

# The Giant Shadow of Corporate Gadflies

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## ABSTRACT

*Modern-day shareholders exert their influence on corporate America more than ever before. From demanding greater accountability of executives to lobbying for a variety of social and environmental policies, shareholders today have the power to alter the way American companies are run. Amazingly, a small group of individual shareholders wields unprecedented power to set these agendas and stands at the epicenter of our contemporary corporate governance ecosystem. In fact, their power continues to rise. They are called the “corporate gadflies.”*

*Corporate gadflies present a puzzling reality. While public corporations in the United States are increasingly owned by large institutional investors, much of their corporate governance agenda has been dominated by a handful of individuals who own tiny slivers of most large companies. How does an economy with corporate equity in the trillions of dollars cede such governance power to corporate gadflies? More importantly, should it? Surprisingly, scholars have paid little attention to the role of corporate gadflies in this ever changing governance landscape.*

*This Article is the first to address the giant shadow that corporate gadflies cast on the U.S. corporate governance landscape. The Article makes three contributions to the corporate governance literature. First, it provides a detailed empirical account both of the growing power and influence that corporate gadflies wield over major corporate issues and of their power to set governance agendas. It does so through a comprehensive dataset of all shareholder proposals submitted to the S&P 1500 companies from 2005 to 2018. Second, the Article uses the context of corporate gadflies to illuminate a key governance debate—the role of large institutional investors in corporate governance. Specifically, the Article underscores the potential concerns that corporate gadflies present and questions the current deference of institutional investors to these gadflies regarding the submission of shareholder proposals. Finally, the Article presents policy reforms aimed at reframing the current discourse on shareholder proposals to potentially spark a new line of inquiry regarding the role of investors in corporate governance.*

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“Power is greater than love, and I did not get where I am by standing in line, nor by being shy.”

-Evelyn Davis

### Introduction

About fifteen blocks from Hermosa Beach, in a quaint 1970s, two-story, twelve-unit apartment building, on a nondescript block of Nelson Avenue, resides one of the most prolific actors in corporate governance.<sup>1</sup> Neither a CEO, nor a well-connected board member of a high-performing corporation, the former Hughes Aircraft employee now saves money by walking or taking public transportation to shareholder meetings.<sup>2</sup> His name is John Chevedden, and he is the leading proponent of shareholder proposals annually in the United States: a corporate gadfly.

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<sup>1</sup> Ross Kerber, *Special Report: Economy-class Activists Investor Crashes the Corporate Party*, REUTERS (Oct. 23, 2013), <https://www.reuters.com/article/us-activist-chevedden-special-report/special-report-economy-class-activist-investor-crashes-the-corporate-party>.

<sup>2</sup> *Id.*

Chevedden was long joined by “the queen of the corporate jungle,” Ms. Evelyn Davis. Davis, who recently passed away, was another unconventional, yet integral player in corporate governance.<sup>3</sup> Davis attended shareholder meetings in outlandish costumes to garner attention throughout her fifty-year tenure as a corporate gadfly.<sup>4</sup> Maintaining the minimum threshold of at least \$2,000 in shares in upwards of eighty companies at a time, she attended as many as 50 meetings a year to argue in support of her shareholder proposals.<sup>5</sup> Davis, like Chevedden, became infamous among corporate executives through her successful proposals to prominent companies like General Motors.<sup>6</sup> The persistence and vigor with which these “Main Street” individuals wage their battles with America’s marquee corporations has earned them the nickname of corporate gadflies—for the nuisance they made of themselves.<sup>7</sup>

In the past, gadflies were perceived as a mere inconvenience. But with the rise of power shareholders wield in corporate America and the increased accumulation of equity capital by a handful of large institutional investors, what role do gadflies play today? We use a comprehensive dataset of shareholder proposals to explore the *existing* role of corporate gadflies in shaping the governance terms of large U.S. public companies. Contrary to what their nickname might imply, our data shows that corporate gadflies have become much more than a mere nuisance. If anything, they might be best equated to Mohamad Ali’s “float like a butterfly, sting like a bee” metaphor.<sup>8</sup>

Indeed, over the last decade, corporate gadflies have evolved to hold an important role in setting the U.S. corporate governance discourse.<sup>9</sup> Our data demonstrate that a large and growing fraction of all shareholders proposals in the S&P 1500 are submitted by a handful of gadflies. In 2018, five individuals accounted for

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<sup>3</sup> Emily Flitter, *Evelyn Y. Davis, Shareholder Scourge of C.E.O.s, Dies at 89*, N.Y. TIMES (Nov. 7, 2018), <https://www.nytimes.com/2018/11/07/business/evelyn-davis-dead.html>.

<sup>4</sup> *Id.*

<sup>5</sup> Laurence Arnold, *Evelyn Davis, Queen of Shareholder Activism, Dies at 89*, BLOOMBERG (Nov. 5, 2018), <https://www.bloomberg.com/news/articles/2018-11-05/evelyn-davis-feisty-queen-of-shareholder-activism-dies-at-89>. According to Rule 14(a)(8), an individual shareholder can submit a shareholder proposal if they continuously hold at least \$2,000, in market value, or 1% of the company’s voting stock for at least one year prior to the shareholder meeting. 17 C.F.R. § 240.14a-8(b) (2018).

<sup>6</sup> *Supra* note 5.

<sup>7</sup> See *infra* notes 90-91, and accompanying text.

<sup>8</sup> Hilary Witeman, ‘Float Like a Butterfly, Sting Like a Bee’: Best Quotes from Muhammad Ali, CNN (June 5, 2016), <https://www.cnn.com/2016/06/04/sport/best-quotes-muhammad-ali/index.html>.

<sup>9</sup> Matteo Tonello, *Shareholder Voting in the United States: Trends and Statistics on the 2015-2018 Proxy Season*, HARV. L. SCH. F. CORP. GOV. & FIN. REG. (Nov. 26, 2019). See also *infra* Section I.C.

close to 40% of all shareholder proposals submitted to S&P 1500 companies.<sup>10</sup> More importantly, gadflies do not tend to focus on esoteric topics but rather on mainstream governance proposals that attract strong shareholder support and accordingly cannot be ignored by management. In 2018, for example, close to 80% of the proposals submitted by gadflies related to shareholder rights, and gadflies submitted over 53% of the proposals that received a majority of shareholder support in the S&P 1500.<sup>11</sup> Gadflies' activity is no longer marginal. They have grown to cast a giant shadow over corporate America.

Importantly, shareholder proposals, including those submitted by gadflies, are not merely symbolic. These proposals are official requests, submitted to a shareholder vote, asking that the company take a specific action, such as implementing a change to the company's corporate governance or environmental practices.<sup>12</sup> They often lead to tangible results, prompting many corporations to act upon these proposals.<sup>13</sup> For example, one gadfly successfully convinced the CEO of Coca-Cola to forego a lavish restricted stock grant, and another pushed Abbott Laboratories to generate a non-GMO version of Similac (an infant formula).<sup>14</sup> More generally, our data also show that when gadflies' proposals receive majority support, they are followed by a management proposal to amend the company's governance terms in 64.5% of the applicable cases, and the vast majority of these management proposals (82%) eventually passed and resulted in an actual governance change.

The dominance of gadflies in the shareholder proposal arena is remarkable. Particularly so, considering that in almost every other aspect of corporate America, small retail investors have ceded power to large institutional investors, hedge funds, and the uber-rich. In fact, many retail investors don't even vote.<sup>15</sup> Yet, corporate

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<sup>10</sup> Using the SharkRepellent dataset, we collected, coded and sorted detailed data on all shareholders' proposals submitted to the S&P 1500 companies from 2005 to 2018. Data file is with the authors. *See also infra* Section I.A.2.

<sup>11</sup> *See supra* Figure 5 (providing data on gadflies share in submitted proposals and passage rates).

<sup>12</sup> Shareholder proposals are governed by Rule 14a-8 of the Securities Exchange Act of 1934, which permits shareholders to force the company to include a resolution in its own proxy materials subject to certain requirements. 17 C.F.R. § 240.14a-8 (2008).

<sup>13</sup> David Larcker & Brian Tayan, *Why Do Individual Investors Sponsor Proxy Resolutions?*, COLUM. L. SCH.: THE CLS BLUE SKY BLOG (Aug. 30, 2016), <http://clsbluesky.law.columbia.edu/2016/08/30/gadflies-at-the-gate-why-do-individual-investors-sponsor-proxy-resolutions/>.

<sup>14</sup> *Id.*

<sup>15</sup> *See, e.g.*, Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55 (2016); Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11 (2017).

gadflies have been gaining power, not losing it, in the corporate governance sphere and persistently continue to dominate the shareholder proposal market. This is despite the fact that they generally do not own more than a few thousand dollars of equity in each company and do not stand to economically benefit from their actions in a meaningful way.<sup>16</sup> At the same time, corporations' largest institutional investors—the Titans of Wall Street—that are better positioned than any other shareholders to set market-wide governance standards refrain from submitting shareholder proposals. In fact, these funds failed to submit a single shareholder proposal in the past decade.<sup>17</sup>

Gadflies' dominance is also puzzling. Why is a key governance tool with vast implications for corporate America largely controlled by “Main Street” retail investors, and why have large institutional investors—who are best positioned to effectuate change—not leveraged their voice in the same manner? Most importantly, can and should we trust these individuals, who hold small fractions of the corporations to which they submit proposals, to safeguard the interests of investors and our economy?

To answer these questions, one must first understand how shareholder proposals have become a primary avenue for shareholder involvement in corporate America.<sup>18</sup> Shareholder proposals are generally brought to a non-binding shareholder vote during the annual meeting. However, important market developments over the past two decades have transformed those so-called “precatory” proposals into “quasi-binding” resolutions. In particular, companies face significant risk of shareholder backlash if they ignore a shareholder proposal that receives majority support.<sup>19</sup>

This dynamic has created a new governance ecosystem. Our empirical evidence shows that gadflies initiate shareholder proposals focused mostly on governance terms that institutional investors and proxy advisors publicly endorse in their guidelines. Once such a proposal is included in the company ballot, many large institutional investors support these initiatives. Indeed, gadflies' governance-related

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<sup>16</sup> Although dominant, corporate gadflies are not alone in submitting proposals. Joining them are labor unions and religious and charitable organizations, who seek to influence the corporations in which they invest. For a comprehensive analysis of shareholder proposals by labor union and pension funds, see DAVID WEBBER, *THE RISE OF THE WORKING-CLASS SHAREHOLDER*, 74–126 (2018).

<sup>17</sup> See *infra* note 118.

<sup>18</sup> Kosmas Papadopoulos, *The Long View: The Role of Shareholder Proposals in Shaping U.S. Corporate Governance (2000-2018)*, HARV. L. SCH. F. CORP. GOV. & FIN. REG. (Feb. 6, 2019) <https://corpgov.law.harvard.edu/2019/02/06/the-long-view-the-role-of-shareholder-proposals-in-shaping-u-s-corporate-governance-2000-2018/>. See also *infra* Section I.B.

<sup>19</sup> See, e.g., Kastiel & Nili, *supra* note 15; Paul Rose, *Shareholder Proposals in the Market for Corporate Influence*, 66 FLA. L. REV. 2179 (2014).

proposals attracted, on average, 47.8% shareholder support between 2005 and 2018. When a shareholder proposal has passed—by receiving a majority of the votes—or comes close to passing, it is likely to lead to a change in company policy. Otherwise, proxy advisory firms are likely to recommend voting against individual directors (or the entire board), potentially subjecting the directors to withhold campaigns that are embarrassing or can result in their defeat or resignation.<sup>20</sup> Gadflies thus operate in this system as “governance facilitators”, translating universal governance guidelines into company-specific governance changes.

However, the power of shareholder proposals and of those who submit them—like gadflies—does not come without its costs. While most proposals address major governance issues,<sup>21</sup> others contain capricious, perhaps comical, requests that reflect the ease by which one can submit proposals. For example, in 2012, Nomura, a Japanese Financial Holding Company listed in the United States, faced several obscure proposals submitted by an individual shareholder.<sup>22</sup> One proposal stipulated a revision that the articles of incorporation state: “all toilets within the company’s offices shall be Japanese-style toilets, thereby toughening the legs and loins and hunkering down on a daily basis, aiming at achieving 4-digit stock prices.”<sup>23</sup> Likewise, in 2005, Proctor & Gamble faced a proposal from a 0.0001% shareholder in the company that recommended Proctor & Gamble sell the company based on the premise that the stock prices had not increased at the same rate as housing prices, which he believed was a result of an increase in “feminist careerism.”<sup>24</sup>

Furthermore, a closer examination of gadflies and their current role exposes the fragility of the existing ecosystem, which heavily relies on a handful of individuals to initiate market-wide governance changes through the submission of shareholder proposals. We show why gadflies cannot, and should not, provide a systemic solution to the lack of institutional investors' involvement in the submission of shareholder

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<sup>20</sup> See Cathy Hwang & Yaron Nili, *Shadow Governance*, 108 CAL. L. REV. (forthcoming 2020) (demonstrating how shareholder input leads to tangible changes in governance documents); Yonca Ertimur, Fabrizio Ferri & Stephen R. Stubben, *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53 (2010) (providing empirical evidence that managers and directors who ignore majority vote shareholder proposals are more likely to face sanctions in the labor market). See also *infra* notes 147-151.

<sup>21</sup> Subodh Mishra, *An Early Look at 2019 US Shareholder Proposals*, HARV. L. SCH. F. CORP. GOV. & FIN. REG. (Mar. 5, 2019), <https://corpgov.law.harvard.edu/2019/03/05/an-early-look-at-2019-us-shareholder-proposals/>.

<sup>22</sup> Nomura, Report of Foreign Private Issuer (Form 6-K), at 18 (2012).

<sup>23</sup> *Id.*

<sup>24</sup> Proctor & Gamble, Annual Report (Form 10-K), at 37 (2005).

proposals. Gadflies face important structural limitations that restrict their ability to explore the shareholder proposal mechanism to its fullest: they operate on a voluntary basis, have limited resources, and lack an institutional body of knowledge that will ensure the succession of their project. What happens when this handful of players—most of whom are already in their 70s—gets tired or pass away? The answer is unclear.

Finally, and most importantly, gadflies' activity is under attack. As gadflies gained traction, public corporations and their lobbyists began to push back against them by strongly advocating for revised rules regulating the submission of shareholder proposals. These lobbying efforts began to show signs of success in November 2019 when the Securities and Exchange Commission ("SEC") proposed amendments to the rules governing shareholder proposals that could severely limit the ability of gadflies to engage in the submission of shareholder proposals. These new rules could result in a dramatic decline in the number of shareholder proposals.<sup>25</sup> Therefore, understanding gadflies' role is particularly important in light of these regulatory developments.

This Article makes several contributions to the literature. First, it is the first to provide a detailed empirical account of the growing influence that corporate gadflies wield on major corporate issues and on their power to set governance agendas. It does so through an original dataset on all shareholder proposals between the years 2005-2018 for 1,500 major, publicly-traded American companies that reveals the staggering power that a handful of individuals hold on the shareholder proposals arena.<sup>26</sup> Second, the Article uses the context of corporate gadflies to illuminate a key governance debate—the role that large institutional investors take (or refrain from taking) in corporate governance.<sup>27</sup> Specifically, the Article underscores the potential concerns that corporate gadflies present and questions the current deference of institutional investors to these gadflies. Finally, the Article explores several policy reforms aimed

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<sup>25</sup> See *infra* notes 212-213.

<sup>26</sup> This Article gathers data from companies listed in Standard & Poor's 1500 list (the "S&P 1500"). The S&P U.S. Indices are a family of equity indices designed to measure the market performance of U.S. stocks trading on U.S. exchanges. The indices are weighted by float-adjusted market capitalization and require unadjusted company market capitalization of \$6.1 billion or more for the S&P 500, \$1.6 billion to \$6.8 billion for the S&P MidCap 400, and \$450 million to \$2.1 billion for the S&P SmallCap 600. Together these three indices comprise the S&P 1500. See S&P Composite 1500, S&P DOW JONES INDICES, <https://us.spindices.com/indices/equity/sp-composite-1500>.

<sup>27</sup> For recent works in this hotly-debated literature, see Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV., 1, 44 (2019); John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve*, SSRN Scholarly Paper ID 3247337 (Social Science Research Network), Mar. 14, 2019; Jill E. Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Pas Investors*, U. PA. L. REV. (2019) (forthcoming); Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, SSRN Scholarly Paper ID 3295098 (Social Science Research Network), Apr. 6, 2019.

at increasing the input of all investors into the shareholder proposal mechanism to reduce the system's reliance on gadflies.

This Article proceeds as follows. Part I provides a rich and textured overview—the literature's first—on corporate gadflies. It also shows empirically both the dominance of corporate gadflies and the absence of many institutional investors from the shareholder proposal playing field. This Part also reveals the different mechanisms through which gadflies exercise their power to set the agenda of large public companies. Part II explains why, despite the relative virtue of gadflies, large shareholders' current reliance on gadflies is troubling. It also shows how gadflies may now be especially deterred by the regulatory backlash their activity generates.

Part III discusses the policy implications of our analysis. After analyzing and criticizing the recent SEC proposed reform in light of the Article's findings, this Part proceeds to offer novel solutions to further foster the shareholder proposal mechanism in a manner that would disarm the concerns raised in Part II. In particular, we suggest a reconceptualization of the way shareholder proposals get to the ballot by enabling the use of "professional filers" or by automatically bringing the most important and popular governance-related shareholder proposals to a shareholder vote periodically. This would eliminate the dependence on a handful of individual proponents. As a result, proposals that large investors support, many of which are not currently being submitted in a timely manner, will be included in the company's ballot. The Article's proposals also aim to reframe the current discourse by academics, investors and regulators regarding the proper role of the shareholder proposal tool in the greater evolving governance landscape. While some regulators and companies have been focusing their efforts at restricting the ability of individual investors to submit shareholder proposals,<sup>28</sup> this Article offers a more holistic approach to this issue with the potential to spark a new line of inquiry into the role of investors in corporate governance.

## **I. The Growing Importance of Corporate Gadflies**

Historically, shareholders paid little attention to corporate governance and often deferred to the decisions of management.<sup>29</sup> In 1957, for example, only twelve out of three thousand publicly traded companies faced a proxy contest.<sup>30</sup> Similarly, the

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<sup>28</sup> See *infra* Section II.C.

<sup>29</sup> See e.g., Paul H. Edelman et. al., *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1402 (2014).

<sup>30</sup> Arren S. De Wied, *Proxy Contests*, FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP (2018) [https://www.friedfrank.com/siteFiles/Publications/Proxy%20Contests%20\(6-503-6878\).pdf](https://www.friedfrank.com/siteFiles/Publications/Proxy%20Contests%20(6-503-6878).pdf) ("A proxy



tool of shareholder proposals, although intended to augment the existing powers of shareholders at the time,<sup>31</sup> initially generated little force.<sup>32</sup> Indeed, it was long thought that shareholder proposals did not have much of an effect.<sup>33</sup>

This is no longer the case. The once “largely inconsequential” role of shareholder vote has evolved into one of power and influence.<sup>34</sup> The increased power in the hands of shareholders has afforded them greater input on the appointment and retention of executives, the make-up and role of the board, the social role of the corporation, the payment of special dividends, or even the dissolution of the corporation.<sup>35</sup> In 2018 alone, there were 268 shareholder campaigns to replace board members<sup>36</sup> and 788 shareholder proposals.<sup>37</sup> And as prominent scholars observe: “[n]ever has voting been more important in corporate law.”<sup>38</sup>

Corporate gadflies are one of the most ubiquitous manifestations of this paradigm shift. Remarkably, a mere *five* individual investors account for close to 40% of the shareholder proposals submitted last year in the S&P 1500.<sup>39</sup> Not only do they

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contest is a campaign to solicit votes (or proxies) in opposition to management at an annual or special meeting of stockholders or through action by written consent.”). See also John Lovullo, *Proxy Contests on the Rise - Activists Emboldened by Success*, LEVICK DAILY (Oct. 28, 2013), <http://news.boardprospects.com/articles/527825/proxy-contests-on-the-rise-activists-emboldened-by>; Harwell Wells, *A Long View of Shareholder Power: From the Antebellum Corporation to the Twenty-First Century*, 67 FLA. L. REV. 1033, 1077.

<sup>31</sup> See Bayless Manning, *Livingston: The American Stockholder*, 67 YALE L.J. 1477, 1483 (1958) (noting the powers shareholder held, such as suing management, attempting to oust management, and selling shares, without referring to the ability to submit shareholder proposals).

<sup>32</sup> *Id.*

<sup>33</sup> Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 177 (2001).

<sup>34</sup> See, e.g., Kobi Kastiel & Yaron Nili, *The Market for Votes*, 10 HARV. BUS. L. REV. (forthcoming, 2020) (manuscript on file with the authors), at 3.

<sup>35</sup> Wells, *supra* note 30, at 1077.

<sup>36</sup> *Review and Analysis of 2018 U.S. Shareholder Activism*, SULLIVAN & CROMWELL LLP (Mar. 14, 2019) <https://www.sullcrom.com/files/upload/SC-Publication-SandC-MnA-2018-US-Shareholder-Activism-Analysis.pdf>. See also Ronald Orol, *Activist Spotlight: 2018 by the Numbers*, THE STREET (June 6, 2018), <https://www.thestreet.com/investing/funds/activist-spotlight-2018-by-the-numbers-14613743>.

<sup>37</sup> Ron Mueller, Beth Ising, & Aaron Briggs, *Shareholder Proposal Developments During the 2018 Proxy Season*, HARV. L. SCH. F. CORP. GOV. & FIN. REG. (Aug. 2, 2018) <https://corpgov.law.harvard.edu/2018/08/02/shareholder-proposal-developments-during-the-2018-proxy-season/>.

<sup>38</sup> Marcel Kahan & Edward B. Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L. J. 1227, 1227 (2008).

<sup>39</sup> See *infra* Figure 3.

dominate shareholder proposal submissions, the proposals they submit also experience much higher passage rates than more sophisticated and resource-rich investors.<sup>40</sup> Their actions also have real impact on companies.

This Part provides a detailed account of corporate gadflies' growing importance to the current governance landscape. We start by analyzing the source behind the increasing importance of the shareholder proposal as a key tool to effectuate governance changes. We then move to gadflies and provide novel empirical data on how these main street investors were able to gain so much influence in corporate America. Then, we highlight the key role of gadflies in the current governance ecosystem and the positive externalities that they generate compared to other investors.

A. *The Significance of Shareholder Proposals*

1. The Evolution of Shareholder Proposals

Shareholder proposals allow shareholders to bring specific matters that relate to the company's governance and other significant issues to a vote at the company's annual meeting. These proposals are most often only advisory, asking the company to act on a specific matter of import to shareholders.<sup>41</sup> The key allure of the shareholder proposal route is the ability to include the proposal in the company's meeting materials (the proxy statement), therefore incurring almost no direct costs.

While nowadays shareholder proposals are common and powerful tools, it was not until the mid-1900s that shareholder engagement through the mechanism of shareholder proposals began to resemble its modern framework.<sup>42</sup> In 1942, the SEC adopted the initial version of what is now Rule 14a-8.<sup>43</sup> This rule stipulated that corporations must include the written proposals of "any qualified security holder"<sup>44</sup> in their proxies and created what are now widely recognized as shareholder proposals.<sup>45</sup>

Civil rights activists were among the first to use this tool, as they saw it as a way to gain access to the annual meetings of national chains during the fight for desegregation.<sup>46</sup> Civil rights activists utilized the tool as a step beyond consumer

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<sup>40</sup> See *infra* Part I.C.

<sup>41</sup> Rule 14a-8.

<sup>42</sup> See generally Wells, *supra* note 30 (noting the development of shareholder power over time).

<sup>43</sup> *Id.*

<sup>44</sup> Exchange Act Release No. 3347 (Dec. 11, 1942).

<sup>45</sup> Wells, *supra* note 30.

<sup>46</sup> Sarah C. Haan, *Civil Rights and Shareholder Activism: SEC v. Medical Committee for Human Rights*, 67 WASH. & LEE L. REV. 1167, 1214–15 (2019) (discussing how one activist was even able to use a single share of stock in W.T. Grant to successfully demand the company desegregate its lunch counters in Baltimore).

protests and boycotts to effectuate change in a company, but they saw varying degrees of success.<sup>47</sup> In this phase of shareholder activism, proponents quickly learned that “the procedures of corporate democracy worked slowly: unless you could marshal the holders of a significant amount of stock, the process played out over a year-long cycle which offered a single opportunity for the expression of shareholder voice.”<sup>48</sup>

Shareholder proposals are not without limits. Securities regulations limit who can submit proposals and their content. Under the current version of Rule 14a-8, the prerequisites to submit a shareholder proposal are relatively nominal: for at least one year, the shareholder must have continuously held at least \$2,000 in market value or 1% of the company’s voting stock, whichever is lower.<sup>49</sup> The shareholder must continue to hold this amount of stock through the date of the meeting during which the proposal is presented.<sup>50</sup> Each shareholder is limited to one proposal at each company’s shareholders’ meeting, and proposals cannot exceed 500 words.

After a shareholder submits a proposal, the proposal faces three potential outcomes: (1) the corporation may allow it to appear on the ballot for a shareholder vote, (2) the proponent may withdraw the proposal after negotiation with the company, or (3) the company may omit proposal from the ballot after receiving a no-action letter from the SEC.<sup>51</sup> The majority of shareholder proposals are precatory in nature, meaning the corporation is under no obligation to adopt the proposal if it passes.<sup>52</sup>

## 2. The Growing Prevalence of Shareholder Proposals

### a. Methodology

Before discussing findings, it is helpful to provide a few brief notes about methodology. Using the SharkRepellent dataset, we collected and hand-coded information on all shareholder proposals submitted between 2005 and 2018 to the S&P 1500 companies. While the data includes any proposal that was included in the company proxy (whether voted on or not), it does not include withdrawn proposals (due to negotiated agreement or otherwise). For each proposal we identified and coded

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<sup>47</sup> *Id.* (outlining and contextualizing Medical Committee for Human Rights’ battle to include its anti-napalm production proposal on Dow Chemical Company’s annual proxy in the 1960s).

<sup>48</sup> *Id.* at 1218.

<sup>49</sup> *See supra* note 5; Kastiel & Nili, *supra* note 34, at 25 n.123.

<sup>50</sup> *Id.* at 40.

<sup>51</sup> *See* Papadopoulos *supra* note 18 (discussing how when a stockholder presents proposals to the boards, the default rule is that such proposals shall be included in the proxy unless the board of the subject company has a legitimate reason to exclude the proposal).

<sup>52</sup> EY CENTER FOR BOARD MATTERS, 2018 PROXY SEASON REVIEW (July 2018) at 4, <https://www.ey.com/Publication/vwLUAssets/EY-cbm-proxy-season-review-2018/> (“At 50% support, if the board is deemed to take insufficient action in response, many investors will consider voting against incumbent directors at the next annual meeting.”).

the company, its market size, the topic of the proposal, the proponent, management recommendation and the outcome of the proposal including specific support rates. We omitted any proposals for the election of specific directors. Our overall sample includes 6,827 shareholder proposals during the sample period.

b. Recent Trends

Notwithstanding the limitations of shareholder proposals, the ability to submit shareholder proposals at low costs coupled with the increased attention to these proposals is reflected in the frequent use of these proposals. Our data reveal several important observations regarding the frequency of shareholder proposals. First, as Figure 1 below shows, there has been a relatively steady and solid number of shareholder proposals submitted to S&P 1500 during that period (an average of 517 proposals per year).

Figure 1: Submitted Shareholder Proposals Over Time in the S&P 1500

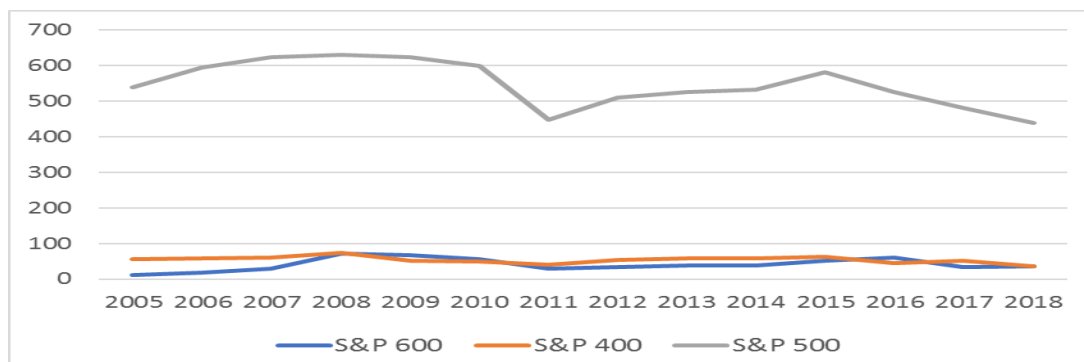


Figure 1 also demonstrates that larger companies received the majority of proposals, likely because these companies receive wide press coverage. For instance, in 2015, over 450 proposals were submitted to the S&P 500 companies, which is comprised of large cap companies. The mid and small cap companies that comprise the S&P 400 and 600, respectively, however, saw less than 150 shareholder proposals combined.

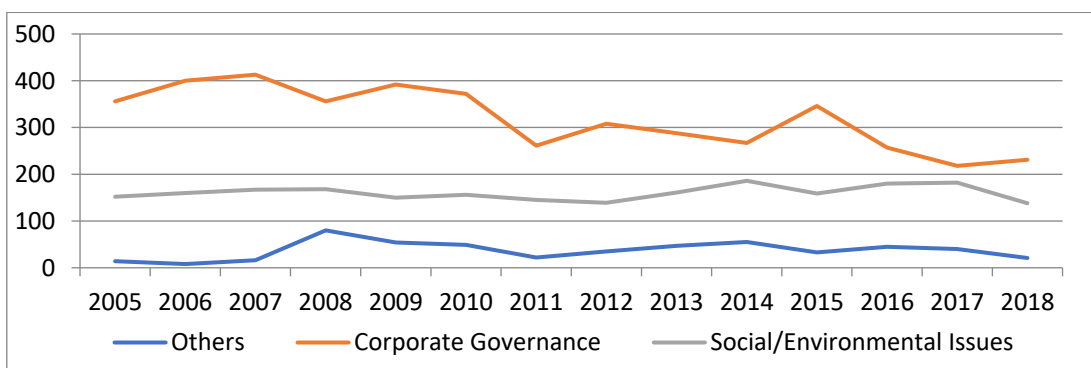
Importantly, in many cases, shareholders proposals do not reach the voting stage. In light of the new reality described in the following Subsection—where proposals that receive majority support require companies to act or risk a withhold campaign—some companies prefer to work with the proposing shareholder to enact a change without the proposal going to a shareholder vote.<sup>53</sup> Our data, therefore, may

<sup>53</sup> Stephen Joyce, *Negotiations Lead to Fall in Proxy Access Proposals*, BLOOMBERG (June 30, 2016), <https://www.bna.com/negotiations-lead-fall-n57982076332> (“[A]n increasing number of

underestimate the true number of shareholder proposals that were submitted to public companies each year, since a portion of them may have settled before going to a vote.<sup>54</sup>

Shareholder proposals span a wide range of topics—from shareholder rights and board composition to environmental and social policy proposals. While historically governance proposals dominated, recently there has been a shift in investors' attention towards social and environmental proposals.<sup>55</sup> For example, in 2017, shareholders submitted 182 environmental and social proposals to S&P 1500 companies.<sup>56</sup>

Figure 2: Submitted Shareholder Proposals by Category<sup>57</sup>



In particular, between 2014 and 2018, the prevalence of political spending proposals increased by 20%,<sup>58</sup> and proposals concerning climate risk, coal-related risks, greenhouse gas emission, gun safety, the opioid crisis, and sustainability reports

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companies negotiating settlements with shareholders led to a material decrease in the number of shareholder proposals seeking proxy access in 2016.”).

<sup>54</sup> For an interesting study documenting the prevalence and characteristics of shareholder proposals settlements in the context of campaign financing disclosure, see Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262 (2016).

<sup>55</sup> Joyce, *supra* note 53; See Mishra, *infra* note 200.

<sup>56</sup> See EY CENTER FOR BOARD MATTERS, *infra* note 52 (noting that shareholders at 106 Russell 3000 companies voted on social and environmental proposals); Proxy Pulse, 2016 Proxy Season Review, Broadridge & PWC, at 5 (“Institutional shareholder support for these proposals has increased over the past five years from 19% in 2014 to almost 29% in 2018.”).

<sup>57</sup> The “Others” category includes: Proposals filed in connection with proxy fights or M&A and reorganization events; proposals related to value maximization demands (such as distribution of dividends); and other miscellaneous proposals.

<sup>58</sup> Proxy Pulse, 2016 Proxy Season Review, Broadridge & PWC, at 6.

all received majority support in at least one shareholder vote in 2018.<sup>59</sup> In 2019, Google's parent company, Alphabet, included thirteen shareholder proposals in its proxy statement, encompassing matters as diverse as "election interference, sexual harassment, hate speech, the gender pay gap, NDAs and mandatory arbitration, freedom of expression, Chinese censorship, sustainability, antitrust, and policies that insulates Google's executives from shareholder accountability."<sup>60</sup> Another notable proposal in 2019 included presidential candidate Bernie Sanders' demand that Walmart Inc. give a board seat to a representative of its workers.<sup>61</sup>

Although the number and share of governance-related proposals has slightly decreased recently,<sup>62</sup> support these proposals receive has remained high, rising from 5% in 1994 to 38% in 2019.<sup>63</sup> Between 2003 and 2018, the most common governance related proposals were to declassify the board, establish an independent board chair, adopt a majority vote standard, adopt proxy access, and adopt a shareholder right to call a special meeting.<sup>64</sup> As these proposals became more widely adopted, however, their prevalence has slightly decreased because companies have adopted them either voluntarily to keep up with current governance standards or in response to shareholder proposals.<sup>65</sup> This in itself is significant in signaling the importance and impact of shareholder proposals.

### 3. Shareholder Proposals and the Greater Governance Ecosystem

So far we have shown that shareholder proposals are frequently utilized, particularly in larger companies. But do shareholder proposals still matter in the new

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<sup>59</sup> EY CENTER FOR BOARD MATTERS, *infra* note 52.

<sup>60</sup> Haan, *infra* note 46 at 1224–25.

<sup>61</sup> *Id.* at 1224.

<sup>62</sup> See Figure 2; see also James R. Copland & Margaret M. O'Keefe, *Proxy Season Preview: Shareholder Activism en Marche*, PROXY MONITOR REPORT Spring 2017 at 6.

<sup>63</sup> *Id.* See Papadopoulos, *supra* note 18 (indicating support level in 1994); THE CONFERENCE BOARD, PROXY VOTING ANALYTICS (2016–2019) (Dec. 2019), at 70 (indicating support level in 2019). 22.5% of the corporate governance proposals in 2019 received majority support.

<sup>64</sup> Papadopoulos, *supra* note 18 (declassifying the board received 1053 proposals filed and 699 proposals voted; independent chair saw 902 and 701; adopt majority voting standard 792 and 490; adopt proxy access 562 and 273; and right to call a special meeting 528 and 351).

<sup>65</sup> PROXY VOTING ANALYTICS, *supra* note 63, at 16–17. This gradual decline is also attributable to the introduction of the say-on-pay votes and the federal regulation imposing more widespread executive compensation disclosure, which had traditionally been main topics of concern for certain investors, such as labor unions.

era of increased engagement by institutional investors<sup>66</sup> and widespread activism by hedge funds.<sup>67</sup> We turn to examine this question in this Subsection.

One key line of argument is that shareholder proposals are no longer as important in this new era of activist hedge funds, where savvy, sophisticated hedge funds or other large institutional investors take large stakes at target companies and directly engage with management through private communications, public campaign, and proxy fights.<sup>68</sup> For example, the famous corporate raider and hedge fund activist, Carl Icahn, noted in a recent interview that submitting shareholder proposals does not “move the needle much,” and that “[i]t’s better for investors to put up their own directors” and “negotiate from a position of strength.” According to him, “You can’t get these guys on boards to be accountable, unless you have a lot of capital and a lot of firepower.”<sup>69</sup>

This argument misses an important mark. While hedge fund activism is a significant development in the U.S. capital market, it does not replace engagement through the submission of shareholder proposals, an activity in which activist hedge funds rarely engage.<sup>70</sup> The two are separate channels of engagement that *supplement*, rather than *replace*, each other. Additionally, activist hedge funds have incentives to engage with targets only where such activities could result in financial returns that meet their investors’ expected rate of return, which is typically significant. Moreover, activist hedge funds typically accumulate meaningful equity positions in their

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<sup>66</sup> See, e.g., ISS Analytics, *The Long View: US Proxy Voting Trends on E&S Issues from 2000 to 2018*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Jan. 31, 2019), <https://corpgov.law.harvard.edu/2019/01/31/the-long-view-us-proxy-voting-trends-on-es-issues-from-2000-to-2018/>. Jill E Fisch, Asaf Hamdani and Steven Davidoff Solomon, *Supra* note 27.

<sup>67</sup> See, e.g., Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, in NEW FINANCIAL INSTRUMENTS AND INSTITUTIONS: OPPORTUNITIES AND POLICY CHALLENGES 101 (Yasuyuki Fuchita & Robert E. Litan eds. 2007) (observing that activist hedge funds “have shaken up boardrooms and forced radical changes at many publicly-traded firm”); Jonathan R. Macey, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 241, 272, (2008) (claiming that hedge funds “are the newest big thing in corporate governance” and that they “actually deliver on their promise to provide more disciplined monitoring of management”). For a survey of the empirical literature on the disciplinary effect of shareholder activism, see Matthew Denes et. al, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405 (2017).

<sup>68</sup> See, e.g., Kahan & Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021 (2007) (describing the basic goals and tactics of activist hedge funds); Lucian Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, J. FIN. ECON. 1, (forthcoming 2020) (providing a comprehensive analysis of the drivers, nature, and consequences of activists' engagements and settlements with public companies).

<sup>69</sup> Kerber, *supra* note 1.

<sup>70</sup> See *supra* note 246.

targets,<sup>71</sup> which limits the ability of all but the largest activists to target large cap companies that are the primary target of shareholder proposals.<sup>72</sup> Consequently, activist hedge funds ignore many targets of shareholder proposals.<sup>73</sup>

Similarly, engagement by large institutional investors does not negate and cannot replace the use of shareholder proposals. To begin, recent evidence shows that large institutional investors have private communications only with a small minority of portfolio companies due to limited personnel time.<sup>74</sup> Moreover, these engagements with portfolio companies often tend to focus on the compensation of senior executives or on general concerns regarding board diversity or sustainability issues.<sup>75</sup> They were not aimed to replace the use of shareholder proposals. Finally, studies demonstrate how the mere submission of shareholder proposals, or the follow-up adoption of certain governance terms that make boards more accountable such as proxy access or majority voting, could enhance the responsiveness of companies to shareholder interests and the overall effectiveness of shareholder engagement.<sup>76</sup> Thus, shareholder proposals operate to complement engagement rather than being replaced by it.

Indeed, evidence shows that the ability to submit shareholder proposals has become a key avenue through which shareholders can pressure management to adopt certain governance standards.<sup>77</sup> The Shareholder Rights Project, a clinical program from Harvard Law School directed by Professor Lucian Bebchuk, exemplifies the importance of shareholder proposals.<sup>78</sup> In its few years of operation, the program

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<sup>71</sup> Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance and Firm Performance* (finding activists hold at median 9.1% of targets).

<sup>72</sup> Compare [https://www.activistsinsight.com/research/ShareholderActivism\\_Q12019.pdf](https://www.activistsinsight.com/research/ShareholderActivism_Q12019.pdf) (finding that 79–82% of activist targets had a market cap of \$10 billion or less from 2016-2018) with *supra* Figure 1 (showing vast majority of proposals occur in S&P 500).

<sup>73</sup> Bebchuk & Hirst *supra* note 27, at 83 ("Hedge funds invest substantial resources in stewardship and take on considerable risks in their activities, including liquidity risk and the risk of unsuccessful engagements. To compensate, activist hedge funds' own beneficial investors demand higher returns, which must sustain first paying the substantial 2-and-20 fees charged by the hedge fund manager.").

<sup>74</sup> Bebchuk & Hirst *supra* note 27, at 46-59.

<sup>75</sup> Matteo Tonello, *Board-Shareholder Engagement Practices*, HARV. L. SCH. F. CORP. GOV. & FIN. REG. (Dec. 30, 2019).

<sup>76</sup> For an interesting analysis of as to how proxy access campaign was also used to enhance board diversity goals, see Michal Barzuza, *Proxy Access for Board Diversity*, 99 B.U. L. REV. 1279 (2019). See also Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119, 1129-34 (2016) (showing how companies become more responsive to shareholder interests after the adoption of majority voting standards).

<sup>77</sup> See *infra* Subsection I.A.

<sup>78</sup> Disclosure: From 2012 to 2014, both of us served as associates at the Shareholder Rights Project.



assisted institutional investors in bringing about declassification of staggered boards at roughly one hundred S&P 500 and Fortune 500 companies through the submission of shareholder proposals. As result of the submission of declassification proposals and related shareholder pressure, the number of S&P 500 companies with staggered boards dropped from 60% in 2001 to fewer than 20% in 2014.<sup>79</sup>

Similarly, the Boardroom Accountability Project launched by New York City Comptroller Scott Stringer included an extensive submission of shareholder proposals regarding shareholder nomination of directors on the company's proxy statement (known as proxy access).<sup>80</sup> By 2017, 141 firms had implemented these proposals.<sup>81</sup> Other shareholders followed the comptroller's initiative and submitted proxy access proposals widely. As a result, by 2019, almost five hundred firms, more than two-thirds of those in the S&P 500, have added proxy access to their bylaws, and empirical evidence shows that these efforts led to a total increase of \$10.6 billion in shareholder value at targeted companies.<sup>82</sup> Building upon this success, the Comptroller Office launched a second project on September 8, 2017. The second project, which targeted 151 companies, focused on improving board diversity.<sup>83</sup>

A third notable example is that of the United Brotherhood of Carpenters Union, which filed shareholder proposals at over seven hundred companies successfully advocating for the adoption of majority voting rules that would require any board

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<sup>79</sup> For a review of the work done by the SRP, see Lucian Bebchuk, Scott Hirst & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3 HARV. BUS. L. REV. 157 (2013). See also Proposals Going to a Vote, SHAREHOLDER RIGHTS PROJECT (2017), <http://srp.law.harvard.edu/companies-voting-onproposals.shtml>.

<sup>80</sup> See Boardroom Accountability Project: Overview, N.Y.C. COMPTROLLER, <https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/overview/> (last visited Jul. 30, 2019).

<sup>81</sup> See Focus Companies, Boardroom Accountability Project, N.Y.C. COMPTROLLER, <https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/focus-companies/> (last visited Jul. 30, 2019).

<sup>82</sup> Stephen T. Giove, Arielle L. Katzman & Daniel Yao, *Proxy Access Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 19, 2018), <https://corpgov.law.harvard.edu/2018/10/19/proxy-access-proposals-2/> ("In total, well over 500 companies, and over two-thirds of the S&P 500, have adopted proxy access by-laws.").

<sup>83</sup> See Press Release, Scott M. Stringer, Comptroller, N.Y.C., Comptroller Stringer, NYC Pension Funds Launch National Boardroom Accountability Project Campaign - Version 2.0 (Sept. 8, 2017), <https://comptroller.nyc.gov/newsroom/press-releases/comptroller-stringer-nyc-pension-funds-launch-national-boardroom-accountability-project-campaign-version-2-0/> ("As part of today's launch, Comptroller Stringer sent letters to the boards of 151 companies... calling on them to publicly disclose the skills, race and gender of board members and to discuss their process for adding and replacing board members.").

candidate to obtain a voting majority before being seated.<sup>84</sup> These examples show that the shareholder proposal tool, if used appropriately, can have a significant real-world impact on important corporate governance issues.

Empirical studies have also documented the extent to which precatory shareholder proposals influence corporate governance structures. In examining a sample of proposals submitted in early 2000s, Thomas and Cotter found an increasing number of proposals that receive majority shareholder support, and this support translated into directors implementing more of the actions called for by shareholders. In particular, they found that "boards are increasingly willing to remove important anti-takeover defenses, such as the classified board and poison pill, in response to shareholders' requests, something rarely seen in the past."<sup>85</sup>

Additional studies reinforce the importance of shareholder proposal. For example, Paul Rose documented and analyzed the different types of proposals adopted from 2003 to 2013 and highlighted their growing number and contribution to the improvement of corporate governance of public companies.<sup>86</sup> Renneboog and Szilagyi provided empirical evidence on implemented proposals, concluding "that shareholder proposals are a useful device of external control."<sup>87</sup> And a line of empirical studies, to which we refer later, documented the increasing power of shareholder votes and the negative consequences for directors that ignore them.<sup>88</sup>

Finally, the notion that the use of shareholder proposals is a weak tool that does not "move the needle much" is also clearly inconsistent with the reaction of large public corporations and their advisors to the use of shareholder proposals. In recent years, the shareholder proposal tool has been under significant attack, which we describe in greater detail in Section II.C. In particular, the low eligibility threshold for submitting and resubmitting proposals has been the subject of hot controversy, culminating in a recent SEC proposal of changes that could make it far more difficult to submit and resubmit proposals to a shareholder vote.<sup>89</sup> If the shareholder proposal is a weak tool, how could one explain the strong regulatory and legal backlash against it? Why would managers and their advisors invest time and effort to exclude submitted

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<sup>84</sup> See Webber, *supra* note 16, at 75.

<sup>85</sup> Randell S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368, 389 (2007).

<sup>86</sup> Rose, *supra* note 19. For a recent study examining the importance of shareholder proposals in the context of proxy access, see Tara Bhandari, Peter Iliev & Jonathan Kalodimos, *Governance Changes through Shareholder Initiatives: The Case of Proxy Access*, SSRN Scholarly Paper ID 2635695 22 (Soc. Sci. Res. Network), Jan. 17, 2017 (regarding proxy access).

<sup>87</sup> Luc Renneboog & Peter G. Szilagyi, *The Role of Shareholder Proposals in Corporate Governance*, 17 J. CORP. FIN. 167 (2011).

<sup>88</sup> See *infra* notes 147-151.

<sup>89</sup> See *infra* Section II.C.1

shareholder proposals, in legal battles at courts or in fighting against the elimination of the shareholder proposal tool through amendment to Rule 14a-8?

*B. The Rise of Corporate Gadflies*

The rise of the shareholder proposal as a key avenue for governance change has also contributed to the empowerment of the corporate gadfly. The relative ease with which one can submit a shareholder proposal, and the low cost associated with it, grants individual shareholders powers they usually are not afforded in corporate America. Below we provide an account of the history of gadflies, empirical evidence of their increasing influence, and analysis of the legal and political economy reasons for their dominance.

1. Three Generations of Gadflies

The term “gadfly” originated with Socrates. In his self-ordained role, Socrates went around “irritating people so as to make them think, and to reconsider their arguments and perhaps alter their convictions and prejudices.”<sup>90</sup> He analogized this behavior to gadflies, small insects that bite and annoy livestock. The term has become popular in the political area to describe politicians who annoy and provoke others.<sup>91</sup> These days, the term “corporate gadflies” is used to describe small, “pesky,” individual shareholders who are engaged in the submission of a massive number of shareholder proposals.

Today's gadflies are part of a lineage of dedicated and often eccentric activists who have taken to the floor of annual meetings, many drawing their inspiration from the brothers John and Lewis Gilbert. The Gilberts’ five decades of criticizing chief executives began in 1932, when Lewis attended a shareholder meeting and was refused permission to ask a question. Since that first meeting, the brothers filed more than 2,000 proposals, attended up to 150 meetings a year, sometimes even bringing props with them. For example, after being forcibly ejected from a Chock Full o’ Nuts meeting, John Gilbert returned the next year wearing boxing gloves.<sup>92</sup> Forty-eight

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<sup>90</sup> *A Political Gadfly*, N.Y. TIMES, May 18, 1936, at 16.

<sup>91</sup> Gadfly, MERRIAM WEBSTER DICTIONARY, <https://www.merriam-webster.com/dictionary/gadfly> (last visited July 19, 2019).

<sup>92</sup> Stephen Foley & Jennifer Bissell, *Corporate Governance: The Resurgent Activist*, THE FINANCIAL TIMES (Jun. 22, 2014, 6:45 PM), <http://ig-legacy.ft.com/content/e13ce5fa-f6cf-11e3-b271-00144feabdc0#slide3>.

percent of shareholder proposals submitted between 1944 and 1951 came from the Gilbert brothers.<sup>93</sup>

In their wake, came a second generation of activists—including Gerald Armstrong and Evelyn Davis—whose approach to questioning chief executives was, respectively, “to harangue and to flirt outrageously.”<sup>94</sup> Of the 2,042 proposals submitted between 1987 and 1994, 22% were submitted by the Gilbert brothers and 15% by Evelyn Davis.<sup>95</sup>

Today, a third generation of gadflies has taken the baton, including William and Kenneth Steiner, John Chevedden, the Rossi family, and the husband and wife duo of James Ritchie and Myra Young. Ken Steiner is confident that gadflies are here to stay, arguing that “You have to rely on the concerned citizen.”<sup>96</sup>

## 2. The Increased Role of Gadflies: Myths and Realities

We now turn to empirically examine some of the common wisdoms regarding gadflies and to shed light on this remarkable and puzzling story of individual shareholder engagement through proposals.<sup>97</sup> We find that gadflies are no longer merely a curiosity with limited effect on corporate law, but rather that they have become an integral part of the governance ecosystem, forming a symbiotic relationship with large institutional investors who rarely submit proposals but are willing to support those submitted by gadflies. In particular, we show that (i) a large portion of all proposals in the U.S. are submitted by a handful of individuals; (ii) a large fraction of “passed proposals” are filed by gadflies; (iii) gadflies have focused on key issues, such as shareholder rights, rather than pursuing their narrow interests; and (iv) a large fraction of the passed proposals submitted by gadflies are then brought to a shareholder vote by management, a necessary step toward their final implementation. We will address each of these points in the rest of this Subsection.

### a. Methodology

Again, before discussing our findings regarding gadflies, it is helpful to provide a few brief notes about methodology. Using the sample we constructed in Part I.A.2 we divided the proponents into several groups including public pension funds, labor unions, other investment groups, religious groups and other stakeholders,

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<sup>93</sup> CorpGov.net, *Gadfly Importance Key to Democratic CorpGov* (Oct. 9, 2019), <https://www.corpgov.net/2019/10/gadfly-importance-key-to-democratic-corgov/>.

<sup>94</sup> *Id.*

<sup>95</sup> Stuart L. Gillan & Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors*, 57 J. FIN. ECON. 275, 281–285 (2000).

<sup>96</sup> Foley & Bissell, *supra* note 92.

<sup>97</sup> See Part I.A.2 for a more detailed description of our methodology.

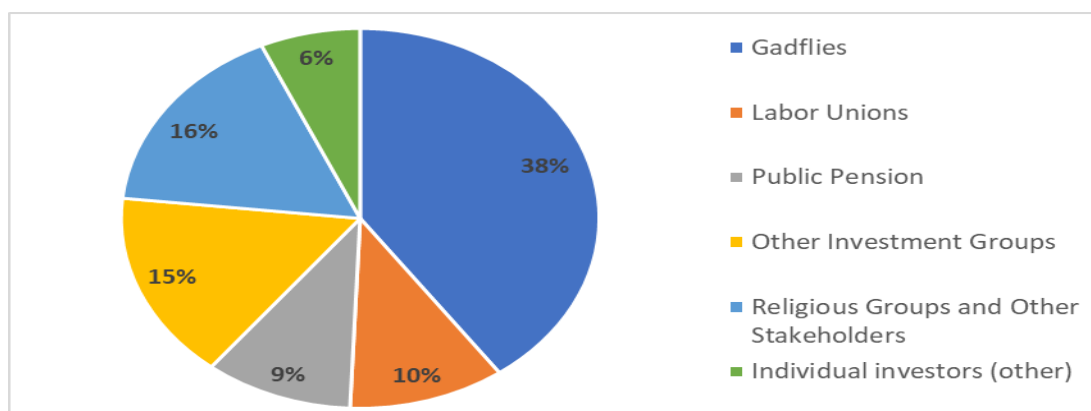
gadflies, and other individuals. The empirical data we provide in the next Section regarding “gadflies” refer to following six individuals/families: Gerald R. Armstrong, the Chevedden family, Evelyn Davis, Young-McRitchie, the Rossi family, and the Steiner family. As before, our data spans the years 2005-2018 and only include proposals that were included in the company proxy materials.

b. The Role of Gadflies – Empirical Findings

(i) Submission Rate. Gadflies are not merely an esoteric phenomenon as some might think considering the fact that the current generation of gadflies can be counted on one hand. Remarkably, as Figure 3 below shows, 38% of the shareholder proposals in the S&P 1500 in 2018 were submitted by a mere *five* individuals (Chevedden, Young-McRitchie, and the Steiners), making them the dominant source of shareholder proposals. Figure 3 also shows that individual shareholders as a whole submitted a total of 44% of proposals in 2018.

More generally, our data indicate that gadflies submitted 27.3% of all 6,827 shareholder proposals in the S&P 1500 between 2005 and 2018. Individual shareholders as a whole submitted a total of 38.5% of proposals during that period, outperforming more established investors.<sup>98</sup>

Figure 3: Proposal Proponents in the S&P 1500 (2018)



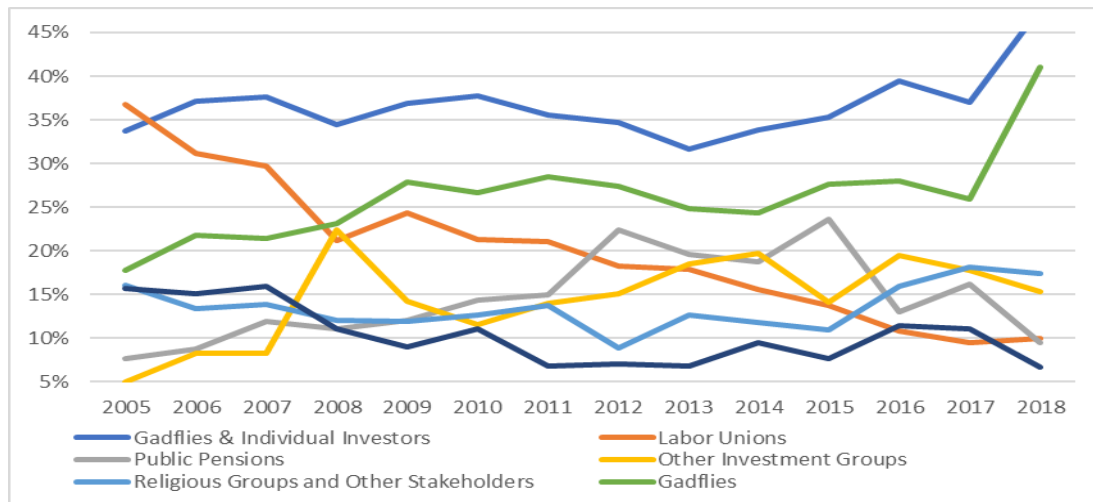
We also examined trends in the identity of shareholder proponents over time. Figure 4 below depicts the increasing role that gadflies have assumed compared to other prominent sources of shareholder proposals. The ratio of gadfly-sponsored proposals has steadily increased over time, doubling during the study period.

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<sup>98</sup> Pension funds submitted 15.3% of all proposals in the sample period, labor unions 21.9% (but their activity has decreased significantly in past few years as Figure 4 indicates), and hedge funds and other active investment advisors (10%).

As Figure 4 illustrates, gadflies eclipsed labor unions as the largest source of proposals in 2008. They have become ‘professional’ shareholder proponents submitting shareholder proposals at high rates year after year. In comparison, pension funds accounted only for 9% of the proposals submitted in 2018.

**Figure 4: Proposal Proponents Over Time in the S&P 1500**



(ii) *Success Rate*. Critics of gadflies often argue that gadflies' "interests diverge from the ordinary diversified investor"<sup>99</sup> and that "[t]hese investors are pursuing special interests, many of which have no rational relationship to the creation of shareholder value and conflict with what an investor may view as material to making an investment decision."<sup>100</sup> If so, gadfly proposals should attract little shareholder support.

In fact, gadflies often are able to gain the support of their fellow, larger investors. For example, the Steiners gained majority support for 29% of their proposals between 2006 and 2014.<sup>101</sup> Likewise, Chevedden and the husband and wife duo of

<sup>99</sup> See SEC, Petition for Rulemaking Regarding Resubmission of Shareholder Proposals Failing to Elicit Meaningful Shareholder Support (2014), <https://www.sec.gov/rules/petitions/2014/petr4-675>.

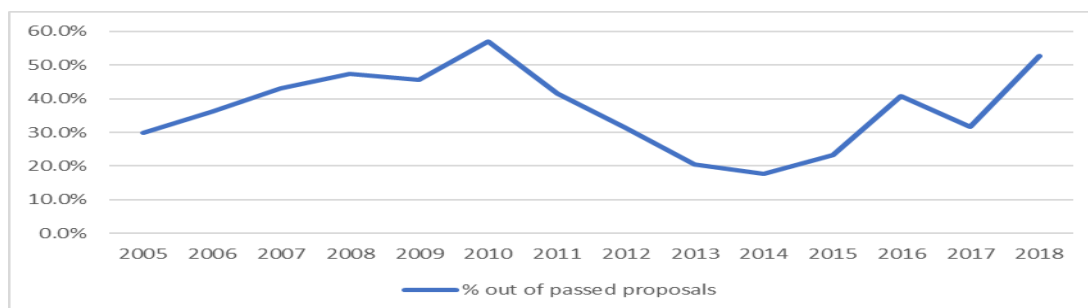
<sup>100</sup> BUSINESS ROUNDTABLE, RESPONSIBLE SHAREHOLDER ENGAGEMENT & LONG-TERM VALUE CREATION: MODERNIZING THE SHAREHOLDER PROPOSAL PROCESS 1 (2016), <https://www.businessroundtable.org/archive/resources/responsible-shareholder-engagement-long-term-value-creation>.

<sup>101</sup> James R. Copland & Margaret M. O'Keefe, *A Report on Corporate Governance and Shareholder Activism*, PROXY MONITOR (2014) at 15, [https://www.proxymonitor.org/pdf/pmr\\_09.pdf](https://www.proxymonitor.org/pdf/pmr_09.pdf).

McRitchie and Young, saw a 19% and 18% success rate, respectively, during this time span.<sup>102</sup>

More generally, our data indicate that 26% of the 1,864 proposals submitted by gadflies between 2005 and 2018 received a majority of shareholder votes cast (which we call “passed proposals”),<sup>103</sup> and that gadflies' proposals constitute a large fraction of the passed proposals.<sup>104</sup> For example, in 2018, over 53% of the passed proposals were submitted by gadflies.<sup>105</sup>

Figure 5: Gadflies' Share in Passed Proposals



Again, these numbers outperform more established investors, such as pension funds that filed only 14% of the passed proposals in the same year. Moreover, this number constitutes only a lower bound of gadflies' influence, as proponents of

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<sup>102</sup> *Id.*

<sup>103</sup> Our overall sample included 6,827 shareholder proposals, and only 17.6% of them receive majority support. Thus, gadflies outperform many other shareholder proponents, including labor unions (19.1%), religious group and other stakeholders (4.2%), hedge funds and active investment advisors (6.3%) and other individuals (6.8%). Only pension funds have higher success rate, with 30.9% of the proposals receiving majority support, though pension funds submitted significantly less proposals during the examined period (1,041 proposals compared to 1,864 submitted by gadflies). Moreover, the most prolific actor among the pension funds is the NYC Comptroller, who is in charge of over 60% of the proposals submitted by pension funds. That actor has lower success rate than gadflies (only 21.5% of its proposals passed, compared to 26.3% by gadflies).

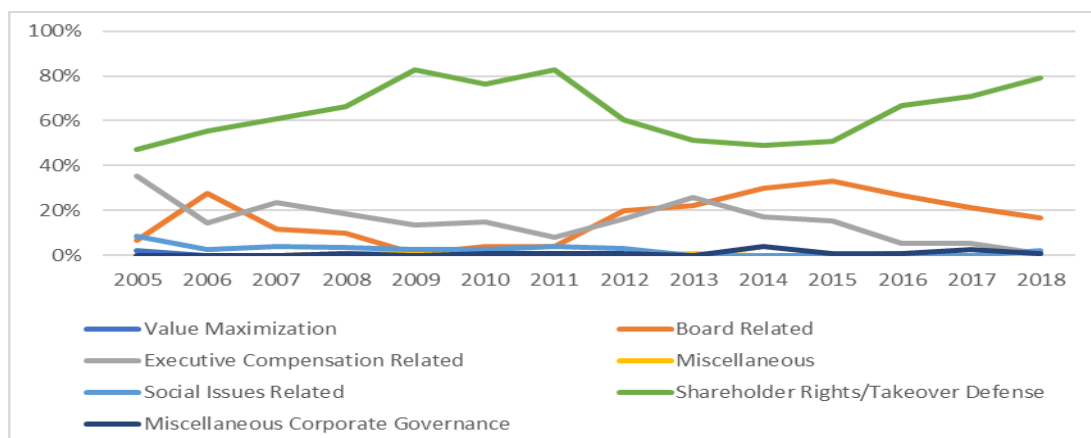
<sup>104</sup> Our data is further corroborated by a another study examining all shareholder proposals submitted between 2003–2014 that found that 25% of proposals submitted by individuals received majority support. See Nickolay Ganchev & Mariassunta Giannetti, *The Costs and Benefits of Shareholder Democracy* (Working Paper, 2019) ("Importantly, proposals submitted by individual shareholders are significantly more likely to pass than proposals submitted by institutions.").

<sup>105</sup> Moreover, this number is probably an underestimation of the popularity of the proposals submitted by gadflies, as in some cases, management could submit a proposal in order to preempt the gadflies and exclude their proposals from the company ballot.

shareholder proposals can often successfully engage companies if their proposals win substantial, but less than majority, support.<sup>106</sup>

(iii) *Type of Proposals*. It has also been argued that gadflies tend to pursue their "own narrow interests."<sup>107</sup> Figure 6 dispels this misconception. Gadflies' proposals do not focus on esoteric corporate policies, on pet peeves they may have with specific companies, or even on larger societal issues. As Figure 6 below shows, gadflies have focused their attention on key governance issues, such as shareholder rights and takeover defenses, with these proposals taking a larger portion of their portfolio. In 2018, close to 80% of the proposals submitted by gadflies were related to shareholder rights, while only little over 2% dealt with environmental and social topics.<sup>108</sup> Similarly, in 2018, of Chevedden's 113 shareholder proposals, 109 focused on corporate governance.<sup>109</sup>

**Figure 6: Percentage of Gadfly Proposals by Topics**



<sup>106</sup> COUNCIL OF INSTITUTIONAL INVESTORS, CLEARING THE BAR: SHAREHOLDER PROPOSALS AND RESUBMISSION THRESHOLDS 1 (2018), [https://docs.wixstatic.com/ugd/72d47f\\_092014c240614a1b9454629039d1c649.pdf](https://docs.wixstatic.com/ugd/72d47f_092014c240614a1b9454629039d1c649.pdf).

<sup>107</sup> See, e.g., Andrew Ackerman, *supra* note 174 (quoting a former member of the SEC commission).

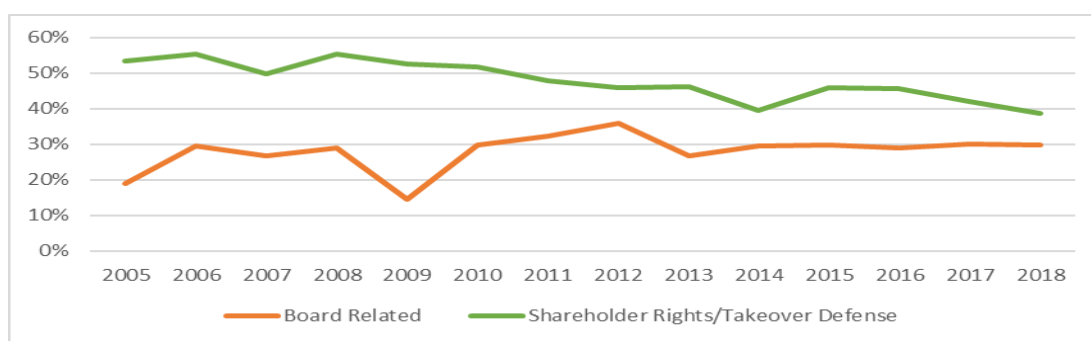
<sup>108</sup> Emiliano Catan and Marcel Kahan recently studied the evolution of shareholders' rights to call special meetings and act by written consent. They find that nearly 90% of the proposals were filed by four gadflies. Emiliano Catan & Marcel Kahan, *The Never-Ending Quest for Shareholder Rights: Special Meetings and Written Consent*, (New York University School of Law, Law & Economics Research Paper Series, Working Paper No. 18-37) (2018).

<sup>109</sup> David F. Larcker & Brian Tayan, *Gadflies at the Gate: Why Do Individual Investors Sponsor Shareholder Resolutions?* STAN. CLOSER LOOK SERIES, Aug. 2016, at 1, <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-59-gadflies-at-gate.pdf>.



This focus on key governance matters, on which large institutional investors and the proxy advisors have published voting guidelines that are more detailed and prescriptive, has allowed gadflies to enjoy the impressive passage rates outlined above.<sup>110</sup> As reflected in Figure 7, the average support rate for gadflies' shareholder rights proposals was 47.8% between 2005 and 2018.<sup>111</sup> Such high support rates have also allowed them to dominate the way that governance proposals are drafted and negotiated with companies, giving them even more power as the voice of shareholders collectively.

**Figure 7: Average Support Rate For Gadflies' Corporate Governance Proposals**



(iv) *Follow-up management proposals.* Critics of corporate gadflies often view them as a trivial phenomenon that does not “move the needle much.”<sup>112</sup> When it comes to the implementation of shareholder proposals, however, this is far from reality.

Under Delaware law, a charter amendment must be initiated by management. Thus, shareholder proposals regarding changes to the company’s charter require a second shareholder vote proposed by management. The governance changes only occur once these management proposals receive the required shareholder support. If gadflies’ proposals have trivial importance, in theory, there should be few follow-up management proposals.

To examine the merit of this claim, we looked at all gadfly proposals that received at least 50% support of all votes cast (*i.e.*, passed proposals) and then hand-

<sup>110</sup> See *infra* notes 101-106, and accompanying text. This trend continues in 2019: 167 shareholder proposals submitted by individuals receive 35.6% of the votes cast (on average). This support rate is higher than any other group of proponents, but for public pension funds, whose proposals receive 38.4% during that year, though public pension funds submitted a significantly lower number of proposal in 2019 (40 proposals). PROXY VOTING ANALYTICS, *supra* note 63, at 69.

<sup>111</sup> See Kahan & Rock, *supra* note 27 (“[W]ith the rise of institutional investors, it takes less time for a new proposal to gain significant shareholder support.”).

<sup>112</sup> Kerber, *supra* note 1.

collected data on whether they were followed by a management proposal on the same topic, submitted to the same company with the three years following the last gadfly passed proposal.<sup>113</sup> We focused our analysis on governance terms that require a follow-up management proposals to initiate charter amendment: board declassification, shareholder action by written consent, shareholders right to call special meeting, proxy access, elimination of supermajority voting requirements and majority voting.

We found that between 2005 and 2017, gadflies submitted 438 passed proposals. We then eliminated from our sample repeated passed proposals that were submitted to the same company multiple times until they eventually triggered an action by management. We ended up with a sample of 344 "unique" passed proposals, 64.5% of which were followed by a management proposal (222 proposals). We also found that 82% of these subsequent management proposals eventually passed and presumably resulted in an actual governance change through charter amendment.<sup>114</sup> For comparison, we conducted the same examination to the same type of passed proposals submitted by pension funds, which are more powerful and resourceful investors. Interestingly, we found that only 49% of these proposals were followed by management proposals (of which only 76% passed).

As Figure 8 shows, the type of gadfly proposal has significant impact on the likelihood that such a proposal will be followed up by a management proposals. For example, successful proposals to declassify the board or to eliminate supermajority voting requirements have had a high likelihood of being followed by a management proposal (86% and 67%, respectively). Moreover, these results constitute the lower bound of gadflies' potential influence as evidence shows that nowadays a shareholder proposal could become outcome determinative if it receives substantial, but less than majority, support.<sup>115</sup>

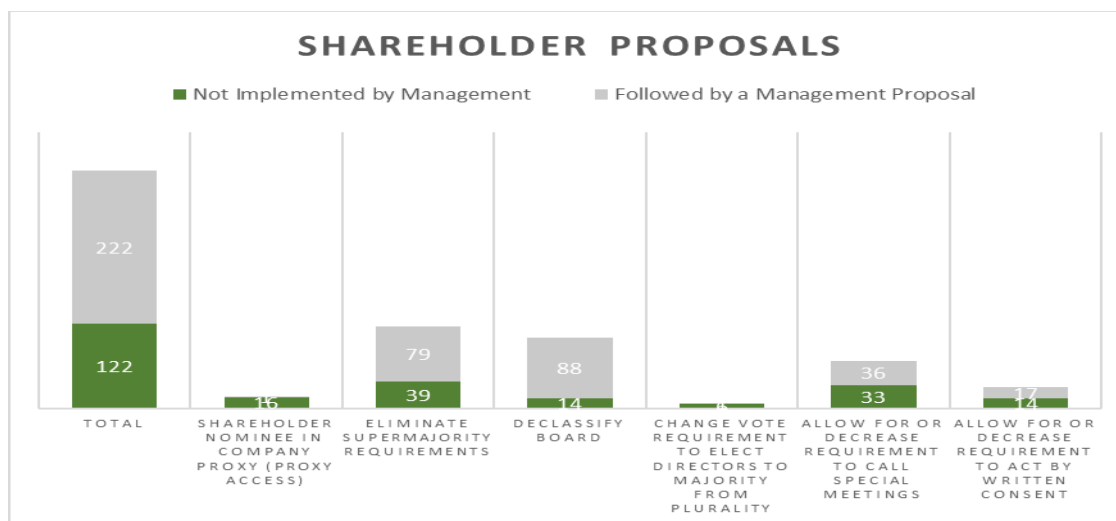
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<sup>113</sup> The overwhelming majority of management proposals are submitted in the year or two following shareholder proposals that receive majority support, but occasionally it might take longer to trigger action by management.

<sup>114</sup> We find that 92% of failed management proposals received majority support of all shares outstanding and at least 70% of votes cast. These management proposals failed despite receiving strong shareholder support due to combination of low turnout of retail investors and approval requirements that required a supermajority of shares outstanding. For a study showing that a non-negligible number of charter amendments have failed since 2012 despite receiving over 90% shareholder support of votes cast, see Scott Hirst, *Frozen Charters*, 34 YALE J. ON REG. 91 (2017).

<sup>115</sup> See *infra* note 235. We also note that several companies included in our sample, such as Netflix, categorically refuse to implement any precatory shareholder proposal. If these companies are excluded from our data, the percentage of follow-up management proposals further increases.

Figure 8: Follow-up Management Proposals



### 3. Power and Gadflies

The previous Section empirically demonstrated the remarkable dominance that handful of individual gadflies have obtained in submitting (and passing) shareholder proposals. But why do wealthier and larger shareholders avoid this task? And how exactly did gadflies achieve their dominance? We now turn to address these important questions.

#### a. Why Gadflies? Filling the Institutional Investor Void

On its face, the natural candidates for submitting shareholder proposals are largest institutional investors, in particular the so-called “Big Three” indexing giants of Wall Street—Vanguard, BlackRock, and State Street. These large investors are well diversified with a non-negligible equity position in nearly all public companies and with significantly more resources than gadflies.<sup>116</sup> But aside from a handful of pension funds, most large U.S. institutional investors do not exercise their voice through shareholder proposals.<sup>117</sup>

<sup>116</sup> See *supra* notes 169–175, and accompanying text. See also Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 727-741 (2019) (providing data on the growing share of passive investing).

<sup>117</sup> See *supra* Figure 4 (providing data on the type of shareholder proponents and percentage of proposals submitted by them).

In a recent study, Lucian Bebchuk and Scott Hirst examined the involvement of the Big Three in stewardship activities. Their review of the almost 4,000 shareholder proposals submitted from 2008 to 2017 did not identify a *single* proposal submitted by any of the Big Three.<sup>118</sup> Bebchuk and Hirst also showed that a large proportion of the Big Three's portfolio companies lack annual elections for all directors, majority voting, or the ability for shareholders to call special meetings have yet to receive shareholder proposals calling for such arrangements. This problem is more prevalent among mid- and small-cap companies—the ones that systematically receive less shareholder proposals.<sup>119</sup> For example, as of 2018, approximately 40% of the S&P 400 and S&P 600 (mid- and small-cap, respectively) companies still had classified boards; approximately 30% of the S&P 600 companies still had not moved to a majority voting standard for director election; and over 80% of the Russell 3000 companies do not have proxy access.<sup>120</sup> Large investors strongly support these initiatives.<sup>121</sup> Thus, had any of the Big Three or other large investors submitted proposals advocating for those changes, it likely would have led to the adoption of these arrangements.

A number of active pension funds, most notably the NYC Comptroller Office, have also been involved in high-profile campaigns that included the submission of proxy access and board diversity proposals.<sup>122</sup> However, the submission of shareholder proposals on a large scale is time consuming, and even organizations such as the NYC Comptroller still have to prioritize their targets.<sup>123</sup>

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<sup>118</sup> Bebchuk & Hirst *supra* note 27, at 44.

<sup>119</sup> See *supra* Figure 1 (showing that larger companies are clearly the subject of the majority of proposals. For instance, in 2015 over 450 proposals were submitted to the S&P 500 companies while less than 150 were submitted to the S&P 400 and S&P 600 altogether).

<sup>120</sup> Treviño, *supra* note 121. See also Shirley Westcott, *supra* note 123 ("[t]o date, about 579 companies have implemented access rights—including 70% of the S&P 500 and 18.6% of the Russell 3000").

<sup>121</sup> The four most popular governance-related shareholder proposals in 2018 were declassifying board (76% of votes cast in favor, on average), eliminating supermajority voting (68%), majority voting in contested election (58%), and the initial adopting of proxy access (53%). Marc Treviño, *2019 Proxy Season Review: Part 1—Rule 14a-8 Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (July 28, 2019), <https://corpgov.law.harvard.edu/2019/07/26/2019-proxy-season-review-part-1-rule-14a-8-shareholder-proposals/>.

<sup>122</sup> See *supra* notes 80–83.

<sup>123</sup> Even after the NYC comptroller's proxy access campaign, only 18.6% of the Russell 3000 companies have implemented access rights. See Shirley Westcott, *Alliance Advisors*, 2019 Proxy Season Preview, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Apr. 15, 2019), <https://corpgov.law.harvard.edu/2018/10/19/proxy-access-proposals-2/>. Moreover, if recent efforts to amend Rule 14a-8 by increasing the submission thresholds turn to be successful, the ability of active pension funds to submit shareholder proposals would be further limited. See Webber, *supra* note 16

The upshot of these empirical studies is clear: although shareholder proposals have proven influential, the largest institutional investors remain inactive in the proposal process until the voting stage. This data is puzzling since the Big Three, as Marcel Kahan and Ed Rock observed, "are better positioned than any other shareholders to set market wide governance standards."<sup>124</sup> So why are the largest institutional investors not submitting their own proposals? Scholars theorize that these investors often refrain from engaging in stewardship for three principal reasons: agency costs, concerns from regulatory backlash, and disclosures on Schedule 13D.<sup>125</sup>

The agency cost view rationalizes the inactive nature of the Big Three by concluding that corporate management could see proposals as confrontational and therefore potentially damaging the relationships and interests of these index funds with their portfolio companies.<sup>126</sup> However, by adopting a reactive rather than proactive role and relying on other shareholders to submit the proposals, the Big Three hinder their potential influence on governance principles, and consequently, diminish the benefit to their own investors.

Furthermore, the substantial and growing power of the Big Three puts them at the risk of a political backlash, which could impose significant legal restraints on the activities of large institutional investors.<sup>127</sup> The threat of regulatory intervention is particularly salient given Main Street's historical suspicion of any substantial accumulation of economic power by Wall Street financiers.<sup>128</sup> One of the best ways to decrease the prospect of a regulatory backlash is to avoid the appearance of power,<sup>129</sup> which might explain the hesitance of these investors to exert significant power through the shareholder proposal mechanism. Similarly, confronting management through

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(explaining that if the Business Roundtable threshold proposal were to go into effect, it would likely mean that the two largest U.S. pension funds would be prevented from making proposals to virtually all companies); *see also* Subsection II.C.1.

<sup>124</sup> Kahan & Rock, *supra* note 27, at 4.

<sup>125</sup> *See, e.g.*, Kahan & Rock, *supra* note 27, at 4; Bebchuk & Hirst, *supra* note 27, at 44.

<sup>126</sup> Bebchuk & Hirst, *supra* note 27, at 44.

<sup>127</sup> *See, e.g.*, Kahan & Rock, *supra* note 27, at 30; Bebchuk & Hirst *supra* note 27, at 27–29.

<sup>128</sup> Kahan & Rock, *supra* note 27, at 30. For an explanation of how popular sentiments against the concentrated power of Wall Street financiers lead to an array of legal rules that significantly decreased the power of the big financial institutions, *see* Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991); Mark J. Roe, *Backlash*, 98 COLUM. L. REV. 217, 217 (1998).

<sup>129</sup> Bebchuk & Hirst *supra* note 27, at 27–29.

proposals could incite management to use its influence to push for more regulation of these institutions.<sup>130</sup>

Finally, the implications of disclosures on Schedule 13D versus Schedule 13G could, at least in theory, also nudge large institutional investors toward a more passive engagement approach and, thus, to avoiding shareholder proposal submissions. Schedule 13D requires investors who are the beneficial owners of at least 5% of a public company to publicly disclose detailed information about the transaction, the company, and the buyer.<sup>131</sup> This Schedule also requires frequent filings to promptly reflect any updates in acquisitions and holdings.<sup>132</sup> Compliance with these filings can prove costly, particularly for institutions (like index funds) with highly dispersed holdings. In contrast, Schedule 13G disclosures are much shorter, requiring basic information regarding the beneficial owner and the amount of securities beneficially owned, and are typically made annually.<sup>133</sup> The burden of providing the large amount of information and costs of avoiding compliance errors incentivizes investors to file on Schedule 13G, as opposed to on Schedule 13D. In order to file on Schedule 13G, investors must refrain from activity that would “effect change” or “influence control.”<sup>134</sup>

In the past, some practitioners expressed concern that the submission of governance proposals would trigger the enhanced reporting requirements of Schedule 13G.<sup>135</sup> However, the SEC has since published guidance clarifying that engaging in discussions regarding corporate governance topics (including the submission of related proposals) would not cause the loss of Schedule 13G eligibility—so long as the discussions are part of a general effort to improve corporate governance at the

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<sup>130</sup> *Id.* at 10–13 (“The Big Three can reduce the risk of corporate managers inciting a backlash by limiting the extent to which their stewardship constrains the power, authority, compensation, and other private interests of corporate managers.”).

<sup>131</sup> Will Kenton, Schedule 13D, INVESTOPEDIA (Apr. 2, 2019) <https://www.investopedia.com/terms/s/schedule13d.asp>.<https://www.investopedia.com/terms/s/schedule13d.asp>.

<sup>132</sup> See Bebchuk & Hirst, *supra* note 27.

<sup>133</sup> *Summary of Schedule 13D and Schedule 13G Filing Obligations*, MINTSLEVIN [https://www.mintz.com/sites/default/files/viewpoints/orig/14/2015/02/Memo\\_-Summary-of-Schedule-13D-and-13G-Filing-Obligations-DOC1.pdf](https://www.mintz.com/sites/default/files/viewpoints/orig/14/2015/02/Memo_-Summary-of-Schedule-13D-and-13G-Filing-Obligations-DOC1.pdf) (Last visited Dec. 20, 2019) ; *Schedule 13D and 13G Reporting by Certain Beneficial Owners of Voting Equity Securities*, INTERACTIVE BROKERS <https://ibkr.info/article/2590> (Last visited Dec. 20, 2019).

<sup>134</sup> *Id.*

<sup>135</sup> SEC, EXCHANGE ACT SECTIONS 13(D) AND 13(G) AND REGULATION 13D-G BENEFICIAL OWNERSHIP REPORTING (July 14, 2016), <https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm#103.11>.

investor's holdings.<sup>136</sup> The threat of being forced onto Schedule 13D, thus, does not seem to be a real impediment for the submission of shareholder proposals by large institutional investors.

Whether out of concern from damaging the relationships with managers of portfolio companies or concerns from regulatory backlash, the relative absence of institutional investors from the proposal stage of shareholder proposals has enabled gadflies to take a more prominent role in the governance ecosystem. And took it they did. Gadflies fill the void left by the Titans of Wall Street.

b. Gadflies' Various Sources of Power

In their seminal work on embattled CEOs, Marcel Kahan and Ed Rock refer to power in the corporate context as the ability to decide key issues facing the firm.<sup>137</sup> But, how exactly do corporate gadflies, who own extremely small stakes in any given public company, assert their power over the agenda of large public companies? Several market developments have led to a rise in gadflies' power: (i) their ability to tailor their proposals to the voting guidelines of proxy advisors and large institutional investors; (ii) the credible threat of withhold/negative vote against directors; (iii) gadflies' ability to crowd out other shareholders; and (iv) gadflies' limited concerns from management retaliation.

(i) *Setting the Agenda for Institutional Investors*: Since gadflies hold only a tiny fraction of the companies' equity capital, their proposals could not pass without the affirmative votes of large institutional investors that increasingly own a dominant share of equity in most public companies.<sup>138</sup> To receive such support, gadflies tend to focus on standardized governance proposals<sup>139</sup> regarding matters on which large institutional investors generally agree and are most likely to support.<sup>140</sup> Moreover,

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<sup>136</sup> *Id.*

<sup>137</sup> Marcel Kahan & Edward B. Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 992–995 (2010).

<sup>138</sup> See Lazard Ltd., Review of Shareholder Activism - H1 2018, 13 (cataloguing that the top 5 shareholders own 24% of equity in the S&P 500); see also Coates, *supra* note 27, at 14 (“We are rapidly moving into a world in which the bulk of equity capital of large companies with dispersed ownership will be owned by a small number of institutions.”).

<sup>139</sup> See *supra* notes 109–111.

<sup>140</sup> For example, a set of consensus governance principles adopted by a large coalition of institutional investors managing in the aggregate more than \$17 trillion expressed support for annual election and the use of a majority voting standard. See Inv’r Stewardship Grp., Corporate Governance and Stewardship Principles, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 7, 2017), <https://corpgov.law.harvard.edu/2017/02/07/corporate-governance-and-stewardship-principles/>. See also the set of corporate-governance principles put forth by a group of leading executives including CEOs of asset managers and of major public companies. These principles support the use of majority

these institutions have already expressed formulaic views on these governance matters in their voting guidelines, enabling gadflies to tailor their proposals for maximum support.<sup>141</sup> By proposing the governance terms to which these institutional investors have publicly committed, gadflies translate universal governance guidelines into company-specific governance changes. In essence, gadflies hold these institutional investors to their promises by setting the agenda on what is to be voted on by shareholders.

By contrast, institutional investors have more diverse views on environmental and social matters, and many voting guidelines provide asset managers more discretion on related proposals. For instance, the voting guidelines of Vanguard state that its funds “*will vote* for proposals to declassify an existing board” or to adopt majority vote for director election, whereas any proposal regarding environmental and social disclosures will be voted on “case-by-case . . . evaluated on its merits.”<sup>142</sup> Consequently, gadflies will find it more difficult to tailor their environmental and social proposals to obtain shareholder support.

Proxy advisory firms have further facilitated this dynamic. Proxy advisors aggregate the views of institutional investors, particularly those not large or engaged enough to publish their own voting guidelines.<sup>143</sup> As a result, they further aid gadflies in tailoring their governance proposals to what institutions already support.

In its 2019 voting guidelines, ISS recommended that shareholders vote *for* proposals to repeal classified boards, to reduce supermajority vote requirements, to provide shareholders with the ability to act by written consent or to call special meeting, and to have directors elected with an affirmative majority of votes cast.<sup>144</sup>

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voting and proxy access, and indicated that “[w]ritten consent and special meeting provisions can be important mechanisms for shareholder action” and that “annual elections may help promote board accountability to shareholders.” Commonsense Principles 2.0 (Oct. 18, 2018), <https://www.governanceprinciples.org/wp-content/uploads/2018/10/CommonsensePrinciples2.0.pdf>.

<sup>141</sup> Bebchuk & Hirst, *supra* note 27, at 2088-91.

<sup>142</sup> THE VANGUARD GROUP, INC., PROXY VOTING GUIDELINES FOR U.S. PORTFOLIO COMPANIES, 10, 16 (April 1, 2019), <https://about.vanguard.com/investment-stewardship/portfolio-company-resources/proxy-voting-guidelines.pdf> (emphasis added).

<sup>143</sup> ISS develops its policies by surveying and discussing them with its institutional clients. Kahan & Rock, *Embattled CEOs*, *supra* note 137, at 1007.

<sup>144</sup> *Id.* at 12, 14. *See* Institutional S’holder Servs., Americas: U.S. Proxy Voting Guidelines Updates: 2017 Benchmark Policy Recommendations 17-19, 27-28 (Nov. 18, 2019), at <https://www.issgovernance.com/file/policy/latest/americas/US-Voting-Guidelines.pdf>. Moreover, when evaluating director performance, ISS will also take into account the lack of such governance mechanisms. It will also generally recommend a vote against or withhold from directors of companies that went public without such governance terms.



Not surprisingly, our data show that gadflies tend to use their proposals to target governance matters, such as these, which significantly increases the likelihood that their proposals will be supported by a large body of shareholders.<sup>145</sup>

Once known for raising their own voices at annual meetings, gadflies now use their voice—through the shareholder proposal—to trigger the voice of other shareholders. In this new ecosystem, gadflies initiate shareholder proposals and large institutional investors—those that are unwilling to be in the driver seat in many cases—overwhelmingly support these initiatives. In essence, this channel of engagement is parallel to the one conducted by activist hedge funds, which Ronald Gilson and Jeffery Gordon described in a recent influential article.<sup>146</sup> Gadflies, like the activist hedge funds in the Gilson and Gordon account, stand at the front, locate the targets, initiate the process and engage with targets, and the large institutional investors support them through the ballot box. Once a shareholder proposal on a formulaic, often non-discretionary, governance matter is included in the company ballot, large institutional investors are likely to vote in accordance with their guidelines. Their hands are tied.

(ii) *The Credible Threat of a Withhold/Negative Vote*: Even though precatory proposals do not legally bind the corporation, boards face obstacles to ignoring those that receive significant support from shareholders.<sup>147</sup> Most significantly, boards face the credible threat of a withhold/negative vote. Under SEC regulations, shareholders must have the option to submit a proxy without a vote for a director candidate, a “voting present” known as withholding.<sup>148</sup>

Though withhold votes have no effect under default corporate law, they are a key way for shareholders to both express their voice within the current regulatory framework and to signal to the board that they are dissatisfied with its actions.<sup>149</sup>

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<sup>145</sup> For studies describing the potential influence of proxy advisors on institutional investors, see *id.* at 1005–06.

<sup>146</sup> Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 864–65 (2013) (arguing hedge funds identify target companies in which changes would enhance value, and mutual funds provide the activist hedge funds with support in those cases where changes would be value-enhancing).

<sup>147</sup> Kahan & Rock, *Embattled CEOs*, *supra* note 137, at 1012 (“[O]nce a proposal has received (or is expected to receive) support, boards are increasingly willing to adopt the recommendation.”).

<sup>148</sup> A method of influence in which shareholders withhold their support from the self-nominated slate of directors. Absent a competing slate, shareholders are only able to withhold their positive votes to indicate lack of satisfaction with directors. See Larcker & Tayan, *Gadflies at the Gate*, *supra* note 109.

<sup>149</sup> In an influential piece from the early 1990s, Joseph Grundfest advocated the use of vote-no campaigns, as a simple, inexpensive way of shareholder engagement. See Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing With Barbarians Inside the Gates*, 45 STAN. L. REV. 857

Indeed, recent empirical research has demonstrated that withhold votes yield negative consequences for directors. One study finds that, even in uncontested director elections, withhold votes have substantial negative impacts on directors' careers, increasing the likelihood the director will leave the board or be moved to less influential positions and decreasing the director's future opportunities in the director labor market.<sup>150</sup> Similarly, another study demonstrates that directors who experience significant decreases in vote margins (in excess of withhold votes) following the board's adoption of a poison pill, an anti-takeover tool that institutional investors generally disfavor, are subject to increase in termination rates across all their directorships.<sup>151</sup>

Moreover, corporations have increasingly adopted arrangements that make withhold votes tantamount to a vote in an uncontested election.<sup>152</sup> Majority voting provisions (a subject of many shareholder proposals) require a majority of votes present to elect the director.<sup>153</sup> Alternatively, some companies have adopted board policies that require resignations of directors elected by only a plurality of votes present.<sup>154</sup> In either case, a withhold vote can unseat the targeted director.

Crucially for the influence of gadflies, the voting guidelines of many large institutional investors and of ISS and Glass Lewis (the two largest and most influential proxy advisory firms) typically recommend submitting a withhold/negative vote against individual directors or the entire board if the board does not respond to shareholder passed proposals.<sup>155</sup> Joining the credible threat of "withhold" campaigns

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(1993).

<sup>150</sup> Reena Aggarwal, Sandeep Dahiya & Nagpurnanand R. Prabhala, *The Power of Shareholder Votes: Evidence from Uncontested Director Elections*, 133 J. FINAN. ECON. 134 (2019).

<sup>151</sup> William C. Johnson, Jonathan M. Karpoff & Michael D. Wittry, *The Consequences to Directors of Deploying Poison Pills* (working paper, 2019); Ertimur et al., *supra* note 20. Diane Del Guercio et. al., *Do Boards Pay Attention When Institutional Investor Activities 'Just Vote No'?*, 90 J. FIN. ECON. 84, 102 (2008) (finding that "just vote no" campaigns may be particularly effective for larger companies because "the power of the media and public opinion is most effective where directors have the most to lose").

<sup>152</sup> Stephen J. Choi et al., *supra* note 76 (describing the shift from plurality to majority voting).

<sup>153</sup> *Id.*, at 1120.

<sup>154</sup> *Id.*, at 1125-26.

<sup>155</sup> See GLASS LEWIS & CO., PROXY PAPER GUIDELINES: 2015 PROXY SEASON 1, 7-8, 28 (2015), [http://www.glasslewis.com/assets/uploads/2013/12/2015\\_GUIDELINES\\_United\\_States.pdf](http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf); INSTITUTIONAL S'HOLDER SERVS., UNITED STATES SUMMARY PROXY VOTING GUIDELINES: 2015 BENCHMARK POLICY RECOMMENDATIONS 13 (Dec. 22, 2014), <http://www.issgovernance.com/file/policy/2015ussummaryvotingguidelines.pdf>.

to shareholder proposals has led boards to pay closer attention to strongly supported precatory shareholder proposals, giving them the potential to be quasi-binding.

(iii) Crowding Out: Gadflies may also strengthen their dominant role in shareholder proposals by making the arena too crowded for other investors to submit shareholder proposals. Crowding out could happen both at the firm and market level. At the firm level, the presence of a gadfly's proposal addressing the same issue on the same company ballot could serve as a ground for exclusion of any additional conflicting proposals submitted by other shareholders under Rule 14a-8(i)(9), essentially preempting other shareholders from submitting similar proposals.<sup>156</sup> At the market level, large shareholders' general reliance on gadflies to handle the shareholder proposal process may cause them to not even consider submitting these proposals themselves, even to companies that are generally less exposed to gadflies' activities, such as mid- and small-cap companies.

Crowding out could lead to negative outcomes if the proposals that gadflies submit do not eventually pass because of factual errors, or gadflies' unwillingness to negotiate with management or to comply with professional norms. In such cases, governance arrangements that shareholders favor will not be adopted.

(iv) Limited Concerns from Management Retaliation: Gadflies are also free from many of the agency conflicts faced by other investors, and they therefore pursue proposals that otherwise would not be put forth. Extensive literature has highlighted the conflicts that private and public pension funds face in exercising governance, as well as the lack of incentives for mutual funds and other large institutions to do so.<sup>157</sup> Unlike these shareholders, gadflies typically suffer little reputational or financial harm by submitting proposals. Rather, they can embrace the stereotype as pesky shareholders and freely submit proposals that might irritate management and the board.

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To sum, the combination of recent market developments surveyed in this Subsection have positioned shareholder proposals as a key governance lever, and gadflies use this lever frequently and effectively. In essence, these practices have often transformed the so-called “precatory” shareholder proposal into “quasi-binding” resolutions due to the looming prospect of more severe sanctions for failure to act on a proposal.<sup>158</sup> Gadfly success arises from their independent position and their focus on

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<sup>156</sup> Treviño, *supra* note 121.

<sup>157</sup> See, e.g., Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1172-1175 (2019); Goshen & Squire, *supra* note 230, at 791-93.

<sup>158</sup> For studies supporting this view, see *supra* notes 150-151.

governance terms that large institutional investors publicly support—leading to passed proposals and actual governance changes, as the board avoids future backlash.<sup>159</sup>

All of the forgoing leads us to the major takeaway of this Part: gadflies play an important role in this new ecosystem as "governance facilitators." They assist (or force, if one heeds the agency cost view of institutions) large institutional investors, who avoid submitting shareholder proposals, in enacting the market-wide corporate governance standards reflected in their policies. Thus, any policy analysis of the current rule governing the submission of shareholder proposals will be incomplete without understanding the broader role that gadflies play in this ecosystem as governance facilitators.

## II. The Limitations of the Existing Ecosystem

In the previous Part, we highlighted the significant contribution of gadflies to the existing corporate governance ecosystem. We showed how large institutional investors tend to avoid submitting shareholder proposals and how gadflies have filled this important gap.

In this Part, we highlight the fragility and deficiencies of a system that heavily relies on corporate gadflies to initiate governance changes through the submission of shareholder proposals. Section A focuses on the structural limitations of corporate gadflies. Unlike institutional investors, gadflies do not receive any compensation, have limited resources, face significant time constraints, and have to bear the high costs associated with submitting shareholder proposals out of their own pocket. Finally, there is neither an organized succession process nor a central body of institutional knowledge to ensure the continuing operation of this system in the future when the current generation of gadflies retires or loses motivation.

Section B explores the costs generated by corporate gadflies' activities. Gadflies could be motivated by personal interests and are less constrained by professional norms. Their activities also could disrupt the operation of public corporations and force the companies to bear the costs of addressing unnecessary shareholder proposals submitted to them.

Finally, Section C outlines another danger corporate gadflies face: backlash by a coalition of large public corporations. Corporate insiders fight gadflies by engaging

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<sup>159</sup> See Kastiel & Nili, *supra* note 15, at 77–78 (referencing evidence showing that companies reconsider and revise their compensation packages even if their "say-on-pay" vote has passed but received a strong objection ratio of 20%-30% of all outstanding votes and that director turnover starts happening as soon as directors are getting 30% dissent votes); see also EY CENTER FOR BOARD MATTERS, *supra* note 52 at 4, ("Thirty-percent support is the level at which many boards take note of the proposal topic."); SEC PROXY VOTING ROUNDTABLE, 102 (Feb. 19, 2015), <http://tinyurl.com/sec-roundtable> (explaining that 25% shareholder support is outcome determinative).

in collective lobbying efforts to amend rules governing the submission of shareholder proposals, excluding proposals submitted by gadflies from the company ballot, and filing lawsuits against them. As individual shareholders, gadflies have limited resources to handle the powerful corporate machinery, and this backlash, if it continues in full force, threatens to reduce the overall effectiveness of gadflies' engagement.

A. *Structural Limitations*

1. Costly Operation and Limited Resources

The submission of shareholder proposals, especially if done on a large scale, can prove a costly operation.<sup>160</sup> While these costs would only constitute a small fraction of large institutional investors' costs, they can prove substantial for individual shareholders. First, individual shareholders have to devote time and resources to the preparation and submission of shareholder proposals as well as to the attendance of various shareholder meetings. Evelyn Davis, who lived in Washington, attended as many as 50 meetings a year and had to spend much of each spring traveling to New York, Chicago, Detroit, Pittsburgh, and other cities to attend annual meetings.<sup>161</sup> Chevedden is known to arrive at the annual meetings of public companies on foot or by bus.<sup>162</sup> As one gadfly summarized it: "meetings are a drain financially and in terms of time."<sup>163</sup>

Second, to submit proposals to a large number of companies, gadflies need to hold a financial stake in a large number of companies simultaneously. Evelyn Davis, for instance, maintained investments of at least \$2,000—the minimum threshold needed to be eligible to file a shareholder proposal—in 80 to 120 companies at any time.<sup>164</sup> Such a portfolio is trivial for institutional investors. However, holding positions in a large number of companies can be expensive and requires significant resources for human investors who typically only have access to their personal wealth.<sup>165</sup> John Chevedden stated that he relies on his father's holdings and teaming

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<sup>160</sup> Rock & Kahan, *supra* note 172, at 1048.

<sup>161</sup> Flitter, *supra* note 4.

<sup>162</sup> Kerber, *supra* note 1.

<sup>163</sup> Maureen Milford, *supra* note 177.

<sup>164</sup> Laurence Arnold, *Evelyn Davis, Queen of Shareholder Activism, Dies at 89*, BLOOMBERG (Nov. 5, 2018) <https://www.bloomberg.com/news/articles/2018-11-05/evelyn-davis-feisty-queen-of-shareholder-activism-dies-at-89>.

<sup>165</sup> Not surprisingly, some gadflies come from wealthy families or cooperate with each other in order to sustain this costly activity. For instance, Davis' Tax filings show her charitable foundation had assets of more than \$11 million at the end of 2017. Flitter, *supra* note 4.

up with other small investors, such as William Steiner and his son Kenneth, to satisfy the threshold in around 100 companies.<sup>166</sup>

As a result of the cost and time investment required, gadflies can only target a limited number of companies. Indeed, evidence we provide in this Article shows gadflies tend to sponsor shareholder proposals at much larger companies (mostly those in the S&P 500), which may attract and be more susceptible to public opinion.<sup>167</sup> Yet, this leaves an entire market of targets, mostly medium- and small-cap companies, which are not subject to the governance reforms initiated by gadflies.<sup>168</sup>

## 2. Lack of Direct Financial Incentives

According to conventional economic theory, individual investors in large public corporations have extremely little (if any) incentive to invest time and effort into the costly process of engaging with companies in order to amend their governance structure.<sup>169</sup> Shareholders, who usually hold an extremely small stake in any given company, must bear all the costs associated with their engagements, while sharing the benefits they generate with all of their fellow shareholders.<sup>170</sup> Thus, it is simply economically rational for most shareholders to be apathetic.

Gadflies are a rare exception to this general theory. Their decision to engage in the submission of shareholder proposals cannot be explained in purely financial terms. As one of the gadflies characterizes their motivation: "[w]e are doing this as a

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<sup>166</sup> Kerber, *supra* note 1.

<sup>167</sup> Our finding is consistent with existing empirical evidence showing that proponents target large American companies rather than those that would benefit most. *See, e.g.*, Randell S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FINANCE 368–91 (2007); Bhandari et al., *supra* note 86.

<sup>168</sup> *See Shareholder Advocate Newsletter, Interview with BU Law Professor David Webber on Efforts to Limit Shareholder Proposals* (July 20, 2017), <https://www.cohenmilstein.com/update/%E2%80%9Cinterview-bu-law-professor-david-webber-efforts-limit-shareholder-proposals%E2%80%9D-shareholder> ("[T]he reality is that very few companies face shareholder proposals in any given year... only 1-3% of all public companies – receive a shareholder proposal per year.").

<sup>169</sup> *See, e.g.*, Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 524–9, 584–91 (1990) (discussing rational apathy); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor As Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L. J. 445, 473, 497 (1990–1991).

<sup>170</sup> Rational apathy has long been recognized as a problem resulting from the separation of ownership and control, which is a dominant feature of U.S. public corporation. For Berle & Means's influential work on this issue, see ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 127 (1932).

public service.”<sup>171</sup> Unlike other players in the corporate governance landscape, such as independent directors, institutional investors, or activist hedge funds, gadflies do not receive any compensation in excess of any increased return on their shares for their engagement or for their contribution to the enhancement of governance terms, not even a reimbursement for expenses.

In contrast, the standard hedge fund charges a base management fee equal to 1-2% of the assets under management and a significant incentive fee, typically 20% of the profits earned.<sup>172</sup> Such structure provides the fund managers with powerful incentives to maximize the returns of target companies. Even mutual funds, which have long been criticized for their limited incentives to invest resources in activism, charge fees based on a flat percentage of the fund’s assets under management, which can be up to around 1.5%.<sup>173</sup>

Compared to institutional investors or hedge funds, individual shareholders have another major disadvantage to achieving governance change: they hold a small amount of shares in the companies they target.<sup>174</sup> In addition to limiting their sway with management and in the vote itself, gadflies’ small stakes limit their upside. Even if the submission of a shareholder proposal leads to the adoption of a governance term that increases the company value, gadflies only stand to receive a tiny fraction of these gains.<sup>175</sup> Moreover, gadflies cannot capture this value unless they maintain their holdings until it is reflected in the stock price, which would inhibit capital redeployment to satisfy the minimum ownership threshold at future targets. These factors—no excess compensation for engagements that benefits shareholders collectively and extremely low equity interest—significantly reduces the incentives of

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<sup>171</sup> Foley & Bissell, *supra* note 92.

<sup>172</sup> Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1064 (2007)

<sup>173</sup> *Id.* at 1051. For additional studies criticizing mutual funds’ limited incentives to expend resources on activism, see Bebchuk & Hirst *supra* note 27, at 44; Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992).

<sup>174</sup> See, e.g., Marcel Kahan & Edward B. Rock, *supra* note 172, at 1048, 1062; Andrew Ackerman, *Corporations Take Swats at a Gadfly*, WALL ST. J. (Mar. 16, 2014, 7:11pm), <https://www.wsj.com/articles/corporations-take-swats-at-a-gadfly-1394664978> (unlike hedge funds or billionaire investors that build significant stakes in a company, gadflies such as Chevedden hold a small amount of shares in the companies they target.).

<sup>175</sup> To grasp the extraordinary nature of gadflies’ action, consider the data provided by Bebchuk and Hirst, which shows that although each of the three largest index fund managers holds a position of 5% or more in a vast number of companies, they completely refrain from submitting shareholder proposals in the past decade. Bebchuk & Hirst *supra* note 27, at 44.

individual shareholders to invest in any sort of engagement, including the submission of shareholder proposals.

So what motivates gadflies? One possible rational is the non-pecuniary benefits, such as attention and the satisfaction of advancing the agenda in which one believes.<sup>176</sup> James McRitchie, one of the famous corporate gadflies, explained in an interview that his "mission is to help shareholders enhance the production of wealth by acting as long-term shareowners." Engaged owners, he argued, "invest not just money, but ideas and actions."<sup>177</sup> Additionally, as we will show in Subsection III.B.1, some gadflies are able to reap minor private benefits apart from their investments.<sup>178</sup>

Overall, this important gadfly operation is conducted, by and large, on a *voluntarily basis* and heavily relies on the *non-pecuniary motivations* of a handful of individuals.<sup>179</sup> However, there are limits to non-pecuniary motivations. Without meaningful financial incentives, there is a risk that over time, these individual shareholders will cease to value publicity or their vision enough to invest their time and resources into being gadflies.

### 3. Lack of Succession

As we have shown, the submission of shareholder proposals has been largely dependent on a handful of individuals.<sup>180</sup> Most of these actors, who conduct this activity at their own expense, are also above the retirement age.<sup>181</sup> Without any real economic rationale to motivate them, gadflies' activity is "fragile" and subject to the risk of discontinuation.

If these individuals cease to submit shareholder proposals for any reason, or if they decide to "retire" or become unable to submit proposals, there is no established succession. In that case, one could expect a significant decrease in this important channel of engagement. There is also no body of institutional knowledge as to how

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<sup>176</sup> Cf. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 Harv. L. Rev. 1641, 1663-65 (2006) (discussing the role of non-pecuniary benefits in motivating controlling shareholders).

<sup>177</sup> Maureen Milford, *Corporate Gadfly: "Crusaders or Crackpots"?*, DIRECTORS & BOARDS <https://www.directorsandboards.com/articles/singlecorporate-gadfly-%E2%80%9Ccrusaders-or-crackpots%E2%80%9D>.

<sup>178</sup> Laurence Arnold, *supra* note 164.

<sup>179</sup> For an interesting, and somewhat equivalent phenomenon, that exists in the consumer context, see Yonathan A. Arbel & Roy Shapira, *Theory of the Nudnik: The Future of Consumer Activism and What We Can Do to Stop it* (forthcoming Vanderbilt Law Review, 2020).

<sup>180</sup> See Section I.C.

<sup>181</sup> Andrew Ackerman, *supra* note 174 (noting that Cheveddan has already retired and is about 70 years old); Foley & Bissell, *supra* note 92 (noting that William Steiner is over 90 years old.).



this current channel of engagement can be transferred to new generation of gadflies (if those do emerge).

### B. *The Efficiency Costs of Gadflies*

The heavy reliance on gadflies for the improvement of governance terms is problematic not only because of the structural limitations they face, but also because these actors could be less fit for the task than other institutional investors. For example, gadflies may be motivated by personal interests, could be less constrained by professional norms and, as their critics argue, could generate externalities by increasing the company's costs of dealing with shareholder proposals.

#### 1. Personal Interests

As noted in the previous section, the dearth of financial benefits to gadfly proposals means gadflies are likely motivated by non-pecuniary benefits or by the receipt of other indirect, side benefits from their activities. Evelyn Davis, for example, published an annual newsletter named “Highlights and Lowlights of Annual Meetings” for over 45 years, to which many companies felt obligated to subscribe.<sup>182</sup> Davis charged \$600 per copy, with a minimum of two copies per subscriber.<sup>183</sup> McRitchie produces income from advertisements on a website that he founded in 1995—CorpGov.net—that provides news and commentary related to corporate governance matters.<sup>184</sup>

Engagement can also yield non-pecuniary benefits, including attention. Gadflies capture the attention of the financial press, powerful executives and their advisors, and other shareholders.<sup>185</sup> Davis showed up to annual meetings not only to urge the board toward better corporate governance but at times, “to flirt with the chief executive, and seemingly always, to draw attention to herself.”<sup>186</sup> She achieved some success in the latter regard. For example, in December 2008, Ken Lewis, the chief

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<sup>182</sup> *Id.*

<sup>183</sup> Laurence Arnold, *supra* note 164.

<sup>184</sup> About, CORPORATE GOVERNANCE, <https://www.corpgov.net/about/> (last visited August 1, 2019) (“The ads help pay the cost of maintaining the site. In good years, they also pay some of my expenses to travel to conferences on corporate governance.”).

<sup>185</sup> Kerber, *supra* note 1 (describing how “Jeffrey Katzenberg [the CEO of DreamWorks Animation SKG] and Chairman Melody Hobson . . . walked across the room to say hello to Chevedden”).

<sup>186</sup> Jena McGregor, *RIP, Evelyn Y. Davis: An Irrepressible Shareholder Activist for the Ages*, THE WASHINGTON POST (Nov. 8, 2018) [https://www.washingtonpost.com/business/2018/11/08/rip-evelyn-y-davis-an-irrepressible-shareholder-activist-ages/?noredirect=on&utm\\_term=.011d2f0871e8](https://www.washingtonpost.com/business/2018/11/08/rip-evelyn-y-davis-an-irrepressible-shareholder-activist-ages/?noredirect=on&utm_term=.011d2f0871e8).

executive of Bank of America, escorted Davis as his date to a black-tie dinner at which he received the Banker of the Year award from the newspaper *American Banker*.<sup>187</sup>

Gadflies may also be motivated by personal emotions, such as revenge. Chevedden launched his career as an activist in the mid-1990s, after being laid off from an aerospace company, then a part of General Motors ("GM"). He filed his first shareholder proposal in 1994, requesting that GM disclose more details of its employment practices. In his filing, Chevedden described the move as intended to promote morale among "dedicated employees who made a valuable contribution to Cold War Victory." The effort failed. GM won the SEC's permission to exclude the proposal based on it being aimed "to the redress of a personal claim or grievance or to further a personal interest."<sup>188</sup> Despite Chevedden's continued filing of hundreds of shareholder proposals at many other large U.S. companies since then, it may well be the case that his activity has been also influenced by his personal experience at GM.

To be clear, we are not claiming that gadflies are *only* motivated by personal considerations or the desire to secure pecuniary side benefits. As some of them argue in public interviews, their mission "is to help shareholders enhance the production of wealth by acting as long-term shareowners,"<sup>189</sup> and "to improve how companies are run."<sup>190</sup> However, in advancing this mission, personal considerations may inevitably influence their decision-making and lead to distortions in their choice of targets, in the engagement process, or in the type of proposals they choose to submit. For example, gadflies may over-invest in engagement with high-profile companies because these targets would bring them the most publicity, consistent with the dominance of the S&P 500 in gadfly proposals.<sup>191</sup> Finally, potential distortions in gadflies' decision-making may go unchecked due to the lack of key disciplinary features present in institutional investors (including hedge fund activists), such as established organizations, with a clear chain of command and mechanisms of accountability, and beneficial owners who can withdraw their funds if displeased.

## 2. Disregarding Professional Norms

Another inefficiency often associated with the engagement of corporate gadflies is their unwillingness to follow conventional professional norms. Gadflies tend to have little interaction with the management of companies outside of the annual meeting, making it more difficult to reach mutual agreements with insiders.<sup>192</sup> The

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<sup>187</sup> Flitter, *supra* note 4.

<sup>188</sup> Kerber, *supra* note 1.

<sup>189</sup> CORPORATE GOVERNANCE, *supra* note 184.

<sup>190</sup> Kerber, *supra* note 1.

<sup>191</sup> See *supra* note 167.

<sup>192</sup> Larcker & Tayan, *Gadflies at the Gate*, *supra* note 109.

non-pecuniary incentives that may drive gadflies may also cause them to be more adversarial than more conventional corporate actors, such as institutional investors. Gadflies' passion and idealism can turn them into corporate crusaders, less willing to compromise, or even negotiate, with companies' insiders. Likewise, engaging with management behind closed doors would yield far less notoriety for gadflies than battling at the annual meeting.

Indeed, executives and lawyers who were the recipients of Chevedden's proposals testify that "there is no reasoning with him," that "[h]e doesn't try to talk to us; he tries to attack," and that "some of his proposals are good, but you can never talk to him about his positions or his supporting statement [because] [h]e wouldn't change them voluntarily."<sup>193</sup> Similarly, a corporate governance expert noted that, while the issues Evelyn Davis raised "were almost always excellent," her "personality sometimes got in the way . . . . At times, she talked so long or interrupted proceedings so often that she was escorted out of the room."<sup>194</sup> This type of behavior creates antagonism among corporate insiders, reduces their willingness to cooperate with gadflies, and, on average, reduces the likelihood that gadflies' proposals will be adopted.

### 3. Waste of Corporate Resources

Critics also claim that individual activism, and gadflies' engagement in particular, wastes corporate resources. Gadflies submit a substantial volume of proposals and companies have to expend significant resources dealing with them, even those that fail.<sup>195</sup> For example, Leo Strine, the recently retired Chief Justice of the Delaware Supreme Court, said that the volume of shareholder proposals has wrought a "constant 'model UN' where managers are repeatedly distracted by referendums on a variety of topics proposed by investors with trifling stakes".<sup>196</sup> Daniel Gallagher, a former SEC commissioner and a well-known opponent of the shareholder proposal tool, expressed a similar view, noting that "annual meetings have been "hijacked" by corporate gadflies," and that "[a] company should be able to use all available means, including litigation, to fulfill its fiduciary duties to all shareholders by seeking to

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<sup>193</sup> Kerber, *supra* note 1.

<sup>194</sup> Flitter, *supra* note 4.

<sup>195</sup> Steven Davidoff Solomon, *Grappling With the Cost of Corporate Gadflies*, N.Y. TIMES (AUG. 19, 2014) <https://dealbook.nytimes.com/2014/08/19/grappling-with-the-cost-of-corporate-gadflies/>.

<sup>196</sup> *Id.*

exclude improper proposals that are so often the work of a small minority of shareholders pursuing their own narrow interests."<sup>197</sup>

In general, the company's cost associated with addressing a shareholder proposal includes the time and expenses incurred in internal deliberation; the attempted exclusion of the proposal through a no-action process (in the appropriate cases); drafting a voting recommendation; negotiation with the proponent; and the fees to the company's outside advisors (such as legal and public relations). The SEC once estimated that a company incurs \$87,000 in relation to one proposal.<sup>198</sup> Proposals can also lead to additional non-quantifiable costs, such as the diversion of management attention.<sup>199</sup>

To be clear, gadflies can create shareholder value as initiators of value maximizing governance changes, but it does not necessarily follow that their activity never generates net negative costs for target companies. While most shareholder proposals gadflies submit address major governance issues,<sup>200</sup> some proposals are less momentous and reflect the ease by which one can submit them.<sup>201</sup> An important indication as to the desirability of gadflies' activity is the level of support that their shareholder proposals receive. When gadflies submit a shareholder proposal on an esoteric topic that barely interests other shareholders, or when their proposals receive low rates of support, the costs related to that proposal would constitute, in our view, a waste of corporate resources. Since the submission of shareholder proposals involves significant discretion, when gadflies exercise bad judgment in the selection of proposals, their activity could prove more costly than beneficial.

We provide extensive evidence on the level of support for various proposals submitted by gadflies in the previous Part. As we have shown, a large fraction of the proposals that received a majority of shareholder support were filed by gadflies.<sup>202</sup>

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<sup>197</sup> Andrew Ackerman, *supra* note 174.

<sup>198</sup> Foley & Bissell, *supra* note 92.

<sup>199</sup> *Id.* (According to Martin Lipton, the founder of founder of Wachtell Lipton, a shareholder proposal "is not an overwhelming burden for a corporation but it is a pain, and an unnecessary diversion of attention.")

<sup>200</sup> Subodh Mishra, *An Early Look at 2019 US Shareholder Proposals*, HARV. L. SCH. F. CORP. GOV. & FIN. REG. (Mar. 5, 2019) <https://corpgov.law.harvard.edu/2019/03/05/an-early-look-at-2019-us-shareholder-proposals/>.

<sup>201</sup> See *supra* note 22. Also, a recent article studies the evolution of shareholders' rights to call special meetings and act by written consents, does not find evidence that gadflies always target those firms where a grant of certain rights, such as the ability to act between annual meetings, would be most productive in light of their governance structure. Catan & Kahan, *supra* note 108.

<sup>202</sup> See Section I.C.

However, some of their proposals also received low shareholder support throughout the years. For example, we found that gadflies submitted 366 shareholder proposals unrelated to shareholder rights or takeover defenses, and only nine of these proposals eventually passed, with the vast majority of them receiving low support rates because they are related to topics that do not generate large consensus among investors. The submission of these proposals (or at least some of them) may indeed constitute a waste of corporate resources.

Gadflies' traits discussed above exacerbate this waste. Their reluctance to comply with professional norms reduces the likelihood of a settlement with management. Their lack of sophisticated advisors and staff available to institutional investors increases the risk of making strategic or factual mistakes that lead to the exclusion of their proposals, undermine their credibility, or hinder their viability. Indeed, some companies that filed lawsuits against Chevedden argued that the sheer volume of his proposals causes him to make factual errors in supporting statements that should disqualify many of his submissions.<sup>203</sup>

### C. *Backlash*

Gadflies are currently under attack. As they gained traction, public corporations and their managers and lobbyists began to recognize them as a force within corporate governance arena and push back against them. This backlash is conducted through a number of channels: regulators, courts, and the SEC. This response is major threat to the existing corporate governance ecosystem, which relies on the ability of gadflies to submit governance-related shareholder proposals.

#### 1. Regulatory Backlash

The ability of shareholders with a relatively small investment in the company to submit shareholder proposals has been the subject of controversy and has recently generated calls for change. The U.S. Chamber of Commerce, one of the largest business-oriented lobbying groups in the United States, has waged a campaign against the submission of shareholder proposals by individuals, calling them "zombie proposals" and arguing that "[i]t is time to enact real shareholder proposal reform to bring an end to these zombies, for good."<sup>204</sup> In a white paper published in 2017, the

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<sup>203</sup> Andrew Ackerman, *supra* note 174 (quoting a spokesman for Express Scripts: "Mr. Chevedden's proposal contained a number of materially false statements that would be misleading for shareholders").

<sup>204</sup> CENTER OF CAPITAL MARKETS COMPETITIVENESS, RAISING THE SEC'S RESUBMISSION THRESHOLDS: "ZOMBIE PROPOSALS" AND THE NEED TO MODERNIZE AN OUTDATED SYSTEM 1 (2017), [https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/10/CCMC\\_ZombieProposal\\_Digital.pdf](https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/10/CCMC_ZombieProposal_Digital.pdf).

U.S. Chamber of Commerce argued that a "reform of the shareholder proposal process is an incremental but important step toward tilting the scales back in favor of the majority of public company investors" and that "Rule 14a-8 reform is long overdue."<sup>205</sup>

The Business Roundtable, an association of chief executive officers of major U.S. corporations,<sup>206</sup> has also strongly advocated for reform in the shareholder-proposal process. The Business Roundtable argues that proposals are dominated by a limited number of individuals who file the same proposal across a wide range of companies in which they own only a nominal amount of shares.<sup>207</sup> In a white paper published in 2016, the Business Roundtable called for modernizing the shareholder proposal process by substantially increasing the \$2,000 holding requirement; increasing the length of the holding requirement; and strengthening the resubmission thresholds.<sup>208</sup> Likewise, the Manhattan Institute for Policy Research, a conservative think tank, called for "punishing" the sponsors of proposals that fail to receive a majority shareholder support by forcing them to reimburse the corporation for at least some portion of the direct costs of addressing their proposals.<sup>209</sup>

These lobbying efforts were not fruitless. If passed, the Financial CHOICE Act, first introduced in 2017, would have limited shareholders' ability to submit proposals by increasing the minimum holding period to three years (from one year) as well as increasing the level of support an unsuccessful proposal must have received to be eligible for resubmission to 6% (from 3%).<sup>210</sup> Although attempts to increase the investment threshold by statute have fallen short, doing so through SEC rulemaking is

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<sup>205</sup> See CENTER OF CAPITAL MARKETS COMPETITIVENESS, SHAREHOLDER PROPOSAL REFORM: THE NEED TO PROTECT INVESTORS AND PROMOTE THE LONG-TERM VALUE OF PUBLIC COMPANIES 1 (2017) [https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/023270\\_-SECShareholder-Proposal-Reform-Report\\_Online\\_Report.pdf](https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/023270_-SECShareholder-Proposal-Reform-Report_Online_Report.pdf).

<sup>206</sup> BUSINESS ROUNDTABLE, <https://www.businessroundtable.org/> (last visited August 8, 2019).

<sup>207</sup> RESPONSIBLE SHAREHOLDER ENGAGEMENT & LONG-TERM VALUE CREATION, *supra* note 100.

<sup>208</sup> *Id.*

<sup>209</sup> THE MANHATTAN INSTITUTE, SEC RULE 14A-8: RIPE FOR REFORM 1 (2016), <https://media4.manhattan-institute.org/sites/default/files/T-JC-0916.pdf>.

<sup>210</sup> H.R. REP. NO. 115-904 (2018) at <https://www.congress.gov/bill/115th-congress/house-bill/5756/text>. The bill stalled in the Senate, although parts of it (unrelated to shareholder proposals) were incorporated into subsequently enacted legislation. Shearman & Sterling LLP, First Major Dodd-Frank Reform Bill Signed Into Law (May 25, 2018), <https://www.shearman.com/perspectives/2018/05/first-major-dodd-frank-reform-bill>.]

a stated near-term priority of the agency and has already yielded concrete steps.<sup>211</sup> In early November, the SEC Commission voted 3-2 to propose amendments to rules governing shareholder proposals.

More specifically, the SEC proposed updating the ownership thresholds from \$2,000 or 1% of a company's voting stock for one year to \$2,000 of voting stock for at least three years, at least \$15,000 for two years, or at least \$25,000 for one year; Additionally, the proposed amendments would raise the resubmission thresholds for matters voted on once, twice, or three or more times in the last five years to thresholds of 5% (from 3% under the current rule), 15% (6%) and 25% (10%), respectively. It would also prohibit the resubmission of a proposal that has been voted on three or more times in a five-year period if it (1) has not received majority support or (2) experienced a decline of 10% or more compared to the immediately preceding vote.

These regulatory efforts could severely limit the ability of gadflies in particular to engage in the submission of shareholder proposals.<sup>212</sup> Unlike institutional investors, gadflies cannot easily meet the \$25,000 threshold for one year holding periods at many companies at the same time. Consequently, the proposed rules would almost certainly significantly reduce the number of companies with which gadflies can engage.<sup>213</sup> Limiting the resubmission of shareholder proposals could negatively affect the ability

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<sup>211</sup> Jay Clayton, Chairman, U.S. SEC., *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (Dec. 6, 2018), <https://www.sec.gov/news/speech/speech-clayton-120618>.

<sup>212</sup> Robert J. Jackson Jr., *Commissioner, Data Appendix to Statement on Proposals to Restrict Shareholder Voting* (Dec. 6, 2018), <https://www.sec.gov/news/statements/2019/jackson-data-appendix-on-proposals-to-restrict-shareholder-voting.pdf> ("The proposed rules would also exclude up to 35% of independent Chair shareholder proposals, 40% of proxy access proposals, 50% of board diversity proposals, and nearly 65% of report on climate change proposals, and 40% of political spending disclosure proposal."). See also Andrew Ackerman, *supra* note 174 (stating that a substantial increase of the submission threshold, would triple the number of excluded proposals). The rule will also limit the ability of other investors, such as public pension funds to submit shareholder proposals. See David Webber, *Big Corporations Are Trying to Silence Their Own Shareholders*, THE WASHINGTON POST (Apr. 13, 2017), at [https://www.washingtonpost.com/opinions/voter-suppression--corporate-style/2017/04/13/bbe62880-1ed5-11e7-be2a-3a1fb24d4671\\_story.html?noredirect=on](https://www.washingtonpost.com/opinions/voter-suppression--corporate-style/2017/04/13/bbe62880-1ed5-11e7-be2a-3a1fb24d4671_story.html?noredirect=on).

<sup>213</sup> The SEC's analysis states that the proxy proposal rule would reduce the number of proposals by about 37%. See Michael Hiltzik, *The SEC is Trying to Stifle Shareholders' Right to Challenge Corporate Managements*, L.A. TIMES (Jan. 7, 2020) <https://www.latimes.com/business/story/2020-01-07/sec-shareholder-proposals>. Also, over three years, a gadfly with \$100,000 in investment capital can submit proposals to 150 targets under the existing rules (50 each year); 12 companies using the proposed \$25,000, one-year holding threshold (4 each year); 6 companies using the proposed \$15,000, two-year holding threshold; or 50 companies using the proposed \$2,000, three-year holding threshold.

of gadflies to build momentum in the market.<sup>214</sup> Moreover, unlike institutional investors, gadflies do not have the adequate resources to fight back or lobby against these proposed regulatory changes.

## 2. Corporate Backlash

In addition to regulatory reform, gadflies face targeted corporate backlash through litigation and massive exclusion of shareholder proposals aimed at deterring individuals from submitting shareholder proposals. In recent years, John Chevedden has come under attack by some of his corporate targets, including Apache Corp., Chipotle Mexican Grill Inc., EMC Corp., Express Scripts Holding Co., and Omnicom Group Inc.<sup>215</sup> Four of the lawsuits filed against Chevedden and his fellow shareholders were successful.

Apache, for example, successfully brought a lawsuit against Chevedden seeking a declaratory judgement that it could exclude a proposal submitted by him from its annual meeting proxy materials. The company argued that Chevedden abused the proxy process and had not proved that he met the ownership threshold, and therefore, that he had no right to offer shareholder proposals.<sup>216</sup> This lawsuit marked the first time a company sued to block a shareholder proposal on procedural grounds.<sup>217</sup> Express Scripts, KBR Inc., and Waste Connections, Inc. subsequently won similar lawsuits against Chevedden.<sup>218</sup>

Chevedden and his defenders see the lawsuits as serving a general purpose to deter proposals by making small shareholders with limited resources "think twice" before filing proposals.<sup>219</sup> As McRitchie explained in an interview, small shareholders are treated differently than large institutions when making proposals, as only small

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<sup>214</sup> See *infra* note 235 and accompanying text.

<sup>215</sup> Jessica Holzer, *Firms Try New Tack Against Gadflies*, WALL ST. J. (June 6, 2011) <https://www.wsj.com/articles/SB10001424052702304906004576367133865305262>.

<sup>216</sup> *Apache Corporation v. John Chevedden*, 696 F.Supp.2d 723 (March 10, 2010).

<sup>217</sup> Holzer, *supra* note 105.

<sup>218</sup> See *Express Scripts Holding Co. v. Chevedden*, No. 4:13-CV-2520-JAR, 2014 WL 631538 (E.D. Mo. Feb. 18, 2014); *Kbr Inc. v. Chevedden*, 776 F. Supp. 2d 415 (S.D. Tex. 2011); *Waste Connections, Inc. v. Chevedden*, 554 Fed. App'x 334 (5th Cir. 2014).

<sup>219</sup> Andrew Ackerman, *SEC's Gallagher Calls for Proxy-Proposal Overhaul*, WALL ST. J. (Mar 7, 2014) <https://www.wsj.com/articles/secs-gallagher-calls-for-proxy-proposal-overhaul-1395948217?tesla=y> (quoting Chevedden: "They just seem to want to stifle the shareholders and not give them a meaningful opportunity to make improvements").



shareholders are “taken . . . to court for filing proxy proposals.”<sup>220</sup> Some investors also worry the suits will prompt additional companies to turn to the courts. Unlike institutions, gadflies do not have financial resources to deal with long legal battles.<sup>221</sup> Others expressed the view that gadflies become a victim of their own success: since a significant portion of gadfly proposals pass, companies have increased interests in eliminating them through litigation before they reach shareholders.<sup>222</sup>

For completeness of the legal picture, it should be noted that a few holdings have sided with Chevedden on the basis that he represents little, if any, legal threat to the companies. In *EMC Corp. v. Chevedden*, a Massachusetts court dismissed a suit, ruling that the company was unlikely to suffer an imminent injury as a result of a proposal for an independent board chairman.<sup>223</sup> In a separate case, a judge in the Southern District of New York declined to allow Omnicom Group to omit a proposal boosting the confidentiality of shareholder-vote tallies. As in the *EMC* case, the judge ruled that Omnicom's threat of harm was remote.<sup>224</sup>

While the number of companies pursuing lawsuits to block shareholder proposals remains relatively small and are so far focused mostly on Chevedden, the widespread exclusion of shareholder proposals submitted mostly by individuals sweeps more broadly. Companies generally try to thwart proposals they dislike by asking the SEC for permission to exclude such resolutions from their proxy materials (a “no-action request”). Companies that seek to exclude proposals rely on a number of

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<sup>220</sup> Nick Dawson, *Spotlight on boards – An interview with James McRitchie, publisher of CorpGov.net and Shareholder Advocate*, CORPORATE GOVERNANCE INSTITUTE (July 1, 2019), <https://corgovinstitute.com/potlight-boards-interview-james-mcritchie-publisher-corgov-net-shareholder-advocate/>.

<sup>221</sup> Jessica Holzer, *supra* note 215.

<sup>222</sup> Andrew Ackerman, *supra* note 174 (Of the 157 proposals he has filed since 2010 that have been voted on, 55 garnered majority support according to data compiled by proxy adviser Institutional Shareholder Services Inc.).

<sup>223</sup> *EMC Corp. v. Chevedden*, 4 F. Supp. 3d 330 (D. Mass. 2014). EMC argued that Chevedden does not own EMC stock, as is required to permit him to file a shareholder proposal. EMC also contended that the proposal contains misleading information in violation of SEC proxy rules. Therefore, the company requested a declaratory judgment that it may exclude the proposal. The court ruled in favor of Chevedden, stating that EMC did not demonstrate that it would suffer an imminent injury in fact if it excluded the proposal or that there is any “case or controversy” between the parties. *See also* Andrew Ackerman, *supra* note 174.

<sup>224</sup> *Omnicom Group, Inc. v. Chevedden*, No. 14 Civ. 0386(LLS), 2014 WL 969801 (S.D.N.Y. Mar. 11, 2014). A similar suit filed by Chipotle for abuse of the proxy process and alleged violation 14a-8 rule was also dismissed by Colorado court for lack of jurisdiction. *Chipotle Mexican Grill, Inc. v. Chevedden*, No. 14-cv-0018-WJM-KMT, 2014 WL 1004529 (D. Colo. Mar. 14, 2014).

exclusion grounds outlined in Rule 14a-8, including: the “ordinary business” exception that has been used to exclude environmental proposals that micromanage the company; the “substantially implemented proposal” exception, which has been used to exclude shareholder proposals that already exist in practice, even if the company’s bylaws contain terms that are different from the shareholder’s proposal; and the existence of a “conflicting management proposal.”<sup>225</sup>

In the 2019 proxy season, 84 S&P Composite 1500 companies challenged a total of 156 proposals through the SEC no-action process, nearly 25% of those submitted. The SEC staff permitted full exclusion of 108 proposals (69% of requests).<sup>226</sup> In total, about a third of proposals excluded through the SEC no-action process between 2006 to 2014 were filed by Chevedden.<sup>227</sup>

In September 2019, the SEC announced that its staff would no longer provide written responses to issuers and shareholder proponents in all instances where a company seeks to exclude a shareholder proposal from its proxy statement. Instead, beginning in 2020, the staff may respond in writing (when it “believes doing so would provide value, such as more broadly applicable guidance about complying with Rule 14a-8”) or orally, and, in some cases, may not provide any response. The SEC has said publicly that it will furnish on its website a chart that tracks the staff’s actions on “no-action” requests.<sup>228</sup> This change in policy is likely to further enhance the ability of companies to exclude shareholder proposals.<sup>229</sup>

### III. Policy Implications

This Part analyzes the policy implications of our findings. In Section A, we explain why the recent regulatory proposals aimed at limiting gadflies’ activity are missing the forest for the trees and divert the attention of policymakers and market participants from the real policy question at stake: should investors have a say in determining market-wide governance standards?

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<sup>225</sup> Treviño, *supra* note 121. The Staff Legal Bulletin 14H, which followed the SEC’s “Whole Foods” no-action decision in 2015 dramatically limited the exclusion available for shareholder proposals that are in “direct conflict” with company proposals. *See* David Katz and Laura McIntosh, Shareholder Proposals in an Era of Reform, HARV. L. SCH. F. CORP. GOV. & FIN. REG. (Dec. 5, 2017), <https://corpgov.law.harvard.edu/2017/12/05/shareholder-proposals-in-an-era-of-reform/>.

<sup>226</sup> Treviño, *supra* note 121.

<sup>227</sup> Andrew Ackerman, *supra* note 174.

<sup>228</sup> Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Release No. 34-87458.

<sup>229</sup> A written, publicly available response sets a precedent that preempts additional companies from using certain problematic practices in the future and assists gadflies in recognizing mistakes in their submission process.

Recognizing the fragility of the current landscape, Section B explores ways to reconcile the regulatory push and the inherent shortcomings of gadflies. We explore two avenues that would enable the adoption of strongly supported governance policies, while minimizing the reliance on gadflies for the submission of shareholder proposals. In particular, we suggest: (1) having the shareholder proposals submitted by an intermediate organization that specializes in filing these proposals; and (2) the automatic submission of shareholder proposals that receive the strongest shareholder support. While this is not an exhaustive list, these solutions are aimed at sparking a much needed discussion on this important topic, refocusing the debate on shareholder proposals rather than on particular aspects of gadflies.

A. *Killing the Messenger? A Critique of Proposed Rule 14a-8 Reform*

The recent SEC proposed reform on submission thresholds misses the forest for the trees. Shareholder proposals must be examined against a broader understanding of two important factors: (i) the systemic legal, financial, and structural constraints that prevent large institutional investors from utilizing the shareholder proposal tool to advance governance terms they publicly support, and (ii) the role that gadflies currently play as "governance facilitators" by initiating important governance changes that large institutional investors overwhelmingly support at annual meetings. Considering this symbiotic relationship between gadflies and large institutional investors, any effort to silence gadflies, without addressing the systemic constraints that large institutional investors face or empowering a replacement, kills the messenger and will hinder the adoption of governance policies these institutions support.

Furthermore, we use the context of corporate gadflies as an invitation to rethink a much broader and important governance debate—the role that large institutional investors play (or refrain from playing) in designing corporate governance arrangements of public corporations. The focus on the "messengers"—the corporate gadflies—diverts the attention of policymakers and market participants from the cardinal question: whether large institutional investors should have a say in determining market-wide corporate governance standards.

To be clear, regulators and scholars may have differing normative positions on whether institutional investors should determine market-wide governance terms. The increased engagement by shareholders has stirred a vivid debate regarding the proper boundaries of shareholder input, with some commentators lamenting uninformed investors' influence on governance,<sup>230</sup> the pursuit of short-term interests at the expense

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<sup>230</sup> See Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 761 (2017) (demonstrating an inevitable tradeoff between empowering versus constraining managers, what they call "principal costs"); Sean J. Griffith, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, TEX. L. REV.

of long-term performance, and the prioritization of the interests of shareholders over other stakeholders.<sup>231</sup> In addition, some have argued that granting shareholders additional avenues for signaling their dissatisfaction with management may be counterproductive either because it increases directors' incentives to focus on the short-term or because shareholder engagement reduces directors' accountability for their individual decisions, thereby insulating them and weakening their incentive to act in shareholders' best interests.<sup>232</sup> Other scholars, however, express skepticism towards leaving this type of decisions in the hands of management, arguing that this may produce inefficient tailoring of corporate governance terms, as "firms that need governance constraints are precisely the ones that do not volunteer to implement them."<sup>233</sup>

Regardless which side of the debate one supports, one thing is clear: instead of focusing on whether gadflies or other individuals should be allowed to submit shareholder proposals, policymakers should recognize the role played by these

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(forthcoming, 2020) (developing a theory of mutual fund voting and arguing that funds ought not to exercise voting discretion over governance issues as they do not have adequate information to decide the matter); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493 (2018) (passive investors should not vote because managers of passive funds are unlikely to thoughtfully engage with the companies and are likely to follow low-cost voting strategies, resulting in uninformed voting).

<sup>231</sup> For concerns that shareholders are uninformed and motivated by short term consideration, see also Goshen & Squire, *supra* note 230, at 767; Lynn Stout, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC*, 63–73 (2012) (criticizing the prioritization of the interest of shareholders over stakeholders); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 653–54, 657–59 (2010) (discussing problems created by the increase in shareholder power and rise of short-term investors ).

<sup>232</sup> Minor Myers, *The Perils of Shareholder Voting on Executive Compensation*, 36 DEL. J. CORP. L. 417 (2011) ("[T]he more involved shareholders are in a firm's managerial decisions, the more difficult it is for directors to be held accountable for the outcome of those decisions. This can weaken directors' ex ante incentives to act in the interests of shareholders."). Critics also argue that granting shareholders another forum for signaling their dissatisfaction with the management and performance of the corporation may be counterproductive. According to this argument, if investors have a tendency to focus on maximizing short-term profits and are signaling concerns over near-term stock performance through their votes, they may be increasing director incentives to focus on short-term stock performance rather than firm value. See Jill E. Fisch, Darius Palia & Steven Davidoff Solomon, *Is Say on Pay All About Pay? The Impact of Firm Performance*, 8 HARV. BUS. L. REV. 101 (2018).

<sup>233</sup> Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. 131, 131 (2018). See also Lucian Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1841 (1989) (discussing the limited effect of market discipline on managerial decision making).

individual shareholders in the ecosystem, as governance facilitators, address it as such, and focus on whether and how to increase the input of *all* investors into the shareholder proposal mechanism.

Finally, limiting the resubmission of shareholder proposals could negatively affect the ability of shareholders to build momentum in the market and to signal to companies and policymakers that a sufficient interest exists to justify the adoption of a certain governance standard through private ordering or mandatory regulation. Indeed, evidence shows that a shareholder proposal is often outcome determinative if it receives around 25% of the votes—one of the thresholds below which the SEC's proposed rules would prohibit resubmission of the proposal. For example, companies reconsider and revised their compensation packages when their "say-on-pay" votes received objection ratios of 20-30% of all outstanding votes.<sup>234</sup> Similarly, Bebchuk, Jackson, Nelson and Tallarita showed that the SEC has historically viewed large minority support for shareholder proposals calling for more transparency as sufficient justification for the adoption of certain mandatory disclosure rules or guidance, as reflected in the context of executive compensation or disclosure matters related to climate change.<sup>235</sup>

#### B. *Enhancing Large Investors' Involvement in Governance Standards*

Gadflies are not necessarily the long term answer to the governance of American corporations. They face important constraints that make them an imperfect solution and raise questions regarding their long-term viability. Regulatory reform, therefore, requires more than a band-aid approach of restricting gadflies' ability to initiate proposals. It requires addressing institutional investors' role directly, invigorating a discourse regarding the role that these large investors should have in shareholder proposals.

Before delving into our proposed solutions, one could ask why there is a need for an intervention in the marketplace in the first place. Gadflies do not have a monopoly on the submission of shareholder proposals. If they do not handle this process properly or if they are driven out of the market due to recent regulatory reforms, the argument goes, another active shareholder could show up at companies' annual meetings and submit shareholder proposals. In particular, one would expect that market forces would eventually ensure that the governance arrangements that a

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<sup>234</sup> See *supra* note 159.

<sup>235</sup> Lucian Bebchuk, Robert J. Jackson, James Nelson & Roberto Tallarita, *The Untenable Case for Keeping Investors in the Dark*, 10 HARV. BUS. L. REV. 14–16 (Forthcoming 2020) (finding that "none of the shareholder proposals that motivated the SEC to reconsider its executive pay disclosure rules in 1992 received majority support").

*majority* of shareholders view as value enhancing on systemic basis would always be adopted.

We are skeptical about this argument. As discussed in length in Subsection II.B.3, there is a set of governance arrangements that many shareholders (including large institutional investors) favor, but a significant fraction of public companies avoid adopting in a timely fashion. Gadflies provide only a partial solution to this problem, which is more prevalent among mid- and small-cap companies—the ones that systematically receive less shareholder proposals.<sup>236</sup> Large investors, particularly the Big Three, are unlikely to fill this void with shareholder proposals due to collective action problems, concerns from damaging the relationships with managers of portfolio companies, and the willingness to debase the prospect of a regulatory backlash by avoiding the appearance of power. The end result is a systemic "friction" in the adoption of governance arrangement that most investors favor. To bridge this gap, we suggest a reconceptualization of the way shareholder proposals get to the ballot altogether—either in the form of a "nudge"<sup>237</sup> or by enabling the use of "professional filers."

#### 1. Gadflies 2.0: The Use of "Professional" Filers

What if gadflies' virtues could be mostly decoupled from their vices? With the proper safe harbors, investors could establish an intermediate organization that would advise and assist large investors in the submission of shareholder proposals and handle all the operational activity associated with the submission of such proposals. This organization could be established by a nonpartisan association of investors, such as the Council of Institutional Investors ("CII"). The organization would hire a handful of full-time employees, who would specialize in the submission of shareholder proposals. Its activity, which would require a relatively modest budget, would be funded on a pro-rated basis by investors who are members of the association. Prior to each proxy season, the organization would conduct a survey among its members and decide which topics would be on its agenda and the type of proposals that would be submitted.

There are a number of advantages to a centralized "professional" filer handling the submission of shareholder proposals on behalf of a coalition of investors. First, it will achieve economies of scale by sharing the costs of engagement between a large pool of investors, resolving coordination problems, and avoiding duplicative engagement by different shareholders (including the submission of the same proposal

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<sup>236</sup> See *supra* notes 118–121.

<sup>237</sup> See RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* 6 (2008). For an article calling for the use of pre-determined default arrangements to incentivize retail investors to vote, see Kastiel & Nili, *supra* note 19.

by two or more investors). Second, this organization will develop expertise and the institutional body of knowledge necessary to handle the submission of proposals in the most efficient way to ensure its long-term operation. Third, the organization will have a market-wide perspective and will be able to run organized campaigns on hot topics that are of interest to a large coalition of shareholders. It could also test the water by trying new types of proposals. Finally, since the organization will negotiate with companies regarding the proposals, it will be the one facing management directly and thus could alleviate the risk of management or regulatory backlash to any single institutional investors. Also, the submission of proposals by this entity conveys the support of a coalition of investors, making passage of a vote more probable and increasing the likelihood that management will voluntarily adopt the proposals.

In fact, this proposed solution will be the next phase in the evolutionary process of "soft" engagement through the submission of shareholder proposals—"Gadflies 2.0". Like gadflies, this non-profit organization will handle the submission of shareholder proposals on a large scale, become a governance "facilitator," initiate market-wide changes to the benefit of other investors, acquire expertise in this field, and will not be deterred from confronting management. However, unlike gadflies, the clients of this organization are well-diversified and have equity positions in almost all public companies; this non-profit organization will have an established platform for submitting proposals, with institutional body of knowledge and paid employees; its high-level decision making will be supported by a coalition of investors; and it will be able to engage with a larger number of companies on a systemic basis. The Shareholder Rights Project at Harvard, which successfully facilitated board de-staggering, provides a proof of concept.<sup>238</sup>

The submission of shareholder proposals on a large scale is time-consuming and costly. The professional filer model will solve this collective action problem by creating a mechanism for cost-sharing that would enable the submission of shareholder proposals on a large scale. This mechanism would ensure that all of the investors who benefit from the submission of proposals bear a portion of the costs associated with it, instead of imposing all costs on a single shareholder.

In a recent article, Lucian Bebchuk and Scott Hirst discussed the costs associated with stewardship activities and call upon policymakers to facilitate the pooling of research, including by having research conducted by outside organizations on behalf of multiple index fund managers.<sup>239</sup> In their view, such pooling of resources,

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<sup>238</sup> *Supra* note 79.

<sup>239</sup> Stephen T. Giove, Arielle L. Katzman & Daniel Yao, Shearman & Sterling LLP, *Proxy Access Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 19, 2018),

which already takes place in Europe,<sup>240</sup> could also improve index fund stewardship in the United States. Pooling of resources, we argue, could also be used to sponsor the submission of shareholder proposals. In this context as well, policy makers should facilitate resource pooling by emphasizing that such resource sharing would not constitute a “group” under Section 13(d).<sup>241</sup>

Technically, the non-profit organization could submit proposals through three avenues. In the first option, the organization will only advise and provide support in connection with the submission of the proposals, but the actual proponent will be an institutional investor. In other words, the organization will prepare the proposals, handle all the procedural aspects of the submission process, negotiate with management, but the signatory—the actual beneficial owner—will still be an institutional investor. Second, the coalition of investors could allocate some additional amount that would enable the organization to purchase a small amount of shares in order to comply with the minimum ownership threshold. The last alternative solution is to relax Rule 14a-8 to enable the submission of shareholder proposals by certain authorized proxies. Such an amendment would enable an institutional investor (or a coalition of investors) that meets the 14a-8 criteria to delegate its eligibility to a third party. That third party will be able to submit the proposal on behalf of the investor for a fee that will also cover the cost of doing so. Under the current regime, institutions cannot delegate their eligibility because proposals must be submitted by the beneficial owner of the stock.<sup>242</sup>

Finally, this professional filer could also directly assist current gadflies with their own submissions, therefore inoculating some of the prevailing concerns regarding gadflies. Specifically, if gadflies invoke concerns regarding the quality of their proposals, they could use a professional filer’s seal of approval to bolster their proposal. Furthermore, the SEC can promulgate a safe harbor provision, exempting gadflies from the restrictions on submission/re-submission if their proposal is made through a professional filer or receives its seal of approval.

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<https://corpgov.law.harvard.edu/2018/10/19/proxy-access-proposals-2/> (“In total, well over 500 companies, and over two-thirds of the S&P 500, have adopted proxy access by-laws.”).

<sup>240</sup> In the United Kingdom, some pooling of stewardship is done through the Investor Forum. *See* Investor Forum, About The Investor Forum (2018), <https://www.investorforum.org.uk/about>. For a discussion of this approach, see Andrew F. Tuch, *Why Do Proxy Advisors Wield So Much Influence? Insights From U.S.-U.K. Comparative Analysis*, SSRN Scholarly Paper ID 3384264 (Social Science Research Network), May 7, 2019.

<sup>241</sup> Bebchuk & Hirst *supra* note 27, at 69–70 (noting that European Securities and Market Authority provides a safe harbor for certain collective efforts by shareholders).

<sup>242</sup> 17 C.F.R. § 240.14a-8.



## 2. "Nudging" Institutional Investors

Another potential solution is to "nudge" institutional investors to vote on key shareholder proposals through automatic balloting. This would take the form of an SEC rule requiring companies to periodically put certain matters to a shareholder vote, such as every 5 years. Such automatic inclusion in the company ballot will avoid the dependency on a handful of individual proponents for the submission of proposals. Since institutional investors are likely to vote on these proposals when brought for their approval, this "nudge" will force them to consistently express their view on, and participate in the design of, major governance arrangements of their portfolio companies (until these proposals pass).<sup>243</sup>

We recognize that not all shareholder proposals are a perfect fit for this proposed solution, as some concern idiosyncratic features of a given company. This solution focuses mostly on the shareholder proposals that relate to market-wide corporate governance standards, which could be applied across the board to a large number of companies. Also, as a starting point, policymakers could focus on the five most popular and generic proposals. Those are the proposals that receive the *strongest support* among public shareholders (*e.g.*, those that receive more than 40% to 50% of the votes cast) and are often more formulaic and thus relatively easy to implement. Our empirical evidence demonstrates that proposals qualifying under this standard concern governance, rather than environmental or social issues. A representative sample of these proposals includes those to adopt annual election for all directors, majority voting, shareholder-initiated special meetings, separation of chairman and CEO roles (when applicable), proxy access, action by written consent, disclosure of gender diversity, and disclosure of political spending. Shareholders would not be permitted to submit individual proposals on matters that are brought to an automatic vote.

Moreover, not all proposals selected for an automatic vote have to be submitted to the company ballot at once. Instead, there could be a rotation through the proposal list during the period. If a company is interested in shortening or extending the interim period between the automatic submission of these proposals, it could ask shareholders to vote on a "say-on-frequency" proposal. It could also be agreed upon in advance that

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<sup>243</sup> In a recent article, Scott Hirst presented the idea of investors' private ordering as a substitute for most mandatory regulation. In particular, Hirst suggested that the SEC should set default arrangements for corporations, but permit corporations to switch to alternative arrangements if their investors approve. See Scott Hirst, *The Case for Investor Ordering*, 8 HARV. BUS. L. REV. 227 (2018); Our proposed solution is different in a couple of major aspects. First, it forces shareholders to vote on the extension/adoption of a given governance arrangement every few years and thus stimulating the market for votes. Second, our solution does not enable shareholders to opt out of mandatory securities regulation.

a proposal receiving shareholder support exceeding a certain threshold would automatically be subject to a shareholder vote the following year, regardless of the predetermined frequency of the automatic submission of that proposal. Finally, once a shareholder proposal passes and is implemented by the company, such proposal would no longer be subject to automatic balloting.

To be clear, this solution does not, by any means, expand existing powers or rights afforded to public shareholders. All of the shareholder proposals that will be submitted to the company's ballot are *permitted* to be submitted even under the existing legal regime. This solution simply adds these to a set of pre-determined proposals on which shareholders will be *required* to vote automatically every few years. Forcing shareholders to express their views on matters on which they are permitted to vote in the first place is not an extension of their powers. Rather, it would eliminate the randomness by which these proposals come to a vote.

We also note that this proposed solution is not radically different from other governance arrangements that already exist in the market place. Since 2010, most U.S. public companies have been required to conduct an advisory vote, either approving or disapproving the pay of senior executives (say-on-pay votes).<sup>244</sup> This rule provides a proof of concept for our proposal. A say-on-pay vote is generally held on an annual basis, but shareholders are able to change the frequency of the vote to every two or three years. Interestingly, while the overwhelming majority of the votes on say-on-pay do not attract strong shareholder opposition,<sup>245</sup> the ever-present specter of receiving a significant percentage of negative votes forces insiders to be more attentive to shareholder demands, to disclose more information, to engage with major shareholders before the proxy season, and to conduct negotiation behind the scenes.<sup>246</sup>

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<sup>244</sup> Section 14A(a)(1) of the Securities Exchange Act of 1934 and SEC Rule 14a-21(a) requires that at least once every three years, at an annual meeting of shareholders, a public company afford its shareholders the right to a nonbinding vote to approve the compensation of the company's named executive officers. Securities Exchange Act of 1934 §14A(a)(1); 17 C.F.R. § 240.14a-21 (2014).

<sup>245</sup> Subodh Mishra & Institutional Shareholder Services, Inc., *2017 Proxy Season Review: Compensation*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Oct. 6, 2017), <https://corpgov.law.harvard.edu/2017/10/06/2017-proxy-season-review-compensation/> (“Since the introduction of say-on-pay, average support levels have remained consistently high. The 2017 proxy season was no exception, with average vote support of 92.1 percent, the highest to date. Failed votes remained a rare occurrence and the failure rate of 1.3 percent for 2017 was the lowest yet.”).

<sup>246</sup> This important disciplinary force exists also in the context of hedge fund activism, but there is a limited number of hedge fund engagements each year, and many companies are not subject to the risk of activist intervention. See Bebchuk & Hirst *supra* note 27, at 82–83 (providing evidence to the limits of hedge fund activism). Shareholder proposals, unlike hedge fund engagements, are more generic and

Another related mechanism is a sunset provision which generally stipulates that a given governance arrangement will automatically expire after a fixed period of time, unless the initially specified duration of that governance provision is extended by a majority shareholder approval. Recently, Lucian Bebchuk and one of us advocated for the adoption of sunset provisions in dual-class IPOs, and analyzed the merits and potential designs of such provisions.<sup>247</sup> Similar to the proposed solution, sunset terms create more opportunities for shareholders to express their view on a specific governance arrangement, and increases the incentives of insiders to be more attentive to shareholder demands and to perform well in order to ensure the extension of the governance arrangement that is subject to the sunset provision.

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Admittedly, our proposed models are not without objections. A major possible objection to these proposed solutions is that subjecting more governance matters to a shareholder vote would entail high costs. Before bringing a matter to a shareholder vote, a company has to convene the board of directors to discuss the proposal, form a recommendation with respect to the proposal, publicly disclose information related to the proposals, and hire proxy solicitors to assist with persuading public shareholders to support management view.<sup>248</sup>

These costs, however, are trivial for public companies.<sup>249</sup> Moreover, these proposed solutions are expected to address only the submission of proposals that traditionally receive strong shareholder support and thus are presumably beneficial to shareholders.<sup>250</sup> Shareholder proposals that generally receive low support will not be

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thus more easily used at a large number of companies at the same time, and thus have a much broader influence on the market.

<sup>247</sup> See Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 618-22 (2017). For earlier work that expresses support for sunsets in other corporatelaw contexts, see Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. PA. L. REV. 713, 751-52 (2003), and John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?*, in REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 677, 704 (Guido Ferrarini et al. eds., 2004).

<sup>248</sup> Jill E. Fisch, *Leave It to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731, 754-58 (2013) (discussing the costs associated with providing shareholders a vote on executive pay).

<sup>249</sup> Foley & Bissell, *supra* note 92.

<sup>250</sup> For instance, shareholder proposals that attracted particularly high rate of support in 2018 are: declassifying board, eliminating supermajority voting, majority voting in uncontested election, and the initial adopting of proxy access.

filed by a professional filer or included in the short list of proposals automatically submitted to the company ballot periodically.

A “one-size-does-not-fit-all” objection<sup>251</sup> would argue that governance arrangements that might be optimal for some companies might not be optimal for others.<sup>252</sup> Therefore, it might be argued, submitting the same short list of shareholder proposals to *all* companies—either automatically or through a professional filer—may be counterproductive, as some companies would benefit from having certain governance arrangements, while others not.

These proposed solutions, however, would not necessarily result in all companies having the same governance arrangements. Subjecting certain governance terms to a shareholder vote does not mean that shareholders will have to approve them. Investors whose money is on the line—including, critically, institutional investors—can also vote with management if they feel that a governance structure that insulates management, such as staggered board, enhances value. The purpose of these solutions is to remedy structural disadvantages inherent in the shareholder proposal arena, while facilitating the adoption of governance arrangements supported by a majority of investors.

Finally, on the ability of institutional investors to screen out harmful proposals, we note a recent working paper that empirically examines stock market reaction to the submission and implementation of shareholder proposals.<sup>253</sup> Contrary to previous literature on the valuation effect of shareholder proposals, the study shows that some of the proposals submitted by gadflies destroy shareholder value.<sup>254</sup> However, it also finds that “if a larger proportion of a company’s shares are held by discerning mutual

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<sup>251</sup> Bebchuk & Kastiel, *supra* note 247 at 623-24 (presenting this argument in the context of dual-class shares).

<sup>252</sup> Zohar Goshen, *Against Mandatory Sunset for Dual Class Firms*, CLS BLUE SKY BLOG (Jan. 2, 2019), <http://clsbluesky.law.columbia.edu/2019/01/02/against-mandatory-sunset-for-dual-class-firms/>; Bernard S. Sharfman, R Street Institute, *The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuk and Kastiel*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG (Apr. 24, 2019), <https://corpgov.law.harvard.edu/2019/04/24/the-undesirability-of-mandatory-time-based-sunsets-in-dual-class-share-structures-a-reply-to-bebchuk-and-kastiel/>.

<sup>253</sup> Gantchev & Giannetti, *supra* note 104.

<sup>254</sup> Previous studies find evidence of positive (albeit small) share price reactions to shareholder proposals. *See, e.g.*, Gillan & Starks, *supra* note 95 (observing a significant positive abnormal return to all proposals sponsored by individuals); Renneboog & Szilagyi *supra* note 87 (finding that shareholder proposals are associated with small but statistically significant share price increases at the target firms); Vicente Cuñat, Mireia Gine & Maria Guadalupe, *The Vote is Cast: The Effect of Corporate Governance on Shareholder Value*, 67 J. FIN. 1943 (2012) (reporting that shareholder proposals that pass earn an abnormal return of 1.30% compared to those that fail).

funds, harmful proposals are more likely to be weeded out," that "[o]verall, shareholder voting appears to provide some discipline in screening out bad proposals," and that in firms with an informed shareholder base, "shareholder proposals yield on average positive abnormal returns."<sup>255</sup> While this type of study suffers from econometric limitations, such as selection effect,<sup>256</sup> its finding (if taken at face value) actually supports the overall message of this Part: policymakers should not spill the baby with the bathwater. Even in the use of shareholder proposals by gadflies is not always optimal, the solution could be to enhance institutional investors' engagement in the process of determining market-wide corporate governance standards, rather than limiting all together the use of shareholder proposals.

### Conclusion

Shareholder proposals have become one of the leading influences on the governance terms of large companies in the U.S. economy. Yet, these proposals have been used in a very sporadic, not to say random, way. In particular, the submission of shareholder proposals has been concentrated in the hands of a few individuals—the corporate gadflies.

Gadflies are not a new phenomenon. They have been around since 1935, but while in the past gadflies were merely perceived as an annoyance, this is no longer the case. We show that the rise in institutional investors' power has created a new ecosystem, whereby gadflies initiate shareholder proposals and the large institutional investors—those that are unwilling to be in the driver seat of governance arrangements—support these initiatives.

Most importantly, as gadflies became a major force within the corporate governance arena, their activity has been subject to significant backlash. The prevailing narrative has been that managers of public companies "are repeatedly distracted by referendums on a variety of topics proposed by investors with trifling stakes." This strong pushback has eventually led the SEC to reinvigorate Rule 14a-8

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<sup>255</sup> Gantchev & Giannetti, *supra* note 104, at 3, 23, 28 (also finding that in firms with more informed shareholders, "bad proposals sponsored by individual investors are between 40% to 70% less likely to pass with majority support").

<sup>256</sup> For example, the authors focus on shareholder proposals that fall within 20% (above and below) of the company's passing threshold, and exclude gadflies' most successful proposals that passed by extremely large margin. The authors also do not consider proposals that shareholders withdraw after negotiations with management. Such proposals generally have high likelihood to pass. Excluding both type of proposals is likely to undervalue the overall effectiveness of gadflies, who tend to focus on corporate governance terms that generate large consensus among investors. Finally, a general concern that related to this entire line of literature is that the difficulty of drawing any causal inference due to a selection effect. For example, certain proponents (such as gadflies) could be more likely to target poorly performing companies.

by proposing to significantly raise both the ownership thresholds for shareholder proposal submissions and the vote outcome hurdles for proposal resubmissions.

As long as the broiling regulatory debate regarding the future of shareholder proposals is ongoing, our hope that is that this Article will contribute to a re-imagination of the shareholder proposal tool and, by extension, the role of shareholders. By shining light on corporate gadflies, their limitations, and the risk that policymakers will silence them altogether, our Article stresses the need to find a systemic solution to prompt institutional investors to become active. This Article and our suggested solutions could be an important, first step in sparking a discourse on the best ways to move in that direction.