PROFESSOR BEBCHUK'S BRAVE NEW WORLD: A REPLY TO "THE MYTH OF THE SHAREHOLDER FRANCHISE"

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INTRODUCTION

IN "The Myth of the Shareholder Franchise,"[1] Professor Bebchuk returns to the shareholder primacy themes he has developed in earlier work,[2] this time to argue that the presumed power of the shareholder franchise to hold directors accountable is illusive. He goes on to propose several changes to the system of corporate governance, which he says will "transform shareholder power to remove directors from a myth into a reality."[3] Bebchuk argues that the accountability mechanisms currently available—independent director monitoring, proxy contests for all or some board seats, and threats of a takeover—are all easily thwarted by management and thus ineffective. Thus, according to Bebchuk, only the threat of reasonably easy removal of some or all directors by dissatisfied shareholders will provide the managerial discipline that results in superior corporate performance and value for shareholders.

The problem is that, while Bebchuk's passion for his thesis is evident, he offers scant empirical support for either the proposition

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[1] Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 Va. L. Rev. 675 (2007).

[2] See, e.g., Lucian Bebchuk & Jesse Fried, Pay without Performance: The Unfulfilled Promise of Executive Compensation (2004) [hereinafter Bebchuk & Fried, Pay without Performance]; Lucian A. Bebchuk & Jesse M. Fried, Pay without Performance: Overview of the Issues, 30 J. Corp. L. 647 (2005); Lucian Arye Bebchuk, The Case for Increasing Shareholder Power, 118 Harv. L. Rev. 833 (2005); Lucian A. Bebchuk, Reply: Letting Shareholders Set the Rules, 119 Harv. L. Rev. 1784 (2006) [hereinafter Bebchuk, Letting Shareholders].

[3] Bebchuk, supra note 1, at 677.

that shareholders have little power to effect director changes or the argument that boosting shareholders' ability to force such changes will improve performance. In fact, as critics of other aspects of Bebchuk's "shareholder primacy" approach to corporate governance have observed, there is little evidence that the public markets assign greater value to companies in which shareholders have power to intercede directly and frequently in corporate decision-making, whether by unilateral shareholder power to amend corporate charters, shareholder referenda to approve business decisions, or regular board election contests.[4]

What Bebchuk lacks in empirics, he makes up for with his various and enthusiastic efforts at reform. He was a vigorous proponent of the Securities and Exchange Commission's now-abandoned proposal to adopt a "shareholder access" rule that would have permitted large shareholders and shareholder groups, under certain conditions, to bypass independent director nominating committees and place a limited number of competing board candidates directly in the corporate proxy solicitation.[5]

Even more dramatically, and abandoning any pretense of academic detachment, Bebchuk has himself become an advocate of change by presenting a specific proposal for governance changes at a targeted public company and by pursuing litigation and obtaining a settlement when his efforts were initially rebuffed.[6]

[4] See, e.g., Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, 119 Harv. L. Rev. 1735, 1736–37 (2006) (responding to Bebchuk's prior proposal to empower shareholders to initiate and adopt amendments to corporate charter documents without director involvement); Leo E. Strine, Jr., Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America, 119 Harv. L. Rev. 1759, 1759–60, 1770 (2006) (same).

[5] See Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,784 (proposed Oct. 23, 2003), *reprinted in* [2003–2004 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,101 (Oct. 23, 2003); Letter from Lucian A. Bebchuk et al. to Jonathan G. Katz, Sec'y, SEC (Dec. 22, 2003), available at http://www.sec.gov/rules/proposed/s71903/labebchuk122203.htm.

[6] See Bebchuk v. CA, Inc., 902 A.2d 737, 738, 745 (Del. Ch. 2006) (dismissing the suit as unripe); Emily Heller, Pressing Their Demands: Shareholder Activists Are Suing for a Say in Corporate Decision-Making—And Winning, Miami Daily Bus. Rev., Oct. 23, 2006, at 12; CA, Inc., Proxy Statement (Schedule 14A), at 43 (Aug. 9, 2006), available at http://www.sec.gov/Archives/edgar/data/356028/000095012306010261/y21182def14a.htm (setting forth Lucian Bebchuk's Stockholder Proposal to Amend the By-Laws with

In his current article, Bebchuk continues his campaign to limit the discretion of corporate managers and increase the ability of shareholders to direct management decisionmaking, presenting yet another proposal for shifting leverage to what he refers to as the "shareholder franchise."

At the heart of Bebchuk's proposed changes to the corporate governance system is a plan that would give shareholders greater power to remove serving directors. The touchstones of his proposal are shareholder access to the corporate ballot, reimbursement of campaign expenses for candidates who meet a minimum threshold of success, and the elimination of classified boards. Shareholders who meet a minimum ownership requirement would be allowed to put their candidates on the corporate proxy ballot, thereby eliminating the cost of funding a separate proxy solicitation.[7] Those candidates who garner at least a threshold percentage of the vote (Bebchuk suggests one-third) would have their entire campaign costs reimbursed.[8] This provision is designed to encourage candidates who have a reasonable likelihood of winning and to discourage frivolous challenges.[9] Additionally, under Bebchuk's proposal, classified boards would be eliminated, at least so far as to give shareholders the chance to replace the entire board at least once every two to three years.[10] Under Bebchuk's proposal, the classified board system would be altered so that, in the case of what he calls a "shareholder revolt," but never defines, an entire staggered board could be removed, or shareholders could choose a system whereby board terms are not staggered but elections are held only once every two to three years. He would also provide for the election of directors by majority vote, permit shareholders to directly amend bylaws on governance matters (and limit the power of directors to do so), and mandate confidential voting.[11] Finally, Bebchuk proposes that shareholders be allowed to "opt out" of his proposed

Respect to the Adoption or Maintenance by the Board of Directors of any CA, Inc. Rights Plan).

[7] Bebchuk, supra note 1, at 696–97.

[8] Id. at 698–99.

[9] Id. at 699.

[10] Id. at 700.

[11] Id. at 701–11.

system but emphasizes that his system should be specified as the default applicable to most companies.[12]

I. PROFESSOR BEBCHUK'S OWN MYTHS

In support of his proposal to alter the traditional balance of power among shareholders, directors, and managers, Bebchuk creates a mythology of his own that not only exaggerates the empirical scholarship that he cites, but also ignores several recent developments that are already affecting the allocation of corporate governance power.

A. Searching for the Evidence of a Problem: Overestimating the Dearth of Contested Elections

Bebchuk relies on data purporting to show that between 1996 and 2005, there was a distressingly low number of director contests in which a rival team attempted to gain management of the company. He intends his reforms to raise that number. His data, however, at least as presented, fail to show that the number of rival slate challenges under the current system is a cause for concern. First, Bebchuk gives no benchmark by which to assess whether the number of rival slate contests is high, low, or "just right." He states that the number he arrives at—an average of twelve per year—is "negligible,"[13] but gives no support for this conclusion. Indeed, Bebchuk emphasizes that his proposed reforms would be utilized only in the rare circumstance of "broad shareholder dissatisfaction."[14] If this is the case, then what basis is there for concluding that a dozen or so contested elections a year does not accurately reflect the rate of occurrence of significant shareholder dissatisfaction? The only answer Bebchuk provides is an almost glib assumption: "Given the hundreds of firms that restated earnings in recent years, and the large number of companies whose boards elect not to follow majority-passed shareholder resolutions, one would expect to see more challenges by rival teams."[15] If Bebchuk hopes to convince us that change is necessary, he must do more than assume

[12] Id. at 707.
[13] Id. at 677.
[14] Id. at 719.
[15] Id. at 688.

that a market with a large number of companies necessarily has many shareholders who want to, but are unable to, remove the directors of those companies.

Furthermore, Bebchuk's selection of data seems contrived to give the impression that fewer rival slate contests occurred between 1996 and 2005 than actually did. He deliberately excludes from his total number of rival slate challenges per year director contests focusing on a takeover or sale of the company.[16] The rationale given for this omission is that "[i]f the bidder's team gains control of the board, the company will not be run differently; rather, it will be sold to the bidder."[17] In the context of his overall argument, however, it makes little sense to exclude takeover-focused contests from the total, since the threat of a sale at the hands of dissidents clearly is a source of discipline on management. Indeed, a necessary premise of Bebchuk's argument—that the mere existence of a threat to the board's incumbency can produce better corporate and managerial performance—rests largely on studies done of boards protected from takeovers.[18] Although conceding in a prior draft that such evidence is "at most suggestive and indirect," Bebchuk reads these existing studies to show that strong protection from takeovers results in poorer corporate performance. Situations in which the board's incumbency has been threatened by a director contest focused on a takeover therefore appear to be at least relevant to Bebchuk's statistical analysis, yet they are set aside in his eagerness to support his theme.[19]

Manipulated to exclude change of control contests, Bebchuk's data show that between 1996 and 2005, there was an annual average of twelve contested elections. This number, according to Bebchuk, is undesirably low due to the existence of several impediments to rival slate challenges. These impediments include high costs, shareholder uncertainty about how rivals will perform if

[16] Id. at 684–85, 686 tbl.2.

[17] Id. at 684.

[18] See id. at 712–14 & nn.69–77.

[19] See generally Lucian A. Bebchuk & Alma Cohen, The Costs of Entrenched Boards, 78 J. Fin. Econ. 409, 410–11, 426–29 (2005); Lucian Bebchuk et al., What Matters in Corporate Governance? 3–4 (John M. Olin Ctr. for Law, Econ. & Bus., Discussion Paper No. 491, 2004), available at http://www.law.harvard.edu/programs/olin_center/papers/pdf/Bebchuk_et%20al_491.pdf.

elected, and the need to run two years in a row in order to gain control if the target company has a classified board.

However, once takeover-focused contests are added to Bebchuk's totals, the average number of rival slate contests per year jumps from twelve to almost twenty-one; if one also adds back contested solicitations not including the election of directors (but which will often include opposition to a board-approved proposal), the average rises to twenty-eight contests per year, more than double Bebchuk's estimate.[20]

B. Underestimating the Present Power of Shareholders to Effect Change

Putting aside, for the moment, Bebchuk's evident manipulation of statistics to fit his thesis, even he acknowledges that the governance landscape has changed dramatically in recent years.[21] Implicitly, therefore, statistics from a decade ago may be irrelevant. This is especially true in light of the substantial increase in the influence of shareholders and shareholder interest groups over the last several years[22] and the recent surge in director willingness, spurred in part by shareholder activism, to stand up to management,[23] all of which have occurred even without the implementation of Bebchuk's "shareholder franchise" reforms.

This should be no surprise. Bebchuk himself proved in *Bebchuk v. CA, Inc.* that, under the existing federal and state regime, the use of a relatively low-cost, "binding" bylaw shareholder resolution, pursuant to the SEC's existing Rule 14a-8, followed by quick tar-

[20] All calculations are based on data in Bebchuk's Table 2: Classification of Contested Proxy Solicitation 1996–2005. Bebchuk, supra note 1, at 686 tbl.2.

[21] Id. at 685–686 (positing that from 2001 to 2005, there were approximately fifty percent more electoral challenges and noting, during the same period, increased shareholder activism as evidenced by "the incidence of shareholder precatory resolutions").

[22] Id.; see also Jared A. Favole, Study Charts Holders' Clout in Sales, Wall St. J., Oct. 25, 2006, at B3D (discussing influence of large activist shareholders on sales of companies).

[23] See Joann S. Lublin & Erin White, Drama in the Boardroom, Wall St. J., Oct. 2, 2006, at B1; Brooke A. Masters, A Clubby World Turns Aggressive and Combative: On Corporate Boards, a New Push for Change, Wash. Post, Sept. 16, 2006, at D1; Kaja Whitehouse, Move Over CEO: Here Come the Directors, Wall St. J., Oct. 9, 2006, at R1; Why Corporate Boardrooms are in Turmoil, Wall St. J., Sept. 16–17, 2006, at A7 [hereinafter Corporate Boardrooms].

geted litigation if the company resists, can bring about a settlement that can help ensure that a proposed change in corporate policy will be put before shareholders for a vote.[24] This all was accomplished, no less, by a law professor of presumably modest means, without the deep pockets of a large investor.

Large investors, however, have also been active in driving changes in corporate direction under the current regime.[25] Consider, for instance, the success of investor Kirk Kerkorian in obtaining board representation without proxy contests and in forcing changes at both Chrysler (now DaimlerChrysler) and General Motors.[26] In another recent example, Carl Icahn pushed Time Warner to change its board makeup and sell off substantial operations,[27] and he has recently taken control of the board of ImClone Systems.[28]

The growing prominence of hedge funds as investors—and as activists often pushing for short-term value enhancement—has also occurred under the present governance system.[29] Bebchuk awkwardly embraces this change in governance dynamics, which he

[24] See Bebchuk v. CA, Inc., 902 A.2d 737, 738, 741–42 (Del. Ch. 2006); see also supra note 6 and accompanying text.

[25] See, e.g., Rakesh Khurana, Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs 60 (2002) (noting the role of institutional investors in holding CEOs more accountable by opposing antitakeover defenses); Jeffrey N. Gordon, Executive Compensation: If There's a Problem, What's the Remedy? The Case for "Compensation Discussion and Analysis," 30 J. Corp. L. 675, 677 (2005) (criticizing the need for other Bebchuk proposals to reform executive compensation, in part because of "activist institutional investors"); Masters, supra note 23, at D1; Corporate Boardrooms, supra note 23, at A7.

[26] Geraldine Fabrikant, A Big Investor Stands to Get a Huge Payoff, N.Y. Times, May 7, 1998, at D1 (recounting Kerkorian's history and role with Chrysler leading up to the merger with Daimler-Benz AG); Micheline Maynard, G.M. Is Pressed to Form Alliance with Two Rivals, N.Y. Times, July 1, 2006, at A1.

[27] Richard Siklos & Andrew Ross Sorkin, Time Warner and Icahn Reach a Settlement, N.Y. Times, Feb. 18, 2006, at C1; 'If He Ruled the World': Carl Icahn's Take on Time Warner and Corporate America, Knowledge@Wharton, Feb. 22, 2006, http://knowledge.wharton.upenn.edu//article.cfm?articleid=1392.

[28] Andrew Pollack, Icahn Wins Control of ImClone Systems and Company's Chief Leaves, N.Y. Times, Oct. 26, 2006, at C3.

[29] See William W. Bratton, Hedge Funds and Governance Targets (Georgetown Law and Econ. Research, Paper No. 928689, 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=928689 (tracking the influence of activist hedge funds on their target companies); Corporate Boardrooms, supra note 23, at A7; Dane Hamilton, This week alone, 4 companies yield to activists, Reuters, Feb. 13, 2007, http://www.reuters.com/article/mergersNews/idUSN1342758820070213.

had ignored in his initial drafts of "The Myth of the Shareholder Franchise," arguing that, although it admittedly will likely increase election contests with short term objectives, the change is somehow a good thing and consistent with his thesis that more contests are always better.[30]

Under the pressure of this vigorous shareholder advocacy led by large activist investors, poison pills and classified boards—two hallmarks of corporate management entrenchment that Bebchuk has cited in previous studies—are rapidly diminishing in significance. The number of public companies that "classify" (stagger the terms of) their boards of directors has steadily declined from sixty-three percent in 2002 to forty-five percent in 2006.[31] Similarly, while approximately sixty percent of public companies had shareholder rights ("poison pill") plans in effect in 2001, by 2005 the percentage had decreased significantly to forty-six percent.[32] This is hardly a governance landscape characterized by weak or ineffective shareholder franchise impact.

II. WOULD SHAREHOLDERS REALLY BE BETTER OFF IN PROFESSOR BEBCHUK'S WORLD?

A. In Defense of the Traditional Role of Directors

The basic structure of American public for-profit corporations as engines of economic growth has long rested on the notion that skilled, professional managers should run the corporate business, subject to the oversight of a board of directors who will act in the best interests of the corporate entity and its investor owners. This system is designed to ensure that shareholders do not simply get

[30] See Bebchuk, supra note 1, at 726–28.

[31] Christopher Shier, Investor Responsibility Research Ctr., 2003 Background Report C: Classified Boards 3 (2003); David Morrison, ISS Corp. Governance Bull., Oct.–Dec. 2006, at 9; see also Jolene Dugan & Ryan Thomas, Institutional S'holder Servs., 2006 Background Report: Classified Boards of Directors at U.S. Companies 4 (2006) (predicting that "at the present pace, the majority of S&P 500 companies will be non-classified in 2006").

[32] Maria Carmen S. Pinnell, Investor Responsibility Research Ctr., 2002 Background Report E: Poison Pills 2 (2002); Mark W. Saltzburg, Institutional S'holder Servs., 2006 Background Report: Poison Pills 5 (2006).

whatever a transitory majority, or an insistent and vocal minority, of their number want at any particular moment.[33]

Directors are more than mere agents appointed to blindly follow shareholder directions. While they have a duty to oversee compliance, directors are more than policemen on the beat looking out for corporate fraud and executive excess.[34] At their best, directors are wise counselors who, as representatives of investor owners, hire, encourage, and guide the best available executive managers for the corporate enterprise. If these managers fail to best serve corporate interests, it is the directors' task to refocus, warn, and, if necessary, fire the deficient managers. Thus, directors function as the crucial link between shareholders and managers. In these most critical respects, directors serve both corporate and shareholder values, not as blind agents but as central actors in the governance triad.

Bebchuk contends that, as the system currently operates, shareholders do not have effective power to remove directors with whose performance they are unhappy. He argues that, because other accountability mechanisms are inherently limited, a toothless shareholder franchise results in a lack of incentives for directors to focus on increasing shareholder value rather than on maximizing their own interests.[35] Bebchuk, however, never defines what he means by "shareholder value."[36] Does he mean immediate sale value of the corporation or its assets? Or longer-term accumulation of wealth? For different members of the investor base, the answers may well differ.

While not answering this critical question, Bebchuk has focused in his recent writings on an issue that is only peripherally related to enterprise value. He and others are currently obsessed with what they perceive to be excessive compensation of some corporate ex-

[33] See Bengt Holmstrom, *Pay without Performance* and the Managerial Power Hypothesis: A Comment, 30 J. Corp. L. 703, 710–13 (2005) (arguing that boards may do significant damage to long-term corporate value by intervening too much and too quickly in executive decisionmaking in response to short-term concerns).

[34] See id. at 711.

[35] Bebchuk, supra note 1, at 679–82 (noting that the judiciary fails to hold directors accountable).

[36] See id. at 679.

ecutives.[37] While it may be true that sloppy oversight and overly generous performance standards that distort executive compensation are symbolic of generally poor board oversight, and that lack of oversight may have some impact on enterprise value, the evidence for such a correlation is not strong. Indeed, even tiny differences in managerial talent can translate into significant disparities in the market value of today's giant corporations, providing a legitimate rationale for offering what may at first glance appear to be excessive compensation.[38] Moreover, even excessive executive compensation, in all but exceptional cases, makes up a very small part of the overall cost structure of most corporations. Executive compensation is not in and of itself typically a significant contributor to corporate profit or loss.[39] A board that concerns itself, at the behest of critics, primarily with executive compensation may well "get it right" on that issue, but miss the strategic and risk management issues that are more critical to corporate success.

Bebchuk's prescription for altering the balance between the governance triad of shareholders, directors, and managers will have an impact far beyond the area of excessive compensation that apparently concerns him most. By making it easier to replace board members, his proposal may indeed allow shareholders unhappy with compensation decisions to have an immediate impact on corporate decisions. Is such a change, however, worth the price if it creates an environment where directors are so intimidated by the risk of removal that they refrain from making long-term, strategic decisions that would enhance corporate value, but not necessarily result in an immediate payoff? Even if the relevant issue is in fact compensation, is Bebchuk's proposed change advisable if it

[37] See, e.g., Bebchuk & Fried, Pay without Performance, supra note 2; Lucian A. Bebchuk & Jesse M. Fried, Executive Compensation at Fannie Mae: A Case Study of Perverse Incentives, Nonperformance Pay, and Camouflage, 30 J. Corp. L. 807, 807–09 (2005).

[38] See In the Money, Economist, Jan. 20–26, 2007, at 3–20; Roy C. Smith, Worth Every Last Million, Wash. Post, Jan. 21, 2007, at B1, B3; Xavier Gabaix & Augustin Landier, Why Has CEO Pay Increased So Much? 2 (MIT Dep't of Econ., Working Paper No. 06-13, 2006), available at http://ssrn.com/abstract=901826.

[39] See Rana Foroohar, Productivity: Are They Worthy? New Studies Say CEO Pay Trends Make Sense, Newsweek, Sept. 18, 2006, at E18; Frederick W. Cook & Co. & Mercer Human Res. Consulting, Research on CEO Compensation for Business Roundtable (July 5, 2006), http://www.businessroundtable.org/pdf/20060705002ExecutiveCompensationResearch_FWC_62906.pdf.

discourages a board from incurring the costs of terminating unsuccessful managers and paying the price of recruiting a CEO who can turn corporate performance around? Critics of Bebchuk and his coauthors have suggested that concerns about executive compensation excesses can best be addressed by greatly enhanced disclosure requirements within the present director nominations and proxy regime, rather than by fundamentally altering the balance between directors and shareholders.[40] Indeed, the SEC has recently taken exactly that step by adopting significantly strengthened requirements for disclosure of executive compensation and related party transactions that became effective in the 2007 proxy season.[41]

Until the impact of those new requirements on investor activism and board responsiveness to investor concerns has been examined, is it responsible to make major structural changes to the manner in which directors are chosen and basic corporate decisions made? Such changes seem particularly unwise when, as noted above and by others, there is mounting evidence that the board-CEO relationship, particularly on CEO compensation and tenure decisions, is already moving very significantly in the direction Bebchuk advocates, with independent directors exercising increasingly tighter oversight of CEOs and other senior managers.[42]

B. The Problem of Shareholder Passivity

The majority of public company shareholders are not active in corporate governance. It is not clear that, as Bebchuk suggests, this apathy is because it is too hard or too costly to be active. Rather, most shareholders lack the incentives necessary to mount challenges to incumbency. Some pension funds and other institutional investors have taken an active role in corporate governance, but

[40] See, e.g., Gordon, supra note 25, at 677.

[41] Executive Compensation and Related Person Disclosure, Securities Act Release No. 8,732A, Exchange Act Release No. 54,302A, Investment Company Act Release No. 27,444A, 71 Fed. Reg. 53,158 (Sept. 8, 2006), *reprinted in* [2006 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,620 (Aug. 23, 2006).

[42] See, e.g., Gordon, supra note 25, at 683–84. For example, from 1995 to 2000, average CEO tenure "shrank from 9.5 years to 7.3 years, and the average tenure of fired CEOs shrank from 7.0 years to 4.6 years." Id. at 683; see also Khurana, supra note 25, at 60–61; Nanette Byrnes, The Great CEO Exodus, Bus. Wk., Oct. 30, 2006, at 78; Lublin & White, supra note 23, at B1; Masters, supra note 23, at D1; Whitehouse, supra note 23, at R1; Corporate Boardrooms, supra note 23, at A7.

many money managers "prefer liquidity to activism"[43] and use a business model that discourages battles with management. In fact, Stephen Bainbridge argues that those institutions most likely to engage in investor activism—union and public employee pension funds—are also the most likely to do so to the detriment of other investors.[44]

Even where activist shareholders do mount challenges, other shareholders often lack incentives to become informed about the competing candidates amongst whom they are voting. This is the classic problem of rational apathy: for the average shareholder, collecting and absorbing the necessary information will entail a much higher opportunity cost than the expected benefit, which is low because most shareholder votes will have little individual impact on the outcome.[45] Therefore, shareholders will rationally choose to spend their time on other more valuable pursuits. Shareholder passivity thus presents a two-fold obstacle to Bebchuk's proposed new governance universe: it suggests, first, that the body of shareholders who would be responsible for deciding between an incumbent director and a rival would not make an informed choice and, second, that even if given greater power to replace directors, few shareholders would take advantage of it.

Bebchuk touches on both of these concerns but fails to provide a convincing response. Though acknowledging that "many shareholders pay little or limited attention to the question of how to vote,"[46] he offers no solution to the difficulty. His proposed reimbursement plan would allow some candidates to risk more money on distributing information and generally presenting their case to shareholders with the promise of reimbursement if they achieve a measure of success.[47] There is no evidence, however, that more information or a more thorough presentation would eliminate the collective-action barriers to informed shareholder voting.

Bebchuk more pointedly addresses the concern that shareholders will fail to exercise the power to remove directors once they

[43] Stephen M. Bainbridge, The Case for Limited Shareholder Voting Rights, 53 UCLA L. Rev. 601, 631 (2006).
[44] Bainbridge, supra note 4, at 1754.
[45] Bainbridge, supra note 43, at 623.
[46] Bebchuk, supra note 1, at 692.
[47] Id. at 698–99.

have it. He takes it as given that most money managers are not likely to sponsor a rival slate or to vote against management, but offers that "they do occasionally vote against management when its position appears to be value decreasing."[48] However, given that money managers are by far the best-suited investors to engage in shareholder activism, the fact that they vote against management only on occasion suggests a persistent passivity problem. Furthermore, as noted earlier, occasions on which these investors have most often mounted challenges to management (that is, those involving takeover issues) were deliberately excluded from Bebchuk's data purporting to show how many contested elections occur per year. Ironically, Bebchuk considers the type of proposed change of control situation in which money managers are most likely to oppose management to be irrelevant to his assessment of the need for reform, yet he offers the same as evidence that shareholder passivity is not the problem that his critics argue it is.

Undoubtedly recognizing the unavailability of a solid response to the shareholder passivity critique, Bebchuk ultimately challenges his critics, concluding that "[t]o provide a basis for such opposition, [my] opponents must argue that making it easier to replace directors would have significant negative consequences."[49] This is misguided. As the person proposing major changes to the well-established corporate governance system, Bebchuk should bear the burden of proving that his proposals would have significant *positive* consequences.

III. SHOULD CORPORATIONS FINANCE CONTESTS?

Bebchuk argues that the problem of costs is the biggest impediment to rival slate challenges, and a large part of his plan—full reimbursement by the corporation if minimum success is attained—seeks to fix this "problem." Under his proposal, challengers who garner a specified percentage of the vote will have their costs fully reimbursed by the corporation.[50] He prefers full to partial reimbursement in order to "encourage challenges when potential rivals believe they have a substantial likelihood (even though no cer-

[48] Id. at 693, 718.
[49] Id. at 718.
[50] Id. at 698–99.

tainty) of winning."[51] Bebchuk does not explain, however, how potential challengers will know, before spending money to research and mount a campaign, that they have a "substantial likelihood" of winning enough support to garner reimbursement. Indeed, earlier in his article, Bebchuk points out that "shareholders cannot infer from a rival team's mounting a challenge that the rival directors would perform better."[52] Thus, substantial information is necessary to convince shareholders of a rival's superiority, and, given the passivity problems discussed above, how likely is it that sufficient information will be absorbed by enough shareholders for the potential rivals to confidently predict success? It appears improbable that any shareholder considering sponsoring a rival slate would be able to foresee how successful that slate would be. Without this foresight, the potential for reimbursement will not be an incentive to most shareholders.

There is also something quite unattractive about a scheme in which dissidents who succeed in getting as little as one-third of the vote can obtain reimbursement, at the expense of other shareholders, for whatever amount they decide to spend on that unsuccessful effort.[53] Will such a low standard for full reimbursement really discourage the frivolous or selfishly motivated election contest?

Considering the rapid spread of majority-vote requirements for director elections, and the board and management changes recently attained through direct pressure from pension funds, hedge funds, and other activist investors, Bebchuk does not make a persuasive argument for offering funds from corporate coffers as an incentive to encourage more director contests.

CONCLUSION

As always, Bebchuk is a provocative and thoughtful analyst of the corporate governance environment. However, his repeated theme is distrust of both the motivations (he sees greed) and competence of corporate managers. His solutions have been to find ways to empower shareholders to directly intervene and rechart

[51] Id. at 698–99.
[52] Id. at 692.
[53] See id. at 698–99.

the course of the business[54] or to more easily change or influence management decisions, either through direct nomination of directors in the corporate proxy[55] or through corporate-financed, contested director elections.[56]

In his thesis, and in his supporting scholarship, Bebchuk too readily brushes aside the significant and demonstrated power that shareholders, particularly significant investors, are already exercising to change corporate management and direction. Instead, he relies on highly selective "evidence" to support his diagnosis of what he deems insufficient shareholder power.[57]

At its core, Bebchuk's thesis is not so much an argument for better corporate governance as it is a design for a new corporate paradigm in which shareholders will no longer be passive investors who are consulted only on fundamental corporate changes, but instead will replace directors as the primary overseers of the professionals who provide centralized management and effective decisionmaking for the enterprise. Thus, in Bebchuk's new world, shareholders would be able to intervene directly and frequently in corporate management by using the corporate equivalents of referenda, initiatives, and recall elections and could do so through corporate-financed campaigns. Such actions would likely be responsive to the momentary popular concerns of the most vocal of the shareholder base, hedge funds, and others with short-term goals. But this would not be an environment that would encourage innovation, investment in the future, and long-term corporate growth.

[54] See, e.g., Bebchuk, Letting Shareholders, supra note 2, at 1785.
[55] See Letter from Lucian A. Bebchuk to Jonathan G. Katz, supra note 5.
[56] Bebchuk, supra note, 1 at 696–700.
[57] See supra Section I.A.