permits shareholders to effectively communicate with their fellow shareholders . . .”).

¹²⁷ See Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 882 (1994).

¹²⁸ See SARGENT & HONABOCH, *supra* note --, at § 5:2.

¹²⁹ See Palmiter, *supra* note --, at 901.

¹³⁰ See Susan W. Liebler, *A Proposal to Rescind the Shareholder Proposal Rule*, 18 GA. L. REV. 425, 426 (1984).

¹³¹ See SARGENT & HONABOCH, *supra* note --, at § 5:2.

¹³² See *id.*

¹³³ See Georgeson Shareholder, *2005 Annual Corporate Governance Review*, 10 [hereinafter *Corporate Governance Review*]. Available at http://www.georgesonshareholder.com/pdf/2005_corpgov_review.pdf. For example, during

not voted on were either omitted by the corporations as not proper under Rule 14a-8 or withdrawn by the proponent. Oftentimes, a proponent agrees to withdraw a proposal following negotiated concessions by management.¹³⁴ Notwithstanding its recent rise, Rule 14a-8 remains controversial. Management generally views it as too permissive while many shareholders view it as too restrictive.¹³⁵ Given the rule's history--it has been revised fourteen times since its 1942 promulgation—it is likely that the SEC will continue to tweak it.¹³⁶

Because the annual shareholders' meeting requirement causes public corporations to solicit proxies annually, it indirectly, as a result of Rule 14a-8, affords shareholders an annual opportunity to present matters to the shareholder body. While this presentation occurs through the corporation's proxy materials and not at the meeting itself, many nonetheless view it as an important component of corporate democracy. While the end result may support shareholders' meetings generally, it does not justify the requirement to hold meetings annually. It is not uncommon for a public corporation to have years where it has no shareholder proposals included in its proxy materials.¹³⁷ And while the number of shareholder proposals submitted and voted on grew explosively from 2001 to 2003, the year-to-year numbers dropped in both 2004 and 2005.¹³⁸ One suspects as memories of Enron, WorldCom and the like fade and corporations continue to enact reforms pushed by shareholder activists, the numbers will continue to decline.

2. *Deliberation*

Hoschett also asserts that “[t]he theory of the annual meeting includes the idea that a deliberative component of the meeting may occur.”¹³⁹ Specifically, “at a noticed annual meeting a form of discourse (i.e., oral reports, questions and answers and in rare instances proxy contests) among

the 2001-2005 period, shareholders submitted 419 proposals to destagger boards or eliminate poison pills, and 314 or 75% of these proposals received a majority of votes cast. See *id.* at 2.

¹³⁴ See *id.*

¹³⁵ See SARGENT & HONABOCH, *supra* note --, at § 5:2.

¹³⁶ See Palmiter, *supra* note --, at 882. Additionally, on numerous occasions the SEC has flip-flopped its position on interpretive issues under the rule. See *id.*

¹³⁷ For example, in 1998 (the only year for which I have data) the proxy statements of 537 out of 1,374 included only director election and/or auditor ratification proposals. Bethel & Gillan, *supra* note --, at 14.

¹³⁸ See *Corporate Governance Review*, *supra* note --, at 1.

¹³⁹ 683 A.2d at 46.

investors and between shareholders and managers is possible.”¹⁴⁰ Therefore, “[s]hareholders’ meetings are mandated and shareholders authorized by statute to transact proper business because we assume that at such meetings something said may matter.”¹⁴¹ The fact of the matter is, however, little deliberation occurs. As mentioned above, very few shareholders actually attend the meetings. Further, the board controls all aspects of the annual meeting. The board sets the location, date, record date, time, and agenda of the annual meeting, all of which impact shareholder attendance and thus opportunity for deliberation.¹⁴² The board also appoints the chairperson for the meeting (typically the corporation’s CEO).¹⁴³ The chairperson has complete authority to set the order of business and meeting rules, including admission restrictions and time limits on speeches from the floor.¹⁴⁴ Thus, oral reports or question and answer session may be brief or omitted entirely.¹⁴⁵ “Anyone who has attended an annual meeting in recent years will tell you that they fall far short of the promised forum of meaningful communications between board members and investors.”¹⁴⁶

Additionally, public corporations reflect an authority based decision structure as opposed to a participatory democracy. It would simply be impractical, if not impossible, to run a public corporation based on shareholder consensus.¹⁴⁷ As a result, the Delaware Code provides that the corporation’s business and affairs “shall be managed by or under the direction of a board of directors,”¹⁴⁸ and the Model Code has a similar

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² See DEL. CODE ANN. tit. 8, §§ 211 & 213; 2 MBCA ANN., *supra* note --, §§ 7.01 & 7.07. See also Nordlund, *supra* note --, at 991. For example, Halliburton was recently accused of holding its annual shareholders’ meeting in a small Oklahoma town to minimize attendance by activist shareholders. See Kelly Kurt, *Move of Halliburton meeting draws fire*, Assoc. Pres (May 15, 2006).

¹⁴³ See DEL. CODE ANN. tit. 8, § 231 ; 2 MBCA ANN., *supra* note --, § 7.08(a).

¹⁴⁴ See DEL. CODE ANN. tit. 8, § 231 ; 2 MBCA ANN., *supra* note --, § 7.08(b). See also Nordlund, *supra* note --, at 989.

¹⁴⁵ See Nordlund, *supra* note --, at 985 (noting that “[s]ome companies have even held ‘no frills’ meetings which deal only with the minimum legal requirements and do not include any presentations on company performance or products.”).

¹⁴⁶ *The End of the Annual Meeting?*, 8 CORP. GOV. ADVISOR 29, 30 (Jul./Aug. 2000).

¹⁴⁷ See Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 5 (2002).

¹⁴⁸ See DEL. CODE ANN. tit. 8, § 141(a). See also *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1291 (Del. 1998) (“One of the most basic tenets of Delaware corporate law is that directors, rather than shareholders, manage the business and affairs of the corporation.”); 2 MBCA ANN., *supra* note --, § 8.01(b) (“All corporate power shall be

provision.¹⁴⁹ Corporate law does recognize the importance of deliberation among board members in reaching decisions. As the drafters of the Model Code put it, “[t]he underlying theory is that the consultation and exchange of views is an integral part of the functioning of the board.”¹⁵⁰ However, there is no similar basis for the assertion that annual shareholders’ meetings are required in order to provide an opportunity for shareholder deliberation.

This view is reinforced by post-*Hoschett* changes to the Delaware Code. In 1997, the Delaware legislature overruled *Hoschett* by amending Section 211(b) of the Delaware Code to specifically allow shareholders to elect directors by written consent in lieu of annual shareholders’ meetings.¹⁵¹ Obviously, if a corporation seeks to elect directors by written consent, there will be no meeting and thus no opportunity for shareholder deliberation. In a similar vein, the Delaware legislature amended Section 211(a) of the Delaware Code in 2000 to allow for virtual shareholders’ meetings held in cyberspace.¹⁵² The section does require that a corporation holding a virtual meeting “implement reasonable measures to provide . . . stockholders a reasonable opportunity to participate in the meeting”¹⁵³ In that regard, however, the section specifically requires only that shareholders have “an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings”¹⁵⁴ There is no specific requirement that the technology used for a virtual meeting afford shareholders an opportunity to communicate with the corporation or fellow shareholders. At least four other states have similarly amended their corporate codes in recent years to allow virtual shareholders’ meetings.¹⁵⁵

3. Confrontation

Although not appearing in *Hoschett*, the Delaware Code, the Model Code, or the exchanges’ listed company materials, some commentators have asserted that a purpose of the annual meeting is to provide

exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors”).

¹⁴⁹ See 2 MBCA ANN., *supra* note --, § 8.01(b).

¹⁵⁰ See, e.g., 2 MBCA ANN., *supra* note --, § 8.20, Historical Background.

¹⁵¹ See 71 Del. Laws, c. 120, §§ 12, 13.

¹⁵² DEL. CODE ANN. tit. 8, § 211(a)(1).

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ The four are California, Maryland, Michigan and Oklahoma. See CAL. CORP. CODE § 600(a) (West 2005); MD. CODE ANN., Corps. & Ass'ns § 2-503; MICH. COMP. LAWS ANN. § 450.1405 (West 2004); OKLA. STAT. ANN. tit. 18, § 1056 (West 2005).

shareholders with an opportunity to confront management.¹⁵⁶ Annual meetings certainly do provide shareholders with such an opportunity, and the possibility of confrontation could perhaps provide an additional check on management. In particular, members of management may be less inclined to engage in opportunistic behavior or shirk responsibility knowing that they may have to explain themselves to shareholders face-to-face and suffer the attendant embarrassment. It may also allow disgruntled shareholders to vent frustration. And some shareholders do avail themselves of the opportunity.¹⁵⁷

However, there is no requirement that directors attend annual shareholders' meetings (although since 2004 SEC proxy rules have required corporations to disclose director attendance).¹⁵⁸ For example, only a single director (the Chairman and CEO) attended Home Depot Inc.'s 2006 annual shareholders' meeting, and he refused to answer questions as to why the other directors were not there.¹⁵⁹ Additionally, similar to deliberation, the amendments to the Delaware Code allowing the election of directors by written consent and virtual shareholders' meetings indicate that the Delaware legislature does not view confrontation opportunity as a purpose of annual shareholders' meetings. If a corporation elects directors by written consent in lieu of a meeting or holds a virtual meeting, there is no opportunity for confrontation.¹⁶⁰ Note that other states may take a different view on this point. The Model Code does not provide for electing directors by written consent or virtual shareholders' meetings, although, as noted above, four states in addition to Delaware allow virtual meetings.¹⁶¹ However, a legislative proposal to amend the Massachusetts corporate code to allow virtual meetings was withdrawn in the wake of protests that virtual

¹⁵⁶ See, e.g., Elizabeth Borso, *Virtual Shareholder Meetings*, 2004 DUKE L. & TECH. REV. 8, *9 (2004); Broc Romanek, *Truth on the Market*, <http://www.truthonthemarket.com/2006/05/16/halliburton-annual-shareholders-meeting-location/#comment-2215>, cmt. 1 (May 17, 2006) ("the purpose of the meeting is to allow shareholders the opportunity - just once a year - . . . to confront management if they so choose.").

¹⁵⁷ See Scott Hensley & Joann S. Lublin, *Pfizer Meeting Gives Dissidents Voice, Not Votes*, THE WALL ST. J., Apr. 28, 2006, at B1 (describing shareholder confrontations occurring at Pfizer Inc.'s annual shareholders' meeting).

¹⁵⁸ See Schedule A, Item 7(h)(3), 17 C.F.R. § 240.14a-101.

¹⁵⁹ See Chad Terhune, *Home Depot's Critics Tear Into Firm's Practices, Conduct*, WALL ST. J., May 27, 2006, at B3.

¹⁶⁰ See Borso, *supra* note --, at 18 (noting that Delaware law does not require virtual meetings "to provide an electronic analogy of confrontation.").

¹⁶¹ See *supra* note ____.

meetings provide no opportunity for face-to-face confrontation.¹⁶² Regardless, the uproar in Massachusetts was because virtual meetings would allow management to avoid ever having to face shareholders at a physical meeting, an entirely different issue than the frequency of meetings. Hence, confrontation opportunity may justify requiring physical meetings, notwithstanding Delaware's view, but it does not justify requiring them annually.

D. Emergence

The lack of strong justification for requiring director elections and shareholder meetings annually raises the question of why these requirements ever emerged. The existing state law requirement of annual shareholders' meetings for the election of directors has a long history. Its origin can be traced back to the twelfth century English trade guilds,¹⁶³ and the requirement became the norm in early corporate charters in England and the United States.¹⁶⁴ It was carried over to the first state general incorporation statutes,¹⁶⁵ and from there to the Delaware Code and the Model Code. Mandatory annual elections and meetings likely made sense for early corporations given the less pronounced separation of ownership and control, geographic proximity of shareholders, the absence of voting by proxy, and primitive communication technology. Specifically, physical attendance by shareholders at meetings was much more necessary (to vote, to be informed, etc.) and less burdensome. Thus, shareholder attendance was likely substantial, and therefore the elections and meetings were much more meaningful. If owners of a majority of shares were physically present at a meeting, shareholders could nominate competing director candidates from the floor, present matters to the shareholder body, and engage in deliberation with fellow shareholders and management.

As for the exchanges, the NYSE began requiring annual meetings for the election of directors in 1909, again back in the days when the requirement likely made sense.¹⁶⁶ Although the founding of the AMEX dates back to 1860,¹⁶⁷ the AMEX did not add its requirement until 1973

¹⁶² See *id.*

¹⁶³ See O'Donnell, *supra* note --, at 57.

¹⁶⁴ See See Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 110 (2002).

¹⁶⁵ See *id.* at 109.

¹⁶⁶ See *ABA Study*, *supra* note --, at 1498.

¹⁶⁷ See *ABA Study*, *supra* note --, at 1500.

after being rebuked by the SEC in the 1960s for lax regulation.¹⁶⁸ The much younger Nasdaq (it was formed in 1971¹⁶⁹) added its requirement in 1987 as part of an effort to secure exemptions from state registration requirements for Nasdaq NMS securities.¹⁷⁰ Nasdaq viewed such exemptions as necessary to successfully compete for listings against the NYSE and AMEX whose listed shares enjoyed exemptions from state registration requirements thereby reducing transaction costs for listed companies.¹⁷¹ Thus, the NYSE requirement emerged when the justifications were valid, the AMEX requirement resulted from regulatory pressure, and the Nasdaq requirement was the consequence of competitive concerns.

E. Conclusion

There simply is no strong justification for requiring director elections and shareholder meetings annually. Annual elections provide at most a minimal check on management, a check that is not dependent on the frequency of elections. Nor are annual elections critical to the exercise of corporate democracy. Likewise, annual shareholders' meetings provide little if any opportunity for shareholder deliberation, and regardless, shareholder deliberation is not mandated by corporate statute and has been severely undercut as a justification for annual shareholders' meetings by recent changes to the Delaware Code. To be sure, annual shareholders' meetings do provide an economical mechanism for shareholders to bring matters before the shareholder body and an opportunity for shareholders to confront management. But justifying the requirement on these bases alone seems misplaced considering the continued controversy surrounding Rule 14a-8 and the absence of statutory or case law authority supporting the confrontation justification.

Further, even if states or regulators were to mandate annual shareholder votes on, for example, executive compensation, there is no reason why the vote would need to be done through the mechanism of a meeting. As

¹⁶⁸ See Michael, *supra* note --, at 1474.

¹⁶⁹ See *ABA Study*, *supra* note --, at 1502.

¹⁷⁰ See Michael, *supra* note --, at 1474.

¹⁷¹ See *id.* The effort was successful but became moot with the passage of the National Securities Markets Improvement Act of 1996 (NSMIA). Pub. L. 104-290, Title III, Oct. 11, 1996. NSMIA amended Section 18 of the Securities Act of 1933 (1933 Act) to exempt "covered securities" from state registration requirements. 15 U.S.C. § 77r(b)(1)(A). The definition of covered securities includes securities traded on a national exchange as well as securities traded on the NMS. See *id.*

discussed above, very few shareholders attend meetings. Consequently, it is highly unlikely that debate and discussion on an issue will occur at the meeting and even less likely that if it does occur it will result in an outcome determinative change in votes. The vote could easily be handled entirely through mail in proxies or a similar mechanism. While I am not suggesting that director elections and shareholders' meetings be entirely abolished—they do occasionally serve a useful purpose—an optional approach, like the one adopted by Minnesota as discussed below, would be much more efficient.

IV. THE MINNESOTA APPROACH

This part explores an alternative approach taken by the State of Minnesota with respect to director elections and shareholders' meetings. Annual director elections and shareholders' meeting are now optional under Minnesota corporate law. This part first details Minnesota's approach and then considers its benefits and costs. It concludes that the approach is superior to the current regime.

A. *Regular Meetings of Shareholders*

Effective January 1984, Minnesota replaced the concept of annual shareholders' meetings with "regular" meetings of shareholders. Specifically, subdivision 1. of Section 302A.431 of the Minnesota Business Corporation Act (Minnesota Code) provides: "Regular meetings of shareholders may be held on an annual or other less frequent periodic basis, but need not be held unless required by the articles or bylaws or by subdivision 2."¹⁷² Subdivision 2. requires a corporation to hold a regular meeting if it has not done so for 15 months and a shareholder or shareholders holding at least three percent of the corporation's voting stock submits a written notice of demand to the corporation's chief executive officer or chief financial officer.¹⁷³ The board is then required to call a regular meeting within 30 days of receipt of the demand to be held no later than 90 days from receipt of the demand.¹⁷⁴ If the board fails to do so, the shareholders making the demand may themselves call and provide notice of a regular meeting, and the corporation is required to reimburse expenses they incur in connection therewith.¹⁷⁵

¹⁷² See MINN. STAT. ANN. § 302A.431, Subd. 1. (West 2004).

¹⁷³ See *id.* § 302A.431, Subd. 2.

¹⁷⁴ See *id.*

¹⁷⁵ See *id.*

Subdivision 4. of Section 302A.431 provides that “[a]t each regular meeting of shareholders there shall be an election of qualified successors for directors who serve for an indefinite term or whose terms have expired or are due to expire within six months after the date of the meeting.”¹⁷⁶ Thus, not only has Minnesota eliminated its requirement to hold an annual meeting, it has also eliminated its requirement to elect directors annually. As the General Comment to the section states, “this statute now provides that the presumptive term of directors is indefinite and is no longer one year.”¹⁷⁷ As a result, “a corporation could conceivably exist for years without calling an official shareholders meeting.”¹⁷⁸

B. Benefits

In adopting the regular meeting approach, Minnesota recognized that “[t]here is no reason for the shareholders of the corporation to be required by state law to meet once each year,”¹⁷⁹ certainly a position consistent with my conclusion in Part III. In explaining the approach, it noted that eliminating the annual meeting requirement “streamline[s] the corporate entity and reduce[es] unnecessary formalities.”¹⁸⁰ The approach has several benefits in addition to reducing formalities.

First, it potentially saves corporations money and time. In connection with an annual shareholders’ meeting, “[c]ompanies frequently spend thousands of dollars to rent hotel ballrooms; more thousands to provide security, transportation and communications; more thousands for lawyers, accountants and p.r. people; and still more thousands for coffee, donuts and

¹⁷⁶ See *id.* § 302A.431, Subd. 4.

¹⁷⁷ *Id.* Gen. Cmt.

¹⁷⁸ *Id.* The same is technically true under both the MBCA and the Delaware Code notwithstanding their annual meeting requirements. While the provisions are phrased in mandatory terms, both the Model Code and Delaware Code provide that the failure to hold an annual meeting does not affect otherwise valid corporate action or cause a forfeiture or dissolution of the corporation. See 2 MBCA ANN., *supra* note --, § 7.01(c); See DEL. CODE ANN. tit. 8, § 211(c). However, under the Model Code, every shareholder (regardless of the number of shares held) has the unqualified right to demand that an annual meeting be held and can apply for a court order to compel a meeting “if an annual meeting was not held within the earlier of 6 months after the end of the corporation’s fiscal year or 15 months after its last annual meeting.” 2 MBCA ANN., *supra* note --, § 7.03(a)(1). The Delaware Code has a similar provision. Note however that under the Delaware Code, a Delaware corporation cannot be compelled to hold an annual meeting if it has instead elected directors through written consent within the applicable time period. See DEL. CODE ANN. tit. 8, § 211(a) & (c).

¹⁷⁹ See MINN. STAT. ANN. § 302A.431, Gen. Cmt.

¹⁸⁰ *Id.*

‘goodie bags.’”¹⁸¹ For larger corporations, these costs run into the seven figures.¹⁸² Perhaps more costly is the time consumed by senior management (especially considering the astronomical compensation paid by many public corporations) in preparing for the annual shareholders’ meeting, time that could likely be better spent.¹⁸³ “Days and days are used up in planning, in rehearsals, in preparing lists of possible questions and answers, in drafting speeches, and in arranging logistics. All this is time not spent in thinking about the business, solving its problems and addressing its future.”¹⁸⁴ Additionally, many companies spend tens of thousands of dollars each year merely determining whether to include Rule 14a-8 shareholder proposals in their proxy materials.¹⁸⁵ Under the Minnesota approach, money and time would be saved in years where no shareholder demands a regular meeting and therefore no meeting is held. Shareholders, in fact, would have an incentive not to demand a meeting unless they anticipate it being meaningful because the costs of meetings are ultimately borne by them as the residual claimants on the corporation’s income and assets.

Second, the Minnesota approach is flexible. It does not provide for a one size fits all rule like the prevailing system. Instead, it starts with the default rule of no requirement to hold a shareholders’ meeting and elect directors annually but allows a corporation (or its shareholders) to opt-in to an annual meeting requirement through an appropriate articles of incorporation or bylaws provision.¹⁸⁶ This flexibility is consistent with the general principle “that corporate law should function as a sort of standard form contract, an ‘off the rack’ set of terms that parties may use for their convenience but may also freely alter.”¹⁸⁷ Such an approach allows parties to customize terms to best fit their particular situation.¹⁸⁸ One could certainly debate whether the better approach would be to set annual director elections and shareholders’ meetings as the default rule and allow

¹⁸¹ See Lochner & Koppes, *supra* note --, at A10.

¹⁸² See *id.*

¹⁸³ See *id.*

¹⁸⁴ *Id.* See also Nordlund, *supra* note --, at 973 (“Very few attendees at an annual meeting of shareholders have any idea of the complex planning and information gathering process that proceeds the meeting.”).

¹⁸⁵ See SARGENT & HONABOCH, *supra* note --, at § 5:2.

¹⁸⁶ See MINN. STAT. ANN. § 302A.431.

¹⁸⁷ See Gordon, *supra* note --, at 1551.

¹⁸⁸ *Id.* at 1553.

corporations to opt-out.¹⁸⁹ Given the lack of strong justification for the annual election and meeting requirement, however, I believe Minnesota has taken the right approach.

The Minnesota approach also provides flexibility to shareholders. Even if a corporation has not opted for something other than the default rule, an owner of 3% or more of the corporation's shares can nevertheless require a corporation to hold a shareholders' meeting to elect directors as often as every 18 months by submitting the requisite demand to the corporation's CEO or CFO.¹⁹⁰ Additionally, shareholders owning less than 3% are not totally excluded from this option. They are free to form a group of shareholders that own in the aggregate 3% or more and submit a valid demand.¹⁹¹ At one time, federal proxy rules may have essentially negated this option with respect to a public corporation, but the rules were relaxed in 1992 to enable a wider range of communication among shareholders without triggering filing and other requirements under the federal proxy rules.¹⁹²

Third, the approach may actually result in more frequent deliberation between management and shareholders. Recall that given the sparse attendance at annual meetings and managements' control over the agenda, etc., there really is little if any deliberative component. Under the Minnesota approach, a shareholder could use a shareholders' meeting demand as leverage to get a private audience with management to discuss issues of particular concern to the shareholder. This currently occurs in the Rule 14a-8 context. Many shareholder proposals have opened pre-meeting discussions and negotiations between management and the proponent that led to management concessions in exchange for the proponent withdrawing the proposal.¹⁹³ Using a meeting demand as leverage would likely be more effective from a shareholder's perspective. The corporation will have more at stake if it cannot convince the shareholder to withdraw the demand—it would have to hold a shareholders' meeting. In the Rule 14a-8 context, the corporation has to hold a meeting regardless, so it is faced with the less

¹⁸⁹ See *infra* text accompanying notes ___ *infra* for a discussion of the related question of whether an enabling instead of a mandatory approach is appropriate with respect to director elections and shareholders' meetings.

¹⁹⁰ See MINN. STAT. ANN. § 302A.431, Subd. 1. Under Minnesota Code Section 302A.225(b), unless otherwise specified in the corporation's articles or bylaws, directors generally serve for indefinite terms that expire at the next regular shareholders' meeting.

¹⁹¹ *Id.*

¹⁹² See generally SARGENT & HONABOCH, *supra* note --, § 3:4.

¹⁹³ See SARGENT & HONABOCH, *supra* note --, § 5:2.

weighty choice of capitulating or including the proposal in the corporation's proxy materials.

C. Costs

The Minnesota approach does have some costs. First, no longer will shareholders be guaranteed an annual opportunity for deliberation, confrontation and presenting matters to the shareholder body. Granted, shareholders are always free to demand a meeting, but even if they do so at every opportunity, the statute only guarantees a regular shareholders' meeting every 18 months. This timing issue could result in delaying or extending an electoral proxy contest by six months or more. Further, smaller shareholders will face the added complication of having to form a group to meet the requisite 3% ownership requirement for making a demand if the corporation is otherwise not required to hold a meeting.¹⁹⁴

Second, many corporations routinely include auditor ratification on the annual meeting agenda. Specifically, they have shareholders vote on the ratification of the outside auditing firm selected by the corporation's audit committee to audit the corporation's financial statements for the coming year. Auditor ratification by shareholders is not required by state or federal law or exchange listing standards.¹⁹⁵ Nonetheless, it persists today and is occasionally the subject of shareholder proposals at companies that do not do it.¹⁹⁶ Obviously, in years that a corporation does not hold a regular meeting, shareholders will not have the opportunity to ratify the selection of the corporation's auditor or to vote on any other matters.

Third, as mentioned above, the Minnesota approach is flexible because it takes an enabling as opposed to mandatory approach with respect to the timing of shareholders' meetings and director elections. This touches on a broader debate in corporate law as to what types of rules, if any, should be mandatory, a debate that is discussed at length elsewhere and beyond the scope of this article.¹⁹⁷ With that said, there are advantages to mandatory

¹⁹⁴ This is arguably a benefit as it makes it more difficult for gadflies and others to abuse the system and allows states to indirectly regulate shareholder access to corporations' proxy materials. See *supra* note ___ and accompanying text.

¹⁹⁵ See *Proxy Season Items*, The Corporate Executive Vol. XVI, No. 1 January-February 2002. See also SEC No-Action Letter, 2005 WL 484410. The practice appears to date back to a push for it in the 1930s by a prominent shareholder activist. It may also have once been an NYSE listing requirement. See *id.*

¹⁹⁶ See SARGENT & HONABOCH, *supra* note --, at § 5:2.

¹⁹⁷ See generally, *Symposium on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1359 (1989).

rules in some contexts, and therefore corporate law contains a number of mandatory rules notwithstanding lost flexibility.¹⁹⁸ These advantages include investor protection against misinformation, elimination of uncertainty, and shareholder protection against opportunistic charter amendments.¹⁹⁹ Keep in mind, however, that the Minnesota approach is not a pure enabling rule. It sets a floor with respect to the timing of shareholders' meetings for the election of directors but allows corporations to adopt a stricter rule. Contrast that to a pure enabling rule such as Delaware Code Section 212 which specifies the default rule of one share, one vote but allows a corporation to freely raise, lower or eliminate the voting rights of shares through a certificate of incorporation provision.²⁰⁰ Thus, the Minnesota approach does not raise the same concerns as a pure enabling rule that would allow a corporation to completely opt-out from holding director elections or shareholders' meetings.

D. Conclusion

The beauty of the Minnesota approach is that it generally preserves the substance of all the justifications for annual director elections and shareholders' meetings discussed above while having the potential to eliminate the holding of meaningless elections and meetings. If an insurgent wants to take a run at ousting a board, it can demand a meeting to do so. The check on management provided by director elections is fully preserved because, as noted above, the check does not come from the frequency of director elections but from the possibility that shareholders could rise up at any given time and oust an incumbent board.²⁰¹ Likewise, a shareholder can demand a shareholders' meeting if he or she believes deliberation or confrontation with management in such a setting is warranted, feels it is necessary to present a matter to the shareholder body, or has some other reason. Absent a reason, however, no demand will be made and therefore the holding of meaningless elections and meetings will be avoided.

At the same time, a corporation is always free to hold a regular shareholders' meetings even if not required to do so. For example, a corporation may view the meetings as an important part of investor or other

¹⁹⁸ See Gordon, *supra* note --, at 1553.

¹⁹⁹ See *id.* at 1555-85.

²⁰⁰ See DEL. CODE ANN. tit. 8, § 212(a).

²⁰¹ See CLARK, *supra* note --, at 96. See also Bebchuk, *supra* note --, at 23 ("there is no reason to assume that the optimal frequency of scheduled elections for directors is once a year.")

stakeholder relations. The point is that the Minnesota approach leaves the choice to a corporation and its shareholders instead of dictating a one size fits all rule that results in many, many meaningless elections and meetings and therefore the unnecessary waste of corporate resources. It is in the best interests of management *and* shareholders to avoid the time and expense of meaningless elections and meetings. As Frank Easterbrook and Daniel Fischel have noted, “[b]ecause voting is expensive, the participants in the venture will arrange to conserve on its use.”²⁰² The same could also be said about annual shareholders’ meetings. The Minnesota approach allows for such conservation and at the same time preserves the benefits of annual director elections and shareholders’ meetings with few costs. Therefore, it is superior to the current scheme.

V. ABOLITION OF EXCHANGES’ LISTING STANDARD

As mentioned above, my solution is to abolish each of the exchanges’ listing standard that requires corporations to hold annual director elections and shareholders’ meetings. This would give effect to the Minnesota approach and allow the “laboratory” of state corporate law to experiment with alternative rules.²⁰³ While the Minnesota approach is more efficient than the current scheme, exposing the issue to corporate federalism may yield an even better outcome. This part provides a brief overview of corporate federalism. It then considers the implications of applying the concept to the frequency of director elections and shareholders’ meetings. Finally, it speculates as to why the listing standards requiring annual director elections and shareholders’ meetings have persisted.

A. *Overview of Corporate Federalism*

The basic idea of corporate federalism is that competition among states for corporate charters leads to the production of corporate codes that generally maximize shareholder value.²⁰⁴ Briefly, managers are free to incorporate a business in any state, regardless of where the firm’s operations are located. Hence, they will choose the jurisdiction that maximizes the joint welfare of management and investors since this will result in the lowest cost of capital.²⁰⁵ Because incorporations generate

²⁰² EASTERBROOK & FISCHEL, *supra* note --, at 66.

²⁰³ See ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 5 (1993).

²⁰⁴ See *id.* See also FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 218 (1991).

²⁰⁵ See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW _ (1991).

revenues for the state and work for local attorneys, states compete with each other in attracting incorporations and will therefore generally seek to produce corporate codes that maximize shareholder value.²⁰⁶ Not knowing what in fact is the best mix of corporate law provisions, states experiment with different rules and the market determines the winner.²⁰⁷ Over time the “losing” states adopt similar rules in response and the preferred solution eventually predominates.²⁰⁸ The end result is typically policy innovation and better rules.²⁰⁹

This is not the case, however, when it comes to rules concerning the frequency of director elections and shareholders’ meetings for public corporations. Because of the overriding exchange rules, there is little motivation for states to experiment in the area.²¹⁰ While there is ostensibly regulatory competition among the three exchanges, they cannot truly compete on listing standards--any changes to their standards must be approved by a single regulator, the SEC.²¹¹ And the SEC has historically pushed for uniform standards among the exchanges, when appropriate.²¹² Moreover, the exchanges, similar to the states, have little motivation to compete on the frequency of elections and meetings given the overlapping state rules.

Further, competition among three as opposed to fifty jurisdictions is less likely to generate experimentation yielding optimal rules.²¹³ Thus, it is not surprising that competition among the exchanges has yielded a uniform but relatively baseless rule. Conversely, experimentation has occurred among the states with respect to private corporations for whom exchange listing standards have no application. For example, Model Code § 7.32, a provision that has been adopted in some form by 20 states, allows a private corporation, among other things, to completely opt-out of director elections

²⁰⁶ See ROMANO, *supra* note --, at _.

²⁰⁷ See EASTERBROOK & FISCHER, *supra* note --, at 218.

²⁰⁸ See ROMANO, *supra* note --, at 5; Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?* 10. Available at SSRN: <http://ssrn.com/abstract=693484>.

²⁰⁹ See *id.*

²¹⁰ See Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 281 (1985). Note that Minnesota’s adoption of its regular meeting approach was done as part of a complete overhaul of its entire corporate code as opposed to an isolated change. See MINN. STAT. ANN. § 302A.001.

²¹¹ See 15 U.S.C. § 78(s)(b).

²¹² See Paul Rose, *The Corporate Governance Industry* (May 17, 2006) at 14. Available at SSRN: <http://ssrn.com/abstract=902900>.

²¹³ See EASTERBROOK & FISCHER, *supra* note --, at _ (noting that even fifty competitors is likely insufficient to yield optimal laws).

and shareholders meetings.²¹⁴ Additionally, experimentation has also occurred among states competing for investment company incorporations. For example, Maryland's corporate code requires annual shareholders' meetings for the election of directors but specifically allows an investment company to opt-out of the requirement through an articles of incorporation or bylaws provision.²¹⁵

B. Implications of Corporate Federalism

By abolishing exchange listing standards that require corporations to hold annual director elections and shareholders' meetings, the number of "jurisdictions" potentially experimenting with different approaches to the issue for public corporations will increase from three to fifty, thereby greatly increasing the likelihood of yielding a more efficient rule. While the Minnesota approach is superior to the current rule, it may not be optimal. It includes a number of variables that could be tweaked by other states, including the minimum share ownership percentage requirement (3%) and the elapsed time requirement (15 months) for a shareholder to demand a meeting.²¹⁶ North Dakota, in fact, takes the same approach as Minnesota but has a five percent minimum share ownership requirement and a slightly different elapsed time requirement ("the earlier of six months after the fiscal year end of the corporation or fifteen months after its last meeting").²¹⁷ Other states may want to experiment with an all together different approach, perhaps divorcing the concepts of director elections and shareholders' meetings or lengthening the time between elections but eliminating staggered boards.

Flexibility on the frequency of elections and meetings is important in light of the continuing corporate governance reform debate. As Chancellor Allen recognized in *Hoschett*, director elections and shareholders meetings play a central role in corporate governance.²¹⁸ Consequently, the best rule should not be viewed in isolation but instead as part of an overall corporate governance package. As Leo Strine, Vice Chancellor, Delaware Court of Chancery recently put it:

²¹⁴ See 2 MBCA ANN., *supra* note --, § 7.32. See *id.* § 7.32, Statutes, at 7-249 thru 7-250 for a list of the 20 states that have adopted some version of Model Code § 7.32.

²¹⁵ See MD. ANN. CODE art. 2, § 501(a) & (b) (2005).

²¹⁶ See MINN. STAT. ANN. § 302A.431(2).

²¹⁷ *Id.* § 10-19.1-71(2).

²¹⁸ See *Hoschett*, 683 A.2d at 44.

State law determinations about corporate elections are not made in a vacuum but as part of an overall consideration of how to shape a working system of corporate law that promotes responsible wealth creation. In that deliberative process, policymakers have to balance the social utility of empowering centralized management against the need for protective mechanisms that ensure managers' fidelity to the entities they govern. That balance informs the policy debate about what transactions stockholders should have the right to veto, how easy it should be to bring a derivative suit, when a board should be able to block a takeover, and most every important question of corporate law.²¹⁹

As mentioned above, various corporate governance reform proposals have been made recently to make the election of directors more meaningful. These include variations on shareholder proxy access, majority voting, and proxy contest expense reimbursement. In connection with adopting one of these proposals, a state may determine it is no longer advisable to elect directors annually. For example, a criticism leveled against many of the proposed reforms is that they will lead to short-termism.²²⁰ Specifically, if directors face meaningful annual elections, management will focus on short-term results to the detriment of the corporation's long-term success. This is because the majority of shares of most public corporations are owned by institutional investors who generally focus on short-term performance. Therefore, the thinking goes, to keep this shareholder base happy, management will likewise adopt a short-term focus to the detriment of the corporation's long-term success.²²¹ Additionally, management will also likely spend even more money and time than under the current system in preparing for an annual meeting with meaningful elections because it will have to actively campaign for the incumbents and against the challengers. Hence, if a state were to experiment with one or more of the proposed reforms, one way to address these concerns would be to lengthen the time between director elections thereby decreasing their frequency.²²² Under the current system, this would not be possible because of the

²¹⁹ Strine, *supra* note --, at 1777.

²²⁰ See Bebchuk, *supra* note --, at 34. See also Strine, *supra* note --, at 1769.

²²¹ See *id.* See also Lipton & Rosenblum, *supra* note --, at 210; see Strine, *supra* note --, at 1769.

²²² See Bebchuk, *supra* note --, at _ (“the short-termism concern might justify providing boards with periods of significant length during which they do not face a meaningful chance of ouster”).

overriding exchange listing standard requirement of annual director elections and shareholders' meetings.

C. Persistence of Exchanges' Requirement

The history outlined in Part III.D. helps explain why the requirement of annual shareholders' meetings for the election of directors emerged but does little to explain why it persists today at the exchange level. The persistence is somewhat surprising considering the purported primary justifications lack validity, state law addresses the area, and a better approach is available. The persistence is likely explained at least in part by public choice theory. The exchanges serve three primary interest groups: listed companies, investors and the SEC. None of these groups have a strong incentive to push for the elimination of the requirement to hold annual shareholders' meetings for the election of directors. For listed companies and the SEC, this is due in large part to the public misperception that annual elections and meetings are critical to corporate democracy and good governance. Thus, for listed companies the costs of holding annual elections and meetings are not great enough to push for change and risk being labeled as anti-democratic or anti-shareholder. For the SEC, pushing for what would be perceived as a reduction in shareholders' rights would be inconsistent with its mission of protecting investors. As for investors, many are likely rationally apathetic as to exchange rules and those who are not, i.e., activist shareholders, highly value the annual opportunity to push their agendas through shareholders' meetings.

Similarly, the exchanges are likely hesitant to unilaterally propose changing the status quo even if the change would benefit both listed companies and investors generally. Softening the annual election and meeting requirement would raise the ire of vocal shareholder activists and would be framed as inconsistent with "encourage[ing] high standards of corporate democracy" and maintaining "appropriate standards of corporate responsibility, integrity and accountability to shareholders,"²²³ the stated purpose of the NYSE corporate governance standards. Additionally, the NYSE and Nasdaq are now explicitly competing on the basis of stringent listing standards. For example, Nasdaq recently announced it is creating a new market tier "that will have the highest initial listing standards in the

²²³ See *id.* § 301.00.

world.” Softening the annual election and meeting requirements would likely be perceived as inconsistent with such a statement.²²⁴

Further, some may believe that ceding the issue of frequency of elections and shareholders’ meetings to the states is ill advised. This is because the idea touches on a 30 year old debate as to whether competition among states for incorporations has led to a race to the top or a race to the bottom in state corporate law.²²⁵ The debate is beyond the scope of this article, but it has produced some thinking that is relevant here. Specifically, Professor Bebchuk has asserted that corporate federalism “works well in some areas of corporate law but poorly in others; that is state competition produces a race for the top with respect to some corporate issues but a race to the bottom with respect to others.”²²⁶ Among the areas he asserts it does not work well are rules with respect to proxy contests.²²⁷ A proxy contest is often a necessary component of a hostile takeover attempt because of the widespread use of poison pills. Hence, rules that make proxy contests more difficult make hostile takeover attempts more difficult and thereby dilute the disciplinary force of the market for corporate control. Since managers are averse to being ousted, they will seek rules that make it more difficult to launch proxy fights even if these rules decrease shareholder value.²²⁸ In an effort to get incorporation business, states may respond by providing rules making proxy contests more difficult.

State rules with respect to the frequency of director elections clearly impact the timing of electoral proxy fights. If for example a state required elections only once every five years, it would be possible to launch an electoral proxy fight only once every five years. Hence, to address this concern, the exchanges could set a minimum standard for the frequency of elections.²²⁹ For example, they could mandate that every listed company make it possible for an insurgent holding a specified percentage of stock to launch an electoral proxy contest to replace a majority of the board at least

²²⁴ Nasdaq Stock Market, Inc. Press Release, NASDAQ Creates New Market Tier with Highest Listing Standards in the World (Feb. 15, 2006). Available at <http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/02-15-2006/0004282412&EDATE=>

²²⁵ See Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 629 (2004). See also See ROMANO, *supra* note --, at 14.

²²⁶ Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits of State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1440 (1992).

²²⁷ See Bebchuk, *supra* note --, at 1468.

²²⁸ See Bebchuk, *supra* note --, at 1468.

²²⁹ See *id.* at 1484 (noting that one way to deal with the issue is to set a minimum standard).

once every two years.²³⁰ This could generally be done through a bylaw amendment entitling a shareholder owning the requisite percentage to call a special meeting for the purpose of removing the incumbent board and electing a new board.²³¹ It should also allay any race to the bottom concerns and still allow ample room for state experimentation. Now if only there was an easy way to deal with the public choice theory considerations.

D. Conclusion

Whether states would actually experiment with different approaches to the frequency of director elections and shareholders' meetings if the exchange requirements were abolished is unclear. Recent research has characterized competition among states for incorporations as weak, largely because Delaware has established itself as the runaway winner of the race.²³² Hence, many states likely view competing as pointless.²³³ Delaware and other states may wait to see, for example, whether high visibility corporations incorporated in Minnesota (e.g., Best Buy Co., Inc.; Medtronic, Inc.; UnitedHealth Group Incorporated) take advantage of the available flexibility and, if so, how it is received by the marketplace. In fact, exchange abolishment may in and of itself aid market acceptance of a Minnesota-type or other approach by signaling to the market that, in the view of the exchanges, innovation is desirable.²³⁴

In any case, weak competition among states is better than no competition, especially considering the current suboptimal scheme. At a minimum, abolishing the exchange requirements will give effect to the superior Minnesota and North Dakota approaches for corporations

²³⁰ I derived the two years from the timing an insurgent is facing under the current system with respect to a corporation that has a staggered board.

²³¹ See, e.g., 2 MBCA ANN., *supra* note --, §§ 7.02 & 8.08; DEL. CODE ANN. tit. 8, §§ 211(d) & 141(k). The corporation would also need to amend its articles/certificate to eliminate any requirement that a director can only be removed for cause. See 2 MBCA ANN., *supra* note -- §8.08(a); DEL. CODE ANN. tit. 8, § 141(k)(1). Note that ousting incumbents outside the annual meeting setting has been done. In fall 2005, Red Zone LLC ousted three of Six Flags, Inc.'s seven directors through a consent solicitation, i.e., Red Zone successfully solicited sufficient written consents from Six Flags' shareholders to remove three directors and replace them with three directors selected by Red Zone. See Six Flags' 2006 Proxy Statement, *supra* note __, at 29.

²³² See Bebchuk & Hamdani, *supra* note --, at __; Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 701-724 (2002). *But see* Romano, *supra* note --, at 12-26.

²³³ See Bebchuk & Hamdani, *supra* note --, at 556.

²³⁴ See Gordon, *supra* note --, at 1569.

incorporated in those states, but it may also lead to experimentation by other states and thus a better rule. At the same time, race to the bottom concerns could be addressed by an exchange listing standard floor. Regardless, the resulting flexibility may prove an important component of a corporate governance reform package.

VI. CONCLUSION

Corporations have been required to hold annual shareholders' meetings for the election of directors since the dawn of corporate law. The requirement is reflected both in state corporate law and exchange listing standards. Although this requirement may have made sense at one time, it no longer does. Today, the large majority of annual director elections and shareholders' meetings are meaningless and therefore a waste of time and money.

One response could be to make them more meaningful. For example, shareholders could be allowed to annually include candidates on a corporation's proxy, management attendance at shareholders' meetings could be mandated; a convenient meeting location could be required, etc. But for what end? There simply is no need for shareholders to *annually* elect directors, exercise corporate democracy, engage in deliberation, present matters to other shareholders, or confront management. It is not the frequency of these events that is important but the possibility that they can be triggered when needed. The Minnesota approach eliminates the annual requirement but preserves the trigger—no shareholders' meeting for the election of directors is held unless shareholders or the corporation deems it necessary.

With that said, I am a believer in corporate federalism, even if competition among states for incorporations is weak. Hence, this article does not call for a blanket adoption of the Minnesota approach but instead proposes that the exchanges abolish their requirements to hold annual shareholders' meetings for the election of directors. This would not only give effect to the Minnesota and North Dakota approaches, but would provide states with a meaningful opportunity to experiment with different rules. And flexibility on the frequency of elections and meetings could be an important part of corporate governance reform.