A Trip Through the Maze of "Corporate Democracy": Shareholder Voice and Management Composition

Thomas W. Joo
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THOMAS W. JOO†

INTRODUCTION

According to a common American myth, shareholders govern corporations through a process of corporate democracy. Even the Supreme Court labors under this misconception.¹ In fact, corporate law gives the board of directors power to manage the corporation and authorizes them to delegate much of this power to executives whom they appoint. Moreover, corporate law also limits shareholders' ability to choose and elect directors; instead, it gives directors themselves primary control over board membership.² This Symposium explores the intersection of race and corporate law. In light of the great power of corporate directors and executives, the lack of diversity in their ranks is a salient issue. This Article assesses the potential for shareholders to use their voice in corporate governance to increase diversity in upper management. The Article pays particular attention to corporate governance reforms proposed or enacted in response to the recent rash of corporate scandals such

† Professor, University of California, Davis, School of Law. This Article was prepared for the 2003 St. John's University School of Law Ronald H. Brown Center for Civil Rights and Economic Development/Northeast People of Color Legal Scholarship Conference. An earlier version was presented at the 2003 Western Law Teachers of Color/Conference of Asian Pacific American Law Faculty Joint Conference. I would like to thank the organizers of and participants in both those conferences. Charles Yu and Wendy Motooka provided indispensable research assistance for this Article. This Article was supported by a research grant from the UC Davis School of Law. © 2003 Thomas W. Joo.


² See infra Parts II.B, III.C.
as the collapse of the Enron Corporation. The new measures hardly usher in a golden age of shareholder empowerment, but they may provide some useful tools for shareholder activists.

Part I of this Article discusses the lack of diversity among corporate directors and the executive officers they appoint. Although American corporations have recently made numerous pronouncements in favor of diversity, they have been slow to diversify their highest ranks. People of color make up a growing proportion of corporations' labor force but not of their directorial and executive class. Part I also introduces various arguments that diversity is not only a racial justice issue but also contributes to better management decision making and greater shareholder wealth.

The insulated, homogeneous oligarchies of corporate boards may pose special obstacles to diversity. Part II discusses the tendency of these types of institutions to perpetuate their own homogeneity. It then goes on to explain how corporate law empowers directors to control the makeup of the board. The doctrine of unilateral director power over board composition reduces the likelihood that questions will be raised about the behavioral bias toward homogeneity and thus helps perpetuate the cycle of homogeneity.

As Professor Ramirez points out in this Symposium, the governments of Norway and Israel have addressed the issue of gender imbalance on corporate boards by requiring a minimum number of women board members. The merits of such a system aside, it is unlikely that the United States will impose similar legal requirements in the foreseeable future. The Supreme Court's recent opinion on affirmative action specifically rejected diversity quotas as unconstitutional in public university admissions. Moreover, as a general matter, corporate board composition is typically characterized as a private law matter between shareholders and management. As a result, corporate law purports to limit itself to procedure rather than substance.

Against this legal and political background, government-mandated quotas for business corporations are hardly likely.

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Thus diversity activists cannot reasonably expect any significant legal mandates concerning corporate board composition. They will most likely have to seek change through the exercise of shareholder voice in individual corporations. Many governance reforms have been enacted or are under consideration in response to the current stock market slump, the Enron scandal, and similar disasters. Even as the political climate becomes relatively amenable to regulation, however, race remains taboo. Thus, the only realistic potential for achieving diversity lies in navigating, and perhaps reforming, the race neutral procedural rules governing the shareholder role in corporate governance.\footnote{5}

As Part II.B explains, the traditional corporate governance regime is heavily slanted in favor of management continuity and discourages active shareholder involvement in choosing board members. Part III examines various ways in which shareholders might attempt to push for board diversity under the traditional corporate governance system, recent reforms, and recently proposed reforms. Recent and pending reforms include board independence requirements imposed under the Sarbanes-Oxley Act, similar requirements proposed by the New York Stock Exchange, and proxy voting reform proposed by the Securities and Exchange Commission. Part III reviews and critiques the potential of these reforms to increase shareholder voice generally and particularly in the context of attempts to increase diversity on corporate boards. The new reforms do not promise any earthshaking changes, but they may provide some increased opportunities for the exercise of shareholder voice in board composition.

\footnote{5 This Article focuses on corporate law, though employment discrimination law may hold some potential. Discrimination lawsuits by executives or potential board candidates would be unlikely "not only because they are so difficult to win and impossible to finance, but also because any potential plaintiff is afraid of being negatively affected in her search for jobs elsewhere." Martha S. West, \textit{Gender Bias in Academic Robes: The Law's Failure to Protect Women Faculty}, 67 TEMP. L. REV. 67, 156 (1994) (critiquing the treatment of women plaintiffs in the university context). If boards' conduct rises to the level of illegal discrimination, however, it may give shareholders a cause of action. See Leonard Baynes, \textit{Racial Stereotypes, Broadcast Corporations, and the Business Judgment Rule}, 37 U. RICH. L. REV. 819, 872 (2003). Whether employment discrimination law applies to corporate director nominations is an unsettled question beyond the scope of this Article.}
I. THE LACK OF DIVERSITY IN UPPER MANAGEMENT

Corporate America has been singing the praises of diversity of late. Corporate support for affirmative action in the recent *Grutter* and *Gratz* Supreme Court cases was perhaps the most high-profile example. A recent study by the Conference Board—a group of the business world’s ultra-elite—found that corporate executives and investors alike claimed to believe that diversity is “a key part of good governance.” The sincerity of the corporate commitment to diversity is, however, open to doubt. While America’s workforce is rapidly becoming browner, America’s corporate boardrooms and executive suites are not.

While *Grutter* and *Gratz* were before the Court, sixty-five major domestic corporations, including 3M, Boeing, Microsoft, and Nike, submitted an *amicus* brief in support of the University of Michigan’s affirmative action policies. The brief argued that diversity in higher education is a compelling government interest because of the “crucial role [it] plays in preparing students to be the leaders this country needs in business, law, and all other pursuits that affect the public interest.” In short, the corporations argued that diversity in higher education improves the diversity and quality of the labor pool.

The corporate *amicus* brief celebrated the minority composition of Microsoft’s work force; it stated that the minority composition of Microsoft’s workforce has expanded from 16.8% to 25.6% between 1997 and 2003. The brief did not say, however, whether minority workers at Microsoft are represented across the spectrum of positions or whether they are disproportionately assigned to low-wage jobs, as they generally are in the economy. As one commentator writes, “African Americans with the same level of education as whites continue to earn substantially less. Blacks continue to occupy proportionally fewer managerial positions and proportionally greater service and unskilled labor positions.”

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6 *See* Brief for Amici Curiae 65 Leading American Businesses in Support of Respondents, *Grutter, Gratz* (Nos. 02-241 and 02-516) [hereinafter *Amicus Brief*].


8 *Amicus* Brief, *supra* note 6, at 2.

In 2002, African Americans made up about 10.9% of the overall workforce of the United States but only about 8% of the information technology (IT) workforce.\textsuperscript{10} Moreover, among blacks in the IT workforce, approximately 39% held administrative positions such as data entry keyer or computer operator, rather than highly skilled jobs that involve programming, engineering, or research.\textsuperscript{11} The figure was roughly the same for Hispanics but only 22% for whites.\textsuperscript{12}

Moreover, the \textit{amicus} brief did not say anything about diversity among the directors and top executives of Microsoft or any other corporation. Job opportunities for minorities is of course desirable. Celebrating labor diversity while ignoring director and executive diversity, however, is not only hypocritical but also ominous. The glass ceiling for professionals obviously does not implicate issues of poverty and survival, but it does raise issues of distributive justice. To some extent, the browning of the workforce, especially the less-skilled sector, is attributable to the fact that employers can pay lower wages to nonwhite immigrants from developing countries, and a primarily white executive class governs this increasingly brown labor class.

Of course, it is commonly argued that corporations should be more concerned about shareholder value than social justice, but even those who value corporate earnings more than racial fairness should be concerned about executive and board diversity. If diversity contributes to a more productive workforce, as corporations seem to acknowledge, it seems to follow that it should also make for good leadership. One recent empirical study found that increased firm value correlates with board diversity.\textsuperscript{13} Based on an extensive review of organizational


\textsuperscript{11} \textit{Id.} at 13 tbl.3.

\textsuperscript{12} \textit{Id.}

\textsuperscript{13} See David A. Carter et al., \textit{Corporate Governance, Board Diversity, and Firm Value}, 38 \textit{FIN. REV.} 33, 50–51 (2003). \textit{But see} Dallas, \textit{supra} note 7, at 1403 n.181. Dallas notes:

Studies of corporate boards of directors that seek to correlate gender and ethnicity to corporate performance are not very useful because most corporate boards, which contain twelve members on average, usually have only one female or minority member who is unlikely to be able to influence significantly board decision making.

\textit{Id.}
behavior scholarship, Lynne Dallas has cited several advantages to heterogeneous boards.\textsuperscript{14} Dallas argues that heterogeneous groups, by bringing together a wide range of viewpoints, excel in “complex decision making requiring creativity and judgment.”\textsuperscript{15} Diverse directors may also engage in more rigorous decision making and monitoring processes because of their varying and sometimes conflicting perspectives.\textsuperscript{16} For example, they may be more likely to actively monitor one another,\textsuperscript{17} to make decisions by considered discussion and negotiation rather than by consensus,\textsuperscript{18} and to consider counterarguments.\textsuperscript{19} They may be less likely to be overconfident\textsuperscript{20} and less likely to take extreme positions. All these tendencies toward greater care are particularly relevant concerns in the wake of the Enron collapse and related scandals, as well as the dot.com meltdown that preceded them. Yet diversity continues to lag.

Take Microsoft again, for example. Microsoft’s website has photos of its eight directors, six of whom appear to be white men, one of whom appears to be a white woman, and one of whom appears to be a black man.\textsuperscript{21} Its website has biographies of ninety-six executives, with photos for eighty-four of them. The vast majority appear to be white men. There are nine who appear to be racial minorities, all of them apparently of East Asian, South Asian, or Arab descent,\textsuperscript{22} except for one senior vice president.\textsuperscript{23}

\textsuperscript{14} Dallas, \textit{supra} note 7, at 1388–1405.
\textsuperscript{15} Id. at 1391.
\textsuperscript{16} See id. at 1399–1403.
\textsuperscript{17} See id. at 1400–01.
\textsuperscript{18} See id. at 1401.
\textsuperscript{19} See id. at 1402.
\textsuperscript{20} See id.
\textsuperscript{22} See Microsoft Press Pass: Information for Journalists, Microsoft Executives, at http://www.microsoft.com/presspass/exec/default.asp (Aug. 15, 2003). With respect to some of these individuals, it is unclear whether they are Asian Americans or foreign nationals directing foreign operations.
\textsuperscript{23} This executive, Orlando Ayala, is identified in a news story on his biography page as “Microsoft’s highest-ranking Hispanic executive.” See Microsoft Press Pass: Information for Journalists, Microsoft Executive Encourages Hispanic Students to Explore High-Tech Careers, at http://www.microsoft.com/presspass/features
I choose Microsoft as an example here not because Microsoft's board and management are especially lagging in terms of diversity but because the Grutter amicus brief touts the firm's diverse workforce. Indeed, Microsoft's upper echelon is actually among the more diverse in corporate America. As Professor Ramirez points out in this Symposium, African Americans and Latinos make up 30% of the population of the United States but only 4.1% of the directors of Fortune 1000 corporations. According to Forbes.com, about 5% of corporate directors are black. Furthermore, about 90% of Fortune 1000 senior executives are white men.

The number of people of color involved at the board level is even lower than these figures suggest because a small pool of individuals occupy the "minority seat" on multiple corporate boards. The average white director serves on 1.7 boards, while the average non-white director serves on 2.2 boards. One important recruiter of director and executive candidates believes that major American corporations think these few individuals are "the only qualified minority candidates to do the job." Two African Americans, Shirley Jackson, the president of Rensselaer Polytechnic Institute, and William Gray III, president of the United Negro College Fund, each sit on eight boards, more than any other individual, black or white. This overlap not only means that diversity on corporate boards is overstated but also suggests that many directors of color are mere figureheads who are too overextended to play a significant role in corporate management. Institutional investors have leveled this charge at Washington insider Vernon Jordan, who sits on a long list of

1998/11-6ayala.asp (Nov. 6, 1998).
24 Ramirez, supra note 3 (citing Gary Strauss, Good Old Boys' Network Still Rules Corporate Boards; Ethnic Members Scarce, and Gains Happen Slowly, USA TODAY, Nov. 1, 2002, at B1).
25 Id.
28 Ackman, supra note 26.
major boards including Dow Jones, American Express, and Xerox.30 As one critic quipped, "Jordan is so busy that having him on your board suggests that at least one director will not be in a position to cause you any trouble."31

Furthermore, corporate reliance on a tiny pool of minority directors may reduce the value of minority directors. Although a minority director may be especially qualified to inject racial sensitivity into corporate decision making, she may be unable to have an effect if she is the only person of color on the board. Boards often have only one minority member. Without a critical mass of persons of color on the board, a lone diverse perspective may be drowned out or ignored by a chorus of homogenous voices.32

II. FACTORS MILITATING AGAINST MANAGEMENT DIVERSITY

A. Homogeneity Begets Homogeneity

It might be argued that due to the competitive pressure of the marketplace, corporations are forced to seek out the best directors and executives. Thus, it might be expected that pointing out the material benefits of diversity would lead directors to pursue diversity on their own. The organizational literature on the benefits of heterogeneous groups has long been available, however, and it has had little effect on diversity.

It is unrealistic to expect boards to see the light and diversify themselves. Homogeneous institutions tend to replicate themselves with homogeneous successors. In her classic study of the corporate power structure, Rosabeth Kanter explained homogeneity as a basis for trust in an uncertain corporate world. Placing someone in a managerial position means placing trust in that person's discretion and thereby creating certainty. In the corporate world, individuals lack significant personal knowledge of one another and thus tend to base their trust on "outward manifestations."33 As Kanter writes:

It is the uncertainty quotient in managerial work... that

31 Fisher, supra note 29 (quoting business school professor Graef Crystal).  
32 See Dallas, supra note 7, at 1403-05.  
causes management to become so socially restricting: to develop tight inner circles excluding social strangers; to keep control in the hands of socially homogeneous peers; to stress conformity ... and to prefer ease of communication and thus social certainty over the strains of dealing with people who are “different.”

... The greater the uncertainty, the greater the pressures for those who have to trust each other to form a homogenous group.\textsuperscript{34}

In less formal terms, “[g]etting on a board is like being invited into a secret club.... There’s a collegiality that’s required, so you aren’t going to be invited in unless you’ve demonstrated that you can work within the system and the club.”\textsuperscript{35}

Although heterogeneity can enhance group decision making, it can also undermine the cohesiveness of a group.\textsuperscript{36} Despite potential long-term gains from workplace diversity, behavioral research also suggests, rather unsurprisingly, that individuals are attracted to, and more likely to trust, persons whom they perceive to be similar. Race is one of the characteristics that define similarity.\textsuperscript{37} Lynne Dallas suggests that effective groups require a balance between the spark provided by heterogeneous viewpoints and the group cohesiveness provided by homogeneity.\textsuperscript{38}

Recent corporate law scholarship has applied the theme of trust in the context of upper management\textsuperscript{39} but has not applied

\textsuperscript{34} Id. at 49.


\textsuperscript{37} Carbado & Gulati, supra note 36, at 1795–96.

\textsuperscript{38} Dallas, supra note 7, at 1393–94.

\textsuperscript{39} See generally Carbado & Gulati, supra note 36, at 1789 (citing Stephen M. Bainbridge, Why a Board? Group Decisionmaking in Corporate Governance, 55 VAND. L. REV. 1 (2002); Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 VA. L. REV. 247 (1999); Neal Kumar Katyal,
it critically to the lack of racial diversity among directors and executives. Devon Carbado and Mitu Gulati, however, have applied it in the related context of employment law. They argue that the pursuit of a harmonious atmosphere may contribute to racial bias in hiring and other employment practices. Carbado and Gulati posit that despite the benefits of diversity, managers may prefer racial homogeneity because they tend to be short-run oriented, and homogeneity makes it easier to establish group cohesiveness in the short-run. Similar reasoning may apply to corporate boards, particularly as investor demand for short-run performance has increased in recent years.

To the extent that homogeneity breeds homogeneity, director homogeneity contributes to executive homogeneity because directors control the appointment of executive officers. In addition, director homogeneity perpetuates itself in two ways. First, the corporate executives appointed by the board make up the pool of the firm's inside director candidates and also dominate the outside directorships for other corporations. Second, and more directly, incumbent directors choose their successors in most situations. This will be explained below. This closed system sets up a cycle of homogenous self-replication, whether conscious or unconscious.

B. Director Control over Board Elections and Executive Appointments

The formal structure of corporate governance envisions a kind of republican democracy in which shareholders vote for directors. If shareholders elect directors, how does directors' bias toward homogeneity determine the composition of the board? Despite the formal trappings of "corporate democracy," directors have far more power over election outcomes than shareholders

40 See id. at 1789–90.  
41 Id. at 1793–94.  
42 The majority of outside directors at major corporations are top executives from other major corporations. See JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 18 (1989); Charles M. Elson, Director Compensation and the Management-Captured Board—The History of a Symptom and a Cure, 50 SMU L. REV. 127, 158 n.117 (1996); Laura Lin, The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and Evidence, 90 NW. U. L. REV. 898, 915 n.93 (1996).
At election time, the incumbent board typically nominates a slate of candidates without input from shareholders. Furthermore, the management slate usually runs unopposed. As will be discussed in detail below, corporate law discourages shareholders from mounting opposition campaigns.\footnote{See Joo, supra note 1, at 44-45.}

Without a choice of candidates, a dissatisfied shareholder may choose to withhold her vote on the slate, but she cannot cast a vote against incumbent directors.\footnote{See infra Part III.c.2.} Withholding one’s vote is a futile gesture because election to the board does not require a majority vote of shareholders but only a plurality of the votes cast once a quorum is met.\footnote{See Joo, supra note 1, at 44.} Thus, in an uncontested election, the incumbent board’s nominees are guaranteed to be elected, regardless of the number of votes withheld by shareholders.\footnote{See \textsc{Del. Code Ann. tit. 8, § 216(3) (2001).} Unless otherwise specified in the corporate charter or bylaws, a majority of shares constitutes a quorum. See § 216(1).} In short, “shareholders in public corporations do not in any realistic sense elect boards. Rather, \textit{boards elect themselves.}”\footnote{See SEC Div. of Corp. Fin., Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors 12 (2003) [hereinafter SEC Staff Report].} The recent wave of corporate scandals has given rise to many attempts to reform corporate governance. Some of the proposed and actual reforms may chip away at the entrenchment of incumbent directors and increase board turnover over the next few years. Some commentators believe the increased turnover could create opportunities for minority board candidates.\footnote{See Blair & Stout, supra note 39, at 311.} For example, under the Sarbanes-Oxley Act and proposed NYSE rule changes, directors will have to meet enhanced requirements of independence and financial expertise. One study of Fortune 1000 corporations found that as the number of inside directors—directors who are also officers of that corporation—on a corporation’s board increases, the proportion of women and

\footnote{See Strauss, supra note 35.}
minorities on the board decreases. This suggests that the new rules requiring outside directors may increase the number of minority directors.

In theory, board turnover may create opportunities for minority directors. These particular reforms, however, will probably have only a limited effect on turnover. For example, the Sarbanes-Oxley Act requires corporations to have an audit committee made up of independent directors. Most of America's major corporations already have independent audit committees, however, because the NYSE and NASDAQ already impose the same requirement. Because the exchange rules are stricter than those in the securities laws, they are more likely to have an effect on turnover. The NYSE has proposed a stricter definition of directorial "independence," as well as a requirement that the majority of the entire board be independent. The NYSE proposal also requires boards to establish independent compensation and nominating committees. The actual effect of these rule changes on turnover is unclear, however. According to the Investor Responsibility Research Center, over 85% of corporations in the S&P 1500 have majority-independent boards. The extent of the turnover effect will depend on how many of these currently independent directors will fail to satisfy the NYSE's new definition.

50 See Carter et al., supra note 13, at 50. This is, of course, consistent with the dearth of high-ranking minority executives.
51 See id. Note, for example, that neither Shirley Jackson nor William Gray III, America's most sought-after directors, is a business executive.
53 NASD MANUAL § 4350(d)(2) (2002); NYSE LISTED COMPANY MANUAL § 303.01(B)(2) (1999).
55 Id. at 9–11.
Moreover, while turnover and independence requirements will create opportunities, they will not necessarily lead to greater diversity by themselves. As long as incumbent boards retain control of the nomination process, homogeneous boards will continue to fill vacancies with replicas of themselves. The only specific reform currently pending that directly addresses the nomination process is the NYSE's proposed requirement of a nominating committee made up exclusively of independent directors. Shareholders seeking corporate reform should not, however, place excessive reliance on independent directors. Incumbent independent directors are likely to renominate themselves, and there is no strong reason to believe that they will replace incumbent inside directors in the interest of diversity. Director independence does not guarantee fidelity to shareholder interests as a general matter, and it certainly does not guarantee greater sensitivity to diversity concerns.

III. POTENTIAL TOOLS FOR CHANGE

A. Corporate Law Litigation

It is unlikely that shareholders have a cause of action against directors who fail to diversify the board. A fundamental principle of state corporate law holds that directors, not shareholders, manage the corporation. Delaware's General Corporation Law, for example, states that “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors.” Thus, even if a majority of shareholders were to demand that the board nominate a more diverse slate of director candidates, the demand would be unenforceable.

As noted above, many organizational theorists and commentators have argued that diversity improves corporate performance. Directors’ failure to maximize corporate performance, however, does not by itself give shareholders a cause of action. Directors owe a duty of care to shareholders.

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57 NYSE REPORT, supra note 54, at 9. As will be discussed below, the SEC has proposed increasing shareholder's ability to nominate directors. See infra Part IV.c.2.
59 DEL. CODE ANN. tit. 8, § 141(a) (2001).
Although this duty of care is sometimes said to incorporate a “duty” to enrich shareholders, this “duty” is largely unenforceable. The duty of care is qualified by the so-called business judgment rule. Under this rule, courts do not evaluate directors’ business decisions under ordinary negligence principles but under a more deferential standard.

The business judgment rule is often interpreted to mean that shareholders may not attack the substance of directors’ business decisions but may only question the board’s decision-making procedures. *Smith v. Van Gorkom*, one of the leading cases on the issue, requires directors to inform themselves before making business decisions. Leonard Baynes has advocated an aggressive approach to the duty of care in diversity issues based on this requirement. Baynes argues that directors of broadcast corporations might be liable for breach of the duty of care for failing to provide more programming that features and is aimed at minorities. According to Baynes, the boards’ decisions not to create minority programming do not deserve the protection of the business judgment rule because neither directors nor the officers and employees on whom they relied had fully informed themselves about the value of the minority broadcast audience.

It is difficult to predict the success of duty of care litigation. Baynes’s argument may be logical, but the case law applying the duty of care and business judgment rule is less so. Courts only rarely find directors liable for breaches of the duty of care. Recent case law has been encouraging, however. The Delaware Court of Chancery recently found that plaintiffs sufficiently pleaded a breach of the duty of care where they alleged facts suggesting that the directors failed to “act in good faith and meet minimal proceduralist standards of attention.” In that case,

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63 Baynes, supra note 5, at 875. Cf. Steven A. Ramirez, Diversity in the Boardroom, 6 STAN. J. L. BUS. & FIN. 85, 128 (2000) (“The board has a duty to exercise ordinary care in overseeing the corporation. This duty, quite clearly, encompasses diversity management.”).
64 See, e.g., Gevurtz, supra note 61, at 279 (stating that “the phrase ‘the business judgment rule’ has a number of different, and conflicting, meanings”).
65 See In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 278 (Del. Ch. 2003).
66 Id.
Disney shareholders made a series of specific factual allegations regarding hasty and uninformed decision making in connection with the compensation and termination of Michael Ovitz as company president. According to the court, "Allegations that Disney's directors abdicated all responsibility to consider appropriately an action of material importance to the corporation puts directly in question whether the board's decision-making processes were employed in a good faith effort to advance corporate interests."67

The Disney case provides useful guidance for shareholders who might try to craft a pleading adapting Baynes's argument to the board diversity context. An allegation of breach of care requires specific factual allegations. The original complaint in Disney was filed in 1997.68 The Delaware Supreme Court dismissed the original complaint, calling it a "pastiche of prolix invective" but instructed the trial court to allow plaintiffs to amend the complaint with more factual specificity.69 The plaintiffs then exercised their state-law right of access to the corporate books and records where they found the facts that finally allowed them to state a cognizable claim. In allowing the amended complaint to go forward, the trial court admonished that the plaintiffs could have avoided the "expensive and time-consuming procedural machinations" had they sought access to corporate books and records before filing the original complaint.70

Delaware and many other states also require a shareholder filing a derivative lawsuit to show that she first demanded that the directors bring the cause of action on behalf of the corporation or that such a demand would have been a futile gesture.72 Making a demand for board action is an ill-advised move because if the board rejects it and opposes the shareholder's suit, which is likely, shareholders will have limited ability to challenge that decision.73 Thus shareholders' complaints must show the futility of making a demand.

67 Id.
68 See Brehm v. Eisner, 746 A.2d 244, 248 n.1 (Del. 2000).
69 See id. at 249, 267.
70 See DEL. CODE ANN. tit. 8, § 220(b) (2001).
71 In re Walt Disney Co., 825 A.2d at 279 n.5.
72 See Aronson v. Lewis, 473 A.2d 805, 807–08 (Del. 1984); see also DEL. CH. Rule 23.1.
73 See Scattered Corp. v. Chicago Stock Exch., 701 A.2d 70, 74 (Del. 1997).
Establishing futility requires pleading specific facts suggesting that the directors could not have impartially evaluated a demand or that the action complained of did not deserve the protections of the business judgment rule. The *Disney* court found that plaintiffs met this requirement. The allegations suggested such a cavalier attitude by directors as to raise doubts that they acted "honestly and in good faith" as required by the business judgment rule. Furthermore, the carelessness of the directors was so severe as to suggest that the directors did not "exercise any business judgment." 

Finally, *Disney* addresses the issue of corporate charter provisions exempting directors from personal monetary liability for breaches of due care. Statutes in Delaware and other states explicitly permit corporate charters to include such exculpation provisions. They do not prevent plaintiffs from obtaining injunctive relief, but effective injunctions may be hard to craft and enforce, so monetary penalties are certainly a useful tool to encourage future reform. In *Disney*, the court found that the directors' lack of good faith suggested that they were not entitled to protection under the statutory exculpation provision.

Like the *Disney* plaintiffs, shareholders seeking to characterize a board's nomination process as a breach of the duty of care will need specific facts about the decision-making process. Thus it will be particularly important to exercise the state law right of access to corporate books and records. The minutes of meetings approving nominations will be particularly important. Plaintiffs might attempt to satisfy the demand futility requirement and avoid statutory exculpation of directors by establishing a lack of good faith through the cavalier attitudes of the directors with respect to diversity issues. With respect to establishing the underlying breach of due care, the *Disney* case suggests that gaps in the minutes can be damning: the court pointed out that according to the minutes, the directors had failed to ask questions about important issues. Taking a cue from the *Disney* decision, shareholders should make an issue of

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74 *In re Walt Disney Co.*, 825 A.2d at 286.
75 Id. at 278.
77 *In re Walt Disney Co.*, 825 A.2d at 290.
78 Id. at 279–81.
the lack of attention paid to the diversity issue in nomination proceedings.

In addition to corporate books and records, proposed changes to the SEC's proxy rules, if enacted, might yield additional information. The proposal would require enhanced corporate disclosure with respect to the director-nomination process.\textsuperscript{79} While much of this disclosure might be excessively general, self-serving boilerplate, the proposal also requires a board's nominating committee to justify its decision if it fails to nominate a shareholder-recommended candidate.\textsuperscript{80} This provision would only apply to nominees recommended by a shareholder or group of shareholders who have owned over three percent of the company's stock for at least one year.\textsuperscript{81}

A potential stumbling block to a duty of care cause of action is that material harm to the corporation caused by a lack of management diversity is much less clear than it was in Disney. In Disney, the directors failed to inform themselves about excessive compensation and separation terms that were obviously costly to the corporation. Despite the evidence showing that diversity is beneficial, it is nearly impossible to demonstrate precisely the nature and degree of harm caused by a lack of diversity. In addition, as noted above, there are arguably some countervailing benefits to board homogeneity.

It is not entirely clear, however, whether a showing of concrete harm is a prerequisite for a finding of liability. In the earlier Van Gorkom case, for example, the court found a breach of due care, even though there was no clear finding of harm. In that case, the court found that the board had not exercised procedural due care in recommending to shareholders that they accept a buyout price of $55 per share. In addition, the court found that the board had failed to disclose to shareholders its deficient procedure for reaching the recommendation. The directors argued that regardless of the procedures they used to reach the $55 price, the result was fair in substance because the price was fair to the shareholders. The court rejected this

\textsuperscript{79} See Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Board of Directors, Release Nos. 34-48301; 1c-26145, 68 Fed. Reg. 48,724 (2003). As of this writing (October 16, 2003), the proposed rules had not been adopted.

\textsuperscript{80} Id.

\textsuperscript{81} Id.
argument without explanation, found the board in breach, and remanded the case for a hearing on damages.\textsuperscript{82} A later Delaware Supreme Court opinion explained that the substantive fairness of price in \textit{Van Gorkom} could not save the directors from liability when they had committed “compound breaches of the duties of care and disclosure.”\textsuperscript{83} In a suit based on failure to nominate directors of color, it may be difficult to show the amount of damages with any specificity. This may preclude the imposition of monetary judgments against directors.\textsuperscript{84} Nonetheless, directors may still be found liable if the court finds “compound breaches” of the sort found in \textit{Van Gorkom}, which would entitle shareholders to injunctive relief. Shareholder demands for corporate records regarding nominations may lead boards to lend more attention to diversity matters in meetings. These demands may have an effect on directors, even if litigation is unsuccessful or never occurs. The SEC disclosure proposal may have a similar effect but a stronger disclosure requirement mandating detailed descriptions of all nomination proceedings would be preferable. Because of the inherent subjectivity involved in the evaluation of director candidates, directors could easily explain the rejection of a shareholder nominee with a boilerplate statement that the directors found another candidate who was more highly qualified.

\textbf{B. Exercising Shareholder Voice Through Shareholder Proposals}

Shareholder lawsuits are the bluntest instruments in the toolbox of corporate governance. These lawsuits can be extremely costly, lengthy, and potentially disruptive to the corporation. Shareholder voting offers some less drastic, though limited, ways to press for reform. Activist shareholders have sought shareholder votes on proposals aimed at increasing board diversity—for example, proposals urging the adoption of formal diversity policies, the nomination of women or minorities,  

\textsuperscript{82} Smith v. Van Gorkom, 488 A.2d 858, 891–93 (Del. 1985).
\textsuperscript{83} Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1166 (Del. 1995) (emphasis omitted).
\textsuperscript{84} As noted above, even when damages can be proven, statutory exculpation provisions may prevent monetary judgments against directors except in cases of egregious bad faith. See supra notes 76–77 and accompanying text.
progress reports on diversification, or the disclosure of director selection criteria. Because of the basic rule that directors manage the corporation, however, shareholders have no power to command directors to diversify the slates they nominate. Thus, as will be explained below, shareholder proposals regarding director action are usually made in non-binding form.

In large corporations, most shareholders vote through the proxy process. This system resembles voting by absentee ballot in political elections but with some significant differences. Before elections take place, incumbent corporate management produces and mails to shareholders a package including the annual report, management's partisan description of the offices and issues to be voted upon, and a proxy card. The vast majority of shareholders will not personally attend the shareholder meeting at which the election will take place. By providing a shareholder with a proxy card, management asks that a shareholder give management the power to cast her votes.

Thus, contacting shareholders to solicit their proxies is crucial to success in a corporate election. Shareholders are often scattered around the world. The board of directors has easy access to the corporation's lists of shareholder names and addresses and uses the corporation's funds to print and send the official corporate proxy mailing. SEC rules give shareholders some opportunity to air their concerns throughout the corporate proxy mailing process. Under SEC Rule 14a-8, the corporation must include certain types of shareholder proposals in its proxy mailings. This rule significantly reduces shareholders' costs in communicating with other shareholders and thus facilitates putting policy proposals to a shareholder vote.

Unfortunately, Rule 14a-8 is qualified with significant limitations on the shareholders' right to proxy access. The corporation may invoke one or more of those limitations as grounds to exclude a proposal from the corporate proxy. Some of these limitations are formal and procedural. For example, at the time she submits a proposal, a shareholder must have owned at

85 See Dallas, supra note 7, at 1384.
86 See Gevirtz, supra note 61, at 206 (stating that because corporations are required to notify shareholders of the meeting, they will bear the cost of mailing the information directly to the shareholders).
87 See 17 C.F.R. § 240.14a-8 (2003) (discussing when a company must include shareholder proposals in its proxy statement).
least $2000 worth of voting stock in the corporation, or 1% of the
voting stock, for at least one year.\footnote{§ 240.14a-8(b)(1).} Other limitations go to the
substance of the proposal. For example, 14a-8(i)(1) states that in
order to be included on the corporate proxy, a proposal must
concern “a proper subject for action by shareholders” under the
laws of the state of incorporation.\footnote{§ 240.14a-8(i)(1).} While this may seem
uncontroversial, it underscores the fact that, despite the federal
rule of shareholder proxy access, state laws limit shareholders’
powers to set corporate policy. Under state law, the directors,
not the shareholders, run the corporation.\footnote{See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2001); see also supra note 59 and
accompanying text.} The SEC has
inserted a note, after the text of the rule, warning that
shareholder proposals that intend to have a binding effect on the
corporation may be improper under state law and further
recommends that shareholders should phrase their proposals as
“recommendations or suggestions.”\footnote{§ 240.14a-8(i)(1), note to para. (i)(1).} Thus, in order to remove
any doubt as to whether the subject of a proposal is proper,
shareholder proposals submitted to a vote usually take this
precatory form.\footnote{See GEVRTZ, supra note 61, at 267.} As a result, diversity activism through
shareholder proposals is likely to consist of campaigns asking the
board to make an effort to diversify itself.

Assuming a non-binding proposal were placed on the proxy
and approved by shareholders, directors might feel some market
pressure to respond; however, they would be legally entitled to
ignore it.\footnote{See Lawrence A. Hamermesh, Corporate Democracy and Stockholder-
Adopted By-Laws: Taking Back the Street? 73 TUL. L. REV. 409, 421–22 (1998).} For example, a majority of Apple Computer
shareholders recently voted for a proposal urging management
to count options awarded to executives as an expense in its
accounting.\footnote{See Ian Fried, Apple Vote: Treat Options as Expenses, CNET NEWS.COM (Apr.
2003).} Generally Accepted Accounting Principles do not
require companies to do this, and most do not.\footnote{See David Millon, Why Is Corporate Management Obsessed with Quarterly
Earnings and What Should Be Done About It?, 70 GEO. WASH. L. REV. 890, 916
(2002) (“Under current accounting principles, options need only be expensed if and
when they are actually exercised.”).} After the vote,
Apple management immediately stated that it would not comply with the proposal. Boards might feel even more confident in ignoring shareholder proposals urging diversity. Unlike expensing options, board diversity is not currently perceived as a pressing issue related to corporate integrity and shareholder value. Furthermore, an individual corporation will not feel great pressure to respond to a diversity proposal, since the vast majority of corporations do nothing to pursue board diversity.

Although both state law and Rule 14a-8 limit shareholders' ability to bind the board, most state corporate codes also empower shareholders to initiate and approve amendments to the corporate bylaws. Thus, shareholder proposals to amend the bylaws appear to be “proper” under state law. Shareholders could conceivably use the corporate proxy to propose and approve a bylaw amendment imposing some diversity requirements on the board. May shareholders use bylaw amendments to order directors to take specific actions? In the diversity context, would state law permit shareholders to propose a bylaw amendment requiring the board to include persons of color, or a specific person of color, in its slate of director nominees? Such a use of the shareholders’ power to amend bylaws is in tension with the principle that directors, not shareholders, manage the corporation. This conflict remains unresolved in most states, including Delaware.

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97 See, e.g., DEL. CODE ANN. tit. 8, § 109(a) (2001). A corporation’s charter can give the board concurrent power to amend the bylaws, but such a provision does not take away the shareholders’ power to do so. This “raises an intriguing prospect for a cartoon-like exchange of amendment and counter-amendment.” GEVURTZ, supra note 61, at 197, n.77.

98 See GEVURTZ, supra note 61, at 198.

99 The exception is Oklahoma, whose supreme court has resolved the tension in favor of shareholders, at least in the context of anti-takeover devices. See Int'l Bhd. of Teamsters Gen. Fund v. Fleming Companies, 975 P.2d 907 (Okla. 1999); see also GEVURTZ, supra note 61, at 197–98 (discussing Fleming); Hamermesh, supra note 93, at 421–24 (summarizing Fleming and the issues involved). The Fleming court held it is proper under Oklahoma law for shareholders to use a bylaw amendment prohibiting the board from enacting “poison pill” takeover defenses and requiring the board to redeem stock options already issued as part of a poison pill. The court rejected the board's argument that the bylaw amendment would encroach on the directors' power, including specific statutory authority to issue options. Fleming, 975 P.2d at 913. It is unclear whether the decision is limited to the poison pill context. Moreover, even if interpreted broadly, the significance of the decision is in doubt, because Oklahoma is not a leading corporate jurisdiction. The issue has not
However, it should be noted that even if a diversity-related proposal were proper under state law and satisfied Rule 14a-8(i)(1), the board might invoke other sections of the rule in an attempt to exclude the proposal from the corporate proxy. Under Rule 14a-8(i)(8), for example, the board may exclude a proposal that "relates to an election for membership on the company's board of directors." In practice, the SEC has interpreted this Election Exclusion Rule to permit many shareholder proposals regarding election procedures, as opposed to the election of specific candidates. Thus, a diversity-related proposal, whether a recommendation or a bylaw, may not call for the nomination of any particular minority candidate. Rather, it should address reforming procedures for nominating minority candidates. The devil is, of course, in the details of devising such procedures.

The exact parameters of the election exclusion are unclear. The SEC has allowed corporations to apply the exclusion to proposals, including precatory proposals, that, on their face, deal with general election procedure or governing structure but might in effect concern a specific candidate in an upcoming election. For example, the SEC permitted AT&T Corporation to exclude a precatory proposal asking the board to adopt a rule prohibiting the CEO from serving as chairman of the board. AT&T had argued that the proposal related to a specific election because it sought to disqualify the incumbent CEO, who was also the...
chairman, from renomination to the board in the next election. In some cases, the effect of a diversity proposal could arguably resemble that of the resolution excluded by AT&T. A proposal requiring diversification of a homogeneous board would necessarily involve nominating new candidates in the next election and could thus entail the exclusion of an incumbent from the next slate.

This discussion of shareholder proposals for director diversity has thus far avoided the fundamental question of the exact substance of a proposal. It is quite difficult to imagine how to craft a proposal with real teeth. In today's political climate, proposals imposing quotas of minority nominees would almost certainly fail to gain majority shareholder approval. As noted above, a proposal might amend the corporate bylaws to include requirements of diversity policies, placement goals, and reporting on hiring. These might resemble requirements under federal affirmative action guidelines for government contractors. Shareholders, however, are unlikely to have the resources or expertise necessary to monitor and administer such requirements. A large and sophisticated government apparatus monitors federal guidelines, and nonetheless, government contractors are often slow to achieve diversity.

103 See supra text accompanying notes 3–5 (discussing Norwegian and Israeli laws requiring gender diversity on boards and the improbability that the U.S. will adopt an analogous rule to address racial diversity).
104 See 41 C.F.R. §§ 60–1 to 60–999 (2002). As noted above, if a corporation is a federal contractor, it is already subject to these guidelines; whether they apply to the nomination of directors, however, is unclear. Diversity activists might attempt to bring the issue to the government's attention. Given the Bush Administration's declared support of the anti-affirmative action plaintiffs in Grutter and Gratz, however, it is unlikely that they would find a sympathetic audience. See President George W. Bush, Remarks by the President on the Michigan Affirmative Action Case (Jan. 15, 2003), available at http://www.whitehouse.gov/news/releases/2003/01/20030115-7.html (last visited Sept. 30, 2003).
105 See generally West, supra note 5 (documenting that universities that are federal contractors subject to affirmative action guidelines fail to achieve parity in hiring and promoting women).
C. Exercising Shareholder Voice by Contesting Elections

1. Impediments to Election Contests

The legal and institutional structure of shareholder voting severely hinders shareholders' ability to nominate alternative director candidates. Even in the rare instances where an election is contested, the corporation is not required to list the names of challengers on the proxy. As discussed above, Rule 14a-8(i)(8) allows management to exclude shareholder proposals relating to specific elections. Thus shareholders fielding opposition candidates have no right to have their candidates included on the corporate proxy.

In order to solicit proxy votes for its alternative candidates, the opposition must coordinate and shoulder the considerable costs of its own independent proxy campaign. The costs of such a campaign include not only printing and mailing, but also the cost of insuring that the proxy solicitation complies with SEC regulations. As noted above, SEC regulations specifically authorize management to exclude from its proxy mailings any shareholder proposals that relate to director elections. Thus, although the formal structure of corporate law empowers shareholders to elect directors, shareholders have no right to use the corporate proxy to contest elections. They may not place alternative director candidates or even non-binding proposals regarding candidates on the corporate ballot. In October 2003, the SEC proposed limited exceptions to this rule, as will be explained in section III.C.2 below.

Shareholders who wish to field an alternative slate must bear the expense and effort of identifying candidates and distributing their own proxies and informational materials to thousands of shareholders. In order to solicit proxies, they will have to obtain the list of shareholder names and addresses from the corporation. Shareholders have the right to obtain this list, but like any right, enforcement sometimes requires a

108 See Del. Code Ann. tit. 8, § 220(b) (2001). The statute requires the shareholder to state a “proper purpose.” The Delaware Supreme Court has held that “the desire to solicit proxies for a slate of directors in opposition to management” is
costly lawsuit. After obtaining the list, shareholders must pay to print and mail thousands of proxies. Once mailed, the proxy may fail to receive shareholders' attention because it will lack the authority of an "official" corporate mailing and may resemble yet another unsolicited bit of junk mail.

Stock exchange rules regarding shares held in brokerage accounts further tilt voting, whether on directorships or on proposals, in favor of incumbent management. An individual holding shares in an account typically does not own the shares so much as she has a contractual claim against the brokerage firm for a number of shares—much as a bank depositor owns no currency but is contractually entitled to a certain amount of money. The upshot is that the corporation's official records do not reflect identities of many of these account holders. The account holder, however, referred to as the "beneficial owner" of the shares, is entitled to the rights of a shareholder including the right to vote.

At election time, proxy materials are often sent to brokers. The broker, as agent, is charged with asking the beneficial owners for instructions on how to vote the proxy. Brokers often receive no response from beneficial owners, whether due to the owners' apathy or the broker's lack of diligence in locating the owner. When the beneficial owners do not provide instructions, stock exchange rules allow corporations to empower the brokers to vote the proxies themselves if the vote involves a routine matter. This practice is known as "broker voting."

such a purpose. Credit Bureau Reports, Inc. v. Credit Bureau of St. Paul, Inc., 290 A.2d 691, 692 (Del. 1972) (quoting Gen. Time Corp. v. Talley Indus., 240 A.2d 755, 756 (Del. 1968)). Shareholders have a similar right under SEC Rule 14a-7. Under that rule, dissident shareholders who produce their own proxy mailings have a right to have the corporation, at its option, mail the proxies at the shareholders' expense or provide the dissident shareholders with the shareholder list. See 17 C.F.R. § 240.14a-7.

109 Corporations sometimes reimburse successful insurgents for the cost of their proxy campaigns. Some shareholders have challenged such reimbursements, but the law in this area remains unclear. See GEVURTZ, supra note 61, at 206–08 (discussing cases).


111 If the broker lacks diligence or good recordkeeping, the beneficial owners may never get the opportunity to vote their shares.

Brokers invariably exercise this power to vote in favor of management. A recent study examined elections in which broker votes were believed to have provided the swing shareholder votes to approve management-initiated proposals. Institutional Shareholder Services, the leading independent shareholder advisory firm, recommended voting against 78 percent of those proposals.

Broker voting may seem unimportant in that it applies only to "routine" matters. "Routine," however, does not mean unimportant. Rather, the NYSE has a narrow list of "non-routine" matters, and any matter not on that list is "routine." Thus, many important matters, including amendments of bylaws governing nomination procedures, would be classified as "routine." "Routine" matters also include elections that are not "contested." Once again, the terminology is misleading. "Contested" elections are only those elections in which all shareholder proxies are solicited by postal mail. Therefore, elections in which dissidents solicit only the proxies of large shareholders or where they solicit proxies over the Internet are not considered "contested." The discounting of partial or Internet proxy contests is particularly unfair in light of the high cost of printing and mailing and the fact that dissident director campaigns must bear their own costs. Broker voting was apparently established to help reach a quorum, but the study mentioned above found evidence suggesting it is no longer necessary for that purpose. The practice has evolved into a protective buffer for management and should be discontinued.

114 Id. at 30.
115 See id. at 32.
117 See Bethel & Gillan, supra note 113, at 33.
118 Id. at 30. The study found that even without broker votes, the average percentage of shares voted in corporate elections was well over seventy percent in 1998. A quorum is generally fifty percent. Id.
2. Expanding the Shareholder Role in Director Elections

Increasing shareholder ability to nominate candidates would be the most direct way to challenge incumbent control over elections. Opening up the nomination system would reduce incumbent entrenchment and provide the opportunity for activist shareholders to put minority candidates before the shareholders. It also has obvious potential benefits to corporate governance in general. As one Wall Street observer put it: “C.E.O.s and corporate boards do respond to moral suasion and bad publicity, even in the absence of legal consequences... [b]ut everyone would be better off if shareholders could rely less on public agitation and more on real power.” Such a change in shareholder power, however, will require reform by the Congress or the SEC. The current SEC interpretation of Rule 14a-8 prevents shareholders from using the corporate proxy to enact, or even suggest, bylaw or charter amendments empowering them to nominate directors. A recent attempt to do so was thwarted when the SEC permitted several corporations to exclude proposals from the corporate proxy on the basis of the election exclusion. Despite allowing the exclusions, the SEC ordered a study of the director nomination system. That study, completed in July 2003, produced a number of limited recommendations for reform.

The proposals in question were part of a concerted campaign by the American Federation of State, County and Municipal Employees Pension Plan (“Pension Plan”). Late in 2002, the Pension Plan sought to place election reform proposals on the proxies of six corporations, including Citigroup and AOL-Time Warner. The Pension Plan wanted the corporations to include on future proxies the name of a director candidate nominated by a shareholder or group of shareholders owning three percent or more of a company’s common stock. In some cases, the Pension Plan proposed a binding bylaw amendment.

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119 James Surowiecki, To the Barricades, THE NEW YORKER, June 9, 2003, at 44.
121 See SEC STAFF REPORT, supra note 47.
122 See id. at 1.
others, it made a precatory proposal urging the board to take the necessary steps to achieve the reform. The corporations planned to exclude the proposals and asked the SEC for a no-action letter on several grounds, including the election exclusion.

The SEC's Division of Corporation Finance ("Division") granted the corporations' no-action requests. As noted above, the SEC has generally interpreted the election exclusion to prohibit proposals regarding specific candidates but to allow procedural proposals. With respect to both the Pension Plan's proposed bylaw amendments and its non-binding proposals, however, the SEC explained that "[t]here appears to be some basis" to apply the election exclusion, because "the proposal, rather than establishing procedures for nomination or qualification generally, would establish a procedure that may result in contested elections of directors." The Pension Plan asked the SEC to review the Division's no-action position.

Even before the Pension Plan campaign began, pressure had been building to increase shareholder access. Two separate groups of shareholder activists had already filed public petitions with the SEC to amend the election exclusion. Although the SEC chose not to review the Citigroup no-action letter, it

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126 The identical language appears in each of the no-action letters. See supra note 125. The Division's use of the term "contested election" in this context is distinct from the NYSE's use of the term with respect to broker proxy voting. See supra text accompanying notes 115–17.
directed the Division to review the nomination and election process and propose possible changes to the proxy rules.\textsuperscript{129} In October 2003, the SEC proposed amendments to the proxy rules that would require the corporation to list shareholder nominees in the corporate proxy materials (the "Proxy Access Requirement"), subject to a number of significant conditions.\textsuperscript{130} These conditions are so restrictive that the procedure is unlikely to be of much practical use in changing the composition of a board.

The Proxy Access Requirement would be conditioned on "triggering events" indicating "the company has been unresponsive to security holder concerns as they relate to the proxy process."\textsuperscript{131} The two triggers would be (1) over thirty-five percent of shares voted in a director election cast "withhold" votes against one of the company's nominees; or (2) a majority of shareholders approve a shareholder proposal requiring the company to disclose shareholder nominees.\textsuperscript{132} Even if one of the triggers were tripped, the company would be required to list only candidates nominated by a shareholder or group of shareholders who have owned a total of over five percent of the company's stock for at least two years.\textsuperscript{133} The rule would require the disclosure of only one, two or three shareholder nominees, depending on the size of the board.\textsuperscript{134} Finally, the triggers would not make proxy access permanent: they would require the company to list shareholder nominees only in elections held in the succeeding calendar year.\textsuperscript{135}

Conditioning proxy access on triggering events would be a significant restriction on nominations. The trigger requirement misplaces the burden of proof. Because directors have nearly complete control over nominations, the rule should presume that shareholders need access to the corporate ballot rather than

\textsuperscript{130} See Proposed Rule: Security Holder Nominations, SEC Release No. 34-48626 (Oct. 14, 2003), http://www.sec.gov/rules/proposed/34-48626.htm. As of this writing (October 16, 2003), the SEC was about to submit the rules to a 60-day public comment period. \textit{Id}.  
\textsuperscript{131} \textit{Id}.  
\textsuperscript{132} \textit{Id}.  
\textsuperscript{133} \textit{Id}.  
\textsuperscript{134} \textit{Id}.  
\textsuperscript{135} \textit{Id}.  
requiring dissidents to prove that need. The triggering events suggested in the report are themselves successful proxy campaigns. Thus, to gain ballot access, dissidents would first have to successfully mount a trigger proxy campaign to encourage “withhold” votes or pass a shareholder proposal. Even under the best of circumstances, success in this trigger campaign might take more than one attempt (i.e., more than one year, because elections are held annually). Even if a trigger campaign were to succeed, the dissidents would have to wait another year to invoke the new access rule at the following election. Finally, the threshold shareholding level of five percent and two years would put nominations far beyond the reach of grassroots activists and even of most institutional investors. According to John Sweeney, head of the AFL-CIO, the high threshold “would make it difficult for even the largest investors to [nominate candidates] and impossible to do so in a timely manner.” 136

The proposed rule changes are too limited to have much impact. If the SEC is serious about empowering shareholders, the Division should reverse its interpretation that boards may exclude shareholder proposals with respect to voting procedures that “may result in contested elections of directors”—the position that started the whole controversy. Recall that the AFSCME Pension Plan did not originally seek a SEC rule change. It sought an interpretation that would allow it to use the mechanisms of corporate democracy to make changes to the internal policies of corporations in which it owns shares. Unless the Division’s trigger proposal is accompanied by a reinterpretation of the election exclusion, the SEC’s proposed rule changes (if passed) will become the ceiling for shareholder access; shareholders will be unable to pass, or even propose, internal rules granting greater access. This position obviously stands corporate democracy on its head and conflicts openly with the idea of corporate governance as a private relationship between shareholders and management. The Division’s report acknowledged that under the Pension Plan’s preferred interpretation of Rule 14a-8’s election exclusion, proposals could “be drafted individually to reflect the make up of a particular

136 See Louis Lavelle, This Corporate Reform Falls Far Short, BusinessWeek Online (October 10, 2003), http://www.businessweek.com/bwdaily/dnflash/oct2003/nf20031010_6139_db042.htm.
137 See supra note and accompanying text.
company as opposed to a ‘one size fits all’ access rule that applies to all companies.” At the same time, however, the Division expressed preference for a uniform rule over custom-tailored rules for each company.

The basis for the Division’s “contested election” interpretation seems to be a preference for director control of nominations. As the Pension Plan pointed out in its request for review of the Citigroup no-action letter, the Division has not permitted the exclusion of certain other proposals that would establish nominally contested elections. For example, shareholders have on multiple occasions made proposals requesting the board to nominate two candidates for each board seat. As recently as three weeks before the Citigroup no-action letter, the Division ruled that the election exclusion does not apply to such proposals. Multiple nominees would necessarily result in contested elections. In those proposals, however, all contestants would be chosen by the incumbent board. Under the Pension Plan’s proposal, however, incumbent control over the board could be truly contested—a result the SEC apparently wants to avoid.

CONCLUSION

In all honesty, dissident success will remain extremely difficult, even if all the reforms suggested in this Article are enacted. Even if shareholders’ access to the corporate proxy for proposals and nominations was to increase dramatically, proposals and candidates would of course need to win shareholder votes. This is notoriously difficult because shareholders who are frustrated with management often find it quicker and easier to sell their shares than to wait for the

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138 SEC STAFF REPORT, supra note 47 at 29.
139 See id. at 30.
change via the mechanisms of corporate governance. This means that the shareholder electorate will tend to favor incumbent management. In the post-Enron market, however, shareholders may be less trusting of incumbents. Moreover, even if it is true that shareholders tend to favor incumbents and do not value diversity, incumbents should have to prove this periodically in fair, contested elections.

Shareholder activists should combine nominations and proposals with other forms of pressure mentioned in this Article, such as demands for corporate records regarding nominations and even lawsuits in the most egregious cases of recalcitrance. Although proxy reform is unlikely to produce a wave of victories in contested elections, respectable showings by shareholder-nominated directors or shareholder-initiated diversity proposals will at least attract incumbent directors' attention, even if they do not succeed—especially if combined with other forms of pressure. In at least some cases, boards' nominating committees might respond proactively in order to head off a credible threat of disruption or embarrassment.

Diversity activists might find the most success with corporations already seeking to establish an image of racial sensitivity, such as those with a recent history of discrimination or those attempting to cultivate a minority, progressive, or "hip" consumer base. In addition, diversity activists should seek the support of large institutional investors. Not only do they wield more votes but some of them also have sufficient clout to put direct and personal pressure on incumbent board members. In particular, diversity activists should seek to bring the issue of board diversity to the attention of institutional investors that are historically relatively liberal or answerable to minority constituents. Certain institutional investors have a history of

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141 See Joo, supra note 1, at 44–45.
142 The governing bodies of the New York City Employees' Retirement System (NYCERS) and the California Public Employees' Retirement System (CalPERS), for example, include elected officials from electorates with large numbers of minorities. The NYCERS Board of Trustees includes a representative of the Mayor, as well as the City Comptroller, the Public Advocate, the heads of the three unions with the largest participation in NYCERS, and the presidents of New York City's five Boroughs. See NYCERS, Board of Trustees, http://www.nycers.org/about/Board.aspx (last visited Aug. 22, 2003). State and local employees elect the Board members of CalPERS. The State Treasurer and State Controller are ex officio members. See CalPERS, Board of Administration, http://www.calpers.org/about/board/board.htm (last visited Aug. 22, 2003).
fighting for diversity and other corporate social responsibility agendas. A notable example is New York City Employees' Retirement System (NYCERS), which in 1991 attempted to use the proxy process to fight a corporation's policy of employment discrimination on the basis of sexual orientation. Although the SEC permitted the corporation to exclude NYCERS's shareholder proposal, the subsequent public outcry eventually led the SEC to reverse its position and announce a policy favoring proposals that "raise significant social policy issues."

Although the current tenor of racial politics does not bode well for diversity mandates at the government level, the politics of corporate law may improve the chances of using shareholder voice to call for diversity at the level of individual corporations. Proposals to expand shareholder power would have stood little chance just a few years ago. Corporate governance reform has political momentum today, however, particularly because the shareholding class expanded so significantly in the 1990s and was so badly disappointed as the millennium turned. For all the current talk of corporate governance reform, corporate democracy remains a myth. Relatively speaking, however, the next few years may provide unusual opportunities for all aspects of shareholder empowerment.

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143 See NYCERS v. SEC, 45 F.3d 7, 9 (2d Cir. 1995).