

# Management Always Wins the Close Ones

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## **Abstract:**

Much has been made of the shareholder franchise as a lever of corporate governance, but there is little empirical evidence about the efficacy of voting. This paper empirically examines votes on management sponsored resolutions. Per stock exchange rules, many executive compensation plans must be approved by shareholders. The paper finds stunning irregularities in the distribution of votes received by management. Management is overwhelmingly more likely to win these votes by a small margin than to lose by a small margin. This success is likely due to several factors, including management's ability to spend corporate funds on campaigning and management's superior access to information about voting outcomes. "Vote buying" and selective vote counting also may explain the results, though there is no direct evidence of such behavior. All of these explanations suggest that the value of voting on management sponsored resolutions is severely adulterated. There also may be widespread breaches of fiduciary duty in close votes on management sponsored resolutions. The paper identifies several policy changes, such as funding for opponents of management sponsored resolutions receiving a certain amount of support, and changes in the regulation (or lack thereof) of shareholder voting, to restore the value and integrity of shareholder voting.

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# I. Introduction

Voting is a “fundamental shareholder right.”<sup>1</sup> Consequently, the Delaware Chancery has articulated a standard of review for actions concerning shareholder votes that is more stringent than the business judgment rule.<sup>2</sup> Many scholars also insist that shareholder voting is essential for maximizing the value of a corporation.<sup>3</sup> The benefits of shareholder voting can only be realized if elections accurately reflect the preferences of shareholders.<sup>4</sup> If managers can disproportionately sway close elections, then the shareholder franchise is less than it’s cracked up to be.

This paper demonstrates that shareholder voting on proposals almost certainly does not reflect shareholder preferences. Instead, voting outcomes are tilted in favor of management. If voting was not tilted, then we would expect a smooth distribution of voting outcomes; voter opinion on different issues will be different, and election outcomes should reflect this variation.

Actual voting results, however, show stark discontinuities. Management sponsored proposals (the vast majority of which concern the approval of stock options or other bonus plans<sup>5</sup>) are *overwhelmingly more likely to win a corporate vote by a very small amount than to lose by a small amount*-- to a degree that cannot occur by chance. (see Figure 1) For example, management exceeded its necessary vote requirement by less than 1% almost fifty separate times in the dataset, while management missed the vote requirement by less than 1% only 5 times. Such a distribution should occur by chance less than 1 in ten trillion times. These results indicate strong management influence on corporate voting of some form or another. Moreover, the results are not simply due to

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<sup>1</sup> In re Gaylord Container Corp. Shareholders Litigation, 747 A.2d 71, 81 (Del.Ch. 1999).

<sup>2</sup> Blasius Indus. v. Atlas Corp., 564 A.2d 651, 659, 669 (Del. Ch. 1988).

<sup>3</sup> See, e.g., Frank H. Easterbrook & Daniel R. Fischel, “Voting in Corporate Law,” 26 J. L. & Econ. 395 (1983); Sanford Grossman & Oliver Hart, “One Share One Vote and the Market for Corporate Control,” 20 J. Fin. Econ. 175 (1988); Lucian Bebchuk, “Efficient and Inefficient Sales of Corporate Control,” 109 Q. J. Econ. 957 (1994); Bernard Black & Henry T.C. Hu, “The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership,” 79 U.S.C. L. Rev. 811 (2006).

<sup>4</sup> Scholars and courts have made similar comments about democratic elections, critiquing a “frustration of the will of the voters.” Davis v. Bandemer, 478 U.S. 109, 133 (1986). For a detailed analysis, see Samuel Issacharoff, Gerrymandering And Political Cartels, 116 Harv. L. Rev. 593, 601-612 (2002)

<sup>5</sup> Approval of stock compensation plans is required by NYSE and NASDAQ rules. See SEC Release No. 34-48108, available at <http://www.sec.gov/rules/sro/34-48108.htm>. For more detail on these rules, see Section II below.

quorum requirements and shareholder indifference. Management enjoys these stunningly high rates of victory in elections even where the number of votes against the management sponsored proposal is extremely high.

Management chooses what issues to put forth to shareholders, so it is no surprise that management should win more often than it loses. But management almost always submits a definitive proxy at least 30 days before the vote is cast,<sup>6</sup> and it is extremely improbable that management can predict voting outcomes precisely so far in advance—many large shareholders refuse to inform management about their intended vote direction, and many votes are received in the final day or days<sup>7</sup>-- so selection of votes likely to win does not explain the discontinuity occurring at 50%.

The most likely explanation for these results is that management takes advantage of overwhelming advantages in close elections. Management can expend corporate funds on campaigning, while opponents must dip into their own pockets. In addition, management typically garners much of the benefit from the passage of the most common proposal (related to stock option plans), while shareholder opponents suffer from free rider problems—if the plan is inefficient, the gains of rejecting it must be shared with all shareholders. In total, management can therefore outspend opponents on advantages such as proxy soliciting companies, which can identify voters most likely to vote in a certain way and attempt to find the necessary votes. As one industry observer put it, management and proxy firms “beat the bushes” until they get the right outcome.<sup>8</sup> If heavy campaigning alone is not enough, management may revert to extraordinary measures. In the hotly contested Hewlett Packard purchase of Compaq, for example, shareholders accused HP management of threatening to withdraw investment banking business from Deutsche Bank if Deutsche Bank Asset Management did not follow HP management’s recommendation on the merger vote.<sup>9</sup>

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<sup>6</sup> A definitive proxy must be submitted before it is mailed and most legal advisers insist on mailing at least 30 days before the meeting. See Planning And Conducting The Annual Shareholders' Meeting, 1579 PLI/Corp 739, 767 (2006). The new e-proxy SEC regulations require proxy materials to be available online 40 days before the meeting. See “SEC Votes to Adopt E-Proxy Rule Amendments and Propose Mandatory Model,” at <http://www.sec.gov/news/press/2006/2006-209.htm>.

<sup>7</sup> Interview with John Wilcox, November 30, 2006.

<sup>8</sup> Interview with John Wilcox, November 30, 2006.

<sup>9</sup> *Hewlett v. Hewlett Packard*, CIV.A. 19513-NC. (Del. Ch. 2002).

These advantages explain why management might win close votes more often than they lose with a degree of precision better than simply choosing which votes to put in front of shareholders, but it cannot explain why management is so good at it—management and proxy firms should miscalculate at least occasionally. In order for management to win as often as it does, management and proxy solicitors must have extraordinarily good information about the number of votes that will be cast for and against management. Because votes can be counted as they arrive rather than after the final ballot is cast, such information is easier to obtain. Moreover, management oversight over the ballot counting procedure, such as whether to count improperly filled out proxies, may in some cases allow enough “play in the joints” to raise the probability of management victory in exceedingly close votes.

Management’s ability to dominate close votes raises several legal and economic concerns. Disproportionately swaying close votes may be a breach of fiduciary duty.<sup>10</sup> In *SWIB*, the management of the Peerless corporation adjourned a close vote on the issuance of new stock related to an executive stock option plan when it appeared that the proposal was about to lose. Management then campaigned over the adjournment period by contacting shareholders likely to vote management’s way, and subsequently won the vote. In a shareholder suit, the Delaware Chancery held that this action “frustrated the shareholder franchise” and held that it was a breach of management’s fiduciary duty absent compelling justification.<sup>11</sup> Management’s ability to disproportionately win close votes clearly frustrates the shareholder franchise in some cases in a way similar to the *SWIB* case, and therefore may be a violation of fiduciary duties.

Management’s extremely high success rate in close votes also suggests the existence of some inefficiencies. Shareholder voting is seen as an efficient means of aggregating shareholder preferences and engendering efficient decisions.<sup>12</sup> If the voting outcome does not reflect underlying shareholder preferences—which will be the case if management has greater ability to drum up votes in close elections than dissident shareholders do—then the efficiency of shareholder voting is undermined.

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<sup>10</sup> State of Wisconsin Investment Board (“SWIB”) v. Peerless Systems Corp., 2000 WL 1805376 (Del. Ch. 2000).

<sup>11</sup> *Id.*

<sup>12</sup> See Zohar Goshen, “Voting (Sincerely) in Corporate Law,” *Theoretical Inquiries in Law* (2004); Nitzan & Procaccia, Optimal Voting Procedures for Profit Maximizing Firms, 51 PUBLIC CHOICE 191 (1986).

Several policy recommendations follow from this analysis. First, disproportionate outcomes are a function of disproportionate ability to influence votes. Corporate law should change to level the playing field. If shareholders fighting a management sponsored resolution can demonstrate a certain amount of support, then they should receive corporate money to hire their own proxy solicitation firm.<sup>13</sup> By ensuring that both sides of contested issue can identify undecided shareholders, this will help ensure that voting outcomes are more likely to reflect underlying shareholder preferences.

Second, the ability to count ballots as they come in confers an unnecessary advantage to management. Ballots should remain uncounted until after the election has ended. If shareholders know that management can always find just enough votes to win, then the shareholders will have no incentive to campaign against a proposal that they view as inefficient. By ensuring that management cannot always find just enough votes, delaying vote counting will encourage shareholders to campaign against proposals that they view as inefficient.

A third proposal is to increase regulation of the voting process. Certain critical players in the voting process, such as Automatic Data Processing's (ADP) Investor Services Unit, which tabulates many shareholder votes on management sponsored resolutions, are completely unregulated. Moreover, there is no way for many institutional investors to confirm that their vote was cast as instructed. Greater regulation to remedy these flaws is warranted, especially considering the irregularities found in the voting outcomes data.

This paper is organized as follows. Section II examines the legal and economic salience of shareholder voting in greater detail. Section III describes the complex mechanics of shareholder voting. Section IV presents summary statistics, while Section V presents the data revealing that management wins a disproportionate number of close votes. Section VI examines several potential explanations for these results in light of the data. Section VII proposes several policy interventions and concludes.

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<sup>13</sup> For a similar proposal and data analysis of directorial elections, see Lucian Bebchuk, "The Myth of the Shareholder Franchise," *Va. L. Rev.* 1. (2007) (forthcoming).

## II. Why Voting is Important and Legal Restrictions on Vote Manipulation

Shareholder voting “plays a central role in the theory of corporate governance and capital structure.”<sup>14</sup> In their seminal article on corporate voting, Easterbrook and Fischel observe that corporate arrangements are inevitably incompletely specified.<sup>15</sup> Voting serves to fill in the details of these arrangements. Easterbrook and Fischel assert that “as residual claimants the shareholders are the group with the appropriate incentives ... to make discretionary decisions.”<sup>16</sup>

Subsequent scholarly efforts have highlighted the value of majority voting for aggregating the preferences of disparate shareholders. Some make a statistical argument in favor of majority voting. If we assume that all shareholders want to maximize the value of their shares and that each shareholder receives a noisy signal about the desirability of a given decision, then the decision favored by a majority of shareholders is likely to be the most efficient one.<sup>17</sup> Others argue that a majority vote is efficient from a Kaldor-Hicks perspective. If a particular decision benefits more shareholders than it hurts (and thereby garners the vote of a majority of shareholders), then it is likely to create value on a net, Kaldor-Hicks basis.<sup>18</sup>

Considerable reliance has been placed on voting in the area of executive compensation. For the entire period of the data sample below, both the NYSE and the NASDAQ required listed companies to obtain approval for many executive compensation stock plans.<sup>19</sup> The NYSE explained the rationale for the rule as follows:

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<sup>14</sup> Black & Hu, *supra* note 3, at 811.

<sup>15</sup> Easterbrook & Fischel, *supra* note 3, at 401-02.

<sup>16</sup> *Id.* at 403.

<sup>17</sup> See Zohar Goshen, “Voting (Sincerely) in Corporate Law,” *2 Theoretical Inquiries in Law* (2004). Goshen defines sincere voting as voting “in accordance with [each shareholders’] personal belief regarding the value of the transaction to the corporation as a whole.” *Id.* at 1.

<sup>18</sup> See Ronald Gilson & Bernard Black, *The Law and Finance of Corporate Acquisitions* 643-44 (1995).

<sup>19</sup> See Edward Rayner, *Hot Issues In Executive Compensation In Mergers And Acquisitions-Options, Management Buyouts, And Retention Arrangements*, 503 PLI/TAX 839, \*857 (2001) for a discussion of the shareholder approval requirements of NYSE Listed Company Manual ¶312.03 & NASD Manual Rule 4350(i)(1) before these rules were amended in 2003.

Equity-compensation plans can help align shareholder and management interests, and equity-based awards have become very important components of employee compensation. In order to provide checks and balances on the process of earmarking shares to be used for equity-based awards, and to provide shareholders a voice regarding the resulting dilution, the Exchange requires that all equity-compensation plans, and any material revisions to the terms of such plans, be subject to stockholder approval.<sup>20</sup>

After the wave of corporate scandals in the early 2000s, the NYSE and NASDAQ reaffirmed their belief in the efficacy of voting as a check on management power by further limiting the types of executive compensation plans that did not require shareholder approval.<sup>21</sup> Again, the implication was that shareholder approval provides an important check and balance on CEO compensation.

The central role played by corporate voting in enhancing efficiency depends upon the sincerity and accuracy of the vote. Allowing deviations from one-share one-vote, for example, engenders bad decision making and may enable the wrong parties to gain control of a corporation.<sup>22</sup> Similarly, strategic voting, voting by shareholders with a conflict of interest, or vote buying can undermine the benefit of voting.<sup>23</sup> Put simply, if voters do not vote sincerely and do not follow the signal they receive about whether a particular decision is a good one, then the decision that gains the majority of shareholder votes no longer enjoys the presumption of being the better decision from a statistical or Kaldor-Hicks perspective.

Not surprisingly, considerable scholarly and judicial effort has been devoted to insuring that corporate voting occurs sincerely and legitimately. For example, the Delaware Chancery Court has announced a “general policy against disenfranchisement.”<sup>24</sup> If a plaintiff establishes that a board acted “with the primary

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<sup>20</sup> NYSE Commentary on Rule 303(A)(8), available at [http://www.sec.gov/rules/sro/34-46620.htm#P29\\_5453](http://www.sec.gov/rules/sro/34-46620.htm#P29_5453) (2002).

<sup>21</sup> See SEC Release No. 34-48108, at II.H, available at <http://www.sec.gov/rules/sro/34-48108.htm>.

<sup>22</sup> See, e.g., the articles in note 3, *supra*.

<sup>23</sup> See Black & Hu, *supra* note 3; Goshen, *supra* note 12.

<sup>24</sup> *Blasius Industries, Inc. v. Atlas Corp.* 564 A.2d 651, 669 (Del.Ch.1988).

purpose of interfering the effectiveness of a stockholder vote,”<sup>25</sup> then the board must meet the “heavy burden of demonstrating a compelling justification for such action.”<sup>26</sup> In a 2000 case applying this standard, the Delaware Chancery ruled that the adjournment of a vote that the board was on the brink of losing, followed by actions to selectively inform only shareholders likely to vote for management about the adjournment, constituted an action with the primary purpose of impeding the exercise of the shareholder franchise.<sup>27</sup>

Similarly, courts treat vote buying—the purchase of a share’s voting power in exchange for consideration personal to the shareholder-- extremely warily. In Delaware, vote-buying that acts to disenfranchise other shareholders is prohibited.<sup>28</sup> In a widely publicized recent case, Hewlett Packard shareholders sued the company concerning the hotly contested approval of HP’s merger with Compaq. The shareholders alleged that the corporation effectively “bought” the vote of shares held by Deutsche Bank by threatening to withhold future investment banking opportunities from Deutsche Bank if Deutsche Bank voted against the merger. While the court ultimately did not find sufficient evidence for such a quid pro quo, it left no doubt that trading votes for investment banking business was improper.<sup>29</sup>

Indeed, scholars are so convinced of the inefficiency of insincere voting that they have recently turned their attention to a less egregious phenomenon called “empty voting.” In empty voting, shareholders’ economic interest is imperfectly aligned with their voting interest, for example if a shareholder’s economic interest is partially hedged. Recent papers assert that even empty voting should be strongly discouraged or ruled illegal.

While there is considerable agreement in both the judiciary and the academy that corporate vote manipulation is bad, there is little evidence about its existence. Indeed, even the mechanics of the corporate voting process are little understood. The next section provides a brief summary of this process.

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<sup>25</sup> Id. at 559.

<sup>26</sup> Id. at 661.

<sup>27</sup> See *SWIB*, supra note 10.

<sup>28</sup> *Schreiber v. Carney* 447 A.2d 17, 26 (Del.Ch. 1982).

<sup>29</sup> *Hewlett v. Hewlett-Packard Co.* 2002 WL 818091, \*2 (Del.Ch. 2002).

### III. The Mechanics of Voting on Management Sponsored Proposals

Conducting a vote on a management sponsored resolution, such as one mandated by the NYSE and NASDAQ rules on stock option plans, is not a straightforward task. Most beneficial owners of a company are not registered owners.<sup>30</sup> Instead, the registered owner is typically the Depository Trust Corporation (DTC), which owns shares under the name of “Cede & Co.”<sup>31</sup> In turn, the DTC holds stock in accounts for its “participants”, which include large banks and brokerage firms. Beneficial owners typically arrange for the purchase of shares through these participants. Thus, there are at least two levels of intermediaries (the DTC and the brokerage or bank) between the beneficial owner and the corporation. This structure facilitates record keeping and clearing and minimizes the transaction costs of exchanging stocks.<sup>32</sup>

The structure complicates the process of allowing beneficial owners to vote their shares, however. When management wants to alter a stock option plan, it will typically attempt to canvass the beneficial shareholders, often by hiring a proxy solicitation firm, before submitting the proposal. Management cannot obtain a precise measure of the likely vote outcome at this stage, but it can get a sense of whether there is significant opposition to a proposal.<sup>33</sup> If management gets the sense that it cannot win the proposal, it will often withdraw or alter the proposal.<sup>34</sup> If management is confident it will win or strongly desires the proposal in spite of significant beneficial owner opposition, it will typically submit a definitive proxy proposal 30 days before an actual vote.

Of course, the registered owner of most of the corporation’s shares is the DTC. When a proxy proposal comes to the DTC, it delegates its voting rights by submitting an omnibus proxy for all of its shares in a single corporation to its participant banks and brokerages. The banks and brokerages are then in charge of ensuring that the interests of

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<sup>30</sup> See John C. Wilcox & John J. Purcell III, “Street Name” Registration & The Proxy Solicitation Process” in *A Practical Guide To Sec Proxy And Compensation Rules* at 1 (2004).

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> Interview with John Wilcox, *supra* note 7.

<sup>34</sup> Interview with Eric Roiter, October 2006.

the beneficial owners are followed. Frequently, the banks and brokerages hire ADP's Investor Communication Division to administer the process of distributing the proxy materials and tabulating the beneficial owner's votes. ADP tabulates all the votes it receives and gives a running count of the vote totals, broken down by bank or brokerage rather than by beneficial owner, to the tabulator, who is an agent of management.<sup>35</sup> The votes typically come in two waves, one when the proxy materials are sent out and another very shortly before the last voting day (at the annual meeting).<sup>36</sup>

Several points about this procedure are worth mentioning. First, management can easily obtain a running count of the voting results from its agent—the tabulator. Shareholders will have a more difficult time getting a running count. Second, at the time of the vote management does not know exactly who has voted and how they have voted because the votes are reported to the tabulator broken out by bank or brokerage, rather than by shareholder.<sup>37</sup> While some institutional investors will inform management about the direction of their vote, others will not. Third, note that some of the critical players in the voting process, such as ADP Investor Services, are outside the reach of the securities laws.

## IV. Data and Summary Statistics

The Investor Responsibility Research Center (IRRC) collected data on corporate votes on shareholder proposals sponsored by management or other parties from 1997 through 2004.<sup>38</sup> The collected votes occurred in over 2700 different companies, including all companies in the Fortune 500 and S&P 500. The dataset includes 16,099 management sponsored proposals and 2,795 shareholder sponsored proposals. From 1997 to 2000, there were approximately 2,500 votes on management sponsored resolutions per year. This number dropped each year between 2001-2004. In 2004, there are only 1,170 votes

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<sup>35</sup> *Id.*; Interview with John Wilcox, *supra* note 8.

<sup>36</sup> Conversation with John Wilcox, *supra* note 8.

<sup>37</sup> Current reporting requirements for mutual funds allow managers of corporations to learn the way a mutual fund voted at a later date. Therefore, management does ultimately learn how a mutual fund voted.

<sup>38</sup> For 1991-1996 and 2005, the IRRC collected data on shareholder proposals, but not management-sponsored proposals. When analyzing the shareholder proposal data, I will frequently include the management sponsored proposal data from these years.

on management sponsored resolutions. This decrease may reflect the fact that it was more difficult for management to get resolutions passed in the post-Enron, post internet-bubble environment.

The most common management sponsored proposals (see Table I) concerned stock option plans for executives and directors. Proposals to adopt or amend stock incentive plans for management or directors constituted 8,056 of the 16,099 (50%) of the management-sponsored proposals. Other common management sponsored proposals were proposals to increase the amount of authorized common stock (1,870 proposals, 11.6% of the sample)<sup>39</sup>, adopt or extend an employee stock purchase plan (1,299 proposals, 8.1% of the sample), approve a merger or acquisition (954 proposals, 5.9% of the sample), and approve long-term or annual bonus plans (936 proposals, 5.8% of the sample).

Different issues must meet different voting thresholds for approval. For example, Delaware corporate default law requires a majority of shares outstanding for a charter amendment or sale of assets to pass,<sup>40</sup> but a majority of votes cast for other issues.<sup>41</sup> Some companies change the default law to require two-thirds or even 80% supermajorities for a proposal to pass. Companies also divide in their treatment of abstaining votes. Some count abstentions as votes against, while others do not.

Many of the votes on management sponsored resolutions in the sample, including votes on stock issuance for executives, occur because they are mandated by the listing requirements of the NYSE or NASDAQ. For the purpose of maintaining a listing, management-sponsored resolutions pass on the basis of a majority of votes cast rule.<sup>42</sup>

Pursuant to state default rules and stock exchange listing requirements, more than three quarters of the proposals in the data (12,329 out of 16,049) used the number of ballots cast or shares present as the voting population.<sup>43</sup> Of these 12,329, approximately

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<sup>39</sup> Such proposals are often related to stock incentive plans. See SWIB, *supra* note 10.

<sup>40</sup> See DGCL § 242(b)(1) (charter amendments); DGCL § 251(c) (mergers); DGCL § 271(a) (asset sales).

<sup>41</sup> This is the default rule in Delaware for matters such as votes on executive compensation plans. See DGCL § 216(2).

<sup>42</sup> See, e.g., DGCL § 216(2); NYSE Listing Company Manual § 312.07 (stating that “the minimum vote which will constitute shareholder approval for listing purposes is defined as approval by a majority of votes cast on a proposal in a proxy bearing on the particular matter”). The NYSE also imposes a quorum requirement. *Id.*

<sup>43</sup> Note that the voting requirement variable is partially missing for numerous votes. (The exact requirement is missing, but the dataset includes a variable indicating whether the vote population is the number of

99% required some form of simple majority of ballots cast in order to pass.<sup>44</sup> There are two types of simple majority rules. The most common rule counts abstentions as negative votes, while the other rule excludes abstentions from the vote population (the denominator).

The remaining 3,720 proposals used the number of shares outstanding as the voting population.<sup>45</sup> Note that it is typically harder to achieve this standard for any given percentage requirement, since there are more shares outstanding than votes cast—some shares are not voted in every election. Of the proposals using shares outstanding as the voting population, approximately 88% required a simple majority of outstanding shares to win.<sup>46</sup> The remaining proposals required supermajorities of shares outstanding to garner passage. 374 required two thirds of outstanding shares to vote in favor of a proposal to guarantee passage, while 63 required 80% of shares outstanding to vote in favor.

Table II presents mean voting outcomes for the entire sample as well as selected subgroups. The mean management proposal in the dataset received approximately 82% of votes in favor, 13% of votes against, and about 1% abstentions. These numbers do not sum to 100% for a simple reason—when votes are counted as a percentage of outstanding shares, the number of votes will be less than the total number of outstanding shares.<sup>47</sup> When the sample is divided by voting population, the mean management proposal gets about 84% favorable votes, 15% negative votes, and 1% ballots cast without choosing an option if the voting population is votes cast. (Note how the percentages sum to one when the voting population is votes cast). When the voting population is shares outstanding, the

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shares outstanding or the number of shares voting.) Because the overwhelming majority of votes with a voting population of ballots cast are decided by a majority rule per state default rule, the majority rule was assigned to these votes. For a detailed analysis of the various types of votes requirements, see John C. Wilcox & John J. Purcell III, “Street Name” Registration & The Proxy Solicitation Process” in *A Practical Guide to SEC PROXY AND COMPENSATION RULES*, supra note 30. Where the vote population variable indicates that the voting population is the number of shares outstanding, but the dataset is missing the exact voting rule, a voting rule was imputed by assigning the voting rule given for the same company voting on the same type of proposal at a different time. Where this procedure provided no evidence about the voting rule, the observations were dropped from the sample.

<sup>44</sup> The other proposals had other requirements, such as two thirds or three quarters of shares voted.

<sup>45</sup> This is the Delaware default rule for votes on 1. charter amendments, DGCL § 242(b)(1), 2. mergers, DGCL § 251(c), and 3. sales of all or substantially all of the assets, DGCL § 271(a).

<sup>46</sup> There are no proposals in this category in which abstentions are not included because the voting population includes all shares outstanding—whether or not a ballot is cast.

<sup>47</sup> Non-votes and abstentions constitute different categories. Non-votes are shares that never submitted proxies, while abstentions are shares that submitted proxies but declined to register a vote on the issue.

mean management proposal gets approximately 75% of the vote, with about 7% of ballots cast against the proposal and a negligible number of abstentions. Not surprisingly, the mean favorable percentage for management sponsored amendments is lower when the voting population is the number of shares outstanding-- the voting population is larger when it includes all shares outstanding, making it more difficult to garner a high percentage of positive votes.

Although management sponsored proposals typically pass easily, they do not always do so. While contested votes are rare in board of director elections,<sup>48</sup> they are considerably more prevalent in management sponsored resolutions. About 6.5% of the management sponsored resolutions in which the voting population is the ballots cast, and 11% of management sponsored resolutions in which the voting population is the total shares outstanding, become close votes, where close is defined by winning or losing by less than 10 percentage points from the cutoff point. The vast majority (over 94%) of these proposals concern executive or director stock option plans. Close votes on management sponsored resolutions have different meanings depending on a company's voting requirement. If the company requires a proposal to garner a majority of votes cast for passage and there is no problem obtaining a quorum, then a close vote implies disagreement among shareholders about a management sponsored resolution. If the company requires a percentage of shares outstanding for passage, then a close vote can mean either substantial disagreement about a proposal or a lack of shareholder interest. In practice, most close votes where the voting requirement is total shares outstanding reflect a lack of participation by shareholders rather than a lack of support for the proposal, as evidenced by the fact that most close votes do not have high numbers of votes against.

Close votes are not randomly distributed across companies. The first row of Table III demonstrates that small companies, companies with lower governance indexes (i.e. better governed companies), and companies with relatively low levels of institutional ownership are all much more likely to have a close vote than other companies.<sup>49</sup>

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<sup>48</sup> Lucian Bebchuk, *The Myth of the Shareholder Franchise*, Va. L. Rev. 1. (2007) (forthcoming). *But see* Jonathan Macey, "Too Many Votes and Not Enough Votes: Lucian Bebchuk and Emperor Joseph II Extol the Virtues of Contested Director Elections and Mozart", Va. L. Rev. (2007) (forthcoming) (challenging the idea that there are too few contested director elections)

<sup>49</sup> Even though a company with below median levels of institutional ownership is more likely to have a close vote than a company with above median levels, the average level of institutional ownership for firms

The next section examines these close votes in more detail and finds stark irregularities in the results of close elections.

## V. Outcomes of Close Votes

Voting is intended to reflect underlying shareholder preferences,<sup>50</sup> and each proposal will have different degrees of shareholder support. Because companies are composed of many shareholders who may all evaluate a given proposal differently, underlying shareholder support for proposals should not exhibit discontinuities. While the typical management sponsored proposal may get an average level of shareholder support, the level of support should exhibit some dispersion and the dispersion should follow the pattern of an ordinary probability distribution, which should be without sudden breaks or stops in the data. If shareholder voting reflects shareholder preferences as voting is intended to, then the outcomes of shareholder votes on management sponsored proposals should also be continuous and not display discontinuities at any level of shareholder support.

It is of course possible that underlying shareholder preferences are discontinuous at 50%. However, it is hard to think of reasons for this discontinuity other than the fact that shareholders care about the fact that 50% is decisive—in other words, their vote preferences depend upon the votes of other shareholders. This meets the definition of insincere voting proposed by Goshen and identified as problematic.

Figures 1a, 1b, and 1c display histograms of the number of votes for management sponsored proposals decided by a simple majority of votes for various ranges of votes and intervals. They all show strong discontinuities at the 50% mark—which is the minimum needed for a management sponsored proposal to pass. Figure 1a, which shows the frequency of votes that receive support between 30% and 70% support in 2%

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that have close votes is higher than the average level of institutional ownership for the entire sample. If a firm has unusually high amounts of institutional ownership (in the top 10% of the distribution), it is more likely to have a close vote than the typical firm.

<sup>50</sup> See supra note 3. The meaning of underlying shareholder preferences is not obvious. On the one hand, underlying shareholder preferences may be the preferences that would be obtained if we could ask each shareholder how they would like to vote on the day of the vote and could record the answer accurately. Alternatively, underlying shareholder preferences might mean the preferences that would occur if we forced each shareholder to hear the best arguments of each side and come to an informed conclusion on voting day. The latter alternative is the obviously unattainable ideal measure.

intervals, reveals that over a relatively wide range of voting outcomes, there is a clear break at 50%, with many votes receiving greater than 50% and very few votes less than 50%. There are more votes that receive between 50% and 53% of the votes than votes that receive between 0 and 50% of the vote. Other than around 50%, there are no obvious discontinuities—exactly the results we would expect if shareholder voting on these votes reflects underlying shareholder preferences.

Figures 1b and 1c focus more closely on votes near the 50% mark. Rather than disappearing when we look with a finer lens, the discontinuity remains, and even grows more pronounced. While there are 47 votes that receive between 50 and 51% of the vote, there are only 5 that receive between 49 and 50. The discontinuity at 50 persists even for intervals of smaller than 1% (Figure 1c), with 28 votes receiving support levels between 50% and 50.5%, while only two receive support between 49.5 and 50.

Using the caliper test suggested by Gerber and Malhotra, the probability of such a discontinuity occurring can be roughly estimated.<sup>51</sup> The caliper test assumes that the underlying distribution of voting outcomes can be modeled using the distribution of voting outcomes between 53 percent and 70 percent—all of these outcomes bring management the same result, so there is little reason to suspect a divergence between underlying shareholder preferences and voting outcomes. This distribution is then extrapolated to the area around 50 percent. The caliper test indicates that the probability of getting the observed 12 votes that receive between 48 and 50 percent support and 93 votes between 50 and 52 percent, given that no discontinuities exist at 50% is less than one in ten trillion. Clearly, there is a non-random discontinuity in the data around 50%.

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<sup>51</sup> See Alan Gerber & Neil Malhotra, “Can political science literatures be believed? A study of publication bias in the APSR and AJPS,” Yale Political Science Working Paper (2006). The probability was estimated as follows. First, I obtain a predicted number of votes that should fall within any specified interval near 50 by regressing (with linear and quadratic terms) the number of votes in a given interval on the level of support for intervals of 1% between 53 and 70 percent.  $f_i = \alpha + \beta p_i + \delta p_i^2 + \varepsilon_i$ , where  $f_i$  is the frequency of votes within interval  $i$ , where  $p_i$  is the percentage of votes received within interval  $i$ , and  $\varepsilon_i$  is an error term. (This assumes that the vote frequencies between 53 and 70 can predict the underlying vote preferences for votes closer to 50.) Then I obtain predicted probability ( $q$ ) of having a vote in the interval  $(50-x, 50)$  given that there is a vote in the interval  $(50-x, 50+x)$ , which is

$q = \hat{f}_{50-x,50} / (\hat{f}_{50-x,50} + \hat{f}_{50,50+x})$ . The probability of getting  $m$  votes in the interval  $(50-x, 50)$  and  $n$  votes in the interval  $(50, 50+x)$  will be Binomial( $m+n, q$ ).

Management sponsored proposals get just over 50% support far more often than they “should” and get just under 50% support far less often than they should.

## **VI. Does the Discontinuity in Voting Reflect Shareholder Preferences?**

While the discontinuity at 50% is clear, its cause is not. (Indeed, it is important to emphasize that there is no one explanation that is clearly supported by the data.) This section examines what may be causing the discontinuity. Different explanations for the discontinuity have different policy implications. If the discontinuity reflects a divergence between underlying shareholder preferences and voting results, then the discontinuity suggests the existence of inefficiencies and breaches of fiduciary duty that should be addressed by changes in policy. If, however, the discontinuity results from idiosyncrasies in the distribution of shareholder preferences, however, then the discontinuity is less likely to reflect inefficiencies in the shareholder voting process.

Evidence from *shareholder* sponsored resolutions suggests that it is unlikely that shareholder preferences exhibit such a discontinuity. If shareholder preferences are discontinuous at 50%, we would expect them to be discontinuous for shareholder sponsored resolutions in addition to management sponsored resolutions. If management efforts to win management sponsored resolutions are what is causing the discontinuity, however, then we would expect shareholder resolutions to exhibit no discontinuity at 50% because the vast majority of shareholder sponsored resolutions are precatory; if getting more than 50% means nothing, then we would expect no discontinuity at 50%. Figure 2 shows that this is the case. There is no discontinuity around 50% that cannot be attributed to chance. This suggests that the discontinuity around 50% for management sponsored proposals is caused by specific behaviors associated with the fact that 50% is the minimum support necessary for the passage of most management sponsored proposals.

Further evidence for this assertion comes from a rare mandatory shareholder resolution (bylaw amendment) sponsored by shareholders of Honeywell International.

This resolution received 49% of the vote, falling just short of passage.<sup>52</sup> Apparently, 49% is a possible outcome when management prefers a vote to fall just short of passage rather than just passing.

### ***A. Management Campaigning***

The simplest explanation for these results is that management campaigns heavily in close elections, using corporate investor relations departments as well as proxy solicitors to target undecided voters and convince them to vote management's way. As one industry participant put it, management "beats the bushes" to find the necessary votes.<sup>53</sup>

This theory partially explains the discontinuity at 50. If management effort is greater than opposition effort in close votes and management has the ability to sway voters, then some votes with initial shareholder support below 50% will be altered by management's campaign so that underlying shareholder opinion at the time of the vote supports management. Because campaign effort is costly, management will have little incentive to build support well above the 50% mark, leading to an actual vote distribution with a disproportionate number of votes slightly above the 50% mark that may reflect underlying shareholder preferences at the time of the vote.

There is nothing illegal about management campaigning for a particular position with shareholders. Nevertheless, there are several asymmetries in the voting process that suggest that certain management campaign practices may be inefficient. Management expends corporate funds on campaigns, while shareholders that oppose management's proposal must expend their own funds—a classic free rider problem. Moreover, management has much better information about the course of the voting as it occurs in realtime because the vote tabulator is management's agent. Thus, management can tailor its effort to the closeness of the vote to a much greater degree than opponents can, giving management another advantage. If campaigning sways some preferences and the goal of a vote is to aggregate informed shareholder preferences, then management's budgetary advantage will lead to shareholder votes that are asymmetrically informed. There will be

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<sup>52</sup> ISS, "Vote Results for Majority Vote Proposals," at <http://blog.issproxy.com/files/Vote%20Results%20for%20Majority%20Vote%20Proposals.pdf>

<sup>53</sup> Interview with John Wilcox, *supra* note 8.

votes won by management that might not go management's way if shareholders had access to information and campaigning from forces that were both in favor and against the management proposal.

Table 3 provides some evidence of the management-campaigning explanation for the discontinuity. When management is campaigning, we would expect them to have more influence on non-institutional investors than institutional investors, so it is not surprising that when institutional ownership is high, management is more likely to lose close votes. Management of smaller companies are less likely to run a highly organized campaign, so it is not surprising that they lose close votes more often than management of large companies. The G Index results are harder to understand. Management of well governed companies should have an easier time convincing shareholders to vote in management's favor and yet low G (well governed) companies lose close votes a higher proportion of the time than poorly governed companies.

The management campaigning explanation does not provide a complete account of the data patterns. Before votes come in, management has incomplete knowledge about likely votes because some investors do not inform management about their vote intentions and small investors are not contacted.<sup>54</sup> Management knows the distribution of votes received, something proposal opponents typically do not know, but many votes are submitted at the last minute.<sup>55</sup> Given this uncertainty, we would expect management to aim for slightly more than 50% support in its campaigning to provide a cushion for unexpectedly low support. When support is unexpectedly low, however, there is no reason to expect management to have a magical ability to identify when that support will be just below 50% rather than just over 50%. Thus, the sharpness of the discontinuity around 50% remains difficult to explain according to the management campaign hypothesis.

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<sup>54</sup> Interview with John Wilcox, *supra* note 8

<sup>55</sup> *Id.*

## ***B. Selective Campaigning***

Another (related) explanation for the discontinuity at 50% is that management targets non-voting shareholders who are likely to vote in management's favor whenever management perceives that a vote is close. For example, suppose that a company has 120 shares outstanding and that management knows that 45 shares will vote against a management sponsored proposal and 35 shares support the proposal, with 40 shares unlikely to vote. If management can identify 11 currently non-voting shares likely to vote its way and convince them to vote, then it can win the vote (46-45).

In this scenario, voting outcomes may well differ from underlying shareholder preferences. For the actual vote to reflect underlying preferences, non-voters (if they had thought about the issue) would have to favor management 31-9. Given that observed shareholder preferences were 45 against and 35 for, it is unlikely that non-voters would favor management to this degree. Thus, selective campaigning may cause voting to inefficiently aggregate shareholder preferences.

Given this, it is no surprise that selective solicitation of votes by management from some shareholders and not others may be a breach of fiduciary duty. In *SWIB*, management adjourned a vote on a management sponsored proposal when it appeared that management was about to lose. Management subsequently contacted only voters likely to vote management's way.<sup>56</sup> The *SWIB* court strongly suggested that this was a breach of fiduciary duty, explaining that

If the purpose of the adjournment was merely to increase shareholder participation on a very close vote so that the Company could abide by "the will of a majority of the shareholders," it makes absolutely no sense that Peerless did not inform all of its shareholders that it had called the adjournment.... Here, the primary purpose behind the adjournment was to ensure the passage of Proposal 2 by interfering with the shareholder vote and allowing Proposal 2 to have more time to gain votes.<sup>57</sup> [On the *Blasius* standard, management actions that are taken for the primary

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<sup>56</sup> *SWIB*, supra note 10, at \*5.

<sup>57</sup> *SWIB*, supra note 10, at \*11.

purpose of interfering with the shareholder vote are a breach of fiduciary duty absent compelling justification.]

Even if selective shareholder solicitation is not a breach of fiduciary duty and does not inevitably cause voting results to diverge from underlying shareholder preferences, selective solicitation is problematic for the same reasons as heavy management campaigning. Management enjoys several systematic advantages, such as the ability to expend corporate dollars on campaigning and track voting results, that give management extraordinary ability to sway close elections. Without the existence of a comparably situated other side, voting results with one sided management involvement do not necessarily reflect shareholder preferences.

Poorly governed companies should be more likely to selectively solicit votes than other companies. The results in Table III confirm that well governed companies are more likely to lose a close vote than poorly governed companies, providing at least some support for the hypothesis that selective campaigning occurs, although note that management is disproportionately successful in close votes under all types of governance. Management facing large numbers of institutional shareholders should also be less likely to selectively solicit because 1. there are fewer non-voting shareholders to solicit and 2. an institutional shareholder is more likely to complain about selective solicitation (see, e.g., *SWIB*). This may explain why companies with higher numbers of institutional owners are more likely to lose close votes (Table III).

Selective shareholder solicitation also offers an incomplete explanation for the voting discontinuity. Given the sizable uncertainties in the outcomes of shareholder votes until the last voting date, it is implausible that management can be so precise in its solicitation efforts that it wins in so many cases. Selective solicitation explains a mild, macroscopic discontinuity at 50%, not a fine, microscopic one.

### ***C. Vote Buying and Logrolling***

If heavy campaigning and selective solicitation do not work (the trees have been shaken but there are not enough votes), then management may resort to other measures to ensure passage of a hotly contested proposal. For example, vote buying, whereby

management offers some voters money or other inducements in exchange for their vote on a closely contested issue, would explain the discontinuity observed in the data.<sup>58</sup> Vote buying is a breach of fiduciary duty.<sup>59</sup> Vote buying need not take the form of cash for votes or business for votes that was the subject of the *Hewlett Packard* litigation.<sup>60</sup> Instead, it can take more subtle forms that resemble logrolling in the legislative context. To illustrate, management may agree to take an action desired by some institutional shareholder, such as a dividend increase, in exchange for a vote on a hotly contested proposal. Because the dividend increase is not the result of a disinterested managerial decision, it may not be efficient.<sup>61</sup>

Evidence of vote buying or logrolling, aside from direct allegations such as the HP-Deutsche Bank example, case, is hard to come by. If companies with poor corporate governance are more likely to breach their fiduciary duty, then the discontinuity at 50 should be more pronounced for poorly governed (high G) firms—a result supported by the data in Table III. Because it is impossible to cut separate non-cash deals with large numbers of investors, indirect vote buying is only feasible with institutional shareholders. As a result, one might think that the discontinuities that result from vote-buying would be more pronounced with more institutional shareholders—a result contradicted by the data. But this argument fails to take account of the fact that institutional shareholders are more likely to complain about such behavior, thereby deterring from even attempting to buy votes with many institutional shareholders.

Vote buying also fails to account for the sharpness of the discontinuity at exactly 50%. Given uncertainty about the number of shares for and against a controversial management proposal, how can management know exactly how many votes to buy?<sup>62</sup>

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<sup>58</sup> This assumes that the opponents of a management sponsored measure have less opportunity to buy votes than management, a strong possibility given the free rider problem that afflicts ordinary shareholders.

<sup>59</sup> *Schreiber v. Carney*, 447 A.2d 17, 26 (Del.Ch. 1982).

<sup>60</sup> *Hewlett v. Hewlett-Packard Co.*, 2002 WL 818091 (Del.Ch. 2002). See Section II.

<sup>61</sup> Although such a quid pro quo probably constitutes a breach of fiduciary duty, it undoubtedly will be hard to prove.

<sup>62</sup> The HP case provides evidence for the existence of uncertainty. HP took “extraordinary measures” to sway the vote of Deutsche Bank, measures that ultimately provoked contentious litigation. And yet Deutsche Bank’s votes ultimately proved unnecessary for HP’s victory. The fact that HP took such risks suggests that management has real uncertainties about the outcome of some contentious votes.

#### ***D. Broker Non-Votes***

Before a rule change in mid 2003,<sup>63</sup> brokers were allowed to vote the shares of some beneficial owners for some management sponsored resolutions whenever the beneficial owner failed to inform the broker of the shareholder's desired vote within ten days of the voting date.<sup>64</sup> Because the vast majority of broker votes are cast in management's favor, broker voting of undirected shares may account for some of the voting discontinuity at 50%. If management only seeks as many broker votes as needed to garner a victory, then there would be many more votes with slightly more than 50% than votes with slightly less than 50%.

This explanation fails to fit the data for at least two reasons. First, if it were true, then we would expect management's success rate in close elections to decline after the rules were changed in 2003 to prohibit broker voting on many types of executive compensation plans. Table IV suggests that this is not the case, though small sample concerns preclude confident conclusions. Management's success rate in close elections does not go down after broker votes are not allowed—it goes up. Second, the uncertainty about the outcome of close elections should lead management to encourage brokers to vote whenever there is significant opposition to a management sponsored proposal. How is management able to cut it so close, with a discontinuity at exactly 50%, and why would management want to cut it so close when lots of broker votes could be obtained cheaply and easily? All of these factors suggest that broker voting is not the most important explanation for the voting discontinuity at 50%, although broker voting may certainly have played a role before it was eliminated in 2003.

#### ***E. Asymmetric Vote Counting Procedures***

Management controlled vote counting procedures offer another explanation for the voting discontinuity. The corporate voting process, detailed in Section III above, is quite complex and shareholders may fail to abide by all proxy requirements. For example, in the SWIB case a number of technical snafus led to a divergence between the

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<sup>63</sup> See supra note 20.

<sup>64</sup> See NYSE Rule 452 (2006).

desired votes of some investors and the actual totals.<sup>65</sup> If the vote tabulator (typically an agent of management) or ADP Investor Services excludes votes for technical reasons and disproportionately excludes no votes on closely contested management sponsored proposals, then management will win many more close votes than they lose.<sup>66</sup> Under this theory, the discontinuity is inefficient because voting outcomes diverge from underlying shareholder preferences.

It should be emphasized that there is no direct evidence about such vote-counting irregularities. Nevertheless, a few circumstantial factors suggest that vote-exclusion may be playing a role. Vote-counting irregularities explain the sharpness of the discontinuity at 50% despite the uncertainty about shareholder votes and votes that arrive on the last day. Vote tabulators or individuals making decisions about vote inclusion or exclusion have excellent information regarding the number of votes needed by management and can apply exclusion standards accordingly. Moreover, because excluding votes has some costs (e.g. shareholder grumpiness), the tabulators will attempt to make the minimum number of exclusions, again leading to an abrupt change at 50%. In addition, the number of votes made under questionable circumstances will typically be limited. As a result, disproportionate vote-exclusions cannot change outcomes where the vote was strongly against a management sponsored proposal. This may explain why there are more votes with approximately 45% support for management than votes with 48% or 49%, a fact that runs strongly against the trends in the data. (See Figure 1).

## **VII. Conclusion and Policy Recommendations**

All of the aforementioned theories probably play some role in causing the discontinuity in voting on management sponsored proposals at 50%. Such abrupt discontinuities rarely come about because of only one cause. Fortunately, however, many of the policy recommendations that ameliorate a problem identified by one hypothesis also ameliorate problems highlighted by other explanations.

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<sup>65</sup> See *SWIB*, supra note 10, at \*4.

<sup>66</sup> Vote tabulators, as agents of management, have an obvious incentive to disproportionately exclude votes against management. ADP Investor Services, which processes the vast majority of votes, has no obvious incentive to favor management.

Several policy changes appear warranted. First, funding asymmetries between management and opponents of a management sponsored amendment are an important cause of the voting discontinuities. Management spends corporate funds soliciting yes votes; opponents outlay their own funds in search of “no”s. Given this asymmetry, it is not surprising that voting results do not accurately reflect the preferences that would be expressed by a fully informed shareholder electorate. In order for voting on items such as stock option plans to effectively aggregate shareholder preferences, the funding asymmetries should be changed. If voting on items such as executive compensation plans is to be effective, then this asymmetry must be changed.

The simplest way to equalize pro and anti management sponsored resolution information and campaigning is to fund opponents of management sponsored resolutions to the same degree as management. This proposal has the benefit of simplicity, but it will be very costly. Most management sponsored resolutions pass by overwhelming margins, and there is no reason to waste corporate funds on frivolous opposition. A better proposal, similar to one made by Bebchuk in the context of contested board elections, is to reimburse opponents of management sponsored resolutions if they receive a certain percentage of the votes.<sup>67</sup>

Second, no party should be allowed to get an update on vote outcomes until the final vote has been submitted. The status quo allows management to obtain frequent vote updates, while shareholder opponents of management often have no comparable knowledge. This allows management to win votes when underlying shareholder preferences are against a proposal because management can tailor its expenditures as needed; if management sees that it is well behind, it can undertake an extraordinary effort, while its opponents have no obvious way of responding. If all parties were ignorant of the vote until the final results were presented, then this asymmetry would be minimized.<sup>68</sup>

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<sup>67</sup> See Lucian Bebchuk, *The Myth of the Shareholder Franchise*, supra note 48. See also Stephen J. Choi & Jill E. Fisch, “How To Fix Wall Street: A Voucher Financing Proposal For Securities Intermediaries,” 113 *Yale L. J.* 269 (2003).

<sup>68</sup> Another possibility would be to allow any party to obtain information about the results on demand. This policy would be more expensive than prohibiting updates until after the final vote, however. Moreover, widely available updates would likely be less effective than a prohibition on updates because opponents suffer from free-rider problems and therefore have less incentive to stay updated on the vote.

A third desirable policy change is the introduction of more regulation to this area. Corporate voting is “fundamental”<sup>69</sup>, yet corporate votes are lightly regulated. Many institutional investors have no way of confirming that their vote was recorded as instructed. ADP Investor Services, which plays the central role in administering corporate voting procedures, is unregulated, and some investors fret about the lack of paper trail from their mailings of preferences to ADP to the ultimate corporate vote.<sup>70</sup> In addition, voting procedures and tabulators are irregular. Some companies count the votes in house; others contract this process out to a third party. Given the importance of corporate voting and the irregularities described above, more regulation, such as a requirement that an independent firm count and inspect votes and periodic SEC audits of closely contested votes, seems justified.

Clearly establishing that management actions that cause voting results to differ from underlying shareholder preferences in a systematic way are breaches of fiduciary duty is another desirable policy. For example, selectively seeking the vote of shareholders likely to vote in management’s favor means that voting outcomes will diverge from shareholder preferences unless non-voting shareholders favor management to an overwhelming and statistically improbably degree. As a result, selective solicitation should constitute a breach of fiduciary duty under the current voting mechanisms. If opponents of management sponsored proposals are funded as recommended above, however, then there should be no such restrictions on managerial solicitation of votes.

This paper demonstrates that corporate voting outcomes are tilted in management’s favor to a degree that cannot occur by chance. In light of corporate voting’s salience, the recommendations made here seem a small price to pay to restore confidence in corporate voting.

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<sup>69</sup> See note 1 supra.

<sup>70</sup> John Wilcox, supra note 8.

**Table 1: Most Common Proposals**

| Specific Proposal                      | Relating to Executive or Board Compensation | Number of Proposals | Percent of Total |
|--|---|---------------------|------------------|
| Adopt or Amend Exec. Stock Option Plan | Yes   | 5,342               | 33.1%            |
| Adopt or Amend Dir. Stock Option Plan  | Yes   | 2,714               | 16.9%            |
| Approve Bonus Plan                     | Yes   | 936                 | 5.8%             |
| Increase Common Stock                  | Maybe                                       | 1,870               | 11.6%            |
| Adopt Employee Stock Purchase Plan     | Maybe                                       | 1,299               | 8.1%             |
| Approve Merger or Acquisition          | No  | 954                 | 5.9%             |
| Total Number of Proposals              |   | 16,099              | 100%             |

This table presents data from the IRRC on the most common types of management sponsored proposals in the sample. The table indicates that proposals that are either certainly or potentially related to managerial or board compensation win consistently.

Table 2: Votes For and Votes Against Proposals

| Voting Population  | Statistic | % Votes For Proposal | % Votes Against Proposal | % Abstentions |
|--------------------|-----------|----------------------|--------------------------|---------------|
|                    |           |                      |                          |               |
| Ballots Cast       | Mean      | 84.4                 | 14.8                     | 1.1           |
|                    | Sd        | 13.4                 | 13.2                     | 2.2           |
|                    | N         | 12019                | 11993                    | 7219          |
|                    |           |                      |                          |               |
| Shares Outstanding | Mean      | 74.6                 | 6.6                      | .69938        |
|                    | Sd        | 12.3                 | 8.8                      | 1.9           |
|                    | N         | 3324                 | 3267                     | 3136          |
|                    |           |                      |                          |               |
| Total              | Mean      | 82.3                 | 13.1                     | .991          |
|                    | Sd        | 13.8                 | 12.8                     | 2.1           |
|                    | N         | 15343                | 15260                    | 10355         |

This table presents the mean percentage, standard deviation, and number of observations for the number of votes for, votes against and abstentions from management sponsored proposals in the sample. These statistics are displayed for all the votes in the dataset in the Total row, and for two different voting population groups (Voting population of ballots cast or voting population of shares outstanding) in the other rows. All the percentages are calculated using the appropriate denominator (counting or not counting abstentions and non-votes). This provides a partial explanation for the large number of missing observations in the abstentions category—for some of the proposals decided by simple majority, abstentions are simply not counted as part of the voting population.

**Table 3: Close Votes and Firm Characteristics**

|   | Governance Index (G) |                    | Market Value       |                    | % Institutional Ownership |                    |
|---|----------------------|--------------------|--------------------|--------------------|---------------------------|--------------------|
|   | Firms Below median   | Firms Above median | Firms Below median | Firms Above median | Firms Below median        | Firms Above median |
| Number of “Close Votes” (Support between 40 and 60 percent) | 419                  | 295                | 478                | 236                | 401                       | 313                |
| Close wins for management (50 to 53 percent support)        | 78                   | 54                 | 93                 | 39                 | 78                        | 54                 |
| Close losses for management (47 to 50 percent support)      | 11                   | 5                  | 14                 | 2                  | 7                         | 9                  |

This table exhibits the number and outcome of “close votes” disaggregated by particular firm characteristics. All votes in the table are decided by majority of actual votes. The Gompers et al governance index (G) has a median of approximately 9, the table indicating that firms with a below median G (better governed firms) have more close votes, and tend to lose close votes relatively more often than firms with a high G. Smaller firms have more close votes and lose close votes more often than large companies. Firms with high levels of institutional ownership have fewer close votes, but lose close votes more frequently, than firms with lower levels of institutional ownership.

**Table 4: Voting Outcomes and Stock Exchange Rules Re: Broker Voting**

|  | Executive Compensation Votes (Broker Votes permitted before 6/30/03, prohibited afterwards) |                     |
|--|---|---------------------|
|  | Before June 30, 2003  | After June 30, 2003 |
| Close wins for management (50 to 53 percent support)   | 75  | 11                  |
| Close losses for management (47 to 50 percent support) | 8   | 1                   |

This table divides the management sponsored proposals sample into two separate time periods. The first time period consists of all votes that took place before June 30, 2003, in which brokers could vote the shares of individuals who had failed to signal a voting preference. This policy was changed after June 30, 2003.

Figure 1a

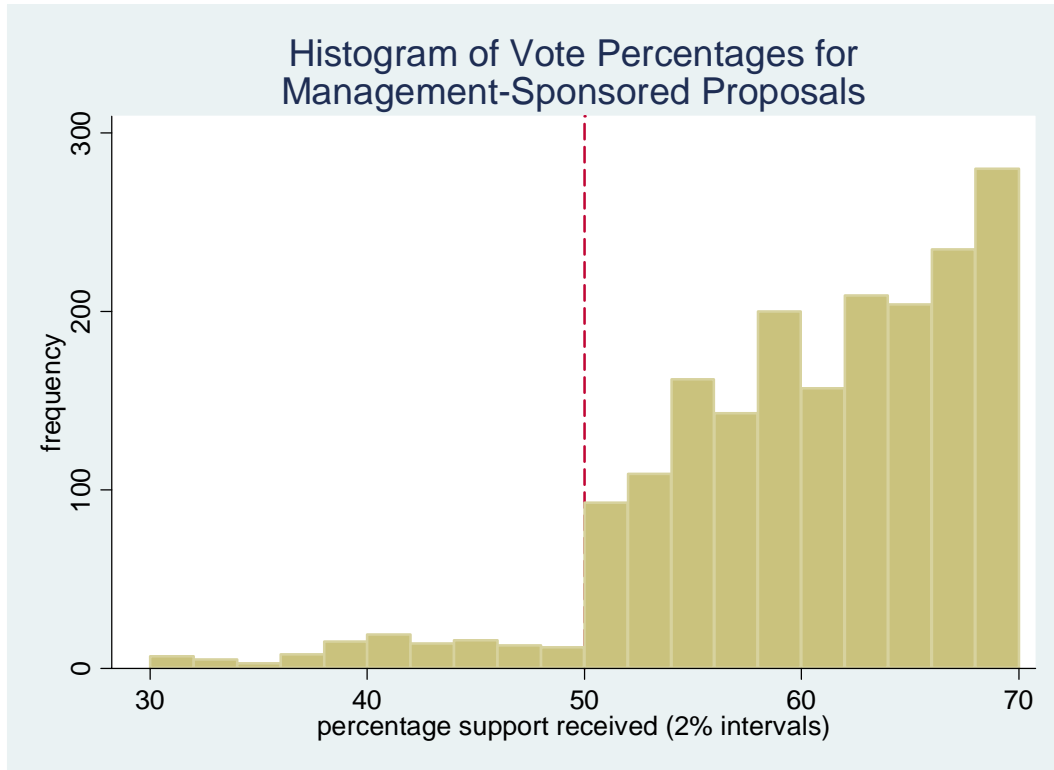


Figure 1b

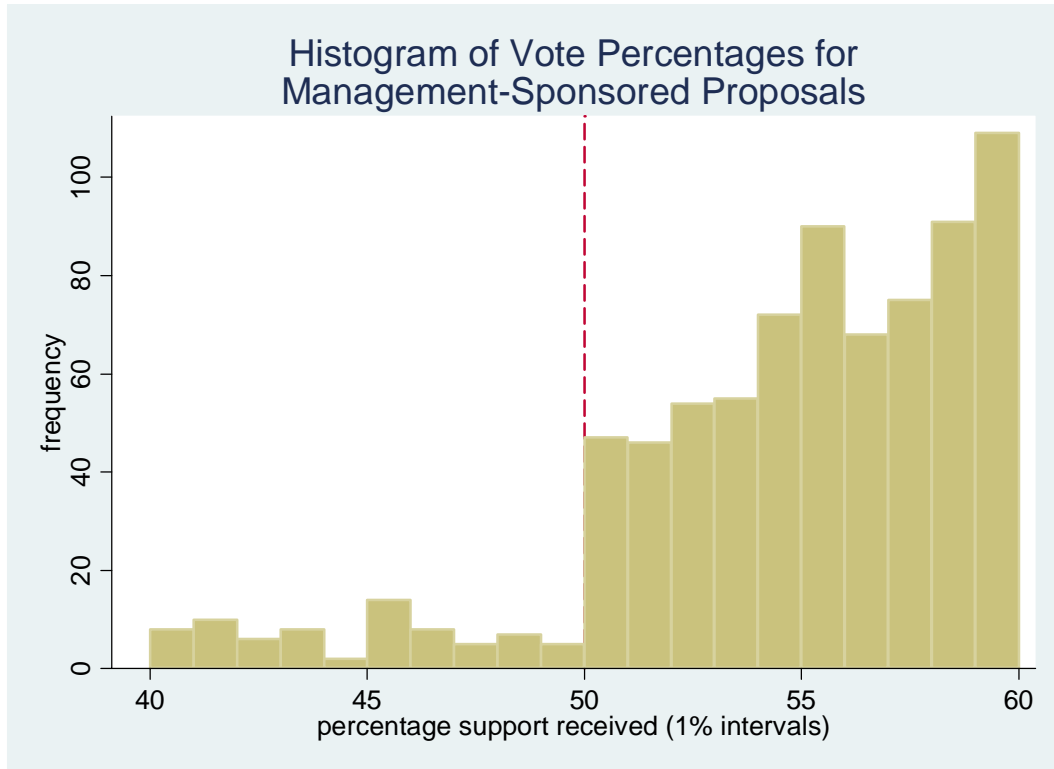


Figure 1c

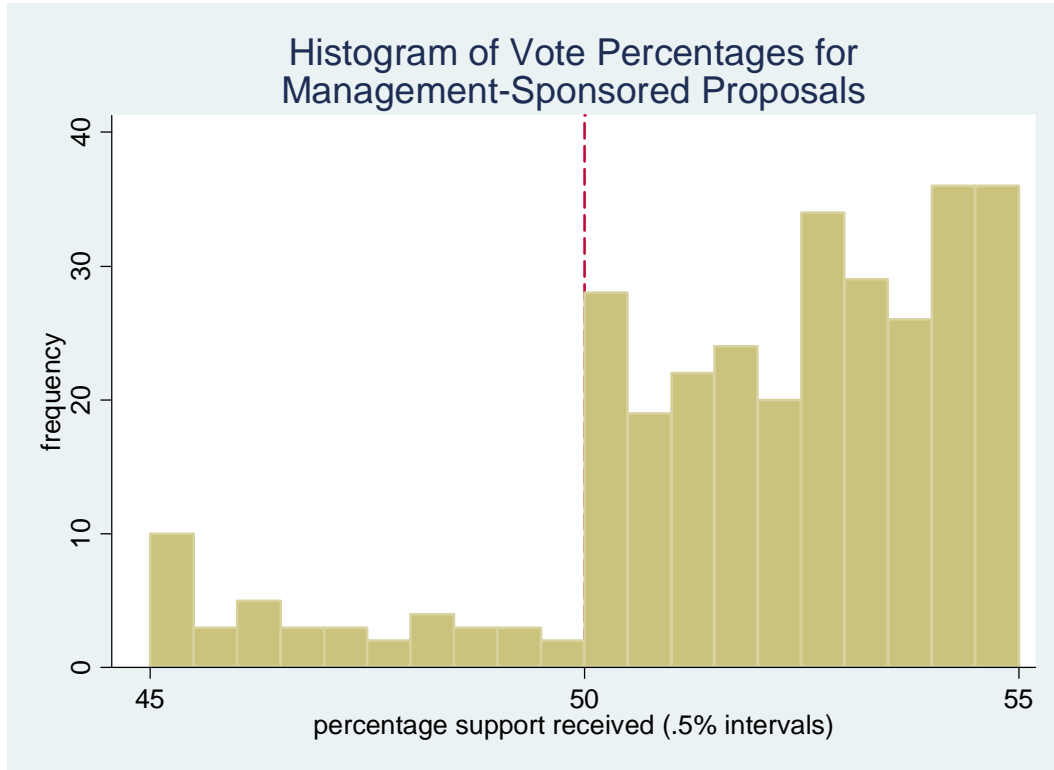


Figure 2

