An Older, Balder Critique of ‘Toward Common Sense and Common Ground’

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For me personally, the most disturbing aspect of Vice Chancellor Leo Strine's paper is the suggestion that "convictional plasticity" correlates positively with age and hair loss. As he would necessarily acknowledge, I outrank him significantly in both categories. By the Vice Chancellor's suggested correlation, then, any convictions I might have once held should have melted away altogether by now. This may partially explain my skepticism about some of his specific proposals, as well as my enthusiasm for his critiques of various sorts of conventional wisdom in the field of corporate governance.

Vice Chancellor Strine begins his remarks by urging that we avoid "snarkasm," reflexive labeling, and preaching to the converted, and that plea counsels that I begin my comments by noting some of the many areas in which he and I share a common view.

First, I commend the Vice Chancellor for identifying, and appealing to, a well-known and long-standing tendency for two groups—management and labor—to put aside conventional opposition and join together to resist takeovers or other corporate actions that appear to deliver short-term gains to shareholders but lead to elimination of jobs—including jobs of corporate managers as well as rank and file laborers. This coalescence of interest groups that are conventionally thought to clash—a coalescence that I call the "we love Bendix" phenomenon—is both well-documented and unsurprising. It would be surprising, in fact, if these two groups did not naturally ally against changes that threaten reductions in force. After all, "management" is "labor," too, as the Vice Chancellor points out. Stephen Bainbridge is clearly correct that there is still plenty of room for conflict between management and labor, but that valid criticism does not

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2. Id. at 3.

3. I use this term because I first encountered the phenomenon when working on a team representing Bendix in its 1982 resistance to a counter-takeover bid by Martin Marietta. See, e.g., Mark Potts, Bendix Delays Meeting of Shareholders, WASH. POST, Sept. 21, 1983, at D7 (according to Bendix, "50,000 employees at 100 plants in the United States and Canada took part in 'Bendix Unity Day' pep rallies—complete with high school marching bands and speeches by company officials and local politicians").


5. Strine, Toward Common Sense, supra note 1, at 4.

6. Stephen M. Bainbridge, The Shared Interests of Managers and Labor in Corporate Governance: A
invalidate Vice Chancellor Strine’s suggestion that the two camps at least consider whether and where their interests might converge.

Second, I applaud the Vice Chancellor as one of the most vocal, credible, and persuasive critics of what he rightfully calls “the corporate governance industry.” Quite simply—and I don’t think this is an unfair synopsis of the Vice Chancellor’s critique—there are lots of very vocal people whose financial and reputational well-being is directly proportional to the size of the governance role given to shareholders, and who (surprise!) are themselves the most vocal in promoting the expansion of that role. The Vice Chancellor appropriately spares no group from being tarred with participation in this industry. High on his list are proxy advisory firms, a totally unregulated sub-industry that has been built entirely in the last 25 years just to enable capital managers to be able to show that their voting decisions can be defended as reasonably reliant on ostensibly expert advice. The Vice Chancellor singles out academics for special criticism because of their persistent emphasis on agency costs associated with corporate managers and their simultaneous deafness to the agency cost story applied to those who manage equity capital for its beneficial owners. And most provocatively, the Vice Chancellor outlines the story of how even “independent directors”—the white knights of managerial monitoring—succumb to the governance industry in order to protect their reputation and present and future positions. The result is what gave rise to Tom Perkins’s recent complaint about directors being more focused on legal compliance than business strategy.

In any event, my critique of the Vice Chancellor does not focus on his assessment of broad trends or problems. Instead, I find his remarks most debatable where they attempt, even tentatively and modestly, to outline specific proposals for change.

Some of the Vice Chancellor’s specific suggestions seem more based in hope than in reality. For example, it seems implausible, to me at least, that institutional investors—who have a long and battle-decorated track record of opposition to poison pills—would forgo opposition to “traditional poison pills” through a pact in which management promises to seek to undo classified boards. Similarly, it is implausible to me that in our lifetimes the Securities and Exchange Commission (SEC) will do away with precatory shareholder resolutions (or, to use the Vice Chancellor’s term, “pizza on the wall”). This idea did not even make the cut in the SEC’s most recent set of proposals for corporate election reform.

Another proposal is one that the Vice Chancellor has articulated more formally and extensively in the past: he suggests adopting a framework in which staggered boards are

Comment on Strine, 33 J. CORP. L. 21, 28-29 (2007).
7. Strine, Toward Common Sense, supra note 1, at 5.
8. Id. at 9.
9. Tom Perkins, The “Compliance” Board, WALL ST. J., Mar. 2, 2007, at A11 (lamenting the prevalence of directors more focused on legal compliance (the “compliance board” model) than on strategic business guidance (the “guidance board” model)).
10. Strine, Toward Common Sense, supra note 1, at 12.
11. Id. at 13.
eliminated, and shareholders elect directors triennially, with expanded proxy access in those less frequent elections. This revised electoral framework, he says, could eliminate the corrosive effects of frequent "withhold campaigns" and de facto cumulative voting that may benefit "short-term activist investors" but not society, or even shareholders, as a whole. Management should consider this reform, the Vice Chancellor says, because investor demands for board accountability will persist. The implicit suggestion, of course, is that adopting a triennial electoral system could make these persistent demands go away.

I wish I could believe that suggestion, but I cannot. Just as it was a mistake to think that Israel's withdrawal from Gaza would bring peace to the Middle East, I suspect that a triennial, quadrennial, or whatever-ennial corporate electoral system will calm no waters at all, no matter how much assurance of proxy access or limitation of takeover defenses is built into the system. The "corporate governance industry" that the Vice Chancellor describes so poignantly will demand care and feeding regardless of the frequency of elections. Indeed, a triennial electoral system will generate even more pressure, from academics as well as institutional investors, to eliminate takeover defenses (most notably poison pills) altogether, since those defenses would become even more formidable under a system in which directors' positions are secure for an uninterruptible three-year period.

Another more practical reason to be skeptical of the Vice Chancellor's triennial electoral proposal is the statutory change it would require. As previously noted, the triennial proposal is not a new idea—indeed, some form of it has been prominently discussed since at least 1991, when Martin Lipton and Steven Rosenblum proposed a five-year election cycle. Despite this extensive exposure, however, the idea has failed to capture the hearts and minds of those who would have to bring it into reality on the ground—namely, the drafters of the various states' corporate statutes. The triennial election proposal necessitates amendments to those statutes, because it would require that the currently universal requirement of an annual meeting be eliminated. However, no legislature has adopted the triennial electoral proposal or anything close to it, and I do not expect that situation to change. As far as Delaware is concerned, and as I have written elsewhere, the development of the Delaware General Corporation Law has, for good reasons, systematically eschewed fundamental changes such as the elimination of the annual meeting requirement. However "rational" or superior a triennial electoral system might be—and I have suggested reasons to question claims of such superiority, at least

14. Strine, Toward Common Sense, supra note 1, at 12.
15. Id.
18. Strine, Toward Common Sense, supra note 1, at 12.
under the prevailing circumstances—I cannot foresee the adoption of such a regime in Delaware or elsewhere.

The Vice Chancellor also aims at state statutory change when he proposes that the law permit stockholders to adopt “non-repealable bylaws requiring that the employment contracts of top executives be subject to stockholder approval.”\textsuperscript{19} The candle in this game,\textsuperscript{20} as the Vice Chancellor lays it out, is the prospect that executive compensation will cease to be as much of a lightning rod for controversy between investors and management.

Again, however, I can’t share these hopes for détente. The Vice Chancellor candidly and appropriately acknowledges that authorizing direct shareholder control of top executive employment contracts is an “admittedly large step,” one that “traditional corporate lawyers” will “rightly fear.”\textsuperscript{21} He also acknowledges that even “if corporate boards accede on major ideas like these in isolation, these ideas will do little to calm the waters for management.”\textsuperscript{22} And he’s right, precisely for the reason he acknowledges: “the mantra of ‘more, more, more’ reform has to stop,” but the only hope that the Vice Chancellor holds out for this cessation is the possibility that labor might stop contributing to the chorus.\textsuperscript{23}

Grasping at what little youth and hair I still have left, however, I still hold out some hope for two of Vice Chancellor Strine’s other suggested reforms. First, he places on the agenda an important question about the alignment of shareholder interests and shareholder rights, when he asks whether our corporate law should require a deeper examination of beneficial ownership—its existence, its duration, its netting against hedges—in defining important rights, such as the right to inspect corporate records, or even to vote on fundamental changes or to seek appraisal.\textsuperscript{24} While this is a sprawling topic, it is increasingly plausible to me that corporate policymakers may take it on in the foreseeable future.\textsuperscript{25}

I also sympathize with (and hold some hope for) the Vice Chancellor’s invitation to consider some form of regulation of proxy advisory services and their compensation/arrangements with clients,\textsuperscript{26} although it strikes me that this invitation is one to which federal law—specifically regulation by the SEC, the Department of Labor, or others at the federal level—rather than state corporation law, is the most appropriate responder.

So where does all this leave me in relation to Vice Chancellor Strine’s policy

\textsuperscript{19} Id. at 13.

\textsuperscript{20} The saying that “the game is not worth the candle . . . alludes to a game of cards in which the stakes are smaller than the cost of burning a candle for light by which to play.” THE NEW DICTIONARY OF CULTURAL LITERACY, THIRD EDITION (E.D. Hirsch, Jr. et al. eds., 3d ed. 2002), available at http://www.bartleby.com/59/3/gameisnotwor.html.

\textsuperscript{21} Strine, Toward Common Sense, supra note 1, at 13.

\textsuperscript{22} Id. at 14.

\textsuperscript{23} Id.

\textsuperscript{24} Id. at 16.

\textsuperscript{25} See, e.g., In re Appraisal of Transkaryotic Therapies, Inc., No. 1554-CC, 2007 Del. Ch. LEXIS 57, at *14-*15 (Del. Ch. May 2, 2007) (inviting legislative reconsideration of defining entitlement to appraisal in a way that would avoid “encourag[ing] appraisal litigation initiated by arbitrageurs who buy into appraisal suits by free-riding on Cede’s votes on behalf of other beneficial holders”).

\textsuperscript{26} Strine, Toward Common Sense, supra note 1, at 15.
recommendations? In short, I'm older, balder, more cynical, and skeptical about the prospects for meaningful positive change, at least in the area of corporate law. The corporate governance wars will not cease. Thus, private ordering, rather than public policy, is more likely to be the means by which managers and deal planners will address the strains of those conflicts. Managers may increasingly, as the Vice Chancellor so romantically puts it, seek solace "in the loving arms of private equity buyers." Converely, those who seek public equity capital may increasingly do so through organizational vehicles that diminish the role of shareholder voice—by relegating public investors to ownership of a nonvoting stock or a minority of voting stock, or by using a noncorporate entity (an LLC, for example) as the vehicle for public equity participation. Indeed, we may already be seeing both of these trends begin to unfold.

27. Id. at 10.

In the transition to public ownership, we have set up a corporate structure that will make it harder for outside parties to take over or influence Google. This structure, called a dual class voting structure, is described elsewhere in this prospectus. . . .

The main effect of this structure is likely to leave our [management] team . . . with increasingly significant control over the company's decisions and fate, as Google shares change hands. After the IPO . . . the executive management team and directors as a group will control 61.4% of the voting power. New investors will fully share in Google's long term economic future but will have little ability to influence its strategic decisions through their voting rights.

Id.

29. See, e.g., The Blackstone Group L.P., Prospectus (June 21, 2007), available at http://sec.gov/Archives/edgar/data/1393818/000104746907005160/a2178575z424b4.htm. Among investment risks, the Blackstone Group notes that:

The Blackstone Group L.P. is managed by our general partner, which is owned by our senior managing directors. Our common unitholders will have only limited voting rights and will have no right to elect our general partner or its directors.

Immediately following this offering, our existing owners will generally have sufficient voting power to determine the outcome of those few matters that may be submitted for a vote of our limited partners, including any attempt to remove our general partner.

Id.