

Governance by Contract: The Implications for Corporate Bylaws

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May 2018

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Boards and shareholders are increasingly using charter and bylaw provisions to customize their corporate governance. Recent examples include forum selection bylaws, majority voting bylaws, and advance notice bylaws. Relying on the contractual conception of the corporation, Delaware courts have accorded substantial deference to board-adopted bylaw provisions, even those that limit shareholder rights. This Article challenges the rationale for deference under the contractual approach. With respect to corporate bylaws, the Article demonstrates that, under Delaware law, shareholders' power to adopt and amend bylaws is more limited than the board's power to do so. As a result, shareholders cannot effectively constrain the board's adoption of bylaws with which they disagree. The resulting power imbalance offers reasons to question the scope of the contract paradigm. DOI: <https://doi.org/10.15779/Z38FF3M05B> Copyright © 2018 Jill E. Fisch. * Perry Golkin Professor of Law and Co-Director, Institute for Law & Economics, University of Pennsylvania Law School. Thanks to Sean Griffith, Steven Davidoff Solomon, and Frank Partnoy for comments on earlier drafts.

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ABSTRACT

Boards and shareholders are increasingly using charter and bylaw provisions to customize their corporate governance. Recent examples include forum selection bylaws, majority voting bylaws, and advance notice bylaws. Relying on the contractual conception of the corporation, Delaware courts have accorded substantial deference to board-adopted bylaw provisions, even those that limit shareholder rights.

This Article challenges the rationale for deference under the contractual approach. With respect to corporate bylaws, the Article demonstrates that, under Delaware law, shareholders' power to adopt and amend bylaws is more limited than the board's power to do so. As a result, shareholders cannot effectively constrain the board's adoption of bylaws with which they disagree. The resulting power imbalance offers reasons to question the scope of the contract paradigm.

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* Perry Golkin Professor of Law and Co-Director, Institute for Law & Economics, University of Pennsylvania Law School. Thanks to Sean Griffith, Steven Davidoff Solomon, and Frank Partnoy for comments on earlier drafts. I am also grateful for helpful comments I received from presentations at "The Corporate Contract in Changing Times: Is the Law Keeping Up?" at UC Berkeley, School of Law and "Can Delaware Be Dethroned? Evaluating Delaware's Dominance of Corporate Law" at UCLA, School of Law.

This analysis suggests two alternative solutions. One possibility is for the Delaware courts and legislature to reconsider existing constraints on shareholder power in order to level the playing field between shareholders and directors and fully realize the contractual paradigm. This approach, which would increase shareholder power, has important normative implications. Alternatively, if Delaware law retains the existing limitations on shareholder power, this Article suggests that judicial reliance on the contract metaphor would be misguided and that courts should scrutinize board-adopted bylaws more closely.

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INTRODUCTION

The contractual approach to corporate law has its roots in the work of leading economists such as Ronald Coase¹ and Oliver Hart.² Although scholars widely accept the utility of the contract metaphor, they debate its implications for regulatory policy.³ Some argue that contract principles support substantial deference to the structural arrangements chosen by corporate participants;⁴

1. Ronald H. Coase, *The Nature of the Firm: Meaning*, in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT* 48, 56 (Oliver E. Williamson & Sidney G. Winter eds., 1993) (“[T]he firm is essentially a choice of contractual arrangements.”).

2. Oliver Hart, *An Economist’s Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757 (1989).

3. See, e.g., William A. Klein, *The Modern Business Organization: Bargaining Under Constraints*, 91 YALE L.J. 1521, 1563 (1982) (arguing that “[t]he modern business organization can best be understood as a series of bargains made under constraints,” but describing this position as positive rather than normative).

4. E.g., FRANK EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

others question the appropriate scope of this deference.⁵ Hart, for example, observed that governance contracts involving the allocation of rights between shareholders and managers are particularly likely to be incomplete within public corporations.⁶

The contractual approach has become particularly influential in supporting deference to the participants' agreed-upon governance terms on both autonomy and efficiency grounds.⁷ Commentators have argued that corporate law should adopt an enabling approach in which default corporate law rules can be freely modified by firm participants rather than imposing one-size-fits-all mandatory regulations.⁸ Increasingly, corporate participants are using private ordering to customize their corporate governance by adopting issuer-specific terms.⁹ I have described this trend as the "New Governance."¹⁰ Recent examples include forum selection bylaws, majority voting bylaws, and advance notice bylaws.¹¹

Then-Chancellor (now Chief Justice) Strine built upon this well-developed contractual model of the corporation in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*¹² As Strine explained in *Boilermakers*, "the bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the DGCL."¹³ In so reasoning, Strine was building upon a judicial tradition

5. E.g., Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989).

6. Oliver D. Hart, *Corporate Governance: Some Theory and Implications*, 105 ECON. J. 678, 690 (1995).

7. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1446 (1989) ("The role of corporate law here, as elsewhere, is to adopt a background term that prevails unless varied by contract.").

8. See, e.g., Troy A. Paredes, Sec. Exch. Comm'r, Statement at Open Meeting to Adopt the Final Rule Regarding Facilitating Shareholder Nominations ("Proxy Access") (Aug. 25, 2010), <http://www.sec.gov/news/speech/2010/spch082510tap.htm> [<https://perma.cc/S4V9-VPN6>] ("[T]he enabling approach defers to private ordering to determine how each firm should be organized to advance its particular needs and interests most effectively."). Other forms of business entity law are more explicit in providing the maximum effect to the participants' agreed-upon terms. See Paul M. Altman & Srinivas M. Raju, *Delaware Alternative Entities and the Implied Contractual Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 BUS. LAW. 1469, 1469 (2005) (explaining that the Delaware Revised Uniform Limited Partnership Act and Limited Liability Company (LLC) Act are "based upon and reflect a strong policy favoring broad freedom of contract in connection with almost all aspects of the formation, operation and termination of Delaware limited partnerships and limited liability companies"); see also Larry E. Ribstein, *Unlimited Contracting in the Delaware Limited Partnership and Its Implications for Corporate Law*, 16 J. CORP. L. 299, 300 (1991) (arguing that the contractual approach reflected in Delaware's LLP statute should be extended to corporations).

9. D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125 (2011).

10. Jill E. Fisch, *The New Governance and the Challenge of Litigation Bylaws*, 81 BROOK. L. REV. 1637 (2016).

11. See *id.* at 1654 (describing advance notice and forum selection bylaws); Stephen Choi, Jill Fisch, Marcel Kahan & Edward Rock, *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119, 1145 (2016) (describing majority voting bylaws).

12. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

13. *Id.* at 939.

embracing the academic model of analyzing the power relationship among corporate constituencies in contractual terms.¹⁴

Strine's contractual model of the corporation, as articulated in *Boilermakers*, relied on two factors. The first was a theory of implied consent.¹⁵ Shareholders implicitly consent to be bound by board-adopted bylaws when they buy stock in a corporation with a charter that confers that power on the board of directors. The second was the shareholders' right to challenge board-adopted bylaws, including "the indefeasible right of the stockholders to adopt and amend bylaws themselves."¹⁶ Strine described the shareholders' ability to do so as "legally sacrosanct."¹⁷

In *ATP Tour, Inc. v. Deutscher Tennis Bund*, the court again relied on this rationale to uphold a board-adopted bylaw that required a losing plaintiff-shareholder to pay the corporation's litigation expenses.¹⁸ The court's reasoning was not merely based on a contract analogy but rather specifically treated the bylaw in question as a contract term, explaining that the bylaw was the equivalent of a "contractual exception to the American Rule."¹⁹ Somewhat ironically, the court based its conclusion on the fact that corporate bylaws are "contracts among a corporation's shareholders," despite the fact that the bylaw in question had been adopted by the board and had not been subjected to a shareholder vote.²⁰

The broad conception of the shareholders' bylaw power reflected in both *Boilermakers* and *ATP* is in tension with an earlier Delaware Supreme Court decision. In *CA Inc. v. AFSCME*, the court held that a shareholder-adopted proxy expense reimbursement bylaw was inconsistent with Delaware law because the shareholders had limited authority to adopt this type of bylaw.²¹ Specifically, the court concluded that the board's statutory authority to manage the corporation operated as a constraint on shareholder power. As the court explained, "[T]he internal governance contract—which here takes the form of a bylaw—is one that would also prevent the directors from exercising their full managerial power in circumstances where their fiduciary duties would otherwise require them to deny reimbursement to a dissident slate."²²

The tension between *Boilermakers/ATP* and *AFSCME* poses a challenge to the contemporary understanding that the contractual nature of the corporate form

14. See, e.g., *Airgas, Inc. v. Air Prod. & Chem., Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (citing *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990)) (describing bylaws as "contracts among a corporation's shareholders").

15. *Boilermakers*, 73 A.2d at 955–56.

16. *Id.* at 956.

17. *Id.*

18. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 557 (Del. 2014).

19. *Id.* at 558.

20. *Id.* Concededly, ATP was a non-stock corporation, but the court did not limit its holding to non-stock corporations.

21. *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227 (Del. 2008).

22. *Id.* at 239.

warrants the high level of judicial deference to private ordering reflected in *Boilermakers*. Within the context of the New Governance, the board's power to adopt and amend bylaw provisions may, for a variety of reasons, be greater than the shareholders' corresponding power to do so. In turn, the resulting limit on the scope of the contract metaphor offers a reason to question the current judicial approach to litigation bylaws.

The implications are twofold. First, a commitment to a contractual paradigm suggests that the Delaware courts and possibly the legislature may want to reconsider the existing constraints on shareholder power in the name of facilitating private ordering. In so doing, they will have to consider the possible consequences of greater shareholder empowerment.²³ Second, to the extent that Delaware law retains the existing limitations on shareholder power reflected in *AFSCME*, the courts should engage in greater scrutiny of board-adopted bylaws because shareholders may be unable to remove those bylaws themselves.²⁴

This Article proceeds as follows. In Part I, the Article briefly sketches the foundation for the contractual model of the corporation and the model's application to issuer-specific bylaws. Part II identifies constraints on shareholder power to adopt and amend bylaws that create a disparity between the board's power and that of the shareholders. Part III considers the implications of this disparity for the contractual approach.

I.

THE CONTRACTUAL NATURE OF CORPORATE BYLAWS

The contractual model of the corporation emphasizes that the relationship between managers and shareholders is contractual in nature. This means that the governing documents of the corporation—the charter and bylaws—operate and bind both managers and shareholders as if they had negotiated their terms and signed them, like a common law contract.²⁵ Originating from a strand of law and

23. These consequences include the increased potential for shareholder activism and the consequences of that activism. Commentators have disagreed about the normative implications of shareholder empowerment. Compare William Bratton & Michael Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 658–59 (2010) (arguing that increased shareholder empowerment caused managers to manage to the market excessively), with Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005) (claiming that “[i]ncreasing shareholder power to intervene . . . would improve corporate governance and enhance shareholder value by addressing important agency problems that have long afflicted publicly traded companies”).

24. The balance of authority between shareholders and directors to adopt governance bylaws has further implications for the scope of permissible shareholder proposals under SEC Rules 14a-8(i)(1) and (2), 17 C.F.R. § 240.14a-8(1) & (2) (2016). Consideration of those implications is beyond the scope of this Article.

25. See, e.g., Jason W. Neyers, *Canadian Corporate Law, Veil-Piercing, and the Private Law Model Corporation*, 50 U. TORONTO L.J. 173, 214 (2000) (questioning whether the “English model [of the corporation] is contractual”).

economics scholarship,²⁶ the model has led some law and economics scholars to argue that market discipline, imposed through stock prices, would lead to the adoption of optimal contract terms for shareholders or, at least, better terms than those imposed by regulation.²⁷

The contractual theory has had important implications for corporate law.²⁸ Scholars have used it to argue that corporate law should facilitate the contracting process by accepting a wide range of firm-specific, customized contract terms.²⁹ In addition, they have reasoned that corporate law should not mandate a one-size-fits-all approach, both because it is unlikely that policymakers would successfully identify the optimal corporate law rules and because it is unlikely that a single rule would be optimal for all issuers.³⁰

The development of firm-specific governance terms has come to be known as private ordering.³¹ Although a variety of scholars have identified limitations to the contractual approach and, as a result, questioned its use as a basis for limiting mandatory regulation,³² the approach nonetheless provides the normative basis for private ordering.³³ Corporate bylaws offer a mechanism by which shareholders (and directors) can engage in this private ordering.³⁴

26. See, e.g., Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703, 1705 (1989) (observing that the “contractual theory of the firm . . . dominate[d] the thinking of most economists and most economically oriented corporate law scholars”); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976) (describing the firm as a “nexus for contacting relationships”).

27. Easterbrook & Fischel, *supra* note 7, at 1430–33.

28. See generally Symposium, *Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989) (discussing implications of the contractual approach for the role of mandatory corporate law).

29. EASTERBROOK & FISCHEL, *supra* note 4, at 5. Frank Easterbrook and Daniel Fischel are among the most influential adherents to the contractual model. See Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391, 1419 (1992) (“Easterbrook and Fischel are worthy heirs to the contractual tradition begun by Coase more than fifty years ago.”).

30. See Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990) (summarizing the debate over private ordering versus mandatory rules).

31. Smith et al., *supra* note 9, at 127 n.12 (discussing various uses of the term “private ordering”).

32. See, e.g., Melvin Aron Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1275 (1999) (arguing against the application of a contractual approach to the duty of loyalty); Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 784 (2006) (“The contractarian theory has turned out to be based largely on an entirely plausible, but in fact imaginary, world of contracting.”).

33. See, e.g., Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435 (2012) (arguing that federal securities laws should facilitate experimentation with proxy access through private ordering).

34. See, e.g., Smith et al., *supra* note 9, at 130 (“We would promote private ordering in public corporations by lowering the barriers to contracting through the adoption of shareholder bylaws.”). Firms can also engage in private ordering by the adoption of firm-specific charter provisions. The critical distinction between the charter and the bylaws is that charter amendments typically require both shareholder and board approval. In contrast, most states allow boards and shareholders to amend the

By virtue of its largely enabling structure, Delaware corporate law is consistent with the private ordering approach.³⁵ The Delaware statute contains relatively few mandatory provisions.³⁶ Instead, most of the statute provides default rules that can be modified through an appropriate charter or bylaw provision.³⁷ For example, the statute contains an antitakeover provision restricting business combinations with an interested shareholder for a period of three years but provides a variety of mechanisms by which a corporation can elect to avoid the application of that provision.³⁸ Similarly, the statute provides that the board of directors will be elected annually but allows a corporation to opt instead for a classified board through a charter provision or shareholder-adopted bylaw.³⁹

In addition to enabling individual corporations to modify the statutory default rules, the Delaware statute facilitates private ordering by allowing corporations to customize their charters and bylaws by including a variety of optional contract-like terms. One of the better known provisions, DGCL 102(b)(7), allows corporations to adopt a charter provision that limits or eliminates certain director liability for monetary damages in duty-of-care claims.⁴⁰ Another provision authorizes corporations to adopt a charter provision renouncing an interest in specified business opportunities, thereby limiting potential claims under the corporate opportunity doctrine.⁴¹ The statute also authorizes corporations to adopt supermajority voting requirements through the inclusion of an optional charter provision.⁴²

Delaware law allows corporations to use bylaws to similar effect. Under the Delaware statute, shareholders have the power to adopt, amend, and repeal bylaws. The corporation can grant directors that same power through a charter provision, but such a provision cannot remove that power from the

bylaws unilaterally. The requirement of joint action means that the contractual approach has different implications for the legitimacy of charter provisions, an issue that is beyond the scope of this Article. In addition, statutes may impose different limits on the scope of permissible private ordering that can be effected pursuant to a charter provision. *See, e.g., Frechter v. Zier*, No. 12038, 2017 Del. Ch. LEXIS 214, at *5 n.19 (Del. Ch. Jan. 24, 2017) (contrasting permissible supermajority requirements under section 109 with section 102(b)(4)).

35. *See generally* Jill E. Fisch, *Leave It to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731 (2013).

36. Fisch, *supra* note 10, at 1671.

37. For exceptions see DEL. CODE ANN. tit. 8, § 211 (2017) (requiring an annual meeting of shareholders); *id.* § 170 (restricting payment of dividends).

38. *Id.* § 203(a).

39. *Id.* § 141(d).

40. John L. Reed & Matt Neiderman, “Good Faith” and the Ability of Directors to Assert § 102(b)(7) of the Delaware General Corporation Law as a Defense to Claims Alleging Abdication, Lack of Oversight, and Similar Breaches of Fiduciary Duty, 29 DEL. J. CORP. L. 111, 113 (2004) (describing history and scope of 102(b)(7)). Concededly, the section is not fully contractual in that it exempts four categories of conduct for which directors cannot be exculpated. *Id.* at 113–14.

41. DEL. CODE ANN. tit. 8, § 122(17) (2017).

42. *Id.* § 102(b)(4).

shareholders.⁴³ The vast majority of Delaware corporate charters vest the board of directors with this authority.⁴⁴

The scope of potential governance bylaws is very broad. The Delaware statute authorizes corporations to adopt “any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.”⁴⁵ Because of this broad scope and because shareholders and boards can each adopt governance bylaws unilaterally, a substantial amount of private ordering in Delaware corporations takes place through the adoption of issuer-specific bylaws.⁴⁶

In turn, Delaware courts have largely accepted the contractual theory of corporate law.⁴⁷ As the Delaware Supreme Court explained in *Airgas*, “Corporate charters and bylaws are contracts among a corporation’s shareholders.”⁴⁸ The contractual theory provides courts with a methodology for interpreting the charter and bylaws—they are interpreted using contract principles.⁴⁹ The theory also provides courts with a basis for enforcement. As Strine explained in *Boilermakers*, “[T]he bylaws constitute a binding part of the contract between a Delaware corporation and its stockholders.”⁵⁰

In *Boilermakers*, the court upheld a board-adopted forum selection bylaw as valid, relying on two different factors. The first was a theory of implied consent. Strine reasoned that the Delaware statute contemplates that directors will, if the charter so provides, have the authority to adopt bylaws unilaterally. Given the statutory framework, if a corporation’s charter authorizes the board to amend the bylaws, its shareholders implicitly agree that they “will be bound by bylaws adopted unilaterally by their boards.”⁵¹ Shareholders consent by deciding to invest in the corporation.⁵²

Second, Strine found support for the contractual analysis in light of the shareholders’ statutory rights when they disagree with a board-adopted bylaw. As Strine noted, the shareholders possess their own right, comparable to that of the board, to adopt or amend bylaws.⁵³ Additionally, shareholders have the

43. *Id.* § 109(a).

44. Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 589 n.25 (2016) (“Universally, publicly traded corporations grant directors such powers from their inception.”).

45. DEL. CODE ANN. tit. 8, § 109(b) (2017).

46. See, e.g., E. Norman Veasey, *The Shareholder Franchise Is Not a Myth: A Response to Professor Bebchuk*, 93 VA. L. REV. 811, 821 (2007) (explaining that shareholders can engage in private ordering by adopting bylaws that modify an issuer’s procedures for electing directors, including the implementation of majority voting).

47. See, e.g., *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010).

48. *Id.*

49. *Id.*

50. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 955 (Del. Ch. 2013).

51. *Id.* at 956.

52. *Id.*

53. *Id.* (citing *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 232 (Del. 2008)).

power to discipline boards that refuse to accede to a shareholder vote concerning a bylaw by removing recalcitrant directors from their positions. Strine therefore concluded that “a corporation’s bylaws are part of an inherently flexible contract between the stockholders and the corporation under which the stockholders have powerful rights they can use to protect themselves if they do not want board-adopted forum selection bylaws to be part of the contract between themselves and the corporation.”⁵⁴

The *Boilermakers* decision reflected a powerful endorsement of contractual freedom in corporate law. As such, it encouraged corporations to engage in private ordering through the adoption and amendment of corporate bylaws.⁵⁵ Corporations responded to this invitation. For example, issuer adoption of forum selection bylaws, which had been used to a limited extent prior to the *Boilermakers* decision, “rapidly accelerated” after *Boilermakers*.⁵⁶

Issuers also began to experiment with other governance bylaws.⁵⁷ In *ATP*, the Delaware Supreme Court upheld a board-adopted fee-shifting bylaw, reasoning that the contractual analysis in *Boilermakers* was applicable.⁵⁸ Likewise, a number of issuers adopted director qualification bylaws to prohibit certain types of compensation agreements for activist-nominated director candidates.⁵⁹ A few issuers even adopted bylaws compelling arbitration.⁶⁰

54. *Id.* at 957.

55. Issuers had previously adopted various types of governance bylaws. For example, advance notice bylaws, which require a shareholder to provide the issuer with advance notice of the intention to nominate competing director candidates, were prevalent prior to the *Boilermakers* decision. See WilmerHale, 2015 M&A Report 5 (2015), https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/2015-WilmerHale-MA-Report.pdf [<https://perma.cc/HR3U-MVZK>] (estimating that “95 percent of the S&P 500 and 90 percent of the Russell 3000 had advance notice provisions at 2014 year-end”). Delaware law imposes a high standard for enjoining advance notice bylaws. See, e.g., Gibson Dunn, Advance Notice Bylaws: Trends and Challenges 2 (2015), <https://www.gibsondunn.com/advance-notice-bylaws-trends-and-challenges> [<https://perma.cc/55EC-KWHQ>] (explaining that the court’s decision in *AB Value Partners* “clarifies that under Delaware law, advance notice bylaws will only be enjoined in cases that pass the relatively high bar of ‘inequitable circumstances’”).

56. Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, 14 J. EMPIRICAL LEGAL STUD. 31, 38 (2017). The Delaware legislature explicitly endorsed the validity of forum selection bylaws in 2015. See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (West 2015).

57. See generally Fisch, *supra* note 10 (describing range of board-adopted governance bylaws).

58. See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014). The Delaware legislature subsequently amended the statute to prohibit fee-shifting bylaws. DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (West 2015).

59. See Matthew D. Cain, Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *How Corporate Governance Is Made: The Case of the Golden Leash*, 164 U. PA. L. REV. 649, 652–53 (2016). Notably, the golden leash bylaw experience was consistent with Strine’s reasoning in *Boilermakers*. When shareholders objected to the bylaws by withholding their votes from directors who adopted them, the offending board responded by repealing the provisions. *Id.*

60. See Claudia Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751 (2014). Several courts upheld the decision to adopt an arbitration bylaw by one issuer, a Massachusetts REIT, although the analysis did not implicate Delaware corporate law. *Del. Cnty. Emps. Ret. Fund v. Portnoy*, No. 13-10405, 2014 U.S. Dist. LEXIS 40107 (D. Mass. Mar. 26, 2014) (applying

Commentators argued that the validity of such bylaws followed from the reasoning in *ATP* and *Boilermakers*.⁶¹

Shareholders also increased their efforts to engage in private ordering through the adoption of governance bylaws. In recent years, shareholders have proposed a variety of governance reforms through bylaw amendments, including majority voting, proxy access, and the right of shareholders to call a special meeting. These proposals have enjoyed considerable voting support. As of January 2014, for example, “almost 90 percent of S&P 500 companies ha[d] adopted some form of majority voting.”⁶² The year 2015 was a “break-through year” for proxy access shareholder bylaws, due in part to a shareholder proposal campaign by the New York City Comptroller.⁶³ Most proxy access proposals received support by a majority of shareholders, and a growing number of issuers are adopting some form of proxy access.⁶⁴

II.

LIMITS OF THE CONTRACT ANALOGY: POWER ASYMMETRY BETWEEN THE BOARD AND SHAREHOLDERS

As noted above, boards and shareholders are using private ordering to adopt issuer-specific governance bylaws. If these bylaws are properly understood as negotiated terms of a contract, arguably courts should give them broad deference. The *Boilermakers* and *ATP* decisions relied on this rationale to uphold forum selection and fee-shifting bylaws, respectively.

There are two critical problems, however, with the contractual analysis. One problem is the question of whether shareholders truly should be understood to consent to the terms of the charter and bylaws as Strine reasoned. The issue of consent is an important one, but it is beyond the scope of this Article.⁶⁵ The

res judicata to deny plaintiff's motion for a declaratory judgment); *Katz v. Commonwealth REIT*, No. 24-C-13-001299 (Md. Cir. Ct. Aug. 31, 2015) (citing contractual analysis of the *Boilermakers* decision); *Corvex Mgmt. LP v. Commonwealth REIT*, No. 24-C-13-001111, 2013 Md. Cir. Ct. LEXIS 3 (Md. Cir. Ct. May 8, 2013) (denying motion to stay arbitration on the basis that the plaintiffs had assented to arbitration where the shares bore a legend providing constructive notice and the plaintiffs were sophisticated investors).

61. See Letter from Jeff Mahoney, Gen. Counsel, Council of Institutional Investors, to Keith F. Higgins, Dir., Div. of Corp. Fin., SEC, and John Ramsey, Acting Dir., Div. of Trading and Mkts., SEC (Dec. 11, 2013) (reasoning that decisions like *Boilermakers* could lead corporations to adopt arbitration bylaws).

62. Choi et al., *supra* note 11, at 1121.

63. SIMPSON THACHER & BARTLETT, PROXY ACCESS PROPOSALS 1 (2015), http://www.stblaw.com/docs/default-source/memos/firmmemo_07_30_15_proxy-access-proposals.pdf [<https://perma.cc/5TZV-HZWD>].

64. WEIL, GOTSHAL & MANGES, WHAT'S NEW FOR THE 2016 PROXY SEASON: ENGAGEMENT, TRANSPARENCY, PROXY ACCESS AND MORE 7 (2016), https://www.weil.com/~media/files/pdfs/1_22_16_governance-alert_final2.pdf?cid=8590500125 [<https://perma.cc/4J78-U338>] (reporting that 124 issuers adopted proxy access between Jan. 1, 2015, and Feb. 4, 2016, either voluntarily or in response to a shareholder proposal).

65. For further discussion of this point, see Verity Winship, *Shareholder Litigation by Contract*, 96 B.U.L. REV. 485, 496 (2016).

second problem, which this Article addresses, is that for a variety of reasons shareholder power to amend the bylaws is more limited than the *Boilermakers* decision suggests. Although the board has broad power to adopt governance bylaws, shareholders do not enjoy analogous power. Accordingly, shareholders are limited in their ability to constrain board actions with which they disagree. This Part identifies several key limitations on shareholder power over the corporation's bylaws. The following Part considers the implications of these limitations.

A. Substantive Limits on Shareholder Power Under Section 109

Although *Boilermakers* and *ATP* describe shareholder power to adopt and amend bylaws under Delaware law as very broad, an earlier Delaware Supreme Court decision, *CA, Inc. v. AFSCME*, suggests a more limited shareholder role.⁶⁶ *AFSCME*, a union pension fund, submitted a shareholder proposal to amend the bylaws pursuant to Rule 14a-8.⁶⁷ The proposed bylaw required the issuer, under certain circumstances, to reimburse reasonable proxy solicitation expenses incurred by a stockholder who nominated one or more candidates for election to the board of directors.⁶⁸ *CA* sought to exclude the shareholder proposal from its proxy statement on the basis that the proposed bylaw was not a proper subject for shareholder action and, if adopted, would be illegal under DGCL section 141(a).⁶⁹

In support of its request for no-action relief, *CA* submitted to the SEC an opinion letter from Delaware counsel, arguing that the proposed bylaw was invalid because it would interfere with the board's authority under the statute and the charter to manage the corporation.⁷⁰ According to the letter, the board, not the shareholders, had the discretion to determine how to expend corporate funds, and the shareholders lacked the authority "unilaterally [to impose] limits on the Board's discretion."⁷¹ The letter also argued that the bylaw would "impede the Board's exercise of its fiduciary duties to manage the business and affairs of the Company."⁷²

66. *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 229 (Del. 2008). Prior to *AFSCME*, the position of the Delaware courts on this issue was less clear. See *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985) (upholding shareholder-adopted bylaw amendments that "required attendance of all directors for a quorum and unanimous approval of the board of directors before board action can be taken . . . thereby limit[ing] the functioning of the Frantz board" even though the amendments were intended to limit the board's "anti-takeover maneuvering").

67. *AFSCME*, 953 A.2d at 229; 17 C.F.R. § 240.14a-8 (2016).

68. *AFSCME*, 953 A.2d at 229–30.

69. No-Action Request from Richards, Layton & Finger, Counsel for *CA, Inc.*, to SEC, Div. of Corp. Fin. (Apr. 17, 2008), <https://www.sec.gov/divisions/corpfin/cf-noaction/2008/ca062708-14a8-incoming.pdf> [<https://perma.cc/J9SJ-5Q49>].

70. *Id.* at 3–4.

71. *Id.* at 7 n.3.

72. *Id.*

The SEC sought guidance from the Delaware Supreme Court as to whether CA's argument was correct as a matter of Delaware corporate law.⁷³ CA used Delaware's newly adopted certification procedure⁷⁴ to certify two questions to the Delaware Supreme Court:

1. Is the AFSCME Proposal a proper subject for action by shareholders as a matter of Delaware law?
2. Would the AFSCME Proposal, if adopted, cause CA to violate any Delaware law to which it is subject?⁷⁵

In its decision, the court provided several guiding principles about the scope of shareholder authority under section 109. First, and perhaps most importantly, the court explicitly rejected the idea that shareholder power to adopt bylaws is coextensive with that of the board of directors.⁷⁶ Instead, the court explained that shareholder power is limited by section 141(a), which provides the board, but not the shareholders, with broad management power over the affairs of the corporation.⁷⁷ The court explained that a shareholder-adopted bylaw would be invalid if it limited "the board's management prerogatives under Section 141(a)."⁷⁸

In *AFSCME*, the court offered guidance on the permissible scope of shareholder bylaws in order to analyze the relationship between board authority under section 141(a) and shareholder power under section 109.⁷⁹ As a starting point, the court recognized that the statutory language was only "marginally

73. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 231 (Del. 2008).

74. S.B. 62, 144th Gen. Assemb., Reg. Sess. (Del. 2007).

75. *AFSCME*, 953 A.2d at 231.

76. "[I]n isolation, Section 109(a) could be read to make the board's and the shareholders' power to adopt, amend or repeal bylaws identical and coextensive, but Section 109(a) does not exist in a vacuum. It must be read together with 8 Del. C. § 141(a) . . ." *Id.* at 232.

77. *See id.* ("No such broad management power is statutorily allocated to the shareholders.")

78. *Id.* at 232. The court's analysis drew on an argument that commentators had developed in response to pill redemption bylaws. *See, e.g.,* Lawrence Hamermesh, *Corporate Democracy and Stockholder Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409 (1998). In the late 1990s, institutional investors attempted to adopt bylaws to restrict a board's use of a poison pill to resist a hostile tender offer. *See, e.g.,* John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. MIAMI L. REV. 605, 610–12 (1997) (describing efforts by institutional investors to introduce pill redemption bylaws). The Delaware courts did not rule on the validity of pill redemption bylaws. *See* Jonathan R. Macey, *The Legality and Utility of the Shareholder Rights Bylaw*, 26 HOFSTRA L. REV. 835, 866 (1998) ("No Delaware court has addressed the legality of the shareholder rights bylaw."). An Oklahoma court, however, upheld a bylaw requiring that the board submit a pill to its shareholders for ratification. *Int'l Bhd. of Teamsters Gen. Fund v. Fleming Cos.*, 975 P.2d 907, 908 (Okla. 1999). Commentators have argued that Delaware law espouses a board-centric model of the corporation that is inconsistent with the *Fleming* decision and defended this model on normative grounds. *See, e.g.,* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 572 (2003) (reasoning both that the corporate form involves the shareholders' decision to delegate this control to the board and that this delegation is efficient); *see also* Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 627 (2006) ("[S]hareholder voting must be constrained in order to preserve the value of authority.").

79. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 232–33 (Del. 2008).

helpful in determining what the Delaware legislature intended to be the lawful scope of the shareholders' power to adopt, amend and repeal bylaws."⁸⁰ Notably, in contrast to the Delaware Limited Liability Company Act and Revised Uniform Partnership Act, the Delaware corporate law statute does not contain any language explicitly endorsing a contractual approach.⁸¹

The court went on to explain that the proper function of bylaws was to address procedural issues rather than to mandate substantive business decisions. This substance/procedure distinction could be used to demarcate the permissible scope of a shareholder-adopted bylaw under Delaware law.⁸² Accordingly, the court then framed its analysis of the first certified question as requiring it to determine whether an expense reimbursement bylaw was "process-related."⁸³ The court concluded that it was. Although the bylaw concededly involved the expenditure of corporate funds, the court reasoned that the expenditure was related to maintaining the integrity of the electoral process. As a result, the bylaw was a proper subject for shareholder action.

The substance/procedure distinction can be understood as a way to determine when a shareholder-adopted bylaw impermissibly infringes upon board authority under section 141(a).⁸⁴ Because section 141(a) vests the board with authority over substantive business decisions, a substantive bylaw could be understood to usurp that authority. A bylaw that addresses the procedure by which a decision is made but leaves the ultimate decision to the board, however, would presumably be valid.⁸⁵ The substance/procedure distinction thus creates a different scope for board-adopted bylaws than for those adopted by shareholders because the board is not limited to process bylaws.

The *AFSCME* court's determination that the proxy reimbursement bylaw was process-based, and therefore legally permissible, did not conclude the analysis, however. The court went on to consider the second question—whether the proposed bylaw would cause CA to violate Delaware law. The court concluded that it would. Reasoning that the bylaw could, hypothetically, require

80. *Id.* at 234.

81. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-1101(b) (2011) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract . . .").

82. *AFSCME*, 953 A.2d at 235 ("[T]here is a general consensus that bylaws that regulate the process by which the board acts are statutorily authorized.").

83. *Id.* at 236.

84. Commentators have suggested other approaches to analyzing this question. For example, Ben Walther distinguishes between bylaws that attempt to circumscribe the managerial authority of the board and those that attempt to control or bind the board. Ben Walther, *Bylaw Governance*, 20 FORDHAM J. CORP. & FIN. L. 399, 414–15 (2015). Jack Coffee offers four criteria for distinguishing proper from improper shareholder bylaws: 1) bylaws that deal with fundamental versus ordinary matters; 2) bylaws that impose negative constraints as opposed to affirmative obligations; 3) bylaws that focus on procedure rather than substance; and 4) bylaws that concern corporate governance rather than business decisions. *See* Coffee, *supra* note 78, at 613–15.

85. *See also* Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1078–79 (Del. Ch. 2004) (stating that there is a "general consensus that bylaws that regulate the process by which the board acts are statutorily authorized").

the board to reimburse a stockholder's proxy expenses in a situation in which reimbursement would violate the board's fiduciary duties, the court held that this deficiency rendered the bylaw facially invalid.⁸⁶

The court reached this conclusion by analogizing to situations in which courts had invalidated contracts that imposed obligations on a board that arguably were inconsistent with the board's fiduciary duties.⁸⁷ Although those situations involved contractual obligations that the board had voluntarily assumed, as opposed to obligations imposed by a shareholder-adopted bylaw, the court found that "the distinction is one without a difference."⁸⁸ The court's rationale was that, in either case, the result would be to limit the board from exercising the full scope of its managerial authority.⁸⁹ Again, the touchstone of the analysis was the board's broad authority under section 141(a).⁹⁰

Although the *AFSCME* decision has been criticized,⁹¹ and the Delaware legislature subsequently amended the statute to authorize explicitly both proxy expense reimbursement bylaws and proxy access bylaws,⁹² the principle that shareholder authority under section 109 is more limited than director authority appears to have survived. In a 2015 decision, Vice-Chancellor Noble invalidated a bylaw that authorized shareholders to remove and replace corporate officers without cause.⁹³ Notably, the plaintiff in that case relied on statutory language that seemed expressly to authorize bylaws that dealt with the appointment and removal of corporate officers.⁹⁴

86. The court explained that it was required to view the bylaw as inconsistent with the law if there was "any possible circumstance under which a board of directors might be required to act [where] the board of directors would breach their fiduciary duties if they complied with the Bylaw." *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 238 (Del. 2008).

87. See *id.* (citing *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1994)).

88. *Id.* at 239.

89. The extent to which the inclusion of a fiduciary out in the bylaw would address this concern is an open issue. See Sabrina Ursaner, Note, *Keeping "Fiduciary Outs" Out of Shareholder-Proposed Bylaws: An Analysis of CA, Inc. v. AFSCME*, 6 N.Y.U. J.L. & BUS. 479, 507–08 (2010).

90. Notably, however, the court suggested that the situation might be different if the limitation had been imposed through a charter provision rather than a bylaw. See *AFSCME*, 953 A.2d at 240 (suggesting that shareholders might have recourse by seeking "to amend the Certificate of Incorporation to include the substance of the Bylaw"). Because the scope of charter provisions is similarly limited to what is permitted by the statute, it is unclear why using a charter provision instead of a bylaw would affect the outcome. The distinction, however, motivated an argument by the plaintiffs in *Boilermakers* that, to the extent that a forum selection provision was permissible, it had to be adopted through a charter provision rather than a bylaw. See *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 955 n. 93 (Del. Ch. 2013). The court rejected that argument. *Id.*

91. See, e.g., Brett H. McDonnell, *Bylaw Reforms for Delaware's Corporation Law*, 33 DEL. J. CORP. L. 651, 668 (2008).

92. See DEL. CODE ANN. tit. 8, §§ 112, 113 (2017).

93. *Gorman v. Salamone*, No. 10183-VCN, 2015 De. Ch. LEXIS 202, at *18–19 (De. Ch. July 31, 2015).

94. *Id.* at *13–14. See Paul M. Tiger & Carolyn Oh, *Gorman v. Salamone: Delaware Court of Chancery Strikes Down Bylaw Granting Stockholders the Right to Remove and Replace Officers*, CLEARY M&A & CORP. GOVERNANCE WATCH (Aug. 31, 2015), <http://www.clearymawatch.com/2015/08/gorman-v-salamone-delaware-court-of-chancery-strikes->

Significantly, Vice-Chancellor Noble relied on the *AFSCME* decision for the proposition that “[s]tockholders’ ability to amend bylaws is ‘not coextensive with the board’s concurrent power and is limited by the board’s management prerogatives under Section 141(a).’”⁹⁵ He further held that the touchstone for determining whether the bylaw infringed on the board’s management function was the substance/procedure distinction developed by the *AFSCME* court.⁹⁶ Applying this standard, he concluded that the bylaw was invalid because it “would allow [shareholders] to make substantive business decisions for the Company.”⁹⁷

B. Additional Statutory Limits on Shareholder Power

Although *AFSCME* distinguished between shareholder and board power to adopt and amend the bylaws, it is only one case. The extent to which future courts will adhere to that distinction remains unclear.⁹⁸ Still, the structure and language of the Delaware corporation statute provide additional reasons to view the scope of shareholder power under section 109 as limited.⁹⁹ One notable feature of the statute is that it contains a number of provisions expressly authorizing shareholders to vote on bylaws that address particular issues. These provisions include authorizing proxy expense reimbursement under section 112, providing proxy access under section 113, classifying the board of directors under section 141(d), requiring majority voting under section 216, and opting out of the state antitakeover statute under section 203(b)(3).

Although the statute does not contain any language indicating that the shareholders may only adopt bylaws addressing subjects expressly authorized therein, there are two possible reasons to read the list of explicit statutory authorizations as limiting the scope of shareholder power. First, if, as section 109 implies, shareholders may adopt bylaws containing “any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation,”¹⁰⁰ the list of subject-specific authorizations would

down-by-law-granting-stockholders-the-right-to-remove-and-replace-officers [https://perma.cc/68XM-3M6B] (explaining *Gorman* decision). Section 142(b) provides: “Officers shall be chosen in such manner and shall hold their offices for such terms as are prescribed by the bylaws or determined by the board of directors or other governing body.” DEL. CODE ANN. tit. 8, § 142(b) (2017) (emphasis added).

95. *Gorman*, 2015 LEXIS 202, at *11 (quoting *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 232 (Del. 2008)).

96. *Id.* at *1314 (holding that “valid bylaws focus on process”).

97. *Id.* at *6.

98. See also Walther, *supra* note 84, at 448 (arguing that *AFSCME*’s “influence may be dwindling”).

99. See also James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 291–92 (2015) (arguing that courts should “divert course from the deceptive nature of the nexus-of-contracts approach and return to the corporate statute to divine the relative rights of the board vis-à-vis the shareholders”).

100. DEL. CODE ANN. tit. 8, § 109(b) (2017).

be unnecessary.¹⁰¹ Consequently, under a formalistic approach to statutory construction,¹⁰² the fact that the statute sets out a litany of subjects upon which a shareholder-adopted bylaw is permitted implies that, in the absence of statutory authorization, at least some types of shareholder-adopted bylaws are not allowed.¹⁰³

Second, the enabling provisions reinforce the idea that shareholder authority over corporate affairs is limited and that all residual authority is vested in the board of directors.¹⁰⁴ This perspective is consistent with the argument identified in the prior Part that board power to manage the corporation is unlimited pursuant to section 141(a), but shareholders possess only those powers expressly conferred by the statute. It is also consistent with a statutory structure that confers specific and limited powers upon shareholders apart from their power to adopt bylaws, vesting all remaining power in the board. For example, the Delaware statute authorizes shareholders to vote on specific issues—election of the board of directors, amendments to the certificate of incorporation, and approval of mergers and other structural changes.¹⁰⁵ Thus, the inclusion of subject-specific shareholder bylaw authorization provisions and the general enabling approach of Delaware corporate law with respect to board power suggest that the scope of shareholder power is more limited than that of the board.

An additional reason that shareholder authority under section 109 is limited is that, in virtually all corporations, it is nonexclusive.¹⁰⁶ Although shareholders have the power to adopt and amend the bylaws, so does the board of directors.

101. Put differently, one could view a bylaw as inconsistent with the statute unless it deals with a subject upon which a bylaw is expressly permitted.

102. Although Delaware adheres to the equal dignity doctrine, in which actions taken pursuant to various statute sections constitute acts of independent legal significance, *see* *Hariton v. Arco Electronics, Inc.*, 188 A.2d 123 (Del. 1963), at least one commentator has noted that the equal dignity rule may not be equally applicable to questions of shareholder power. *See* Larry E. Ribstein, *Takeover Defenses and the Corporate Contract*, 78 GEO. L.J. 71, 117 n.253 (1989) (“Rules limiting directors’ powers play a different role in the economic structure of the firm than do rules limiting the power of the majority of the shareholders.”).

103. *See* Hamermesh, *supra* note 78, at 444 (arguing that “as a matter of formal statutory construction, then, it is preferable to read section 141(a) as an absolute preclusion against by-law limits on director management authority, in the absence of explicit statutory authority for such limits outside of section 109(b)”).

104. The structure is similar to the federalist system imposed by the U.S. Constitution in which Congress has limited authority and all residual power remains with the states. *See generally* John Yoo, *The Judicial Safeguards of Federalism*, 70 S. CAL. L. REV. 1311, 1393 (1997) (“The Tenth Amendment states that ‘the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.’”).

105. *But see* Bebchuk, *supra* note 23 (arguing that the scope of subjects upon which shareholders can vote should be expanded).

106. *See* Hamermesh, *supra* note 78, at 417 n.27 (“This is thus an area in which the statutory default rule in states like Delaware, New York, and Oklahoma—denying the directors the power to adopt and amend by-laws—is sharply at odds with custom and practice.”).

As a result, even if the shareholders adopt a bylaw, their action may be overturned by the board.¹⁰⁷

The Delaware statute contains provisions that explicitly protect a shareholder-adopted bylaw from board repeal, but they are applicable only to a few substantive issues. For example, DGCL section 216 provides that a shareholder-adopted bylaw specifying the votes required for the election of directors “shall not be further amended or repealed by the board of directors.”¹⁰⁸ Absent language such as that found in section 216, it appears that the board of a Delaware corporation is free to amend or repeal a shareholder-adopted bylaw with which it disagrees.¹⁰⁹

In contrast, it is unclear under Delaware law whether shareholders can prevent the board from overturning a shareholder-adopted bylaw by including language to that effect in a proposed bylaw.¹¹⁰ Indeed, the Delaware Supreme Court stated in dictum that a shareholder-adopted bylaw that purported to be insulated from board override would be void, reasoning that the limitation was “in obvious conflict” with the directors’ “general authority to adopt or amend corporate by-laws.”¹¹¹ Relatedly, a Delaware court explicitly upheld a board’s decision to repeal a critical bylaw even though the shareholders were about to vote to reject the bylaw’s repeal.¹¹² The court reasoned that the shareholders had an appropriate remedy available in that they could call a special meeting, vote to reinstate the bylaw, and then remove the offending directors.¹¹³

Delaware law differs in this regard from the Model Business Corporation Act.¹¹⁴ The Model Act explicitly authorizes shareholders to insulate any shareholder-adopted bylaw from board override, providing that “[a] corporation’s board of directors may amend or repeal the corporation’s bylaws,

107. See *id.* at 416 (“Even if the stockholders could validly initiate and adopt a by-law limiting the authority of the directors, such a by-law amendment would accomplish little or nothing if the board of directors could simply repeal it after the stockholders adopted it.”).

108. DEL. CODE ANN. tit. 8, § 216 (2017).

109. Vice-Chancellor Jacobs explicitly referenced the board’s power as a limitation on the contractual approach in *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 492 (Del. Ch. 1995). As he explained: “[A]lthough the by-laws are a contract between the corporation and its stockholders, the contract was subject to the board’s power to amend the by-laws unilaterally.” *Id.*

110. See L. John Bird, Comment, *Stockholder and Corporate Board Bylaw Battles: Delaware Law and the Ability of a Corporate Board to Change or Overrule Stockholder Bylaw Amendments*, 11 U. PA. J. BUS. & EMP. L. 217, 219 (2008) (observing that the Delaware statute places “no express limits on the application of such director amendment authority to stockholder-adopted by-laws”); see also *In re Pennzoil Corp.*, SEC No-Action Letter, 1993 SEC No-Act LEXIS 304, at *1–2, 66 (Feb. 24, 1993) (approving, on other grounds, exclusion of a shareholder-proposed bylaw amendment that included language barring its repeal without shareholder approval).

111. *Centaur Partners, IV v. Nat’l Intergroup, Inc.*, 582 A.2d 923, 929 (Del. 1990). But see *Am. Int’l Rent-a-Car, Inc. v. Cross*, 1984 Del. Ch. LEXIS 413, at *9 (Del. Ch. May 9, 1984) (suggesting in dictum that shareholders could amend the bylaws and remove the board’s power to amend the applicable provision further).

112. *Am. Int’l Rent-a-Car, Inc.*, 1984 Del. Ch. LEXIS 413, at *9.

113. *Id.*

114. Bird, *supra* note 110, at 219.

unless . . . the shareholders in amending, repealing or adopting a bylaw expressly provide that the board of directors may not amend, repeal, or reinstate that bylaw.”¹¹⁵ As one commentator noted, Delaware could amend its statute to take a similar approach, thereby increasing (or explicitly acknowledging) shareholder power.¹¹⁶

On the other hand, a broadly construed board power to amend or repeal shareholder-adopted bylaws might provide a solution to the question of shareholder authority raised in *AFSCME*. To the extent that a board retains the authority to repeal a shareholder-adopted bylaw that would infringe on its managerial authority or cause it to violate its fiduciary duties, arguably that power alone should save the bylaw from the infirmity identified in *AFSCME*. At least at issuers for which the board has concurrent authority with the shareholders to amend the bylaws, the board’s power to do so would seem to imply that a shareholder-adopted bylaw could not infringe on board authority under section 141(a).

Then-Vice Chancellor Strine implicitly made this point in dictum in *General DataComm Industries v. Wisconsin Investment Board*.¹¹⁷ In considering whether a shareholder-proposed bylaw that prevented the board from repricing options without shareholder approval was valid under Delaware law, he observed that the board could repeal the offending bylaw at any time if it determined that it was necessary to do so.¹¹⁸ Accordingly, he suggested that a bylaw might not constrain board discretion in the same way as a poison pill that could not be redeemed by a new board majority, which the court had previously rejected.¹¹⁹

Boards can also block shareholder efforts to insulate a bylaw from board repeal by proactively adopting their own bylaw that does not preclude subsequent board amendment. Boards at a number of issuers have used this approach with respect to majority voting bylaws.¹²⁰ Currently, under the laws of

115. MODEL BUS. CORP. ACT § 10.20(b) (AM. BAR ASS’N 2010).

116. Bird, *supra* note 110, at 229 (observing that Delaware “could adopt the relevant provisions of the Model Business Corporation Act wholesale, giving shareholders the ability to adopt bylaws that cannot be further amended by the board when so stated within the bylaw”). Alternatively, Delaware could reinforce its director primacy position by explicitly granting the board the power to amend any shareholder-adopted bylaw. *See id.* (“[T]he legislature could amend existing statutes to give the board explicit power to amend or revoke shareholder adopted bylaw amendments.”).

117. *Gen. DataComm Indus., Inc. v. State of Wis. Inv. Bd.*, 731 A.2d 818, 821 (Del. Ch. 1999) (implying that the board had the power to repeal shareholder-adopted bylaws but noting that the law in this area was unsettled).

118. *Id.* at 821 (footnotes omitted) (“It may be that GDC is correct in stating that the Repricing Bylaw is obviously invalid under the teaching of *Quickturn*. But the question of whether a stockholder-approved bylaw that can potentially be repealed at any time by the GDC board of directors exercising its business judgment, *see* 8 Del. C. § 109(a), is clearly invalid under the teaching of a case involving a board-approved contractual rights plan precluding, by contract, a new board majority from redeeming the rights under the plan until six months after election seems to me to be a question worthy of careful consideration.”).

119. *Id.* (suggesting the possibility that the bylaw presented a situation that was distinguishable from that in *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998)).

120. Mary Siegel, *The Holes in Majority Voting*, 2011 COLUM. BUS. L. REV. 364, 374 (2011).

many states, including Delaware, a shareholder-adopted majority voting bylaw is insulated from board repeal.¹²¹ This restriction does not apply, however, to a board-adopted majority voting bylaw. As a result, boards can avoid the restriction on their power by adopting majority voting bylaws themselves.¹²² As one commentator noted, “In so doing, directors doubly benefit: they not only gain approval from shareholders who support majority voting, but the directors have also assured themselves the opportunity to repeal, unilaterally, their own bylaw.”¹²³

A related issue is whether shareholders indeed have the power to amend or repeal a board-adopted bylaw with which they disagree, as Strine suggested in *Boilermakers*.¹²⁴ The issue is potentially problematic to the extent that the board’s bylaw authority is broader than that of the shareholders, as suggested in *AFSCME*. If a board adopts a bylaw pursuant to its authority under section 141(a) that the shareholders could not have adopted on their own, it is not clear that the shareholders have the power to amend or repeal that bylaw. In other words, it is plausible that *AFSCME* sets analogous limits on both shareholder power to adopt bylaws and their power to amend or repeal board-adopted bylaws.¹²⁵ Although the Delaware courts have not had occasion to address this question, as corporations increase their efforts at private ordering and shareholders become more willing to challenge board-adopted governance measures, the issue is more likely to arise.¹²⁶

Shareholders, of course, have other ways of responding to an issuer’s governance provisions. In particular, shareholders can discipline boards directly by withholding support for directors or, if an issuer has majority voting, by removing directors who adopt objectionable bylaws. While these methods have been somewhat successful, they are not enough to close the existing gap between

121. See, e.g., DEL. CODE ANN. tit. 8, § 216 (2017) (“A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.”).

122. Siegel, *supra* note 120.

123. *Id.* at 374.

124. See *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 958 (Del. Ch. 2013) (observing that “stockholders retain the right to modify the corporation’s bylaws”). Notably, prior to the *Boilermakers* decision, shareholders at four issuers introduced non-binding proposals seeking to repeal a board-adopted forum selection bylaw. Claudia Allen, *Exclusive Forum Provisions: Putting on the Brakes*, CONF. BD. BLOG (Dec. 19, 2012), <http://tcbblogs.org/governance/2012/12/19/exclusive-forum-provisions-putting-on-the-brakes> [<https://perma.cc/HD4K-VDBQ>]. Only two of those proposals went to a vote, and neither received the support of a majority of the shareholders. The other two companies repealed their respective bylaws prior to a vote. *Id.*

125. Cf. *Invacare Corp. v. Healthdyne Techs, Inc.*, 968 F. Supp. 1578 (N.D. Ga. 1997) (holding that, under Georgia corporate law, shareholders could not adopt a bylaw to overturn the “dead-hand” provision of a poison pill because the law vested sole authority over the terms of a poison pill in the board of directors).

126. Relatedly, shareholders have actively sought to overturn corporate charter provisions establishing staggered boards, an endeavor aided by the Harvard Shareholder Rights Project. See Fisch, *supra* note 10, at 1647 (describing Shareholder Rights Project).

board and shareholder power. In addition, as will be discussed below, they are vulnerable to practical problems.¹²⁷

One of the most powerful options for shareholders is to withhold voting support from director candidates who adopt or fail to repeal an objectionable governance provision.¹²⁸ The effectiveness of this approach has been enhanced by the role of the major proxy advisory firms, ISS and Glass Lewis.¹²⁹ These firms have highlighted both unilateral board actions that reduce shareholder rights and board failures to respond to shareholder demands,¹³⁰ labeling them critical factors influencing their recommendations with respect to director elections.¹³¹ In response, shareholders take these recommendations very seriously.¹³² For example, one commentator reported that, of the various reasons for ISS issuing a negative recommendation with respect to a director candidate, a “lack of ‘responsiveness’” is “clearly the most impactful.”¹³³

A recent example demonstrates the potential effectiveness of shareholder power to withhold votes in director elections. In 2013, ISS published a policy position indicating its intention to recommend that shareholders withhold their votes from directors who had adopted a director compensation bylaw limiting a board candidate’s ability to receive compensation from a third party.¹³⁴ So-called “golden leash” bylaws were developed by the law firm Wachtell Lipton as a response to compensation arrangements between activist hedge funds and their

127. See *infra* Part II.C.

128. Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 660 (2009) (describing “withhold vote” campaigns by shareholders); Yonca Ertimur, Fabrizio Ferri & David Oesch, *Understanding Uncontested Director Elections*, MGMT. SCI. (forthcoming 2018) (providing empirical analysis of factors driving shareholders to withhold votes in uncontested elections).

129. See Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 868 (2010) (finding that while proxy advisors enhance shareholder voting power, their influence is often overstated).

130. See *e.g.*, WEIL, GOTSHAL & MANGES, HEADS UP FOR 2015 PROXY SEASON: TWO PROXY ADVISORY FIRM DEVELOPMENTS (2014), http://www.weil.com/~media/files/pdfs/pcag_alert_nov2014.pdf [<https://perma.cc/V8SF-6LC9>] (describing ISS and Glass Lewis policies, adopted in 2015, of generally issuing “negative vote recommendations against directors if the board amends the bylaws or charter without shareholder approval in a manner that materially diminishes shareholder rights or otherwise impedes shareholder ability to exercise their rights”); Ertimur et al, *supra* note 128, at 3 (reporting that of ISS board-level withhold recommendations, “72.2 percent are due to lack of responsiveness to shareholder proposals receiving a majority vote”).

131. See SULLIVAN & CROMWELL, 2015 PROXY SEASON REVIEW 19–21 (2015) (describing ISS’s practice of issuing withhold recommendations for unilateral board action and lack of responsiveness).

132. Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35 (2013).

133. SULLIVAN & CROMWELL, *supra* note 131, at 21.

134. CHRIS CERNICH ET AL., ISS, WHEELING OUT THE PROCRUSTEAN BED: BYLAW RESTRICTIONS ON DISSIDENT NOMINEE COMPENSATION 1 (2013).

director nominees.¹³⁵ Following ISS's announcement, directors at Provident Bank, the first issuer affected by the ISS position, received a withhold vote of approximately 34 percent, an extremely high level of withhold votes.¹³⁶ Within the next six months, twenty-eight of the thirty-two issuers that had adopted golden leash bylaws repealed them.¹³⁷ Notably, the threat of shareholder voting pressure was sufficient to cause the issuers in question to repeal their bylaws without the need for litigation challenging the bylaws' validity.

The impact of the shareholder vote on director elections has increased with the advent of majority voting. Under traditional plurality voting, it was not possible for shareholders to fail to elect a director candidate in an uncontested election. Under majority voting, a director candidate must receive a majority of votes cast, and a large against or withhold vote can require the director to tender his or her resignation.¹³⁸ Thus, majority voting theoretically gives real teeth to the shareholders' ability to vote on director elections.

Despite the fact that these tools exist and are increasing in importance, their practical effect is limited. At issuers with plurality voting, a high withhold vote remains symbolic and does not remove the director from the board. Even at the substantial number of issuers that have adopted majority voting, the number of directors who fail to receive a majority vote is very small and, of those, even fewer wind up losing their jobs.¹³⁹ Nor does it appear likely, given the high costs involved, that shareholders would mount a proxy contest for the purpose of removing or replacing directors who adopt a bylaw with which shareholders disagree.¹⁴⁰

More importantly, this tactic has limited utility because it is merely responsive to board authority and does not truly empower shareholders to participate actively in governance. Although shareholders can use their voting power in director elections to apply pressure with respect to board-adopted governance provisions, the ability to apply pressure in response to unwanted board actions is not the equivalent of consenting to those actions. Given the limitations above, the lack of sufficient mobilization in response to an

135. See Martin Lipton, *Bylaw Protection Against Dissident Director Conflict/Enrichment Schemes*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 10, 2013), <http://corpgov.law.harvard.edu/2013/05/10/bylaw-protection-against-dissident-director-conflictenrichment-schemes> [<https://perma.cc/7GFF-2TGA>] (proposing model golden leash bylaw).

136. Provident Fin. Holdings, Inc., Annual Meeting Results (Form 8-K) (Nov. 26, 2013), <https://www.sec.gov/Archives/edgar/data/1010470/000093905713000530/prov8kip112613.htm> [<https://perma.cc/LTE5-5BQ9>].

137. Cain et al., *supra* note 59, at 675–76.

138. See generally Choi et al., *supra* note 11 (describing majority voting).

139. *Id.* at 1122 (reporting that, between 2007 and 2013, only eight directors failed to receive a majority of “for” votes at issuers with majority voting and that, of those, only three left the board following the election).

140. See, e.g., STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 210 (2008) (noting that proxy contests are “enormously expensive”).

objectionable bylaw does not mean that shareholders have otherwise consented to its adoption.

Finally, in some states, there is an even greater power gap between boards and shareholders than in Delaware. *Boilermakers* is premised on the fact that, under Delaware law, shareholder authority to amend the bylaws cannot be eliminated.¹⁴¹ Not every state corporation statute is similar. In some states, a corporation can be structured so that directors have exclusive authority to amend the bylaws. In Texas, for example, a corporation may eliminate shareholder authority to amend the bylaws through an appropriate provision in its charter.¹⁴² In Maryland, a corporation can grant the power to the board, the shareholders, or both.¹⁴³ Indeed, following the *Fleming* decision, the Oklahoma legislature amended its corporation statute to provide as a default rule that only the board of directors has the power to amend or repeal the corporation's bylaws, although a corporation may voluntarily grant this power to the shareholders as well.¹⁴⁴ The Indiana statute is similar.¹⁴⁵

Even in states in which corporations cannot eliminate shareholders power to adopt or amend the bylaws, this power may be restricted to certain types of governance provisions. For example, although Delaware authorizes shareholders to amend the bylaws to adopt majority voting,¹⁴⁶ as of 2011, only nineteen states allowed shareholder-adopted majority voting bylaws without prior charter authorization or board approval.¹⁴⁷ In summary, to the extent that either state law or firm-specific provisions limit shareholders authority to adopt, amend, and repeal the bylaws in whole or in part, an essential predicate of *Boilermakers'* contractual approach is missing.

C. Practical Limits to Shareholder Power

In addition to legal limits on shareholder power to act through the adoption and amendment of the bylaws, shareholders also face practical limits on their power to implement changes to the bylaws. Indeed, as Strine has noted, the

141. Other courts have relied on the *Boilermakers* decision to apply a contractual approach to governance issues involving Delaware corporations. *See, e.g., In re CytRx Corp. Stockholder Derivative Litig.*, 2015 U.S. Dist. LEXIS 176966, *13 (C.D. Cal. Oct. 30, 2015) ("There is no question after *Boilermakers* that a forum-selection bylaw unilaterally adopted by a Delaware corporation's board of directors is facially valid under Delaware contract and corporate law."); *North v. McNamara*, 47 F. Supp. 3d 635, 642 (S.D. Ohio 2014) (same).

142. TEX. BUS. ORGS. CODE ANN. § 21.057(c) (West 2015) ("A corporation's board of directors may amend or repeal bylaws or adopt new bylaws unless: (1) the corporation's certificate of formation or this code wholly or partly reserves the power exclusively to the corporation's shareholders . . .").

143. MD. CODE ANN., BUS. REG. § 2-109(b) (West 2013).

144. OKLA. STAT. tit. 18, § 1013 (2015).

145. IND. CODE § 23-1-39-1 (2017) ("Unless the articles of incorporation or section 4 of this chapter provide otherwise, only a corporation's board of directors may amend or repeal the corporation's bylaws.").

146. DEL. CODE ANN. tit. 8, § 216 (2017).

147. Siegel, *supra* note 120, at 371–72.

“practical realities of stock market ownership have changed in ways that deprive most stockholders of both their right to voice and their right of exit.”¹⁴⁸ Strine and Walter have termed this a “separation of ownership from ownership.”¹⁴⁹ Many shareholders hold their stock through institutional intermediaries such as pension funds and mutual funds, in which the power to vote rests in the hands of the institutional agent. Moreover, there are reasons to believe that institutional investors’ voting preferences, which dominate the voting results, differ from those of retail investors.¹⁵⁰

The standard collective action problem poses another practical limit.¹⁵¹ An extensive literature observes that because shareholders of US public companies are dispersed, they face costs when they seek to act collectively, and they must typically bear those costs personally, unlike directors.¹⁵² The rise of shareholder activism and the impact of intermediaries such as ISS have dramatically reduced these costs.¹⁵³ In addition, activist hedge funds have taken on a role as governance intermediaries. Hedge funds can identify governance failures and then mobilize traditionally passive institutional investors to respond to those failures.¹⁵⁴ Nonetheless, governance issues are rarely of sufficiently high value to attract the interest of hedge fund activists. Rather, recent work supports the conclusion that hedge fund activism is focused largely on other areas, such as sale, capital structure, and corporate strategy.¹⁵⁵

148. Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and Citizens United*, 100 CORNELL L. REV. 335, 370 (2015).

149. *Id.* at 340 (quoting Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 6 (2007)).

150. See Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 51 (2017) (describing low voting turnout by retail investors and concern that retail shareholders have different voting preferences from institutional investors).

151. See, e.g., Kelli A. Alces, *The Equity Trustee*, 42 ARIZ. ST. L.J. 717, 722–35 (2010) (describing the collective action problem among shareholders).

152. See, e.g., Bainbridge, *supra* note 78, at 613 (“Collective action problems preclude the shareholders from exercising meaningful day-to-day or even year-to-year control over managerial decisions.”); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 312 (1999) (“[S]hareholders still face collective action problems [making it] always extremely difficult, and often impossible, for shareholders to use their rights to vote on fundamental changes to oppose a transaction or policy the board favors.”); Stephen Choi & Jill E. Fisch, *How To Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 271 (2003) (“[S]hareholder collective action is rare, even though it may benefit shareholders as a group.”).

153. See Cain et al., *supra* note 59 (using the golden leash as an example of an intermediary acting to reduce collective action costs); *supra* notes 129–133 and accompanying text (discussing proxy advisors).

154. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 862, 897 (2013) (describing activists as “arbitraging governance rights that become more valuable through their activity monitoring companies to identify strategic opportunities and then presenting them to institutional investors for their approval”).

155. C.N.V. Krishnan, Frank Partnoy & Randall Thomas, *The Second Wave of Hedge Fund Activism: The Importance of Reputation, Clout, and Expertise*, 40 J. CORP. FIN. 296 (2016).

In addition, supermajority voting requirements at specific issuers may heighten the collective action problem by raising the threshold required to amend or repeal a board-adopted bylaw.¹⁵⁶ Delaware law allows a corporation to require “a supermajority vote for adopting any subsequent bylaw amendment.”¹⁵⁷ It is common for corporations to adopt supermajority voting requirements for some or all shareholder actions.¹⁵⁸ IPO charters increasingly contain supermajority provisions—88 percent of IPO charters in 2015 contained supermajority provisions.¹⁵⁹ Although the incidence of these requirements has declined in S&P 500 companies, approximately 30 percent retained a supermajority requirement in 2013.¹⁶⁰ Notably, if an issuer’s charter contains a supermajority requirement, that requirement can only be repealed by that same supermajority.¹⁶¹

156. See, e.g., Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1348 (2013) (“[C]harters commonly contain provisions that deter shareholders from amending bylaws—for instance, with supermajority vote requirements.”).

157. Stephen M. Gill, Kai Haakon, E. Liekefett & Leonard Wood, *Structural Defenses to Shareholder Activism*, 47 REV. SEC. & COMMODITIES REG. 151, 155 (2014); see DEL. CODE ANN. tit. 8, § 102(b)(4) (2017) (authorizing charter provision to require the vote “of a larger portion of the stock . . . than is required by this chapter”); *Id.* § 216 (authorizing corporations to specify the required vote for shareholder action and providing that, in the absence of a specific provision, the required threshold is “the majority of shares present in person or represented by proxy”). Other state statutes are similar. See, e.g., Scott Hirst, *Frozen Charters*, 34 YALE J. REG. 91, 100 (2017) (“Each state permits a corporation to require a greater vote requirement . . . in order to approve an amendment to important parts of the charter.”).

158. Hirst, *supra* note 157, at 125 n.127 (reporting that, in author’s sample of Russell 3000 companies, “[41.9 percent had] supermajority provisions to amend one or more provisions of their bylaws”).

159. See WILMERHALE, 2016 M&A REPORT 4 (2016), https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/2016-WilmerHale-MA-Report.pdf [<https://perma.cc/L9GM-Z54N>]. The reported data included only Delaware corporations and included those containing supermajority requirements “to approve mergers or change corporate charter and bylaws.” *Id.*

160. See Gill et al., *supra* note 157, at 156 n.37 (noting that this number reflects a decline from 67.62 percent in 2003). The number of issuers with supermajority requirements continues to decline, however, as shareholder proposals asking issuers to repeal supermajority requirements have been fairly common in recent years. See, e.g., Holly Gregory, *Hot Topics for the 2016 Proxy Season*, PRACTICAL LAW, Oct. 2015, at 30, 33–34, http://www.sidley.com/~media/publications/oct15_governancecounselor.pdf [<https://perma.cc/2H8Z-FNL7>] (identifying “elimination or reduction of supermajority vote requirements” as one of the types of shareholder proposals receiving the highest average level of shareholder support in 2015 and observing that “[e]limination of supermajority provisions to amend by-laws” was likely to “continue to be a focus of 2016 shareholder proposals”).

161. DEL. CODE ANN. tit. 8, § 242(b)(4) (2017) (“Whenever the certificate of incorporation shall require for action . . . by the holders of any class or series of shares or by the members, or by the holders of any other securities having voting power the vote of a greater number or proportion than is required by any section of this title, the provision of the certificate of incorporation requiring such greater vote shall not be altered, amended, or repealed except by such greater vote.”); see also Illumina Inc., SEC No-Action Letter, 2016 SEC No-Act. LEXIS 245 (Mar. 18, 2016), <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/mcritchieyoung031816-14a8.pdf> [<https://perma.cc/A9N7-ZZ8H>] (upholding Illumina’s effort to exclude shareholder proposal seeking to repeal majority voting requirement on the basis that the proposal conflicted with the board’s proposal to retain the supermajority requirement).

Although shareholders can, in theory, obtain the necessary votes to adopt or amend a bylaw even in a corporation with a supermajority voting requirement, such a requirement heightens the collective action problem. As Scott Hirst has documented, voter turnout varies substantially among issuers.¹⁶² Many issuers regularly experience turnout levels that are below the supermajority thresholds.¹⁶³ The problem of insufficient voter turnout has been exacerbated by the virtual elimination of discretionary voting by brokers.¹⁶⁴

The impact of supermajority requirements is exacerbated by the standard vote-counting methodology.¹⁶⁵ According to a recent study, more than half of large public companies count abstentions with respect to shareholder proposals as “no” votes.¹⁶⁶ Because a shareholder-initiated bylaw amendment must necessarily take the form of a shareholder proposal, this methodology has the effect of allowing issuers to treat some shareholder proposals as failing even if they receive a majority of votes cast.¹⁶⁷ The study found sixty-three shareholder-sponsored proposals between 2004 and 2014 that issuers identified as failing but that would have passed under a so-called “simple majority” formula.¹⁶⁸ A responsive shareholder initiative has been to file resolutions seeking to have issuers shift to the simple majority approach that would eliminate abstentions from the vote count.¹⁶⁹

162. Hirst, *supra* note 157.

163. *See id.* at 102 (documenting that, in Russell 3000 companies in 2013, “almost 50% of meetings had turnout below 80% of shares outstanding”).

164. Historically, according to NYSE and Nasdaq rules, brokers were able to exercise voting power for shares they held as custodians if the beneficial owners did not submit voting instructions. Changes to those rules have greatly reduced that power and resulted in an increased number of shares not being voted. *See* Fisch, *supra* note 150, at 26–27 (describing amendments to NYSE and Nasdaq rules reducing the scope of issues on which brokers can exercise discretionary voting authority with respect to uninstructed shares).

165. This methodology may not be consistent with the applicable statutes in all states. *See, e.g.*, Abbott Labs., SEC No-Action Letter, 2016 SEC No-Act. LEXIS 79, at *10–20 (Jan. 29, 2016), <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/kennethsteinerabbott012916-14a8.pdf> [<https://perma.cc/2G4H-3VSL>] (SEC inquiry from Abbott Labs., Inc., arguing that a simple majority approach was invalid under Ill. Bus. Corp. Act Section 7.60, which provides that shareholder action requires the affirmative vote of a majority of the shares represented at the meeting and entitled to vote on a matter). The language of the Delaware statute is similar to that of the Illinois statute. *See* DEL. CODE ANN. tit. 8, § 216(2) (2017) (“In all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders.”).

166. *See* INVESTOR VOICE, SIMPLE-MAJORITY STANDARD FOR USE IN CORPORATE PROXIES (2015), http://www.investorvoice.net/wp-content/uploads/2015/03/Vote-Counting_Synopsis_Version-9e_2015.0315.pdf [<https://perma.cc/AUS8-34FR>] (describing simple majority formula).

167. Bruce Herbert, *Simple Majority Vote Counting Initiative for Proxies*, CORP. GOVERNANCE (Mar. 19, 2015), <http://www.corpgov.net/2015/03/simple-majority-vote-counting-initiative-for-proxies> [<https://perma.cc/ZCR2-VH4D>].

168. INVESTOR VOICE, *supra* note 166, at 2.

169. Gregory J. Millman, *Why Shareholder Proposals Win More Votes, Lose Anyway*, WALL ST. J. (Mar. 20, 2015, 10:32 AM), http://blogs.wsj.com/riskandcompliance/2015/03/20/why-shareholder-proposals-win-more-votes-lose-anyway/?mod=WSJ_hps_sections_riskcompliance [<https://perma.cc/92YB-YTMZ>]. To date these proposals have received limited shareholder support.

A final practical impediment to shareholder power is the SEC's gatekeeping role. Shareholder resolutions seeking to amend the bylaws are typically, albeit not inevitably, presented to the issuer in the form of Rule 14a-8 shareholder proposals.¹⁷⁰ It is commonplace for issuers to seek SEC approval to exclude from the proxy statement shareholder proposals that they do not support.¹⁷¹ One basis for excluding a shareholder proposal is if that proposal, if implemented, would cause the issuer to violate state law.¹⁷² This leaves the SEC staff in the awkward position of attempting to determine the scope of shareholder bylaw authority despite the fact that, as noted above in Part II.A, Delaware law is somewhat unclear on the issue.¹⁷³

Delaware amended its constitution in 2007 to permit the SEC to certify questions regarding Delaware corporate law to the state supreme court.¹⁷⁴ Although the SEC used the certification procedure in *AFSCME*,¹⁷⁵ it is not required to do so, and the Delaware Supreme Court is not required to accept the SEC's request for a ruling.¹⁷⁶ As a result, the SEC staff is repeatedly called upon to determine whether a shareholder-proposed bylaw is permissible, with only the submissions of the proponent and the issuer to guide it in making that

See, e.g., Shirley Westcott, 2016 Proxy Season Review, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 11, 2016), <https://corpgov.law.harvard.edu/2016/08/11/2016-proxy-season-review-2> [<https://perma.cc/QP2X-7V27>] (“[T]he eight resolutions that came to a vote averaged only single-digit (7.9%) support.”).

170. *See* Donna Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921, 938 (1998) (discussing no-action letters relating to shareholder proposals under Rule 14a-8). A shareholder may mount an independent proxy solicitation seeking to amend the bylaws, but, given the costs of such a solicitation, shareholders are unlikely to do so outside of the control context. *Cf. Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1187 (Del. 2010) (describing Air Product's proposal of three bylaw amendments in conjunction with a proxy contest “[a]s part of its takeover strategy”).

171. 17 C.F.R. § 240.14a-8(j) (2017) (designating required procedures for issuer seeking to exclude a shareholder proposal); *see* Alan Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 886–92 (1994) (explaining the no-action process).

172. 17 C.F.R. § 240.14a-8(j)(2) (2017).

173. *See* John C. Coffee, Jr., *Bylaw Barricades: Unions and Shareholder Rights*, N.Y.L.J., Mar. 1997, at 31 (observing that, in *International Brotherhood of Teamsters General Fund v. Fleming Companies*, 1997 U.S. Dist. LEXIS 2980 (W.D. Okla. Jan. 24, 1997), “the district court read SEC Rule 14a-8 very differently than the SEC has read that rule on shareholder proposals in recent years and determined that a mandatory bylaw amendment was a proper subject under state law”).

174. DEL. CONST. art. IV, § 11(8), *amended by* 76 Del. Laws 2007, ch. 37, § 1 (effective May 3, 2007).

175. *See* *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 229 n.1 (Del. 2008)); *see also* No-Action Request, *supra* note 69, at 3 (arguing that a proxy reimbursement proposal should be excluded under Rule 14a-8(i)(2)).

176. *See, e.g.,* Junis L. Baldon, Note, *Taking a Backseat: How Delaware Can Alter the Role of the SEC in Evaluating Shareholder Proposals*, 4 OHIO ST. BUS. L.J. 101, 121–22 (2009) (“The opportunity still exists for the SEC to go astray and continue to issue pronouncement [*sic*] of state law with minimal state guidance.”).

determination.¹⁷⁷ Although a full analysis of the staff's approach to this question is beyond the scope of this Article,¹⁷⁸ it is clear that the procedure has the practical effect of preventing many proposed bylaws from being presented to the shareholders.¹⁷⁹

III.

SOLUTIONS TO RENDER THE CONTRACTUAL MODEL MORE WORKABLE

The foregoing discussion demonstrates that the shareholder power to act through the adoption, amendment, and repeal of the bylaws is, for a variety of reasons, less expansive than board power. As a result, the level of judicial deference reflected in *Boilermakers* and *ATP*—deference that is based on the contractual theory—may be inappropriate. In particular, board-adopted governance provisions may not merit limited oversight because their adoption does not adhere to contractual principles, as discussed above. If shareholders lack the power to block or overturn provisions with which they disagree, the courts should not presume that shareholders have consented to these provisions.

Two alternative solutions are possible. One approach is to remediate the failure of existing law to conform with the contractual metaphor by increasing shareholder power. If shareholder authority to adopt, amend, and repeal corporate bylaws were commensurate with board authority, the corporate bylaws would more closely resemble the theoretical contract envisioned in *Boilermakers*. Shareholder empowerment, however, raises normative concerns and creates tension with the board-centric model of Delaware corporate law.

177. An issuer seeking exclusion under this provision is required to submit a supporting opinion from counsel. 17 C.F.R. § 240.14a-8(j)(2)(iii) (2017).

178. For a more detailed analysis and an argument that the SEC should adopt a policy of refusing to exclude shareholder proposals on the basis that they violate state law, see Christopher Bruner, *Managing Corporate Federalism: The Least-Bad Approach to the Shareholder Bylaw Debate*, 36 DEL. J. CORP. L. 1, 43 (2011).

179. The Wall Street Journal reported that, during the 2017 proxy season, issuers submitted 288 requests to exclude a shareholder proposal, and the SEC staff granted 78 percent of such requests. Tatyana Shumsky, *SEC Lets More Companies Ignore Shareholder Proposals in 2017*, WALL ST. J. (July 7, 2017) <https://www.wsj.com/articles/sec-lets-more-companies-ignore-shareholder-proposals-in-2017-1499447145> [<https://perma.cc/E8DQ-4PUR>]. See, e.g., Scott's Liquid Gold Inc., SEC No-Action Letter, 2013 SEC No-Act LEXIS 383, at *1, 4 (May 7, 2013), <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/michaeldeutschrecon050713-14a8.pdf> [<https://perma.cc/B6LY-5MFT>] (allowing exclusion of a proposal on the basis that it impermissibly limited the board's authority by mandating specified disclosures); Pfizer Inc., SEC No-Action Letter, 2012 SEC No-Act LEXIS 161, at *1 (Feb. 22, 2012), <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/donaldvuchetich022212-14a8.pdf> [<https://perma.cc/H9RY-C6WN>] (allowing exclusion of proposed dispute resolution bylaw); Vail Resorts, Inc., SEC No-Action Letter, 2011 SEC No-Act LEXIS 492, at *1 (Sep. 16, 2011), <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/jeffreydoppel091611-14a8.pdf> [<https://perma.cc/5QTY-KXT4>] (approving exclusion of stockholder proposal to amend the bylaws to "make distributions to stockholders a higher priority than debt repayment or asset acquisition"); Monsanto Co., SEC No-Action Letter, 2008 SEC No-Act LEXIS 746 (Nov. 7, 2008), <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2008/harringtoninvestments121808-14a8.pdf> [<https://perma.cc/TQ6Y-G4D9>] (concurring with exclusion of stockholder proposal to amend the bylaws to require directors to take an oath of allegiance to the U.S. Constitution).

Accordingly, an alternative approach would be for courts to recognize the limits of the contract analogy and to scrutinize board-adopted bylaws more closely. This Article draws upon the Delaware Supreme Court's *Unocal* decision¹⁸⁰ to develop a framework for enhanced judicial scrutiny of such bylaws.

A. Invigorating the Corporate Contract Through Increased Shareholder Empowerment

Strine is undoubtedly correct in observing that the courts have little reason to interfere with governance terms that are freely adopted by the corporation's participants. Private ordering is consistent with Delaware's enabling approach to corporate law, as well as the widely held expectation that market discipline will lead issuers to adopt governance terms that are value-enhancing.¹⁸¹ Private ordering offers market participants the opportunity to overcome informational issues that limit regulators' ability to identify optimal governance structures. It also offers firms individualized tailoring that enables them to vary their governance structures to reflect firm-specific characteristics.¹⁸² The problem with private ordering under Delaware corporate law is that the board's control over governance terms is far greater than that of the shareholders, and the board, acting alone, may fail to select optimal governance structures for a variety of reasons.¹⁸³

One possible solution is to modify Delaware law to level the playing field, granting shareholders greater authority to engage in private ordering. The Delaware legislature could choose to do so by reducing or eliminating the limitations on shareholder power to adopt and amend the bylaws described in this Article. It could, for example, amend the corporate statute, either broadly to endorse shareholder power or more narrowly to remove specific existing obstacles to the exercise of that power. Taking the broad approach, the legislature could reconcile the existing tension between sections 109 and 141(a) by providing that, notwithstanding section 141(a), shareholders have the power to adopt any bylaw, substantive or procedural, relating to the business and affairs

180. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

181. See, e.g., Barry Baysinger & Henry Butler, *Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law*, 10 J. CORP. L. 431, 446–49 (1985) (characterizing this position as that of the “corporate federalists”).

182. See Daniel M. Gallagher, *Commissioner Gallagher Discusses Federal Preemption of State Corporate Governance*, CLS BLUE SKY BLOG (Apr. 7, 2014) <http://clsbluesky.law.columbia.edu/2014/04/07/commissioner-gallagher-discusses-federal-preemption-of-state-corporate-governance> [https://perma.cc/FE9Y-3YVG] (describing the Dodd-Frank Act's federalization of corporate governance as a “one-size-fits-none model”); see also David F. Larcker & Allan L. McCall, *Proxy Advisers Don't Help Shareholders*, WALL ST. J. (Dec. 8 2013, 6:51 PM) <https://www.wsj.com/articles/proxy-advisers-don8217t-help-shareholdersproxy-advisers-don8217t-help-shareholders-1386530835> [https://perma.cc/7S28-JME6] (terming proxy advisor's one-size-fits-all governance practices “best guesses”).

183. See Michal Barzuza, *Do Heterogeneous Firms Select Their Right “Size” of Corporate Governance Arrangements?* (Va. L. & Econ. Research Working Paper No. 16, 2016) (arguing that agency problems interfere with firms' selection of efficient governance provisions).

of the corporation.¹⁸⁴ Such a provision would make clear that both parties to the corporate contract—the shareholders and the board—have equal power to choose the contract terms. Alternatively, the legislature could amend the corporation statute to mirror the LLC and limited partnership statutes, which explicitly give maximum effect to freedom of contract. A more tailored approach could address the relative authority of the board and the shareholders with respect to a particular bylaw about which they disagree. For example, the legislature might amend the statute to provide explicit authority for the shareholders to amend or repeal a board-adopted bylaw by simple majority vote. Similarly, the statute could follow the Model Business Corporations Act approach discussed above and preclude the board from amending or repealing a shareholder-adopted bylaw.

Statutory changes such as those outlined above would add useful clarity to the issue of shareholders' bylaw power, but legislative action is not necessary. The Delaware courts created the existing tension between sections 109 and 141(a), and they have the power to reread the statute to eliminate that tension. The Delaware courts are famous for their incremental and context-specific approach to corporate law,¹⁸⁵ and for their sensitivity to market and institutional developments that warrant a reconsideration of their prior precedents.¹⁸⁶ As noted above, the *AFSCME* decision's narrow approach to shareholder bylaw power might be ripe for such reconsideration considering recent developments in the exercise of shareholder power. Investor activism has increased, including the growing use by institutional investors of shareholder proposals to introduce bylaw amendments relating to governance structures. Such amendments include the implementation of majority voting and proxy access. These changes should prompt the court to reconsider shareholder power to adopt and amend bylaws.¹⁸⁷

The question of whether to increase shareholder power in this way to support a contractual approach to evaluating the validity of corporate bylaws raises important normative considerations, however. In particular, whether

184. See *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 234 (Del. 2008) (noting that the existing statutory language is “only marginally helpful in determining what the Delaware legislature intended to be the lawful scope of the shareholders’ power to adopt, amend and repeal bylaws”).

185. See, e.g., Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1079 (2000) (noting the Delaware courts’ willingness to reconsider their prior precedents rather than adhering to strong principles of stare decisis).

186. See, e.g., *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015); *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016); see also Fisch, *supra* note 185, at 1079.

187. Although the Delaware courts rarely overrule corporate law precedents directly, the case law reflects a variety of areas in which the courts have announced a new approach that reflects a substantial departure from that taken in previous cases. See, e.g., *Corwin*, 125 A.3d at 311 (imposing limits on the scope of the court’s prior decisions in *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009), *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986)); *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (clarifying that the “obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty,” despite the court’s prior articulation of a duty of good faith in *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006)).

Delaware law should be modified to increase shareholder power is controversial. On the one hand, greater shareholder power can enable shareholders to monitor management more effectively. Some commentators further view shareholder power as an inherent right of stock ownership. For example, Lucian Bebchuk proposed that corporate law grant shareholders the authority to “initiate and adopt any rules-of-the-game decisions.”¹⁸⁸ Bebchuk would go so far as to enable shareholders to initiate charter amendments and reincorporation decisions.¹⁸⁹ His view, consistent with the analysis in the preceding Part of this Article, is that existing law precludes shareholders from adopting value-increasing governance arrangements that management disfavors.¹⁹⁰

Similarly, Gordon Smith, Matthew Wright, and Marcus Kai Hintze have broadly defended the value of private ordering and argued in favor of changes to the Delaware statute, case law, and Rule 14a-8 that would “enhance the ability of shareholders in public corporations to contract with shareholder bylaws.”¹⁹¹ Brett McDonnell observed that expansive shareholder bylaw power can be justified by the fact that the bylaws are the main source for shareholder initiatives to shape corporate governance without board approval.¹⁹² Accordingly, he proposed four statutory changes designed to increase shareholder power.¹⁹³

However, there are reasons to be cautious about this response. Although shareholder empowerment may provide benefits to the corporation, it also has its costs. Bill Bratton and Michael Wachter articulated one of the more powerful positions against shareholder empowerment, arguing that it is likely to cause managers to manage to the market—problematic because it creates an incentive for excessive risk-taking.¹⁹⁴ Greater shareholder empowerment is also in tension with the board-centric model of the corporation.¹⁹⁵ Stephen Bainbridge challenged Bebchuk’s argument for greater shareholder power by identifying a variety of efficiency benefits that result from the separation of ownership and control.¹⁹⁶ Commentators have also warned that shareholder empowerment

188. Bebchuk, *supra* note 23, at 865; *see also id.* at 871 (proposing to “empower shareholders in public corporations by facilitating their ability to contract”).

189. *Id.* at 913.

190. *Id.* at 845–46.

191. Smith et al., *supra* note 31, at 188.

192. McDonnell, *supra* note 91, at 656.

193. *Id.* at 665. McDonnell’s suggestions included codifying the substance/procedure distinction, providing that shareholder-adopted bylaws may limit board discretion, explicitly authorizing shareholders to adopt bylaws dealing with poison pills, and providing that the board cannot amend a shareholder bylaw. *Id.*

194. Bratton & Wachter, *supra* note 23, at 657–61.

195. Stephen Bainbridge is best known for arguing that shareholders’ interests are best served by empowering the board of directors as a strong central authority, a model he termed “Director Primacy.” Bainbridge, *supra* note 78, at 557–59.

196. Stephen M. Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1735 (2006). Board primacy can also be justified for a number of pragmatic reasons. For example, as Jeff Gordon has observed, increased shareholder power may be misused due to the “risks of pathologies in shareholder voting and because

creates a risk of self-dealing or interest group behavior because shareholders, unlike directors, do not usually owe fiduciary duties to the corporation and their fellow shareholders.¹⁹⁷ Finally, to the extent that contractual freedom is value-enhancing, business participants can obtain that freedom by selecting alternative business forms such as the LLC. By retaining the managerial approach in corporate law, Delaware thus offers businesses a range of structural options.

The preceding arguments offer reasons to be cautious about embracing shareholder empowerment in order to justify application of the contractual approach. Although it is beyond the scope of this Article to assess the relative costs and benefits of increased shareholder empowerment, Delaware need not level the contractual playing field. The courts could instead reduce their reliance on the contractual model and impose greater scrutiny on board-adopted bylaws. The next Section considers that alternative.

B. The Alternative: Increased Judicial Oversight

Because leveling the playing field with respect to corporate bylaws would increase shareholder empowerment, those favoring director primacy are likely to reject that approach. If Delaware law continues to limit the scope of shareholder bylaw authority, the alternative is for courts to engage in greater judicial oversight of board-adopted governance terms.

Increased judicial oversight of board-adopted governance bylaws could be workable. Indeed, existing case law offers a model that could readily be extended to the New Governance: the analytical approach developed in the *Unocal* case.¹⁹⁸ In *Unocal*, the Delaware Supreme Court announced a new framework requiring courts to apply enhanced scrutiny when reviewing board-adopted antitakeover devices. The test involves a two-part inquiry encompassing both reasonableness and proportionality.¹⁹⁹ First, the “directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness exist[s]

of the chance that shareholders could use such initiative power to extract private gains.” Jeffrey N. Gordon, “Just Say Never?” *Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett*, 19 CARDOZO L. REV. 511, 547 (1997).

197. See, e.g., Frederick H. Alexander & James D. Honaker, *Power to the Franchise or the Fiduciaries?: An Analysis of the Limits on Stockholder Activist Bylaws*, 33 DEL. J. CORP. L. 749, 755 (2008) (“[S]tockholders cannot use their statutory power to adopt bylaws to make management decisions: because stockholders do not owe fiduciary duties to the other stockholders.”); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564 (2006) (“[S]hareholders . . . may use any incremental power conferred upon them to pursue those interests to the detriment of shareholders as a class.”).

198. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

199. See *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1374 (Del. 1995) (describing “*Unocal*’s reasonableness and proportionality review”).

...²⁰⁰ Second, the board's response must be "reasonable in relation to the threat posed."²⁰¹

The same enhanced scrutiny, which might be understood as an intermediate-level review, can be applied to the board's unilateral adoption²⁰² of a governance provision that materially diminishes shareholder rights.²⁰³ First, the court would consider whether the board reasonably believed that the provision was necessary to address a threat to the corporation. Second, the court would determine whether the provision was a proportional response to that threat. If the governance provision meets these standards, the court would uphold its adoption.

In evaluating the nature of the threat, the courts should consider the subject matter of the bylaw with two principles in mind. First, in keeping with the rationale for director primacy, the courts should more readily accept actions designed to protect the board's discretion with respect to decisions that are "so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight."²⁰⁴ The case for shareholder authority is less compelling with respect to management's basic business choices.²⁰⁵ Second, the courts should be mindful that the right of shareholders to elect directors freely is a fundamental basis for the legitimacy of director primacy.²⁰⁶ Accordingly, bylaws that materially interfere with that election power require greater justification.

A few examples demonstrate the application of this intermediate-level scrutiny to common types of board-adopted bylaws and illustrate how this

200. *Unocal*, 493 A.2d at 955.

201. *Id.* The *Unocal* court identified a third factor that "the directors may not have acted solely or primarily out of a desire to perpetuate themselves in office." *Id.* This factor has played a more limited role in subsequent analysis of *Unocal*. See, e.g., *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987) (concluding that the third factor was satisfied where "[t]he Newmont board acted to maintain the company's independence and not merely to preserve its own control").

202. The approach advocated by this Article applies specifically to unilateral board action. This Article does not take a position on whether this level of judicial oversight is necessary or appropriate for provisions that are subject to shareholder approval, such as a charter amendment or shareholder-ratified bylaw.

203. This language is taken from the policy positions of the proxy advisory firms, ISS and Glass Lewis, which have adopted such a standard in deciding whether to recommend against the election of a director candidate. See WEIL, GOTSHAL & MANGES, HEADS UP FOR THE 2016 PROXY SEASON: ISS AND GLASS LEWIS UPDATE THEIR VOTING POLICIES (2015), <https://www.weil.com/~media/files/pdfs/revised-pcag-alert-112315.pdf> [<https://perma.cc/8NHW-LYA9>]; Ellen Odoner & Lyuba Goltser, *ISS and Glass Lewis Updated 2016 Voting Policies*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Dec. 2, 2015), <https://corpgov.law.harvard.edu/2015/12/02/iss-and-glass-lewis-updated-2016-voting-policies> [<https://perma.cc/ZJZ9-4LSS>] (describing updates to ISS and Glass Lewis policies).

204. Amendments to Rules on Shareholder Proposals, SEC Release No. 23200, 1998 WL 254809, at *4 (May 21, 1998).

205. *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 348 (3d Cir. 2015) (finding that management, rather than shareholders, are best positioned to determine which products to sell—a basic business choice).

206. See *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.").

approach focuses on existing power dynamics more effectively than contractual analysis. The first example is forum selection bylaws such as the bylaw at issue in the *Boilermakers* case. Boards have adopted forum selection bylaws in response to the growth of shareholder litigation, particularly M&A litigation.²⁰⁷ Forum selection bylaws seek to limit the need for a corporation to defend itself against lawsuits in multiple courts based on a single transaction.²⁰⁸

Because the vast majority of forum selection bylaws are adopted unilaterally and not subjected to a shareholder vote,²⁰⁹ intermediate-level review should apply. Courts should analyze a board's adoption of a forum selection bylaw under a *Unocal*-type approach as follows. First, the increase in M&A litigation generally and multi-forum litigation in particular should qualify as a sufficient threat to corporate value. Commentators have noted the costs of defending against litigation in multiple forums as well as the risk of conflicting judgments and reverse auctions by plaintiffs' counsel.²¹⁰ In addition, boards manage litigation and litigation risk as a core function of their duties.²¹¹ Second, Delaware courts should treat adoption of a forum selection bylaw as a proportionate response to the threat. Such bylaws address the problems associated with multi-forum litigation without drastically reducing shareholders' litigation rights.

Fee-shifting bylaws might be analyzed differently. Although the problem of meritless litigation closely tracks the concern over multi-forum litigation, a board's determination that shareholders too frequently file suits that do not discipline corporate management or vindicate shareholder rights is more questionable.²¹² Nonetheless, the frequency with which mergers are challenged through litigation coupled with the infrequency with which this litigation results

207. See Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465 (2015) (detailing the rise in merger litigation); Fisch, *supra* note 10 (describing litigation bylaws as a response to that rise).

208. Joseph Grundfest was one of the first to suggest this approach. See Joseph Grundfest, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches* (Stanford Univ. Rock Ctr. for Corp. Governance Working Paper, Paper No. 91, 2010), <http://ssrn.com/abstract=1690561>.

209. See Romano & Sanga, *supra* note 56, at 27, 31 (reporting that, in the sample studied, "[o]nly 12 percent of midstream adoptions were put to a shareholder vote").

210. See, e.g., U.S. CHAMBER INST. FOR LEGAL REFORM, ECONOMIC CONSEQUENCES: THE REAL COSTS OF U.S. SECURITIES CLASS ACTION LITIGATION 1, 3 (2014), http://www.instituteforlegalreform.com/uploads/sites/1/EconomicConsequences_Web.pdf [<https://perma.cc/BKG7-YCV8>] (describing the costs of shareholder suits).

211. See, e.g., Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 522 (1989) (observing that "no principled distinction can be drawn between a board's decisions relating to corporate litigation generally and those relating to other business matters").

212. This is especially true because a substantial percentage of shareholder litigation involves challenges to director conduct or oversight. See, e.g., Erica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story about the "Genius of American Corporate Law,"* 63 EMORY L.J. 1383, 1395 (2014) (arguing that the information revealed through discovery in shareholder litigation "disciplines management").

in a monetary recovery for the plaintiff class has led many to conclude that a substantial percentage of lawsuits are without merit.²¹³ A reviewing court could therefore conclude that the potential for excessive and frivolous litigation constitutes a threat.

Whether a fee-shifting bylaw such as that seen in *ATP* represents a reasonable response to that threat is, however, doubtful. As critics have observed, the specific bylaw in *ATP* would likely discourage both “good” and “bad” lawsuits from being brought.²¹⁴ On the other hand, fee-shifting bylaws need not be as broad as the bylaw adopted by the *ATP* board. Rather, a board could narrowly tailor a fee-shifting bylaw so that it discouraged frivolous litigation while allowing meritorious suits to proceed.²¹⁵ More rigorous judicial scrutiny would thus bring a more nuanced approach to the validity of fee-shifting bylaws than either the broad acceptance of the *ATP* decision or the Delaware legislature’s subsequent rejection of all charter and bylaw provisions that impose liability on a shareholder in connection with the litigation of an internal corporate claim.²¹⁶

A third example is advance notice bylaws, which require shareholders to provide the issuer with advance notice of their intent to nominate a director candidate, and to disclose various pieces of information relating to that nomination. Advance notice bylaws are almost ubiquitous among public issuers.²¹⁷ The Delaware courts have observed that “[a]dvance notice requirements are ‘commonplace’ and ‘are often construed and frequently upheld as valid by Delaware courts.’”²¹⁸ The scope of advance notice bylaws varies tremendously, however, both with respect to the amount of advance notice

213. See Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 559–560 (2015) (summarizing this debate); DEL. STATE BAR COUNCIL, EXPLANATION OF COUNCIL LEGISLATIVE PROPOSAL 3 (2015) <http://www.corporatedefensedisputes.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.pdf> [https://perma.cc/T2N4-5K8F] (observing that “[s]ome officers and directors and their advocates assert, on the other hand, that stockholder litigation causes corporations expense without producing commensurate benefits”).

214. See, e.g., Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 30 (2015) (terming such a bylaw “extreme” because it “[takes] no account of the merits of the underlying claim”); DEL. STATE BAR COUNCIL, *supra* note 213, at 3, 6 (arguing that fee-shifting bylaws like the one in *ATP* would make shareholder litigation “untenable” and “eliminate the only extant regulation of substantive corporate law”).

215. See, e.g., Albert H. Choi, *Fee-Shifting and Shareholder Litigation* (Va. Law & Econ. Research Working Paper No. 15, 2016) (developing a model for optimal fee-shifting bylaws, including heightened judicial oversight).

216. DEL. CODE ANN. tit. 8, § 115 (2016).

217. See Romano & Sanga, *supra* note 56.

218. *Goggin v. Vermillion, Inc.*, No. 6465-VCN, 2011 WL 2347704, at *4 (Del. Ch. June 3, 2011) (quoting *Openwave Sys., Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, 924 A.2d 228, 238–39 (Del. Ch. 2007)).

required and the extent of mandated disclosure.²¹⁹ Commentators have characterized the courts' approach to advance notice bylaws as "[j]udicial [s]chizophrenia."²²⁰ In particular, the effort to determine when the requirements of a specific bylaw excessively burden shareholders' voting rights appears somewhat unprincipled.²²¹

The test proposed in this Article would add clarity. Issuers defend advance notice bylaws on the basis that they allow shareholders sufficient time and information to vote intelligently.²²² A bylaw providing a notice period and required information that is reasonably related to these objectives should survive judicial scrutiny.²²³ To the extent that an advance notice bylaw has the effect of precluding shareholders from exercising their voting rights, however, this test would provide the court with a basis for invalidating it as disproportionate to those goals.²²⁴

A similar intermediate-level scrutiny could be applied to other board-adopted bylaws that limit the effectiveness of shareholders' voting rights. This analysis would clarify the scope of the board's authority.²²⁵ For example, in the recent *Frechter v. Zier* decision, the board adopted a bylaw requiring a two-thirds shareholder vote to remove a director.²²⁶ The court held that the bylaw was invalid because it conflicted with section 141(k).²²⁷ The decision is in tension,

219. See, e.g., Elina Khasina, Note, *Disclosure of "Beneficial Ownership" of Synthetic Positions in Takeover Campaigns*, 2009 COLUM. BUS. L. REV. 904 (2009) (proposing that issuers adopt an advance notice bylaw that requires shareholders to disclose their ownership of derivative securities).

220. Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485, 570 (1994).

221. See, e.g., Morgan N. Neuwirth, *Shareholder Franchise—No Compromise: Why the Delaware Courts Must Proscribe All Managerial Interference with Corporate Voting*, 145 U. PA. L. REV. 423, 467 (1996) (describing *Stroud v. Grace*, 606 A.2d 75 (Del. 1992), a case involving the validity of an advance notice bylaw, as "[o]ne of the more confusing cases in recent Delaware law").

222. See *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 728 A.2d 25, 41 (Del. Ch. 1998) (upholding bylaw on the basis that "the 90 to 100 day delay interval chosen by the Quickturn board is reasonable in relation to th[e] purpose . . . [of giving] the shareholders a reasonable opportunity to inform themselves about the issues presented").

223. See *id.* at 40–43 (concluding that the specific bylaw at issue was a reasonable response to the identified concerns); *In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 482 (Del. Ch. 2000) (stating that a sixty-day advance notice bylaw "merely lengthens the electoral contest in a way that appears to strike a reasonable balance between the electorate's need to hear out all participants in the debate and the acquiror's need for an adequate opportunity to line up a slate before the meeting"). But see *Chesapeake Corp. v. Shore*, 771 A.2d 293, 319 (Del. Ch. 2000) (applying the "compelling justification" standard to strike down a board-adopted supermajority bylaw, where the board's "primary purpose" was to impair stockholders).

224. See, e.g., Fisch, *supra* note 10, at 1655–56 (describing bylaws adopted by Allergan board as unduly restrictive of shareholder voting rights).

225. See, e.g., J.W. Verret, *Defending Against Shareholder Proxy Access: Delaware's Future Reviewing Company Defenses in the Era of Dodd-Frank*, 36 J. CORP. LAW 391, 404–06 (2011) (discussing potential board adoption of director qualification bylaws or bylaws that limit the powers of dissident-nominated directors to defend shareholders' rights).

226. *Frechter v. Zier*, No. 12038-VCG, 2017 Del. Ch. LEXIS 214 (Del. Ch. Jan. 24, 2017).

227. As the court noted, section 141(k) is subject to two exceptions—for corporations that have classified boards and those that have cumulative voting. *Id.* at *5 n.20. Neither exception was applicable

however, with section 216, which seems explicitly to authorize supermajority bylaws,²²⁸ as well as earlier cases that have not viewed such bylaws as invalid.²²⁹ Rather than relying on the statute, the court's analysis could have focused on the board's rationale for the bylaw and the extent to which a supermajority requirement, in the context of the specific corporation, materially limited shareholders' voting rights. The court should have recognized that a supermajority requirement does not, by itself, prevent shareholders from achieving their desired outcome.

Finally, the same rationale can be applied to provide a more principled analysis of the shareholder-adopted bylaw in *AFSCME*. Because of the critical importance of the shareholders' right to elect directors, in addition to subjecting board efforts to interfere with that right to careful scrutiny, courts should view shareholder power to adopt bylaws that focus on the election and structure of the board more expansively. The touchstone for the validity of such bylaws should be the subject matter—the election process—rather than whether the bylaws are properly characterized as substantive or procedural.

This approach appears to be consistent with legislative intent as reflected in the Delaware statutory amendment subsequent to the *AFSCME* decision, which explicitly authorized shareholders to adopt bylaws implementing proxy access²³⁰ and authorized reimbursement of proxy contest expenses.²³¹ The same principle should be applied to similar shareholder-adopted bylaws that address the power of the shareholders to nominate, elect, and remove members of the board, rather than requiring explicit statutory authorization for each. Notably, however, the analysis suggested in this Part does not interfere with the fundamental role of the board in overseeing the operation of the corporation and is therefore less intrusive than the shareholder empowerment approach discussed in the preceding Section of this Part.

CONCLUSION

The contractual approach to corporate law—which has been widely defended in legal scholarship for more than twenty-five years—has received

in *Frechter*. The court further noted that its decision was limited to the validity of a supermajority bylaw, observing that section 102(b)(4) of the statute provides that a certificate of incorporation may require “for any corporate action . . . a larger portion of the stock . . . than is required by this chapter.” *Id.* at *5 n.19 (citing DEL. CODE ANN. tit. 8, § 102(b)(4) (2017)).

228. See DEL. CODE ANN. tit. 8, § 216 (2017) (“Subject to this chapter in respect of the vote that shall be required for a specified action, the certificate of incorporation or bylaws of any corporation authorized to issue stock may specify . . . the votes that shall be necessary for, the transaction of any business . . .”).

229. See, e.g., *Chesapeake Corp. v. Shore*, 771 A.2d 293 (Del. Ch. 2000) (rejecting board-adopted supermajority bylaw based on the board's purpose for adopting it).

230. DEL. CODE ANN. tit. 8, § 112 (2017).

231. *Id.* § 113 (2017).

strong judicial support in two recent Delaware decisions.²³² The courts' expansive endorsement of freedom of contract in these cases opens the door to broad-based experimentation and implementation of New Governance provisions tailored to issuer-specific needs. The Delaware courts have explicitly relied on contractual principles to justify broad deference to this experimentation.

At the same time, these decisions may stretch the contract analogy too far. In particular, several aspects of existing law limit the ability of shareholders to participate on an equal footing with boards in the private ordering process. This asymmetry undermines the justification for the broad judicial deference. In the absence of true shareholder power to limit the board's adoption of unwanted governance provisions, the courts' characterization of New Governance provisions in terms of contract is overstated.

One possible solution is for the courts or the legislature to overturn existing limits on shareholder power so as to warrant reliance on the contractual analogy. Although this approach may be desirable, increased shareholder empowerment raises a number of potential concerns. Courts could instead rethink the existing level of deference given to board-adopted governance provisions and subject those provisions to greater judicial scrutiny. Intermediate-level scrutiny would allow courts to play a meaningful role in preventing boards from adopting bylaws that excessively interfere with shareholder rights. The need for courts to exercise such scrutiny responds to the reality that the corporation is not truly a contract, and shareholders, due to existing legal and practical obstacles, cannot protect themselves effectively.

232. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014); *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

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