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# THE GIANT SHADOW OF CORPORATE GADFLIES

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## ABSTRACT

*Modern-day shareholders influence 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 how American companies are run. Amazingly, a small group of individual shareholders wields unprecedented power to set corporate agendas and stands at the epicenter of our contemporary corporate governance ecosystem. In fact, the power of these individuals, known as “corporate gadflies,” continues to rise.*

*Corporate gadflies present a puzzling reality. Although public corporations in the United States are increasingly owned by large institutional investors, much of their corporate governance agenda has been and is still 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 so much 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.*

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*This Article is the first to address the giant shadow that corporate gadflies cast on the corporate governance landscape in the United States. The Article makes three contributions to the literature. First, using a comprehensive dataset of all shareholder proposals submitted to the S&P 1500 companies from 2005 to 2018, it offers a detailed empirical account of both the growing power and influence that corporate gadflies wield over major corporate issues and of gadflies' power to set governance agendas. Second, the Article uses the context of corporate gadflies to elucidate a key governance debate over the role of large institutional investors in corporate governance. Specifically, the Article underscores the potential concerns raised by the activity of corporate gadflies and questions the current deference of institutional investors to these gadflies regarding the submission of shareholder proposals. Finally, the Article proposes policy reforms aimed at reframing the current discourse on shareholder proposals and potentially sparking 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<sup>1</sup>

## INTRODUCTION

On a nondescript block of Nelson Avenue, about fifteen blocks from California’s Hermosa Beach, in a quaint 1970s, two-story, twelve-unit apartment building, resides one of the most prolific actors in U.S. corporate governance.<sup>2</sup> Neither a CEO nor a well-connected board member of a high-performing corporation, this former Hughes Aircraft employee now walks or takes public transportation to shareholder meetings to save money.<sup>3</sup> His name is John Chevedden, and he is the leading proponent of shareholder proposals annually in the United States: he is a corporate gadfly.

1. Evelyn Y. Davis, *Shareholder Activist and CEO Foil, Dead at 89*, CBS NEWS (Nov. 5, 2018, 4:46 PM), <https://www.cbsnews.com/news/evelyn-y-davis-shareholder-activist-and-ceo-foil-dead-at-89> [<https://perma.cc/T4F3-23PF>].

2. Ross Kerber, *Special Report: Economy-class Activists Investor Crashes the Corporate Party*, REUTERS (Oct. 23, 2013, 7:05 AM), <https://www.reuters.com/article/us-activist-chevedden-special-report/special-report-economy-class-activist-investor-crashes-the-corporate-party-idUSBRE99M0LE20131023> [<https://perma.cc/3LKS-T5KT>].

3. *Id.*

For a long time, Chevedden was joined in his activities by the “[q]ueen of the [c]orporate [j]ungle,” Ms. Evelyn Davis. Davis, who recently passed away, was another unconventional, yet integral player in corporate governance.<sup>4</sup> Throughout her fifty-year tenure as a corporate gadfly, Davis attended shareholder meetings in outlandish costumes to attract attention.<sup>5</sup> Maintaining the minimum threshold of at least \$2,000 worth of shares in upwards of eighty companies at a time, she attended as many as fifty meetings a year to argue in support of her shareholder proposals.<sup>6</sup> Davis, like Chevedden, became infamous among corporate executives due to her successful proposals for changes at prominent companies like General Motors.<sup>7</sup> The persistence and vigor with which these “Main Street” individuals have waged their battles with America’s blue chip corporations have earned them the sobriquet of corporate gadflies, reflecting the nuisance they make of themselves.<sup>8</sup>

In the past, gadflies were perceived as a mere inconvenience. However, with the rise in power that shareholders now wield in corporate America and the increased accumulation of equity capital by a handful of large institutional investors, the question arises as to what role 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 moniker might imply, our data shows that corporate gadflies have become much more than a mere nuisance. If anything, they might be best likened to Muhammad Ali’s “float like a butterfly, sting like a bee” metaphor.<sup>9</sup>

Indeed, over the last decade, corporate gadflies have come to play an important role in setting the U.S. corporate governance discourse.<sup>10</sup> Our data

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4. 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> [<https://perma.cc/7MXB-M297>].

5. *Id.*

6. Laurence Arnold, *Evelyn Davis, Queen of Shareholder Activism, Dies at 89*, BLOOMBERG (Nov. 5, 2018, 8:05 AM), <https://www.bloomberg.com/news/articles/2018-11-05/evelyn-davis-feisty-queen-of-shareholder-activism-dies-at-89> [<https://perma.cc/8QGG-4HLW>]. Under Rule 14(a)(8), for meetings held on or after January 1, 2022, a shareholder can submit a proposal if they continuously hold at least \$25,000 in market value for at least one year prior to the shareholder meeting or \$15,000 for at least two years. If a shareholder holds the shares for at least three years, that threshold decreases to \$2,000. 17 C.F.R. § 240.14a-8(b) (2021). For meetings held prior to January 1, 2022, shareholders must hold only \$2,000 or 1% of a company’s securities for one year in order to submit a proposal. *Id.*

7. Arnold, *supra* note 6.

8. See *infra* notes 92–93 and accompanying text.

9. Hilary Whiteman, ‘Float Like a Butterfly, Sting Like a Bee’: Best Quotes from Muhamad Ali, CNN (June 4, 2016, 10:48 AM), <https://www.cnn.com/2016/06/04/sport/best-quotes-muhammad-ali/index.html> [<https://perma.cc/CSX8-C5XE>].

10. Matteo Tonello, *Shareholder Voting in the United States: Trends and Statistics on the 2015–2018 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 26, 2018), <https://corp.gov>.

demonstrates that a large and growing proportion of all shareholder proposals among the S&P 1500 are submitted by a handful of gadflies. In 2018, five individuals accounted for close to 40% of all shareholder proposals submitted to S&P 1500 companies.<sup>11</sup> More importantly, gadflies do not tend to focus on esoteric topics; rather, they usually submit 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 among the S&P 1500.<sup>12</sup> Clearly, gadflies' scope of activity is no longer marginal and has grown to cast a giant shadow over corporate America—one that corporations and regulators have begun to challenge with increasing vigor.

It is important to recognize that 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>13</sup> Shareholder proposals often lead to tangible results, prompting many corporations to act upon them.<sup>14</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 the infant formula Similac.<sup>15</sup> More generally, our data also shows that in 64.5% of the cases in which gadflies' proposals received majority support, management subsequently presented proposals to amend the company's applicable governance terms. The vast majority of these management proposals (82%) eventually passed and resulted in actual governance changes.

The dominance of gadflies in the shareholder proposal arena is remarkable, particularly considering that in almost every other aspect of corporate America, small retail investors have ceded power to large

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law.harvard.edu/2018/11/26/shareholder-voting-in-the-united-states-trends-and-statistics-on-the-2015-2018-proxy-season [https://perma.cc/3XFJ-3T6G]; *see infra* Section I.C.

11. 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. The SharkRepellent dataset is now hosted within the FactSet dataset. *See infra* Section I.A.2.

12. *See infra* Figure 5 (providing data on gadflies share in submitted proposals and passage rates).

13. 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 (2021).

14. David Larcker & Brian Tayan, *Gadflies at the Gate: Why Do Individual Investors Sponsor Proxy Resolutions?*, in STAN. CLOSER LOOK SERIES 1 (2016), <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-59-gadflies-at-gate.pdf> [https://perma.cc/LPS7-A4CB].

15. *Id.*

institutional investors, hedge funds, and the uber-rich. In fact, many retail investors don't even vote.<sup>16</sup> Yet, corporate gadflies have been gaining, not losing, influence in the corporate governance sphere, and persistently continue to dominate the shareholder proposal market. In fact, gadflies' influence has become so pronounced that the SEC has recently enacted more stringent requirements to the shareholder proposal regime, with the potential to reduce gadflies' power.<sup>17</sup> This is despite the fact that gadflies generally do not own more than a few thousand dollars of equity in each company, nor do they stand to benefit economically from their actions in any meaningful way.<sup>18</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>19</sup>

Gadflies' dominance, however, 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 the public trust these individuals, who hold small fractions of the corporations to which they submit proposals, to safeguard the interests of investors and the economy?

To answer these questions, one must first understand how shareholder proposals have become a primary avenue for shareholder involvement in corporate America.<sup>20</sup> Shareholder proposals are generally brought to a non-binding shareholder vote during the corporation's 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>21</sup>

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

17. See *supra* note 6.

18. 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: LABOR'S LAST BEST WEAPON* 45–151 (2018).

19. See discussion *infra* note 118.

20. Kosmas Papadopoulos, *The Long View: The Role of Shareholder Proposals in Shaping U.S. Corporate Governance (2000–2018)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (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> [<https://perma.cc/9AG5-QK2Z>]; see *infra* Section I.B.

21. See, e.g., Kastiel & Nili, *supra* note 16; see also, e.g., Paul Rose, *Shareholder Proposals in the*

This dynamic has created a new governance ecosystem. Our empirical evidence shows that gadflies initiate shareholder proposals that focus primarily 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 proposals attracted, on average, 47.8% shareholder support between 2005 and 2018.<sup>22</sup> 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. Absent such a response by management, proxy advisory firms are likely to recommend voting against individual directors or even the entire board, potentially subjecting the directors to withhold campaigns that are embarrassing or that can result in their defeat or resignation.<sup>23</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 costs. While most proposals address major governance issues,<sup>24</sup> others contain capricious, perhaps even comical requests that reflect the ease with which such proposals can be submitted. For example, in 2012, Nomura Holdings, Inc., a Japanese financial holding company listed in the United States, faced several obscure proposals submitted by an individual shareholder.<sup>25</sup> One of these proposals requested that the articles of incorporation be revised to 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>26</sup> Similarly, in 2005, Procter & Gamble faced a proposal from a 0.0001% shareholder in the company that recommended that Procter & Gamble sell the company based on the premise that the stock prices had not increased at the same rate as housing prices, the

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*Market for Corporate Influence*, 66 FLA. L. REV. 2179 (2014).

22. See *infra* notes 113–15 and accompanying text.

23. See Yonca Ertimur, Fabrizio Ferri & Stephen R. Stubben, *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53 (2010) (providing evidence that managers and directors who ignore majority vote shareholder proposals are more likely to face labor market sanctions); see also Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 CALIF. L. REV. 1097 (2020) (demonstrating how shareholder input leads to tangible changes in governance documents); *infra* notes 147–52.

24. Subodh Mishra, *An Early Look at 2019 US Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 5, 2019), <https://corpgov.law.harvard.edu/2019/03/05/an-early-look-at-2019-us-shareholder-proposals> [<https://perma.cc/L3ZM-FGBE>].

25. Nomura Holdings, Inc., Report of Foreign Private Issuer (Form 6-K), at 18 (Feb. 10, 2012).

26. Julia La Roche, *Shareholders Demand Nomura Install Japanese-Style Toilets to Increase the Stock Price*, BUS. INSIDER, (June 1, 2012, 1:00 PM), <https://www.businessinsider.com/shareholders-want-nomura-to-install-japanese-style-toilets-2012-6> [<https://perma.cc/3MFY-LM48>].

shareholder in question attributing this to an increase in “feminist careerism.”<sup>27</sup>

Furthermore, a closer examination of gadflies and their current role reveals the fragility of the existing ecosystem, which relies heavily on a handful of individuals to initiate market-wide governance changes through the submission of shareholder proposals. We demonstrate why gadflies cannot, and should not, provide a systemic solution to institutional investors’ lack of involvement in the submission of shareholder proposals. Gadflies face important structural limitations that restrict their ability to exploit the shareholder proposal mechanism to its fullest: they operate on a voluntary basis, have limited resources, and lack an institutional body of knowledge that would ensure the successful realization of their agendas. What will happen when this handful of players, most of whom are already in their seventies, gets tired or pass away? Perhaps more immediately, what will happen in the coming years as new regulations limit gadflies’ ability to engage? The answer is unclear.

Finally, and most significantly, gadflies’ activity is under attack. As gadflies have gained traction, public corporations and their lobbyists have begun to push back against them by strongly advocating for revised rules regulating the submission of shareholder proposals. These lobbying efforts showed their first signs of success in September 2020, when the Securities and Exchange Commission (SEC) voted to adopt amendments to the rules governing shareholder proposals. These new rules could limit the ability of gadflies to submit shareholder proposals, resulting in a significant decline in the number of shareholder proposals.<sup>28</sup> Understanding gadflies’ role is, therefore, particularly important in light of these regulatory developments.

This Article makes several contributions to the literature in the field. First, using a comprehensive dataset of all shareholder proposals submitted to the S&P 1500 companies from 2005 to 2018, it offers a detailed empirical account of gadflies’ growing influence on major corporate issues and of their power to set governance agendas.<sup>29</sup> Second, the Article uses the context of corporate gadflies to elucidate a key governance debate over the role that large institutional investors take (or refrain from taking) in corporate

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27. Procter & Gamble Co., Proxy Statement (DEF 14A), at 37 (Aug. 30, 2005).

28. See *infra* notes 113–216.

29. This Article gathers data from companies listed in Standard & Poor’s 1500 list (S&P 1500). 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 Mid-Cap 400, and \$450 million to \$2.1 billion for the S&P Small-Cap 600. See *S&P Composite 1500*, S&P DOW JONES INDICES, <https://us.spindices.com/indices/equity/sp-composite-1500> [https://perma.cc/2KDU-KPNT#overview].

governance.<sup>30</sup> Specifically, the Article underscores the potential concerns raised by the activity of corporate gadflies and questions the current deference of institutional investors to these gadflies. Finally, the Article explores several policy reforms aimed at increasing the input of all investors into the shareholder proposal mechanism in order to reduce the system's reliance on gadflies.

This Article proceeds as follows. Part I provides a comprehensive and nuanced 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 in the shareholder proposal arena. 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 large shareholders' current reliance on gadflies is troubling despite the relative virtue of gadflies. It also demonstrates how gadflies may now be especially deterred by the regulatory backlash their activity has generated.

Part III discusses the policy implications of our analysis. After examining the recent SEC-proposed reform in light of the Article's findings, this Part presents 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 are brought to the ballot, either by enabling the use of “professional filers” or by requiring that the most important and popular governance-related shareholder proposals be brought to a shareholder vote on a periodic basis. Such reforms could eliminate the dependence on a handful of individual proponents, and, as a result, proposals that large investors support, many of which are not currently being submitted in a timely manner, would 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 corporate governance landscape. While some regulators and companies have been focusing their efforts on restricting the ability of individual investors to submit shareholder proposals,<sup>31</sup> this Article offers a more holistic approach to this issue with the potential to spark a new line of

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30. 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., 2029, 2076 (2019). See also Jill E. Fisch, Asaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17 (2019); John C. Coates, IV, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harvard Pub. Law, Working Paper No. 19-07, 2018), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3247337](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337); Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders* (N.Y. Univ. Sch. of Law, Law & Econ. Research Paper Series, Working Paper No. 18-39, 2019), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3295098](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098).

31. See *infra* Section II.C.

inquiry into the role of investors in corporate governance.

### I. THE GROWING IMPORTANCE OF CORPORATE GADFLIES

Historically, shareholders have paid little attention to corporate governance and have often deferred to the decisions of management.<sup>32</sup> In 1957, for example, only 12 out of 3,000 publicly traded companies faced a proxy contest.<sup>33</sup> Similarly, the tool of shareholder proposals, although originally intended to augment the existing powers of shareholders at the time,<sup>34</sup> initially generated little impact.<sup>35</sup> Indeed, it was long thought that shareholder proposals did not have much of an effect on corporations.<sup>36</sup>

This is no longer the case. The once “largely inconsequential” role of shareholder voting has evolved into one of power and influence.<sup>37</sup> The increased power in the hands of shareholders has conferred upon them greater input regarding the appointment and retention of executives, the makeup and role of the board, the social role of the corporation, the payment of special dividends, and even the dissolution of the corporation.<sup>38</sup> In 2018 alone, 268 shareholder campaigns to replace board members,<sup>39</sup> and a total of 788 shareholder proposals were submitted in the United States.<sup>40</sup> And as some prominent scholars have observed: “[n]ever has voting been more

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32. See, e.g., Paul H. Edelman, Randall S. Thomas & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1402 (2014).

33. WARREN S. DE WIED, FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP, PROXY CONTESTS 1 (2018) (“A proxy 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 Harwell Wells, *A Long View of Shareholder Power: From the Antebellum Corporation to the Twenty-First Century*, 67 FLA. L. REV. 1033, 1077 (2016); see also John Lovallo, *Proxy Contests on the Rise – Activists Emboldened by Success*, BOARD PROSPECTS (Oct. 30, 2013), <http://news.boardprospects.com/articles/527825/proxy-contests-on-the-rise-activists-emboldened-by> [<https://perma.cc/74QM-ZJ75>].

34. See, e.g., Bayless Manning, *Reviews*, 67 YALE L.J. 1477, 1483 (1958) (reviewing JOSEPH A. LIVINGSTON, *THE AMERICAN STOCKHOLDER* (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).

35. *Id.*

36. Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 177–78 (2001).

37. See, e.g., Kobi Kastiel & Yaron Nili, *Competing for Votes*, 10 HARV. BUS. L. REV. 287 (2020).

38. Wells, *supra* note 33, at 1035.

39. SULLIVAN & CROMWELL LLP, REVIEW AND ANALYSIS OF 2018 U.S. SHAREHOLDER ACTIVISM 15, 26 (2019), <https://www.sullcrom.com/files/upload/SC-Publication-SandC-MnA-2018-US-Shareholder-Activism-Analysis.pdf> [<https://perma.cc/YSB6-TSQ8>]; see Ronald Orol, *Activist Spotlight: 2018 by the Numbers*, THE STREET (June 6, 2018, 1:36 PM), <https://www.thestreet.com/investing/funds/activist-spotlight-2018-by-the-numbers-14613743> [<https://perma.cc/FFK9-A4BD>].

40. Ron Mueller, Beth Ising & Aaron Briggs, *Shareholder Proposal Developments During the 2018 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 2, 2018), <https://corpgov.law.harvard.edu/2018/08/02/shareholder-proposal-developments-during-the-2018-proxy-season> [<https://perma.cc/E43A-NP5D>].

important in corporate law.”<sup>41</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 among the S&P 1500.<sup>42</sup> Not only do gadflies dominate shareholder proposal submissions, but their proposals also experience much higher passage rates than do those of more sophisticated and resource-rich investors.<sup>43</sup> Gadflies’ activities make a real impact on companies.

This Part provides a detailed account of corporate gadflies’ growing importance in the current governance landscape. We begin by analyzing the sources of the increasing importance of the shareholder proposal as a key tool for effectuating governance changes. We continue by examining gadflies, providing original empirical data on how these Main Street investors were able to gain so much influence in corporate America. Finally, 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 relating 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 importance to shareholders.<sup>44</sup> The key allure of the shareholder proposal route is the ability to have the proposal included in the company’s meeting materials (the proxy statement), thereby incurring almost no direct costs for bringing the proposal.

While shareholder proposals are now 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>45</sup> In 1942, the SEC adopted the initial version of what is now Rule 14a-8.<sup>46</sup> This rule stipulated that corporations must include the written proposals of “a qualified security holder”<sup>47</sup> in their proxies, thus creating

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41. Marcel Kahan & Edward B. Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1227 (2008).

42. *See infra* Figure 3.

43. *See infra* Section I.C.

44. 17 C.F.R. § 240.14a-8 (2021).

45. *See generally* Wells, *supra* note 33 (noting the development of shareholder power over time).

46. *See generally id.* at 1078.

47. Exchange Act Release No. 3347, 7 Fed. Reg. 10,655, 10,656 (Dec. 22, 1942).

what are now widely recognized as shareholder proposals.<sup>48</sup>

Civil rights activists were among the first to use this tool, identifying it as a way to gain access to the annual meetings of national corporations during the fight for desegregation.<sup>49</sup> Civil rights activists utilized the tool as a step beyond consumer protests and boycotts to effectuate change in a company, but they experienced varying degrees of success.<sup>50</sup> In this phase of shareholder activism, proponents quickly learned that “[t]he 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>51</sup>

Even today, shareholder proposals are not without limitations. Securities regulations limit who can submit proposals and their content. Under the current version of Rule 14a-8, the prerequisites for submitting 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>52</sup> However, under the recently revised version of Rule 14a-8, the threshold for submitting such a proposal will increase significantly. For at least one year, the shareholder must have continuously held at least \$25,000 in market value.<sup>53</sup> The threshold decreases the longer the shareholder has held the stock, dropping to \$15,000 for at least two years and \$2,000 for at least three years.<sup>54</sup> The shareholder must continue to hold this amount of stock through the date of the meeting at which the proposal is presented.<sup>55</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 negotiations with the company; or (3) the company may omit the proposal

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48. Wells, *supra* note 33, at 1078.

49. See Sarah C. Haan, *Civil Rights and Shareholder Activism: SEC v. Medical Committee for Human Rights*, 76 WASH. & LEE L. REV. 1167, 1214–15 (2019) (discussing how an activist used a single share in W.T. Grant to successfully demand the company desegregate its lunch counters in Baltimore).

50. *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).

51. See *id.* at 1218.

52. See *supra* note 6; see also Kastiel & Nili, *supra* note 37, at 25 n.123.

53. See *supra* note 6; see also Kastiel & Nili, *supra* note 37, at 25 n.123.

54. Kastiel & Nili, *supra* note 37, at 25.

55. *Id.*

from the ballot after receiving a no-action letter from the SEC.<sup>56</sup> The majority of shareholder proposals are precatory in nature, meaning that the corporation is under no obligation to adopt the proposal if it passes.<sup>57</sup>

## 2. The Growing Prevalence of Shareholder Proposals

### i. Methodology

Before discussing our 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 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 proposals that were withdrawn due to a negotiated agreement or otherwise. For each proposal, we identified and coded the company, its market size, the topic of the proposal, the proponent, the 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 study period.

### ii. Recent Trends

Notwithstanding the limitations on 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 significant number of shareholder proposals submitted to the S&P 1500 during this period (an average of 517 proposals per year).

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56. See Papadopoulos, *supra* note 20 (discussing how when a stockholder presents proposals to the board, 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).

57. Kellie C. Huenekens & Jamie Smith, *2018 Proxy Season Review*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 8, 2018), <https://corpgov.law.harvard.edu/2018/08/08/2018-proxy-season-review-3> [<https://perma.cc/JY28-DVTX>] (“[A]t 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.”).

FIGURE 1. Submitted Shareholder Proposals Over Time in the S&amp;P 1500

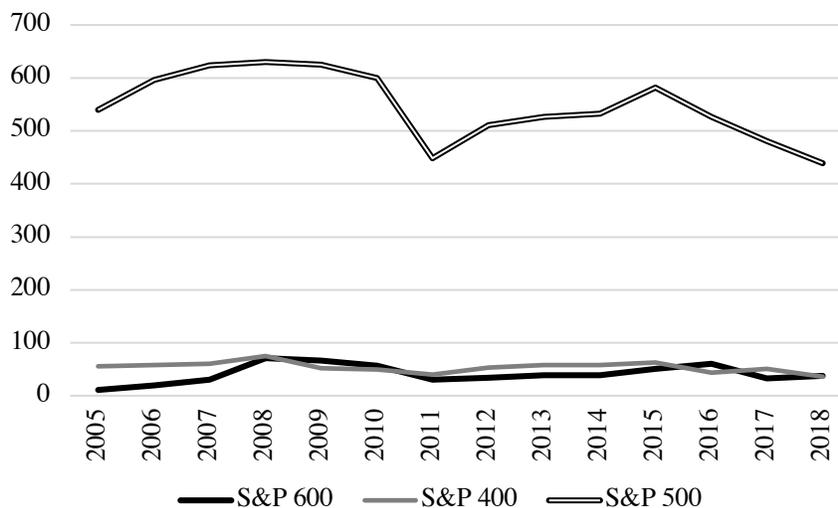


Figure 1 also demonstrates that larger companies received the majority of proposals, probably because these companies receive wide press coverage. For example, in 2015, over 450 proposals were submitted to large-cap companies that comprise the S&P. In contrast, fewer than 150 shareholder proposals combined were submitted to the mid- and small-cap companies that comprise the S&P 400 and 600, respectively.

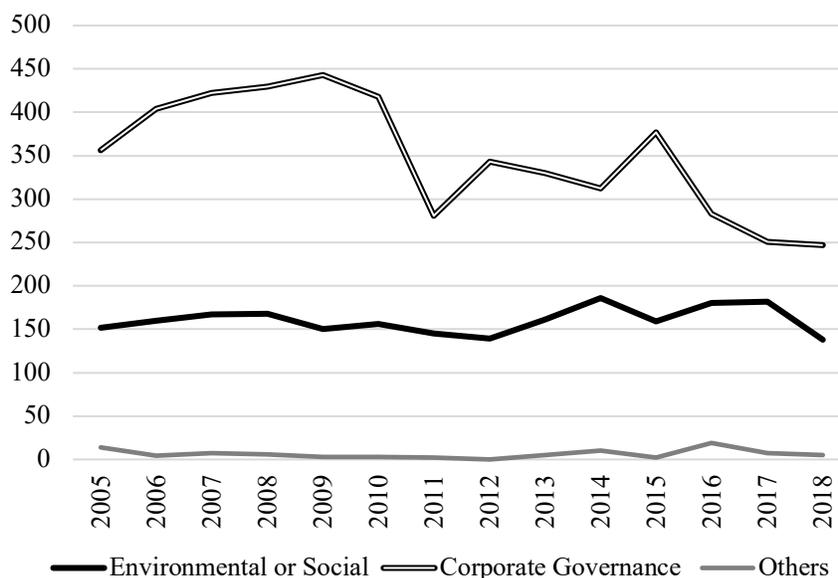
Importantly, in many cases, shareholder proposals do not reach the voting stage. In light of the new reality described in the following Subsection, wherein proposals that receive majority support require companies to act or risk a withhold campaign, some companies prefer to work with the proposing shareholder to bring about a change rather than have the proposal go to a shareholder vote.<sup>58</sup> Consequently, our data may actually underestimate the true number of shareholder proposals that were submitted to public companies each year, since a portion of them may be settled before reaching a vote.<sup>59</sup>

58. Stephen Joyce, *Negotiations Lead to Fall in Proxy Access Proposals*, BLOOMBERG (June 30, 2016), <https://www.bna.com/negotiations-lead-fall-n57982076332> [<https://perma.cc/JL6Q-TNPB>] (“[A]n increasing number of companies negotiating settlements with shareholders led to a material decrease in the number of shareholder proposals seeking proxy access in 2016.”).

59. 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).

Shareholder proposals cover a wide range of issues, from shareholder rights and board composition to environmental and social policy. While historically, proposals have been governance dominated, recently investors have shifted their attention towards social and environmental proposals.<sup>60</sup> For example, in 2017, shareholders submitted 182 environmental and social proposals to S&P 1500 companies.<sup>61</sup>

FIGURE 2: Submitted Shareholder Proposals by Category<sup>62</sup>



In particular, between 2014 and 2018, the prevalence of political spending proposals increased by 20%,<sup>63</sup> and proposals concerning climate risk, coal-related risks, greenhouse gas emissions, gun safety, the opioid crisis, and sustainability reports all received majority support in at least one

60. Joyce, *supra* note 58; see Mishra, *supra* note 24.

61. See Huennekens & Smith, *supra* note 57 (noting that shareholders at 106 Russell 3000 companies voted on social and environmental proposals); see also PROXYPULSE, BROADRIDGE & PWC GOVERNANCE INSIGHTS CTR., 2018 PROXY SEASON REVIEW 2 (2d ed. 2018) (“Institutional shareholder support for these proposals has increased over the past five years (from 19% in 2014 to almost 29% in 2018).”).

62. The “Others” category includes proposals filed in connection with proxy fights or M&A events; proposals related to value maximization demands (such as distribution of dividends); and other miscellaneous proposals.

63. PROXYPULSE, *supra* note 61, at 6.

shareholder vote in 2018.<sup>64</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, gender pay gap, NDAs and mandatory arbitration, freedom of expression, Chinese censorship, sustainability, antitrust, and the corporate governance policies that insulates Google's executives from shareholder accountability."<sup>65</sup> Another notable proposal in 2019 included presidential candidate Bernie Sanders's demand that Walmart give a board seat to a representative of its workers.<sup>66</sup>

Although the number and proportion of governance-related proposals has decreased slightly recently,<sup>67</sup> the support these proposals receive continues to remain high, growing from 5% in 1994 to 38% in 2019.<sup>68</sup> Between 2003 and 2018, the most common governance-related proposals were for declassifying the board, establishing an independent board chair, adopting a majority vote standard, adopting proxy access, and adopting a shareholder right to call a special meeting.<sup>69</sup> As these proposals have become more widely adopted, however, their prevalence has decreased slightly, either because companies have adopted the proposed changes voluntarily to keep up with current governance standards or in response to shareholder proposals.<sup>70</sup> This in itself is significant in signaling the importance and impact of shareholder proposals.

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

Thus far, we have shown that shareholder proposals are submitted frequently, particularly in larger companies. But do shareholder proposals still matter in the new era of increased engagement by institutional

64. Huennekens & Smith, *supra* note 57.

65. Haan, *supra* note 49, at 1224–25.

66. *Id.*

67. See *supra* Figure 2; James R. Copland & Margaret M. O'Keefe, *Proxy Season Preview: Shareholder Activism en Marche*, PROXY MONITOR (2017), [https://www.proxymonitor.org/Forms/pmr\\_14.aspx](https://www.proxymonitor.org/Forms/pmr_14.aspx) [<https://perma.cc/W24R-LKES>].

68. See Papadopoulos, *supra* note 20 (indicating support level in 1994); MATTEO TONELLO, CONFERENCE BD., PROXY VOTING ANALYTICS (2016–2019) AND 2020 SEASON PREVIEW 70 (2019), <https://cclg.rutgers.edu/wp-content/uploads/Proxy-Voting-Analytics-2016-2019.pdf> [<https://perma.cc/H4X4-6WEN>] (indicating support level in 2019). 22.5% of the corporate governance proposals in 2019 received majority support. TONELLO, *supra*, at 70.

69. Papadopoulos, *supra* note 20 (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).

70. TONELLO, *supra* note 68, at 16–17. This gradual decline is also attributable to the introduction of "say-on-pay" and federal regulation imposing more executive compensation disclosure, which had traditionally been key topic of concern for certain investors, such as labor unions. *Id.* at 16.

investors<sup>71</sup> and widespread activism by hedge funds?<sup>72</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 in target companies and directly engage with management through private communications, public campaigns, and proxy fights.<sup>73</sup> For example, in a recent interview, the famous corporate raider and hedge fund activist, Carl Icahn, maintained 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 board to be accountable, unless you have a lot of capital and a lot of firepower.”<sup>74</sup>

Icahn’s argument overlooks an important point. 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>75</sup> The two are separate channels of engagement that *supplement*, rather than *replace*, each other. Additionally, activist hedge funds have incentives to engage only with those targets where such engagement could result in financial returns that meet their investors’ expected rate of return, a factor which usually is significant. Moreover, activist hedge funds typically accumulate meaningful equity positions in their targets,<sup>76</sup> which limits the ability of all but the largest activists to target large-cap companies that are the primary target of

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71. Jill E. Fisch et al., *supra* note 30, at 17; see, e.g., Kosmas Papadopoulos, *The Long View: US Proxy Voting Trends on E&S Issues from 2000 to 2018*, HARV. L. SCH. F. ON CORP. GOVERNANCE (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> [<https://perma.cc/AX89-8LHQ>].

72. 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) (activist hedge funds “have shaken up boardrooms and forced radical changes at many publicly traded firms”). For a survey of the empirical literature on the disciplinary effect of shareholder activism, see Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliam, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405, 406 (2017).

73. See, e.g., Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, 137 J. FIN. ECON. 1, 34 (2020) (providing a comprehensive analysis of the drivers, nature, and consequences of activists’ engagements and settlements with companies); see also, e.g., Marcel Kahan & Edward Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1029 (2007) (describing the basic goals and tactics of activist hedge funds).

74. Kerber, *supra* note 2.

75. See discussion and sources cited *infra* note 247.

76. Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1732 (2008) (finding activists hold at median 9.1% of targets).

shareholder proposals.<sup>77</sup> As a result, activist hedge funds ignore many targets of shareholder proposals.<sup>78</sup>

Similarly, engagement by large institutional investors does not negate and cannot replace the use of shareholder proposals. First, recent evidence shows that due to limited personnel time, large institutional investors have private communications with only a small minority of portfolio companies.<sup>79</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>80</sup> The purpose of such private communications differs from and is not aimed at replacing 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, can enhance the responsiveness of companies to shareholder interests and the overall effectiveness of shareholder engagement.<sup>81</sup> Thus, shareholder proposals operate as a complementary mechanism to direct investor engagement rather than as a substitute for it.

Indeed, evidence shows how the ability to submit shareholder proposals has become a key avenue through which shareholders can pressure management to adopt certain governance standards.<sup>82</sup> The Shareholder Rights Project, a Harvard Law School clinical program directed by Professor Lucian Bebchuk, highlights the importance of shareholder proposals.<sup>83</sup> In its few years of operation, the program has assisted institutional investors in bringing about the declassification of staggered boards at roughly one hundred S&P 500 and Fortune 500 companies through the submission of

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77. Compare ACTIVIST INSIGHT, SHAREHOLDER ACTIVISM IN Q1 2019 (2019), [https://www.activistinsight.com/research/ShareholderActivism\\_Q12019.pdf](https://www.activistinsight.com/research/ShareholderActivism_Q12019.pdf) [<https://perma.cc/MWN5-GTGZ>] (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).

78. Bebchuk & Hirst, *supra* note 30, at 2137 (“[H]edge funds invest substantial resources in stewardship and take on considerable risks in their activities . . . . 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.”).

79. *Id.* at 2030.

80. Matteo Tonello & Matteo Gatti, *Board-Shareholder Engagement Practices*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 30, 2019), <https://corpgov.law.harvard.edu/2019/12/30/board-shareholder-engagement-practices> [<https://perma.cc/K658-FTG8>].

81. See Michal Barzuza, *Proxy Access for Board Diversity*, 99 B.U. L. REV. 1279, 1279 (2019) (showing how proxy access campaigns were used to enhance board diversity goals); see also Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119, 1129–34 (2016) (showing increased responsiveness to shareholder interests after adoption of majority voting standards).

82. See *supra* Section I.A.

83. Disclosure: From 2012 to 2014, both of us served as associates at the Shareholder Rights Project.

shareholder proposals. As a result of the submission of declassification proposals and related shareholder pressure, the proportion of S&P 500 companies with staggered boards dropped from 60% in 2001 to fewer than 20% in 2014.<sup>84</sup>

Similarly, the Boardroom Accountability Project, launched by New York City Comptroller Scott Stringer in 2014, involved extensive submissions of shareholder proposals regarding shareholder nomination of directors in the company's proxy statement (known as proxy access).<sup>85</sup> By 2017, 141 firms had implemented these proposals.<sup>86</sup> Other shareholders followed the Comptroller's initiative and widely submitted proxy access proposals at numerous companies. As a result, by 2019, almost 500 firms, more than two-thirds of those in the S&P 500, had 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>87</sup> Building upon this success, the Comptroller's Office launched a second project on September 8, 2017, targeting 151 companies and focusing on improving board diversity.<sup>88</sup>

A third notable example of the importance of shareholder proposals 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 candidate to obtain a voting majority before being seated.<sup>89</sup> These examples demonstrate that the shareholder proposal tool, if used appropriately, can have a

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84. For a review of the work done by the SRP, see generally Lucian Bebchuk, Scott Hirst & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3 HARV. BUS. L. REV. 157 (2013).

85. See *Boardroom Accountability Project: Overview*, N.Y.C. COMPTROLLER, <https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/overview> [<https://perma.cc/7GBC-4WLR>].

86. See *Boardroom Accountability Project Focus Companies*, N.Y.C. COMPTROLLER, <https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/focus-companies> [<https://perma.cc/7E3L-YEP7>].

87. Stephen T. Giove, Arielle L. Katzman & Daniel Yao, *Proxy Access Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 19, 2018), <https://corpgov.law.harvard.edu/2018/10/19/proxy-access-proposals-2> [<https://perma.cc/Z5MU-UFFJ>] (“In total, well over 500 companies, and over two-thirds of the S&P 500, have adopted proxy access by-laws.”); Tara Bhandari, Peter Iliev & Jonathan Kalodimos, *Governance Changes Through Shareholder Initiatives: The Case of Proxy Access*, J. FIN. QUANTITATIVE ANALYSIS, June 30, 2020, at 1, 1–32. For a critique of these findings see Bernard S. Sharfman, *What Shareholder Proposals on Proxy Access Tell Us About Its Value*, 34 YALE J. ON REG. ONLINE 1 (2016).

88. See Press Release, N.Y.C. Comptroller, 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> [<https://perma.cc/YS3S-YGNW>] (“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.”).

89. See WEBBER, *supra* note 18, at 75.

significant and genuine 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 the early 2000s, Randall Thomas and James Cotter found an increasing number of proposals that received 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>90</sup>

Additional studies reinforce the importance of shareholder proposals. For example, Paul Rose documented and analyzed the different types of proposals adopted from 2003 to 2013 and highlighted their growing number and increased contribution to the improvement of corporate governance of public companies.<sup>91</sup> Luc Renneboog and Peter Szilagyi provided empirical evidence on implemented proposals, concluding “that shareholder proposals are a useful device of external control.”<sup>92</sup> Another line of empirical studies, to which we refer later, documented the increasing power of shareholder votes and the negative consequences for directors who ignore them.<sup>93</sup>

Finally, the contention 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 shareholder proposals. Notably, in recent years, the shareholder proposal tool has come under significant attack, a phenomenon we describe in greater detail in Section II.C. In particular, the low eligibility threshold for submitting and resubmitting proposals has been subject to intense controversy, culminating in recent amendments to Rule 14a-8 that make it far more difficult to submit and even more difficult to resubmit proposals to a shareholder vote.<sup>94</sup> If the shareholder proposal is a weak tool, how can the strong regulatory and legal backlash against it be explained? If shareholder proposals are not effective, why would managers and their advisors invest the time and effort to eliminate the shareholder proposal tool through a regulatory amendment to

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90. Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368, 368 (2007).

91. Rose, *supra* note 21, at 2179–80. For a study examining the importance of shareholder proposals in the context of proxy access, see generally Tara Bhandari, Peter Iliev & Jonathan Kalodimos, *Governance Changes Through Shareholder Initiatives: The Case of Proxy Access*, J. FIN. QUANTITATIVE ANALYSIS, June 30, 2020, at 1 (regarding proxy access).

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

93. *See infra* notes 147–52.

94. *See infra* Section II.C.1.

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 a shareholder proposal can be submitted, and the low cost associated with it, grants individual shareholders powers they usually are not accorded in corporate America. Below, we present 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, who saw it as his self-ordained role to go around “irritating people so as to make them think, and to reconsider their arguments and perhaps alter their convictions or prejudices.”<sup>95</sup> He analogized this behavior to that of 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>96</sup> These days, the term “corporate gadflies” is used to describe small, “pesky” individual shareholders who are engaged in the submission of massive numbers 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 Gilbert attended a shareholder meeting and was refused permission to ask a question. Following that first meeting, the brothers filed more than 2,000 proposals, and 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>97</sup> Forty-eight percent of all the shareholder proposals submitted between 1944 and 1951 came from the Gilbert brothers.<sup>98</sup>

Following in their wake came a second generation of activists,

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95. *A Political Gadfly*, N.Y. TIMES, May 18, 1936, at 16.

96. *Gadfly*, MERRIAM WEBSTER DICTIONARY, <https://www.merriam-webster.com/dictionary/gadfly> [<https://perma.cc/XYJ6-G42M>].

97. Stephen Foley & Jennifer Bissell, Comment, *Corporate Governance: The Resurgent Activist*, FIN. TIMES (June 22, 2014, 6:45 PM), <http://ig-legacy.ft.com/content/e13ce5fa-f6cf-11e3-b271-00144feabdc0#slide3> [<https://perma.cc/54TT-3VCM>].

98. James McRitchie, *Gadfly Importance Key to Democratic CorpGov*, CORP. GOVERNANCE (Oct. 9, 2019), <https://www.corpgov.net/2019/10/gadfly-importance-key-to-democratic-corpgov> [<https://perma.cc/9YBE-79ZH>].

including Gerald Armstrong and Evelyn Davis, whose approach to questioning chief executives was, respectively, “to harangue and to flirt outrageously.”<sup>99</sup> Of all the 2,042 shareholder proposals submitted between 1987 and 1994, 22% were submitted by the Gilbert brothers and 15% by Evelyn Davis.<sup>100</sup>

Today, a third generation of gadflies has taken up the baton, including William and Kenneth Steiner, John Chevedden, the Rossi family, and the husband-and-wife team of James Ritchie and Myra Young. Steiner, a third-generation gadfly, is confident that gadflies are here to stay, arguing, “You have to rely on the concerned citizen.”<sup>101</sup>

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

We now turn to examine some of the common preconceptions regarding gadflies and to shed light on this remarkable and curious story of individual shareholder engagement through the submission of proposals. We find that gadflies are no longer merely a curiosity with limited effect on corporate law, but rather, 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 United States are submitted by a handful of individuals; (ii) a high proportion of “passed proposals” are filed by gadflies; (iii) gadflies have focused on key issues, such as shareholder rights, rather than pursuing their personal 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 this Subsection.

### i. 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 Section I.A.2, we divided the proponents into several groups, including public pension funds, labor unions, other investment groups, religious groups and other stakeholders, gadflies, and other individuals. The data we provide regarding “gadflies” refer to the following six individuals or families: Gerald R. Armstrong, the Chevedden family, Evelyn Davis, Myra

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99. Foley & Bissell, *supra* note 97.

100. McRitchie, *supra* note 98; Stuart L. Gillan & Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors*, 57 J. FIN. ECON. 275, 281–85 (2000).

101. Foley & Bissell, *supra* note 97.

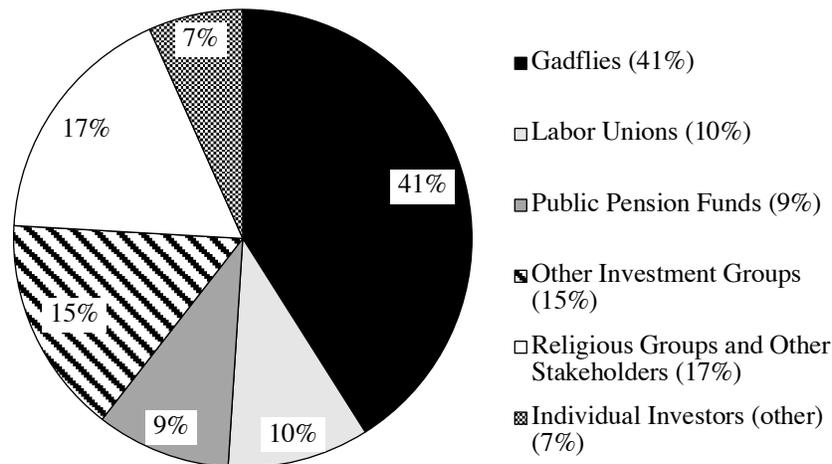
Young and James McRitchie, the Rossi family, and the Steiner family. As before, our data spans the years 2005 to 2018 and includes only proposals that were included in the company proxy materials.

ii. Submission Rate

Although the current generation of gadflies can be counted on one hand, gadflies are not merely an esoteric phenomenon. Remarkably, as Figure 3 below shows, 41% of the shareholder proposals among 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 in 2018, individual shareholders altogether submitted a total of 48% of proposals.

More generally, our data indicate that gadflies submitted 27.3% of all 6,827 shareholder proposals submitted among the S&P 1500 between 2005 and 2018. As a whole, individual shareholders submitted a total of 38.5% of proposals during that period, exceeding more established investors.<sup>102</sup>

FIGURE 3: Proposal Proponents Among 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

102. 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%).

in comparison to other prominent sources of shareholder proposals. The proportion of gadfly-sponsored proposals has increased steadily over time, doubling during the study period. As Figure 4 illustrates, gadflies eclipsed labor unions as the largest source of proposals in 2008. Gadflies 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.

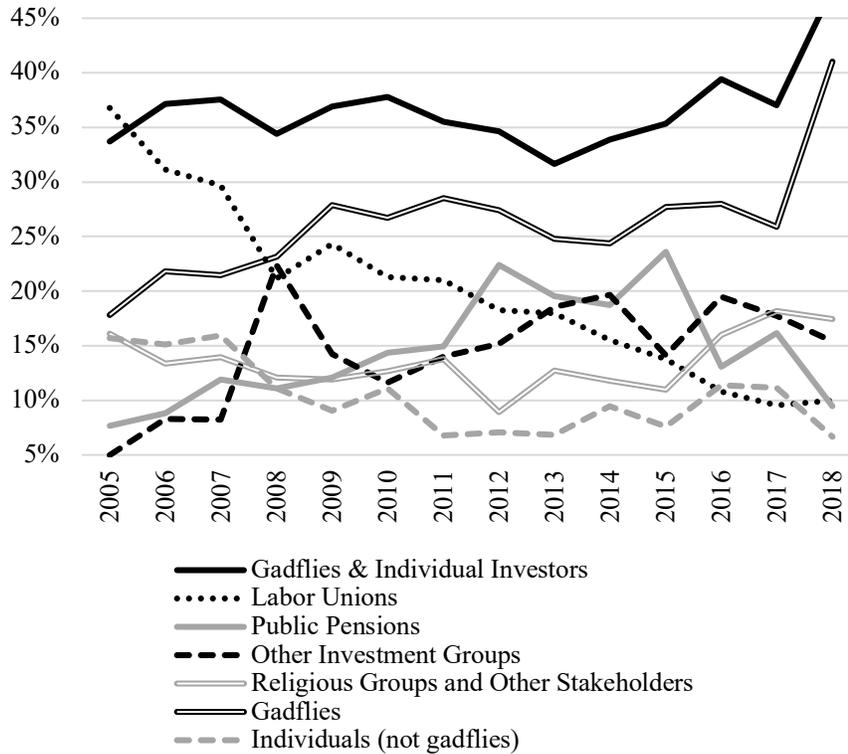
iii. Success Rate

Critics of gadflies often argue that gadflies’ interests diverge from that of the ordinary diversified investor’s and that gadflies “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>103</sup> If this was indeed the case, gadfly proposals should attract little shareholder support.

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103. BUS. ROUNDTABLE, RESPONSIBLE SHAREHOLDER ENGAGEMENT AND LONG-TERM VALUE CREATION: MODERNIZING THE SHAREHOLDER PROPOSAL PROCESS 2 (2016), <https://s3.amazonaws.com/brt.org/archive/reports/BRT%20Shareholder%20proposal%20paper-final.pdf> [<https://perma.cc/Y2AV-X3SQ>].

FIGURE 4: Proposal Proponents Over Time in the S&amp;P 1500



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>104</sup> Likewise, Chevedden and the husband-and-wife duo of McRitchie and Young experienced a 19% and 18% success rate, respectively, during this time span.<sup>105</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 (passed proposals),<sup>106</sup> and that gadflies' proposals

104. JAMES R. COPLAND & MARGARET M. O'KEEFE, PROXY MONITOR, A REPORT ON CORPORATE GOVERNANCE AND SHAREHOLDER ACTIVISM 15 (2014), [https://www.proxymonitor.org/pdf/pmr\\_09.pdf](https://www.proxymonitor.org/pdf/pmr_09.pdf) [<https://perma.cc/8QQG-EMPT>].

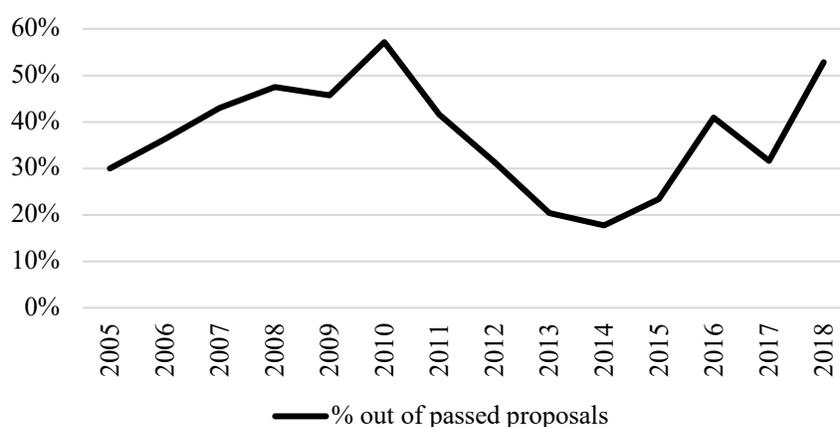
105. *Id.*

106. Our overall sample included 6,827 shareholder proposals with 17.6% of them receiving 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

constituted a large proportion of the passed proposals.<sup>107</sup> For example, in 2018, gadflies submitted over 53% of the passed proposals.<sup>108</sup>

Again, the numbers associated with gadflies' proposals exceed those of more established investors, as pension funds filed only 14% of the passed proposals in the same year. Moreover, the number of passed proposals represents only a *minimal* level of gadflies' influence, as proponents of shareholder proposals can often successfully engage companies if their proposals win substantial, but less than majority, support.<sup>109</sup>

FIGURE 5: Gadflies' Share in Passed Proposals



(6.3%), and other individuals (6.8%). Only pension funds have a 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 proposals 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).

107. Similarly, another study examining all shareholder proposals submitted between 2003–2014 found that 25% of proposals submitted by individuals received majority support. Nickolay Ganchev & Mariassunta Giannetti, *The Costs and Benefits of Shareholder Democracy: Gadflies and Low-Cost Activism* 11, 16–17 (European Corp. Governance Inst., Working Paper, Paper No. 586/2018, 2020) (“Importantly, proposals submitted by individual shareholders are relatively more likely to pass than proposals submitted by institutions.”).

108. Moreover, this number underestimates the popularity of proposals submitted by gadflies, as, in some cases, management could preempt gadflies by submitting its own proposal.

109. BRANDON WHITEHILL, COUNCIL INSTITUTIONAL INV., CII RESEARCH & EDUC. FUND, CLEARING THE BAR: SHAREHOLDER PROPOSALS AND RESUBMISSION THRESHOLDS 3–4 (2018), [https://docs.wixstatic.com/ugd/72d47f\\_092014c240614a1b9454629039d1c649.pdf](https://docs.wixstatic.com/ugd/72d47f_092014c240614a1b9454629039d1c649.pdf) [<https://perma.cc/6LPL-6HQ8>].

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iv. Type of Proposals

It has also been argued that gadflies tend to pursue their “own narrow interests.”<sup>110</sup> Figure 6 dispels this misconception. Gadflies’ proposals do not focus on esoteric corporate policies, pet peeves gadflies may have with specific companies, or even larger societal issues.

As Figure 6 below shows, gadflies have focused on key governance issues, such as shareholder rights and takeover defenses, with these proposals representing a larger portion of the total number of proposals. In 2018, close to 80% of the proposals submitted by gadflies were related to shareholder rights and board related issues, while only a little over 2% dealt with environmental and social topics.<sup>111</sup> Similarly, in 2018, of Chevedden’s 113 shareholder proposals, 109 focused on corporate governance.<sup>112</sup>

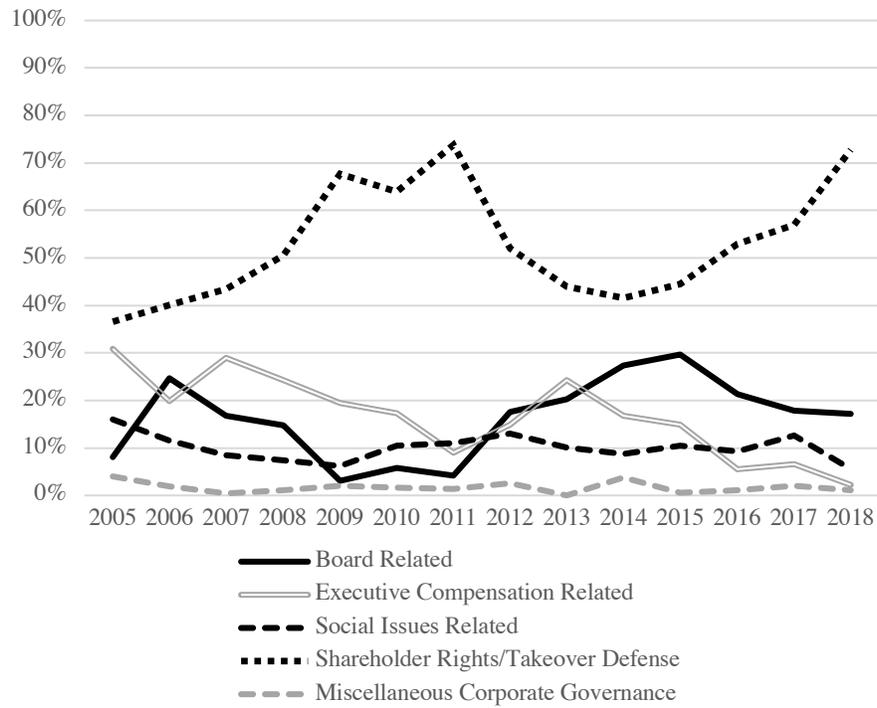
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110. See, e.g., Andrew Ackerman, *Corporations Take Swats at a Gadfly*, WALL ST. J. (Mar. 12, 2014, 7:11 PM), <https://www.wsj.com/articles/corporations-take-swats-at-a-gadfly-1394664978> [<https://perma.cc/VXX7-5Y2M>] (quoting a former member of the SEC commission).

111. Catan and Kahan recently studied the evolution of shareholders’ rights to call special meetings and act by written consent. They found that nearly 90% of the proposals were filed by four gadflies. Emiliano M. Catan & Marcel Kahan, *The Never-Ending Quest for Shareholder Rights: Special Meetings and Written Consent*, 99 B.U. L. REV. 743, 743, 763 n.65 (2019).

112. Larcker & Tayan, *supra* note 14, at 1.

FIGURE 6: Percentage of Gadfly Proposals by Topics

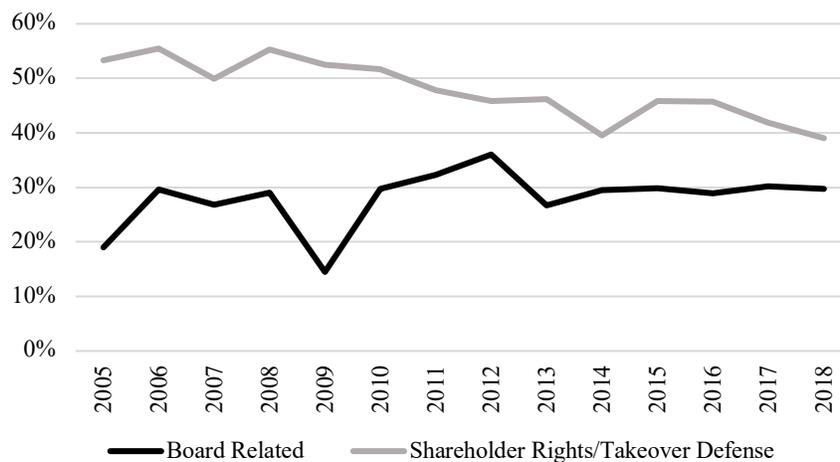


This focus on key governance matters, about which large institutional investors and the proxy advisors have published more detailed and prescriptive voting guidelines, has enabled gadflies to enjoy the impressive passage rates presented above.<sup>113</sup> As reflected in Figure 7, the average support rate for gadflies' proposals related to shareholder rights and the removal of antitakeover defenses remained steady at 47.8% between the years 2005 and 2018.<sup>114</sup> Such high support rates have also allowed gadflies to dominate the way governance proposals are drafted and negotiated with companies, giving them even more power as the voice of shareholders as a group.

113. See *supra* notes 102–07 and accompanying text. This trend continued 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 proposals in 2019 (40 proposals). TONELLO, *supra* note 68, at 69.

114. See Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1045 (2010) (“[W]ith the rise of institutional investors, it takes less time for a new proposal to gain significant shareholder support.”).

FIGURE 7: Average Support Rate for Gadflies' Corporate Governance Proposals



#### v. Follow-Up Management Proposals

Critics of corporate gadflies often view them as a trivial phenomenon with little impact.<sup>115</sup> However, when it comes to the implementation of shareholder proposals, this sentiment 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 occur only once these management-generated proposals receive the required shareholder support. If gadflies' proposals have little impact, there should be few follow-up management proposals.

To examine whether gadflies' proposals were indeed trivial in nature, we studied all gadfly proposals that received at least 50% support of all votes cast (for example, passed proposals) and then hand-collected data on whether they were followed by a management proposal on the same topic, submitted to the same company within the three years following the last gadfly-generated passed proposal.<sup>116</sup> Our analysis focused on governance terms that

115. Kerber, *supra* note 2.

116. 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

require a follow-up management proposal to initiate a charter amendment: board declassification, shareholder action by written consent, shareholders' right to call a 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 ultimately had a sample of 344 unique passed proposals, of which 222, or 64.5%, were followed by a management proposal. We also found that 82% of these management proposals eventually passed and presumably resulted in an actual governance change through charter amendment.<sup>117</sup>

For comparison, we conducted the same examination of the same type of passed proposals submitted by pension funds, which are more powerful and resourceful investors than are gadflies. Interestingly, we found that only 49% of pension funds' proposals were followed by management proposals, and only 76% of these actually passed.

As Figure 8 shows, the subject matter of the gadfly proposal has a significant impact on the likelihood that such a proposal would lead to a ratifying management proposal. 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 represent the lower limits of gadflies' potential influence, as evidence shows that today, a shareholder proposal can become outcome determinative if it receives substantial, but less than majority, support.<sup>118</sup>

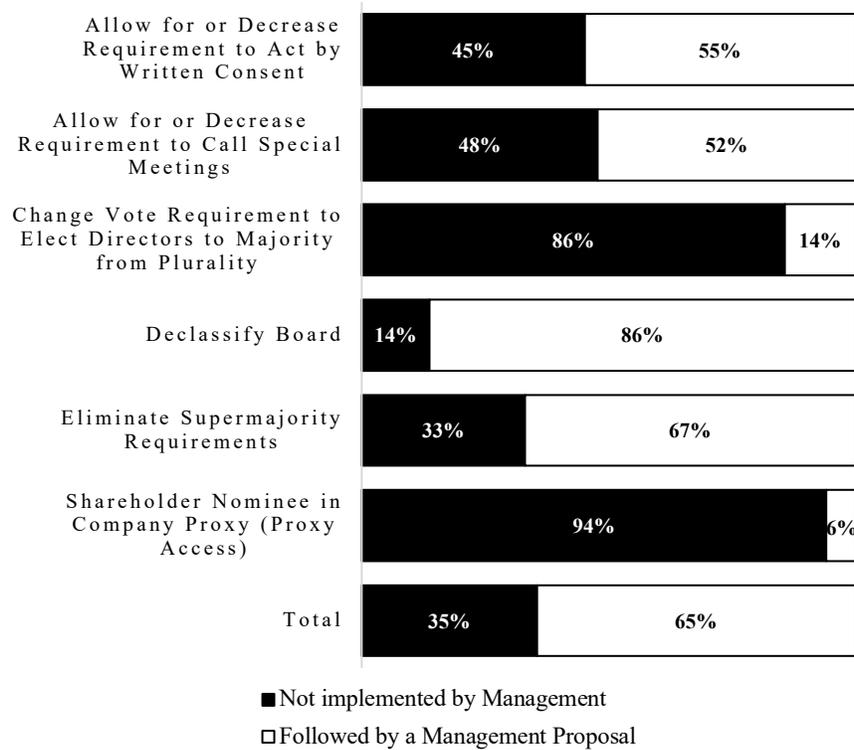
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trigger action by management.

117. We find that 92% of failed management proposals received majority support of outstanding shares and at least 70% of votes cast. These proposals failed despite receiving strong shareholder support due to a combination of low turnout of retail investors and a supermajority of shares outstanding requirement. For a study showing the large number of failed charter amendments despite receiving over 90% shareholder support, see Scott Hirst, *Frozen Charters*, 34 YALE J. ON REG. 91 (2017).

118. See Ackerman, *supra* note 110. We also note that several companies 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 a 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.

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

Ostensibly, the natural candidates for submitting shareholder proposals are the 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 non-negligible equity positions in nearly all public companies and significantly more resources

than gadflies enjoy.<sup>119</sup> But apart from a handful of pension funds, most large U.S. institutional investors do not express their voice through shareholder proposals.<sup>120</sup>

In a recent study, Lucian Bebchuk and Scott Hirst examined the involvement of the Big Three in stewardship activities. Their review of the almost 1,500 shareholder proposals submitted from 2008 to 2017 did not identify a *single* proposal submitted by any of the Big Three.<sup>121</sup> Bebchuk and Hirst also showed that a large proportion of the Big Three's portfolio companies lacked annual elections for all directors, majority voting, or the ability for shareholders to call special meetings, and had yet to receive shareholder proposals calling for such arrangements. This problem is more prevalent among mid- and small-cap companies, which systematically receive fewer shareholder proposals.<sup>122</sup> For example, as of 2018, approximately 40% of the S&P 400 and S&P 600 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 did not have proxy access.<sup>123</sup> The Big Three and other large investors strongly support declassification of boards, majority voting for directors, and proxy access.<sup>124</sup> Thus, had any of the Big Three or other large investors submitted proposals advocating those changes, these arrangements would likely have been adopted.

A number of active pension funds, most notably the Office of the New York City Comptroller, have also been involved in high-profile campaigns that included the submission of proxy access and board diversity proposals.<sup>125</sup> However, the submission of shareholder proposals on a large scale is time-consuming, and even organizations such as the Office of the

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119. See, e.g., Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 727–41 (2019) (providing data on the growing share of passive investing).

120. See *supra* Figure 4 (providing data on the type of shareholder proponents and percentage of proposals submitted by them).

121. Bebchuk & Hirst, *supra* note 30, at 2104.

122. 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).

123. Marc Treviño, *2019 Proxy Season Review: Part 1—Rule 14a-8 Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 26, 2019), <https://corpgov.law.harvard.edu/2019/07/26/2019-proxy-season-review-part-1-rule-14a-8-shareholder-proposals> [<https://perma.cc/479D-NHK3>]; see Shirley Westcott, *2019 Proxy Season Preview*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 15, 2019), <https://corpgov.law.harvard.edu/2019/04/15/2019-proxy-season-preview-2> [<https://perma.cc/SA3F-7235>] (“To date, about 579 companies have implemented access rights—including 70% of the S&P 500 and 18.6% of the Russell 3000 . . .”).

124. 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%). Treviño, *supra* note 123.

125. See *supra* notes 85–86.

New York City Comptroller still have to prioritize their targets.<sup>126</sup>

The conclusion to be drawn from these empirical studies is clear: although shareholder proposals have proven influential, most of the largest institutional investors remain inactive in the proposal process until the voting stage. This is puzzling since the Big Three, as Marcel Kahan and Edward Rock have observed, “are better positioned than any other shareholders to set [market wide governance] standards.”<sup>127</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 of regulatory backlash, and disclosures on Schedule 13D.<sup>128</sup>

The agency cost view rationalizes the inactive nature of the Big Three by concluding that corporate management could view proposals as confrontational and therefore potentially damaging to the relationships and interests of these index funds with their portfolio companies.<sup>129</sup> However, by adopting a reactive rather than proactive role and relying on other shareholders to submit the proposals, the Big Three reduce their potential influence on the governance principles of their portfolio companies.

The Big Three’s concern regarding regulatory or political backlash stems from their substantial and growing power. The fear is that such backlash could result in the imposition of significant legal restraints on the activities of large institutional investors.<sup>130</sup> The threat of regulatory intervention is particularly substantial given Main Street’s historical suspicion of any substantial accumulation of economic power by Wall Street financiers.<sup>131</sup> One of the most effective ways to reduce the prospect of a regulatory backlash is to avoid the appearance of power,<sup>132</sup> which might explain the hesitance of these investors to use the shareholder proposal

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126. Even after the NYC comptroller’s proxy access campaign, only 18.6% of the Russell 3000 companies have implemented access rights. *See* Westcott, *supra* note 123. 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 18 (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 infra* Section II.C.1.

127. Kahan & Rock, *supra* note 30, at Abstract.

128. *See id.*; Bebchuk & Hirst, *supra* note 30, at 2104.

129. Bebchuk & Hirst, *supra* note 30, at 2104.

130. *See, e.g.*, Kahan & Rock, *supra* note 30, at 30; Bebchuk & Hirst, *supra* note 30, at 2087–90.

131. Kahan & Rock, *supra* note 30, 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). *See also* Mark J. Roe, *Backlash*, 98 COLUM. L. REV. 217, 217 (1998).

132. Bebchuk & Hirst, *supra* note 30, at 2087–90.

mechanism to exert significant power. Similarly, submitting proposals in order to confront management could propel management to use its influence to push for more regulation of these institutions.<sup>133</sup>

Finally, the implications of disclosures on Schedule 13D could, at least in theory, also push large institutional investors into taking a more passive engagement approach and, thus, avoiding shareholder proposal submissions. In order to avoid filing on Schedule 13D, investors must refrain from activity that would “effect change” or “influence control.”<sup>134</sup> 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>135</sup> This Schedule also requires frequent filings to promptly reflect any updates in acquisitions and holdings.<sup>136</sup> Compliance with these filings can prove costly, particularly for institutions, such as index funds, with highly dispersed holdings. In contrast, Schedule 13G or Schedule 13F disclosures, typically made only annually, are much shorter, requiring basic information regarding the beneficial owner and the amount of securities beneficially owned.<sup>137</sup> The burden of providing the large amount of information required by Schedule 13D and the costs of avoiding compliance errors related to it, incentivize investors to avoid filing on Schedule 13D.

In the past, some investors expressed concern that the submission of governance proposals would trigger the more burdensome reporting requirements of Schedule 13D.<sup>138</sup> However, the SEC has since published guidance clarifying that engaging in discussions regarding corporate governance topics, including the submission of related proposals, does not lead to the loss of Schedule 13G eligibility, as long as the discussions are part of a general effort to improve corporate governance of the investor’s holdings.<sup>139</sup> Therefore, the threat of being forced into filing a Schedule 13D

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133. *Id.* at 2069–70 (“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.”).

134. *Id.*

135. Will Kenton, *Schedule 13D*, INVESTOPEDIA (Aug. 22, 2020), <https://www.investopedia.com/terms/s/schedule13d.asp> [<https://perma.cc/JUY3-MXK3>].

136. See Bechuk & Hirst, *supra* note 30.

137. *Schedule 13D and 13G Reporting by Certain Beneficial Owners of Voting Equity Securities*, INTERACTIVE BROKERS, <https://ibkr.info/article/2590> [<https://perma.cc/5EXD-59SG>]; MINTZLEVIN, SUMMARY OF SCHEDULE 13D AND SCHEDULE 13G FILING OBLIGATIONS (2015), [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) [<https://perma.cc/5XU3-E4SC>].

138. Div. of Corp. Fin., *Compliance and Disclosure Interpretation: Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting*, U.S. SEC. & EXCHANGE COMMISSION, (July 14, 2016), <https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm#103.11> [<https://perma.cc/A38W-N69R>].

139. *Id.*

does not seem to be a real impediment to the submission of shareholder proposals by large institutional investors.

Whether due to concern over damaging their relationships with managers of portfolio companies or fears of regulatory backlash, the relative absence of institutional investors from the proposal stage of shareholder proposals has enabled gadflies to assume a more prominent role in the corporate governance ecosystem. And take it they have, with gadflies now filling some of the void left by the Titans of Wall Street.

## ii. Gadflies' Various Sources of Power

In their seminal work on embattled CEOs, Kahan and Rock refer to power in the corporate context as the ability to decide key issues facing the firm.<sup>140</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: their ability to tailor their proposals to the voting guidelines of proxy advisors and large institutional investors; the credible threat of withholding or a negative vote against directors; gadflies' ability to crowd out other shareholders; and gadflies' limited concerns over management retaliation.

### a. Setting the Agenda for Institutional Investors

Because gadflies hold only a tiny fraction of 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>141</sup> To receive such support, gadflies tend to focus on standardized governance proposals<sup>142</sup> regarding matters on which large institutional investors generally agree and which they are most likely to support.<sup>143</sup> Moreover, these large institutional investors have already

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140. Kahan & Rock, *supra* note 114, at 992–95.

141. See Coates, *supra* note 30, 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.”); see also LAZARD LTD., REVIEW OF SHAREHOLDER ACTIVISM—1H 2018, at 13 (2018) (cataloguing that the top five shareholders own 24% of equity in the S&P 500), <https://www.lazard.com/media/450655/lazards-review-of-shareholder-activism-1h-2018.pdf> [https://perma.cc/765F-77RL].

142. See *supra* notes 109–12.

143. 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 (Feb. 7, 2017), <https://corp.gov.law.harvard.edu/2017/02/07/corporate-governance-and-stewardship-principles> [https://perma.cc/W9VW-F48K]. For a set of corporate-governance principles put forth by a group of leading executives including CEOs of asset managers and of major public companies, see also COMMONSENSE PRINCIPLES 2.0, GOVERNANCEPRINCIPLES.ORG (2018), <https://www.governanceprinciples.org/wp-content/uploads/>

expressed formulaic views on these governance matters in their voting guidelines, enabling gadflies to tailor their proposals to achieve maximum support.<sup>144</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 for what is to be voted on by shareholders.

In contrast, institutional investors have more diverse views on environmental and social matters, and many voting guidelines provide asset managers more discretion on proposals relating to such matters. For example, the voting guidelines of Vanguard state that its funds “*will vote* for proposals to declassify an existing board” or to adopt a majority vote for a director’s election, whereas any proposal regarding environmental and social disclosures will be voted on “case-by-case . . . [and] evaluated on its merits.”<sup>145</sup> Consequently, gadflies are likely to find it more difficult to tailor their environmental and social proposals to obtain shareholder support.

Proxy advisory firms have further reinforced this dynamic. Proxy advisors aggregate the views of institutional investors, particularly those not large or engaged enough to publish their own voting guidelines.<sup>146</sup> As a result, proxy advisors’ guidelines further aid gadflies in tailoring their governance proposals to what institutions already support.

In its 2019 voting guidelines, the Institutional Shareholders Services (ISS) recommended that shareholders vote *in favor* of proposals to repeal classified boards, reduce supermajority vote requirements, provide shareholders with the ability to act by written consent or to call special meetings, and to have directors elected with an affirmative majority of votes cast.<sup>147</sup> Not surprisingly, our data show that gadflies tend to use their

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2018/10/CommonsensePrinciples2.0.pdf [https://perma.cc/EZ83-DBRG]. These principles support the use of majority 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.” *Id.*

144. Bebhuk & Hirst, *supra* note 30, at 2088–91. Gadflies support their proposals with reference to guidelines of large institutional investors and industry best practices. See Asaf Eckstein, *The Push Towards Corporate Guidelines* (working paper, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3705140](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3705140).

145. THE VANGUARD GROUP, INC., PROXY VOTING GUIDELINES FOR U.S. PORTFOLIO COMPANIES 10, 16 (Apr. 1, 2019), [https://about.vanguard.com/investment-stewardship/portfolio-company-resources/proxy\\_voting\\_summary.pdf](https://about.vanguard.com/investment-stewardship/portfolio-company-resources/proxy_voting_summary.pdf) [https://perma.cc/4T4Z-KM62] (emphasis added).

146. ISS develops its policies by surveying and discussing them with its institutional clients. Kahan & Rock, *supra* note 114, at 1007.

147. THE VANGUARD GROUP, INC., *supra* note 145, at 12, 14; see INSTITUTIONAL S’HOLDER SERVS. UNITED STATES PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS 17–19, 27–28 (2020), <https://www.issgovernance.com/file/policy/latest/americas/US-Voting-Guidelines.pdf> [https://perma.cc/4T4Z-KM62].

proposals to target governance issues such as these, which significantly increases the likelihood that their proposals will be supported by a large body of shareholders.<sup>148</sup>

Another strategy used by gadflies to increase the success rate of their proposals is to select new topics for shareholder proposals based on past success of proposals with similar structures or substance that were submitted by other proponents. For example, they may review proposals submitted by large institutional investors, such as the proposals submitted by the New York City Comptroller, which are publicly available, and then draft their proposals in a similar manner to reduce the likelihood of a successful objection from a target company.<sup>149</sup> Moreover, at the beginning of each proxy season, gadflies can also receive information from ISS on other prominent proponents regarding the type of proposals that were already submitted, and such information further enables gadflies to fine-tune their own proposals in a manner that increases the success likelihood of their proposals.<sup>150</sup>

Once known for raising their own voices at annual meetings, gadflies now use the shareholder proposal mechanism to express their voice in order to trigger the voice of other shareholders. In this new ecosystem, gadflies initiate shareholder proposals and large institutional investors, which are often unwilling to take the lead, overwhelmingly support these initiatives. In essence, this method of engagement is parallel to that conducted by activist hedge funds, which Ronald Gilson and Jeffrey Gordon described in a recent influential article.<sup>151</sup> Gadflies, like the activist hedge funds in Gilson and Gordon's account, stand at the forefront, locate the targets, initiate the process and engage with targets, and the large institutional investors support these initiators at the ballot box. Once a shareholder proposal on a formulaic, often nondiscretionary, governance matter is included in the company ballot, large institutional investors are likely to vote in accordance with their guidelines. Their hands are tied.

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148. For studies describing the potential influence of proxy advisors on institutional investors, see Kahan & Rock, *supra* note 114, at 1005–06.

149. Telephone Interview with James McRitchie, Publisher, Corp. Governance (July 16, 2020).

150. *Id.*

151. 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 that hedge funds identify target companies in which changes would enhance value and that mutual funds provide the activist hedge funds with support in those cases where changes would be value enhancing).

b. The Credible Threat of a Withhold or a 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>152</sup> most significantly, the credible threat of a “withhold” or a “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>153</sup> Withhold votes 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>154</sup> 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 a substantial negative impact on directors’ careers, increasing the likelihood that a director will leave the board or be moved to a less influential position and decreasing a director’s future opportunities in the director labor market.<sup>155</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 increased termination rates across all their directorships.<sup>156</sup>

Moreover, corporations have increasingly adopted arrangements that make withhold votes tantamount to a vote in an uncontested election.<sup>157</sup> Majority voting provisions, a subject of many shareholder proposals, require a majority of votes present to elect the director.<sup>158</sup> Alternatively, some companies have adopted board policies that require resignations of directors

152. Kahan & Rock, *supra* note 114, at 1045 (“[O]nce a proposal has received [or is expected to receive] support, boards are increasingly willing to adopt the recommendation.”).

153. “Withholding” is 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, *supra* note 14.

154. 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. Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857 (1993).

155. Reena Aggarwal, Sandeep Dahiya & Nagpurnanand R. Prabhala, *The Power of Shareholder Votes: Evidence from Uncontested Director Elections*, 133 J. FIN. ECON. 134 (2019).

156. Diane Del Guercio, Laura Seery & Tracie Woidtke, *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”); Ertimur et al., *supra* note 23; William C. Johnson, Jonathan M. Karpoff & Michael D. Wittry, *The Consequences to Directors of Deploying Poison Pills* (Fisher Coll. of Bus. Working Paper Series, Working Paper No. 2019-03-023, 2019).

157. Choi et al., *supra* note 81 (describing the shift from plurality to majority voting).

158. *Id.* at 1120.

elected by only a plurality of votes present.<sup>159</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 or negative vote against individual directors or the entire board if the board does not respond to shareholder-passed proposals.<sup>160</sup> The credible threat of withhold campaigns to shareholder proposals has led boards to pay closer attention to strongly supported precatory shareholder proposals, giving them the potential to be quasi-binding.

### c. Crowding Out

Gadflies may also strengthen their dominant role in shareholder proposals by submitting a large number of proposals such that the arena becomes too crowded for other investors to submit shareholder proposals. Crowding out could happen at both the firm and the 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 excluding any additional conflicting proposals submitted by other shareholders under Rule 14a-8(i)(9), essentially preempting other shareholders from submitting similar proposals.<sup>161</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 conventional business norms. In such cases, governance arrangements that shareholders favor will not be adopted.

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159. *Id.* at 1125–26.

160. See GLASS LEWIS & CO., 2020 PROXY PAPER GUIDELINES 1, 8, 27 (2020), [https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines\\_US.pdf](https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf) [<https://perma.cc/3PT9-83DC>]; see also INSTITUTIONAL SHAREHOLDER SERVS., *supra* note 147, at 12–15.

161. Treviño, *supra* note 123. McRitchie, however, claims:

I generally try not to step in front of a larger investor. I usually check to see if someone else filed a similar proposal at a target company and ensure they do not intend to file again. If I file and a larger shareholder files a similar proposal after mine, I frequently withdraw my proposal. Larger shareholders typically get more attention from the press and spend more and can spend more on vote-getting efforts. My purpose for filing it to prompt positive change. I am happy to defer and move on to the next possible target.

James McRitchie, *The Giant Shadow of Corporate Gadflies*, CORP. GOVERNANCE (Feb. 12, 2021), <https://www.corpgov.net/2020/07/the-giant-shadow-of-corporate-gadflies> [<https://perma.cc/J6DK-ZG93>].

d. Agency Conflicts of Large Investors

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 by larger investors. 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>162</sup> For example, managers of active investment funds often make discretionary trading decisions. Therefore, having direct access to the executives of their funds' portfolio companies and to "soft" information about those portfolio companies could be valuable to those funds' managers. For this reason, they have no incentive to irritate the managers of their portfolio companies by submitting shareholder proposals, potentially risking the willingness of executives to maintain such direct access.<sup>163</sup> Similarly, it has been argued that business relationships between index fund managers and their portfolio companies give the index fund managers incentives to be deferential corporate managers.<sup>164</sup>

Unlike these large shareholders, gadflies do not have such profit-related incentives to defer to the preferences and positions of corporate managers and avoid the submission of proposals that may irritate managers. Occasionally, gadflies also experiment with what appear to be idiosyncratic proposals that do not appear in the policies of large investors. Some of these proposals eventually lead to a shift in mainstream corporate governance practices, while many others fall by the wayside.<sup>165</sup>

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In sum, the combination of recent market developments surveyed in this Subsection has positioned shareholder proposals as a key governance lever, which gadflies use frequently and effectively. In essence, these practices

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162. See, e.g., Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1172–75 (2019); see also, e.g., Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 791–93 (2017).

163. Lucian Bebchuk & Scott Hirst, *Are Active Mutual Funds More Active Owners than Index Funds?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 3, 2018), <https://corpgov.law.harvard.edu/2018/10/03/are-active-mutual-funds-more-active-owners-than-index-funds> [<https://perma.cc/UK6S-QV6E>].

164. For a current discussion of this type of conflict, see Bebchuk & Hirst, *supra* note 30, at 44. See also Dragana Cvijanović, Amil Dasgupta & Konstantinos E. Zachariadis, *Ties that Bind: How Business Connections Affect Mutual Fund Activism*, 71 J. FIN. 2933, 2933 (2016) (finding that "business ties significantly influence promanagement voting at the level of individual pairs of fund families and firms"); Griffith & Lund, *supra* note 162, at 1181–86.

165. For example, James McRitchie claims, "[P]roxy access came about, at least in part, because I filed a rulemaking petition with the SEC. Shareholder rights to hold special meetings didn't become widespread among companies or governance policies until gadflies relentlessly filed." McRitchie, *supra* note 161.

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>166</sup> Gadflies’ success arises from their independent position and their focus on governance terms that large institutional investors publicly support, leading to passed proposals and actual governance changes, as the board avoids future backlash.<sup>167</sup>

The major conclusion arising from all the forgoing in this Part is that 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 rules 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

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

This Part focuses on 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 examines the structural limitations of corporate gadflies. Unlike institutional investors, gadflies do not receive any compensation; in fact, they have limited resources, face significant time constraints, and must bear the high costs associated with submitting shareholder proposals out of their own pockets. 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.

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166. For studies supporting this view, see *supra* notes 147–49.

167. See Huenekens & Smith, *supra* note 57 at 4 (“Thirty-percent support is the level at which many boards take note of the proposal topic . . . .”); see also Kastiel & Nili, *supra* note 16, 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”); Alan Beller, Senior Counsel, Cleary, Gottlieb, Steen & Hamilton LLP, Statement at the U.S. Securities and Exchange Commission Proxy Voting Roundtable 102 (Feb. 19, 2015) (unofficial transcript available at the Securities and Exchange Commission), <https://www.sec.gov/spotlight/proxy-voting-roundtable/proxy-voting-roundtable-transcript.txt> [<https://perma.cc/A9HH-9LFP>] (explaining that 25% shareholder support is outcome determinative).

Section B explores the costs generated by corporate gadflies' activities. Gadflies could be motivated by personal interests and are often less constrained by conventional business 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 from a coalition of large public corporations. Corporate insiders fight gadflies by engaging 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 cope with 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 activity.<sup>168</sup> While these costs would constitute only a small fraction of large institutional investors' costs, they can prove substantial for individual shareholders. First, individual shareholders must devote time and resources to preparing and submitting shareholder proposals as well as to attending various shareholder meetings. Evelyn Davis, who lived in Washington, attended as many as fifty meetings a year and spent much of each spring traveling to New York, Chicago, Detroit, Pittsburgh, and other cities to attend annual meetings.<sup>169</sup> Chevedden is known to arrive at the annual meetings of public companies on foot or by bus.<sup>170</sup> As summarized by one gadfly: "meetings are a drain financially and in terms of time."<sup>171</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

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168. Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1048 (2007).

169. Flitter, *supra* note 4.

170. Kerber, *supra* note 2.

171. Maureen Milford, *Corporate Gadfly: "Crusaders or Crackpots"?*, in DIRS. & BDS., THE STATE OF CORPORATE DEMOCRACY 20, 27 (2017), <https://www.directorsandboards.com/articles/singlecorporate-gadfly-%E2%80%9Ccrusaders-or-crackpots%E2%80%9D> [https://perma.cc/37LZ-Y9X6].

least \$2,000, the minimum threshold needed to be eligible to file a shareholder proposal, in eighty to one hundred and twenty companies at any time.<sup>172</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 individual investors who typically have access to only their personal wealth.<sup>173</sup> John Chevedden has stated that he relies on his father's holdings and on collaborating with other small investors, such as William Steiner and his son Kenneth, to satisfy the threshold in around one hundred companies.<sup>174</sup>

The amended Rule 14a-8 provides additional barriers making these strategies even more difficult, if not impossible. For individuals such as Mr. Chevedden to maintain eligibility, they must either increase their investments tenfold to \$25,000 per company, or they must lock up their smaller, \$2,000 investment, in a company for at least three years, while also delaying their ability to suggest governance changes in new companies in their portfolio.<sup>175</sup> Perhaps an even larger barrier, the rule now prohibits investors like Mr. Chevedden from aggregating their holdings to meet eligibility thresholds—a reversal of the longstanding tradition of allowing investors to do so.<sup>176</sup>

As a result of the cost and time investment required, gadflies can target only a limited number of companies. Indeed, the evidence we provide in this Article shows that gadflies tend to sponsor shareholder proposals at much larger companies, mostly those in the S&P 500, which may attract and be more sensitive to public opinion.<sup>177</sup> Yet, this leaves an entire market of targets, mostly medium- and small-cap companies, that are not subject to the governance reforms initiated by gadflies.<sup>178</sup>

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172. Arnold, *supra* note 6.

173. 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.

174. Kerber, *supra* note 2.

175. 17 C.F.R. § 240.14a-8 (2021).

176. Allison Herren Lee, *Statement on the Amendments to Rule 14a-8*, U.S. SEC. EXCHANGE COMMISSION (Sept. 23, 2020), <https://www.sec.gov/news/public-statement/lee-14a8-2020-09-23> [<https://perma.cc/UC2M-HTWN>].

177. Moreover, since large companies receive more proposals prior to the annual meeting compared to small companies, it is easier for a gadfly to demand that another shareholder proponent present the gadfly's proposal at the meeting, with no additional cost. Our finding regarding gadflies' tendency to focus on large companies is consistent with existing empirical evidence showing that proponents target large American companies rather than those that would benefit most. *See, e.g.*, Bhandari et al., *supra* note 91; Thomas & Cotter, *supra* note 90, at 368–91.

178. *See Interview with BU Law Professor David Webber on Efforts to Limit Shareholder Proposals*, SHAREHOLDER ADVOC. NEWSL. (Cohen Milstein Sellers & Toll PLLC), July 20, 2017, <https://www.cohenmilstein.com/update/%E2%80%9Cinterview-bu-law-professor-david-webber-effort-s-limit-shareholder-proposals%E2%80%9D-shareholder> [<https://perma.cc/36HS-LZYK>] (“The reality is

## 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 in the costly process of engaging with companies in order to amend their governance structure.<sup>179</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>180</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 public service.”<sup>181</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 beyond 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, a standard hedge fund charges a base management fee equal to 1% to 2% of the assets under management and a significant incentive fee, typically 20% of the profits earned.<sup>182</sup> Such a 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>183</sup>

Compared to institutional investors or hedge funds, individual

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that very few companies face shareholder proposals in any given year. . . . only 1–3% of all public companies . . . receive a shareholder proposal per year.”)

179. See, e.g., Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 524–29, 584–91 (1990) (discussing rational apathy); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1318–28 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 473, 497 (1991).

180. 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 corporations. For Berle & Means’s influential work on this issue, see ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 127 (1933).

181. Foley & Bissell, *supra* note 97.

182. Kahan & Rock, *supra* note 168, at 1064.

183. *Id.* at 1051. For additional studies criticizing mutual funds’ limited incentives to expend resources on activism, see Bebchuk & Hirst, *supra* note 30, at 44. See also Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 827–29 (1992).

shareholders suffer from another major disadvantage in achieving governance change: they hold a small number of shares in the companies they target.<sup>184</sup> In addition to limiting their leverage with management and in the vote itself, gadflies' small stakes limit their potential gain. Even if the submission of a shareholder proposal leads to the adoption of a governance term that increases the company value, gadflies stand to receive only a tiny fraction of these gains. Moreover, gadflies cannot capture this value unless they maintain their holdings until the new value is reflected in the stock price, which would inhibit capital redeployment to satisfy the minimum ownership threshold at future targets, which has become even more important given the increase in holdings thresholds. These factors—no excess compensation for engagements that benefits shareholders collectively and extremely low equity interest—significantly reduce the incentives of individual shareholders to invest in any sort of engagement, including the submission of shareholder proposals.

So what motivates gadflies? One possible rationale is the nonpecuniary benefits, such as gaining attention and enjoying the satisfaction of advancing the agenda in which one believes.<sup>185</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*.”<sup>186</sup> Engaged owners, he argued, “invest not just money, but ideas and actions.”<sup>187</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>188</sup>

Overall, this important gadfly operation is conducted, by and large, on a *voluntary basis* and relies heavily on the *nonpecuniary motivations* of a handful of individuals.<sup>189</sup> However, there are limits to nonpecuniary 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 gadfly activities rather than pursue other opportunities.

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184. See, e.g., Kahan & Rock, *supra* note 168, at 1048, 1062; Ackerman, *supra* note 110 (“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 compan[ies] [they] target[.]”).

185. 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 nonpecuniary benefits in motivating controlling shareholders).

186. Milford, *supra* note 171, at 21.

187. *Id.* at 21.

188. Arnold, *supra* note 6.

189. For a similar phenomenon 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*, 73 VAND. L. REV. 929 (2020).

### 3. Lack of Succession

As we have shown, the submission of shareholder proposals has been largely dependent on a handful of individuals.<sup>190</sup> Most of these actors, who conduct this activity at their own expense, are also above retirement age.<sup>191</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 this current channel of engagement can be transferred to a new generation of gadflies if such individuals do emerge.

#### B. THE 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 due to additional reasons. For example, gadflies may be motivated by personal interests, could be less constrained by business norms, and, as their critics argue, could generate externalities, in some instances, 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 from gadfly proposals means gadflies are likely motivated by nonpecuniary benefits or by the receipt of other indirect, ancillary benefits from their activities. Evelyn Davis, for example, published an annual newsletter named "Highlights and Lowlights of Annual Meetings" for over forty-five years, to which many companies felt obligated to subscribe.<sup>192</sup> Davis charged \$600 per copy, with a minimum of two copies per subscriber.<sup>193</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>194</sup>

Engagement can also yield nonpecuniary benefits, including attention.

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190. See *supra* Section I.B.

191. Ackerman, *supra* note 110 (noting that Cheveddan has already retired and is about seventy years old); Foley & Bissell, *supra* note 97 (noting that William Steiner is over ninety years old).

192. Arnold, *supra* note 6.

193. *Id.*

194. Although, McRitchie claims that his ad revenue is "negligible." McRitchie, *supra* note 161; see *About, CORP. GOVERNANCE*, <https://www.corpgov.net/about> [<https://perma.cc/J7HR-VT4E>] ("The ads help pay the cost of maintaining the site, although they fall short of even paying my internet service.").

Gadflies capture the attention of the financial press, powerful executives and their advisors, and other shareholders.<sup>195</sup> Davis would show up to annual meetings not only to urge the board toward better corporate governance but also, at times, “to flirt with the chief executive, and seemingly always, to draw attention to herself.”<sup>196</sup> She did achieve some success in the latter regard. For example, in December 2008, Ken Lewis, the chief 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>197</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 its being aimed “to the redress of a personal claim or grievance or to further a personal interest.”<sup>198</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>199</sup> and “to improve how companies are run.”<sup>200</sup> However, in advancing this mission, personal considerations may inevitably influence their decision-making and lead to distortions in their choice of targets, the engagement process, or the type of proposals they choose to submit. For example, gadflies may overinvest in engagement with high-profile companies because these targets would bring them the most publicity, a

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195. Kerber, *supra* note 2 (describing how “Jeffrey Katzenberg [the CEO of DreamWorks Animation SKG] and Chairman Melody Hobson . . . walked across the room to say hello to Chevedden”).

196. Jena McGregor, *RIP, Evelyn Y. Davis: An Irrepressible Shareholder Activist for the Ages*, WASH. POST (Nov. 8, 2018, 3:57 PM), [https://www.washingtonpost.com/business/2018/11/08/rip-evel-yn-y-davis-an-irrepressible-shareholder-activist-ages/?noredirect=on&utm\\_term=.011d2f0871e8](https://www.washingtonpost.com/business/2018/11/08/rip-evel-yn-y-davis-an-irrepressible-shareholder-activist-ages/?noredirect=on&utm_term=.011d2f0871e8) [https://perma.cc/AR3G-UHKH].

197. Flitter, *supra* note 4.

198. Kerber, *supra* note 2.

199. *About*, *supra* note 194 (emphasis omitted).

200. Kerber, *supra* note 2.

hypothesis which is consistent with the dominance of the S&P 500 as targets of gadfly proposals.<sup>201</sup> Finally, potential distortions in gadflies' decision-making may go unchecked due to the lack of key disciplinary features present with institutional investors, including hedge fund activists, such as established organizations with mechanisms of accountability, and beneficial owners who can withdraw their funds if displeased.

## 2. Disregarding Conventional Business Norms

Another inefficiency often associated with the engagement of corporate gadflies is their unwillingness to follow conventional business norms. Gadflies tend to have little interaction with the management of companies outside of the annual meeting, making it more difficult for them to reach mutual agreements with insiders.<sup>202</sup> The nonpecuniary 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 transform them into corporate crusaders, less willing to compromise, or even negotiate, with company insiders. Similarly, 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 claimed 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>203</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>204</sup> This type of behavior creates antagonism among corporate insiders, reducing their willingness to cooperate with gadflies, and ultimately diminishing the likelihood that some 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 are compelled to expend significant resources

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201. See *supra* note 25.

202. Larcker & Tayan, *supra* note 14, at 2.

203. Kerber, *supra* note 2.

204. Flitter, *supra* note 4.

addressing them, even those that fail.<sup>205</sup> For example, Leo Strine, the recently retired Chief Justice of the Delaware Supreme Court, contended 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>206</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 exclude improper proposals that are so often the work of a small minority of shareholders pursuing their own narrow interests.”<sup>207</sup>

In general, the company’s cost associated with addressing a shareholder proposal includes the time and expenses incurred in internal deliberations; the attempted exclusion of the proposal through a no-action process (in appropriate cases); drafting voting recommendations; negotiation with the proponent; and the fees to the company’s outside advisors, such as legal and public relations professionals. The SEC once estimated that a company incurs costs of \$87,000 for each proposal submitted.<sup>208</sup> Proposals can also lead to additional nonquantifiable costs, such as the diversion of management’s attention.<sup>209</sup>

To be clear, when initiating governance changes, gadflies can create shareholder value; however, their activities can also generate negative costs for target companies. While most shareholder proposals that gadflies submit address major governance issues,<sup>210</sup> some proposals are less momentous and reflect the ease with which one can submit them.<sup>211</sup> An important indicator of the benefits 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

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205. Steven Davidoff Solomon, *Grappling with the Cost of Corporate Gadflies*, N.Y. TIMES (Aug. 19, 2014, 8:02 PM), <https://dealbook.nytimes.com/2014/08/19/grappling-with-the-cost-of-corporate-gadflies> [<https://perma.cc/25AP-ZMVJ>].

206. Stephen Foley & Jennifer Bissell, *Corporate Governance: The Resurgent Activist*, FIN. TIMES (June 22, 2014, 6:45 PM), <http://ig-legacy.ft.com/content/e13ce5fa-f6cf-11e3-b271-00144feabdc0#slide0> [<https://perma.cc/JP9V-BNRN>].

207. *Id.*; Ackerman, *supra* note 110.

208. Foley & Bissell, *supra* note 97.

209. *Id.* According to Martin Lipton, the 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.” *Id.*

210. Mishra, *supra* note 24.

211. *See id.* Also, a recent article studied the evolution of shareholders’ rights to call special meetings and act by written consents and did 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 111, at 743.

proposals receive low levels of support, the costs related to that proposal would, in our view, constitute 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.

In the previous Part, we provided extensive evidence about the level of support for various proposals submitted by gadflies. As we have shown, a large proportion of the proposals that received a majority of shareholder support were filed by gadflies.<sup>212</sup> However, some gadfly proposals have 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 9 of these proposals eventually passed, with the vast majority of them receiving low support rates because they were related to topics that do not generate significant consensus among investors.<sup>213</sup> 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 conventional business norms reduces the likelihood of a settlement with management. Their lack of sophisticated advisors and staff, which institutional investors do enjoy, increases the risk of making strategic or factual mistakes that may 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 caused him to make factual errors in supporting statements that should disqualify many of his submissions.<sup>214</sup>

### C. BACKLASH

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

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212. See *supra* Section I.C.

213. For data about the type of proposals, see *supra* notes 111–15.

214. Ackerman, *supra* note 110 (quoting a spokesman for Express Scripts as saying “Mr. Chevedden’s proposal contained a number of materially false statements that would be misleading for shareholders”).

## 1. Regulatory Backlash

The ability of shareholders with a relatively small investment in a company to submit shareholder proposals has long 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>215</sup> In a white paper published in 2017, the 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>216</sup>

The Business Roundtable, an association of chief executive officers of major U.S. corporations,<sup>217</sup> has also strongly advocated for reform in the shareholder proposal process. The Business Roundtable argues that proposal submissions 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>218</sup> In a white paper published in 2016, the Business Roundtable called for modernizing the shareholder proposal process by substantially increasing the \$2,000 minimum holding requirement; increasing the length of the holding period requirement; and strengthening the resubmission thresholds.<sup>219</sup> In a related move, 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>220</sup>

These lobbying efforts have not been fruitless. The Financial CHOICE

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215. CTR. FOR CAPITAL MKTS. COMPETITIVENESS, RAISING THE SEC’S RESUBMISSION THRESHOLDS: “ZOMBIE PROPOSALS” AND THE NEED TO MODERNIZE AN OUTDATED SYSTEM 9 (2018), [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) [<https://perma.cc/9UDY-SQ7C>].

216. See CTR. FOR CAPITAL MKTS. COMPETITIVENESS, SHAREHOLDER PROPOSAL REFORM: THE NEED TO PROTECT INVESTORS AND PROMOTE THE LONG-TERM VALUE OF PUBLIC COMPANIES 3 (2017), [https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/023270\\_CCMC-SEC-Shareholder-Proposal-Reform-Report\\_Online\\_Report.pdf](https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/023270_CCMC-SEC-Shareholder-Proposal-Reform-Report_Online_Report.pdf) [<https://perma.cc/GC4U-R3ZV>].

217. See generally BUS. ROUNDTABLE, <https://www.businessroundtable.org> [<https://perma.cc/8KYE-L7KW>].

218. BUS. ROUNDTABLE, *supra* note 103.

219. *Id.*

220. JAMES R. COPLAND, THE MANHATTAN INSTITUTE, SEC RULE 14A-8: RIPE FOR REFORM 3 (2016), <https://media4.manhattan-institute.org/sites/default/files/T-JC-0916.pdf> [<https://perma.cc/BW3S-5HFG>].

Act, first introduced in 2017, would have limited shareholders' ability to submit proposals by increasing the minimum holding period from one year to three years as well as increasing the level of support an unsuccessful proposal must have received to be eligible for resubmission from 3% to 6%.<sup>221</sup> These attempts to increase the investment threshold by statute were followed by SEC rulemaking that has resulted in concrete steps.<sup>222</sup> In early November 2019, the SEC Commission voted three to two to propose amendments to rules governing shareholder proposals, and in September 2020, the Commission adopted a modified version of its original proposal.<sup>223</sup>

More specifically, the SEC updated 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 amendments 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% (from 6% under the current rule) and 25% (from 10% under the current rule), respectively. While the initial proposal would have also prohibited the resubmission of a proposal that has been voted on three or more times in a five-year period if it has not received majority support or has experienced a decline in support of 10% or more compared to the immediately preceding vote, the SEC omitted it from its final rules, citing the significant opposition to it.<sup>224</sup>

These regulatory efforts could severely limit the ability of gadflies in particular to engage in the submission of shareholder proposals.<sup>225</sup> As

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221. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 844 (2017). The bill stalled in the Senate, although parts of it (unrelated to shareholder proposals) were incorporated into subsequently enacted legislation. Reena Sahni, Lona Nallengara, Timothy Byrne & Naffie Lamin, *First Major Dodd-Frank Reform Bill Signed into Law*, SHEARMAN & STERLING (May 25, 2018), <https://www.shearman.com/perspectives/2018/05/first-major-dodd-frank-reform-bill> [<https://perma.cc/479F-4P9V>].

222. Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, 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> [<https://perma.cc/L7R6-CSPG>].

223. Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Amendments to Modernize Shareholder Proposal Rule (Sept. 23, 2020), <https://www.sec.gov/news/press-release/2020-220> [<https://perma.cc/8UWE-TU35>].

224. Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Exchange Act Release No. 34-89964, 85 Fed. Reg. 70240, 70260 (Nov. 4, 2020).

225. OFFICE OF COMM'R ROBERT J. JACKSON, JR., DATA APPENDIX ON PROPOSALS TO RESTRICT SHAREHOLDER VOTING 6 (2019), <https://www.sec.gov/news/statements/2019/jackson-data-appendix-on-proposals-to-restrict-shareholder-voting.pdf> [<https://perma.cc/S4XF-UX23>] ("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 Ackerman, *supra* note 110 (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 H. Webber, *Big Corporations Are Trying to Silence Their Own Shareholders*, WASH. POST (Apr. 13, 2017), <https://www.washingtonpost.com/news/energy-environment/wp/2017/04/13/big-corporations-are-trying-to-silence-their-own-shareholders/>.

Commissioner Crenshaw notes, unlike institutional investors, gadflies cannot easily meet the \$25,000 threshold for one-year holding periods at many companies at the same time: “it is unreasonable to expect an investor who identifies an existing problem, but cannot afford to invest \$25,000, to wait three years to suggest a solution.”<sup>226</sup> According to Commissioner Lee, these rules represent a “huge, unprecedented hike” meant to target retail investors.<sup>227</sup> Consequently, the newly adopted rules would almost certainly significantly reduce the number of companies with which gadflies can engage.<sup>228</sup> Limiting the resubmission of shareholder proposals could negatively affect the ability of gadflies to build momentum in the market.<sup>229</sup> Yet, the appointment of Gary Gensler as the new SEC chair and the news of a potential repeal of the SEC rules under the Congressional Review Act<sup>230</sup> are a positive development that may reverse some of the aforementioned regulatory backlash.

## 2. Corporate Backlash

In addition to regulatory reform, gadflies face targeted corporate backlash through litigation and massive exclusion of shareholder proposals, both aimed at deterring individuals from submitting shareholder proposals. In recent years, John Chevedden has come under attack from some of his corporate targets, including Apache Corp., Chipotle Mexican Grill Inc., EMC Corp., Express Scripts Holding Co., and Omnicom Group Inc.<sup>231</sup> Four of the lawsuits filed against Chevedden and his fellow shareholders were successful.

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[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) [https://perma.cc/7EFY-95C7].

226. Caroline A. Crenshaw, *Statement on Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8*, U.S. SEC. EXCHANGE COMMISSION (Sept. 23, 2020), <https://www.sec.gov/news/public-statement/crenshaw-14a8-2020-09-23-0> [https://perma.cc/C4YU-T7R5].

227. See Lee, *supra* note 176.

228. The SEC’s analysis states that the proxy proposal rule would reduce the number of proposals by about 37%. See Michael Hiltzik, *Column: The SEC Is Trying to Stifle Shareholders’ Right to Challenge Corporate Managements*, L.A. TIMES (Jan. 7, 2020, 6:00 AM), <https://www.latimes.com/business/story/2020-01-07/sec-shareholder-proposals> [https://perma.cc/2JSU-8VK6]. Also, over three years, a gadfly with \$100,000 in investment capital can submit proposals to one hundred fifty targets under the existing rules (fifty each year); twelve companies using the proposed \$25,000, one-year holding threshold (four each year); six companies using the proposed \$15,000, two-year holding threshold; or fifty companies using the proposed \$2,000, three-year holding threshold. *Id.*

229. See *infra* note 238 and accompanying text.

230. Hazel Bradford, *Senate Moves to Undo SEC Shareholder Rights Rule Change*, PENSIONS & INV. (Mar. 26, 2021, 4:40 PM), <https://www.pionline.com/regulation/senate-moves-undo-sec-shareholder-rights-rule-change> [https://perma.cc/YQA8-FWTW].

231. Jessica Holzer, *Firms Try New Tack Against Gadflies*, WALL ST. J. (June 6, 2011), <https://www.wsj.com/articles/SB10001424052702304906004576367133865305262> [https://perma.cc/WE3Q-SBPT].

Apache, for example, successfully brought a lawsuit against Chevedden seeking a declaratory judgment that it could exclude a proposal submitted by him from its annual meeting proxy materials. The company argued that Chevedden had abused the proxy process and had not proven that he met the ownership threshold; therefore, he lacked any right to submit shareholder proposals.<sup>232</sup> This lawsuit “marked the first time a company has sued to block a shareholder proposal on procedural grounds.”<sup>233</sup> Express Scripts, KBR Inc., and Waste Connections, Inc. subsequently won similar lawsuits against Chevedden.<sup>234</sup>

Chevedden and his defenders believe that the lawsuits serve the general purpose of deterring proposals by making small shareholders with limited resources “think twice” before filing proposals.<sup>235</sup> As McRitchie explained in an interview, small shareholders are treated differently than large institutions when making proposals, as only small shareholders are taken to court for filing proxy proposals.<sup>236</sup> Some investors also worry that the suits will prompt additional companies to turn to the courts. Unlike institutions, gadflies do not have the financial resources to cope with long legal battles.<sup>237</sup> Others expressed the view that gadflies become a victim of their own success: since a significant portion of gadfly proposals pass, companies have an increased interest in eliminating these proposals through litigation before they reach shareholders.<sup>238</sup>

To complete the legal picture, it should be noted that a few court holdings have supported Chevedden, concluding that he represents little, if any, legal threat to the companies. In *EMC Corp. v. Chevedden*, a Massachusetts court dismissed a suit against him, ruling that the company was unlikely to suffer an imminent injury as a result of a proposal for an independent board chairman.<sup>239</sup> In a separate case, a judge in the Southern

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232. *Apache Corp. v. Chevedden*, 696 F. Supp. 2d 723, 741 (S.D. Tex. 2010).

233. Holzer, *supra* note 231.

234. *See Waste Connections, Inc. v. Chevedden*, 554 F. App'x 334 (5th Cir. 2014); *see also* Express Scripts Holding Co. v. Chevedden, No. 13-CV-2520, 2014 U.S. Dist. LEXIS 19689 (E.D. Mo. Feb. 18, 2014); *KBR Inc. v. Chevedden*, 776 F. Supp. 2d 415 (S.D. Tex. 2011).

235. Andrew Ackerman, *SEC's Gallagher Calls for Proxy-Proposal Overhaul*, WALL ST. J. (Mar 27, 2014, 3:25 PM), <https://www.wsj.com/articles/secs-gallagher-calls-for-proxy-proposal-overhaul-1395948217?tesla=y> [<https://perma.cc/4M92-V2F2>] (quoting Chevedden as saying “[t]hey just seem to want to stifle the shareholders and not give them a meaningful opportunity to make improvements”).

236. Proxy Insight, *Spotlight on Boards: James McRitchie; Say on Pay: Shareholder Spring Returns; Voting News*, PROXY MONTHLY, May 2016, at 1, 3.

237. Holzer, *supra* note 231.

238. Ackerman, *supra* note 110. 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. *Id.*

239. 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 contained misleading information in

District of New York declined to allow Omnicom Group to omit a proposal promoting the confidentiality of shareholder vote tallies. As in the *EMC* case, the judge ruled that Omnicom's threat of harm was remote.<sup>240</sup>

The number of companies pursuing lawsuits to block specific shareholder proposals remains relatively small, and these companies have focused mostly on Chevedden to date. However, more comprehensive attempts to exclude shareholder proposals, mostly those submitted by individuals, have a much wider impact. 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 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>241</sup>

In the 2019 proxy season, 84 of the S&P 1500 companies challenged a total of 156 proposals through the SEC no-action process, nearly 25% of all the proposals submitted. The SEC staff permitted full exclusion of 108 proposals (69% of requests).<sup>242</sup> In total, about one third of proposals excluded through the SEC no-action process between 2006 to 2014 were filed by Chevedden.<sup>243</sup>

In September 2019, the SEC announced that its staff would no longer provide written responses to issuers and shareholder proponents in every

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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. *EMC Corp. v. Chevedden*, 4 F. Supp. 3d 330 (D. Mass. 2014); see Ackerman, *supra* note 110.

240. *Omnicom Group, Inc. v. Chevedden*, No. 14 Civ. 0386, 2014 U.S. Dist. LEXIS 33036, at \*3–4 (S.D.N.Y. Mar. 11, 2014). A similar suit filed by Chipotle for abuse of the proxy process and alleged violation of Rule 14a-8 was also dismissed by a Colorado court for lack of jurisdiction. *Chipotle Mexican Grill, Inc. v. Chevedden*, No. 14-cv-0018, 2014 U.S. Dist. LEXIS 33378, at \*1–4 (D. Colo. Mar. 14, 2014).

241. Treviño, *supra* note 123, at 24–27. 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 A. Katz & Laura A. McIntosh, *Shareholder Proposals in an Era of Reform*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 5, 2017), <https://corpgov.law.harvard.edu/2017/12/05/shareholder-proposals-in-an-era-of-reform> [https://perma.cc/R3VL-RGSL].

242. Treviño, *supra* note 123, at 24.

243. Ackerman, *supra* note 110.

instance in which a company is seeking 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, it may not provide any response.<sup>244</sup> The SEC has publicly stated that it will furnish a chart on its website that tracks the staff’s responses on “no-action” requests.<sup>245</sup> This change in policy is likely to further enhance the ability of companies to exclude shareholder proposals.<sup>246</sup>

### III. POLICY IMPLICATIONS

This Part analyzes the policy implications of our findings. In Section A, we explain why the recent regulatory efforts aimed at limiting gadflies’ activity are “missing the forest for the trees.” By focusing on individual investors, these regulatory efforts divert the attention of policymakers and market participants from the real policy question at stake of whether investors have a say in determining market-wide governance standards.

Recognizing the fragility of the current landscape, Section B explores ways to reconcile the regulatory pressure 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) allowing 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.<sup>247</sup>

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244. *Announcement Regarding Rule 14a-8 No-Action Requests*, U.S. SEC. EXCHANGE COMMISSION (Sept. 6, 2019), <https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests> [https://perma.cc/H4ES-ZAFT].

245. Abe Friedman, Krystal Berrini & Allie Rutherford, *SEC Proposed Rule Amendments on Shareholder Proposals and Proxy Advisors: Implications for Issuers, Investors and Proxy Advisors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 9, 2019), <https://corpgov.law.harvard.edu/2019/12/09/sec-proposed-rule-amendments-on-shareholder-proposals-and-proxy-advisors-implications-for-issuers-investors-and-proxy-advisors> [https://perma.cc/88FN-TCJT].

246. 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.

247. For example, Adi Libson and Gideon Parchomovsky suggest incentivizing index funds to submit shareholder proposals by employing tax mechanisms to help defray the extra-cost born by active funds. Adi Libson & Gideon Parchomovsky, *Reversing the Fortunes of Active Funds*, 99 TEX. L. REV. (forthcoming 2021), <https://ssrn.com/abstract=3517849>.

## A. KILLING THE MESSENGER? A CRITIQUE OF RULE 14A-8 “REFORM”

The recent SEC amendments to submission and resubmission thresholds clearly overlook larger, more important issues by focusing on these procedural points. Any reform must examine shareholder proposals against a broader understanding of two important factors: 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 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 that neither addresses the systemic constraints that large institutional investors face nor empowers a replacement mechanism effectively “kills the messenger”—the gadflies—and will thus hinder the adoption of governance policies these institutional investors support.

Furthermore, we use the context of corporate gadflies as an invitation to rethink a much broader and important governance debate over the role that large institutional investors should play (if at all) in designing market-wide corporate governance arrangements of public corporations. The SEC’s focus on the “messengers”—the gadflies—diverts the attention of policymakers and market participants from this cardinal debate.

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 vibrant debate regarding the proper boundaries of shareholder input, with some commentators lamenting uninformed investors’ influence on governance,<sup>248</sup> the pursuit of short-term interests at the expense of long-term performance, and the prioritization of the interests of shareholders over other stakeholders.<sup>249</sup> In addition, some have argued that granting shareholders

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248. See Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 101, 102 (2018) (arguing that 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); see also Goshen & Squire, *supra* note 162, at 770 (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*, 98 TEX. L. REV. 983, 983 (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).

249. For concerns that shareholders are uninformed and motivated by short term consideration, see LYNN A. 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); see also William W. Bratton & Michael L. Wachter, *The Case Against*

additional avenues for signaling their dissatisfaction with management may be counterproductive, either because this course would increase 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>250</sup> Other scholars, however, have expressed skepticism about leaving this type of decision in the hands of management, arguing that doing so could result in inefficient revisions of corporate governance terms, as "firms that need governance constraints are precisely the ones that do not volunteer to implement them."<sup>251</sup>

Regardless of which side of the debate one supports, it is clear that rather than determining whether gadflies or other individuals should be allowed to submit shareholder proposals, policymakers should instead recognize the role played by these individual shareholders in the ecosystem as governance facilitators 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 undermine 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 minimum thresholds a proposal must meet for resubmission under the new rule. For example, companies reconsider and revise their compensation packages when their "say-on-pay" votes receive objection ratios of 20–30% of all outstanding votes.<sup>252</sup> Similarly, Lucian Bebchuk, Robert Jackson, James Nelson, and Roberto Tallarita showed that

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*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); Goshen & Squire, *supra* note 162, at 772–73.

250. Minor Myers, *The Perils of Shareholder Voting on Executive Compensation*, 36 DEL. J. CORP. L. 417, 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." 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, 101 (2018).

251. Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. 131, 131 (2018); see Lucian Arye 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 decisionmaking).

252. See *supra* note 159.

the SEC has historically maintained that large minority support for shareholder proposals calling for more transparency serves as sufficient justification for the adoption of certain mandatory disclosure rules or guidance in the context of executive compensation or disclosure matters related to climate change.<sup>253</sup>

Yet, the recent appointment of a new SEC chair and the potential repeal of the 14a-8 reform provide an opportunity to reimagine the shareholder proposal ecosystem and should spur the agency to consider a more holistic response to the systemic constraints shareholder proponents, including large institutional investors, may face.

#### B. ENHANCING LARGE INVESTORS' INVOLVEMENT IN GOVERNANCE STANDARDS

Gadflies are not necessarily the long-term answer to the governance problem of American corporations. Gadflies face serious 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 stifling gadflies' ability to initiate proposals. Rather, it requires addressing institutional investors' role directly, stimulating a discourse about the role that these large investors should have (if at all) in submitting 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, it could be argued that another active shareholder could participate in companies' annual meetings and submit shareholder proposals. In particular, one would expect that market forces would eventually ensure that the governance arrangements that a *majority* of shareholders view as value enhancing would always be adopted on a systemic basis.

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

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253. Lucian A. Bebchuk, Robert J. Jackson Jr., James D. Nelson & Roberto Tallarita, *The Untenable Case for Keeping Investors in the Dark*, 10 HARV. BUS. L. REV. 1, 14–16 (2020) (finding that “none of the shareholder proposals that motivated the SEC to reconsider its executive pay disclosure rules in 1992 received majority support”).

among mid- and small-cap companies that systematically receive fewer shareholder proposals.<sup>254</sup> Large investors, particularly the Big Three, are unlikely to fill this void with shareholder proposals due to collective action problems, concerns over damaging their relationships with managers of portfolio companies, and their willingness to reduce the prospect of a regulatory backlash by avoiding the appearance of exercising power. The end result is a systemic avoidance, particularly in mid- and small-cap companies, of the adoption of governance arrangements that most investors favor. To bridge this gap, we suggest a complete reconceptualization of the way shareholder proposals are put on the ballot, either by enabling the use of “professional filers” or by applying a “nudge.”<sup>255</sup>

### 1. Gadflies 2.0: The Use of “Professional” Filers

What if gadflies’ virtues could be largely 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 small number 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 prorated basis by investor members of the association. Prior to each proxy season, the organization would conduct a survey among its members and determine 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 would achieve economies of scale by sharing the costs of engagement among a large pool of investors, resolving coordination problems, and avoiding duplicative engagement by different shareholders, including the submission of the same proposal by two or more investors. Second, this organization would develop expertise and the institutional body of knowledge necessary to handle the submission of proposals in the most efficient way in order to ensure its continued long-term operation. Third, the organization would have a market-wide perspective and would be able to run organized campaigns on critical topics of interest to a large coalition of

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254. See *supra* notes 118–21.

255. 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 predetermined default arrangements to incentivize retail investors to vote, see Kastiel & Nili, *supra* note 16.

shareholders. It could also test the water by trying new types of proposals. Finally, since the organization would be negotiating with companies regarding the proposals, it would be the party facing management directly, thus alleviating the risk of management or regulatory backlash to any single institutional investors. Also, the submission of proposals by this entity would convey the support of a coalition of investors and would make the passage of the proposals at a vote more probable, thereby increasing the likelihood that management would voluntarily adopt the proposals.

In fact, this proposed solution could be the next phase in the evolutionary process of “soft” engagement through the submission of shareholder proposals: “Gadflies 2.0.” Like gadflies, this nonprofit organization could handle the submission of shareholder proposals, but on an even larger scale, become a governance “facilitator,” initiate market-wide changes benefitting other investors, acquire expertise in this field, and remain undeterred from confronting management. However, unlike gadflies, the clients of this organization would be well diversified and have equity positions in almost all public companies. This nonprofit organization would have an established platform for submitting proposals, with an institutional body of knowledge and paid employees. Its high-level decision-making would be supported by a coalition of investors, and it would 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 at many large companies, provides a proof of concept.<sup>256</sup> Other examples include Interfaith Center on Corporate Responsibility (ICCR), a coalition of over three hundred global institutional investors, whose members filed 280 proposals for 2020, and “As You Sow,” a group which regularly introduces many shareholder resolutions, mostly on environmental-, social-, and governance-related matters.<sup>257</sup>

The submission of shareholder proposals on a large scale is time-consuming and costly. The professional filer model would 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 the costs on a single shareholder, as occurs using the gadfly approach.

In a recent article, Bebchuk and Hirst discuss the costs associated with stewardship activities and call upon policymakers to facilitate the pooling of

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256. See *supra* notes 83–84.

257. See McRitchie, *supra* note 161, at 7.

research, including having research conducted by outside organizations on behalf of multiple index fund managers.<sup>258</sup> In their view, such pooling of resources, which already takes place in Europe,<sup>259</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, policymakers should facilitate resource pooling by emphasizing that such resource sharing would not constitute a “group” under Section 13(d).<sup>260</sup>

Technically, the filing nonprofit organization could submit proposals through three avenues. In the first option, the organization would only advise and provide support in connection with the submission of the proposals, but the actual proponent would be an institutional investor. In essence, the organization would prepare the proposals, handle all the procedural aspects of the submission process, and negotiate with management, but the signatory—the actual beneficial owner—would still be an institutional investor. Second, the coalition of investors could allocate some additional sum that would enable the organization to purchase a small number 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 would be able to submit the proposal on behalf of the investor for a fee that would also cover the cost of submission. Under the current regime, institutions cannot delegate their eligibility because proposals must be submitted by the beneficial owner of the stock.<sup>261</sup>

Finally, this professional filer could also directly assist current gadflies with their own submissions, thereby eliminating or reducing some of the prevailing concerns regarding gadflies. Specifically, if issuers invoke concerns about the quality of gadflies’ proposals, the latter could use a professional filer’s seal of approval to bolster their proposals. Furthermore,

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258. See Bebhuk & Hirst, *supra* note 30, at 2029–30, 2120–21; see also Stephen T. Giove, Arielle L. Katzman & Daniel Yao, *Proxy Access Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 19, 2018), <https://corpgov.law.harvard.edu/2018/10/19/proxy-access-proposals-2> [<https://perma.cc/73LY-9YW6>] (“In total, well over 500 companies, and over two-thirds of the S&P 500, have adopted proxy access by-laws.”).

259. Bebhuk & Hirst, *supra* note 30, at 2121. In the United Kingdom, some pooling of stewardship is done through the Investor Forum. See *About the Investor Forum*, INVESTOR F., <https://www.investorforum.org.uk/about> [<https://perma.cc/WG74-785T>]. For a discussion of this approach, see Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 B.U. L. REV. 1459, 1485–87 (2019).

260. Bebhuk & Hirst *supra* note 30, at 2120–21 (noting that European Securities and Market Authority provides a safe harbor for certain collective efforts by shareholders).

261. 17 C.F.R. § 240.14a-8 (2021).

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the SEC could promulgate a safe harbor provision, exempting gadflies from the restrictions on submission or re-submission if their proposal is made through a professional filer or receives its seal of approval.

## 2. “Nudging” Institutional Investors

Another potential solution to the inherent shortcomings of gadflies 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 put certain matters to a shareholder vote periodically, such as once every five years. Such automatic inclusion on the company ballot would 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 the company ballot, this “nudge” would 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>262</sup>

We recognize that not all shareholder proposals are a perfect fit for this proposed solution, as some concern particular 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, to begin with, policymakers could focus on the five most popular and generic proposals. Those are the proposals that receive the *strongest support* among public shareholders (for example, 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 those matters that are brought to an automatic vote.

Moreover, not all proposals selected for an automatic vote would have to be submitted to the company ballot simultaneously. Instead, there could

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262. 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. Scott Hirst, *The Case for Investor Ordering*, 8 HARV. BUS. L. REV. 227, 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. Second, our solution does not enable shareholders to opt out of mandatory securities regulation.

be a rotation through the proposal list during a specified period. If a company is interested in reducing 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 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 would be submitted to the company’s ballot are *permitted* to be submitted even under the existing legal regime. This solution simply adds a requirement that shareholders be *required* to vote on a set of predetermined proposals every few years. Forcing shareholders to express their views on matters on which they are in any case permitted to vote 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. 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>263</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 proposals do not attract strong shareholder opposition,<sup>264</sup> the ever-present specter of receiving a significant percentage of negative votes forces insiders to be more attentive to shareholder demands, disclose more information, engage with major shareholders before the proxy season, and conduct negotiations behind the scenes.<sup>265</sup>

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263. 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 (2021).

264. Subodh Mishra, *2017 Proxy Season Review: Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 6, 2017), <https://corpgov.law.harvard.edu/2017/10/06/2017-proxy-season-review-compensation> [<https://perma.cc/9NAG-SX72>] (“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.”).

265. This important disciplinary force exists also in the context of hedge fund activism, but there is

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 this Article's authors advocated for the adoption of sunset provisions in dual-class IPOs, and analyzed the merits and potential designs of such provisions.<sup>266</sup> As with the solution proposed herein, sunset terms create more opportunities for shareholders to express their views on specific governance arrangements. Sunset terms also increase the incentives of insiders to be more attentive to shareholder demands 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 susceptible to possible objections. One major potential 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 must 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's view.<sup>267</sup>

These costs, however, are trivial for public companies.<sup>268</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>269</sup> Shareholder proposals that generally receive low support will not be filed by a professional filer or

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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 30, at 2136–37 (providing evidence to the limits of hedge fund activism). Shareholder proposals, unlike hedge fund engagements, are more generic and thus more easily used at a large number of companies at the same time and have a much broader influence on the market.

266. 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 corporate law contexts, see John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?*, in REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 677, 704–05 (Guido Ferrarini et al. eds., 2004); see also Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. PA. L. REV. 713, 751–52 (2003).

267. 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).

268. Foley & Bissell, *supra* note 97.

269. For instance, shareholder proposals that attracted particularly high rates of support in 2018 are declassifying the board, eliminating supermajority voting, majority voting in uncontested elections, and the initial adopting of proxy access.

included in the short list of proposals automatically submitted to the company ballot periodically.

A “one-size-does-not-fit-all” objection<sup>270</sup> would argue that governance arrangements that might be optimal for some companies might not be optimal for others.<sup>271</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 would not.

However, these proposed solutions 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 with money at stake—including, critically, institutional investors—can also vote with management if they feel that a governance structure which insulates management, such as a 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, regarding 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>272</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>273</sup> However, it also finds that if a larger proportion of a company’s shares are held by discerning mutual funds, harmful proposals are more likely to be weeded out, that overall, shareholder

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270. Bebchuk & Kastiel, *supra* note 266, at 623–24 (presenting this argument in the context of dual-class shares).

271. Zohar Goshen, *Against Mandatory Sunset for Dual Class Firms*, COLUM. L. SCH.: THE CLS BLUE SKY BLOG (Jan. 2, 2019), <http://clsbluesky.law.columbia.edu/2019/01/02/against-mandatory-sunset-for-dual-class-firms> [https://perma.cc/6HXL-ZMC4]; Bernard S. Sharfman, *The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuk and Kastiel*, HARV. L. SCH. F. ON CORP. GOVERNANCE (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> [https://perma.cc/GEF7-WUGH].

272. See Gantchev & Giannetti, *supra* note 107.

273. Previous studies find evidence of positive (albeit small) share price reactions to shareholder proposals. See, e.g., Vicente Cuñat, Mireia Gine & Maria Guadalupe, *The Vote Is Cast: The Effect of Corporate Governance on Shareholder Value*, 67 J. FIN. 1943, 1945 (2012) (reporting that shareholder proposals that pass earn an abnormal return of 1.30% compared to those that fail); see also, e.g., Gillan & Starks, *supra* note 100, at 280, 297–99 (observing a significant positive abnormal return to all proposals sponsored by individuals); Renneboog & Szilagyi, *supra* note 92, at 173–75 (finding that shareholder proposals are associated with small but statistically significant share price increases at the target firms).

voting appears to provide some discipline in screening out bad proposals, and that in firms with an informed shareholder base, “shareholder proposals yield positive abnormal returns . . . .”<sup>274</sup> While this type of study suffers from econometric limitations, such as selection effect,<sup>275</sup> its finding, if taken at face value, actually supports the overall message of this Part: policymakers should not discard the good along with the bad. Even if 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 the use of shareholder proposals altogether.

### CONCLUSION

Shareholder proposals have become one of the leading forces influencing 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 gadflies were perceived as an annoyance in the past, they are no longer seen as such. We show that the rise in institutional investors’ power has created a new ecosystem, wherein gadflies initiate shareholder proposals and the large institutional investors—that are unwilling to be in the driver seat—support these initiatives.

Most importantly, as gadflies have become 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.”<sup>276</sup> This strong pushback has eventually led the SEC to reinvigorate Rule 14a-8 by raising both the ownership thresholds for shareholder proposal submissions and the vote

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274. Gantchev & Giannetti, *supra* note 107, at 2–3, 6 (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).

275. 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. *See id.* The authors also do not consider proposals that shareholders withdraw after negotiations with management. *See id.* 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 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.

276. Foley & Bissell, *supra* note 206.

outcome hurdles for proposal resubmissions.

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