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Via E-Mail

June 7, 2021

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Universal Proxy, Release No. 34-91603; IC-34246 (File No. S7-24-16)

Dear Madam Secretary,

I am writing in response to the Commission's request for comment on its Universal Proxy release and rule proposal (the "Release"). I am writing in my individual capacity, and not on behalf of Boston University, and the views expressed in this letter are mine alone. I appreciate the opportunity to respond to the Release, and to provide information regarding universal proxies that I hope will be of assistance to the Commission.

I am writing to attach the published version of my article, *Universal Proxies*, an earlier draft of which was previously submitted as part of the comment file and was referred to in the Release.¹

The article provides empirical evidence regarding how universal proxies would have altered the outcomes of past proxy contests, and uses that evidence to consider claims that have been made about universal proxies, including claims made prior to the Release, in the Release itself, and in comment letters that were previously submitted in response to the Release.

The evidence presented in the article suggests that universal proxies would have a significant impact on proxy contests in a way that would enfranchise shareholders, by overcoming distortions in proxy contest outcomes. The article shows no evidence that universal proxies are likely to favor shareholder activists; if anything, the opposite may be the case.

In place of the Commission's Proposed Rule, the article suggests that the Commission adopt an "investor ordered" approach to universal proxies, whereby the proposed rule would be a default, that companies could opt-out of with the approval of a majority of their outside investors. The article explains that, if the Commission considers the potential costs of a universal proxy rule raised by certain commentators to be significant, then an investor ordered default rule approach would be at least as good and possibly better than a mandatory rule requiring the use of universal proxies. If outside investors in a company also believed that the universal proxy rule was costly for their company then they would approve the company opting out of the rule. This possibility would allow the Commission to substantially discount any potential costs to companies in its economic analysis of an investor ordered rule. It would also allow the Commission to

¹ Scott Hirst, *Universal Proxies*, 35 YALE J. REG. 437 (2018).

conduct more effective retrospective analysis of the rule, by observing how many companies do indeed opt-out of the rule.

Should you have any questions about the article or the conclusions drawn above, please do not hesitate to contact me.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Scott Hirst', with a stylized flourish at the end.

Scott Hirst

UNIVERSAL PROXIES

Scott Hirst[†]

Contested director elections are a central feature of the corporate landscape and underlie shareholder activism. Rules governing proxy voting by shareholders prevent shareholders from “mixing and matching” among nominees from the two sides of contests. This Article’s analysis shows that these proxy voting rules can lead to distorted proxy contest outcomes: different directors being elected than if shareholders had been able to vote how they wished. These distortions are likely to have significant consequences for the affected companies and ex ante consequences for many more companies.

Changes to corporate voting rules are currently the subject of an important policy debate. The Securities and Exchange Commission (SEC) has proposed a universal proxy regulation, which would allow shareholders to vote for their preferred mix of nominees, and would eliminate distortions in proxy contest outcomes. But the rule has been met with substantial opposition. This Article provides the first empirical analysis of the extent of distortions, and the likely effects of universal proxies.

The Article’s empirical analysis uses a comprehensive and largely hand-collected data set. It demonstrates that distorted proxy contest outcomes are a real and practical problem. As many as 15% of proxy contests between 2001 and 2016 may have had distorted outcomes. Contrary to the claims of most commentators, there is no empirical evidence that universal proxies would favor special interests or lead to more frequent proxy contests.

The Article analyzes how the SEC should implement universal proxies and explains that a rule permitting corporations to opt out of universal proxies would be superior to the SEC’s proposed regulation, which would require all

[†] Research Director, Harvard Law School Program on Institutional Investors; Lecturer on Law, Harvard Law School. For many helpful comments and discussions, I am grateful to MaryEllen Andersen, Michal Barzuza, Scott Bauguess, Lucian Bebchuk, Bill Bratton, Tara Bhandari, Jay Brown, Emiliano Catan, Chris Cernich, Ning Chiu, Art Crozier, Larry Denny, Ofer Eldar, Elisabeth de Fontenay, Jill Fisch, Jesse Fried, Rich Grossman, Colleen Honigsberg, Robert Jackson, Marcel Kahan, Kobi Kastiel, Joshua Mitts, Yaron Nili, Gabriel Rauterberg, Sarath Sanga, Holger Spamann, Max Stearns, Fred Vars, Andrew Verstein, David Walker, Kathy Zeiler, and participants in workshops at American University Washington College of Law, Boston University School of Law, Brooklyn Law School, the Faculty of Law of the University of Hong Kong, Harvard Law School, the University of Alabama School of Law, the University of Colorado Law School, the University of Maryland Francis King Carey School of Law, the University of Miami School of Law, the University of Pennsylvania Law School, USC Gould School of Law, the Wharton School at the University of Pennsylvania, the 2017 National Business Law Scholars Conference, the 2017 Junior Corporate Law Workshop, and the 2018 American Law and Economics Association Annual Meeting. I am grateful to the Harvard Law School Program on Corporate Governance for financial support and to Jordan Figueroa for research assistance.

corporations to use universal proxies. If the SEC chooses not to implement a universal proxy regulation, the Article explains how investors could implement universal proxies through private ordering to adopt “nominee consent policies.”

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Introduction

Director elections are central to the functioning of corporations and their futures. They are even more important in light of the rise of hedge fund activism. However, federal and state rules governing director elections limit how shareholders can vote in election contests. This Article shows how this limitation creates the possibility of distortions in election outcomes: different directors being elected than a plurality of shareholders would have preferred. The Securities and Exchange Commission (SEC) has proposed a “universal proxy” regulation that would allow shareholders to vote as they wish and eliminate the possibility of distortions. But the regulation has been met with substantial opposition. This Article provides the first empirical evidence of the extent of distortions in proxy contest outcomes and the likely effects of universal proxies. Based on this evidence, the Article concludes that the SEC should adopt an opt-out version of its proposed universal proxy rule. If the SEC does not adopt universal proxies (including for political reasons), the Article proposes that corporations should adopt their own universal proxy arrangements by “nominee consent” policies as a second-best alternative.

Director elections are central to the operations of corporations. This principle is enshrined both in state law¹ and federal securities law.² The directors chosen in elections determine the future course of the corporation. If the election process reelects directors that have made poor decisions, or fails to elect directors that are likely to make good decisions, then it can have a harmful effect on directors’ incentives in managing corporations.

Director elections also lie at the crux of the contentious debate about the value of shareholder activism. Most director elections involve the nominees put forward by the corporation (“management nominees”), who are often elected unopposed. However, a small number of director elections are contested³ and involve dissidents who put forward competing nominees for election because

1. See, e.g., *Blasius Indus. Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (“The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”).

2. The entire system of federal regulation of corporate disclosure is built upon Section 14 of the Securities Exchange Act of 1934, which governs the solicitation of proxies for corporate elections. See *Securities Exchange Act of 1934*, 15 U.S.C. § 78n (2018).

3. Contested elections represent about 0.5% of director elections each year. See *infra* Table 4 and accompanying text.

they disagree with the direction taken by corporate management. Contested elections take on an outsized significance, since only at these elections do investors have a choice among potential directors. These contests often determine the future direction of the corporation and involve great attention and activity. Incumbent directors and managers fight to maintain their positions and continue the corporation's current direction; dissidents fight to replace directors and influence that direction. Shareholders are equally concerned with contested elections, as the value of their investment in the corporation is at stake. The majority of dissidents initiating proxy contests are hedge fund activists, who acquire stakes in corporations they consider to be undervalued and seek to influence those corporations to increase value. The impact of this kind of shareholder activism on long-term value is currently the subject of considerable debate.⁴ In more than 90% of activist engagements, management and dissidents reach a settlement.⁵ The effects of contested elections have an impact well beyond the boundaries of the particular contest: their outcomes set the expectations of parties contemplating potential activist engagements or settlements of existing engagements regarding the likely outcome if the engagement is not settled. The importance of these elections for the corporate landscape, and the heightened conflict they present, means that the rules for how contested elections are conducted are of central importance.

The combination of state and federal law that governs director elections limits shareholders' ability to choose the nominees they may prefer in contested elections. Director elections are governed by state corporate law, which provides that director elections take place at shareholder meetings.⁶ Rather than attending the shareholder meeting, shareholders vote almost entirely by proxy. In this context, the word "proxy" refers to the power vested by the shareholder in persons (the "proxy holders") to vote on behalf of the shareholder; the vesting takes place by the shareholder executing a form of proxy or "proxy card."⁷ The proxy card instructs proxy holders to vote for a director or withholds authority from the proxy holder to vote for certain directors, which are commonly referred to as "withhold votes." Proxy holders are required to attend the meeting and vote as instructed.

In contested elections, each side solicits shareholders to execute their side's proxy card, thereby appointing their representatives as the shareholders' proxy holders. The Securities Exchange Act of 1934⁸ empowered the SEC to regulate

4. See *infra* note 35 and accompanying text.

5. See *infra* Table 1 and accompanying text.

6. See, e.g., DEL. CODE ANN. tit. 8, § 211(b) (2017) ("Unless directors are elected by written consent in lieu of an annual meeting, an annual meeting of stockholders shall be held for the election of directors . . ."). Usually these are annual meetings, but they may also be special meetings called for the particular purpose. In a limited number of corporations, shareholders may also be able to act by written consent, including electing directors to fill vacancies on the board.

7. So-called because the form of proxy that is generally solicited from shareholders is usually printed on card stock. See 17 C.F.R. § 240.14a-4(a)(2) (2017) (referring to "the proxy card").

8. Securities Exchange Act of 1934, 15 U.S.C. § 78a-78qq (2018).

the solicitation of proxies.⁹ Part of the SEC's proxy regulations, known as the "bona fide nominee rule," prevents parties from soliciting proxies for nominees without the nominees' consent.¹⁰

As a practical matter, this limits each side to using proxy cards which include only their own nominees. State law considers proxy cards executed by shareholders to revoke any proxy cards that they have previously executed,¹¹ so shareholders cannot vote on multiple proxy cards solicited by different sides. In a contested election, these rules prevent shareholders voting on these cards from "mixing and matching" among nominees from different sides' proxy cards,¹² which the shareholders could do if they were to attend the meeting in person.¹³

Marcel Kahan has analogized this situation to a political election, with "a Democratic voting station where you can only vote for Democrats and a Republican voting station where you can only vote for Republicans and there isn't any option to split your vote,"¹⁴ for instance, by voting for a Democratic presidential candidate and a Republican senatorial candidate. In such a system, if a voter at a Democratic voting station wanted to support a Republican senatorial candidate, they could not vote *for* that nominee; the best they could do would be to *not* vote for the Democratic opponent.

9. *Id.* § 78n(a)(1) ("It shall be unlawful for any person . . . in contravention of such rules 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 . . .").

10. See 17 C.F.R. § 240.14a-4 (2017) ("No proxy shall confer authority: (1) To vote for the election of any person to any office for which a bona fide nominee is not named in the proxy statement . . ."). The bona fide nominee rule had previously been incorporated into the precursor to Rule 14a-4 in 1940. See Exchange Act Release No. 34-2376, 5 Fed. Reg. 174 (Jan. 12, 1940). The intention of the rule appears to have been to curb a practice whereby parties sought proxies to vote for nominees that, if elected, were expected to immediately resign and be replaced by other nominees that had not been named. See Ronald J. Gilson et al., *How the Proxy Rules Discourage Constructive Engagement: Regulatory Barriers to Electing a Minority of Directors*, 17 J. CORP. L. 29, 40 (1991). ("Our best conjecture concerning the rule's goal is to prevent dissidents (or management) from running dummy director candidates. Conceivably, opportunistic managers or challengers might seek to mislead voters by placing director candidates on their proxy who had not assented or did not intend to serve."). In 1967, language was added to Rule 14a-4 to codify the administrative interpretation of "bona fide nominee[s]" as ones that had "consented to be named and to serve if elected." See Exchange Act Release No. 34-8206, 32 Fed. Reg. 20,960 (Dec. 14, 1967).

11. See, e.g., *Standard Power & Light Corp. v. Inv. Assocs.*, 51 A.2d 572, 580 (Del. Ch. 1947), *aff'd*, 51 A.2d 572 (Del. 1947) ("[W]hen two proxies are offered bearing the same name, then the proxy that appears from the evidence to have been last executed will be accepted and counted under the theory that the latter – that is, more recent-proxy constitutes a revocation of the former."); see also *Concord Fin. v. Tri-State Motor Transit Co. of Del.*, 567 A.2d 1, 8 (Del. Ch. 1989) (reaffirming *Investment Associates*).

12. As explained further in Part I, in the case of a "short slate" shareholders may be able to vote for certain management nominees on the dissident card, but only those selected by the dissidents, not any other mix that the shareholder may prefer.

13. As explained further in Part I, shareholders wishing to vote for their own mix of management and shareholder nominees can execute a "legal proxy" to vote in their specified way at the meeting. However, this involves certain difficulties and is rarely used by shareholders.

14. Ronald D. Orol, *Universal Proxy Battle Fight Gathers Steam at SEC*, THE STREET (Sept. 20, 2013, 3:49 PM), <http://www.thestreet.com/story/12043872/1/the-deal-universal-proxy-battle-fight-gathers-steam-at-sec.html> [<http://perma.cc/Y495-7ELH>].

The solution to this problem is obvious. Parties could be permitted or required to solicit “universal proxies.” Universal proxies are simply proxy cards that include nominees from each side. The idea of a universal proxy should seem uncontroversial. No other common law jurisdictions use the split proxy system that governs corporate voting in the United States, and there are no close analogues in political elections. Investor groups have urged the SEC to adopt a universal proxy rule so that they would be able to mix and match their preferred nominees.¹⁵ In response, the SEC has proposed a universal proxy regulation (“the Release”) aimed at allowing shareholders to vote by proxy in the same way that state law would permit them to vote if they attended the shareholder meeting.¹⁶ However, the idea of a universal proxy has been met with substantial opposition, led by the U.S. Chamber of Commerce. Opponents of a universal proxy rule have raised concerns that it is likely to increase the ease and frequency of proxy fights and empower special interests.¹⁷ This opposition has resulted in the U.S. House of Representatives passing two bills that, if enacted, would have the effect of preventing the SEC from implementing a universal proxy rule.¹⁸

This Article informs that debate. It provides a framework to understand the consequences of the mix-and-match problem and shows how it can result in distorted election outcomes. Prior to this Article, there had been scant evidence about the extent of such distortions or the likely effects of a universal proxy rule

15. See, e.g., Letter from Glenn Davis, Dir. of Research, Council of Institutional Inv'rs, to Elizabeth Murphy, Sec'y, U.S. Sec. & Exch. Comm'n 1 (Jan. 8, 2014), <http://www.sec.gov/rules/petitions/2014/petn4-672.pdf> [<http://perma.cc/DD6V-D6UP>] (requesting that the SEC “facilitate the use of universal proxy cards featuring a complete list of board candidates in cases of a contested election of directors”).

16. Exchange Act Release No. 34-79164, 81 Fed. Reg. 79,122, 79,124 (Nov. 10, 2016) (“[R]eplicating the vote that could be achieved at a shareholder meeting is the most appropriate means to ensure that shareholders using the proxy process are able to fully and consistently exercise the ‘fair corporate suffrage’ available to them under state corporate law and that Congress intended our proxy rules to effectuate.” (footnote omitted)).

17. Letter from R. Bruce Josten, Exec. Vice President, U.S. Chamber of Commerce, to Members of the U.S. House of Representatives (June 22, 2016), http://www.uschamber.com/sites/default/files/documents/files/160622_kv_hr5485_financialservicesgeneralgovernmentappropriationsact2017_house.pdf [<http://perma.cc/SU39-MVWL>] (urging members to “[s]upport an amendment [to the Act] expected to be offered that would place a funding limitation prohibiting the Securities and Exchange Commission (SEC) from developing, implementing, finalizing or enforcing universal proxy ballot proposals or SEC rulemaking to allow or explore universal proxy ballots”); Letter from Tom Quaadman, Vice President, Ctr. for Capital Mkts. Competitiveness, to Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n 3-4 (Feb. 18, 2015), <http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/02/2015-2.18-Letter-to-SEC-re-Universal-Proxy-Roundtable.pdf> [<http://perma.cc/MJS8-A7XY>] (“Mandating a universal ballot . . . would inevitably increase the frequency and ease of proxy fights . . . [T]he universal ballot may empower a small vocal minority at the expense of the majority.”).

18. See Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 845 (2017) (“The Commission may not require that a solicitation of a proxy, consent, or authorization to vote a security of an issuer in an election of members of the board of directors of the issuer be made using a single ballot or card that lists both individuals nominated by (or on behalf of) the issuer and individuals nominated by (or on behalf of) other proponents and permits the person granting the proxy, consent, or authorization to select from among individuals in both groups.”); see also H.R. 5485, 114th Cong. § 1215 (2016) (containing identical language and proposing to prevent the SEC from using appropriated funds to “propose, issue, implement, administer, or enforce any requirement” of the kind described in § 845 of the Financial CHOICE Act bill).

on contest outcomes. As a result, there has been no basis to evaluate the claims made by opponents of the rule about the potential cost of universal proxies. The empirical analysis in this Article allows an evaluation of the extent of distortions in proxy contest outcomes, and the likely effects of universal proxies.

One potential consequence of the mix-and-match problem in the current proxy voting rules is distortions in the outcomes of proxy contests. That is, different directors may be elected than if all shareholders had been able to vote as they wished, for instance, by attending the shareholder meeting or using a universal proxy. Distorted proxy contest outcomes can take two forms. First, there may be a distorted choice between the sides in the proxy contest. That is, the split between the number of management nominees elected and the number of dissident nominees elected may be different from the split which investors would have made had they been able to mix and match. Such a distorted choice between sides took place at the 2009 annual meeting of Biogen Idec Inc. Four nominees were elected: two management nominees and two dissident nominees. Had the average withhold votes on each side been voted in favor of nominees on the other side, management nominee Alan Glassberg would have been elected in place of dissident nominee Richard Mulligan. Mulligan's election likely represented a distorted choice between sides.

Second, there may be a distorted choice within sides. That is, the particular nominees that are elected from one side may be different from the nominees that investors would have chosen had they been able to mix and match. A distortion of this kind may have taken place at the 2015 annual meeting of Rovi Corporation. Seven board seats were up for election. Two dissident nominees were elected, along with five management nominees, including James Meyer. Had shareholders withholding votes been able to vote for opposing nominees and had the number of shareholders that preferred to vote for management candidate James O'Shaughnessy over Meyer exceeded the number that preferred Meyer over O'Shaughnessy by 18% of the votes cast on that card, O'Shaughnessy would have been elected in Meyer's place.

The Article's empirical analysis shows that distorted proxy contests represent a real and practical problem. As many as 15% of proxy contests between 2001 and 2016 may have had distorted outcomes. Based on the most conservative assumptions about how shareholders could have voted under such a system, at least 7% of contests are likely to have been distorted, including 10% of contests at large corporations.

The analysis shows no evidence to support the claim made by opponents of the regulation that universal proxies would favor shareholder activists. If anything, the actual effect is likely to favor managers. Of the contests where a distortion can be expected to have favored one side or the other, universal proxies can be expected to have resulted in management nominees being elected in place of dissident nominees in two-thirds of cases, compared to one-third of cases where dissident nominees would be elected in place of management nominees.

This analysis permits inferences about the further effects of universal proxies that assuage many concerns raised in the debate. Concerns have focused on the possibility that universal proxies would increase the ease of proxy contests for dissidents or dissidents' success rates in proxy contests. Since the evidence provides no basis to conclude that universal proxies would favor dissident nominees, there is also no evidence that dissidents are likely to initiate proxy contests more often under a universal proxy system. If anything, a universal proxy system may lead to slightly fewer proxy contests. Universal proxies could only have resulted in different outcomes where at least 30% of votes were in favor of at least one dissident. Contrary to concerns raised by commentators, universal proxies are therefore unlikely to result in greater success for dissidents with parochial views that are not shared by a significant proportion of shareholders.

These results present a puzzle. If universal proxies would be likely to favor managers and not dissidents, why are they opposed so strongly by groups that generally represent the interests of managers? It could be that these groups misunderstand the likely effect of the regulation. If this is the case, the evidence presented in this Article could cause them to relax their opposition. If they do not do so, one explanation may be that these groups are attacking universal proxies for their strategic value in a larger fight over increases in shareholder power.¹⁹ The value to such groups in opposing increases in shareholder power may outweigh the benefits that universal proxies would give their constituents in resisting dissidents.

The normative value of universal proxies in eliminating distorted proxy contest outcomes is clear. However, it is much harder to determine the normative effects of which sides win proxy contests for two reasons. First, the effects of universal proxies on proxy contest outcomes presented in the Article describe a partial equilibrium: it is based on an analysis of voting data, holding constant many other factors, like the voting choices of investors, and the nomination choices of management and dissidents. Were universal proxies to be implemented, many of these other factors may change, with uncertain outcomes. Second, even if the full equilibrium effects of universal proxies on proxy contest outcomes and future proxy contests were known, the nature of the relationship between universal proxies and shareholder value is not clear. Rather, it is the subject of considerable debate. For these reasons, it is impossible to undertake a comprehensive determination of the value or welfare effects of universal proxies.

Instead, the SEC should consider the validity of the arguments made for and against universal proxies. The argument that universal proxies permit shareholders to vote as if they had attended the shareholder meeting is essentially a truism. However, the empirical analysis presented in the Article shows that

19. See Marcel Kahan & Edward Rock, *Symbolic Corporate Governance Politics*, 94 B.U. L. REV. 1997, 2006 (2014) (discussing the strategic and symbolic value of other corporate governance debates, including proxy access).

shareholder voting with universal proxies would have more than mere expressive significance: it would eliminate a substantial number of distortions in proxy contest outcomes. This would have ex post and ex ante benefits for the management of corporations. The Article's empirical analysis dispels the major arguments made against universal proxies that they are unlikely to favor special interests or will result in more proxy contests. This calculus has a clear conclusion: the SEC should implement a universal proxy regulation.

Proxy arrangements could be designed either to effectively prohibit universal proxies (like the current rule), to require universal proxies, or to permit universal proxies. A universal proxy regulation could make such arrangements mandatory for the entire set of corporations to which the rule applied, as with the SEC's proposed rule. Alternatively, a regulation could be designed to permit private ordering, whereby corporations could opt out of (or opt into) the default proxy arrangement. Given the unresolvable uncertainties about the effects of universal proxies on shareholder value, it is possible that a mandatory rule may not be desirable for all corporations. If structured correctly, a privately ordered rule with universal proxies as the default would result in the same or greater aggregate net benefit as a mandatory rule. If universal proxies did prove to be costly for some companies, as opponents claim, then those companies would opt out of the default rule where the cost of universal proxies was greater than the cost of opting out. If this was not the case and no corporations opted out, the effects of a privately ordered rule would be the same as a mandatory rule. If *any* corporations opted out, the privately ordered rule would have greater aggregate net benefit. Since managers and insiders could privately benefit from proxy arrangements, managers or insiders who can determine the corporation's proxy rules may choose arrangements that are not in the best interests of the corporation. Private ordering can therefore only be optimal if opting out requires the approval of a majority of outside investors. I refer to this structure as "investor ordering."

An investor-ordered universal proxy rule would have additional advantages. Given their opposition to universal proxies, there is a substantial possibility that the U.S. Chamber of Commerce or the Business Roundtable might challenge the validity of a universal proxy regulation, as they have done in the past with proxy access and other SEC rules.²⁰ Were the SEC to implement a mandatory universal proxy rule notwithstanding the advantages of investor-ordering, its decision may be subject to invalidation as "arbitrary and capricious"

20. See, e.g., *Nat'l Ass'n of Mfrs. v. SEC*, 748 F.3d 359 (D.C. Cir. 2014) (challenging, in collaboration with the U.S. Chamber of Commerce, the SEC's conflict mineral rule on the grounds that it insufficiently considered the costs of the rule); *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (invalidating the SEC's proxy access rule); *Chamber of Commerce of the U.S. v. SEC*, 443 F.3d 890 (D.C. Cir. 2006) (challenging SEC rulemaking requiring mutual funds to have independent directors); *Chamber of Commerce of the U.S. v. SEC*, 412 F.3d 133 (D.C. Cir. 2005) (same); *Bus. Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (challenging the SEC's decision to bar self-regulatory organizations from listing dual-class stock).

under the Administrative Procedure Act.²¹ Were the SEC to instead implement an investor-ordered regulation, the potential costs of the regulation would be capped at the cost of opting out. This would considerably simplify the otherwise difficult consideration of the costs of the regulation, eliminating grounds on which the regulation could be challenged.

Despite the strength of the arguments in favor of universal proxies, the current SEC appears unlikely to move forward with the proposed regulation. If this were the case, a second-best solution would be for universal proxies to be implemented by individual corporations adopting “nominee consent policies.” Nominee consent policies would require any person nominated for election as a director to consent to be included in any proxy statement submitted for the election. This would permit either side to include the other’s nominees in a universal proxy if it so desired. If managers of corporations were not willing to implement nominee consent policies of their own volition, investors could bring precatory proposals requesting that directors implement such policies. Shareholders themselves could also amend corporate bylaws to include nominee consent policies.

This remainder of this Article is structured as follows. Part I describes the background to contested director elections, including their importance, the “mix-and-match” problem that arises from the current proxy system, and the universal proxy solution. Part II describes how distorted proxy contests can result from the current proxy system. Part III presents an empirical analysis of the incidence of distorted proxy contests and the likely effects of universal proxies. Part IV considers the implications of these effects for the universal proxies debate and evaluates the alternatives for implementing universal proxies by SEC regulation or nominee consent proposals.

I. The Problem with Corporate Voting Rules

Contested elections are a key feature of the corporate governance landscape. This Part explains why corporate elections—and contested elections in particular—are so important. It then discusses the set of rules that govern contested elections and how they can prevent investors from being able to vote for the set of director nominees that they would prefer. Universal proxies, where a single voting card allows investors to vote for whichever set of director nominees that they would prefer, are the solution to this problem. This Part provides a brief history of universal proxies in the United States and their part in the important debate about corporate voting rules.

21. See Administrative Procedure Act, 5 U.S.C. § 706(2) (2018); see also *Bus. Roundtable*, 647 F.3d at 1148 (finding the SEC’s failure to undertake sufficient economic analysis to be arbitrary and capricious).

A. *The Importance of Corporate Elections*

Contested director elections are of central importance to the operation of corporations and to the corporate landscape more generally. State corporate law gives directors of corporations the power to manage the corporation. Director elections are the means by which shareholders appoint and replace directors. They therefore determine the future of the corporation, and are fundamental to both state corporate law and federal securities law. The rise of hedge fund activism in recent years has made director elections even more important: hedge fund activists exercise power by nominating (or threatening to nominate) their own director nominees to the boards of directors of corporations. The number of contested director elections are relatively small, but these elections have disproportional importance because they are the only ones where shareholders have a real ability to replace directors and because such contests determine the background against which election contests take place.

1. The Importance of Director Elections in Corporations

A central feature of corporations is that they are managed by directors on behalf of their investors.²² Director elections therefore have two fundamental effects on the corporation. Director elections determine which directors will make decisions about the corporation in the future and therefore determine the future of the corporation. Director elections also have an *ex ante* effect on corporations, as the director selection mechanism determines how directors make decisions. If director elections reappoint directors that make bad decisions or fail to select those directors who are likely to make good decisions, then directors will have reduced incentives to make good decisions. Director elections are also the key protection provided to shareholders, who don't have fixed contracts that protect their interests in the same way as other constituents such as creditors and employees.²³ If shareholders do not agree with the decisions that directors make in managing the corporation, rather than interfering with those decisions or seeking judicial review of those decisions, shareholders' main remedy is to appoint different directors that they believe will make decisions that they prefer.²⁴ Most public corporations have a very large number of shareholders.

22. Directors appoint executives to manage the corporation on their behalf and then monitor the strategy and performance of those managers. Although a distinction is often drawn between the directors of the corporation and the executives, who are sometimes referred to as the managers of the corporation, I will generally use the terms "managers" and "management" to refer to both directors and executives.

23. Although directors have fiduciary duties, these are owed to the corporation and not to shareholders. Business judgments made by directors in their management of the corporation are generally shielded from judicial review, and the difficulties for shareholders in bringing claims of breach of fiduciary duty against directors weakens the extent to which fiduciary duties can be used to ensure that directors act in the interests of shareholders.

24. *See, e.g., Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 949, 959 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate

Director elections also provide a way for the views of these shareholders to be aggregated and translated into a choice of directors that represents the preferences of the holders of a majority of the shares of the corporation.

The importance of director elections is reflected in their fundamental positions in both state corporate law and federal securities law. Because director elections determine the choice of directors, state law regards them as “the ideological underpinning on which the legitimacy of directorial power rests.”²⁵ The federal regulation of corporations after they become public is based in large part on the Securities Exchange Act’s regulation of proxy voting, the means by which investors elect directors.²⁶

2. Contested Election and Hedge Fund Activism

Election contests have become more important in recent years because of the key role they play in hedge fund activism. Hedge fund activists are private investment funds that acquire significant minority stakes²⁷ in corporations they believe to be underperforming and request that directors take strategic, operational, or financial actions to improve the performance of the corporation.²⁸ Hedge fund activists are able to cause the corporation to implement these actions by having their nominees elected to the board of directors through proxy contests or threatening to do so. Without the threat of an election contest to replace directors, activist investors would have no effective option to affect the operations of the corporation, and their requests could easily be dismissed by management.

Hedge fund activists are only one of several types of dissidents that frequently nominate directors.²⁹ In the past, many dissidents were potential acquirers seeking to gain control of the corporation without the agreement of the incumbent directors.³⁰ In smaller corporations, dissidents may be former

democracy are at their disposal to turn the board out.”); *see also* *Citizens United v. FEC*, 558 U.S. 310, 361-62 (2010) (“There is, furthermore, little evidence of abuse that cannot be corrected by shareholders ‘through the procedures of corporate democracy.’” (quoting *First Nat. Bank of Bos. v. Belotti*, 435 U.S. 765, 794 (1978))).

25. *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988).

26. 15 U.S.C. §§ 78a-78pp (2018).

27. The stake is usually between 5% and 10% of the corporation’s common stock. *See* Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1748 (2008) (“The interquartile of hedge funds’ initial stakes is from 5.4% to 8.8%.”).

28. For a discussion of hedge fund activism generally, *see* Alon Brav et al., *Hedge Fund Activism: A Review*, 4 FOUND. & TRENDS FIN. 185 (2009).

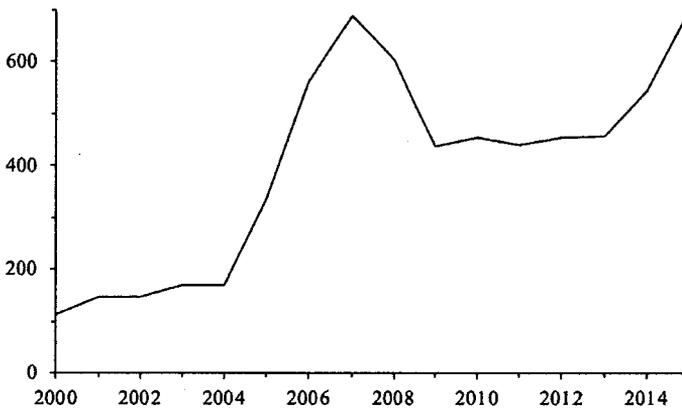
29. A specific subset of hedge fund activists target “closed end funds,” which are publicly listed investment funds that invest in a portfolio of liquid assets. The value of the closed end fund shares is often traded at less than the aggregate value of their underlying assets. These hedge funds attempt to gain control of the funds in order to liquidate their portfolios and return the capital to investors, resulting in a net gain to investors.

30. Since the development of “shareholder rights plans,” commonly referred to as “poison pills” in the mid-1980s, proxy contests are the only way for a potential acquirer to make an offer to buy the shares of the corporation from shareholders where the board of directors does not support the acquisition. Poison pills have the effect of preventing potential acquirers from acquiring over a fixed

directors or executives that have been ousted from management of the corporation after internal disagreements.

In recent years, hedge fund activism has become more common and has accounted for a majority of proxy contest activity, especially among larger corporations.³¹ According to data from FactSet Research Systems, contested elections involving activist investors represented 92% of the proxy contests announced at companies in the Russell 3000 Index from 2008 to 2015. Figure 1, below, shows the number of activist engagements announced at all U.S. corporations each year from 2000 to 2015.³²

Figure 1: Activist Engagements Announced, 2000-2015³³



The influence of hedge fund activists on corporations has become the focus of considerable energy from corporations and investors and the subject of intense academic debate, especially about whether such influence improves the long-term value of the corporation. Investor activism generally results in a short-term

percentage of the corporation's voting shares, usually 15% or 20%, without the consent of the board of directors. *See, e.g.*, *Air Prods. & Chems., Inc. v. Airgas*, 16 A.3d 48, 94-101 (Del. Ch. 2011) (analyzing the history of poison pill jurisprudence and approving a poison pill); *Moran v Household Int'l, Inc.*, 500 A.2d 1346, 1357 (Del. 1985) (approving an early poison pill). For an academic analysis of the problems with poison pills, see Lucian Ayre Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002), and for the opposing view, see Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037 (2002). In order to undertake the acquisition, the potential acquirer must first replace a majority of the board of directors through a proxy contest.

31. Vyacheslav Fos, *The Disciplinary Effects of Proxy Contests*, 63 MGMT. SCI. 655, 656 (2016) ("The number (proportion) of proxy contests sponsored by activist hedge funds increased from 162 (38%) from 1994 through 2002 to 440 (70%) from 2003 through 2012.").

32. *See* FACTSET RESEARCH SYSTEM, SHARKREPELLENT (database updated Nov. 2017), <http://www.sharkrepellent.net/request?an=dt.pr&pg=login&rnd=500199> [<http://perma.cc/9TNS-ML4N>] [hereinafter SHARKREPELLENT]. The database provides information about engagements by activists, including proxy contests. FactSet, the database administrator, claims that the database includes all proxy contests since 2001, regardless of firm size. For each contest, the database provides information concerning the company, the dissident, and descriptive information about the contest, and the outcome.

33. *See id.*

increase in the value of the corporation.³⁴ Opponents of investor activism have expressed the view that, while it might increase the short-term value of corporations as a result of myopic actions, it may harm the long-term value of the corporation.³⁵ Others have suggested that this view is not correct, either as a theoretical matter,³⁶ or as an empirical matter,³⁷ and that the increases in value from activism are sustained in the long-term.

This Article does not take a position on the value of investor activism, other than to note the intensity of the debate and the implications for the corporate landscape beyond the instances of engagements by dissidents. Managers spend considerable time and resources attempting to forestall activist interventions in order to maintain the direction for the company that they believe to be best and—in the case of the directors opposed by dissidents—in order to maintain their positions. Investors in corporations are forced to determine whether they support activist interventions at those corporations and decide on rules that may increase or decrease the incidence of activist interventions.³⁸ Finally, judges and regulators determine the ground rules against which activist engagements are conducted and must make decisions about the rules that best serve corporations and investors as a whole, including those by which proxy contests are conducted.

3. The Effects of Corporate Voting Rules and Contested Elections

There are a relatively small number of contested corporate elections where shareholders have a real choice among directors and the ability to replace incumbent directors, but these contests have outsized importance. 99.5% of elections of directors at large U.S. corporations between 2008 and 2015 were uncontested.³⁹ In these elections, the only nominees for election to the board of directors that shareholders may vote for are those nominated by the incumbent board of directors itself. These elections are akin to political elections in a one-party state: there is no choice between candidates and no possibility of replacing directors. The default requirement for the election of directors at these corporations is a plurality of votes cast. In an uncontested election, this means that so as long as nominees receive *any* votes, they will be elected.⁴⁰

34. Brav et al., *supra* note 28, at 188-89.

35. See, e.g., William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 702 (2010).

36. See, e.g., Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1637 (2013).

37. See, e.g., Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1085 (2015).

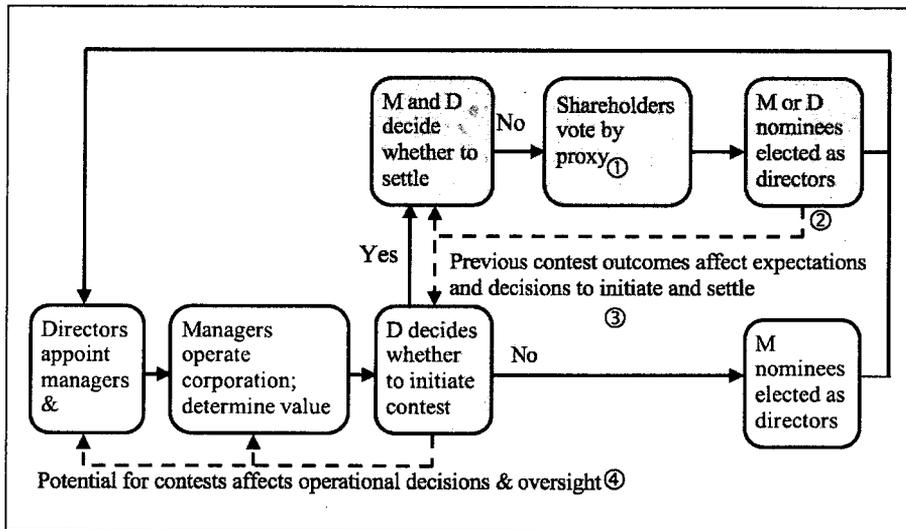
38. Since shareholder activists are usually hedge funds, some investors in the corporation—notably public pension funds and endowments—may also consider investing in the activist hedge fund itself.

39. Based on calculations from SHARKREPELLENT, *supra* note 32. For further information about the sample, see the discussion in *infra* Part III.

40. Some corporations have adopted a “majority voting policy,” or a variation on it, which requires directors to receive at least a majority of the votes cast to be able to take their position or

Although rare, contested elections are fundamental events for corporations, often determining the future direction of the corporation. More importantly, contested elections have far-reaching consequences for other corporations. Figure 2 sets out a simple model of contested elections and their effects. Directors appoint managers to manage the corporation, and monitor their actions. The actions of managers in operating the corporation determine the value of the corporation to its shareholders. Potential dissidents consider whether to initiate a proxy contest by putting forward nominees for election as directors. If no dissidents put forward nominees, management nominees are uncontested at the corporation's annual meeting and are elected unopposed. If a dissident does initiate a proxy contest, managers and dissidents have the possibility of reaching a settlement, which may involve managers appointing one or more dissident nominees to the board of directors.⁴¹ If no settlement is reached, the proxy contest goes to a vote. Shareholders cast their votes according to the proxy rules in force, and the aggregate vote determines which management nominees or dissident nominees are elected as the new directors of the corporation. Since directors oversee the actions of managers, election of dissident nominees may result in the removal of managers or influence managers to alter their operations of the corporation.

Figure 2: A Model of Contested Elections and Their Effects



to tender their resignation if they do not receive at least such a majority. For a comprehensive discussion of plurality and majority voting in uncontested director elections, see Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119 (2016).

41. For a discussion of settlements in proxy contests, see Lucian A. Bebchuk et al., *Dancing with Activists*, (Harvard Law and Econ. Discussion Paper No. 906, 2017), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2948869 [<http://perma.cc/R3FW-7DVD>].

Figure 2 also sets out the effects of corporate voting rules and shareholder voting in election contests. These can be conceptualized into a chain of four levels of outcomes, marked as ① to ④ in Figure 2. First, and most obviously, corporate voting rules determine how shareholders can vote in corporate elections. Second, shareholder votes determine election outcomes, such as which directors are elected. Third, election outcomes influence the expectations of dissidents and managers about the likely outcome of potential future proxy contests, which affect whether dissidents decide to initiate proxy contests, and whether managers and dissidents decide to settle proxy contests. Fourth, the extent to which dissidents initiate engagements and their likelihood of success affect managers' and directors' decisions about how to operate corporations and directors' decisions whether to appoint or replace managers. These decisions, in turn, affect the value of corporations and of shareholders' investments in corporations.

The possibility of a dissident commencing a proxy contest and possibly having dissident nominees elected will also influence management decisions regarding the operation of the corporation and directors' decisions about appointing and monitoring managers. The possibility of proxy contests therefore has effects on many more corporations than those at which proxy contests actually take place.

The possibility of settlement of proxy contests means that contested elections take place at only a small subset of engagements between management and dissidents. Because proxy contests are costly for both management and dissidents, where the parties both expect that one or the other will prevail in the contest there is usually some other resolution: if the dissident is unlikely to be successful, they withdraw. If the dissident has a reasonable likelihood of success, there is a settlement between management and the dissident. Table 1, below, shows the number of engagements between corporations and dissidents announced between 2008 and 2015 for corporations in the Russell 3000 Index⁴² and the actual number of proxy contests that were announced, as well as the number for which definitive proxy statements were filed and the contests that were actually voted upon.

42. The Russell 3000 Index comprises the 3,000 largest public corporations listed in the United States by market capitalization. The composition of the index changes slightly from year to year, but from 2008 to 2017 the corporations included ranged in size from about \$100-150 million to over \$500 billion. See *Russell Index Market Capitalization Ranges*, FTSE RUSSELL (May 12, 2017), <http://www.ftserussell.com/research-insights/452ikulsk-reconstitution/market-capitalization-ranges> [<http://perma.cc/U7Z7-J9RZ>].

Table 1: Dissident Engagements and Proxy Contests Announced at Companies in the Russell 3000 Index, 2008-2015⁴³

	2008	2009	2010	2011	2012	2013	2014	2015	Total	% of Total
Engagements	183	84	136	128	148	161	228	227	1,295	100.0%
Proxy Contests	54	27	42	40	37	54	53	50	357	27.6%
Definitive Proxy Statements Filed	29	14	18	18	16	31	18	23	167	12.9%
Proxy Contests Voted On	19	10	12	12	7	21	14	13	108	8.3%

As Table 1 shows, of the 1,295 engagements by dissidents with Russell 3000 corporations between 2008 and 2015, only 108, or 8%, resulted in contested elections. The decrease in the numbers of proxy contests each year in Table 1 results from engagements settling either before a proxy contest is announced, or if one is announced, before proxy statements are filed or voted upon. Only where the parties do not share similar beliefs about the likely outcome will a contested election actually be voted upon.

The few engagements that go to a vote provide the main evidence of the likely outcomes of the very many engagements that do not result in contests. As a result, the small number of proxy contests that are voted upon take on an outsized importance in influencing other engagements.

B. Corporate Voting Rules

1. Proxy Voting

Voting in director elections takes place by proxy and is governed by a combination of state and federal law. Shareholders execute a form of proxy or “proxy card,”⁴⁴ which vests power in a person or persons (the “proxy holder”) to vote on behalf of the shareholder at the meeting of shareholders at which the election takes place. The proxy card is not a ballot—submission of a proxy card does not represent the act of voting itself. Instead, it specifies how the proxy holder is to vote on behalf of the shareholder. At the meeting, the proxy holder completes a ballot form aggregating the votes of all of the shareholders for which it holds proxies.⁴⁵ Proxy holders are appointed pursuant to state corporate law⁴⁶

43. SHARKREPELLENT, *supra* note 32.

44. See 17 C.F.R. § 240.14a-4(a)(2) (2018).

45. See, e.g., DEL. CODE ANN. tit. 8, § 211(e) (2017) (“All elections of directors shall be by written ballot unless otherwise provided in the certificate of incorporation.”).

46. See, e.g., *id.* § 212(b) (“Each stockholder entitled to vote at a meeting of stockholders . . . may authorize another person or persons to act for such stockholder by proxy.”).

and the proxy relationship is governed by agency principles, which are part of state common law.

Federal securities laws govern the solicitation of proxies, imposing stringent requirements on parties that solicit proxies.⁴⁷ In any corporate election, the corporation solicits proxies to vote as recommended by the directors. In contested elections, the dissidents also solicit their own proxies to vote for the dissident nominees. Federal securities laws require each side soliciting proxies to use their own proxy card, as well as to prepare detailed disclosure regarding the persons soliciting the proxies and their nominees. Rule 14a requires solicitations to contain certain information included in a proxy statement and places certain restrictions on the form of proxy cards. Among other things, proxy cards are required to provide a means for shareholders to “withhold” authority from their proxy holder to vote for particular nominees.⁴⁸

One provision of the federal proxy rules in particular has an important impact on the dynamics of proxy contests. Rule 14a-4 permits solicitation only for “bona fide nominees” named in the party’s proxy statement, which are nominees that have consented to such inclusion and intend to serve as directors if elected.⁴⁹ In practice, parties do not agree to have their nominees included on other parties’ proxy cards,⁵⁰ so the proxy card solicited by each party contains only its own nominees. If a shareholder wishes to vote for some or all of the management nominees, the shareholder returns the proxy card solicited by management, indicating which management nominees it wishes the proxy holder to vote for.⁵¹ If a shareholder wishes to vote for some or all of the dissident nominees, it returns the proxy card solicited by the dissident, indicating which of the dissident nominees it wishes the proxy holder to vote for.⁵²

47. The solicitation of proxies is governed by Section 14(a) of the Securities Exchange Act, 15 U.S.C. §§ 78a-pp (2018), and the rules promulgated thereunder, primarily Rule 14a, 17 C.F.R. § 240.14a (2017).

48. 17 C.F.R. § 240.14a-4(b)(2) (2017) (“Such form of proxy shall clearly provide any of the following means for security holders to withhold authority to vote for each nominee . . .”). Before this provision was added in 1979, proxy cards did not provide a means for withholding authority to vote for particular nominees, and only provided for the election of the entire slate of nominees. *See* Exchange Act Release No. 34-16356, 44 Fed. Reg. 68,764 (Nov. 21, 1979).

49. 17 C.F.R. § 240.14a-4(d) (2017) (“No proxy shall confer authority: (1) To vote for the election of any person to any office for which a bona fide nominee is not named in the proxy statement . . .”).

50. *See, e.g.,* Inv’r Advisory Comm., *Recommendations of the Investor as Owner Subcommittee Regarding SEC Rulemaking To Explore Universal Proxy Ballots*, U.S. SEC. & EXCHANGE COMM’N 2 (July 23, 2013), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-universal-proxy.pdf> [<http://perma.cc/5KMQ-HE8R>] (“Directors nominated by an incumbent board have only very rarely consented to being named as nominees in a proxy statement issued by a shareholder in opposition to management.”); *see also* discussion *infra* Section I.C.

51. The proxy statement is required to provide that the proxy holder will vote the shares in accordance with the specifications on the proxy card. *See* 17 C.F.R. § 240.14a-4(e) (2017).

52. Where a dissident nominates candidates for less than half of the positions on the board of directors (a “short slate”), they may also solicit proxies to vote for those management nominees that they do not oppose. *See id.* § 240.14a-4(d)(4).

2. The Mix-and-Match Problem

The bona fide nominee rule combines with state law rules to create a peculiar problem. State law prevents shareholders from executing more than one proxy card. A proxy card executed by a shareholder supersedes and revokes any proxy card previously executed by that shareholder.⁵³ Because shareholders can execute a proxy card solicited by only one the parties, and those proxies contain only the nominees of that side, shareholders cannot “mix and match” candidates from different sides of the contest; the proxy voting rules effectively limit the expressive ability of shareholders to vote for the mix of nominees that they prefer, if they wish to vote on a solicited proxy card. For instance, if there are four contested board seats up for election, shareholders cannot use proxy cards solicited by the parties to vote for two of the management nominees and two of the dissident nominees. At most, they can vote on the management card for two nominees or on the dissident card for two nominees, in each case withholding their votes from the other two nominees on the card.

In uncontested elections, withholding votes from nominees has become a way for shareholders to signal their disapproval of directors.⁵⁴ In a contested election, withholding votes is inferior to voting *for* an opposition candidate. The winners of the contest are determined by the number of votes cast *for* the candidate.⁵⁵ As a result, withheld votes are not considered in determining the successful nominee. Compared to voting for a nominee (for example, if the shareholder is voting for all of the other nominees on that side), shareholders withholding their votes will have some effect, as the nominee will receive fewer votes than if the shareholders had voted for them. But the opposing nominee will not receive any additional votes.

The mix-and-match problem appears to be unique to corporate voting in the United States. In most advanced common law countries, including the United Kingdom, France, Canada, and Australia, dissidents do not use their own proxy card. Instead, shareholders have robust rights to include items in the agenda of shareholder meetings, including putting forward dissident nominees for

53. See, e.g., *Concord Fin. v. Tri-State Motor Transit Co. of Del.*, 567 A.2d 1, 8 (Del. Ch. 1989); *Standard Power & Light Corp. v. Inv. Assocs.*, 51 A.2d 572, 580 (Del. Ch. 1947).

54. Joseph Grundfest initially suggested withholding votes as part of a “just vote no” campaign. See Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 865 (1993) (“[S]hareholders can express their lack of confidence in management’s performance by marking their proxy cards to withhold authority for the reelection of these corporate board.”). For an empirical analysis of the purposes for which shareholders withhold votes, see Yonca Ertimur et al., *Understanding Uncontested Director Elections*, MGMT. SCI. (forthcoming 2018) (manuscript at 1), <http://pubsonline.informs.org/doi/pdf/10.1287/mnsc.2017.2760> [<http://perma.cc/C9RJ-ULL4>].

55. See, e.g., DEL. CODE ANN. tit. 8, § 216(3) (2017) (“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.”).

election.⁵⁶ These nominees are then included in the form of proxy distributed by the corporation. There is therefore one proxy card that includes all of the nominees.⁵⁷ It is also difficult to find close analogues to the mix-and-match problem in political contests or other voting scenarios outside corporate elections.⁵⁸

The above discussion assumes that shareholders vote on proxy cards solicited by the parties. Shareholders have two alternatives that avoid the effect of the mix-and-match problem, however these are rarely used. First, shareholders may also choose to grant a proxy that they design themselves, commonly referred to as a “legal proxy.” Because the proxy has not been solicited, SEC proxy rules, including the bona fide nominee rule, do not apply.⁵⁹ As a result, shareholders can authorize the proxy holder to vote for whichever nominee the shareholder wishes to specify. Second, if a shareholder is the “record owner” of their shares, they can attend the shareholder meeting and vote in person. However, in most

56. REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 53 (3d ed. 2017) (“[A]lmost all jurisdictions permit a qualified minority (usually a small percentage) of shareholders to contest the board’s slate by adding additional nominees to the agenda of the shareholders’ meeting.”); see also Council Directive No. 2007/36, O.J. L 184/17 (2007), Art. 6 (requiring European Union member states to ensure that shareholders have the right to put items on the agenda of the general meeting). The right to include items in the agenda of general meetings was already in place at most member states prior to 2007. See *Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by Shareholders of Companies Having Their Registered*, SEC (2006) 81, 88-91 (Feb. 17, 2006) (detailing the rights to place items on agenda and table resolutions in 27 European jurisdictions).

57. The United States has long considered whether corporations should be required to include shareholder nominees in the corporation’s proxy card and other proxy materials, a proposal commonly referred to as “proxy access.” See Amended Proxy Rules, Exchange Act Release No. 34-3347, 7 Fed. Reg. 10653 (Dec. 18, 1942) (describing, among other revisions considered but not adopted, “[t]he suggestion that minority stockholders be given an opportunity to use the management’s proxy material in support of their own nominees for directorships.”). Attempts by the SEC to introduce requirements for proxy access have been unsuccessful. See *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (striking down the SEC’s proxy access regulation). Many companies have amended their bylaws to allow proxy access. However, most proxy access bylaws do not permit proxy access by dissidents that intend to change or influence control of the corporation. See Gail Weinstein & Philip Richter, *Universal Proxy Unlikely to be Adopted (and Would Have Little Effect Anyway)*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 21, 2016), <http://corpgov.law.harvard.edu/2016/12/21/universal-proxy-unlikely-to-be-adopted-and-would-have-little-effect-anyway> [<http://perma.cc/RY2G-6XAT>]. This and other stringent requirements on the use of proxy access mean that the great majority of dissidents are unlikely to use proxy access to put forward their nominees for election. See Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1409 (2011) (discussing the impediments to dissidents using proxy access at length, and concluding that “[o]verall, for most dissidents, proxy access would not represent an attractive alternative”).

58. The system has superficial similarities to the U.S. partisan primary election contest, where citizens choose which party they want to select nominees from and then are restricted to voting on that party’s ballot, for that party’s nominee. However, corporate elections are conceptually different because they involve only one stage and does not have a second contest among the primary winners. The appropriate analogy to the corporate election would be if the winner of the general election were determined by how many primary votes each nominee received.

59. Rule 14a-1 provides that a solicitation must include: “(i) Any request for a proxy whether or not accompanied by or included in a form of proxy; (ii) Any request to execute or not to execute, or to revoke, a proxy; or (iii) The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.” 17 C.F.R. § 240.14a-1 (2017).

cases, investors are not the record owner of their shares. They hold their shares through intermediaries, such as brokers, banks, and custodians,⁶⁰ referred to as holding “in street name.” They would need a legal proxy from the registered owner of the shares to attend the shareholder meeting. Legal proxies are not straightforward to use, because of the complexity of share ownership⁶¹ and its effects on shareholder voting.⁶² These complexities affect all proxies, but systems and intermediaries have developed to facilitate voting by solicited proxies, which do not apply to legal proxies.⁶³ Legal proxies are therefore more onerous and costly to use than the standard voting machinery.⁶⁴ They are used only by large investors with the most sophisticated staff,⁶⁵ and even among such investors, only infrequently.⁶⁶

60. Brokers and custodians in turn hold shares through a single securities depository, the Depository Trust Corporation (DTC).

61. The complexity in the share ownership system results from the need to rapidly and efficiently transfer ownership of shares purchased through modern markets and trading systems. Requiring purchases of shares to be reflected in the books of the corporation, as was formerly the case, substantially hinders the ability of shareholders to rapidly trade their shares on markets or trading platforms. To solve this problem, record ownership of most shares was transferred to the DTC. Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1237-38 (2008).

62. This system of ownership and voting is sometimes referred to as “proxy plumbing.” See Kara Scannell, *SEC Probes “Proxy Plumbing,”* WALL ST. J. (July 15, 2010), <http://www.wsj.com/articles/SB10001424052748703792704575366910882553810> [http://perma.cc/AW7J-BJFG] (describing the SEC’s concept release describing proxy plumbing issues and soliciting comment); see also Exchange Act Release No. 34-62495, 75 Fed. Reg. 42,982 (Jul. 22, 2010). For a discussion of many of these issues and how they affect shareholder voting, see Kahan & Rock, *supra* note 57.

63. The DTC gives an omnibus proxy for the shares of which it is the record owner, which gives each bank and custodian for which it holds shares the power to give proxies for those shares. Brokers and custodians in turn distribute a “voting instruction form” to each of the beneficial owners, asking how they wish to vote. The broker or custodian then aggregates the voting instructions they receive and provides an omnibus proxy to the proxy holder with respect to those shares. This process has been streamlined by corporations, brokers, and banks through intermediaries that design and distribute the voting instruction forms to beneficial owners, operate platforms for beneficial owners to provide voting instruction electronically, telephonically or by mail, and receive and tabulate the completed instructions. Broadridge and proxy advisers such as Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. provide electronic platforms for investors to submit their proxy cards electronically.

64. A legal proxy is generally drafted by an attorney and requires coordination among the investor, the custodian, and any other intermediaries. In contrast, completing a voting instruction form is very straightforward for the beneficial owner and does not require a lawyer or coordination with the custodian.

65. See Inv’r Advisory Comm., *supra* note 50, at 1 (“The complexity and expense of exercising full voting rights for the election of directors while not attending a shareholders meeting in person are substantial, and typically only large institutional holders ever avail themselves of these procedures.”).

66. One question is why very large investment funds do not use legal proxies more often. One explanation is the investment managers of these funds bear the cost of voting themselves, and cannot pass them on to the investment funds that they manage. Because the investment manager will capture only a tiny percentage of the benefit to the corporation from voting in the right way, they will not have incentives to spend significant amounts on that decision. See Lucian A. Bebchuk et al., *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 96 (2017). If an investment fund has a 5% investment in a company that is involved in a proxy contest that has a market value of \$1 billion—i.e., a \$50 million investment—and a certain outcome would increase the value of the company and the investment by 1% (\$500,000), and the investment manager charges a fee of 0.1%, the investment manager would capture only \$500 from voting in the right way.

3. The Universal Proxy Solution

The solution to the mix-and-match problem created by the proxy rules is conceptually straightforward. Parties could be permitted or required to solicit “universal proxies.” A universal proxy is a single proxy card that includes all of the management and dissident nominees for election as directors at a particular meeting. Shareholders could use the universal proxy to vote for as many nominees as there are seats available for election, in whichever combination they prefer.

Recent support for universal proxies has led the SEC to propose a universal proxy rule. The universal proxies rule has gained support from investor groups, but garnered opposition from groups traditionally associated with corporate managers. However, to date, there has been a dearth of evidence on the likely effects of universal proxies. Although universal proxies were first proposed more than twenty-five years ago, a universal proxy has never been used in a proxy fight at a major U.S. corporation.⁶⁷ As a result, neither those advocating universal proxies nor those opposing them have any evidence to back up their claims regarding the effects of a universal proxy rule.⁶⁸

C. A Brief History of Universal Proxies in the United States

Since they were first proposed in 1991,⁶⁹ there have been several attempts to use universal proxies in proxy contests in the United States, although their use has never been agreed upon or employed in a major proxy contest at a U.S.

67. As discussed further below, a universal ballot was used at a proxy contest at a large U.S. corporation, and a Canadian and a Swiss corporation listed in the United States have used universal proxies in contested elections.

68. The SEC staff conceded this dearth of evidence in the Release. See Exchange Act Release No. 34-79164, *supra* note 16, at 79,163 (“[E]ither more registrant nominees or more dissident nominees might be elected than under the [current arrangement] However, these effects are uncertain because it is difficult to predict the extent or direction of any changes in voting behavior as a result of the proposed amendments . . .”).

69. An early suggestion of a universal proxy came in after the SEC proposed amendments to the proxy rules in 1991. Exchange Act Release No. 34-29315, 56 Fed. Reg. 28,987 (June 17, 1991). Ronald Gilson, Lilli Gordon, and John Pound published an academic article analyzing the problem, and the difficulties it created for vote splitting. Ronald J. Gilson et al., *supra* note 10. They proposed that the SEC revise the wording of the bona fide nominee rule to permit parties soliciting proxy cards to include nominees that had consented to be named in *any* proxy statement—so that either party could include nominees that had been named in either proxy statement. In a comment letter to the SEC on the proposed changes, a group of law professors led by Bernard Black endorsed a similar suggestion. Bernard S. Black, *Next Steps in Proxy Reform*, 18 J. CORP. L. 1 (1992). In its 1992 release adopting the amendments, the SEC adverted to the universal proxy rule, but indicated that it had chosen not to adopt it because of the substantial changes it would involve to the proxy rules. Exchange Act Release No. 34-31326, 57 Fed. Reg. 48,276 (Oct. 16, 1992) (“Proposals to require the company to include shareholder nominees in the company’s proxy statement would represent a substantial change in the Commission’s proxy rules. This would essentially mandate a universal ballot including both management nominees and independent candidates for board seats.”).

corporation.⁷⁰ A universal proxy was proposed by dissidents at Pershing Square, L.P. for the 2009 annual meeting of Target Corporation,⁷¹ Trian Fund Management, L.P. for the 2015 annual meeting of E.I. du Pont de Nemours and Company,⁷² and Pershing Square L.P. for the 2017 annual meeting of Automatic Data Processing, Inc. (ADP).⁷³ Target,⁷⁴ Du Pont,⁷⁵ and ADP⁷⁶ all refused consent for their management nominees to be included on the dissident cards. Management of three corporations have attempted to use universal proxy cards: Tessera Technologies, Inc. for its 2013 annual meeting, for which Starboard Value LP had nominated directors for election;⁷⁷ Shutterfly, Inc., for its 2015 annual meeting, for which Marathon Partners Equity Management, LLC had nominated directors⁷⁸; and GrafTech International Ltd., for its 2015 annual meeting, for which Nathan Milikowsky (a former director) had nominated

70. At three proxy contests at two small-capitalization U.S. corporations, Research Frontiers Inc. and BIOLASE, Inc., management proxy statements included dissident nominees. However, these were more akin to proxy access situations, than universal proxies, as neither dissident solicited proxies at the contests. *See* BIOLASE, Inc., Definitive Proxy Statement (Schedule 14A) 1 (Apr. 3, 2015); BIOLASE, Inc., Definitive Proxy Statement (Schedule 14A) 2 (July 29, 2014); Research Frontiers Inc., Definitive Proxy Statement (Schedule 14A) 7 (Apr. 25, 2012) (“Although the Company could have excluded [dissident nominee Darryl Daigle] from its proxy statement pursuant . . . , the Company elected to include the proposal.”).

71. *See* Pershing Square Capital Mgmt., L.P., Letter to Target Corporation, Filed as Exhibit to Additional Soliciting Material (Schedule 14A) (Apr. 21, 2009). This was suggested by Professor Gilson, one of the coauthors of the 1991 article describing the problems with one-sided proxies. *See* Gilson et al., *supra* note 69.

72. Trian’s letter to the company requesting universal proxies was not filed with the SEC. *But see* Antoine Gara, *Trian’s Proxy War With DuPont Revives Dormant Voting Debate*, FORBES (Mar. 3, 2015), <http://www.forbes.com/sites/antoinegara/2015/03/03/trians-proxy-war-with-dupont-revives-dormant-voting-debate> [<http://perma.cc/8R3X-QY3P>].

73. *See* Pershing Square Capital Mgmt., L.P., Letter to Automatic Data Processing, Inc., Filed as Exhibit to Additional Soliciting Material (Schedule 14A) (Sept. 15, 2017).

74. Target Corp., Definitive Additional Proxy Soliciting Material on Form 14A (Apr. 21, 2009) (suggesting that it “would cause delay and confusion”). Target did not respond to a request to use its nominees on the Pershing Square proxy card. *See* Pershing Square Capital Mgmt., L.P., Press Release Filed as Soliciting Material (Schedule 14A) (Apr. 21, 2009). Target also rebuffed a suggestion from Pershing Square that it facilitate a universal ballot solution as had been used at CSX, described below. *See* Target Corp., Letter to Pershing Square Capital Management, L.P., Filed as Exhibit to Additional Soliciting Materials (Schedule 14A) (May 26, 2009).

75. E.I. du Pont de Nemours & Co., Letter to Nelson Peltz, Filed as Exhibit to Additional Soliciting Materials (Schedule 14A) (Mar. 3, 2015).

76. Automatic Data Processing, Inc., Letter to Pershing Square Capital Management, L.P., Filed as Exhibit to Additional Soliciting Materials (Schedule 14A) (Sept. 22, 2017) (contending that switching to a universal proxy “would result in significant risks of confusion and disenfranchisement for our stockholders”).

77. Tessera Techs., Inc., Letter to Olshan Frome Wolosky, Filed as Exhibit to Definitive Additional Materials (Schedule 14A) (Apr. 29, 2013).

78. Shutterfly, Inc., Press Release Filed as Additional Soliciting Material (Schedule 14A) (May 22, 2015).

directors.⁷⁹ Both Starboard⁸⁰ and Marathon⁸¹ refused to consent to their nominees being included on the management proxy card. In the GrafTech contest, both parties consented to the inclusion of their nominees on each other's proxy card.⁸² However, while the proxy contest was pending, the company agreed to be acquired,⁸³ and as a result the proxy contest did not go to a vote. In a proxy contest initiated by Starboard Value LP that was pending at the time this Article was published, the shareholders of Mellanox Technologies, Ltd., an Israeli company listed on the Nasdaq exchange, approved an amendment to the company's articles of association that requires both sides to use a universal proxy in contested elections, by use of a nominee consent policy.⁸⁴ That universal proxies have been suggested equally frequently by management and dissidents suggests that either side may benefit from distortions in the current system of proxy voting and that different sides may benefit from a universal proxy in different situations. Each instance seems to have involved some attempt by the party proposing a universal proxy to gain a tactical advantage. In several of the cases where management has proposed a universal proxy, it would have delayed the annual meeting, which may have been to the advantage of management in those cases.⁸⁵ Proposing a voting mechanism that institutional investors prefer may also give that side a public relations advantage.

79. GrafTech Int'l Ltd., Preliminary Proxy Statement (Schedule 14A) (Apr. 13, 2015); Nathan Milikowsky, Preliminary Proxy Statement (Schedule 14A) (Apr. 23, 2015).

80. Starboard Value L.P., Letter to Skadden Arps, Filed as Exhibit to Additional Soliciting Material (Schedule 14A) (May 2, 2013) (refusing on the basis that the suggestion came three weeks before the meeting, and both sides had already mailed their proxy cards, and claiming it would "create further delay and confusion for shareholders" and would require that voting be reset, potentially disenfranchising shareholders that had already voted).

81. Marathon Partners Equity Mgmt., LLC, Letter to Gordon Davidson, Counsel to Shutterfly, Inc., Filed as Definitive Additional Material (Schedule 14A) (May 26, 2015) (refusing on the basis that the suggestion came three weeks before the meeting, and after both sides had mailed definitive proxy statements, and claiming that the suggestion was an attempt to "manipulate the timing or voting mechanics" of the meeting).

82. GrafTech Int'l Ltd., Preliminary Proxy Statement (Schedule 14A), at 7 (Apr. 13, 2015); Nathan Milikowsky, Preliminary Proxy Statement (Schedule 14A), at 19 (Apr. 23, 2015).

83. GrafTech Int'l Ltd., Current Report (Form 8-K), at 1 (May 18, 2018).

84. After Starboard announced that it would put forward nominees for election to the board of Mellanox at its May 2018 annual meeting, Mellanox delayed its annual meeting to July 2018, so that it could hold an extraordinary general meeting in May 2018 for the purpose of approving two changes to its articles of incorporation, one of which would implement a nominee consent policy that, if adopted, would require any nominee for election to consent to be included in a universal proxy, and would require both parties to use a universal proxy in any contested election. Mellanox Technologies, Ltd., Definitive Proxy Statement (Schedule 14A), at 32-35 (May 7, 2018). Both amendments were approved. Mellanox Technologies, Ltd., Current Report (Form 8-K) (May 24, 2018).

85. As mentioned in *supra* notes 80 and 81, the dissidents in the Tessera and Shutterfly contests both responded that using a universal proxy would affect the timing of the meeting. In the Mellanox contest, Starboard responded that the "the only reason Mellanox is proposing the EGM is to purposely delay the 2018 Meeting." Letter to the Shareholders of Mellanox Technologies, Ltd., Filed as Exhibit to Additional Soliciting Material (Schedule 14A), at 1 (Mar. 12, 2018). Starboard offered to work with Mellanox for both parties to use a universal proxy without the need for a nominee consent policy, however, Mellanox rejected the offer. See Mellanox Technologies, Ltd., Definitive Proxy Statement (Schedule 14A), at 2 (May 7, 2018); Mellanox Technologies, Ltd., Letter to Olshan Frome Wolosky LLP, Attached as Exhibit to Current Report (Form 8-K), at 2 (Mar. 15, 2018).

These potential public relations benefits, or the tactical advantages that delays in instituting a universal proxy in a contest might require, are likely to have played a part in decisions to propose or to reject suggestions of universal proxies. A party is likely to propose a universal proxy where it appears likely that none of their nominees would be elected under the current proxy voting system, but some of its nominees might be elected if a universal were to be used.⁸⁶ In each of the three cases where dissidents proposed universal proxies, there were signals before the meeting that there was support for electing a mix of dissident and management nominees,⁸⁷ suggesting that a universal proxy may have led to the election of some dissident nominees, but in each case none of the dissident nominees were elected.⁸⁸ Similarly, where management proposed a universal proxy card in the Tessler and Shutterfly contests, there were signals of support for a mix of management and dissidents.⁸⁹ In both cases, without a universal proxy, dissidents nominees received very significant support.⁹⁰ Conversations with practitioners involved in proxy contests and articles issued by practitioners, suggest that there may now be a greater recognition of the impact of universal proxies on voting, and a greater willingness on the part of managers to consider universal proxies in particular contests, especially where managers believe that dissidents nominees are likely to receive substantial support.⁹¹

Some evidence of how a universal proxy might function in the United States can be gleaned from the use of a universal *ballot* by one U.S. corporation, CSX, and by the use of universal proxies at two foreign corporations listed in the United States. A universal *ballot*—as opposed to a universal *proxy*—was used in a proxy contest at the 2008 annual meeting of CSX Corporation. CSX is incorporated in Virginia. Whereas ballots at most other corporations are submitted at the meeting, generally by proxy holders on behalf of shareholders not attending the shareholder meeting, CSX circulated a ballot to shareholders and permitted them to submit it electronically, as permitted by Virginia’s Stock Corporation Act.⁹² The CSX voting results show that many shareholders used

86. Weinstein & Richter, *supra* note 57.

87. In each case, proxy advisor ISS had favored some (but not all) of the dissident nominees. Data from SharkRepellent.net, last accessed March 23, 2018. *See supra* note 32.

88. Data from SharkRepellent.net. *See id.*

89. In the Tessler contest, ISS recommended for two of the six dissident nominees; in the Shutterfly contest, it recommended for two of the three dissidents. Data from SharkRepellent.net, last accessed March 23, 2018. *See id.*

90. At Shutterfly, two of three dissident nominees were elected. Data from SharkRepellent.net, last accessed March 23, 2018. *See id.* The day before the Tessler meeting, when they were likely to have known the voting results, management agreed to appoint all of the dissident nominees. Tessler Technologies, Inc., Current Report (Form 8-K) (May 24, 2013).

91. *See, e.g.,* Weinstein & Richter, *supra* note 57; David Whissel, *Universal Proxies Move Forward*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 28, 2016), <http://corpgov.law.harvard.edu/2016/11/28/universal-proxies-move-forward> [<http://perma.cc/LYB5-VAKT>].

92. *See* VA. CODE ANN. §13.1-664.1.E (2007) (“If authorized by the board of directors, any shareholder vote to be taken by written ballot may be satisfied by a ballot submitted by electronic transmission by the shareholder or the shareholder’s proxy, provided that any such electronic transmission

this method to split their vote among the management and dissident candidates.⁹³ A universal ballot was also used in a proxy contest initiated by Pershing Square at the 2012 annual meeting of Canadian corporation Canadian Pacific Railway Limited,⁹⁴ and at a proxy contest initiated by Carl Icahn at the 2013 annual meeting of Swiss corporation Transocean Ltd.⁹⁵ Canadian proxy rules did not contain a rule preventing parties from soliciting for other nominees, and Swiss securities law required the use of a universal proxy. Because both corporations are listed on the New York Stock Exchange, proxies were solicited from U.S. shareholders. Universal proxies did not appear to create significant problems for either party in the Transocean or Canadian Pacific proxy contests or for intermediaries involved in those contests, suggesting that universal proxies are a feasible alternative to the current system of proxy voting.

D. The Debate About Universal Proxies

Following the attempted uses of universal proxies at U.S. corporations described above, there were calls for the SEC to adopt a universal proxy rule. In 2013, the Investor as Owner Subcommittee of the Investor Advisory Committee

shall either set forth or be submitted with information from which it can be determined that the electronic transmission was authorized by the shareholder or the shareholder's proxy.”)

93. A large pension fund shareholder, the State Board of Administration Florida, also stated that it had split its vote, rather than voting only for two dissidents and withholding the remainder of its votes as it would have done had the universal ballot not been provided. *SBA Proxy Vote Decisionmaking: A Case Analysis of the 2008 TCI/3G Versus CSX Proxy Contest*, ST. BD. OF ADMIN. FLA. 86-87 (2009) (“For the entire stock position of 1,156,413 shares, the SBA voted in favor of all of CSX’s nominees except three; . . . We voted in favor of two of the dissident candidates If the CSX vote had been an all or nothing vote . . . then the SBA likely would have voted the entire dissident slate This procedure allowed the SBA to exercise its entire vote by voting for the dissident and incumbent candidates that it desired to elect.”).

94. At the 2012 annual meeting of Canadian Pacific Railway Limited, for which Pershing Square had put forward nominees, Canadian Pacific elected to use a universal proxy card, including the Pershing Square nominees along with its own nominees in its proxy card, and Pershing Square followed suit. See Canadian Pacific Railway Ltd., Form of Proxy – English (Mar. 22, 2012) (management proxy card); Canadian Pacific Railway Ltd., Form of Proxy – English (Apr. 5, 2012) (Pershing Square proxy card). On the morning of the meeting, presumably in response to the proxy returns, Canadian Pacific announced the resignation of its CEO and four other directors, resulting in all seven Pershing Square nominees and nine management nominees being elected by default. See Ian Austen, *Ackman Wins Proxy Fight at Canadian Pacific*, N.Y. TIMES DEALBOOK (May 17, 2012), <http://dealbook.nytimes.com/2012/05/17/canadian-pacific-c-e-o-and-five-directors-step-down> [http://perma.cc/5A4A-TAW6]. The corporation did not release results of the vote for the six directors that resigned, making it difficult to interpret the results. Canadian Pacific Railway Ltd., Report on Voting Results (May 18, 2012).

95. The parties solicited identical proxy cards, each containing five nominees put forward by management and three nominees put forward by Icahn. See Transocean Ltd., White Proxy (Schedule 14A) (Apr. 2, 2013); Icahn Partners LP, Gold Proxy (Schedule 14A) (Apr. 17, 2013). Four management nominees and one Icahn nominee were elected. See Transocean Ltd., Current Report (Form 8-K) (May 20, 2013).

(IAC) of the SEC⁹⁶ recommended that the SEC consider a universal ballot rule.⁹⁷ The Council on Institutional Investors subsequently petitioned the SEC to consider adopting a universal proxy rule.⁹⁸ Two SEC commissioners also urged consideration of the issue.⁹⁹ As a result of these efforts, the then-Chair of the SEC, Mary Jo White, announced that the SEC would consider a universal proxy rule.¹⁰⁰ The arguments made in favor of a universal proxy focused on the fact that it would improve investor suffrage by enhancing the ability of investors to vote in proxy contests. This argument focuses narrowly on the first of the four levels of the effect of corporate voting rules described in Section I.A.3 above, determining how shareholders are able to vote.¹⁰¹ This “expressive” argument disregards the effect of universal proxies on proxy contest outcomes, future contests, and the value of corporations.

The idea of a universal proxy rule met with staunch opposition. After Chair White announced that the SEC would consider a universal proxy rule, the U.S. Chamber of Commerce lobbied Congress to prevent the SEC from implementing universal proxies.¹⁰² This resulted in an amendment to the Fiscal Year 2017

96. The IAC was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act to, *inter alia*, “advise and consult with the Commission on— (i) regulatory priorities of the Commission; . . . (iii) initiatives to protect investor interest; and (iv) initiatives to promote investor confidence and the integrity of the securities marketplace; and (B) submit to the Commission such findings and recommendations as the Committee determines are appropriate, including recommendations for proposed legislative changes.” See Investor Protection and Securities Reform Act of 2010 § 911, 15 U.S.C. § 78a (2018) (adding to the Securities and Exchange Act of 1934 § 39, 15 U.S.C. § 78pp (2018)).

97. The recommendation was presented to the Committee by Roy Katzovitz, the Chief Legal Officer of Pershing Square, who had been involved in the Target proxy contest and the Canadian Pacific proxy contest, and subsequently remained a vocal advocate for a universal proxy rule.

98. Letter from Davis, *supra* note 15.

99. Luis A. Aguilar, Comm’r, U.S. Sec. & Exch. Comm’n, *Seeing Capital Markets Through Investor Eyes*, (Dec. 15, 2013), <http://www.sec.gov/news/speech/2013-spch120513-2laa> [<http://perma.cc/T6KG-NR8K>]; Kara M. Stein, Comm’r, U.S. Sec. & Exch. Comm’n, *Remarks at the “SEC Speaks” Conference: What Lies Ahead? The SEC in 2016* (Feb. 19, 2016), <http://www.sec.gov/news/speech/stein-sec-speaks-2016.html> [<http://perma.cc/3VGT-8PP2>]; Kara M. Stein, Comm’r, U.S. Sec. & Exch. Comm’n, *Toward Healthy Companies and a Stronger Economy, Remarks to the U.S. Treasury Department’s Corporate Women in Finance Symposium* (Apr. 30 2015), <http://www.sec.gov/news/speech/stein-toward-healthy-companies.html> [<http://perma.cc/X7PW-LJ2U>]; Kara M. Stein, Comm’r, U.S. Sec. & Exch. Comm’n, *Remarks to the Council of Institutional Investors* (May 8, 2014), <http://www.sec.gov/news/speech/2014-spch050814kms> [<http://perma.cc/YP8A-QLX6>].

100. Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, *Building Meaningful Communication and Engagement with Shareholders* (June 25, 2015), <http://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html> [<http://perma.cc/H8WL-HNU4>].

101. This would seem to be grounded in ideas of corporate or shareholder democracy. For a discussion of the ideas of shareholder democracy, see, for example, FRANK D. EMERSON & FRANKLIN C. LATCHAM, *SHAREHOLDER DEMOCRACY: A BROADER OUTLOOK FOR CORPORATIONS* (1954); Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53 (2008); and Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy Symposium: Understanding Corporate Law through History*, 63 WASH. & LEE L. REV. 1389 (2006).

102. Letter from R. Bruce Josten, Exec. Vice President, U.S. Chamber of Commerce, to Chairman Andrew Crenshaw and Ranking Member José Serrano (May 24, 2016), http://www.uschamber.com/sites/default/files/documents/files/160524_fy17financialservicesgeneralgovernmentappropriations_crenshaw_serrano.pdf [<http://perma.cc/PHF9-X5ZC>]; see also Letter from Josten, *supra* note 17 (encouraging Congress to set a funding limitation to block the universal proxy rule); Letter from

Financial Services and General Government Appropriations bill that would have effectively prohibited the SEC from developing, implementing, finalizing, or enforcing a universal proxy rule.¹⁰³ The bill was not passed by the Senate, but identical language is included in the draft Financial CHOICE Act bill,¹⁰⁴ and in the draft 2018 Financial Services and General Governance Appropriations bill.¹⁰⁵

This opposition was based on concerns that mandating universal proxies would “increase the frequency and ease of proxy fights,” which the Chamber of Commerce describes as being harmful to corporations, and “empower[ing] a small vocal minority at the expense of the majority.”¹⁰⁶ Following the Release, two groups affiliated with the Chamber of Commerce¹⁰⁷ submitted comment letters that claimed that the Release would “[i]ncrease the frequency and ease of proxy fights for dissident shareholders” and “[f]avor activist investors over rank-and-file shareholders and other corporate constituencies.”¹⁰⁸ These arguments do not controvert proponents’ argument about the expressive effects of universal proxies on how shareholders may vote. Instead, they focus on a different level of the effect of corporate voting rules and contested elections. They seem predicated on an (unstated) argument that increasing the likelihood of proxy contests will reduce the value of corporations—the fourth level of the effects of corporate voting described in Section I.A.3 above.

R. Bruce Josten, Exec. Vice President, U.S. Chamber of Commerce, to Chairman Thad Cochran and Vice Chairwoman Barbara Mikulski (June 15, 2016), http://www.uschamber.com/sites/default/files/documents/files/160615_fy17financialservicesgeneralgovernmentappropriations_cochran_mikulski.pdf [<http://perma.cc/DB62-M9V6>] (same).

103. H.R. 5485, 114th Cong. § 1215 (2016).

104. See Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 845 (2017).

105. See U.S. H.R. Comm. on Appropriations, *Draft Financial Services and General Government Appropriations Act*, U.S. HOUSE REPRESENTATIVES § 932 (June 28, 2017, 10:54 AM), <http://appropriations.house.gov/uploadedfiles/bills-115hr-sc-ap-fy2018-fs-services-financialservicesandgeneralgovernment.pdf> [<http://perma.cc/YLY6-YH38>].

106. Letter from Quaadman, *supra* note 17, at 3-4 (“Proxy contests are significantly disruptive to public companies, often to the ultimate detriment of their investors.” (citation omitted)); see also 162 CONG. REC. H4,500 (daily ed. July 7, 2016) (statement of Rep. Garrett) (“[U]niversal proxy ballots are a means for special interest groups to easily then nominate their preferred candidates to a company’s board The adoption of the universal proxy rule would only increase the likelihood of high profile proxy fights at public companies, which would then serve to distract the employees and management of these companies from carrying out their core mission.”).

107. The Chamber of Commerce’s Center for Capital Markets Competitiveness and the Corporate Coalition for Investor Value is a group formed by the Chamber of Commerce shortly after Chair White announced that the SEC would consider a universal proxy rule. See Alexis Leondis & Miles Weiss, *U.S. Chamber Forms Coalition To Fend Off Activist Hedge Funds*, BLOOMBERG (July 2, 2015), <http://www.bloomberg.com/news/articles/2015-07-02/u-s-chamber-forms-coalition-to-fend-off-activist-hedge-funds> [<http://perma.cc/GX52-MD34>].

108. See Letter from Corp. Governance Coal. for Inv’r Value to Brent J. Fields, Sec’y, U.S. Sec. & Exch. Comm’n 2 (Jan. 9, 2017), <http://www.sec.gov/comments/s7-24-16/s72416-1471280-130424.pdf> [<http://perma.cc/4H5C-RW4U>]; Letter from Tom Quaadman, Exec. Vice President, Ctr. for Capital Mkts. Competitiveness, to Brent J. Fields, Sec’y, U.S. Sec. & Exch. Comm’n 2 (Jan. 9, 2017), <http://www.sec.gov/comments/s7-24-16/s72416-1471278-130423.pdf> [<http://perma.cc/KX5P-WMFE>].

After much deliberation, and despite the House bills, a proposed rule was released on October 26, 2016.¹⁰⁹ The Release indicated that the purpose of the proposed rule is “to ensure that shareholders using the proxy process are able to fully and consistently exercise . . . ‘fair corporate suffrage,’” by allowing them to fully exercise their voting rights.¹¹⁰ The Release aimed to do this by “replicating the vote that could be achieved at a shareholder meeting,”¹¹¹ which the Release effectuates by permitting and requiring universal proxies.

The Release proposes changes to Rule 14a-4(d) that would eliminate the short slate rule and modify the bona fide nominee rule such that any person who has consented to be named in a proxy statement would be a bona fide nominee,¹¹² thereby permitting either party to include on their proxy any opposing nominee that has consented to be nominated by the opposing side, without requiring the party to obtain consent. However, the Release goes further, and proposes a new rule, Rule 14a-19, that would *require* management and dissidents to use universal proxy cards in contested elections.¹¹³ A dissident would be required to give notice of the dissidents’ nominees to the corporation,¹¹⁴ file a definitive

109. Exchange Act Release No. 34-79164, 81 Fed. Reg. 79,122, 79,122 (proposed Oct. 26, 2016); *see also* Open Meeting (Webcast), SEC. & EXCHANGE COMM’N (Oct. 26, 2016), http://www.sec.gov/video/webcast-archive-player.shtml?document_id=102616openmeeting [<http://perma.cc/GJ97-823Q>].

110. 81 Fed. Reg. at 79,124.

111. *Id.* Replicating by proxy how shareholders could vote if they attended the shareholder meeting was the rationale for universal proxies put forth in most of the calls for consideration of a universal proxy rule. *See* Letter from Davis, *supra* note 15, at 2 (“[T]he Commission’s current proxy rules impede shareholders’ state law voting rights in proxy contests.”); Inv’r Advisory Comm., *supra* note 50, at 1 (“[R]etail investors and institutional investors other than the largest in the U.S. do not have the practical ability to vote their shares at shareholder meetings in the same manner that is available to shareholders who attend shareholder meetings in person.”). In advance of the rule, Chair White stated that “the fundamental concept [is] that our proxy system should allow shareholders to do through the use of a proxy ballot what they can do in person at a shareholders’ meeting.” White, *supra* note 100.

One comment letter on the Release has picked up on the rationale that “‘fair corporate suffrage,’ . . . is most appropriately served by ‘replicating the vote that could be achieved at a shareholder meeting’” to claim that “[a] rule instituting universal proxies would likely exceed the Commission’s existing powers under Section 14(a) of the Exchange Act” and “would also be vulnerable to challenge under the Administrative Procedure Act.” *See* Letter from Davis Polk & Wardwell LLP to Brent J. Fields, Sec’y, U.S. Sec. & Exch. Comm’n 2 (Jan. 4, 2017) (alteration omitted), <http://www.sec.gov/comments/s7-24-16/s72416-1459123-130241.pdf> [<http://perma.cc/PV7D-GS95>]. However, this seems to mistake replication of the shareholder meeting for the end purpose of the rule, whereas the Release makes clear that its purpose is “to ensure ‘fair corporate suffrage,’” 81 Fed. Reg. at 79,124, and, since shareholders have greater voting rights at the shareholder meeting, that is the measure of how proxy voting rights can be improved in order to improve suffrage and protect investors.

112. *See* 81 Fed. Reg. at 79,184 (proposing new language for § 240.14a-4(d)(1)(i): “A person shall not be deemed to be a bona fide nominee and shall not be named as such unless the person has consented to being named in a proxy statement relating to the registrant’s next annual meeting” (emphasis added)). The rule changes would not apply to registered investment companies or business development companies, which would continue to require consent for inclusion of nominees on their proxy cards and continue to be subject to the short slate rules. *See id.* at 79,184-85.

113. *See id.* at 79,185-86 (proposing § 240.14a-19: “Solicitation of proxies in support of director nominees other than the registrant’s nominees”).

114. *See id.* (proposed § 240.14a-19(a)(1), 19(b)).

proxy statement by a set time,¹¹⁵ and solicit holders of a majority of the voting power of shares entitled to vote on the nominees.¹¹⁶ Both the dissident and management would then be required to use a universal proxy card that set forth both parties' nominees, identified and grouped by management or dissident, listed alphabetically within the group with the same font for all nominees.¹¹⁷

The change in control of the SEC under the Trump administration suggests that this opposition will prevent the adoption of a universal proxy rule.¹¹⁸ However, the widespread investor support for universal proxies has led commentators to predict that, even if a universal proxies rule is not implemented, shareholder pressure will lead to corporations adopting universal proxies by private ordering.¹¹⁹

* * *

Neither advocates nor opponents of universal proxies puts forward any evidence regarding the higher-level effects of universal proxies, starting with the effects on proxy contest outcomes.¹²⁰ The very limited history of universal proxies at U.S. corporations provides very little basis to draw inferences about those effects. Part II puts forward a conceptual framework for understanding the effects of universal proxies on proxy contest outcomes. Part III provides evidence of the incidence of these effects and draws reasonable inferences regarding the effects of universal proxies on future proxy contests.

II. Distortions in Proxy Contests

This Part puts forward a conceptual framework regarding the effects of the current proxy voting rules and universal proxies. The current proxy voting rules create the potential for distorted proxy contest outcomes.¹²¹ Universal proxies

115. See *id.* (proposed § 240.14a-19(a)(2)).

116. Exchange Act Release No. 34-79164, 81 Fed. Reg. 79,122, 79,185 (Nov. 10, 2016) (proposed § 240.14a-19(a)(3)).

117. See *id.* at 79,186 (proposed § 240.14a-19(e)). The proposed rules would not apply to consent solicitation, or solicitations for registered investment companies or business development companies. See *id.* at 79,185 (proposed § 240.14a-19(g)).

118. See Ronald Orol, *Why Team Trump Will Probably Kill SEC Rule Reshaping Proxy Fights*, THE STREET (Nov. 22, 2016, 2:15 PM), <http://www.thestreet.com/story/13903049/1/why-team-trump-will-probably-kill-sec-rule-reshaping-proxy-fights.html> [<http://perma.cc/EVR9-R36T>].

119. See *Before the Board, A Davis Polk Podcast on Corporate Governance, Episode 4: Universal Proxy*, DAVIS POLK & WARDWELL LLP (Jan. 9, 2017), <http://www.davispolk.com/publications/podcast-before-board-corporate-governance-universal-proxy> [<http://perma.cc/V7MD-LTWZ>] (“Companies will see, at some point, shareholder proponents asking companies to implement universal proxies through the shareholder proposal process.”).

120. Indeed, in her speech announcing that the SEC would consider a universal proxy rule proposal, Chair White acknowledge that panelists at the SEC’s roundtable had “differed on whether the adoption of a universal proxy ballot would increase or decrease shareholder activism or otherwise impact the outcome of election contests.” White, *supra* note 100.

121. Phrased in the terms of the social choice literature, in some cases the restriction in the “range” of voting imposed by the current proxy system may thwart the selection of a “Condorcet winner” of the director election—the set of nominees that would be preferred by a plurality of votes in pairwise comparisons among sets of nominees. The range restriction may also prevent the revelation of a

would eliminate these distortions. Distorted proxy contests may be of two types. First, there may be a distorted choice between nominees on different sides. Second, there may be a distorted choice of nominees within each side, either among management nominees, or among dissident nominees. Each type of distorted proxy contest could result in either management or dissident nominees being elected, depending on the circumstances, and the two types of distorted proxy contest could both occur in the same election. This Part considers each of these types of distorted proxy contest, using case studies that illustrate each type of distorted proxy contest.

A. Distortions Between Sides

The first kind of distorted contest involves distorted choices between nominees on different sides, whereby a management nominee may be elected in place of a dissident nominee, or a dissident nominee in place of a management nominee.

Consider an annual meeting of a corporation for which there are two incumbent (management) nominees up for election, Mary and Nathan. A dissident shareholder, such as a hedge fund activist, nominates two director nominees, David and Elizabeth. Consider that the company has one hundred shares, which are held by four groups of shareholders.¹²² Loyalist shareholders hold forty shares; they prefer management's nominees. They vote on the management proxy card, for Mary and Nathan. Reformer shareholders hold thirty shares and prefer the dissident's nominees. They vote on the dissident proxy card for David and Emily. A third group of "splitting" shareholders hold thirty shares. Each would prefer that Mary and David be elected, rather than either Emily or Nathan. If the shareholders were not constrained in how they could vote—for instance, if all of them attended the shareholder meeting in person—then Mary and David would be elected, with the results as shown in Figure 3(a) below.

"cycle" among the preferences of voters, where shareholders with a plurality of votes prefer, for instance, the set of nominees *A* to set *B*; set *B* to set *C*; but set *C* to set *A* (that is, their collective preferences are "intransitive").

122. In most large public corporations, shares will be held by many different shareholders. The analogy to this example would be the group of shareholders that prefers to vote with management, the group that prefers to vote with the dissident, and the group that prefers to split their votes between management and the dissident.

Figure 3(a): Unconstrained Vote Results

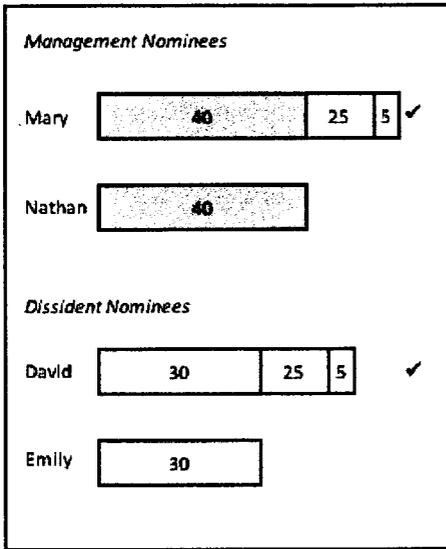
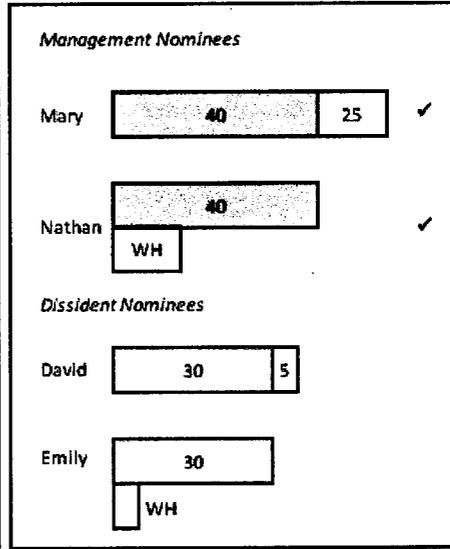


Figure 3(b): Distortion Between Sides from Proxy Voting



However, as described in Part I, shareholders do not attend annual meetings, and instead vote by proxy. The group that would like to split their vote are unable to do so because of the proxy voting rules. They are forced to choose between one of the two side’s proxy cards. Assume that twenty-five vote on the management card, for Mary, withholding from Nathan, and five vote on the dissident card, voting for David, and withholding from Emily. The results would be as shown in Figure 3(b). Nathan would be elected rather than David. The proxy voting system results in a distortion in the contest outcome, with a different nominee—Nathan—being elected than the nominee—David—that a plurality of shareholders would have preferred.

In this case, the distorted outcome favored a management nominee, because the third group of shareholders would have preferred to vote for a dissident and weren’t able to because they voted on the management proxy card. However, the distorted outcome could also favor dissident nominees, if shareholders vote on the dissident card and withhold enough votes that would have resulted in the election of a management nominee.

Distorted proxy contests will result from the current proxy voting system where shareholders voting on a one-sided card would prefer to vote for a nominee not included on the card. If this is the case, the only option they have is to withhold from nominees on the card they are voting on, instead of voting for the nominee they would prefer. As discussed above, withhold votes will not be considered in determining the result of the election. Put another way, a nominee’s election or nonelection may be a distorted outcome, depending on the

number of votes withheld on each card. The current proxy voting system will result in the distorted choice of a nominee *A* over a nominee *B* that shareholders in the aggregate would have preferred, where the number of votes for *A* plus the number of votes withheld from opposing nominees that would have gone to *A* is greater than the number of votes for *B* plus the number of votes withheld from opposing nominees that would have gone to *B*.

The distorted outcome that is most likely is that the last-elected nominee would be replaced by the first nonelected nominee, although it is also possible that there may be more than one distorted choice in the same election, e.g., the second-last elected and last elected nominees, may be elected over the first nonelected and second nonelected nominees that shareholders prefer.

The current proxy system will result in a distorted choice between sides if a management nominee was elected over a dissident nominee, even though the sum of the for and withhold votes that would have gone to the dissident nominee is greater than the sum of the for and withhold votes that would have gone to the management nominee, and vice versa for the distorted election of a dissident nominee over a management nominee.

One example of a distorted choice between sides was in the proxy contest at the 2009 annual meeting of Biogen Idec Inc. At the time of the meeting, the corporation had a classified board with thirteen directors, four of whom were up for election at the 2009 annual meeting.¹²³ Hedge fund activist Carl Icahn nominated four directors for election to fill the four available positions: Alexander Denner, Richard Mulligan, David Sidransky, and Thomas Deuel.¹²⁴ Proxy advisor¹²⁵ ISS recommended that shareholders vote on the Icahn card, for Icahn nominees Denner and Mulligan.¹²⁶ Table 2, below, shows the for, withheld, and total votes cast for each management (“M”) or Icahn (“D”) nominee (in millions of votes), with the nominees ranked by votes cast for.¹²⁷ The nominees elected are those ranked one to four.

123. Biogen Idec Inc., Definitive Proxy Statement (Schedule 14A), at 6 (Apr. 27, 2009).

124. Icahn Partners LP, Definitive Proxy Statement (Schedule 14A) (May 15, 2009).

125. Proxy advisors provide information to institutional investors about corporate elections, and recommendations regarding how those investors should vote. See Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 870 (2010).

126. Icahn Partners LP, Press Release Filed as Exhibit to Definitive Additional Materials (Schedule 14A) (May 28, 2009).

127. Biogen Idec Inc., Quarterly Report (Form 10-Q) (July 16, 2009).

Table 2: Biogen Idec 2009 Election Results (millions)¹²⁸

<i>Nominee</i>	<i>Side</i>	<i>For</i>	<i>WH</i>	<i>Total</i>	<i>Rank</i>	<i>Elected</i>	<i>For+ Avg.WH</i>	<i>New Rank</i>	<i>Elected</i>
Alexander Denner	D	139.0	4.1	143.1	1	✓	144.4	2	✓
Robert Pangia	M	116.6	3.7	120.3	2	✓	144.5	1	✓
William Young	M	115.9	4.4	120.3	3	✓	143.8	3	✓
Richard Mulligan	D	114.3	7.2	121.5	4	✓	119.7	5	
Alan Glassberg	M	112.4	2.6	115.0	5		140.2	4	✓
Lawrence Best	M	82.5	10.9	93.4	6		110.3	6	
David Sidransky	D	67.4	48.8	116.2	7		72.8	7	
Thomas Deuel	D	64.9	51.3	116.2	8		70.3	8	
<i>Avg. Mgmt.</i>		106.8	5.4	112.3					
<i>Avg. Diss.</i>		96.4	27.8	124.3					

As Table 2 shows, two management nominees, Robert Pangia and William Young, were elected, together with Icahn nominees Alexander Denner and Richard Mulligan. Mulligan was the last nominee elected, and management nominee Alan Glassberg was the first nominee not elected, with 1.9 million votes fewer than Mulligan.¹²⁹

The number of votes withheld from the candidates varied significantly. On the dissident card, an average of 27.8 million votes were withheld from the four dissident nominees. On the management card, many fewer votes were withheld—an average of 5.4 million votes.

Let us assume that shareholders withholding on the management card would have preferred voting *for* dissident nominees to withholding *against* management nominees, and vice versa for shareholders withholding votes on the dissident card. Let us further assume that shareholder preferences are evenly split among which nominee on the other card they would have voted for, had they the opportunity. These assumptions are analyzed in greater depth in Part III. In each case, those shareholders were unable to vote as they would have preferred because they voted on one-sided proxies. Had they instead voted at the annual meeting, or on a universal proxy, each nominee would have also received the average number of votes withheld on the opposite card, so the results would have been as set out in the “For+Avg. WH” column of Table 2, and the ranking of nominees by for votes would have been as set out in the “New Rank” column.

128. *Id.*

129. Consideration of the total votes cast suggests that 93.4 million shares (39% of the total voted) were voted on the management proxy card, 116.2 million shares were voted on the Icahn proxy card (49% of the total voted), and 26.9 million shares (11% of the total voted) must have voted by legal proxy at the meeting. Of the 26.9 million shares, 5.3 million for two management and two dissident nominees (Pangia, Young, Denner, and Mulligan) and 21.6 million for three management and one dissident nominee (Pangia, Young, Glassberg, and Denner). *Id.*

Management nominee Glassberg would have received more votes than Icahn nominee Mulligan and would have been elected in his place.¹³⁰

B. Distortions Within Sides

The second kind of distorted proxy contest involves a distorted choice of nominees among those nominated by one side, either among the management nominees, or the dissident nominees. That is, a management nominee that shareholders prefer less may be elected in place of another management nominee that they prefer more, or a dissident nominee that shareholders prefer less may be elected in place of another dissident nominee that they prefer more. This may take place anytime that at least one nominee is elected from each side.

Consider the example above, but assume that twenty-five shares of the splitting group prefer Mary and David, and five prefer Nathan and David. Were all of the shareholders to vote at the annual meeting, the results would be as shown in Figure 4(a) below. Nathan and David would be elected.¹³¹

Figure 4(a): Unconstrained Vote Results

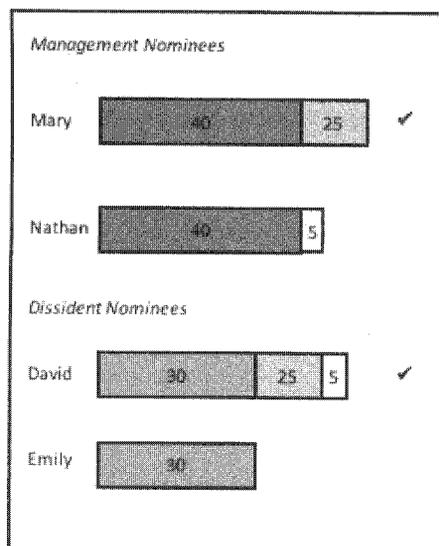
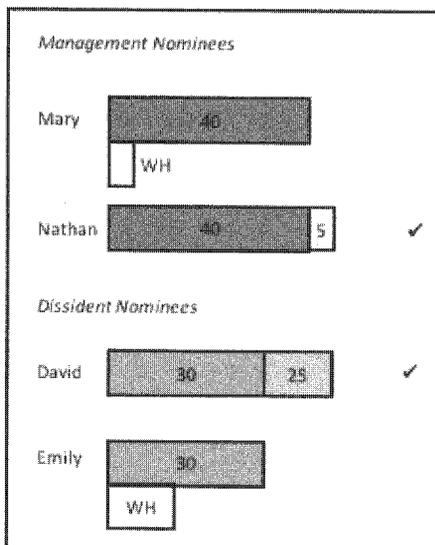


Figure 4(b): Distortion Within Sides from Proxy Voting



However, if the shareholders all vote by proxy, the splitting groups will be forced to decide between voting on the management and the dissident proxy

130. The presence of a Mulligan rather than Glassberg on the Board of Directors may have facilitated subsequent changes in the management of Biogen. Six months after the annual meeting, Biogen announced that its President and Chief Executive Officer, James C. Mullen, would retire. Biogen Idec Inc., Current Report (Form 8-K) (Jan. 4, 2010).

131. For a similar example, see Whissel, *supra* note 91.

cards. If the twenty-five that prefer Mary and David vote on the dissident proxy card, for David (withholding from Emily), and the five that prefer Nathan and David vote on the management card, for Nathan (withholding from Mary), the results will be as shown in Figure 4(b). Nathan and David would be elected. Nathan's election represents a distortion in the contest outcome within sides, as a plurality of shareholders would have preferred that Mary be elected.

This could also occur in combination with the distorted choice between sides described in Section II.A—there may be a distorted choice between dissident and management nominees, *and* the wrong nominees may be among either group. A distortion within a side is an instance of the general situation where there is distorted election of nominee *A* over nominee *B*, except that in this case both *A* and *B* are from the same side.

The potential for a distorted choice within a side can be seen in the case of the 2015 proxy contest at Rovi Corporation. Rovi is the maker of the TV guides that appear on cable boxes and allow viewers to select shows; it has since acquired TiVo Inc. and taken on TiVo's name.¹³² In 2015, Rovi had seven directors, all of whom were up for election at the 2015 annual meeting.¹³³ An activist investor, Engaged Capital LLC, led by Glenn Welling, nominated three directors, Raghavendra Rau, David Lockwood, and Welling himself.¹³⁴ The Engaged Capital proxy card indicated that it would withhold from management nominees other than Alan Earhart, Ruthann Quindlen, Thomas Carson, and Steven Lucas.¹³⁵ ISS recommended that shareholders vote on the Engaged Capital proxy card for dissident nominees Rau and Welling, and withhold from dissident nominee Lockwood.¹³⁶ The results of the election are set out in Table 3, below (in millions of votes).

29, 2016). 132. Rovi Corp., Press Release, Filed as Exhibit to Current Report (Form 8-K) (Apr.

133. Rovi Corp., Definitive Proxy Statement (Form 14A) (Apr. 13, 2015).

134. Engaged Capital, LLC, Definitive Proxy Statement (Schedule 14A) (Apr. 13, 2015).

135. *Id.*

136. Engaged Capital, LLC, Press Release, Filed as Exhibit to Definitive Additional Materials (Schedule 14A) (Apr. 28, 2015).

Table 3: Rovi Corporation 2015 Election Results (millions)¹³⁷

<i>Nominee</i>	<i>M/D</i>	<i>For</i>	<i>WH</i>	<i>Elected</i>	<i>Behind JM</i>	<i>% of DL WH</i>
Alan Earhart	M	74.2	7.1	✓		
Ruthann Quindlen	M	74.2	7.1	✓		
Thomas Carson	M	74.1	7.2	✓		
Steven Lucas	M	74.1	7.2	✓		
Raghavendra Rau	D	47.4	0.9	✓		
Glenn Welling	D	43.1	5.2	✓		
James Meyer	M	33.8	0.2	✓		
James O'Shaughnessy	M	30.9	3.1		2.9	6.9%
Andrew Ludwick	M	27.0	7.0			
David Lockwood	D	5.4	42.0			

The four unopposed management nominees were elected, followed by two of the three Engaged Capital nominees, Rau and Welling, and one of the management nominees opposed by the dissidents, James Meyer. The nominees with the most for votes of those not elected were management nominees James O'Shaughnessy and Andrew Ludwick, with O'Shaughnessy receiving 2.9 million fewer for votes than Meyer (8% of shares voting on the management card), and Ludwick receiving 6.8 million fewer for votes than Meyer (20% of shares voting on the management card). Compared to the number of votes withheld on the dissident card, these numbers are very small—the margin between Meyer and O'Shaughnessy is only 6.9% of the forty-two million total withheld from one dissident nominee, David Lockwood. That is, had 6% of the votes withheld from David Lockwood represented shareholders who preferred O'Shaughnessy to Meyer, then if those shareholders had been able to vote for their preferred candidate, O'Shaughnessy would have been elected in place of Meyer.¹³⁸ While the preferences shareholders voting on the dissident card would have among Meyer, O'Shaughnessy and Ludwick cannot be known, there is some reason to suggest that shareholders may have preferred O'Shaughnessy or

137. Rovi Corp., Current Report (Form 8-K) (May 19, 2015).

138. Of course, this assumes that no shareholders withholding votes on the dissident card would have voted for Meyer. To the extent shareholders withholding from dissidents had voted for Meyer, O'Shaughnessy would have had to receive more votes than Meyer in an amount equal to 18% of the votes withheld on the dissident card.

Ludwick to Meyer,¹³⁹ and that O'Shaughnessy's qualifications would have made him well-suited to handle particular issues that Rovi later faced.¹⁴⁰

III. The Incidence of Distorted Proxy Contests

This Part describes an empirical analysis to determine the number of proxy contests likely to have been distorted by the current restrictions on proxies and the number of contests which could have had different outcomes had universal proxies been used. Section III.A describes the data used to perform this analysis. Sections III.B and III.C presents the methodology for determining the expected and maximum numbers of distortions, respectively, and the results of these analyses. Section III.D considers factors associated with distorted proxy contests. Section III.E considers the assumptions on which this analysis is based.

A. Data on Recent Proxy Contests

To analyze the incidence of distorted proxy contests, I gather data on proxy contests between 2001 and December 2016. I use SharkRepellent data to identify all proxy contests during that period at U.S. corporations that sought board representation and were voted on.¹⁴¹

SharkRepellent also provides data on contest-specific information, including the nominees for election, and whether they were elected. I gather the number of votes for and withheld for each nominee from a combination of SharkRepellent, ISS Voting Analytics, and manual collection from the SEC's EDGAR database. SharkRepellent includes vote results for corporations in the Russell 3000 Index for meetings from 2008 onwards. ISS Voting Analytics includes vote results for a similar set of corporations from 2003 onwards, which I use for meetings from 2003 to 2007. I manually collect vote results for meetings prior to 2003, for corporations outside the Russell 3000, and where vote results are otherwise not included in the SharkRepellent or ISS databases. I also check

139. At the two uncontested annual meetings preceding the proxy contest, O'Shaughnessy and Ludwick received more for votes than Meyer. Ludwick was also the sitting chairman of the board of the corporation, which may have led some shareholders to prefer him to Meyer. On the other hand, since shareholders voting on the dissident card are likely to have been unhappy with the performance of the corporation, they may also have been happy with him not being elected.

140. O'Shaughnessy had a background as intellectual property counsel and had been a consultant on intangible assets. Rovi's 2015 proxy statement stated that his "experience in the field of patent law is integral to the company and its business and helps provide strategic guidance to the company and the Board of Directors." Rovi Corp., Definitive Proxy Statement (Form 14A), at 11 (Apr. 13, 2015). After the election, the board was left without any intellectual property experts, even though intellectual property licensing generated 54% of the company's total revenue in 2016. TiVo Corporation, Annual Report (Form 10-K), at 8 (Feb. 27, 2018). To protect its intellectual property, the company filed litigation against competitor Comcast for patent infringement in April 2016, *id.* at 25), which resulted in lengthy litigation. See Connor Tweardy, *TiVo v. Comcast: TiVo Files New Round of Patent Infringement Actions Against Comcast*, HARV. J.L. & TECH. (Feb. 10, 2018), <http://jolt.law.harvard.edu/digest/tivo-v-comcast-tivo-files-new-round-of-patent-litigation-against-comcast> [<http://perma.cc/S6J8-G59C>].

141. For more information, see *supra* note 32.

any apparent anomalies in the SharkRepellent and ISS voting results and correct them where necessary.

From 2001 to 2016, SharkRepellent identifies completed proxy contests at 452 meetings.¹⁴² I exclude those that do not represent bona fide proxy contests. A number of contests in the sample involved written consent solicitations¹⁴³ or solicitations for special meetings.¹⁴⁴ I exclude these from the sample since none of these involved direct decisions among two sets of nominees. I also exclude contests at which no director election was voted on, and meetings that do not appear to have involved a real contest by a dissident.¹⁴⁵ These exclusions leave 354 bona fide proxy contests at 297 corporations.

Second, I exclude from the sample bona fide proxy contests that can't be analyzed using my methodology. For sixty contested meetings the corporation failed to release the voting results for all candidates. In most cases, these corporations only released information for the nominees that were elected, and not for the nominees that were not elected.¹⁴⁶ I also exclude the twenty-five contested meetings for corporations that permit cumulative voting, whereby a shareholder can choose to cumulate their aggregate votes on fewer nominees. Cumulative voting prevents application of the analyses and distributional assumptions I use below.¹⁴⁷ Excluding these contests leaves a total of 269 contests at 229 corporations. Table 4 shows the number of bona fide contests,

142. At four meetings, two different dissidents put forward nominees. Two of these four contested meetings were excluded for other reasons; one I excluded since there were three different dissident cards. At the fourth meeting, involving Amylin Pharmaceuticals, the two dissidents agreed to combine their nominees onto one card, which I consider as one contest.

143. Five contests in the initial sample were solicitations by written consent, whereby a dissident solicited consents from shareholders to remove existing directors and elect new directors. In this case, the main contest was a plebiscite on the preliminary matter of whether to remove the directors, and—on the same written consent—whether to replace them with a slate of directors chosen by the dissident.

144. Two contests involved special meetings called by a dissident to vote on a proposal to remove directors and to appoint a slate put forward by the dissident.

145. These were contests at the American Express Corporation, at each annual meeting from 2010 to 2013, and involved a disgruntled former employee, Peter Lindner, who purported to put himself forward as a nominee for election to the board. *See* Am. Express Corp., Definitive Proxy Statement (Schedule 14A), at 73 (Mar. 8, 2013). In none of the years did Lindner file a definitive proxy statement or solicit proxy materials, and in no year did he receive more than 11 votes (out of more than 900 million votes cast at the meeting), corresponding to the 11 shares he himself owned of record. *See, e.g.*, Am. Express Corp., Quarterly Report (Form 10-Q), at 75 (May 1, 2009).

146. These were the 2015 proxy contest at Myers Industries, Inc., the 2009 proxy contest at Trico Marine Services, Inc., the 2008 proxy contest at Rackable Systems, Inc. (now known as Silicon Graphics International Corp.), and the 2014 proxy contest at GrafTech International Ltd. In each of these instances, the corporation only provided voting results for the nominees that were elected to the board and failed to provide results for those that were not elected, in apparent violation of the requirements of Item 5.07(b) of Form 8-K (requiring disclosure of “a separate tabulation for each nominee for election to office”). *See* GrafTech Int'l Ltd., Current Report (Form 8-K) (May 21, 2014); Myers Indus., Current Report (Form 8-K) (Apr. 30, 2015); Trico Marine Servs., Inc., Quarterly Report (Form 10-Q) (Aug. 10, 2009).

147. For example, if a shareholder held 100 shares, and there were 10 board seats up for election, instead of voting a maximum of 100 votes for any single nominee, the shareholder could cumulate all of the 1,000 votes to which it is entitled on a single candidate, or split those votes between multiple candidates as it wished.

those that took place at companies in the Russell 3000 Index, and those that are included in my sample, for 2001 to 2016. Table 4 also shows the proportion of all listed companies¹⁴⁸ that had bona fide proxy contests in that year, and the proportion of companies in the Russell 3000 Index.¹⁴⁹

Table 4: Bona Fide Contest and Contests in Sample, 2001-2016

Year	Bona Fide Contests		Russell 3000 Bona Fide Contests		Contests in Sample	
	n	%	n	%	All	R3000
2001	25	0.4%	5	0.2%	18	5
2002	23	0.4%	2	0.1%	17	1
2003	23	0.4%	6	0.2%	17	4
2004	12	0.2%	1	0.0%	7	0
2005	8	0.2%	4	0.1%	5	3
2006	27	0.5%	9	0.3%	19	6
2007	21	0.4%	4	0.1%	15	3
2008	35	0.8%	12	0.4%	23	11
2009	31	0.7%	14	0.5%	28	13
2010	21	0.5%	6	0.2%	18	6
2011	15	0.4%	8	0.3%	9	5
2012	20	0.5%	8	0.3%	15	7
2013	24	0.6%	12	0.4%	20	11
2014	24	0.5%	15	0.5%	19	13
2015	20	0.5%	10	0.3%	17	9
2016	25	0.6%	11	0.4%	22	10
Total	354		127		269	107
Avg.	22.1	0.5%	7.9	0.3%	16.8	6.7

Table 4 shows that the number of bona fide proxy contests per year varies from eight to thirty-five, which represents between 0.2% to 0.8% of listed companies each year. The numbers and proportions for Russell 3000 companies are even smaller, from one contest in 2004 to fifteen in 2015, representing between 0.03% and 0.5% of Russell 3000 companies in each year. As the difference between these numbers shows, a significant number of the proxy contests that take place each year are at very small corporations that are not part of the Russell 3000.¹⁵⁰ However, according to my data, these corporations make up less than 1% of the total market capitalization of U.S. public corporations in

148. The number of listed companies in each year is taken from the World Federation of Exchanges, published by the World Bank. *Listed Domestic Companies, Total*, WORLD BANK, <http://data.worldbank.org/indicator/CM.MKT.LDOM.NO?view=chart> [<http://perma.cc/7L47-75LV>].

149. The number of companies in the Russell 3000 Index is taken as of December 31 of each year, from data provided to the author by FTSE Russell (correspondence and data on file with author). The number varies, because of delistings and spin-offs, from 2,906 companies in December 2001, to 3,054 companies in December 2014.

150. These are corporations with market capitalizations below approximately \$100 million, which was the cutoff for inclusion in the Russell 3000 Index in these years.

the relevant years.¹⁵¹ While my sample includes proxy contests at these “microcap” companies, I pay particular attention to contests at corporations in the Russell 3000, as they represent the overwhelming proportion of equity invested in U.S. public corporations.

For each proxy contest in the sample, I gather the voting results for each nominee from the SharkRepellent database, including the number of shares that voted for, withheld,¹⁵² and abstained from voting. I examine each of the cases where abstain votes were listed in the data, as Rule 14a-4 generally does not provide for an option to abstain on director nominations; in most cases these are not significant in number, and I reclassify these as withholds.¹⁵³ I also exclude nominees that were not voted on, for instance, where the election of a particular director was contingent on another proposal (e.g., increasing the size of the board) and that prior proposal failed. I conduct spot checks of the data for a number of contests, comparing it to SEC filings containing the definitive proxy cards and election results, and correct any obvious errors or omissions.

B. Methodology for Identifying Expected Distortions in Proxy Contests

My approach to determine which proxy contests can be expected to have had their outcomes distorted by the current proxy system follows the intuition developed in Part II. Assuming that the for votes remain the same regardless of the voting system,¹⁵⁴ the election of a nominee can be expected to have been distorted if another (nonelected) nominee would have been elected in their place, if shareholders withholding votes because they were unable to mix and match had instead been permitted to vote for nominees on another card. This would have been the case had the difference in those withhold votes going to the nonelected nominee over the elected nominee been large enough to overcome the gap in for votes between the elected and nonelected nominees under the current proxy system.¹⁵⁵ This is likely to be a function of how close nonelected nominees were to being elected and how many votes were withheld on each side.

151. Cf. Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1369 (2011) (“[M]icro-cap companies ... account for less than 2.5% of the market capitalization of U.S. companies.”).

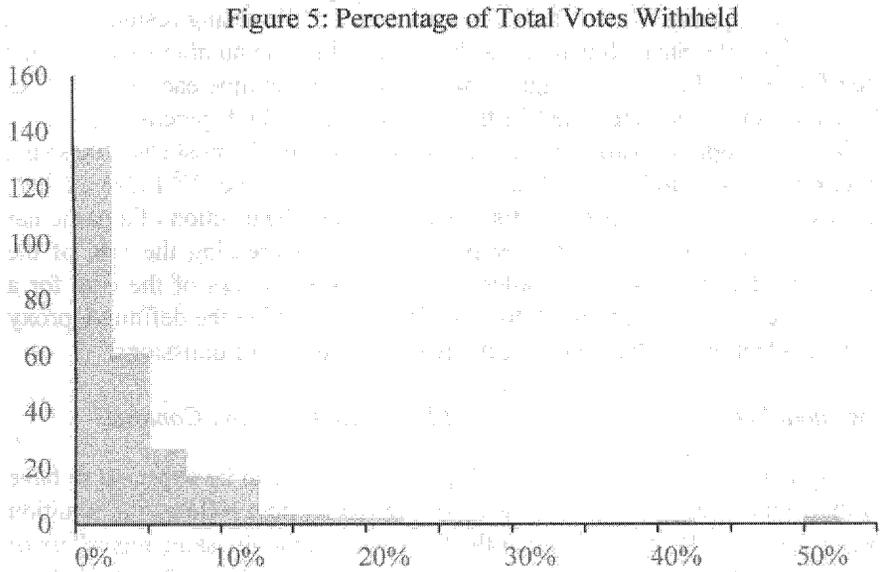
152. SharkRepellent refers to these as votes “against,” however in most cases this is inaccurate, as Rule 14a-4 requires proxy cards on director elections to include options to vote for and withhold, and only against in the event that state law permits votes to be cast against a nominee. See SHARKREPELLANT, *supra* note 32.

153. The voting results of the 2008 proxy contest at Grubb & Ellis Company list implausibly high levels of abstentions for each nominee, apparently recording shares voted on the opposing card, and therefore not voted for a particular nominee, as abstain votes for those nominees. This appears to be an error on the part of the corporation, and I disregard these abstentions.

154. I consider the validity of this assumption in depth in *infra* Section III.E.

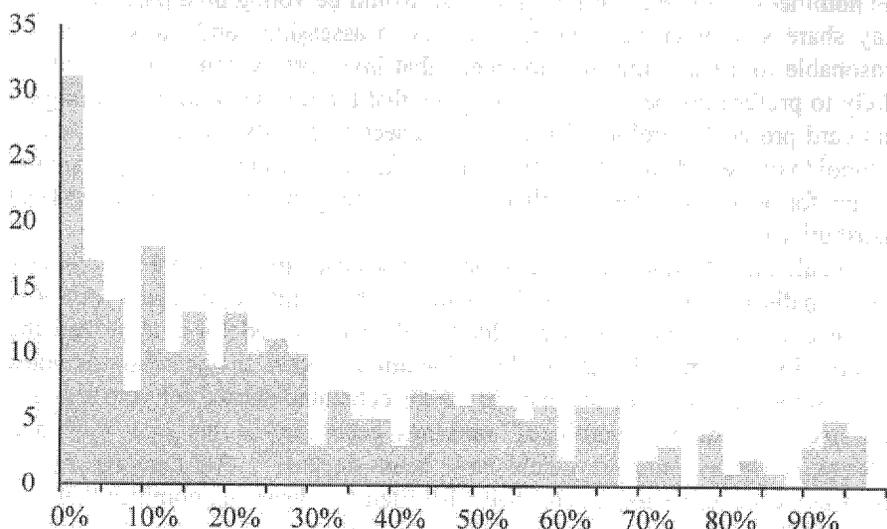
155. A distortion can be expected if a nominee, e , was elected and another nominee, n , was not elected, and the “for” votes received by each nominee f , and redistributed withhold votes, r , that each nominee would have received if shareholder had been able to vote for any nominee they preferred, were as follows: $f_e > f_{ne}$, and $f_e + r_e < f_{ne} + r_{ne}$.

Figure 5 shows the number of meetings with different levels of votes withheld as a percentage of the average number of shares voted or withheld per board seat up for election.



As Figure 5 shows, most meetings had very few withheld votes—the median proportion of total votes withheld is 2.55%. However, thirty meetings (11%) had more than 10% of total votes withheld, and seventy-four (28%) had more than 5% of total votes withheld. Figure 6, below, shows the distribution of proxy contests by narrowness of margin—the percentage increase in for votes that would have been necessary for the first nonelected nominee to have overtaken the last-elected nominee.

Figure 6: Minimum Percentage Difference in for Votes



As Figure 6 shows, most contests were not very close. The median difference between the number of for votes for the last-elected nominee and the first not-elected nominees was 23.1% of the votes cast per seat. However, a reasonable number of the contests were close or very close. At forty-eight contests (17.8%), the difference was less than 5%. The likelihood of distortions from the current proxy voting rules can be expected to be greater at the intersection of these groups: close elections with a significant number of withhold votes.

If investors that withheld votes were instead able to vote for nominees on the other side rather than withholding, which nominee would they vote for? Given the impossibility of determining this question, I make conservative assumptions about how investors would vote.¹⁵⁶ First, I assume that investors who could vote on the other card would choose randomly which nominees to vote for on that card (uniform distribution). As a result, if there are n opposed nominees on the new card that the investor could vote for,¹⁵⁷ I assume that each nominee has a probability of being chosen by that investor equal to $\frac{1}{n}$.

156. Pershing Square used a similar approach of assuming that shareholders withholding votes would prefer to vote on the other card in evaluating how close their nominee, Bill Ackman, was to being elected in their contest at ADP. However, in that case, Pershing Square questionably assumed that all of the votes withheld against a particular management nominee, Eric Fast, would have gone to Bill Ackman if a universal proxy had been used. *Pershing Square Comments on Today's ADP Election Results*, BUS. WIRE (Nov. 7, 2017), <http://www.businesswire.com/news/home/20171107006255/en/Pershing-Square-Comments-Today%E2%80%99s-ADP-Election-Results> [<http://perma.cc/V2XG-PABN>].

157. I consider only nominees that are "opposed." All dissidents are opposed, but if there is a short slate, not all management may be opposed.

In reality, investors are likely to have some ranking of preference among the nominees.¹⁵⁸ Given that investors who would be voting on a particular card may share similar criteria and approaches to assessing candidates, it is also reasonable to assume that the nominees that investors switching to a card are likely to prefer may be the same nominees that the investors already voting on that card prefer. I therefore also consider a second distribution model whereby withheld votes are distributed among opposing nominees in the same proportion as the for votes of investors that actually voted on that card (proportional distribution).

I calculate the total votes withheld from opposed management¹⁵⁹ nominees and from dissident nominees and divide this by the number of opposed nominees on the other side that the shareholder could have voted for if they had the opportunity. I then add this number of withheld votes to the total for votes received by each nominee to generate the expected undistorted for vote for each nominee. I recalculate nominees' rankings according to the new total and determine which nominees would have been elected.¹⁶⁰ The outcome of the proxy contest is expected to have been distorted if at least one nominee that was not elected would have been elected based on the new totals.

For the proportional distribution model, I follow a similar approach, but instead add to each opposed nominee the total number of votes withheld on the opposing card, multiplied by the number of for votes received by that nominee as a proportion of all for votes cast for opposed nominees on that side.

In both cases I do not distribute withholds received by unopposed nominees, and I do not distribute withheld votes to unopposed nominees. As described above, where a dissident uses a short slate and does not put forward nominees to oppose all management nominees, votes cast on the dissident proxy card can be voted in favor of unopposed management nominees. Unopposed management nominees therefore already receive votes from the dissident card, and these votes would not be affected by a universal proxy.

C. The Likely Incidence of Distortions in Recent Proxy Contests

Table 5 shows the contests that can be expected to have been distorted, based on the assumptions above. For each expected distorted contest, Table 5 shows the number of management and dissident nominees actually elected, the number expected to have been elected without distortion, the nominees elected

158. That is, choices are likely to not be random and choices of votes from different investors are unlikely to be independent of each other.

159. I do not include votes withheld from unopposed management nominees, since the short slate rules permit shareholders voting on the dissident card to vote for these nominees.

160. The expected undistorted for votes for each nominee i , $E(f_i)$, can be expressed algebraically as a function of the for votes (f_j) received by the nominee and the withheld votes (w_j) received by each of the n opposing nominees, j , such that: $E(f_i) = f_i + \sum_{j=1}^n w_j/n$.

that would not have been elected without distortion, and the nominees not elected that would have been elected without distortion. It also shows whether the distortion occurs under the uniform distributional assumption, the proportional distributional assumption, or both. The table is split into those proxy contests that took place at companies that were in the Russell 3000 Index at the time of the contest (Panel 1) and at other companies (Panel 2).

Table 5: Expected Distorted Proxy Contests Outcomes, 2001-2016

(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>Company / Dissident, Year</i>	<i># M/D Elected</i>	<i># M / D Expected Elected Without Distortion</i>	<i>Removing Distortion Expected to Favor M/D</i>	<i>Nominees Elected / Expected Not Elected Without Distortion</i>	<i>Nominees Not Elected / Expected Without Distortion</i>	<i>Distorted With Unif. / Prop. Dist.</i>
Panel 1: Russell 3000 Corporations						
Amylin Pharmaceuticals / Carl Icahn & Eastbourne Capital Mgmt., 2009	10 / 2	11 / 1	M	Behrens (D)	Wilson (M)	Both
Benchmark Electronics / Engaged Capital, 2016	6 / 2	7 / 1	M	Gifford (D)	Dawson (M)	Both
Biogen Idec Inc. / Carl Icahn, 2009	2 / 2	3 / 1	M	Mulligan (D)	Glassberg (M)	Both
CSX Corp. / TCI Fund Mgmt. and 3G Capital Mgmt., 2008	8 / 4	10 / 2	M x 2	O'Toole (D) Hohn (D)	Royal (M) Richardson (M)	Both
Datascope Corp. / Ramius Capital Group, 2007	1 / 1	2 / 0	M	Dantzker (D)	Asmundson (M)	Both
Forest Laboratories / Carl Icahn, 2012	9 / 1	10 / 0	M	Legault (D)	Goldwasser (M)	Both
International Game Technology / Ader Investment Mgmt., 2013	7 / 1	8 / 0	M	Silvers (D)	Roberson (M)	Both
Mentor Graphics / Carl Icahn, 2011	5 / 3	6 / 2	M	Schechter (D)	Fiebiger (M)	Both
ModusLink Global Solutions / Peerless Systems Corp., 2012	1 / 1	0 / 2	D	Fenton (M)	Brog (D)	Uniform
Rovi Corp. / Engaged Capital LLC, 2015	5 / 2	6 / 1	M	Welling (D)	O'Shaughnessy (M)	Uniform
Sensient Technologies / FrontFour Capital Group, 2014	9 / 0	8 / 1	D	Whitelaw (M)	Redmond (D)	Both

Table 5 (cont.): Expected Distorted Proxy Contests Outcomes, 2001-2016

<i>Company / Dissident, Year</i>	<i># M/D Elected</i>	<i># M / D Expected Elected Without Distortion</i>	<i>Removing Distortion Expected to Favor M/D</i>	<i>Nominees Elected / Expected Not Elected Without Distortion</i>	<i>Nominees Not Elected / Expected Elected Without Distortion</i>	<i>Distorted With Unif. / Prop. Dist.</i>
Panel 2: Non-Russell 3000 Corporations						
California Micro Devices / Dialectic Capital Mgmt., 2009	4 / 3	5 / 2	M	Gullard (D)	Meyercord (M)	Prop.
Crown Crafts, Inc. / Wynnefield Partners Small Cap Value, 2007	2 / 1	3 / 0	M	Wasserman (D)	Fox (M)	Both
Del Global Technologies Corp. / Steel Partners, 2003	1 / 4	1 / 4	-	Smith (M)	Brady (M)	Both
Fifth Street Senior Floating Rate Corp. / Ironsides Partners, 2016	1 / 1	0 / 2	D	Dimitrov (M)	Knapp (D)	Both
IEC Electronics Corp. / Vintage Capital Mgmt. and Kahn Capital Mgmt., 2015	0 / 7	1 / 6	M	Schlarbaum (D)	Hudson (M)	Prop.
Point Blank Solutions, Inc. / Steel Partners II, L.P., 2008	2 / 5	2 / 5	-	Berndt (M) Hannigan (M)	Campbell (M) Henry (M)	Both
Telkonet, Inc. / Peter Kross, 2016	2 / 3	2 / 3	-	Tienor (M) Ledwick (M)	Davis (M) Warner (M)	Both
Virtus Total Return Fund / Bulldog Investors, 2016	1 / 0	0 / 1	D	Mann (M)	Dakos (D)	Both

Table 5 shows that eighteen contests can be expected to have been distorted assuming uniform distribution, and eighteen assuming proportional distribution. Sixteen of these contests can be expected to have been distorted under both models, suggesting that the approach is robust to the choice of distributional assumption. I henceforth focus on results assuming uniform distribution, unless otherwise stated.

The eighteen distorted contests represent 6.7% of the contests in the sample. Eleven of the contests with switches are Russell 3000 companies (Panel 1), representing 10.3% of the contests at Russell 3000 companies in the sample. The seven non-Russell 3000 companies distorted represent 4.3% of the non-Russell 3000 companies in the sample, suggesting distortions may be more likely to occur at larger corporations.

At two of these contests, at CSX Corporation and Benihana, Inc., two nominees would have been replaced by nominees from the other side. At most other contests, one nominee would likely have been replaced by another from the other side. At three of the non-Russell 3000 companies, the distortion is likely to have occurred within the management side; if there were no distortion, a different management nominee would have been elected.

Column (4) of Table 5 shows that, at ten out of the fifteen contests (67%) where there is likely to have been a distortion between sides, universal proxies could be expected to have favored management nominees, resulting in a management nominee replacing a dissident that was actually elected. At only five of the fifteen contests (33%) could universal proxies be expected to have assisted dissident nominees. The difference is even more pronounced for the eleven contests at Russell 3000 companies, at nine (81%) of which universal proxies would have favored management nominees.

At six of the fifteen contests with distortions between sides (40%) a mix of dissident and management nominees were elected, and there would still have been a mix if the distortions were eliminated. At six other contests, a mix of management and dissident nominees were elected but had universal proxies been used, one side could have been expected to win all of the positions. At the remaining three contests (20%) management nominees were elected to all of the available seats, but had universal proxies been used, dissidents would have won one or more seats.

D. The Maximum Bounds of Distortions in Recent Proxy Contests

The analysis above is based on conservative assumptions and may therefore underestimate the number of distorted proxy contests. In order to evaluate the upper bound on the possible costs of a universal proxy rule, this section analyzes the maximum number of distorted proxy contest outcomes that may have occurred.

Assuming that the number of for votes are fixed, it is possible to say when a nominee's election could *not* have been distorted, and, by implication, when a contest could possibly have been distorted.¹⁶¹ A nominee's election could not have been distorted if the difference in for votes for an unelected nominee to be elected is so great that even if the maximum number of withhold votes from the other side had been voted for that nominee, the nominee still would not have been elected. Conversely, an outcome *may* have been distorted if the difference in for votes between a nonelected nominee and the last-elected nominee is less than the maximum number of withhold votes that could have gone to that nominee if shareholders had been permitted to vote for whichever nominee they wished.¹⁶²

161. Rather than calculate the possibility or impossibility of a distortion, it would be preferable to calculate the likelihood of a nominee's election having been distorted, or conversely, the likelihood of such election changing if universal proxies had been used. However, the for and withhold vote data for each nominee doesn't allow inferences regarding the probability of distortion. In particular, it would be necessary to know (or assume) the number of shareholders withholding and the proportion of the withhold votes that each could have voted for an opposing nominee. Without this information, the maximum and expected number of distorted contests are the most that can be inferred.

162. In the terms used in *supra* note 155, a distorted outcome is only possible if: $f_c - f_{nc} < \max(r_{ne})$.

What is the maximum number of votes that could have gone to a nominee? It cannot be the total number of votes withheld on a particular card, as that is likely to include multiple withholds from investors who have withheld from more than one nominee. Since each share only allows one vote per nominee,¹⁶³ an investor that withholds from multiple nominees could not reallocate those to a single nominee on the other card.

Because vote results are aggregated, it is impossible to determine how many withhold votes were from different shareholders. To illustrate, consider the example described in Part II, where two incumbent directors, Mary and Nathan, were challenged by two dissident nominees, David and Emily. Assume there are two voters, Alice and Bob, each with ten shares, both of which vote on the management proxy card. The corporation discloses that each management nominee received ten for votes and ten withhold votes, as shown in the left panel of Table 6, below.

Table 6: Multiple Withholds by a Single Shareholder

	<i>Observed Outcome</i>		<i>Possible Scenario 1</i>				<i>Possible Scenario 2</i>			
	<i>For</i>	<i>WH</i>	<i>Alice</i>		<i>Bob</i>		<i>Alice</i>		<i>Bob</i>	
	<i>For</i>	<i>WH</i>	<i>For</i>	<i>WH</i>	<i>For</i>	<i>WH</i>	<i>For</i>	<i>WH</i>	<i>For</i>	<i>WH</i>
<i>Mary</i>	10	10	10			10		10		
<i>Nathan</i>	10	10		10	10		10			10
<i>David</i>										
<i>Emily</i>										

There are two possible scenarios that could have led to the voting results in the left panel of Table 6. In the first scenario, in the center panel, Alice voted for Mary and withheld from Nathan, and Bob did the opposite. If the shareholders had been able to vote on the dissident card, each of them could have chosen to vote for a single dissident. However, the observed outcome could also have resulted from Alice voting for Mary and Nathan, and Bob withholding from both nominees, as in the right panel. In that case, if Bob were unconstrained in his voting, for instance if he voted on a universal proxy, he could not have cumulated

163. As discussed in *supra* Section III.A, contests at corporations that permit cumulative voting contests were excluded from the sample.

the twenty total withhold votes onto a single dissident nominee. He could only have voted his ten shares for each of the two dissident nominees.

The most conservative assumption of the total number of withhold votes that could instead be voted for a nominee is the maximum number of withholds from a single nominee on the other side, since this could not involve any cumulation of multiple votes. This will underestimate potential vote switching to the extent an investor did not withhold from the “maximum withhold” nominee, but did withhold from another nominee. I consider this assumption in greater depth in Section III.E and the effects of varying the assumption.

There will be withhold votes on each card, so the nominee that was elected is also likely to receive some withhold votes. However, to determine the maximum number of distortable contests, I assume that none of these withhold votes go to the elected nominee. This can be thought of as all withhold votes that could switch to a particular elected nominee instead going to other nominees on the same card as the elected nominee, with zero to the particular elected nominee. This is clearly implausible, but serves to create a maximum bound for possible distortions.

I compare (a) the difference between the number of for votes received by the elected nominees and the nonelected nominees, to (b) the maximum number of withhold votes that could be received by the last-elected nominees. I consider that a nonelected nominee could have been elected in place of an elected nominee if (b) is greater than (a).¹⁶⁴ I separately consider both the situation where withhold votes are distributed to dissident nominees, and to management nominees. This creates the potential for switches between sides and within sides.

Where the dissident has put forward a short slate, I exclude from consideration any unopposed management nominees—those that the dissident indicated it would vote its proxies for—as their voting results already include votes cast on both the management and the dissident cards.

The potentially distorted proxy contests that result from this analysis are listed in Table 7, below. Column (2) shows the number of management and dissident nominees elected. Columns (3) and (4) show the results if withhold votes were distributed to nonelected dissident nominees. Columns (5) and (6) show the results if withhold votes were distributed to nonelected management nominees. Columns (3) and (5) show the split of nominees that would have been elected with such distributions, and Columns (4) and (6) show whether the distributions would have resulted in a dissident nominee replacing a management nominee, a management nominee replacing a dissident nominee, a switch in nominees within sides, or no switch. Panel 1 shows the results for contests at Russell 3000 companies, and Panel 2 shows the results for contests at other companies.

164. In the terms set out above, I identify distorted outcomes where: $f_e - f_{ne} < \max(r_{ne})$.

Table 7: Contests that Could Possibly Have Had Different Outcomes with Universal Proxies, 2001-2016

(1) <i>Company / Dissident, Year</i>	(2) # M/D Elected	(3) # M / D Expected Elected With Distribution to D	(4) Switches from Distributing to D	(5) # M / D Expected Elected With Distribution to M	(6) Switches from Distributing to M
Panel 1: Russell 3000 Corporations					
Amylin Pharmaceuticals, Inc. / Carl C. Icahn & Eastbourne Capital Management, 2009	10 / 2	10 / 2	-	11 / 1	D to M
Benchmark Electronics, Inc. / Engaged Capital LLC, 2016	6 / 2	6 / 2	-	6 / 2	Within M
Biglari Holdings Inc. / Groveland Capital 2015	6 / 0	5 / 1	M to D	6 / 0	-
Biogen Idec Inc. / Carl C. Icahn, 2009	2 / 2	2 / 2	-	3 / 1	D to M
Bob Evans Farms, Inc. / Sandell Asset Management Corp., 2014	8 / 4	7 / 5	M to D	8 / 4	Within M
CSX Corporation / TCI Fund Management (UK) and 3G Capital Management, Inc., 2008	8 / 4	8 / 4	-	9 / 3	D to M
Datascope Corp. / Ramius Capital Group, LLC, 2007	1 / 1	1 / 1	-	1 / 1	Within M
Exar Corporation / GWA Investments, LLC, 2005	0 / 3	0 / 3	-	1 / 2	D to M
Forest Laboratories, Inc. / Carl C. Icahn, 2012	9 / 1	9 / 1	-	9 / 1	Within M
GenCorp Inc. / Pirate Capital LLC, 2006	0 / 3	0 / 3	-	1 / 2	D to M
Grubb & Ellis Company / Anthony W. Thompson, 2008	3 / 0	2 / 1	M to D	3 / 0	-
Hercules Incorporated / International Specialty Products, Inc., 2001	0 / 4	0 / 4	-	1 / 3	D to M
Insituform Technologies, Inc. / Water Asset Management LLC, 2008	6 / 1	6 / 1	-	6 / 1	Within M
International Game Technology / Ader Investment Management LP, 2013	7 / 1	7 / 1	-	7 / 1	Within M
Mentor Graphics Corporation / Carl C. Icahn, 2011	5 / 3	5 / 3	-	6 / 2	D to M
ModusLink Global Solutions, Inc. / Peerless Systems Corporation, 2012	1 / 1	0 / 2	M to D	1 / 1	-
Morgans Hotel Group Co. / Kerrisdale Capital Management, LLC, 2014	7 / 2	7 / 2	-	8 / 1	D to M
Rovi Corporation / Engaged Capital LLC, 2015	5 / 2	5 / 2	-	5 / 2	Within M
Sensient Technologies Corporation / FrontFour Capital Group LLC, 2014	9 / 0	8 / 1	M to D	9 / 0	-
Shutterfly, Inc. / Marathon Partners Equity Management, LLC, 2015	1 / 2	0 / 3	M to D	1 / 2	Within M
Stillwater Mining Company / Clinton Group, Inc., 2013	4 / 4	3 / 5	M to D	4 / 4	Within M
The Pantry, Inc. / Concerned Pantry Shareholders (Lone Star Value Management, LLC and JCP Investment Management LLC), 2014	6 / 3	6 / 3	-	7 / 2	D to M
ValueVision Media, Inc. / Clinton Group, Inc. and Cannell Capital, LLC, 2014	4 / 4	4 / 4	-	4 / 4	Within M

Table 7 (cont.): Contests that Could Possibly Have Had Different Outcomes with Universal Proxies, 2001-2016

(1)	(2)	(3)	(4)	(5)	(6)
<i>Company / Dissident, Year</i>	<i># M/D Elected</i>	<i># M/D Expected Elected With Distribution to D</i>	<i>Switches from Distributing to D</i>	<i># M/D Expected Elected With Distribution to M</i>	<i>Switches from Distributing to M</i>
Panel 2: Non-Russell 3000 Corporations					
ALCO Stores, Inc. / Concerned ALCO Stockholders (VI Capital Fund, LP) and Milwaukee Private Wealth Management, Inc., 2014	0 / 7	0 / 7	-	1 / 6	D to M
Benihana Inc. / Providence Recovery Partners, L.P., 2005	2 / 0	1 / 1	M to D	2 / 0	-
California Micro Devices Corporation / Dialectic Capital Management LLC, 2009	4 / 3	4 / 3	-	5 / 2	D to M
CellStar Corporation / Timothy Durham, 2007	0 / 3	0 / 3	-	1 / 2	D to M
Crown Crafts, Inc. / Wynnefield Partners Small Cap Value, LP, 2007	2 / 1	2 / 1	-	3 / 0	D to M
Del Global Technologies Corp. / Steel Partners II, L.P., 2003	1 / 4	1 / 4	-	1 / 4	Within M
Fifth Street Senior Floating Rate Corp. / Ironsides Partners LLC, 2016	1 / 1	0 / 2	M to D	1 / 1	Within M
Hooper Holmes, Inc. / Ronald V. Aprahamian, 2009	0 / 2	0 / 2	-	1 / 1	D to M
IEC Electronics Corp. / Vintage Capital Management LLC and Kahn Capital Management, 2015	0 / 7	0 / 7	-	1 / 6	D to M
Mac-Gray Corporation / Fairview Capital Investment Management, 2009	1 / 1	1 / 1	-	2 / 0	D to M
Point Blank Solutions, Inc. / Steel Partners II, L.P., 2008	2 / 5	2 / 5	-	2 / 5	Within M
Pro-Dex, Inc. / Nicholas Swenson (AO Partners I, LP) and Farnam Street Capital, Inc., 2013	2 / 3	2 / 3	-	2 / 3	Within M
Support.com, Inc. / Vertex Capital Advisors LLC, Bradley Louis Radoff, and Joshua E. Schechter, 2016	1 / 5	1 / 5	-	1 / 5	Within M
Telkonet, Inc. / Peter Kross, 2016	2 / 3	2 / 3	-	2 / 3	Within M
TICC Capital Corp. / TPG Specialty Lending, Inc., 2016	1 / 0	0 / 1	M to D	1 / 0	-
Tollgrade Communications, Inc. / Ramius Capital Group, LLC, 2009	2 / 3	2 / 3	-	3 / 2	D to M
Virtus Total Return Fund / Bulldog Investors LLC, 2016	1 / 0	0 / 1	M to D	1 / 0	-

Table 7 shows that of the proxy contests in the sample, forty contests (14.9% of the sample) may have involved a distorted choice among nominees. The corollary is that, based on these assumptions, 85.1% of contests could *not* have involved distortion.

The proportions are generally similar to those assuming uniform distribution described above: twenty-eight of the contests involved a distortion between sides, of which seventeen (60.7%) would have favored management, and eleven (39.3%) would have favored dissidents. Twenty-three contests that may have been distorted were at Russell 3000 companies (21.5% of Russell 3000 contests in the sample), and seventeen were at non-Russell 3000 companies (10.5% of those companies in the sample).

E. Assumptions Underlying Empirical Analysis and Robustness Tests

The contests considered in this analysis occurred subject to the current proxy voting rules. It is therefore impossible to know precisely what the outcome would have been with universal proxies. This analysis, and its results, depend entirely on a set of assumptions about how investors would have acted had the rules of the system been different. In this section, I consider first the validity of the assumption that underlies the entire method: that for votes are likely to remain the same under universal proxies. I then consider more specific assumptions that underlie each of the distributional models and the robustness of those assumptions.

1. Assumption of Independent For Votes

The key assumption that I make is that each investor would have cast the same for votes under a universal proxy system as it did under the current proxy system. My model of investors is that, for each contest, each investor has a set of preferences among the nominees that are formed prior to—and do not change based on—the rules by which the contest will be determined. For instance, an investor may prefer all management nominees over any dissident nominees; or all dissident nominees over all management nominees, or (importantly) some but not all management nominees, and one or more dissident nominees. I assume that if an investor prefers all management or all dissident nominees under the current proxy voting system, that investor would have the same preference under the universal proxy voting system, and in each case, vote for all of those nominees. Importantly, I assume that if an investor prefers some mix of *A* management and *B* dissident nominees, then—when subject to the current proxy system—the investor votes on either the management card for the *A* nominees, or on the dissident card for the *B* nominees, and withholds its votes from the remaining nominees on the card. I assume that if the investor had instead voted on a universal proxy, it would continue to vote for the nominees that they actually

voted for, and would not vote for nominees that it was able to but declined to vote for under the current system.

The plausibility of this assumption will depend on the investors making the voting decisions. The assumption will fail to the extent that investors vote according to their preferences and their preferences change based on the voting rules governing the contest. For instance, a large body of literature suggests that consumers' preferences between several options can be affected by the addition of another option.¹⁶⁵

Shareholders that vote in director elections are overwhelmingly institutional investors. Most of the shares of the corporations which I consider are held by institutions—an average of 83% of those corporations in my sample that survived as of December 31, 2016. In 2016, 91% of shares owned by institutional investors were voted at annual meetings on average, compared to 28% of shares held by retail investors.¹⁶⁶ This suggests that retail investors represent about 6% of the votes cast at director elections.¹⁶⁷ Institutional investors are staffed by professional investment managers that have experience determining whether management nominees or dissident nominees are likely to be best for the corporation and the investments they manage. Fiduciary duties require these managers to take care in exercising these decisions on behalf of their investors.¹⁶⁸ It therefore seems reasonable to assume that these investors will have considered each nominee, and will have some ordering among the nominees, and that this will not be affected by the rules of voting.

A second possible problem may occur if the actors do not vote according to their preferences, and vote on different bases depending on the rules. For instance, it is possible that investors might vote strategically.¹⁶⁹ Two kinds of

165. See, e.g., Itamar Simonson & Amos Tversky, *Choice in Context: Tradeoff Contrast and Extremeness Aversion*, 29 J. MARKETING RES. 281 (1992); Amos Tversky & Itamar Simonson, *Context-Dependent Preferences*, 39 MGMT. SCI. 1179 (1993).

166. 2016 Proxy Season Review – Third Edition, BROADRIDGE & PWC 1 (2016), <http://www.broadridge.com/assets/pdf/broadridge-proxypulse-2016-proxy-season-review.pdf> [<http://perma.cc/8YGGZ-2ML9>].

167. The figures are based on uncontested elections, but even if retail investor turnout in contested elections were to double, the likely percentage of votes attributable to retail investors would be only 11%. That retail investors are likely to represent such a small percentage of shares voted in contested elections diminishes considerably the significance of concerns raised by a SEC Commissioner and several commentators that the rules the SEC proposes would disadvantage retail shareholders. See Michael S. Piwowar, *Dissenting Statement at Open Meeting on Universal Proxy*, U.S. SEC. & EXCHANGE COMMISSION (Oct. 26, 2016), <http://www.sec.gov/news/statement/statement-piowar-universal-proxy-10-26-2015.html> [<http://perma.cc/RW5U-9P6C>] (“In particular, [the] universal proxy proposal will be to the detriment of retail investors.”); see also, e.g., Letter from Davis Polk & Wardwell LLP, *supra* note 111, at 6; Letter from Quaadman, *supra* note 108, at 4 (“Because the proposed rules do not require an insurgent to solicit all shareholders, it stands to reason that retail investors (who, on average, possess fewer votes and proportionally less voting power) will be left out in the cold.”).

168. See, e.g., Letter from Alan D. Lebowitz, Deputy Assistant Sec’y, Dep’t of Labor, to Robert Monks, Institutional S’holder Servs., Inc. (Jan. 23, 1990), *reprinted in* 17 Pens. & Ben. Rep. (BNA) 244.

169. Any democratic election among three or more candidates is theoretically susceptible to strategic manipulation. Allan Gibbard, *Manipulation of Voting Schemes: A General Result*, 41 ECONOMETRICA 587 (1973); Mark Allen Satterthwaite, *Strategy-Proofness and Arrow’s Conditions:*

strategic voting could be conceived of. Either investors could vote for nominees that they do not prefer, or they could vote for only a subset of the nominees they prefer, and withhold from others. I discuss the second type of strategic behavior further below. As for the possibility that investors would vote “insincerely,” for nominees than they do not prefer, it is difficult to see how this could increase the chances of their preferred nominees being elected. In addition, insincere voting will be made much more difficult given the relatively large number of voters and the difficulty in knowing how each is likely to vote. Even if there were an optimal strategy to increase the likelihood of preferred nominees being elected, it may be very difficult or costly for institutional investors to obtain the necessary information and perform the necessary calculations to determine what this strategy would be.¹⁷⁰

2. Assumptions Regarding Continuing Withholds

The discussion above assumes that all of the votes withheld on one side will switch to the other side. It is possible that some investors would continue to withhold, even if they were permitted to vote for whichever nominee they wished. However, this would be irrational.¹⁷¹ In an uncontested election, withhold votes have become a way for shareholders to signal their disapproval of the directors nominated, even though it is very unlikely to have any effect on whether those directors are elected or not. In a contested election, investors have a much stronger way of signaling that they disapprove of managers—by voting for one or more dissidents. Moreover, if an election is contested, against a

Existence and Correspondence Theorems for Voting Procedures and Social Welfare Functions, 10 J. ECON. THEORY 187 (1975).

170. Even if voters have free and perfect information about the voting behavior of other voters, it may be computationally difficult for them to determine how best to exploit this information to their advantage. See J.J. Bartholdi et al., *The Computational Difficulty of Manipulating an Election*, 6 SOC. CHOICE & WELFARE 227, 228 (1989) (considering voting systems with single winners); see also Reshef Meir, Ariel D. Procaccia et al., *Complexity of Strategic Behavior in Multi-Winner Elections*, 33 J. ARTIF. INT. RES. 149, 154 (2008) (considering voting systems with multiple winners). However, strategic voting requires information about how other voters are likely to vote. See, e.g., David P. Myatt, *On the Theory of Strategic Voting*, 74 REV. ECON. STUD. 255, 274 (2007). This may be costly or difficult to acquire. Even in single-winner elections, strategic voting is generally considered to be less common in practice than often thought. See, e.g., R. Michael Alvarez & Jonathan Nagler, *A New Approach for Modelling Strategic Voting in Multiparty Elections*, 30 BRIT. J. POL. SCI. 57, 75 (2000).

171. It is possible that an investor could wish to withhold to signal disapproval of both a management nominee and a dissident nominee. However, such a signal will be much less clear (and presumably, much less likely to be sent), in a contested election. Consider an uncontested election with m nominees and n shareholders. It will be clear if shareholders withhold from any particular nominee, as that nominee will receive fewer than $m \times n$ total votes. However, in a contested election, shareholders cannot vote for all m nominees. It will not be clear from any particular nominee's vote total whether shareholders withheld from them and voted for a nominee on the other side, or withheld from nominees on both sides. While it would be possible to compare the total number of votes that could be cast for all nominees, and the total number that were actually cast to determine the aggregate number of shares that were not voted for either side, this would require additional computations from the figures disclosed, and it is not clear what the appropriate interpretation of this figure would be. As a result, any attempt to send a signal by withholding from both sides would seem to be quixotic at best.

baseline of voting for management, withholding from management would have the same directional effect as voting for a dissident, but in a weaker form.¹⁷²

As discussed above, 90% or more of the votes represented in director elections are those of institutional investors.¹⁷³ U.S. institutional investors have fiduciary duties to vote their shares,¹⁷⁴ because their vote is a resource they hold as a fiduciary for their investors. As a practical matter, these investors do vote their shares; more than 90% of shares controlled by institutional investors are voted.¹⁷⁵ Using their votes in a weaker rather than stronger fashion could be considered a breach of fiduciary duty.

There may be a strategic reason for institutional investors to continue to withhold from some of their preferred nominees. Among the nominees that they would like to have elected, some institutional investors may have much stronger preferences in favor of some nominees than others. For instance, an institutional investor that would like to split its vote between management and dissident nominees may feel much more strongly that a dissident nominee should be elected than that their preferred management nominees be elected. In that case, the investor may be willing to withhold from the management nominee they prefer, in order to reduce the likelihood that the management nominee would be elected in place of the dissident nominee. Whether or not this strategy is likely to be used is difficult to determine. Conversations with a number of institutional investor representatives who are involved in voting decisions suggest that most would not use this strategy, although one representative did indicate that their funds may consider voting in this way.

Some evidence of whether institutional investors will continue to withhold when voting on a universal proxy can be gathered from the results of the 2013 proxy contest at Transocean Ltd. There were five management nominees up for election; Carl Icahn nominated three dissident nominees.¹⁷⁶ As discussed in Section I.C, because Transocean is a Swiss corporation, it used a universal proxy. However, because it is listed on the New York Stock Exchange, it is subject to U.S. securities regulations. Investment companies that voted shares in the proxy

172. The effects of switching versus withholding can be analogized to the effects of wins in games between two Major League Baseball rivals, compared to wins in other games. If the Boston Red Sox beat the New York Yankees, then compared to the Yankees, the Red Sox's win-loss record will rise by two: the Red Sox record a win, and the Yankees record a loss. If the Red Sox beat any other team, the Red Sox' win-loss record will rise only one compared to the Yankees: the Red Sox record a win, but the Yankees do not record a loss. For an investor whose baseline is voting for management, the latter situation is akin to choosing to withhold, rather than choosing to vote for the dissident.

173. SHARKREPELLENT, *supra* note 32.

174. See, e.g., Letter from Lebowitz, *supra* note 168, at 3 ("The fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock."). This opinion applies to advisers to qualified pension plans, which is functionally most investment advisers that advise pension plans or defined contribution plans. It does not technically apply to state public pension plans, but these generally regard themselves as having fiduciary duties that require them to vote.

175. BROADRIDGE & PWC, *supra* note 166, at 1.

176. See SHARKREPELLANT, *supra* note 32. Data was last accessed March 23, 2018.

contest were required to disclose their votes in the contest.¹⁷⁷ Of the 319 investment companies disclosing valid votes, 310 (97%) voted for 5 nominees.¹⁷⁸ Only 9 funds (2.8%) chose to withhold by voting for fewer than 5 nominees.¹⁷⁹ While caution is warranted in placing significant weight on the results of a single proxy contest at a non-U.S. corporation, this would seem to support the conclusion that institutional investors would not continue to withhold votes in proxy contests in significant numbers if unconstrained by the current proxy voting rules.

For the reasons above, I consider it reasonable to assume that shareholders will not withhold. However, I conduct robustness tests by relaxing this assumption, and assuming that a certain proportion of investors continue to withhold, assuming 10%, 25% and 50% of shares withheld would continue to be withheld even if shareholders had the opportunity to vote for whichever nominee they wished.¹⁸⁰ These tests are described in Table 8.

Table 8: Sensitivity Analysis for Expected Distorted Proxy Contests Assuming Continuing Withholding

<i>Distributional Assumption</i>	<i>Proportion of Other Withhold Votes Switching</i>			
	<i>0%</i>	<i>10%</i>	<i>25%</i>	<i>50%</i>
<i>Uniform</i>	18	16	12	9
<i>Proportional</i>	18	16	10	9

Assuming 10% continuing withholds, sixteen of the eighteen expected distorted contests (89%) would continue to have different outcomes, whether withholds are distributed uniformly or proportionally. Even assuming 25% or 50% continued withholding, between nine and twelve contests (50% to 67%) would be expected to be distorted, suggesting that the analysis is robust to significant variation of assumptions.

177. Form N-PX, 17 C.F.R. § 274.129 (2017) (requiring the disclosure of proxy voting records).

178. Data obtained from ProxyInsight, <http://www.proxyinsight.com> [<http://perma.cc/8J5S-87MX>].

179. *Id.*

180. The expected undistorted for votes for each nominee i , $E(u_i)$, are calculated as a function of the for votes (f_i) received by the nominee and the withhold votes (w_j) received by each of the n opposing nominees, j , as: $E(u_i) = f_i + (1 - c) (\sum_{j=1}^n w_j/n)$.

3. Assumptions Regarding Maximum Withholds

In determining the maximum number of votes withheld that might instead be voted for a particular nominee, I used the maximum number of withholds from a single nominee on the other side, since this avoids the possible cumulation of multiple votes, which is not permitted in the contests that I consider. Where different shareholders withhold from different nominees, this analysis will disregard situations where multiple distinct withholding shareholders would have voted for a single nominee and will therefore underestimate the potential level of distortion.

To consider the effects of weakening this assumption, and the continuing withhold assumption described above, I conduct sensitivity analyses on the maximum distortion analysis. I assume that in addition to the maximum number of votes withheld against an opposing nominee, a certain percentage of votes withheld from other nominees are from distinct shareholders. I assume that 0%, 10%, 25%, or 50% of withholds on the opposing card other than those for the maximum withhold nominee also switch to the nonelected nominee. As above, I also consider continuing withhold levels of 0%, 10%, 25%, or 50%.¹⁸¹ The results are shown in Table 9 below.

Table 9: Number of Maximum Distorted Proxy Contests Assuming Additional Switching and/or Continuing Withholding

<i>Proportion of Other Withhold Votes Switching</i>	<i>Proportion of Withhold Votes Continuing to Withhold</i>			
	<i>0%</i>	<i>10%</i>	<i>25%</i>	<i>50%</i>
<i>0%</i>	40	38	32	28
<i>10%</i>	41	40	36	30
<i>25%</i>	46	44	40	33
<i>50%</i>	52	50	44	39

Table 9 supports the view that the calculations are generally robust even if the assumptions used are weakened. Even assuming that 50% of investors continue to withhold, the number of contests that could result in switches falls less than 25%.

181. For each pair of an elected nominee e and a nonelected nominee ne , distorted outcomes are identified for each model where: $f_e - f_{ne} < (1 - c)(\max(r_{ne}) + s(\sum_{j=1}^n w_j))$.

IV. The Implications for Proxy Contests

This part considers the implications of the results in Part III for the universal proxy debate. First, it considers the likely consequences of a universal proxy rule for distortions in proxy contests. Second, it considers why groups representing managers may have opposed universal proxies, even though universal proxies are likely to favor managers. Third, it considers the conclusions that can and cannot be drawn regarding the normative implications of universal proxies.

A. The Likely Consequences of Universal Proxies

A number of inferences regarding distortions in proxy contests and the effects of universal proxies can be drawn from these results. Obviously, these conclusions are based on previous contests, and there is no assurance that the underlying behavior or outcomes would remain the same were universal proxies adopted. However, as the discussion in Section III.E.1 regarding investor voting behavior made clear, there are reasons to believe that investor preferences might be independent of the voting system and not driven by strategic considerations, which would suggest that conclusions from the past may be useful for contests in the future. This section first considers the implications of universal proxies for the significance of distortions. It then considers the arguments made by opponents of universal proxies, who say that universal proxies would favor dissident nominees, and would lead to more proxy contests. There are also a number of other inferences that can be drawn from the empirical evidence.

1. The Significance of Distortions, and Universal Proxies

The earlier analysis demonstrates that the mix-and-match problem can result in distortions in proxy contests, and that these are a real and practical problem. The analysis identifies at least eighteen and up to forty companies that are likely to have had a director elected without plurality support. Assuming votes were cast rationally in these contests, it is likely that shareholders believed that another director would have made better decisions on behalf of the company. By lowering the likelihood that directors making poor choices would be replaced in the event of a contest, or that directors making good choices would be reelected, these distortions are likely to have weakened the incentives of directors to make value-enhancing decisions in the much broader set of companies where there was at least a threat of a proxy contest.

The absolute number of contests that may be affected by universal proxies appears to be small. The strongest conclusion that can be drawn from the analysis above is that, even assuming maximum switching, 229 proxy contests (85.1%) would have been completely unaffected by universal proxies. However, this is a result of there being very few proxy contests that actually went to a vote. The possibly distorted forty contests represent 14.9% of the proxy contests in the

sample, a significant percentage; the eighteen contests at which universal proxies can be expected to have changed outcomes represent 6.7% of all proxy contests considered.

While these numbers are still relatively small, as discussed in Part I, those contests that do go to a vote set the expectations for dissidents and management making decisions in the much larger number of engagements that are settled, and the very large number of corporations where an engagement could potentially take place.¹⁸² Therefore, the significant proportion of contests with distorted outcomes is likely to have an outsized significance, influencing the decision to settle and the terms of settlement of many more engagements between management and dissidents, as well as their decisions about potential engagements.

2. Which Side Would Universal Proxies Favor?

As discussed above, distorted outcomes can favor either management or dissidents in proxy contests. Similarly, eliminating distorted outcomes could favor either dissidents or management.

The results above show that, of the fifteen contests where universal proxies can be expected to have had distortions between sides, management nominees can be expected to have been favored at ten contests, and dissident nominees at five contests. These results are not significantly different from an even split between favoring management and favoring dissidents. This casts doubt on the claim made by opponents of universal proxies that they are likely to help dissidents. If anything, to the extent universal proxies led to different outcomes in contests, they would favor management more frequently than dissidents.

3. The Frequency of Proxy Contests

Opponents of a universal proxy rule have raised the concern that universal proxies would increase the ease by which dissidents can mount proxy contests, and therefore increase the frequency of proxy contests. This is perceived as a cost of a universal proxy rule, because those commentators view shareholder activism and proxy contests as generally harmful to corporations. Whatever one's view on the value of proxy contests and shareholder activism, the results above undermine opponents' claim.

The results above suggest that, at the proxy contests conducted since 2001, a universal proxy rule would have reduced dissidents' success in proxy contests, or, put another way, made it more difficult for dissidents to be successful in proxy

182. As a point of comparison, of the 4,417 securities class actions filed between 1996 and 2014, only 16 (0.4%) actually reached a verdict. See Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review*, NERA 2, 41 (Jan. 2017), http://www.nera.com/content/dam/nera/publications/2017/PUB_2016_Securities_Year-End_Trends_Report_0117.pdf [<http://perma.cc/BJ69-78GN>].

contests. To the extent this would have affected the decisions of dissidents to initiate proxy contests, it would have actually made proxy contests slightly less frequent.

4. The Frequency of Mixed Board Outcomes

A number of commentators have suggested that universal proxies may increase the success of dissidents not overall, but by increasing the incidence of mixed boards, that is, of at least one dissident nominee being elected. The argument seems to be based on the belief that shareholders that are currently dissatisfied with management but prefer to vote on the management card cannot currently vote for any dissident shareholders. With a universal proxy, those shareholders could vote for at least one dissident, rather than just withhold from management.

Of the forty contests where universal proxies could possibly have resulted in a different outcome, only six would have gone from zero dissidents elected to at least one dissident elected. Therefore, the concern that universal proxies would result in more mixed board results should be limited.

5. Universal Proxies and Dissidents with Parochial Interests

Opponents of a universal proxy rule have suggested that it would facilitate proxy fights by individual shareholders or small groups with parochial interests that are not shared by the wider body of shareholders.¹⁸³ The evidence presented above allows the evaluation of this claim.

An example of the kind of parochial interest that critics appear to have in mind may be that of Peter Lindner. As noted in Section III.A, the data exclude certain non-bona fide proxy contests. These include four annual meetings at American Express Corporation where Mr. Lindner, a disgruntled former employee of the corporation, put himself forward for election as a director. In each of these cases, Mr. Lindner did not file a definitive proxy statement or solicit proxies from investors and received only eleven votes (out of a total of more than 900 million votes cast at the meeting), corresponding to the eleven shares he himself owned of record.¹⁸⁴ The universal proxy rule proposed in the Release would require dissidents to solicit at least 50% of shares able to vote at the meeting. This would exclude situations companies from having to use universal proxies in situations such as Mr. Lindner's.

Would universal proxies facilitate proxy contests by special interest groups more generally? This can be evaluated by considering the level of support that

183. Letter from Quaadman, *supra* note 17, at 4 (“[T]he universal proxy card would facilitate proxy fights by individual shareholders (or small groups of shareholders) . . . who may nominate directors who advance their own parochial agenda without regard to the broader interests of the company or its shareholders.”).

184. See *supra* note 145.

dissidents received in proxy contests generally and in the proxy contests whose outcomes might be affected by universal proxies. Dissidents that receive support from a significant proportion of shares voted at the meeting could not be said to be special interest shareholders. Dissidents with special interest that do not represent the preferences of a significant number of shareholders will therefore be those that receive a limited percentage of support in the election. Figure 7, below, shows the distribution of proxy contests by the number of votes cast at the meeting where investors voted for at least one dissident nominee.

Figure 7: Support for Dissidents in Contests Expected to be Distorted, Possibly Distorted, and Not Distortable

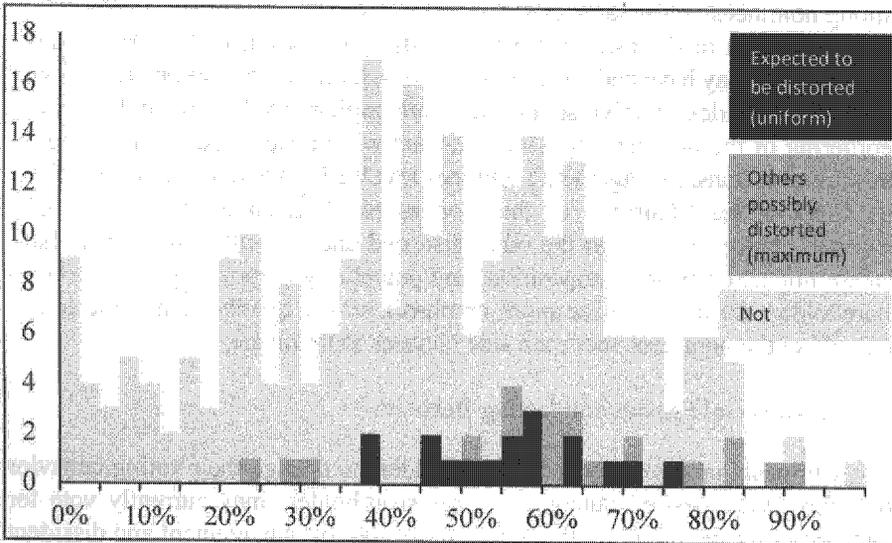


Figure 7 shows a wide distribution of levels of support for dissidents in proxy contests. Contrary to expectations, a significant number of proxy contests go to a vote even though dissidents receive limited support. At thirty-five contests (13%), less than 20% of shares voted for at least one dissident. However, those contests whose outcomes can be expected to be affected by universal proxies and those additional contests that might potentially be affected by universal proxies are those that generally receive much higher levels of dissident support. None of the thirty-five contests where dissidents received votes from less than 20% of shareholders could have been affected by a universal proxy rule, and only 8 of the 149 contests where less than 50% of shares supported any dissident (5.4% of those contests, and 3.0% of all contests). It would therefore seem that a well-designed universal proxy rule is unlikely to affect the success of dissidents representing special interests that aren't shared by the broader body of shareholders.

6. Effects of Universal Proxies on Choices of Nominees

At an SEC roundtable debating possible universal proxy rules, one commentator suggested that a move to universal proxies might result in a greater focus on the nominees, rather than the side that they represent.¹⁸⁵ This seems to be consistent with the analysis in Part II regarding distortions within sides. Under the current proxy system, shareholders are forced to undertake a two-step process: first, does the shareholder prefer the management side or the activist side, and second, which of the nominees on the chosen side's card should the shareholder vote for. In contests in which a universal proxy card is solicited, shareholders are able to choose any nominee, without distortion, including among nominees on the same card.

At sixteen of the forty contests identified in Section III.C (40% of those contests) that may have had distorted outcomes, there could have been a distorted choice within sides. If universal proxies were implemented, there could be some reordering of the nominees that were elected within each side. At a number of these corporations, management nominees involved in the distortion were either the CEO or the Chairman of the corporation.¹⁸⁶ Each of these potentially distorted choices, as well as the other distorted choices within sides, may have had an impact on board composition, and potentially corporate performance. If shareholders do indeed place more emphasis on the quality of nominees, this may affect the nominees that each side chooses to nominate.

7. Universal Proxies and Voting Behavior

Universal proxies may force shareholders to change their voting behavior to achieve their desired outcomes. Some shareholders may currently vote for nominees with the intention that a particular split of management and dissident nominees will be elected, e.g., that two out of four dissident nominees would be elected. These shareholders may have adopted voting behavior based on

185. See Chris Cernich, Managing Dir., Institutional S'holder Servs., Statement at the U.S. Securities and Exchange Commission Proxy Voting Roundtable (Feb. 19, 2015), <http://www.sec.gov/spotlight/proxy-voting-roundtable/proxy-voting-roundtable-transcript.txt> [<http://perma.cc/Q5NK-AJ6N>] ("One of the interesting things about a universal ballot . . . is that it actually puts an awful lot more emphasis on the qualifications going forward of each of the nominees.").

186. At Bob Evans Farm, the election of Chairman & CEO Steven Davis may have been distorted, and had it not been, may have instead resulted in the election of another management nominee, Bill Ingram or Cheryl Krueger. At Shutterfly, the election of CEO Jeffrey Housenbold may have been distorted, and had shareholders been able to vote as they wished, another management candidate, James White, may have been elected in his place. At Amylin Pharmaceuticals, the board chairman, Joseph Cook, was not elected, but may have been elected in place of another management nominee, James Gavin, had there been no distortion. In other proxy fights, distortions may have affected whether the chief executive officer of the corporation was elected as a director, albeit with low levels of likelihood. For instance, at Stillwater Mining, CEO Francis McCallister was elected, however it is possible that a dissident nominee, Greg Taxin, would have been elected in his place had withhold votes been voted for nominees. At Mac-Gray, CEO Stewart MacDonald was not elected, but may have been elected in place of dissident Bruce Ginsberg had withheld votes instead been voted for nominees.

experience from previous proxy contests, where they have learned that such voting behavior will be more likely to result in the election of the number of dissident nominees that they prefer. For instance, the shareholder may choose to vote on the dissident card but withhold from two unwanted dissident directors. As discussed in Part II, if those withhold votes are instead cast in favor of management candidates, the management candidates may receive more for votes than the dissidents, and fewer dissidents may be elected than the shareholders would prefer. Shareholders may therefore need to collectively adjust their voting behavior so that their preferred split of directors is elected. That is, shareholders may currently vote with a particular equilibrium in mind, and will need to change their behavior to maintain that equilibrium given the changes in voting from universal proxies. In the example above, shareholders might vote for more dissident nominees, or (as suggested in Section III.E.2) may withhold from management nominees whose election they prefer less than the dissident nominees. The impact of such changes on the conclusions that can be drawn from the analysis is discussed further in Section IV.B.

8. Explaining Management Opposition to Universal Proxies

On their face, the findings in Part III present a puzzle. Why have groups like the U.S. Chamber of Commerce and the Business Roundtable that represent managers staunchly opposed a proposal that would likely assist managers in the face of challenges from dissidents? It could be that these groups have conducted research demonstrating that the actual effects of a universal proxy rule favor dissidents. However, if this were true, they would likely have included such research in making their case for how the rule would favor special interests and increase the incidence of proxy contests. Any such evidence would not only have strengthened their case considerably, it may have led the SEC to a different conclusion in its economic analysis and could have provided grounds for a challenge to the validity of the rule under the Administrative Procedure Act.¹⁸⁷ An alternative explanation could be that the Chamber of Commerce and Business Roundtable misunderstand the likely effects of the rule. Were that the case, evidence presented in this Article may cause them to reconsider.

If management interest groups do not relax their opposition to universal proxies, despite evidence that universal proxies might be advantageous for them, why might this be the case? One explanation is that preventing universal proxies may be a minor battle in a broader campaign against expansions in shareholder

187. With respect to the SEC's recent conflict minerals rule, groups representing managers—including the U.S. Chamber of Commerce and the Business Roundtable—put forward considerable evidence of the cost of the rule, which formed the basis for a challenge to the validity of the rule. The U.S. Chamber of Commerce and the Business Roundtable have themselves brought such challenges to SEC rules in the past, for instance, in *Chamber of Commerce of the United States v. SEC*, 412 F.3d 133 (D.C. Cir. 2005), and *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

power.¹⁸⁸ The effect of universal proxies in eliminating distorted proxy contest outcomes means that it decreases the “noise” in corporate voting¹⁸⁹—the instances where director election outcomes do not match the result from an aggregation of shareholder preferences—and increases the “signal-to-noise ratio”—the extent to which shareholder votes result in the collectively-desired combination of directors being elected. This can be thought of as another level of effect of proxy rules to add to those described in Section I.C.3 and Figure 1: by enhancing shareholders’ influence over corporate elections, universal proxies affect the power of shareholders vis-à-vis managers.

Viewed through this lens, the opposition to universal proxies by the Chamber of Commerce and the Business Roundtable may be rational, even though universal proxies would bolster the position of individual managers. It may be more important for managers to oppose the expansion of shareholder power through universal proxies, which could beget further increases.¹⁹⁰ Were universal proxies to be implemented and *not* result in the negative consequences foreseen by the U.S. Chamber of Commerce and the Business Roundtable, regulators might reasonably consider implementing regulations that further increased shareholder power. Any weakening of the opposition to shareholder-power-increasing regulations might embolden investors to further seek such increases.

The politics of universal proxies appears to be even starker than the examples described by Marcel Kahan and Edward Rock.¹⁹¹ In their examples, the reforms opposed by managers would have had negative effects on most managers.¹⁹² In this case, universal proxies are likely to assist most managers in defending against dissidents. Yet this benefit would appear to be dominated by the importance of opposing increases in shareholder power.

B. The Implications for the Universal Proxy Debate

The normative implications of universal proxies can be thought of in two dimensions. First, universal proxies eliminate the distortions that can result from the current system of proxy voting rules. This has important *ex post* and *ex ante* benefits for corporations. The current system may result in the election of

188. Kahan & Rock, *supra* note 19, at 2024. Marcel Kahan and Edward Rock consider most closely symbolic exercises in corporate governance politics, but also consider strategic explanations for interest group actions on shareholder voting rules. Although their theory focuses on the actions of shareholder activists, their theory also serves to explain the actions of management.

189. Since shareholders can use legal proxies, it is more precise to say that universal proxies lower the cost of noise reduction in corporate voting.

190. Kahan and Rock make a similar argument for the battle over proxy access. *See Id.* at 2024

191. Kahan and Rock give the examples of poison pills, proxy access, majority voting, and supermajority provisions. *Id.* at 1998.

192. Albeit very small effects, which would “hardly seem to justify the intensity of the contest.” *Id.*

directors that shareholders do not believe are likely to make the best decisions in the management of the corporation. By doing so, the current system may also reduce the incentives of directors to make good decisions, since it is less likely that their reelection will hinge on shareholders' views of their decisions. Universal proxies would remedy both of these problems.

The second dimension is whether universal proxies would advantage one side or the other in proxy contests, and how it might affect settlement decisions and decisions by activists on whether to initiate proxy contests. On this dimension, the normative implications of universal proxies are much less clear, for two reasons. First, the results from Part III represent, at best, a partial equilibrium. The proxy contest system is likely to reequilibrate to incorporate the effects of universal proxies on proxy contest outcomes. For instance, as described in Section IV.A.8, if universal proxies lead to lower support for dissidents and a lower likelihood of dissident campaigns being successful, but institutional investors prefer the current level of dissident success, institutional investors are likely to increase the extent to which they support dissidents. Second, the corporate-value effects of a universal proxy rule depend on the effects of hedge fund activism on longer-term corporate value, which are the subject of much debate. Even assuming that the long-term equilibrium effect of universal proxies means fewer dissident nominees were elected and fewer proxy contests would be initiated, it is not clear the effect this would have on corporations. The lower threat of hedge fund activism might increase the value of corporations, by permitting managers to undertake long-term value-enhancing actions without the threat of short-term-appropriative hedge fund activism.¹⁹³ Alternatively, the lower threat of hedge fund activism might decrease the value of corporations, by reducing the discipline on managers to undertake value-enhancing actions.¹⁹⁴ For this reason, the SEC declined to predict the effects of universal proxies on corporate governance.¹⁹⁵ As a result of these difficulties, there is not sufficient extant evidence for a comprehensive analysis of all of the value effects of universal proxies.

Combining these two dimensions of normative implications, it is clear that universal proxies offer significant benefits in eliminating distortions. These benefits exist in addition to whatever expressive benefits shareholders receive from being able to vote for the mix of nominees that they prefer. It is much less clear that universal proxies would have particular costs or benefits associated with favoring one side or another, or increasing or decreasing the level of hedge fund activism. The analysis in Part III dispels the main arguments made against

193. See, e.g., Martijn Cremers et al., *Hedge Fund Activism and Long-Term Firm Value* (Working Paper, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231 [<http://perma.cc/PWD6-TVFU>].

194. See, e.g., Bebchuk et al., *supra* note 37.

195. See Exchange Act Release No. 34-79164, 81 Fed. Reg. 79,122, 79,127 (Nov. 10, 2016) (“[I]t is difficult to predict the likely extent or direction of these broader potential effects, but we cannot rule out the possibility that they could be significant.” (footnote omitted)).

universal proxies. Universal proxies are unlikely to favor dissidents or special interests and consequently, are unlikely to result in an increase in the number of proxy contests. If anything, universal proxies are likely to favor managers, so may result in a *decrease* in the number of proxy contests. Since this calculus provides strong arguments for universal proxies and weakens the arguments against, should lead the SEC to towards implementing universal proxies. Part 0 considers how such implementation could take place.

V. Fixing Distortions in Proxy Contests

Given the conclusion that universal proxies should be implemented, Section V.A considers how SEC regulation should be structured, taking into account the uncertainty about the ultimate effects of universal proxies. However, there are a number of obstacles to an SEC universal proxy regulation in the current political environment. Given investor support for universal proxies, Section V.B considers how investors could themselves implement universal proxies, as a second-best solution to SEC regulation.

A. Universal Proxy Regulation

Before evaluating the universal proxy rule in the SEC's Release, this Section considers the potential alternatives for proxy regulations. Potential regulations differ in the nature of the default proxy arrangement, and whether the arrangement is mandatory or privately ordered.¹⁹⁶

Default proxy arrangements at corporations could take several forms. An arrangement could effectively *prohibit* a universal proxy, such as by preventing nominees from being included in the proxy statements of other nominees, or by using the current rule, which prohibits such inclusion without consent of the nominee. Alternatively, the arrangement could also be structured to *permit* one or both sides to use a universal proxy, by allowing either side to include nominees that had consented to be nominated in any proxy statement for the meeting.¹⁹⁷ Finally, an arrangement could *require* each party to include both parties' nominees on their proxy card, as in the SEC's proposed universal proxy rule.¹⁹⁸

A second dimension is whether all corporations of a particular kind are required to have the particular arrangement regarding proxy voting (a mandatory rule) or whether corporations are permitted to switch from the default

196. For a more general and comprehensive discussion of the arguments applied here to proxy arrangements, see Scott Hirst, *The Case for Investor Ordering* (Harvard Law Sch. Program on Corp. Governance Discussion Paper 2017-13, 2018), <http://ssrn.com/abstract=3011327> [<http://perma.cc/KR3K-H5AS>].

197. The SEC raised the possibility of permitting but not requiring a universal proxy card in its proposed rulemaking, but did not compare the potential costs and benefits of such a rule to the rule it proposed. See 81 Fed. Reg. at 79, 128 n.67.

198. *Id.* at 79,122.

arrangement to another arrangement (a privately ordered rule). The SEC's proposed universal proxy rule is a mandatory rule: the corporations to which the rule applied would be required to follow the arrangements for universal proxies set out in Rule 14a-19.¹⁹⁹ The current bona fide nominee rule is also mandatory, in the sense that all corporations have the same arrangement whereby nominees may only be included on proxy cards if the nominee has consented to be named in that nominee's proxy statement, and firms cannot choose to opt out of that arrangement.

The alternative is for the rule to permit private ordering. For instance, the proposed rule could permit corporations to opt out of the requirement that both parties use universal proxy cards. The corporation could then replace that arrangement with an alternative, such as using universal proxy cards or prohibiting them without consent. Where a rule is privately ordered, a further consideration is how the corporation is permitted to switch from the default arrangement to an alternative arrangement. For instance, switching could be initiated by management, investors, or both and could either require approval by managers, investors, or both. The next Section considers the choice among the parameters described above in reverse order.

The conclusions drawn in Section IV.B have important implications regarding the choice among alternative proxy rules. A universal proxy rule would be valuable in reducing distortions, and the arguments made against a universal proxy rule appear invalid. On the other hand, as discussed in Section IV.B, there are considerable unresolvable uncertainties about the ultimate costs and benefits of a universal proxy rule. This suggests that while the SEC should change the default arrangement to permit or require universal proxies, this arrangement should not be mandatory, but should instead permit corporations to opt out of universal proxies by appropriate corporate action.

Given the uncertain costs and benefits associated with a universal proxy rule, a privately ordered universal proxy rule would result in the same or greater aggregate net benefit as a mandatory rule.²⁰⁰ Opponents of a universal proxy rule argue that it would be costly for corporations.²⁰¹ If universal proxies indeed

199. *Id.*

200. This assumes that a universal proxy rule would have little or no potential externalities outside the corporation, or that such potential externalities would not be internalized by investors in the corporation. See Hirst, *supra* note 196 (discussing the externality assumption underlying investor ordering). This seems to be a reasonable assumption: a corporation's proxy voting arrangement is unlikely to affect parties other than the corporation itself and its investors, and no such externalities were identified in comments to the Release. However, this would be for the SEC to determine in their rulemaking.

201. See, e.g., Letter from Davis Polk & Wardwell LLP, *supra* note 111, at 6; Letter from John A. Hayes, Chair, Corp. Governance Comm., Bus. Roundtable, to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n 3 (Jan. 9, 2017), <http://www.sec.gov/comments/s7-24-16/s72416-1468026-130391.pdf> [<http://perma.cc/5CWT-77HB>]; Letter from Quaadman, *supra* note 108, at 6; Letter from Darla C. Stuckey, President & CEO, Soc'y for Corp. Governance, to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n 2 (Jan. 10, 2017), <http://www.sec.gov/comments/s7-24-16/s72416-1475144-130482.pdf> [<http://perma.cc/Y63U-SEAL>].

proved costly for some corporations, those corporations would opt out of universal proxies where the cost of the universal proxy rule was greater than the (likely low) cost of opting out. As a result, if *any* corporations chose to opt out of a universal proxy rule, the rule would have greater aggregate net benefit than a mandatory rule. If universal proxies had benefits for all corporations (or costs that were less than the cost of opting out), then no corporations would opt out, and a privately ordered rule would have the same aggregate net benefit as a mandatory rule.

To be optimal, a privately ordered rule would require investor approval for corporations to opt out of universal proxies, what I refer to as “investor-ordering.” Since the incentives of managers and investors regarding a universal proxy rule may not be aligned, managers may opt out when it is in their own interests, but that may not maximize the value of the corporation. In contrast, investors not aligned with managers or dissidents will prefer to maximize the value of the corporation, so would only approve opt-outs that were value-maximizing. Since dissident investors generally hold less than 10% of the outstanding shares of the corporation,²⁰² they could influence, but not determine, the outcome of a vote to opt out of a universal proxy arrangement. Nevertheless, it may be preferable for a regulation to require that any opt-outs from universal proxy rules take place before the pendency of a proxy contest.

Implementing universal proxies by investor-ordering rather than as a mandatory rule would have two additional benefits for the SEC. First, an investor-ordered regulation would be less susceptible to judicial invalidation. Given the opposition to universal proxies from the U.S. Chamber of Commerce and the Business Roundtable, there is significant possibility that one or both organizations might challenge an SEC universal proxy rule before the D.C. Circuit. Each organization has successfully challenged SEC rules in the past,²⁰³ including a successful challenge by both organizations to the SEC’s most recent attempt at significant proxy regulation.²⁰⁴ The requirement that the SEC consider reasonable alternatives as part of its cost-benefit analysis²⁰⁵ means that it would be required to consider an investor-ordered rule. For the reasons outlined above, an investor-ordered rule will have the same or greater aggregate net benefits as a mandatory rule. If the SEC nevertheless implemented a mandatory rule, that

202. Brav et al., *supra* note 27, at 1747 (noting that the “median (maximum) percentage stake that a hedge fund takes in the target is 6.3% (9.1%)”).

203. See, e.g., Chamber of Commerce of the U.S. v. SEC, 443 F.3d 890 (D.C. Cir. 2006) (challenging SEC rulemaking requiring mutual funds to have independent directors); Chamber of Commerce of the U.S. v. SEC, 412 F.3d 133 (D.C. Cir. 2005) (same); Bus. Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990) (challenging the SEC’s decision to bar self-regulatory organizations from listing dual-class stock).

204. Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (invalidating the SEC’s proxy access rule).

205. See, e.g., Laclede Gas Co. v. FERC, 873 F.2d 1494, 1498 (D.C. Cir. 1989) (requiring an agency to consider “facially reasonable alternatives” raised by a party).

decision could be considered arbitrary and capricious, in violation of the Administrative Procedure Act.²⁰⁶

If the SEC did choose to implement an investor-ordered rule, its analysis of the potential costs of the rule would be considerably more straightforward and less open to challenge. Given the uncertainties discussed in Section IV.B, determining the costs of a mandatory universal proxy with any degree of precision is likely impossible, and the effort to do so would be an inviting target for opponents to challenge the validity of the rule.²⁰⁷ However, the cost of an investor-ordered rule would be capped at the cost of corporations opting out of the rule. This would be much easier and less costly for the SEC to ascertain.

Second, the SEC undertakes retrospective analysis of its regulations, as recommended by Executive Order 13,579²⁰⁸ and as often required by Congress.²⁰⁹ Retrospective analysis of a mandatory universal proxy rule would be important given the uncertainty of the effects of the rule. If the costs prophesied by opponents of the rule were to materialize, retrospective analysis and revision of the regulation would be the only way to avoid such costs. However, retrospective analysis of a mandatory universal proxy rule would be difficult because there would be no variation in the corporations affected by the rule. Retrospective analysis of an investor-ordered universal proxy rule would be less necessary, because if there were substantial costs, corporations would simply opt out of the rule. To the extent retrospective analysis would be valuable, it would be more straightforward for an investor-ordered universal proxy rule, as the number of corporations that had opted out of the rule would provide a ready metric of the value of the rule. A low incidence of opting out of the rule would lend legitimacy to the rule and rebut criticisms. The variation in outcomes of proxy contests at corporations that had and had not opted out would make determination of the effects of the rule more straightforward.

An investor-ordered rule would make the choice of default proxy arrangement less consequential than a mandatory rule. If corporations believe that an alternative proxy arrangement was preferable, they could opt out of the default and into the alternative arrangement.

There are reasons to believe that an arrangement permitting but not requiring a universal proxy would be sufficient. Since the outcome of an election is a zero-sum game, a universal proxy is likely to benefit one side or the other.

206. See Administrative Procedure Act, 5 U.S.C. § 706(2) (2018); *Bus. Roundtable*, 647 F.3d at 1148 (finding the SEC's failure to undertake sufficient economic analysis to be arbitrary and capricious).

207. See, e.g., *id.* at 1149 (citing, as grounds for invalidating the rule, that the SEC "failed adequately to quantify the certain costs or explain why those costs could not be quantified"); see also *Nat'l Ass'n of Mfrs. v. SEC*, 748 F.3d 359 (D.C. Cir. 2014) (challenging, in conjunction with the U.S. Chamber of Commerce, the SEC's conflict mineral rule on the grounds that it insufficiently considered the costs of the rule).

208. Exec. Order No. 13,579, 76 Fed. Reg. 41,585 (July 14, 2011).

209. The draft Financial CHOICE Act would require retrospective analysis of regulations every five years. See Financial CHOICE Act of 2017, H.R. 10, 115th Cong. §§ 315-316 (2017).

Therefore, one side or the other could be counted upon to distribute a universal proxy in every contest, and shareholders would invariably have the opportunity to use a universal proxy even though it was not required. However, there may be some uncertainty regarding the effect of a universal proxy, leading neither side to distribute a universal proxy. Alternatively, if a universal proxy advantaged a dissident, the dissident might not distribute the proxy card to all shareholders in order to reduce mailing expenses, preventing some shareholders from being able to vote on a universal proxy.

A final consideration in favor of an arrangement permitting rather than requiring universal proxies is Section 845 of the draft Financial CHOICE Act. If the provision becomes law, it would prohibit the SEC from “requiring” universal proxy cards but would not prohibit the SEC from merely permitting a universal proxy card.²¹⁰

B. Nominee Consent Policies

The draft Financial CHOICE Act and the change in control of the SEC under the Trump Administration have made the future of universal proxies much less clear. Even though the opposition to the universal proxy rule is likely misguided, it seems unlikely that the SEC Chairman appointed by President Trump, Jay Clayton, will pursue a universal proxy rule.²¹¹ In the absence of any SEC rulemaking, the bona fide nominee rule will remain in effect.

Even with the bona fide nominee rule in effect, it would be possible for universal proxies to be implemented by private ordering on a corporation-by-corporation basis. Rather than changing the bona fide nominee rule itself, corporations could implement a policy whereby all nominees consented to inclusion in all proxy statements submitted for the election, what I refer to as a “nominee consent policy.”

Corporations could require that, as a precondition for their nomination as a director, the nominee give consent to inclusion in *any* proxy statement that is submitted in connection with the election of directors at the annual meeting at which they are nominated. Such language would apply to both management nominees and dissident nominees and would permit either management or dissidents to use a universal proxy card if they wished.²¹² A nominee consent

210. *Id.* § 845.

211. Even though SEC action requires a majority vote of Commissioners, because the SEC Chairman manages the SEC staff and controls the SEC’s agenda, the Chairman has the power to prevent the SEC from taking certain actions. *See, e.g.,* Aulana L. Peters, *Independent Agencies: Government’s Scourge or Salvation Symposium: The Independence of Independent Agencies*, 1988 DUKE L.J. 286, 288.

212. In two recent proxy contests, management have attempted to construe statements in questionnaires that dissident nominees are required to submit to the corporation as consent for the dissident nominee to be included on the management proxy card, although one such attempt was withdrawn after being challenged by the dissident. *See* Andrew M. Freedman, *Trap for the Unwary Shareholder Activist: The Latest Tactic by Companies To Tilt the Playing Field in Proxy Contests*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 6, 2017), <http://corpgov.law.harvard.edu/2017/07>

policy could be a bylaw of the corporation or even included in the corporation's charter. If a contest arose in which a universal proxy might favor the dissident, managers may be tempted to amend the nominee consent policy, which they could generally do if the policy were a bylaw of the corporation.²¹³ To forestall this possibility, the nominee consent policy provision should either provide that it cannot be repealed without a vote of the shareholders of the corporation, or be included in the corporation's charter, which would have the same effect.

Since a nominee consent policy was first suggested in earlier drafts of this Article one company has adopted a nominee consent policy. Mellanox Technologies, Ltd. approved an amendment to the company's charter²¹⁴ that requires any shareholders putting forward nominees for election to provide the consent of each nominee to be named in any proxy card for the company's next shareholder meeting.²¹⁵ The charter of the corporation also *requires* each side in a contested election to use a universal proxy card.²¹⁶

Without SEC action, nominee consent policies could only be implemented on a corporation-by-corporation basis. Directors of corporations could adopt a bylaw amendment incorporating the universal proxy consent policy. Directors that accept the results presented in Part III showing that a universal proxy card could more often favor managers might be incentivized to adopt such nominee consent policies. However, there are reasons to believe that directors may not be willing to implement these policies unprompted. Managers may prefer to maintain the status quo arrangement, either because of uncertainty about the likely effects of a universal proxy, or from an aversion to being an early-adopter of a universal proxy. Since a nominee consent policy would only have any effect on the corporation in the event of a proxy contest, adopting a nominee consent policy may be interpreted as implying that directors believe that there is a

/06/trap-for-the-unwary-shareholder-activist-the-latest-tactic-by-companies-to-tilt-the-playing-field-in-proxy-contests [http://perma.cc/92FJ-VHYT].

213. In most corporations, directors have the power to amend bylaws of the corporation. A question might arise whether such amendment would be prohibited as being an unreasonable impedance on stockholder voting. *See, e.g.,* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988) (imposing a heavy burden of demonstrating a compelling justification for actions done with the primary purpose of impeding the exercise of stockholder voting power).

214. Since Mellanox is an Israeli company, the amendments are to its articles of association, which are akin to the certificate of incorporation of a U.S. corporation. *See* Mellanox Technologies, Ltd., Definitive Proxy Statement (Schedule 14A), at 2 (May 7, 2018).

215. *Id.* at 32-35 (requiring shareholders putting forward nominees to provide "the consent of each nominee to be named as a nominee for election as a Director of the Company in any proxy statement or proxy, intermediary instruction form or written ballot (each a 'proxy card') relating to the Company's next Annual General Meeting or Extraordinary General Meeting at which Directors are to be elected").

216. *Id.* at 34 (requiring that, "in the event of a contested election, each proxy card used in connection with the election of Directors of the Company . . . shall (A) set forth the names of (I) all persons nominated for election by the Board of Directors and (II) all persons with respect to whom a written notice of a shareholder's intent to make a nomination for election as a Director at such meeting has been given . . ."). The amendment requires that the universal proxy distinguish between the management nominees and the dissident nominees and group them as such; to list the nominees in alphabetical order within each group; and to use the same font for all nominees. *Id.*

significant likelihood of an activist intervening in the corporation and potentially commencing a proxy contest.

Nominee consent policies could also be initiated by investors. Investors could submit a shareholder proposal pursuant to Rule 14a-8²¹⁷ that would request that directors implement a nominee consent policy. While such proposals are merely precatory and do not require directors to follow the request of shareholders, there is considerable pressure on directors to follow successful precatory proposals.²¹⁸ Precatory proposals have led to widespread changes on other corporate governance proposals, such as majority voting,²¹⁹ board declassification,²²⁰ and proxy access.²²¹ An example of a precatory resolution to implement a nominee consent policy is included in the Appendix.

If precatory proposals proved insufficient, investors could put forward bylaw amendment proposals. In the past, some directors have demurred from implementing precatory proposals even after they receive significant majorities on multiple occasions.²²² For other precatory proposals, directors might implement a version of the requested policy with details that make it much less restrictive, although nominee consent policies are difficult to narrow. If successful, bylaw amendment proposals have the advantage of taking effect without requiring further action by directors. Bylaw amendment proposals are more complicated and therefore costlier to prepare and submit than precatory proposals and may receive lower levels of investor support than precatory proposals.²²³ They have therefore rarely been used in the past.²²⁴ Bylaw amendment proposals would be better submitted in the few cases where directors refuse to implement precatory proposals recommending universal proxy consent policies. An example of a bylaw amendment resolution to implement a nominee consent policy is included in the Appendix.

217. 17 C.F.R. § 240.14a-8 (2017).

218. See Scott Hirst, *Social Responsibility Resolutions*, 43 J. CORP. L. 217, 239 (2018) (discussing the pressure for directors to follow the wishes of a majority of their shareholders). In addition, directors not following such proposals are likely to have substantially higher levels of withheld votes at subsequent elections, which directors prefer to avoid. See Ertimur et al., *supra* note 54 (manuscript at 7) (documenting an average of 29.79% votes withheld for lack of board responsiveness to a successful precatory shareholder proposal).

219. Choi et al., *supra* note 40.

220. Lucian Bebchuk et al., *Towards the Declassification of S&P 500 Boards*, 3 HARV. BUS. L. REV. 157 (2013).

221. Tara Bhandari et al., *Governance Changes through Shareholder Initiatives: The Case of Proxy Access* (Fourth Annual Conference on Fin. Mkt. Regulation 2017), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2635695 [<http://perma.cc/VT7Z-D77E>].

222. The results of board declassification proposals described in Bebchuk et al., *supra* note 220, at 167, show a number of corporations that failed to implement board declassifications despite multiple successful shareholder proposals recommending the action.

223. Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 341 (2010).

224. *Id.* at 340 (describing evidence that only twelve bylaw amendment proposals were voted on within a five-year period).

Investor-initiated adoption of nominated consent policies would be a significantly inferior second-best alternative to SEC rulemaking. Resource constraints on the part of many investors and agency costs on the part of others are likely to lead to under-initiation of nominee consent policies by investors. While such policies would likely be valuable at the great majority of corporations, investor initiation would only lead to some limited proportion adopting the policy, and it would take considerable time and duplication of effort to do so.²²⁵ In contrast, SEC regulation has economies of scale: it could change the default arrangement for all corporations, all at once.

Investor-initiated adoption of nominee consent policies would nonetheless be valuable, and not just for its effects at particular corporations. Such adoptions would signal to the SEC that there was considerable investor support for a change from the current proxy rules. In the past, investor-initiated changes to executive compensation led to SEC action on the topic. If—or when—a proxy contest took place at a corporation that had adopted a nominee consent policy, the outcome of the contest would provide further evidence for the effects of universal proxies.

Conclusion

Contested director elections are a key feature of the corporate landscape. However, the current proxy voting rules can prevent shareholders from choosing the mix of nominees that they prefer in a contested election. This Article shows that this can lead to distortions in proxy contest outcomes: different directors being elected than a plurality of shareholders would prefer. These may be either distortions between the two sides in the contest, within sides, or both.

Universal proxies would allow shareholders to vote for the mix of nominees they prefer and eliminate the possibility of distortions. However, a proposed universal proxy regulation has been met with significant opposition. Both sides of this debate have suffered from a lack of evidence about the extent of distortions and the likely effects of a universal proxy rule.

This Article provides empirical evidence of the extent of distortions and the likely effects of a proposed universal proxy regulation that would address the problem. The analysis shows that distorted outcomes are a real and practical problem. As many as 15% of proxy contests between 2001 and 2016 may have had distorted outcomes. Seven percent of proxy contests during that period, and 10% of contests at large corporations, can be expected to have had distorted outcomes.

This analysis permits further inferences that illuminate the debate over a universal proxy rule. Contrary to claims made by opponents of universal proxies, there is no evidence that a universal proxy rule would favor dissidents. If anything, a universal proxy rule may slightly favor management nominees.

225. See, e.g., Michal Barzuza, *The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. (forthcoming 2018).

Because proxy contests are initiated by dissidents, a universal proxy contest is unlikely to lead to additional proxy contests.

The significant incidence of potential distortions within sides suggests that a universal proxy rule may result in greater focus on the actual nominees, rather than just the sides proposing them. The evidence presented in this Article shows that the significant benefits of universal proxies in eliminating distortions would outweigh the possible costs foreseen by some commentators, which are unlikely to eventuate.

In contrast to the SEC's proposed mandatory rule, universal proxies would be best implemented as an investor-ordered rule that would set an arrangement permitting or requiring universal proxies as a default and permit corporations to opt out of the arrangement by a shareholder vote. If the SEC fails to implement a universal proxy regulation, a second-best solution is available through private ordering. Corporations or investors could initiate bylaw amendments implementing nominee consent policies, which would require nominees to consent to inclusion on other proxy statements for contested elections. Whether implemented by SEC regulation or by private ordering, universal proxy arrangements would have important benefits for corporations and investors by eliminating distortions in proxy contest outcomes.

Appendix: Model Nominee Consent Resolutions

A. Precatory Nominee Consent Policy Resolution

RESOLVED, that the shareholders of [Corporation] urge the Board of Directors to take all necessary steps to implement a nominee consent policy, whereby all nominees for election as directors of the corporation at a meeting of shareholders shall be required to consent to their inclusion in any proxy statement filed with the Securities and Exchange Commission regarding election of nominees at that meeting of shareholders.

B. Nominee Consent Policy Bylaw Amendment Resolution

RESOLVED, that the bylaws of [Corporation] are hereby amended to add [Section __] as follows:

No person may be appointed as a director or nominated for election as a director unless that person has submitted to the secretary of the corporation their consent, in writing, to their inclusion in any proxy statement filed with the Securities and Exchange Commission for the purpose of soliciting proxies for a meeting at which the person is a nominee for election as a director.