

Can We Do Better by Ordinary Investors?

April 1, 2014 | Client Update | 3-minute read

That is the title of a law review [article](#) by Delaware Supreme Court Justice Leo Strine. Chief Justice Strine wades into the debate taken up by Professor Lucian Bebchuk, who strongly advocates that managers who make investments be given increased shareholder power, against others who Professor Bebchuk has dubbed “insulation advocates,” namely those who favor wide discretion for corporate managers in the form of boards and executives. The first part of the article presents the two starkly opposing views between the direct democracy pushed by Professor Bebchuk and those concerned that the consequences of being subject to majority shareholder whims will lead to an intense focus on the short-term that harms corporations. The article cites numerous dueling studies that attempt to prove either proposition, “[a]s may fit their shared experiences as Dungeons & Dragons aficionados, Bebchuk and his sparring partners share an affinity for exploring ‘myth’ and engaging in rhetorical jousts where no real world blood is shed.”

The true value, however, is Chief Justice Strine’s own pragmatic attempts to find some common ground, by offering several suggestions on possible improvements toward creating a corporate governance system that better serves ordinary investors and long-term wealth gains in holding accountable the money managers who wield voting power:

- Require index funds, the ultimate long-term investor that perhaps best represents the mainstream investor community, to vote in a way that reflect distinct investment philosophies of their clients, instead of the existing system where funds from the same family may end up voting differently on a merger depending on whether they hold target or acquirer shares, which he calls “incoherent, stupid, and reflective of a lack of judgment” about the funds’ individual investors’ interests
- Reduce the number of voting matters, or permit investors to decide not to vote in some cases, so that good decisions can be made and over-reliance on proxy advisory firms avoided (one footnote indicates that BlackRock voted on 129,814 proposals at 14,872 meetings worldwide during the 2012 proxy season)
- Instead of majority voting for directors which presents no alternative candidates, adopt bylaws that reimburse proxy contest expenses if the contestants’ slates achieve credible (such as 35%) victories and combine this approach with proxy access so that qualifying nominees appear on companies’ ballots
- Since at the current rate “classified boards will be rarer than novel turns of phrases by political pundits,” institutional investors should “get smart and learn to love” the standard form of poison pills, instead of exhibiting “reflexive hostility” when pills are adopted
- In light of his view that the current system essentially lets some shareholders use corporate funds on a subsidized basis to press their own initiatives, Chief Justice Strine urges that Rule 14a-8’s threshold ownership level be amended to \$2 million and require a filing fee, and also permit companies to exclude proposals that do not receive at least 20% support in the first year and 30% in the second year to avoid the same proposals receiving low votes reappearing every year, that becomes “redolent of Ceausescu-style vote rigging”
- Mandate up-to-date and complete information about the economic interests of activist shareholders, including shortening the deadline for 13D filings
- Seek say-on-pay votes only every three or four years as studies show that the current voting pattern is driven by dissatisfaction with a company’s poor performance rather than a philosophical disagreement with a company’s executive compensation program
- Give 401(k) investors additional investment choices, such as investing in private equity funds that span a longer time period than actively traded mutual funds with faster portfolio turnovers

Ultimately, Chief Justice Strine is concerned that shareholder empowerment in today’s market do not reach the “ordinary investor” whose funds are at stake, given that those who affect governance in the form of voting and other types of

activism are not sufficiently accountable to the end investor. The 154 footnotes in his 54-page article also provide a detailed library of corporate governance studies that reach divergent conclusions, indicating that the debate about the balance of power between corporations and shareholders is far from over.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Ning Chiu

+1 212 450 4908

ning.chiu@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's privacy notice for further details.