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INSTITUTIONS AS RELATIONAL INVESTORS: A NEW LOOK AT CUMULATIVE VOTING

Jeffrey N. Gordon*

The hostile takeover may have become a receding memory, but the problem that the market in corporate control purported to address nevertheless remains. In a world of imperfect competition, the product, capital, and managerial markets may temporarily indulge suboptimal performance by a firm's managers. As cases such as GM, Sears, American Express, and IBM illustrate, a firm with a substantial franchise and substantial financial reserves can sustain deteriorating economic performance over a significant period, resulting in a long slow slide of economic values. Shareholders and society generally will benefit from a mechanism that replaces the firm's incumbent managers well before the firm succumbs to competitive forces.1 The shareholder interest is obvious: as the

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* Professor of Law, Columbia University, and Co-Director, Center for Law and Economic Studies. I have had the benefit of discussion and comments from Akhil Amar, Bernie Black, Jack Coffee, Ron Gilson, Lewis Kornhauser, Lou Lowenstein, Mark Roe, and participants at the May 1993 conference on "Relational Investing" sponsored by the Institutional Investor Project of the Columbia University Center for Law and Economic Studies. I received valuable research assistance from Andrew Shapiro and David Gross. Virginia K. Rosenbaum of the Investor Responsibility Research Center shared unpublished data on cumulative voting in firms that the IRRC follows.

For my father and mother.

1. This is based on an assumption that corporate governance matters to the performance of the firm and thus significantly affects performance of the national economy. This assumption might be contested by those who believe that another factor, such as technological innovation or education of the work force, is the key variable and that governance, if it matters at all, is marginal. Corporate governance matters, however, because management matters. Most industrial organization theorists have dropped the idea of the firm as simply a production function—a mixture in a black box of labor, materials, and technology that ferments to produce goods—in exchange for the view that the firm is a governance structure in which management is constantly making critical decisions about which activities should be organized under one roof—the firm—and which should be coordinated through markets. (The seminal paper was R.H. Coase, The Nature of the Firm, 4 Economica N.S. 386 (1937).) As business historian Alfred Chandler has argued, managers' strategic and organizational choices—not the availability of particular inputs—are the most important elements of firm level and national economic performance. See Alfred D. Chandler, Scale and Scope: The Dynamics of Industrial Capitalism (Takashi Hikino asst., 1990) (comparative study of United States, Great Britain and Germany); Alfred D. Chandler, Jr., The Visible Hand: The Managerial Revolution in American Business (1977) (study of changing modes of managerial organization in U.S.). Because management matters, corporate governance—which seeks to hold managers accountable for their choices and use of the firm's resources—also should matter.

Sometimes corporate governance will have limited significance, particularly for firms operating in highly competitive markets with limited capital needs. In such an environment, in which the existence of the firm is continuously at stake, the product market will discipline managers more vigorously than any board could. But in the world in which most large firms operate—one characterized by imperfect competition and large
firm heads to oblivion, share values head to zero. The social interest is no less compelling, since wasteful use of real economic resources reduces society's wealth and since the consequences of poor management are eventually shared by workers, suppliers, customers, and communities.\(^2\)

The hostile takeover became important in the 1970s and 1980s at least in part because of the legal, practical and cultural barriers to internal shareholder mobilization at a time of accelerating economic change. The low rate of internal shareholder intervention to replace managers who followed suboptimal strategies opened up opportunities for takeover entrepreneurs. As events in the late 1980s demonstrated, however, hostile takeovers were not an ideal intervention mechanism. The transaction costs were high; the associated financial market structure became overextended; the legal rules promoted "last dollar" auctions that, among other factors, led to bidder overpayment and fragile financial structures; the magnitude of the transactions led to speculation and illegality; and the eventual political reaction produced deal-breaking legal rules that were perversely more protective of managers than ever before.\(^3\)

Moreover, the classic 1980s bust-up takeover may now be obsolete. Those transactions addressed a specific problem—the unwieldy, often unmanageable business that was a legacy of an earlier wave of conglomerate acquisitions. In evaluating such a situation, takeover entrepreneurs did not need much information: only that pieces of the business were worth more in the relevant asset markets than was the business as a whole. As a result of this activity, and the preemptive restructuring un-

sunk organizational and physical capital—the board has a much more significant role in holding managers to account.

This footnote reflects an ongoing collaboration with Ron Gilson and Mark Roe on a grant proposal for research on “Governance of the Twenty-first Century Corporation” (on file with author).

2. This illustrates the point that the maximization of social welfare is not necessarily inconsistent with using the shareholder wealth maximization criterion as the lodestar for corporate governance. Indeed, the ultimate defense of the shareholder wealth criterion must be cast in social welfare terms: that the sum of payouts by the firm—wages, supplier payments, dividends, interest, and taxes—will be maximized by a system that assigns the residual claim to shareholders and empowers them to select managers who will act responsively. This is not an uncomplicated point, however, since good management of a declining firm may decide, for example, that plant closings and other disruptions are necessary. See Jeffrey N. Gordon, Corporations, Markets, and Courts, 91 Colum. L. Rev. 1931, 1953-54 (1991).


Paramount Communications Inc. v. QVC Network, Inc., Nos. 427, 428, 1993 WL 50302 (Del. Dec. 9, 1993) is not to the contrary. In entering into a merger agreement that would have shifted control of Paramount to a single large shareholder, the Paramount board was found to have come under a duty to obtain the best value available for stockholders, and in particular, to compare competitive offers from Viacom and QVC. The Court in no way suggested that Paramount would have been obliged to accept an unsolicited bid from QVC without the prior decision of the board to sell control to Viacom.
dertaken by many firms, this particular problem has been substantially addressed. The competitiveness and performance problems that now seem most important are likely to require much more information to fix. This suggests that a strategy that works from within the corporation might add value over a strategy driven by capital markets.

Corporate law academics, many of them my Columbia colleagues, have recently promoted the idea that a happy alternative to hostile takeovers may be possible within the existing share ownership distribution of the large public corporation. Since institutional investors hold 55 percent of the stock of the largest 100 firms, appropriate changes in legal rules and institutional culture could make it possible for institutional investors to serve a new role in corporate governance. This stock ownership pattern also provides an important reason for a new institutional role: as the traditional means by which institutions have expressed dissatisfaction with management—exit by selling the stock—becomes increasingly costly, a new strategy of "voice" becomes increasingly desirable.6


5. The costs are incurred in the discount often associated with the sale of a large block of stock and by search and transactions costs associated with the subsequent need to rebalance portfolios. Many institutions want to hold portfolios that include the entire market, particularly index funds, so exit is not feasible. Similarly, a desire driven by diversification concerns to hold portfolios that represent significant market segments may make exit especially costly. See Manhattan Institute Center for Corporate Governance Forum: How Should Institutional Investors Relate to Corporate Boards and Management 21–22 (Apr. 20, 1993) (transcript on file with author) (Remarks of Carol O’Cleireacain, Commissioner, New York City Department of Finance) (“Divesting from all underperformers would send transaction costs skyrocketing, reduce our diversification drastically, and destroy our ability to track any index.”); Stern Stewart, Roundtable on Relationship Investing and Shareholder Communication, 6 J. Applied Corp. Fin. 4, 30–31 (1993) (remarks of Ned Regan on public pension funds as “indexed, permanent owners”).

Some argue that the model to which institutional engagement should aspire is "relational investing," in which institutions see themselves as long term investors in the firm—owners—rather than as short term traders or arbitrageurs. As a preliminary matter, this Article sets forth and defends a specific model of the means of such investor behavior—the "board composition" approach. This approach holds that institutional investors in their role as relational investors in the large public corporation should primarily exert influence to enhance the quality, independence, and accountability of the board, rather than to intervene in business decision-making.

The ability of institutional investors successfully to pursue a board composition approach to relational investing may depend to a significant extent upon the mechanisms of director selection. Hence, this Article proposes that institutions should attempt to revive cumulative voting, a vehicle for proportional board representation of significant shareholder minorities, which was a common feature in corporate governance until the managerialist assaults of the 1950s. Adoption of cumulative voting would not ordinarily produce election contests waged by institutional in-

7. See, e.g., Louis Lowenstein, Sense and Nonsense in Corporate Finance 211-17 (1991) (describing DuPont minority interest in GM in 1920s as "a model for what might yet be"). Professor Lowenstein has also expressed skepticism about the compatibility of the American investing style to a high level of relational investing. See Louis Lowenstein, "More Like Whom?" J. Corp. L. (forthcoming 1994).

8. Cumulative voting is best understood in contrast to "straight" voting, under which a separate contest is held for each board seat, so that the vote of a simple majority determines every seat (except in the case of three or more candidates without a provision for runoff elections, where a plurality is sufficient). In the business corporation context, straight voting ensures that a majority shareholder elects all the directors. Under cumulative voting, candidates are elected as a group, by a rule that permits a sufficiently large minority to win one or more seats. In the corporate context, a shareholder receives, for each share, a number of votes equal to the number of directors to be elected, which may be allocated among the candidates as the shareholder chooses. Well-known formulas inform the minority (and the majority) how to allocate votes for maximum effect. The greater the number of directors to be elected, the smaller the minority block necessary to elect one director. See, e.g., Edward Aranow & Herbert Einhorn, Proxy Contests for Corporate Control 331-33 (2d ed. 1968). These formulas derive from Arthur T. Cole, Jr., Legal and Mathematical Aspects of Cumulative Voting, 2 S.C.L.Q. 225 (1950); see also Amihai Glazer et al., Cumulative Voting in Corporate Elections: Introducing Strategy into the Equation, 35 S.C. L. Rev. 295, 299-306 (1984) (developing equation based on game theoretic notions that produces same result as Cole's in case of two-bloc competition where, as in usual corporate case, total number of shares voted is very large in relation to number of directors to be elected, and noting that a more sophisticated procedure is necessary for competition among blocs of 3 or more); Lewis R. Mills, The Mathematics of Cumulative Voting, 1968 Duke L.J. 28 (correcting Cole's equation in case of fractional voting rights); John Kasdan, Ties in Cumulative Voting (Columbia University Center for Law & Economic Studies Working Paper No. 98, 1999) (refining formula to account for possibility of ties).
vestors but rather would give institutions additional leverage in negotia-
tions over the composition of the board. This would enhance the
directors’ sense of independence from management and accountability
to shareholders. The traditional objection to cumulative voting—that it
encourages disruption and rent-seeking by minority interests—would not
generally apply to the candidates for this proposal, large public corpora-
tions in which activist institutions have a significant ownership stake. In-
stitutions are likely to use power added by cumulative voting to pursue
strategies that will increase share values, producing gains that are com-
mon to all shareholders, rather than to extract private gains, such as
greenmail. Thus, unlike the traditional argument for (and against) cu-
mulative voting in terms of the desirability of minority representation,
this Article argues that cumulative voting in the large public firm can
provide a means for virtual representation of majority interests by a well-
motivated minority.

This Article proceeds as follows. Part I presents the argument for the
board composition approach for institutional investors engaged in rela-
tional investing. In order to understand the scope of the proposal and
the new role that cumulative voting can play in corporate governance, it
is important to understand the history of cumulative voting in American
corporate law, a peculiar story, in which a governance mechanism drawn
from the political realm was made to apply to private corporations. Parts
II and III explore, respectively, the rise and fall of cumulative voting as a
mandatory feature of state law, and as a relatively common feature of
corporate charters. For both states and individual firms, the elimination
of cumulative voting appears to have been catalyzed by managerial con-
cern that cumulative voting rendered firms more vulnerable to proxy
contests or takeover bids.

This observation, however, does not yield the conclusion that cumu-
lative voting should be reinstated as a mandatory state or federal legal
rule. Despite the crucial role of entrenchment motives in triggering the
legislative elimination of mandatory cumulative voting, the evidence is far
from clear that cumulative voting increases aggregate shareholder welfare
across all firms at all times. This is illustrated by a case study of Califor-
nia’s recent elimination of mandatory cumulative voting. In fact, empiri-
cal and historical evidence developed in Part III shows that elimination of
cumulative voting by large public firms often will reduce shareholder
welfare, at least at times when the market in corporate control is active.
But the question whether cumulative voting has value as an internal gov-
ernance mechanism, as opposed to an adjunct of the market for control,
is unresolved by the empirical evidence.

Part IV develops a new rationale for cumulative voting in the large
public corporation, one that is suited to a time when hostile takeovers will
be rare and institutions will choose to exercise “voice” rather than “exit.”
Because of the recent changes in the ownership structure of large public
firms, cumulative voting has a new role to play in corporate governance:
it can provide access to the boardroom for activist institutions, who will serve as virtual representatives for other public shareholders. Such institutional engagement has reasonable prospects of enhancing the independence and accountability, and thus the effectiveness, of the board in its monitoring of management. These improvements are likely to increase shareholder welfare, particularly at a time when a firm’s adaptability to changing competitive conditions is becoming especially important. Thus, for firms of appropriate ownership structure, cumulative voting reemerges as a valuable part of the internal governance mechanism. Part IV also develops an implementation strategy for the revival of cumulative voting, which would require obtaining majority shareholder endorsement and eventually acceptance by the incumbent board, and explains why managements should be amenable to the change.

I. INSTITUTIONS AS RELATIONAL INVESTORS

Relational investing depends on the interrelation of three elements: substantial share ownership, a commitment to an extended holding period, and a reciprocal engagement with management over the business policy decisions of the firm. Substantial share ownership is important because it carries voting power, which increases management’s receptivity to shareholder engagement; because it bonds the investor’s belief in the value of the engagement; and because it may bond the investor’s commitment to a long-term relationship (depending on liquidity of the stock.\(^9\)) A credible commitment to an extended holding period similarly increases management’s willingness to engage because it indicates that the investor shares management’s desired time-frame for the measurement of success. Reciprocal engagement is the vehicle for the benefits of relational investing.\(^{10}\) Management shares information and plans and commits to take seriously the investor’s responses; patient capital is not passive capital. The investor is generally supportive but is prepared to intervene energetically in a crisis. The base case of contemporary relational investing involves a large single investor who has a substantial economic investment in the firm, most often as equity, who is represented on the board, and who is prepared to intervene at critical moments to re-

\(^{9}\) See Coffee, supra note 6, at 1288–89 & n.33, 1328 (discussing effect of liquidity on shareholders’ willingness to play relational role). If the market in a particular security is very liquid, then even a sizeable block may not bond a long-term commitment; moreover, even where the market is less liquid, the issuing company may fear an exit strategy through sale of the block to a takeover entrepreneur. This is why negotiated large block investments frequently contain standstill agreements, including positions taken by so-called “patient capital” funds.

place senior management or to chart a new direction in the firm's business.\textsuperscript{11}

Institutional investors face practical and legal restraints on their capacity to become base-case relational investors. Institutions are financial intermediaries which collect and invest funds from diverse individuals and groups. Because of historical concerns about the concentration of economic power, individual institutional investors, particularly banks or insurers, are generally prohibited by law from holding a large enough block in any particular firm to exert significant influence or to obtain significant gains from relational engagement.\textsuperscript{12} The shifting needs and investment preferences of the ultimate beneficial owners of institutional claims also militate against an institution's holding a large, potentially illiquid stock position or committing to an indefinite holding period in any one company.

Nonetheless, although no single institution endurably holds a large enough block in a particular firm for base-case relational investing, institutions as a group indeed may. Even in today's environment of relatively high portfolio turnover, the overall percentage of institutional ownership in many firms is quite stable.\textsuperscript{13} This produces some relational possibilities, but the set is constrained by the need for institutional coordination. Given relatively easy free-riding, institutions will want to adopt low-cost strategies that may be applicable across many firms. Moreover, institutions are quite diverse, both in their type and in their individual tradi-

\textsuperscript{11} See, e.g., Lowenstein, supra note 7, at 211–17 (describing relationship of DuPont to GM in 1920s, and of Warren Buffet/Berkshire Hathaway to several companies, more recently). Many would see Buffet's intervention in Salomon Brothers after its Treasury bond market troubles, perhaps saving the firm, as demonstrating the benefits of relational investing. The pre-1933 House of Morgan is also sometimes mentioned as an example of a relational investor because of its close involvement with firm management, see Michael C. Jensen, Eclipse of the Public Corporation, Harv. Bus. Rev., Sept.–Oct. 1989, at 61, 65. Professor Garten points out that relational investing such as that practiced by DuPont or the House of Morgan was not predicated on equity participation only but rather was supported by accompanying business relationships—supplier-customer ties in the case of DuPont, and underwriter-issuer ties in the case of Morgan. Thus the old-style relational investor cared about the stability and growth of the firm, which would protect its business income, more than shareholder wealth maximization. See Helen Garten, Institutional Investors and the New Financial Order, 44 Rutgers L. Rev. 585, 590–91 (1992).


\textsuperscript{13} See sources cited supra note 4. Indeed, there is also evidence that institutional turnover may not be as high as commonly supposed. See Carolyn Brancato & Patrick Gaughan, Pension Fund Turnover and Trading Patterns: A Pilot Study, Columbia Institutional Investor Project, Center for Law and Economic Studies, Columbia University School of Law (Jan. 18, 1991) (on file with the Columbia Law Review) (close analysis of portfolios of two pension funds shows high degree of continuous ownership of securities, especially for portion of portfolio that is indexed). The average holding period for a stock in CalPERS' portfolio is 10 years. See Dale M. Hanson, The Long-Term Perspective: One Institutional Investor's Point of View, Address to the Current Investment Issues Seminar (Sept. 29, 1992) (manuscript on file with the Columbia Law Review) (reporting that CalPERS' annual portfolio turnover in U.S. stocks is less than 10 percent).
tions. Public pension funds, for example, have exhibited much greater willingness to enter the governance fray than have private pension funds. Institutions of similar type also have different internal cultures that will, in turn, lead to different behavior in the governance arena. Because of the need to attract widespread support from other institutions prepared to be at least moderately active, an activist institution will necessarily pursue policies with broad appeal.

A further constraint on the capacity of institutional investors to serve as base-case relational investors is the difficulty in generating appropriate incentives for institutional managers. The principal/agent problems in institutional manager behavior are likely to be even more difficult than in the case of a publicly-held corporation. In the case of private institutional investors, managers ordinarily hold infinitesimal stakes in the funds they manage and rarely participate in gains and losses because of assorted regulatory restrictions on performance-based compensation.

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14. See Roberta Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 Colum. L. Rev. 795, 797, 831–37 (1993); Black, supra note 6, at 827–28. The conflicts of interest that disabled private pension fund managers have been recently developed in historical context in Mark J. Roe, The Modern Corporation and Private Pensions, 41 UCLA L. Rev. 75 (1993).


17. The principal/agency problem similarly goes all the way down.

18. Obviously the manager will not be a large investor in the fund itself. But if the manager is a significant stockholder in the fund’s investment advisor, whose profits are related to size of pools under investment management, then there will be some link between any action that enhances fund performance—whether positive intervention as stockholder or good stock-picking—and fund manager compensation. Many significant investment advisors are private firms (e.g., FMR, which manages the Fidelity group of funds); many are not (e.g., Merrill Lynch). But even in the privately held investment advisor, it may be hard to create the right incentives for a fund manager, since most advisors have organized a stable of funds, and the advisor’s profits depend upon the performance of the funds as a group. (Warren Buffet, who has a substantial ownership stake in Berkshire Hathaway, is an exception to this pattern.) A better alignment of incentives might arise if the fund manager invested a substantial proportion of her personal wealth in the fund, but there seems to be no evidence of this behavior, perhaps in part because many funds are designed to focus on specific sectors or strategies that would make them inappropriately diversified for an entire personal portfolio.

19. See Coffee, supra note 6, at 1363–65. In the case of index funds, designing appropriate incentive compensation is particularly difficult because the gains associated
In addition, in the case of public institutional investors such as public pension funds, managers—who may be, or may be selected by, elected or appointed public officials—have incentives to appeal to the interests of political constituencies.\(^\text{20}\)

Thus, relational investing by institutions will probably take on a character significantly different from the base case.\(^\text{21}\) Institutional investors acting collectively are unlikely to develop the resource-intensive reciprocal engagement with a firm that is the hallmark of base-case relational investing. Instead, the possible stances that institutions might adopt fall along a range of three rough categories, in ascending order of engagement: the “board structure” position, the “board composition” position, with corporate governance activity are, by definition, shared with all other index funds, in direct proportion to share ownership. For managed funds, some scheme of incentive compensation could be devised for the actual portfolio managers of the fund even if not for the investment advisor, the corporate entity. That is, the investment advisor could give a bonus to the portfolio manager who out-performed peer funds, whether through stock-picking or corporate governance activity, and still perceive a net benefit from superior performance that led to an inflow of investor funds. This inducement to the fund manager to engage in corporate governance activity is limited by the fact that the same information that might inform governance often can also lead to a trading decision. The fund (and the manager through the bonus) captures only a pro rata share of gains from corporate governance, but realizes 100 percent of gains from trading. See Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 Colum. L. Rev. 1549, 1576 n.83 (1989) (informationally efficient markets not inconsistent with shareholder adoption of wealth-decreasing charter amendments).


21. Alternatively, institutional investors might invest in relational investor funds to overcome the obstacles to coordination. See, e.g., Allen R. Myerson, Pension Funds Join in Turnaround Venture, N.Y. Times, Nov. 2, 1993, at D1 (describing relational investor fund that will provide cash and governance involvement to distressed firms). However, a number of drawbacks suggest that such funds will not solve the corporate monitoring problem. First, the returns from corporate governance activity by these funds would have to be substantial to justify the premiums that the sponsors will presumably charge. Moreover, these funds would be functionally closed-end funds and thus presumably would be subject to the discount from net asset value associated with almost all such vehicles, whether or not this discount was recognized via trading. See Ronald J. Gilson & Reinier Kraakman, Investment Companies as Guardian Shareholders: The Place of the MSIC in the Corporate Governance Debate, 45 Stan. L. Rev. 985, 1005 (1993). Second, the time horizon of such funds may not be consistent with relational investing. Existing funds contemplate a holding period of three to five years, which is more enduring than an overnight trade, but is hardly the long haul. See Lilli A. Gordon & John Pound, Gordon Group Inc., Active Investing in the U.S. Equity Market: Past Performance and Future Prospects 2, 14 (1993) [hereinafter Gordon Group] (describing investment time horizons and other characteristics, benefits, and risks of relational investment partnerships). Some corporate governance funds contemplate an even shorter time frame. See Stewart, supra note 5, at 25–27 (comments of Nell Minow on Lens Fund, which exits on basis of target return rather than duration). Finally, even if institutional investors may invest in true relational investing funds, the total of such investments will never amount to a large part of the portfolio. Thus, we need to formulate a strategy that will work for the institution’s direct equity investments. For an account of the initial experience of relational investor or “patient capital” funds, see generally Patient Capital Funds: A Novel Approach or Just a Fancy Name for Investment?, 10 Corp. Control Alert 1 (July 1993).
and the "policy participation" position. What follows is a sketch of those possibilities and a brief for the "board composition" position.

Board Structure. The least interventionist stance is the "board structure" position, in which the institutional shareholder focuses its activities on devising the optimal monitor of management. Engagement at this level has recently led to calls for a board dominated by independent directors, nominating committees composed of independent directors, compensation committees composed of unconflicted independent directors (so that CEOs of two corporations cannot serve on one another's compensation committees), and, the newest trend, the separation of the chief executive officer from the board chairmanship. The underlying theory of this position is that a structure that can hold the board at arm's length from management will make the board a more effective monitor of management and thus more willing and able to intervene at appropriate moments. An institutional investor adopting this stance would vote for and perhaps initiate shareholder proposals promoting "good governance" mechanisms.

Board Composition. An intermediate stance is the "board composition" position, in which the institutional shareholder seeks to play a significant role in the selection of directors. This position can lead to two different sorts of engagement: generic and active.

Under the "generic" approach, institutions press for changes in the process of director selection or in the selection criteria. This is based on a belief that small group psychology could dull the monitoring zeal of even nominally independent directors, so that it will be important to make directors feel directly accountable to shareholder interests. This could lead institutions in a variety of directions, for example, to press for director nominations from a pool of professional directors, whose reputation and livelihood depend on energetic representation of shareholder interests. Alternatively, the institution might believe that directors with certain skills or backgrounds are particularly useful as independent directors, such as former CEOs or entrepreneurs or even business school professors. Institutions might press in a general way for directors of a particular sort, help develop a pool of potential director nominees, and/or press for nomination of particular individuals. The important element here is an institutional role in the selection of directors—whether by their categorical or individual qualifications—that will enhance the directors' sense of accountability to shareholders, creating not just an "independent" director, but an "accountable" director. Thus the generic approach is based on a view that monitoring by able directors who conceive of themselves as independent can enhance managerial performance and that institutional engagement can enhance the quality and

22. See Gilson & Kraakman, supra note 6, at 833-92. For an account of how Lockheed changed its director selection process to take institutional suggestions into account, see Walter Skowronski & John Pound, Building Relationships with Major Shareholders, 6 J. Applied Corp. Fin. 39, 41-45 (1999).
independence of such directors.\textsuperscript{23} Institutional reliance on this strategy says, in effect, pick the best directors, make directors feel accountable to shareholders, and count on them to intervene as necessary.

An "active" approach to the board composition position requires the institutional shareholder to monitor the performance of the company and, in the case of poor performance where the board itself has not appropriately intervened, to take steps to change the board. This is obviously a much more interventionist position, since the institutional shareholder itself must come to a judgment about managerial performance and the performance of the incumbent directors. The institution could measure performance by objective criteria, such as comparative stock price performance in the industry or various accounting measures, for example, return on equity, or it could attempt to engage in more complicated analysis of the firm's business environment and strategies. The institution could also evaluate seriously the claims of proxy contest insurgents as a basis for voting.

\textit{Policy Participation.} The most interventionist stance by the institutional relational shareholder is the "policy participation" position, in which the institution seeks active involvement in business decision-making by the firm. This general position has many variants. The institution might want involvement in a generic set of business issues faced by most firms, such as designing the most effective compensation system for senior managers or general approaches towards diversification or dividend policy. Alternatively, the institution might want to be involved in specific business questions, particularly when the firm, by some performance measure, is faltering. For example: Should Sears sell off its catalogue division? Should IBM break itself up into separate companies? Should GM dismiss the CEO? Should Kodak downsize and spin off its chemicals subsidiary? This engagement might occur on a continuing basis, as through regular meetings with senior management or through formation of a shareholder advisory committee, or the institution might insist upon it only at times of crisis.\textsuperscript{24} Behind the call for this level of engagement—

\begin{footnotes}

\textsuperscript{23} The recent activism of current boards at a number of major companies, which has led to CEO turnover at a number of firms, including GM, Westinghouse, IBM, American Express, and Kodak, should not alleviate concerns about the true independence of boards as they are currently selected. In most of these cases, the board's hand was forced by deteriorating product market results and a significant fall-off in stock prices. The failures of monitoring occurred in the years leading to the crisis, and there is hardly evidence that today's boards would intervene at a pre-crisis stage. Moreover, the current mood of board activism is in part the residue of the takeover movement of the 1980s. This will recede into memory; the more lasting consequence may be the substantially augmented power for management to resist proxy battles, which will dampen pressure on the board.

\textsuperscript{24} As to the potential effectiveness of shareholder advisory committees, compare Gilson & Kraakman, supra note 6, at 871--72 (likely to be ineffective because of little information or power) with Rock, supra note 16, at 490--504 (conceivably useful if convened on ad hoc basis in quasi-crisis situations, but relatively ineffective as general monitor or general representative of shareholder opinion).
\end{footnotes}
either to be consulted or to be heeded—might also be the threat to work to change the composition of the board.25

Determining which of these three modes of relational behavior could develop and survive over a long period of time is a complicated matter, and the normative question is even more difficult. My current view is that institutions should adopt the "board composition" position (which subsumes concerns about "board structure").26 Thus institutions should generally pursue a generic approach of (1) trying to buttress the selection of especially able independent directors, who will feel accountable to the institutions as shareholders; (2) on occasion switching to the active mode of changing the board when management (and the board) fails by important performance indicators; but (3) in general avoiding "policy participation." This conclusion assumes the continuation both of the legal barriers to large block ownership by institutions and of significant limitations on performance-based compensation to institutional managers. This view is based on three important concerns: heterogeneity, competence, and political durability.

Heterogeneity. One major concern about institutional engagement in corporate governance is that ideas disseminate quickly and that heterogeneity of opinion will too quickly be suppressed. Some important organizational and business innovations will be lost, to society's long-run economic detriment, and some innovations may be pressed too far. The phenomenon of large-scale leveraged buyouts in the late 1980s shows how quickly questionable innovations can spread under existing arrangements.27 Institutional engagement in business decisions might only accelerate this trend.

This risk, which may arise from any concentration of decision-making power, will be exacerbated by the particular constraints on institutional behavior. The legal barriers to large block ownership mean that effective action by institutional investors will require concerted effort by many of the institutional holders in the firm. Free rider problems will put pressure on institutional actors to limit the costs of their relational engagement. These factors will probably lead to consensus views about what is to be done (because if there is no consensus, nothing can be done) and to generic policies (because custom-tailored policies are much more expensive to develop).

25. Another variant of this strategy is for the institution to put one of its own officers directly on the board, either as a continuing director or temporarily during a time of crisis. This is different from the board composition strategy because of the direct engagement by the institution in the business affairs of the firm.

26. I think it reasonably obvious that a "board structure" policy alone is unlikely to energize the internal governance mechanisms in an adequate way.

27. One way to understand Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989) (sustaining Time management's combination with Warner despite hostile bid from Paramount that shareholders would probably have chosen), is as an effort to slow the pace of economic change to provide a chance for assessment of that particular innovation. See Gordon, supra note 2, at 1987.
Thus constrained, collective institutional action presents two serious problems for the policy participation model. First, the consensus generic policy might be the right policy, in the sense of maximizing share values on average and over time, but might not be the right policy for every firm. There may be average policies, but there are few average firms. For some firms, for example, unrelated diversification may actually increase values. Tailored decisions by the firm's managers, under the monitoring of an independent board, might increase shareholder welfare beyond the consensus generic policy.

The more serious problem is that the consensus generic policy might simply be wrong, in the sense that it reduces average share values. If so, relational institutional involvement in business decision-making will produce "common mode failure," in which the consequences of a particular misjudgment are amplified because of wide-scale application. One year's conventional wisdom on a business policy issue will be the next year's common fallacy. This year extensive employee layoffs are deemed necessary to "flatten" managerial structures and to "reengineer" corporate organizations for higher productivity. Next year we may decide that sig-
significant support staff is desirable because skilled people, unlike inventory, cannot be supplied "just in time" and that the demoralization effects of layoffs outweigh the cost-savings.\textsuperscript{31} Institutions are prone to fads, at least in investment decision-making, some of which turn out to be wrong. Consider the "Nifty Fifty" growth stock strategy of the early 1970s, the reliance on portfolio insurance before the 1987 stock market crash, and the boom-bust cycles in various parts of the stock market. The consequences of these fads for the allocation of real economic resources has been limited by the marginal impact of secondary market activity on firm behavior.\textsuperscript{32} The widespread application in corporate boardrooms of similarly faulty consensus generic policies would obviously have greater consequences.\textsuperscript{33} There already may be too much consensus in American business policymaking. Direct, relational institutional engagement in business policymaking will only exacerbate this trend.\textsuperscript{34}


33. This is not to say that managers, and even professional directors, are not themselves subject to fads, but that the problems with institutions may be worse because of their necessary sensitivity to the influence of stock market trends. Bernie Black argues that institutional engagement will counter the management fad-following tendency and otherwise disentangle from the concerns raised in this paragraph. See Black, supra note 6, at 866-67.

34. This problem may be further exacerbated by the tendency of some of the proponents of institutional activism to overread the implications of empirical studies on governance structure or particular business strategy. Suppose a study shows that, on average, dismissal of a CEO increases stock prices. Apart from the problem that a sample with a positive mean can contain many negative cases, and that over time the market may learn to differently value a particular governance change, it would be a mistake to conclude that if any randomly selected CEO were fired, the firm's stock price would go up, on average. For firms in the study, a process of information gathering and analysis, and the application of certain decision parameters led to the identification of a particular CEO to be terminated. Unless the institution is prepared to go through a similar procedure, it cannot hope to replicate the average positive results in a subsequent sample. This may sound obvious, but event studies lend themselves to this misinterpretation. At most a study of CEO termination will show that it is possible that firing the CEO will increase share prices. The point is that in the effort to economize on costs, institutions may be tempted to rely on simple decision procedures: push for the portfolio-maximizing average governance or business change, or screen companies by simple criteria, such as return-on-equity performance, by quartile, for standard prescriptive action. The closer these rule-of-thumb procedures get to actual business decisions, the greater the likelihood of bad results that will discredit relational investing by institutions.

Even a board composition strategy is subject to some of the same criticism. The evidence that independent directors enhance board performance is not the strongest, see, e.g., Black, supra note 29, at 899-903, which may be at least partially accounted for by relatively weak definitions of independence. There may be other important variables, for
By contrast, a "board composition" strategy is unlikely to be harmful in this way. A consensus, generic policy favoring the selection of well-qualified independent directors will not produce consensus, generic business strategies. If anything, a board composition strategy may embolden managements to try nonconventional strategies that they have defended before a genuinely more independent board. A board composition approach tries to foster in directors an allegiance to shareholders rather than to a specific managerial team; it promotes general standards and qualifications which may encourage a useful sense of professionalism for such directors. But directors who may be well-qualified by a consensus standard will not necessarily share opinions about a business problem.35

Competence. The second problem with the "policy participation" approach is the debatable institutional competence to execute such a strategy. To engage in serious evaluation and second-guessing of management strategies, institutions would clearly have to take an approach to staffing themselves that differs dramatically from current practice, which focuses on stock-picking and marketing skills. Alternatively, institutions could retain consultants to focus on specific problem cases. Under either example, the degree to which the firm is subject to product market pressure. Insulation through temporary market power or a large cash hoard encourages board complacency as well as managerial slack, and, by contrast, product market pressure stimulates board action. In some circumstances, conceivably, the optimal board is dominated by directors who have invested a large percentage of their personal wealth in the firm. The concept of directorial independence is contestable as well. Is an officer of a customer or supplier of the firm "independent"? Independence in such a case seems problematic because of the incumbent management team's ability to alter the terms of trade with the related party. But such a director may also have a particular interest in the economic well-being of the firm that leads to more aggressive action. See Garten, supra note 11 (old-style relationship investing supported by business ties).

It is also noteworthy that some of the initial impetus for independent directors arose from the concern in the 1960s and 1970s about corporate accountability rather than the concern about corporate performance more characteristic of the 1980s and 1990s. Corporate law violations in price-fixing and campaign contributions, not to mention questionable payments abroad to foreign government officials and politicians, raised serious questions about the internal monitoring systems of corporations. The problem was that corporations were following profit-maximizing strategies all too comprehensively; independent directors, it was thought, would halt such overreaching. The takeover movement provided a new rationale for independent directors, who were to be ostensibly disinterested decision-makers in corporate control contests. The current hope that independent directors can substitute for vigorous competition in product or control markets is the third spin on the idea.

In short, pushing for independent directors without looking for specific characteristics that have made such directors valuable in other firms may not be optimal. But the case for independent directors is intuitively strong and the chance that the addition of able people to a board will lead to worse corporate performance seems remote.

35. Conceivably, the membership of a truly independent director could reduce the collegiality of the board, which for a particular firm could be optimal. Yet the risk seems remote that a competent, if independent, director would significantly stifle board cohesion at a firm where management's performance was sufficiently exemplary to call for support rather than monitoring.
approach competence is likely to be an increasing function of cost. Faced with free rider problems in the absence of some mechanism to share costs, institutions are unlikely to acquire the necessary competence. By contrast, a board-composition approach provides a mechanism that injects competent monitors into the firm's business decision-making in a way that distributes these costs across all shareholders. Institutions are far more likely to be competent at describing the credentials or backgrounds of those who would bring a valuable perspective to the board, and perhaps even at identifying particular individuals who possess such qualifications. Because directors' fees are paid by the corporation itself, a board-composition approach alleviates free-riding.

Political Durability. The third problem with "policy participation" is its long-term political durability. Assume that institutions force a substantial downsizing on a particular firm that results in plant closings and employee layoffs. Any number of politically potent actors who object to this result—unions, incumbent managers, elected or appointed officials—could raise the cudgel against "monopoly capital." The populist appeal of such arguments already contributes to the existing constraints on institutional size and activity. State legislatures and Congress are likely to

36. This is the insight behind Joe Grundfest's argument that institutional investors should use performance screens to identify problem firms and then simply vote against reelection of the incumbent board, on the theory that such a no-confidence vote would precipitate major changes. See Joseph A. Grundfest, Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates, 45 Stan. L. Rev. 857 (1993). Although this strategy has attracted some institutional adherents in recent years, in 1993 the number of orchestrated "just vote no" campaigns was small. See Investor Responsibility Research Ctr. (IRRC), Negotiating, Limited Use of New Proxy Rules Mark Season, Corp. Governance Bull., Mar.-Apr. 1993, at 1, 3. One problem with the strategy is that it may not satisfactorily answer the question "compared to what." On possible concerns with using performance screens, see supra note 30.

The more serious problem with this strategy, and with the related strategy seen in cases like GM, IBM, Sears, American Express, and Westinghouse of pressuring the board to replace the CEO of an underperforming firm, is that the intervention comes after the loss of substantial shareholder value. This illustrates the cost/competence problem for the policy participation approach. A low-cost method of detecting poor performance, such as screening, will produce many instances of noisy, ambiguous signals that provide a weak basis for institutional intervention, yet by the time the signals are clear enough to warrant a strong measure like firing the CEO, much of the damage will have already occurred. The hope of a board composition strategy is to infuse the board with a spirit of directorial independence that would lead to reevaluation of the firm's direction much earlier.

respond to this new outcry, as the history of anti-takeover laws in the 1970s and 1980s readily illustrates.\textsuperscript{38} This argument suggests that institutions will eventually be blocked by political reaction from intervening to influence firms to adopt certain optimal business policies.\textsuperscript{39} The flip side of the argument, however, is that institutions adopting a business policy position may also face political pressure to influence the firm to adopt policies to serve the interests of some politically potent group.\textsuperscript{40} Once it becomes clear that institutions have direct access to the executive suite, political groups are very likely to seek to exploit that avenue. Certain institutions, such as public pension funds, are particularly vulnerable to that pressure, but the regulatory environment in which any large institutional investor operates generalizes that vulnerability.

By contrast, a "board composition" position should be easier to sustain precisely because the institutions are not assuming direct power. They are merely playing a heightened corporate governance role in securing the services of able independent directors, who are responsible, firm by firm, for particular decisions. Even if firms take decisions that tend to promote shareholder interests over those of other constituencies, there is no specific aspect of institutional involvement to which the political process can react.

The responses to economic dislocations in the 1980s provide support for this point. The managerial layoffs and headquarters relocations associated with some hostile takeovers easily became grist for popular outcry against takeovers, principally because these disruptions seemed the result of centralized decision-making by a handful of entrepreneurs ("raiders") and their investment banking co-conspirators. Where no identifiable group could be blamed for the much more widespread firm-by-firm layoffs associated with general economic change in the same period, public reaction was quite different: it was marked by malaise (which may have led to a change of presidential administrations), but not by a targeted political attack or significant legislative enactment.\textsuperscript{41} The constituency


\textsuperscript{39} One early sign is the formation by the American Bar Association's Section on Business Law of an Ad Hoc Subcommittee on Institutional Investors with an apparent agenda of questioning the appropriateness and accountability of institutional engagement.

\textsuperscript{40} See, e.g., Leslie Wayne, U.S. Officials in Plea to Pension Funds, N.Y. Times, Oct. 12, 1993, at D2 (Secretary of Labor urges institutions to avoid pressure on portfolio companies to cut payrolls and to add non-financial criteria in evaluating investments).

\textsuperscript{41} Congress did pass the Worker Adjustment and Retraining Notification Act of 1988, Pub. L. No. 100-379, 102 Stat. 890 (1988) (to be codified at 29 U.S.C. §§ 2101-2109); however, it was so riddled with loopholes that its practical effect has been minimal. See John T. Addision & McKinley L. Blackburn, The Worker Adjustment and Retraining Notification Act: Effects on Notice Provision (1993) (unpublished manuscript) (on file
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statutes adopted at the end of the 1980s may have given boards the discretion to trade off the interests of shareholders against those of other constituencies—protection against centralized pressure—but they also permitted directors to favor shareholders if they chose—protection for decentralized decision-making. Thus, taking into account the political environment in which economic action is situated, institutions will be most successful if they pursue a strategy that preserves the decentralized nature of the firm’s response to general market pressures. This logic argues for a “board composition” approach, even if agency problems mean that particular board action in a given case is not as effective as direct institutional business policy intervention.42

The foregoing lines of argument suggest the conclusion that, in their role as relational investors, institutions should principally pursue strategies that increase their influence over the composition of the board and the ability of the board to monitor managers.43 This Article ultimately tries to show how cumulative voting can usefully augment that influence and suggests that institutional investors should thus devote resources toward this end. However, before arguing for the revival of cumulative voting, we need first to understand the reasons for its demise. The evidence suggests two very different hypotheses: one holds that cumulative voting fell victim to a managerialist race to the bottom; the other posits that


42. This is a localized example of a broader argument that the optimal corporate law (or legal institution) might not be the most “efficient” law, but rather the law that is most efficient given the political environment in which it will operate. From a strictly economic point of view, a regime that focuses solely on shareholder wealth maximization might be most efficient and thus superior, but if the predictable political reaction to the consequences of such a regime produces highly restrictive laws, society (and shareholders) would be better off with a regime that accommodates these political forces. Thus the optimal corporate law is the second-best legal regime. I develop these themes in a work in progress, Corporate Governance and the Transition Costs of Capitalism.

43. This is not to condemn recent high-profile institutional activism that has contributed to several CEO ousters. Where the company has unambiguously failed by appropriate performance measures, institutional pressure on the board to reshuffle the management team may be useful, not only for the particular firm’s performance, but also as a general deterrent. The institutions can be thought of as reminding the boards of that their job is to monitor the performance of the managerial team on behalf of the shareholders. This is not inconsistent with what I have termed an “active” board composition strategy, since it focuses on bottom line performance and the board’s monitoring role, and is backed by the implicit threat to try to change the board if it fails to respond. Far more problematic, in my view, would be pressure for adoption of particular business strategies, even by a company in crisis. This would amount to policy participation. Most firms, however, are not in crisis and institutional investors should work on strategies that could strengthen governance so as to avoid unnecessary crisis (understanding that in a competitive market some firms must fail or exit). Accountable directors may improve the monitoring of managers, perhaps leading to better decisions outside of crisis, but also serving in the appropriate, rare case as a shareholder sentinel to call for more direct engagement by institutional investors.
cumulative voting, even if once useful, came to interfere with good governance. Even the negative hypothesis that cumulative voting was a casualty of corporate legal evolution tells us why we might well reexamine cumulative voting: in changed environmental circumstances, a disfavored trait may play a crucial new role.

II. THE RISE AND FALL OF MANDATORY CUMULATIVE VOTING

A. The Rise and Fall in the Several States

Cumulative voting was not required in corporate elections at common law. Its application to shareholder voting is a path-dependent historical oddity. As part of the Illinois constitutional revision of 1870, adherents of proportional representation won a major battle to require cumulative voting for the Illinois House of Representatives. The principle having prevailed, the constitutional convention also required cumulative voting in the election of directors of private corporations. The objective was to protect minority interests against overreaching by a majority, particularly in circumstances in which representation on the board would give the minority the information necessary to police against fraud.

44. During the 1870 Illinois constitutional convention, a particularly influential member, the editor of the Chicago Tribune, Joseph Medill, seized upon proportional representation as a solution to a particular problem in Illinois politics: the Republicans were in the majority of most of the legislative districts in the northern part of the state, despite a substantial Democratic vote, and the situation was reversed in the southern part of the state. This meant that Democrats in the north and Republicans in the south were closed out of legislative representation and that the legislature itself might be unrepresentative of the majority of the voters. Medill, the chair of the convention's Committee on Electoral and Representative Reform, was an adherent of the views on minority representation of John Stuart Mill, whose recent essay, Considerations on Representative Government, had attracted significant attention. See generally John Stuart Mill, Considerations on Representative Government (New York, Harper & Brothers 1862). The committee's proposal on minority representation for the Illinois House of Representatives—to use cumulative voting in three member districts—was quite controversial and was submitted separately to the voters, where it was adopted by a relatively narrow margin.

Medill also successfully pressed the case for cumulative voting in private corporations with the Committee on Miscellaneous Corporations. As demonstrated by a floor speech and an editorial in his newspaper shortly before the vote on the constitution, Medill was spurred by a recent scandal at the Erie Railroad in which a board dominated by Fiske, Gould, and Lane to the exclusion of minority representatives had looted the corporation. Thus, as the Committee on Miscellaneous Corporations explained, "we have provided for the protection of the minority of stockholders of private corporations in the election of directors." See Wolfson v. Avery, 126 N.E.2d 701 (Ill. 1955) (providing historical account that emphasizes importance of minority representation at Illinois constitutional convention); Charles M. Williams, Cumulative Voting for Directors (1951) (providing lengthy account of the adoption of and debate around cumulative voting that has been relied upon by all subsequent writers); Whitney Campbell, The Origin and Growth of Cumulative Voting for Directors, 10 Bus. Law. 3 (1955).

45. The floor speech of Joseph Medill included the following:
Once Illinois had set the example, cumulative voting spread relatively rapidly in the late 19th century as states introduced incorporation as of right, replacing the regime of incorporation by special legislative charter.\textsuperscript{46} As shown by Chart I and the state-by-state history of cumulative voting in Appendix I, seven states had adopted mandatory cumulative voting provisions by 1880, and the number had increased to eighteen by 1900. All but six of these adoptions were by state constitutional provisions. Several of the adopting states were economically very significant, including Illinois (1870), Pennsylvania (1873), California (1878), and Michigan (1885). Later in the period, some states began to enact permissive cumulative voting statutes, which permitted corporations to adopt cumulative voting by charter provision or in the by-laws.\textsuperscript{47} Adherents of cumulative voting opposed permissive statutes, arguing that, if cumulative voting was desirable, it “should not be at the will of incorporators who may compose the majority group, nor should a majority be afforded the

We put our money into a stock company, and the first thing we know it is confiscated by the ring. The men who get control of stock by proxies, which they coax or purchase on misrepresentation, elect the entire board and then do as they please. The remainder of the stockholders are in the dark. They have nobody in the board to watch their interests, to protect against waste, extravagance or mismanagement, or to take any steps to protect them until it is too late. This majority having obtained absolute control of the offices of the company proceed to plunder the stockholders by high salaries, multiplication of offices, speculating in its money and franchises, and abusing their trusts in every respect. That this practice is common, is notorious throughout the Union as well as within this State, and it is growing worse all the time. This provision will unquestionably afford every stockholder more power of self-protection than he now possesses. Its object is not to cripple or injure the rights of the majority in any respect. Their power to control the offices of the company remains intact; but this is to protect the minority from being plundered and robbed out of house and home, their stock confiscated and lost for the want of some representative to look after their interest.

\textsuperscript{46} Through the early 19th century, almost all incorporations in the United States were pursuant to special charters enacted by the legislature. In the mid-19th century, some states, particularly important commercial states, had dual systems, under which corporate status could be attained either by a special charter or under a general corporation act. In the latter part of the 19th century, these states amended constitutions to eliminate the dual system; other states added constitutional provisions for incorporation as of right, and both groups of states adopted implementing corporate codes. See Henry N. Butler, Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges, 14 J. Legal Stud. 129, 138–63 (1985). This transfer to private groups of what previously had been seen as state power to confer corporate status may account for the framing of some of the debate over cumulative voting in terms of democratic theory, rather than simply in economic terms. See infra text accompanying note 142.

\textsuperscript{47} Since cumulative voting was not known at common law, it was generally (but not universally) assumed that specific legislative permission would be required for its use. See, e.g., State ex rel. Baumgardner v. Stockley, 13 N.E. 279, 280 (Ohio 1887); Harlowe E. Bowes & Ledlie A. De Bow, Cumulative Voting at Elections of Directors of Corporations, 21 Minn. L. Rev. 351, 352, 355 (1937).
Chart I

Note: This chart is based on explicit state adoption by statute or by constitution of the cumulative voting change in question, in the year of adoption. The source of the data is Appendix I, a state-by-state survey of cumulative voting adoptions and changes.
opportunity to withdraw any such grant at its pleasure by amending the corporate charter or by-laws.” Nevertheless, several important states adopted permissive provisions, including New York (1892), New Jersey (1900), and then, as part of its move for corporate preeminence, Delaware (1917).

As Chart I shows, after the initial pre-1900 burst of adoptions of mandatory cumulative voting, a narrow majority of the states that subsequently added cumulative voting provisions chose the permissive form. By 1945, twenty-two states had mandatory cumulative voting provisions, and fifteen had permissive. Thus in the 1900–1945 period, four states (net) adopted the mandatory form; twelve, the permissive. Only two states permanently switched from mandatory to permissive during the entire period—Nevada in 1903 and Colorado in 1915. (Michigan changed from mandatory to permissive in 1931 but then switched back in 1937.)

The high water mark of mandatory cumulative voting as a force in American corporate law was probably the late 1940s. At that point, twenty-two states had mandatory provisions. The Banking Act of 1933 required cumulative voting for national banks. The Securities and Exchange Commission favored cumulative voting in the reorganization cases of the 1930s and 1940s. The first Model Business Corporation Act proposed by the American Bar Association, officially published in 1950 but drafted in the late 1940s, called for mandatory cumulative voting.

Matters changed abruptly, however, in the 1950s. The seven states that adopted cumulative voting in this period all chose the permissive form. In the 1960s and early 1970s the trend was even more pronounced: states began switching wholesale from mandatory to permissive. The 1980s were a rout. Twelve states switched from mandatory to permissive. By 1992, only six states maintained mandatory cumulative voting; forty-four jurisdictions (including the District of Columbia) chose the permissive form; one state (Massachusetts) did not permit cumulative voting.

50. See Williams, supra note 44, at 35; Norman D. Lattin, The Law of Corporations § 91 (2d ed. 1971).
51. Model Business Corp. Act § 31, ¶ 4 (1950). The first draft was prepared in 1946. See Cumulative Voting: Developing Trends, 1972 Corp. J. 363, 364 [hereinafter Developing Trends]. A precursor to the ABA’s work was the Model Business Corporation Act promulgated by the National Conference of Commissioners on Uniform State Laws in 1928, which also prescribed mandatory cumulative voting (§ 28). See Model Business Corp. Act § 28, 9 U.L.A. 107–09 (1951). The Act was initially promulgated as a “uniform act,” but when the effort at uniformity failed, the Commissioners designated it a “model act.” See id. at 49 (historical note). Cumulative voting was also advocated in the 1920s by leading business academics concerned with shareholder rights, see, e.g., William Z. Ripley, Main Street and Wall Street 133–40, 215 (1927).
52. North Carolina oddly switched from permissive to mandatory in 1955.
voting. No important corporate law jurisdiction maintained mandatory cumulative voting.\(^{53}\)

B. How Goes the Race?

This remarkable pattern of diffusion and collapse of an innovation in corporate law\(^{54}\) presents a puzzle: is such a systematic change in state corporate law evidence of a race to the bottom, the top, or somewhere else, in the competition among states for incorporations?\(^{55}\) In the case of the repeal of mandatory cumulative voting, competing hypotheses are plausible. For example, repeal may reduce shareholder welfare because of the managerial entrenchment effect; or repeal may enhance shareholder welfare by reducing the firm's exposure to disruptive or rent-seeking activity by a willful minority.\(^{56}\)

Missing from the available evidence is an "event study" that assesses stock price movements in firms incorporated in states where repeal occurs to determine the impact on shareholder welfare. I am skeptical whether such a study would provide useful information in the case of mandatory cumulative voting. Apart from the particular factors that make it unlikely that such a study would generate economically and statistically significant results,\(^{57}\) such a study might well obscure the historically

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53. The remaining six states were Arizona, Kentucky, Nebraska, North Dakota, South Dakota, and West Virginia.

54. This is in contrast with the one-way diffusion Romano shows for four other corporate law innovations, Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 J.L. Econ. & Organization 225, 233–37 (1985).


56. Alternatively, on a pure governance level, repeal may, on one hand, deprive the board of fresh insight that stimulates better corporate decisionmaking; or, on the other hand, repeal may protect the board from minority disruption that interferes with the best corporate decisionmaking.

57. The most important reason is that a change in the state law on cumulative voting often will have no immediate effect on particular firms, because firms in mandatory states typically provide for cumulative voting in the charter. Thus the event that eliminates cumulative voting is a separate shareholder vote. Shareholders may foresee that elimination of the mandatory requirement will eventually lead to elimination of cumulative voting at particular firms, but the economic significance of the event—likely to be small, see Elliott J. Weiss & Lawrence J. White, Of Econometrics and Indeterminacy: A
contingent and firm-specific nature of the question. For example, the
effect of the elimination of cumulative voting in the 1950s, when proxy
battles merely determined board representation and control, might well
be different from that in the 1980s, when proxy battles were sometimes a
substitute for, and at other times an adjunct to, a takeover bid.\textsuperscript{58}
Moreover, stock price studies tend to focus on large publicly-traded firms.\textsuperscript{59}
and, in the desire to generate a large sample of firms, a study may ignore
significant differences among firms that may bear on the utility of partic-
ular governance structures.\textsuperscript{60}

Study of Investors’ Reactions to “Changes” in Corporate Law, 75 Cal. L. Rev. 551 (1987)—
will be further dampened by the distance between the law change and the charter change.
That is, even assuming that elimination of cumulative voting for particular firms would
noticeably affect stock prices, see Sanjai Bhagat & James A. Brickley, Cumulative Voting:
this seems unlikely in the case of the elimination of the legal requirement.

The other very serious problem is to identify the relevant event day for the legal
change in question. By the effective date of legislation, its impact has been anticipated.
This leads to a technique in which stock price changes around the key moments of
legislative action (assuming they can be identified!) are aggregated, which in turn may
create severe problems of statistical significance. Moreover, the elimination of mandatory
cumulative voting is often part of a legislative package that changes other aspects of
corporate law, ranging from general revision of the corporate code to other provisions
with probable antitakeover effect. For an excellent description of event study
methodology, see Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate
Acquisitions 185–204, 217–19, 221–25 (Supp. 1993) [hereinafter Black
& Gilson].

58. As a technical matter, one could break a multi-decade sample into panels of
discrete years, in order to increase the likelihood that common elements were motivating
the change under examination. (But such panels reduce the sample size and thus make
statistically significant results less likely.) Early studies of takeover gains tended to
aggregate cases across many years, an approach which conflated types of transactions that
are quite different in motive and effect. Recent studies are more sensitive to factors of
time and transaction type. Compare, e.g., Michael C. Jensen & Richard S. Ruback, The
conclusions based on aggregating data) with, e.g., Michael Bradley et al., Synergistic Gains
from Corporate Acquisitions and Their Division Between the Stockholders of Target and
Acquiring Firms, 21 J. Fin. Econ. 3 (1988) (more equivocal results from matching bidder
and target pairs and breaking down data into multiple subperiods); see generally Gilson &
Black, supra note 57, at 503-513 (presenting aggregating studies as well as those
partitioning the data set). Moreover, stock price studies measure investor expectations:
stock prices change because of changed investor expectations about future cash flows,
which expectations may (or may not) subsequently be realized. Over time, investors will
learn about realizations as well, which will affect investor expectations about subsequent
transactions of the same type. Studies that aggregate even similar cases across a significant
time period may efface the impact of this learning. See Gordon, supra note 55, at 33–36
(analysis of studies of dual class common stock recapitalizations).

59. Stocks must be publicly traded for stock prices to be readily observable and, since
the event study methodology depends on an efficient market in the firm’s stock, the firm
should have a sizable market capitalization and float.

60. Breaking down the sample into subsamples according to some criteria deemed
relevant makes statistical significance harder to obtain, particularly if the effects are small.
In some areas it may be possible, see, e.g., Gregg A. Jarrell & Annette B. Poulsen, Dual-
Class Recapitalizations as Antitakeover Mechanisms, 20 J. Fin. Econ. 129 (1988)
Rather than undertake such an event study, I have looked at salient historical factors operating during the two periods of rapid movement away from mandatory cumulative voting, the 1950s and the 1980s. The evidence suggests that at both times managerialist motives activated the process of legislative change: in the 1950s, managers wanted to reduce the threat of proxy contests which, among other characteristics, seemed to jeopardize senior management tenure; in the 1980s, they wanted to reduce the threat of hostile takeovers by eliminating a particular route to board representation. But notwithstanding the catalytic role of entrenchment motives and the likelihood that in many particular cases elimination of cumulative voting had a negative impact on shareholders, the heterogeneity of firms and circumstances makes it hard to insist on cumulative voting as a mandatory rule of corporate law. This skepticism is borne out by an examination of the legislative process in some states, particularly California, that recently eliminated cumulative voting. Good (or mixed) things may emerge despite bad motives. Thus this Article's argument for a revival of cumulative voting is a custom-tailored claim: for firms of a particular ownership structure, cumulative voting is likely to improve shareholder welfare.

1. The 1950s. — The attack on mandatory cumulative voting in the 1950s was triggered by a series of high-profile proxy contests involving major public corporations in which cumulative voting played a conspicuous role. Although never very numerous, the incidence of proxy contests increased in the 1950s: there were twenty contests in 1952, twenty-seven in 1953, thirty-three in 1954, and thirty-six in 1955. The targets included the New York Central Railroad; Twentieth Century Fox; the New York, New Haven and Hartford Railroad; Fairbanks, Morse & Co.; Montgomery Ward & Co.; and Libby, McNeill & Libby Co.

Cumulative voting figured prominently in these contests. In the course of the struggle for the New York Central, for example, dissident (segmenting sample before and after stock exchange response, by level of insider holdings, and by stock price response).


62. See Whetten, supra note 61, at 2; sources cited infra note 63.

63. Much of the foregoing is drawn from Leland C. Whetten, Cumulative Voting for Directors: Its Origin and Significance, Stud. Bus. & Econ., Feb. 1959, at 1, 6-11; see also Edward Aranow & Herbert Einhorn, Proxy Contests for Corporate Control 240-41, 341-43, 353-55 (2d ed. 1968). A review by Charles Steadman based on SEC records for the January 1954–March 1955 period shows 36 proxy contests involving 28 companies, which were evenly split (14–14) as to cumulative voting. Of the contests in the 14 firms with cumulative voting, insurgents won control in three cases and representation in nine
Robert Young made the call for cumulative voting a battle cry. In the infamous 1953 contest involving Twentieth Century Fox, after it had become clear that an insurgent group held enough stock to elect a few directors under the existing cumulative voting scheme, the board called a special meeting two weeks prior to the annual meeting, at which the cumulative voting provision was removed from the corporation's charter and by-laws. After a 1955 contest in which insurgents won board representation, Western Air Lines, which was incorporated in Delaware but did substantially all of its business in California, subsequently obtained shareholder approval for elimination of a cumulative voting charter provision. This precipitated litigation that produced the famous ruling asserting a state's right to impose corporate governance provisions on "pseudo-foreign" corporations, *Western Air Lines v. Sobieski*.

Cumulative voting was also at the heart of perhaps the most famous proxy contest of the period, the battle for Montgomery Ward. In that struggle cumulative voting provided dissident Louis Wolfson the vehicle for his symbolic victory over incumbent Sewell Avery. Although Wolfson and allies held only a minority interest and failed in a bitter proxy battle to obtain control of the board, cumulative voting allowed Wolfson to win several board seats. The incumbent senior managers resigned soon after what was widely seen as a pyrrhic victory. In the course of the other cases. See Charles W. Steadman & George D. Gibson, Should Cumulative Voting for Directors Be Mandatory? A Debate, 10 Bus. Law., Nov. 1955, at 9, 20-21.

64. Of course after he obtained control, he opposed cumulative voting on the grounds of its "peculiar danger" given the stockholdings of previous management and its allies. See Steadman & Gibson, supra note 63, at 14-15.

65. Tactical maneuvers to limit the influence of cumulative voting in the midst of a proxy battle are not just relics of a bygone day in corporate law. During the election contest at Sears waged in 1991 by Robert Monks, Sears reduced the size of its board (from 15 to 10) and thus the number of directors to be elected (from 5 to 3), which raised the level of support that Monks would need to win a seat (from 17 percent to 25 percent). Monks was defeated, receiving 15 percent of the vote. This percentage would not have won a seat on the original board configuration, but as his chances for success dimmed, some of his support probably melted. See Eric N. Berg, A Troubled Sears Plans to Cut Five Directors, N.Y. Times, Mar. 14, 1991, at D1; Eric N. Berg, Dissident Sears Holder Fails to Win Board Seat, May 10, 1991, at D1; Telephone interview with John Wilcox, Georgeson & Co. (Dec. 14, 1993).


68. Wolfson obtained only 3 of 9 seats. Nevertheless, shortly thereafter the chairman, Sewell Avery, and the president, Edmund Krider, both resigned. See Stock Market Study,
proxy contest, Montgomery Ward management tried to extirpate "the curse of cumulative voting" through classification of the board. Wolfson won a pivotal legal victory against use of classification where cumulative voting was required.

Cumulative voting came under special attack during the 1950s because it increases the chances of a proxy contest. With cumulative voting an insurgent can obtain a significant measure of success merely by obtaining enough votes for board representation. In the case where the insurgent's objective is to obtain control, cumulative voting can provide the satisfactory consolation prize of board representation, from which the insurgent can plan another campaign or press for new business strategies. In the case where the insurgent wants only board representation, in order to monitor management or to affect business decisions, cumulative voting, until very recently, has provided the only practical vehicle. Cumulative voting also strengthens the insurgent's hand in negotiations that frequently end, or avoid, proxy contests.

The quantitative evidence supports the theoretical claim that proxy contests are more likely in firms with cumulative voting. Williams' study of proxy solicitations during the period 1943-1948 for 2900 firms tracked by the SEC showed 69 cases of significant election contests. Of these, 41 firms had cumulative voting, and 28 did not. Williams estimated that approximately 40 percent of the 2900-firm sample had cumulative voting, either because they were incorporated in a state with mandatory cumula-
tive voting (33 percent) or because they had chosen cumulative voting by charter provision (6 percent). Thus 60 percent of the proxy contest firms had cumulative voting despite the fact that cumulative voting was found in only 40 percent of the entire universe of firms. This difference is statistically significant at the 99 percent confidence level. Williams also concluded that especially in large firms, the presence of cumulative voting led to voluntary inclusion of minority nominees in a number of cases.

Williams also reports that a typical contested election in firms with cumulative voting was a representation contest rather than a control contest and that in a "large majority" of cases the insurgents gained one or more board seats. This is consistent with Borstadt and Zwirlein's study of 142 proxy contests in the 1962-1986 period, which reports that in representation contests insurgents won at least one seat in 60 percent of the cases. It is also consistent with Duvall and Austin's study of 67 proxy contests in the 1956-1960 period, which reports the presence of cumula-

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73. See Williams, supra note 44, at 66-69. This means that by Williams' reckoning, nine percent of the firms in permissive states had cumulative voting. Compare infra note 93.

74. Z = 3.29. In light of recent IRRC data that suggests cumulative voting was found in roughly twenty percent of firms by the end of the 1980s, see infra note 115, Williams' results are consistent with David Ikenberry & Josef Lakonishok, Corporate Governance Through the Proxy Contest: Evidence and Implications, 66 J. Bus. 405, 414 (1993) (In study of 97 proxy contests in 1968-87 period, cumulative voting is found in thirty-four percent of cases (32 of 95)). The inference drawn from Ikenberry & Lakonishok that cumulative voting increases the likelihood of a proxy contest is also statistically significant at the 99 percent confidence level, Z = 5.98.


76. This is consistent with Dodd and Warner's study of 96 proxy contests of NYSE firms during the period 1962-1978, in which dissidents won at least one board seat in approximately sixty percent of the cases. See Peter Dodd & Jerold B. Warner, On Corporate Governance: A Study of Proxy Contests, 11 J. Fin. Econ. 401, 409 (1983). Of the 96 contests, 71 were for control and 25 were for board representation. See id. The incumbents won a board majority in 53 (75%) of the control contests, but of this group, dissidents won at least one seat in 27 cases (51%). See id. In 11 of the representation contests (44%) the dissidents won at least one seat; in 45 of the control contests (63%) the dissidents won at least one seat. See id. These results, which show many boards split between dissidents and management, clearly reflect the impact of cumulative voting.

These results are also consistent with Ikenberry and Lakonishok's study of 95 proxy contests during the period 1968-1987, in which cumulative voting won dissidents at least one board seat in 72 percent of the cases (23 of 32), whereas without cumulative voting, dissidents won at least one seat in only 41 percent of the cases (26 of 63). See Ikenberry & Lakonishok, supra note 74, at 413-14. Ikenberry and Lakonishok do not classify their contests by initial purpose, but it is suggestive that the dissidents under cumulative voting won a minority representation in 50 percent of the cases (16 of 32), but won all seats in only six percent of the cases (2 of 32).

tive voting in every insurgent-side success in representation elections (11 of 19). 78

The increased number of high visibility proxy contests in the 1950s led to a general debate, including Congressional and SEC hearings in 1955, over the value of proxy battles and the need for further regulation. 79 At about the same time, the corporate bar engaged in a sustained reconsideration of its position on cumulative voting. 80 In a debate on cumulative voting organized by the Section on Business Law of the American Bar Association, the objections voiced by George Gibson, a name partner of the largest firm in Virginia and an eventual chair of the section, are especially interesting: "In a sentence, American management is of one mind in opposing cumulative voting; most of all, opposing mandatory cumulative voting, secondarily, opposing the institution of cumulative voting where permitted by statute." 81 He cited two reasons: first, the obligation of directors to represent all shareholders, as opposed to specific groups; second, the need for "harmony and mutual respect" that would be "endangered by the introduction of minority representation." 82

The upshot was a redraft in 1955 of the Model Act provision on cumulative voting that replaced the specific recommendation of the mandatory form with equally recommended permissive and mandatory provisions. 83 Thus the corporate bar, which only shortly before had en-

81. Steadman & Gibson, supra note 63, at 26.
82. Id.
83. In 1955 a provision was added to give a jurisdiction that wanted to adhere to the Model Act appropriate language for permissive cumulative voting. See Developing Trends, supra note 51, at 363, 364–65 (citing Model Business Corp. Act, 1959 Addendum of Revisions, Alternative Provisions and Optional Section: Revisions and Alternative Sections § 14).

Another move against cumulative voting was proposed legislation to eliminate the cumulative voting requirement for director elections in national banks, see 12 U.S.C. § 61 (1989), that had been added by the Banking Act of 1933. The legislation was submitted in the Senate in March 1954, very brief hearings were held in April 1955 at which only proponents testified, and the bill passed the Senate. Hearings in the House in July 1956 quickly became tumultuous and extended for five days. An advertisement by an opposition group in the Wall Street Journal described the legislation as an act whose effect would be to "nullify" shareholder voting power and "to entrench existing managements in permanent power as self-perpetuating dynasties without any adequate check by the actual owners of such institutions"; the advertisement urged wires to Congress in opposition. Despite support from the Administration, the American Bankers Association, and the Independent Bankers Association, the legislation was never reported out of committee. See generally Cumulative Voting for National Bank Directors: Hearings on S. 256 Before the House Comm. on Banking and Currency, 84th Cong., 2d Sess. (1956) [hereinafter
endorsed mandatory cumulative voting in the initial version of the Model Act, now began to attack it as destructive of good corporate decision-making. Such a change very likely influenced those states that, in the course of updating their corporate codes, tended to follow the Model Act as "the better view" and as the low-cost way to assure that local corporations received the benefit of the most "modern" thinking. As Appendix I shows, seven states that revised their corporate law in the mid-1950s and early 1960s adopted permissive cumulative voting. Other forces, perhaps including the threat by local managers to reincorporate elsewhere, were operating on those states, but it seems clear that the Model Act had become a way for the corporate bar to reflect and disseminate American management's views about corporate governance—in this particular case, about the undesirability of cumulative voting.

Judged with hindsight, it seems that managerial entrenchment motivated the effort to roll back cumulative voting in the 1950s. In the cases that stirred public debate, incumbent management wanted to deprive a potential dissident of any possible avenue of attack and was able to enlist the support of the corporate bar to this end. Shareholder welfare was irrelevant to this management/bar coalition. In the Montgomery Ward contest, for example, shareholders gained tremendously. Because of a notoriously conservative investment strategy, Montgomery Ward traded in the high $40s during early 1954, despite a cash and securities hoard of $50 a share. Wolfson announced his proxy contest in August and campaigned on a platform of financial restructuring and reinvestment, including a self-tender at $93 a share. In February 1955, when he mailed


84. See, e.g., infra Appendix II (discussing state revision process).

85. By another tally, in the 1955–1969 period, 25 jurisdictions adopted business corporation laws based partially or substantially on the Model Act, of which 12 adopted permissive cumulative voting. See Developing Trends, supra note 51, at 365. It seems also that the elimination from the Model Act of the mandatory cumulative voting option in 1969 put pressure on state legislatures then considering corporate law revision to choose permissive cumulative voting. See id. at 366. The movement away from cumulative voting was not to be complete, however. For example, the use of classification to undermine cumulative voting led some states to require a minimum number of directors in each class, typically three. See Humphrys v. Winous Co., 133 N.E.2d 780, 788–89 (Ohio 1956) (discussing such legislative change in Ohio during 1954–55 period).

86. For a general attack on the uniform laws enterprise that offers an interest group account of the uniform law-making process, see Larry E. Ribstein & Bruce H. Kobayashi, A Theory of Uniform Laws (George Mason University School of Law, Law and Economics Working Paper No. 93-004, 1993). A sustained interest group analysis of the Model Business Corporation Act would begin with the fact that the Model Act is authored by the Committee on Corporate Laws of the ABA Section of Business Law, whose membership consists primarily of corporate practitioners.

Note also that proposed repeal by Congress in 1955–56 of mandatory cumulative voting for national banks, see supra note 83, became a salient political issue that resulted in the failure of the legislation, whereas most state corporate law-making is very low-visibility.
his proxy materials, the stock was trading in the low $80s.\textsuperscript{87} None of these financial elements figured in the published debates of the era.\textsuperscript{88}

Nevertheless, the overall impact on shareholder welfare of the elimination of mandatory cumulative voting statutes is difficult to judge. Although proxy battles are, on average, associated with an increase in shareholder wealth,\textsuperscript{89} it would be premature to conclude that elimination of a vehicle that may increase the likelihood of proxy battles necessarily reduces shareholder wealth. "Average" effects conceal a range of outcomes that are sensitive to many factors that do not necessarily correlate with the existence of cumulative voting: for example, whether the proxy contest is subsequently followed by a takeover bid or by managerial turnover. And the association between cumulative voting and the incidence of proxy battles is hardly one for one. The more interesting issue of the comparative statistics of firm performance with and without minority directors, or, more broadly, without exposure to the possibility of minority directors, remains elusive.

2. The 1980s. — The takeover wave of the 1980s presented a sustained challenge to managerial control and tenure. The threat came from two different directions: first, from an increased number of proxy battles, both in and out of the takeover context; and second, from hostile bids to obtain majority share ownership. Proxy battles presented not only the direct threat of loss of control but also an increased risk of senior managerial turnover. As the Montgomery Ward contest illustrated, even in cases where the insurgent was defeated, senior managers often lost.\textsuperscript{90}

\textsuperscript{87} See Sobel, supra note 67, at 16–21. The text above suggests that the general propensity of cumulative voting to foster proxy contests and a series of high-profile battles precipitated the turn against mandatory cumulative voting. However, it may be that the Montgomery Ward battle, in which an outsider was able to use cumulative voting to assault a citadel like Montgomery Ward, was entirely sufficient. Often the saliency of a single corporate law case is sufficient to trigger significant change. See, e.g., Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (leading to widespread statutory limitation on director exposure to monetary damages for breach of duty of care); City Capital Associates v. Interco, 551 A.2d 787 (Del. Ch.), appeal dismissed, 556 A.2d 1070 (Del. 1988) (leading to public threats to reincorporate out of Delaware that arguably led to Delaware antitakeover statute and perhaps to greater judicial protection of target defensive tactics).

\textsuperscript{88} Conceivably shareholder welfare was regarded as only one of many competing goals in the 1950s, which I have elsewhere described as “the high tide of benevolent managerialism that reflected the importance of the corporation to the organization of social life.” Gordon, supra note 2, at 1982.

\textsuperscript{89} See Gilson & Black, supra note 57, at 931–37 (summarizing studies).

\textsuperscript{90} For evidence of this general phenomenon, see Harry DeAngelo & Linda DeAngelo, Proxy Contests and the Governance of Publicly Held Corporations, 23 J. Fin. Econ. 29, 46–49 (1989) (study of 60 proxy contests between 1978 and 1985: In one third of cases (21 of 60), dissidents obtained board control; for half the cases (20 of 39) in which dissidents did not obtain board control, the CEO, president, and/or board chairman resigned within 3 years of contest, 13 by end of first year; detailed case studies show significant dissident activity to replace incumbents in at least 75 percent of such turnovers); Ikenberry & Lakonishok, supra note 74, at 414, 424–25 (study of proxy contests between 1968 and 1987: where dissidents obtained at least one seat (50 of 95 cases), turnover of
Sometimes senior management was ousted in a subsequent takeover bid; at other times senior management simply resigned. The proxy battle apparently often served as a signal to external markets, and to the firm's board, of serious management deficiencies that warranted change. Corporate managers would want to eliminate any mechanism like cumulative voting that, by reducing the threshold of success, might encourage proxy contests.

Moreover, cumulative voting was also perceived as increasing the risk of a hostile takeover bid. The ascribed danger was that "even if [raiders] are not able to gain immediate control of the targets, board representation gives them access to confidential internal corporate information and creates the possibility of disruption at the board level. . . ."91 Thus, among the standard list of preventative antitakeover measures was elimination of cumulative voting, either through charter amendment in a permissive state or by reincorporation from a mandatory state to a permissive state.92

Management's willingness to change corporate domicile to avoid cumulative voting had a significant impact on the decision by several states to shift to permissive regimes.93 From an examination of the legislative senior management occurred in 58 percent of the cases (29 of 50) within two years following conclusion of contest; where management retained all seats (45 of 95 cases), such senior management turnover occurred in 25 percent of the cases (11 of 45). For the entire sample, such senior management turnover occurred in 42 percent of the cases (40 of 95)); J. Harold Mulherin & Annette B. Poulsen, Does A Proxy Have Real Moxie? An Analysis of Proxy Contests in the 1980s, at 9, tbl. 2 (Oct. 1, 1992) (unpublished manuscript, on file with author) (study of 187 proxy contests between 1979 and 1989: almost two thirds (64 percent) of contests were followed by change in top management within three years).

DeAngelo and DeAngelo also report that 15 firms of their 60-firm sample were sold or liquidated either during the campaign or shortly thereafter because of pressure by the dissidents, and that in seven of these cases, the transaction occurred after the dissidents obtained minority board representation. See DeAngelo & DeAngelo, supra, at 43-44.

91. 1 Arthur Fleischer, Jr., et al., Takeover Defense 457 (4th ed. 1990). The pace of proxy battles picked up during the 1980s, from a level of 10-13 annually during the 1979-1984 period, to 28 in 1988 and 31 in 1989. Although proxy battles were initially a tactic separate from tender offers, by the mid-1980s proxy contests and tender offers became intertwined. See Mulherin & Poulsen, supra note 90, at tbls. 1 & 2. Mulherin and Poulsen report that for a sample of 187 proxy contests between 1979 and 1989, 81 firms (43 percent) were subject to a tender offer in the period surrounding the proxy contest. In 54 of the cases subject to tender offer, the bidder was a proxy contestant; in the remaining 27 tender-related cases, a third party entered. See id. at 6-7. The most obvious explanation for the conjoining of proxy battle to a tender offer is the need to overcome defensive tactics such as the poison pill and state law protective options that are in the control of the target's board.


93. A survey of the Fortune 500 as of 1992 turned up 11 firms that had shifted corporate domicile to Delaware in the mid-1980s to avoid cumulative voting. The timing
process in four states that eliminated cumulative voting in the 1980s, California, Illinois, Ohio, and Missouri, it seems clear that legislative revision was significantly affected by the effort to hold onto corporations that might otherwise relocate to Delaware. Does this mean that the race was to the bottom? Antitakeover motives spurred the legislative process: but for the managerial response to takeover pressure, mandatory cumulative voting would probably not have disappeared so quickly and totally from the legislative landscape. It is therefore tempting to identify the elimination of mandatory cumulative voting as another kind of second generation antitakeover statute, which, as the empirical evidence makes relatively clear, generally reduces shareholder wealth. Antitakeover statutes clog the market in control that is the engine of the race-to-the top claim. Nevertheless it does not follow that mandatory cumulative voting—a regime under which every firm has cumulative voting—is necessarily optimal from the shareholder point of view.

The story behind the California elimination of mandatory cumulative voting is especially illuminating in this regard. Antitakeover motives seem to have provided a legislative cover for a defensive action by California public utilities against non-shareholder constituency pressure that cumulative voting made possible. Cumulative voting had been a longstanding objection of large public corporations to a California domicile. In 1976 cumulative voting was described as "the greatest burden of correlates rather well with the shifts by 9 states in the late 1980s from mandatory to permissive regimes. The firms were:

<table>
<thead>
<tr>
<th>Firm</th>
<th>Original State</th>
<th>Year</th>
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<tbody>
<tr>
<td>Atlantic Richfield</td>
<td>Pa.</td>
<td>1985</td>
</tr>
<tr>
<td>Clorox</td>
<td>Cal.</td>
<td>1986</td>
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<tr>
<td>Crane</td>
<td>Ill.</td>
<td>1985</td>
</tr>
<tr>
<td>Intel</td>
<td>Cal.</td>
<td>1989</td>
</tr>
<tr>
<td>Lockheed</td>
<td>Cal.</td>
<td>1986</td>
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<tr>
<td>Nacco</td>
<td>Ohio</td>
<td>1986</td>
</tr>
<tr>
<td>Occidental Petroleum</td>
<td>Cal.</td>
<td>1986</td>
</tr>
<tr>
<td>USG</td>
<td>Ill.</td>
<td>1986</td>
</tr>
<tr>
<td>Western Digital</td>
<td>Cal.</td>
<td>1987</td>
</tr>
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94. One might label it "second generation" because it focuses, in accordance with CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987), on internal governance procedures that can reduce the firm's susceptibility to takeover bids, whereas "first generation" statutes regulated the takeover process itself and were struck down by Edgar v. Mite Corp., 457 U.S. 624 (1982).

95. State "antitakeover" laws reduce shareholder wealth by 1 percent to 5 percent, depending on the strictness of the law. See Black, supra note 29, at 911–12 (collecting studies); Romano (1993), supra note 55, at 60–72, (summarizing debate).

Firms faced with hostile bids were very blunt about describing cumulative voting as an important reason for their exit. Nevertheless the legislature remained unmoved. Several large public firms left California for Delaware in the mid-1980s.

The origin of the effort in the late 1980s to eliminate cumulative voting was a 1987 report of the Corporations Committee of the Business Law Section of the California State Bar. The lawyers who drafted the revisions represented mostly high-tech companies, typically smaller public firms, not the large public companies that had changed domicile earlier. These firms were concerned about their increased vulnerability to

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98. See, e.g., Susan A. Rose, Comment, Optional Cumulative Voting & Staggered Terms of Directors: Is the California Climate Warming to Corporations?, 27 San Diego L. Rev. 467, 479 n.90 (1990) (“reason for reincorporation in Delaware is to prevent The Limited Inc. from gaining representation on the company’s board through the use of California’s cumulative voting procedures” (quoting Letter from Philip M. Hawley to Shareholders of Carter-Hawley-Hale (July 12, 1984))); see also Lockheed Corp. Proxy Statement 15 (April 1, 1986) (on file with author) (“One of the major advantages of the Reincorporation is that Delaware corporate law does not provide for [mandatory] cumulative voting.”); Union Oil Proxy Statement/Prospectus 8 (March 28, 1983) (on file with author) (explaining proposed creation of holding company structure with publicly-traded entity incorporated in Delaware as permitting addition of shark repellent charter provisions, elimination of preemptive rights, and elimination of cumulative voting); Western Digital Corp. Proxy Statement 12 (Oct. 2, 1986) (on file with author) (“In approving the Reorganization Proposal, the Board of Directors determined to take the following steps which may have anti-takeover effects: changing the election of directors by eliminating the right of shareholders to cumulate votes . . . ”).

By this point, although avoiding cumulative voting was regarded as significant, the crucial element in the out-migration was California’s delay in adopting a statutory limitation on directors’ liability for monetary damages in cases of alleged breaches of the duty of care, and, in the end, the adoption of a relatively restrictive provision.

100. See Memorandum on Legislative Proposal to Permit Classification of Directors by Term of Office and Elimination of Cumulative Voting for Corporations with Publicly Traded Securities (June 18, 1987). Various proposals to amend California corporation law in response to the takeover pressure of the 1980s were routed through an ad hoc commission, the Senate Commission on Corporate Governance, Shareholder Rights, and Securities Transactions [hereinafter Senate Commission], made up of state legislators, state officials, corporate lawyers, business representatives, shareholder activists, and legal academics. At least some commission members were persuaded by the argument that changes in California law “to eliminate the features that corporate managers objected to the most” were necessary in order to hold as California corporations various firms doing business in the state. The corporate bar worried that the exit of firms diminished the value of expertise in California law. State officials wanted corporations with a large California presence to be governed by California law. Telephone Interview with Susan Henrichson, Deputy Attorney General, State of California, and State Attorney General Designee on the Senate Commission (July 22, 1993).

101. Telephone Interview with Ronald Moskowitz, 1987 chair of the Corporations Committee (July 7, 1992). Note that Apple and Hewlett-Packard were California Fortune
proxy fights because of cumulative voting.\textsuperscript{102} The legislative debate was framed in terms of antitakeover implications.\textsuperscript{103} It was also argued that cumulative voting made a firm more susceptible to greenmail.\textsuperscript{104} Despite the opposition of, among others, the California State Teachers Retirement System and Institutional Shareholder Services,\textsuperscript{105} the legislation was adopted in the 1989 legislative session with the goal of making “incorporating in California more attractive.”\textsuperscript{106} This historical account suggests that the elimination of mandatory cumulative voting in California was antitakeover legislation and may have been part of a race to the bottom.

However, further inquiry reveals a more complicated causal chain that suggests that elimination may have served shareholder interests.\textsuperscript{107} The actual political impetus for passage of the legislation was apparently supplied not by the small high-tech firms, but by California public utilities that could not exit from the California corporate law regime. At its 1989 annual meeting, Pacific Enterprises, parent of Pacific Gas & Electric as well as Thrifty Stores, a drug store chain, was surprised by the near success of a labor union leader at winning a board seat. Marshalling support from employees under an ESOP with pass-through voting, a regional director of the Utility Workers Union obtained 75 percent of the votes necessary (7 percent) to win a board seat. In shocked reaction to the possibility of a union representative on the board, the public utilities’ managements, which are tied to a California corporate domicile by the Public Utility Commission, began pushing for the repeal of mandatory cumulative voting. The repeal measure, which was obtained at the very

500 companies that had not yet reincorporated to Delaware by the time of the legislative enactment.

\textsuperscript{102} Telephone Interview with Janice Hester-Amy, California State Teachers Retirement System (CalSTERS) designee on the Senate Commission (Aug. 17, 1993).

\textsuperscript{103} See, e.g., Revised Procedure Helps Company Resist Union Official’s Drive for Board Seat BNA Daily Lab. Rep., Mar. 6, 1990, at A-4, available in LEXIS, BNA Library, DLABRT File [hereinafter BNA Revised Procedure] (legislative assistant to bill’s sponsor, Assemblyman Bob Epple, said “the idea was to make it more difficult to mount a hostile takeover”).

\textsuperscript{104} Telephone Interview with Art Carter, lobbyist for the California State Association of Electrical Workers (Aug. 20, 1993). Walt Disney Productions, then a California corporation, had paid $325 million in greenmail to Saul Steinberg in 1984. See infra note 146 and accompanying text.

\textsuperscript{105} See Rose, supra note 98, at 490 n.183.


\textsuperscript{107} The following account is based on August 20, 1993 telephone interviews with Richard Damm, Senate Commission staff member, Richard Buxbaum, law professor and Senate Commission member, and Art Carter, lobbyist for California State Association of Electrical Workers. Additional facts were drawn from BNA Revised Procedure, supra note 103, at A-4, and from All Three California Electrics Drop Cumulative Voting Under New Law, Elec. Util. Wk., May 14, 1990, at 19, available in LEXIS, Energy Library, ELUTL File.
next legislative session, was not high-profile legislation. Most of the legislative actors believed it to be antitakeover legislation designed to retain California corporations, and the unions, completely unaware of the proposal, made no move to oppose it. It was only in 1990, when Pacific Enterprises proposed to eliminate cumulative voting from its charter, that unions were alerted to the change. The California State Association of Electrical Workers strenuously sought to reverse the change in the next legislative session but was unsuccessful; a legal change that could easily have been blocked was impossible to undo. In 1990 all three investor-owned electric utilities in California eliminated cumulative voting from their charters.

Thus from the shareholder point of view, elimination of mandatory cumulative voting in California is a mixed story. Most of the large public corporations had previously exited the state, so the effect of the change was in this respect already limited. For smaller, high-tech firms, cumulative voting may not necessarily improve shareholder welfare. For example, vigorous product market competition in the high-tech area may discipline management in ways that reduce the importance of a formal mechanism to facilitate shareholder access to the board. In any event, the sophisticated entrepreneurs, venture capitalists, and other initial investors in such firms would have had both the incentive and the skill to custom tailor a control regime that would optimize shareholder value; a mandatory term seems of doubtful benefit. In the case of the public utilities, a standard argument is that constituency representation on the board will reduce shareholder value: The constituent can use its board position to extract a greater share of the firm's profits (for example, in higher wages); the very process of trying to negotiate these claims at the board level will divert management from its primary role; and the multiplicity of claims will complicate the monitoring of managerial performance. Thus the change in the law is likely to have had different effects across firms, with the net impact uncertain.

108. See Ronald J. Gilson & Mark J. Roe, Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization, 102 Yale L.J. 871, 891–94 (1993) (product market competition may be key to success of Japanese governance system); see also supra note 1 and accompanying text.

109. See generally Gordon, supra note 19 (developing arguments against mandatory rules in most circumstances); Symposium, Contractual Freedom in Corporate Law, 89 Colum. L. Rev. 1395 (1989) (presenting different positions on mandatory corporate law debate).

110. See Oliver Williamson, Corporate Governance, 93 Yale L.J. 1197, 1206–07 (1984); Robert C. Clark, Corporate Law 20 (1986). Both the positive and the normative claim are contestable, of course. The German system of codetermination, for example, puts labor representatives on the supervisory board, presumably to facilitate negotiations over wages. As it emerged from a U.S. government-sponsored reorganization in 1979, Chrysler Corporation had a United Auto Workers representative on the board, reflective of the fact that the workers were, like shareholders, residual claimants.
In the other states I examined, Ohio, Illinois, and Missouri, the stories seem more straightforward.\textsuperscript{111} States were anxious to "modernize" their corporate law regimes, and especially to retain large public corporations that might otherwise move to Delaware. Antitakeover motives seemed to be in the air, but cumulative voting changes were not bundled with the antitakeover statutes adopted by each state. Thus one can be relatively confident about the importance of antitakeover impetus, suspicious about entrenchment motives, but still agnostic about the overall effects on shareholder wealth across the various corporations that would be freed from the mandatory regime. The case for cumulative voting needs a theory of shareholder and board interaction that does not generalize across all firms.

III. CUMULATIVE VOTING IN CORPORATIONS

The elimination of cumulative voting on a firm-by-firm basis paralleled the collapse of mandatory cumulative voting in the states. Cumulative voting was never as widespread among individual firms as might be suggested by the number of states that mandated it, however, because many firms were incorporated in states where cumulative voting was permissive, such as Delaware.\textsuperscript{112} In the 1940s cumulative voting was found in 40 percent of a sample of 2900 of the most significant corporations.\textsuperscript{113} By 1982, after the pressure from proxy contests beginning in the 1950s and from takeovers thereafter, approximately 24 percent of NYSE firms had cumulative voting.\textsuperscript{114} By 1989, after a decade of intense takeover activity, of a sample of nearly 1500 publicly-traded firms, only 18 percent had cumulative voting.\textsuperscript{115} A 1992 survey of the Fortune 500 indicated that of the 395 firms for which data was available, 14 percent had cumulative voting.\textsuperscript{116} This pronounced downward trend shows significant atrophy in the use of a governance mechanism.

Has this change served shareholder interests? Notwithstanding management's claims in the course of obtaining shareholder approval, the empirical and historical evidence is negative: the elimination of cumulative voting in large public firms has reduced shareholder wealth on aver-

\textsuperscript{111} See infra Appendix II for a discussion of the history of cumulative voting in these states.
\textsuperscript{112} This is not to say that Delaware firms did not often have cumulative voting. Even after the decimation of cumulative voting in the 1980s, a 1992 survey of Fortune 500 firms showed that 11 percent of Delaware corporations had cumulative voting. See Fortune 500 Survey, supra note 93.
\textsuperscript{113} See Williams, supra note 44, at 66–69; supra text accompanying note 73.
\textsuperscript{114} See Bhagat & Brickley, supra note 57, at 343.
\textsuperscript{115} See Corp. Takeover Defenses, supra note 92, app. G (sample covering 1,440 firms tracked by the IRRC, accounting for approximately 93 percent of the total capitalization of the NYSE, the Amex, and NASDAQ). A 1993 compilation reports cumulative voting in 16% of the IRRC sample. See Investor Responsibility Research Ctr., Corporate Takeover Defenses xiv (1993).
\textsuperscript{116} See Fortune 500 Survey, supra note 93.
age; managerial entrenchment motives seem to play the dominant role in the management decision to pursue elimination of cumulative voting. This evidence supports the argument that a revival of cumulative voting by institutional investors for appropriately selected large public firms would increase shareholder welfare, but is not itself dispositive: Cumulative voting may have a different impact on shareholder welfare in an era of frequent hostile takeovers than at a time of more conventional shareholder activity.

In seeking to eliminate cumulative voting, managements have offered shareholders "good governance" reasons that, if true, should lead to an increase in shareholder welfare. In a 1992 survey of Fortune 500 firms, I obtained twenty-five proxy statements of firms that eliminated cumulative voting at some point in their corporate lives. The most common justification found in this sample was a double-barreled attack on the principle and consequences of minority board representation: directors "should represent all shareholders, rather than the interests of a special constituency, and . . . the presence on the Board of one or more director representing such a constituency could disrupt and impair the efficient management of the Corporation."

Because the elimination of cumulative voting in a specific firm ordinarily requires shareholder approval, a stock price study can track the empirical question of shareholder welfare. Despite the "good governance" argument, the empirical evidence is that the recent elimination of cumulative voting in the large public firm has reduced shareholder welfare. Bhagat and Brickley studied NYSE firms in the 1962-82 period that eliminated cumulative voting (nineteen firms) or took other measures (such as classification of the board) that reduced the effect of cumulative voting (107 observations, some in the same firm). They found that elimination of cumulative voting reduced shareholder wealth by 1.57 per-

117. I sent the entire group a questionnaire. I obtained 333 responses. For an additional 62 firms I was able to supplement my survey results with information from the Institutional Investor Research Center, especially from Corp. Takeover Defenses, supra note 92. Of the 395 firms in my sample, 56 had cumulative voting and 36 had eliminated cumulative voting. See Fortune 500 Survey, supra note 93.

118. Lockheed Corp., Notice of Annual Meeting and Proxy Statement 15–16 (Apr. 1, 1986) (on file with author). This is also the most common objection raised to shareholder proposals in favor of cumulative voting.

119. Firms can eliminate cumulative voting in four ways, the three most common of which require a shareholder vote. Corporations domiciled in mandatory jurisdictions can reincorporate in a permissive jurisdiction under a charter that provides for straight voting. Corporations in permissive states can amend their charter to eliminate cumulative voting. In states that shift from mandatory to permissive cumulative voting, corporate action requiring shareholder vote is usually necessary, either to opt out of the mandatory regime or to eliminate a charter provision that tracked the statutory mandate. In a less common scenario, in some states, such as Missouri, the board acting alone through a bylaw amendment can eliminate cumulative voting if it was prescribed only in the firm's bylaws and if the board otherwise has the power to amend the bylaws. See Appendix I.

120. See Bhagat & Brickley, supra note 57, at 348–50.
cent on average and that all measures that reduced its effectiveness (including elimination) reduced shareholder wealth by 0.88 percent on average.\footnote{121} Although they come from one study only, these results are economically significant.

In understanding the motives for the elimination of cumulative voting and the likely effect, it is illuminating to consider the historical context in which large public firms have raced to make this governance change. Firms rarely implement good governance strategies in a vacuum. Efforts to eliminate cumulative voting often seemed driven by the fear of a specific takeover effort in which cumulative voting could play a role or, especially in the 1980s, were initiated as a barricade against any potential raider.\footnote{122} A few examples give the flavor. In 1964, for example, Quaker State Oil Refining Corporation successfully moved to eliminate a cumula-

\footnote{121. These results were statistically significant at or above the 95\% confidence level. See id. at 354. Actually, at least 52 firms eliminated cumulative voting during the period, but the analysis was performed on a "clean" sample of 19 firms, which was screened to eliminate possibly confounding events, such as adoption of an employee compensation pension plan. See id. at 349-50. The claim that shareholders would vote for a governance change that reduced shareholder value, and a study that purports to show this, seem at first glance paradoxical. The usual explanation is in terms of management's control over the firm's proxy machinery and the collective action problems associated with shareholder voting. See, e.g., Gordon, supra note 19, at 1573-80.}

\footnote{122. Ironically, cumulative voting has also been used tactically to forestall a raider. In 1964, The B.F. Goodrich Co., the subject of a possible hostile takeover bid by Northwest Industries, both classified its board and adopted cumulative voting to discourage the offeror by delaying its control over the board. See The B.F. Goodrich Co., Notice to Stockholders and Proxy Statement 5 (Feb. 21, 1969) (on file with author); Telephone Interview with Joan Taffi, Counsel, The B.F. Goodrich Company (July 7, 1993). With a classified board, the purchaser of a majority but not a supermajority of the corporation's stock might have to wait three years (assuming three classes) to attain control of the board. The takeover threat vanished over the ensuing year and the company immediately eliminated cumulative voting. See The B.F. Goodrich Co., Notice to Stockholders and Proxy Statement 2-3 (Mar. 13, 1970) (on file with author). More recently various firms have adopted "contingent" cumulative voting to strengthen the antitakeover effect of board classification. Straight voting applies until a shareholder reaches a trigger point of stock ownership, at which point other shareholders may vote cumulatively. The effect is the same as that achieved by the temporary adoption of cumulative voting by B.F. Goodrich, although in this case the temporary effect is embedded into the charter. This device rejects cumulative voting except in the case where it can be employed as a management entrenchment tactic. See Institutional Shareholder Services, Inc., The ISS Proxy Voting Manual 174-75 (2d ed. 1991). The Fortune 500 survey, supra note 93, shows that firms that have adopted this device include Dover Corp., Harris Corp., International Multifoods, Martin Marietta, and Maxus Energy Corp. Maxus adopted contingent cumulative voting, along with a series of other antitakeover measures, in 1985 to fend off a hostile bid from Occidental Petroleum (Maxus was then known as Diamond Shamrock Corp.). See Letter from Lynne Ciuba, Counsel, Maxus Energy Corp., to Jeffrey Gordon, Professor of Law, Columbia School of Law (July 15, 1993) (on file with author). These measures obviously had only limited effect, since the company went through a major restructuring in 1987 in response to a hostile bid from Mesa Petroleum (T. Boone Pickens). See Diamond Shamrock Corp., Notice of Annual Meeting and Proxy Statement 1-2 (Apr. 3, 1987) (on file with author).}
tive voting charter provision in response to the board's discovering "that a stockholder has recently been acquiring a substantial holding in the Company and may be in a position in the future through cumulative voting to gain a seat on the Board." To assuage possible shareholder objection, the cumulative voting proposal was bundled with a two-for-one stock split, which was then commonly thought a desirable corporate development. In October 1987, Gencorp held a special meeting to eliminate cumulative voting, following an effort at the previous annual meeting by the Gabelli Group to invoke it to elect a director. (Gencorp successfully rejected Gabelli's effort, on the ground of insufficient notice.) In February 1990, as previously described, Pacific Enterprises, at a special meeting, eliminated cumulative voting following the almost-successful campaign by a labor union official to win a board seat. The company anticipated "a more extensive election contest by individuals supported by the union" in 1990 and explained that the elimination of cumulative voting would make their election more difficult.

The most important recent example of elimination of cumulative voting in response to a specific takeover threat was Gulf Oil's reincorporation from Pennsylvania to Delaware to try to fend off Boone Pickens' efforts to force a restructuring. Pickens and his partners began buying Gulf stock in August 1983, ultimately acquiring more than 13 percent, as part of a stated objective to force Gulf to set up an oil royalty trust to pass production profits tax-free to shareholders. As part of its counterstrategy, Gulf called a special shareholder meeting in December to approve the reincorporation, fearing that, under the existing cumulative voting provisions in its charter, Pickens could elect three directors, push for his plan from the inside, and eventually force Gulf to buy his stock at a premium. Gulf's reincorporation proposal passed by a bare

123. Quaker State Oil Refining Corp., Notice of Special Meeting of Stockholders and Proxy Statement 3 (July 9, 1964) (on file with author).
125. See id. at 11. Before the annual meeting, Gencorp was the subject of a hostile takeover bid that was eventually withdrawn after the company undertook a leveraged restructuring. See id. at 14-15.
128. See Tim Metz et al., Future of Gulf Oil Hinges on Proxy Fight Led by Mesa Chairman, Wall St. J., Nov. 2, 1983, at A1, A18; see also Gulf Oil Corp., Notice of Special Meeting of Shareholders and Proxy Statement/Prospectus 7 (Oct. 26, 1983) (on file with author) ("One of the immediate effects and, in the view of the Board of Directors, one of the principal advantages of the Reorganization results from the fact that Delaware law does not provide for cumulative voting in the election of directors (unless the certificate of
majority, Pickens made a partial tender, and eventually Gulf management sold the firm to Chevron, which outbid a management buyout proposal.\textsuperscript{129}

The raid on Gulf seems to have galvanized efforts to eliminate cumulative voting. One factor that distinguished Gulf from other major oil companies was the relative vulnerability that cumulative voting apparently created. Cumulative voting invited Pickens' initial gambit to seek board representation; but for cumulative voting, he might have looked elsewhere, and so, at the far edge of the causal chain, but for cumulative voting Gulf would have remained independent.\textsuperscript{130} In short, cumulative voting made it easier for a minority stakeholder—who might not have been able to finance a bid for a majority of the stock—to put a company in play. The prudent corporate manager would want to eliminate this exposure.

Implementation of such risk-averse strategies led, in the 1980s, to an unprecedented wave of charter amendments and reincorporations to eliminate cumulative voting, even at the largest firms, since the activity of takeover entrepreneurs like Pickens revealed that size alone was not an adequate takeover defense. My survey of the 1992 Fortune 500 showed a relative smattering of cumulative voting eliminations in the 1960s (five in the decade) and the 1970s (two in the decade) but a torrent beginning in 1983 (27 in the ensuing decade). A recent study by the Investor Responsibility Research Center of a nearly 1500-firm sample shows a similar pattern: after relatively rare eliminations of cumulative voting in the 1970s and early 1980s, many firms (139) eliminated cumulative voting in the 1983–92 period, a period of unprecedented activity in the market for corporate control.

\begin{table}
\centering
\begin{tabular}{|l|l|}
\hline
        & Fortune 500 & IRRC 1500 \\
\hline
1983    & 2           & 7           \\
1984    & 2           & 6           \\
1985    & 3           & 21          \\
1986    & 6           & 19          \\
1987    & 5           & 25          \\
1988    & 3           & 16          \\
1989    & 2           & 10          \\
1990    & 2           & 20          \\
1991    & 0           & 6           \\
1992    & 2           & 9           \\
\hline
\end{tabular}
\end{table}

incorporation otherwise provides, which it does not in the case of the Holding Company).\textsuperscript{a}).

129. See Gulf Oil Corp. — Takeover, supra note 127.
130. I owe this suggestion to Steven Kaplan.
The pattern revealed in Table I suggests that takeover lawyers were giving firms the same advice: eliminate cumulative voting.\textsuperscript{131} Whatever the general governance issues raised by cumulative voting, the control threat that it apparently entailed was dispositive. Thus the historical pattern is consistent with the empirical evidence that the recent wave of cumulative voting eliminations served management's interests more than shareholders'.

Nevertheless, the value of cumulative voting as a governance reform for the 1990s is still open for debate. The evaluation of cumulative voting throughout much of the 1970s and especially the 1980s included a worried assessment of its impact on a firm's susceptibility to a hostile takeover bid. As an empirical matter, the elimination of cumulative voting played like a shark repellent charter amendment, which commonly reduces shareholder wealth.\textsuperscript{132} In light of changes in the legal and financial framework that make hostile takeovers much harder to mount in the 1990s,\textsuperscript{133} cumulative voting must now be evaluated principally for its effect upon the governance of a firm that is unlikely to undergo a control transaction. In other words, the Bhagat & Brickley study collapses arguably different variables: the value of cumulative voting as a means to enhance capital market pressure on the firm and as a means to improve the firm's internal governance mechanism.\textsuperscript{134} A case for the revival of cumulative voting for the large public firm must attend to current historical circumstances, in which the governance question is key. To that argument we now turn.

IV. THE REVIVAL OF CUMULATIVE VOTING

A. A New Rationale

An argument for a revival of interest in cumulative voting has several burdens to overcome. Mandatory cumulative voting, which fifty years ago was embraced by twenty-two states, including several major commercial states, has fallen into great disfavor, finding only six remaining adherents, none of which is a major commercial state.\textsuperscript{135} Nor do corporations tend to use the option in permissive states: cumulative voting is increasingly

\begin{itemize}
\item \textsuperscript{131} See, e.g., Fleischer et al., supra note 91, at 457–58.
\item \textsuperscript{132} See Gilson & Black, supra note 57, at 621–26 (summarizing studies).
\item \textsuperscript{133} See Gordon, supra note 2, at 1931–32.
\item \textsuperscript{134} Bhagat & Brickley supply some limited evidence that cumulative voting will indeed have value as a governance mechanism in the large public firm. Of their 19-firm sample of firms eliminating cumulative voting, they identify seven firms that exhibited no evidence of a looming proxy battle or takeover bid in the two-year period prior to the event date, and find an average effect on shareholder wealth of negative 2.01 percent; six of the seven firms show negative returns; one, no change. See Bhagat & Brickley, supra note 57, at 356–57. The sample is too small to draw any strong conclusions. See also infra note 147.
\item \textsuperscript{135} See supra text accompanying notes 50–53.
\end{itemize}
absent from the governance structure of large public corporations.\textsuperscript{136} The plausibility of cumulative voting may have been undermined by the quixotic efforts of a small band of individual shareholders who fought for its reinstatement in an era of its widespread elimination. Ever since the 1950s, the major public proponents of cumulative voting have been the Gilbert brothers, who annually present such shareholder proposals at many firms arguing that minority representation is an essential feature of shareholder democracy.\textsuperscript{137} The repeated failure of these proposals and the absence of significant public support from the academic or activist institutional investor community has somewhat discredited cumulative voting as an important corporate governance reform.

The more significant burden is the intellectual one. One possible reason that cumulative voting has not been seriously examined for a generation is that the debate that raged in the 1950s seems to have been won by its opponents. Cumulative voting took hold in nineteenth and early twentieth century American corporate law for two reasons: an ideological belief in minority representation in legislative bodies, which was carried over to the boards of directors, and a functional concern about the vulnerability of minorities to exploitation by overreaching majorities, especially in light of the difficulties that public shareholders faced in obtaining information about the firm. By the 1950s the original functional explanations had lost much of their force. Many of the federal securities laws adopted in the 1930s and 1940s aimed directly at the shady practices of nineteenth century corporate predation, including fraud in the issuance of securities and fraud in obtaining proxies, and maintenance of certain abusive holding company structures. Moreover, new state statutes gave shareholders some access to corporate books and records; more importantly, the continuous disclosure requirements under the 1934 Securities Exchange Act gave shareholders access to accurate, timely corporate information that had previously been available only to a director. The Securities Exchange Commission took a vigorous enforcement role in expounding the disclosure system and in policing against financial fraud. In addition, state law fiduciary rules on self-dealing by corporate insiders were toughened.\textsuperscript{138} Express and implied private rights of action under the federal securities laws gave public shareholders additional protection against management depredations.

\textsuperscript{136} See supra text accompanying notes 113–116.


\textsuperscript{138} See Harold Marsh, Jr., Are Directors Trustees?: Conflict of Interest and Corporate Morality, 22 Bus. Law. 35 (1966) (reaction to abuses produced per se prohibitions by 1880, which were somewhat relaxed in ensuing decades).
The opponents of cumulative voting could also point to ways in which cumulative voting might interfere with optimal corporate function, especially in the large public corporation. A minority stockholder could insist on a board seat, and, depending on his disposition, reduce the board’s effectiveness. Instead of an effective working group, the board could become a debating forum. More seriously, a minority stockholder might use board access and the threat of disruption to hold up the corporation for greenmail, or conceivably to obtain access to competitively valuable information. In general, as Williams put it, cumulative voting can be seen as meaning “the election of directors who are by their nature partisans of particular interest groups; and the role of a partisan on the board of directors is inherently inconsistent with the proper function of a director.”

Finally, as a matter of theory, the corporate board seems a poor venue for the play of different notions of representative democracy among a shareholder electorate. Unlike a government, the corporation has a limited function under the constraints of a regime of profit and loss. Unlike citizens of a state, shareholders of a public firm can readily exit through the stock market. In the case of a close corporation, where exit is limited, it may be, as the opponents of cumulative voting argued, that specifically tailored shareholder agreements to cover governance or buyouts and involuntary dissolution statutes, are superior to cumulative voting. In general “shareholder democracy” borders on conceptual incoherence, the phrase a virtual oxymoron. Both straight voting and cumulative voting link voting power to the number of shares owned; both systems of corporate voting link aggregate wealth, not persons or interests.

139. It is put this way in the most convincing anti-cumulative voting piece of the 1950s debate:
The “raider” is pictured as using cumulative voting to elect a minority of the directors either (i) as a first step toward eventually electing a majority of the directors and wresting control from a dedicated and successful management in order to carry out his personal designs; or (ii) as a means of pressuring that management, through harassing conduct and threats in and out of directors meetings, into taking the action demanded by the “raider” at the expense of the majority stockholders. Such action might take the form of acquiring some property in which the “raider” is interested, declaring unwise dividends or other action to cause a temporary rise in the market price of the stock so that he can take a profit at capital gain rates, or the corporation buying out his shares at an exorbitant price.

Sturdy, supra note 80, at 550; see also Ralph E. Axley, The Case Against Cumulative Voting, 1950 Wis. L. Rev. 278, 283. Courts did not police such potential uses of cumulative voting. See Chicago Macaroni Mfg. Co. v. Boggiano, 67 N.E. 17 (Ill. 1903); Tomlin v. Farmers & Merchants Bank, 52 Mo. App. 430 (Ct. App. 1893).

140. Williams, supra note 75, at 112.

141. See Sturdy, supra note 80, at 556–65.

142. For a justification of shareholder voting per share rather than per capita, see Gordon, supra note 6, at 359 (noting avoidance of exploitation of economic majority by numerical majority, and increased likelihood of correct shareholder decision-making because shareholder incentives to collect and analyze information increase with economic
It is hard to take seriously the deontological equality-based arguments that underlie much democratic theory in a debate about cumulative voting in corporate law.\textsuperscript{143} Cumulative voting, like most of corporate law, should rise or fall on functional arguments about its usefulness in securing the highest possible total return from corporate economic activity.\textsuperscript{144} In particular, cumulative voting should be evaluated on its capacity to enhance management's accountability to shareholders.

The rise and fall of cumulative voting is not, however, simply the result of an evolutionary process in which a dysfunctional adaptation was eventually rejected. For some time cumulative voting has been a remedy in search of a problem. The base case that gave cumulative voting its legitimacy was the firm in which discrete minority interests faced a cohesive majority. The debates in the 1870s posed the hypothetical of a 49 percent shareholder facing a 51 percent shareholder; the same hypothetical was posed in Congressional debates in the 1950s.\textsuperscript{145} Under these conditions one might worry about possible oppression of the minority from a majority-only board. But as Berle and Means reported in 1932, the actual

\textsuperscript{143} See, e.g., John Rawls, Political Liberalism XIV (1993); Amy Gutmann, Liberal Equality (1980); Bruce Ackerman, Social Justice in the Liberal State (1980); Ronald Dworkin, Taking Rights Seriously (1977); Lawrence G. Sager, The Incorrigible Constitution, 65 N.Y.U. L. Rev. 893 (1990). Moreover, shareholders are ordinarily assumed to share the same goal—the maximization of share price, see infra note 151. Thus the important arguments for and against cumulative voting in the political realm, where voters have very different objectives, will ultimately be quite different than in the corporate realm. See, e.g., Lani Guinier, No Two Seats: The Elusive Quest for Political Equality, 77 Va. L. Rev. 1413 (1991) (discussing the need to ensure meaningful minority interest representation at both electoral and legislative stages of political process); Lani Guinier, The Representation of Minority Interests: The Question of Single-Member Districts, 14 Cardozo L. Rev. 1195 (1993) (arguing for increased emphasis on voter participation and choice, and stressing importance of proportionality as means of increasing minority interest representation); Akhil R. Amar, Note, Choosing Representatives by Lottery Voting, 93 Yale L.J. 1283, 1300-03 (1984) (discussing advantages of lottery voting versus cumulative voting in securing effective proportional representation); see generally Douglas W. Rae, The Political Consequences of Electoral Laws 31-46 (1967) (examples of different cumulative voting methods used in Western European nations).

\textsuperscript{144} This is not necessarily to embrace a shareholder wealth maximization standard as the only objective of corporate law. The question of the distribution of the surplus of economic activity is different from the question of the conditions under which that surplus will be maximized. See supra note 2. Moreover, society may well situate "corporate law" within a system that constrains profit maximization or gives voice in corporate governance to interests other than shareholder interests. The rules of corporate law under any such system should be evaluated in functional terms, not on the basis of a priori theory.

\textsuperscript{145} See Williams, supra note 42, at 28-29 (quoting 19th century debates in Idaho and Pennsylvania); House of Representatives Hearings on S. 256, supra note 83, at 37 (statement of Fred Walker, director of First National Bank of Arlington, Virginia).
distribution of share ownership meant that in many large public firms, there was no majority; ownership was separated from control.

In the large public corporation there was no face-off between majority and minority interests; rather, management was the party on the other side. Thus the potential role of cumulative voting changed, from giving a minority a voice in a majority-dominated firm to giving a minority a voice in a management-dominated firm. This led to a significant problem. Management’s control, because it rested only on the proxy machinery and on the majority’s apathy, seemed at risk in such a confrontation. Because a tenacious minority could do real damage to management’s position, management would face the temptation to accede to various rent-extraction proposals that a minority might present. In short, in the absence of a majority check on minority power and without adequate monitoring of management by the majority, the minority’s power under a cumulative voting regime made the firm vulnerable to hold-up.

Cumulative voting enhanced the potential influence of a cohesive minority, which, as contemporary public choice theory makes us aware, faces a lower cost of organization than a diffuse majority. In the context of the public corporation, a rent-seeking minority could use that power to extract private gains. Indeed, the presence of cumulative voting might conceivably encourage the formation of rent-seeking minority blocs, as the returns from minority ownership positions increased. For example, a potential greenmailer would gain additional leverage in a firm with cumulative voting, because his minority stake could provide immediate board representation.\[14\]

146. In the Pickens/Gulf Oil contest, see supra text accompanying notes 127–129, “Gulf insiders [were] particularly worried that without the switch [the elimination of cumulative voting following upon the reincorporation of Gulf from Pennsylvania to Delaware] Mr. Pickens could win a seat on the board and make so much trouble . . . that Gulf would be forced to buy the group’s stock at a multimillion-dollar premium.” Metz et al., supra note 128, at A18. Although Pickens had previously accepted greenmail, he did not accept it in the Gulf contest, even though it was offered. See Sobel, supra note 67, at 140–46. One of the arguments made for the repeal of mandatory cumulative voting in California was that it would reduce firms’ vulnerability to greenmail. Walt Disney Productions, for example, was a California corporation at the time of the greenmail payment to the Saul Steinberg group. But see Heckmann v. Ahmanson, 214 Cal. Rptr. 177, 182–83 (Cal. App. 1985) (limiting corporation’s ability to pay greenmail in Disney litigation). Disney reincorporated in Delaware in 1987.

Other firms with cumulative voting that paid greenmail include: General Host, a New York corporation that paid to Clabir, see Michael Bradley & L. Macdonald Wakeman, The Wealth Effects of Targeted Share Repurchases, 11 J. Fin. Econ. 301, 310 n.3 (1983); and Chicago Rivet and Machine Company, a Michigan corporation that paid to dissidents, see DeAngelo & DeAngelo, supra note 90, at 53. Nevertheless the incidence of greenmail was sufficiently widespread in firms without cumulative voting that it would be hard to make an empirical case that cumulative voting made a particular firm a greenmail target. Pickens, for example, obtained greenmail from Superior Oil, a California corporation, but also from Phillips Petroleum, which did not have cumulative voting. In theory a firm could adopt an anti-greenmail charter amendment, but drafting an appropriate provision is complicated, see Ronald J. Gilson, Drafting an Effective Greenmail Prohibition, 88 Colum.
In such circumstances, whether cumulative voting would increase the value of the firm is not obvious. Minority representation on the board could add independent, critical scrutiny of management action and thereby improve corporation decision-making and managerial accountability. Or cumulative voting could lead to costly managerial strategies to buy off a determined minority, in addition to potential disharmony on the board. In any event, management has been able to use its influence over the proxy process and the not altogether fanciful concerns regarding cumulative voting to eliminate cumulative voting from most public corporation charters.

The analysis thus far suggests that cumulative voting, conceived as a means of proportional representation for minority interests, may become a vehicle for minority rent-seeking. But this concern depends on a particular ownership structure, in which a discrete minority faces a disorganized majority. The ownership structure of the typical public corporation is now visibly different from this model. For many firms, institutions as a

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L. Rev. 329 (1988), and management might therefore prefer the option of buying off an obstreperous shareholder, see, e.g., Levine v. Smith, 591 A.2d. 194 (Del. 1991) (G.M.’s repurchase of shares of Ross Perot), and private gain-seeking may take forms other than greenmail.

147. This argument is not inconsistent with Bhagat and Brickley’s finding of average negative shareholder wealth effects associated with the elimination of cumulative voting. See Bhagat & Brickley, supra note 57, at 353–55. The board access provided by cumulative voting may increase shareholder wealth in two ways: first, it may improve the firm’s performance because of the activity of a “relational” investor; second, it may increase the possibility of a takeover bid, both generally and relative to other firms in the industry. See supra notes 127–129 and accompanying text. Bhaghat and Brickley’s sample was drawn from the period 1962–82, but almost all cases of the elimination of cumulative voting (17 of 19) occurred after the 1968 adoption of the Williams Act, see Bhagat & Brickley, supra note 57, at 348–51. Thus the pure corporate governance effect and the takeover effect of elimination are hard to disaggregate. A comparable study of firms that are currently eliminating cumulative voting might possibly separate the effects, because poison pills and state antitakeover laws and cases have significantly reduced the possibility of hostile acquisitions.

148. It has also been argued that cumulative voting would reduce the value of the firm because it potentially impedes changes in control and because it “increases the chance that there will be multipeaked preferences among the members of the board” that create the potential for “inconsistent or illogical decisions.” Frank H. Easterbrook & Daniel R. Fischel, Voting in Corporate Law, 26 J.L. & Econ. 395, 409–10 (1983). Because of the interaction of cumulative voting and board classification, cumulative voting indeed has defensive uses, see infra text accompanying notes 181–182, but managements promoting the elimination of cumulative voting have obviously decided that on balance it facilitates changes in control, see supra text accompanying notes 92–93. Moreover, the firms that contemplate a defensive use have adopted contingent cumulative voting schemes that restrict its availability to circumstances in which a single shareholder owns more than a threshold amount, see supra note 122 and accompanying text. Inconsistent decision-making or “cycling” on a board may be more likely with cumulative voting. Nonetheless, it seems unlikely to be a significant problem because of the small group dynamics of a board engaged in repeat play, faced with both the immediate evidence of a cycle and its destructive consequence. See Gordon, supra note 6, at 371–72.
group own 50 percent or more of the stock.149 Cumulative voting in such a firm should play a very different role: it should give activist institutions the power to put directors on the board. In exercising that power, institutions would almost assuredly act on behalf of shareholder welfare generally, and not as part of a rent-seeking strategy. The elements that limit the power of individual institutions—the ownership constraints and the limits on managerial compensation—also make it very unlikely that institutions would use this governance mechanism to seek significant private gains. In order to accumulate the votes necessary to elect directors, activist institutions would have to coordinate their actions, which would give rise to cross-monitoring of institutional behavior.150 Institutional managers would have little incentive to pursue private gains because they cannot capture such gains in their compensation. The strategy that institutions would reliably pursue under cumulative voting would be to enhance the quality, independence, and accountability of the board in the hope that this will improve the firm’s performance. Institutions will earn returns from this strategy through their share ownership, meaning that the benefits of institutional engagement flow to all shareholders.151 This model reconceives the purpose of cumulative voting: Instead of providing a mechanism for minority representation, cumulative voting becomes a vehicle for virtual representation of majoritarian interests by a well-motivated minority.152

149. See supra note 4 and accompanying text.

150. See Black, supra note 6, at 855–61 (An institution will use its voting power appropriately because the reputation that ensues “will elicit cooperation from other money managers.”); Mark J. Roe, Some Differences in Corporate Structure in Germany, Japan, and the United States, 102 Yale L.J. 1927, 1981–82 (1993) (noting that coalitions among institutions usually are a prerequisite to action). This mutual monitoring can also be relied upon to limit the possible rent-seeking of other potential large investors, such as suppliers or customers, who in Japanese keiretsu fashion may acquire stock and attempt to exert influence.

Indeed, the board composition approach to relational investing, of which cumulative voting is a part, will reduce the opportunistic potential of large investors, including institutions. Investor influence will tend to be mediated through the board, whose proceedings are more susceptible to legal scrutiny than behind-the-scenes maneuvering. Rent-seeking possibilities by institutional investors already exist; a board composition approach will make cross-monitoring easier. See Gordon, supra note 6, at 376–379.

151. Underlying this argument is a claim that all shareholders, irrespective of risk and time preferences, prefer that corporations maximize the share price, a claim of “shareholder unanimity.” Although shareholder unanimity theorems are unlikely to hold in the pure forms as presented in the finance literature, see Gordon, supra note 6, at 368–70, in practice public shareholders are likely to be better off on average if managers can be disciplined to pursue share price maximization. The important point is that institutional investors are likely to pursue gains common to all shareholders rather than private gains allegedly pursued by the large shareholding individual.

152. Burke defines virtual representation as a relationship in which “there is a communion of interests and a sympathy in feelings and desires between those who act in the name of any description of people and the people in whose name they act.” Edmund Burke, Burke’s Politics 494 (Ross J.S. Hoffman & Paul Levack eds., 1949). For a general discussion, see Hanna F. Pitkin, The Concept of Representation 173–89 (1967). For a
Viewed in this light, cumulative voting helps overcome the rational apathy problem in the public firm. It changes in a favorable way the cost-benefit analysis of the activist institutional shareholder. Compare two strategies for adding a minority of independent directors to the board: a direct election contest and cumulative voting.\textsuperscript{153} Success in the direct election requires 51 percent of the vote; success under cumulative voting requires only minority support (how much support depends on the number of directors up for election).\textsuperscript{154} Although the exact cost func-

discussion of virtual representation in American constitutional law, see John H. Ely, Democracy and Distrust 82-88 (1980).

One possible objection to this model is that opening the door to the use of cumulative voting for institutions, who might represent all public shareholders, will necessarily open the door as well to its use by minorities with private gain-seeking objectives. The answer is that the ownership structure that makes this reconception of cumulative voting possible will also reduce the risk of its use in rent-seeking, because of greater checking of the minority and greater monitoring of management. A minority gains its power because of the disorganization of the opposing majority. Institutions will provide an organized counterweight in firms that adopt cumulative voting on the theory proposed here. Classification, which raises the threshold of interest necessary to elect directors, may also play a role in reducing this risk. See infra notes 180-182 and accompanying text.

The heightened concern about greenmail in the 1980s in firms that had cumulative voting, see supra note 146, is not an objection to this argument. To be sure, those firms may have had significant institutional share ownership. What they lacked was shareholder organization (although later in the decade firms came under increased institutional pressure to resist greenmail). The initial formation of an activist shareholder block, the shareholder mobilization necessary to push management to adopt cumulative voting, and the annual negotiation over board composition by the activist minority would all generate an organizational counterweight to potential opportunistic use of cumulative voting by a minority stockholder.

\textsuperscript{153} As discussed below, the proxy rules now permit a dissident to present a slate of directors that includes some of management’s nominees as well as its own candidates. See infra note 172 and accompanying text. The assumption on which the discussion proceeds is that the activist institution is engaging in a representation contest rather than a control contest. The number of directors that an institution might want to add to a board is a complicated question. Presumably the institution wants to break up the small group psychology that might inhibit the board’s monitoring of managers, and seeks to enhance the sense of accountability that directors will feel to shareholders. Less desirable would be a sentinel, who could alert large shareholders to corporate events as appropriate. The decision would depend very much on the particular firm and the particular director(s) the institution might want to add.


\textsuperscript{154} The measures of success may not be identical. Assume an institution wishes to add 5 directors to a 15-person board. Under straight voting, if it can gather 51 percent support, it can elect those 5 directors at once, even if the board has three classes. Under cumulative voting, obtaining minority support will produce fewer than 5 directors (depending on the percentage obtained) and, ironically, if the institution can gather majority support, may not always produce as good an outcome as under straight voting. In the hypothetical above, for example, management, with 49 percent, would win 2 seats. Of course, under straight voting, if the institution fails to obtain 51 percent, it loses
tions depend on the distribution of share ownership in the particular firm, on average the organizational and campaign costs for success under cumulative voting will surely be less than in the direct election. The majority of shareholders in a public corporation may in fact remain apathetic, because not every institution will play an activist role and because of coordination costs among institutions (assuming that individual institutions continue to own relatively small blocks only). But a core of institutional activists, a well-organized minority, could use cumulative voting to play a significant role in a board-composition strategy, whose benefits all shareholders would ratably receive. The goal would not be to nominate a specific minority slate, but rather to use the structural leverage of a cumulative provision to obtain agreement on directors who would add independence and perhaps particular entrepreneurial strengths to the board. In this way, cumulative voting would become a remedy to a genuine current problem: how to enhance the power of shareholders in order to buttress the independence of the board and its capacity to monitor the managerial team.

The revival of cumulative voting in an era of growing institutional stock ownership can also be defended in terms of comparative market liquidity. Cumulative voting arose at a time when stock markets for most firms were illiquid. Because exit was difficult, voice required special protection. As markets became deeper and broader, the need to protect voice in public firms via cumulative voting diminished; an investor dissatisfied with management's running of the firm could sell—this became the "Wall Street Rule." Modern revisions of mandatory cumulative voting statutes reflect the importance of market liquidity in their continuation of mandatory cumulative voting in the closely-held firm. As noted completely. So cumulative voting will be an influence-maximizing strategy when institutions believe they can regularly assemble a significant minority voting block in director elections but not a majority.


156. Thus it should be clear that this paper does not argue for a return to mandatory cumulative voting, but argues rather that for firms with a particular ownership structure, cumulative voting can function in a way that should increase the value of the firm to shareholders. There might well be circumstances, for example, a firm with an ESOP with pass-through voting, see, e.g., supra text accompanying note 126 (discussing election campaign at Pacific Enterprises by union representative), when cumulative voting, whatever its potential virtues as a vehicle of minority representation, would not serve this goal.

157. See supra text accompanying notes 5–6.

many institutional investors now feel that exit is much less feasible—that their effective market liquidity is substantially diminished. Thus voice once again becomes more important and, in appropriate circumstances, deserving of the special protection that cumulative voting can offer.

Cumulative voting may be particularly desirable for firms facing a complicated competitive environment, in which the adaptability of the firm becomes increasingly valuable. A standard objection to cumulative voting is its potential for boardroom disruption that distracts management from its tasks.160 This objection stands, although in weaker form, even with an ownership structure that reduces the risks of private gain-seeking and thus makes opportunistic disruption unlikely. The objection is founded on the same assumptions about boardroom dynamics that lead managers to prefer a collegial board rather than a monitoring board.161 But as the firm’s ability to adapt quickly to new competitive scenarios gains in value, the risks of boardroom complacency become much more threatening than the risks of boardroom disruption. The balance then shifts in favor of the desirability of more tension in the boardroom and more questioning of management’s plans and underlying assumptions, all of which may hasten the firm’s response to changed circumstance. Thus the institutional use of cumulative voting, which buttresses director independence and accountability, will strengthen the board’s ability to prod management in valuable ways. Not only may cumulative voting help address the governance problems faced by locked-in institutional holders, but it may also enhance the board’s role in the firm’s early warning system against economic obsolescence.

Such a renewal of cumulative voting at firms with an appropriate ownership structure will serve managerial interests as well. Cumulative voting increases the likelihood that institutions will take a “board composition” approach to their role as relational shareholder rather than resort to a “policy participation” approach. In conjunction with other reforms that would enhance their influence over the composition of the board,162 activist institutions may decide that their long-run interests are better served by working through the board than through special access to management. Managers may find board-centered institutional engagement less threatening or disruptive than the alternatives.

B. Implementation

What are the practical problems to implementation of this scheme? The most significant one is that, in the absence of a mandatory statute,
the charter must provide for cumulative voting, at least under Delaware law. In almost all states, managers have veto power over charter amendment, which requires an affirmative board resolution as well as a shareholder vote. This means that cumulative voting can be added only after a campaign in which shareholders, through affirmative endorsement of precatory resolutions and other efforts, persuade managers to make this change. How hard will it be to get majority shareholder support for this change? How hard will it be subsequently to persuade managers to adopt the necessary resolution?

1. **Persuading shareholders.** — One useful piece of evidence is the indication of a base level of support for current shareholder proposals in favor of cumulative voting. As Table II indicates, recent proposals have drawn, on average, approximately twenty percent of the shareholder votes cast on the proposal. This support is growing, albeit slowly; in no recent case has a cumulative voting proposal obtained majority support. It is significant that support for cumulative voting proposals varies widely among firms. This suggests that shareholders are sensitive to firm-specific factors in weighing the value of cumulative voting.

![Table II](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of proposals</th>
<th>Avg. in favor</th>
<th>High %</th>
<th>Low %</th>
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<td>20.2</td>
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<tr>
<td>1993</td>
<td>28</td>
<td>22.6</td>
<td>44.9</td>
<td>6.0</td>
</tr>
</tbody>
</table>

163. Corporate Governance Background Report J: Cumulative Voting, IRRC Corp. Governance Service (IRRC) J-2 (1991) [hereinafter IRRC Background Report J]. A proposal at Bank of Boston received 39.0% support; a proposal at Carter-Wallace received 3.1% support. See id. The IRRC generally reports support as a percentage of shareholders voting for or against a matter, not including abstentions in the denominator. Companies often claim that shareholder proposals that receive a majority of votes cast for or against have not passed because they either count abstentions or insist on a majority of shares outstanding, which includes shares not present at the meeting.

164. 1992 Background Report Update: Cumulative Voting, IRRC Corp. Governance Service (IRRC) JJ-2 to JJ-3 (Mar. 3, 1992) [hereinafter IRRC 1992 Update]. A proposal at Zenith Electronics received 37% support; a proposal at Fuqua Ind. received 6.4% support. See id.


166. IRRC May 1993 Voting Results, supra note 165, at 8, 11. A proposal at Pacific Enterprises received 44.9% support; a proposal at Church and Dwight received 6.0% support. See id. at 11.
Current cumulative voting shareholder proposals have been the least popular governance proposal in the recent wave of shareholder activism, perhaps because of their idiosyncratic sponsorship and weak theoretical foundation. Among institutional investors, the response follows a familiar pattern: a majority of public pension funds tend to support cumulative voting, private pension funds almost always oppose it, and investment managers and charitable endowments generally oppose it. On the other hand, management proposals to eliminate cumulative voting have generated significant, and increasing, investor concern. The overall level of shareholder support for such proposals has fallen from approximately 70 percent in 1986 to 64 percent in 1991. Thus, on average, roughly twice as many shareholders against the elimination of cumulative voting as vote for its reinstatement. Perhaps more important has been the fact that management proposals to eliminate cumulative voting have produced some very close votes in recent years, in some cases attaining only a bare majority.

All this suggests not only some shift in shareholder attitudes toward cumulative voting, but more importantly, growing attention to the nuances of actual corporate governance arrangements and implications. The variation in the level of shareholder support indicates that differences among firms in both ownership distribution and the consequences of potential minority access to the board are important factors. Thus the current failure of cumulative voting proposals should not dishearten activist institutions who are seeking a means of increasing their influence over the board: General shareholder proposals for the reinstatement of cumulative voting based on the simple assertion of the unalloyed virtues of "minority representation" may not be persuasive in light of the possibilities for minority shareholder opportunism. But shareholders who

168. See Investor Responsibility Research Ctr., Cumulative Voting Update, Mar. 3, 1992, at J-J-4. A 1991 survey, for example, reported 58% of public pension funds as favoring cumulative voting proposals, compared to only 14% of private pension funds, 32% of investment managers, and 37% of charitable endowments. See id. The general advice provided by Institutional Shareholder Services is to favor cumulative voting. See Institutional Shareholder Service, supra note 122, at 173.
169. See IRRC Background Report J, supra note 163, at J-J-3; IRRC 1992 Update, supra note 164, at J-J-3 (providing percentage for each of six cases).
170. This is based on shares actually voted, not abstentions or no-shows, which, if not constant over time or across reinstatement as opposed to elimination proposals, would confound the direct comparison in the text.
171. In 1991 close votes over proposals took place at Interstate Power (58.3% in favor); Mips Computer System (55.6% in favor); Standard Federal Bank (50.2% in favor). See IRRC 1992 Update, supra note 164, at J-J-3. Similar close votes took place in 1990 at Tidewater (51.2% in favor) and West (56.2% in favor). See IRRC Background Report J, supra note 163, at J-J-3. And in 1989 close votes took place at Intel (54.8% in favor, part of general proposal for reincorporation in Delaware from California) and Tandon (51.7% in favor, part of general proposal for reincorporation in Delaware from California). See IRRC Background Report B, supra note 126, at B-8.
may be reluctant to vote for an abstract governance theory may well vote for a governance device when they understand the implications given a certain distribution of ownership and power in the firm. In particular, institutional investors should be willing to reexamine their positions as they understand that the effect of reinstating cumulative voting at an appropriate firm will be to provide a low cost way to enhance institutional voice in the selection of directors. It should be possible to assemble a majority coalition on behalf of cumulative voting at many firms with significant institutional ownership.

One potential objection to this proposal is that the conditions under which it becomes possible to add cumulative voting to the governance structure of a particular firm make such a change unnecessary. That is, if the majority of shareholders could be organized on behalf of this cumulative voting proposal, then they also would support a proxy contest on behalf of minority directors. Under the recently adopted proxy reforms, a proxy contestant can now present a slate that includes management nominees as well as the contestant's nominees. Since the goal of the two strategies is the same, and since the cumulative voting strategy requires both shareholder action and subsequent management agreement, why not follow the direct election strategy?

The key difference is that cumulative voting, once in place, would permit an activist core of institutions to play a significant role in the annual decision over board composition, whereas the direct election strategy requires the assembling of a majority coalition annually. This makes the cumulative voting strategy stronger in at least two respects. First, institutions are quite diverse, facing different incentives and cultural constraints on their potential corporate governance engagement. Many institutions may prefer to be passive with regard to the annual decision regarding director elections but understand that they will benefit from the activism of other institutions. Thus, passive institutions who would not like involvement in annual proxy contests could be mobilized on behalf of a structural change that would empower active institutions.

Second, it is much more difficult to organize an absolute majority on a yearly basis than to organize the minority necessary to elect a director under cumulative voting. Take for example a relatively small, classified board for a public corporation: a twelve-member board with four members elected annually. The standard cumulative voting formulas show that a twenty-one percent block could elect one director at each annual election, ultimately providing for a potential institutional representation of three. In the absence of cumulative voting, gradual attainment of this level of representation would require three successive proxy contests.


173. See supra note 8.
in which success required majority shareholder support.\footnote{This assumes that the institutions wish to add one director annually rather than three all at once, which in the case of a four-person class would mean defeating all but one of management's nominees. Such a challenge would seem highly confrontational and would evoke a vigorous management response that could make it very difficult for institutions to gather majority shareholder support. Moreover, annual as opposed to episodic institutional engagement over director nominations is part of the accountability process at the heart of relational investing.} Holding together a twenty-one percent block would require a modest degree of coordination among activist institutions at a given firm and a relatively inexpensive proxy campaign.\footnote{An institution's solicitation of 10 or fewer shareholders on behalf of director nominees is not subject to proxy regulation (other than the antifraud requirements). See 17 C.F.R. § 240.14a-2(b)(2) (1993). Depending on the institutional ownership pattern, this could lead to very low-cost director election under cumulative voting. Where further solicitation was necessary, an institution soliciting fellow shareholders on behalf of director nominees would be required to file a proxy statement with the SEC, even after the SEC's 1992 proxy rule reforms, see Bernard S. Black, Next Steps in Proxy Reform, 18 J. Corp. L. 1, 49-50 & n.73 (1992), but if the universe of its solicitation under cumulative voting was limited to a small number of institutional investors, it could reduce mailing costs substantially and avoid an expensive public campaign. Additionally, the effort to organize a 21\% block (rather than a 51\% block) would face a lower risk of triggering a poison pill, the trigger point of which is typically set at 15 or 20 percent. Alternatively, the number of firms for which the ownership structure would permit a low cost direct election strategy to elect minority directors is fewer than the firms for which a low cost cumulative voting strategy is possible. As observed previously, see supra note 154, this is true given an ownership structure in which activist institutions can assemble significant minority, but not majority, voting support. The cumulative voting strategy also seems superior to other recent proposals to increase institutional influence over board composition, in particular, proposals to give institutions the right to nominate a specific number of directors on the managerial slate for firms with a certain level of institutional stock ownership, see, e.g., Louis Lowenstein, What's Wrong With Wall Street: Short Term Gain and the Absentee Shareholder 209-11 (1988); Felix Rohatyn, Power and Property: Financial Institutions and Corporate America, Columbia Univ. Institutional Investor Project, Conference on Relational Investing, May 6, 1993, reprinted at 1 Corp. Governance Advisor 30 (Aug./Sept. 1993), or more radical suggestions such as turning over control of the corporation's proxy machinery to its largest stockholders, see George W. Dent, Jr., Toward Unifying Ownership and Control in the Public Corporation, 1989 Wis. L. Rev. 881, 907-08. Such proposals will require either legal change or widespread acceptance by public corporations and a mechanism for institutional agreement on specific nominees. Once institutions are given the "right" to
2. **Persuading managers.** — The most significant impediment to the implementation of cumulative voting is the need for management, or, more precisely, the incumbent board, to be willing to adopt the resolution that is necessary to put a proposed cumulative voting charter amendment before shareholders. Precatory resolutions are, after all, only precatory; management is legally free to ignore them. Why should managers agree to a proposal the very point of which is to increase the level of institutional monitoring? One reason is that a majority vote by the shareholders is hard to ignore, particularly where the proponents are institutional investors. Board refusal of such a request would seem provocative and might precipitate an election contest in the following year to produce a more responsive board. Once one firm succumbs to the pressure, other firms will find it very hard to resist. Another reason for managers to agree is that the alternatives may be worse. Managers may prefer to encourage institutions to pursue a “board composition” strategy rather than a more confrontational approach in which activist institutions, finding themselves thwarted in their efforts for board influence, press for “policy participation.”

Any assessment of the potential level of managerial resistance to the adoption of cumulative voting must consider the radical changes that have occurred in the corporate control market. The pressure on states to eliminate mandatory cumulative voting and the movement by individual firms similarly to amend their charters arose from the increased vulnerability to hostile takeovers associated with cumulative voting, not because of “good governance” considerations. However, poison pills and the discretion given management by state antitakeover legislation and judicial decisions have greatly reduced the threat of a hostile takeover bid. The risks to management from cumulative voting have thus been substantially decreased.

Furthermore, board classification, now found in approximately one half of the 1500 firms in the IRRC database, should offer managers an additional degree of comfort. Historically, classification has been criticized as undercutting the influence of cumulative voting. It was widely adopted in the 1970s and 1980s as part of the standard antitakeover package. In the present context, however, classification may make cumulative voting more appealing, precisely because it raises the share ownership necessary to obtain board representation. This means that a coalition of

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179. See Gordon, supra note 3.

180. See Corp. Takeover Defenses, supra note 92.

181. See supra text accompanying note 148.
institutions could assemble a sufficient block, but that the individual shareholder seeking representation of his or her minority interests, whose motives and actions might conceivably be questionable, probably would not.  

The institutional proponents of cumulative voting might tailor the proposal in a way to further limit grounds for objection. The proposal might be presented as a time-limited experiment, rather than as a permanent change in governance structure. For example, the proposed charter amendment could expire unless renewed by a shareholder vote (that management would be required to schedule) in, say, the sixth year following adoption of the amendment. Or perhaps the proposal could be structured to provide for a version of contingent cumulative voting, such that cumulative voting would be non-applicable if a single shareholder or partnership obtained beneficial ownership of more than X percent of the stock. In the alternative, cumulative voting might be made contingent on beneficial ownership of more than Y percent of the firm's stock by entities required to file on Form 13F or other comparable forms required of institutional investors only. Both of these modifications might further clarify to management that the goal of the cumulative voting provision is to enhance institutional influence, rather than to serve as a vehicle for a control entrepreneur.

CONCLUSION

Institutional investors who decide that a board-composition strategy is the best and most durable mode of relational investing must think about how to increase their influence over the selection of directors. The independence of the board and its ability to monitor management very much depends on developing in the directors an immediate sense of accountability to shareholders. To be sure, institutions can negotiate with management over board nominations in any event, or make recommendations to the board's nominating committee. But the institutions' negotiating position—and the ultimate sense of director independence—will obviously be enhanced by a built-in structure that provides a ready avenue for board representation as a back-up. Therefore it will be worth the time, effort, and expenditure of resources for institutions to organize majority support in favor of resolutions that urge management to institute cumulative voting and to begin to campaign with management for the appropriate charter amendments.

182. This is not an endorsement of classification, and certainly is not meant to suggest that firms pursuing cumulative voting on the proposal here should classify the board, since the risks of minority board representation in a firm with substantial institutional ownership are easy to overstate. Rather the point is that governance arrangements currently found in many large firms should increase managers' comfort.

183. This would reduce the utility of cumulative voting in a control contest waged by a single large holder.

184. This would limit the availability of cumulative voting to times in the history of a firm when its ownership structure fits the model I have described.
APPENDIX I


**Nevada:** adopted mandatory cumulative voting in 1881, Act of Feb. 11, 1881, ch. 25, § 1, 1881 Nev. Stat. 34, 34–36; converted to permissive cu-


New York: arguably adopted permissive cumulative voting in 1878, requiring opt-in through articles or bylaws, Act of May 23, 1878, ch. 334, § 1 (3), 1878 N.Y. Laws 4211 (corporation may establish "the basis of voting at all meeting of association or directors thereof, giving at least one vote to each member having paid for one full share"); explicitly adopted permissive cumulative voting, requiring opt-in through articles, Act of May 18, 1892, ch. 687, § 20, ¶ 3, 1892 N.Y. Laws 1800, 1807-08 (codified at N.Y. Bus. Corp. Law § 618 (McKinney 1986)) (preserving prior right of preexisting corporations).


Ohio: adopted mandatory cumulative voting in 1898, Act of Apr. 23, 1898, § 3245, 1898 Ohio Laws 230; converted to permissive cumulative voting in 1986, requiring opt-out by articles amendment (even for newly-formed corporations) which is defeated by shareholder opposition sufficient to elect one director cumulatively, Act of July 24, 1986, § 1, 1986 Ohio Laws 547, 548–50 (codified at Ohio Rev. Code Ann. § 1701.55 (Baldwin 1986)).


South Dakota: adopted mandatory cumulative voting in 1889, S.D. Const. of 1889, art. XVII, § 5; reflected in statutory provision as early as 1965, South Dakota Business Corporation Act, ch. 22, §§ 31, 36, 1965 S.D. Laws 34, 48, 50 (codified at S.D. Codified Laws Ann. §§ 47-4-17, 47-5-6 (1991)).


Ohio: In Ohio the elimination of cumulative voting was instigated by a 1984 recommendation of the Ohio State Bar Association. See Ohio State Bar Ass'n, Report on Senate Bill 259: Cumulative Voting 4 (Dec. 1985). The accompanying Bar Association Report claimed that the “principal winner” from the change would be “the State of Ohio, because it can be confidently expected that the additional flexibility which the proposed legislation would create will assist in obtaining and maintaining incorporations within the State.” Id. at 2. The Bar Association was, of course, also aware of the potential antitakeover implications of the elimination of cumulative voting. The chair of the cumulative voting subcommittee said that the need to offer options for corporate protection against takeovers was a key reason for the legislation. See Leigh Trevor, Voting Bill to Get Early Attention, Business First of Greater Columbus, Dec. 23, 1985, at 15 (remarks of Leigh Trevor, who was also co-chairman of the Bar Association's Corporation Law Committee), cited in June A. Striegel, Comment, Cumulative Voting, Yesterday and Today: The July, 1986 Amendments to Ohio's General Corporation Law, 55 U. Cin. L. Rev. 1265, 1275 n.63 (1987). The Bar Association was also probably influenced by client beliefs that cumulative voting increased firms' vulnerability to takeovers, as reflected in the reported positions of both the Ohio Chamber of Commerce and the Ohio Manufacturers Association, see Matthew Hall, New Board Rules: More Outsiders, No More Cumulative Voting, Ohio Bus., July 1986, at 58.

The Bar Association asserted that the “disparity” between Ohio and states without mandatory cumulative voting “puts Ohio at a substantial disadvantage in the National competition to attract corporate headquarters,” Ohio Bar Ass'n Report, supra, at 3, a somewhat puzzling claim, since many firms headquartered in Ohio were incorporated in Delaware, but one designed to strengthen the case for the legislative change. The proposed legislation was initially introduced in the Ohio Senate in September 1985 and was passed by the Senate in February 1986, and then by the Ohio House in July 1986. See Act of July 24, 1986, § 1, 1986 Ohio Laws 547, 548–50 (codified at Ohio Rev. Code Ann. § 1701.55 (Baldwin 1986)); Ohio House Comm. on Civil and Commercial Law, Report on S.B. 259, at 4 (Mar. 18, 1986). One of the sponsors, Sen. Paul Pfeifer, was quoted as saying that the legislation arose out of Ohio corporations' fear of the national “takeover mania.” See Striegel, supra, at 1274 n.59.

Illinois: Illinois is a more complicated case because of its multi-step movement away from mandatory cumulative voting, reflecting certain tensions appropriate for the jurisdiction that first introduced cumulative voting to American corporate law. As part of the general redrafting in 1970 of the Illinois Constitution, the constitutional convention eliminated the cumulative voting requirement adopted a century before, citing the importance of attracting new incorporations to Illinois and retaining existing Illinois corporations. See Roanoke Agency v. Edgar,


In a key change adopted as part of the 1983 general revision of the Illinois corporate code, the legislature recognized that the 1981 requirement of a unanimous vote had made the elimination of cumulative voting a practical impossibility for the existing public firms whose Illinois incorporation the State was trying to retain. The new law required only an ordinary charter amendment. See 1983 Ill. Laws 83-1025, § 7.40 (codified at Ill. Ann. Stat. ch. 805, ¶ 5/7.40 (Smith-Hurd 1993)); see also Nissen, supra, at 648. To address the concerns behind the 1970 transition provision, shareholders voting against elimination of cumulative voting were given dissenters’ rights. (The constitutionality of the 1983 statute is apparently an open question, particularly in light of the grudging acceptance by the court in Roanoke Agency of even a unanimity requirement. See 461 N.E.2d at 1371–72.) The Illinois revisers have argued that since shareholders of a pre-1970 Illinois corporation can be made to suffer the elimination of cumulative voting through reincorporation in Delaware, protected only by dissenters rights, they are no worse off if the Illinois corporation is permitted to take such action itself, and might be better off since Illinois law might be otherwise more protective. See William H. Painter, Introduction to Symposium on the 1983 Illinois Business Corporation Act, 1985 U. Ill. L. Rev. 635, 638–39 (Professor Painter was a member of the Illinois Secretary of State’s Advisory Committee that drafted the 1983 revision.); see also Nissen, supra, at 669.

For the 1983 general revision, the first in 50 years, the Illinois Secretary of State assembled an advisory committee of legislators, lawyers, and business representatives. The actors on both occasions were keenly aware that cumulative voting contributed to the "flight" of Illinois corporations to other jurisdictions, especially Delaware. See, e.g., Illinois House of Representatives, Transcription of Debate on H.B. 419, 133 (May 14, 1981) (statement of Rep. Leinenweber) ("This Bill . . . does tend to bring the law in Illinois to become a little bit more flexible, a little bit more in line with the other states . . . and . . . we would encourage people to stay in Illinois and incorporate here rather than go elsewhere."); Painter, supra, at 638; Nissen, supra, at 654–55.

To be sure, the elimination of mandatory cumulative voting showed responsiveness to managerial governance preferences. It was also the case that the Illinois mandatory cumulative provision had been construed so broadly as to hamper a board's responsiveness to genuine business dilemmas, see, e.g., People ex rel. Weber v. Cohn, 171 N.E. 159 (Ill. 1930) (prohibiting directors from filling board vacancies), and to preclude certain finance options, such as issuance of nonvoting shares, see People ex rel. Watseka Telephone Co. v. Emmerson, 134 N.E. 707, 710 (Ill. 1922).

Missouri: In Missouri, the elimination of cumulative voting, which was embedded in the state constitution as well as the corporate code, see Appendix I, was initiated in 1987 by the Business Law Committee of the Missouri Bar. See generally Don G. Lents & Virginia S. Pentland, Elimination of Mandatory Cumulative Voting in Missouri, 47 J. Mo. B. 21 (Jan.—Feb. 1991) (Lents was vice chairman of the Business Law Committee). The motives were standard: the sense that mandatory cumulative voting was not part of a "modern" corporate statute, as reflected by its elimination in the Model Business Corporation Act; the opposition of the corporate community, especially Missouri public corporations, who worried about its unpredictable effects and possible uses in hostile takeovers; and the effort to retain Missouri corporate status for the approximately dozen large firms incorporated in Missouri, such as Ralston Purina and Emerson Electric. Telephone Interview with Don Lents (Aug. 20, 1993); Telephone Interview with Prof. Richard Tyler, member of the Business Law Committee of the Missouri bar (Aug. 24, 1993). The Missouri General Assembly approved presentation of the constitutional amendment for a March 1988 vote. The public explanation of the proposed amendment was that passage "would add to the tools available to Missouri in its efforts to attract and retain businesses," Don G. Lents, Proposition 2 May Aid Business Growth, St. Louis Post-Dispatch, Feb. 26, 1988, at 3C, and that cumulative voting could facilitate hostile takeovers, see id. The antitakeover appeal would have had public resonance because of the very recent hostile takeover of TWA, which had major business operations in Missouri, by Carl Icahn.
Notwithstanding the lack of organized opposition, the constitutional amendment was defeated by a narrow margin, apparently because it appeared on the same ballot as a widely unpopular tax measure and was joined with a proposal regarding consideration for corporate shares that suggested it had fiscal implications. Lents interview, supra. The state legislature agreed to submit a measure limited to cumulative voting to the voters in August 1988. The corporate community invested greater resources in public support and lobbying for the amendment and it passed by a large majority. Tyler interview, supra. Implementing legislation, also endorsed by the Bar and promoted by the corporate community, was proposed in the next legislative session and enacted by June 1989. The legislation allows corporations to opt out of cumulative voting either through bylaw amendment or charter amendment. This means that in cases where cumulative voting had been prescribed in the bylaws only and where, as is typical, directors have power to amend the bylaws, shareholder approval may not be required. See Mo. Ann. Stat. § 351.245(3) (Vernon 1991).