THE MANY MYTHS OF LUCIAN BEBCHUK

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INTRODUCTION

"THE Myth of the Shareholder Franchise"[1] is the most recent salvo in Professor Lucian Bebchuk's twenty-year campaign to recast the corporate law of Delaware in the image of his own writings. Ignoring decades of salutary historical development and the overwhelming lessons of observed boardroom behavior, Bebchuk advocates the abandonment of the traditional process for selecting and retaining directors of U.S. public corporations. In its stead, Bebchuk offers a novel electoral system of his own recent invention—a regime specifically designed to encourage costly proxy contests and frankly founded on the premise that corporate directors will not do their jobs absent the constant fear of imminent replacement.

Bebchuk's prescription is policy revolution masquerading as reform. Indeed, it is increasingly clear through his writings and lectures, and now through his personal litigation against major corporations, that Bebchuk has become a deconstructionist who seeks to overthrow the fundamental framework of existing corporate law. The Bebchuk approach would discard the management concepts of U.S. corporate law that have nurtured the most successful economy in the world. It would transfer the basic responsibility of corporate management from directors to shareholders. And it would thus leave management and directors subservient to the whims of shareholders (or, perhaps more accurately, to the demands of the most vocal of them), no matter how self-serving they may be, no matter how parochial their interest, no matter how inconsistent with long-term corporate performance, and no matter how destructive to the economy as a whole.

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[1] Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 Va. L. Rev. 675 (2007).

In support of these broad-sweeping reforms, Bebchuk offers only the hope—certainly not the promise—of ill-defined and unquantified benefits. Thus, in response to the objection that the electoral system he seeks to dismantle has enabled U.S. firms to consistently outperform their global peers, Bebchuk concedes that there is no empirical evidence to support his position and manages nothing more than rank speculation that corporations would perform better if they followed his nostrums.[2] Remarkably, Bebchuk fails entirely to account for the costs his proposal will exact, in both corporate dollars wasted and, perhaps even more substantially, perpetual management distraction. And he waves aside without analysis his proposal's potential to undermine both the model of board collegiality that has served the U.S. corporation so well and the corresponding willingness of the most highly qualified people to serve as directors.

The view here is that Bebchuk has utterly failed to carry the burden of justifying the radical reform he proposes. Our analysis will proceed in three parts. First, we will show that the "myth of the shareholder franchise" is no myth at all and that the patchy data set Bebchuk has cobbled together actually tends to confirm that shareholder voting is fulfilling its assigned role in the scheme of U.S. corporate law. Second, we will show that Bebchuk has systematically failed to account for the likely and severe negative consequences of his proposal. Third, we will argue that it is Bebchuk's critique—and not the incumbent corporate law regime—that is founded on a series of untenable myths. We will conclude with the observation that the director-centered Delaware way has long served the national economy well, and no part of it should be overturned on the promise of an unsupported and increasingly unsupportable theory.

[2] See id. at 714 ("To be sure, empirical evidence about the effects of insulation from removal via a takeover does not directly identify the effects of reducing insulation from removal via a proxy fight."). In a prior draft of his essay, Bebchuk conceded that "it is not possible to provide direct . . . evidence about the effects of the proposed regime system on corporate value." Lucian A. Bebchuk, The Myth of the Shareholder Franchise 28 (Nov. 2006 draft) (on file with the Virginia Law Review Association).

I.

The form of argument of "The Myth of the Shareholder Franchise" is easily summarized. Citing a few decontextualized passages from Delaware corporate law decisions, Bebchuk declares that the "shareholder franchise" plays a "critical role" in the U.S. corporate governance regime.[3] The essay then goes on to describe empirical research showing that over the past ten years, there have been what Bebchuk calls a "quite small" number of electoral challenges to incumbent U.S. directors.[4] Next—without ever saying so explicitly, still less explaining why—the essay assumes that the incidence of electoral challenges is too small and hence proposes a radical restructuring of the U.S. corporate election system, in which the electoral campaign costs of insurgent slates would be fully reimbursable from the corporate fisc, provided the insurgent managed to secure thirty-three percent of the vote.[5] This system, Bebchuk believes, will ensure that contested director elections will occur more frequently and that the election process will better serve its (alleged) function of "disciplining" directors, thereby improving director performance and shareholder value.[6] Finally, the essay summarily considers and rejects a number of possible objections to the electoral revolution it proposes.[7]

There is nothing right about this argument.

First, Bebchuk's account of the role of the "shareholder franchise" is more a collection of headlines than an argument. To be sure, the annual shareholder vote is a significant incident of shareholder power. But this does not mean that shareholder elections should be frequently contested or incumbent directors easily ousted, and Bebchuk does not offer a shred of contrary authority or logic. Indeed, the opinion he cites for the proposition that "'[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests,'"[8] *Blasius Industries v. Atlas Corp.*, goes on to note—in the very next paragraph—that

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[3] See id. at 679–82.
[4] See id. at 682–88.
[5] See id. at 697–700.
[6] See id. at 711–14.
[7] See id. at 711–31.
[8] Id. at 676 (quoting Blasius Indus. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988)).

even though stockholder votes often have "little practical importance" because they are seldom contested, and might therefore be "seen functionally as an unimportant formalism," it is the fact of the vote, rather than whether it is contested, that serves its legitimizing function.[9] Thus, as *Blasius* itself suggests, the shareholder vote has historically satisfied its assigned role in the Delaware scheme without a high incidence of contested director elections. Rather, the annual election of directors provides a "safety valve," a recourse for extreme cases of mismanagement or shareholder disaffection. Contested or not, elections are elections, and they serve an important role in the overall balance of power between directors and stockholders.[10]

Running through the whole of Bebchuk's analysis is the assumption that contested elections are normatively favored as a matter of Delaware law, at least in part because only such contests sufficiently "discipline" directors to advance shareholder interests. The essay, however, provides no support for this assumption. And, in fact, there is nothing in Delaware's corporate statutes, decided cases, or elsewhere to suggest that the law favors contested elections. Nor, moreover, does Bebchuk adduce any support for the proposition that "[s]hareholder power to remove directors is supposed to provide a mechanism for ensuring that directors are well chosen,"[11] or that the "power to replace directors is supposed to play a key role" in shaping director incentives.[12] We see no connection at all between the mechanism for choosing directors and the removal power, and, as developed in the balance of this Response,

[9] See 564 A.2d at 659.

[10] See, e.g., Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, 119 Harv. L. Rev. 1735, 1750 (2006) ("[S]hareholder voting is properly understood not as a primary component of the corporate decisionmaking structure, but rather as an accountability device of last resort, to be used sparingly, at most."); Martin Lipton & Steven A. Rosenblum, Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come, 59 Bus. Law. 67, 69 (2003) ("Typically an election contest is a last resort, as it should be in light of the extraordinary disruption that an election contest brings to bear on the entire organization."). As detailed below, the only "myth" of the shareholder franchise is Bebchuk's account, whereby directors only fulfill their duties against the constant threat of electoral challenge. This has never been the role of director elections, and Bebchuk provides neither argument nor authority to the contrary.

[11] Bebchuk, supra note 1, at 677.

[12] Id. at 680.

we are deeply skeptical that director elections have been or are designed to be the fearsome tool of director discipline that Bebchuk imagines. Both the statutory design and long experience suggest powerfully to the contrary.

Second, Bebchuk's contention that the number of contested director elections is somehow too small is a conclusion dressed up as an argument. As an initial matter, we question several of the essay's accounting choices. For example, the essay acknowledges a total of 303 contested proxy solicitations over the past ten years,[13] and then excludes 185 of them (61%) as not relevant to the viability of the corporate franchise.[14] But of the 185 excluded contests, the vast majority (162) involved real disputes over the direction of public companies, with an insurgent position contesting the recommendation of the board in connection with a bid for corporate control or otherwise. Given that the question presented is the degree to which stockholders are able to, and do, express their views through the ballot box, there is no good reason to exclude these types of elections—unless the object of the empirical exercise is to create the smallest possible relevant data set.[15] We note, moreover, that the number of contested elections hit an all-time high in 2006, and the incidence of proxy fights is expected to "ratchet even higher in 2007."[16]

But the important issue here is not whether the number of contested elections over the past decade is 118 (as Bebchuk contends) or something more than double that. The essay's fatal infirmity is that it provides literally no argument or evidence to support its conclusion that the number of contested elections is "negligible"[17] or "quite small."[18] The essay provides no account of the intended role of annual elections in the statutory scheme; no account of the

[13] Id. at 683.

[14] Id. at 685–86.

[15] The exclusion of elections in which "the contest was over the sale of the company even though there was no particular hostile bidder," see id. at 684 n.17, is particularly difficult to understand. Such contests concern the strategic direction of the company rather than a specific transaction and would therefore seem to implicate the precise issue Bebchuk wishes to examine—the ability of stockholders to decide a firm's direction.

[16] Kaja Whitehouse, Proxy Fights Hit High In 2006, And More Seen For 2007, Corp. Governance (Dow Jones & Co., Jersey City, N.J.), Jan. 31, 2007, at 4, 4.

[17] Bebchuk, supra note 1, at 677.

[18] Id. at 688.

historical levels of contested elections, or whether or why the numbers of contests change over time; no account of how contested elections intersect with other devices built into the corporate law to ensure maximum corporate performance; and no analysis whatsoever of whether one should expect or strive for a large or small number of such contests. Bebchuk's methodology consists solely of observing that there are thousands of public companies in the United States and only hundreds of contested directorial elections, and concluding from these two data points that the number of contests is "too small" and should be increased.

In our view, this feint at empirical analysis plainly fails to establish a basis for contemplating the massive restructuring of the nation's time-tested system for electing corporate directors. To the contrary, we suggest that Bebchuk's results are entirely consistent with the built-in design of U.S. corporate law. Finding that there are only twelve (or twenty) instances each year where rival slates seek to "manage the firm better" than incumbent management does not signal a dysfunctional election system. It demonstrates, instead, that there are few instances in which people outside the firm have any legitimate claim to know better how to manage its affairs.

Last year's high-profile contest between Carl Icahn and Time Warner illustrates the point: Icahn, the notorious corporate raider-turned-"activist," launched a campaign in early 2006—including the explicit threat of a proxy fight—attacking Time Warner's performance and management and urging a split-up of the company's businesses. But after months of costly agitation, including the preparation of a lengthy investment banking report, Icahn failed to win over even a fraction of his fellow shareholders, and he called off the control contest before it started.[19] In Bebchuk's laboratory, the Icahn effort counts for nothing.

The fundamental flaw in the Bebchuk critique is that it provides no intellectual or historical framework to evaluate its central claim of "not enough." Not enough compared to what? Not enough to achieve what objective? Consider, by way of analogy, the process

[19] See, e.g., Matthew Karnitschnig, Icahn Ends Effort to Take Control of Time Warner: Activist Cuts Director Slate After Gaining Little Support; Settlement Talks Under Way, Wall St. J., Feb. 17, 2006, at A1; Richard Siklos & Andrew Ross Sorkin, Time Warner and Icahn Reach a Settlement, N.Y. Times, Feb. 18, 2006, at C1.

for altering or amending the U.S. Constitution.[20] No one would doubt the structural significance of the amendment right—indeed, the Article V amendment right was called "the most important clause in the constitution" during the Continental Congress[21]—and yet, we have changed the Constitution only seventeen times in the 215 years since it and the Bill of Rights were ratified in 1791, an average of less than once per decade. Is that "not enough"? Ought we reimburse amendment efforts in order to encourage more frequent amendment campaigns (even if rejected by two-thirds of the citizenry)? Or, to take an example that Bebchuk might perceive as slightly closer to home: it is increasingly recognized that post-tenure performance review is an important check on academic performance.[22] Yet, out of the roughly 280,000 tenured professors in the United States, only about fifty to seventy-five—about a quarter of a tenth of a percent—lose their tenure each year.[23] Is that "not enough"? Should the rules for reviewing academic performance be changed to ensure that more tenure reviews are "contested" and more tenured faculty are removed?

The question, of course, cannot be answered without knowing far more than the raw numbers of amendments over time or dismissals in a year. An appropriate analysis would take account (among other things) of the purpose of the amendment process or tenure system; the costs (both in individual cases and on a system-wide basis) of change; the countervailing value of continuity; and the alternative mechanisms in place to ensure accountability and responsiveness. We think it would be relatively uncontroversial to conclude, however, that the low incidence of constitutional amendments is more reasonably attributed to the sound design of the constitutional order, and the citizenry's prudent preference for continuity over change, than to any structural infirmity in the amendment process itself. And we would similarly conclude that

[20] See U.S. Const. art. V.

[21] 1 Annals of Cong. 523 (Joseph Gales ed., 1789) (quoting Elbridge Gerry).

[22] See, e.g., Neil W. Hamilton, The Ethics of Peer Review in the Academic and Legal Professions, 42 S. Tex. L. Rev. 227, 240 (2001) ("Over the past fifteen years, an increasing proportion (now thought to be approximately fifty percent) of the colleges and universities that grant tenure have adopted some form of post-tenure review that subjects tenured professors to a systematic assessment of performance . . . .").

[23] Joann S. Lublin, Travel Expenses Prompt Yale To Force Out Institute Chief, Wall St. J., Jan. 10, 2005, at B1.

the low incidence of removal of tenured faculty affirms the wisdom of the tenure selection process and permits faculty the freedom to pursue their sound intellectual judgment, rather than signaling any design flaw in the review system.

So too with director elections. Absent a rigorous demonstration that the incidence of contested elections is somehow too low—which the essay has surely not provided—the mere demonstration of a small absolute number of contested elections demonstrates exactly nothing. The more reasonable presumption is that the low number of electoral fights reflects the simple truths that the director nomination process works;[24] that incumbent directors are far more often than not the best people for the job; that freedom from frequent electoral contests permits directors to exercise their best business judgment in the interests of the corporation as a whole; and that the costs of contested elections generally far outweigh any hypothetical benefits.

Third, the essay does not even pretend to present direct evidence that the reform proposal—subsidizing insurgent director slates—would produce any benefits to any corporate constituency. Bebchuk acknowledges that the available data is at best consistent with—but cannot directly support—the case for encouraging election contests.[25] Moreover, even the admittedly indirect evidence the essay seeks to marshal is highly contestable. Bebchuk claims that "there is evidence that insulation of boards from replacement via a hostile takeover leads to increase in managerial slack,"[26] but there

[24] Bebchuk's account neglects to mention that before director candidates are even presented to the stockholder electorate, they must first be selected by incumbent non-employee board members sitting on a nominating committee. Recent regulatory reforms have invigorated this first stage selection process by ensuring the independence of the nominating committee, see, e.g., NYSE, Inc., Listed Company Manual § 303A.04(a) (2004), available at http://www.nyse.com/lcm/lcm_section.html (requiring that nominating committees be composed "entirely of independent directors"); NASDAQ, Inc., Manual § 4350(c)(4) (2006), available at http://nasdaq.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=1014 (requiring that nominations be approved by either a majority of the independent directors or a committee "comprised solely of independent directors"), and subjecting the nomination process to public scrutiny. See, e.g., Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors; Republication, 68 Fed. Reg. 69,204, 69,205 (Dec. 11, 2003).

[25] Bebchuk, supra note 1, at 712.

[26] Id.

is also evidence to the contrary—indeed, even the Bertrand and Mullainathan article on which Bebchuk relies acknowledges studies that have found "zero" correlation between antitakeover legislation and negative effects on share prices.[27] In short, and as Bebchuk conceded in prior drafts of his essay based upon equally inconclusive data, it is simply "not possible" to construct a persuasive empirical case for reform.[28]

The complete lack of supporting evidence is particularly telling in view of Bebchuk's recognition that "the United Kingdom has long had . . . a system" for facilitating contested director elections such as he proposes in the essay.[29] Bebchuk's concession on the U.K. experience is telling: "[T]he U.K. experience does *not* prove that such a reform [as Bebchuk proposes in the essay] would be positive on balance."[30] Thus, Bebchuk is apparently unable to find any authority in the entire British experience to support his pro-

[27] See Marianne Bertrand & Sendhil Mullainathan, Is There Discretion in Wage Setting? A Test Using Takeover Legislation, 30 RAND J. Econ. 535, 540 (1999). While Professors Bertrand and Mullainathan purport to demonstrate that antitakeover statutes result in higher wages, Bebchuk cites the article for the idea that antitakeover statutes "[cause] increases in managerial slack." Bebchuk, supra note 1, at 712. Managerial slack and increased employee wages are two different things—directors with greater protection from the short-term threat of a takeover might favor marginal increases in wages on the view that such investment in human capital will foster long-term corporate growth, or in recognition of their obligation to employees as a valid corporate constituency. We note, moreover, that Institutional Shareholder Services has found that takeover defenses are "*positively* correlated with performance and risk," Mark D. Brockway, New Study Links Corporate Governance and Firm Performance, Friday Rep., (Institutional S'holder Servs., Rockville, Md.) Feb. 20, 2004, available at http://va.issproxy.com/resourcecenter/publications/Governance_Weekly/fridayreport02202004.html (citing Lawrence D. Brown & Marcus L. Caylor, Corporate Governance and Firm Performance (Dec. 7, 2004) (unpublished manuscript, on file with the Virginia Law Review Association), available at http://www.issproxy.com/pdf/Corporate%20Governance%20Study%201.04.pdf) (emphasis added) and that not only have most studies found *no* correlation between increased shareholder activism and long-term share value, many have found that "the long-run average stock return [of companies targeted by activists] is negative and in some cases statistically significant," see Jonathan M. Karpoff, The Impact of Shareholder Activism on Target Companies: A Survey of Empirical Findings 29 (Aug. 18, 2001) (unpublished manuscript, on file with the Virginia Law Review Association), available at http://ssrn.com/abstract=885365.

[28] Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 28 (Nov. 2006 draft) (on file with the Virginia Law Review Association).

[29] Bebchuk, supra note 1, at 725.

[30] Id. at 725 (emphasis added).

contest position—even though, by his own admission, such contests are favored under traditional background principles of U.K. law. To import procontest rules into our statutory scheme is thus all risk and no reward—that is, Bebchuk would have us run the obvious risk of upsetting the careful and enormously successful historical balance of power between U.S. shareholders and directors, with no credible corresponding promise of improved corporate performance.

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For these reasons, we think that Bebchuk has failed to carry the burden of justifying radical reform of long-established corporate election process. The essay never demonstrates that an increase in contested directorial elections will increase corporate performance or yield any other quantifiable good. It never demonstrates that it is consistent with, let alone mandated by, Delaware law or the corporate law of any other U.S. jurisdiction. It never even shows that anyone would be better off with even one more proxy contest than we have today. It does not try to do any of these things. And it is a telling fact, nowhere acknowledged by Bebchuk, that there is apparently no market demand for the "franchise reform" Bebchuk advocates.[31] The essay is thus selling something that no one wants

[31] The "free rider problem" described in the essay—that fewer election contests develop because potential insurgents do not recoup the full benefit of their investment in reform, see id. at 689–90, is no answer to the market's total indifference to Bebchuk's proposed reforms. As Gilchrist Sparks has observed, "[I]f the broader investor marketplace (as distinguished from narrower interest groups) truly demanded an across-the-board increase in contested elections, institutional investors could, with a minute percentage of total invested capital under management, create a fund to be used to subsidize selected contest activity." A. Gilchrist Sparks, III, Corporate Democracy—What It Is, What It Isn't, and What It Should Be, *in* What All Business Lawyers & Litigators Must Know About Delaware Law Developments 2006, at 279, 286–87 (PLI Corp. Law & Practice, Course Handbook Series No. B-1543, 2006). The absence of any such fund proves that the nation's institutional investors do not highly value the kind of "franchise" Bebchuk seeks. Moreover, we are skeptical of Bebchuk's "free rider" claim. It may be that insurgents in some instances do not capture all the alleged benefits of a value-enhancing proxy contest, as the essay suggests. See Bebchuk, supra note 1, at 691. But at the same time, an insurgent's investment in a single proxy contest creates private benefits that extend beyond that single investment, insofar as it increases the credibility of threatened action against corporations more generally and thereby creates hold-up or settlement value in other contexts. See, e.g., Steven Gray, Bigger Than They Look: How Can Investors with Small Stakes Have Such a Large Impact in Proxy Fights?, Wall St. J., Oct. 9, 2006, at R6 (noting

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.

II.

Not only has Bebchuk thus failed to establish that his proposed reform will create any measurable benefits, but the essay blithely disregards the likely serious negative consequences of its central proposal. To be sure, Bebchuk purports to catalogue a number of potential "adverse effects" of his plan to increase the number of contested director elections.[32] But the essay never truly acknowledges the most elementary and serious problems:

1. Waste and Disruption. To the elementary objection that "election reform . . . would lead to large-scale disruption of corporate management," Bebchuk responds that notwithstanding the reform, contested elections will not really happen that often and, when they do, whatever costs are incurred "would be a price worth paying for a process that could improve corporate governance in these companies as well as produce system-wide benefits."[33] That is the sum total of the argument: putting a rabbit in the hat and pulling it out. Bebchuk makes no serious attempt to take account of the costs, in both dollars expensed and management distraction, of the reforms he proposes, still less to undertake any kind of quantitative analysis of the costs, and still less again to compare them against a reasonable reckoning of any alleged "benefits." He is instead content to assert—not just without evidence, but literally without analysis—that these (potentially very substantial) costs would be "worth paying." Given this cavalier attitude toward the costs of the proposed reform, one wonders whether Bebchuk would seriously advocate implementing it even if given the choice, especially because observed experience confirms that "[a]n election contest is a tremendously disruptive event for a company" that "diverts large

that a rising trend in proxy contests by small stakeholders is "likely to persist, largely because investors are increasingly impressed with the improved performance at companies [where such proxy contests have succeeded]").

[32] Bebchuk, supra note 1, at 718–725.

[33] Id. at 716, 719. Bebchuk's claim that his reform would not meaningfully increase the incidence of contested elections is somewhat peculiar, given that such an increase is the obvious and central intent of his proposal.

amounts of management time and attention from the operation of the business, as well as potentially imposing significant monetary costs for the printing and mailing of proxy materials and supplements and the assistance of outside advisors."[34]

2. Special Interests. Bebchuk similarly waves off the concern that his proposal would empower "special interests" (such as public pension funds or labor unions) to the detriment of the shareholder body as a whole, whether through disproportionate board representation or leveraging the threat of compensable proxy contests into concessions that uniquely serve special interests.[35] As Vice Chancellor Strine recently observed, the "institutions most inclined to be activist investors are associated with state governments and labor unions, [which] often appear to be driven by concerns other than a desire to increase the economic performance of the companies in which they invest."[36] Like all noncontrolling shareholders—and unlike directors—these special interest shareholders owe no legal duties to other shareholders or to the corporation, and are thus at liberty to pursue their narrow nonshareholder-centered agendas irrespective of the broader corporate good—and they

[34] Lipton & Rosenblum, supra note 10, at 83–84. Perhaps recognizing that his analysis has failed to account for the potentially excessive costs of reform, Bebchuk adds that if "the incidence of contests . . . is deemed to be too high," the levels for triggering insurgent compensation might be increased (presumably by requiring an insurgent to garner some percentage higher than thirty-three percent) to qualify for reimbursement. Bebchuk, supra note 1, at 720. But Bebchuk never indicates who decides whether the incidence of contested elections is "too high" or "too low" or even identifies the criteria relevant to such a determination. As set forth above, we do not believe Bebchuk has provided any persuasive evidence to suggest that present levels should be deemed "too low."

[35] Bebchuk, supra note 1, at 720–722. Bebchuk does not dispute that special interest shareholders may attempt to interfere with a firm's operations in order to achieve goals not shared by (or beneficial to) the stockholder body at large. See id.

[36] Leo E. Strine, Jr., Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America, 119 Harv. L. Rev. 1759, 1765 (2006); see also Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc., 462 F.3d 121 (2d Cir. 2006) (discussing a union pension fund seeking ability to propose bylaw amendments that would permit shareholder-nominated candidates for director to be included in the corporation's own proxy statement); Marleen O'Connor, Labor's Role in the American Corporate Governance Structure, 22 Comp. Lab. L. & Pol'y J. 97, 110–14 (2000) (describing the actions of union funds in seeking recognition of union organizing activity without regard to effect on corporate performance).

have often done exactly that.[37] Bebchuk appears to contend that because special interest candidates would be unlikely to obtain a "majority of votes," his proposal would be unlikely to increase special interest leverage. But the question is not whether such "special interest" candidates will win a majority of votes; the question is whether they will appear to have, ex ante, a likelihood of reaching the thirty-three percent threshold necessary for reimbursement of expenses under the Bebchuk reform.[38] It is frankly difficult to conceive that any rational observer would not expect to see this proposal increasing the incidence of "special interest" challenges—indeed, the entire point of the proposal is to increase challenges across the board. There is nothing in its design that excludes special interest holders from its benefits, and they are precisely the kind of repeat-player candidates who would stand to benefit most (and run the most challenges) from a general shareholder subsidy for election expenses. Here again, the Bebchuk plan seems certain to increase the incidence of electoral contests (and the concomitant direct and diversion costs), without any demonstration of benefit to any corporate constituency.

3. Short-Termism. Properly conceived, a director's obligation is to manage the affairs of the corporation to ensure its sustainable

[37] See, e.g., Karpoff, supra note 27, at 6–7 (gathering authority supporting the view that "shareholder activism tends to impair firm management and degrade firm performance").

[38] Nor, contrary to Bebchuk's apparent surmise, would a special interest shareholder need to exceed the thirty-three percent threshold in every (or even most) contested elections in order to benefit from the proposed reform. As noted in the text, there are repeat players invested across the entire corporate spectrum, with the incentive and financial wherewithal to challenge boards in industries across the economy. Even a fractional reduction in the cost of an economy-wide proxy program might make frequent challenges net beneficial to a special interest. No one knows how tinkering with the system would impact behavior. Moreover, even a challenge likely to fail imposes "extortion costs" on a corporation, as the board is forced to exert time and money defending its position; boards will thus often negotiate in order to avoid these costs. Additionally, we are skeptical of Bebchuk's claim that special interest candidates would be unable to prevail in "post-reform" elections. See Bebchuk, supra note 1, at 722–23. The potential for special interest "logrolling"—in which institutional or special interest holders trade off their votes in one proxy fight for the support of the insurgent in another—means that hedge funds and institutions might be able to take advantage of the Bebchuk plan to gain board seats (and certainly to mount cost-free proxy fights) even without appealing to shareholder interests as a whole.

long-term growth.[39] But certain vocal shareholders, notably hedge funds and arbitrageurs, invest over much shorter time horizons—"they are primarily financial engineers interested in the largest possible profit in the shortest period of time,"[40] who usually maintain "laser-beam focus on quarter-to-quarter earnings"[41]—and they accordingly favor a short-term spike in the share price over long-term wealth creation.[42] Indeed, "[i]n most cases, the[se investors] have no interest at all in the long-term economic success of the enterprise."[43] By increasing the ability of these most vocal shareholders to challenge directorial authority, the Bebchuk plan invites directors to abandon their long-term focus.[44] We asked the following question more than twenty-five years ago: "Whether the long-term interests of the nation's corporate system and economy should be jeopardized in order to benefit speculators interested not in the vitality and continued existence of the business enterprise in which they have bought shares, but only in a quick profit on the sale of

[39] See, e.g., William T. Allen, Ambiguity in Corporation Law, 22 Del. J. Corp. L. 894, 896–97 (1997) ("[T]he proper orientation of corporation law is the *protection of long-term value of capital* committed indefinitely to the firm.").

[40] Robert G. Kirby, Should a director think like a shareholder? (It depends on who the shareholder is!), *in* Directorship: Significant Issues Facing Directors: 1996, at 6-1, 6-2 (Directorship Inc. & Inst. for Research on Bd. of Dir. eds., 1996).

[41] Strine, supra note 36, at 1764 ("[Short-termism] helped create managerial incentives that contributed to the debacles at corporations like Enron, WorldCom, HealthSouth, and Adelphia."). Paul R. Charron, who recently stepped down as CEO of Liz Claiborne, Inc. after twelve years in the role, bluntly explained the pressure the market creates, forcing a short-term focus: "'I'm always two quarters away from being a horse's ass' . . . . 'The market has a very short attention span.'" Nanette Byrnes, The Great CEO Exodus, Bus. Wk., Oct. 30, 2006, at 78, 80.

[42] See, e.g., Lipton & Rosenblum, supra note 10, at 78 ("Some [investors] seek to push the corporation into steps designed to create a short-term pop in the company's share price so that they can turn a quick profit."); Theodore N. Mirvis et al., A Response to Bebchuk's *The Case for Increasing Shareholder Power*, 119 Harv. L. Rev. F. (forthcoming June 2007) (manuscript at 11, on file with Virginia Law Review Association) ("[S]hareholders with short-term investment horizons (such as hedge funds) will support corporate policies that tend to inflate current share prices at the expense of long run value, such as foregoing research and development investment or accepting an immediate though less than fully priced premium bid.") (citing Iman Anabtawi, Some Skepticism About Increasing Shareholder Power, 53 UCLA L. Rev. 561, 579–83 (2006)).

[43] Kirby, supra note 40, at 6-1.

[44] See, e.g., Sparks, supra note 31, at 287 ("[T]he short-term view of a large segment of the electorate may result in additional and undesirable pressures upon management to maximize short-term gains at the expense of long-term wealth creation.").

those shares?"[45] Bebchuk's proposal and the rise of the activist hedge fund shareholder raise the question anew. The Bebchuk plan will inevitably confront directors with a choice between maintaining an appropriate long-term focus (and inviting a distracting and subsidized electoral challenge) and the risk of being replaced with new directors answering to short-term investors. Either way, the reform perversely incentivizes directors to generate immediate returns at the cost of future growth, at the expense of the corporation and its shareholders (and the economy as a whole).[46] Not surprisingly, as the question has remained the same, so has the answer: "[T]he policy considerations in favor of not jeopardizing the economy are so strong that not even a remote risk [of encouraging short-termism] is acceptable."[47]

4. Recruitment. Bebchuk dismisses the concern that encouraging expensive election battles might deter quality director candidates from serving with the observation that "most individuals occupying business positions are not granted security by their firms, even though doing so might well attract more job seekers."[48] The analysis is both inaccurate and irrelevant. As we detail below, directors do not enjoy "complete security," as Bebchuk imagines; to the contrary, directors today are subject to a wide variety of governance pressures, including shareholder litigation, increased regulatory and reporting burdens, increased exposure to personal liability, and the threat of an election contest in the extreme case. As we have pointed out in earlier writings, such "developments have begun to create problems in recruiting the best candidates for direc-

[45] Martin Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101, 104 (1979).

[46] See, e.g., Martin Lipton & Steven A. Rosenblum, A New System of Corporate Governance: The Quinquennial Election of Directors, 58 U. Chi. L. Rev. 187, 192 (1991) ("The health and stability of these economies depends on the ability of corporations to maintain healthy and stable business operations over the long term and to compete in world markets."); see also Bengt Holmstrom, *Pay without Performance* and the Managerial Power Hypothesis: A Comment, 30 J. Corp. L. 703, 704–05 (2005) ("Without the shareholder value movement we would not have had the scandals. Evidently, shareholder value can be pursued in wrong ways, and that lesson needs to be taken more seriously by anyone contemplating a wholesale reform of corporate governance.").

[47] Lipton, supra note 45, at 105.

[48] Bebchuk, supra note 1, at 724.

tor."[49] At any rate, the important issue is not whether directors enjoy more or less job security than other executives, but rather whether the Bebchuk plan to create an electoral fishbowl will further erode the ability of corporations to attract and retain top-quality directors. Based on observed experience, we fear the answer is yes and believe that "the prospect of facing election contests on a regular basis could be the nail in the coffin for director recruiting."[50] Bebchuk, however, does not seriously engage the issue at all, as if retaining the most qualified and experienced managers doesn't really matter.[51]

5. Adverse Impact on Board Process. We note, finally, that Bebchuk takes no account of the impact that his proposal would have on the effective functioning of boards of directors. Our experience is that the best boards are characterized by a frank collegiality nourished by the common purpose of advancing the corporate agenda. Boards under electoral attack—or, even worse yet, boards with members from warring factions—benefit from none of these advantages of collective decisionmaking.[52] They instead become politicized and balkanized; relations among directors, and between management and the board, become more defensive, more formal, and often less open. Directors in a constant electoral fishbowl may often become unduly risk averse, with potentially significant deleterious effects for long-term corporate performance. And of course, all of these considerations make board service a far

[49] Lipton & Rosenblum, supra note 10, at 86; see also Nanette Byrnes & Jane Sasseen, Board of Hard Knocks, Bus. Wk., Jan. 22, 2007, at 36, 38 (noting that in the present environment, "[m]any board candidates no longer find the job attractive").

[50] Lipton & Rosenblum, supra note 10, at 86

[51] In addition to arguing that his proposal likely will not deter qualified candidates from serving as directors, Bebchuk suggests that "[e]ven if reform did make these positions somewhat less attractive, shareholders could well be better off countering this effect with increased pay." Bebchuk, supra note 1, at 725. This argument misses the point because "[t]he best candidates for director . . . have already achieved a high level of success professionally and financially" and "are not dependent on the fees they are paid as directors"; thus, they are not likely to accept otherwise unacceptable directorships in exchange for a pay raise. Lipton & Rosenblum, supra note 10, at 86.

[52] The recent scandal at Hewlett-Packard Co. is a prime example of how warring factions on a board can misdirect a board's time and attention and even eventually cause damage to the company itself. See Joann S. Lublin & Erin White, Drama in the Boardroom, Wall St. J., Oct. 2, 2006, at B1 (stating that the "all-out war" at Hewlett-Packard "highlight[s] the pitfalls that may await a board whose directors are fiercely independent of management and, at times, antagonistic toward one another").

less attractive undertaking—thereby exacerbating the difficulty of effective recruitment and further eroding overall corporate performance.[53] These are substantial costs, admittedly difficult to quantify, but nevertheless potentially very serious, that go to the heart of the board process. Bebchuk has failed even to recognize them, let alone attempt to calculate them.

III.

In other circumstances we might conclude here, satisfied to have demonstrated that the Bebchuk plan to subsidize contested elections has no reliable benefits and very substantial risks. But Bebchuk is such a prolific and gifted analyst that we think it prudent to anticipate in this space his next attack (and perhaps to enhance our case against his last). We therefore turn to our own series of "myths"—the unsupported assumptions of many of the recent attacks on traditional principles of corporate law—in order to challenge the premises of this and the next of Bebchuk's incessant calls for "reform."

1. The Myth of the Runaway Agency Costs. The central theme of contemporary corporations scholarship is that corporate officers suffer from what Bebchuk calls "an agency problem."[54] Briefly stated, the theory holds that corporate directors and officers operating within the traditional fiduciary framework will manage the business and affairs of corporations in their own interests, rather than in the interests of shareholders and other proper corporate constituencies.[55] The theory has become so ingrained in academic thought that Bebchuk feels no obligation to demonstrate its legitimacy—he is instead satisfied to assert that the theory "is widely recognized," citing as support a lone thirty-year-old article.[56]

[53] See, e.g., Lipton & Rosenblum, supra note 10, at 82–83, 85–87; Gray, supra note 31, at R6 (noting recent warnings from experts that "prospective directors [will] be reluctant to join an acrimonious board").

[54] Bebchuk, supra note 1, at 679.

[55] See, e.g., Ronald J. Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819, 836 (1981).

[56] Bebchuk, supra note 1, at 679 & n.5 (citing Michael Jensen & William Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. Fin. Econ. 305, 308–10 (1976), *reprinted in* Michael C. Jensen, A Theory of the Firm: Governance, Residual Claims, and Organizational Forms 83, 86–87 (2000)).

As applied in much contemporary scholarship, the agency model simply assumes that directors are scoundrels. For example, Bebchuk asserts (without citing any authority) that directors and officers "engage in empire-building, take excessive compensation, enjoy excessive perks, pursue pet projects, elevate cronies, refuse to accept beneficial acquisition offers, remain in power too long, and so forth."[57] In the same vein, Bebchuk has recently written elsewhere that corporate officers resist "value-increasing changes" for purely "self-serving reasons" and describes what he imagines to be the "bargaining" that takes place between directors and shareholders over the division of corporate spoils and the "diver[sion of corporate] resources" for the private benefit of directors and managers.[58] Because venal, self-interested directors are assumed to be the norm, "fear of replacement" is the only effective mechanism "to make directors accountable and provide[] them with incentives to serve shareholder interests."[59] In any other context, the assumption of group venality—director misbehavior—might well be regarded as slanderous if not plain prejudicial.

We believe that this "agency cost" account of director conduct is pure myth.[60] Note that Bebchuk makes no attempt to establish that directorial misconduct in fact occurs except in the rare and outlying case, and he fails to identify even a single situation in which actual and unredressed directoral misconduct conformed to the predictions of the agency model. We doubt he can. The assumption that directors are engaged in a constant struggle to maximize their personal gains at shareholders' expense cannot even remotely be squared with the experience of those of us who regularly work with directors as they endeavor to discharge their fiduciary obligations.[61]

[57] Id.

[58] Lucian Arye Bebchuk, The Case for Increasing Shareholder Power, 118 Harv. L. Rev. 833, 850–64 (2005).

[59] Bebchuk, supra note 1, at 680.

[60] We have previously responded to Bebchuk's reliance on concerns regarding "agency costs" in another context. See Mirvis et al., supra note 42, at 7 ("[T]he assumption that undergirds much of Bebchuk's analysis—that directors are generally engaged in a constant struggle to maximize their private benefits at shareholders' expense—cannot be even remotely squared with the experience of those of us who actually work with directors as they strive to meet their fiduciary obligations.").

[61] See, e.g., id.; Holmstrom, supra note 46, at 705 ("In my experience, board members have much more integrity and are more thoughtful than many believe."). We note that this same analysis applies to Bebchuk's attempt to deflect his proposal's risk

To the contrary, our experience indicates that public company directors are acutely aware of their fiduciary duties, to shareholders and others, and work hard to meet them. Moreover, to the extent directors can be shown to "divert corporate resources" or resist "value-increasing changes," they would clearly be subject to liability under current law.[62] That litigation challenging ordinary course directorial conduct is infrequently brought and even less frequently successful—notwithstanding the existence of an active, entrepreneurial, and economically incentivized plaintiffs' bar—is powerful confirmation that the self-interested conduct predicted by agency theory is very much the exception rather than the rule.

In recognition that the agency model "reflects both a mistaken view of corporate law, and a mistaken view of corporate economics," a "new generation of corporate scholars" is reconsidering the validity of agency analysis.[63] Thus, for example, James McConvill

of adverse impact on stakeholders. Bebchuk recognizes that his proposal may well decrease the ability or inclination of directors to attend to the interests of nonshareholder corporate stakeholders, and he does not (because he cannot) dispute that directors may "give weight to the interests of other [corporate] constituencies." William T. Allen & Leo E. Strine, Jr., When the Existing Economic Order Deserves a Champion: The Enduring Relevance of Martin Lipton's Vision of the Corporate Law, 60 Bus. Law. 1383, 1391 (2005). He attempts to meet this concern with the claim that because directors' personal economic interests are not generally aligned with those of stakeholders, it must be assumed that directors do not exercise their discretion to benefit stakeholders. But (in the world beyond the agency cost model) it simply cannot be assumed that directors perform their corporate functions only so as to advance their own personal interests. Indeed, the whole fabric of corporate and fiduciary law, both as a matter of theory and as tested in long practice, rests on the entirely opposite assumption—that directors will understand their obligations to the corporation and exercise their authority to advance its long term interests.

[62] This point merits emphasis: a peculiarity of Bebchuk's account of agency theory is that the self-interested conduct he assumes directors engage in as a matter of course is unquestionably illegal under Delaware law, which acts as a strong deterrent to any director's decision to engage in self-interested conduct. See Douglas G. Baird & Robert K. Rasmussen, The Prime Directive 7 (Vanderbilt Univ. Law Sch. Law & Econ. Working Paper Series, Working Paper No. 06-19, 2006), available at http://ssrn.com/abstract=930187 ("For outside directors who care about their reputations, even a small risk of legal liability in a world in which there are relatively effective courts and reliable auditors, may be enough to keep managers in line."). It is unclear why Bebchuk believes the governance-based fixes he proposes will fare any better than the remedy of shareholder litigation—unless his real complaint is with the judges who enforce (or, in Bebchuk's conception, fail to enforce) existing fiduciary rules.

[63] Lynn A. Stout, Shareholders Unplugged, Legal Aff., Mar.–Apr. 2006, at 21, 21. Professors Blair and Stout compare the agency model to a superseded Kuhnian

recently examined a substantial body of behavioral economics to conclude that the negative portrait of directors required by the agency model—that of officers who "cannot be trusted and, in the absence of external incentives . . . are naturally inclined to pursue their own self-interest at the expense of the corporation and its shareholders"—must be rejected as inaccurate and incomplete.[64] Others have observed that the agency model of director behavior is inconsistent with directors' own experience of serving on a board and that the model simply fails to account for the effective and faithful decisionmaking that occurs "when directors meet behind closed doors and are confronted with important decisions."[65] These academics are recognizing what practitioners have known all along—that the self-interested director conjured by the agency theory bears no resemblance to the vast majority of faithful fiduciaries who actually serve on the boards of U.S. public companies.

2. The Myth of the Unconstrained Director. Closely related to the agency cost myth is Bebchuk's assumption that public company directors—absent the sorts of reforms he proposes here and elsewhere—have free rein to plunder the corporate fisc and misappropriate shareholder wealth.[66] The truth is to the contrary: "corporate managers operate within a pervasive web of accountability mechanisms," which collectively constrain directorial conduct and power-

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"paradigm" that increasingly fails to account for observed "phenomena" of corporate law. See Margaret M. Blair & Lynn A. Stout, Specific Investment: Explaining Anomalies in Corporate Law, 31 J. Corp. L. 719 (2006); see also Bainbridge, supra note 10, at 1746 ("A single-minded focus on agency costs, however, such as that exhibited by Bebchuk, can easily lead one into error."); Baird & Rasmussen, supra note 62, at 11–13 (criticizing scholarly focus on agency costs as excessive and for detracting from the board's "prime directive" of choosing the best managers).

[64] James McConvill, Executive Compensation and Corporate Governance: Rising Above the "Pay-for-Performance" Principle, 43 Am. Bus. L.J. 413, 415 (2006).

[65] Rakesh Khurana & Katharina Pick, The Social Nature of Boards, 70 Brook. L. Rev. 1259, 1267 (2005). See also Lynn A. Stout, On the Proper Motives of Corporate Directors (Or, Why You Don't Want to Invite *Homo Economicus* to Join Your Board), 28 Del. J. Corp. L. 1, 8–9 (2003) ("[W]hy do we trust directors to manage tens of trillions of dollars of corporate assets? And, why do they seem to mostly live up to our trust?") [hereinafter Stout, Proper Motives]. In a more recent paper, Stout similarly notes, "[i]f director governance is so wasteful, inefficient, and harmful to shareholders' interests, it seems odd indeed that the business world has shown so little interest in exploring alternatives." Lynn A. Stout, Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May Be Right, 60 Bus. Law. 1435, 1453–54 (2005).

[66] See, e.g., Bebchuk, supra note 58, at 850.

fully encourage effective management.[67] Moreover, the recent proliferation in the number and intensity of these accountability devices has created "a sea change in the way American businesses are run. . . . in a stunningly short period of time."[68]

Thus, for example, directors are now selected by a nominating committee of independent directors and not by a chief executive officer, with the result that "[b]oards are much less beholden to their CEOs, and much more susceptible to outside pressure, than ever before."[69] The stock markets have adopted new independence and governance rules that regulate director conduct (and require additional monitoring) across the whole spectrum of corporate affairs.[70] In addition, directors remain subject to the fiduciary requirements of state corporation law, the concomitant risk of shareholder litigation, and the increasing (if nevertheless still rare) threat of real personal liability. The ever more intensive surveillance of large institutional shareholders provides a further layer of accountability. And the recent emergence of "proxy advisory" firms, such as Institutional Shareholder Services and Glass, Lewis & Co., has created yet another active monitor of director conduct.[71] Bebchuk's worldview takes account of none of this, frozen as it is in a past that may never have existed but certainly no longer does.

The external constraints that Bebchuk ignores augment the most important motivational forces that have always ensured director performance: reputation and the social, personal, and professional benefits that flow from success.[72] As we and others have repeatedly

[67] Stephen M. Bainbridge, The Case for Limited Shareholder Voting Rights, 53 UCLA L. Rev. 601, 625 (2006).

[68] Alan Murray, Leash Gets Shorter for Beleaguered CEOs, Wall St. J., Aug. 23, 2006, at A2.

[69] Id.

[70] As Professor Bainbridge recently wrote in response to an entirely different Bebchuk proposal, "Given that these rules are still quite new, with as yet uncertain effects, it is unwise to consider implementing reforms of the sort Bebchuk proposes." Bainbridge, supra note 10, at 1741.

[71] See, e.g., Institutional S'holder Servs., 2004 Postseason Report: A New Corporate Governance World: From Confrontation to Constructive Dialogue 3 (2004), available at http://www.issproxy.com/pdf/2004ISSPSR.pdf (reporting "an impressive degree [of] constructive dialogue between shareholders and corporations"). Whether the proxy advisor services are in fact enhancing corporate performance remains an entirely open question. See, e.g., Paul Rose, The Corporate Governance Industry, 32 J. Corp. L. (forthcoming 2007), available at http://ssrn.com/abstract=902900.

[72] Stout, Proper Motives, supra note 65, at 8–9.

pointed out, reputation is the coin of the realm in the world of business—no director wants to be associated with an unsuccessful enterprise, much less suffer the reputational harm associated with a fiduciary breach.[73] Bebchuk and others in the agency cost school systematically discount these powerful social constraints, but other scholars are increasingly recognizing the importance of "corporate culture norms of fairness and trust."[74]

3. The Myth of the Shareholder Owner. Also central to Bebchuk's critique is the myth that as "owners" of the corporation, shareholders should be further empowered to determine the focus and direction of the corporation they "own." Shareholders do not "own" corporations. They own securities—shares of stock—which entitle them to very limited electoral rights and the right to share in the financial returns produced by the corporation's business operations. Conceiving of public shareholders as "owners" may in some instances be a helpful metaphor, but it is never an accurate description of their rights under corporate law. Shareholders possess none of the incidents of ownership of a corporation—neither the right of possession, nor the right of control, nor the right of exclusion—and thus "have no more claim to intrinsic ownership and control of the corporation's assets than do other stakeholders."[75]

Equally misleading is the similar myth that directors are "agents" of shareholder "principals." Like the shareholder/owner model, the agent/principal analogy flatly misdescribes the legal relationship between shareholders and directors. U.S. corporate law is built on the contrary premise that directors must manage corpo-

[73] Baird & Rasmussen, supra note 62, at 7 ("[Directors] may give managers slack, but they will not tolerate dishonesty. They will not sacrifice their own reputations for the sake of a golfing buddy."); Lipton & Rosenblum, supra note 10, at 76; Lipton & Rosenblum, supra note 46, at 195–97; Stout, Proper Motives, supra note 65, at 8–10.

[74] Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 Va. L. Rev. 247, 315–16 (1999). Bebchuk's insistence that more electoral contests are necessary to "discipline" directors and instill them with "fear," see, for example, Bebchuk, supra note 1, at 680, 704, 715, 723, 728, misses the mark for closely related reasons. As we have already described, directors generally serve on boards not out of economic or professional necessity, but out of the desire to serve as part of a productive and collegial team. Subjecting such individuals to blunt accountability instruments of "fear" and "discipline" will not ensure superior performance; to the contrary, it will ensure only that many of the best potential directors will simply refuse to serve.

[75] Lipton & Rosenblum, supra note 10, at 72.

rations in accordance with their independent business judgment. Section 141(a) of the Delaware corporations statute thus grants management power directly to the board of directors: "The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors."[76] Nowhere does the statute subject the board's managerial power to the periodic expression of shareholder sentiment: a corporation is not a "town meeting."[77] "Nor does the statute anywhere suggest that the power to manage the corporation is a residual right of shareholders that is vested in the board by an act of agency or delegation."[78] Thus, case after leading case confirms that directors—not shareholders—are vested with the right and independent obligation to direct the management of corporate affairs.[79]

This primary managerial role correlates directly with directors' unique exposure to liability. Unlike directors (who face direct and unlimited exposure for wrongful corporate acts), shareholders enjoy limited liability for corporate actions, precisely "because the corporate form assigns to them only a few residual elements of corporate control."[80] But if a corporation undertakes action because its shareholder-owners or shareholder-principals demand it, there would be little basis in law or equity to shield the shareholder from direct and unlimited liability in the event the conduct proves wrongful.[81]

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[76] Del. Code Ann. tit. 8, § 141(a) (2006).

[77] TW Servs. v. SWT Acquisition Corp., No. 10,427, 1989 WL 20290, at *12 n.14 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 Del. J. Corp. L. 1169, 1186–87 n.14 (1989).

[78] Theodore N. Mirvis et al., What is a director?, Deal, Mar. 20–26, 2006, at 28, 28.

[79] See, e.g., Quickturn Design Sys. v. Shapiro, 721 A.2d 1281, 1291 (Del. 1998) ("One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation."); Paramount Commc'ns v. QVC Network, 637 A.2d 34, 42 (Del. 1994) ("Under normal circumstances, neither the courts nor the stockholders should interfere with the managerial decisions of the directors."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) ("[I]n the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality."). Cf. Unisuper Ltd. v. News Corp., No. Civ.A. 1699-N 2006 WL 207505, at *3 (Del. Ch. Jan. 20, 2006) (noting that references to agency law principles in an earlier decision in the case were designed only to "illustrate by analogy the gap filling nature of fiduciary duties").

[80] Mirvis et al., supra note 78, at 28.

[81] Id. at 28, 50.

4. The Myth of the Monolithic Shareholder. Equally erroneous is the assumption—central to Bebchuk's analysis—that the shareholder body is united by a common interest in maximizing share value and therefore can be relied upon to promote corporate policies to support that end. They are not and cannot. As we have already pointed out, the shareholder body includes substantial special interest investors who cast their votes "without consideration, perspective or even interest in the long-term interests of the corporation and its shareholders as a whole."[82] There are short-term investors (such as hedge funds) who may support corporate policies that inflate current share prices at the expense of long-run value, and there are long-term investors who will support the long-term commitment of capital to well-managed corporate enterprises.[83] In addition, the shareholder body increasingly includes "hedged investors," who may hold large blocks of corporate voting rights with little or no corresponding economic interests—or even when they have an economic interest in a decline in share price. As we have written elsewhere, "[e]mpowering shareholders under these circumstances . . . risks to destroy corporate value and compromise the interests of non-hedged shareholders, and is socially inefficient as well."[84]

Moreover, short-term, highly hedged investors such as hedge funds increasingly acquire corporate electoral power far beyond their economic interests. "Vote buying by hedge funds is probably common," and such professional investors may often "borrow" millions of shares for short periods and at nominal amounts at or around voting record dates in order to influence corporate elections (without, of course, any corresponding interest in corporate performance).[85] Such investors may be in a position to influence

[82] Martin Lipton, Twenty-Five Years After *Takeover Bids in the Target's Boardroom*: Old Battles, New Attacks and the Continuing War, 60 Bus. Law. 1369, 1377 (2005).

[83] See, e.g., Anabtawi, supra note 42, at 579–83.

[84] Mirvis et al., supra note 42, manuscript at 13.

[85] David Skeel, Behind the Hedge, Legal Aff., Nov.–Dec. 2005, at 28, 32; see also Shaun Martin & Frank Partnoy, Encumbered Shares, 2005 U. Ill. L. Rev. 775; Kara Scannell, Hedge Funds Vote (Often), Wall St. J., Mar. 22, 2007, at C1; Henry T.C. Hu & Bernard Black, Hedge Funds, Insiders, and Empty Voting: Decoupling of Economic and Voting Ownership in Public Companies 5–7 (Eur. Corporate Governance Inst., Working Paper No. 56/2006, 2006), available at http://ssrn.com/abstract=874098 (detailing the "new vote buying" practices of hedge funds and like investors).

corporate policy so as to advance their private interests—which may be inimical to the interest of the corporation as a whole—and yet they owe no duty of any kind to any of their fellow shareholders.[86] Only an empowered board not subservient to constant electoral interference can effectively mediate among competing shareholder interests and maintain a proper focus on long-term growth. The increasing diversity of the shareholder body—and, in particular, the emerging prominence of short-term investors with disproportionate voting rights obtained through synthetic financial instruments—thus militates powerfully against Bebchuk's plan to subsidize and incentivize election challenges.[87]

CONCLUSION

These are the many myths of Lucian Bebchuk, and they add up to the ultimate mythical conclusion, as flawed as its constituent parts, that shareholders should replace directors as the fundamental arbiters of corporate policy. We see no justification for such a radical break with our successful corporate law tradition. We instead continue to advocate an alternative that is no "myth" at all, but instead a corporate governance regime grounded in historical fact, with a long record of superlative performance: the director-

[86] As Vice Chancellor Strine recently noted, such private interests "drive[] institutions to vote no on the buy side, and yes on the sell side, of a merger between two companies of roughly equal market capitalization." Strine, supra note 36, at 1764. As an example of the perverse potential effects of hedged voting, Vice Chancellor Strine observed that, in connection with Compaq's merger with Hewlett-Packard, a "prominent institutional investment firm" voted its indexed Compaq shares in favor of the merger (because of the premium paid) while it at the same time voted its indexed Hewlett-Packard shares against the merger (because it believed the merger was likely to destroy long-term value). Id. at 1764 n.23.

[87] Bebchuk notes that hedge fund activism has contributed to the recent increase in the incidence of contested elections. See Bebchuk, supra note 1, at 726–28. We do not disagree that hedge funds, in search of "short-term" boosts in share price, are "contributing to the trend" of more proxy fights. Whitehouse, supra note 16, at 4. But Bebchuk overlooks the additional significant point that, at the same time hedge fund-type investors seek to use elections to advance their narrow investment interests, hedge fund voting practices are corroding the corporate franchise from the inside out. Indeed, the "borrowed vote" and "empty voting" practices commonly associated with hedge funds increasingly allow such activist investors to manipulate the corporate franchise for private gain, usually with an immediate-term perspective and often at the expense of the corporation and its shareholders as a whole. See Kara Scannell, How Borrowed Shares Swing Company Votes, Wall St. J., Jan. 26, 2007, at A1.

centric Delaware way. Notwithstanding decades of academic criticism, much of it from Bebchuk himself, the corporate form as it has developed and evolved in practice remains the only proven vehicle for organizing and deploying capital on the large and dynamic scale of the modern U.S. economy. It should not be overturned for a myth.