

EMPIRICAL STUDY

SHAREHOLDER ACTIVISM: DIRECTORIAL RESPONSES TO INVESTORS' ATTEMPTS TO CHANGE THE CORPORATE GOVERNANCE LANDSCAPE

I. INTRODUCTION

“Shareholder proposals are brief statements requesting certain action by the management [often a board of directors] of a public company.”¹ Sources indicate that institutional investors (or institutional shareholders) have become more active in corporate governance over the past ten years.² Concurrently, corporate America has become an instrument used by political and social groups for social change.³ A result of the increased role undertaken by institutional investors has been “dramatically increased usage of the shareholder proposal process.”⁴

This Empirical Study analyzes the support from shareholders in the increasing number of corporate-governance-related shareholder proposals in terms of simple majority voting and reviews board support in the form of implementation of these proposals. This Study also evaluates the impact of the type of the shareholder, whether individual or institutional, on the proposal’s eventual success.

II. BACKGROUND HISTORY

A. *The Shareholder Proposal Process Under SEC Rule 14a-8*

The basis for shareholder proposal requirements lies in Rule 14a-8, which establishes the conditions needed for a proposal to be placed on a company’s proxy statement.⁵ The Securities and Exchange Commission (“SEC”) enacted this rule “to ensure

1. MARK J.P. ANSON, HANDBOOK OF ALTERNATIVE ASSETS 478 (2002).

2. Susan Cooper Philpot, *Proxy Statements and Proxies Under the Securities Exchange Act of 1934*, in SECURITIES FILINGS 2004, at 155, 265 (Steven V. Bernard et al. eds., 2004).

3. *Id.*

4. *Id.*

5. 17 C.F.R. § 240.14a-8 (2005).

shareholder participation in important company decisions.”⁶ Although the rule was implemented to augment shareholder involvement in corporate governance, shareholders remained passive until the SEC amended federal proxy rules.⁷

All shareholder proposals go through a similar process. Any shareholder—individual or institutional—can make a proposal.⁸ Once a shareholder submits a proposal, under the circumstances outlined by Rule 14a-8,⁹ the proposal is “included on the company’s proxy statement at the expense of the company . . . [and] must be presented at the annual shareholders’ meeting.”¹⁰ The proposals are then voted upon at the annual shareholders’ meeting.¹¹

A simple majority vote, however, is insufficient to pass the proposal.¹² “A passed shareholder proposal is not binding on the corporation unless the corporation’s bylaws make [the proposal] binding on the management of the company.”¹³ Rather, after a proposal receives a simple majority from the shareholders, the decision rests with the board to either reject or implement the proposal.¹⁴ The rationale is that proposals submitted under Rule 14a-8 may be “precatory rather than mandatory proposals, i.e., only requesting but not requiring board action, and so even though a proposal receives [a simple majority] of the votes cast, implementation may nevertheless remain at the discretion of the board.”¹⁵ Even if the proposal is mandatory, the board may determine that it is not in the company’s best interest to implement the directive and, therefore, that it can reject it on the grounds of the business judgment rule.¹⁶

6. Christine L. Ayotte, *Reevaluating the Shareholder Proposal Rule in the Wake of Cracker Barrel and the Era of Institutional Investors*, 48 CATH. U. L. REV. 511, 511-12 (1999).

7. For a comprehensive discussion of SEC Rule 14a-8, its goals, and the recent phenomenon of shareholder activism, see Bradley S. Austin & C. Keith Taylor, *Recent Trends Surrounding the Responsiveness of Corporate Boards of Directors to Shareholder Proposals* 3-4 (Wake Forest L. Rev. Center for Empirical Legal Stud., Working Paper No. 2, 2005), <http://www.law.wfu.edu/prebuilt/Austin-Taylor%20Final.pdf>.

8. 17 C.F.R. § 240.14a-8(b).

9. *Id.* § 240.14a-8.

10. ANSON, *supra* note 1, at 478-79.

11. *Id.* at 479.

12. *Id.*

13. *Id.*

14. *Id.*

15. Patty M. DeGaetano, *The Shareholder Direct Access Teeter-Totter: Will Increased Shareholder Voice in the Director Nomination Process Protect Investors?*, 41 CAL. W. L. REV. 361, 396 n.213 (2005) (internal quotation marks omitted).

16. See *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 66-67

B. Types of Investors

As stated earlier, a shareholder proposal can come from either an individual investor or an institutional investor.¹⁷ An individual investor is a person who invests in shares of a company. An institutional investor, as defined by National Association of Security Dealers (“NASD”) Rule 3110(c)(4), can be an entity or persons.¹⁸ Institutions owe a fiduciary duty to their own shareholders or beneficiaries and, therefore, are frequently and primarily concerned with enhancing shareholder wealth.¹⁹ Thus, with both kinds of investors, profit maximization is a major objective.

1. Individual and Institutional Investors

An individual investor is probably more risk averse than a powerful institutional investor and, thus, is looking for “the highest expected return commensurate with an acceptable level of risk.”²⁰ While an institutional investor may have similar objectives, it will likely have far more financial influence to accomplish its objective.

The institutional investor, because of its fiscal impact on a company, generally wields more power than does an individual investor. This power also has an impact on voting because institutional investors are occasionally “able to put enough pressure on management to convince the company to implement the proposal without going through with a vote.”²¹ “The threat that a large investor . . . will sell a company’s stock [to that company’s detriment] is sometimes enough to bring management to the bargaining table.”²²

(Del. 1989) (discussing the “classic factors upon which a board may base a proper business decision to accept or reject a proposal”).

17. See *supra* note 10 and accompanying text.

18. NASD Rule 3110(c)(4). Rule 3110(c)(4) defines an institutional investor as a “bank, savings and loan association, insurance company, or registered investment company; an investment advisor registered under Section 203 of the Investment Advisors Act of 1940; and any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.” *Id.*

19. JAMES P. HAWLEY & ANDREW T. WILLIAMS, *THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC* 103 (2000).

20. Donald S. Chisum, *Book Review*, 86 HARV. L. REV. 1103, 1112 (1973) (reviewing VICTOR BRUDNEY & MARVIN A. CHIRELSTEIN, *CASES AND MATERIALS ON CORPORATE FINANCE* (1972)).

21. Marc H. Follardori, *Shareholder Proposals*, in 3 PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 2004, at 25, 91 (Klaus Eppler et al. eds., 2004).

22. *Id.*

There are, on the other hand, some restraints on institutional investors which often preclude them from being able to dump large shares of stock, effectively limiting their substantial bargaining advantage. Traditionally, an institutional investor would “vote with its feet by selling its stock,”²³ but, by the late 1980s, many institutional investors had grown so big and had such enormous portfolios that this was no longer an option because

[e]ven though their portfolios were diversified, institutional investors simply could not dump large blocks of stock onto the market. If an institutional investor jettisoned a sizable block of stock onto the market, the price of that stock could drop precipitously, possibly resulting in negative repercussions throughout the market. Continued dumping of large blocks of stock could lead to a market crash, driving down the value of an institutional investor’s overall portfolio even though most institutional investors hold indexed portfolios. And, to the extent a portfolio is indexed, it is almost impossible, as a practical matter, to sell individual underperforming stocks.²⁴

In addition, many institutional investors are governed by rules that “impose fiduciary restraints on their freedom of action for the benefit of shareholders, members, or clients.”²⁵ Selling large amounts of stock on the open market and subjecting its portfolios to market volatility could be considered a “breach of an institutional investor’s fiduciary duty to its clients.”²⁶ Because of these limitations, institutions value corporate action that makes their total investments more attractive to the public. Essentially, the role of an institutionalized investor “is like that of the judge in a beauty contest whereby the purpose is not to pick the most attractive contestant but to pick the contestant whom one thinks the other judges will find attractive.”²⁷

While these are very legitimate considerations, large investors should wield some power in getting their proposals implemented because of the nature of their financial interests. Institutional investors “see governance as a means to improve the general quality of their investments, and provide assurances and reduce risk of

23. Norma M. Sharara & Ann E. Hoke-Witherspoon, *The Evolution of the 1992 Shareholder Communication Proxy Rules and Their Impact on Corporate Governance*, 49 BUS. LAW. 327, 332 (1993).

24. *Id.*

25. *Id.*

26. *Id.*

27. MICHAEL SOLOMON, *ROCK AND ROLL ECONOMICS* 59 (2003).

negative returns in the event of market downturn.”²⁸ As a result, they “will continue to press for stronger levers of power over election of directors, higher standards for directors to adhere to in exercise of their fiduciary duty, and more stringent fiduciary requirements for directors even to monitor corporate compliance.”²⁹

“The most popular type of proposal sponsored by institutional investors . . . involves elimination of takeover defences, and the overwhelming majority of these proposals involve rescission of poison pills.”³⁰ Due to the sheer volume of the common institutional investor’s interest in a company, it would seem logical that its interests generally are more important to a company’s board than those of an individual investor.

C. *Proposals Dealing With Corporate Governance Issues*

In the past twenty years, there has been a “significant increase in the number of shareholder proposals submitted to American public corporations” and in the amount of support that those proposals have received.³¹ “In the 2003 proxy season . . . 166 majority votes were obtained, a record 68 percent increase from the previous peak of ninety-nine majority vote resolutions in 2002”³²

In evaluating the success rates of shareholder proposals, this Study evaluated the three most common types of shareholder proposals: poison pill, board declassification, and executive compensation proposals.³³ It should be noted that voters are not required to vote for all proposals and are authorized to withhold their vote.³⁴ This practice may have the effect of skewing the results of a shareholder proposal vote.³⁵ However, vote withholding seldom

28. Carol Brancato & Michael Price, *The Institutional Investor’s Goals for Corporate Law in the Twenty-First Century*, 25 DEL. J. CORP. L. 35, 39 (2000).

29. *Id.*

30. Roberta Romano, *Less is more: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, in CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY 507, 518 (Joseph McCahery et al. eds., 2002).

31. Andrew R. Brownstein & Igor Kirman, *Can A Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 BUS. LAW. 23, 23 (2004).

32. *Id.*

33. *See infra* Part III.D.

34. Warren F. Grienberger, *Institutional Shareholders and Corporate Governance*, in PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 1995, at 371 (PLI Corp. L. & Practice Course Handbook Series 1995).

35. For example, a company with one hundred voting shares would have a proposal fail if it received only forty-six affirmative votes (46%). However, if ten shareholders withhold their vote, the forty-six affirmative votes would result in

changes the outcome of a proxy vote for directors and other management proposals.³⁶ Because this Study does not look at such management proposals, we recognize that vote withholding may affect the accuracy of our data concerning the ability of proposals to gain a simple majority.

1. *Poison Pill*

The term poison pill describes the “corporate strategy that seeks to prevent a hostile takeover by making the acquisition too expensive.”³⁷ The typical “poison pill is established by issuing a special dividend in the form of a right to purchase additional shares of the issuing firm’s common stock.”³⁸ However, the empirical data on whether poison pills effectively prevent takeovers has been described as inconclusive.³⁹ This Study uses the term poison pill in the context of proposals seeking the rescission of poison pills or requesting that a corporation refrain from implementing a poison pill.

2. *Board Declassification*

Board declassification is a term that refers to shareholders’ attempts “to eliminate [a] company’s classified board structure.”⁴⁰ Classified boards stagger director elections so that only a portion of the board is elected in any year, which prevents fast changes in the board’s constitution.⁴¹ The policy of corporation law mandates that “stockholders have the authority to determine the governance structure of their corporations.”⁴²

3. *Executive Compensation*

Executive compensation proposals attempt to “persuade executives to moderate their compensation demands.”⁴³ “[These proposals have] also been the target of increased shareholder activism. . . . Institutional investors have mounted challenges to

the measure passing (51%).

36. Grienberger, *supra* note 34, at 370.

37. 2 INTERNATIONAL ENCYCLOPEDIA OF THE STOCK MARKET 838 (Michael Scheimo et al. eds., 1999).

38. JONATHAN M. KARPOFF ET AL., CORPORATE GOVERNANCE AND FIRM PERFORMANCE 26 (2000).

39. Romano, *supra* note 30, at 518.

40. See *Chesapeake Corp. v. Shore*, 771 A.2d 293, 297 (Del. Ch. 2000) (discussing a board declassification proposal).

41. Patrick S. McGurn, *Classification Cancels Corporate Accountability*, 55 STAN. L. REV. 839, 839-40 (2002).

42. *Shore*, 771 A.2d at 298.

43. STEVEN BALSAM, AN INTRODUCTION TO EXECUTIVE COMPENSATION 216 (2002).

executive compensation through the shareholder proposal process, by voting against compensation plans, and by withholding votes from the board of directors to protest excessive compensation packages.”⁴⁴ Under Rule 14a-8, the SEC requires “corporations to include shareholder proposals dealing with executive compensation on the corporate proxy,” thereby facilitating the use of shareholder voting to address executive compensation.⁴⁵

III. METHODOLOGY

A. *Generally*

In conducting this Study, we sought to determine whether increased use of shareholder proposals actually gave more power to the activist shareholder. First, we tried to determine which proposal types were most likely to gain the majority support of shareholders. Second, we studied the degree to which boards of directors were responsive by evaluating how likely they were to implement the proposals. Third, we hoped to learn whether the proposal process was truly democratic. To determine this, we contrasted the success of proposals submitted by individual investors against those submitted by institutional investors.

B. *Data Source*

We compiled our data based on information gathered by The Corporate Library (“TCL”).⁴⁶ TCL gathers data on over two thousand major American corporations listed in four common indexes.⁴⁷ It tracks proposals that have been submitted to those companies and uses several sources to determine whether those proposals have been implemented.⁴⁸ TCL provides services that rate individual companies,⁴⁹ but we have intentionally refrained from conducting individual analyses in this Study. Instead, we aim to provide general answers about who and what is important in the shareholder proposal process.

44. Jill E. Fisch, *Teaching Corporate Governance Through Shareholder Litigation*, 34 GA. L. REV. 745, 762-63 (2000) (footnotes omitted).

45. *Id.* at 763.

46. The Corporate Library, <http://www.thecorporatelibrary.com> (last visited Feb. 3, 2006). We most recently updated our data from TCL on October 28, 2005.

47. THE CORPORATE LIBRARY, BOARD ANALYST: ENHANCING SHAREHOLDER VALUE MINIMIZING INVESTOR RISK 3, <http://www.thecorporatelibrary.com/Products-and-Services/BAbrochure.pdf>.

48. Austin & Taylor, *supra* note 7, at 10.

49. THE CORPORATE LIBRARY, *supra* note 47, at 3.

C. Dates

We limited our study to those proposals which were submitted during the period from 2000 through 2004. Although several of the 2004 proposals have already been addressed by boards, some proposals still await board action.⁵⁰ Thus, we limited our use of the 2004 data when analyzing board implementation. First, we did not use the 2004 data to analyze the likelihood of successful implementation unless the current data indicated a higher success rate than 2003 proposals. Second, we compared the 2004 success rates of different proposal types in order to determine which types require less time for implementation.

D. Population Size

While shareholder proposals can run the gamut of topics from human rights to militarism,⁵¹ we wanted to focus on those that dealt directly with corporate governance issues. In particular, we limited our study to proposals concerning board declassification, executive compensation, and poison pills. These were easily the three most common proposal types, and they collectively accounted for 37.4% of all proposals.⁵² Altogether, there were 2,639 proposals submitted during our five-year sample period, including 472 executive compensation proposals, 260 poison pill proposals, and 254 board declassification proposals.⁵³ Chart 1 shows the annual number of proposals submitted for each type.

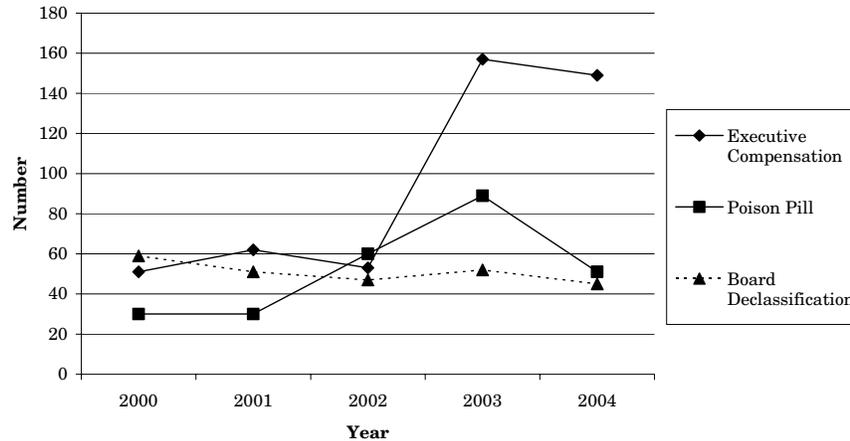
50. Data on file with authors.

51. Proposals were submitted on a variety of issues, ranging from mainstream corporate governance topics to nongovernance issues such as human rights, militarism, and HIV/AIDS. All data used in this study comes from The Corporate Library's online database. *See supra* note 47.

52. Executive compensation proposals accounted for 17.9%, poison pills accounted for 9.9%, and board declassification for 9.6% (data on file with authors).

53. The total number of submitted executive compensation, board declassification, and poison pill proposals actually decreased from 2003 to 2004. *See infra* Chart 1. Interestingly, however, the total number for all proposal types remained essentially the same. There were 666 proposals submitted in 2004 compared to 678 proposals submitted in 2003 (data on file with authors).

Chart 1:
Number of Proposals per Year, by Type of Proposal



E. Population Groups

We began by looking at each proposal type's annual success rate in garnering a simple majority vote from shareholders ("majority support rate"). Then, we looked at their annual rates of implementation by boards of directors ("success rate"). Next, we studied whether proposals that gained a simple majority were more likely to be implemented by the boards.

We then focused on the proponents of these three types of shareholder proposals. We divided the proposals into three groups based on the name or names listed as proponent(s) of each proposal. The first group was for individual shareholders, where we placed proposals that were officially submitted only by distinct individuals.⁵⁴

The second group was for "institutional" proponents. For the purposes of this Study, we placed any proposals that officially included at least one multi-person entity in the institutional group.⁵⁵ It is important to note that our category of institutional proponents

54. We placed a proposal in the "individual" class even if it was submitted by multiple individuals, as long as each proponent was specifically listed by name. For example, a Verizon proposal submitted by "Joseph A. Ristuccia and Ann Ristuccia" was categorized as individual, but an Exxon Mobil proposal submitted by "John R. Weber, Sr., and two co-proponents" was categorized as indeterminate (data on file with authors).

55. Thus, for example, an Exxon Mobil proposal by "Sisters of St. Dominic of Caldwell" was categorized as institutional, as were a Honeywell proposal by the "Eleanora Halfman Trust" and proposals by similar entities (data on file with authors).

might fail to include some individuals who would qualify as institutional investors under NASD Rule 3110(c)(4).⁵⁶

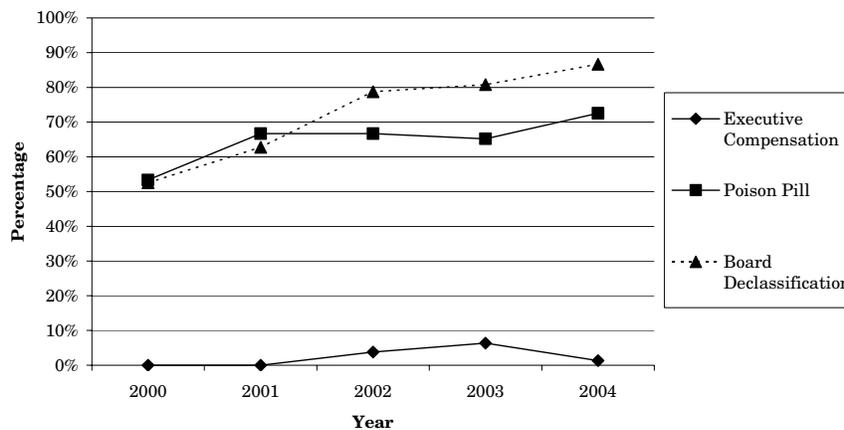
The third group was reserved for indeterminate proponents. This group included any proposal which did not fit into the first two groups.⁵⁷ Because this portion of the Study compares institutional and individual proponents, we have eliminated the indeterminate group from that section of our results.

IV. RESULTS

The percentage of proposals that received a simple majority vote was higher for each type in 2004 than it was in 2000. Board declassification proposals performed better each year, with 52.5% gaining a simple majority in 2000, 62.8% in 2001, 78.7% in 2002, 80.8% in 2003, and 86.7% in 2004.⁵⁸

Poison pill proposals had the highest rate of simple majority success in 2000, at 53.3%. In 2001 and 2002, the poison pill majority support rate was 66.7%, followed by 65.2% in 2003, and 72.6% in 2004. No executive compensation proposals received a simple majority in either 2000 or 2001, but they have since been successful 3.8% of the time in 2002, 6.4% in 2003, and 1.3% in 2004. Chart 2 graphs the annual majority support rates for each proposal type.

**Chart 2:
Percentage of Proposals that Received a
Simple Majority Vote**



56. See NASD Rule 3110(c)(4).

57. For example, we categorized proposals submitted by “undisclosed” proponents or by “several shareholders” as indeterminate (data on file with authors).

58. Data on file with authors.

Chart 3 shows how often each proposal type has actually been implemented by boards of directors.⁵⁹ Board declassification proposals had only a 3.4% success rate in 2000, which rose to 3.9% in 2001, 17% in 2002, and 28.8% in 2003. So far, 42.2% of 2004 board declassification proposals have been implemented by boards.

Poison pills had a zero success rate in 2000, a 10% success rate in 2001, 6.7% in 2002, and 13.5% in 2003. Currently, 9.8% of 2004 poison pill proposals have been implemented. While none of the boards implemented executive compensation proposals in 2000 or 2001, that category had a 1.9% success rate in 2002 and a 3.8% success rate in 2003. To date, none of the 2004 executive compensation proposals have been implemented.

Chart 3:
**Percentage of Proposals that were Implemented
by Boards of Directors**

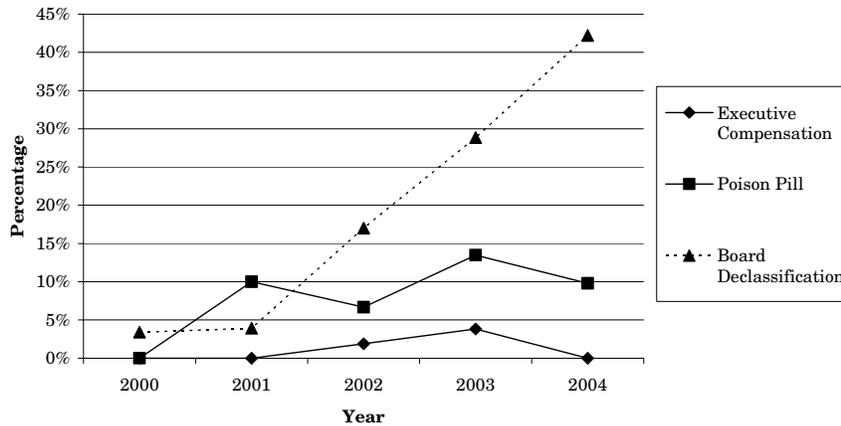


Chart 4 indicates the rates of implementation for proposals that gained a simple majority vote.⁶⁰ In 2000, board declassification proposals that won a simple majority had a 6.5% success rate. In 2001, that number was 6.3%, followed by 21.6% in 2002 and 35.7% in 2003. Currently, the 2004 rate for these proposals has risen to 46.2%.

Boards did not implement any of the 2000 poison pill proposals

59. See *infra* Chart 3.

60. See *infra* Chart 4.

that won a simple majority. However, they implemented 15% of proposals in 2001, 10% in 2002, and 20.7% in 2003. Thus far, 13.5% of the 2004 poison pills that won a simple majority have been implemented. Executive compensation proposals had a zero success rate in 2000 and 2001, followed by a 50% rate in 2002 and a 60% rate in 2003. Boards have yet to implement any of the 2004 proposals for this category.

Chart 4:
Percentage of Proposals that Received a Simple Majority
Vote and were Implemented by Boards of Directors

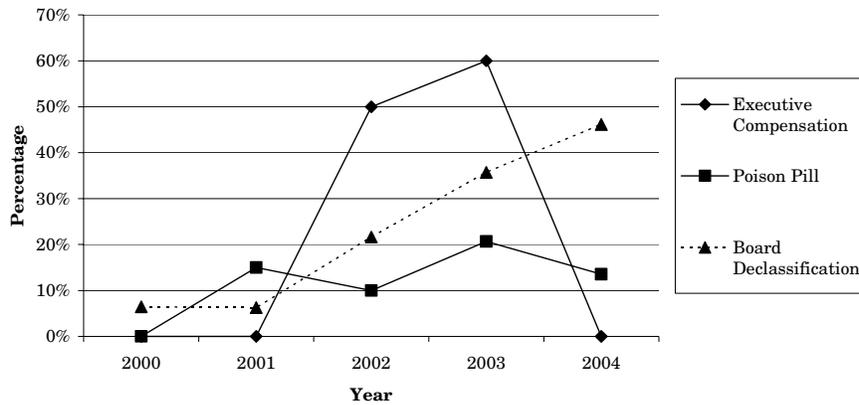


Chart 5 categorizes the total annual number of board declassification, poison pill, and executive compensation proposals submitted by institutional and individual proponents.⁶¹ In 2000, institutional investors proposed 46 of those three proposal types. This figure rose to 49 in 2001, 52 in 2002, and 123 in 2003 before declining to 105 in 2004. Individual proponents submitted 83 of these proposals in 2000, followed by 77 in 2001, 73 in 2002, 124 in 2003, and 102 in 2004.

61. *See infra* Chart 5.

Chart 5:
Number of Proposals by Year, Institutional or Individual

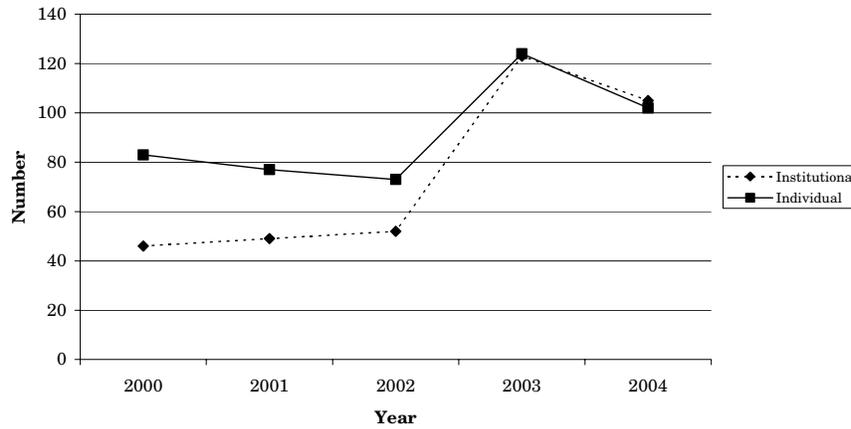


Chart 6 illustrates the majority support rates of proposals that were submitted by institutional and individual proponents.⁶² It shows the likelihood that an institution or individual's proposal will win simple majority support, the overall rate of implementation by the board, and the rate of implementation for proposals that gained a simple majority.

Institutional proponents had a 47.8% majority support rate in 2000. The rate was 36.7% in 2001, 40.4% in 2002, 29.3% in 2003, and 15.2% in 2004. Meanwhile, the majority support rate for individual proponents were as follows: 28.9% in 2000; 39% in 2001; 58.9% in 2002; 44.4% in 2003; and 47.1% in 2004.

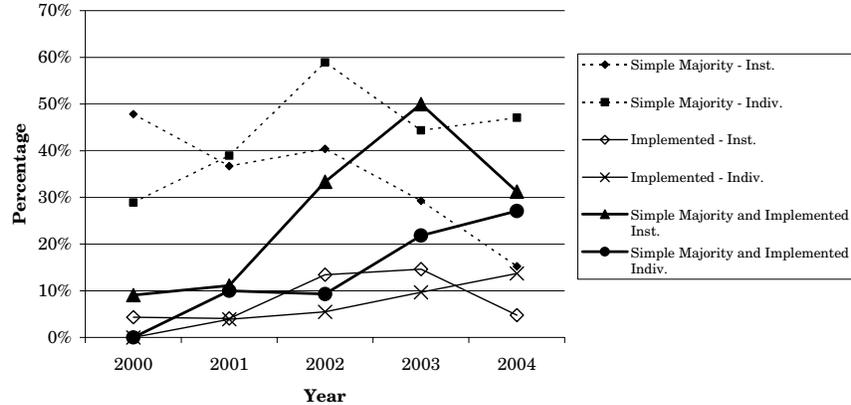
In 2000, boards implemented 4.3% of proposals submitted by institutional investors. They implemented 4.1% in 2001, 13.5% in 2002, and 14.6% in 2003. So far, they have implemented 4.8% of 2004 institutional proposals. Zero individual proposals were implemented in 2000, but 3.9% were implemented in 2001, 5.5% in 2002, and 9.7% in 2003. Currently, 13.7% of individual proposals from 2004 have been implemented.

When institutional proposals gained a simple majority, they had a 9.1% rate of implementation in 2000. This rose to 11.1% in 2001, 33.3% in 2002, and 50% in 2003. To date, boards have implemented 31.3% of institutional proposals that won a simple majority in 2004. In comparison, boards implemented none of the individual investors' proposals that won simple majority support in 2000. However, 10% of these proposals were implemented in 2001, 9.3% in 2002, and

62. See *infra* Chart 6.

21.8% in 2003. Currently, 27.1% of such proposals from 2004 have been implemented.

**Chart 6:
Majority Support Rates and Success Rates for Proposals
Based on Institutional and Individual Proponents**



V. ANALYSIS

This Study hoped to answer two general questions. First, we hoped to determine which corporate governance issues galvanized voting shareholders and boards of directors. Second, we sought to learn whether institutional investors were more influential proponents than individual investors. Our results indicate that voting shareholders and boards of directors have grown increasingly responsive to board declassification proposals with each passing year. Furthermore, although institutional investors appear to have lost substantial influence over voting shareholders, their proposals remain the most likely to receive board implementation.

A. Popular Support

Board declassification proposals have experienced a dramatic rise in support at the shareholder voting stage of the proposal process. As Chart 2 indicates, this group has become more likely to receive a simple majority in each year and is now 65% more successful than it was in 2000.⁶³ In the same period, poison pill proposals have only become 36% more likely to gain a simple majority.

63. See *supra* Chart 2.

In the past two years, executive compensation proposals have been submitted far more often than those for board declassification and poison pills.⁶⁴ At first glance, it would seem logical for that category to receive significant support during the voting process. However, no more than 6.4% of executive compensation proposals won a simple majority in any year, and this group actually decreased to a 1.3% majority support rate in 2004.

Although executive compensation proposals received far less popular support than the other two groups, their majority support rate over the past three years is still greater than the zero majority support rate these proposals achieved in 2000 and 2001. Thus, voting shareholders have grown more responsive to each type of proposal and have become particularly supportive of board declassification proposals.

B. Board Implementation

Although shareholder actions can send compelling messages to boards of directors,⁶⁵ simple majority votes do not necessarily translate into implementation by those boards.⁶⁶ Our analysis next addressed the rates of implementation for each type of proposal as functions of the total number of proposals and of those proposals that received a simple majority vote. Once again, board declassification proposals have grown far more successful than they were in 2000.

Charts 3 and 4 show that, since 2001, the rate of implementation for board declassification proposals has steadily risen each year.⁶⁷ Since 2001, the success rate for board declassification proposals has risen on average 12.8% each year.⁶⁸ In fact, the upward trend for implementation of board declassification proposals is remarkably consistent.⁶⁹ Consequently, the overall rate of implementation in 2004 is over twelve times greater than the 2000 rate. Likewise, board declassification proposals that have won a simple majority have also grown increasingly successful since

64. *See supra* Chart 1. Additionally, executive compensation proposals almost tripled annually in 2003 and 2004 compared to their 2000-02 levels. There were, on average, 153 executive compensation proposals submitted in 2003 and 2004, compared to an annual average of 55.3 from 2000-02 (data on file with authors).

65. *See* Brownstein & Kirman, *supra* note 31, at 46.

66. ANSON, *supra* note 1, at 479.

67. *See supra* Charts 3, 4.

68. *See supra* Chart 3.

69. *See supra* Chart 3. The increase from 2001 to 2002 was 13.1%. From 2002 to 2003 it was 11.8%, and, to date, the rise from 2003 to 2004 is 13.4%. Thus, in no year did the increase deviate more than 1% from the average.

2001.⁷⁰ For these proposals, the rate of increase has also been relatively steady, even though it has been shrinking to some degree.⁷¹ In this case, the 2004 implementation rate is over seven times greater than the 2000 rate.

While implementation rates for poison pill and executive compensation proposals have risen, their results are not as dramatic as those for board declassification proposals. In fact, in both Charts 3 and 4, the implementation rates for each proposal type appear to have decreased from 2003 to 2004.⁷² Because many 2004 proposals may still be implemented, we elected not to analyze 2004 implementation results when they declined from the 2003 data.

These declines are due, at least in part, to the possibility that poison pill and executive compensation proposals may take longer to implement than those for board declassification. Board declassification proposals require a separate binding shareholder vote in order to be implemented.⁷³ In 2000, the Council of Institutional Investors recommended that boards submit such proposals for a binding vote at their next shareholder meeting.⁷⁴ Boards take such recommendations seriously because they are often tied to a threat of withholding votes for director nominees.⁷⁵ As a result, it appears that boards have acted quickly in response to those board declassification proposals that received popular support.

Setting aside the 2004 data, the results show that both poison pill and executive compensation proposals have been increasingly successful. However, this trend has caveats. Although executive compensation proposals were submitted far more often than the other two types, not a single one even gained a simple majority until 2002. Over the next two years, overall implementation rose steadily to 3.8%. However, there were not enough executive compensation proposals before the boards to generate reliable results.⁷⁶ Ultimately, it seems that shareholders have prevented all but the most promising executive compensation proposals from ever reaching the boards, as those proposals that won a simple majority

70. *See supra* Chart 4.

71. *See supra* Chart 4. From 2001 to 2002, the likelihood of implementation for board declassification proposals that won a simple majority rose by 15.3 percentage points. From 2002 to 2003, it rose 14.1 percentage points, and from 2003 to 2004, 10.5 percentage points.

72. *See supra* Charts 3-4.

73. Brownstein & Kirman, *supra* note 31, at 51.

74. *Id.* at 50-51 & n.158.

75. *Id.* at 50.

76. In 2002, only two proposals came before boards by gaining a simple majority. That number rose to ten in 2003 before declining to two in 2004 (data on file with authors).

had a 50% success rate in 2002 and a 60% rate in 2003.⁷⁷ A comparison of these results with the high number of submitted executive compensation proposals indicates the high level of controversy surrounding the executive compensation issue.⁷⁸ As a result, only the strongest proposals survived the proxy voting battlefield.

Poison pill proposals have also seen increasing success. Although the success rate for poison pills did not always see an annual increase, it has seen an overall rise. While none of the 2000 poison pill proposals succeeded, boards implemented 13.5% of the 2003 proposals.⁷⁹ As Chart 4 indicates, the 2003 success rate rose to 20.7% for proposals that won a simple majority.⁸⁰ Thus, for each type of proposal, boards have become more responsive to shareholder action. Ultimately, however, the push for board declassification has led the way. In 2000, less than one of every twenty board declassification proposals was implemented. Four years later, nearly one of every two such proposals has succeeded.

Our implementation analysis for these three proposal types shows great gains in board responsiveness to board declassification and poison pill proposals. The recent success of these traditional governance issues may be attributable, at least in part, to growing corporate concern about compliance with the Sarbanes-Oxley Act,⁸¹ which Congress enacted to regulate corporate governance issues and protect against investor mistrust.⁸² Although inconclusive, the data also seem to indicate that boards may be increasingly responsive to the rare executive compensation proposal that survives a shareholder vote.

C. *The Impact of the Institutional Proponent*

While individual investors play an activist role and succeed during the proxy voting process, it appears that they lack the influence to force board implementation of their proposals. Chart 5 shows that, in 2000, individuals submitted almost twice as many governance proposals as institutions.⁸³ However, in 2003 and 2004 both proponent groups submitted nearly the same number of

77. See *supra* Chart 4. Of course, these executive compensation results are skewed by the extremely small data set.

78. Georgeson Shareholder, Annual Corporate Governance Review 2004, at iii (2004), available at www.georgesonshareholder.com/pdf/2004_corpgov.pdf.

79. See *supra* Chart 3.

80. See *supra* Chart 4.

81. GEORGESON SHAREHOLDER, *supra* note 78, at ii.

82. Kathryn Stewart Lehman, Comment, *Executive Compensation Following the Sarbanes-Oxley Act of 2002*, 81 N.C. L. REV. 2115, 2117 (2003).

83. See *supra* Chart 5.

proposals.⁸⁴ The data show that the proposal has been a more common tool for each type of investor over the past two years, and it appears that institutions have overcome an initial hesitancy to use the strategy.

Additionally, institutional investors' influence no longer appears to translate into success at the proxy voting stage. Chart 6 shows that individual proposals have become more likely to win a simple majority while institutional proposals have had diminished success.⁸⁵ In 2000, individual proposals gained simple majority support only 60.5% as often as institutional proposals.⁸⁶ However, by 2004, *institutional* proposals succeeded only 32.3% as often as *individual* proposals.⁸⁷ This result is in part due to increasingly popular individual proposals, as they were over 50% more likely to win majority support in 2004 than they were in 2000.⁸⁸ Just as significant, however, is the decline of institutional investors, whose proposals were almost 70% *less* likely to gain support in 2004 than in 2000.⁸⁹ At least during the shareholder voting period, the roles of the individual and the institution have reversed.

However, institutional proponents have consistently been the power players in securing board implementation. Once again, we excluded 2004 implementation data because perceived declines might exist only due to an ongoing implementation period. Looking at the data from 2000 to 2003, it appears that proposals made by institutional investors are more successful than those made by individuals.⁹⁰ In 2000, none of the individual proposals were implemented, compared to a 4.3% implementation rate for institutional proposals.⁹¹ Both institutions and individuals have seen increasing success rates, but 2003 institutional proposals were over twice as likely to be implemented as individual proposals from

84. *See supra* Chart 5.

85. *See supra* Chart 6.

86. *See supra* Chart 6. This percentage was derived by dividing the 2000 individual proposal majority support rate by the 2000 institutional majority support rate. Individual proposals in 2000 succeeded 28.9% of the time compared to a 47.8% majority support rate for institutional proposals in the same year (data on file with authors).

87. *See supra* Chart 6. This percentage was derived by dividing the 2004 institutional proposal majority support rate by the 2004 individual majority support rate. Institutional proposals in 2004 succeeded 15.2% of the time, compared to a 47.1% majority support rate for individual proposals in the same year (data on file with authors).

88. *See supra* Chart 6.

89. *See supra* Chart 6.

90. *See supra* Chart 6.

91. *See supra* Chart 6.

the same year.⁹² Thus, institutional proposals have become increasingly successful despite their diminishing support from voting shareholders.

The resilience of institutional proposals despite lackluster shareholder support suggests that boards are more responsive to institutional proponents. Chart 6 most dramatically illustrates this by plotting the success rate for proposals that won a simple majority and were later implemented.⁹³ Again, both groups of proponents were more successful in 2003 than they had been before. However, boards have grown significantly more likely to implement institutional proposals that came before them than to implement similar individual proposals. In 2000, the success rate for institutional proposals that had won a simple majority was 9.1 percentage points higher than that for individual proposals.⁹⁴ By 2003, 50% of such institutional proposals succeeded—28.2 percentage points higher than the 21.8% success rate for individual proposals.⁹⁵ Based on these results, we conclude that, as compared to individuals, institutions have strengthened their influence on boards since 2000.

In recent years, shareholder activism has expanded well beyond traditional concerns.⁹⁶ At the same time, our Study indicates tremendous growth in board responsiveness to core governance issues. The data reveal two particularly significant findings: first, substantial shareholder support has paved the way for a dramatic increase in successful board declassifications; second, institutional investors have strengthened their influence over boards even while those investors have lost the support of their fellow shareholders.

In her ideal world, the individual investor would want her voice to be as loud as those of the institutions. While this is not the case, there are still several reasons for the individual to celebrate. Unlike five years ago, she actually has a voice, and her corporate governance proposals have a significant chance of success. The institutional investor ultimately wants the company to be attractive to the public. The individual investor, however, may have other considerations while protecting her own financial interest. As a result, the “shareholder rights agenda”⁹⁷ has seen increasing success. Regardless of who submits them, boards have become more

92. *See supra* Part IV.

93. *See supra* Chart 6.

94. *See supra* Part IV.

95. *See supra* Part IV.

96. David Marcus, *Beyond the Pill: The Maturation of Corporate Governance*, DEL. LAW WEEKLY, July 6, 2005, at 1, 1.

97. *Id.* (listing poison pills and board declassification among the traditional beliefs of the shareholder rights agenda).

responsive to proposals which aim to protect some of those basic “rights.”

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