TOWARD A THEORY OF SHAREHOLDER LEVERAGE
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Over the past several years increased shareholder activism has triggered significant corporate governance changes aimed at enhancing shareholders’ power over director elections and corporate affairs. These changes threaten both the director primacy theory and the team production theory of corporate governance by undermining directors’ broad discretion to make decisions on behalf of the corporation and all of its constituents. But such changes have not resulted in a regime of shareholder primacy. Rather they can be better understood as a regime of shareholder leverage. Despite the increased power at their disposal, in most circumstances, the shareholders remain content to defer to directors. When they are not content, directors retain the freedom to ignore and even circumvent shareholders’ will, blunting the force of increased shareholder power. The theory of shareholder leverage therefore contends that while the current governance regime paves the way for shareholders to exercise greater influence over director decision-making, directors still appropriately remain the primary power source in the modern public corporation.

A significant number of corporate governance changes have occurred in the past few years, particularly surrounding executive compensation and director elections. Indeed, public company shareholders now have a say on pay—an advisory vote on the compensation packages of the top executives.1 Additionally, director election processes have been radically altered. By the beginning of 2014, 91 percent of S&P 500 companies had declassified their boards—up from 40 percent a decade ago2—and almost 90 percent of S&P 500 companies had adopted some form of majority voting whereby directors must either receive a majority shareholder vote or resign upon failure to receive majority shareholder support.3 In 2006, only 16 percent of S&P 500 companies had implemented such standards.4 Moreover, while the D.C. Circuit

3. Marc S. Gerber, US Corporate Governance: Boards of Directors Face Increased Scrutiny, SKADDEN (Jan. 16, 2014), http://www.skadden.com/insights/us-corporate-governance-boards-directors-face-increased-scrutiny; see also SPENCERSTUART, supra note 77, at 13 (noting that 84 percent of boards have policies requiring directors who fail to secure majority vote to offer their resignation, up form 56 percent in 2008).
overturned the Security and Exchange Commission’s (SEC) mandated proxy access rule which would have required that corporations enable certain shareholders to nominate candidates of their choice on the corporation’s proxy statement,\(^5\) beginning in 2012 shareholders have been allowed to submit shareholder proposals seeking to adopt procedures for proxy access.\(^5\) These changes collectively pave the way towards greater shareholder influence over corporate affairs.

Such changes also appear to breathe new life into the shareholder primacy theory while undermining both the director primacy and team production theory of corporate governance. Enhanced shareholder power certainly runs counter to the broad director discretion envisioned by director primacy. It not only limits director decision-making in connection with management and their pay policies but also constrains directors’ freedom to make business decisions that may be disfavored by shareholders. Increased shareholder power also increases the probability that directors will focus exclusively on shareholders rather than balancing the competing concerns of all corporate constituents as envisioned by the team production model.

But evidence reveals that with respect to compensation and election matters, shareholders are largely content not to exercise their increased powers. Thus, the vast majority of directors continue to get elected at high rates.\(^7\) In the last election cycle, only 61 director nominees received less than majority support.\(^8\) Similarly, shareholders overwhelmingly approve the vast majority of discretionary voting in uncontested director elections, a change which was viewed as significant because studies suggested that when brokers cast uninstructed votes, those votes tended to favor management. See § 78f(b)(3)(A-B); see generally Melissa Aguilar, Reminder: Broker Votes Out for Say On Pay, COMPLIANCE WEEK (Aug. 17, 2010), http://www.complianceweek.com/reminder-broker-votes-out-for-say-on-pay/article/187418 (“Since brokers historically tended to cast those votes in favor of management, observers say the change could make it tougher for some companies to win shareholder approval of management say-on-pay resolutions, which will become mandatory under the law.”). Elimination of such votes was therefore presumed to enhance shareholder voting power. Knute J. Salhus & Jeffries L. Oliver-Li, SEC Approves Elimination of Broker Discretionary Voting in Uncontested Elections of Directors, WILMERHALE (July 2, 2009), http://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=93237.

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\(^5\) Business Roundtable v. SEC, 647 F.3d 1144, 1147, 1156 (D.C. Cir. 2011).


\(^7\) See id. at 33.

\(^8\) James B. Stewart, Bad Directors and Why They Aren’t Thrown Out, N.Y. TIMES, Mar. 29, 2013, http://www.nytimes.com/2013/03/30/business/why-bad-directors-arent-thrown-out.html. One study found that “only 8 percent of the directors who received majority withheld votes at companies with plurality plus” regimes stepped down after the vote, and “only half of directors at companies with majority standards did so.” See IRCC INST., GMI RATINGS, THE
pay packages, with the result that less than 2 percent of company pay packages get rejected.\textsuperscript{9} Then too, when shareholders exercise their power, directors are able to thwart that exercise. There are several highly publicized examples of shareholders repeatedly rejecting pay packages that corporations do not alter.\textsuperscript{10} This is because some corporations have opted to ignore the advisory say on pay vote. Evidence also reveals that most directors who fail to receive a majority of the shareholder vote remain on the board. Of the 61 directors who failed to receive majority vote in 2013, 51 remained on the board at the start of the 2014 proxy season, resulting in what some have called “zombie directors.”\textsuperscript{11} This is because the board has discretion to refuse to accept directors’ resignations or otherwise retain directors, when they fail to get a majority vote.\textsuperscript{12} This means that directors have considerable discretion to make decisions that are at odds with shareholder preferences.

To be sure, despite this discretion shareholders do enjoy significantly more sway over director decision-making. Empirical evidence confirms that directors have increased their engagement with shareholders, enhanced their disclosures in an effort to prevent any shareholder discontent, and altered their policies on compensation as well as director recruitment and retention.\textsuperscript{13} These actions suggest that while the board continues to have considerable discretion in the current corporate governance regime, shareholders have increased leverage. The critical question then becomes whether a shareholder leverage model of corporate governance can provide a more appropriate balance between board discretion and accountability.

\textsuperscript{9} See INSTITUTIONAL SHAREHOLDER SERVICES, supra note 6, at 6.
\textsuperscript{10} See id.
\textsuperscript{11} See, e.g., Stewart, supra note 8.
\textsuperscript{12} See generally id. ("[T]he reality is that H.P. can do whatever it wants, regardless of what the shareholders say.").