Frozen Charters

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In 2012, the New York Stock Exchange changed its policies to prevent brokers from voting shares on corporate governance proposals when they have not received instructions from beneficial owners. Although the change was intended to protect investors and improve corporate governance, it has had the opposite effect: a significant number of U.S. public companies are no longer able to amend important parts of their corporate charters, despite the support of their boards of directors and overwhelming majorities of shareholders. Their charters are frozen.

This Article provides the first empirical and policy analysis of the broker voting change and its significant unintended consequences. I provide empirical evidence that the broker voting change has resulted in the failure of more than fifty charter amendments at U.S. public companies, despite board approval and overwhelming shareholder support, and that hundreds more companies have frozen charters as a result of the change. The rule change has also made it more difficult to amend corporate bylaws and given some insiders a de-facto veto in proxy voting contests. These costs substantially outweigh the negligible benefits of the broker voting change. I compare a number of solutions to address these problems and identify several that would be preferable to the current approach.

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Introduction

In 2011, a large U.S. public corporation put forward an amendment to its charter, the central document establishing the internal rules of the corporation. The board of directors and management supported and recommended the change. At the required shareholder vote on the amendment, more than 99% of the votes cast were in favor of the amendment. But the amendment failed. Directors, managers, and shareholders supported a change in the company’s charter, yet were unable to change it. The company’s charter is frozen. This result is the consequence of a 2012 change in New York Stock Exchange (NYSE) policies relating to broker voting rules, Information Memorandum 12-4 (hereinafter the broker voting change). Although the broker voting change was intended to protect investors and improve corporate governance and accountability, it has had the opposite effect. This is the first article to analyze the significant unintended consequences of the broker voting change, and to identify the problem of frozen charters.

Approximately 85% of investors hold shares through brokers, and many of those investors do not instruct brokers how to vote their shares at annual meetings. Uninstructed broker votes therefore represent a substantial proportion of the outstanding shares of many corporations (an average of 10% in my sample). In order to protect shareholders from the potentially distortive effects of voting by brokers (who do not have an economic interest in the corporation), the NYSE, whose rules effectively govern broker voting, has progressively limited the instances in which brokers may vote shares. Based on this concern, in 2012, the NYSE restricted brokers from voting uninstructed shares on charter and bylaw amendments.

Although the intention of the broker voting change was to protect investors and enfranchise shareholders, it has done neither. By preventing uninstructed broker voting, the rule change was intended to prevent voting distortions. However, the rule change has instead created a different kind of distortion. Preventing brokers from voting uninstructed shares means that none

1. The amendment took place pursuant to a 2011 agreement with a client of the Shareholder Rights Project, at which time I served as Associate Director of the Project. For further information on the work of the Shareholder Rights Project during the years 2011-2014, see Shareholder Rights Project, HARV. L. SCH. PROGRAM ON INSTITUTIONAL INV., http://www.srp.law.harvard.edu/index.shtml [http://perma.cc/8G6R-K2SL].

2. Although the change related to NYSE Rule 452, see infra note 3, it was technically a change of interpretation of the rule, rather than a rule change itself, as is discussed further in Section I.B.3.


4. I develop a theory that explains these different kinds of distortions in Part II.
of those shares will be voted in favor of the proposal, even though some of the 
shares have beneficial owners that are in favor of the proposal. Where the 
proposal failed, but would have passed had the uninstructed shares that 
supported the proposal voted, the outcome is what I term a “distorted fail.”

The main type of distorted fail results from the broker voting change is 
frozen charters. Despite strong support from shareholders and directors, there 
are a number of corporations that, because of high supermajority requirements 
for amending parts of their charters, are unable to reach these thresholds 
without uninstructed broker votes. Empirical data on the number of failed 
charter amendments since the broker voting change was implemented reveals 
the impact of the rule change. In the three years after the broker voting change 
took effect, in 54 of the 63 companies where charter amendments failed despite 
receiving overwhelming shareholder support, the company would have had 
their amendments pass had the broker voting change not been implemented.6 
Overall, the broker voting change has significantly increased the proportion of 
charter amendments that fail despite receiving overwhelming shareholder 
support and has increased the likelihood of failure for charter amendments in a 
statistically and economically significant manner.

There are two other related kinds of distorted fail results from the broker 
voting change. Similar to frozen charters, the elimination of discretionary 
broker voting has prevented shareholders of a number of corporations from 
amending the bylaws of those corporations. And in a number of other 
companies, the prohibition on broker voting has left insiders with a de facto 
veto right over certain charter amendments.

The unintended, shareholder-harming distorted fail results from the broker 
voting change should be weighed against its intended consequence, of 
preventing what I term “distorted passes” from uninstructed broker voting. 
Uninstructed broker votes will result in a distorted pass when a majority of the 
shareholders of the corporation prefer that a proposal fail, but uninstructed 
broker votes in favor of the proposal cause it to pass.

5. I arbitrarily define “overwhelming shareholder support” as support from 
shareholders representing 90% of votes cast. The 90% threshold has valence as a measure of 
overwhelming support within corporate law—for instance, as the ownership threshold (albeit of 
shares outstanding) above which a short-form merger procedure is permitted in DEL. CODE ANN. 
tit. 8, § 253.

6. See the analysis and assumptions discussed in Section I.B, infra. In particular, 
this assumes that shareholders would have voted or not voted in the same proportions had the 
broker voting change not been implemented. While it is impossible to tell whether this is the case, 
there are significant reasons to suggest that this is the case. In particular, very little information 
was released around the time of the broker voting change about its effect on corporate governance 
proposals, and there has been almost no discussion since that time. Given that most shareholders 
were likely unaware of the effects of the change, there would have been no basis for them to 
change their voting behavior. Anecdotal evidence from discussions with corporate governance 
representatives of institutional investors suggests that the broker voting change had no effect on 
their voting behavior.
However, most charter amendments are strongly supported by shareholders, and brokers generally follow management recommendations by supporting these charter amendments. Thus, in the overwhelming majority of cases, there would be no distortive effects of broker voting on charter amendments. The number of cases where there may be distorted pass outcomes is very small: there have been no charter amendments since the broker voting change came into effect that would have had distorted pass outcomes had broker votes been permitted, and only one other management proposal (0.12% of all management proposals during that period).

In fact, the foregoing analysis significantly underestimates the true effect of the broker voting change, because only a small number of charter amendments go to a vote each year. I use a novel method to estimate the number of companies that are affected by the consequences of the broker voting change, using corporations’ voting requirements and turnout in director elections. I estimate that between 13% and 15% of U.S. corporations have been rendered unable to amend part of their charters as a result of the broker voting change. In addition, between 7% and 8% of corporations effectively have an insider veto as a result of the broker voting change, and between 8% and 9.5% of corporations now have board-only bylaw amendments as a result of the broker voting change. I also estimate the number of companies where eliminating broker voting has prevented distorted pass results, and find that, based on current patterns of support for corporate governance proposals, the broker voting change would prevent distorted pass results at only 0.1% of companies. In short, the broker voting change was implemented to solve a problem that—if it existed at all—had negligible effects.

These empirical results allow for an evaluation of the broker voting change against its own implicit policy goals of protecting investors, enfranchising shareholders, and improving corporate governance and accountability. The substantial negative effects of the broker voting change in creating distorted fail results—preventing charter and bylaw amendments desired by shareholders and giving insiders a veto over charter amendments—significantly outweigh its very limited benefits in preventing distorted pass results.

The broker voting change failed so clearly against the policy goals it references because charter amendment votes differ in two important respects from director elections and executive compensation vote, which the broker voting change did not reflect. First, as opposed to director election and executive compensation votes, where shareholders may choose to express their dissatisfaction with director or management compensation, shareholders generally support charter amendments. This is due to the fact that directors generally do not put forward charter amendments that are unlikely to garner such support. Second, the manner in which proxy votes are tallied differs markedly between the different types of proposals. Whether directors are elected and executive compensation proposals pass depends on their level of
support as a proportion of the votes cast at the meeting. However, charter amendments require a proportion of shares outstanding in order to pass, and often a supermajority of shares outstanding. As a result, excluding uninstructed broker votes has a much more significant effect in a charter amendment proposal.

Given these differences, it was inapposite to apply reasoning from recent changes to Rule 452 to uninstructed broker voting on corporate governance proposals. Such unintended results could have been prevented had the broker voting change been implemented in a different manner. Whereas other changes to broker voting rules in the past have involved lengthy processes including public disclosure and comment, the broker voting change involved neither. Had public comment been permitted, corporations, investors, or their representatives may have pointed out the potential negative consequences of the broker voting change.

After offering an empirical analysis of the broker voting change, I consider the implications of the rule from a number of perspectives. From a firm value perspective, the broker voting change prevents value-enhancing changes to the corporation. From the contractarian framework of corporate law scholarship, the broker voting change is problematic in that it changes an implicit term on which the amendment provisions contained in corporate charters rely, thereby changing the terms of the corporate contract from those which the parties intended. Additionally, examining the broker voting change from the perspective of directors and managers suggests that certain directors and managers may actually prefer that particular charter amendments be stymied by the broker voting change. Therefore, instead of empowering shareholders, the rule change may disempower shareholders of some corporations to the benefit of their managers.

There are a number of possible alternatives to address the distorted fail results created by the broker voting change. Although the current pattern of support for charter amendments and other corporate governance proposals means there are very few potential distorted pass results, it is possible to imagine alternative scenarios in which this is not the case. Any analysis should therefore consider the likely effects of such solutions in both reducing distorted fail results and avoiding distorted pass results.

The simplest solution, reversing the broker voting change, would eliminate the distorted fail results of frozen charters, failed bylaw votes, and insider vetoes created by the broker voting change. However, it would reinstate the possibility of distorted pass results, albeit in what are likely to be very limited numbers. Another possibility would be to implement strategies to

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7. As I explain further in Section I.C, I do not suggest that the broker voting change was implemented as a result of pressure from such issuers or their advisors on the NYSE to implement the rule, as the interviews I conducted with NYSE and SEC officials suggest that this was not the case. See notes of interviews conducted with senior NYSE and SEC officials, on file with the Yale Journal on Regulation.
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reduce the number of undirected broker votes, which would reduce both distorted pass and distorted fail results. However, such efforts may be costly, and are unlikely to provide a complete solution to the problem. A more promising alternative, proportional voting, whereby brokers vote uninstructed shares in the same proportion as other shareholders at the meeting or other shareholder clients of the broker, has the possibility of eliminating both kinds of distortion.

Finally, broker voting rules could be amended to allow broker voting on certain types of corporate governance proposals where distorted fail outcomes would otherwise be likely, but where distorted pass outcomes would not, such as amendments to remove supermajority provisions, amendments that shareholders generally support, or amendments for which a supermajority is required.

These solutions offer the possibility of reducing the likelihood of distorted fail results, while also minimizing the possibility of distorted pass results. In order to avoid the procedural shortcomings involved in implementing the broker voting change, any reform should take place through the NYSE rulemaking process, with notice and public comment, and an SEC determination that the new rule has the effect of protecting investors. In the interim, the NYSE should reverse the broker voting change to prevent the harm it is currently causing to investors.

The existing literature regarding charter amendments, broker voting, and the effect of the broker voting change in particular on charter amendments, remains extremely limited. Financial economists have tried to quantify the extent of broker voting and its effects. Before the disclosure of broker non-votes made such questions obsolete, two articles compared voting results for routine and non-routine issues to estimate the extent of broker voting, and its direction. In explaining why “management always wins the close ones,” Yair Listokin considered in passing the possible effects of distortions by broker voting, and presented evidence about the effects of the 2003 limitation on broker voting on executive compensation plans. A recent working paper also considered the effects of the 2009 prohibition of uninstructed broker voting on director elections. Following the release of Information Memorandum 12-4, a number of lawyers and other practitioners noted the change, and several

commentators speculated about its potential effects on charter amendments.\(^{12}\) However, the change went almost unremarked upon by academic researchers,\(^ {13}\) and the limited practitioner attention soon abated. This Article represents the first economic and empirical analysis of the broker voting change.

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\(^{13}\) One exception is the consideration given to the broker voting change by Professor J. Robert Brown Jr., who speculated about its potential effects on the ability of corporations to achieve quorum requirements. J. Robert Brown Jr., NYSE Rule 452 and Voting Uninstructed Shares (Part 3), THERACETOTHEBOTTOM.ORG (Feb. 1, 2012, 6:00 AM), http://www.theracetothebottom.org/home/2012/2/1/nyse-rule-452-and-voting-uninstructed-shares-part-3.html [http://perma.cc/HEW6-XQR7].
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The Article is structured as follows. Part I explains the charter amendment process, broker voting, and the broker voting rules, including the recent changes that established the policy on which the broker voting change was based, and the broker voting change itself. Part II examines the kinds of distortion created by broker voting—distorted pass outcomes and distorted fail outcomes—and uses these to demonstrate the consequences of the broker voting change on charter and bylaw amendments in the period since it was implemented. Part III expands this analysis by considering those companies that have been unwittingly affected by the broker voting change, but may not yet have brought charter or bylaw amendments. Part IV evaluates the broker voting change from its own perspective of investor protection, as well as several other perspectives, and Part V considers potential solutions for addressing the negative consequences of frozen charters.

I. Charter Amendments and Broker Voting

This Article examines the phenomenon of frozen charters, and links it to the effect of recent broker voting changes. In this Part I, I first set out the background of shareholder voting to approve charter amendments. I then focus on part of the shareholder vote—voting of uninstructed shares by brokers. I examine the rules that govern broker voting, most notably NYSE Rule 452, and then move to consider recent changes to the broker voting rules, including the broker voting change contained in Information Memorandum 12-4.

A. Amending Corporate Charters

The general procedure for amending the charter of a corporation is for the board of directors of the corporation to approve an amendment to the charter, and for directors to put forward a proposal that the amendment be approved by a vote of shareholders.14 The proposal is then voted on at a meeting of shareholders.15 If the amendment is approved, it is formalized by a filing with the secretary of state of the corporation’s state of incorporation.

The vote threshold required to approve an amendment varies from state to state, and from company to company. Default rules vary between requiring a majority of outstanding shares,16 two-third of outstanding shares,17 and a

14. See, e.g., DEL. CODE ANN. tit. 8, § 242(b)(1).
15. Generally, the meeting at which this occurs is the annual shareholders meeting, though it can also be voted on at a special meeting of shareholders. Some states may allow shareholder approval by written consent in lieu of a meeting. See, e.g., DEL. CODE ANN. tit. 8, § 228.
16. Sixteen states, including Delaware, California, and New York, require approval by a majority of outstanding shares as a default rule. See, e.g., DEL. CODE ANN. tit. 8, § 242(b)(1). The other states in this group are Alaska, Hawaii, Kansas, Maine, Michigan, Missouri, Nevada, New Jersey, New Mexico, Oklahoma, Pennsylvania, Rhode Island, and Washington. See ALASKA STAT. § 10.06.504(a) (Ak.); CAL. CORP. CODE § 902 (Cal.); HAW. REV. STAT. § 414-283 (Haw.); KAN. STAT. ANN. § 17-6602 (Kan.); 13-C ME. REV. STAT. § 1003 (Me.); MICH. CORP. L.
majority of the votes cast at a meeting at which a quorum of the majority of the outstanding shares are present. Each state permits a corporation to require a greater vote requirement, and a significant number of corporations take advantage of this provision with charter provisions requiring votes of, for example, 66%, 75%, or 80% of outstanding shares in order to approve an amendment to important parts of the charter. Although a supermajority provision could require supermajority approval for amending any part of the charter, they most frequently apply to anti-takeover provisions. Table 1 below sets out the distribution of voting requirements for the sample of companies I use in Part III.

17. Eight states require the affirmative vote of two-thirds of the outstanding shares as a default rule. The states in this group are Illinois, Louisiana, Maryland, Massachusetts, Ohio, South Carolina, Texas, and Virginia. See 805 ILL. COMP. STAT. 5/10.20 (Ill.); LA. STAT. ANN. 12:31 (La.); MD. CODE ANN. CORPS. & ASS'NS. § 2-604 (Md.); MASS. GEN. LAWS ch. 156D, § 10.03 (Mass.); OHIO REV. CODE ANN. 1701.71 (Ohio); S.C. CODE ANN. § 33-10-103 (S.C.); TEX. BUS. ORGS. CODE ANN. § 21.364 (Tex.); VA. CODE ANN. § 13.1-707 (Va.).

18. Twenty-six states and the District of Columbia follow the provisions of the Model Business Corporation Act (MBCA), which requires a majority of the votes cast at a meeting at which a quorum of the outstanding shares is present. See MODEL BUS. CORP. ACT § 7.25(c). The states in this group are Alabama, Arizona, Arkansas, Colorado, Connecticut, District of Columbia, Florida, Georgia, Idaho, Indiana, Iowa, Kentucky, Minnesota, Mississippi, Montana, Nebraska, New Hampshire, North Carolina, North Dakota, Oregon, South Dakota, Tennessee, Utah, Vermont, West Virginia, Wisconsin, and Wyoming. See ALA. CODE § 10A-2-10.03 (Ala.); ARIZ. REV. STAT. ANN. § 10-1003 (Ariz.); ARK. CODE ANN. § 4-27-1003 (Ark.); COLO. REV. STAT. § 7-110-103 (Colo.); CONN. GEN. STAT. § 33-797 (Conn.); D.C. CODE § 29-308.03 (D.C.); FLA. STAT. § 607.1003 (Fla.); GA. CODE ANN. § 14-2-1003 (Ga.); IDAHO CODE § 30-1-1003 (Idaho.); IND. CODE § 23-1-38-3 (Ind.); IOWA CODE § 490.1003 (Iowa); KY. REV. STAT. ANN. § 271B.10-030 (Ky.); MONT. STAT. § 302A.135 (Mont.); MISS. CODE ANN. § 79-4-10.03 (Miss.); NEB. CODE ANN. § 35-1-227 (Neb.); N.H. REV. STAT. ANN. § 293-A:10.03 (N.H.); N.C. GEN. STAT. § 55-10-03 (N.C.); N.D. CENT. CODE § 10-19.1-19 (N.D.); OR. REV. STAT. § 60.437 (Or.); S.D. CODIFIED LAWS § 47-1A-1003 (S.D.); TENN. CODE ANN. § 48-20-103 (Tenn.); UTAH CODE ANN. § 16-10a-1003 (Utah); VT. STAT. ANN. tit. 11A, § 10.03 (Vt.); W. VA. CODE § 31D-10-1003 (W. Va.); WIS. STAT. § 180.1003 (Wis.); WYO. STAT. ANN. § 17-16-1003 (Wyo.).

19. See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(4).

20. See, e.g., RESTATED CERTIFICATE OF INCORPORATION OF CHESAPEAKE ENERGY CORPORATION (Aug. 10, 2001) ("Notwithstanding anything contained in this Certificate of Incorporation to the contrary, the affirmative vote of the holders of at least sixty-six and two-thirds percent (66 2/3%) of the issued and outstanding stock having voting power, voting together as a single class, shall be required to amend, repeal or adopt any provision inconsistent with Articles V, VI, VII, VIII and this Article IX of this Certificate of Incorporation.").

21. As explained in Part III, these are companies incorporated in the United States that are part of the Russell 3000 index, which contains the largest 3,000 corporations listed on exchanges in the United States. For a discussion of the composition of the Russell 3000 and an explanation of why I use it, see infra note 75.
Table 1: Voting Requirements for Charter Amendments at U.S.-Incorporated Russell 3000 Corporations

<table>
<thead>
<tr>
<th>Vote Standard</th>
<th>Percentage</th>
<th>Companies</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Votes Cast</td>
<td>50%</td>
<td>150</td>
<td>5.8%</td>
</tr>
<tr>
<td></td>
<td>50%</td>
<td>917</td>
<td>35.3%</td>
</tr>
<tr>
<td></td>
<td>50% - 59%</td>
<td>1</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>60% - 69%</td>
<td>874</td>
<td>33.7%</td>
</tr>
<tr>
<td></td>
<td>70% - 79%</td>
<td>245</td>
<td>9.4%</td>
</tr>
<tr>
<td></td>
<td>80% - 89%</td>
<td>392</td>
<td>15.1%</td>
</tr>
<tr>
<td></td>
<td>90% - 100%</td>
<td>17</td>
<td>0.7%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>2,596</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

As Table 1 shows, 25.2% of the companies in my sample require approval of 70% or more of the outstanding shares of the corporation to amend part of their charters. Most supermajority requirements are a percentage of shares outstanding, rather than the votes cast on the proposal. If all outstanding shares were voted, these proportions would be the same. In reality, a substantial percentage of shareholders do not vote, significantly reducing the proportion of outstanding shares that are actually voted, which I refer to as “shareholder turnout.”

The level of shareholder turnout in corporations varies with the level of institutional ownership of the corporation. Of shares held by institutions, an average of 90% were voted at annual meetings in 2013, whereas only 30% of shares owned by individual or retail investors were voted. The distribution of

22. I exclude uninstructed broker votes from “shareholder turnout,” so shareholder turnout is the number of shares that are voted for, against, or abstain on a proposal (but not uninstructed broker shares), divided by the number of outstanding shares of the corporation.

23. Many institutional investors, including investment advisers and pension funds governed by the Employee Retirement Income Security Act of 1974 (ERISA), have a fiduciary duty to vote their shares. See, e.g., Letter from Alan D. Lebowitz, Deputy Assistant Sec’y, Dept. of Labor, to Helmuth Fandl, Chairman Ret. Board, Avon Products Inc. (Feb. 23, 1988) (reprinted at 15 PENS. REPTR. (BNA) 391); Letter from Alan D. Lebowitz, Deputy Assistant Sec’y, Dept. of Labor, to Robert Monks, Pres., Institutional S’holders Servs., Inc. 3 (Jan. 23, 1990) (reprinted at 17 PENS. REPTR. (BNA) 244); Interpretive Bulletin Relating to Written Statements of Investment Policy, including Proxy Voting Policy or Guidelines, 29 C.F.R. § 2509.94-2 (July 29, 1994); Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy Including Proxy Voting Policies or Guidelines, 29 C.F.R. § 2509.08-2 (October 17, 2008).

shareholder turnout (excluding uninstructed broker votes) for director elections from 2012 to 2014 for my sample is set out in Figure 1 below.\textsuperscript{25}

Figure 1: Shareholder Turnout in Director Elections for Russell 3000 Companies, 2012-14

As Figure 1 makes clear, turnout is generally high—the median turnout is 81.0\%. However, there are a substantial number of corporations that have turnout below some of the significant supermajority thresholds mentioned in Table 1—almost 50\% of meetings had turnout below 80\% of shares outstanding. As a result, the treatment of uninstructed broker votes can be central to whether or not charter amendments pass.

\textbf{B. Broker Voting}

Under state law, the right to vote shares of the corporation belongs to the registered owner (or record holder) of the shares.\textsuperscript{26} While it is possible for an

\textsuperscript{25} Figure 1 and similar figures showing distributions throughout this Article are density histograms with bin width of 1\%, rendered as line charts.

\textsuperscript{26} This is the person or entity that is listed in the share register of the corporation. \textit{See}, \textit{e.g.}, \textbf{DEL. CODE ANN.} tit. 8, § 219 (describing the list of stockholders entitled to vote at the meeting of stockholders, including the number of shares registered in the name of the stockholder).
investor to be directly registered as the owner of shares, most investors hold shares through securities intermediaries, such as a broker, bank, or custodian. In these cases, the intermediary is the registered owner of the shares, and the investor owns in "street name"—their interest as the beneficial owner is recorded in the books of the intermediary. Investors generally buy shares through brokers who place orders on their behalf through stock exchanges that manage the transfer of the shares from the seller's broker. Although an investor can request that their broker transfer the registration to the investor, such requests are rare. As a result, brokers and other intermediaries are the registered owners of approximately 85% of public company shares.

Shareholder voting takes place by proxy. The corporation distributes a form of proxy and an accompanying proxy statement to shareholders. Shareholders complete the form of proxy, authorizing certain proxy holders (usually the directors of the corporation) to vote on their behalf, in favor or against each proposal on the proxy form as the shareholder specifies. If the shareholder is the record owner, they complete their own proxy form. However, where the shareholder holds shares in street name, the broker is the registered owner of the shares, and rules applicable to the broker govern the voting of the shares.

Broker voting is governed by the exchanges of which the broker is a member, including with respect to the voting of shares that are listed on other exchanges. Because almost all brokers are members of the NYSE, the NYSE

27. "Securities intermediary" is defined in Act Rule 17Ad-20, 17 C.F.R. § 240 of the General Rules and Regulations promulgated pursuant to the Securities Exchange Act of 1934, 15 U.S.C. § 78m(d) (2012) to include a clearing agency registered under Section 17A of the Exchange Act or a person, including a bank, broker, or dealer, that maintains securities accounts for others.

28. For simplicity, I will generally refer to intermediaries as "brokers," though in actual fact particular investors may have intermediaries that are brokers, banks, or custodians, or some combination thereof. The Exchange Act and NYSE Rules use the term "broker-dealer." A "broker" is defined as a person who undertakes transactions in securities for the account of others, see 15 U.S.C. § 3(a)(4), whereas a "dealer" is one who buys and sells securities for their own account, see id. § 3(a)(5).

29. The shares are often held by another intermediary called a "custodian." In the case of large retail brokers, custodian entities are often under common ownership with the broker entity.

30. Investors and brokers disfavor this approach, as it increases the difficulty, cost, and time required to transfer the shares, and brokers may charge the investor an additional fee to transfer the registration.


32. It is also possible that the corporation may give notice of where to access proxy materials online, in lieu of sending the materials themselves.

33. For many corporations, shareholders may give their proxy electronically or telephonically as well as in physical form.

34. See Rule 452, supra note 3; see also N.Y. STOCK. EXCH. INC. MKT. LLC. COMP. GUIDE § 723 (relating to members of NYSE MKT exchange (formerly, the American Stock Exchange), which is substantively identical to Rule 452). FINRA Rule 2251, which applies
Rules govern essentially all broker voting in companies listed on U.S. exchanges. Where a shareholder holds shares in street name, the broker is the registered owner and receives the corporation's proxy materials. The broker sends these proxy materials to the beneficial owner or their investment adviser, either with a blank, signed proxy form, or a request that the beneficial owner provide the broker with voting instructions. If the beneficial owner receives a signed proxy form, they can vote by submitting it to the corporation, and the broker has no further role in the voting of the proxy. If the beneficial owner receives a request for voting instructions, they vote by returning instructions to the broker by the tenth day before the company's meeting, and the broker votes the shares as directed by the beneficial owner. The question of broker discretionary voting arises in the situation where the broker has not received voting instructions by this deadline.

Broker discretionary voting is important because many shareholders—especially retail investors—do not instruct brokers how to vote their shares. Political scientists have long observed that it is not economically rational for individuals to vote in political elections, since acquiring information to vote is costly and the likelihood of an individual influencing the outcome of an election is vanishingly small. Shareholder proxy votes exacerbate this problem: it is even less rational for a shareholder to vote. Because shareholder votes are weighted by the number of shares held, it is even less likely that an individual shareholder will influence the outcome of a shareholder vote. Furthermore, the specialized nature of corporate governance matters makes it more difficult for most individuals to gather information about how to vote.
voting is also less likely to have expressive significance than voting as a citizen.\textsuperscript{40}

Due to the fact that few individual investors vote, uninstructed broker votes represent a substantial number of shares at many companies. For my sample, the average level of uninstructed broker votes was 10.1\% of outstanding shares. Figure 2 below sets out the distribution of broker votes for director elections from 2012 to 2014 for the companies in my sample.\textsuperscript{41}

Figure 2: Uninstructed Broker Votes in Director Elections of U.S. Russell 3000 Companies, 2012-14

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure2}
\end{figure}


\textsuperscript{41} The sample is those companies disclosing broker non-votes for annual elections between 2012 and 2014.
C. Broker Voting Rules

1. Rule 452

Discretionary broker voting is governed by NYSE Rule 452. The rule provides that a broker that has sent proxy materials to the beneficial owner of shares and has not received instructions on voting the shares by the deadline:

may give or authorize the giving of a proxy to [vote] such stock, provided the person in the member organization giving or authorizing the giving of the proxy has no knowledge of any contest as to the action to be taken at the meeting and provided such action is adequately disclosed to stockholders and does not include authorization for a merger, consolidation or any other matter which may affect substantially the rights or privileges of such stock. 42

The supplementary materials to Rule 452 give further guidance as to when brokers are not permitted to vote without instructions from the beneficial owner, and list 21 matters on which brokers are not permitted to vote discretionarily. These include contested proposals, shareholder proposals opposed by management, proposals relating to mergers, proposals involving appraisal rights, preemptive rights, or voting provisions, proposals relating to executive compensation, and proposals for the election of directors. 43 Rule 452 reflects a concern about the distortive effects of broker voting, based on the widely held understanding that brokers vote overwhelmingly in the manner recommended by directors. 44 The rule therefore prohibits broker voting in situations where there is most concern about potential distortion—issues where there is likely to be divergence between what managers recommend (and what brokers are likely to support) and what shareholders might prefer—such as mergers or contested elections.

2. 2003 and 2010 Amendments to Rule 452

Since the precursor to Rule 452 was adopted in 1937, 45 the matters on which brokers are permitted to vote discretionarily have changed several times.

42. NYSE Rule 452, supra note 3; see also NYSE Rule 452.10, supra note 3.
43. NYSE Rule 452.11 (listing “when member organization may not vote without customer instructions”).
The most recent of these changes, in 2003 and 2010, help explain the rationale for the changes made in the broker voting change.

In 2003, following the implementation of the requirement for shareholders to approve equity compensation plans, Rule 452 was amended to prevent broker discretionary voting on equity compensation plans. In approving the rule change, the SEC considered the importance of ensuring that votes on executive compensation matters reflect the views of beneficial shareholders and concluded that the amendments served to protect shareholders and were in the public interest.

Following the implementation of the 2003 changes, the SEC created a "Proxy Working Group" to review the rules regulating the proxy voting process, and in particular, Rule 452. The Proxy Working Group recognized the potentially distorting effect of broker votes:

[T]he problem with broker voting is that it allows someone (i.e. the broker) who does not have an economic interest in the corporation the opportunity to vote on the corporation's business. A second problem is that historically brokers have generally cast uninstructed shares overwhelmingly in support of the board's recommendations, which provides a significant advantage to the incumbent board in director elections and other matters.

The Proxy Working Group concluded that, in the interests of "better corporate governance and transparency of the election process," broker voting on uncontested elections should be eliminated.

The Dodd Frank Act contained a provision requiring exchanges to prevent their members from making uninstructed votes on elections of directors or executive compensation matters, or any other significant matter as determined by the SEC. The SEC subsequently approved amendments put forward by the NYSE to prevent brokers from voting uninstructed shares in director elections, effective January 1, 2010. In approving the amendments, the SEC concluded that the rules would "better enfranchise shareholders, and thereby enhance corporate governance and accountability" and would "protect investors and the

47. See id. at 40,008-09.
48. The Proxy Working Group included representatives of a number of corporations, institutional investors, and attorneys, and their sessions were also attended by representatives of the SEC, the NYSE, and the National Association of Securities Dealers, the predecessor of the Financial Industry Regulatory Authority (FINRA).
50. Id. at 14.
51. Id. at 15.
public interest.” The SEC subsequently approved NYSE rules prohibiting uninstructed broker voting on executive compensation matters in September 2010, concluding that “the proposal will further investor protection and the public interest” and “should enhance corporate governance and accountability to shareholders.” For these and other votes on which brokers do not vote uninstructed shares, the number of uninstructed shares not voting is required to be disclosed in the company’s election results as “broker non-votes.”

The 2003 and 2010 amendments to the NYSE rules followed a formal process for notice and comment. Amendments to NYSE rules (and those of other exchanges) are governed by Section 19(b) of the Exchange Act and Rule 19b-4 of the General Rules and Regulations promulgated thereunder. These set out comprehensive requirements for proposed amendments of exchange rules, including that the proposed rule be filed in the Federal Register, and that public comments be requested so that the public have a chance to provide meaningful comment on the proposal. The SEC must consider the public comments and determine whether the rule satisfies the requirements of the Exchange Act and rules, including being designed “in general, to protect investors and the public interest.” The proposed amendments therefore had detailed explanatory materials, public comment, and lengthy consideration of the rules and the comments by the SEC, on the basis of which the SEC determined the rules had the effect of protecting investors and the public interest.

3. Information Memorandum 12-4

The change in broker voting, which is the subject of this Article, took place on January 25, 2012. On that date, the NYSE released Information Memorandum 12-4 announcing that it would no longer treat certain corporate governance matters as “Broker May Vote” for the purposes of Rule 452. The

57. See Form 19b-4, supra note 56, at 2.
59. With respect to the 2009 SEC Release, 153 comment letters were received and reviewed. See 2009 SEC Release, supra note 53, at 33,293.
announcement stated that "[m]ore recently, the approach to broker voting of uninstructed shares has narrowed through changes in [NYSE] rules as well as through legislative action," and noted the restrictions on broker voting for director elections and executive compensation. It then continued:

In light of these and other recent congressional and public policy trends disfavoring broker voting of uninstructed shares, the [NYSE] has determined that it will no longer continue its previous approach under Rule 452 of allowing member organizations to vote on such proposals without specific client instructions. Accordingly, proposals that the [NYSE] previously ruled as "Broker May Vote" including, for example, proposals to de-stagger the board of directors, majority voting in the election of directors, eliminating supermajority voting requirements, providing for the use of consents, providing rights to call a special meeting, and certain types of anti-takeover provision overrides, that are included on proxy statements going forward will be treated as "Broker May Not Vote" matters.61

As a result, since January 25, 2012,62 brokers have no longer been able to vote uninstructed shares on charter amendments, as well as bylaw amendments and other corporate governance proposals.63

In contrast to the previous broker voting changes to which it refers, Information Memorandum 12-4 did not follow the thorough rulemaking procedure contemplated by the Exchange Act.64 It was two pages in length, and 394 words. It gave very little explanation of the reasoning behind the changes it implemented, or consideration of their potential effects. There was no advanced notice of the changes in the broker voting change, nor any ability to publicly comment. There was no public consideration of the rule change by the SEC, and no conclusions were drawn as to whether the rule change would protect investors and the public interest.65 These procedural shortcomings may explain

61. Information Memorandum 12-4, supra note 60.
62. The broker voting change does not indicate a phase-in period or start date. It does indicate that it applies to proposals “that are included on proxy statements going forward.” A number of companies that had filed proxy statements prior to January 25, 2012 for meetings that took place after that date that included charter amendments did not separate broker votes. The last of these meetings, that of Qualcomm Incorporated, took place on March 6, 2012. See Current Report (Form 8-K), QUALCOMM INC. (Mar. 9, 2015).
63. Although all of the examples listed in the broker voting change are amendments that reduce takeover defenses from subsequent amendment proposals where broker votes have been excluded, it appears to have been interpreted to also apply to other kinds of corporate governance amendments, such as ones that put in place takeover defenses.
64. Section 19 of the Exchange Act permits a proposed rule change to avoid the normal process if designed by the exchange as “constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization.” 15 U.S.C. § 78s(b)(3)(A) (2012).
65. Interviews conducted with NYSE and SEC officials who held relevant positions at the time of the broker voting change suggest that the SEC preferred that the NYSE take this policy change approach, rather than propose a rule change, with the concomitant procedural requirements described above (on file with the Yale Journal on Regulation).
why the consequences described in Part II, and the broader effects described in Part III, were not anticipated and avoided.66

II. Consequences of the Broker Voting Changes

This Part develops a theory for assessing the consequences of the broker voting change. The treatment of uninstructed broker voting can distort the outcome of shareholder votes in two ways—"distorted pass" results where uninstructed broker voting is permitted, and "distorted fail" results where uninstructed broker voting is not permitted. The main consequences of distorted fails are frozen charters: many companies are now unable to amend their charters because of the broker voting change. There are also two related consequences—bylaws that are unamendable by shareholders, and a newfound ability by insiders to wield a veto. All of these consequences reduce shareholder welfare, the opposite effect of that which the broker voting change intended. By contrast, the positive effect of the broker voting change—preventing distorted pass results—has had a limited impact on shareholder welfare.67

A. Broker Voting Distortions

Broker voting can cause distortions if brokers vote differently than if the beneficial owners voted themselves. If shareholders of all shares held by brokers gave voting instructions, there would be no distortion. However, if shareholders do not give voting instructions, there will undoubtedly be some divergence between the actual vote and the preferences of those shareholders.68

To illustrate, assume that the proportion of outstanding shares held by shareholders in favor of a proposal is 60%, and that holders of 15% of the outstanding shares of the corporation do not give voting instructions to their

66. In an interview with the author, a senior official at the SEC at the time of the broker voting change made clear that the SEC did not consider the effect of the change on supermajorities, but approved of the broker voting change on the principle that preventing broker voting improved the integrity of voting (notes of interview by the author with former SEC Official, on file with the Yale Journal on Regulation).


68. It can be argued that because shareholders do not vote, they must prefer to abstain. Because the treatment of broker non-votes is akin to an abstain vote, there is therefore no distortion. However, just because a shareholder makes a rational decision not to vote (for instance, because the cost of informing themselves about the proposal exceeds the likely effect of their vote if they are a small shareholder) does not mean that the shareholder would not prefer that the proposal either pass or fail.
broker.\textsuperscript{69} Consider first the situation where brokers are permitted to vote uninstructed shares. Consistent with the evidence and widely held views that brokers vote uninstructed shares overwhelmingly as directors recommend,\textsuperscript{70} I will assume—for the simplicity of the example—that brokers vote 100\% of uninstructed shares, following director recommendations, in favor of management proposals.\textsuperscript{71} 15\% of the shares of the company will therefore be voted by brokers in favor of the proposal. However, had the shareholders themselves voted, only 60\% of that 15\%, or 9\% of the outstanding shares, would have voted in favor. As a result, broker voting has positively distorted the total vote by 6\%. Consider now the situation where broker voting is not permitted. Now none of the uninstructed shares are voted in favor of the proposal. As a result, prohibiting broker voting has negatively distorted the total vote by 9\%.

However, more important than the vote tally is the outcome of the vote, which is binary—if the proposal receives more votes than the vote requirement, the proposal will pass; otherwise it will fail. This binary outcome can be distorted in two different ways, analogous to the analytical concepts of a “false positive” and a “false negative.” Either a proposal may not have sufficient support to pass if undistorted, but distortive broker voting could cause it to pass (which I term a “distorted pass”); or a proposal would have sufficient support to pass if undistorted, but a distortive lack of broker voting could cause it to fail (which I term a “distorted fail”). Given the evidence that brokers vote overwhelmingly as directors recommend, broker voting can only be distortive in the direction of director recommendations—which are almost exclusively in favor of charter and bylaw amendments.\textsuperscript{72} As a result, permitting broker voting can cause a distorted pass in circumstances where shareholders would prefer that the proposal fail but broker votes increase the vote beyond the vote required and cause the proposal to pass. In contrast, if shareholders preferred the proposal to pass and broker votes increased the vote in favor, the proposal would still pass, and there would be no distortion in the outcome. To illustrate, assume that a proposal is supported by shareholders holding 45\% of outstanding shares and requires 50\% to pass. If the outcome is not distorted, the proposal will fail. However, if shareholders of 15\% of outstanding shares do not instruct their broker how to vote, and their brokers vote 100\% of such shares in favor of the proposal, then the percentage of outstanding shares in

\textsuperscript{69} Let us further assume, here and throughout the examples in this section, that support for the proposal is uniformly distributed among those shareholders that vote and those that do not instruct their broker how to vote.

\textsuperscript{70} See discussion infra Section II.B.1.

\textsuperscript{71} Almost all director recommendations are in favor of management proposals. For a discussion of why this is the case, and data on the small number of exceptions, see infra Section V.D.

\textsuperscript{72} There are a very small number of cases where directors have not given a recommendation or recommended against corporate governance proposals they have approved. See discussion infra Section V.D and Table 11 for further details.
favor will be $85\% \times 45\% + 15\%$, or $53.25\%$, and the result will be a distorted pass.\(^{73}\)

The converse is true where broker voting is not permitted. If shareholders holding more than the required proportion of shares prefer that a vote would pass, but the prohibition on brokers voting uninstructed shares means that less than the required proportion is actually voted in favor, then the result will be a distorted fail. To illustrate, assume that a proposal is supported by shareholders holding 90% of outstanding shares, and requires approval of 80% of outstanding shares to pass. If the outcome is not distorted, the proposal will pass. However, if brokers are not permitted to vote uninstructed shares, and if shareholders holding 15% of outstanding shares do not instruct their broker how to vote, then the percentage of shares in favor will be $0.85\% \times 90\%$, or 76.5%, and the result will be a "distorted fail."

Following from this analysis, the broker voting change, in disallowing broker votes, has eliminated the possibility of distorted passes, but created the possibility for distorted fails. Sections II.B and II.C consider these two kinds of consequences.

### B. Distorted Fails

1. Frozen charters

The most significant distorted fail outcomes from the broker voting change are frozen charters. Broker votes represent, on average, 10.4% of the outstanding shares of corporations in my sample. For many corporations, particularly those with high supermajority requirements for certain charter amendments, turnout at annual meetings is such that the corporations are unable to reach those requirements without broker votes. Therefore, as a result of the broker voting change, those corporations are no longer able to amend certain parts of their charters, even where directors and shareholders strongly support such amendments. Their charters are frozen.

Although the great majority of charter amendments that go to a vote pass, a significant number of companies have failed in their attempts to amend their charters since the broker voting change came into effect. Of the 645 proposals to amend corporate charters put forward by corporations\(^{74}\) between 2012 and 2014, 121 (19% of the total) have failed. Of those, 82 (13% of the total) have failed despite receiving greater than 90% of the votes cast.\(^{75}\) The charters of

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73. As further discussed in Section IV.A below, the broker voting change was implemented to avoid such a result.

74. This excludes shareholder proposals, as they cannot by themselves effect amendments to charters, and since the overwhelming majority of them are precatory, they generally do not by themselves effect changes to bylaws or corporate governance policies.

75. Data for results discussed in this Section is drawn from the FactSet TrueCourse, Inc. SharkRepellent.net Proxy Database. The FactSet SharkRepellent database contains data for approximately 4,000 U.S. public companies, including those in the Russell 3000
these companies are frozen. These charter amendments generally related to the removal of takeover protections, such as declassification of the board or reductions in supermajority requirements to amend the company’s charter or bylaws or take other corporate action.

A company will have a frozen charter if the percentage of votes cast in favor of the proposal is greater than 90%, and the percentage of outstanding shares voted in favor for the proposal is less than the percentage of outstanding shares required for charter amendments.

Take, for instance, the case of Teradata Corporation. At the corporation’s 2012 annual meeting, the corporation put forward a management proposal to declassify the corporation’s board of directors. The directors of the corporation recommended that shareholders vote in favor of the resolution, and 99.6% of shareholders voting at the meeting voted in favor of the proposal.

indices. The Russell 3000 index covers the largest 3,000 U.S. companies, which according to the publisher of the index, Russell Investments, comprises 98% of the investable U.S. equity market. As of May 29, 2014, the market capitalization of companies in the Russell 3000 index ranged from $751 billion to $177 million. See RUSSELL INDEXES, Market Capitalization Ranges (May 29, 2015), http://www.russell.com/indexes/americas/tools-resources/reconstitution/market-capitalization-ranges.page [http://perma.cc/XNG4-DT7N]. There are approximately 700 additional companies covered by SharkRepellent, but because the database was originally set up to track poison pills, many of the companies included are those that are outside the Russell 3000 index but have poison pills. To avoid biasing my sample, I limit my consideration here to companies in the Russell 3000 at the time of the meeting where the proposal was considered. Since charter amendment rules are governed by place of incorporation, I exclude non-U.S. companies from my sample.

Many of the other proposals that failed (i.e., those that received less than 90% support) were attempts to add takeover protections of the kind that are generally disfavored by shareholders.

This can also be expressed algebraically. Throughout this article, I will use alpha (α) to represent a proportion of outstanding shares, with a subscript to represent the numerator—so α₀ for the proportion of outstanding shares in favor of a proposal, αₜ for the proportion of outstanding shares that are uninstructed broker votes (or “broker non-votes”), αₜ for the turnout as a proportion of outstanding shares, and αₕ for the proportion of outstanding shares required for a vote to be approved. I will use beta (β) to represent a proportion of votes cast (i.e., votes cast for, against and abstained, but not including broker votes)—for instance, β for the proportion of votes cast in favor. Where necessary, I will use theta (θ) for the raw number of votes—for instance, θ for the number of raw votes cast in favor.

Note that the choice of 90% is arbitrary. It is intended as a level to demonstrate that an overwhelming proportion of shareholders are in favor of a proposal. As the threshold is lowered, more of the 121 charter amendments that failed will be defined as having frozen charters, although slightly lower proportions of those are likely to have resulted from the broker voting changes.

Expressed algebraically: β₉₀ > 0.9 and αₜ < αₕ.

Definitive Proxy Statement (Schedule 14A), TERADATA CORP. 64 (Mar. 1, 2012). The corporation had previously received a shareholder proposal was put forward by the State of North Carolina Equity Investment Fund Pooled Trust, which was represented by the Shareholder Rights Project. See Outcomes of Proposals for the 2012 Proxy Season, SHAREHOLDER RTS. PROJECT (2012), http://www.srp.law.harvard.edu/2012-declassification-proposals.shtml [http://perma.cc/F2RE-W7D4]. The management proposal was put forward pursuant to an agreement with the proponent, with the proponent agreeing to withdraw the shareholder proposal if the corporation put forward the management proposal. I served as the Shareholder Rights Project’s Associate Director and assisted with the proposal, and with subsequent engagement with Teradata.

TERADATA CORP., supra note 80, at 5.
proposal. However, the shares voted constituted only 75.9% of the shares outstanding as of the record date. The corporation's charter required a vote of 80% of outstanding shares to amend the classified board provision, so the proposal failed.

To what extent are these frozen charters due to the broker voting change? Consistent with the views of the NYSE Proxy Working Group and the evidence of Bethel and Gillan that brokers overwhelmingly follow management recommendations, let us again assume that 100% of broker votes would vote in accordance with management recommendations if they are permitted to vote. Using this assumption, we can describe the counterfactual situation where the broker voting change had not come into effect. In that case, the percentage of outstanding shares in favor for each company would be the percentage actually voted in favor plus the number of broker votes. Therefore, a frozen charter will be the result of the broker voting change where the percentage of shares outstanding voted for, plus the percentage of broker votes is greater than the vote requirement.

To illustrate, consider the example of the management proposal to declassify the board of directors of Akamai Technologies, Inc. put forward in 2013. The proposal received the support of 73.2% of the shares outstanding. However, the voting requirement for the proposal to pass was 75%. Uninstructed broker votes represented 10.9% of shares outstanding. Had those shares been voted in favor of the proposal by brokers, the total in favor ($\alpha_{fr} + \alpha_{bv}$) would have been 84.1%, and the proposal would have passed.

Table A.1 in Appendix A lists the companies where charter amendments have failed since the broker voting change took effect (from 2012 to 2014). It reveals that, of the charter amendments voted on since the broker voting change, in 54 of the 63 company-years (86%) where proposals failed despite receiving at least 90% support, the company would have had at least one proposal pass if the broker voting change had not applied.

83. In the event that there were no distortion from broker voting – for instance, if there were proportional voting as discussed in Section V.C, the proportion voting in favor would not be 100% of the broker vote, but the proportion of the broker vote represented by $\beta_{fr}$, so the proposal would pass if $\alpha_{fr} + \beta_{fr} \alpha_{fr} > \alpha_{req}$.
84. Expressed algebraically: $\beta_{fr} > 0.9$ and $\alpha_{fr} < \alpha_{req}$ and $\alpha_{fr} + \alpha_{bv} > \alpha_{req}$.
85. See Current Report (Form 8-K), AKAMAI TECHNOLOGIES, INC. (May 15, 2013). The proposal was brought pursuant to an agreement with the Illinois State Board of Investment, which had previously submitted a shareholder proposal to the corporation. The Illinois State Board of Investment was represented by the Shareholder Rights Project. See SHAREHOLDER RTS. PROJECT, supra note 80.
86. 7 of the 50 companies listed in Panels 1-3 of Appendix A had proposals fail despite receiving more than 90% support in two different years, and three companies had proposals fail in all three years.
87. One of these companies, NYSE Euronext, had two charter amendments in 2013, where one would have failed and the other one would have passed if the broker voting change had not applied. Of the other companies, ModusLink Global Solutions, Inc. failed to disclose the number of broker votes, and L.-3 Communications Holdings, Inc. claimed that a
To put this into historical perspective, Figure 3, below, shows the proportion of management proposals that failed despite receiving greater than 90% support of votes cast from 2005 to 2014.

The average percentage of companies with proposals receiving 90% support that had proposals fail from 2005 to 2011 was 2.7%. Had broker votes been permitted from 2012 to 2014, I estimate that an average of 2.8% of companies with proposals receiving 90% support would have failed during that period. However, without broker votes, the actual average jumped to 13.1% over that period.

Another way of examining the effect of the broker voting change on frozen charters is to consider whether the likelihood of failure for proposals increased following the implementation of the rule. A regression (described in Appendix B) of whether charter amendments pass or fail, dependent on whether the vote took place after the broker voting change, shows that the timing of the vote is strongly significant (at the 1% level) in determining the

unanimous vote was required to approve the proposal. See Current Report (Form 8-K), NYSE EURONEXT (Apr. 25, 2013); Current Report (Form 8-K), MODUSLINK GLOBAL SOLUTIONS, INC. (Mar. 12, 2013); Current Report (Form 8-K), L-3 COMMUNICATIONS HOLDINGS, INC. (Apr. 30, 2013).
probability of the vote failing, and that the likelihood of a proposal failing increased by 4.9% after the broker voting change came into effect.

These results demonstrate that the broker voting change had a significant and economically meaningful impact on both the likelihood of amendment proposals failing and on the number of amendment proposals that have actually failed.

2. Shareholder-Unamendable Bylaws

So far, the discussion has focused on the effect of the broker voting change on charter amendments. The rule change also applies to bylaw amendments, which differ from charter amendments in several important respects.

While board approval is necessary to amend a charter, state law permits the bylaws of corporations to be amended by action of shareholders, without the approval of the board. A significant number of corporations have bylaws that can be also amended by the board of directors without a vote of shareholders. Bylaws therefore provide protection for shareholders in the event of a disagreement between the shareholders and directors regarding whether a certain bylaw amendment is in the best interests of shareholders. However, in the same way that the broker voting change has resulted in shareholders being unable to approve charter amendments, it has also resulted in shareholders of many corporations being unable to amend bylaws amendments.

Take, for example, the case of insurance company Cigna Corporation. The corporation has a classified board as stipulated in the bylaws of the corporation. Following receipt of a shareholder proposal, the corporation put forward a management proposal to amend the bylaws of the corporation to declassify the board of directors at its 2012 annual meeting. The board of directors of the corporation made no recommendation on the proposal, although it stated that it

88. See, e.g., DEL. CODE ANN. tit. 8, § 241.
89. See, e.g., DEL. CODE ANN. tit. 8, § 109(a).
90. See, e.g., Monsanto Co., Amended and Restated Bylaws § 67 (Jan. 11, 2016) (requiring a vote of 70% of outstanding shares to amend the bylaws, but allowing amendment by the vote of a majority of the Board of Directors). A notable exception in Delaware is for bylaw provisions classifying the board of the corporation, which can only be added upon a vote of stockholders of the corporation. See DEL. CODE ANN. tit. 8, § 141(b).
91. In practice, instances of shareholders attempting to unilaterally amend the bylaws of a corporation are rare. Only 10 shareholder proposals submitted from 2012 to 2014 (0.7% of shareholder proposals submitted during that period) were binding bylaw proposals. See RAJEEV KUMAR GEORGESON, ANNUAL CORPORATE GOVERNANCE REVIEW 14, 22 (2014). For a discussion of the reasons why this is the case, see Lucian Bebchuk & Scott Hirst, Private Ordering and the Proxy Access Debate, 65 BUS. LAWYER 329 (2010).
92. The shareholder proposal was put forward by the Ohio Public Employees Retirement System, which was represented by the Shareholder Rights Project. See SHAREHOLDER RTS. PROJECT, supra note 78.
93. Definitive Proxy Statement (Form 14A), CIGNA CORP. 67 (Mar. 16, 2012).
“continues to believe that the classified board structure has been and remains in the best interests of the Company and its shareholders.” However, these constituted only 72% of the outstanding shares of the corporation. A vote of 80% of the outstanding shares of the corporation was necessary to amend the bylaw provision establishing the classified board. 9.2% of the outstanding shares were uninstructed broker votes and did not vote at the meeting. After continued engagement with the Ohio Public Employees Retirement System, including a second shareholder proposal requesting declassification of the board, the directors of the corporation exercised their power to amend the bylaws without the need for shareholder approval to remove the classified board provision.

Table A.4 in Appendix A lists the 10 companies where bylaw amendments that received greater than 90% support of votes cast have failed since the broker voting change came into effect, and shows that 9 of the 10 companies would have had their bylaw amendment pass if the broker voting change had not applied. This represents a lower number than the number of frozen charters because there are fewer bylaw amendments put forward for shareholder approval than charter amendments. Furthermore, in some of those cases, boards could also act unilaterally to amend the bylaws. However, as above, the effect has been to reduce the number of corporate governance changes preferred by shareholders.

3. Insider Vetoes

Just as the broker voting change has made it impossible to amend parts of the charters of many corporations, it has also granted insiders a new veto power—i.e., situations in which all of the shareholders could formerly have amended the charter if they so desired, but whereby an insider block can now prevent the company from amending its charter.

To illustrate, consider the case of Cerner Corporation. At its 2013 annual meeting of shareholders, the company put forward a management proposal to amend its charter to declassify its board of directors. The company had in place a supermajority requirement requiring a vote of 80% of outstanding shares to amend the relevant provision of its charter. The proposal received the

94. Id.
96. See Amended and Restated Bylaws, CIGNA CORP. 20 (Oct. 26, 2010).
99. See Definitive Proxy Statement (Schedule 14A), CERNER CORP. (Apr. 15, 2013). This proposal resulted from engagement by a client represented by the Shareholder Rights Project, discussed further at supra note 1.
support of 70% of shares outstanding (representing 86% of the votes cast) and failed.\footnote{See Current Report (Form 8-K), CERNER CORP. (May 24, 2013).} About 7.5% of shares outstanding were uninstructed broker shares, which did not vote. With uninstructed brokers prohibited from voting, there were only 93% of the shares outstanding available to vote. According to its 2013 proxy statement, the officers and directors of Cerner held 14% of the outstanding shares of the corporation.\footnote{See CERNER CORP., supra note 99.} If all of the directors and officers opposed an amendment proposal, even if all other shareholders voted in favor of the proposal, it could receive at most 79% of the vote, insufficient to amend the relevant provisions of the charter. As a result of the broker voting change, directors and officers had a veto over amendments to those provisions of the charter.

Let us assume that insiders generally vote, and that their votes are therefore included in shareholder turnout. Insiders will have a veto if a vote will pass if they vote, but will not pass if they do not vote, i.e., shareholder turnout is greater than the vote requirement, but shareholder turnout \textit{less} the proportion of shares held by insiders is less than the vote requirement.\footnote{\[ \alpha_n > \alpha_{req} \text{ and } \alpha_n - \alpha_{ins} < \alpha_{req}. \]} This will be the result of the broker voting change if the shareholder turnout \textit{less} the proportion of shares held by insiders plus uninstructed broker votes would be greater than the vote requirement.\footnote{\[ \alpha_n > \alpha_{req} \text{ and } \alpha_n - \alpha_{ins} < \alpha_{req} \text{ and } \alpha_n - \alpha_{ins} + \alpha_{bro} > \alpha_{req}. \]}

The possibility of insiders vetoing charter amendments is especially problematic for votes on proposals such as anti-takeover amendments, where managements' preferences may diverge acutely from the preferences of most shareholders. Anti-takeover amendments represent a large proportion of the charter amendment votes that fail despite receiving strong shareholder support.\footnote{In my dataset, 88.7\% of the charter amendment proposals that failed despite receiving more than 90\% of votes cast were proposals to reduce takeover protection.} It is possible that shareholders in general prefer to amend the charter to remove anti-takeover defenses, as the threat of a takeover may encourage management to perform more effectively, and shareholders may benefit from the potential premium paid in the case of a takeover.\footnote{See, e.g., Henry G. Manne, \textit{Mergers and the Market for Corporate Control}, 73 J. POL. ECON. 110 (1965) (introducing the concept of a market for corporate control); Michael C. Jensen & Richard S. Ruback, \textit{The Market for Corporate Control: The Scientific Evidence}, 11 J. FIN. ECON. 5 (1983) (analyzing the effects of takeovers); Michael C. Jensen, \textit{Takeovers: Their Causes and Consequences}, 2 J. ECON. PERSP. 21 (1988) (summarizing the evidence of the effects of takeovers).} Consequently, shareholder proposals put forward in 2014 requesting that companies remove classified boards, a key takeover defense, received average support of 81\% of votes cast.\footnote{See GEORGESON, supra note 91, at 20.} However, insiders—managers—are likely to prefer not to amend such charter provisions, for corresponding reasons—the threat of a takeover that might lead to their replacement will reduce their job security, and put more
pressure on them to perform than they may otherwise prefer. In these cases, an insider veto would allow managers to stymie a charter amendment that would otherwise be value-enhancing for the substantial majority of shareholders of the company.

So far I have been describing the set of negative consequences of the broker voting change's elimination of broker voting, the distorted fail results. I now turn to consider the positive effects the broker voting change has had in eliminating distorted pass results.

C. Distorted Passes

As described in Part I, the broker voting change restricted broker voting on corporate governance matters, such as charter amendments, based on a concern that broker voting could distort the outcomes of shareholder votes where shareholders disagree with management recommendations. In the terminology coined in Section I.A, these are distorted pass results. In this Section, I consider the positive consequences of the broker voting change in eliminating such distorted pass proposals.

In order to evaluate this scenario, it is necessary to consider the preferences of the shareholders as a whole, including those who hold their own shares and do not vote, and those that hold their shares through a broker and do not instruct their broker how to vote. Because non-voting shareholders do not vote, their preferences are necessarily unknowable. It is also difficult to gather data on whether the characteristics of non-voting shareholders differ from other shareholders, and therefore whether their preferences are likely to differ from other shareholders. In the absence of any basis on which to believe otherwise, I will assume that the preferences of shareholders that do not vote (and do not instruct their brokers to vote) are the same as the preferences of the shareholders that do vote.⁷⁷ As a result, I take the proportion of votes cast that are in favor of a proposal as an indicator of the preferences of all shareholders with respect to the proposal.

The criterion for determining whether a vote would have been positively distorted by broker votes will vary between companies that have "shares outstanding" and "votes cast" requirements. For a company with a vote requirement that is a percentage of shares outstanding, a vote would be distorted by broker votes if less than 50% of votes cast are in favor of the proposal.

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⁷⁷ This is consistent with the discussion in Section I.B, which states that many shareholders do not vote because it is not rational for them to gather information regarding the vote. The assumption is consistent with the view that, if the group of shareholders that do not vote had spent time to inform themselves about the best voting outcome, the proportion of those shareholders that would vote in favor would tend towards the proportion of the shareholders that are well informed about the vote that voted in favor.

⁷⁸ This corresponds to the variable βₜₜₜ. I include in "votes cast" votes to abstain, as well as votes for and against.
proposal, but the votes cast in favor of the proposal plus broker votes would be greater than the vote requirement.109

Table A.3 of Appendix A shows the nine proposals put forward from 2012 to 2014 that received support of less than 50% of votes cast. Of those proposals, seven required a majority of votes cast for approval,110 and two required a majority of outstanding shares. As Table A.3 shows, allowing broker voting would have distorted the outcome of only one of these proposals, that of Pacific Sunwear of California, Inc. The proposal required a majority of votes cast. 48% of votes cast were in favor of the proposal, which failed. Had the 12% of outstanding shares held by brokers been voted in favor of the proposal, 55% of votes cast would have been in favor, and the proposal would have passed. Note that the percentage of votes cast was already very close to 50%. In the other six instances, the vote was not close enough to 50% for broker votes to have distorted the outcome. As a result, it is difficult to conclude that the broker voting change has had a significant effect in preventing distortion of shareholder voting on management proposals.

The very small number of management proposals where a majority of votes cast were against the proposal is to be expected. A management proposal requires the approval of directors. Directors must believe that the proposal is in the best interests of the company;111 this may be more difficult to establish for those proposals that are widely opposed by shareholders. In addition to their legal duty, bringing a management proposal is costly—directors must spend time considering the proposal, often seek legal advice regarding the proposal, and must approve disclosure regarding the proposal for the proxy statement. The failure of a management proposal may also have negative reputational costs for directors and managers.

As a result of these factors, directors are unlikely to put forward a management proposal that they think is unlikely to succeed. In addition, shareholders generally follow directors’ recommendations, unless they have reason to believe that interests of directors differs from their own. One such

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109. In other words, \( \beta_{\text{for}} < 0.5 \) and \( \alpha_{\text{for}} + \alpha_{\text{bv}} > \alpha_{\text{req}} \). For those companies that have a vote requirement that is a percentage of votes cast, a vote would be distorted by broker votes if less than 50% of votes cast are in favor of the proposal, and the number of votes cast in favor and broker votes (as a proportion of all votes cast and broker votes \( \beta_{\text{for+bv}} \)) is greater than the vote required \( \beta_{\text{req}} \), i.e.: \( \beta_{\text{for}} < 0.5 \) and \( \beta_{\text{for+bv}} > \beta_{\text{req}} \). Since adding broker votes changes the denominator as well as the numerator of the percentage of votes cast, \( \beta_{\text{for+bv}} \) is calculated as the it total number of votes cast in favor \( (\theta_{\text{for}}) \) plus the total number of broker votes \( (\theta_{\text{bv}}) \), divided by the total number of votes cast for \( (\theta_{\text{for}}) \), against \( (\theta_{\text{ag}}) \), abstained \( (\theta_{\text{ab}}) \) and by brokers \( (\theta_{\text{bv}}) \). For example:

\[
\beta_{\text{for+bv}} = \frac{\theta_{\text{for}} + \theta_{\text{bv}}}{\theta_{\text{for}} + \theta_{\text{ag}} + \theta_{\text{ab}} + \theta_{\text{bv}}}
\]

110. Five proposals were to approve the use of a shareholder rights plan (i.e. poison pill); because shareholder rights plans are not contained in the charter, they only require the approval of a majority of votes cast. Green Plains Renewable Energy, Inc. is an Iowa company, and Iowa follows the Model Business Corporation Act, where the vote requirement to amend the company’s charter is a majority of votes cast. See sources cited in supra note 18.

111. See, e.g., DEL. CODE ANN. tit. 8, § 242(b)(1) (“[T]he board of directors shall adopt a resolution setting forth the amendment proposed, declaring its advisability . . .”).
situation may occur with an amendment relating to takeover defenses, where directors and managers may have self-interested reasons for their recommendation. Consistent with this theory, all seven failing proposals that received less than 50% support from shareholders were proposals to authorize takeover defenses. As a result of these factors, there are very few management proposals that fail because of low levels of shareholder support, and so the likely magnitude of the risk of distortion by the inclusion of broker votes is extremely limited.

Figure 4 below shows the distribution of shareholder support for the 851 management proposals that were voted on at U.S.-incorporated Russell 3000 companies between 2012 and 2014.

As Figure 4 shows, most management proposals receive very high levels of support—the median level of support was 98.6%. Only the seven proposals listed in Table A.3 of Appendix A, 1.1% of the total, received support of less than 50% of votes cast. Since proposals can only be distorted if they receive less than 50% support, and the likelihood of receiving less than 50% support is extremely low, the chances of distortion occurring as a result of broker voting are also extremely low.

112. Well-advised corporations are likely to understand that, in the absence of a large blockholder who is in favor of the proposal, the likelihood of such proposals passing may be low and are less likely to bring a proposal. Six of the nine companies—all except Cameron International Corporation, Healthcare Trust of America, Inc., and Wynn Resorts Ltd.—are small capitalization companies (outside the Russell 1000), and may have not have had access to high-quality advice regarding the likelihood of success of the proposals.
A single management proposal since the broker voting change came into effect could have resulted in distortion, that of Pacific Sunwear of California, Inc. in 2012. In that case, the board of directors brought a proposal to ratify a shareholder rights plan (commonly known as a poison pill) that the board had adopted the previous year. The proposal did not amend the charter or bylaws, and required only 50% of votes cast to be in favor. The corporation had a number of significant blockholders, including a shareholder with 29.8% of the voting power, a private equity fund with 19.9% of the voting power, which collectively appear to have been instrumental in putting in place the poison pill, and a hedge fund with 14.7% of the voting power, which appears to have been disadvantaged by the poison pill. The directors, including representatives of the two largest holders, recommended in favor of the proposal; ISS recommended against the proposal. Shareholders representing 48.4% of the votes cast voted in favor of the proposal, which failed. Had even a quarter of the broker shares been voted in favor of the proposal, it would have passed. Pacific Sunwear’s potential distorted pass represents 0.12% of the management proposals brought during this period. This is lower than the chances of a company having its charter frozen by an order of magnitude, and therefore the benefits of avoiding distorted passes are significantly outweighed by the costs of the distorted fail effects of the broker voting change.

III. Companies Affected by the Broker Voting Changes

In Part II, I confined my analysis to amendments that have been brought to a vote since the broker voting change was implemented. However, since only a small proportion of companies have brought such proposals to a vote (12% of my sample), the results presented in Part II underestimate the true effects of the broker voting change. In this Part, I consider the effects of the broker voting change on those companies that have not brought such a proposal to a vote.

114. Id. at 28.
116. Id.
117. After amending the poison pill to meet ISS’s guidelines, the corporation resubmitted it for ratification at its 2013 annual meeting. See Definitive Proxy Statement, PAC. SUNWEAR OF CAL. INC. 25 (Apr. 26, 2013). ISS recommended in favor, and the proposal passed, receiving 96% of the votes cast. See Current Report (Form 8-K), PAC. SUNWEAR OF CAL. INC. 2 (June 7, 2013).
A. Frozen Charters

In circumstances where there has not yet been a charter amendment proposed, we cannot be certain how an amendment would fare, or the effect of the broker voting change on the likelihood of such an amendment. However, we can be certain that a potential amendment would fail where, even if all of the shareholders that voted had cast their votes in favor of the amendment, those shareholders would still be insufficient to meet the voting requirement necessary to amend the charter. This definition will underestimate the number of frozen charters as defined above, as there may be some amendments that would fail if they received 90% support, but would pass if they received 100% support. The frozen charter will be the result of the broker voting change if, in addition to this criterion, shareholder turnout and uninstructed broker votes are greater than the vote required.

To determine the number of frozen charters among companies that have not yet had charter amendment proposals, and whether those are caused by the broker voting change, I gather proxies for shareholder turnout, uninstructed broker votes, and voting requirements for each U.S. company in the Russell 3000 index. I determine applicable voting requirements from whether the company has a supermajority provision to amend its charter or bylaws, and if not, the default charter amendment requirement in its state of incorporation.

To estimate likely shareholder turnout and broker votes for a potential charter amendment, I use voting in director elections. Since Rule 452 was amended to prevent uninstructed broker voting on director elections in 2010, corporations have been required to disclose broker vote/non-vote figures for director elections.

However, using these figures as estimators of turnout for a potential charter amendment proposal presents two potential problems. Director election turnout (and charter amendment turnout) may vary from year to year. I therefore estimate the number of frozen charters in each year from 2010 to 2014. To be even more conservative, I also consider the number of frozen charters assuming each company had their maximum turnout within that period (and the corresponding number of uninstructed broker votes).

118. In other words: \( \alpha_0 < \alpha_{req} \). This is consistent with the analysis above, where I used \( \alpha_{for} < \alpha_{req} \) and \( \beta_{for} > 0.9 \). Because \( \alpha_{for} = \alpha_0 \times \beta_{for} \), so the first condition is \( \alpha_0 \times \beta_{for} < \alpha_{req} \). Since we are assuming \( \beta_{for} = 1 \), the first condition simplifies to \( \alpha_0 < \alpha_{req} \). Similarly, assuming that \( \beta_{for} = 1 \), the second condition, \( \beta_{for} > 0.9 \), is always satisfied. This assumes that the company has a “shares outstanding” standard to amend the relevant part of its charter. Though since almost all “votes cast” standards require a majority of votes cast, if more than 90% of votes cast are in favor of a proposal at such a company, the proposal will pass.

119. In other words: \( \alpha_0 < \alpha_{req} \) and \( \alpha_0 + \alpha_{bv} > \alpha_{req} \).

120. See Form 8-K Current Report, supra note 55. However, a number of corporations nonetheless disclose zero broker non-votes. Where this is an inaccurate disclosure of a positive number of broker non-votes, they will not be picked up by my method, which will therefore produce an underestimate of the number of corporations affected by the broker voting change.
A second problem in estimating turnout may occur if there is systematically higher turnout for meetings with votes involving charter amendments than for meetings without charter amendment votes. Intuitively, it makes sense that if a company has an amendment proposal on the ballot and is concerned that the amendment may fail, management of the company may employ a proxy solicitor to try to get a greater number of shareholders to vote. I examine this possibility at length in Appendix C, and undertake a variety of tests to determine if this is the case. My analysis shows that, between 2010 and 2014, director election turnout was not higher at annual meetings where corporations also had corporate governance proposals on their ballot. However, because there is intuitive and anecdotal evidence to suggest that increases are possible (if not widespread), I also test the number of frozen charters based on an arbitrary assumption that corporations are able to increase turnout by 5%.

I limit my sample to companies that are currently in the Russell 3000 index. I exclude companies with missing turnout data. I exclude meetings with contested elections, where shareholder votes may be split with competing candidates. I eliminate companies where cumulative voting or multiple classes of shares with different voting rights makes it difficult to estimate likely shareholder amendment turnout. This leaves a sample of 11,288 company years, or an average of 2,257.6 companies per year. My results are set out in Table 2 below.

121. As described in Appendix C, having a corporate governance proposal on the ballot was actually associated with lower director election turnout.

122. According to FactSet SharkRepellent, one corporation, Apache Corporation, put forward management proposals in 2013, 2014, and 2015. The proposals in 2013 and 2014 had turnout of 74.9% and 78.2%, respectively, insufficient to satisfy the company’s 80% supermajority requirement, even with more than 98% of votes cast in support each year. In 2015, the proposal received 83.4% turnout and passed. This suggests that some corporations with frozen charters can, through sustained effort, increase their turnout sufficiently to overcome frozen charters. Apache Corporation increased its turnout by 4.5% from 2013 to 2014, and by 6.6% from 2014 to 2015, an average of 5.5%.

123. For a discussion of the composition of the Russell 3000 index, see supra note 75 and accompanying text.

124. Although these companies are not identified as such in the SharkRepellent database, I identify them as those where with significant variation in turnout among directors—which I evaluate as the standard deviation of director turnout greater than 10% of the mean director turnout.
Table 2: Estimated Frozen Charters Resulting from the Broker Voting Change (BVC)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Companies</th>
<th>Frozen Charter Because of BVC</th>
<th>%</th>
<th>Frozen Charter Because of BVC with 5% Inflation</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>2,022</td>
<td>261</td>
<td>12.9%</td>
<td>254</td>
<td>12.6%</td>
</tr>
<tr>
<td>2011</td>
<td>2,155</td>
<td>302</td>
<td>14.0%</td>
<td>282</td>
<td>13.1%</td>
</tr>
<tr>
<td>2012</td>
<td>2,205</td>
<td>326</td>
<td>14.8%</td>
<td>282</td>
<td>12.8%</td>
</tr>
<tr>
<td>2013</td>
<td>2,310</td>
<td>312</td>
<td>13.5%</td>
<td>285</td>
<td>12.3%</td>
</tr>
<tr>
<td>2014</td>
<td>2,596</td>
<td>371</td>
<td>14.3%</td>
<td>353</td>
<td>13.6%</td>
</tr>
<tr>
<td>Max a0</td>
<td>2,619</td>
<td>256</td>
<td>9.8%</td>
<td>233</td>
<td>8.9%</td>
</tr>
</tbody>
</table>

I estimate that, based on yearly data from 2010 to 2014, between 13% and 15% of U.S. companies have frozen charters as a result of the broker voting change. Even on the most conservative assumptions—using the maximum turnout between 2010 and 2014, I estimate that about 10% of U.S. companies have frozen charters as a result of the broker voting change. The possibility of increasing turnout by 5% decreases the number of frozen charters caused by the broker voting change by a very small amount—the proportion of companies with frozen charters remains between 12.6% and 13.6% based on actual numbers, or 8.9% assuming the maximum turnout between 2010 and 2014.

B. Shareholder-Unamendable Bylaws

I use the same methodology as in Section III.A to determine the number of corporations where the broker voting change has made it impossible for shareholders to amend the bylaws of the corporation.125 The default requirement in most states for a bylaw amendment is only a majority of votes cast,126 but a majority of companies provide for supermajority requirements for shareholder votes to amend certain bylaw provisions.127 The FactSet SharkRepellent database provides data regarding supermajority requirements

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125. As before, I evaluate the number of companies where: \( a_{eq} < a_{req} \) and \( a_{eq} + \Delta v > a_{req} \). In this instance I use \( a_{eq} \) to represent the vote required for the bylaw amendment, rather than the charter amendment.

126. See, e.g., DEL. CODE ANN. tit. 8, § 109.

127. 1,087 companies in my sample (41.9%) have supermajority provisions for amending one or more provisions of their bylaws.
for bylaw amendment. However, the database does not differentiate between corporations that require a majority of outstanding shares to amend certain bylaw provisions, and those that require a majority of votes cast. To be conservative, I assume that all companies without a supermajority require only a majority of votes cast. As a result, my analysis is likely to significantly underestimate the number of companies with board-only bylaw amendments. Table 3 below sets out my results.

Table 3: Bylaws Not Amendable by Shareholders as a Result of the Broker Voting Change (BVC)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Companies</th>
<th>Bylaw Not Amendable By Shareholders Because of BVC</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>2,022</td>
<td>173</td>
<td>8.6%</td>
</tr>
<tr>
<td>2011</td>
<td>2,155</td>
<td>193</td>
<td>9.0%</td>
</tr>
<tr>
<td>2012</td>
<td>2,205</td>
<td>209</td>
<td>9.5%</td>
</tr>
<tr>
<td>2013</td>
<td>2,310</td>
<td>192</td>
<td>8.3%</td>
</tr>
<tr>
<td>2014</td>
<td>2,596</td>
<td>239</td>
<td>9.2%</td>
</tr>
<tr>
<td>Max $\alpha_{50}$ 2010-14</td>
<td>2,619</td>
<td>162</td>
<td>6.2%</td>
</tr>
</tbody>
</table>

Table 3 shows that, based on 2010 to 2014 data, the broker voting change has made it impossible for shareholders to amend the bylaws of between 8.3% and 9.5% of U.S corporations, or 6.2% of U.S. corporations using the most conservative estimate.

C. Insider Vetoes

As with frozen charters, it is possible to estimate the number of companies where the broker voting change has given insiders a veto over certain charter

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128. I do not include calculations based on a 5% inflation figure in Table 3 or Table 4, as the inflation is predicated on the possibility that management would choose to employ a proxy solicitor to increase turnout. In the situations described in Section III.B and Section III.C, I am assuming that management prefers not to amend the bylaws or charter; if they did, they could bring a bylaw amendment themselves, or could refrain from exercising their veto over the amendment. If management prefers not to amend the bylaws or charter, there would be no reason for them to employ a proxy solicitor to increase turnout.
amendments. Based on the same simplifying assumption that all shareholders support a particular resolution, insiders will have a veto as a result of the broker voting change where turnout is greater than the vote requirement, but turnout less the insider block is less than the vote required, and turnout plus broker votes less the insider vote would be greater than the vote required. I use the same methodology and data as above, including insider holdings taken from the FactSet SharkRepellent database. My results are shown in Table 4 below.

Table 4: Insider Veto As a Result of the Broker Voting Change (BVC)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Companies</th>
<th>Insider Veto Because of BVC</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>2,022</td>
<td>135</td>
<td>6.7%</td>
</tr>
<tr>
<td>2011</td>
<td>2,155</td>
<td>166</td>
<td>7.7%</td>
</tr>
<tr>
<td>2012</td>
<td>2,205</td>
<td>170</td>
<td>7.7%</td>
</tr>
<tr>
<td>2013</td>
<td>2,310</td>
<td>170</td>
<td>7.4%</td>
</tr>
<tr>
<td>2014</td>
<td>2,596</td>
<td>209</td>
<td>8.1%</td>
</tr>
<tr>
<td>Max a_{so} 2010-14</td>
<td>2,619</td>
<td>196</td>
<td>7.5%</td>
</tr>
</tbody>
</table>

As shown in Table 4, I estimate that the broker voting change has resulted in insiders at between 6.7% and 8.1% of U.S. companies having a potential veto over charter amendments, or 7.5% of companies using the most conservative assumptions. Of course, since shareholder support for a particular resolution will be less than 100%, there will be a greater set of companies where the broker voting change has given insiders a de facto veto over certain amendments.

D. Distorted Passes

In the same way that I extended my consideration of frozen charters to the large majority of companies that have not had charter amendments go to a vote, it is possible to consider the likelihood of potential distorted passes for proposals that have not yet been voted on.

129. \( \beta_{for} = 1 \).
130. If \( a_{ins} \) represents the insider block, then: \( a_{so} > a_{req} \) and \( a_{so} - a_{ins} < a_{req} \) and \( a_{so} - a_{ins} + a_{obv} > a_{req} \).
131. \( \beta_{for} < 1 \).
I find that 370 companies (16.6%) could potentially have a distorted pass result. However, these are only potentially distortable companies. To estimate the likely number of distorted passes, it is necessary to consider the level of support that would be necessary for the companies above to have votes distorted, and the likelihood of those levels of support occurring. The level of support necessary for the vote to be distorted will be a function of the number of broker votes and the turnout for the vote. The lower the number of broker votes as a proportion of the turnout, the closer the level of support must be to 0.5 for the outcome to be distorted. Table 5 below shows the distortable companies by the range of support at which they could be distorted.

Table 5: Expected Number of Distorted Companies

<table>
<thead>
<tr>
<th>Minimum Support for Distortion</th>
<th>Companies</th>
<th>Range of Support for Distortion</th>
<th>Likelihood of Support in Range</th>
<th>Expected Number of Distorted Pass Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>45%-50%</td>
<td>244</td>
<td>45%-50%</td>
<td>0.4%</td>
<td>0.9</td>
</tr>
<tr>
<td>40%-45%</td>
<td>62</td>
<td>40%-50%</td>
<td>0.6%</td>
<td>0.4</td>
</tr>
<tr>
<td>35%-40%</td>
<td>30</td>
<td>35%-50%</td>
<td>0.9%</td>
<td>0.3</td>
</tr>
<tr>
<td>30%-35%</td>
<td>14</td>
<td>30%-50%</td>
<td>0.9%</td>
<td>0.1</td>
</tr>
<tr>
<td>20%-30%</td>
<td>8</td>
<td>20%-50%</td>
<td>0.9%</td>
<td>0.1</td>
</tr>
<tr>
<td>10%-20%</td>
<td>6</td>
<td>10%-50%</td>
<td>1.1%</td>
<td>0.1</td>
</tr>
<tr>
<td>0%-10%</td>
<td>6</td>
<td>0%-50%</td>
<td>1.1%</td>
<td>0.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>370</strong></td>
<td></td>
<td></td>
<td><strong>1.8</strong></td>
</tr>
</tbody>
</table>

Along with the breakdown of distortable companies by the minimum level of support necessary for distortion, Table 5 also shows the likelihood of proposal support being between that level and 0.5, based on the proportion of all management proposals that received support in that range from 2012 to 2014. By multiplying this likelihood by the number of companies requiring

\[
\beta_{for} > \frac{a_{\text{est}} \cdot a_{bo}}{a_{bo}}. 
\]

For companies with votes cast requirements:

\[
\beta_{for} > \frac{b_{\text{est}} (a_{bo} + b_{bo}) - b_{bo}}{b_{bo}}. 
\]

132. For companies with outstanding shares requirements, rearranging the formula above, we can see that:

133. This assumes that the likelihood of that level of support is independent of the “distortability” of the company submitting the proposal. In reality, companies that are
that level of support, we can estimate the number of companies that are likely to have a distorted pass outcome as a result of broker votes. As Table 5 shows, only 1.8 companies, or 0.08% of the companies in my sample, can be expected to have a distorted pass outcomes as a result of broker votes.

This result reflects the low number of management proposals that are likely to receive less than 50% of shareholder support brought by directors. However, if management were to begin bringing forward more unpopular proposals, the number of potential distorted pass proposals would also change. Since such a possibility cannot be ruled out, any solution to the problem of distortion should minimize the risk of distorted passes as well as reducing the incidence of distorted fails.

IV. Evaluating the Broker Voting Changes

I turn now to consider the broker voting change from a normative perspective. I evaluate the broker voting change from several frames of reference. First, consistent with its own goals, I consider the broker voting change from an investor perspective. Second, I consider the broker voting change from a firm value perspective. Third, I consider the broker voting change from the perspective of the contractarian theory that underlies corporate law. Fourth, I consider the broker voting change from the perspective of directors and managers. I conclude with some words about the procedure by which the broker voting change was put in place.

A. The Investor Perspective

Because the broker voting change is so short—about half a page of text—it does not explicitly set out the reasons underlying its prohibition on uninstructed broker voting for certain corporate governance proposals. Instead, it references recent “changes in [NYSE] rules as well as through legislative action,” gives the example of the 2010 prohibition on broker voting of uninstructed shares in the election of directors and executive compensation matters, and indicates that the changes are being made “in light of these and other recent congressional and public policy trends disfavoring broker voting of uninstructed shares.” To understand the goals of the broker voting change, it is therefore necessary to refer to the reasons underlying the 2010 changes prohibiting uninstructed broker voting on director elections and executive compensation. The underlying rationales cited in the SEC orders approving the 2010 prohibitions on uninstructed broker voting on director elections and broker voting on executive compensation were to “better enfranchise

distortable may be slightly more likely to put forward proposals that have lower levels of support, and therefore the estimates in Table 5 may underestimate the level of expected distortion, though likely by less than an order of magnitude.

134. See Information Memorandum 12-4, supra note 60, at 1.
shareholders”135 and thereby “further investor protection and the public interest”136 and “enhance corporate governance and accountability to shareholders.”137 I therefore consider first how the broker voting change fares against its own implicit goal of investor protection.

Taking into account the consequences of the broker voting change outlined in Parts II and III, how does the broker voting change fare when evaluated against these aims? Here it is necessary to weigh the benefits of the broker voting change for investors in eliminating distorted pass results, with its costs to investors in causing distorted fail outcomes for proposals that investors consider to be value enhancing. As Part II shows, the number of distorted fail outcomes resulting from the broker voting change, particularly frozen charters, clearly outweighs the small number of distorted pass results that the broker voting change has prevented. And on a prospective basis, as described in Part III, the number of companies that are likely to have frozen charters without broker voting, and other distorted fail outcomes that likely resulted from the elimination of broker voting, clearly outweigh the small number of companies where permitting broker voting could result in distorted pass outcomes.138 By freezing charters, the broker voting change has disenfranchised shareholders. To the extent that these shareholders believe that charter amendments they vote on would enhance corporate governance and accountability to shareholders, the broker voting change has prevented such enhancement and accountability. As Sections II.B and II.C illustrate, there are other additional ways in which, rather than protecting shareholders from distortion in favor of insiders, the broker voting change has actually harmed investors—by giving certain insiders veto power over amendments that shareholders may believe to be in their interest, and by taking away shareholders’ ability to amend certain bylaws.

The most obvious counterargument in favor of the broker voting change is that broker voting is empty voting; brokers do not have any economic interest in the shares they vote, and therefore should not be controlling how those shares are voted.139 However, this argument against broker voting is like the old saw, variously attributed, that it might work in practice, but how does it work in theory? Voting by an actor without an economic interest is problematic not because it violates any established rule of corporate law. Indeed, many investors vote through intermediaries such as investment advisers that may not

137. See id. at 9; see also 2009 SEC Release, supra note 53, at 33,296 n.34 (arguing also that the 2009 change to the broker voting rules would “enhance corporate governance and accountability”). This is also consistent with statements made during interviews by NYSE and SEC staff members at the time the broker voting change was adopted (interview notes on file with the Yale Journal on Regulation).
138. This assumes that the distribution of support for corporate governance proposals would remain constant.
139. Indeed, this argument was put forward in defense of the broker voting rule change by a former SEC official in an interview with the author. See interview with former SEC Official (on file with the Yale Journal on Regulation).
have any economic interest in the shares that they are responsible for buying and voting. Instead, exercising voting rights without having an economic interest is considered undesirable because of the outcomes it is prone to produce—the voting actor influencing outcomes in their own interest, rather than the interests of their beneficiary. But—in contrast to voting on other matters, like director elections and executive compensation—the nature of voting on management proposals means that there are few, if any, circumstances where there may be a potential divergence between brokers’ interests and the interests of the beneficial owners of the shares.

As outlined above, charter amendment votes differ in two important respects from the director elections and executive compensation votes that the broker voting change refers to. First, there is a greater possibility for a divergence between director recommendations and shareholder preferences in director elections or executive compensation votes than in charter amendments. Second, the default rule for most charter amendments is not with reference to votes cast, but to shares outstanding. As was explained in Part I above, many corporations have supermajority requirements requiring the approval of a higher proportion of shares outstanding. With a votes cast standard, preventing uninstructed broker voting will have a limited effect on the chance of the proposal passing, as broker votes will be eliminated from both the numerator and denominator of the proportion of votes cast. Indeed, Akyol, Raff, and Verwijmeren found that the 2010 amendments to Rule 452 eliminating uninstructed broker voting for director elections did not decrease approval rates for directors. However, as demonstrated by the number of frozen charters observed in Part II above, with a shares outstanding standard, preventing broker voting will have a much greater impact on the likelihood of a proposal passing. It was therefore inapposite to apply reasoning from recent changes to Rule 452 to uninstructed broker voting on corporate governance proposals.

B. The Firm Value Perspective

The consequences of the broker voting change have been to prevent changes in the corporation’s governance. Given that they garnered the support of managers, directors, and shareholders, it is likely that these changes are value-enhancing for the corporation and its shareholders. However, in a

140. See, e.g., The 2009 SEC Release, supra note 53, at 33,296, (indicating that the proposed rule “should better enfranchise shareholders by helping assure that votes . . . are determined by those with an economic interest in the company” (footnote omitted)).
141. This excludes those companies incorporated in states governed by MBCA-based statutes that have not overridden the default amendment rule in those states, though as discussed in Section III.A, these represent only 5% of the sample I consider.
142. See Ali C. Akyol et al., supra note 10, at 17 (“[W]e observe no decrease in approval rates after the change in Rule 452. In fact, the increase in approval rates in annual meetings after 2009 is statistically significant at the 1% level.”).
143. Indeed, as directors are required to declare that such proposals are in the best interests of the company, and are bound by fiduciary duties, this is a strong presumption.
number of these corporations, frozen charters have prevented the corporation from making such amendments. To the extent this is the result of the broker voting change, the rule change has prevented the maximization of firm value.

An argument could be made that charter amendments of the kind prevented by frozen charters are not value enhancing, and that by preventing them, the broker voting change has maximized firm value. Indeed, one side of an active debate in corporate law and financial economics holds that removing anti-takeover devices (as most charter amendments seek to do) reduces firm value.\footnote{See, e.g., Martijn Cremers et al., \emph{Staggered Boards and Long-Term Firm Value, Revisited} (Mar. 14, 2016), https://ssrn.com/abstract=2364165 [https://perma.cc/QU8R-LWMY]. For the contrary view, see Lucian A. Bebchuk & Alma Cohen, \emph{The Costs of Entrenched Boards}, 78 J. FIN. ECON. 409 (2005); Olubunmi Faleye, \emph{Classified Boards, Firm Value, and Managerial Entrenchment}, 83 J. FIN. ECON. 501 (2007).} However, that would imply that the directors that propose and recommend the charter amendment as being in the best interests of the corporation do so wrongly, in spite of their fiduciary duties. In Section III.D, I speculate about how this could come to pass. However, such an argument would also mean that the large majority of shareholders that vote for the charter amendment as being in their own best interests are also mistaken, which seems implausible.

C. The Contractarian Perspective

Another way to evaluate the broker voting change is from the perspective of the contractarian view of corporate law. Economists and corporate law scholars have long understood the corporation as a “nexus of contracts” among different parties in the corporation.\footnote{See, e.g., Armen A. Alchian & Harold Demsetz, \emph{Production, Information Costs, and Economic Organization}, 62 AM. ECON. REV. 777 (1972); Frank H. Easterbrook & Daniel R. Fischel, \emph{The Corporate Contract}, 89 COLUM. L. REV. 1416 (1989); Michael C. Jensen & William H. Meckling, \emph{Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure}, 3 J. FIN. ECON. 305 (1976).} To the extent this analogy holds, the corporate charter is the central part of that contract. The charter defines the key terms of the contract among the corporation and its shareholders (which I will refer to as the “corporate contract”)—either by incorporating those terms explicitly, or by remaining silent and therefore adopting the default terms set out in state law. One of the crucial terms in the contract is the process for its amendment. The corporate law of most states provides certain mandatory requirements for charter amendments, although all states allow these to be modified in certain ways in the charter. Charter terms do not explicitly deal with broker voting. However, as the discussion in Part I indicates, the treatment of broker voting is central to the results of shareholder approval votes, because of its influence on the level of turnout, and because brokers overwhelmingly vote in favor of management proposals. As a result, the term of the corporate contract that deals with the requirements for shareholder approval of

\[144\]
amendments is predicated on certain expectations about the treatment of broker
voting.

The amendment terms of the charters in almost all of the companies in my
sample were adopted prior to January 2012. These amendment terms were
predicated on uninstructed broker voting being permitted on charter
amendments. As discussed above, it was also generally understood that brokers
voted overwhelmingly in favor of management, and that broker votes
represented, on average, about 10% of shares outstanding. The prohibition on
broker voting on charter amendments implicitly modifies the amendment
requirements of corporate charters from how they were understood by directors
and shareholders. To the extent this resulted in frozen charters, the expectation
of directors and shareholders that the charter could be amended given a certain
level of shareholder support has been thwarted. Thwarting the intention of
the corporate contract is value-reducing because it results in a move away from
contractual terms agreed to by all of the parties to the contractual nexus of the
corporation. As a result, it is likely that changing the terms of the contract
from those that were understood by the parties results in a less efficient

146. Ten companies in my sample successfully amended their charters to reduce
or eliminate supermajority requirements for charter amendments at their 2012 annual meetings.
147. See Proxy Working Group Report, supra note 44, at 14; Marcel Kahan &
Edward Rock, The Insignificance of Proxy Access, 97 VA. L. REV. 1347, 1360 (2011) ([T]he
broker can vote the uninstructed shares in its discretion—which usually means in accordance with
management recommendations.

149. The significance of this point is diminished by many other changes to the
factors that influence the difficulty of amending corporate charters since those charters were
entered into—for instance, the rise of institutional investors. However many such changes are
endogenous to the shareholders or the corporation, whereas the broker voting change is
exogenous.

150. See, e.g., Easterbrook & Fischel, supra note 145.
151. A long-standing debate in corporate law concerns whether the initial
corporate contract is efficient. Corporate contracts are understood to be efficient because the
parties designing the corporate contract cannot benefit from introducing inefficient terms, because
the other parties are informed of their value, and will price the inefficient term accordingly.
Therefore, the parties to the initial charter will draft value-maximizing terms. If the corporate
contract is efficient, then any unintended change to the corporate contract—such as a change in
the effect of the amendment term—will make the contract less efficient.
152. Having the option to amend the contract is likely to be efficient. Evidence
for the efficiency of amendment can be found in the fact that public company charters could
effectively prevent amendments by requiring 100% unanimity; however, only one company in my
sample implemented this requirement. In order for a charter preventing amendment to be efficient,
shareholders would have to believe that there is some benefit to preventing themselves from
amending the charter, and that that benefit would outweigh the cost of preventing current or future
amendments to the charter. Of course, despite these beliefs, shareholders could not have already
taken the efficient action to prevent future amendments. In any other set of circumstances,
changing the amendment term to prevent amendment will reduce the value of the company.
D. Directors’ and Managers’ Perspective

Throughout this Article I have assumed that, because charter amendments require the approval of directors, directors (and managers) support such charter amendments. However, there may be reasons to believe that directors and managers prefer that certain amendments fail, notwithstanding their approval of the amendments. There are a small number of management proposals where directors have not given a recommendation either for or against the proposal, or have recommended against the proposal. Table 6 below sets out the number of such recommendations for charter and bylaw amendments from 2005 to 2013.

Table 6: Number of “No Recommendation” and “Against” Recommendations by Type of Management Proposal, 2005-13

<table>
<thead>
<tr>
<th>Type of Proposal</th>
<th>No Recommendation</th>
<th>“Against” Recommendation</th>
<th>All Proposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charter Amendments</td>
<td>7</td>
<td>2</td>
<td>1,826</td>
</tr>
<tr>
<td>Bylaw Amendments</td>
<td>2</td>
<td>4</td>
<td>359</td>
</tr>
<tr>
<td>Other</td>
<td>8</td>
<td>1</td>
<td>260</td>
</tr>
<tr>
<td>Total</td>
<td>17</td>
<td>7</td>
<td>2,445</td>
</tr>
</tbody>
</table>

Although there are very few instances where directors do not recommend in favor of a management proposal,154 there are a large number of situations where management proposals approved by directors were preceded at the previous annual meeting by shareholder proposals that directors recommended against, and put forward numerous arguments against, casting doubt that the directors’ approvals and recommendations of a management proposal signal their true preferences. The most explicit example of directors bringing a proposal they do not personally support occurred at the 2013 annual meeting of Costco Wholesale Corporation. The board of directors approved a management proposal to declassify the board,155 but the board made no recommendation

153. These include amendments of both charter and bylaws.
154. One reason there may be so few instances where directors make no recommendation or recommend against a proposal is because failing to recommend the proposal may cast doubt on whether the directors believe the proposal is in the best interests of the company, and therefore whether their decision to approve the proposal was consistent with their fiduciary duties.
155. The management proposal followed a shareholder proposal put forward by the Pension Reserves Investment Management Board, which was represented by the Shareholder
about the proposal, and stated that "each director has advised the Company that as a shareholder he or she intends to vote AGAINST the proposal." 156

Why might directors approve amendments that they personally disfavor? This may be the case if a precatory shareholder proposal requesting the amendment has previously been approved by the shareholders of the company. The voting guidelines of many institutional investors indicate that, if that is the case, they will withhold votes from directors that fail to implement the request contained in the shareholder proposal. 157 Similarly, the policies of the major proxy advisory firms are to recommend withhold votes against directors that fail to implement the request contained in a successful shareholder proposal. 158 Directors wishing to avoid having a significant proportion of votes withheld in their own elections may therefore comply with shareholder wishes that an amendment be put forward, even though they personally oppose the amendment.

This is most likely to be the case for potential charter amendments, where directors' (and managers') preferences regarding amendments diverge from the preferences of the substantial majority of shareholders, such as charter amendments to remove anti-takeover measures like classified boards. In these cases, it is possible that shareholders may prefer to amend the charter to remove such anti-takeover defenses, based on the belief that the threat of a takeover may encourage management to perform more effectively, and shareholders may benefit from the potential premium paid in the case of a takeover. Consequently, shareholder proposals put forward in 2014 requesting that companies remove classified boards, a key takeover defense, received average support of 81% of votes cast. 159 However, managers may prefer not to amend the charter to remove anti-takeover provisions, for corresponding reasons – the


156. Definitive Proxy Statement, COSTCO WHOLESALE CORP. 27 (Dec. 17, 2013) (emphasis in original). Costco Wholesale Corporation is a Washington corporation. Its actions are unlikely to be permissible in other states. For example, DEL. CODE ANN. tit. 8, § 242(b)(1) requires that the board of directors adopt a resolution “declaring [the] advisability” of a charter amendment.

157. See, e.g., State Street Global Advisors, 3 PROXY VOTING AND ENGAGEMENT GUIDELINES (Mar. 2015), http://www.ssga.com/investment-topics/environmental-social-governance/2015/Proxy-Voting-and-Engagement-Guidelines-United-States.pdf [http://perma.cc/QMZ8-QZ68] (“SSGA may withhold votes from directors based on the following: . . . Directors of companies that have ignored a shareholder proposal which received a majority of the shares outstanding at the last annual or special meeting, unless management submits the proposal(s) on the ballot as a binding management proposal, recommending shareholders vote for the particular proposal(s) . . . .”).

158. See, e.g., INSTITUTIONAL S'HOLDERS SERVS. INC., U.S. SUMMARY PROXY VOTING GUIDELINES 15 (2016), http://www.issgovernance.com/file/policy/2016-us-summary-voting-guidelines-dec-2015.pdf [http://perma.cc/3CVC-VHZZ] (indicating that ISS will generally vote for board nominees, except, inter alia, that it will “[v]ote case-by-case on individual directors, committee members, or the entire board of directors as appropriate if: . . . [t]he board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year.”).

159. See GEORGESON, supra note 91, at 20.
threat of a takeover that might lead to their replacement will reduce their job security, and put more pressure on them to perform than they may otherwise prefer.\(^{160}\)

V. Fixing Frozen Charters

In this Part, I consider how the problems described above may be mitigated. I consider four kinds of solutions. Most obviously, the changes in the broker voting change could be reversed. Alternatively, steps could be taken to reduce the level of uninstructed broker votes. If uninstructed broker votes cannot be eliminated, a proportional system of voting could be implemented, or a system could be devised to permit uninstructed broker voting in particular circumstances. I conclude with some comments on the procedure by which any reform should be undertaken.

I evaluate each of the solutions presented below against the goals inherent in the framework developed in Section II.A above: to reduce both distorted fail proposals and distorted pass proposals. As discussed in Section II.C above, there were only a small number of management proposals that received low levels of shareholder support from 2012 to 2014, which limited the positive impact of eliminating distorted pass proposals during that period.\(^{161}\) However, it is not possible to conclude that this distribution of shareholder support is the natural state of the world. Indeed, it is possible to conceive of circumstances where a much larger number of proposals might receive low shareholder support.\(^{162}\) For the reasons set out in Section II.C, it seems unlikely that directors of a significant number of companies would bring proposals that had a significant chance of failing. However, since the possibility cannot be ruled out, any solution to the problem of distortion should minimize the risk of distorted passes as well as reducing the incidence of distorted fails. The ideal solution would therefore undo the effects of the broker voting change in freezing corporate charters\(^ {163}\) (as well as other “distorted fails” for bylaw amendments, and insider vetoes), while maintaining the potential benefits of the broker

\(^{160}\) Although this might prompt the question of whether such managers, or others acting with their interests in mind, were instrumental in bringing about the broker voting change, interviews with NYSE and SEC staff who were in relevant positions at the time the broker voting change was implemented suggest that this is not the case, and that the result was an unintended consequence, albeit one that such managers may not disfavor (interview notes on file with the *Yale Journal on Regulation*).

\(^{161}\) See supra Section II.C.

\(^{162}\) For example, during the 1980s and 1990s, a significant number of companies amended their charters to put in place takeover defenses, such as staggered boards. These types of amendments may have received significantly lower levels of shareholders support.

\(^{163}\) There are a number of companies that have frozen charters that are not the result of the broker voting change. Because of high supermajority requirements and/or low shareholder turnout, these companies would have frozen charters even if broker voting were permitted. Remedying frozen charters in these cases would require some other kind of intervention—for instance, court intervention to invalidate the supermajority requirement of the charter.
voting change in reducing distorted passes. I also comment on the potential cost and workability of the solutions.

Before discussing potential systemic solutions to the problem created by the broker voting change, it is worth discussing solutions that individual companies can implement. Most obviously, as discussed in Section III.A, a corporation could use the services of a proxy solicitor to increase its turnout. This option, including its limitations, is discussed in Section V.B. A company with a frozen charter generally cannot reduce the voting requirements for amending the charter, as such requirements themselves are generally also subject to the same voting requirements. There are also two theoretically possible but practically far-fetched solutions: disregarding the charter provision\(^{164}\) and undertaking a merger to remove the charter provision.\(^{165}\) Though they are unlikely to be plausible solutions for large public corporations, I mention them for completeness.

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164. A company could disregard the voting requirement provision in its charter, and seek judicial validation either in advance or after the fact. A similar process occurred at Baxter International Inc. The corporation had tried in 2006, 2011, 2012, and 2013 to amend its charter to declassify its board of directors (two of these proposals followed engagement with the Nathan Cummings Foundation, which was represented by the Shareholder Rights Project). Each attempt failed because of a provision in the corporation’s charter that required approval of “at least two-thirds of the holders of all the securities of the Corporation then entitled to vote on such change” to amend the declassification provision. See AMENDED AND RESTATED CERTIFICATE OF INCORPORATION, FILED AS EXHIBIT 3.1 TO CURRENT REPORT (FORM 8-K), at 8 (2013). In 2014, the Delaware Court of Chancery found (and the Delaware Supreme Court affirmed) that a very similarly worded voting agreement provision was ambiguous and should be treated as providing for a per-share scheme. Salamone v. Gorman, 106 A.3d 354 (Del. 2014). Pursuant to an agreement with an activist investor, Third Point Advisors, Baxter brought an application in the Court of Chancery to validate its treatment of its voting provision as a per-share scheme. However, the Court of Chancery denied Baxter’s motion since the provision had not been put to a vote. See Definitive Proxy Statement (Schedule 14A), BAXTER INTERNATIONAL INC. 62–63 (Mar. 24, 2016). After the charter amendment was approved at the corporation’s 2016 annual meeting on a per-share basis, the Court of Chancery validated the treatment and the amendment. In re Baxter Int’l Inc., C.A. No. 11609-CB (Del. Ch. Jan. 15, 2016). However, while this makes clear that judicial approval of a voting provision is possible if the provision is ambiguous, it is not clear that a court would overrule an unambiguous supermajority vote requirement.

165. A corporation could theoretically undertake a merger into a wholly-owned subsidiary specially created for that purpose, and stipulate that the charter of the other corporation become the charter of the surviving corporation. The charter of the other corporation could be set up as identical to the charter of the existing corporation, but with a lower voting requirement for charter amendments. This assumes either that the voting requirement for stockholder votes to approve mergers is lower than that to amend the charter, or that a merger vote would have a higher shareholder turnout. This may have unforeseen consequences for the corporation’s contractual relationships—e.g., triggering “change of control” provisions in contracts. In addition, it would involve substantial transaction costs for the corporation, including the preparation of merger documents and holding a shareholder vote. See, e.g., DEL. CODE ANN. tit. 8, § 251(e). Although state corporations laws provide for short-form mergers into wholly-owned subsidiaries of a constituent corporation, such that a vote of shareholders of a constituent corporation would not be required—for example, see id. § 251(g)—that procedure only applies if there are no changes to the certificate of incorporation of the surviving corporation, which would not be the case here. In 2013, a new provision, id. § 251(h), was added to the Delaware Code allowing a merger without a vote of constituent corporation shareholders. However, that provision only operates when a corporation has made a tender offer for all of the shares of the constituent corporation, and as a result thereof, owns at least 50% of the shares of the constituent corporation, which is very unlikely.
A. Reversing the Broker Voting Change

The most obvious solution to the problems outlined in Parts II and III is to reverse the broker voting change. This would have the converse consequences to those described in Parts II and III above. The distorted pass results caused by the broker voting change would disappear: the frozen charters caused by the broker voting change and bylaws made amendable only by the board would once again be amendable by shareholder vote, and the number of insider vetoes would be reduced. However, the possibility of distorted fail proposals would be reinstated. As discussed above, given the current practice of corporations, whereby very few bring management proposals that are likely to receive less than a majority of votes cast, the benefit from eliminating those frozen charters and other distorted fail proposals outweigh the very few instances of distorted pass proposals that might occur. However, there remains the possibility that the number of distorted pass proposals could increase, especially given that the reinstated potential for distortion from broker votes could increase the likelihood of such proposals passing. One solution could be to continue to require the disclosure of the number of uninstructed broker votes being voted, so that their distortive effect could be observed, and appropriate steps taken if distorted pass results became a significant problem.

Furthermore, reversing the broker voting change could be done inexpensively, through the NYSE’s issuance of further guidance reinstating charter amendments to the status of “brokers may vote,” thereby allowing brokers the discretion to vote without authority from beneficial owners. Given the simplicity of this solution and the ease by which it could be implemented, the broker voting change could be reversed as an interim measure to reduce harm to shareholders during the lengthy time period that may be required for comprehensive reforms to be designed, debated, and implemented.

B. Reducing Uninstructed Broker Votes

An alternative solution to the problem of distortive broker votes would be to reduce or eliminate uninstructed broker votes. If uninstructed broker votes could be eliminated, this would obviate the need to choose between distorted fails and distorted passes; both would be eliminated. Even if uninstructed broker votes could only be reduced and not eliminated entirely, this would still reduce the intensity of both kinds of distortions, and therefore the likelihood that either would affect voting outcomes.

The number of uninstructed broker votes could be reduced in a number of ways, some of which could be implemented by corporations, others of which could be implemented by brokers. As discussed in Part I, most uninstructed shares held through brokers are beneficially owned by retail investors. Corporations can already take steps to increase the response level from retail shareholders. Response rates among retail investors are higher when
corporations mail proxy materials in full paper format, rather than electronic notification, or the “notice and access” methods permitted by the SEC. In addition, corporations can hire proxy solicitors to telephone individual retail investors to encourage them to vote.

Presumably by using such techniques, a small number of the corporations that had charter amendments fail have since been able to increase their turnout sufficiently for similar charter amendments to pass. Apache Corporation put forward a management proposal to declassify its board of directors at its 2013 annual meeting. Despite receiving 99% of votes cast, the proposal received votes from only 74% of shares outstanding, below the corporation’s 80% supermajority amendment requirement, and failed. Apache Corporation put forward a second declassification proposal in at its 2014 meeting, and received votes from 77% of shares outstanding yet again failing the supermajority requirement. Finally, in 2015, a declassification proposal put forward by the company passed, receiving votes from 83% of shares outstanding. Three other corporations—Capital One Financial Corporation, Chesapeake Energy Corporation, and NCR Corporation—have been able to pass amendments that previously failed.

However, repeated attempts at passing amendments are not always successful—Teradata Corporation, whose attempted amendment was described in Part II, subsequently tried and failed a second time to amend its charter. Proxy solicitations to significantly increase turnout are also likely to be expensive. Most proxy solicitors charge a flat fee (e.g., $15,500 in the case of Teradata’s solicitation in 2014), plus out of pocket expenses. The magnitude of these expenses is not disclosed in the proxy statement, but these are generally several dollars per shareholder contacted, with potential fees of several dollars more if the shareholder actually votes. As a result, soliciting

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166. See BROADRIDGE & PWC PROXY PULSE: HOW WELL DO YOU KNOW YOUR SHAREHOLDERS? (2013), http://media.broadridge.com/documents/Broadridge-PwC-ProxyPulse-First-Edition.pdf [http://perma.cc/82SP-9GAQ] (noting that only about 17% of retail shares receiving a notice were voted from 2007 to 2012, compared to 36% of shares receiving a full paper package).


173. See Definitive Proxy Statement (Schedule 14A), TERADATA CORP. 52 (Mar. 6, 2014).


175. See TERADATA CORP., supra note 173, at 58.

176. See, e.g., Proxy Solicitation Agreement Between Northwest Bancorp Inc. and Laurel Hill Group, LLC, filed as Exhibit 99.8 to Northwest Bancshares, Inc., Pre-Effective Amendment No. 1 to Registration Statement (Form S-1) (Oct. 26, 2009) (stipulating telephone
voting instructions from a large number of shareholders that do not instruct their brokers on how to vote can quickly become expensive. Even if increasing turnout were successful and cost effective for a particular corporation, to solve the general problem caused by the broker voting changes, it would need to be undertaken in every corporation suffering from a frozen charter, at considerable time and expense across the affected corporations.

A more permanent solution could be to reduce the number of retail investors. Many corporations have buyback programs targeted at small lots of shares. However, this requires retail investors to choose to tender into the buyback, which is unlikely to be universal. Other transactions could compulsorily acquire small shareholdings. In a reverse stock split, a corporation reduces the number of its outstanding shares by combining shares in a particular ratio. If a corporation undertook a reverse stock split with a high ratio, for example, requiring that 100 old shares be exchanged for 1 new share (a “1-for-100” reverse split), those shareholders with lots smaller than the ratio would receive cash for their shares. However, this is likely to be a drastic and expensive undertaking for a corporation, and since it will affect the number of shares outstanding, may have undesired effects on the liquidity of the company. Its costs are therefore likely to outweigh the benefits in reducing the number of small shareholders.

An alternative solution from those implemented by corporations with respect to their shareholders is for brokers to implement a solution with respect to their clients. The most promising solution is client-directed voting. Brokers could require their clients to direct how their shares should be voted if they fail to give instructions for a particular meeting. For example, clients could instruct that their shares be voted as management recommends or against management’s recommendation. Alternatively, clients could request that their shares be voted proportionally (as further discussed below). To the extent that this could be implemented when clients establish a relationship with a broker, it could significantly reduce the number of uninstructed broker shares. However, there would inevitably be some brokers that do not choose to participate. In

addition, it may be difficult for brokers to require existing clients to decide on a voting option, or to force a default election upon existing clients. It is also likely that one of the options for clients under a client-directed voting system would be to choose that their shares not be voted if uninstructed; to the extent clients choose this option, there would be no reduction in distorted fail results.

Although several of these solutions—especially client directed voting—show promise, all could only be partially effective—none can completely eliminate uninstructed shares, and therefore the problems of distorted pass results and distorted fail results must be dealt with in another manner.

C. Proportional Voting

An alternative approach to broker voting considered by the Proxy Working Group178 (and advocated by several commenters on the proposal to limit uninstructed broker voting on director elections)179 is proportional voting. This would replace the current structure whereby brokers can either vote all of the shares they hold or none of the shares they hold depending on the matter, with a system whereby brokers would be required to vote in proportion to the votes of other shareholders. For instance, if 95% of other shareholders voted in favor of a proposal, brokers would vote 95% of their shares in favor of the proposal and 5% of their shares against the proposal.

Assuming that the preferences of shareholders holding their shares through brokers are the same as other shareholders, this solution would eliminate any distortion in shareholder voting. Consequently, it would avoid both of the types of distorted outcomes discussed above. Assuming continued high levels of shareholder support for management proposals, proportional voting would undo the frozen charters caused by the broker voting change, as well as the other kinds of distorted fail proposals, failed bylaw amendments and insider vetoes. Since broker votes would follow the votes of other shareholders, proportional voting would also avoid any distorted fail outcomes. Proportional voting would also obviate the need for an arbitrary list of matters on which brokers could or could not vote, such as that contained in the supplementary materials to Rule 452—instead brokers would vote proportionally on all matters.

However, proportional voting would be complicated to implement.180 Brokers would need to obtain a measure of the proportion in which they vote their shares. There are two separate reference groups by which the appropriate proportion could be measured—the other shareholders of the corporation as a whole, or other shareholders that have instructed a particular broker to vote.

179. See 2009 SEC Release, supra note 53, at 33,301.
180. While the Proxy Working Group noted that it was "somewhat attractive, it ultimately concluded that "in many ways proportional voting creates its own set of problems" and that "it was not the optimum result." See Proxy Working Group Report, supra note 44, at 17-18.
The most obvious proportion for brokers to vote would be the proportion of votes cast by all other (non-broker) shareholders of the corporation. This would most accurately reflect overall shareholder preferences. However, if the preferences of shareholders as a whole were different from those shareholders who do not vote, this could result in distortions of its own. Logistically, basing proportional voting on the aggregate proportion of votes cast would require a tabulation of the shares of all of the other shareholders prior to the broker submitting their proxies. Broadridge Financial Solutions, Inc. handles the overwhelming majority of proxy statement distribution and vote handling for most corporations. Broadridge could provide preliminary vote counts to the corporation for distribution to brokers, or to brokers directly. In order for proxies to be voted by brokers, this information would need to be received several days before votes were due. This problem has been overcome with respect to broker-by-broker proportional voting (described below), and although coordinating vote tallies from multiple sources would be more difficult, this is likely to be surmountable.

An alternative would be for brokers to give proxies to the proxy holders to vote their shares in a proportion to be determined. Most proxy cards in uncontested elections appoint selected officers or directors of the corporation as the proxy holder, and direct the proxy holder to vote in the manner specified on the proxy card. To implement proportional voting, the proxy card could include an option of having the proxy holder split the shares in the proportion voted by other shareholders. Such a system could be most easily implemented by SEC regulation. While it could also conceivably be implemented by private ordering, on a company-by-company basis, such a solution would have significant limitations. Each company would have to act individually, thereby duplicating significant effort, and requiring a very long lead time for the change to be adopted by a substantial number of companies, if at all; it is also likely that many companies would not implement the system. If such a system were to be feasibly implemented in an efficient manner, SEC regulation would therefore be required.

The alternative to voting on an aggregate basis would be for brokers to vote uninstructed shares according to voting proportions obtained on a broker-by-broker basis, from the instructions each broker receives from beneficial owners that do submit such voting instructions. A broker-by-broker system would be straightforward to implement. The brokers, or Broadridge acting on their behalf, could tally the instructions they received from their other

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181. It may also be possible for brokers to submit a blank proxy to the tabulating organization or to directors, allowing them to vote the uninstructed shares in the proportion that is later established.

182. Most proxy cards already indicate that the proxy will be voted in a particular way if no direction is made on a proxy card with respect to a particular vote, usually following directors' recommendations.

183. For a broader discussion of the relative merits of regulatory and private ordering solutions, see Bebchuk & Hirst, supra note 91.
beneficial owners, and then split the proxies of the uninstructed shares in the same proportions. As above, the tabulation would need to be done several days prior to the votes being cast. However, as discussed in Part I above, beneficial owners holding their shares through brokers are already required to notify the broker of their votes at least ten days before the meeting. As a result, the timing issue is unlikely to be a problem. Indeed, the Proxy Working Group noted that one broker, Charles Schwab, had implemented proportional voting as early as 2005. Following the release of the Proxy Working Group’s report, the Securities and Financial Markets Association (SIFMA) issued a “best practices” memorandum recommending that their member brokers implement proportional voting of uninstructed shares in proportion to the votes cast by the retail clients of the broker. According to news reports, four large brokers—Charles Schwab, Ameritrade, Morgan Stanley, Merrill Lynch, and Goldman Sachs—adopted broker-by-broker proportional voting. In a presentation to SIFMA in 2007, Richard Daly, chief executive officer of Broadridge, outlined how they provided proportional voting services to “four large broker clients” in 2007. The proportion was established based on shares voted by retail customers of the broker. The proportion was calculated as of two days prior to the meeting, and then recalculated the day before the meeting and the day of the meeting, in order to account for newly voted shares.

Although a broker-by-broker system could be easily implemented, it might result in other distortions where only a small number of street-name holders submit instructions to a particular broker and those holders have different preferences from other shareholders. The votes of the shareholders that do vote would be “overweighted” to the extent of the uninstructed shares. The larger the ratio of uninstructed shares to the shares being used to determine the proportion, the stronger this effect. The Proxy Working Group considered there to be a possibility of manipulation where a broker has a disproportionately large number of uninstructed shares. However, the concerns expressed by the Proxy Working Group seem to have been assuaged where the pool of votes used to set the proportion included only retail investors. Henry Hu and Bernard Black also consider this approach, and

184. See N.Y. STOCK. EXCH. INC., supra note 3, at R. 451(b)(1).
186. See Proxy Working Group Addendum, supra note 177, at 4.
188. See Slides from presentation by Richard J. Daly, Chief Exec. Officer, Broadridge Financial Solutions, Inc., to SIFMA Operations Conference (Apr. 29-May 2, 2007).
190. See Proxy Working Group Addendum, supra note 177, at 4 (“By limiting the vote to be considered in making proportional voting decisions to the retail vote, the Proxy Working Group thought that the potential for manipulation could be significantly reduced.”).
conclude that there is no reason to believe that the distortion would be problematic.¹⁹¹

A potential argument against a proportional voting solution is that the preferences of shareholders that do not vote may not match the preferences of those that do vote, whether that proportion is taken on an aggregate basis or on a broker-by-broker basis. Most clearly, shareholders holding through brokers that do not vote (which are assumed to be retail investors) will differ from the majority of holders of outstanding shares (which are large institutions). To a lesser extent, shareholders holding through a certain broker that do vote may differ from those that hold through that same broker that do not. However, it is not clear that these differences will be substantial. Based on a rational actor model of voting, the main difference between shareholders that vote and shareholders that do not vote is that shareholders that vote have informed themselves about the proposal and the outcome that is likely to maximize value for them. The underlying interest of shareholders that do not vote is the same—to maximize the value of their shares. Aside from random variation, there is no reason to believe that if non-voting shareholders informed themselves about the proposal, their preferences would differ from that of shareholders that do vote. It is especially unlikely that shareholders would come to differing conclusions where significant majorities of shareholders are in favor of a proposal—as is the case with frozen charters by definition—and where directors and shareholders agree on the value of the proposal.

It is clear that the logistical issues involved in a proportional voting system are surmountable, whether through regulatory action, or through private ordering by corporations or brokers. This would speak in favor of re-allowing uninstructed broker voting, though encouraging a move towards proportional voting.

D. Broker Voting on Certain Charter Amendments

A fourth set of alternatives would be to replace the broker voting change with a rule that permits broker voting on a circumscribed set of corporate governance proposals. Although this would not eliminate distortions from broker voting in the same way as proportional voting, it would minimize the harm from such distortions.

Allowing broker voting in any form will open up potential “empty voting” counterarguments of the kind discussed in Section IV.A, that brokers do not have an economic interest in the shares they are voting. However, for the reasons outlined in that Section, this is unlikely to be a significant problem in

¹⁹¹. See Henry T. C. Hu & Bernard Black, Equity and Debt Decoupling and Empty Voting II: Importance and Extensions, 156 U. PENN. L. REV. 625, 705-06 (2008) (“This would somewhat overweight the instructions that shareholders convey, but creates no obvious incentive problems. At the margin, the prospect of overweighted voting might induce more economic owners to vote.”).
Frozen Charters

practice. Similarly, to the extent that the preferences of the shareholders who do not vote differ from those that do, broker voting that is guided by past shareholder votes (including that described in Section V.D.2 below), will be a distortion of shareholders’ aggregate preferences, similar to that discussed in Section V.C above with respect to proportional voting. However, as discussed, there are reasons to believe that this may not be a significant problem in practice.

The set of corporate governance proposals where broker voting would be allowed would be those with the greatest likelihood of distorted fail outcomes and the least likelihood of distorted pass outcomes. Such a rule could be implemented by an addition to the supplementary materials to Rule 452, indicating that a broker could not vote an uninstructed proxy on a corporate governance matter such as the kinds listed in the broker voting change, unless the proposal met certain conditions. One version of this approach, described in Section V.D.2 below, was considered by NYSE and SEC officials as an alternative to the broker voting change. I consider three possible alternatives for what kind of proposals would be permitted.

1. Broker Voting for Removing Supermajorities

One set of corporate governance proposals where broker voting could be permitted is charter or bylaw amendments to remove supermajority provisions. Most frozen charters occur in companies with high supermajority requirements. However, most supermajority requirements cannot be removed, because they are themselves subject to supermajority requirements for amendment. Therefore, charter amendments to remove them are also likely to suffer distorted fails if broker voting is not permitted. Allowing broker votes on amendments removing supermajorities would allow the circularity problem to be broken. There are currently high levels of shareholder support for removing supermajority provisions, so it is unlikely that such a proposal would have the possibility of a distorted pass result.

Allowing broker voting on amendments to remove supermajority provisions envisages a two-step process for amendment of other charter provisions: the charter would be amended to remove the supermajority provision, then the substantive provision could be amended at a subsequent meeting. Not only would this take several years, but also such a private

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192. Interview with NYSE and SEC officials (on file with the *Yale Journal on Regulation*).

193. This is unsurprising. In companies without supermajorities, if a proposal is overwhelmingly supported, then the possibility of 10-15% of shares being uninstructed broker shares and not vote is unlikely to reduce the overall vote below 50%.

ordering solution would require each affected company to go through this process and would therefore be more duplicative than a regulatory solution.

2. Broker Voting for Proposals that Shareholders Generally Support

Permitting brokers to vote only on matters that generally receive substantial shareholder support target the kinds of proposals where frozen charters and other distorted fail outcomes are most likely to be an issue, while minimizing the risk of potential distortion. The possibility of a distorted fail outcome would be eliminated, and since the proposal receives majority support, a distorted pass outcome is also not possible.

One difficulty with this solution would lie in choosing a bright line rule for those corporate governance proposals on which broker voting would be permitted. One alternative would be to set out a list of topics that generally receive strong shareholder support in the supplementary materials to Rule 452, and allow broker discretionary voting on those proposals. This approach was considered by NYSE and SEC officials as an alternative to the broker voting change. However, this approach would not reflect variances in voting outcomes across firms and across time, and would likely need to be updated on a regular basis through the lengthy SEC rulemaking procedure.

A better alternative would be to permit broker voting on a proposal that previously received a strong majority (e.g., greater than 80% of votes cast) at a previous annual meeting of the company. Similar to the approach in Section V.D.1 above, this would require a two-step process to amend the charter. This approach would also reflect the general practice of many corporations, which may wait for a successful shareholder proposal to demonstrate the preferences of the company’s shareholders before putting forward a management charter amendment proposal on a particular topic.

3. Broker Voting Where a Supermajority Is Required

A third set of corporate governance resolutions on which broker voting could be allowed are those amendments for which a supermajority vote is required. This would be a broader set of amendments than that described in

195. Interviews with NYSE and SEC officials (on file with the Yale Journal on Regulation).
196. The two steps consist of: a vote to demonstrate sufficient support at the first meeting, and then an actual amendment vote at the second meeting, which would likely take place the following year. In contrast to the approach in Section V.D.1 above, the first proposal could be submitted by a shareholder, whereas a supermajority amendment proposal would have to be put forward by the board of directors.
As discussed in Section V.D.1 above, proposals that require a supermajority for amendment are the very proposals that are likely to result in frozen charters and other distorted fail proposals. They are also proposals where there is almost no likelihood of a distorted pass outcome, since significant support for the proposal would be required for it to pass. Permitting brokers to vote only where a supermajority of outstanding shares is required would therefore reduce frozen charters and other distorted fail outcomes, while minimizing potential distorted pass outcomes. An addition to the supplementary materials permitting broker voting on such proposals could also be drafted in a straightforward manner, without ambiguity.

E. Procedure of Reform

As discussed in Section IV.E above, because the broker voting change was not a formal amendment to Rule 452, it avoided the considered process required for reviewing and approving such rule changes. Similarly, it could easily be undone by a similar information memorandum amending the NYSE policy on the matter. However, there may be reasons to believe that the NYSE will not wish to take action on the matter without going through the SEC rulemaking procedure. The most practical approach would therefore be for the NYSE to work with the SEC on developing a new policy for the treatment of broker votes on corporate governance proposals, and to submit that policy to the SEC for approval through the rule-making process described in Section IV.E above.

198. This would also encompass all amendments with supermajority provisions that were themselves subject to supermajority approval requirements, thereby encapsulating the set of proposals discussed in Section V.D.1, above.

199. It is possible that the NYSE may face pressure from directors or managers of some of the issuers listed on the exchange not to alter the broker voting change. As discussed in Section IV.D, it is possible that some directors and managers may prefer that certain charter amendments they have approved for submission to a vote of shareholders do not actually pass. If this is the case, these directors and managers may be less concerned about the shortcomings of the broker voting change, and may wish for it to remain in effect. Since the NYSE is funded by fees from corporations and members, rather than from investors, it may have an incentive to take actions preferred by those responsible for the corporation—directors and managers. If this were the case, it might be unrealistic to expect the NYSE to act on its own initiative to solve the problems created by the broker voting change. However, interviews with NYSE and SEC officials suggest that this is not a realistic concern (notes of interviews with SEC and NYSE officials, on file with the Yale Journal on Regulation).

200. According to interviews with NYSE and SEC officials in relevant positions at the time the broker voting change was implemented, the SEC requested that the NYSE issue the broker voting change to amend its current practice rather than go through the rule-making procedure. The SEC suggested that the prior treatment of broker votes on corporate governance proposals had not been correct (notes of interviews with SEC and NYSE officials, on file with the Yale Journal on Regulation). Both organizations may have a preference for a definitive answer in the form of rulemaking, rather than a further reversal of the practice, which may be likely to create confusion regarding the appropriate practice and its regulatory basis.

201. If the NYSE was not willing to submit a request for a change to its rules, it is possible for the SEC to take action of its own volition. The SEC may be able to take action to strike down the broker voting change, on the basis that it was a rule making, and not merely a
Another alternative, discussed in a number of the solutions above, would be private ordering, taken either by corporations, or by brokers. However, given the perspective of directors and managers on the broker voting change described in Section IV.D above, there are reasons to doubt that directors or managers would undertake action to reverse its investor-harming effect of their own volition. Instead, investors may need to engage with directors and managers to encourage them to take such action. Given the number of companies that would have to undertake individual action, this process is likely to be considerably slower than a regulatory solution. Since there are a smaller number of brokers, a broker-based private ordering solution may be more efficient.

Given the time that an SEC or private ordering process is likely to take, it would be optimal for the NYSE—if necessary, at the request of the SEC—to first take action to reverse the broker voting change, so as to avoid the investor-harming effects of the broker voting change on companies bringing charter amendments in the interim.

Conclusion

Broker voting rules create the possibility of two kinds of distortion. If brokers are permitted to vote and follow management recommendations, then broker voting will positively distort vote tallies, and may result in a distorted pass result for a proposal. The NYSE implemented the broker voting change to prevent such distortions. However, the broker voting change’s elimination of broker voting has another distorting effect: reducing vote tallies from the value they would have had if the preferences of all shareholders were considered. When disqualifying brokers from voting results in a proposal failing where shareholders would have preferred that it passed, there will be a “distorted fail.” Distorted fails have been the unintended consequence of the broker voting change. As a result, parts of the charters of a substantial number of corporations are frozen. The shareholders of a number of corporations are unable to amend their bylaws, and certain corporations now permit insiders a de facto veto over charter amendments. Given current levels of support for management proposals, these effects significantly outweigh the possibility of distorted pass outcomes that the broker voting change was designed to address. As a result, although the broker voting change has an implicit investor protection rationale, its effect has been the opposite: many charter amendments that investors favor as being in their interests and value-enhancing can no longer be implemented. The implicit change in the amendment term of the charter also undermines the
corporate contract. I propose a number of potential solutions to these problems. At the very least, and as an interim measure, the broker voting change should be reversed. The NYSE and SEC should then work together to develop a policy for the treatment of broker votes on corporate governance proposals that reduces both kinds of potential distortion. The most promising potential solutions appear to be either proportional voting or defining a set of corporate governance matters on which brokers could and could not vote. In this way, the investor protection rationale of broker voting reform could be upheld.
Appendix A: Distorted Fail and Distorted Pass Outcomes, 2012-14

Table A.1: Failed Charter Amendments Receiving >90% of Votes Cast

<table>
<thead>
<tr>
<th>Company</th>
<th>Year</th>
<th>% For ((\alpha_{fer}))</th>
<th>Broker Votes ((\alpha_{b}))</th>
<th>% Req'd ((\alpha_{req}))</th>
<th>% For + Broker Votes ((\alpha_{fer} + \alpha_{b}))</th>
<th>Result if BVs permitted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alcoa Inc.</td>
<td>2012</td>
<td>47.3%</td>
<td>25.6%</td>
<td>80.0%</td>
<td>72.8%</td>
<td>Fail</td>
</tr>
<tr>
<td>Avista Corporation</td>
<td>2012</td>
<td>74.6%</td>
<td>11.8%</td>
<td>80.0%</td>
<td>86.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>Duke Energy Corporation</td>
<td>2012</td>
<td>52.7%</td>
<td>28.8%</td>
<td>80.0%</td>
<td>81.6%</td>
<td>Pass</td>
</tr>
<tr>
<td>Franklin Street Properties Corp.</td>
<td>2012</td>
<td>70.6%</td>
<td>16.6%</td>
<td>80.0%</td>
<td>87.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Hercules Offshore, Inc.</td>
<td>2012</td>
<td>67.5%</td>
<td>21.9%</td>
<td>75.0%</td>
<td>89.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>PPG Industries, Inc.</td>
<td>2012</td>
<td>67.1%</td>
<td>12.6%</td>
<td>80.0%</td>
<td>79.8%</td>
<td>Fail</td>
</tr>
<tr>
<td>Piedmont Natural Gas Company, Inc.</td>
<td>2012</td>
<td>54.5%</td>
<td>28.5%</td>
<td>80.0%</td>
<td>83.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Principal Financial Group, Inc.</td>
<td>2012</td>
<td>58.1%</td>
<td>5.9%</td>
<td>75.0%</td>
<td>64.0%</td>
<td>Fail</td>
</tr>
<tr>
<td>SUPERVALU INC.</td>
<td>2012</td>
<td>50.5%</td>
<td>24.1%</td>
<td>75.0%</td>
<td>74.6%</td>
<td>Fail</td>
</tr>
<tr>
<td>Solta Medical, Inc.</td>
<td>2012</td>
<td>61.1%</td>
<td>22.9%</td>
<td>66.7%</td>
<td>84.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>St. Jude Medical, Inc.</td>
<td>2012</td>
<td>77.8%</td>
<td>9.1%</td>
<td>80.0%</td>
<td>87.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>Teradata Corporation</td>
<td>2012</td>
<td>75.9%</td>
<td>7.9%</td>
<td>80.0%</td>
<td>83.8%</td>
<td>Pass</td>
</tr>
<tr>
<td>Akamai Technologies, Inc.</td>
<td>2013</td>
<td>73.2%</td>
<td>10.9%</td>
<td>75.0%</td>
<td>84.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Apache Corporation</td>
<td>2013</td>
<td>73.9%</td>
<td>9.5%</td>
<td>80.0%</td>
<td>83.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>Avista Corporation</td>
<td>2013</td>
<td>73.8%</td>
<td>12.9%</td>
<td>80.0%</td>
<td>86.7%</td>
<td>Pass</td>
</tr>
<tr>
<td>Capital One Financial Corporation</td>
<td>2013</td>
<td>80.0%</td>
<td>5.5%</td>
<td>80.0%</td>
<td>85.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>Chesapeake Energy Corporation</td>
<td>2013</td>
<td>60.1%</td>
<td>22.4%</td>
<td>66.7%</td>
<td>82.6%</td>
<td>Pass</td>
</tr>
<tr>
<td>Cliffs Natural Resources Inc.</td>
<td>2013</td>
<td>46.7%</td>
<td>17.4%</td>
<td>50.0%</td>
<td>64.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Connecticut Water Service, Inc.</td>
<td>2013</td>
<td>57.9%</td>
<td>25.3%</td>
<td>80.0%</td>
<td>83.2%</td>
<td>Pass</td>
</tr>
<tr>
<td>Emerson Electric Co.</td>
<td>2013</td>
<td>71.2%</td>
<td>14.3%</td>
<td>85.0%</td>
<td>85.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>Energen Corporation</td>
<td>2013</td>
<td>78.3%</td>
<td>8.9%</td>
<td>80.0%</td>
<td>87.3%</td>
<td>Pass</td>
</tr>
<tr>
<td>FirstEnergy Corp.</td>
<td>2013</td>
<td>73.3%</td>
<td>11.7%</td>
<td>80.0%</td>
<td>85.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Company</td>
<td>Year</td>
<td>% For (a_f0)</td>
<td>Broker Votes (a_b0)</td>
<td>% Reg’d (a_r0)</td>
<td>% For + Broker Votes (a_f0+a_b0)</td>
<td>Result if BVs permitted</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>------</td>
<td>--------------</td>
<td>---------------------</td>
<td>---------------</td>
<td>---------------------------------</td>
<td>-------------------------</td>
</tr>
<tr>
<td>L-3 Communications Holdings, Inc.</td>
<td>2013</td>
<td>79.3%</td>
<td>8.8%</td>
<td>n/a</td>
<td>88.1%</td>
<td>Fail</td>
</tr>
<tr>
<td>Marathon Petroleum Corporation</td>
<td>2013</td>
<td>74.2%</td>
<td>9.2%</td>
<td>80.0%</td>
<td>83.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>Masco Corporation</td>
<td>2013</td>
<td>76.5%</td>
<td>5.0%</td>
<td>80.0%</td>
<td>81.5%</td>
<td>Pass</td>
</tr>
<tr>
<td>Mattersight Corporation</td>
<td>2013</td>
<td>69.2%</td>
<td>19.7%</td>
<td>80.0%</td>
<td>88.9%</td>
<td>Pass</td>
</tr>
<tr>
<td>ModusLink Global Solutions, Inc.</td>
<td>2013</td>
<td>60.9%</td>
<td>0.0%</td>
<td>75.0%</td>
<td>60.9%</td>
<td>Fail</td>
</tr>
<tr>
<td>NYSE Euronext</td>
<td>2013</td>
<td>63.7%</td>
<td>16.5%</td>
<td>80.0%</td>
<td>80.2%</td>
<td>Pass</td>
</tr>
<tr>
<td>OGE Energy Corp.</td>
<td>2013</td>
<td>65.3%</td>
<td>16.4%</td>
<td>80.0%</td>
<td>81.7%</td>
<td>Pass</td>
</tr>
<tr>
<td>PPG Industries, Inc.</td>
<td>2013</td>
<td>68.4%</td>
<td>12.3%</td>
<td>80.0%</td>
<td>80.7%</td>
<td>Pass</td>
</tr>
<tr>
<td>Principal Financial Group, Inc.</td>
<td>2013</td>
<td>61.4%</td>
<td>4.0%</td>
<td>75.0%</td>
<td>65.4%</td>
<td>Fail</td>
</tr>
<tr>
<td>QEP Resources, Inc.</td>
<td>2013</td>
<td>77.5%</td>
<td>9.1%</td>
<td>80.0%</td>
<td>86.7%</td>
<td>Pass</td>
</tr>
<tr>
<td>Reinsurance Group of America, Inc.</td>
<td>2013</td>
<td>81.5%</td>
<td>4.4%</td>
<td>85.0%</td>
<td>85.9%</td>
<td>Pass</td>
</tr>
<tr>
<td>SPX Corporation</td>
<td>2013</td>
<td>78.0%</td>
<td>6.1%</td>
<td>80.0%</td>
<td>84.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Southside Bancshares, Inc.</td>
<td>2013</td>
<td>56.2%</td>
<td>26.2%</td>
<td>66.7%</td>
<td>82.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>St. Jude Medical, Inc.</td>
<td>2013</td>
<td>77.2%</td>
<td>8.9%</td>
<td>80.0%</td>
<td>86.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>The Goodyear Tire &amp; Rubber Company</td>
<td>2013</td>
<td>70.2%</td>
<td>14.8%</td>
<td>66.7%</td>
<td>85.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>Allegheny Technologies Incorporated</td>
<td>2014</td>
<td>72.8%</td>
<td>8.8%</td>
<td>75.0%</td>
<td>81.6%</td>
<td>Pass</td>
</tr>
<tr>
<td>Apache Corporation</td>
<td>2014</td>
<td>77.4%</td>
<td>7.9%</td>
<td>80.0%</td>
<td>85.3%</td>
<td>Pass</td>
</tr>
<tr>
<td>Avista Corporation</td>
<td>2014</td>
<td>70.8%</td>
<td>16.0%</td>
<td>80.0%</td>
<td>86.8%</td>
<td>Pass</td>
</tr>
<tr>
<td>CME Group Inc.</td>
<td>2014</td>
<td>75.1%</td>
<td>0.0%</td>
<td>50.0%</td>
<td>75.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Capital One Financial Corporation</td>
<td>2014</td>
<td>80.9%</td>
<td>4.8%</td>
<td>80.0%</td>
<td>85.8%</td>
<td>Pass</td>
</tr>
<tr>
<td>Casella Waste Systems, Inc.</td>
<td>2014</td>
<td>65.9%</td>
<td>11.5%</td>
<td>75.0%</td>
<td>77.4%</td>
<td>Pass</td>
</tr>
<tr>
<td>Dover Corporation</td>
<td>2014</td>
<td>76.6%</td>
<td>8.2%</td>
<td>80.0%</td>
<td>84.8%</td>
<td>Pass</td>
</tr>
<tr>
<td>Government Properties Income</td>
<td>2014</td>
<td>59.3%</td>
<td>30.6%</td>
<td>66.7%</td>
<td>89.9%</td>
<td>Pass</td>
</tr>
<tr>
<td>Company</td>
<td>Year</td>
<td>% For (af)</td>
<td>Broker Votes (ab)</td>
<td>% Req’d (areq)</td>
<td>% For + Broker Votes (af+ab) permitted</td>
<td>Result if BVs permitted</td>
</tr>
<tr>
<td>----------------------------------------</td>
<td>------</td>
<td>------------</td>
<td>-------------------</td>
<td>----------------</td>
<td>----------------------------------------</td>
<td>------------------------</td>
</tr>
<tr>
<td>Hecla Mining Company</td>
<td>2014</td>
<td>41.1%</td>
<td>32.3%</td>
<td>80.0%</td>
<td>73.4%</td>
<td>Fail</td>
</tr>
<tr>
<td>Hess Corporation</td>
<td>2014</td>
<td>79.6%</td>
<td>8.2%</td>
<td>80.0%</td>
<td>87.8%</td>
<td>Pass</td>
</tr>
<tr>
<td>Higher One Holdings, Inc.</td>
<td>2014</td>
<td>77.8%</td>
<td>14.0%</td>
<td>80.0%</td>
<td>91.8%</td>
<td>Pass</td>
</tr>
<tr>
<td>MFA Financial, Inc.</td>
<td>2014</td>
<td>68.5%</td>
<td>19.1%</td>
<td>80.0%</td>
<td>87.6%</td>
<td>Pass</td>
</tr>
<tr>
<td>ModusLink Global Solutions, Inc.</td>
<td>2014</td>
<td>58.0%</td>
<td>21.9%</td>
<td>75.0%</td>
<td>79.9%</td>
<td>Pass</td>
</tr>
<tr>
<td>Molycorp, Inc.</td>
<td>2014</td>
<td>49.5%</td>
<td>26.8%</td>
<td>66.7%</td>
<td>76.3%</td>
<td>Pass</td>
</tr>
<tr>
<td>NCR Corporation</td>
<td>2014</td>
<td>78.4%</td>
<td>9.6%</td>
<td>80.0%</td>
<td>88.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>PPG Industries, Inc.</td>
<td>2014</td>
<td>67.1%</td>
<td>13.0%</td>
<td>80.0%</td>
<td>80.1%</td>
<td>Pass</td>
</tr>
<tr>
<td>Piedmont Natural Gas Company, Inc.</td>
<td>2014</td>
<td>59.0%</td>
<td>25.7%</td>
<td>80.0%</td>
<td>84.7%</td>
<td>Pass</td>
</tr>
<tr>
<td>Public Service Enterprise Group Incor.</td>
<td>2014</td>
<td>72.5%</td>
<td>14.5%</td>
<td>80.0%</td>
<td>87.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>Rentech, Inc.</td>
<td>2014</td>
<td>64.8%</td>
<td>19.8%</td>
<td>66.7%</td>
<td>84.6%</td>
<td>Pass</td>
</tr>
<tr>
<td>Rockwell Collins, Inc.</td>
<td>2014</td>
<td>73.1%</td>
<td>11.4%</td>
<td>80.0%</td>
<td>84.5%</td>
<td>Pass</td>
</tr>
<tr>
<td>SCANA Corporation</td>
<td>2014</td>
<td>62.4%</td>
<td>19.6%</td>
<td>80.0%</td>
<td>82.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>SPX Corporation</td>
<td>2014</td>
<td>76.7%</td>
<td>5.5%</td>
<td>80.0%</td>
<td>82.2%</td>
<td>Pass</td>
</tr>
<tr>
<td>Select Income REIT</td>
<td>2014</td>
<td>37.7%</td>
<td>7.8%</td>
<td>66.7%</td>
<td>45.5%</td>
<td>Fail</td>
</tr>
<tr>
<td>St. Jude Medical, Inc.</td>
<td>2014</td>
<td>75.1%</td>
<td>8.8%</td>
<td>80.0%</td>
<td>83.9%</td>
<td>Pass</td>
</tr>
<tr>
<td>Teradata Corporation</td>
<td>2014</td>
<td>73.8%</td>
<td>9.3%</td>
<td>80.0%</td>
<td>83.2%</td>
<td>Pass</td>
</tr>
<tr>
<td>Windstream Holdings, Inc.</td>
<td>2014</td>
<td>48.0%</td>
<td>36.8%</td>
<td>66.7%</td>
<td>84.8%</td>
<td>Pass</td>
</tr>
<tr>
<td>Company</td>
<td>Year</td>
<td>% For (a_for)</td>
<td>Broker Votes (a_bv)</td>
<td>% Reg'd (a_req)</td>
<td>% For + Broker Votes (a_for+a_bv)</td>
<td>Result if BVs permitted</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>------</td>
<td>---------------</td>
<td>---------------------</td>
<td>---------------</td>
<td>---------------------------------</td>
<td>-------------------------</td>
</tr>
<tr>
<td>Boston Scientific Corporation</td>
<td>2012</td>
<td>78.9%</td>
<td>6.6%</td>
<td>80.0%</td>
<td>85.5%</td>
<td>Pass</td>
</tr>
<tr>
<td>Chesapeake Energy Corporation</td>
<td>2012</td>
<td>62.0%</td>
<td>19.0%</td>
<td>66.7%</td>
<td>81.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>Cigna Corporation</td>
<td>2012</td>
<td>72.0%</td>
<td>9.3%</td>
<td>80.0%</td>
<td>81.3%</td>
<td>Pass</td>
</tr>
<tr>
<td>Piedmont Natural Gas Company, Inc.</td>
<td>2012</td>
<td>54.5%</td>
<td>28.5%</td>
<td>80.0%</td>
<td>83.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>SUPERVALU INC.</td>
<td>2012</td>
<td>50.5%</td>
<td>24.1%</td>
<td>75.0%</td>
<td>74.6%</td>
<td>Fail</td>
</tr>
<tr>
<td>Cleco Corporation</td>
<td>2013</td>
<td>76.3%</td>
<td>9.2%</td>
<td>80.0%</td>
<td>85.6%</td>
<td>Pass</td>
</tr>
<tr>
<td>The Goodyear Tire &amp; Rubber Company</td>
<td>2013</td>
<td>70.4%</td>
<td>14.8%</td>
<td>66.7%</td>
<td>85.2%</td>
<td>Pass</td>
</tr>
<tr>
<td>NxStage Medical, Inc.</td>
<td>2014</td>
<td>72.1%</td>
<td>15.2%</td>
<td>75.0%</td>
<td>87.3%</td>
<td>Pass</td>
</tr>
<tr>
<td>Piedmont Natural Gas Company, Inc.</td>
<td>2014</td>
<td>59.2%</td>
<td>25.7%</td>
<td>80.0%</td>
<td>84.9%</td>
<td>Pass</td>
</tr>
<tr>
<td>Rentech, Inc.</td>
<td>2014</td>
<td>66.5%</td>
<td>19.8%</td>
<td>66.7%</td>
<td>86.3%</td>
<td>Pass</td>
</tr>
</tbody>
</table>

202. Note that all of the bylaw amendments had "shares outstanding" supermajority requirements. This is unsurprising: votes cast requirement are normally a supermajority and would not have resulted in failures if supported by greater than 90% of the votes cast.
Table A.3: Management Proposals Receiving Less Than 50% Shareholder Support, 2012-14 (Majority of Votes Cast Standard)

<table>
<thead>
<tr>
<th>Company</th>
<th>Year</th>
<th>Type of Proposal</th>
<th>% Votes Cast For ((\beta_{for}))</th>
<th>Broker Votes ((a_o))</th>
<th>Votes For and Broker Votes as % of Votes Cast ((\beta_{for}+a_o))</th>
<th>Result if BVs voted in favor</th>
</tr>
</thead>
<tbody>
<tr>
<td>FRED’S Inc.</td>
<td>2012</td>
<td>Other</td>
<td>14.3%</td>
<td>6.3%</td>
<td>19.9%</td>
<td>Fail</td>
</tr>
<tr>
<td>Green Plains Inc.</td>
<td>2012</td>
<td>Amend Charter</td>
<td>40.4%</td>
<td>0.0%</td>
<td>40.4%</td>
<td>Fail</td>
</tr>
<tr>
<td>Obagi Medical Products, Inc.</td>
<td>2012</td>
<td>Other</td>
<td>36.6%</td>
<td>4.8%</td>
<td>39.9%</td>
<td>Fail</td>
</tr>
<tr>
<td>Pacific Sunwear of California, Inc.</td>
<td>2012</td>
<td>Other</td>
<td>48.4%</td>
<td>11.9%</td>
<td>55.0%</td>
<td>Pass</td>
</tr>
<tr>
<td>Viad Corp</td>
<td>2012</td>
<td>Other</td>
<td>43.4%</td>
<td>4.2%</td>
<td>46.0%</td>
<td>Fail</td>
</tr>
<tr>
<td>Benchmark Electronics, Inc.</td>
<td>2013</td>
<td>Other</td>
<td>46.8%</td>
<td>4.2%</td>
<td>49.2%</td>
<td>Fail</td>
</tr>
<tr>
<td>Wynn Resorts, Limited</td>
<td>2014</td>
<td>Amend Bylaws</td>
<td>39.9%</td>
<td>6.3%</td>
<td>44.1%</td>
<td>Fail</td>
</tr>
</tbody>
</table>

Table A.4: Management Proposals Receiving <50% Shareholder Support, 2012-14 (Majority of Votes Outstanding Standard)

<table>
<thead>
<tr>
<th>Company</th>
<th>Year</th>
<th>Type of Proposal</th>
<th>% Outst. Cast For ((\alpha_{for}))</th>
<th>Broker Votes ((a_b))</th>
<th>For and Broker Votes ((\alpha_{for}+a_b))</th>
<th>Result if BVs voted in favor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cameron International Corporation</td>
<td>2012</td>
<td>Amend Charter</td>
<td>40.1%</td>
<td>2.9%</td>
<td>43.0%</td>
<td>Fail</td>
</tr>
<tr>
<td>Healthcare Trust of America, Inc.</td>
<td>2014</td>
<td>Amend Charter</td>
<td>22.6%</td>
<td>0.0%</td>
<td>22.6%</td>
<td>Fail</td>
</tr>
</tbody>
</table>
Appendix B: The Broker Voting Change and the Likelihood of Charter Amendment Failure

To test empirically whether the broker voting change had a significant effect on the likelihood of failure of a particular proposal, I use a logistic regression model. I use a binary variable for whether the vote passes or fails (1 or 0, respectively), as the dependent variable. My key independent variable is whether the vote took place between 2012 and 2014 (a binary variable taking the value 1 for 2012 to 2014 and 0 for previous years). Given the importance of supermajority voting requirements, I control for the voting requirement necessary to approve the vote ($\alpha_{req}$). In a second specification, I add an interaction term between the vote requirement and the time. The two specifications can be written as follows:

\[
\begin{align*}
f(\text{Fail}) &= a + b_1 \cdot \text{Time} + b_2 \cdot \alpha_{req} + e \\
f(\text{Fail}) &= a + b_1 \cdot \text{Time} + b_2 \cdot \alpha_{req} + b_3 \cdot \text{Time} \cdot \alpha_{req} + e
\end{align*}
\]

Given the low likelihood of failure with a votes cast standard, I exclude votes that did not have a votes outstanding requirement. I cluster standard errors by company. My results are set out in Table B.1 below.

Table B.1: Effect of the Broker Voting Change on Likelihood of Proposal Failing

<table>
<thead>
<tr>
<th>Variables</th>
<th>(1) Fail</th>
<th>(2) Fail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time (2012-2014)</td>
<td>1.041***</td>
<td>-3.491***</td>
</tr>
<tr>
<td></td>
<td>(0.180)</td>
<td>(1.303)</td>
</tr>
<tr>
<td>Vote Required</td>
<td>7.028***</td>
<td>4.441***</td>
</tr>
<tr>
<td></td>
<td>(0.867)</td>
<td>(1.050)</td>
</tr>
<tr>
<td>Time $\times$ Vote Required</td>
<td></td>
<td>6.570***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(1.873)</td>
</tr>
<tr>
<td>Constant</td>
<td>-6.968***</td>
<td>-5.2040***</td>
</tr>
<tr>
<td></td>
<td>(0.598)</td>
<td>(0.664)</td>
</tr>
<tr>
<td>Observations</td>
<td>2,051</td>
<td>2,051</td>
</tr>
<tr>
<td>Chi²</td>
<td>90.72</td>
<td>125.01</td>
</tr>
<tr>
<td>Difference in Odds Ratios for Time (Time = 1 – Time = 0)</td>
<td>0.1006</td>
<td>0.0489</td>
</tr>
</tbody>
</table>
As Table B.1 shows, whether or not the vote took place after the broker voting change is significant at the 1% level in determining the probability of the vote failing. In the second model, which shows a better degree of fit, the likelihood of a proposal failing increases 4.9% if the proposal took place after the broker voting change.
Appendix C: Charter Amendments and Director Election Turnout

In Part III, I used director election turnout to predict the companies that are likely to have frozen charters. This approach is predicated on a number of key assumptions. First, it assumes that turnout for director election proposals at a particular meeting is correlated with turnout for corporate governance proposals. Second, it assumes that turnout for director election proposals is unaffected by whether there is a corporate governance proposal being voted on at the election or is affected in a consistent way. In this Appendix C, I examine the validity of each of these assumptions.

A. Correlation with Director Election Turnout

In order to test the assumption that turnout for corporate governance proposals is correlated with the turnout for director election proposals at a particular meeting, I use data for meetings taking place after the broker voting change took effect. After that time broker votes are excluded from vote tallies for both director election proposals and corporate governance proposals, permitting a simple calculation of the correlation between the two.

Figure C.1 below shows turnout for director election proposals and corporate governance proposals.
As Figure C.1 illustrates, director election proposal turnout and corporate governance proposal turnout are almost perfectly correlated, with a correlation coefficient of 99.9%. Figure C.1 makes clear that there are a small number of meetings—seven out of 379 meetings, or 1.8%—where corporate governance turnout varies from director voting turnout by more than 1%; these are likely to be instances of irregularities in the treatment or disclosure of broker non-votes.203

This has intuitive support—director election proposals and corporate governance proposals appear on the same proxy card. There seems to be little reason to believe that a shareholder would vote on one proposal and not the other. The largest shareholders of most corporations are mutual funds and pension funds, which have fiduciary duties to vote their shares.204 This gives confidence that director election proposal turnout can be used as a proxy for corporate governance proposal turnout.

203. The meetings where there was such a variance were the 2012 meeting of Cigna Corporation, the 2012 meeting of Redwood Trust, Inc., the 2013 meeting of Tredegar Corporation, the 2013 meeting of Walter Investment Management Corp., the 2013 meeting of Joy Global Inc., the 2014 meeting of The NASDAQ OMX Group, Inc., and the 2013 meeting of Live Nation Entertainment, Inc.

204. See supra note 17 and accompanying text.
B. Turnout in Director Elections When a Corporate Governance Proposal Is Also Being Voted on

In the model described in in Part III, I use turnout in director elections as a proxy for the expected turnout if there were a corporate governance proposal at a particular company. However, in the elections I am using to make predictions, there are no corporate governance proposals being voted on. Therefore my predictions depend on the assumption that turnout will be the same where there is not a corporate governance proposal on the ballot (the data I am using) and when there is a corporate governance proposal on the ballot (the situations I am trying to predict). There are reasons to suggest that this may not be the case. Shareholders may be aware of the possibility of a frozen charter, and therefore the importance of voting, and may be more likely to vote at such meetings. Alternatively, if managers of corporations putting forward a corporate governance proposal wish the proposal to succeed, they may hire a proxy solicitor, who will take active steps to increase shareholder turnout, either by sending additional correspondence to shareholders encouraging them to vote, or by telephoning shareholders to encourage them to vote.

To examine this assumption, I look at that set of companies that had a corporate governance proposal in a particular year, \( t \), and that did not have a corporate governance proposal in the previous year, \( t-1 \). I look at years from 2010 onwards, when broker votes were excluded on director election proposals. I compare director election turnout in the year with the corporate governance proposal on the ballot (\( \alpha_{t,0,t} \)), and turnout in the previous year (\( \alpha_{0,t-1} \)). Figure C.2, below, plots \( \alpha_{t,0,t} \) against \( \alpha_{0,t-1} \), as well as the trendline of the data, and a line showing equality.
As Figure C.2 illustrates, there is a strong correlation between director election turnout in years where there is a corporate governance proposal on the ballot and years where there is not (a correlation of 76.4%), but with some significant variation year to year. While there is some variation from a perfect correlation (shown by divergence from the 45° line), this is likely to be the result of random year-to-year variation in turnout. For comparison, Figure C.3 below compares director election proposal turnout in years when there is no corporate governance proposal on the ballot from director election turnout in the same company in the previous years, in which there is also no corporate governance proposal on the ballot.
Figure C.3: Scatterplot of Turnout in Years Without a Corporate Governance Proposal and Lagged Turnout in Years Without a Corporate Governance Proposal

Figure C.3 exhibits similar variation to Figure C.2, albeit with a slightly higher correlation (82.7%). However, there are a similar number of outlying observations with significant year-to-year variation. The trendline in both Figure C.2 and Figure C.3 shows some mean reversion—that firms with lower turnout in the previous year have higher turnout in the following year, and vice versa—but not a systematic bias toward an increase in turnout among companies that moved from not having a proposal to having a proposal.

To test this relationship, I generate a metric, $\alpha_{\Delta t_0}$, that calculates the increase in director election turnout, $\alpha_{t_0}$, from year $t-1$ to director election turnout in year $t$, as follows:

$$\alpha_{\Delta t_0} = \frac{\alpha_{t_0,t} - \alpha_{t_0,t-1}}{\alpha_{t_0,t-1}}.$$

I split firm-years in my sample into four types: those with no corporate governance proposal in year $t-1$ or year $t$ (‘0,0’ firm-years); those with a corporate governance proposal in year $t-1$ but not in year $t$ (‘1,0’ firm-years); those with no corporate governance proposal in year $t-1$ but a corporate governance proposal in year $t$ (‘0,1’ firm-years); and those with corporate governance proposals in each year (‘1,1’ firm-years). Table C.1 below illustrates the breakdown, and shows the number of firm-years in each category.
Table C.1: Breakdown of Years in Sample Based on Corporate Governance Proposals in Year $t$-1 and Year $t$

<table>
<thead>
<tr>
<th>Year $t$-1</th>
<th>No Corporate Governance Proposal</th>
<th>Corporate Governance Proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Corporate Governance Proposal</td>
<td>$(0,0)$ firm-years</td>
<td>$(0,1)$ firm-years</td>
</tr>
<tr>
<td></td>
<td>812 firm-years</td>
<td>432 firm-years</td>
</tr>
<tr>
<td>Corporate Governance Proposal</td>
<td>$(1,0)$ firm-years</td>
<td>$(1,1)$ firm-years</td>
</tr>
<tr>
<td></td>
<td>347 firm-years</td>
<td>60 firm-years</td>
</tr>
</tbody>
</table>

Figure C.4 below shows the distribution of $\alpha_{\Delta t_o}$ for $(0,0)$ and $(0,1)$ firm-years.

Figure C.4: Distribution of $\alpha_{\Delta t_o}$ for $(0,0)$ and $(0,1)$ Firm-Years
If there were a systematic increase between years without a corporate governance proposal and years with a corporate governance proposal, we would expect to see the (0,1) firm-year distribution slightly to the right of the (0,0) distribution. However, as Figure C.4 shows, there is no obvious difference between the two distributions.

If there were no systematic increase in a year in which there is a corporate governance proposal, then we would expect the mean of the distribution for years in which there is a corporate governance proposal to be the same as the mean of the distribution in years where there is no proposal. Table C.2 below shows the means for of $\alpha_{\Delta t_0}$ and for the samples of $\alpha_{\Delta t_0}$ where there is a proposal and there is no proposal, and the results of t-tests for the differences between years where there is a proposal and where there is no proposal.

Contrary to expectations, the mean of the (0,1) group is lower than the mean of the (0,0) group, by 0.00899. That is, the change in turnout from firm-years where there was no proposal in year $t-1$ to a proposal in year $t$ is less than the increase between two years when there was no proposal in either year, by 0.8%. However, the results of the t-test for the difference of means is probability of that this difference is greater than zero is only 0.0894.

However, this is not the end of the matter. The lack of effect over the entire group of corporate governance proposals may belie an effect in the subset of companies that I am concerned with that is nonetheless washed out by a lack of effect among other companies. Consider when a corporation may employ a proxy solicitor to try and increase its turnout in order to increase the likelihood that a corporate governance proposal passes. Having a proxy...
solicitor increase turnout is expensive, so a rational board of directors will not employ such measures in all instances. If the board believes the shareholder proposal is likely to pass without any intervention, there is no need to employ a proxy solicitor. Assuming strong shareholder support for a proposal, this is likely to be the case if the turnout in the previous year was above the voting requirement for the proposal. If the proposal is likely to fail even if a proxy solicitor is employed, then the corporation is also unlikely to expend the resources in a futile effort. This is likely to be the case if the firm has a supermajority requirement, and turnout in the previous year was significantly below the vote required for the proposal to pass. Only if the proposal is likely to fail by a small margin if a proxy solicitor is not employed might the corporation consider employing a proxy solicitor and increasing its turnout.205

Table C.3 below shows the corresponding means and t-test, where the sample of firms to those where there was a supermajority requirement, and the turnout in year $t-1$ was less than the vote required ($\alpha_{req}$) but still within 0.10 of $\alpha_{req}$, i.e.:

$$\alpha_{req} - 0.1 < \alpha_{t_{0},t-1} < \alpha_{req}.$$ 

Table C.3: Comparison of Means of Firm-Years (0,1) and (0,0) Where $\alpha_{t_{0},t-1}$ Is Within 0.10 of $\alpha_{req}$

<table>
<thead>
<tr>
<th>Firm-year</th>
<th>n</th>
<th>Mean $\alpha_{A_{t_{0}}}$</th>
<th>Std. Error</th>
<th>95% Conf. Interval</th>
</tr>
</thead>
<tbody>
<tr>
<td>(0,1)</td>
<td>36</td>
<td>0.0081</td>
<td>0.0140</td>
<td>-0.0202</td>
</tr>
<tr>
<td>(0,0)</td>
<td>70</td>
<td>0.0188</td>
<td>0.0091</td>
<td>0.0006</td>
</tr>
<tr>
<td>(0,1) - (0,0)</td>
<td></td>
<td>-0.0107</td>
<td>0.0162</td>
<td>-0.0427</td>
</tr>
<tr>
<td>$t$-test for $(0,1) - (0,0) &gt; 0$</td>
<td></td>
<td>$t = -0.659$</td>
<td>d.f. = 104</td>
<td></td>
</tr>
<tr>
<td>$Pr((0,1) - (0,0) &gt; 0)$</td>
<td></td>
<td>0.256</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table C.3 shows the expected sign for the mean change in turnout—i.e., that there was, on average, a very small (0.8%) increase in turnout in firm years

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205. For an analysis of strategic employment of proxy solicitors in the context of shareholder proposals, see Yair Listokin, Management Always Wins the Close Ones, 10 AM. L. & ECON. REV. 159 (2008).
with corporate governance proposals, where the previous year’s turnout was close to but below the vote required. However, Table C.3 again shows a lower change between firm-years where there was no proposal and when there was a proposal, than between two firm-years in which there was no proposal, despite the sample being limited to situations where management would be more likely to employ a proxy solicitor.\textsuperscript{206}

I also consider this question within a multivariate model, using a panel data set. I once again use as the dependent variable the proportionate change in turnout from the previous year. I include dummy variables for each of the sets of firm-years described above as (0,1), (1,0), and (1,1). The base case, where each of these dummy variables is zero, represents the set of firm-years described above as (0,0). In a second specification of this model, I also use dummy variables that take the value of 1 where the turnout in the previous year is below the vote requirement by less than 0.10 (\(\alpha_{\text{req}} - \alpha_{t-1} < 0.10\)). Table C.4 below shows the results.

\textsuperscript{206} A test of firms that had turnout in year \(t-1\) of less than \(\alpha_{\text{req}}\) but still within 0.05 of \(\alpha_{\text{req}}\), i.e., \(\alpha_{\text{req}} - 0.05 < \alpha_{t-1} < \alpha_{\text{req}}\), “not reported” shows a similar result.
Table C.4: Results of Multivariate Regression

<table>
<thead>
<tr>
<th>Variables</th>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$a_{\Delta t_0}$</td>
<td>$a_{\Delta t_0}$</td>
</tr>
<tr>
<td><strong>Firm years (0,1)</strong></td>
<td>-0.0113*</td>
<td>-0.0096</td>
</tr>
<tr>
<td></td>
<td>-1.71</td>
<td>-1.38</td>
</tr>
<tr>
<td><strong>Firm year (1,0)</strong></td>
<td>-0.00859</td>
<td>-0.00834</td>
</tr>
<tr>
<td></td>
<td>-1.16</td>
<td>-1.12</td>
</tr>
<tr>
<td><strong>Firm years (1,1)</strong></td>
<td>-0.0164</td>
<td>-0.0188</td>
</tr>
<tr>
<td></td>
<td>-0.83</td>
<td>-0.95</td>
</tr>
<tr>
<td>$\alpha_{req} - 0.1 &lt; \alpha_{t_0,t-1} &lt; \alpha_{req}$</td>
<td>0.0448*</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>Firm year (0,1) x</strong></td>
<td>-0.01845</td>
<td>0.0141***</td>
</tr>
<tr>
<td>$\alpha_{req} - 0.1 &lt; \alpha_{t_0,t-1} &lt; \alpha_{req}$</td>
<td>-0.94</td>
<td></td>
</tr>
<tr>
<td><strong>Constant</strong></td>
<td>0.0182***</td>
<td>0.0141***</td>
</tr>
<tr>
<td></td>
<td>6.85</td>
<td>3.98</td>
</tr>
<tr>
<td><strong>$R^2$</strong></td>
<td>0.0012</td>
<td>0.0016</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>1,651</td>
<td>1,651</td>
</tr>
<tr>
<td><strong>Firm Fixed Effect</strong></td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

As before, the coefficients are not significant and are in fact negative, and this suggests that there is no increase in the event of a shareholder proposal being on the ballot (and there may be a very small decrease). This is also the case for the coefficient on the interaction term for (0,1) firm years where the turnout is within 10% of the vote requirements—even in those cases, director election turnout decreased in the year where there was a corporate governance proposal on the ballot.

The foregoing analysis allows the rejection of the possibility that turnout might increase in the event that a corporate governance proposal is included on the ballot.