SHAREHOLDER CAMPAIGN FUNDS: A CAMPAIGN SUBSIDY SCHEME FOR CORPORATE ELECTIONS

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In the vivid imagination of Delaware courts, the shareholder franchise is "the ideological underpinning" upon which corporate power rests. A corporate election to choose who should lead the firm is corporate democracy at work since such elections give shareholders the power "to turn the board out." However, in reality, the vast majority of corporate elections are ho-hum affairs. The current board members are reelected without contest. Annual corporate meetings to hold the elections are dull—held in front of tame audiences in quiet auditoriums. Election outcomes are predictable. Rarely is there a contested corporate election in which the incumbent directors face a challenge for their board seats. Even these affairs, while more interesting, are still as predictable. The incumbents always have the upper hand. The corporate election system is, as a consequence, broken, anticompetitive, and in need of significant reform.

Yet, as this Article shows, previous proposals have overlooked the "genius" of the public sector. In particular, in political elections, campaign reformers have already offered a good answer for how to create competitive elections: Make campaign subsidies available to challengers. This solution works even though the contestants' campaign costs are high, voters are apathetic and dispersed widely, and incumbents have a natural, built-in advantage. Most notably, for instance, in federal elections, the system of public subsidies for eligible presidential campaigns, the Presidential Campaign Fund, provides a remarkably sturdy roadmap for how to reform corporate elections and create a subsidy system for shareholder challenges to the board of directors.

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INTRODUCTION

In the vivid imagination of Delaware courts, the shareholder franchise is "the ideological underpinning" upon which corporate power rests.[1] A corporate election to choose who should sit on the board of directors and lead the firm is corporate democracy at work. Such elections, they theorize, give shareholders the power "to turn the board out."[2] However, in reality, the vast majority of corporate elections are ho-hum affairs. The incumbent directors of the firm spend freely from the corporate treasury to put on lavish campaigns for their own reelection. And, similar to a politician who amasses a large war chest meant to scare off potential rivals, the current board members are mostly

1. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (arguing that the right to vote is "critical to the theory that legitimates the exercise of power by some . . . over vast aggregations of property that they do not own").

2. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) (noting that if stockholders are unhappy with board action, "the powers of corporate democracy are at their disposal to turn the board out").

reelected without opposition. Thus, annual corporate meetings to hold elections are dull affairs, held in front of tame audiences in quiet auditoriums. Election outcomes are predictable.

Since the cost to shareholders who might be inclined to take on the current board can run well into six figures (and frequently more than $1 million), rarely is there a contested corporate election in which the incumbent directors face a challenge for their board seats.[3] Even when a shareholder decides to launch a challenge to the firm leadership, these affairs, while more interesting, are still as predictable.[4] The incumbents continue to have the upper hand.[5]

The corporate election system is, as a consequence, broken, anticompetitive, and in need of significant reform. Indeed, the need for reform of this system of corporate elections has prompted a robust debate from all corners, from prominent corporate law scholars[6] to Delaware judges and legislators[7] to investor-activists[8] to the SEC, the main regulatory authority for corporate entities.[9]

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3. *See* Lee Harris, *Missing in Activism: Retail Investor Absence in Corporate Elections*, 2010 COLUM. BUS. L. REV. 104, 145–53 (summarizing statistics for contested campaign costs).

4. *See generally id.* (finding that incumbent officers and directors win a majority of contested corporate elections).

5. *See generally id.* (discussing various advantages enjoyed by incumbents).

6. *See, e.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 699 (2007) (arguing that challengers in contested elections should be reimbursed on the condition that they obtain sufficiently wide support). Not all commentators want shareholders to have a voice in management of the firm. *See, e.g.*, Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 742–43 (2007) (arguing that Bebchuk's proposed reform is "something that no one wants and no one needs, something contrary to long history and successful practice, and something that is not supported by empirical data or by successful comparative experience"); Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 790–91 (2007) (responding that the notion that shareholder control over public campaigns will create benefits is the "myth": "An extensive literature on the theory of the corporation . . . suggests that shareholders enjoy net benefits from board governance. This is because board governance, while increasing agency costs, also promotes efficient and informed decisionmaking, discourages intershareholder opportunism, and encourages valuable specific investment in corporate team production").

7. *See* DEL. CODE ANN. tit. 8, § 112 (2010) (providing that a firm may have bylaws that allow both firm and shareholder nominees to be included in the proxy statement); E. Norman Veasey, *The Stockholder Franchise Is Not a Myth: A Response to Professor Bebchuk*, 93 VA. L. REV. 811, 816–18 (2007) (arguing that there is no need to reform corporate law rules to increase shareholder power to replace directors in elections).

8. Carl C. Icahn, Op-Ed., *The Economy Needs Corporate Governance Reform*, WALL ST. J., Jan. 23, 2009, at A13 (proposing that the U.S. Congress pass legislation giving shareholders more rights in electing board members).

9. *See* Electronic Shareholder Forums, Exchange Act Release No. 34-57,172, Investment Company Act Release No. 28,124, 73 Fed. Reg. 4450 (Jan. 25, 2008) (to be codified at 17 C.F.R. pt. 240).

Yet, as this Article shows, previous proposals have overlooked the "genius" of the public sector.[10] In particular, in political elections, campaign reformers have already offered a good answer for how to create competitive elections: Make campaign subsidies available to challengers. This solution works even though the contestants' campaign costs are high, voters are apathetic and dispersed widely, and incumbents have a natural, built-in advantage. Most notably, for instance, in federal elections, the Presidential Campaign Fund (PCF)—the system of public subsidies for eligible presidential campaigns—provides a remarkably sturdy roadmap for how to reform corporate elections and create a subsidy system for shareholder challenges to the board of directors.

The PCF operates on the basis of "check-the-box" funding by those completing a tax return and has raised millions of dollars per presidential election cycle, and more than $1 billion since its inception.[11] The PCF offers rules for funding a subsidy system for campaigns, deciding eligibility among candidates, and establishing spending limits. As such, the PCF offers an off-the-rack, easy-to-use baseline set of principles for creating an election subsidy system for corporations and, what's more, may resolve several of the prickliest questions in corporate law.

Indeed, if such a change were made, this would not be the first time reform has been patterned after the PCF. The PCF method of funding federal campaigns has generated several similar efforts at the state level and additional attempts at PCF-like schemes at the federal level. At the state level, every state with an income tax now gives those completing a tax return a chance to allocate some portion of state treasury dollars to various good causes, including education, combating child abuse, and the Special Olympics.[12] On the federal level, PCF-like schemes have also been crafted (but failed to pass

10. Corporate law scholars have previously (and correctly) noted the "genius of American corporate law," as Roberta Romano has famously put it, but have not been nearly as gung-ho to forge links between private and public law. *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1 (1993).

11. John M. de Figueiredo & Elizabeth Garrett, *Paying for Politics*, 78 S. CAL. L. REV. 591, 600 (2005) (noting that $235 million was raised in 2000 via the Presidential Election Campaign Fund). *See generally* JOSEPH E. CANTOR, CRS REPORT FOR CONGRESS, THE PRESIDENTIAL ELECTION CAMPAIGN FUND AND TAX CHECKOFF: BACKGROUND AND CURRENT ISSUES 3–5 (2005) (noting that $1.4 billion had been raised through 2005, and more than $1.3 billion had been distributed to campaigns or political parties).

12. *See* Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 403 (1998); Nancy C. Staudt, *Taxation Without Representation*, 55 TAX L. REV. 555, 565 n.52 (2002); *see also* Richard Briffault, *Public Funding and Democratic Elections*, 148 U. PA. L. REV. 563, 566–67, 570 (1999) (describing state and local efforts to create public funding systems); Deborah Goldberg, *Federal and State Campaign Finance Reform: Lessons for the New Millennium*, 34 ARIZ. ST. L.J. 1143, 1156 (2002) (describing state and local efforts to create public funding schemes).

Congress) for use to fund the Peace Corps, among other federal programs.[13] The point is that the scheme that originated with the PCF has been used to create broad-based subsidies for a wide range of causes, not just federal elections.

In short, this Article presents an argument *against* the current funding system of corporate elections, which heavily favors incumbent directors.[14] The Article then proceeds to outline a solution that replicates what has been pushed by campaign finance reformers for political elections—to wit, a subsidy system for shareholder challenges to the board of directors. Part I brings the uninitiated up to date on spending in corporate elections and the advantages of money enjoyed by incumbent board directors who routinely stand for reelection to the boards of firms. It provides a sense of the current spending rules for corporate elections and explains how those rules advantage incumbents, while handicapping shareholders who would dare to launch a challenge to incumbent director reelection.

Although the relationship between money and politics is a path well worn by the work of prior commentators, in Part II, I discuss briefly how incumbent spending advantages have undermined competition in political elections and helped advantage incumbent elected officials. Part III discusses how reformers in the political sphere have grappled with incumbent advantage by subsidizing campaign expenses for eligible candidates. More specially, in this Part, I analyze the PCF and illustrate how it has become one of the most visible (and rare) successes of political campaign reform advocates.

Part IV introduces a reform scheme, the *Shareholder* Campaign Fund (SCF), for corporate elections based on principles similar to the PCF, and assesses the benefits of such a system for incumbent advantage in corporate elections. In short, an SCF can be expected to create greater competition in corporate elections and offers a partial solution to several nagging problems in corporate elections, including so-called shareholder apathy, free riding, fragmented shareholder interests, and the incidence of managerial misbehavior. Also, as the Article shows, a move to an SCF can also act as a "shareholder preference gauge" of whether contested corporate elections are wanted in the first place. Thus, an SCF can help answer the question of how much board turnover through corporate elections is desirable.

Part V puts the SCF in action. In this Part, I turn to data from companies that have experienced a contested corporate election in recent years, 2006–2008,

13. Staudt, *supra* note 12, at 565.

14. Throughout this Article, I refer to contests between management and shareholders for votes as contested corporate elections, challenges, or contests. These contests are also variously known in the literature as proxy contests, proxy challenges, independent proxy solicitations, or some variation of the same.

and use this data to briefly demonstrate how an SCF can be expected to work. As the demonstration shows, the levels of subsidies that might be eligible for potential challengers depend, crucially, on shareholder support.

Finally, although clairvoyance is impossible, Part VI attempts to anticipate a couple of the likely critiques of the SCF and responds to them. I attempt to address why shareholder campaigns are important conduits for corporate democracy, better than other popular alternatives, like proxy access, and why an SCF is unlikely to spur an unusual number of frivolous shareholder campaigns.

The significance of this Article is at least twofold. First, this Article proposes a new funding scheme for shareholder challenges to the board of directors similar to the public funding scheme used on the federal election level to encourage and support political challengers. If implemented, this proposal for an SCF stands to increase shareholder participation in corporate governance, reverse the coordination problems associated with corporate elections, and diversify the identity of contestants (and shareholder interests) that emerge in shareholder-led campaigns. If implemented, the SCF will lend important new insight into shareholder preferences and the desirability of more challenges to the leadership of the board through corporate elections.

A second notable significance of this Article is that it takes a close look at the public funding mechanism for federal campaigns generally. The public funding of presidential campaigns is an area that is conspicuously undertheorized in law reviews. Although millions of Americans who have completed a tax return have participated in this federal funding scheme (not to mention the millions that have participated in similar schemes adopted by states), a surprisingly limited number of analyses of the system have been undertaken by legal scholars.[15]

I. ANTICOMPETITIVE CORPORATE ELECTIONS

One of the basic characteristics of the firm is that all corporate power rests with the members of the board of directors, who are at least theoretically

15. *But see* Levmore, *supra* note 12, at 389 (noting that taxpayers are asked on their 1040 tax return whether or not they want to donate $3 to the Presidential Election Campaign Fund); Saul Levmore, *Voting With Intensity*, 53 STAN. L. REV. 111, 131 (2000) (noting that there are limits to the legal spending a candidate can do with respect to accepted federal funds); Staudt, *supra* note 12, at 563 (observing that Congress enacted the Presidential Campaign Fund in order to delegate budgeting power to the taxpayers and ensure candidates felt "'equally obligated to [all] the citizens'" instead of just a few small groups) (quoting 112 CONG. REC. 26398 (daily ed. Oct. 12, 1966) (statement of Sen. Long)).

chosen by shareholders of the firm.[16] State statutes require firms to hold annual elections to give shareholders a chance to vote on who should serve on the board of directors.[17] In theory, these elections provide a check on managerial misconduct and create an incentive for incumbent directors to make decisions in the firm's/shareholders' interests, lest they be thrown out at the next election and lose their lucrative posts.[18] However, in reality, under the current rule structure, particularly the rules regarding campaign spending, these elections are not contests in a meaningful sense. Consequently, in most cases, shareholder-voters have no choice whatsoever in corporate elections. Most of these elections are uncontested. Director-nominees routinely stand for reelection without opposition.[19]

Only infrequently are elections contested by challengers. In these cases, challengers nominate themselves (or their loyalists) for a seat on the board of directors.[20] Although such contested elections occur rarely, when they do, they have many similarities to political elections. Campaign material is mailed to potential voter-shareholders, contestants set up phone-banking operations, pricey voting consultants are hired, and so forth.[21] This Part describes in more detail the current system of corporate elections and how the current rule structure heavily favors incumbents and stifles competitive corporate elections.

A. Incumbent Expenses

The current corporate election rules provide that incumbent directors may use the corporate treasury to fund their campaign expenses.[22] In order to ensure that they stay in office, the incumbent management can send shareholders (the voters) marketing materials, retain the services of professional proxy solicitation services, establish a phone bank, and hire a public relations

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16. *See* DEL. CODE ANN. tit. 8 § 141 (a) (2010); MODEL BUS. CORP. ACT § 8.01(b) (1969) (amended 2005).

17. *See* DEL. CODE ANN. tit. 8 § 211(b); MODEL BUS. CORP. ACT § 7.28(a).

18. *See* James R. Hagerty & Joann S. Lublin, *Countrywide Directors' Dilemma*, WALL ST. J., Nov. 3, 2007, at B1 (noting that total compensation for Countrywide's outside directors was between $344,988 and $477,824 in 2006, a range above the median total compensation for directors of the two hundred largest companies, which was $204,975 in 2006).

19. *See* Harris, *supra* note 3, at 120 (finding that, on average, only a few dozen contested corporate elections occur each year).

20. *See, e.g.*, *id.* (finding that contested elections occur approximately forty-four times per year); GEORGESON, ANNUAL CORPORATE GOVERNANCE REVIEW 46–47 (2009), *available at* http://www.georgeson.com/usa/download/acgr/acgr2009.pdf (listing contested corporate elections in 2009).

21. Bebchuk, *supra* note 6, at 688–89 (discussing briefly the use of consultants in the recent Six Flags proxy contests and the extravagant costs associated with proxy consultancies).

22. *See* Lawyers' Adver. Co. v. Consol. Ry. Lighting & Refrigerating Co., 80 N.E. 199 (N.Y. 1907) (noting that the firm may spend out of the corporate treasury for notification costs).

firm, lawyers, consultants, and others, all on the corporate tab.[23] There are few checks on the board's discretion to use corporate funds. For instance, incumbents can spend on the corporate dime regardless of whether the election is contested or whether they are running unopposed.[24] Even when no challenger competes for an open seat on the board, incumbents, at their discretion, can use corporate resources to put on an elaborate campaign.

Further, incumbents can use corporate resources, regardless of whether the incumbents win or lose the election.[25] Thus, even if shareholders were disgruntled about campaign spending or other evidence of director incompetence and decide to turn out directors (a highly unlikely event), shareholders would have no right to recover for a lavish campaign bill.[26]

As an illustrative case, consider a recent contest over board seats launched by AirTran, a national low-cost airline, against Midwest Air, the target. Initially, AirTran made an offer to acquire the small regional carrier for fifteen dollars a share, a 65 percent premium over the pre-bid trading price of Midwest stock. The directors of Midwest rejected the offer, saying the bid was "inadequate" and calling AirTran "opportunistic."[27] As a result, preceding the next annual meeting, AirTran launched an expensive campaign to elect three nominees to the nine-member Midwest board.[28]

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23. *See, e.g.*, Definitive Proxy Statement (Form DEFC 14A), CSX Corp., at 61 (Apr. 25, 2008), *available at* http://www.sec.gov/Archives/edgar/data/277948/000095014408003190/g11808dfdefc14a.htm#156 (estimating that CSX's total expenses for proxy solicitation shall be $22 million, which, among other things, includes mailing and advertising costs, phone solicitation costs, and the hiring of a proxy solicitation firm).

24. *See* Levin v. Metro-Goldwyn-Mayer, Inc., 264 F. Supp. 797, 801–03 (S.D.N.Y. 1967) (noting that the board may spend regardless of whether there is a contest, since the board is legally obligated to give shareholders notice of the annual meeting and agenda items, including corporate elections).

25. Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E. 2d 291, 293 (N.Y. 1955) (holding that the former incumbent directors could be reimbursed for their expenses, even though they lost their campaign for reelection and were ousted).

26. Also, keep in mind that incumbent spending is at least partially for personal interest—namely, to keep their lucrative seats on the board of directors. However, unlike other areas of corporate law, where shareholders have to vote ex ante on a board decision that creates a potential conflict of interest, no shareholder vote is required to ratify a decision to spend related to a corporate election. Regardless of shareholder approval, incumbents can spend lavishly to campaign for their own reelection, since the decision is largely protected by the business judgment rule. *See generally* LEE HARRIS, MASTERING CORPORATIONS AND OTHER BUSINESS ENTITIES 169, 172–73 (2009) (discussing the business judgment rule and ratification by shareholders in conflict of interest transactions).

27. *Midwest Air's Board Seeks Rejection of AirTran Offer*, WALL ST. J., Apr. 14, 2007, at A6.

28. AirTran paid each of its three nominees a fee related to campaign activities of at least $40,000, paid $200,000 for a proxy solicitation firm, and $150,000 for legal and printing costs, among other expenses. *See* Definitive Proxy Statement, Contested Solicitation (Form DEFC 14A), Air Tran Holdings, Inc., at 19 (May 18, 2007), *available at* http://www.sec.gov/Archives/edgar/data/948845/000119312507118776/ddefc14a.htm (filed under Midwest Air Group, Inc.) (providing estimates of expenses).

A typical strategy, these nominees were chosen, no doubt, because they could be trusted to support AirTran's acquisition offer and repudiate any takeover defenses.[29] Midwest opposed the election of the three AirTran nominees.[30] In defense of its strategy to continue as a standalone entity and defeat the election of AirTran's nominees, the Midwest board spent an estimated $225,000 of corporate funds to contact shareholders, which included hiring an expensive proxy solicitation firm, MacKenzie Partners, to the tune of $100,000 (plus expenses).[31] Decisions by the incumbent directors to spend from the corporate treasury to stay in office (even decisions like Midwest's decision to try to fend off a high-value offer from AirTran) are generally beyond challenge.

B. Spending Limits

Furthermore, the current rules provide no real check or good estimate of reasonable levels of expenditures for these election contests.[32] The absence of law on this point also tends to inure to the benefit of incumbent directors. On the face of the relevant opinions, courts have articulated a relatively firm set of criteria. They have said, for instance, that incumbents may rely on the corporate treasury to fund their expenses so long as such expenses are "reasonable."[33] However, when defining this standard, court opinions have been less firm, suggesting that reasonableness creates no serious limits on spending at all.[34] Also, while courts have suggested that spending must be only in the firm's interest, the definition of interest in these cases is unusually broad.[35]

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29. *See generally* Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

30. *See* Definitive Proxy Statement, Contested Solicitation (Form DEFC 14A), Air Tran Holdings, Inc., *supra* note 28, at 7.

31. Definitive Proxy Statement (Form DEFM 14A), Midwest Air Group, Inc., at 35 (Sept. 27, 2007) [hereinafter Midwest Definitive Proxy], *available at* http://www.sec.gov/Archives/edgar/data/948845/000119312507116403/ddefc14a.htm. AirTran won the battle but ultimately lost the war. More than 60 percent of Midwest shareholders voted to seat AirTran's nominees, which put pressure on the nine-member board to consider all options for sale. Ultimately, however, a group led by a national carrier, Northwest, made a higher bid for Midwest Air.

32. Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291, 293 (N.Y. 1955) (noting that director spending in proxy contests cannot be unlimited, must be reasonable, and not for personal gain).

33. *Id.*

34. *See, e.g.*, Levin v. Metro-Goldwyn-Mayer, Inc., 264 F. Supp. 797, 802 (S.D.N.Y. 1967) (finding the expenditures to be fair and reasonable); *see also* Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1071, 1107–08 (1990); Harris, *supra* note 3, at 154–62 (discussing relevant court opinions on incumbent spending).

35. *See* Steinberg v. Adams, 90 F. Supp. 604, 608 (S.D.N.Y. 1950) (noting that the distinction between "policy" and purely personnel questions is blurred); *Rosenfeld*, 128 N.E.2d at 293 (holding that

As mentioned, Midwest Air, a small regional carrier, spent well into the six figures as it attempted to stave off a campaign launched by national cost-cutter, AirTran.[36] In other cases, incumbents have spent millions of dollars from the corporate treasury to fund campaign expenditures.[37] In one recent case, incumbents budgeted $14 million to defend against a shareholder-challenger.[38] As in these cases, incumbents have broad discretion to spend and face few real limits from courts on the levels of expenditures they can make from the corporate treasury in order to remain in office.[39]

C. Challenger Expenses

Finally, the current rules for corporate elections provide that challengers who launch a corporate campaign must bear the upfront costs of a corporate election out of their own pockets.[40] While they might be reimbursed for their expenses later, pursuant to a board resolution, the circumstances under which a challenger will be reimbursed are daunting. Unlike incumbents, challengers are effectively only eligible for reimbursement if they win the election *and* win control of the firm.[41]

By itself, a challenger winning an election is not enough to ensure reimbursement for campaign expenses.[42] Rather, challengers are only eligible for reimbursement pursuant to a resolution of the board of directors. Thus, challengers counting on reimbursement for their expenses out of the corporate treasury must wage a successful campaign for control of the firm—in other words, by winning a majority of the board seats.[43] Certainly, a challenger that wins a short slate (less than a majority of the seats on the board of directors)

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recoverable expenses must be reasonable and not for personal gain); *see also* Bebchuk & Kahan, *supra* note 34, at 1107 (noting that the distinction between policy and personnel questions is largely "spurious").

36. Midwest Definitive Proxy, *supra* note 31, at 35.

37. Harris, *supra* note 3, at 146 (discussing recent corporate elections in which incumbents budgeted more than $1 million for expenses).

38. *See* Definitive Proxy Statement (Form DEFC 14A), Motorola, Inc., at 61 (Mar. 14, 2007), *available at* http://www.sec.gov/Archives/edgar/data/68505/000095013707003824/c10691dcdefc14a.htm.

39. Bebchuk & Kahan, *supra* note 34, at 1107 (noting that the incumbents are rarely denied reimbursement based on the technical limits).

40. *See, e.g.*, *Steinberg*, 90 F. Supp. at 607–08 (holding that successful challengers who paid out-of-pocket for the contest could be reimbursed by board resolution).

41. Bebchuk & Kahan, *supra* note 34, at 1108–09 (discussing limitations that challengers face for reimbursement of their expenditures).

42. *Id.* at 1109 ("[N]ote that even challengers who win a contest are not automatically entitled to reimbursement.").

43. *Id.* at 1110 ("Challengers who gain control of the corporation, that is, win a majority of the seats on the board, receive reimbursement for their expenses.").

will still have substantial influence in the boardroom.[44] In these cases, it is possible that such a shareholder will be able to broker a deal with the incumbent directors to support a reimbursement resolution. However, challengers successful on a short slate have no guarantees.

Since the board operates under majority rules, the only way to ensure a resolution of the board of directors is to control a majority of the seats on the board. Thus, challengers must win a majority of seats on the board to ensure they can get through a reimbursement resolution. A challenger's chances of getting control of the board and a concomitant reimbursement resolution are even dimmer at firms with staggered elections, where only a third of board seats come up for election at a given time.[45] At firms with staggered boards, the connection between board control and a reimbursement resolution means that challengers will likely have to succeed in at least *two* consecutive elections. This is a costly and high-risk strategy for challengers who want to challenge incumbent directors but are hopeful to have their campaign expenses reimbursed.

Consider again, for instance, the Midwest/AirTran election. AirTran spent approximately $570,000 on the election and won three out of nine Midwest board seats.[46] Even though AirTran won the corporate election, it was not necessarily entitled to reimbursement for expenses since it did not win majority control of the board. The board was still controlled by the Midwest incumbents, who retained six of the nine seats.[47] Even though the three AirTran directors might present a resolution for reimbursement, the incumbents could (and would be likely to) simply vote down proposals to reimburse AirTran for its expenses. The new directors would have to broker a deal with returning incumbents, or else eat the costs of their campaign expenditures.

Further, even in cases when challengers win a majority of the board seats in a corporate election, they are not guaranteed reimbursement. In fact, the case law has provided that such challengers (but not incumbents) must also

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44. *See, e.g.*, Press Release, Motorola, Inc., Motorola and Carl Icahn Reach Agreement (Apr. 7, 2008), *available at* http://mediacenter.motorola.com/content/detail.aspx?ReleaseID=6403&NewsAreaId=2 (providing agreement for board seats).

45. *See* DEL. CODE ANN. tit. 8, § 141(d) (2010); *see also* HARRIS, *supra* note 26, at 127 (discussing staggered boards); Bebchuk, *supra* note 6, at 694 (discussing the impact of staggered boards on corporate election outcomes).

46. *See* Definitive Proxy Statement (Form DEFC 14A), AirTran Holdings, Inc., at 19 (May 18, 2007), *available at* http://www.sec.gov/Archives/edgar/data/948845/000119312507118776/ddefc14a.htm; *see also* Bloomberg News, *Suitor for Midwest Air Wins Board Seats*, N.Y. TIMES, June 15, 2007, at C10.

47. *See* Bloomberg News, *supra* note 46 (noting that AirTran nominees secured three seats on Midwest's nine-member board).

have their expenses approved by a vote of a majority of shareholders.[48] The requirement of shareholder approval is one-sided in that incumbents can spend without having to take such a decision to shareholders for a vote.[49] For successful challengers, this means that they must not only control the board such that they can pass a resolution for reimbursement, they must go an extra step before they can actually make payment from firm resources. They must take the issue to another full shareholder vote (post successful campaign).

In short, even once they are in control of the firm, courts have found that a resolution for reimbursement should be approved by a majority of shareholders.[50] Admittedly, for the vast majority of successful challengers, this requirement of later shareholder approval is a relatively small additional obstacle. Since a successful challenger has already won shareholder approval on an earlier vote on board seats, it is likely that such a challenger will be able to secure shareholder approval for reimbursement as well.[51] Nevertheless, the requirement of shareholder approval still creates at least some small levels of uncertainty for challengers and amplifies their risk of possibly not receiving reimbursement.

D. Corporate Election Outcomes

The lopsided nature of the funding rules for corporate elections has at least three consequences. Specifically, the incumbent funding advantage (1) reduces the number of contested corporate elections overall and the number of control challenges; (2) reduces those elections that do occur to a narrow class

48. *See* Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291, 293 (N.Y. 1955). Additionally, challengers sometimes settle their grievance with the board and as part of the settlement may receive reimbursement. *See, e.g.*, Definitive Additional Proxy Materials (Form DEFA 14A), Parlux Fragrances, Inc., Parlux Fragrances and Glenn Nussdorf Reach Amicable Resolution of All Disputes (Feb. 6, 2007), *available at* http://www.sec.gov/Archives/edgar/data/802356/000095012307001451/y30045dadefa14a.htm (describing settlement of a proxy fight between Parlux Fragrances and shareholder Glenn Nussdorf); *see also* HARRIS, *supra* note 26, at 228; Bebchuk & Kahan, *supra* note 34, at 1110.

49. Although instances are rare, incumbents even have discretion to reimburse challengers for their expenses. Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 300 (2003) (noting that voluntary reimbursement of challenger expenses by an incumbent board is rare).

50. Interestingly, a successful challenger in a derivative suit would not normally have to seek out approval from shareholders. *See* Steinberg v. Adams, 90 F. Supp. 604, 608 (S.D.N.Y. 1950) (noting that successful derivative plaintiffs are "reimbursed regardless of the view[ ] of the stockholders").

51. In fact, the shareholder vote for expenses is frequently lopsided in favor of challengers. *See, e.g.*, *Rosenfeld*, 128 N.E.2d at 292 (finding that the successful shareholder challenger received shareholder approval for reimbursement by a margin of 16 to 1).

of almost identical, large shareholders; and (3) likely skews the outcome of these elections in favor of incumbents.[52]

First, corporate elections spending rules heavily favor incumbents and, as a consequence, reduce the number of challenges to directors that even take place at all. Before the first campaign mailer is posted, incumbents have a decided tactical advantage: money. And money matters a great deal to whether a corporate election is contested in the first place. According to my prior analysis of a sample of recent contested corporate elections, the median total spending by challengers and incumbents in contested corporate elections was over half a million dollars.[53] As that analysis showed, when campaign spending is broken out by investor identity, unsurprisingly, individual investors who participate in corporate elections are substantially underfunded, compared to incumbent directors. They lose the money war and, in the vast majority of cases, lose these campaigns. As a consequence, incumbents' funding advantage puts corporate elections out of reach as a serious mechanism of activism for many shareholders.

Second, the incumbent advantage helps ensure that challenges in corporate elections are launched mostly by institutional investors. As I reported in a previous paper, the current funding rules for contested corporate elections reduce those elections that do occur to a narrow class of almost identical shareholders, including private equity funds, the firm founder or former CEO, large shareholders, and a handful of shareholder activists.[54] Individual or retail investors almost never participate in corporate elections. In fact, according to the same research, nearly three-fourths of challenges (72 percent) are by institutional investors.[55] The current funding rules preclude campaigns that might be launched by average shareholders—primarily those who tend to own a small stake, hold a diversified portfolio, and have a relatively long-term investment horizon—if a different system were in place.

Third, the preliminary evidence (and intuition) suggests that the campaign spending advantage is related to election outcomes, a point I explored in another paper.[56] In fact, previous research found that median challenger spending when successful (broadly defined to include both straight victories and settlements) is $250,000, significantly more than the amount challengers

52. Harris, *supra* note 3, at 109.
53. *Id.* at 147–48.
54. *Id.* at 126–39 (discussing findings on challenger identity in corporate elections).
55. *Id.* at 128–29 (breaking out contested corporate elections based on whether the challenger was an institution or individual).
56. This relationship between spending and election outcomes is the subject of another study. *See* Lee Harris, *Spending as a Determinant of Corporate Election Outcomes* (July 1, 2010) (on file with author).

spend in losing campaigns, where the median spending is $150,000.[57] As demonstrated in that paper, one of the only consistent and statistically significant differences between winners and losers in contested corporate elections is the amount budgeted for such elections.[58]

II. ANTICOMPETITIVE POLITICAL ELECTIONS

Similarly, incumbent advantage in political elections hinges on access to money. In fact, it would be difficult to overstate the importance of money to political elections and the advantages of incumbency because of incumbents' access to the donors who back campaigns.[59] These monetary advantages tend to undermine competitive political elections and virtually ensure that incumbents are returned to office for as long as they desire (or at least as long as term limits allow).[60]

Even though the relationship of money and politics has been treated extensively by others elsewhere, it is necessary to briefly revisit at least two relevant points here since, just like in corporate elections, in political contests incumbents' access to money can undermine competitive elections.[61] First, as campaign-related expenses (and campaign war chests) have grown over time, elected officials' access to donors has convinced many would-be candidates to avoid the fight in the first place, leaving politicos to run unopposed. Second, even when a challenger to an already elected official does emerge, frequently

57. *See* Harris, *supra* note 3, at 145–46.

58. *See id.* at 152 (finding that "one of the most integral issues in contested corporate election outcomes may be election spending levels, particularly challenger spending. Spending is one of the only statistically significant mean differences that hold between institutional and individual investors, between winners and losers, and between settlers and losers").

59. Mark Hanna, a Republican in the nineteenth century, famously remarked: "There are two things that are important in politics. The first thing is money and I can't remember what the second is." David D. Kirkpatrick, *Does Corporate Money Lead to Political Corruption?*, N.Y. TIMES, Jan. 23, 2010, at WK1. For a good collection of elected officials' comments about the importance of money to election outcomes and access to those elected, see E. Joshua Rosenkranz, *Faulty Assumptions in "Faulty Assumptions": A Response to Professor Smith's Critiques of Campaign Finance Reform*, 30 CONN. L. REV. 867 (1998).

60. Rosenkranz, *supra* note 59, at 885 (noting win rates for the higher fundraiser in federal elections and noting that the higher fundraiser is usually the incumbent).

61. Spencer Overton, *The Donor Class: Campaign Finance, Democracy, and Participation*, 153 U. PA. L. REV. 73, 88 (2004) ("While voters make decisions in the voting booth, money often plays a critical role in the agenda-setting and persuasion that precede election day."). Even the U.S. Supreme Court has discussed the strong perception that money influences political outcomes. *See* McConnell v. Fed. Election Comm'n, 540 U.S. 93, 146–51 (2003) (noting that the drive to fundraise and keep track of fundraising is a measure of success), *overruled by* Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876 (2010); *see also* Overton, *supra*, at 86–88 (noting several court cases where justices seem to suggest that money is related to electoral success).

she is at a severe disadvantage in fundraising, and, ultimately, her message is drowned out.

To begin with, consider the growth in campaign-related spending and how it affects potential challengers' decision to enter electoral politics in the first place. In contested congressional elections, which are the usual barometer for campaign spending analyses, the Center for Responsive Politics reports that average spending both by challengers and incumbents was just over $100,000 in 1974.[62] However, by 2008 challengers raised and spent over $1.8 million, while incumbents raised almost $2.8 million.[63] According to one source, in 2002 candidates for federal office (and their political action committees) spent more than $1 billion on television advertising alone.[64]

The numbers are staggering.[65] One predictable consequence of the increases in campaign-related spending is that in political elections, many incumbents run unopposed.[66] The growth in campaign spending tends to frustrate nonwealthy citizens' ability to participate.[67] The growth in the importance of money effectively shuts out all but a few categories of candidates from participating in these elections.[68]

Imagine a potential candidate who is contemplating a run for office. With the stiff costs of a campaign, only a very narrow class of challengers will be able to raise sufficient resources to put on a realistic campaign. As a consequence, many would-be challengers will avoid running for office in the first place.[69] Thus, in politics, successful candidacies are generally limited to two

62. CTR. FOR RESPONSIVE POLITICS, BIG PICTURE: THE DOLLARS AND CENTS OF INCUMBENCY (2010), http://www.opensecrets.org/bigpicture/cost.asp.

63. *Id.*; *see also* Briffault, *supra* note 12, at 570, 575.

64. Thomas Cmar, *Toward a Small Donor Democracy: The Past and Future of Incentive Programs for Small Political Contributions*, 32 FORDHAM URB. L.J. 443, 444 (2005); *see also* Joanna M. Shepherd, *Money, Politics, and Impartial Justice*, 58 DUKE L.J., 623, 640–41 (2009) (noting the marked increased in spending on state Supreme Court races between 1990 and 2004).

65. *See* Jamin Raskin & John Bonifaz, *The Constitutional Imperative and Practical Superiority of Democratically Financed Elections*, 94 COLUM. L. REV. 1160, 1174 (1994) (arguing that the costs of campaigns "have placed candidacy far beyond the means not only of the poor, but also of ordinary working people").

66. *See* Rosenkranz, *supra* note 59, at 884 (noting legislator comments regarding the decision not to run).

67. *See* Cmar, *supra* note 64, at 444 (noting the increase in television spending from election cycle to election cycle). *But see* Bradley A. Smith, *Faulty Assumptions and Undemocratic Consequences of Campaign Finance Reform*, 105 YALE L.J. 1049, 1059 (1996) (arguing that in politics "there is actually good cause to believe that we do not spend *enough* on campaigns").

68. *See* Goldberg, *supra* note 12, at 1157 (noting that public funding gets "campaign funds to people who would otherwise not have the resources to run for office"); *id.* at 1158 (describing how state public funding programs encourage political participation).

69. Rosenkranz, *supra* note 59, at 884 (arguing that qualified leaders cannot participate because they are unable to raise sufficient resources: "Talented, brilliant, energetic, committed leaders need not

types of individuals—(1) the small number of candidates who are wealthy on their own, can afford to personally fund a political campaign, and are willing to spend their wealth in that way;[70] and (2) candidates, like incumbents typically, who are well networked such that they can raise money from wealthy contacts.[71]

Additionally, even in cases in which there is a challenger, the research has demonstrated for some time that incumbents have a decided money advantage.[72] They raise more money and have wide access to the so-called "donor class."[73] Furthermore, both critics and supporters of campaign reform for political elections are in agreement that the candidate who raises the most in a given election has a high probability of winning the election.[74] For instance, in federal elections for the U.S. House and Senate, which are not part of a public subsidy scheme, incumbents continue to have a decided fundraising advantage. According to recent statistics, incumbents in congressional elections can expect to out-raise their opponents by a rate of 4.5 to 1. Not surprisingly, these incumbents win the vast majority (approximately 90 percent) of contested political elections.[75] In short, of those who do decide to run for office, the ever-increasing cost means that many candidates will have relatively paltry resources and little chance to compete seriously. These less-funded challengers will be less likely to get their message heard and are likely to lose to better-financed incumbents. Incumbents, it appears, are able to translate money advantage into election outcomes in their favor.

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apply if they lack either a trust fund or the will, stomach, capacity, and contacts to raise large sums of money").

70. *See* Javier Diaz-Gimenez et al., *Dimensions of Inequality: Facts on the U.S. Distributions of Earnings, Income, and Wealth*, 21 FED. RES. BANK OF MINNEAPOLIS Q. REV. 3, 5–8 (1997), *available at* http://www.minneapolisfed.org/research/QR/QR2121.pdf (noting the breakdown of wealth disparities); Overton, *supra* note 61, at 97 (noting persistent concentrations of wealth).

71. *See* Raskin & Bonifaz, *supra* note 65, at 1166 (describing the current landscape for congressional elections); Rosenkranz, *supra* note 59, at 874 (discussing the positive correlation between incumbency and fundraising).

72. Raskin & Bonifaz, *supra* note 65, at 1175–77 (analyzing data on election outcomes and fundraising in congressional elections and finding that the high fundraiser routinely wins).

73. Overton, *supra* note 61, at 115 ("Incumbents often receive more large contributions from the donor class than challengers do."); *see* Rosenkranz, *supra* note 59, at 874 (noting that incumbents get the vast majority of the money doled out from political action committees (PACs)).

74. *See* Rosenkranz, *supra* note 59, at 883–84 (proponent of reform noting the relationship between money and election outcomes); Smith, *supra* note 67, at 1064 (opponent of reform noting the same).

75. *See* Cmar, *supra* note 64, at 444 (noting that close to 90 percent of incumbents for Congress won in 2002 and noting statistics on average fundraising); *see also* Overton, *supra* note 61, at 86 (noting that the highest fundraiser won 90 percent of primaries and 94 percent of general elections).

III. TOWARD COMPETITIVE POLITICAL ELECTIONS: THE PRESIDENTIAL ELECTION CAMPAIGN FUND

In the political sphere, the issues just raised have led to myriad attempts at reform, from donor limits to tax credits to matching funds to, importantly, public subsidies of eligible campaigns. To be frank, very few of these legislative reforms have survived counterargument, court scrutiny, or reversal by a subsequent group of legislators.[76] The one apparently enduring victory that political campaign reformers have had was in the 1970s, when a raft of reforms was passed in the fallout from the scandals of the Richard Nixon presidency.[77]

Significantly, during this time, Congress approved legislation for optional public financing of presidential campaigns and, with it, the creation of the Presidential Campaign Fund (PCF).[78] Today, more than thirty years old, the PCF—the only federal system of public subsidies for eligible candidates—has been an arguable success based on some indicators.[79] Virtually every major candidate for president (with a handful of notable exceptions) has voluntarily

76. *See, e.g.*, Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876, 886 (2010) (striking down a federal statute barring corporations from using general treasury funds to make independent expenditures that expressly advocate the election or defeat of a candidate).

77. *See generally* Fred Wertheimer & Susan Weiss Manes, *Campaign Finance Reform: A Key to Restoring the Health of Our Democracy*, 94 COLUM. L. REV. 1126, 1142–43 (1994). It is not clear how long even these reforms will endure. For instance, for the first time since the inception of the public subsidy system, a major presidential candidate, Barack Obama, did not participate, opting out of the public grant. *See* Shailagh Murray & Perry Bacon Jr., *Obama to Reject Public Funds for Election*, WASH. POST, June 20, 2008, at A1. As a consequence, many commentators have viewed his decision as a death blow to public funding at the federal level and anticipate that subsequent presidential aspirants will also opt out of public funding. *See* Leslie Wayne, *Obama's Decision Threatens Public Financing System*, N.Y. TIMES, June 20, 2008, at A18.

78. *See* 2 U.S.C. § 441a (b), (c) (1988); 26 U.S.C. §§ 9001, 9013, 9031, 9042 (2006). For information regarding the rules of public funding of presidential elections, see FED. ELECTION COMM'N, PUBLIC FUNDING OF PRESIDENTIAL ELECTIONS (updated 2009) [hereinafter FEC, PUBLIC FUNDING], *available at* http://www.fec.gov/pages/brochures/public_funding_brochure.pdf. The first Presidential Campaign Fund was established by Congress in 1971, despite a threat from Nixon that he would veto the bill. *See* CANTOR, *supra* note 11, at 1.

79. Wertheimer & Manes, *supra* note 77, at 1142–43 (asserting that the presidential finance system is an "effective means for . . . controlling campaign spending, and allowing challengers to compete with incumbents' otherwise overwhelming financial edge"). *But see* CAMPAIGN FINANCE INST., PARTICIPATION, COMPETITION, ENGAGEMENT: HOW TO REVIVE AND IMPROVE PUBLIC FUNDING FOR PRESIDENTIAL NOMINATION POLITICS xi, 6 (2003), *available at* http://www.cfinst.org/president/pdf/fullreport.pdf (noting that political candidates frequently view public funding as "less valuable" and arguing that the public funding system needs an overhaul: "The political dangers for candidates who stay in the system have gone up and the benefits of staying in have gone down. Moreover, the system's overall finances have become shaky"); de Figueiredo & Garrett, *supra* note 11, at 637 (arguing that the Presidential Campaign Fund needs to be "overhauled").

participated in the funding system. Furthermore, this public fund has buy-in from millions of voters who have discretion over funding for the system.[80]

TABLE 1: General Elections Since Founding of PCF

Year	Democratic Nominee	Republican Nominee	Public Subsidies?
1976	Jimmy Carter	Gerald Ford	Both
1980	Jimmy Carter	Ronald Reagan	Both
1984	Walter Mondale	Ronald Reagan	Both
1988	Michael Dukakis	George Bush	Both
1992	Bill Clinton	George Bush	Both
1996	Bill Clinton	Bob Dole	Both
2000	Al Gore	George Bush	Both
2004	John Kerry	George Bush	Both
2008	Barack Obama	John McCain	McCain

This Part introduces some of the core tenants of the PCF, setting the stage for Part III through Part VI, where these core tenants are applied to reforming corporate elections and providing subsidies to shareholder-challengers.

A. Practical Considerations

1. Funding

The first critical takeaway from the public subsidy system for presidential campaigns, the PCF, is how the campaign fund is raised or collected from the body politic.

Importantly, under the PCF, those completing a tax return play a direct role in deciding the size of the fund—and, indeed, the fund's very existence—by choosing to check a box on their tax returns.[81] That is, a critical feature of the public funding in presidential elections is the predetermined, flat check-off amount for a relatively nominal sum. Those completing a tax return can elect to allocate $3 of public resources to the PCF, which is held in reserve by

80. Although millions of Americans continue to participate in the PCF, it is worth pointing out that the number of Americans participating has declined in recent years. This appears to be a trend, though an explanation remains an open question. For instance, some have argued that fewer Americans have participated in the PCF because of the advent and general growth of electronic tax return software. Such software, by default, opts out of the PCF on the taxpayers' behalf. *See* CAMPAIGN FINANCE INST., *supra* note 79, at 57.

81. *See* 26 U.S.C. § 6096(a) (2006).

the U.S. Treasury.[82] Those completing a tax return may make the election by checking "yes," signaling their approval when they complete their taxes every year.[83] The check-off ensures that $3 that would normally be held in a general operations account is redirected to a special campaign fund.[84] The funding is used to finance primary elections, nominating conventions, and general elections.[85]

Another significant feature of the PCF's funding structure is that, while the PCF relies on the approval of those completing a tax return, only a small percentage of such individuals need to approve of check-off funding for a sizable fund to be created. The PCF is not akin to a referendum, where majority rules apply. Instead, even a small share of the public may have a say in creating a fund. For instance, if one hundred individuals state a preference on their tax return for the fund, then the Treasury will set aside $300 of the federal budget for the creation of a fund; if fifty individuals state such a preference, the Treasury sets aside $150; and if no one expresses such a preference, the Treasury, of course, sets aside nothing. To take one other example, consider the 2004 tax year, the last year of a presidential contest for which data are available. Just over 9 percent of those completing a tax return directed the Treasury department to set aside a small sum for the presidential campaign fund, a total set-aside of almost $55.7 million.[86]

Another beauty of the PCF funding setup is that the $3 level is flat but not static. That is, though the check-off amount is not automatically indexed to inflation, Congress may pass legislation to alter the flat amount to reflect growth in campaign costs. For instance, in 1993, Congress approved legislation to increase the check-off amount from $1 to $3.[87] The rationale is that an increase in the check-off amount might be necessary in order to maintain a reasonably sized fund given increases in costs of running a campaign due to inflation.[88]

Finally, under the funding rules for the PCF, those completing a tax return are given an equal ability to participate in the decision to create a fund. The check-off amount does not vary by taxpayer. All those completing a tax

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82. Previously, those completing a tax return were asked to contribute $1 to presidential campaigns. *See* FEC, PUBLIC FUNDING, *supra* note 78, at 2.
83. *See* CAMPAIGN FINANCE INST., *supra* note 79, at 47.
84. 26 U.S.C. § 6096(a).
85. FEC, PUBLIC FUNDING, *supra* note 78, at 1.
86. CANTOR, *supra* note 11, at 4.
87. CAMPAIGN FINANCE INST., *supra* note 79, at 50.
88. *Id.* at 50 (noting that there had been 316 percent inflation since 1974, the year of reform). Some have argued that Congress should approve an additional increase in the check-off amount. *See, e.g.*, *id.* at xvii (recommending a check-off amount of $5 that is indexed for inflation).

return—those who owe taxes, those expecting a refund, and those electing not to participate—have an equal say in how much is contributed (or not contributed) to the fund. Thus, a taxpayer's own individual tax refund (or tax liability) remains unchanged regardless of whether they make the election.[89] Regardless of wealth, location, age, gender, or other variables, each taxpayer is treated the same, with only the ability to redirect a nominal portion of public resources: $3. In short, the fundraising system is clear, functional, and fair. These principles can also be used in creating a subsidy system in corporate contested elections, as shall be discussed in more detail.

2. Eligibility

A second core tenant of the PCF is that, while not all candidates are eligible for public funds, eligibility is tied to relatively modest standards. Public subsidies hinge on the candidates' ability to claim moderate success by generating a decent, but far from majority, base of voter support.[90]

In the primary, only candidates who show sufficient preexisting support are eligible for matching funds.[91] To be specific, prior to receiving matching funds, primary candidates must be able to raise $5000 in twenty states to be eligible for public funding.[92] However, the candidate must raise the $5000 from more than just a handful of supporters. The rules effectively require the candidates to raise $5000 in increments of $250 or less.[93] Thus, assuming the most basic effort, a candidate for president could meet the threshold requirements by raising $100,000 from just 400 people. Of course, this is hardly enough of a base of support to create the impression of a winning campaign.[94] Still, the thought appears to be that candidates that are able to generate support

89. In fact, this likely causes some confusion among taxpayers. *See* de Figueiredo & Garrett, *supra* note 11, at 638 (explaining that one rationale for the participation decline is confusion among taxpayers). Interestingly, it is worth noting that this is different from how it is done frequently on the state level. On the state level, an election to support a cause will reduce the state taxpayers' refund or increase their tax liability. Levmore, *supra* note 12, at 403.

90. *See* 26 U.S.C. § 9004(a)(1) (2006) (providing that eligible presidential candidates receive a grant); *id.* §§ 9033(b), 9037 (providing that eligible presidential primary candidates may receive matching funds).

91. Interestingly, "candidates" is defined to include only those who seek the nomination of a political party.

92. *See* FEC, PUBLIC FUNDING, *supra* note 78, at 2.

93. In other words, if a candidate gets $2000 from one donor, she will only be able to count $250 of that as an eligible donation. *See id.* at 2.

94. For example, Barack Obama, who won the 2008 presidential election, had over 400,000 individual donors by August 31, 2008. *See* Michael J. Malbin, *Small Donors, Large Donors and the Internet: The Case for Public Financing After Obama* 16 tbl.3 (Campaign Finance Inst. Working Paper, 2009), *available at* http://cfinst.org/president/pdf/PresidentialWorkingPaper_April09.pdf.

across states have shown "broad-based public support" and should be recognized as credible.[95]

In a general election, candidates from minor parties and new parties are also eligible for public subsidies. Again, however, eligibility hinges on the candidates' success, minimally defined. In the case of candidates from new and emerging political parties, the marker for credibility is set at 5 percent of the vote—not enough to create the impression of a competitive campaign for the presidency, but a solid showing nonetheless.[96]

Specifically, campaign finance rules suggest that minor party candidates are eligible for public funding in a general election if their nominee received at least 5 percent of the vote in the last general election.[97] For instance, based on Ross Perot's showing in 1996 as the nominee for the Reform Party, the nominee for the Reform Party in 2000 received a public subsidy.[98] Further, candidates in a general election representing a new party are also eligible for public funding depending on their overall vote count. Although a new party's candidate cannot get upfront public funding, a successful candidate—one that receives at least 5 percent of the vote—can get reimbursed for eligible expenses after the election.[99]

Thus, one of the important upshots of public financing rules is modest standards of eligibility. The rules are not set so high as to only reserve subsidies for candidates who have a realistic chance of winning public office. Rather, under the public financing system for these federal elections, even candidates from new parties, who arguably have no real shot of winning office, qualify for public funding if they are able to garner just 5 percent of the popular vote. This creates the possibility for widespread participation, not just subsidization for one or two major party candidates. Under the eligibility standards of the PCF, even new or minor party candidates may be eligible for a public subsidy for campaign expenditures if they can generate decent appeal. Thus, while the rules seek to tie funding to some level of success, the threshold is a relatively low one, and the rationale is to encourage wider, more diverse participation. This principle of broadly defining success can (and should) be used in crafting subsidy systems for challengers in corporate elections.

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95. *See* FEC, PUBLIC FUNDING, *supra* note 78, at 2.
96. *See id.* at 3.
97. *See id.* at 3–4.
98. CAMPAIGN FINANCE INST., *supra* note 79, at 61. Notably, other general election candidates from minor parties have received public funding, including John Anderson in 1980 and Pat Buchanan in 2000. *Id.* at 61.
99. *See* FEC, PUBLIC FUNDING, *supra* note 78, at 4.

3. Spending Limits

A third principle of the PCF is limits on expenditures that are set, in effect, by the body politic itself. When Congress passed campaign finance reforms, including the PCF, it placed a flat statutory limit on general election spending at $20 million in 1974, and provided that the spending limit would increase from year to year based on inflation using the Consumer Price Index.[100] In 2008, the statutory limit for the primaries was $42.05 million.[101] The statutory limit for the general election in 2008, the last general election, was $84.1 million.[102] For eligible candidates, the grant is expected to be their major source of funding. Accordingly, in a general election, candidates who elect to participate in the system are generally prohibited from raising private money.[103]

However, though rarely discussed, the body politic—individual Americans completing a tax return—sets the real limit on campaign expenditures under the PCF. Consider, for instance, how potential shortfalls in the PCF are handled. Because Congress has set a fixed grant amount, it is conceivable that there could be budget shortfalls in cases in which there are too many candidates eligible for fund distributions. If there are too many eligible candidates (that is, presidential aspirants that can make a claim on 5 percent of the vote), there could be too many campaigns drawing down on the PCF. Absent congressional act, the Treasury secretary would not have authority to redirect different federal resources to shore up the fund because an unexpected number of candidates met the eligibility threshold.[104] As more and more serious candidates (those who receive 5 percent or higher proportion of the vote) decide to compete, there are fewer resources to go around. As a result, with a large number of candidacies, the PCF might run out of money.[105]

Alternatively, the PCF would experience a shortfall if too few make the choice to allocate tax revenue to the PCF on their tax returns.[106] On the one hand, if the PCF were a wildly popular program among those completing a tax

100. *See* CANTOR, *supra* note 11, at 2.

101. *See* FEC, PUBLIC FUNDING, *supra* note 78, at 3 n.6. For a list of spending limits in primaries from 1976–2004, see CAMPAIGN FINANCE INST., *supra* note 79, app. at 103 tbl.A.2.1.

102. *See* FEC, PUBLIC FUNDING, *supra* note 78, at 3 n.7.

103. *See id.* at 3.

104. *See* 26 U.S.C. § 9006(c) (2006).

105. According to some, this was exactly the predicament of the PCF on the eve of the 2008 election. Some argued that if Obama had participated and taken his allotted share of the public subsidy, the PCF would have been insolvent. *See* CAMPAIGN FINANCE INST., *supra* note 79, at 52 (making a prediction in 2003 that the public funding system will face bankruptcy by 2008 unless more candidates opt out of the system).

106. *See id.* at 51 tbl.4.3 (providing statistics that show that fewer Americans are selecting the check-off).

return, many would participate and "check off," and the PCF coffers would swell. There would be plenty in the fund to cover the statutory grant amount for eligible campaigns. However, if the PCF lost its appeal and Americans became disenchanted with public subsidies, PCF coffers would correspondingly shrink. If this were to happen, there might not be enough in the fund to make the grant amount. In fact, if those completing a tax return decide there should be no special set-aside and public subsidy for politicians, they can "vote" through their tax returns not to continue to fund the system. In this way, the PCF serves as a sort of gauge of taxpayer preference for public subsidies in the first place. As long as those completing a tax return agree that challengers need subsides, they will make a funding decision accordingly. As taxpayer support fades, so too does the PCF.

In the event of a shortfall on either basis, the Treasury simply allocates whatever is available in the fund to eligible candidates on a pro rata basis.[107] Though candidates have a general limit on expenditures set out by statute, those completing a tax return and the candidates themselves set a more important limit. Regardless of the statutory grant limit, if too few of those completing a tax return choose not to allocate to the fund, then candidates' access to public financing for campaign expenditures will be limited as the size of the fund shrinks in light of the taxpayers' changed preference for public subsidy. Similarly, if too many candidates qualify for fund distributions, this would also limit the amount that is available from the fund for each eligible candidate. There should never be too many candidates receiving public subsidies since they merely split one pot, or too much spent since no pot exists unless those completing a tax return approve. Thus, an important takeaway principle from the structure of limits in the presidential funding system is that those completing a tax return and the candidates themselves have an important say in what level of expenditures, if at all, will be made from election to election.

B. Political Election Outcomes

On at least two fronts—participation and the influence of special interest groups—public funding of presidential campaigns seems to create positive effects. In short, the PCF seems to increase participation in presidential

107. *See* 26 U.S.C. § 9006(c) (directing the secretary of the Treasury to allocate funds on a pro rata basis if the fund is insufficient to satisfy full entitlement). Potential shortfalls are not hypothetical. In recent presidential election years, the Treasury has edged close to experiencing a shortfall, such that the candidate distributions would fall below the statutory limit. *See* CAMPAIGN FINANCE INST., *supra* note 79, at 47–53 (noting that the presidential campaign fund has edged toward insolvency in recent years).

elections, broadly defined, and to decrease the dominance of special interest groups.

1. Participation Rates

First, public subsidies through the PCF positively affect participation. Public subsidies should improve participation rates since the subsidies change the expected outcome for potential candidates. Recall that many potential candidates avoid running for office since there is a rational expectation of loss to a well-funded opponent. By contrast, rules for public funding of elections affect election outcomes by giving challengers a better shot at winning political elections. For instance, in congressional elections, where there has been no campaign finance reform, the data (as mentioned) currently suggest that challengers are losing a majority of these contests.[108] Part of the reason is likely the funding advantage that redounds to incumbents. Though there are admittedly significant counterexamples, in political elections the candidate with the deepest resources has a high likelihood of walking to victory.[109]

However, public financing of presidential campaigns seems to upend some of the traditional notions of an incumbent's financial advantage and, importantly, the effect of fundraising on election outcomes. In fact, every nominee from a major party has participated in the PCF, except one.[110] Furthermore, since the advent of this presidential finance system, challengers have been victorious in general elections 50 percent of the time (three of the last six elections) between 1976 and 2004.[111] Compared to the success rates of challengers in congressional elections (around 10 percent), where there is no comparable funding system, challengers in presidential races have been extremely successful. The public funding likely creates a different set of expectations for potential candidates regarding getting their message out and their likelihood of victory—and likely encourages them to run for office.

Additionally, public subsidies through the PCF likely affect voter participation rates. That is, the public funding system likely legitimizes election results

108. *See supra* text accompanying notes 56–75.

109. *See, e.g.*, Cmar, *supra* note 64, at 443 (noting that in the 2002 congressional election, 94 percent of candidates with the most money won their races); Overton, *supra* note 61, at 86–89 (finding that candidates with the most in financial resources have a decisive advantage and are likely to win).

110. *See supra* tbl.1 and text accompanying notes 78–80.

111. CANTOR, *supra* note 11, at 8. The three challengers—Jimmy Carter, Ronald Reagan, Bill Clinton—all defeated sitting presidents—Gerald Ford, Jimmy Carter, and George Bush, respectively. *See* Wertheimer & Manes, *supra* note 77, at 1143–44; *see also* Briffault, *supra* note 12, at 571 (arguing that public funding "substantially contributed" to past presidential campaigns).

in the minds of the electorate and likely reduces frustration with the system.[112] The voters are less likely to feel that an election has been "bought" by a wealthy candidate or, perhaps worse, a special interest group.[113] Instead, election results will look like they have been earned, which should make voting appear more important to the result and recharge a normally apathetic electorate. Perhaps for these reasons, public opinion polls suggest that a majority of the public (53 percent) approves of public subsidies and the PCF.[114]

Finally, the PCF has created a new conduit for participation in public affairs. The PCF increases voters' ability to participate in the election process, beyond simply voting in periodic elections or running for office. Voters are able to participate by making a funding decision about how public resources should be used—namely, whether a public subsidy system should be created in the first place. Since its inception, those completing a tax return have eagerly participated in the fund. In fact, in the last five tax years, approximately thirty-three million people have elected to fund the public subsidy system.[115]

2. Perceived Power of Special Interest Groups

Second, the PCF will likely decrease the perceived power that special interest groups hold over elections. One of the problems with political elections prior to reform efforts was the disproportionate influence (whether actual or perceived) of special interest groups. Through their fundraising and donations, these groups are able to supply all-important donations to politicians. For instance, in the 1972 campaign, the last campaign prior to public financing reform, the incumbent Nixon needed only 154 ultra-wealthy contributors to ante up more than one-third of his campaign dollars. Their average donation was $138,000 each![116] Reform efforts, however, seem to undercut some of the fundraising influence of these groups.

One of the advantages of the PCF is that it permits those completing a tax return to participate directly in fundraising for eligible federal candidates.

112. *See* Overton, *supra* note 61, at 101 (advocating campaign finance reform in order to increase participation and arguing that participation "enhances the legitimacy of government decisions"); *id.* at 103 (noting "frustration" and "suspicion" of those excluded from participation).

113. *See generally* Raskin & Bonifaz, *supra* note 65, at 1181–82 (discussing turnout and election legitimacy).

114. *See* Wertheimer & Manes, *supra* note 77, at 1151.

115. *See* FED. ELECTION COMM'N, THE $3 TAX CHECKOFF 1 (1993), *available at* http://www.fec.gov/pages/brochures/checkoff_brochure.pdf. *See generally* Wertheimer & Manes, *supra* note 77, at 1151 (comparing the percentage of Americans who check the box (17.7 percent) to the much smaller percentage of Americans who have said they contributed to a campaign (6 percent) or a political party (4 percent)).

116. CAMPAIGN FINANCE INST., *supra* note 79, at 27.

Participants elect to make an allocation to the presidential campaign fund and, thus, in a small way help provide funding for candidates. Taxpayer participation reinforces notions of democracy—the idea that our political body owes its existence to (and is under the control of) the ordinary citizenry. At the same time, the funding scheme reduces candidate reliance on donations from special interest groups.

IV. TOWARD COMPETITIVE CORPORATE ELECTIONS: SHAREHOLDER CAMPAIGN FUNDS

Similar to political elections, incumbent directors and managers in corporate elections have a huge fundraising advantage.[117] As already discussed, under the current rules, corporate directors may spend freely from the corporate treasury, while the challengers may not. Thus, challenges in both corporate elections and campaigns for public office are dominated by a small set of ultra-wealthy individuals or institutional investors who can afford the costs of campaigning. In the next Parts, I attempt to demonstrate how principles of campaign finance reforms in the public sector, particularly campaign subsidies like the Presidential Campaign Fund, can be applied to corporate elections. Specifically, PCF principles of funding, eligibility, and spending might also be used to create a *Shareholder* Campaign Fund that reimburses eligible shareholder-challengers for expenses incurred in corporate elections.

A. Practical Considerations

1. Funding

To begin with, imagine if the PCF funding mechanism previously explained—an approval mechanism, uniform rates across constituents, and the ability to raise or lower the check-off rate—were applied to corporate elections. First, consider the PCF approval mechanism and how relatively seamlessly it could be appropriated for use in creating a Shareholder Campaign Fund (SCF). Recall that in the public sector the taxpayer must approve subsidies for eligible federal candidates. The taxpayer may approve or disapprove of the creation of a subsidy fund by making such intention known on their tax return. Tax returns, of course, are required under law and must be

117. Indeed, some of the most important corporate scholars have noted, at least in passing, the value of comparing contested corporate elections with political elections. *See* Jonathan R. Macey, *Too Many Notes and Not Enough Votes: Lucian Bebchuk and Emperor Joseph Ii Kvetch About Contested Director Elections and Mozart's* Seraglio, 93 VA. L. REV. 759, 765–68 (2007).

completed prior to a legally mandated deadline, April 15.[118] As a result, during tax season, taxpayers routinely spend hours preparing their return. They might cull charitable donation receipts, calculate mortgage interest deductions, or commiserate with their tax advisor. In so doing, these taxpayers learn a great deal about the activities of their government. At the same time, taxpayers are given an option on their return to allocate a small portion of public resources to the creation of a fund for campaign subsidies.

This yearly routine between taxpayers and the federal government via the tax return can be compared to another yearly, legally prescribed back-and-forth: the one that takes place between shareholders and their firms. For example, firms are required by state laws, at least once a year, to communicate formally with their shareholder constituency by way of an annual meeting and accompanying proxy statement.[119] Like taxpayers who tally receipts and scour their return line by line, shareholders who want to be informed of ongoings at their investment can spend hours reviewing firm proxy statements, which detail the activities of the firm and make various disclosures.[120] The proxy statement is not just information, but also a call to action. Proxy statements are accompanied by a proxy card, which shareholders use to approve various substantial decisions contemplated by the board of directors.[121] During the proxy statement season, shareholders vote to approve changes in the charter of the firm, any merger plans, and directors to the board.[122]

Just as tax returns are used to give taxpayers a chance to allocate public money for a campaign fund, the annual meeting and accompanying proxy statement could be used to give shareholders a chance to vote on the creation of a shareholder campaign fund. That is, the proxy statement machinery might be used to ask shareholders whether a campaign fund would be desirable. While making their proxy statement of firm activities, firms could also ask shareholders whether they want a small sum—say, $1 or maybe less—allocated to a fund that would subsidize shareholder campaigns. Depending on how many

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118. *See* 26 U.S.C.A. § 6072(a) (West 2009) (providing that the April 15 deadline applies to individuals computing income on a calendar-year basis).

119. *See, e.g.*, DEL. CODE ANN. tit. 8, § 211(b) (2009); MODEL BUS. CORP. ACT § 7.01(a) (2005) (providing that a "corporation shall hold a meeting of shareholders annually at a time stated in or fixed in accordance with the bylaws").

120. The proxy statement is an extremely long, complicated document with several disclosures that the firm is required to make. Shareholders interested in reviewing this document might spend at least several hours to do so, assuming they even have the fortitude to digest its contents in a single day. *See* HARRIS, *supra* note 26, at 222–25.

121. *See, e.g.*, DEL. CODE ANN. tit. 8, § 212(c); MODEL BUS. CORP. ACT § 7.22(b). Shareholders also review conflict of interest decisions. *See, e.g.*, DEL. CODE ANN. tit. 8, § 144(a)(2); MODEL BUS. CORP. ACT § 8.63(a).

122. *See* HARRIS, *supra* note 26, at 221–22.

shareholders approve, the firm would be required to set aside such monies to create the fund. For instance, if the check-off amount is $1 and holders of 1000 shares vote to approve, the firm would have to set aside $1000. If the check-off amount is $0.50 and holders of 1000 shares vote to approve, the firm would set aside $500; and so on. Thus, since every shareholder would have a say over how at least part of corporate resources should be used to fund shareholder challenges, it is conceivable that a sizeable fund could be created based on approvals from far less than a majority of shares.[123]

Also, though the proposed reform calls for a flat rate that would apply to all shares equally, there is no reason that the rate needs to be static. For instance, in the public funding system of presidential aspirants, the funding rate is flat, but subject to change by Congress. As mentioned, Congress has in the past raised the flat rate amount to $3 in order to grow the size of the fund to meet the advertising expense associated with a modern campaign. In a similar way, the rate for a Shareholder Campaign Fund might be increased over time to reflect the various changes in the costs of funding a reasonable shareholder campaign. For that matter, the amount of the flat rate could vary firm to firm to reflect differences in outstanding shares, and increases in the funding level could be a matter resolved by the ordinary operation of the firm charter. Thus, as with other charter amendments, an amendment to change the level of the check-off might be increased upon the recommendation of the board of directors and the approval of shareholders.[124]

One benefit of such a system of check-off funding through firm annual proxy machinery is that it would be simple to administer. Firms already have long experience (and existing legal obligation) in communicating with shareholders and requesting their approval for various firm activities.[125] Creating an SCF, along the same lines as the public system found for candidates in presidential elections, would require little more than for firms to piggyback off of their existing proxy machinery. More importantly, using the existing proxy machinery to get shareholder approval for the creation of a subsidy system would be easy to understand for shareholders who receive the annual communication. Shareholders would only be asked to check "yes" or "no" as to whether they would like to help create a shareholder campaign fund. The transaction costs to each individual shareholder would be extremely low since there would be little need to prepare or research whether to make this funding

123. *See* discussion *infra* Part V.
124. *See, e.g.*, DEL. CODE ANN. tit. 8, § 242; MODEL BUS. CORP. ACT § 10.03.
125. *See, e.g.*, MODEL BUS. CORP. ACT. §§ 10.03, 12.02; HARRIS, *supra* note 26, at 221–22.

decision. There would be no competing camps with competing disclosures to sort through and only a small amount of money at stake.[126]

Furthermore, the real magic of individual check-off is that funding relies on private parties making decisions that are in their own best interest, without an external agent or regulator, like the courts or legislature. Shareholders would have a say in whether corporate resources should be set aside to fund shareholder challenges.[127] Since investors are normally thought to be profit-motivated, such shareholders would only make that election in cases in which a corporate challenge is expected to benefit the firm and its shareholders.[128] Thus, shareholder preferences would serve as an important market-relevant check on whether a fund should be created and at what level.

2. Eligibility

Recall that under the current corporate rules, shareholders are only eligible for reimbursement if they are successful in a control contest.[129] However, the problem with this standard is that the threshold—winning control of the board—is set too high and reduces the number of credible campaigns that might otherwise occur.[130] Thus, a second contribution from the public sector that also makes good sense in crafting corporate election reform is the method of determining eligibility for campaign funding.

As discussed before, the eligibility requirements will affect the quality of shareholder campaigns. If the eligibility requirements for corporate funding are

126. For larger shareholders, of course, a larger amount of money would be at stake. For instance, a shareholder who owns one thousand shares of Firm X would get to make ten times as many funding decisions as someone who owns only one hundred shares in Firm X. However, the point is that for every shareholder, the funding decision would be small, relative to their investment stake. Even for shareholders with larger stakes, the funding decision would represent a small portion of the value of their total investment.

127. Incidentally, this is a vast improvement over Delaware's recent changes to the proxy rules. Under those rules, the board of directors has discretion to decide whether to set out a reimbursement schedule to determine reimbursement eligibility for challengers. The problem, of course, is that the board has a self-interest in setting reimbursement rates low and eligibility criteria high. *See* DEL. CODE ANN. tit. 8, § 113; *see also* CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227, 237 (Del. 2008) (noting that under Delaware law, "shareholders are entitled to facilitate the exercise of that right by proposing a bylaw that would encourage candidates other than board-sponsored nominees to stand for election").

128. *Cf*. Jill E. Fisch, *Frankenstein's Monster Hits the Campaign Trail: An Approach to Regulation of Corporate Political Expenditures*, 32 WM. & MARY L. REV. 587, 621 (1991) (arguing that firms make political donations only when such donations are expected to generate an "overall economic benefit").

129. *See infra* Part I.C.

130. *See* HARRIS, *supra* note 26, at 228.

set too low, it might encourage frivolous campaigns.[131] Would-be challengers might emerge "out of the woodwork" to take advantage of the availability of a subsidy.[132] At the same time, high eligibility thresholds will over-deter. For instance, if the criterion for subsidization is winning a contested election, as it is under the current rules, then candidates who have run a solid a campaign, but come just short of gaining over 50 percent of support in an election, might be dissuaded.[133] In other words, if eligibility is set too high, there could be far too few credible campaigns.[134]

Again, the public sector has already provided a ready tool, a threshold not tethered to a simple binary, like winning or losing. In fact, the public subsidy system for federal election premises reimbursement on garnering only 5 percent of the vote.[135] The goal here is not to advocate exactly where the line for eligibility for corporate subsidy should be drawn. Rather, the point is that, as in the public sector, a new system of shareholder campaigns should attempt to identify a moderate threshold standard for eligibility for reimbursement without going so far as to make the standard actually winning a corporate election.[136] As with the PCF, a subsidy system for shareholder challengers might deem a "success" to be something significantly less than winning a contested corporate election, but still tie eligibility to how many shareholders actually voted in a contested corporate election and how many voted for the shareholder-challengers.

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131. *See* Bebchuk, *supra* note 6, at 698 (discussing frivolous campaigns and their relationship to shareholder reimbursement schedules); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 414 (1983) (noting that reform of corporate elections must be able "to distinguish plausible challengers from frivolous ones").

132. *See* Easterbrook & Fischel, *supra* note 131, at 414 ("The firm's offer to pay for the contest may become an attractive nuisance. There are always publicity seekers willing to stand for office on someone else's money."); *cf.* Philip Shishkin, *States Cut Services for Elderly, Disabled: As Budget Shortfalls Force Reductions in Home Care, Low-Income People May Face Nursing Homes, Advocates Say*, WALL ST. J., Nov. 20, 2008, at D1 (finding that under the "woodwork effect theory," expanding eligibility of funds might create incentives for individuals to apply to use services that they normally would not apply to collect).

133. *See* Bebchuk, *supra* note 6, at 698–99 (discussing high eligibility standards for reimbursement of campaign expenses).

134. *See generally id.* at 699 (noting that the "optimal" reimbursement schedule would provide full reimbursement to challengers with "sufficiently high" levels of support and no reimbursement to challengers with "sufficiently low" levels of support).

135. Buckley v. Valeo, 519 F.2d 821, 849 (D.C. Cir. 1975) (noting that the 5 percent threshold of votes was set "[t]o discourage frivolous campaigns designed to obtain public funding").

136. *Cf.* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 874 (2005) (arguing for reimbursement of some shareholder expenses for activities that "pass a certain threshold of success (such as attracting a certain percentage of the company's shares or of the shares voted)").

Admittedly, a low threshold may seem at first glance to present problems. After all, many public companies have shareholders that control large stakes.[137] Thus, in theory, if reform were implemented and the eligibility standard set too low, in some cases a challenger might only need to convince a single large shareholder to support their contest in order to qualify for a corporate subsidy. On the other hand, reaching even an extremely low threshold—even a threshold as low as 5 percent, the criteria for political elections—is not overly easy.

For one thing, shareholder-voters arrive with a certain management bias. Shareholder-voters favor incumbent managers, just as voters in political elections tend to favor incumbent public officeholders.[138] As a consequence, in many cases of contested corporate elections, shareholders tend to naturally, almost reflexively, vote with management.[139] As previous commentators have argued, shareholders tend to vote with management because they are uncertain about the intention of the reformers; have a long-standing relationship with directors that they want preserved; and believe that managers are better informed.[140] Challengers seeking to reach any meaningful threshold will have to overcome this natural shareholder tendency to side with management, a task that is fraught with difficulties.[141]

Also, shareholders have a tendency to vote down certain reform measures, particularly reforms that have only social or ideological benefit.[142] The data suggest that shareholders overwhelmingly vote down such proposals by wide margins.[143] Thus, the reform called for here is unlikely to increase the chances for successful (reimbursable) challenges surrounding a social agenda.

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137. For instance, as I analyzed in a prior article, in my database on companies that have had a contested election in recent years (2006–2008), more than 95 percent had at least one shareholder who owned more than 5 percent of outstanding shares, the threshold for public disclosure to the Securities and Exchange Commission. *See* Harris, *supra* note 3, at app. A.

138. Bebchuk, *supra* note 136, at 858–59 (discussing the difficulties in convincing the shareholder community that incumbent managers should be removed and that the challenger, if elected, would improve firm performance).

139. *See generally* Easterbrook & Fischel, *supra* note 131, at 396–98, 414 (discussing management bias and uncertainty over challengers). *See also* Bebchuk, *supra* note 136, at 877.

140. *See* Bebchuk, *supra* note 136, at 877; *see also* Easterbrook & Fischel, *supra* note 131, at 414–16.

141. Bebchuk, *supra* note 136, at 857 (noting that shareholders tend to vote with management because of uncertainty).

142. *Id.* at 883 (noting the difficulty of obtaining support for special interest proposals).

143. In fact, at least one study of shareholder proposals found that of ninety shareholder proposals submitted on social policy issues, none were approved by shareholders. *See* Cynthia J. Campbell et al., *Current Perspectives on Shareholder Proposals: Lessons From the 1997 Proxy Season*, 28 FIN. MGMT. 89, 91–92 (1999).

3. Spending Limits

A final takeaway from the public sector that might be applied to shareholder-led campaigns in corporate elections is how to determine limits on spending. Recall that under the public subsidy system of the PCF, major party candidates and new candidates are limited by the size of the fund and the number of candidates with eligible claims. In short, any candidate who receives 5 percent or more of the vote is eligible for partial reimbursement, depending on how they fare as compared to other candidates and, significantly, how much the fund has collected.

Similarly, under the proposed reform, challengers in a contested corporate election would have to limit their expenditures to what has been collected in the campaign fund. As a result, the level of challenger reimbursement would depend on the size of the fund and the number of eligible contestants. If there are many eligible contests making a claim on the fund, then fund resources might be inadequate and have to be divided on a pro rata basis. Also, if too few shareholders elect to direct a nominal sum to the firm treasury to create the fund, then its coffers will run low, and there will be very little in campaign funds to go around.[144]

Further, the principles just described might help fill a gaping chasm in corporate case law. Current case law regarding expenditures for corporate campaign expenses is inchoate and scattered. As a practical matter, the current law on point suggests that incumbents may spend freely from the corporate treasury. To be sure, the case law suggests that incumbents may not spend at unreasonable levels to maintain their board seats, and they must always spend in the firm interest. However, judges have few concrete benchmarks to judge whether incumbents have been excessive. Courts have been loath to define what reasonable expenses are or what kind of expense would *not* be in the firm interest.[145]

As a result, expenditures in contested corporate elections are made on all sorts of things, including social activities, travel, consultants, and all manner of marketing materials to win shareholder votes. Expense estimates from recent proxy statement filings ranged from the spartan (a few hundred dollars budgeted) to the lavish (approximately $22 million budgeted).[146] Limits related to

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144. For an example, see Part V, *infra*.

145. *See, e.g.*, Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291 (N.Y. 1955).

146. *See infra* text accompanying notes 186–187. In 2008, CSX faced a challenge from the Children's Investment Fund, a private equity firm. Children's Investments estimated their total expenses related to the contest to be $9 million, while CSX estimated their expenses would top $20 million. *See* Definitive Proxy Statement, Contested Solicitation (Form DEFC 14A), The Children's Investment

"firm interest" or "reasonable" expenses are, for all intents and purposes, nonexistent. By contrast, the SCF might represent a substantial improvement over the current scheme. Specifically, the SCF might aid courts confronted with challenges over incumbent overspending by creating a real benchmark for courts to use to rein in incumbent expenses that are out of proportion.

B. Expected Corporate Election Outcomes

Previous corporate law scholars have lamented the problems of the current corporate election system. These commentators have argued that the current system creates a context for shareholder apathy, induces free riding, and, more recently, fails to acknowledge the problems that attend when shareholders have divergent interests.[147] Notably, the proposed reform does a remarkable job of mitigating each of these festering problems.

1. Shareholder Apathy Problem

For starters, an SCF may increase shareholder participation rates and reduce shareholder apathy. In the current system of corporate voting, many shareholders fail to review proxy statements and frequently do not participate in the voting process that precedes annual meetings. As Daniel Fischel and Frank Easterbrook previously wrote in their now famous article, so-called shareholder apathy is rational and predictable since the costs of making an informed decision are high—for example, having to read a long, tiresome proxy statement—while to the vast majority of shareholders the benefit of voting is close to nil.[148] Shareholder apathy creates several practical problems for the firm. One problem, among others, is that low participation rates make it

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Fund Management LLP, at 24 (May 2, 2008), *available at* http://www.sec.gov/Archives/edgar/data/277948/000110465908027252/a08-12469_2defc14a.htm (filed under CSX Corporation) (providing estimates of expenses); Definitive Proxy Statement, (Form DEFC 14A), CSX Corp., at 61 (April 25, 2008), *available at* http://www.sec.gov/Archives/edgar/data/277948/000095014408003190/g11808dfdefc14a.htm; Press Release, CSX Corp., CSX Announces Final Voting Results for 2008 Annual Meeting of Shareholders (July 31, 2008), http://www.csx.com/?fuseaction=employees.retirees_news-detail&i=49798; *see also* Chad Bray, *CSX to Seat Funds' Board Nominees*, WALL ST. J., Sept. 17, 2008; Steven M. Davidoff, *The Wait at CSX*, N.Y. TIMES, June 27, 2008, at C7; Michael J. de la Merced, *A Hedge Fund Struggles for CSX Is Left in Limbo*, N.Y. TIMES, June 26, 2008, at C3.

147. *See, e.g.,* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1268 (2008) (discussing the traditional view).

148. *See* Easterbrook & Fischel, *supra* note 131, at 402 (noting that shareholder voters do not expect their vote to change election outcomes and, thus, have no incentive "to study the firm's affairs and vote intelligently").

harder for the firm to get the quorum necessary to conduct business at corporate meetings and drive up the costs the firm must expend in soliciting votes.[149]

Importantly, subsidies to challengers in corporate elections from an SCF will likely improve informed voting and participation.[150] Observers of political reforms have found that election reforms that open up channels of participation tend to legitimize elections in the eyes of voters and enhance participation rates.[151] Recall that a corporate election subsidy system similar to the subsidy system in the public sector would give each shareholder a new avenue to participate in firm affairs. Since the SCF depends on shareholder approvals, it is also likely to be viewed as legitimizing. The SCF would rebut the impression that corporate elections are not important or, worse, are rigged to favor wealthy and special interests, such as institutional investors.[152]

Further, through funding, the SCF would provide shareholders, both small retail investors and large institutional investors, a direct mechanism for participating in the governance of the firm in a way that counts in real dollars (or cents, as the case may be). This is in stark contrast to shareholder voting generally, which frequently has little effect on the outcome of elections and, as a result, has little expected value to shareholders. In the case of the usual election, a shareholder has little incentive to make an informed vote since it is extremely unlikely that her vote will affect the outcome of the election contest.

By contrast, in a firm-organized subsidy scheme, like the SCF, shareholders would see the effect of their choice to fund (or not fund) immediately—the size of the campaign fund would grow (or not). Their votes would count for something, regardless of how nominal. Importantly, the SCF would create new incentives for shareholders to take an active role in firm governance, regardless of the size of their stake. For instance, minority stakeholders in the firm would have an important and undeniable role. Similar to the public subsidy system for political elections, creation of the fund for shareholder campaigns would not depend on the agreement of the firm's largest shareholders. Even if the larger shareholders elect not to approve contribution to the fund, a sizeable fund might still be created if enough small shareholders each make an individual decision to redirect some small sum for shareholder campaigns.[153]

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149. MODEL BUS. CORP. ACT § 7.25 (2005) (providing quorum requirements).

150. *See* Easterbrook & Fischel, *supra* note 131, at 396–98, 414 (discussing shareholder voting and apathy).

151. *See* Overton, *supra* note 61, at 100–04 (discussing legitimatization through widespread participation).

152. *Cf*. Raskin & Bonifaz, *supra* note 65, at 1182 (describing reform in political elections as a way to improve voter confidence in elections).

153. On this point, one potential critique of the SCF is that vesting power to create a fund in minority holders is, in some sense, undemocratic. Imagine if those holding a majority of firm shares

At the same time, this new mode of participating in firm affairs by funding (or not funding) might also have unique value to large or institutional shareholders. Previous research has found that institutional shareholders sometimes avoid activist activities, particularly corporate campaigns to oust directors.[154] Such shareholders frequently do not have the time, expertise, or inclination to engage in such forms of activism.[155] Another advantage of the SCF, therefore, is that it would give these institutional shareholders a way to encourage such contests and help them get off the ground, without leading the charge themselves. By making a funding decision, large and institutional shareholders can ensure that an SCF is created, and the sheer presence of the fund should encourage a challenge. As the SCF grows in size, it sends a unique signal to potential challengers—that shareholders demand change through annual elections. When the fund is large, therefore, potential challengers are more apt to emerge, a point that will be elaborated on shortly.

Moreover, to the extent that the SCF increases the incidence of contested corporate elections, it might also enhance shareholder participation rates in firm governance. In contested corporate elections, shareholders can expect to field appeals for their vote from at least two groups: incumbent management and the challengers. This competitive atmosphere is likely to generate more interest, excitement, and information than in usual (uncontested) elections. Similar logic applies to the political context, where the concern is that with few incumbents being challenged for office, elected officials are not forced to articulate

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elect not to participate and avoid "checking the box." In the case of presidential campaigns, by comparison, the vast majority of taxpayers, 73 percent, do not tick the check-off, in effect voting "no" to the presidential campaign fund. Similarly, larger institutional shareholders might own a majority of outstanding shares and elect not to fund the SCF. Such shareholders, for instance, will likely already have sufficient resources to mount a campaign should they choose to, and might have less incentive to "vote" to establish a fund that chiefly permits small shareholders the means to mount a campaign they could not otherwise launch. As a result, in one view, the SCF is antidemocratic. It creates the prospect—and the real possibility—of a fund created with the approval of only a minority of shareholders. However, while perhaps antimajoritarian, a shareholder fund is not obviously antidemocratic. Although a simple majority of shareholders might not be able to head off the ultimate creation of the fund, their vote can still affect the size of the fund and the ultimate disposition of a shareholder campaign. Each shareholder, that is, still has a say in fund size increases. More importantly though, if a majority of shareholders believe that the fund has been misused to fund a campaign that is ill-considered, they can, once the campaign is launched, vote it down. Thus, while those holding a majority of shares cannot on their own prevent the creation of a shareholder campaign fund, they can still steer the ultimate outcome of a shareholder vote, which is in many ways more important.

154. Bebchuk, *supra* note 136, at 876 & n.91 (noting that some mutual funds are reluctant to engage in proxy contests and calling such funds "reluctant" activists) (citing Robert C. Pozen, *Institutional Investors: The Reluctant Activists*, HARV. BUS. REV., Jan.–Feb. 1994, at 140).

155. Bebchuk, *supra* note 6, at 691 (noting that "running a contest that demands management time and attention . . . does not sit well with the business model of such funds").

and promote their views.[156] In a contested political election, however, the dynamics are far different. In contested congressional elections, for instance, the incumbent and challengers spend vast sums on materials to educate the electorate on their positions and, of course, the positions of their opponents. According to some commentators, even nasty attack ads create an educational opportunity for the electorate.[157]

This same sort of dynamic can be applied to the corporate context. In the corporate context, the shortage of candidate choice in director elections means that there will be little debate about firm strategy. In contrast, in contested corporate elections, directors frequently spend hundreds of thousands of dollars to inform shareholders of their strategy and to draw contrasts with challengers. Thus, to the extent that the subsidy increases the incidence of contested elections, it would also likely create an opportunity for the electorate (here, shareholders) to learn, digest, and ruminate on the capabilities of those seeking office and the issues in the election. Thus, as in political elections, a contest increases the flow of information, participation, and voter turnout.[158]

Incidentally, as shareholders participate in the SCF, there may be positive spillover into other areas of corporate governance as well. That is, as shareholders are asked to make a decision on whether an allocation should be made to the shareholder fund, such shareholders might also be convinced to take a more active stance with respect to other matters affecting the firm.

2. Free-Rider Problem

According to many corporate law scholars, from Robert Clark to Lucian Bebchuk, even when the benefit of participation in the corporate election could create significant value, many shareholders will still avoid these contests since successful contestants will not be able to fully appropriate the benefit of

156. Mark Brown argues that electoral competition and choice create better government. Mark Brown, *Popularizing Ballot Access: The Front Door to Election Reform*, 58 OHIO ST. L.J. 1281, 1308–09 (1997) ("Even unsuccessful competition is important because it aborts complacency and fosters better government."). Moreover, Cass Sunstein has noted the importance of political debate in the American constitutional tradition and has advocated for campaign finance reform. *See* Cass Sunstein, *Political Equality and Unintended Consequences*, 94 COLUM. L. REV. 1390, 1392 (1994) ("The constitutional system aspires to a form of 'government by discussion.'").

157. Smith, *supra* note 67, at 1061 (noting that attack ads can "increase public awareness in a positive way").

158. *See* Brown, *supra* note 156, at 1317–18 (noting that lack of choice reduces election turnout and interest in political elections).

their efforts.[159] The free-rider problem is shorthand for the idea that not only are campaign costs high, but such costs are borne solely by the challenger, though many may benefit from the campaign.[160] A successful challenger in a contested corporate election might be able to extract beneficial changes from the firm.[161] However, beneficial changes will only redound to them to the extent of their shareholding.[162]

If challengers only hold a small stake in a particular firm, as many diversified shareholders do, even a victory in a contested corporate election will create very little benefit to the challenger. Other shareholders would also benefit and, thus, be allowed to free ride off the efforts of challengers. The same is true for large, institutional shareholders. That is, shareholders with a large stake in the firm may still avoid participation in a contested corporate election since the benefits of a potential contest are spread across all other shareholders.

To illustrate this problem with a simple, stylized example, consider a firm with one hundred outstanding shares and only two shareholders, *A* and *B*. Shareholder *A* owns eighty shares and Shareholder *B* owns twenty shares. Assume that if either one of these shareholders launched a campaign, he or she would accomplish the ouster of incompetent directors and see a total appreciation of $110,000 in firm value with new leadership. Meanwhile, the costs of launching a campaign are $100,000. Unlike the shareholder apathy problem described above, in this scenario the benefit of participation in the contested corporate election exceeds the costs ($110,000 > $100,000). However, it is unlikely either shareholder *A* or *B* would ever launch a campaign since the benefit of the contest ($110,000) has to be shared with the other. Shareholder *A*, who owned 80 percent of outstanding shares, would get 80 percent of the benefit, or $88,000, while *B*, who owned 20 percent of outstanding shares, would get 20 percent of the benefit, or $22,000, without having to lift a finger. As a consequence, it is unlikely that either one of them would launch a campaign because each Shareholder's individual benefit would be less than the costs of the campaign. In short, shareholders, large or small, have less incentive

159. *See* ROBERT CHARLES CLARK, CORPORATE LAW § 9.5.2, at 392 (1986) (discussing the cost-benefit problem, which leads shareholders to leave activism to others); Bebchuk, *supra* note 6, at 689 (discussing the "free-rider problem" as an impediment to electoral challenge).

160. Easterbrook & Fischel, *supra* note 131, at 413 (discussing the free-rider problem as a "divergence between cost and benefit" of an electoral challenge).

161. HARRIS, *supra* note 26, at 223 ("If, say, the successful challengers are about to replace the incumbent board of directors with a new slate of individuals who are able to increase firm value and the price of the company's shares, the gains to the challengers will continue to be a function of her shareholder stake. The successful challenger will, in other words, have to share the gains from challenge with other shareholders.").

162. *See* Bebchuk, *supra* note 6, at 689–90 (discussing an example of how the expected benefit of an electoral challenge is a function of shareholding).

to pursue challenges since they will have to share the gains generated with other shareholders pro rata.

However, consider how a challenger subsidy scheme, like the SCF, would likely affect the incidence of contested corporate elections and the free-rider problem endemic to corporate elections. With a subsidy system for challengers, the downside risk to shareholder-challengers—the costs of the campaign—are spread among all shareholders. Recall that, under the proposed reform, the eligibility standards provide that even modestly successful shareholder-led campaigns will be paid for out of the funds of the corporate treasury. As a consequence, the costs of the campaign will not be borne by the challenger-proponent exclusively. Instead, these costs will be shared among all shareholders. Under the proposed reform, once a fund has been created, shareholders can expect to share equally in the costs. Regardless of whether a particular shareholder has voted for the fund—that is, elected to direct a nominal sum to the fund—every shareholder will bear the costs of such campaigns since the costs of these campaigns come from firm resources.

Instead of fixating on campaign costs, under the proposed reform, shareholder-challengers will be more likely to consider whether the objective of the contest is likely to enhance firm value and the expected popularity of the campaign among other shareholders. First, potential challengers would likely consider whether the campaign is likely to produce value for the firm. After all, even costless campaigns would not be worth it in terms of time and effort if the campaign is unlikely to produce value for the firm. In fact, a value-reducing campaign would hurt the challenger to the extent of her shareholding. Second, potential challengers would consider whether the contest will be at least marginally (for example, 5 percent) popular among shareholders. Recall that challengers must front the initial costs of the challenge and will only be reimbursed if they can show a modest indicator of success. Thus, shareholders would not necessarily launch frivolous (or social) campaigns since these would be unlikely to generate the threshold support, and the costs of these vanity campaigns would continue to fall on the challenger.

3. Fragmented Shareholder Interest Problem

Additionally, the proposed reform helps resolve the problem of fragmented shareholder interests. Traditionally, shareholders, whether activist or passivist, are thought to share the same core objective: maximizing the value of their investment.[163] However, as Lynn Stout and Iman Anabtawi have persuasively argued in their research, shareholder interests are not always in sync.[164] In fact, shareholder interests are increasingly heterogeneous and often at odds.[165] In short, this line of research has posited that contestants in corporate elections cannot be expected to pursue an interest shared by all shareholder groups since shareholders have dissimilar interests.

For instance, one of the most easily appreciated potential differences among shareholders is in terms of shareholder time horizons.[166] Some shareholders intend to be long-term holders; others only want to commit to a short-term investment.[167] If the evidence suggested that the vast majority of challenges were brought by short-term holders, this finding could be worrisome.[168] It might suggest that the short-term holders pursued corporate election challenges as a way to further their own interests (like quick pops in the stock price), even though such interests might conflict with the interests of long-term holders (who might, for instance, desire steady, stable increases in firm value).[169]

In fact, my previous research found that institutional investors and wealthy individuals with large stakes in the target firm almost always (and exclusively) mount corporate election challenges to directors. In recent years, small retail investors launched only a handful of the more than 133 campaigns.[170] The rest were launched by individual investors with large stakes in the target firm, and

163. *See* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1268 (2008) (discussing the traditional view).

164. *Id.* at 1258 ("Increasingly, the economic interests of one shareholder or shareholder group conflict with the economic interests of others. The result is that activist shareholders are using their growing influence not to improve overall firm performance, as has generally been assumed, but to profit at other shareholders' expense."); *see also* Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) (describing various strategies for separating economic interest from power to vote in contested corporate elections).

165. *See* Anabtawi & Stout, *supra* note 163, at 1258.

166. For a discussion of how differences in diversification can create unique shareholder interests, see Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 585 (2006); *see also* Joy v. North, 692 F. 2d 880, 886 (2d Cir. 1982) (discussing diversification strategies among shareholders). For several additional hypothetical examples of divergent interests among shareholders, see Anabtawi & Stout, *supra* note 163, at 1258–59.

167. *See* Anabtawi & Stout, *supra* note 163, at 1290–92 (discussing conflicts that arise from activists' short investment horizons); Anabtawi, *supra* note 166, at 579–81 (noting differences in time horizon among shareholders and their implications: "For example, shareholders with a short timeframe will favor the inflation of current share prices at the expense of long-run value. On the other hand, long-term investors will be willing to sacrifice immediate profits for future appreciation").

168. *See* Anabtawi & Stout, *supra* note 163, at 1291; *see also* Anabtawi, *supra* note 166, at 564, 579–80 (describing the investment strategy of pension funds and noting that these shareholders are "concerned about the long-term value of [their] investments").

169. Anabtawi & Stout, *supra* note 163, at 1291 (describing how activists might create short-term improvement in stock price but not necessarily improve long-term firm value).

170. Harris, *supra* note 3, at 108, 120.

institutional investors.[171] Such contestants, as Stout and Anabtawi have argued, likely pursue their own narrow interests in such contests and not necessarily the interests of the shareholder community at large.[172]

The SCF tips the balance the other way and will likely help diversify the identity of contestants that launch corporate elections. Specifically, the SCF creates an opportunity for average or retail shareholders to launch challenges to the incumbent leaders of the firm at annual meetings. With corporate campaign subsidies, shareholder-challengers need only be marginally successful—reaching a low eligibility threshold—before they qualify for some reimbursement. With the proposed reform in place, some average shareholders, like retail investors, may be more apt to launch a campaign on the expectation that there is a higher probability that they will receive funding, even when they are only partially successful. As other contestants emerge, incentivized by the lure of corporate subsidy, the identity of contestants in proxy contests will diversify, and a wider variety of shareholder interests will be pursued through corporate elections.

4. Managerial Misconduct

A fourth potential upside of the SCF goes to the heart of firm governance and how decisions should be made and how firm strategy is shaped. State corporate codes put decisionmaking in the hands of boards of directors, and centralized management is one of the key characteristics of the firm.[173] The problem, however, is that without regular elections (or comparable corporate governance structure), some managers might be prone to ignore shareholder preferences and, worse, use their position to pursue their own personal agendas.[174] For instance, if directors know that the threat of ouster is phantasmal, some of them might have little fear in making decisions to increase their compensation (beyond market rates), adopting rules that operate to entrench themselves, or engaging in other selfish acts.[175]

The proposal for an SCF, by contrast, creates a new method for giving shareholders a voice in corporate affairs and decisionmaking. The SCF increases

171. *Id.* at 128, 135–36.

172. Anabtawi & Stout, *supra* note 163, at 1260 (noting that activist investors, like hedge funds, often pursue self-interest "while failing to help—or even harming—the firm and its other shareholders").

173. *See* DEL. CODE ANN. tit. 8 § 141 (a) (2009); MODEL BUS. CORP. ACT § 8.01(b) (2005); *see also* HARRIS, *supra* note 26, at 127 (discussing central characteristics of the firm, including centralized management); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550 (2003) (referring to "director primacy").

174. Bebchuk, *supra* note 136, at 850 (describing self-dealing behavior by managers when effective corporate governance structures are not in place).

175. *Id.* at 854–55 (presenting empirical evidence that incumbent directors routinely ignore shareholder preferences with respect to staggered boards).

the prospect of contested corporate elections and, as a consequence, helps refocus directors' attention on shareholder and firm interests.[176] Under the reform proposal, shareholders would be able to oust (or credibly threaten to oust)[177] underperforming managers.[178] Because contested corporate elections often put managers' career and board posts in jeopardy, incumbent directors will want to avoid these contests. They will be incentivized to avoid personal misconduct and other activities that will raise shareholder ire and create a basis for a shareholder campaign.

To the extent that shareholders have good ideas about the direction and strategy for the firm, directors are more likely to take them seriously if shareholders have a credible option to mount a campaign for the replacement of directors. As in political elections, public officials cannot afford to disregard the preferences of those who helped them get to office or those who can play a role in their removal.[179] Similarly, contested corporate elections create oversight of management actions. In short, the SCF, which helps subsidize such elections, helps hold potential managerial misconduct in check and forces incumbent managers to heed shareholder preferences.

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176. Bebchuk, *supra* note 6, at 682 (discussing various significances of the shareholder franchise: "[A] viable shareholder power to replace directors is important in our board-based corporate governance system. Such power is necessary to provide directors with strong affirmative incentives to focus on shareholder interests"); *see also* Easterbrook & Fischel, *supra* note 131, at 403 (arguing that managers will act in shareholder interests "in order to advance their own careers and to avoid being ousted").

177. Importantly, the threat of corrective action can be just as important as the actual use of the action. If directors realize that shareholders have a credible option to remove them for bad conduct, such action might not need to be taken in order to encourage managers to perform well. For instance, Lucian Bebchuk has recently observed:

> [I]t should be emphasized that the benefits of shareholder intervention power should not be measured solely, or even primarily, by the rate of actual shareholder intervention. Indeed, a large fraction of the benefits would be indirect. Introducing the power to intervene would induce management to act differently in order to avoid shareholder intervention. Thus, even if a regime of intervention did not lead to the adoption of many shareholder-initiated proposals, it would not imply that the power is not working as hoped; on the contrary, lack of shareholder-initiated proposals could well mean that the power is working rather well.

Bebchuk, *supra* note 136, at 878; *see id.* at 876 (noting that the "frequency" of shareholder intervention is in some ways beside the point).

178. For empirical evidence on this point, see Bebchuk, *supra* note 6, at 677, 712–14 (summarizing empirical studies on the relationship between challenges and firm value); Brian J. Bushee, *Do Institutional Investors Prefer Near-Term Earnings Over Long-Run Value?*, 18 CONTEMP. ACCT. RES. 20 (2001); Choi & Fisch, *supra* note 49, at 299 n.135 (noting empirical studies); Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence From CalPERS*, 51 J. FIN. 227 (1996). "Shareholder power to remove directors is supposed to provide a mechanism for ensuring that directors are well chosen and have incentives to serve shareholder interests once chosen." Bebchuk, *supra* note 6, at 677.

179. *See, e.g.*, Raskin & Bonifaz, *supra* note 65, at 1179 (describing how the political process is geared to create policy results for the wealthy who have supported candidates for office); *see also* Lee A. Harris, *From Vermont to Mississippi: Race and Cash Welfare*, 38 COLUM. HUM. RTS. L. REV. 1, 32–38 (2006) (describing how policymakers decide how to allocate resources and make welfare policy).

In addition, the SCF likely enhances firm value by encouraging contested corporate elections, which in turn spurs valuable debate. The debate that occurs as a natural consequence of a contested corporate election has the promise of making managers better corporate leaders. Regardless of the outcome of a contested corporate election, the very fact that there is a contest creates a forum for contestants to explain their strategy, direction, and (in the case of managers) actions to the shareholder community. The contest sharpens the debate.[180] It makes the debaters think hard about their actions and likely improves their communication skills, time spent on deliberation and, ultimately, their actions.[181] Thus, contests make for better decisionmaking, which might also improve firm strategy and enhance firm value.[182]

Last, even if the SCF failed to enhance firm value, the reform might still be worth the candle, since it affirms shareholder importance. That is, as the SCF gives shareholders a conduit for making their preferences known, it reinforces the idea that shareholders are the ultimate owners of the firm and, as such, that their preferences matter.[183] Thus, increased shareholder participation matches up with generally shared values that the ultimate owners should have some discretion and authority over firm assets, even if those choices are not obviously value-enhancing.[184]

180. *Cf.* Overton, *supra* note 61, at 101 (suggesting that debate resulting from political elections ensures fully informed decisionmaking by officials).

181. *Cf.* Brown, *supra* note 156, at 1308–09 (arguing that competition and choice create better government). "Even unsuccessful competition is important because it aborts complacency and fosters better government." *Id.*

182. In the end, the answers to the best course are partly an empirical question on whether shareholder voice increases firm value. If it does, then, of course, reform measures like this one that improve shareholder voice can be expected to improve firm value. Hard empirical data, at this point, have been inconclusive and, in any event, are beyond the scope of this Article. *Cf.* Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008).

183. *See, e.g.*, Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681, 684–85 (2007) (noting that the debate is between those "who believe that shareholders actually own corporations and should have a greater say in how they are run" and their skeptics); *cf.* Overton, *supra* note 61, at 102 (noting in the context of campaign finance reform that proposals that encourage wider participation are important, since they give citizens a role in making decisions that "affect their lives"). *But see* Stout, *supra* note 6, at 791 (noting that the metaphor of shareholders-as-owners is "misleading").

184. *See* HARRIS, *supra* note 26, at 180–83. In fact, as some courts have suggested, there is something democratic about shareholders having the right to participate in governance. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) (noting that if stockholders are unhappy with board action, "the powers of corporate democracy are at their disposal to turn the board out"); Blasius Indus. v. Atlas Corp., 564 A. 2d 651, 659 (Del. Ch. 1988) (finding that the right to vote is "critical to the theory that legitimates the exercise or power by some . . . over vast aggregations of property that they do not own"); *see also* Bebchuk, *supra* note 6, at 676.

5. Shareholder Preference Gauge

Finally, if implemented, the SCF does a good job of signaling when a shareholder contest is desirable in the first place.[185] That is, the shareholder fund serves as a sort of preference gauge for (1) how many contested elections are desirable and (2) whether shareholders might vote to approve reforms in the firm's governance.

First, the financing scheme described here gives shareholders a vote on whether they believe there are enough challenges. If shareholders believe that there should be more contested elections, many of them will simply vote to allocate corporate treasury dollars to fund such campaigns. As the corporate campaign fund swells, some potential challengers will get the signal that shareholders are interested in reform at the firm. Some of these observers will launch a campaign as a result, expecting that they might succeed and that they will be fully reimbursed for their expenses. However, if shareholders believe that there are too many contested elections at a given firm, they may simply choose not to allocate more corporate treasury dollars. As the value of the corporate campaign treasury plummets, observers will be hesitant to launch a costly campaign since they will probably not get fully reimbursed for their eligible expenses.

Second, the size of the fund sends a signal to potential challengers about whether shareholders will vote to approve change in the first place. Shareholder interest in a particular undertaking is gauged directly by how shareholders vote if the issue ever comes to a vote. However, shareholder interest more generally is hard to measure prior to actually launching a challenge. Although the size of the fund does not give potential challengers any good information about what type of reforms are in order, it does communicate important information nonetheless. Based on the size of the fund, shareholder-challengers will have a reliable way of ascertaining whether shareholders are poised to support reform. For instance, if increasing numbers of shareholders believe the firm is headed in the right direction, there would be little reason for the median shareholder to choose to contribute, and the fund would be relatively small. Shareholder-challengers would be dissuaded from bringing a campaign because they will gauge that the prospect of winning a majority of shareholder votes is dim (regardless of whether there is an adequate reimbursement fund). However, if increasing numbers of shareholders want to see changes in the firm, they will

185. *See, e.g.*, Macey, *supra* note 117, at 764 (remarking about the need to establish a baseline in order to buy the claim that contests are a more important corporate governance tool than disciplined managers).

be inclined to approve funding through a corporate financing scheme, like the SCF. As the fund grows larger, some shareholder-challengers will have an incentive to mount a campaign for changes since they will expect that there is a growing desire for change.[186]

V. THE SHAREHOLDER CAMPAIGN FUND IN ACTION

Consider the chart below, which relies on data from companies that have actually experienced a contested corporate election in recent years, 2006–2008. According to information from Georgeson, the prominent proxy consulting firm, and additional information from a hand-collected set of proxy filings, approximately 133 firms received an election challenge, on average forty-four contested corporate elections per year. As seen below, combined contestants' estimated spending would top $200 million, and incumbents and challengers would typically spend well into six figures for campaign expenses. These are staggering amounts, which could not be easily absorbed by rank-and-file investors interested in bringing a challenge to incumbent directors at annual meetings.

TABLE 2: Summary Statistics for Contested Election Spending (2006–2008)

	Median	**Mean**	**Min**	**Max**	**Total**
Challenges Per Year	46	44	31	56	133
Incumbent Expenses	$200,000	$1.2 mill.	$6000	$22 mill.	$138 mill.
Challenger Expenses	$225,000	$652,130	$350	$9 mill.	$84 mill.
Outstanding Shares	26.4 mill.	99.6 mill.	11,000	2.386 bill.	12.948 bill.

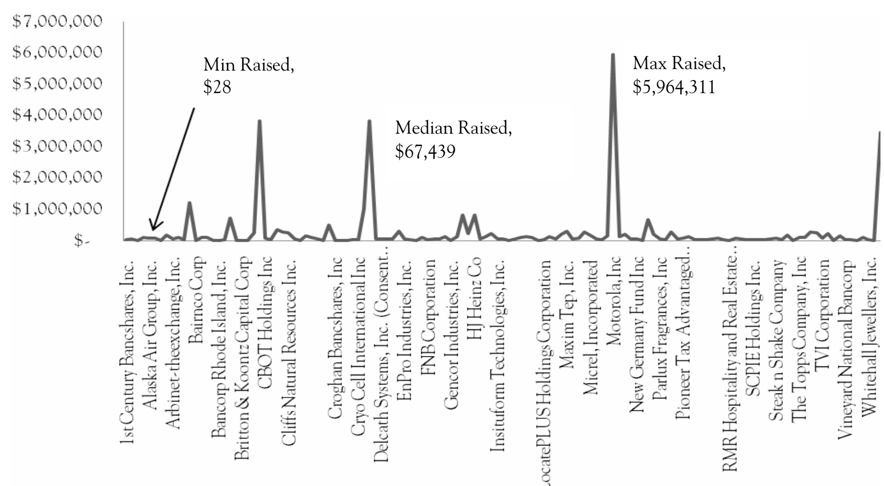
As mentioned, one of the advantages of the SCF is that it relies on shareholder preferences. Recall that, through the funding decision, shareholders decide the level of firm resources that are devoted to the fund and whether a fund is created at all. In recent years (2006–2008), companies receiving a

186. In other areas, a leader might be able to assess his or her constituents' preferences by taking a poll, survey, or similar device. However, this is not possible in corporate law, since such communication would be legally equivalent to a full-fledged campaign. That is, such communication would be tantamount to a "solicitation," and the solicitor would have to supply all shareholders with costly information as if the solicitor had conducted a campaign. *See* 17 C.F.R. § 240.14a-1(l) (2010).

challenge had, on average, approximately 100 million shares outstanding.[187] How many of these outstanding shares can be expected to participate in the SCF is unknowable.

However, the analogy to the public sector might also be useful here. If the SCF turned out to produce participation rates comparable to the rates of significant donations in political elections, 1 percent might be a fair expected yield. In fact, according to commentators, the rate for significant personal donations (>$200) in political elections is between 0.22 percent (as a proportion of the voting age population) and 2 percent (as a proportion of election voting), depending on which count is used.[188] As seen below, if only 1 percent (one million) of these shares, on average, voted to establish a fund on companies that faced a challenge in recent years, a sizeable fund could be created even if such shareholders only had a right to redirect a small amount of firm resources.

FIGURE 1: Amount Raised at 1 Percent



187. For example, Motorola, Inc. had 2,385,724,367 outstanding shares. *See* Definitive Proxy Statement (Form DEFC 14A), Motorola, Inc., at 1 (Mar. 14, 2007), *available at* http://www.sec.gov/Archives/edgar/data/68505/000095013707003824/c10691dcdefc14a.htm. On the other hand, American Republic Realty Fund I had 11,000 outstanding partnership units. *See* Definitive Proxy Statement (Form DEF 14A), American Republic Realty Fund I (Oct. 25, 2006), *available at* http://www.sec.gov/Archives/edgar/data/711512/000089742306000110/def14a.htm.

188. Overton, *supra* note 61, at 75 & n.8 (reporting available donations statistics for donations above $200).

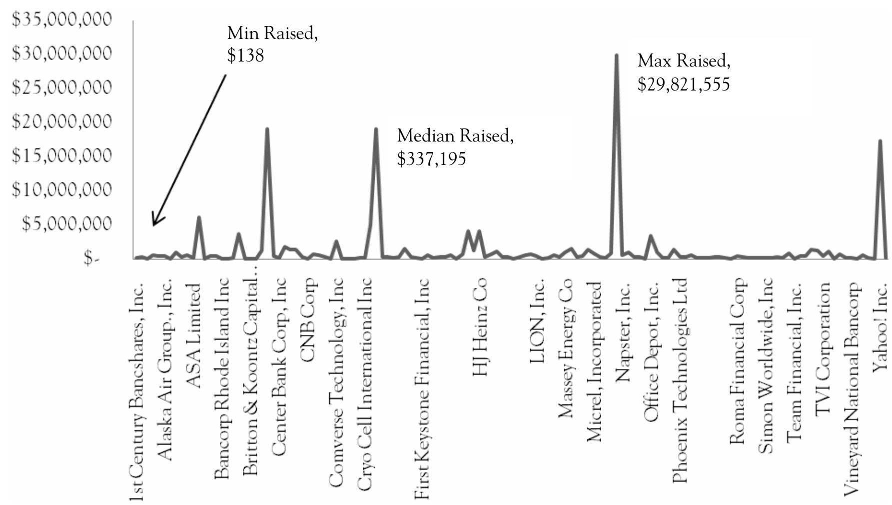
Even set at an extremely small amount, the one million shares voted in favor of creating a fund would represent enough to cover challenger expenses in most cases. In the above example, if each shareholder is given discretion to allocate (or not allocate) twenty-five cents of corporate resources, one million shares would raise a median fund size value at more than $67,000. At firms with significantly more than the median number of outstanding shares (like Motorola), giving shareholders discretion to redirect a small amount of the corporate treasury could raise a fund worth almost $6 million. Thus, in this example, the allocation amount could be less than twenty-five cents, and a fund large enough to cover expenses in many challenger campaigns could be generated.

Of course, if the levels of shares voted in support of a fund changed, the size of the SCF would grow or shrink commensurably. For instance, assume that less than 1 percent of shares are voted to create a fund. The fund would shrink, and less of a subsidy would be available to challengers. As mentioned, a small fund would suggest that shareholders would not like to see another contested election. Perhaps, for instance, the last election did not have the promised effect. Maybe the last contest did not lift the target's stock prices or have a positive disciplinary effect on management.

Now assume, as below, that a larger proportion of shares are voted in favor of creating a fund. In the public sector, while only a small percentage make a federally disclosed donation during a congressional election, a larger percentage of Americans, it turns out, make small donations from year to year. In fact, without regard to size, between 4 to 6 percent of Americans make a donation to a political candidate, including local, state, and federal candidates.[189] If approximately 5 percent of shares made an affirmative funding decision, then firms would have a median SCF size of $337,195.

189. Rosenkranz, *supra* note 59, at 888.

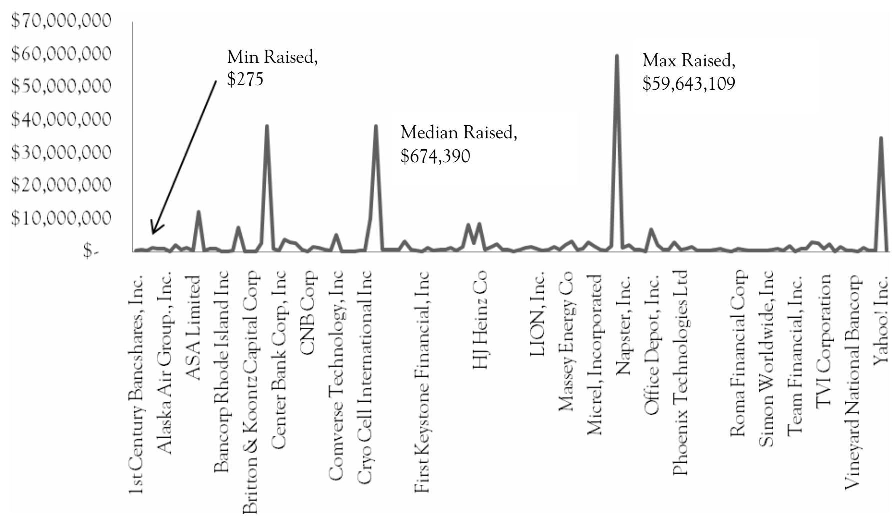
FIGURE 2: Amount Raised at 5 Percent



In fact, shares might be voted in favor of creating a challenger fund at even greater rates. For instance, the political donor analogy is arguably inapt. When making a political donation, an individual contributes her own personal wealth to a campaign. However, with an SCF, participating shares would merely redesignate a portion of the firm's wealth, which includes the shareholder's stake in the firm, but also the investments of other shareholders. Thus, given that the cost of the funding decision is spread out, perhaps greater proportions of shareholders could be expected to participate. Perhaps the best analogy from the public sector is participation rates in the PCF, the fund created by those who turn in their tax returns and have a chance to redirect a portion of Treasury resources. As mentioned, more than 9 percent of those turning in their tax returns elected to participate in the PCF.[190]

190. *See* CANTOR, *supra* note 11, at 4.

FIGURE 3: Amount Raised at 10 Percent



In the case in which 10 percent of shareholders participate in the SCF, the median fund from our sample of companies would rise to approximately $674,391, as seen above. If approximately 50 percent of shares were voted in the affirmative (not shown here), the SCF would swell to over $3.3 million.[191] Thus, fund size and fund creation depend on shareholder approval. As shareholder participation rates rise, the fund swells. As shareholders elect not (or neglect) to participate, fund resources tighten.

VI. POSSIBLE CRITIQUES OF THE SHAREHOLDER CAMPAIGN FUND

It is impossible to anticipate every critique of the Shareholder Campaign Fund. However, two possible arguments against the SCF merit a preemptive response.

A. Shareholder Proxy Access

So far, the argument has been that the corporate election system is broken and that the best way to fix it is to encourage shareholders to bring independent

191. In fact, if 50 percent of shares were voted in the affirmative, then a sizeable fund that met the median level of expenses in recent years could be created by giving shareholders a chance to allocate (or not allocate) less than a penny! That is, to raise a fund valued at $225,000, the median challenger spending level, would mean that firms could set the allocation amount at $0.0045, assuming more than half the shares (or 50 million shares) were voted in favor of creating a fund.

challenges to incumbent directors and subsidize those efforts. However, some would argue that the simplest way to give shareholders voice in annual elections is by giving shareholders access to the proxy statement and permitting them to make proposals, not encouraging independent campaigns.[192] Through so-called proxy access, shareholders might make proposals that are included as part of the annual materials that the firm would normally send out.[193] Shareholders making such proposals can avoid some disclosure obligations and the costs of dissemination.[194] Importantly, the procedural barriers for access to the issuer proxy statement are relatively low. Shareholders need only hold a relatively modest stake in the firm for a year or longer, make a brief proposal limited to 500 words, and transmit the proposal to the firm a reasonable time in advance of the annual meeting.[195]

Thus, one critique of the SCF is that there are ready alternatives for creating shareholder voice. In particular, proxy access gives shareholders a low-cost way of communicating with other shareholders and bringing an issue to a vote. For instance, Bebchuk has argued that shareholder proxy access rules should be modified to permit shareholders to use the proxy to bring issues to a vote in front of the shareholder community, when challengers can show a minimum ownership stake in the firm and commit to maintaining an investment in the firm over the long term.[196]

However, one problem with the current rules of shareholder proposals is the inordinate discretion those rules vest with managers. While the procedural requirements for shareholder campaigns via an issuer proxy statement are modest, the exclusionary rules regarding the content of shareholder proposals are exceedingly broad, vest too much discretion with the incumbent board of directors, and create severe limits on shareholder proposals. Under these exclusionary rules, boards have significant power and discretion to exclude shareholder proposals that, for instance, undermine board powers, proposals that concern insignificant items, proposals related to board elections, proposals related to dividends, proposals that concern activity beyond the board power, and proposals related to "ordinary business operations."[197]

As a consequence of the wide latitude given to boards via the exclusionary rules, boards have been able to avoid including the vast majority of

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192. *See* Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1267–68 (2009) (arguing that proxy access is ideal for implementing shareholder voting rights).

193. *Id.* at 1307–08.

194. *See* 17 C.F.R. § 240.14a-8 (2010).

195. *See id.* §§ 240.14a-8, 14a-7, 14a-8, 14a-2, 14a-2(b)(1).

196. *See* Bebchuk, *supra* note 6, at 697 (discussing shareholder access to the ballot as part of reform of corporate elections).

197. *See, e.g.*, 17 C.F.R. § 240.14a-8(i)(7).

shareholder proposals with the proxy statement. Once excluded, these shareholder proposals can typically only be transmitted to shareholder-voters through an independent communication—that is, through a costly independent campaign challenge. Alternatively, a shareholder can launch a lawsuit and argue that the exclusion was wrongful. However, such disputes on whether exclusion was wrongful can be difficult and costly.

Furthermore, of these exclusions, one of the most important is the exclusion related to elections to the board of directors. Under the exclusionary rules, shareholders cannot normally make a shareholder proposal that contests incumbent director leadership at the firm.[198] Thus, the only way shareholders can oust incumbent directors from the board is by launching an independent, freestanding corporate campaign. Although reform may come to the exclusionary rules, board discretion and control over the contents of the proxy statement are likely to continue. In short, the large discretion vested with the board respecting exclusion, the expectation that the board will exclude the proposal, and the costs of such suits from wrongful exclusion are likely to dissuade many shareholders (except the largest stakeholders and particularly wealthy shareholders) from making the proposal in the first place.[199]

Even if the exclusions were eliminated or modified to divest boards of some of their discretion, as has been proposed by corporate law scholars and, recently, the SEC, increased access to the proxy may create significant administrative burdens on firms.[200] As more candidates stand for election, the higher the strain on the election machinery in terms of preparing functional ballots and conducting a vote.[201] Each additional candidate may only present an incidental cost on the conduct of elections, but in the aggregate, an unusually large ballot can strain the election machinery.

Finally, it is not clear that shareholder proposals made through the firm proxy are as effective a method of effecting change at the firm as a sufficiently financed shareholder campaign. For one thing, shareholder proposals are rarely binding on the boards.[202] Instead, proposals are usually cast merely as recommendations for reform, which the board may ignore at its discretion.

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198. However, shareholders can make proposals to change the bylaws to permit shareholders to propose a slate. AFSCME v. Am. Int'l Group, Inc., 462 F.3d 121, 123 (2d Cir. 2006).

199. *See* Choi & Fisch, *supra* note 49, at 308 (noting that fighting a wrongful exclusion "can generate substantial legal expenses for activists").

200. *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024 (proposed June 18, 2009) (to be codified at 17 C.F.R. pt. 200, 232, 240, 249, and 274); Easterbrook & Fischel, *supra* note 131, at 425 (discussing administrative burdens that come with expanded proxy access).

201. *See* Easterbrook & Fischel, *supra* note 131, at 425.

202. *See* Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749, 1813 (2010).

Additionally, shareholders who use shareholder proposals as a way to communicate to the shareholding community are constrained in their ability to market themselves and their strategy for the firm. As mentioned, shareholders who make a proposal must limit the contents of the proposal to 500 words.[203] However, convincing other shareholders to change position and support a shareholder proposal is difficult and complex, often requiring more than a short statement.[204] As discussed, shareholders have a natural tendency to support management. In fact, the available empirical evidence seems to suggest that shareholders who launch a proposal have a dimmer chance of causing change at the firm than shareholders who launch independent campaigns.[205] For instance, my previous empirical research suggests that those shareholders who launch a campaign succeed (broadly speaking) close to half of the time. However, shareholders who launch a proposal rarely win.[206]

B. Frivolous Shareholder Campaigns

A second critique of the proposal for an SCF is that it might result in too many contestants in corporate elections. Too many candidates could have real costs to the election machinery and the electorate.[207] For instance, too many candidates may confuse the electorate, lower voter interest, and drown out the most serious election messages.[208] Frivolous candidacies may emerge, and too much electoral choice may create an impediment to serious candidates for office and create a cacophony of voice, such that no one is heard, and principles of deliberation are undermined.[209]

However, the eligibility requirements and spending limits, previously discussed, will probably reduce the likelihood of a high incidence of non-serious

203. 17 C.F.R. § 240.14a-8(d) (2010) (requiring that the text and supporting statement of shareholder proposals appearing on the firm proxy statement be limited to 500 words).

204. Bebchuk, *supra* note 6, at 689 (arguing that shareholders who oppose management will have to market their strategy to the shareholder community and noting that such efforts are costly and difficult); *cf*. Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 341 (2010) (arguing that shareholder proposals for bylaw amendments often exceed 500 words, and it would be difficult to "address[ ] most of the relevant elements (not to mention the supporting statement) within such a limit").

205. *See, e.g.*, Erickson, *supra* note 202, at 1813 & n.236 (citing evidence from Risk Metrics, a proxy-voting consultancy).

206. *See* Campbell et al., *supra* note 143, at 91–92.

207. *See* Bullock v. Carter, 405 U.S. 134, 145 (1972) (arguing that a large number of candidacies could clog elections and create confusion for voters); *see also* Raskin & Bonifaz, *supra* note 65, at 1186 (discussing frivolous candidacies in political elections).

208. *Bullock*, 405 U.S. at 145.

209. *See generally* Easterbrook & Fischel, *supra* note 131, at 414 (discussing the problem of frivolous campaigns that comes with a universal reimbursement rule).

candidacies. For instance, it is not clear that frivolous campaigns can meet even a moderate threshold for eligibility. Additionally, under the spending limits, SCF grant amounts would depend on the number of candidates. Recall that the amount from the SCF that candidates receive is a function of the number of eligible candidates that emerge at the annual election and make application for a subsidy from the SCF. For starters, consider a case where two challengers enter the field and are eligible for reimbursement. These challengers would split the fund subsidies. Three eligible challenges would divvy the subsidy three ways. As more candidates draw on the fund, there are fewer fund resources to go around. Assuming that challengers face the median cost constraint, very quickly the fund will not be able to cover all challenger expenses. Challengers interested in pursuing a challenge in this environment will have to accept partial reimbursement. Even if the size of the fund is large, the more candidates there are, the less money there will be to go around. Because the SCF depends on the number of candidates for office, the SCF likely dissuades frivolous candidacies.

In the end, another important point to consider here is the downside consequences of doing nothing and the prospect of continuing the status quo—primarily, few contestants in corporate elections. Absent reform, the current evidence suggests that only a small number of challengers take on incumbent directors in corporate elections. In fact, as detailed in a previous paper, out of thousands of public campaigns, there are only a few dozen contested elections, on average, per year.[210] Too few candidates in corporate elections means voters have little choice (other than incumbents), which confounds the basic point of obligating firms to hold corporate elections in the first place.

CONCLUSION

No matter what, incumbent directors in contested corporate elections will continue to have some advantages, just as incumbents do in political elections.[211] The managers of a firm, after all, have built up important relationships with the shareholder-voter community through their time at the helm. Significantly, however, these managers have also been able to rely on a campaign funding advantage. Although it is not obvious what can (or should) be done about the relationship advantage that incumbents will continue to enjoy in contested corporate elections, a good system to reform the funding advantage already exists in the political sphere. This public subsidy system helps

210. Harris, *supra* note 3, at 108, 120–21.
211. Briffault, *supra* note 12, at 569 (describing incumbent advantages beyond fundraising ability).

enhance participation rates, legitimize elections, and reduce the influence of special interest groups, among other benefits. It could do the same for corporate elections.