Proceedings of the 2014 Delaware Business Law Forum: Director-Centric Governance in the Golden Age of Shareholder Activism

*By Diane Holt Frankle, Holly J. Gregory, Gregory V. Varallo, and Christopher H. Lyons**

In October 2014, leading corporate governance practitioners from around the United States convened at the biennial Delaware Business Law Forum, along with current and former jurists of the Delaware Supreme Court and Court of Chancery, to discuss and debate developing topics in corporate governance. Participants also included representatives of "activist" investors, institutional investors, public company directors and those who advise them, academics, and others. The participants considered and debated the extent to which corporate governance remains "board-centric," the extent to which the rise of shareholder activism is changing that paradigm, and what implications such changes may have for the future. This Article reports on the key questions discussed at the Forum and attempts to summarize the discussion and consensus (if any) reached with respect to these questions.

Introduction

On October 24 and 25, 2014, the biennial Delaware Business Law Forum convened in Wilmington, Delaware under the aegis of the Business Law Section of the American Bar Association.[1] Corporate governance practitioners from around the United States and current and former jurists from the Delaware Supreme Court and Court of Chancery were in attendance, along with representatives of "activist" investors, institutional investors, public company directors and

* Diane Holt Frankle is a partner at Kaye Scholer LLP in Palo Alto, California; Holly J. Gregory is a partner at Sidley Austin LLP in New York, New York; and Gregory V. Varallo is a director, and Christopher H. Lyons is an associate, at Richards, Layton & Finger, P.A. in Wilmington, Delaware. The authors or their firms were involved in some of the cases discussed herein. The opinions expressed in this article are those of the authors (or of the participants at the Forum) and not necessarily those of their firms or their clients.

1. The Delaware Business Law Forum is organized by the American Bar Association and held every other year in Wilmington, Delaware. The mission of the Forum is "to provide a forum in which Delaware's judiciary and a diverse and experienced group of business lawyers can have a candid discussion on subjects of current or emerging importance that affect the development of Delaware business law." *Delaware Business Law Forum Committee*, Am. B. Association, http://apps.americanbar.org/dch/committee.cfm?com=CL102000 (last visited Mar. 9, 2015). The 2014 Forum was held in October 2014 and chaired by Diane Frankle, Holly Gregory, and Greg Varallo. Chris Lyons served as Reporter.

those who advise them, academics, and others. The Forum opened with a keynote address from Delaware Supreme Court Chief Justice Leo E. Strine, Jr. (appearing elsewhere in this volume),[2] and then proceeded with panel and breakout sessions debating several issues pertaining to the current state of corporate governance under Delaware law, concluding in an oral argument presented by two leading corporate governance litigators and presided over by the Honorable Karen L. Valihura of the Delaware Supreme Court.

The purpose of this Article is to report on the discussion of the key questions presented at the Forum and, where reached, the consensus views on such questions. While the task of attempting to define a "consensus" of the eighty participants in the Forum is undoubtedly one fraught with many perils, it is a task undertaken in a modest attempt to add to the literature. Of course, the authors are guilty of exercising a liberal degree of literary license in attempting to distill consensus that may not otherwise have been obvious at the Forum itself.

Question No. 1: Do Corporations Still Operate Under a "Board-centric" Governance Model?

The framework of corporate governance is still "board-centric" in that most of the leading governance statutes, including the Delaware General Corporation Law, continue to provide the board the central role in managing or directing the corporation.[3] In addition, the courts, and most significantly the Delaware courts, continue to enforce and respect the primary role of the board.[4]

The answer is not unqualified, however, especially with respect to publicly traded corporations, which are subject to an increasing array of federal law and regulation that has provided shareholders greater influence, an influence that is supported by prominent proxy advisory services that have obtained significant power to influence shareholder votes.

2. Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-making and Reduce the Litigation Target Zone*, 70 Bus. Law. 679 (2015).

3. *See* Del. Code Ann. tit. 8, § 141(a) (2011) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."); *see also, e.g.*, CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 232 (Del. 2008) (holding invalid a stockholder-adopted bylaw that would limit board freedom to provide or deny expense reimbursement to participants in proxy contests, citing board's managerial power under 8 *Del. C.* § 141(a) and noting that "[n]o such broad management power is statutorily allocated to the shareholders. Indeed, it is well-established that stockholders of a corporation subject to the DGCL may not directly manage the business and affairs of the corporation, at least without specific authorization in either the statute or the certificate of incorporation.").

4. *See, e.g.*, Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 111 (Del. Ch. 2011) (holding that board was permitted to adopt and maintain a poison pill preventing hostile takeover at a premium, in face of "sufficient evidence that a majority of stockholders might be willing to tender their shares," because board in good faith believed the hostile offer was inadequate); *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 415 (Del. Ch. 2010) ("[D]irector primacy remains the centerpiece of Delaware law, even when a controlling stockholder is present."); *see also* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 940, 948 (Del. Ch. 2013) (explaining that bylaws, even if unilaterally adopted by board, "are presumed to be valid" and holding board-adopted forum-selection bylaw facially valid).

In the past ten years, the once fairly common staggered board has become relatively rare among large public companies,[5] as institutional investors and governance advisors have come to view it as an impediment to board accountability.[6] This is despite recent empirical evidence indicating that companies that adopt staggered boards tend to experience positive abnormal returns after doing so, whereas companies that de-stagger their boards tend to have zero abnormal returns or negative abnormal returns.[7]

Likewise, the ability of boards to adopt shareholder rights plans (or "poison pills"), either on a "clear day" in response to existential threats or in the face of a rapid accumulation of shares or the emergence of a hostile acquirer, once widely accepted and repeatedly confirmed as a lawful exercise of board authority in Delaware decisional authorities,[8] has all but vanished as a practical matter under pressure from shareholders and proxy advisory firms.[9]

5. For example, it has been reported that as of 2014 "93% of boards [of S&P 500 companies] have one-year director terms." SPENCER STUART BD. SERVS., SPENCER STUART U.S. BOARD INDEX 2014, at 15 (2014) [hereinafter SPENCER STUART]. This percentage "has increased significantly from 55% in 2004." *Id.*

6. *See, e.g.*, GLASS, LEWIS & CO., LLC, 2015 PROXY SEASON: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE 20 (2015) [hereinafter GLASS, LEWIS] ("Glass Lewis favors the repeal of staggered boards and the annual election of directors. We believe staggered boards are less accountable to shareholders than boards that are elected annually. Furthermore, we feel the annual election of directors encourages board members to focus on shareholder interests."); INSTITUTIONAL S'HOLDER SERVS., UNITED STATES SUMMARY PROXY VOTING GUIDELINES 17 (Dec. 22, 2014) [hereinafter ISS] ("General Recommendation: Vote against proposals to classify (stagger) the board. Vote for proposals to repeal classified boards and to elect all directors annually."); COUNCIL OF INSTITUTIONAL INVESTORS, CORPORATE GOVERNANCE POLICIES 5 (Oct. 1, 2014) [hereinafter CII] ("All directors should be elected annually. Boards should not be classified (staggered).").

7. *See* Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, Staggered Boards and Firm Value, Revisited 33 (July 14, 2014) (unpublished manuscript available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2364165). This recent evidence appears to contradict earlier cross-sectional research indicating that staggered boards are associated with lower firm values, *see, e.g.*, Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 410–11, 430 (2005) (finding evidence that staggered boards were associated with lower firm value), results that may indicate that "having a relatively low firm value induces some firms to adopt a staggered board (rather than the adoption of a staggered board causing lower firm value)," but that a staggered board is not inherently destructive of value. Cremers, Litov & Sepe, *supra*, at 5.

8. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); *Air Prods. & Chems.*, 16 A.3d 48, at 112.

9. GLASS, LEWIS, *supra* note 6, at 37 ("Glass Lewis believes that poison pill plans are not generally in shareholders' best interests. . . . Typically we recommend that shareholders vote against these plans to protect their financial interests and ensure that they have an opportunity to consider any offer for their shares, especially those at a premium."); ISS, *supra* note 6, at 24 ("General Recommendation: Vote for shareholder proposals requesting that the company submit its poison pill to a shareholder vote or redeem it unless the company has: (1) [a] shareholder approved poison pill in place; or (2) [t]he company has adopted a policy concerning the adoption of a pill in the future specifying that the board will only adopt a shareholder rights plan if either: [s]hareholders have approved the adoption of the plan; or [t]he board, in its exercise of its fiduciary responsibilities, determines that it is in the best interest of shareholders under the circumstances to adopt a pill without the delay in adoption that would result from seeking stockholder approval (i.e., the 'fiduciary out' provision). A poison pill adopted under this fiduciary out will be put to a shareholder ratification vote within 12 months of adoption or expire. If the pill is not approved by a majority of the votes cast on this issue, the plan will immediately terminate."); CII, *supra* note 6, at 12 ("A majority vote of common shares outstanding should be required to approve . . . [p]oison pills . . . .").

Moreover, while compensation of executive officers is clearly within the purview of the board, the Dodd-Frank Act's requirement that shareholders have an advisory vote on executive compensation[10] is, together with the influence of proxy advisory firms, as a practical matter constraining board decisions. Proxy advisory firms have established outer boundaries and unacceptable terms of compensation that boards and compensation committees traverse at their peril.[11] In particular, while the "say-on-pay" votes provided for under federal law are technically non-binding,[12] the proxy advisory services have made clear that they will recommend voting against or withholding votes from compensation committee members who fail to respond "adequately" to say-on-pay votes that receive material opposition, even if a majority of the shareholders actually vote *in favor* of the current compensation practices.[13]

All of this bears particular importance in the current climate because, with respect to director elections, majority voting has become the de facto standard for all but the smallest public companies,[14] and the loss of the broker discretionary vote

10. 15 U.S.C. § 78n-1(a), (b) (2012).

11. Glass, Lewis, *supra* note 6, at 12 (noting that Glass Lewis "will consider recommending that shareholders vote against," for example, "[a]ll members of the compensation committee who are up for election and served when the company failed to align pay with performance (e.g., a company receives an F grade in our pay-for-performance analysis) if shareholders are not provided with an advisory vote on executive compensation at the annual meeting" and against "[a]ll members of the compensation committee if excessive employee perquisites and benefits were allowed"); *id.* at 36–53 (listing evaluation factors for executive and director pay); ISS, *supra* note 6, at 36–48 (same); *id.* at 37 ("General Recommendation: . . . Vote against or withhold from the members of the Compensation Committee and potentially the full board if . . . [t]he company has recently practiced or approved problematic pay practices, including option repricing or option backdating; or [t]he situation is egregious."); CII, *supra* note 6, at 13–22 (articulating executive compensation principles that "should apply to all companies," while recognizing need for "company-by-company" structuring of executive compensation).

12. *See* 15 U.S.C. § 78n-1(c) (2012) ("The shareholder vote referred to in subsections (a) and (b) shall not be binding on the issuer or the board of directors of an issuer, and may not be construed—(1) as overruling a decision by such issuer or board of directors; (2) to create or imply any change to the fiduciary duties of such issuer or board of directors; (3) to create or imply any additional fiduciary duties for such issuer or board of directors; or (4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.").

13. Glass, Lewis, *supra* note 6, at 28 ("At companies that received a significant level of shareholder opposition (25% or greater) to their say-on-pay proposal at the previous annual meeting, we believe the board should demonstrate some level of engagement and responsiveness to the shareholder concerns behind the discontent, particularly in response to shareholder engagement. . . . In the absence of any evidence that the board is actively engaging shareholders on these issues and responding accordingly, we may recommend holding compensation committee members accountable for failing to adequately respond to shareholder opposition, giving careful consideration to the level of shareholder protest and the severity and history of compensation problems."); ISS, *supra* note 6, at 37 (recommending that shareholders "[v]ote against or withhold from the members of the Compensation Committee and potentially the full board if . . . [t]he board fails to respond adequately to a previous [Management Say-on-Pay] proposal that received less than 70 percent support of votes cast").

14. *See* Spencer Stuart, *supra* note 5, at 15 ("It has become standard practice for boards to establish policies requiring directors who fail to secure a majority vote to offer their resignation. 86% of [S&P 500] boards now have such policies, up from 65% in 2009."); Skadden, Arps, Slate, Meagher & Flom LLP, 2014 Insights: A Collection of Commentaries on the Critical Legal Issues in the Year Ahead 157 (2014) ("Approximately 90 percent of S&P 500 companies (and approximately 46 percent of Russell 3000 companies) have a majority voting standard in director elections and/or a policy requiring resignation if a director fails to get majority support; shareholder proposals on this topic received

has increased the importance of the vote of the institutional shareholders, who make up an increasing percentage of most public companies' stockholder base.

Pension funds and other large institutional investors posit that while the board is the primary decision-maker in the corporation, shareholders have a legitimate and important role in pressing for accountability and, when necessary, the ability to affect the leadership of what they view to be poorly performing companies, in at least the most egregious cases. One institutional holder who participated in the Forum likened such shareholders to passengers in a car, willing to endure traffic jams and bumps, but sometimes tiring of repeated jams or car wrecks and willing then to consider replacing the driver. Given that many large institutional holders are heavily indexed in their holdings, the option of simply selling the securities of a poorly performing portfolio company is not realistic and thus the assertion of a more activist approach to governance, and in some extreme cases a resort to litigation, have become the "safety valve" for many such investors. To paraphrase one large institutional holder at the conference, their thinking about corporate governance is "board-centric until it isn't."

Question No. 2: Is the "Board-centric" Governance Model Under Siege?

The views on whether board-centrism is in fact "under siege" varied widely, but the consensus may be described as follows: while the "rules of the game" remain primarily "board-centric," the increasing strength and fervor of the players on the shareholders' side of the field have increasingly driven directors to be more responsive to and concerned with the demands of shareholders and, in particular, those of institutional investors and activist shareholders. Because the relative costs and benefits of those demands vary from case to case and company to company, it likely cannot be said on a universal basis whether this development amounts to a "siege" on directors and the existing model of corporate governance, or whether it is simply a healthy vivification of a previously too-distant relationship between directors and their constituencies.

Rather as expected, participants in the Forum who served on one or more public company boards and who had lived through dialogue with activist investors viewed the board-centric governance model as directly and increasingly threatened. Activist investors did not.

Proponents of the view that the board-centric model was under siege pointed to the facts that a large majority of S&P 500 profits were currently used to repurchase stock or pay dividends,[15] a significant percentage of proxy fights

average shareholder support of 58 percent in 2013."). Although many of these policies allow the board to reject the resignation of a director who did not receive majority support, the Delaware Supreme Court has held that stockholders are entitled to inspect the corporate books and records in order to investigate the suitability of such directors to serve in these circumstances. City of Westland Police & Fire Ret. Sys. v. Axcelis Techs., Inc., 1 A.3d 281, 291 (Del. 2010).

15. *See* Lu Wang & Callie Bost, *S&P 500 Companies Spend Almost All Profits on Buybacks*, Bloomberg (Oct. 6, 2014), http://www.bloomberg.com/news/2014-10-06/s-p-500-companies-spend-almost-all-profits-on-buybacks-payouts.html.

conducted in 2014 had been won by activists (and that the percentage was likely understated given the number of such contests that settle before they become contests),[16] and public company boards seemed to be rushing headlong to abandon any defenses in response to governance critiques by shareholders and proxy advisory services. Majority voting in uncontested director elections, which was almost unknown just a few years ago, has been widely adopted and is generally viewed as a powerful change agent.[17] Say-on-pay rules have had a powerful influence on compensation committee behavior. And board nomination policies and procedures have likewise evolved in response to activist criticism of board "slating" policies and the composition of many boards. Moreover, board decisions regarding fundamental matters such as strategy and capital allocation are now subject to real-time shareholder commentary and discussion—and, hence, pressure.

Concern was raised by director participants that the focus of institutional shareholders is often on short-term outcomes. They perceive both a lack of patience and a growing "what have you done for me lately?" attitude among many shareholders. This short-term focus was troubling to some participants, given recent evidence highlighting the possible negative effects of excessive responsiveness to short-term demands.[18]

Directors also commented that the governance menu seemed increasingly "one-size-fits-all" and there seemed to be less recognition among shareholders that the driver, to use the car analogy, might get to the same destination using many different routes—or that different vehicles might be better suited to different routes.

Proponents of the view that the board-centric framework for corporate governance is not under attack asserted that recent governance developments and reforms were net positive for corporations and provided institutional investors, including indexed investors, the ability to help create and preserve value in their portfolios. Activist attempts to engage in dialogue with investee boards and activists' support for some companies even in the face of adverse recommendations

16. Data provided by FactSet Research Systems Inc., through its SharkRepellent.net website, indicates that 73 percent (sixty-seven of ninety-two) of proxy fights where an outcome was reached in 2014 resulted in outright victories, partial victories, or settlements by the dissident. *See Proxy Fights 2014*, SharkRepellent.net (last visited Mar. 21, 2015).

17. *See supra* note 14; *see also* Yonca Ertimur, Fabrizio Ferri & David Oesch, *Does the Director Election System Matter? Evidence from Majority Voting* (May 30, 2013) (unpublished manuscript available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1880974) (finding an increase in boards' responsiveness to shareholders at companies that have implemented a majority-voting standard).

18. *See* Jie (Jack) He & Xuan Tian, *The Dark Side of Analyst Coverage: The Case of Innovation*, 109 J. Fin. Econ. 856, 858 (2013) (finding that, in response to pressure to meet near-term earnings targets, "managers boost current earnings by sacrificing long-term investment in innovative projects that are highly risky and slow in generating revenues"); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. Pa. L. Rev. 653, 702–03 nn.154–55 (2010) (citing research indicating that only 59 percent of executives would approve high net-present-value projects that would cause company to miss earnings by ten cents); John R. Graham et al., *The Economic Implications of Corporate Financial Reporting*, 40 J. Acct. & Econ. 3, 32–35 & fig. 5 (2005) (showing that 55.3 percent of surveyed CFOs would delay starting a new project, even if it entailed a small sacrifice in value, in order to meet quarterly earnings target).

from proxy advisory firms were cited as examples of activists' respect for the board-centric model and their attempts to work within the framework of that model. One participant noted that shareholders have not obtained "new" statutory rights other than advisory "say-on-pay" votes, despite the governance scandals that shook the capital markets at the beginning of the century, and that federal proxy access rules had been struck down by the courts.[19]

Question No. 3: How Do Board-adopted Director Qualification, Exclusive Forum, and "Loser Pays" Bylaws Impact Governance and Shareholder Interests?

Forum participants debated these issues in break-out sessions. With respect to director qualification bylaws, while it was noted that such bylaws were permitted by Delaware statute,[20] the consensus seemed to be to approach such bylaws with some reasonable degree of skepticism, unless a strong business or legal case existed for them. Thus, companies that operated in a regulated industry might well have need for highly specific director qualification bylaws. However, qualification bylaws that were obviously intended to discriminate against activists, especially when adopted after the outset of an activist campaign, were viewed with a good deal more cynicism.

With respect to bylaws providing for an exclusive forum for the adjudication of governance issues, it was noted that such provisions appeared to have received increasing acceptance in the various state and federal courts that have considered them[21] and, except in the most egregious cases, were likely to

19. Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011) (vacating proxy access rules based on conclusion that SEC was "arbitrary and capricious" in promulgating them). *But see* Del. Code Ann. tit. 8, § 112 (2011) (providing for private ordering proxy access under state law); 17 C.F.R. § 240.14a-8(i)(8) (2014) (SEC rule allowing shareholders to submit proposals to adopt proxy access rules as matter of company-specific private ordering).

20. Del. Code Ann. tit. 8, § 141(b) (2011) ("Directors need not be stockholders unless so required by the certificate of incorporation or the bylaws. The certificate of incorporation or bylaws may prescribe other qualifications for directors.").

21. City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229 (Del. Ch. 2014) (upholding forum-selection bylaw adopted by board on same day as merger agreement that selected corporation's headquarter state rather than state of incorporation and dismissing action filed in state of incorporation in contravention of bylaw); Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013) (holding board-adopted forum-selection bylaw facially valid); *see also* North v. McNamara, No. 1:13-cv- 833, 2014 WL 4684377 (S.D. Ohio Sept. 19, 2014) (upholding and enforcing forum-selection bylaw adopted by board after alleged wrongdoing and granting motion to transfer venue to District of Delaware); Beth v. Protective Life Corp., CV-2014-902474.00 (Ala. Cir. Ct. Sept. 19, 2014) (order) (granting motion to dismiss based on forum-selection bylaw); Brewerton v. Oplink Commc'ns Inc., C.A. No. RG14-750111 (Cal. Super. Ct. Dec. 12, 2014) (order) (enforcing forum-selection bylaw the adoption of which coincided with approval of challenged transaction and dismissing action filed in contravention of bylaw); Groen v. Safeway Inc., C.A. No. RG14-716641, slip op. at 2 (Cal. Super. Ct. May 14, 2014); Transcript of Oral Argument at 38, Miller v. Beam, Inc., No. 2014 CH 00932 (Ill. Cir. Ct. Ch. Div. Mar. 5, 2014); Daugherty v. Ahn, No. CC-11-06211-C, 2013 WL 9977799 (Tex. Dist. Ct. Feb. 15, 2013) (granting motion to dismiss based on forum-selection bylaw). As of this writing, the Corporation Law Section of the Delaware State Bar Association has approved proposed legislation that would explicitly permit forum-selection provisions in certificates of incorporation or bylaws, so long as they do not preclude litigating in Delaware. The legislation is expected to be introduced to the Delaware General Assembly in the near future.

enjoy continuing support in the courts. Moreover, it seemed the participants were quite familiar with the costs and inefficiencies inherent in multi-jurisdictional shareholder litigation,[22] and the consensus view on forum-selection bylaws reflected that apparent awareness. While some voiced the view that shareholders should be free to adjudicate their disputes with management wherever the corporation had subjected itself to jurisdiction, this appeared to be the minority view.[23]

The majority consensus seemed to be that fee-shifting bylaws would likely be subject to significant scrutiny in court and universal disapprobation among the proxy advisory services.[24] A number of small issuers adopted such bylaws[25] in

22. *See, e.g.*, *In re* Allion Healthcare Inc. S'holders Litig., No. 5022-CC, 2011 WL 1135016, at *4 (Del. Ch. Mar. 29, 2011) (noting that, with respect to multi-forum deal litigation, "[t]he potential problems, as one can imagine, are numerous" and explaining some of those problems).

23. Indeed, even ISS appears to be relatively open to recommending shareholder votes in favor of forum-selection bylaws in certain circumstances. *See* ISS, *supra* note 6, at 23–24 ("General Recommendation: Vote case-by-case on bylaws which impact shareholders' litigation rights [which may include exclusive venue provisions], taking into account factors such as: [t]he company's stated rationale for adopting such a provision; [d]isclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or shareholder lawsuits outside the jurisdiction of incorporation; [t]he breadth of application of the bylaw, including the types of lawsuits to which it would apply and the definition of key terms; and [g]overnance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the bylaws) and their ability to hold directors accountable through annual director elections and a majority vote standard in uncontested elections."); *see also* GLASS, LEWIS, *supra* note 6, at 39 ("Glass Lewis believes that charter or bylaw provisions limiting a shareholder's choice of legal venue are not in the best interests of shareholders. . . . For this reason, we recommend that shareholders vote against any bylaw or charter amendment seeking to adopt an exclusive forum provision *unless* the company: (i) provides a compelling argument on why the provision would directly benefit shareholders; (ii) provides evidence of abuse of legal process in other, non-favored jurisdictions; (iii) narrowly tailors such provision to the risks involved; and (iv) maintains a strong record of good corporate governance practices." (emphasis added)). *But see* CII, *supra* note 6, at 5 ("Companies should not attempt to restrict the venue for shareowner claims by adopting charter or bylaw provisions that seek to establish an exclusive forum.").

ISS does, however, subject board-adopted forum-selection bylaws to its "Unilateral Bylaw/Charter Amendments" policy, which recommends that shareholders "[g]enerally vote against or withhold [votes] from directors individually, committee members, or the entire board . . . if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders." ISS, *supra* note 6, at 13, 24.

24. *See* GLASS, LEWIS, *supra* note 6, at 40 ("Glass Lewis . . . strongly opposes the adoption of . . . fee-shifting bylaws and, if adopted without shareholder approval, will recommend voting against the governance committee.").

25. *See* Claudia H. Allen, *Fee Shifting Bylaws: Where Are We Now?*, CORP. L. & ACCOUNTABILITY REP., Jan. 16, 2015, at 1, 2–3 *available at* http://www.kattenlaw.com/files/77171_BNA_CLAR_CAllen.pdf (reporting that "only 39 domestic corporations, out of the approximately 5,000 public companies traded on U.S. stock exchanges," have adopted fee-shifting bylaws or charter provisions; that 30 of those corporations were formed in Delaware; and "no large cap companies have adopted fee-shifting, and 67.6 percent (23) of the 34 companies [for which data is available] have market caps below (and in many cases significantly below) $1 billion"). *Cf.* John C. Coffee, Jr., *Fee-Shifting and the SEC: Does It Still Believe in Private Enforcement?*, THE CLS BLUE SKY BLOG (Oct. 14, 2014), http://clsbluesky.law.columbia.edu/2014/10/14/fee-shifting-and-the-sec-does-it-still-believe-in-private-enforcement/ ("Between May 29 and September 29, 2014, some 24 public companies adopted either bylaws or charter provisions mandating that an 'unsuccessful' plaintiff in shareholder litigation (whether in state or federal court or arbitration) must pay the fees and expenses of all defendants. . . . Although 24 companies is not a large number, the trend is accelerating, and it resembles the first trickle of water through a leak in a dam. Soon the dam breaks, and a cascade descends upon those below.

the wake of the Delaware Supreme Court's decision in *ATP Tour, Inc. v. Deutscher Tennis Bund*,[26] in which the court held such bylaws to be statutorily valid at least under the circumstances presented in that case. (And one state has reacted with legislation affirmatively requiring fee shifting in all derivative actions.[27]) Those representing the activist point of view, however, expressed unwavering opposition to the idea of fee-shifting bylaws, and those who more often represented issuers expressed concern about the level of scrutiny such bylaws were likely to receive when challenged.

Activists complained that fee-shifting bylaws effectively limited access to the courts, closing off the ultimate "escape valve" in the case of dysfunctional governance. In particular, it was noted that plaintiffs would not bring any but the most egregious cases were such bylaws to become common, as no shareholder was likely to risk paying the defendants' fees, in any case where the plaintiff did not "substantially prevail" on all of its claims, in order to pursue claims for which the individual shareholder's proportionate share of any recovery would likely be much smaller than the potential liability. At least, plaintiffs would not do so unless and until the courts responded by increasing potential fees and lead-plaintiff rewards sufficiently to counteract the bylaws' disincentive effects, which in turn would further erode the portion of benefits from successful shareholder litigation that accrue to the intended beneficiaries of that litigation. Moreover, these bylaws did not typically result in fee shifting in the event of a settlement prior to judgment, giving rise to further cynicism and concern that these bylaws would protect directors from scrutiny.

Thus, fee-shifting bylaws would seemingly do away with the benefits created by the advent of representative litigation in the corporate context, and perhaps even exacerbate the collective-action problem and therefore increase agency costs beyond the point that originally led to the development of representative litigation mechanisms such as class and derivative actions.[28] And it is not incon-

By the end of September, adoption of fee-shifting provisions was occurring on a virtually daily basis. . . . If fee-shifting bylaws are upheld, defendant issuers should logically regard them as a riskless move that has little downside. Probably, proxy advisors would object to such board-adopted bylaws, but this is not the kind of board action that could easily fuel a proxy contest or be easily overturned by a shareholder vote. As a result, such provisions, unless challenged by the SEC, will predictably become prevalent.").

26. 91 A.3d 554 (Del. 2014).

27. *See* OKLA. STAT. ANN. tit. 18, § 1126(c) (West, Westlaw through ch. 430 (end) of the 2d Sess. of the 54th Leg. (2014)) ("In any derivative action instituted by a shareholder of a domestic or foreign corporation, the court having jurisdiction, upon final judgment, shall require the nonprevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees, taxable as costs, incurred as a result of such action.").

28. *See, e.g.*, Bird v. Lida, Inc., 681 A.2d 399, 403 (Del. Ch. 1996) ("In a public company with widely distributed shares any particular shareholder has very little incentive to incur those costs [of shareholder monitoring] himself in pursuit of a collective good, since unless there is some method to force a sharing of costs, he will bear all of the costs and only a (small) pro rata share of any gains that the monitoring yields. Thus, it is likely that in a public corporation there will be less shareholder monitoring expenditures than would be optimum from the point of the shareholders as a collectivity. One way the corporation law deals with this conundrum is through the derivative lawsuit and the recognized practice of awarding to successful shareholder champions and their attorneys risk-adjusted reimbursement payments (i.e., contingency based attorneys' fees). The derivative suit offers

ceivable that their adoption and use might have the unintended effect that, even if the courts uphold the bylaws, they might ratchet up plaintiffs' attorney's fees and lead-plaintiffs' rewards to address the increased risk inherent in pursuing shareholder litigation, much to the chagrin of the defense-side advocates who champion fee-shifting bylaws.

Importantly, the Delaware General Assembly has indicated that it would take up the question of legislation potentially limiting *ATP Tour* in its 2015 session.[29] Thus, the widespread adoption of fee-shifting bylaws was viewed as unlikely at this point, as companies wait and see how the Delaware legislature and the courts respond.

Question no. 4: In Light of the Current Trajectory, What Will the Future of Corporate Governance Look Like?

Not unexpectedly, views about the future varied. Predictions included:

- We are likely to see more "hybrid" boards made up of a mix of activist and non-activist candidates.
- Some public issuers will consider going private, and some companies that might otherwise consider an IPO will decide to remain private to avoid the governance pressure associated with being a public company.
- We may see potentially greater use of dual-class voting structures.
- Participants generally agreed that shareholder engagement will continue to expand, and that there will be heightened attention on how directors are chosen and elected, and what mechanisms encourage board refreshment.[30]

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to risk-accepting shareholders and lawyers a method and incentives to pursue monitoring activities that are wealth increasing for the collectivity (the corporation or the body of its shareholders)." (citation omitted)).

29. *See* Del. S.J. Res. 12, 147th Gen. Assemb. (2014) (Delaware Senate Joint Resolution "Calling for Continued Examination of Important Proposed Amendments to the Delaware General Corporate Law Relating to Fee-Shifting Bylaws and Other Aspects of Corporate Litigation," calling for Delaware bar to "continue its ongoing examination of the State's business entity laws with an eye toward maintaining balance, efficiency, fairness and predictability"; considering, among other things, whether legislation limiting corporations' ability to adopt fee-shifting bylaws would be appropriate; and "submit[ting] to the 148th General Assembly [which began on January 13, 2015] for consideration any legislative proposals deemed meritorious in continuing and promoting the adoption and use of the State's business entity laws by corporations and their investors"). As of this writing, the Corporation Law Section of the Delaware State Bar Association had approved proposed legislation that would prohibit fee-shifting provisions in certificates of incorporation or bylaws.

30. *See, e.g.*, Cal. Pub. Emps.' Ret. Sys., Global Principles of Accountable Corporate Governance § 1.5 (2014) ("Boards should consider all relevant facts and circumstances to determine whether a director should be considered independent. These considerations include the director's years of service on the board. Extended periods of service may adversely impact a director's ability to bring an objective perspective to the boardroom."); Glass, Lewis, *supra* note 6, at 21 ("Glass Lewis believes that director age and term limits typically are not in shareholders' best interests. . . . However, we support routine director evaluation, preferably performed independently by an external firm, and periodic board refreshment to foster the sharing of new perspectives in the boardroom and the generation of new ideas and business strategies."); ISS, *supra* note 6, at 17 (recommending votes against man-

- Participants also thought that the trend of professionalization of the boardroom would likely continue, due to the continued pressure for independent directors, but with some cost in the resulting lack of a sufficient number of directors with deep industry knowledge.
- Ideas like taxing long- and short-term holders differently were discussed, but did not seem to gather support of a majority of participants.

In summary, while there were no "votes" or other objective indicia of formal consensus reached, the view of the Forum participants appeared to be that we are witnessing and will continue to witness a gradual adjustment of the board-shareholder relationship, resulting in more dialogue with and concern for the ideas put forward by activist and institutional shareholders alike. This expansion of the board-shareholder relationship is being fueled by the economic reality of indexed investing, the rise and establishment of the proxy advisory firms like ISS and Glass Lewis, and the continued growth in influence of activist shareholders.

The views on whether this evolution in the board-shareholder relationship was an objectively "good" thing or not were as varied as the background of the participants in the Forum. We will not attempt to wade here into the ongoing dialogue between Mr. Lipton and Professor Bebchuk.[31] Suffice it to say that gov-

datory age or term limits, but recommending that shareholders "scrutinize boards where the average tenure of all directors exceeds 15 years for independence from management and for sufficient turnover to ensure that new perspectives are being added to the board"); CII, *supra* note 6, at 26 ("Extended periods of service may adversely impact a director's ability to bring an objective perspective to the boardroom.").

31. *See, e.g.*, Martin Lipton, *The Threat to the Economy and Society from Activism and Short-Termism Updated*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 27, 2015, 9:02 AM), http://blogs.law.harvard.edu/corpgov/2015/01/27/the-threat-to-the-economy-and-society-from-activism-and-short-termism-updated/; Martin Lipton, *The Threat to the Economy and Society from Activism and Short-Termism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 22, 2015, 9:18 AM), http://blogs.law.harvard.edu/corpgov/2015/01/22/the-threat-to-the-economy-and-society-from-activism-and-short-termism/; Martin Lipton & Sara J. Lewis, *The Threat to Shareholders and the Economy from Attacks by Activist Hedge Funds*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 14, 2015, 9:02 AM), http://blogs.law.harvard.edu/corpgov/2015/01/14/the-threat-to-shareholders-and-the-economy-from-activist-hedge-funds/; Martin Lipton, *The Long-Term Consequences of Hedge Fund Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 20, 2014, 4:31 PM), https://blogs.law.harvard.edu/corpgov/2014/08/20/the-long-term-consequences-of-hedge-fund-activism/; Lucian Bebchuk, *Wachtell Keeps Running Away from the Evidence*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 28, 2014, 9:15 AM), https://blogs.law.harvard.edu/corpgov/2014/07/28/wachtell-keeps-running-away-from-the-evidence/; Martin Lipton & Steven A. Rosenblum, *Do Activist Hedge Funds Really Create Long Term Value?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 22, 2014, 3:55 PM), http://blogs.law.harvard.edu/corpgov/2014/07/22/do-activist-hedge-funds-really-create-long-term-value/; Martin Lipton et al., *Current Thoughts About Activism, Revisited*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 8, 2014, 9:19 AM), http://blogs.law.harvard.edu/corpgov/2014/04/08/current-thoughts-about-activism-revisited/; Lucian Bebchuk et al., *Still Running Away from the Evidence: A Reply to Wachtell Lipton's Review of Empirical Work*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 5, 2014, 9:02 AM), https://blogs.law.harvard.edu/corpgov/2014/03/05/still-running-away-from-the-evidence-a-reply-to-wachtell-liptons-review-of-empirical-work/; Martin Lipton, *Empiricism and Experience; Activism and Short-Termism; The Real World of Business*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 28, 2013, 9:40 AM), https://blogs.law.harvard.edu/corpgov/2013/10/28/empiricism-and-experience-activism-and-short-termism-the-real-world-of-business/; Lucian Bebchuk et al., *Don't Run Away from the Evidence: A Reply to Wachtell Lipton*, HARV. L.

ernance is changing in perceptible ways, and that the influence of shareholders and outside advisory services has never been greater and is not likely to recede at any point in the near future.

The "board-centric" governance model established in state corporate law is likely to continue, but boards are feeling and will continue to feel pressures that may detract from their emphasis on and deference to the long-term best interests of the firm as seen solely from their point of view. For good or ill, shareholders now have a much greater voice in the direction that the board takes, and shareholder views relating to the ability of the board to deploy statutorily permissible defensive measures, or structural impediments to hostile accumulations, seem to be driving a level of "disarmament" not seen since the beginning of hostile takeover activities in the early 1980s. The shareholder voices are far more prevalent in the boardroom. Those voices appear to be listened to much more intently by the board. That trend is likely to continue.

SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 17, 2013, 9:00 AM), https://blogs.law.harvard.edu/corpgov/2013/09/17/dont-run-away-from-the-evidence-a-reply-to-wachtell-lipton/; Martin Lipton et al., *The Bebchuk Syllogism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 26, 2013, 12:32 PM), http://blogs.law.harvard.edu/corpgov/2013/08/26/the-bebchuk-syllogism/; Lucian Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 19, 2013, 9:36 AM), https://blogs.law.harvard.edu/corpgov/2013/08/19/the-long-term-effects-of-hedge-fund-activism/ (discussing study, forthcoming in the June 2015 issue of the *Columbia Law Review*, available in draft form through SSRN at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577); Martin Lipton et al., *Current Thoughts About Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 9, 2013, 9:15 AM), http://blogs.law.harvard.edu/corpgov/2013/08/09/current-thoughts-about-activism/ (opining "that the statistics Professor Bebchuk uses do not establish the validity of his claims that activist attacks are beneficial nor justify his uncritical embrace of activists" and identifying recent studies that "reflect the true effects of activism and that it is in the national interest to reverse the legislation and regulation that promotes activism"); Lucian Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 22, 2013, 9:18 AM), http://blogs.law.harvard.edu/corpgov/2013/04/22/the-myth-that-insulating-boards-serves-long-term-value/ (discussing study, subsequently published as Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013)); Martin Lipton, *Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy,* HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 26, 2013, 9:22 AM), http://blogs.law.harvard.edu/corpgov/2013/02/26/bite-the-apple-poison-the-apple-paralyze-the-company-wreck-the-economy/.