

## Shareholder Rights and the DGCL

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The past and current designers of the Delaware General Corporation Law (DGCL) have much to celebrate. The DGCL directly governs the majority of publicly traded companies in the United States, and it has had considerable influence on the design of the other corporate codes of states that govern the remainder of U.S. public companies. The importance of the DGCL gives its designers correspondingly important responsibility. Because of the DGCL's dominant role, improving it can produce substantial benefits for investors and the economy.

One major area for potential improvement concerns shareholder rights. Shareholders in publicly traded U.S. companies have much weaker rights than shareholders in the United Kingdom or other common-law countries such as Canada and Australia. The United Kingdom provides an especially useful comparison point because, like the United States, it has a large, developed stock market dominated by companies with dispersed ownership. In its recent report, the bipartisan Committee on Capital Market Regulation stressed that the relative weakness of shareholder rights “creates an important potential competitive problem for the U.S.” A reform of the DGCL could contribute substantially to closing the gap.

I have put forward detailed and comprehensive proposals for strengthening shareholder rights in three recent articles.<sup>1</sup> Here, I will briefly sketch the changes that would be worth making in connection with shareholders' critical power to replace directors.

In *Blasius*, Chancellor Allen famously stated that “[t]he shareholder franchise is the ideological underpinning upon



which the legitimacy of directorial power rests.” The shareholder franchise is a key mechanism for establishing board accountability under Delaware law. As I analyze in my academic work, however, the arrangements established by the DGCL are less hospitable for director replacement by shareholders than the arrangements in the United Kingdom and other common-law countries.

To begin, unlike corresponding laws in the United Kingdom, the DGCL makes possible corporate arrangements that do not ever provide shareholders with the ability to replace a majority

of the directors in one vote. An empirical study I co-authored with Alma Cohen indicates that staggered boards, which the DGCL allows and many Delaware firms have, have a negative and economically meaningful correlation with firm value.

Second, the corporate law codes of the United Kingdom and other common-law countries grant shareholders with a sufficient stake the right to place director candidates on the corporate ballot. The DGCL fails to grant this right. It should be amended to provide such a right.

Third, facing a growing recognition that director elections should be governed by a majority voting standard, the DGCL was recently amended to facilitate the adoption of bylaws establishing such a standard. Although this is a beneficial change, the best approach would be for the DGCL to establish majority voting as the default arrangement.

Fourth, the DGCL should facilitate shareholder-adopted election bylaws. Directors should not have an excessive role in setting the rules of the game governing their own election. At a

minimum, directors should not be allowed to repeal or amend shareholder-adopted election bylaws. The DGCL's recent amendments preclude the board from doing so with respect to shareholder-adopted bylaws establishing majority voting. The logic underlying this new provision clearly warrants extending it to other election bylaws established by shareholders.

Finally, the corporate codes of the United Kingdom and other common-law countries grant shareholders with a sufficient stake the power to place proposals for changes in corporate arrangements, such as those governing corporate elections, on the corporate ballot. The DGCL should also provide such a right. To be sure, shareholders of Delaware companies can amend company bylaws to grant shareholders



rights to place candidates and proposals on the ballot. But the DGCL would do well to provide such rights as the default arrangement.

In his *Disney* decision, Chancellor Chandler emphasizes that the redress for management failures "must come from the markets, through

the action of shareholders and the free flow of capital, and not from this court." For shareholders to be well-positioned to take the actions that are sometimes necessary for improving corporate value and performance, the DGCL should grant shareholders some of the rights that investors in other developed stock markets have. Strengthening shareholder rights in the DGCL is an important task that awaits the designers of this important code after they rightly celebrate this significant

anniversary. ♦

#### FOOTNOTE

1. *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006); *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 676 (2007).

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