

## **A Bridle, a Prod, and a Big Stick: An Evaluation of Class Actions, Shareholder Proposals, and the Ultra Vires Doctrine as Methods for Controlling Corporate Behavior**

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# A BRIDLE, A PROD, AND A BIG STICK: AN EVALUATION OF CLASS ACTIONS, SHAREHOLDER PROPOSALS, AND THE ULTRA VIRES DOCTRINE AS METHODS FOR CONTROLLING CORPORATE BEHAVIOR

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*"Great corporations exist only because they are created and  
safeguarded by our institutions; and it is therefore our right and  
our duty to see that they work in harmony with these  
institutions."*<sup>1</sup>

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<sup>1</sup> President Theodore Roosevelt, State of the Union Address (Dec. 3, 1901), reprinted in Theodore R. Lotchin, Note, *No Good Deed Goes Unpunished? Establishing a Self-Evaluative Privilege for Corporate Internal Investigations*, 46 WM. & MARY L. REV. 1137, 1137 (2004), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=29542>; see also President Theodore Roosevelt, State of the Union Address (Dec. 7, 1903), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=29544>.

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## INTRODUCTION

This Article evaluates recently applied methods of influencing corporate behavior and recommends that a dormant legal doctrine be revitalized and added to the "tool box" of activists and concerned shareholders. This study focuses on efforts to remedy and prevent employment discrimination and draws upon data from recent cases.<sup>2</sup> The lessons derived from this analysis, however, may be applied in other contexts, including efforts to improve the conduct of American corporations with regard to labor relations, environmental protection, and human rights in the developing world.

The methods of influencing corporate behavior that will be evaluated include class action lawsuits and shareholder proposals to amend corporate policy.<sup>3</sup> In both contexts, there are procedural hurdles to achieving success. Even when success is achieved, there are limits to the actual changes in organizational behavior that result.

There is a third means for influencing corporate behavior, often ignored, that does not involve the same theoretical or structural limitations. The ultra vires doctrine historically allowed a shareholder to sue to prevent a company from engaging in an activity outside of the specific parameters of its corporate charter. While the doctrine was almost done away with during the 1900s inasmuch as companies are now free to alter their field of business as they wish, a narrow slice of this doctrine remains.<sup>4</sup> Namely, forty-seven states require corporate charters to limit a corporation to "lawful activities," and forty-nine states have statutes empowering the state to enjoin or dissolve the corporation for illegal acts.<sup>5</sup>

Therefore, shareholders still have the power to sue a

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<sup>2</sup> See discussion *infra* Part I.

<sup>3</sup> See discussion *infra* Parts I.C, II.C.

<sup>4</sup> See discussion *infra* Part III.A.

<sup>5</sup> See *infra* note 93 and accompanying text.

company to prevent the violation of laws. In the context of a company such as Wal-Mart, a well-documented pattern of widespread illegal gender discrimination could therefore be grounds for a shareholder to bring an ultra vires lawsuit.<sup>6</sup> Unlike a shareholder proposal, the available remedies could include a court order to cease the activity and to adopt a detailed monitoring, training, and compliance plan. Unlike a class action, the high hurdles of certifying the plaintiffs as class representatives would not exist. Nor would there be the same mix of practical concerns that contribute to class action attorneys emphasizing monetary rewards over long-term, disciplined equitable relief that is actually geared to altering company practices in the future.<sup>7</sup>

The only limitation on using the ultra vires doctrine is that there must be evidence that a company is in violation of an actual law in a jurisdiction where it operates.<sup>8</sup> In those contexts, ultra vires can effectively enable a form of a shareholder enforcement suit to ensure compliance with the federal laws of the United States, the laws of individual states, the statutes of foreign nations, or even international human rights laws.<sup>9</sup>

While an ultra vires suit could also be initiated by a state attorney general, this Article focuses upon the use of the ultra vires doctrine by shareholder activists. Institutional investors and shareholder groups have already sacrificed large amounts of resources over the past decade in their efforts to improve corporate conduct.<sup>10</sup> These groups could use the ultra vires doctrine to achieve more tangible results with a smaller expenditure of resources.

## I. CLASS ACTION LAWSUITS: A BRIDLE

### A. *Reasons for Pursuing a Class Action Lawsuit*

Pursuing an employment discrimination lawsuit as a class action—that is, using a single suit to provide redress for an entire group of harmed people instead of each person suing individually—is desirable for several reasons. One practical

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<sup>6</sup> See discussion *infra* Part III.C.

<sup>7</sup> See discussion *infra* Part III.B.

<sup>8</sup> See discussion *infra* Part III.D.

<sup>9</sup> See discussion *infra* Parts III.B, III.D.

<sup>10</sup> See discussion *infra* Part II.A.

reason is that lawyers who invest extensive resources on a contingency basis often need a larger incentive to accept a case than the incentive that a settlement or ruling on one individual plaintiff's case would be. Second, certification of a case as a class action drastically increases the chances that an employer will settle because it raises the stakes in terms of potential bad publicity and financial loss if the case goes to trial. Third, in addition to monetary awards and punitive damages, an equitable remedy may be possible; for example, the plaintiffs could ask for a court-ordered regimen of monitoring and non-discrimination compliance training to affect future hiring, compensation, and promotion decisions. In that sense, if equitable remedies are sought by plaintiffs and awarded by a court or consented to in a settlement agreement, a class action can be a bridle with which to lead a corporation in a certain direction. As described *infra*, however, the use of equitable remedies in class action lawsuits has been in decline for over a decade.<sup>11</sup>

#### *B. Obstacles to Winning a Class Action Lawsuit*

The first potential impediment to getting a class action certified is the employment agreement between a company and its employees. A clause requiring arbitration of disputes with all employees will make a lawsuit against the employer nearly impossible.<sup>12</sup> In that event, each dispute will be handled individually by an arbitrator.<sup>13</sup> Under such circumstances, as

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<sup>11</sup> See discussion *infra* Part I.C.

<sup>12</sup> See *Class Consciousness-Raising*, FULTON COUNTY DAILY REP., Sept. 20, 2004, at B1 (providing an edited transcript of a panel discussion led by Charles A. Shanor of Emory University Law School and including "R. Lawrence Ashe Jr. of Ashe, Rafuse & Hill; Harlan S. Miller III of Miller Billips & Ates; Joshua F. Thorpe of Bondurant, Mixson & Elmore; and C. Geoffrey Weirich of Paul, Hastings, Janofsky & Walker"). Judicial review of arbitration awards is extremely narrow and very difficult to obtain. See Cameron L. Sabin, Note, *The Adjudicatory Boat Without a Keel: Private Arbitration and the Need for Public Oversight of Arbitrators*, 87 IOWA L. REV. 1337, 1347-49 (2002) (describing the limitations on judicial action in arbitration awards under federal and state law); see also Michael H. LeRoy & Peter Feuille, *The Revolving Door of Justice: Arbitration Agreements That Expand Court Review of an Award*, 19 OHIO ST. J. ON DISP. RESOL. 861, 871-73 (2004) (detailing the narrow criteria for judicial review of arbitration decisions under federal law).

<sup>13</sup> Class arbitrations are possible but only if several requirements are met. First, the employment agreement must not preclude a class arbitration, and even if it does, as of 2005, the current policy of the American Arbitration Association ("AAA") is first to seek court guidance before allowing a class arbitration to proceed. A class arbitration may still not offer all the benefits that a plaintiff may desire from

compared to a class action suit, the deterrent impact of a massive financial award, the public-relations leverage that a plaintiff class enjoys during the course of a high-stakes lawsuit, and the possible equitable relief of court-ordered change in corporate policy will not be available.

The Supreme Court in 1977<sup>14</sup> and 1982<sup>15</sup> decided that, even though race- and gender-discrimination lawsuits under Title VII of the Civil Rights Act are inherently class based, these cases must still meet the class certification requirements of Rule 23 of the Federal Rules of Civil Procedure. That is, plaintiffs' attorneys must establish that the lawsuit will adequately represent the interests of all the parties that it claims to represent.<sup>16</sup> The guidelines for ensuring the adequacy of representation are surprisingly imprecise,<sup>17</sup> but the Supreme Court, in *Amchem Products, Inc. v. Windsor*,<sup>18</sup> recently stressed the need for rigorous analysis on the part of certifying courts to determine whether the class and representative plaintiffs experienced the same harm and share the same interests.<sup>19</sup> In this same case, the Supreme Court stressed the need to evaluate the competency of the attorneys involved in the lawsuit and whether any attorney is compromised by a conflict, interrelation, or alignment of interests.<sup>20</sup>

The ease of class certification thus frequently turns on the

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a lawsuit. For the most currently available information on the policies of the AAA, see AM. ARBITRATION ASS'N, AAA CLASS ARBITRATION POLICY (2005), available at <http://www.adr.org/ClassArbitrationPolicy>.

<sup>14</sup> See *E. Tex. Motor Freight Sys., Inc. v. Rodriguez*, 431 U.S. 395, 403, 405–06 (1977) (“We are not unaware that suits alleging racial or ethnic discrimination are often by their very nature class suits . . . . But careful attention to the requirements of Fed. Rule Civ Proc. 23 remains nonetheless indispensable.”).

<sup>15</sup> See *Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 156–57 (1982) (holding that litigants pursuing a class action under Title VII must meet the Rule 23(a) requirements).

<sup>16</sup> See FED. R. CIV. P. 23(a)(4).

<sup>17</sup> For a thorough review of the jurisprudence governing adequacy of representation, including the lack of substantive guidelines in the Class Action Fairness Act of 2003, H.R. 1115, 108th Cong. (2003), see generally Debra Lyn Bassett, *When Reform Is Not Enough: Assuring More Than Merely “Adequate” Representation in Class Actions*, 38 GA. L. REV. 927 (2004).

<sup>18</sup> 521 U.S. 591 (1997).

<sup>19</sup> See *id.* at 625–27 (stating the need for careful evaluation of Rule 23's requirements in certifying a class that represents the interests of all potential members).

<sup>20</sup> See *id.* at 626 n.20 (discussing the importance of evaluating the adequacy-of-representation requirement along with the other requirements of Rule 23).

nature of evidence and the contours of the underlying claim, and even at the federal appellate level courts disagree as to the threshold level of evidence necessary to allow a class action case to go forward.<sup>21</sup> Certification is easiest if there is a company rule, a widespread practice, a test with a disparate impact, or a stated decision at the top of a management hierarchy that fosters discrimination.<sup>22</sup> A more difficult situation for establishing a class action is when the company claims to have delegated personnel decisions to the subjective discretion of managers at the local level. In these cases, an expert witness is needed to aggregate information to demonstrate convincingly that discrimination is likely occurring.<sup>23</sup> While this is a difficult hurdle to overcome, it is not impossible as demonstrated by *Dukes v. Wal-Mart Stores, Inc.*,<sup>24</sup> in which a class of up to 1.6 million female Wal-Mart workers was certified.<sup>25</sup> This may qualify as the largest class action gender-discrimination suit in U.S. history.<sup>26</sup> This kind of aggregation of proof from the local level is possible when a company's hourly employees are, for example, 65% female but store managers at the same company are 14% female.<sup>27</sup>

Despite the occasional success, recent class action developments in the Federal Rules of Civil Procedure have tended to favor corporate defendants.<sup>28</sup> For example, Rule 23(f)

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<sup>21</sup> Compare *Allison v. Citgo Petroleum Corp.*, 151 F.3d 402, 410–11, 414–16 (5th Cir. 1998) (finding certification of a class under Rule 23(b)(2) impermissible if class members seek compensatory or punitive damages as the predominant—as opposed to incidental—form of relief), with *Robinson v. Metro-N. Commuter R.R. Co.*, 267 F.3d 147, 162–64 (2d Cir. 2001) (rejecting *Allison*'s incidental damages standard and adopting an “ad hoc approach” to class certification treatment under Rule 23(b)(2) which allows the district court discretion to certify a class even if compensatory or punitive damages are the predominant relief sought).

<sup>22</sup> See *Class Consciousness-Raising*, *supra* note 12, at B1.

<sup>23</sup> See *id.*

<sup>24</sup> 222 F.R.D. 137, 145, 150, 160 (N.D. Cal. 2004).

<sup>25</sup> See Constance L. Hays, *The Wal-Mart Culture Pulls In 2 Directions*, INT'L HERALD TRIB., July 1, 2004, at 1R.

<sup>26</sup> *Compliance, Diversity Focus at Wal-Mart Annual*, WOMEN'S WEAR DAILY, June 7, 2004.

<sup>27</sup> See *Dukes v. Wal-Mart Stores, Inc.*, 222 F.R.D. 137, 146, 161 (N.D. Cal. 2004); see also *Class Consciousness-Raising*, *supra* note 12, at B1 (stating that more than fifty percent of lower-level store employees were females but only a small percentage of store managers and assistant managers were female).

<sup>28</sup> See Anthony Rollo & Gabriel A. Crowson, *Mapping the New Class Action Frontier—A Primer on the Class Action Fairness Act and Amended Federal Rule 23*, 59 CONSUMER FIN. L.Q. REP. 11, 13 (2005) (quoting President Bush as stating that

was added in 2003 to allow for the immediate appeal of a class action certification to a circuit court.<sup>29</sup> Plaintiff's counsel in the context of class actions must also consider which venue will be most favorable to them. Certain courts, such as the United States Court of Appeals for the Eleventh Circuit, are generally not as favorable to plaintiffs in large lawsuits as is the Ninth Circuit.<sup>30</sup>

If both sides of a class action discrimination lawsuit want to settle the case early in the process, there is one last impediment. As of 1997, with the *Amchem* decision, the Supreme Court established that almost all of the class certification requirements of the Federal Rules of Civil Procedure must be met before a class-wide settlement will be allowed.<sup>31</sup>

### C. Limitations of Class Action Lawsuits to Alter Corporate Behavior

A recent empirical study found that class actions are actually ineffective in significantly compensating plaintiffs, in affecting share price, or in bringing about lasting change.<sup>32</sup> First, during the past decade, even cases with large settlements only created an average of approximately \$10,000 of benefits per class member, which is below what one would expect in a typical individual suit.<sup>33</sup> For example, discrimination settlements under the auspices of the Equal Employment Opportunity Commission in 1995 averaged \$35,000, while the mean trial recovery obtained by private plaintiffs was \$100,000.<sup>34</sup>

Second, the impact of class action lawsuits on share price, both at the time of filing and at the time of settlement, is lower than what one might expect. A systematic study of thirty-three class action awards and twenty-six settlements revealed no

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reforms to the Rules "will keep out-of-state businesses, workers, and shareholders from being dragged before unfriendly, local juries, or forced into unfair settlement").

<sup>29</sup> FED. R. CIV. P. 23(f).

<sup>30</sup> See *Class Consciousness-Raising*, *supra* note 12, at B1 (comparing the conservative trend of the Eleventh Circuit with the more liberal and plaintiff-favorable Ninth Circuit).

<sup>31</sup> See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 620 (1997).

<sup>32</sup> See Michael Selmi, *The Price of Discrimination: The Nature of Class Action Employment Discrimination Litigation and Its Effects*, 81 TEX. L. REV. 1249, 1250-51 (2003).

<sup>33</sup> See *id.* at 1250.

<sup>34</sup> Michael Selmi, *Public vs. Private Enforcement of Civil Rights: The Case of Housing and Employment*, 45 UCLA L. REV. 1401, 1435 (1998).



statistically relevant impact on share price at either the time of filing or at the time of settlement.<sup>35</sup> Even in cases of large settlements, such as the \$192.5 million settlement involving Coca-Cola in 2000, the settlement had little effect on share price.<sup>36</sup> The Coca-Cola settlement amounted to roughly 0.15% of the firm's market capitalization,<sup>37</sup> contributing to a decrease of about six cents from the sixty dollars share price at the time of settlement.<sup>38</sup>

Prior to 1991, lawyers and courts emphasized remedial relief that altered policy, required hiring preferences for former victims, and set out goals and timetables.<sup>39</sup> In 1991, Title VII was revised to provide punitive damages,<sup>40</sup> and since then, monetary relief has been the "core of the remedial package."<sup>41</sup> "[T]here is little attempt to remedy past discrimination by other methods."<sup>42</sup> In three of the most highly visible cases—Texaco's \$176 million settlement, Coca-Cola's \$192 million settlement, and Home Depot's \$104 million settlement—not a single consent decree required a change in employment practices.<sup>43</sup>

Observers have suggested that the focus of the plaintiffs and the courts upon rewarding monetary compensation instead of ensuring change represents a shift toward handling discrimination as a transaction or a cost of doing business.<sup>44</sup> In cases where a consent decree or court order results in a prescribed change of policy, the monitoring has been left to plaintiffs' attorneys and diversity task forces, neither of which

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<sup>35</sup> See Selmi, *supra* note 32, at 1257–68.

<sup>36</sup> See *id.* at 1250 n.7.

<sup>37</sup> See *id.* at 1250.

<sup>38</sup> See *id.* at 1250 n.7. See also Davan Maharaj, *Coca-Cola To Settle Racial Bias Lawsuit; Workplace: Soft Drink Giant Agrees To Pay \$192.5 Million Over Allegations It Treated Blacks Unfairly*, L.A. TIMES, Nov. 17, 2000, at A1 (stating that the market had incorporated the possibility of Coca-Cola's settlement into its stock price months before the terms of the settlement were publicly announced).

<sup>39</sup> See, e.g., *Kirkland v. N.Y. State Dep't of Corr. Servs.*, 711 F.2d 1117, 1123–24 (2d Cir. 1983) (providing race-conscious promotional relief); *Officers for Justice v. Civil Serv. Comm'n*, 688 F.2d 615, 635–36 (9th Cir. 1982) (validating promotional goals and timetables); *United States v. City of Alexandria*, 614 F.2d 1358, 1368 (5th Cir. 1980) (requiring job performance goals).

<sup>40</sup> *B. Ford Robertson, Commissioner v. Schleier: The Excludability of ADEA Awards Under Section 104(a)(2) of the Internal Revenue Code*, 31 WAKE FOREST L. REV. 557, 562 (1996).

<sup>41</sup> Selmi, *supra* note 32, at 1299.

<sup>42</sup> *Id.*

<sup>43</sup> See *id.* at 1249–50.

<sup>44</sup> See *id.* at 1251–52, 1301.

have a significant enough stake to ensure that change occurs.<sup>45</sup> Therefore, although class actions present an opportunity to alter the behavior of corporations with equitable remedies, because of structural and financial motives they have ceased to be the quintessential embodiment of public law litigation. That is, typical class action lawsuits are no longer about enforcing absolute rules of society; rather, they resemble transaction costs, or instances where businesses may pay a fee for breaking rules.<sup>46</sup>

## II. SHAREHOLDER PROPOSALS: A PROD

### *A. Recent Trends and Reasons for Pursuing Shareholder Proposals*

Conventional wisdom considers shareholders as either the owners of the firm or the principals in a relationship in which managers serve as their agents. In fact, the obligation to manage and establish policy for the firm is held by the board of directors.<sup>47</sup> The mechanisms through which shareholders influence actual managerial decisions are few indeed.<sup>48</sup> They vote annually to elect directors (usually from a slate, proposed by existing members of the board, that includes the same number of nominees as there are vacancies), must vote to approve changes in the bylaws or in the charter (usually proposed in the first instance by the board), and vote on extraordinary matters such as mergers, major sales of assets, or dissolution (again, proposed by the board).

One area where shareholders have more ability to originate action is in the area of shareholders proposals. These are simply resolutions put forward by shareholders for collective consideration. They can relate to either issues of corporate strategy or of political or social issues more generally. An example of the former type is a proposal to limit the corporation's use of poison pills; an example of the latter is a proposal to explore the company's history of equality in employment. The federal government oversees a regulatory regime that seeks to ensure that proper proposals are included in materials circulated

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<sup>45</sup> *Id.* at 1252.

<sup>46</sup> *Id.* at 1251–52.

<sup>47</sup> *See, e.g.*, DEL. CODE ANN. tit. 8, § 141 (2005).

<sup>48</sup> *See* DAVID P. TWOMEY ET AL., ANDERSON'S BUSINESS LAW & THE REGULATORY ENVIRONMENT 941 (14th ed. 2001).

to shareholders in preparation for annual meetings. Even though only few proposals receive a majority vote from shareholders, many shareholder activists nevertheless use them to raise issues in the public eye, with other shareholders, or with firm managers. This section discusses the influence of proposals in affecting corporate behavior, especially with regard to employment discrimination.

There is presently a growing trend of shareholder activism on a variety of issues, particularly environmental causes and corporate governance. Shareholders also campaign to alter business practices in countries linked to international terrorism, to improve working conditions in foreign factories, and to curb the marketing of tobacco to youngsters abroad.<sup>49</sup> Shareholder resolutions to curb employment discrimination provide a vivid example of the growing trend of shareholder activism. According to Meg Voorhes, Director of the Investor Responsibility Research Center's Social Issues Service, in 1999, only one proposal for changing an employment nondiscrimination policy related to sexual orientation went before shareholders and it received 8 percent of the vote.<sup>50</sup> 2000 and 2001 saw little change, as only one proposal was brought each year.<sup>51</sup> As the campaign around Cracker Barrel gained traction in 2002, however, five proposals reached shareholders and they garnered an average of twenty-two percent of the vote.<sup>52</sup>

Institutional investors that care to influence corporate behavior through shareholder proposals can have particular impact, because they own sufficient shares to demand attention from corporations' decisionmakers. According to one executive of a socially-responsible investment firm, "The advantage of having an institutional holder file these resolutions is that companies always return their phone calls. If they want a dialogue, they get it."<sup>53</sup>

Beginning in the late 1990s, shareholder activists—especially institutional investors—began to see the possibility that corporations could incur liabilities as a result of litigation

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<sup>49</sup> *Id.*

<sup>50</sup> Michael S. Markowitz, *Gay Rights; Shareholders' Power Is the New Weapon in Fight for Workplace Equality*, *NEWSDAY*, Jan. 4, 2004 at F10.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* (quoting Shelley Alpern, Assistant Vice President at Trillium Asset Management).

and public relations damage due to widespread employment discrimination.<sup>54</sup> Various activist groups, motivated by either religious convictions or progressive ideals, also began to mobilize to alter what they saw as socially undesirable behavior. These groups were joined by leaders of large public pension funds. Together, these unified interests began using shareholder proposals to attempt to modify discriminatory corporate employment practices. For example, Equality Project—a group of shareholder activist groups that includes Pride Foundation, Walden Asset Management, Trillium Asset Management, and ISIS Asset Management—succeeded in changing Wal-Mart's equal employment opportunity policy to include sexual orientation and gender identity.<sup>55</sup>

The example of Equality Project's successful campaign to amend Wal-Mart's employment opportunity policy, however, highlights not only the power of shareholder campaigns, but also the limitations of shareholder proposals. Shareholder proposals were one aspect of a multi-pronged strategy, and it took a significant amount of time to bring about change. Negotiations between Equality Project and Wal-Mart's management lasted for two years, from September 2001 until June 2003, before a policy amendment was agreed upon.<sup>56</sup> Therefore, the role of shareholder proposals, as illustrated by the efforts of Equality Project, is often to mount pressure, generate media attention, and build momentum behind a policy change.

The case of Cracker Barrel provides another vivid example of: (1) the eagerness of shareholders to invest years of time and extensive financial resources to change corporate behavior; (2) the potential of shareholder activism; and (3) the limitations of current methods.

### 1. Case Study: Cracker Barrel

The battle to alter Cracker Barrel's formal, written

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<sup>54</sup> See Maureen Minehan, *Shareholders May Help Determine Employment Issues*, HR MAGAZINE, Feb. 1998, at 160.

<sup>55</sup> See Lance Turner, *Wal-Mart Changes Policy To Protect Gays*, ARKANSAS BUS., July 7, 2003, at 10. Wal-Mart had approximately 1.3 million employees at the time of the announcement and said that the changes were effective immediately. *Id.*

<sup>56</sup> *Id.* At the time of the announcement, Wal-Mart, the number one retailer in the world with \$246.53 billion in annual sales, became the forty-ninth company in the top fifty of the Fortune 500 to bar discrimination based on sexual orientation; ExxonMobil was still refusing to alter its policy. *Id.*

discrimination policy involved a high-profile boycott and negotiations between activists and management coupled with shareholder proposals.<sup>57</sup> For over a decade—from 1991 to 2002—these shareholder proposals and the concerted external campaign failed to alter the company's policy or practices.<sup>58</sup> During this time, Cracker Barrel's parent company, publicly traded CRBL Group, Inc., enjoyed great financial success<sup>59</sup> even as it became "the poster boy for corporate antigay bigotry."<sup>60</sup>

In 1991, Cracker Barrel issued a memo stating that people who did not demonstrate "normal heterosexual values" could not work for the company.<sup>61</sup> At least eleven Cracker Barrel employees lost their jobs in the 1990s because of their sexual orientation, though the number may be as high as twenty.<sup>62</sup> One of the dismissed employees, Cheryl Summerville, a backup cook at the Douglasville, Georgia Cracker Barrel Old Country Store, did not previously hide her orientation and her immediate supervisor did not want to dismiss her.<sup>63</sup> Yet her district manager fired her, writing on her separation papers the reason for termination: "Employee is gay."<sup>64</sup>

Because Georgia is one of the many states where Cracker Barrel operates that does not have a law preventing discrimination based on sexual orientation, the company's policy and Cheryl Summerville's firing were not illegal. In her words, "I called the ACLU and they said there was nothing I could do at

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<sup>57</sup> Jeremy Quittner, *Cracker Barrel Buckles: The Family Restaurant's Change of Heart Provides a Prime Example for Activists Committed To Reforming Other Antigay Corporations*, THE ADVOCATE, Feb. 4, 2003, at 24.

<sup>58</sup> *Id.*

<sup>59</sup> In 2002, CBRL had approximately "50,000 employees in 41 states, [was] publicly traded on the NASDAQ and rank[ed] 704th in the Fortune 1000. For the fiscal year ending August 2, 2002, it had \$92 million in net income, nearly a 90% increase over the \$49 million in net income reported a year earlier. At the end of the calendar year its stock was trading at around \$30 a share." *Id.*

<sup>60</sup> *Id.* This characterization of Cracker Barrel is attributed to Shelley Alpern, Assistant Vice President of Boston-based Trillium Asset Management Corporation, which specializes in socially responsible investing: "It is important the poster boy for corporate antigay bigotry has finally acknowledged that lesbians and gays are part of their own workforce and part of their customer base as well. . . . The importance of this cannot be underestimated in terms of the company's ability to create a comfortable working environment for lesbian and gay employees." *Id.* (quoting Shelley Alpern, Assistant Vice President at Trillium Asset Management).

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

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

all.”<sup>65</sup>

For the next ten years, the New York City Employees' Retirement System (NYCERS), one of five pension funds for New York City workers that together control 391,000 shares of stock in CBRL, Cracker Barrel's parent company, sponsored shareholder proposals that would push Cracker Barrel to overhaul its employment policy through a proxy vote.<sup>66</sup> The shareholder proposal was coupled with a nationwide, decade-long boycott by gays and lesbians.<sup>67</sup> Outside the coordinated campaign of external pressure, several discrimination lawsuits were also filed, at least two of which attempted class-wide redress.<sup>68</sup>

Finally, prior to the November 26, 2002 shareholders' meeting, shareholders controlling fifty-eight percent of CBRL's 49.8 million outstanding shares voted by proxy to approve the proposal.<sup>69</sup> While no vote was taken at the shareholders' meeting, immediately afterward the board voted unanimously to add sexual orientation to its written nondiscrimination policy.<sup>70</sup> The decade-long campaign of shareholder action, letter writing, negotiations, and attempted economic damage is therefore illustrative of both the promise and problems of bringing about change through shareholder proposals alone.

It bears repeating that the specific goal of recent shareholder proposals was to change official corporate policies. Another limitation of this strategy, even if policies are changed, is that policy alterations may not have a direct impact on day-to-day functions. The campaigns to mobilize shareholders to vote on a

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<sup>65</sup> *Id.* (quoting Cheryl Summerville, a former Cracker Barrel employee).

<sup>66</sup> *Id.* "NYCERS owns 189,000 shares." *Id.*

<sup>67</sup> In 2002, the Human Rights Campaign ("HRC"), a Washington, D.C.-based gay advocacy organization gave CBRL zero points out of a possible one hundred in its annual rating of company attitudes toward gay men and lesbians. HRC's WorkNet scale assigns points based on several factors, such as whether a company provides domestic-partner benefits or has a written corporate policy that bans discrimination on the grounds of sexual orientation and gender identity. According to HRC's Education Director, Kim Mills, "[t]hey [Cracker Barrel] had no nondiscrimination policy, no gay and lesbian employees' organization, no appropriate and respectful marketing to the gay and lesbian community." Mills explained that "working actively against the shareholder resolutions [in past years] got them that zero." *Id.*

<sup>68</sup> The NAACP attempted at least one class action lawsuit. Class action certification was denied in 2002. *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

proposed policy change, however, helped raise the issue of discrimination to management's attention. Also, once a policy is changed, it is possible that employees can later sue when a company policy is violated to their detriment. In summation, the nudging effect that shareholders can have upon a company's management is reflected in the title of this section: shareholder proposals are a prod with which to push a corporation in a certain direction.

### *B. Obstacles to Passing a Shareholder Proposal*

Though shareholder proposals may prod corporations into action as they did in the Cracker Barrel case, there are a number of obstacles that shareholder activists face when they use shareholder proposals to create change. First, the proper subject matter for shareholder proposals is limited by federal law. The SEC prevented shareholder proposals from affecting employment policies in the 1990s, saying that employment policies were part of the normal course of business of a company and therefore in the domain of the board and management.<sup>71</sup> That changed in 1998 when the SEC reversed its "Cracker Barrel decision" and changed its rules to allow voting on shareholder proposals affecting employment policies.<sup>72</sup> There are still issues, however, that are off limits to shareholder proposals—domestic partner benefits being one of them—since these issues are still considered to fall within the ambit of the ordinary course of business.<sup>73</sup>

Second, there are requirements pertaining to the votes required to adopt a proposal. For a shareholder meeting to be valid, a minimum number, or quorum, of shareholders, or authorized proxies, must be present. Further, a shareholder resolution may need more than a simple majority of cast votes to pass. For example, the corporate charter may require a supermajority of votes at the meeting or set some other minimum threshold of total shareholder participation for a resolution to pass. Non-voting shareholders who are present at the meeting or abstentions may either be counted as votes for or against the measure depending on the company charter and bylaws.

There is one scenario in which shareholder action may be

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<sup>71</sup> See Minehan, *supra* note 54, at 160.

<sup>72</sup> *Id.*

<sup>73</sup> See Markowitz, *supra* note 50, at F10.

taken without a meeting. A number of states have adopted the Revised Model Business Corporation Act ("RMBCA") provision that "[a]ction required or permitted by this Act to be taken at a shareholders' meeting may be taken without a meeting if the action is taken by all the shareholders entitled to vote on the action."<sup>74</sup> To pass, however, the resolution in this case would require delivery to the corporation of a written consent describing the action to be taken and signed by all the shareholders entitled to vote on the action.<sup>75</sup>

### C. Limitations of Shareholder Proposals

It has been asserted that majority shareholder resolutions can be ignored by directors since directors have the discretion—some would say the obligation—to exercise independently their best business judgment in carrying out their fiduciary duty.<sup>76</sup> According to this line of reasoning, "[w]hile majority shareholder support for precatory proposals is an important consideration for directors, it should not be the only one that they take into account when making decisions as fiduciaries, which they are required to make in the best interest of the company and all shareholders as a whole."<sup>77</sup>

Even shareholder activists acknowledge that shareholder proposals would not get anywhere if not for a coordinated public relations effort. Grant Lukenbill, Vice Chairman of the Equality Project, says resolutions are most effective as part of a "multifaceted approach." In truth, by the time a resolution comes up, the company has probably already been lobbied by gay and lesbian groups, by employee resource groups and has watched its competitors change their policies."<sup>78</sup>

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<sup>74</sup> REVISED MODEL BUS. CORP. ACT § 7.04(a) (2002).

<sup>75</sup> *Id.*

<sup>76</sup> See Andrew R. Brownstein & Igor Kirman, *Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 BUS. LAW. 23, 24 (2004); see also Quittner, *supra* note 57 (noting that a proxy vote by shareholders is not legally binding and a company's board is not required to follow such a vote).

<sup>77</sup> Brownstein & Kirman, *supra* note 76, at 24. In general, courts refrain from enjoining the action of directors unless there is proof of acting: (1) on an uninformed basis; (2) in bad faith; or (3) not in the best interest of the corporation. This principle is known as the "business judgment rule." TWOMEY ET AL., *supra* note 48, at 945. In keeping with this rule, courts do not interfere with a board's discretion unless illegal conduct or fraud harms the rights of creditors, shareholders, or the corporation. See *id.* at 942.

<sup>78</sup> Markowitz, *supra* note 50, at F10 (quoting Grant Lukenbill, vice chairman of



Resolutions have been withdrawn without a vote when a company agrees to make a change. For example, CSX stated that it started to revise its code of ethics even before the New York City Comptroller filed a resolution.<sup>79</sup> When a resolution in favor of equal employment opportunity for gays and lesbians was filed at J.C. Penny, the board decided to back it in the company's proxy statement; the measure drew ninety-three percent support.<sup>80</sup> Other companies institute changes while insisting they are merely clarifying policies that were already in place.<sup>81</sup> Even Cracker Barrel, which at one point issued a memorandum stating that only heterosexual men and women were to be retained as employees, declared that its inclusion of sexual orientation in their antidiscrimination policy was simply a clarification of its existing policy.<sup>82</sup>

A separate issue from the passage of formal policy changes is whether the reality in the workplace has changed. This is one reason that the Human Rights Campaign maintains an annual report card on workplace conditions.<sup>83</sup> The fact that shareholder activists have prodded aerospace giant Lockheed Martin to take steps that dramatically improved its score is evidence that these efforts are potentially producing results beyond mere policy changes.<sup>84</sup> Also, while a change in formal policy may have no direct impact on ongoing and future day-to-day decisions, it does give potential future plaintiffs grounds for a lawsuit.

To summarize, shareholder proposals have in fact succeeded in changing corporate behavior in various ways over the past decade, even though they only rarely receive more than a small percentage of the actual vote. They are most effective when they

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the Equality Project, which promotes gay and lesbian shareholder initiatives).

<sup>79</sup> *See id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *See* Quittner, *supra* note 57 (noting that Cracker Barrel claimed it had "always had a strong written policy that prohibits discrimination of any kind in the workplace" even though it had previously issued a memo stating people who did not demonstrate "normal heterosexual values" could not work for the company) (quoting Julie Davis, spokeswoman for Cracker Barrel).

<sup>83</sup> HUMAN RIGHTS CAMPAIGN FOUND., CORPORATE EQUALITY INDEX ON GAY, LESBIAN, BISEXUAL AND TRANSGENDER SOCIAL RESPONSIBILITY 2 (2004), *available at* <http://www.business-humanrights.org/Categories/Miscellaneous/Ratingsindexes/HRCCorporateEqualityIndexUSA> (follow Corporate Equality Index 2004 hyperlink) (stating that the intent of the Index is to be a "road map to equal treatment for GLBT Americans in the workplace and marketplace").

<sup>84</sup> *See* Markowitz, *supra* note 50, at F10.

are coupled with other forms of pressure. When successful, they can potentially contribute to a change not only in formal policy but in the daily practice of firms.

### III. ULTRA VIRES: A BIG STICK

#### A. *Evidence That Ultra Vires Lives*<sup>85</sup>

The incorporation statutes of forty-nine states allow these states to dissolve a corporation or enjoin it from engaging in ultra vires activities—that is, activities outside of the corporation’s authority.<sup>86</sup> Even critics of the ultra vires doctrine acknowledge that these provisions of states’ incorporation laws are based “on the notion that the state had an interest in deterring [ultra vires] activity by virtue of its responsibility to protect the public welfare.”<sup>87</sup>

While the requirement of listing specific corporate purposes and powers was removed from state incorporation laws, the requirement that the corporation’s purposes and activities be “lawful” or “legal” was never removed.<sup>88</sup> The Model Business Corporation Act states that the articles of incorporation shall set forth “[t]he purpose or purposes for which the corporation is organized which may be stated to be, or to include, the transaction of any or all lawful business for which corporations may be incorporated under this Act.”<sup>89</sup> The Revised Model Business Corporation Act establishes that “[e]very corporation incorporated under this Act has the purpose of engaging in any lawful business.”<sup>90</sup>

The first section of the Delaware statute establishes that “[a] corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes.”<sup>91</sup> The New York incorporation statute allows that “[a] corporation may

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<sup>85</sup> For a more comprehensive review of the history of the ultra vires doctrine, see Kent Greenfield, *Ultra vires Lives! A Stakeholder Analysis of Corporate Illegality*, 87 VA. L. REV. 1279, 1302–23 (2001).

<sup>86</sup> See Michael A. Schaeftler, *Ultra vires—Ultra Useless: The Myth of State Interest in Ultra vires Acts of Business Corporations*, 9 J. CORP. L. 81, 85 n.9 (1983). The one exception is North Dakota. See N.D. CENT. CODE § 10-19.1-08 (2001).

<sup>87</sup> Schaeftler, *supra* note 86, at 85.

<sup>88</sup> JAMES D. COX ET AL., CORPORATIONS § 3.6, at 3.15 (1st ed. 1995).

<sup>89</sup> MODEL BUS. CORP. ACT § 54(c) (1969).

<sup>90</sup> REVISED MODEL BUS. CORP. ACT § 3.01(a) (1999).

<sup>91</sup> DEL. CODE ANN. tit. 8, § 101(b) (2001).

be formed under this chapter for any lawful business purpose.”<sup>92</sup> Forty-six states and the District of Columbia have some kind of language in their incorporation statutes limiting corporations to lawful purposes and activities.<sup>93</sup>

It is important to clarify that illegal activities constituted one variety of ultra vires activity during the doctrine's glory days in the 1800s and early 1900s and since then have never been rationalized as permissible as a matter of corporate law, even when profitable. Fletcher's *Cyclopedia of the Law of Private Corporations* explains the traditional notion this way: “[A]n illegal act or contract, defined as one expressly prohibited by the charter or a general statute, or which is immoral or against public policy, is ultra vires and also something more.”<sup>94</sup> “If an act or contract is illegal, . . . it is doubtless ultra vires in the broad

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<sup>92</sup> N.Y. BUS. CORP. LAW § 201 (McKinney 2003).

<sup>93</sup> See ALA. CODE § 10-2B-3.01 (LexisNexis 1999); ALASKA STAT. § 10.06.005 (2004); ARIZ. REV. STAT. ANN. § 10-301 (2004); ARK. CODE ANN. § 4-26-103 (2001); CAL. CORP. CODE § 206 (Deering 2003); COLO. REV. STAT. § 7-103-101 (2004); CONN. GEN. STAT. ANN. § 33-645 (WEST 1997); D.C. CODE ANN. § 29-301.04 (LexisNexis 2001); FLA. STAT. ANN. § 607.0301 (West 2001); GA. CODE ANN. § 14-2-301 (2003); HAW. REV. STAT. ANN. § 414-41 (LexisNexis 2004); IDAHO CODE ANN. § 30-1-301 (1999); 805 ILL. COMP. STAT. ANN. 5/3.05 (West 2004); IND. CODE ANN. § 23-1-22-1 (West 2005); IOWA CODE ANN. § 491.1 (West 1999); KAN. STAT. ANN. § 17-6001 (1995); KY. REV. STAT. ANN. § 271B.3-010 (LexisNexis 2003); LA. REV. STAT. ANN. § 12:22 (1994); ME. REV. STAT. ANN. TIT. 13-B, § 201 (2005); MD. CODE ANN., CORPS. & ASS'NS § 2-101 (LexisNexis 1999); MASS. ANN. LAWS CH. 156, § 6 (LexisNexis 1996); MICH. COMP. LAWS SERV. § 450.1251 (LexisNexis 2001); MISS. CODE ANN. § 79-4-3.01 (2001); MO. ANN. STAT. § 351.386 (West 2001); MONT. CODE ANN. § 35-1-114 (2003); NEB. REV. STAT. § 21-2024 (1997); NEV. REV. STAT. ANN. § 78.030 (LexisNexis 2004); N.H. REV. STAT. ANN. § 293-A:3.01 (LexisNexis 1999); N.J. STAT. ANN. § 14A:2-1 (West 2003); N.M. STAT. § 53-11-3 (2003); N.C. GEN. STAT. § 55-3-01 (2003); OHIO REV. CODE ANN. § 1701.03 (LexisNexis 2004); OKLA. STAT. ANN. TIT. 18, § 1005 (West 1999); OR. REV. STAT. § 60.074 (2003); 15 PA. CONS. STAT. ANN. § 1301 (West 1995); R.I. GEN. LAWS § 7-1.1-3 (1999); S.C. CODE ANN. § 33-3-101 (1990); S.D. CODIFIED LAWS § 47-2-3 (2000); TENN. CODE ANN. § 48-13-101 (2002); TEX. BUS. ORGS. CODE ANN. § 2.001 (Vernon 2001); UTAH CODE ANN. § 16-10A-301 (2001); VA. CODE ANN. § 13.1-626 (1999); WASH. REV. CODE ANN. § 23B.03.010 (West 1994); WIS. STAT. ANN. § 180.0301 (West 2002); WYO. STAT. ANN. § 17-16-301 (2005). The only three states that do not have such language are Minnesota, North Dakota, and Vermont. See MINN. STAT. ANN. § 302A.101 (West 2004) (“A corporation may be incorporated under this chapter for any business purpose or purposes . . .”); N.D. CENT. CODE § 10-19.1-08 (2001) (“A corporation may be incorporated under this chapter for any business purpose or purposes . . .”). Vermont does not have such statutory language. It has specific purposes listed, but the general purposes section—Title 11, §41—was repealed in 1971. VT. STAT. ANN. TIT. 11, § 41 (repealed 1971).

<sup>94</sup> 7A WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 3400, at 10 (perm. ed., rev. vol. 1997) (footnote omitted).

sense as being ‘without power.’”<sup>95</sup>

Courts have held that illegal acts are indeed ultra vires. For example, in *Roth v. Robertson*,<sup>96</sup> the New York Supreme Court held the corporate directors of an amusement park personally liable for “hush money” paid in exchange for assurances that a law prohibiting the operation of their business on Sundays would not be enforced. The payments were “something more than an ultra vires transaction, it was one bad in morals, and so evidently so that the plea that the payment was made for the supposed interest of the corporation cannot be deemed any excuse in law.”<sup>97</sup> The court recognized the difference between acts that are simply ultra vires but not unlawful and acts that are both. In the context of illegal ultra vires acts, the court stated that corporate directors would be required to refund damages to the corporation arising from such an act, even if the shareholder plaintiff had acquiesced in the act.<sup>98</sup> Since then, no one has seriously argued that companies should be authorized in their charter to commit illegal acts. In fact, even proposed limitations to the ultra vires doctrine proposed during the doctrine’s decline still explicitly prohibited acts “repugnant to law.”<sup>99</sup>

Perhaps the best evidence of the continued relevance of ultra vires are companies’ own articles of incorporation. Even a contractarian, who believes in a paradigm whereby companies are nothing more than a “nexus of contracts,” will see that, in drafting their charters, companies have accepted a binding commitment to engage in only legal activities. For example, Unocal’s articles of incorporation state that the “purpose of the corporation is to engage in any lawful act or activity for which a

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<sup>95</sup> *Id.* at 12. In the context of contracts, the status of illegal contracts is clearly settled: “Contracts that are illegal are certainly ultra vires.” *Eckhart v. Heier*, 162 N.W. 150, 151 (S.D. 1917).

<sup>96</sup> 64 Misc. 343, 345, 118 N.Y.S. 351, 353 (Sup. Ct. Erie County 1909).

<sup>97</sup> *Id.* at 343, 118 N.Y.S. at 353.

<sup>98</sup> *See id.* at 345–46, 118 N.Y.S. at 353.

<sup>99</sup> Robert S. Stevens, *A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine*, 36 YALE L.J. 297, 321 (1927). The relevant section reads as follows:

I. A corporation which has been formed under this Act, or a corporation of a class which might be formed under this Act, shall have the capacity to act possessed by an unincorporated association of natural persons.

II. The authority of such a corporation to act shall be limited to the performance of those acts which are necessary or proper for the accomplishment of its purposes and which are not repugnant to law.

*Id.*

corporation may be organized" under California law.<sup>100</sup> Nike, Inc. states in its charter that its purpose is "to engage in any lawful activity for which corporations may be organized" under Oregon law.<sup>101</sup> Ford Motor Company's articles of incorporation list a variety of business purposes that the company may engage in, including the manufacture and sale of automobiles. The articles also state that the company is empowered "[t]o do everything necessary, suitable or proper for the accomplishment of any purpose . . . hereinbefore set forth," and additionally "to do every other act or thing incidental or appurtenant to or growing out of or connected with the aforesaid business or purposes, objects or powers, . . . provided the same be not inconsistent with the laws under which the corporation is organized."<sup>102</sup> General Electric's charter states that the corporation's purposes include "any activity which may promote the interests of the corporation, or enhance the value of its property, to the fullest extent permitted by law, and in furtherance of the foregoing purposes to exercise all powers now or hereafter granted or permitted by law."<sup>103</sup> Philip Morris is incorporated "to transact any lawful business."<sup>104</sup>

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<sup>100</sup> Union Oil Co. of Cal., Restated Articles of Incorporation, art. II (June 29, 1994).

<sup>101</sup> Nike, Inc., Restated Articles of Incorporation, art. III (Sept. 23, 2005).

<sup>102</sup> Ford Motor Co., Restated Certificate of Incorporation, art. III, § 13 (Aug. 2, 2000).

<sup>103</sup> Gen. Electric Co., Certificate of Incorporation, § 2D (Apr. 27, 2000).

<sup>104</sup> Philip Morris Cos. Inc., Restated Articles of Incorporation, art. II (Mar. 18, 1997). In addition, Sears, Roebuck & Company's charter states that the purposes of the corporation are, *inter alia*, "[t]o engage in any activity which may promote the interests of the Corporation, or enhance the value of its property, to the fullest extent permitted by law." Sears, Roebuck & Co., Restated Certificate of Incorporation, art. II, § 2.2 (May 13, 1996). Moreover, Boeing's charter states that "[t]he nature of the business, or objects or purposes to be transacted, promoted, or carried on, are those necessary to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of the State of Delaware." The Boeing Co., Restated Certificate of Incorporation, art. III (Aug. 14, 1997). IBM's certificate of incorporation explains that the purpose of the corporation "is to engage in any lawful act or activity for which corporations may be organized" under New York law. Int'l Bus. Mach. Corp., Certificate of Incorporation, art. II (Apr. 28, 1999). Raytheon Company states in its charter that "[t]he purpose of the Corporation shall be to engage in any lawful act or activity for which corporations may be organized and incorporated under the General Corporation Law of the State of Delaware." Raytheon Co., Restated Certificate of Incorporation, art. III (May 5, 2005). Columbia Hunter Capital Corporation is organized "to engage in any lawful act or activity for which corporations may be organized" under Delaware law. Columbia Hunter Capital Corp., Certificate of Incorporation, art. III (Oct. 19, 2000). Sprint Corporation "is organized for profit, and the purpose for which it is formed is

*B. Reasons for Pursuing an Ultra Vires Lawsuit*

There are several advantages to choosing an ultra vires suit to influence corporate behavior. First, there is no ambiguous standard or difficult threshold to hurdle, such as certifying a class action lawsuit or rallying a minimum number of shareholders to support a shareholder proposal. A single shareholder owning a few shares of a company may sue to enjoin an activity.<sup>105</sup>

Second, there are fewer unforeseeable contingencies and fewer evidentiary burdens than in a class action litigation; since there is a lower risk of failure and lower costs associated with the initial stages of the suit, a relatively smaller financial commitment is required. Therefore, the main questions for the plaintiff shareholder's attorney are whether there is sufficient evidence to prove that the company is engaging in illegal activity and what equitable remedies should be requested from the court.

Third, the remedies allowed for in all states except North Dakota are either equitable relief (including injunctions) or the dissolution of the company.<sup>106</sup> In other words, in its most extreme theoretical application, a violation of the ultra vires doctrine would empower courts to impose a "death sentence" on corporations that, for example, were engaging in ongoing and severe violations of law. On a more moderate level of application, a court could be asked to enjoin the illegal conduct<sup>107</sup> or to exercise its powers in equity and order the company to achieve certain benchmarks or engage in certain remedial or preventative programs to prevent further illegalities. As the ALI's Principles of Corporate Governance state in section 2.01: "[T]he corporation, in the conduct of its business . . . [i]s obliged, to the same extent as a natural person, to act within the

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to engage in any lawful act or activity for which corporations may be organized" under Kansas law. *Sprint Corp.*, Articles of Incorporation, art. II (Apr. 28, 2000). Nabisco states that its purpose "is to engage in any lawful act or activity for which corporations may be organized" under Delaware law. *Nabisco Group Holdings Corp.*, Restated Certificate of Incorporation, art. III (June 16, 1999).

<sup>105</sup> *Dodge v. Woolsey*, 59 U.S. (18 How.) 331, 343 (1855); see *infra* note 107.

<sup>106</sup> See *Greenfield*, *supra* note 85, at 1359.

<sup>107</sup> See, e.g., *Hoole v. Great W. Ry.*, 3 L.R.-Ch. 262, 266-67 (Ch. App. 1867) (holding that an individual shareholder can bring suit to enjoin an ultra vires act); *Beman v. Rufford*, 61 Eng. Rep. 212, 218 (V.C. 1851) (holding that non-assenting shareholders can sue even when the majority of shareholders ratified the act).

boundaries set by law.”<sup>108</sup> The comment to that section clarifies that “[t]he appropriate vehicle to remedy an alleged violation of the principles stated in § 2.01 would be an action for injunctive or other equitable relief by a shareholder.”<sup>109</sup> As the United States Supreme Court has ruled, “beyond the limits of the act of incorporation, the will of the majority cannot make an act valid; and the powers of a court of equity may be put in motion at the instance of a single shareholder.”<sup>110</sup> The power to order a company to change a pattern of behavior is one advantage that an ultra vires suit offers in comparison to a shareholder proposal to change policy.

Unlike a typical shareholders’ derivative suit, no showing would have to be made that a demand was made to directors to act or that such a request would be obviously fruitless.<sup>111</sup> Unlike a shareholder suit seeking to hold directors accountable for breaching a duty of care, no showing of a financial loss to the company would be required.<sup>112</sup> Unlike a derivative case attempting to recover damages from directors, the proof that some monitoring system was in place would not absolve the directors from liability.<sup>113</sup>

### *C. Obstacles To Winning an Ultra Vires Suit*

The two obstacles to success in an ultra vires lawsuit would be producing evidence that a company is presently engaging in unlawful conduct and then convincing the judge to use the court’s powers in equity to enforce the relevant law by requiring action or the cessation of action by the company. Significantly, the profitability or lack of profitability of an illegal act is irrelevant and therefore does not represent an obstacle of any kind.

In the context of employment discrimination, class action

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<sup>108</sup> PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(b)(1) (1992).

<sup>109</sup> *Id.* § 2.01 cmt. j.

<sup>110</sup> *Dodge*, 59 U.S. (18 How.) at 343.

<sup>111</sup> See generally *Marx v. Akers*, 88 N.Y.2d 189, 666 N.E.2d 1034, 644 N.Y.S.2d 121 (1996) (detailing the universal demand approach and the demand/futility approach).

<sup>112</sup> See *Miller v. AT&T*, 507 F.2d 759, 763 (3d Cir. 1974) (denying a motion to dismiss on the ground of plaintiffs’ sufficient allegation of actual corporate loss).

<sup>113</sup> See *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996) (noting that the burden of proof for plaintiffs seeking to hold directors liable is quite high when evidence of a reporting system exists).

lawsuits have demonstrated that it is possible to meet the threshold requirement of aggregated evidence of discrimination, even when human resources management is decentralized.<sup>114</sup> Statistics about under-representative composition of upper corporate management are well known and suggest that similar patterns of discrimination could be proven at many corporations. For example, a 2002 survey found that 82% of the director positions on Fortune 1000 companies were held by white men, 11% by white women, 3% by African Americans, 2% by Asian Americans, and 2% by Hispanics.

In general, both labor law violations and illegal discrimination are under-reported to government watchdogs. For example, the U.S. Department of Labor, charged with enforcement of child labor, wage, and hour provisions of federal labor law, cited only 104 cases of child labor violations in fiscal year 1998, even though an estimated one million child labor violations occur in U.S. agriculture every year.<sup>115</sup> While the lack of perfect information on employment law violations is an obstacle to bringing an ultra vires suit, facts such as these may be seen instead as indicative of an opportunity. Groups of shareholders and institutional investors<sup>116</sup> are increasingly eager to wield their power to influence corporate behavior. The activism of shareholders coupled with a powerful, unused doctrinal tool in the face of unchecked legal violations should logically result in multiple opportunities and contexts in which to prove that the ultra vires doctrine can truly impact corporate behavior to the benefit of all stakeholders. Even shareholders not concerned with the ethics of a pressured company would arguably benefit in the long run when their company ceases or avoids conduct that could lead to fines or tort claims in the future.

#### *D. Limitations of Using Ultra Vires*

The key limitation to the ultra vires doctrine is that it will

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<sup>114</sup> See *Dukes v. Wal-Mart Stores Inc.*, 222 F.R.D. 137, 145, 150, 160 (N.D. Cal. 2004).

<sup>115</sup> HUMAN RIGHTS WATCH, WORLD REPORT 2001: UNITED STATES: HUMAN RIGHTS DEVELOPMENTS (2001), available at <http://www.hrw.org/wr2k1/usa/#labor>. Compounding the problem, "penalties were typically too weak to discourage employers from using illegal child labor." *Id.*

<sup>116</sup> See discussion *supra* Part II.A.



work only when a corporation is violating a law in a jurisdiction where it is engaged in a business activity. Once that is established, however, an *ultra vires* suit can be brought in the state where the company is incorporated to enforce, in effect, the law of the jurisdiction where the lawbreaking is occurring.<sup>117</sup> For example, Nevada has a state law banning employment discrimination in both the public and private sectors. Therefore, a single shareholder with proof of discriminatory treatment of homosexuals by Wal-Mart in Nevada could sue in a Delaware court (where Wal-Mart is chartered) and ask for equitable relief of the situation. The key limitation of the other evaluated methods—namely, the difficulty or impossibility of bringing about actual change in corporate conduct—should be less of a problem in the context of an *ultra vires* lawsuit because equitable relief is, by the nature of the claim, the focus of the remedy.<sup>118</sup>

### CONCLUSION

Studying attempts to alter corporate behavior in the context of employment discrimination over the past decade yields several key insights that activists and shareholders can learn from and can apply to other contexts.

First, class actions are increasingly difficult to have certified by a court due to the Supreme Court's 1997 decision that adequacy of representation must be rigorously scrutinized. Furthermore, while class actions have historically held the promise of equitable relief—that is, the possibility to win a court order that a company take concrete steps to achieve specific future goals—that outcome is no longer frequently pursued nor achieved. There is also evidence that even on an individual level, plaintiffs may recover more monetary compensation with an individual action. Finally, even very large settlements do not impact the bottom line sufficiently to affect share prices at either the time of the lawsuit's filing or at the time of settlement. Therefore, class actions during the past decade of antidiscrimination activism appear to be limited in both their theoretical ability to deter undesirable behavior and in their practical ability to lead a company in a certain direction.

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<sup>117</sup> Cf. Greenfield, *supra* note 85, at 1372 (stressing that the *ultra vires* doctrine renders an illegal corporate act unlawful in any jurisdiction, not simply where the company is incorporated).

<sup>118</sup> See *supra* Part I.C.

Second, shareholder proposals are an increasingly frequent means for shareholder activists to prod corporate policy in a certain direction. While it is still not easy to mobilize a campaign on such a large scale, at least SEC regulations now allow proposals that affect areas that were previously in the exclusive purview of directors. The problem with shareholder proposals is that while they may succeed in changing formal policy, a shareholder proposal is inherently incapable of mandating specific enforceable goals or activities.

As the case of Cracker Barrel illustrates, shareholder proposals and lawsuits, supplemented by strategies from outside the realm of corporate law such as boycotts and coordinated negative publicity, have together managed to change policies at some large recalcitrant companies. On the other hand, these struggles have taken a decade of concerted, focused effort to achieve results, and it remains an open question whether the formal policy alterations that have been implemented will result in actual changes in the day-to-day conduct of these corporations.

Therefore, class action lawsuits are like a bridle: conceivably useful to lead a corporation in a specific direction through the use of equitable remedies, but they are unwieldy. Shareholder actions are like a prod for nudging a corporation in a vague direction, but that nudging will not necessarily result in predictable, specific steps.

While no one likes to beat a recalcitrant animal, in situations where a corporation engages in an ongoing, undeterred pattern of illegal conduct, it is good to know that there is also a stick in the tool shed. It is important to emphasize once again that ultra vires suits can be initiated by either states' attorneys general or shareholders. This Article has analyzed the ultra vires doctrine from the perspective of shareholder activists rather than the perspective of state law enforcement. Unlike a shareholders' derivative action, no proof of loss of profitability is needed to win at trial. Just evidence of ongoing illegal acts should be enough to win a judgment.

As discussed, the dissolution of the company is one available remedy, albeit an extreme and unlikely outcome. Given the choice, when confronted with a persistent pattern of illegal conduct, a court will be more likely to order—and the company more likely to accept—a remedy in equity. A basic tenet of equitable relief is that a court can tailor a remedy to a situation,

require that specific steps be taken, provide mechanisms for measuring outcomes, and enforce ongoing accountability to the court.

Obviously, many questions about the pursuit of an ultra vires lawsuit cannot be answered with complete certainty until a case is filed. Courts have dealt with questions surrounding the mechanics and implementation of various doctrines for centuries on a case-by-case basis, however, and a revival of the ultra vires doctrine will prove to be no exception.