The Alarming Legality of Security Manipulation Through Shareholder Proposals

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ABSTRACT

Shareholder proposals attract attention from scholars in finance and economics because they present an opportunity to study both quasi-democratic decision-making at the corporate level and the impact of this decision-making on firm outcomes. These studies capture the effect of various proposals but rarely address whether regulations should allow many of them in the first place due to the possibility of stock price manipulation. Recent changes to shareholder proposal rules, adopted in September 2020, sought to address the potential for exploitation that some proposals create (but ultimately failed to do so). This Article shows the potential for apparently legal stock price manipulation if shareholder proposals remain relatively unregulated. We propose improvements to decrease this risk of stock price manipulation, which should help the government prosecute the offenders.

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INTRODUCTION

Holding stock in most corporations trading on American exchanges entitles the holder to certain rights.[1] Those rights include voting for board members, voting on proposals for corporate governance changes, and submitting proposals for a shareholder vote.[2] This third right is of particular interest because its exercise can bring the shareholder closer to direct corporate governance than the other rights.[3] Rather than selecting a board member to act on the shareholder's behalf, or voting on a measure proposed by others, the shareholder can actually propose changes to the

1. *See generally* Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407 (2006); HOLGER SPAMANN & GUHAN SUBRAMANIAN, CORPORATIONS 43–60 (2018); Schnell v. Chris-Craft Indus., 285 A.2d 437, 439 (Del. 1971); Blasius Indus. v. Atlas Corp., 564 A.2d 651, 657 (Del. Ch. 1988).

2. *See generally* Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605 (2007); SPAMANN & SUBRAMANIAN, *supra* note 1; *Schnell*, 285 A.2d at 439; *Blasius*, 564 A.2d at 657.

3. *See generally* CAM HOANG, GARY TYGESSON & VIOLET RICHARDSON, SHAREHOLDER PROPOSALS: STRATEGIES AND TACTICS, DORSEY & WHITNEY LLP (2016), https://www.dorsey.com/~/media/files/newsresources/events/2016/10/shareholder-proposals---powerpoint-presentation.pdf [https://perma.cc/E3NB-9TZG].

corporation's business practices that others can approve.[4] Whether these proposals harm or benefit corporations has been a subject of much debate in finance and economics, with several scholars suggesting that shareholder proposals are harmful.[5] Despite these findings, we are unaware of any publications in law, finance, or economics that address potential remedies for shareholder proposals designed to harm the firm: our Article fills this gap in the literature.

The plausibility that shareholder proposals can harm a corporation has many implications. First, this might mean that even well-meaning shareholders should leave firm governance to board members and the executive team those board members select. Second, these findings suggest that investors respond negatively when receiving news of a proposal, which institutional investors corroborate by frequently opposing proposals not made by the board of directors or management team.[6] Third, and most alarmingly, the limitations on who might make these proposals are remarkably few.[7] The proponent must prove essentially three elements:

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4. *See generally Id.*; SPAMANN & SUBRAMANIAN, *supra* note 1. *See also Schnell*, 285 A.2d at 439; *Blasius*, 564 A.2d at 652–57.

5. *Compare* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 833 (2005), *with* John G. Matsusaka, Oguzhan Ozbas & Irene Yi, *Can Shareholder Proposals Hurt Shareholders? Evidence from SEC No-Action Letter Decisions* (Marshall Sch. of Bus. Working Paper, Paper No. 17-7, 2019), https://ssrn.com/abstract=2881408 [https://perma.cc/6K2A-9ZKF] [hereinafter Matsusaka, *Shareholder Proposals*], *and* John G. Matsusaka, Oguzhan Ozbas & Irene Yi, *Opportunistic Proposals by Union Shareholders*, 32 REV. FIN. STUD. 3215, 3215 (2019) [hereinafter Matsusaka, *Opportunistic Proposals*], *and* John G. Matsusaka & Oguzhan Ozbas, *A Theory of Shareholder Approval and Proposal Rights*, 33 J.L. ECON. & ORG. 377, 377 (2017) [hereinafter Matsusaka, *Shareholder Approval*]; Vicente Cuñat, Mireia Gine & Maria Guadalupe, *The Vote Is Cast: The Effect of Corporate Governance on Shareholder Value*, 67 J. FIN. 1943, 1943 (2012). *See also* Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405, 405 (2017).

6. *See* Matsusaka, *Shareholder Proposals*, *supra* note 5, at 2.

7. 17 C.F.R. § 240.14a-8 (2020); *see also* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Statement by Chairman Clayton on Modernizing the Shareholder Proposal Framework for the Benefit of All Shareholders (Sept. 24, 2020) (transcript available at HARV. L. SCH. F. ON CORP. GOVERNANCE), https://corpgov.law.harvard.edu/2020/09/24/statement-by-chairman-clayton-on-modernizing-the-shareholder-proposal-framework-for-the-benefit-of-all-shareholders/ [https://perma.cc/5SUT-79C4]; Allison Herren Lee, Comm'r, U.S. Sec. & Exch. Comm'n, Statement by Commissioner Lee on the Amendments to Rule 14a-8 (Sept. 24, 2020) (transcript available at HARV. L. SCH. F. ON CORP. GOVERNANCE), https://corpgov.law.harvard.edu/2020/09/24/statement-by-commissioner-lee-on-the-amendments-to-rule-14a-8/ [https://perma.cc/8AVN-RJND]; Elad L. Roisman, Comm'r, U.S. Sec. & Exch. Comm'n, Statement by Commissioner Roisman on Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 (Sept. 24, 2020) (transcript available at HARV. L. SCH. F. ON CORP. GOVERNANCE), https://corpgov.law.harvard.edu/2020/09/24/statement-by-commissioner-roisman-on-procedural-requirements-and-resubmission-thresholds-under-exchange-act-rule-14a-8 [https://perma.cc/YV5K-W3NH]; Marc A. Leaf & Sarah M. Bartlett, *Amendments to Exchange Act Rule 14a-8*, FAEGRE DRINKER (Sept. 25, 2020), https://www.faegredrinker.com/en/insights/publications/2020/9/amendments-to-exchange-act-rule-14a-8 [https://perma.cc/3664-MCRU].

they own either at least $2,000 worth of company shares or 1% or more of company shares, they owned these shares in excess of three years (or one year, if the individual holds $25,000 of company stock), and they intend to hold these shares indefinitely.[8] Of course, the last element is remarkably hard to disprove, and even if a shareholder later sells their shares, the shareholder can simply claim that they changed their mind about their intent to hold the shares at some point after filing the shareholder proposal.[9]

Why is this relevant? Why should shareholders be limited in exercising their right to govern the corporation directly? The answer is simple: Not every shareholder's priority is the success of the company. The opportunity to manipulate stock prices could be more lucrative for some shareholders than merely drawing dividends or growing their wealth through capital gains, as current rules do not eliminate the plausibility that some investors may hold both a long and a short position in the same security. Where the short exposure exceeds the long exposure, it would be more beneficial for the shareholder that the company experience a bout of "bad luck"—and when the shareholder can cause the "bad luck" by making unwise proposals that may lower company value,[10] the potential for price manipulation increases and should be countervailed by regulation.[11]

To illustrate, imagine a shareholder holds $2,000 of Apple Inc. (ticker symbol AAPL) stock in a Fidelity brokerage account, which they have owned for the time necessary to submit a shareholder proposal.[12] Simultaneously, the shareholder holds a $100,000 short position in the same company in a Charles Schwab account. This shareholder can satisfy the requirements necessary to submit a proposal to the company. Then, the shareholder might submit a proposal deliberately intended to harm the company, knowing that the proposal may lower the stock price and increase the value of their short position much more than decrease the value of their long position. Alarmingly, the current rules do not

8. 17 C.F.R. § 240.14a-8 (2020).

9. There is nothing in the statute forbidding shareholders from changing their mind about holding the shares after filing the shareholder proposal. *See id.*

10. Matsusaka, *Shareholder Proposals*, *supra* note 5, at 3; Matsusaka, *Opportunistic Proposals*, *supra* note 5, at 3256–57; Matsusaka, *Shareholder Approval*, *supra* note 5, at 398, 408.

11. We suggest regulation rather than free market solutions because government has already entered the field. If government agencies and taxpayer dollars are already being diverted to pay for government regulation, we might as well ensure that the government regulates efficiently.

12. The necessary time to cast such a proposal with $2,000 or more in securities is actively changing, so let us assume that the shareholder has met the long-term holding requirements, whatever those requirements are. 17 C.F.R. § 240.14a-8 (2020). *See generally* Clayton, *supra* note 7; Lee, *supra* note 7; Roisman, *supra* note 7; Leaf & Bartlett, *supra* note 7.

prohibit this action.[13] While the United States Securities and Exchange Commission (SEC) has recently released alterations to its rules that *might* make transactions like this more cumbersome, the difficulty of benefitting from an intentionally harmful shareholder proposal is not greatly increased.[14]

Part I of this Article outlines the laws, rules, and regulations governing shareholder proposals and the litigation surrounding them. We discuss how lenient the regulation on shareholder proposals is compared to the statutory, regulatory, and common law restrictions on what other stakeholders may and may not do when governing or interacting with the corporation. Part II of this Article surveys the economic and financial literature, discussing the effects of shareholder proposals on firm value. In Part III, this Article argues for additional regulation that would reduce the possibility of intentionally harmful shareholder proposals and aid in their detection. This Article concludes by demonstrating that excluding intentionally harmful proposals will likely reduce firm litigation costs, increase the chances that future proposals will *increase* firm value, and punish nefarious activities by shareholders not acting in good faith.

I. LAWS, RULES, AND REGULATIONS

The laws, rules, and regulations governing shareholder relations with the companies in which they hold stock arise out of the Code of Federal Regulations.[15] The laws, rules, and regulations governing the conduct of board members, executives, and majority shareholders generally arise from common law principles, state and federal statutes, and state and federal regulations.[16] State statutes and case law regarding stock ownership and company incorporation do exist, but the primary guidance for investors comes from the United States Congress and the administrative agencies Congress created to oversee security trading: primarily the SEC.[17] Congress sometimes alters laws governing securities trading and corporation management, such as when it passed the Dodd-

13. *See* 17 C.F.R. § 240.14a-8 (2020).

14. *See generally* Clayton, *supra* note 7; Lee, *supra* note 7; Roisman, *supra* note 7; Leaf & Bartlett, *supra* note 7.

15. *See, e.g.*, 17 C.F.R. § 240.14a-8 (2020).

16. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 5–8; *cf.* Schnell v. Chris-Craft Indus., 285 A.2d 437, 439 (Del. 1971); Blasius Indus. v. Atlas Corp., 564 A.2d 651, 654 (Del. Ch. 1988); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721 (Del. 1971); Perlman v. Feldmann, 219 F.2d 173, 175 (2d Cir. 1955).

17. *What We Do*, U.S. SEC. & EXCH. COMM'N (Dec. 18, 2020), https://www.sec.gov/about/what-we-do [https://perma.cc/S8Y7-8CRK].

Frank Act and the Sarbanes-Oxley Act.[18] However, the bulk of regulatory and enforcement authority falls to the SEC.[19]

A. Overview of Corporate Governance

We begin via an overview of corporate governance law to demonstrate precisely where shareholder proposals fall in the grand scheme of running a publicly traded corporation under United States law. Shareholder proposals are hardly the main governance mechanisms through which shareholders exercise control over their corporation; that is part of why it is so surprising that the impact of these proposals can be felt distinctly in firm stock prices. Nevertheless, shareholder proposals are among the few direct ways that shareholders can influence the governance of a corporation—ordinarily, they can only act through their elected representatives on the board of directors. The empirical findings show that this direct form of shareholder democracy can have a negative effect.[20] Given the heavy regulations otherwise imposed upon corporate leadership that we will discuss in this section,[21] it would be inconsistent *not* to extend similar regulations to activities by "activist" shareholders that can result in stock price manipulation.

1. Officers, Directors, and Shareholders

All corporations have one or more directors, one or more officers, and one or more shareholders.[22] When a company has multiple directors, they act as a group, known as a board of directors, which is the corporation's governing body.[23] Directors appoint and supervise the officers who run the corporation's daily operations.[24] It is through directors that shareholders usually exercise control over the corporation in which they hold shares: by electing the directors that most closely align

18. *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002); *Sarbanes-Oxley and Dodd-Frank*, STEMBER COHN & DAVIDSON-WELLING, https://stembercohn.com/practice-areas/employment-law-2/sarbanes-oxley-and-dodd-frank-whistleblower [https://perma.cc/FN8H-SU8B].

19. *What We Do*, *supra* note 17.

20. *See generally* Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

21. *See generally* SPAMANN & SUBRAMANIAN, *supra* note 1. *See also Schnell*, 285 A.2d at 439; *Blasius Indus.*, 564 A.2d at 654; *Sinclair Oil Corp.*, 280 A.2d at 721; *Perlman*, 219 F.2d at 175.

22. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 5–8.

23. *Id.* at 8; *see also Powers & Duties of Corporation Directors & Officers*, WOLTERS KLUWER (2019), https://www.wolterskluwer.com/en/expert-insights/powers-and-duties-of-corporation-directors-and-officers [https://perma.cc/N7AF-K523] [hereinafter *Powers & Duties*].

24. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 8.

with their own interest in a type of representative democratic system.[25] Typically, directors are responsible for making major business decisions and advising officers, whereas the officers are responsible for day-to-day decisions and implementing the board of directors' policies.[26]

Major business decisions that directors are typically responsible for (and which can result in their liability) include fixing executive compensation, pensions, retirement, and other compensation plans; deciding if and when dividends should be declared; and proposing special corporate matters, such as amendments to the articles of incorporation, mergers, asset and stock sales, and dissolutions, to the corporation's shareholders.[27] Directors generally cannot take certain actions, including amending the corporation's articles of incorporation or sales of almost all of the corporation's assets, without first obtaining shareholder approval.[28] Less important decisions, though, need not be approved by shareholders. In the event the board's conduct does not coincide with shareholder preferences, the shareholders' remedy is simply to elect new directors. Company officers have very similar duties to directors, excluding, of course, facing liability for setting officer compensation (unless the executive is also the board member who votes for his own excessive compensation).[29]

A shareholder is an individual who or entity that owns shares in a corporation.[30] Shareholders can be split into two types based on the types of shares they hold: (i) common shareholders, who own shares of the corporation's common stock, and (ii) preferred shareholders, who own shares of the corporation's preferred stock (if the company has issued any preferred stock at all).[31] Common shareholders are the most prevalent type

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25. *See generally Powers & Duties*, *supra* note 23.

26. *Id.*; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 5–8; *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 53–54 (Del. 2006); Weinberger v. UOP, Inc., 457 A.2d 701, 710–11 (Del. 1983); *In re* Trulia, Inc. S'holder Litig., 129 A.3d 884, 889 (Del. Ch. 2016).

27. *Powers & Duties*, *supra* note 23; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 5–8; *In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 53–54; *Weinberger*, 457 A.2d at 710–11; *In re Trulia, Inc. S'holder Litig.*, 129 A.3d at 889.

28. *Powers & Duties*, *supra* note 23; *see, e.g.*, Kahn v. M & F Worldwide Corp., 88 A.3d 635, 642 (Del. 2014), *overruled by* Flood v. Synutra Int'l, Inc., 195 A.3d 754 (Del. 2018); Glassman v. Unocal Expl. Corp., 777 A.2d 242, 247 (Del. 2001); SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141, 194–312.

29. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also* Schnell v. Chris-Craft Indus., 285 A.2d 437, 439 (Del. 1971); Blasius Indus. v. Atlas Corp., 564 A.2d 651, 654 (Del. Ch. 1988); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721 (Del. 1971); Perlman v. Feldmann, 219 F.2d 173, 175 (2d Cir. 1955).

30. *What Is a Shareholder?*, CORP. FIN. INST. (2020), https://corporatefinanceinstitute.com/resources/knowledge/finance/shareholder/ [https://perma.cc/N6EY-TNZZ]; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 5–8, 43–60.

31. *What Is a Shareholder?*, *supra* note 30; *see also* SPAMANN & SUBRAMANIAN, *supra* note 11, at 47.

of shareholder and typically have the right to vote on matters concerning the corporation, including electing directors.[32] In contrast, preferred shareholders typically have no voting rights.[33] However, preferred shareholders are paid dividends prior to common stockholders and have a preferred claim to company assets at dissolution, superior to that of the common stockholders.[34] Majority shareholders usually have fiduciary duties similar to those imposed on directors and officers, but minority shareholders share no such responsibilities.[35]

2. Governing Law

Generally, the state law (where the business incorporates) governs that corporation's governance activities.[36] More than half of the publicly traded companies on United States stock exchanges are incorporated in Delaware.[37] Moreover, approximately two-thirds of Fortune 500 companies, including Apple Inc. and The Coca-Cola Company, have chosen Delaware as their state of incorporation.[38] Delaware has been the predominant choice for corporations since the early 1900s.[39] There are several reasons why Delaware dominates other states in this respect.[40] The Delaware General Corporation Law, which governs the corporations that incorporate within the state, is one of the most "advanced and flexible" corporation statutes in America.[41] Perhaps most importantly, however, many corporations choose Delaware due to the Delaware Court of Chancery, a non-jury trial court, which serves as Delaware's court of original and exclusive equity jurisdiction and

32. *What Is a Shareholder?*, *supra* note 30; *see also* SPAMANN & SUBRAMANIAN, *supra* note 11, at 47.

33. *What Is a Shareholder?*, *supra* note 30; *see also* SPAMANN & SUBRAMANIAN, *supra* note 11, at 47.

34. *What Is a Shareholder?*, *supra* note 30; *see also* SPAMANN & SUBRAMANIAN, *supra* note 11, at 47.

35. Perlman v. Feldmann, 219 F.2d 173, 176 (2d Cir. 1955); *In re* Delphi Fin. Grp. S'holder Litig., No. 7144-VCG, 2012 WL 729232, at *9 (Del. Ch. Mar. 6, 2012); Weinberger v. UOP, Inc., 457 A.2d 701, 710–11 (Del. 1983).

36. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8; *see also State of Incorporation: Everything You Need to Know*, UPCOUNSEL, https://www.upcounsel.com/state-of-incorporation [https://perma.cc/FHM4-4ELU].

37. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8; *see also* Alana Semuels, *The Tiny State Whose Laws Affect Workers Everywhere*, THE ATLANTIC (Oct. 3, 2016), https://www.theatlantic.com/business/archive/2016/10/corporate-governance/502487 [https://perma.cc/N2GF-5Z7A].

38. Semuels, *supra* note 37; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8.

39. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8. *See generally* LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE (Del. Dep't of State 2007).

40. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8.

41. BLACK, *supra* note 39, at 1; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8.

adjudicates, among others, corporate law cases.[42] Five justices—some of the country's most renowned experts in corporate law—serve on the Delaware Court of Chancery.[43]

3. Fiduciary Duties

In this backdrop of corporate law, lawyers, and policymakers can find many requirements imposed on members of a corporation.[44] These requirements are well-tailored to optimize corporate performance, and we draw our inspiration for additional regulations on shareholder activism from the existence of these requirements.[45] In almost any context, the duty of care, the duty of loyalty, and additional statutory and regulatory authority govern the conduct of key figures in a corporation, including majority shareholders.[46] Yet, one exception to that rule is shareholder activism: When it comes to shareholder proposals, these duties, or any rules similar thereto, have yet to be applied.[47] We will describe the duties and legal regulations that place boundaries on the conduct of majority shareholders, board members, and corporate officers and suggest that the same spirit that gives rise to these restraints on corporate conduct[48] should lead us to restrain shareholder activism designed to harm rather than benefit the corporation.

i. Officers and Directors

Directors of corporations have fiduciary duties of care and loyalty.[49] Executives, board members, and, in some cases, majority shareholders owe these duties to the corporation and its stockholders (though this

42. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8; *see also* Semuels, *supra* note 37, at 5–7.

43. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 7–8; *see also* Semuels, *supra* note 37, at 5–7.

44. *See generally* DEL. CODE ANN. tit. 8 (West 2021); SPAMANN & SUBRAMANIAN, *supra* note 1. *See also* Schnell v. Chris-Craft Indus., 285 A.2d 437, 439–40 (Del. 1971); Blasius Indus. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719 (Del. 1971).

45. *See generally* DEL. CODE ANN. tit. 8 (West 2021). *See also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 239 (Del. 2009); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983); Smith v. Van Gorkom, 488 A.2d 858, 872 (1985).

46. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *Schnell*, 285 A.2d at 439–40; *Blasius Indus.*, 564 A.2d at 663; *Sinclair Oil Corp.*, 280 A.2d at 719–20; Perlman v. Feldmann, 219 F.2d 173, 176 (2d Cir. 1955); DEL. CODE ANN. tit. 8 (West 2021).

47. *See, e.g.*, C.F.R. § 240.14a-8 (2021); Clayton, *supra* note 7; Lee, *supra* note 7; Roisman, *supra* note 7; Leaf & Bartlett, *supra* note 7.

48. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also Schnell*, 285 A.2d at 439–40; *Blasius Indus.*, 564 A.2d at 663; *Sinclair Oil Corp.*, 280 A.2d at 719; *Perlman*, 219 F.2d at 176. *See generally* DEL. CODE ANN. tit. 8 (West 2021).

49. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also Lyondell Chem. Co.*, 970 A.2d at 239; *Weinberger*, 457 A.2d at 710; *Smith*, 488 A.2d at 872.

section will focus primarily on the duties of executives and board members).[50] Violation of these duties can lead to direct or derivative lawsuits by stockholders on behalf of themselves, the corporation, or both.[51] In a dissolution or insolvency context, duties may be owed to creditors, as residual claimants of value, as well.[52] The fiduciary duty of care requires that directors keep themselves reasonably informed when making decisions on behalf of the corporation and make those decisions in good faith.[53] The fiduciary duty of loyalty requires a director to act in good faith and in a manner the director reasonably believes to be in the best interests of the corporation and its stockholders.[54] These duties alone have attracted a tremendous amount of litigation and regulation—a quality apparently unshared by shareholder proposals and the responsibilities of those who submit them.[55] Under the current law, something as basic as the duty of good faith would not apply to a minority shareholder who deliberately proposes a harmful proposal, even though this would be a crucial element in determining liability of directors, executives, and even majority shareholders (where applicable).[56] While some provisions of Delaware law permit these duties to be somewhat restricted via modifications to a company's certificate of incorporation,[57] there are ample examples where no such abrogation occurred and directors faced liability for their actions.[58]

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50. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also Schnell*, 285 A.2d at 439–40; *Blasius Indus.*, 564 A.2d at 663; *Sinclair Oil Corp.*, 280 A.2d at 719; *Perlman*, 219 F.2d at 176.

51. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also Lyondell Chem. Co.*, 970 A.2d at 239; *Weinberger*, 457 A.2d at 710; *Smith*, 488 A.2d at 872.

52. *See, e.g.*, Huff Energy Fund, L.P. v. Gershen, No. 11116-VCS, 2016 WL 5462958, at *42 (Del. Ch. Sept. 29, 2016).

53. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Smith*, 488 A.2d at 873; *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 53 (Del. 2006); Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006).

54. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82; *see also* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1340 (Del. 1987); *Blasius*, 564 A.2d at 657; Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

55. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see, e.g.*, *Lyondell Chem. Co.*, 970 A.2d at 237; *Weinberger*, 457 A.2d at 703; *Smith*, 488 A.2d at 864; *In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 46.

56. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82; *Ivanhoe*, 535 A.2d at 1341; *Blasius Indus.*, 564 A.2d at 662–63; *Guth*, 5 A.2d at 510.

57. *See* DEL. CODE ANN. tit. 8 § 102(b)(7) (West 2021). *See generally Lyondell Chem. Co.*, 970 A.2d 235 (discussing provisions indemnifying and holding harmless directors for any alleged breaches of the fiduciary duty of care but not the duty of loyalty).

58. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also* Schnell v. Chris-Craft Indus., 285 A.2d 437, 439 (Del. 1971); *Blasius Indus.*, 564 A.2d at 662–64; Sinclair Oil Corp. v. Levien, 280 A.2d 717, 723 (Del. 1971).

a. The Fiduciary Duty of Care

The fiduciary duty of care requires a director to be informed of all material information reasonably available before making a business decision.[59] The director, executive, or majority shareholder must act with the level of care that an ordinarily careful and prudent person would use in their position under similar circumstances.[60] According to the American Law Institute's Principles of Corporate Governance, the fiduciary duty of a director is as follows:

> A director or officer has a duty to the corporation to perform the director's or officer's functions: in good faith; in a manner that he or she reasonably believes to be in the best interests of the corporation; and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.[61]

In reviewing whether an individual bound by the duty has satisfied it, courts have looked at the information available to a director and the process followed by the board in reaching its decisions.[62]

In evaluating a director's actions under the duty of care standard, courts apply the "business judgment rule" when directors act with the requisite knowledge, employ due consideration when reaching a decision, and otherwise meet the elements necessary to justify the rule's application.[63] Under the business judgment rule, courts will presume that disinterested directors have made decisions on an informed basis with a good faith belief that the decisions are in the best interests of the corporation.[64] The American Law Institute provides the following definition of the business judgment rule in its Principles of Corporate Governance:

> A director or officer who makes a business judgment in good faith fulfills the duty under this section if the director or officer: (1) is not interested in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent that

59. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Smith*, 488 A.2d at 872; *Blasius Indus.*, 564 A.2d at 652; *Guth*, 5 A.2d at 510.

60. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Smith*, 488 A.2d at 872; *Blasius Indus.*, 564 A.2d at 652; *Guth*, 5 A.2d at 510.

61. PRINCIPLES OF CORPORATE GOVERNANCE § 4.01(a) (AM. L. INST. 2020).

62. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Smith*, 488 A.2d at 874; *Blasius Indus.*, 564 A.2d at 659; *Guth*, 5 A.2d at 515.

63. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also* Aronson v. Lewis, 473 A.2d 805, 818 (Del. 1984); *Smith*, 488 A.2d at 872–73; Moran v. Household Int'l Inc., 500 A.2d 1346, 1350 (Del. 1985).

64. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Aronson*, 473 A.2d at 811; *Smith*, 488 A.2d at 871; *Moran*, 500 A.2d at 1350.

> the director or officer reasonably believes is appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.[65]

Individuals challenging board decisions can rebut this presumption by demonstrating that the directors were grossly negligent in their decision-making and thus in violation of their duty of care.[66] In *Smith v. Van Gorkom*, a seemingly earth-shattering case of business organizations law, the Delaware Supreme Court held that even very experienced directors who sold their company shares at a $20 premium over the market price could be held liable because they decided to sell too quickly for the court's preference and without viewing enough studies of value.[67] While this was certainly the exception to the principle that the reasonable business judgment rule ordinarily shields directors from liability, it reminds us that even under apparently beneficial circumstances for the shareholders (such as the $20 premium over market price), directors can face liability for taking insufficient time to study company valuations or to consider the impact of their actions on shareholders.[68] We are aware of no case even remotely similar that imposes a duty on an activist submitting a shareholder proposal. Individuals submitting such proposals need not even seek the protection of the business judgment rule because the fiduciary duty of care under which the rule applies does not extend to shareholder activists.

A counterargument can be sustained that the business judgment rule ordinarily protects directors, executives, and majority shareholders and leads to a dismissal of most litigation.[69] This would mean that the litigation threats these individuals actually face are not much greater than minority shareholder proponents of ill-advised proposals.[70] After all, the outcome observed in *Smith v. Van Gorkom* is the exception that proves the rule.[71] Under the business judgment rule, courts focus on the leadership's process in making a decision rather than the outcome of the decision, which permits almost any choice made by leadership to withstand scrutiny as long as the process of reaching it does not greatly offend the court.[72] In

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65. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 61, § 4.01(c).

66. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Aronson*, 473 A.2d at 811; *Smith*, 488 A.2d at 884.

67. *See Smith*, 488 A.2d at 874; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–107.

68. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Aronson*, 473 A.2d at 812; *Smith*, 488 A.2d at 890.

69. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Aronson*, 473 A.2d at 818; *Smith*, 488 A.2d at 893; *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 75 (Del. 2006).

70. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also Aronson*, 473 A.2d at 818; *Smith*, 488 A.2d at 893; *In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 75.

71. *See Smith*, 488 A.2d at 888; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141.

72. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141.

determining whether a defendant satisfied their fiduciary duty of care, a court will generally give deference to the defendant and will not substitute its own judgment for the defendant's, even if a decision turned out to be unwise, so long as the decider acted on an informed basis, in good faith, and in the rational belief that the decision made was in the best interests of the company and its stockholders.[73]

If the plaintiff fails to rebut the business judgment rule presumption and cannot demonstrate a breach of a fiduciary duty, the plaintiff will not be entitled to a remedy (and the defendant will not be subject to reprimand) unless the challenged transaction constitutes waste.[74] To recover on a claim of waste, a plaintiff must prove that the relevant exchange was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration."[75] This standard is stringent, and the plaintiff can only prove waste occurred in the "rare, 'unconscionable case where directors irrationally squander or give away corporate assets.'"[76] However, recovery is still technically possible, though not against shareholders deliberately submitting proposals that would squander corporate assets.

Delaware directors also owe a fiduciary duty of disclosure as part of their duty of care.[77] The fiduciary duty of disclosure requires directors to disclose fully and fairly all material information within the board's control when it seeks shareholder action.[78] Directors further owe a fiduciary duty of candor, also part of their duty of care.[79] The duty of candor requires directors to communicate honestly and to make full and fair disclosures to their fellow directors and the corporation's stockholders of all information known to them that is relevant to the decision under consideration.[80] Moreover, directors, executives, and other individuals owing fiduciary

73. *See Aronson*, 473 A.2d at 811; *In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 52; Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369 (Del. 2006); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985); *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141.

74. *See In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 74; SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141.

75. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 74; SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141.

76. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d at 74 (quoting Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000)); *see* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141.

77. *See* Chatham Asset Mgmt., LLC v. Papanier, No. 2017-0088-AGB, 2017 WL 6550428, at *9 (Del. Ch. Dec. 22, 2017).

78. *Id.*

79. *See generally* Steven Smith, *Duties and Liabilities of Boards of Directors*, BUCHANAN LABS (July 2, 2015), http://buchanan-labs.com/duties-and-liabilities-of-boards-of-directors-2/ [https://perma.cc/VUE3-F6MQ].

80. *See id.*

duties to the corporation cannot trade on insider information.[81] The duty of candid disclosure of such information to the public prior to trading on it forms the very basis of American insider trading regulations.[82] We are, once again, unaware of any such impositions of duty on proponents of activist shareholder proposals that promote drastic changes in the way a particular publicly traded corporation does business, even if the business of the corporation is generally good in its unaltered state.

b. The Fiduciary Duty of Loyalty

Another duty not extended to activist minority shareholders is the fiduciary duty of loyalty to the corporation and its shareholders.[83] This obligation is crucial in preventing majority shareholders, executives, and board members from proposing actions deliberately harmful to a corporation due to some potential benefit that might accrue to the activist shareholder.[84] Ordinarily, this duty might prevent a parent corporation from taking advantage of its subsidiary by engaging in dealings that would be overly beneficial to the owner company and detrimental to the shareholders.[85] In the same spirit, this duty, if applied to proponents of harmful proposals, would be remarkably helpful in preventing individuals from shorting the same company to which they submit unhelpful ideas. Nevertheless, no such duty appears to apply to minority shareholder activists, although it applies to majority shareholders, officers, directors, and corporations that hold a particular company as a subsidiary of their own.[86]

The duty of loyalty prohibits self-dealing by requiring officers, directors, and majority shareholders to act in good faith and in a manner they reasonably believe to be in the best interests of the corporation and its stockholders.[87] An executive's, board member's, or majority shareholder's own financial or other self-interest may not take priority over the interests of the corporation and its stockholders when these

81. *See* Chiarella v. United States, 445 U.S. 222, 227 (1980); *see also* Dirks v. SEC, 463 U.S. 646, 651 (1983).

82. *See Chiarella*, 445 U.S. at 227; *Dirks*, 463 U.S. at 651.

83. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987); *see also* Blasius Indus. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

84. *See Ivanhoe Partners*, 535 A.2d at 1345; *see also Blasius Indus.*, 564 A.2d at 663; *Guth*, 5 A.2d at 510; SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

85. *See Ivanhoe Partners*, 535 A.2d at 1345; *see also Blasius Indus.*, 564 A.2d at 663; *Guth*, 5 A.2d at 510; SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

86. *See Ivanhoe Partners*, 535 A.2d at 1345; *see also Blasius Indus.*, 564 A.2d at 663; *Guth*, 5 A.2d at 510; SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

87. *See Ivanhoe Partners*, 535 A.2d at 1341; *see also Blasius Indus.*, 564 A.2d at 657; SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

individuals make decisions on behalf of the corporation.[88] The director also has an obligation to act in good faith in the oversight of the corporation.[89] Perhaps the most important aspect of the duty of loyalty is the difficulty of mounting a business judgment rule defense—the most popular defensive mechanism available to parties sued in the corporate context under a breach of fiduciary duty.[90] While amply available to defendants in lawsuits arising from an alleged breach of the duty of care, this rule becomes much more inaccessible when the suit arises from an alleged breach of the duty of loyalty.[91] That is because a director's duty of loyalty is commonly challenged in connection with conflicts of interest and corporate opportunities, as described below.[92]

1. Conflicts of Interest

A conflict of interest may exist when a member of company leadership has a direct or indirect personal or financial interest in a transaction or other matter involving the corporation.[93] Individuals who have a duty of loyalty to the corporation should promptly disclose potential conflicts of interest to the board and describe all material facts concerning the transaction or other matters that are known to the conflicted individual.[94] Following disclosure, an interested individual should not decide on the matter that involves the conflict of interest.[95] In some situations, the conflicted individual must refrain from participating in discussions or excuse themselves from meetings during the discussion.[96] A majority of disinterested directors should approve transactions that present conflicts of interest after full disclosure of all material information regarding the transaction and the nature of the conflicted individual's

88. *See Ivanhoe Partners*, 535 A.2d at 1341; *see also Blasius Indus.*, 564 A.2d at 657; SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

89. *See Ivanhoe Partners*, 535 A.2d at 1341; *see also Blasius Indus.*, 564 A.2d at 657; SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

90. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 83–141; *see also* Aronson v. Lewis, 473 A.2d 805, 809 (Del. 1984); Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1975).

91. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also* Matthew Gensburg, *The Business Judgment Rule and Its Limits and Exceptions*, GENSBURG CALANDRIELLO & KANTER, P.C. (May 22, 2018), https://www.gcklegal.com/business-judgment-rule-limits-exceptions [https://perma.cc/8TPV-FKAK].

92. *See* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–141; *see also Aronson*, 473 A.2d at 814; *Smith*, 488 A.2d at 865.

93. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1264 (Del. 1989); Guth v. Loft, Inc., 5 A.2d 503, 511 (Del. 1939); *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

94. *See Mills Acquisition Co.*, 559 A.2d at 1280; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

95. *See Mills Acquisition Co.*, 559 A.2d at 1282; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

96. *See Mills Acquisition Co.*, 559 A.2d at 1282. *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

interest in the transaction.[97] Conflicted members of corporate leadership have a duty to disclose to the board material information in their possession affecting a board decision, especially where the conflicted individuals have a personal interest in the outcome of the decision.[98]

Coincidentally, a conflict of interest may remove the protections of the business judgment rule.[99] The business judgment rule does not apply if invoked by an interested fiduciary. Hence, if the allegations of a duty of loyalty violation come in connection with some personal interest that the accused could advance by acting inappropriately, then the business judgment rule defense may be altogether unavailable.[100] The potential unavailability of the business judgment rule is why conflicts of interest pose significant problems for members of company leadership despite posing no problem for proponents of bad corporate policy who submit shareholder proposals. Under the current rules, individuals who seek the company's demise face no liability for submitting proposals that might lead to its demise as long as the proponent is not part of the corporate leadership team.

2. Corporate Opportunities

The duty of loyalty generally requires that if a director gains access to a corporate opportunity related to the corporation's business, the director must first make that opportunity available to the corporation before pursuing it on their own behalf.[101] Directors should consider the following factors when deciding whether a potential business transaction is a corporate opportunity: (i) the relevance of the opportunity to the corporation's existing or proposed business; (ii) the context in which the director became aware of the opportunity; (iii) the possible impact of the opportunity on the corporation and the level of interest of the corporation in the opportunity; and (iv) the reasonableness of any corporate expectation that the director should present the opportunity to the corporation.[102] If an individual subject to the duty of loyalty presents the opportunity to the board and the disinterested directors disclaim interest in

97. *See Mills Acquisition Co.*, 559 A.2d at 1280; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

98. *See Mills Acquisition Co.*, 559 A.2d at 1280; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

99. *See* Westmoreland Cnty. Emp. Ret. Sys. v. Parkinson, 727 F.3d 719, 725–56 (7th Cir. 2013); Emerald Partners v. Berlin, 787 A.2d 85, 91 (Del. 2001); *see also* Gensburg, *supra* note 91.

100. *See Westmoreland Cnty. Emp. Ret. Sys.*, 727 F.3d at 726; *Emerald Partners*, 787 A.2d at 91; *see also* Gensburg, *supra* note 91.

101. *See* J. Leo Johnson, Inc. v. Carmer, 156 A.2d 499, 502 (Del. 1959); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986).

102. *See Guth*, 5 A.2d at 511.

the opportunity, the interested individual may generally pursue the opportunity on their own behalf.[103] Board members are subject to the same fiduciary duties as are officers, and the duty may extend to majority shareholders as well.[104]

Take the case of *Guth v. Loft, Inc.* as an important example.[105] The case discusses what is now a historic event of the transfer of rights to Pepsi-Cola.[106] Guth, the president of Loft, received an offer in his capacity to purchase Pepsi-Cola as a replacement for a deal Loft had with Coca-Cola.[107] Guth saw the benefit in the transaction and the future proceeds of Pepsi-Cola through its business with Loft[108] and purchased Pepsi-Cola for himself rather than on behalf of his company.[109] Because Guth violated his duty of loyalty and engaged in beneficial self-dealing as opposed to bringing the offer to his company, the court forced him to turn over his shares of Pepsi-Cola to Loft and any profits otherwise gained from the transaction with Pepsi-Cola.[110]

A similar duty, however, does not exist for minority shareholders who file proposals to change a company's manner of business. Such shareholders can, at least in theory, ask the corporation to engage in business dealings that would forego valuable business opportunities for that corporation, but that might create those same opportunities for the proponents of the proposal. For example, proposals to engage in more carbon-neutral processes for the manufacture of products, if adopted, would undoubtedly aid businesses that specialize in producing manufacturing equipment that has a low carbon footprint. Does it make sense to permit members of the benefitting industry to purchase shares in certain companies and then make proposals that those companies engage them in one-sided business ventures? One might argue that this would breach the fiduciary duty of loyalty if done by a director or manager of the non-benefitting company,[111] but because minority shareholders have no such duty, they can make these proposals to their hearts' (and wallets') content. In fact, if they are clever, they may submit the shareholder proposals in ways that are not obviously affiliated with their carbon-neutral-manufacturing-equipment business, hence removing suspicion in

103. *Id.*
104. *See generally Powers & Duties*, *supra* note 23.
105. *Guth*, 5 A.2d 503.
106. *Id.* at 506.
107. *Id.* at 506–07.
108. *Id.* at 506.
109. *Id.* at 507–08.
110. *Id.* at 508.
111. *E.g.*, *id.* at 511; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

the eyes of the retail shareholder (and perhaps even the "smart money" shareholder) that the proponent is up to no good.

ii. Shareholders

In contrast to the broad fiduciary duties owed by directors and officers, shareholders only owe fiduciary duties to the corporation and other shareholders if they are deemed a "controlling" shareholder.[112] However, this is not a trivial imposition for majority shareholders, as they can frequently face lawsuits similar to the ones levied against executives and directors for a breach of a fiduciary duty.[113] Nevertheless, unlike some states, Delaware does not impose on controlling shareholders (and their representatives in management) a "heightened" fiduciary duty.[114] When the "heightened" duty applies—in certain other states and in the Delaware limited liability context—it requires the controlling shareholders to share pro rata with the minority all corporate benefits.[115] A controlling shareholder is a shareholder who holds at least 50% of the corporation's shares and exercises actual control under Delaware law, but this concept may soon evolve to include shareholders who control a sufficiently large block of a corporation to be able to control its operations.[116]

Because minority shareholders do not owe fiduciary duties to the corporation or the other shareholders, minority shareholders may act in self-serving ways thus harming the corporation.[117] However, this risk has generally "attracted little attention for two [main] reasons."[118] First, minority shareholders historically "played a largely passive role" in public corporations.[119] Second, the common belief is that the shareholder's "primary goal is to improve the [corporation's] overall economic performance."[120] After all, this is usually the way the shareholder profits from owning a company's shares: by a rise in its stock price and dividend payouts that will manifest themselves into dividend and capital gains for

112. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 723 (Del. 1971); Perlman v. Feldmann, 219 F.2d 173, 177 (2d Cir. 1955); *In re* Delphi Fin. Grp. S'holder Litig., No. 7144-VCG, 2012 WL 729232, at *15 (Del. Ch. Mar. 6, 2012).

113. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987); Blasius Indus. v. Atlas Corp., 564 A.2d 651, 658 (Del. Ch. 1988); *Guth*, 5 A.2d at 510; *see also* SPAMANN & SUBRAMANIAN, *supra* note 1, at 61–82.

114. *See* Nixon v. Blackwell, 626 A.2d 1366, 1373 (Del. 1993).

115. *Id.* at 1371.

116. *Id.*

117. Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1257 (2008).

118. *Id.*

119. *Id.*

120. *Id.* at 1258.

that shareholder. As discussed in this Article, these assumptions no longer hold true in certain scenarios.[121]

B. Overview of Short-Selling

A traditional short sale occurs when an investor sells stock that the investor does not yet own or when a sale is consummated by delivering stock borrowed by, or for the account of, the investor.[122] The investor later closes out the short position by returning the borrowed security to the stock lender, usually by purchasing securities on the open market.[123] Investors selling short-stock believe the stock's price will fall, hoping to purchase the stock at a lower price, return the stock to the lender, and make a profit on the difference between the price of stock sale and the price of stock repurchase and return.[124] If the price of the stock instead increases, the short seller seeking to terminate their position would purchase the stock at the higher price and will incur a loss.[125] This loss occurs because the price of selling the borrowed stock was lower than the price paid upon repurchase and return of the borrowed shares. Therefore, the short seller profits when the share price decreases between the investor's sale and subsequent repurchase, thus generating a potential incentive for security price manipulation to the downside.[126]

There are other ways to short securities that do not require borrowing and selling shares.[127] Investors could sell call options by writing the option themselves and conveying the option to a willing buyer.[128] A call option entitles the buyer to purchase the stock at the previously agreed strike price from the writer of the option.[129] The option locks in the price, so no matter how high or low the price of the underlying security goes, the individual holding the option can buy that stock at the strike price.[130] The writer of the call option, on the other hand, must convey the stock at the strike price even if the actual price of the security is higher.[131] Hence, the individual

121. *Id.*

122. *Short Sales*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/answers/shortsale.htm [https://perma.cc/35FK-HZXV].

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

127. ID Analysts, *Short Call Options Strategy Explained (Simple Guide)*, INVESTING DAILY (Nov. 21, 2018), https://www.investingdaily.com/44389/short-call-options-stragegy/ [https://perma.cc/T77S-ZSXB]; Jon Lewis, *Put Options: The Best Way to Short Stocks*, INV. PLACE (June 26, 2009), https://investorplace.com/2009/06/use-put-options-to-short-stocks/ [https://perma.cc/XQ7J-JLHV].

128. *See* ID Analysts, *supra* note 127.

129. *See id.*

130. *See id.*

131. *See id.*

writing the call option has a short position, because they are counting on the stock price to fall or remain below the strike price, and the buyer of the call option has a long position, because they have the right (but not the obligation) to purchase the underlying security.[132] Needless to say, options are only valuable so long as the stock price is actually above the strike price of the option.[133] Otherwise, the option holder can simply purchase the stock for less on the open market and allow the option contract to expire.[134]

Similar to shorting stocks through a derivative call option, the investor can also achieve the same or similar result through put options.[135] While a call option entitles the buyer to buy at a price that the parties previously agreed to, a put option entitles the buyer to sell at a price the parties previously agreed to.[136] These options function in the opposite direction of a call option.[137] While a call option entitles the holder to purchase shares of stock from the writer at the strike price, the put option entitles the holder to sell shares of stock to the writer at the strike price.[138] Hence, an individual wishing to bet against a stock may purchase several put options at a particular strike price.[139] Then, when the stock suffers a decline below the stock price, the right to sell that stock above its new low price suddenly becomes valuable and marketable to holders of that security.[140] The holder of the put option can then sell it to individuals (basically as an insurance policy against stock declines), and those individuals can cash in on the put and force the writer to pay the strike price for shares that are far less expensive on the open market.[141] This is somewhat akin to selling home insurance for a home that has already caught fire: The seller can command a very high price.[142]

There are a number of other creative ways investors can short securities, but the concept is largely the same, and we do not wish to exhaust the reader by listing every one. What is important to note is that shorting a stock is not always lucrative for the short-sellers because obvious risks exist.[143] The potential for severe losses if a stock's price goes up after the short sale creates an additional incentive for the short seller to

132. *See id.*
133. *See id.*
134. *See id.*
135. *See* Lewis, *supra* note 127.
136. *Id.*; ID Analysts, *supra* note 127.
137. *See* Lewis, *supra* note 127; ID Analysts, *supra* note 127.
138. Lewis, *supra* note 127.
139. *Id.*
140. *Id.*
141. *Id.*
142. *Id.*
143. ID Analysts, *supra* note 127; *see* Lewis, *supra* note 127.

manipulate stock prices downward because a short sale might expose them to potentially infinite liability if the price of the shorted security continues to rise in value before the trader can close their position.[144] Brokerage firms generally lend stock to individuals engaging in short sales, using either the firm's own inventory, the margin account of another firm's customer, or another lender.[145] Many brokerages will automatically close a short position after the investor has lost a sufficient amount of money for betting on a stock's price to fall when the price actually rises (especially if the trader cannot honor a margin call).[146] However, investors can still find themselves deeply in debt after an unsuccessful round of short selling.[147]

Short selling is not without controversy.[148] The biggest concern with short selling is its potential for market abuse.[149] In 2008, for example, over the course of just one hour, the shares of HBOS plc, a banking and insurance company in the United Kingdom, dramatically declined when rumors abounded that the bank had significant financial problems.[150] The rumors proved to be false, and the share price recovered later that day, but investors with short positions in HBOS shares made a significant profit.[151] There is widespread speculation that a hedge fund planted the rumors to make a quick buck.[152] Shareholder proposals also have the potential to inspire price declines because markets may negatively view a corporation having to address a pesky proposal.[153] Hence, shareholders that hold short positions in various firms but own sufficient securities to file shareholder proposals stand well-poised to profit from filing proposals calculated to reduce firm value.

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144. Adam Hayes, *Short Selling*, INVESTOPEDIA (Mar. 13, 2021), https://www.investopedia.com/terms/s/shortselling.asp [https://perma.cc/47CC-GRYH].

145. Adam Hayes, *Who Benefits from Lending Shares in a Short Sale?*, INVESTOPEDIA (Jan. 29, 2021), https://www.investopedia.com/ask/answers/05/shortsalebenefit.asp [https://perma.cc/F4XL-4H2T].

146. *See, e.g.*, *Why Did My Broker Close My Position Without My Consent?*, ALPARI, https://alpari.com/en/faq/trading_terms/position_closed_by_broker/ [https://perma.cc/A6LM-JMNF].

147. *See, e.g.*, Sarah Marsh, *German Billionaire Commits Suicide After VW Losses*, REUTERS (Jan. 6, 2009), https://www.reuters.com/article/us-merckle-newsmaker-sb-idUSTRE5055O820090106 [https://perma.cc/8BJA-X4HS].

148. David Prosser, *The Big Question: What Is Short Selling, and Is It a Practice that Should Be Stamped Out?*, INDEP. (Oct. 22, 2011), https://www.independent.co.uk/news/business/analysis-and-features/the-big-question-what-is-short-selling-and-is-it-a-practice-that-should-be-stamped-out-874717.html [https://perma.cc/HZ5D-HLWY].

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *See* Matsusaka, *Shareholder Proposals*, *supra* note 5, at 2. *See generally* Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

C. The SEC and Shareholder Proposals

The SEC, while created via laws passed by the legislative branch, operates as an independent regulatory agency of the United States government.[154] The SEC investigates administrative, civil, and criminal misconduct involving market manipulation and works closely with the United States Attorneys to prosecute offenders.[155] The SEC also has its own sets of rules and guidelines.[156] Some of these guidelines can be found within the Code of Federal Regulations.[157] Others can be found within the internal rules of the SEC.[158] The Commission itself enforces the rules and guidelines that it sets forth, sometimes serving as an interested party and in other instances essentially arbitrating disputes between conflicting parties.[159]

The SEC plays an important role in the relationship between shareholders and corporations.[160] Part of the SEC's task is to reduce

154. Mary Jo White, Chairperson, U.S. Sec. and Exch. Comm'n, 14th Annual A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture at Fordham Law School: The Importance of Independence (Oct. 3, 2013), https://www.sec.gov/news/speech/spch100113mjw [https://perma.cc/GA45-N85L].

155. *How Investigations Work*, U.S SEC. & EXCH. COMM'N (Jan. 27, 2017), https://www.sec.gov/enforce/how-investigations-work.html [https://perma.cc/MFG5-N8VG]; *What We Do*, U.S. SEC. & EXCH. COMM'N (Jan. 27, 2017), https://www.sec.gov/about/what-we-do [https://perma.cc/ZMG2-7S7V].

156. *Rules and Regulations for the Securities and Exchange Commission and Major Securities Laws*, U.S. SEC. & EXCH. COMM'N (Mar. 29, 2017), https://www.sec.gov/about/laws/secrulesregs.htm [https://perma.cc/3C8W-QUQZ].

157. 17 C.F.R. §§ 230, 240, 250, 260, 270, 275, 300 (2019).

158. *Researching the Federal Securities Laws Through the SEC Website*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/reportspubs/investor-publications/investorpubssecuritieslaws htm.html [https://perma.cc/3C8W-QUQZ].

159. *See generally* ENFORCEMENT MANUAL, U.S. SEC. & EXCH. COMM'N (2017), https://www.sec.gov/divisions/enforce/enforcementmanual.pdf [https://perma.cc/XJ8A-5TBP].

160. *See* Roel C. Campos, Comm'r, U.S. Sec. & Exch. Comm'n, Speech by SEC Commissioner: Remarks Before the CNMV Corporate Governance and Securities Markets Conference (Feb. 8, 2007), https://www.sec.gov/news/speech/2007/spch020807rcc.htm [https://perma.cc/A57H-Y2BF]; Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Amendments to Modernize Shareholder Proposal Rule (Nov. 5, 2019), https://www.sec.gov/news/press-release/2019-232 [https://perma.cc/6SP7-M557] [hereinafter SEC Proposes Amendments]; *2015 No-Action Letters Issued Under Exchange Act Rule 14a-8*, U.S. SEC. & EXCH. COMM'N (2016), https://www.sec.gov/divisions/corpfin/cf-noaction/2015_14a-8.shtml [https://perma.cc/6MR9-QT3X] [hereinafter *2015 No-Action Letters*]; *2016 No-Action Letters Issued Under Exchange Act Rule 14a-8*, U.S. SEC. & EXCH. COMM'N (2016), https://www.sec.gov/divisions/corpfin/cf-noaction/2016_14a-8.shtml [hereinafter *2016 No-Action Letters*]; *2017 No-Action Letters Issued Under Exchange Act Rule 14a-8*, U.S. SEC. & EXCH. COMM'N (2017), https://www.sec.gov/divisions/corpfin/cf-noaction/2017_14a-8.shtml [hereinafter *2017 No-Action Letters*]; *2018 No-Action Letters Issued Under Exchange Act Rule 14a-8*, U.S. SEC. & EXCH. COMM'N (2018), https://www.sec.gov/divisions/corpfin/cf-noaction/2018_14a-8.shtml [hereinafter *2018 No-Action Letters*]; *2019 No-Action Letters Issued Under Exchange Act Rule 14a-8*, U.S. SEC. & EXCH. COMM'N (2019), https://www.sec.gov/divisions/corpfin/cf-noaction/2019_14a-8.shtml [hereinafter *2019 No-Action Letters*]; *2019–2020 No-Action Responses Issued Under Exchange Act Rule 14a-8*, U.S. SEC. & EXCH. COMM'N (Feb. 1, 2021), https://www.sec.gov/corpfin/2019-2020-

instances of foul play. For example, the agency monitors and curtails insider trading by collaborating with other investigative agencies such as the Federal Bureau of Investigation.[161] The SEC also helps ensure that investor voices reach the ears of corporate leadership.[162] As holders of the corporation's shares, stockholders should have at least some voice in the corporation's operation if they so desire.[163] To that extent, the SEC ordinarily requires that shareholder proposals receive company attention if the proposals comply with certain rules.[164] Specifically, a proposal that complies with the rules must be included on the ballot for vote by other shareholders at the next shareholder meeting.[165] Failure to include a compliant proposal from an investor not only subjects the corporation to a potential lawsuit from the rebuffed investor but also subjects the corporation to enforcement actions and penalties brought by the SEC.[166]

The rules governing shareholder proposals originated in the Securities Exchange Act of 1934.[167] This Act gave the SEC the authority to craft rules and requirements for the submission of shareholder proposals.[168] The SEC did so in 17 C.F.R. § 240.14a-8: Shareholder proposals (commonly known as Rule 14a-8).[169] This rule, fashioned in a question-and-answer format, explains to the company and its shareholders the rules regarding the submission of various proposals that both sides must follow.[170] Corporate attorneys frequently employ these rules to attempt to exclude shareholder proposals from consideration by pointing out to the SEC that the shareholder did not comply with one or more of the rules that the agency has promulgated for submission of such proposals.[171] As a result, the corporation will request that the SEC issue a "no-action letter," which is a letter that confirms the SEC plans to take no action

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shareholder-proposals-no-action [https://perma.cc/9G95-KURT] [hereinafter *2019-2020 No-Action Responses*].

161. *Insider Trading — Proactive Enforcement Paying Off*, FED. BUREAU OF INVESTIGATION (Aug. 13, 2012), https://www.fbi.gov/news/stories/insider-trading [https://perma.cc/4JCW-FHNC].

162. 17 C.F.R. § 240.14a-8 (2020); SEC Proposes Amendments, *supra* note 160; *2016 No-Action Letters*, *supra* note 160; *2017 No-Action Letters*, *supra* note 160; *2018 No-Action Letters*, *supra* note 160; *2019 No-Action Letters*, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

163. Bebchuk, *supra* note 5.

164. 17 C.F.R. § 240.14a-8 (2020); SEC Proposes Amendments, *supra* note 160; *2016 No-Action Letters*, *supra* note 160; *2017 No-Action Letters*, *supra* note 160; *2018 No-Action Letters*, *supra* note 160; *2019 No-Action Letters*, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

165. *Id.*

166. 17 C.F.R. § 240.14a-8 (2020).

167. 17 C.F.R. § 240 (2020).

168. 17 C.F.R. § 240.14a-8 (2020).

169. *Id.*

170. *Id.*

171. *See, e.g.*, *2016 No-Action Letters*, *supra* note 160; *2017 No-Action Letters*, *supra* note 160; *2018 No-Action Letters*, *supra* note 160; *2019 No-Action Letters*, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

against the company for excluding a particular proposal from the annual meeting materials and from a shareholder vote.[172]

These letters are not technically binding on the SEC, and the shareholder can still pursue their own personal court action to require the proposal to receive a vote.[173] However, when the SEC issues a no-action letter, it is typically the end of the discussion.[174] Thousands of requests for no-action letters have been submitted to the SEC over the past two decades, and the SEC has usually sided with the corporations on whether a no-action letter would issue.[175] However, a non-trivial number of cases have involved corporations losing their bid to exclude the proposal, leaving them the choice to either negotiate with the proponent to reach some settlement or to put the matter to a vote at the annual meeting.[176] Refusing to choose one of these options would open the corporation to an enforcement action not only by the shareholder but by the SEC as well—a path likely far more destructive than its alternative, and one that would still ultimately lead to the proposal receiving a vote at the annual shareholders' meeting.

As mentioned above, almost anyone who is truly interested in making a shareholder proposal to any company can do so: all the proponent would have to do is purchase at least $2,000 worth of company shares or 1% or more of company shares, hold the stock for at least three years,[177] and then state their subjective intent *at the time of the proposal* to continue holding the security.[178] That is, the investor could, theoretically, change their mind and sell the stock later regardless of their earlier implicit claim that they intended to hold the security indefinitely.[179] The possibility of almost anyone submitting a proposal leaves publicly-traded companies

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172. *No Action Letters*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/fast-answers/answersnoactionhtm.html; SEC Proposes Amendments, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

173. *See, e.g.*, N.Y.C. Emps.' Ret. Sys. v. SEC, 45 F.3d 7, 12–13 (2d Cir. 1995).

174. *See id.* at 13.

175. *2016 No-Action Letters*, *supra* note 160; *2017 No-Action Letters*, *supra* note 160; *2018 No-Action Letters*, *supra* note 160; *2019 No-Action Letters*, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

176. Hannah Orowitz & Brigid Rosati Georgeson, *An Early Look at the 2020 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 10, 2020), https://corpgov.law.harvard.edu/2020/06/10/an-early-look-at-the-2020-proxy-season/ [https://perma.cc/FJ2A-VPPS]; *see also* SEC Proposes Amendments, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

177. The three-year requirement was recently raised from one year. *See* Clayton, *supra* note 7; Lee, *supra* note 7; Roisman, *supra* note 7; Leaf & Bartlett, *supra* note 7. The proponent can still hold for just over one year if the individual holds $25,000 of company stock. This is pocket change for many Wall Street traders.

178. *Shareholder Proposals*, U.S. SEC. & EXCH. COMM'N (Oct. 16, 2012), https://www.sec.gov/interps/legal/cfslb14g.htm [https://perma.cc/QA9V-Y8Q8]; 17 C.F.R. § 240.14a-8 (2020).

179. 17 C.F.R. § 240.14a-8 (2020).

open to proposals from individuals who are just "passing through" without any significant stake in the company.[180] Hence, the economic disincentives ordinarily present to dissuade poor behavior by shareholders are not necessarily effective in these cases.

Currently, the SEC only receives a few hundred requests per year to permit exclusion of proposals.[181] However, there are significantly more stockholders that could qualify as individuals with the right to make such proposals. If these shareholders began to submit proposal after proposal, it is entirely possible that both the SEC staff handling these no-action letter requests and the companies receiving them would become overwhelmed.[182] Naturally, it may not be optimal for the shareholder to engage in such behavior, as they would effectively be participating in devaluing their own company.[183] However, the window appears open for activists or nefarious actors to infiltrate the rank of company ownership and slow its legal operations.[184] The fact that this has not taken place yet (at least not to a detectable degree) is quite surprising, especially because the current short-selling market allows investors to potentially profiteer off of a company's woes.

So far, without the unregulated influx of proposals from troublemakers, the SEC ordinarily receives and processes most no-action letters during the first part of the year.[185] Generally, the process of submitting a proposal and battling with the corporation to ensure that the proposal appears on the ballot unfolds as follows:

1. A shareholder conceives of a particular action that they wish the company to take or refrain from taking. These actions can include anything from reducing pollution and adopting corporate social responsibility policies to amending shareholder voting procedures.[186]

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180. *Id.*

181. SEC Proposes Amendments, *supra* note 160; *2016 No-Action Letters*, *supra* note 160; *2017 No-Action Letters*, *supra* note 160; *2018 No-Action Letters*, *supra* note 160; *2019 No-Action Letters*, *supra* note 160; *2019–2020 No-Action*, *supra* note 160.

182. *See, e.g.*, *US Government Shutdown Ends — SEC Issues Guidance to Address Significant Backlog of Filing Reviews and Shareholder Proposals*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Jan. 27, 2019), https://www.skadden.com/insights/publications/2019/01/us-government-shutdown-ends [https://perma.cc/P8ZN-KS5L].

183. *See* Chris R. Murphy, *Why Do Companies Care About Their Stock Price?*, INVESTOPEDIA (Jan. 29, 2021), https://www.investopedia.com/investing/why-do-companies-care-about-their-stock-prices/ [https://perma.cc/TT4A-KCDZ].

184. *See* 17 C.F.R. § 240.14a-8 (2020).

185. *See, e.g.*, *Division of Investment Management Staff No-Action and Interpretive Letters*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/investment/investment-management-no-action-letters [https://perma.cc/23XG-75ML].

186. COUNCIL OF INSTITUTIONAL INVS., EVERYTHING YOU EVER WANTED TO KNOW ABOUT FILING A SHAREOWNER PROPOSAL BUT WERE AFRAID TO ASK 8–9 (2011).

2. The shareholder drafts a proposal to that effect and submits it to the company prior to the annual meeting in hopes of having the proposal included for a vote by other shareholders.[187]
3. The corporation decides its course of action. Because there is little evidence that corporate leadership views these proposals as helpful, as indicated by hundreds of no-action letter requests, the corporation seeks to essentially suppress the matter from coming to a vote by seeking a no-action letter from the SEC.[188] In so doing, the company provides the SEC with the proposal it received and then cites reasons under Rule 14a-8 why the proposal violates SEC rules and should be excluded.[189]
4. Sometimes, the shareholder responds (typically represented by a lawyer), arguing why the proposal *does not* violate guidelines and that it cannot be properly excluded.[190]
5. The parties negotiate. While the filings arrive at the SEC, there is frequently quite a bit of action on the sidelines: the company and the shareholder engage in negotiations where the company sometimes offers concessions in exchange for the shareholder withdrawing their offer.[191] It is even possible for company leadership to take some (but rarely all) steps to implement the shareholder proposal without requiring a vote at the annual meeting.[192]
6. If the parties reach an agreement, they typically file a document with the SEC notifying agency attorneys that the SEC need not reach a conclusion regarding the no-action request.[193] Instead, the attorneys are informed that the shareholder is withdrawing their proposal and the "case" should be closed.[194]
7. In the alternative, when no agreement can be reached, the SEC decides whether or not the proposal complies with SEC rules.[195] If so, then the SEC declines to issue the no-action letter the company seeks. If not, then the SEC will issue such a letter:[196] (a) If the SEC refuses to issue a no-action letter, the company

187. *Id.* at 7.
188. *Id.* at 12.
189. *Id.*
190. *Id.*
191. *Id.* at 4.
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.* at 12.
196. *Id.*

> must either include the shareholder proposal on the annual ballot (and thus risk it passing by a popular vote) or face lawsuits from both the SEC and the shareholder that carry significant penalties;[197] (b) If the SEC issues a no-action letter, the company may still include the proposal on its ballot if its leadership so desires, or it may omit the proposal.[198] If the leadership omits the proposal, the shareholder may sue to have the proposal included on the ballot during a future annual meeting.[199] Some negotiations may also occur at this stage, perhaps to settle or prevent such a lawsuit, but evidence of this is less available.[200]

Given this large number of steps (and filings that can span hundreds of pages), shareholder proposals can cause publicly-traded companies a non-trivial amount of hassle.[201] This hassle would be especially pronounced for smaller companies with low market capitalization that must rely on general counsel or hire expensive outside counsel to deal with suboptimal proposals.[202] A larger portion of a small company's revenues may have to be devoted to lawyer fees to oppose the proposal.[203] Moreover, if we assume that company leadership has at least some incentive to lead the company to prosperity, then we can infer that opposition to shareholder proposals denotes executives' beliefs that the proposal would harm the company if passed.[204] Furthermore, the existence of a potential proposal that can drastically alter the way a company does business results in a heightened possibility of significant and extreme change.[205] This change increases uncertainty around the company, has the potential to interfere with the contracts available to the company, may interfere with the ability to raise capital, and generally reduces the price that market traders are willing to pay for shares in the company (thus harming the net worth of the remaining shareholders that had nothing to do with the proposal whatsoever).[206]

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197. *Id.* at 13.

198. *See id.* at 12.

199. *Id.*

200. *See id.*

201. *Responsible Shareholder Engagement & Long-Term Value Creation*, BUS. ROUNDTABLE, https://www.businessroundtable.org/archive/resources/responsible-shareholder-engagement-long-term-value-creation [https://perma.cc/G5V7-9D35].

202. *See id.*

203. *See generally* James McRitchie, *The Costs and Benefits of Shareholder Democracy*, CORP. GOVERNANCE (Dec. 5, 2019), https://www.corpgov.net/2019/12/the-costs-and-benefits-of-share holder-democracy/ [https://perma.cc/J8YN-27HZ].

204. Matsusaka, *Shareholder Proposals*, *supra* note 5, at 1.

205. *See id.* at 1–2.

206. *Id.* at 29.

Currently, there are many SEC regulations that could exclude a proposal. For example, this could happen if the proposal's length exceeds 500 words, if the proposal is a second or subsequent submission for vote at the same shareholder meeting, or if the proposal fails to comply with the other requirements under Rule 14a-8. However, nothing in the regulations requires the individual submitting the proposal to be acting in good faith (or otherwise demonstrating loyalty or care) toward the corporation.[207] Thus, it is apparently legal to submit a proposal with full knowledge that the proposal would harm the market price of company stock.[208] Because shareholder proposals lack a good faith requirement, the executive team, members of the board, and other shareholders have little recourse against a troublemaking proponent.[209] The SEC has recently adopted several amendments to Rule 14a-8, which purport to make the exploitation of the shareholder proposal more difficult.[210] Nevertheless, none of these amendments would seriously hamper stock price manipulation through the filing of proposals intended to harm a publicly traded company.

In November of 2019, momentum for changing shareholder proposal rules escalated when the SEC proposed amendments to modernize Rule 14a-8.[211] The proposed amendments would: (i) increase the ownership requirements that a shareholder must satisfy to be eligible for filing a proposal;[212] (ii) update the current "one proposal" rule to clarify that a single person cannot submit more than one shareholder proposal at the same shareholders' meeting, regardless of whether the person submits a proposal as a shareholder or as a shareholder representative; and (iii) modernize the levels of shareholder support a proposal must receive to be eligible for resubmission of the proposal at the company's future shareholder meetings.[213] Although discussion of these rules, and their

207. 17 C.F.R. § 240.14a-8 (2020).

208. Matsusaka, *Shareholder Proposals*, *supra* note 5, at 29–30.

209. *See* 17 C.F.R. § 240.14a-8 (2020).

210. Matsusaka, *Shareholder Proposals*, *supra* note 5, at 7; Matsusaka, *Opportunistic Proposals*, *supra* note 5, at 3221 n.4. *See generally* Matsusaka, *Shareholder Approval*, *supra* note 5; Leaf & Bartlett, *supra* note 7.

211. *See* SEC Proposes Amendments, *supra* note 160.

212. Specifically, the proposed amendment would update the current requirement that a shareholder hold at least $2,000 or 1% of a company's securities for at least three years to be eligible to submit a proposal. In addition to eliminating the 1% threshold, the proposal would amend the rule with the following three alternative thresholds: "continuous ownership of at least $2,000 of the company's securities for at least three years; continuous ownership of at least $15,000 of the company's securities for at least two years; or continuous ownership of at least $25,000 of the company's securities for at least one year." SEC Proposes Amendments, *supra* note 160.

213. The proposed amendments would modernize the current resubmission thresholds of 3%, 6%, and 10% for matters voted on once, twice, or three or more times in the last five years, respectively, with thresholds of 5%, 15%, and 25%, respectively, and would add a new provision that

adoption in September of 2020, is a step in the right direction,[214] it does little to quell the possibility of the actions described below.

D. Room for Exploitation

The rules noted above leave ample room for abuse.[215] As suggested in this Article's introduction, it is entirely possible for individuals to take a small $2,000 position in a company, wait the appropriate amount of time to qualify for making a shareholder proposal, take a $1,000,000 short position in the company through another brokerage, and then send proposals that would harm the business. It may not be advisable for investors hoping to grow their portfolio from market gains to hold the same long and short positions, but it might be ideal for someone seeking to manipulate the market.[216] It is true that the individual must certify ownership of at least $2,000 in company stock to be eligible for making shareholder proposals, but the requirement is not a *net* requirement: the shareholder need only disclose their ownership of $2,000 at the brokerage where the shareholder holds the long position.[217] There is no requirement to disclose the short positions.[218]

Moreover, it may not even be necessary to open two separate brokerage accounts.[219] It is quite possible to construct a long and short position in the same company within the same brokerage and still avoid reducing one's share of company stock below $2,000.[220] The availability of options trading makes this possible.[221] All an investor must do is sell

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would permit exclusion of a proposal that has been previously voted on three or more times in the past five years if the proposal "(i) received less than 50% of the votes cast and (ii) experienced a decline in shareholder support of 10[%] . . . or more compared to the immediately preceding vote." SEC Proposes Amendments, *supra* note 160.

214. *See generally* Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5; Leaf & Bartlett, *supra* note 7.

215. *Cf.* 17 C.F.R. § 240.14a-8 (2020).

216. Raymond Stein, *Advanced Trading: Going Long and Short on the Same Instrument in the Same Account*, TRADERS EXCLUSIVE, https://tradersexclusive.com/ad_trad_go_long_and_short/ [https://perma.cc/22DS-F677].

217. 17 C.F.R. § 240.14a-8 (2020).

218. *See id.*

219. Stein, *supra* note 216. A brokerage account is a financial account that can be opened with an investment firm that provides access to stocks, bonds, and mutual funds. Many brokers permit brokerage accounts to be opened quickly online, and many brokerage firms permit brokerage accounts to be opened with no initial deposit. Arielle O'Shea, *What Is a Brokerage Account and How Do I Open One?*, NERD WALLET (Mar. 17, 2021), https://www.nerdwallet.com/article/investing/what-is-how-to-open-brokerage-account [https://perma.cc/HA3X-R3WV].

220. Stein, *supra* note 216.

221. Leslie Kramer, *Long Position vs. Short Position: What's the Difference?*, INVESTOPEDIA (Jan. 28, 2021), https://www.investopedia.com/ask/answers/100314/whats-difference-between-long-and-short-position-market.asp [https://perma.cc/ZKY6-Q4PR].

call options on the stock.[222] If the investor does not own any call options on the stock, they can simply write the call options and sell them, binding themselves to the contract these options imply; at the choice of the buyer, the writer of the call option shall provide to the buyer 100 shares of stock at the agreed strike price,[223] if the buyer exercises the option prior to expiration.[224]

Furthermore, there is nothing requiring that these call options be covered by existing shares, even if the seller of the option is selling options they wrote and did not buy from another trader.[225] That is, an individual could hold only 100 shares of a $20-per-share company and yet sell call options on 1,000 or 1,000,000 shares they do not own (depending on the limitations of the brokerage and the available leverage in the investor's account).[226] If the shareholder can then manipulate the stock price to fall after selling these options, the options lose value, and the shareholder can cover their position and walk away with the profit.[227] In the alternative, if the shareholder has great faith in their ability to manipulate the price of the stock, the individual can simply wait until the option expires out of the money, walking away with the entirety of the proceeds from selling the option without spending the money to cover[228] the position.

This trade is not without risks, of course. Because writing a naked call option,[229] as described, above requires the writer to furnish shares of stock they do not own, writing such an option exposes the trader to

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222. Stein, *supra* note 216. Call options are financial contracts providing the buyer with the right, but not the obligation, to buy a stock, bond, commodity, or other asset or instrument at a specific price within a specified time period. A call buyer profits when the price of the underlying asset profits. Jason Fernando, *Call Option Definition*, INVESTOPEDIA (Feb. 2, 2021), https://www.investopedia.com/terms/c/calloption.asp [https://perma.cc/WKD3-32AJ].

223. "Strike price" is the price at which a put or call option can be exercised. Jason Fernando, *Strike Price*, INVESTOPEDIA (Feb. 7, 2021), https://www.investopedia.com/terms/s/strikeprice.asp [https://perma.cc/2GUW-5CU3].

224. Jeff Bishop, *Everything You Need to Know to Sell a Call Option*, RAGING BULL (Nov. 4, 2019), https://ragingbull.com/options/sell-call-option/ [https://perma.cc/7FA9-YY99].

225. *Id.*

226. *Id.*

227. Scott Connor, *Options Trading Guide: What Are Put & Call Options*, AMERITRADE (July 21, 2020), https://tickertape.tdameritrade.com/trading/options-basics-what-are-puts-and-calls-16682 [https://perma.cc/NK7Q-BSDZ]. A trader could achieve this simply by purchasing call options from yet another trader and holding them until expiration to offset the effects of the options originally written by the trader.

228. Covering a position means the investor purchases options from yet another option writer and uses them to offset the options the investor has written earlier. James Chen, *Short Covering*, INVESTOPEDIA (Jan. 28, 2021), https://www.investopedia.com/terms/s/shortcovering.asp [https://perma.cc/2KGD-NE54].

229. A "naked option" is an option sold without "any previously set-aside shares or cash to fulfill the option obligation at expiration." Gordon Scott, *Naked Option*, INVESTOPEDIA (May 2, 2019), https://www.investopedia.com/terms/n/nakedoption.asp [https://perma.cc/YUX7-6MXT]. Naked call options that are exercised "create a short position in the seller's account." *Id.*

potentially infinite liability (because the price of the stock can theoretically grow infinitely above the option strike-price in the time remaining prior to the option's expiration).[230] However, a trader who has the ability to manipulate the stock price of the security they short may have a reduced risk of this happening, thereby gaining an unfair trading advantage.[231]

Shorting the security can be accomplished through purchasing options as well as selling them.[232] Put options, which give the holder the right (but not the obligation) to purchase a security at the strike price, prove crucial in this arrangement.[233] A clever trader who can anticipate a stock drop would purchase put options that would cover the stock they own or perhaps stock they do not own.[234] In this way, the shareholder can ensure that they can sell the stock at a price above that which the shareholder anticipates in the future.[235] This strategy is valuable for the sale of the securities the shareholder may have used to file a damaging shareholder proposal in the first place.[236] Any option contracts covering shares that the shareholder does not own can be sold for a profit to other shareholders in need of them.[237] If no other traders need them (although there are almost always those who do), the investor can simply purchase *additional* shares of the stock below the strike price of the put option and sell them at the strike price using their remaining put option contracts.[238] Then, the shareholder collects the difference between the purchase price of the shares and the strike price of the put option as profit.[239]

The recent SEC rules can taper down potential stock manipulation activity but not by much. Recall that $2,000 now entitles the holder to a proposal once they have held the securities for three years rather than just one.[240] However, marginally greater positions in the same security permit

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230. Jared Woodard, *Why Covered Calls Are Riskier than You Think*, THE ST. (Nov. 15, 2011), https://www.thestreet.com/investing/options/why-covered-calls-are-riskier-than-you-think-11311917 [https://perma.cc/S4G8-R4BZ].

231. Ken Little, *How to Legally Manipulate Stock Prices*, THE BALANCE (Aug. 5, 2019), https://www.thebalance.com/how-to-legally-manipulate-stock-prices-3140856 [https://perma.cc/YC6Q-GPX4].

232. *How to Short a Stock with Options*, FINANCHILL, https://financhill.com/blog/investing/how-to-short-a-stock-with-options [https://perma.cc/D4LJ-YU8N].

233. Scott Connor, *The Short Option: A Primer on Selling Put and Call Options*, AMERITRADE (July 13, 2018), https://tickertape.tdameritrade.com/trading/short-options-primer-16744 [https://perma.cc/DG3M-WAN8].

234. *Protective Put (Long Stock + Long Put)*, FIDELITY (2013), https://www.fidelity.com/learning-center/investment-products/options/options-strategy-guide/protective-put [https://perma.cc/EH6N-VCX7].

235. *Id.*

236. *See id.*

237. *Id.*

238. *Id.*

239. *Id.*

240. Leaf & Bartlett, *supra* note 7.

the shareholder to exercise their right to file proposals just as before.[241] For example, holding $25,000 in the security permits the submission of a shareholder proposal after just one year of ownership.[242] A middle ground exists at $15,000, where two years of ownership constitute the litmus test for having a sufficient stake in the company.[243] These new requirements will hardly decrease the possibility of stock manipulation by the big players: hedge funds, investment funds, mutual funds, foundations, trust funds, and other large investment vehicles often hold well over $25,000 in a wide variety of securities (if not all securities available on the American exchanges). Meeting the threshold necessary might only pose problems for the retail investors, and if a retail investor has less than $25,000 to invest, it is entirely possible they are in no position to profitably short the security anyway. In summary, the SEC rule change might reduce the problem of pesky shareholder proposals from retail investors with little stake in the company, but it does nothing to thwart or eliminate the potential for stock price manipulation by those actually equipped to do it.

Some may argue that obvious stock manipulation by deliberately poor proposals may breach a fiduciary duty to other investors to not deliberately devalue the company.[244] The law regarding this potential is highly amorphous and perhaps still waiting to form: We are aware of no fiduciary duty currently extended to minority shareholders in a non-merger context. While a case might be made for negligence, breach of fiduciary duty, or other tort, the slow process[245] of the courts—which take years if not decades to decide such matters—fails to compare to the fast profit made from a well-timed trade (which can occur in less than one second). Moreover, there are strong indications that most jurisdictions would not impose such a duty on investors to begin with, meaning that devaluing one's own company may seem unwise, but it is not illegal.[246]

241. *Id.*

242. *Id.*

243. *Id.*

244. *See generally Protective Put (Long Stock + Long Put)*, *supra* note 234.

245. *See* Patrick Kitchin, *The Slow Pace of Litigation Process*, KITCHIN LEGAL, https://www.kitchinlegal.com/the-slow-pace-of-litigation-process [https://perma.cc/RCM8-MLH5].

246. As discussed above, majority or controlling shareholders of a corporation may owe fiduciary duties in certain scenarios, but such fiduciary duties are only owed if the shareholder assumes "control" of the corporation (and even if the shareholder has "control" of the corporation, the shareholder may still owe no fiduciary duties at all). *Fiduciary Duties: An Important Consideration in Owning and Running a Business*, CARLILE PATCHEN & MURPHY LLP (Nov. 25, 2019), https://www.cpmlaw.com/fiduciary-duties/ [https://perma.cc/8MMS-RFS2]. Minority shareholders do not owe any fiduciary duties to the corporation or the other shareholders. *See* Anabtawi & Stout, *supra* note 117, at 1257.

In other areas of law, such as criminal enforcement of security laws, corporations will find little respite from shareholders with ill intent.[247] The SEC does frequently enforce laws against insider trading, market manipulation through false information, and similar offenses.[248] However, shareholders crippling their own companies, while seemingly nefarious, does not currently fit into the SEC's enforcement scheme mainly focused on insider trading and fraud regulation; bad shareholder proposals are not illegal. After all, nothing about submitting a shareholder proposal involves fraud: the proponent is not stating a falsehood about anything, but rather merely states the shareholder's preference for how the corporation should be run.[249] There is no requirement that the proponent certify their good faith or that they hold no short interests in the company.[250]

In fact, since there is no law, rule, or regulation that would prevent a shareholder from honestly desiring their company's demise (due to holding short interests or otherwise), the shareholder may make a proposal with the open intent of harming their company without recourse. Hence, there is little opportunity to commit fraud in the first place (except perhaps via misrepresentation and forgery regarding the number of shares the shareholder holds and how long they have held them).[251] The shareholder could conceivably misrepresent their intent to hold the shares indefinitely into the future.[252] However, not only would this lack of intent be notoriously hard to prove, but a poor proposal need not be accompanied by a future intent to sell the $2,000 interest.[253] The shareholder can actually maintain its stake in the company (while closing the short positions for a

247. *See generally* Michael D. Ricciuti, Walter P. Loughlin, Jeffrey L. Bornstein, Brian W. Stolarz & Leanne E. Hartmann, *Criminal Enforcement of the Securities Laws*, *in* THE SECURITIES ENFORCEMENT MANUAL (Michael J. Missal & Richard M. Phillips eds., 2d ed. 2007), https://files.klgates.com/files/upload/se_manual_chapter_8.pdf [https://perma.cc/P2YS-E33A].

248. *See generally* TOM SWIERS, OFFICE OF INT'L AFFS., U.S. SEC. & EXCH. COMM'N, MARKET MANIPULATION, https://www.sec.gov/files/Market%20Manipulations%20and%20Case%20Studies.pdf [https://perma.cc/FPN6-H79P]; *SEC Enforcement Actions – Insider Trading Cases*, U.S. SEC. & EXCH. COMM'N (July 15, 2019), https://www.sec.gov/spotlight/insidertrading/cases.shtml [https://perma.cc/GEJ2-QQA4].

249. *See generally* Jeffrey Karpf, Sandra Flow & Mandeep Kalra, *Board Composition and Shareholder Proposals*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Jan. 28, 2020), https://corpgov.law.harvard.edu/2020/01/28/board-composition-and-shareholder-proposals/ [https://perma.cc/7MGJ-TGYP].

250. *Cf.* 17 C.F.R. § 240.14a-8 (2020).

251. *Id.* This type of misrepresentation, even if made, rarely suffers from any type of prosecution and is regularly treated as a mistake. The company receiving the shareholder proposal merely sends a no-action letter request to the SEC pointing out the deficiency in proof of long-term ownership, and the SEC promptly issues a no-action letter. This ordinarily ends the matter fairly quickly, and we are aware of no repercussions to the shareholder except the exclusion of the proposal from the ballot at the next shareholders' meeting.

252. *Cf. Id.*

253. *Cf. Id.*

profit) in hopes of submitting *future* damaging proposals and profiteering even more in subsequent years by taking more and more short positions as the years pass.

Moreover, the submission of an intentionally foul shareholder proposal likely cannot lead to penalties for insider trading.[254] While the trader might know their own submission will soon become public and reduce the company's stock price, this is not the type of non-public information that would prohibit trading the security.[255] After all, to constitute insider trading, the individual must know of some non-public detail about company operations, not the upcoming publication of a shareholder proposal from outside the company by one of its shareholders.[256] Submitting a proposal cannot be considered manipulation of markets by knowingly inducing others to trade on information that was not true.[257] There is no truth asserted in a proposal: It is merely a suggestion, however misguided, about how the company should conduct its business.[258] From a certain perspective, some might argue it should be legal for owners to destroy their property if they want to destroy it.[259] However, in instances where the ownership is shared and where suspect motives may exist for causing the destruction, potential abuses may become commonplace.

II. THE DOCUMENTED IMPACT OF SHAREHOLDER PROPOSALS ON CORPORATIONS

Financial and economic literature suggests a complicated relationship between corporate leadership, shareholders, shareholder proposals, and company prospects.[260] Theoretical models incorporate the possibility that the right to make proposals may hurt shareholders by shifting the position of leadership toward the goals of the activists.[261] This can happen if the shareholder proposal passes or if the leadership, which

254. *Insider Trading*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/fast-answers/answersinsiderhtm.html [https://perma.cc/9WY7-FNWV].

255. *See generally* Harry S. Davis, *Overview of the Law of Insider Trading*, *in* SCHULTE ROTH & ZABEL LLP, INSIDER TRADING LAW AND COMPLIANCE ANSWER BOOK (Harry S. Davis ed., 2018).

256. *What Is Material Nonpublic Information?*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/finance/material-non-public-information/ [https://perma.cc/MQX6-ZJ5X].

257. *See generally id.*

258. *Shareholder Proposal Law and Legal Definition*, US LEGAL, https://definitions.uslegal.com/s/shareholder-proposal/ [https://perma.cc/W7HU-GUL4].

259. *See generally* Lior Strahilevitz, *The Right to Destroy*, 114 YALE L.J. 781 (2005).

260. *See generally* Bebchuk, *supra* note 5; Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5; Cuñat, Gine & Guadalupe, *supra* note 5; Denes, Karpoff & McWilliams, *supra* note 5.

261. *See generally* Matsusaka, *Shareholder Approval*, *supra* note 5.

has incentives to discourage proposals (and votes on them at annual meetings), negotiates a settlement with the proponent.[262] Inevitably, such a settlement would move the company at least a little in the direction desired by the proponent.[263] Such movements can occur even when they decrease overall shareholder wealth.[264]

Empirical studies also provide examples of opportunistic behavior by shareholders who make various proposals,[265] though not yet in the context of short sellers that game the system. We suspect the latter studies are not currently available because data on proposers shorting their own stock is ordinarily private and unavailable for research. Future empirical analysis of short selling may be forced to rely on self-reporting or participants opting into a study, which may not be as accurate as other ways of gathering data.[266] However, other shareholders that would benefit from reducing the profits of the corporation have fearlessly engaged in attempts to manipulate the way corporations do business.[267]

Unions often exemplify this relationship. Unions frequently hold securities in the companies where they represent employees to gain an advantage in collective bargaining negotiations.[268] Because it is ordinarily the duty of unions to maximize employee wages and benefits, this action runs contrary to the company's intent to maximize profit (and therefore to potentially minimize expenditures such as wages).[269] These organizations have the necessary incentives to impact firm operations negatively by seeking to increase employee wages, because unions often hold stock in these corporations well in excess of $2,000 and often hold these securities well in excess of the required holding period.[270] The employees, in turn, hope that the increase in wages will exceed whatever losses they can expect to suffer as a result of their shareholder activism.[271]

Scholars find this precise relationship greatly increases the use of shareholder proposals by unions as bargaining chips in years when the

262. *See generally id.*

263. *See generally id.*

264. *See generally id.*

265. *See generally* Matsusaka, *Opportunistic Proposals*, *supra* note 5.

266. "[S]hort sellers are generally reluctant to report their positions publicly. Many fund managers believe that disclosing positions can lead to 'copycat investing,' making them reluctant to give away their informational advantages. Additionally . . . [there is evidence that] firms take legal and regulatory actions against disclosed short sellers by alleging criminal conduct, suing them, hiring private investigators, asking public authorities to investigate them, and manipulating securities markets to impede short selling." Barbara A. Bliss, Peter Molk & Frank Partnoy, *Negative Activism*, 97 WASH. U. L. REV. 1333, 1347–48 (2020).

267. *See generally* Matsusaka, *Opportunistic Proposals*, *supra* note 5.

268. *See generally id.*

269. *See generally id.*

270. *See generally id.*

271. *See generally id.*

collective bargaining agreement must be renewed.[272] These scholars have discovered that "in contract expiration years compared with non-expiration years, unions increase their proposal rate by one-fifth, particularly proposals concerning executive compensation."[273] These proposals are unlikely to receive support from outside groups, but the average proposal still results in a negative market reaction.[274] Moreover, the proposals are frequently withdrawn once the union achieves wage concessions for union workers.[275] This suggests that unions file these proposals to impose a hardship upon the management team and essentially use such proposals as bargaining chips at the negotiation table.[276] Few would argue that these types of exploitative tactics improve shareholder returns, and yet they are still legal despite a detrimental impact (or at least a potential impact) on the stock price.[277] A similar outcome can be achieved far more frequently by shareholders who, instead of limiting themselves to filing harassing proposals in certain contract years, submit their proposals annually to dozens of companies while shorting their stock. This is precisely the type of damaging, counterproductive result that the SEC should seek to prevent.

As scholars dug deeper into shareholder proposals, they began to look at all shareholder proposals, not just those filed by unions.[278] Surveying proposals from 2007 through 2018, they found that the market reacted positively when the SEC allowed exclusion.[279] This suggests that the market generally viewed proposals as potentially harming corporations rather than helping them, which is entirely consistent with investors' relief when the SEC permits setting such proposals aside before they even have the chance of passing by a majority vote.[280] Moreover, it is possible that the stock price would have risen sooner (and perhaps higher) if the proposal had never been made in the first place.

Of course, this can be true without anyone shorting the company and filing nefarious proposals; it is entirely possible, and perhaps even likely, that the executives have greater knowledge about optimal firm management than those shareholders themselves. Then, the exclusion of shareholder proposals might be viewed positively by the market even if the proposals are well-meaning (but generally misguided). The potential

272. *See generally id.*
273. Matsusaka, *Opportunistic Proposals*, *supra* note 5.
274. *See generally id.*
275. *See generally id.*
276. *See generally id.*
277. *See generally id.*
278. Matsusaka, *Shareholder Proposals*, *supra* note 5, at 11–12.
279. *Id.* at 1, 3–4.
280. *See generally id.*

negative effect that news of proposals has on stock price might become even worse if the rules do not exclude individuals filing shareholder proposals specifically to reduce stock price. The fact that current SEC rules illegalize a significant amount of potentially harmless activity but do not illegalize this type of misconduct appears to be an oversight.

Financial research further indicates that particular kinds of shareholder proposals tend to do the most damage.[281] Investor skepticism seems to be highest regarding proposals concerning corporate governance and proposals affecting already highly profitable firms.[282] The former might be a reaction to the fact that investors believe corporate governance at most firms is more optimum than whatever measures shareholders propose. Shareholder proposals seeking to change the way highly profitable firms operate may risk "killing the goose that laid the golden egg." According to financial scholars, shareholders appear to have fewer concerns that bad proposals will pass and more fear that considering the proposals and negotiating with the proponents will distract managers from their task of maximizing shareholder wealth.[283] After all, if management is properly motivated to avoid wasting company resources and decreasing firm value, then managers would necessarily need to address these proposals rather than risking their passage.[284]

Some academic dispute does exist with respect to whether shareholder activism is a positive thing in its current form and whether it should be *expanded* rather than curtailed.[285] For example, Professor Bebchuk has argued forcefully that shareholders do not have enough power.[286] He presents empirical evidence showing that shareholders, despite holding shares of the company, ordinarily lack the necessary power to affect corporate change.[287] Professor Bebchuk suggests this should lead to granting shareholders additional voting powers, such as the right to initiate and adopt "rules-of-the-game" decisions to alter the company's charter or even the state of incorporation.[288] Crucial to this argument is Professor Bebchuk's point that merely voting for directors that could, theoretically, initiate these changes on shareholders' behalf proves insufficient in practice to actually change the path of the corporation.[289]

281. *See generally id.*
282. *See generally id.*
283. *See generally id.*
284. *See generally id.*
285. Bebchuk, *supra* note 5, at 880.
286. *See id.* at 870–72.
287. *Id.* at 844.
288. *See generally id.*
289. *Id.* at 856.

Nevertheless, Professor Bebchuk's analysis seems silent with respect to shareholder activism intended to actually *hurt* the company.[290] The article appears to avoid consideration of what would happen if some shareholders formulated a nefarious intent.[291] Nor can the article rely on the more recent research on shareholder proposals we cite above, because Professor Bebchuk published his article almost fifteen years prior to publication of this research.[292] Therefore, it may be possible that some of the conclusions he reached require reconsideration in light of new findings that shareholder democracy may decrease the value of the corporation.[293]

Earlier economic and financial research about the value of shareholder proposals does exist, which may appear contrary to the more recent studies.[294] For example, proposals that pass by a close margin result in positive abnormal returns to the tune of 2.8%, with larger returns in firms with anti-takeover provisions.[295] Higher institutional ownership and stronger investor activism are also associated with an increased return for the shareholders.[296] A recent literature review found that activism associated with adopting certain characteristics of corporate takeovers, like significant stockholdings, is associated with positive changes in share values and firm operating performance.[297] Other activism seems to have little effect on firm value.[298] This research may suggest that activism has actually become more value-increasing for firms over time.[299] This result may be consistent with prior theoretical work suggesting the importance of shareholder activism in order to keep rogue managers in line.[300] Moreover, it may be a sign of businesses and their shareholders copying effective strategies from others.[301]

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290. *See generally id.*

291. *See generally* Bebchuk, *supra* note 5.

292. *See generally id.*; Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

293. *See generally* Bebchuk, *supra* note 5; Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

294. *See generally* Cuñat, Gine & Guadalupe, *supra* note 5; Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

295. *See generally* Cuñat, Gine & Guadalupe, *supra* note 5.

296. *See generally id.*

297. Denes, Karpoff & McWilliams, *supra* note 5, at 411.

298. *See generally* Denes, Karpoff & McWilliams, *supra* note 5; Cuñat, Gine & Guadalupe, *supra* note 5.

299. *See generally* Denes, Karpoff & McWilliams, *supra* note 5; Cuñat, Gine & Guadalupe, *supra* note 5.

300. *See generally* Denes, Karpoff & McWilliams, *supra* note 5; Cuñat, Gine & Guadalupe, *supra* note 5.

301. *See generally* Denes, Karpoff & McWilliams, *supra* note 5; Cuñat, Gine & Guadalupe, *supra* note 5.

However, the existence of such arguments regarding the benefits of shareholder proposals does not constitute a strong case against tighter regulation of those who make proposals.[302] For example, studies that suggest closely-contested shareholder proposals *that ultimately pass* are helpful but cannot say very much about the shareholder proposals that might be filed by individuals seeking to short the stock with no intent to generate a close vote at the shareholder meetings.[303] After all, almost by definition, intentionally poor proposals would not receive very much support at the meeting because (presumably) most of the shareholders wish their company would succeed.[304] Therefore, studies that only observe the effect of closely contested proposals do not negate the need for tighter controls on ill-motivated parties, because these studies do not observe the effect of all proposals, only the effect of proposals that pass.[305]

Similarly, literature reviews that draw conclusions about passed activist measures are less helpful in evaluating the economic and financial benefit of *all* proposals because few proposals pass or even make it to a vote.[306] Therefore, more recent research that focuses specifically on the proposals themselves should prove more useful in determining whether nefarious actors can harm a corporation when they file a proposal that does not and will not receive much support.[307] However, we should note that even if there was serious academic debate about the costs and benefits of filing shareholder proposals, this would not eliminate the possibility that nefarious actors enter and manipulate the system in its current state. Even studies suggesting that shareholder proposals are *generally* helpful to firm value would have to square with the fact that a purposely harmful proposal breaks with the general trend by creating the possibility that the corporation takes a wrong step. There is no scholarship of which we are aware that claims intentionally harmful proposals somehow increases firm value. Additionally, no literature suggests that additional ownership and disclosure requirements would decrease the value of shareholder proposals to the firm. Hence, additional regulation would have few downsides, but could potentially anticipate and prevent a stock manipulation catastrophe for firms particularly susceptible to suffer declines after receiving a shareholder proposal.

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302. *See generally* Cuñat, Gine & Guadalupe, *supra* note 5; Denes, Karpoff & McWilliams, *supra* note 5.

303. *See generally* Cuñat, Gine & Guadalupe, *supra* note 5.

304. *Id.*

305. *Id.*

306. *Id.*

307. Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

III. PROPOSED REGULATION

At this point, we hope to have convinced the reader that a significant gap in SEC rules regarding shareholder proposals exists.[308] We have engaged in a lengthy survey of rules that *might* govern the conduct of ill-motivated minority shareholders, yet we could not isolate a single rule that would prohibit it. Ill-motivated short sellers and other affiliated parties could easily submit shareholder proposals that lower stock value and then reap profits from their misconduct.[309] What, then, could be done about it? We propose two additional rules that the SEC, Congress, or the states (particularly Delaware) might adopt that would prevent the exploitation of the shareholder proposal system.

First, we would require that shareholders certify and prove that they hold no short positions in the firm to which they submit a shareholder proposal. This would also include certifying (but not proving) that family members, close friends, and business associates do not possess a short interest. Second, we suggest that the SEC adopt a requirement that the proponent of a proposal certify that they make the proposal in good faith. Good faith naturally excludes proposals made for the purpose of extorting concessions from a firm, attempted stock price manipulation, and other nefarious purposes (such as filing proposals due to a personal dislike of the leadership team). Whether the SEC, Congress, or the states promulgate these rules, shareholders who fabricate documents or make false representations in meeting these requirements should be held accountable as strictly as individuals who engage in insider trading or stock price manipulation.

A. Prohibiting Proposals from Short Sellers

Although short selling is part and parcel of the American stock market,[310] it is not viewed as favorably in other jurisdictions. For example, many exchanges abroad do not permit short selling of any kind.[311] Furthermore, numerous European jurisdictions, including France, Italy, Spain, Greece, and Belgium, have enacted short sale bans in an attempt to stabilize financial markets and improve investor confidence in the wake of

308. *Cf.* 17 C.F.R. § 240.14a-8 (2020).

309. *See generally* Matsusaka, *Shareholder Proposals*, *supra* note 5.

310. Brian Beers, *Short Selling Basics*, INVESTOPEDIA (Jan. 28, 2021), https://www.investopedia.com/articles/investing/100913/basics-short-selling.asp [https://perma.cc/8DVS-YNTF].

311. Rupert Neate, Kim Willsher & Juliette Garside, *Four Countries Ban Short-Selling to Ease Market Pressure*, THE GUARDIAN (Aug. 11, 2011), https://www.theguardian.com/business/2011/aug/11/short-selling-ban-europe-france [https://perma.cc/GR9M-TQJC]; *Is Short Selling Illegal?*, MEISSNER ASSOC. (2020), https://www.secwhistleblowerattorney.net/securities-fraud-whistleblower-lawyer/is-short-selling-illegal/ [https://perma.cc/X8DZ-CKNG].

the COVID-19 pandemic.[312] The common justification for permitting short-sale transactions in the United States is that it provides flexibility and profitability not otherwise available to investors. For example, the existence of call or put options permits traders to take time-sensitive positions that would otherwise be unavailable to investors in common stocks, bonds, or other securities.[313] This justification alone, even unaccompanied by the idea that the United States is a country that values the freedom of contract, seems sufficient to permit the practice.[314] That said, it is important to restrict short sellers from engaging in certain activities.[315]

The regulation we suggest, implemented via the SEC, Congressional act, or state law, would prevent individuals with short interests in a company from filing shareholder proposals. This regulation, if properly enforced, would almost entirely eliminate the problem we have discussed in the pages above. If the trouble with permitting almost anyone to file shareholder proposals is that short sellers may use them to reduce share value, then a direct ban on these types of proposals from short sellers should do the trick. After all, the potential for exploitation is rather obvious, and this remedy would be tailored to the problem it seeks to address. The short seller would not lose the value of its long or short positions except to the extent that the seller values its right to make shareholder proposals. The short seller would still be able to attend annual meetings, cast votes on proposals submitted by others, cast votes on the membership of the board of directors, and exercise residual claimholder rights that accompany the holding of any amount of equity.[316]

Like all rules, this one is not entirely costless to the regulated: the short sellers who hold equity interest in a company would partially lose the ability to influence that company. However, this is not a permanent loss. It would not be difficult for short sellers to simply close out their short positions in a particular firm if they wish to take part in the shareholder proposal process. We suggest giving ample warning that this rule will apply from a certain date, so all but the most extreme short sellers will be able to adjust their portfolios accordingly if they deem that

312. *Short Sale Bans in Response to the COVID-19 Pandemic*, SHEARMAN & STERLING (Apr. 1, 2020), https://www.shearman.com/perspectives/2020/03/short-sale-bans-in-response-to-the-covid-19-pandemic [https://perma.cc/AYN3-9H2W].

313. *How to Buy and Sell Put and Call Options*, SNIDER ADVISORS, https://www.snideradvisors.com/buy-sell-put-call-options/ [https://perma.cc/PC49-R3DR].

314. *Is Short Selling Illegal?*, *supra* note 311.

315. The United States already restricts many short selling activities through various regulations. *Short Sale Restriction (SSR)*, LIGHTSPEED, https://www.lightspeed.com/trading-basics/short-sale-restriction-ssr [https://perma.cc/NZG7-L8ED].

316. *See generally* Velasco, *supra* note 1.

advantageous. This change might make short selling marginally more disadvantageous, but it would improve the lot of those holding long positions in the stock and of the corporation's leadership team. By eliminating the possibility that short sellers use shareholder proposals to hurt the firm, the risks associated with the stock would fall, resulting in a rise in price. Moreover, management would save a significant amount of their time and legal costs from dealing with potentially harmful proposals, possibly raising company prospects in the eyes of the market.[317]

A regulation that eliminates a potentially profitable short selling activity will likely face challenges and attempts by parties to circumvent the regulation. For example, individuals may file nefarious shareholder proposals with firms where they hold no shorts but where their family members, friends, and/or business associates hold a short position. Hence, the regulation should be worded strongly to also prohibit this type of proposal activity. In fact, a proposal meant to benefit *any* short position within the company should be prohibited and potentially punished with criminal and civil penalties. Otherwise, individuals could sabotage firms on behalf of others.

These suggestions will, undoubtedly, raise the issue of enforcement. Regulators can take several steps to detect misconduct via shareholder proposal and curtail such activity. For example, just as investors must certify and provide proof of holding at least $2,000 in company shares for at least three years, investors could be required to certify that they hold no short interest in the corporation whose governance or operations they seek to change. This certification would subject individuals who misrepresent their positions to fraud charges if they fail to make the proper disclosures. Moreover, brokerages that provide confirmation of the $2,000 three-year holding requirement can be required to certify that the investor has accurately stated they hold no short positions in the company.[318] This requirement would allow additional oversight to ensure accuracy.

Of course, as mentioned earlier, an investor who wanted to avoid detection as a short seller could simply short the security from a different brokerage account. A second brokerage account means additional fees—imposing costs to the misconduct that have nothing to do with

317. *See generally* Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

318. *See* Roger W. Byrd, *SEC Reverses Position Regarding Proof of Ownership for Rule 14a-8 Shareholder Proposals*, BLOOMBERG L. (Dec. 18, 2011), https://news.bloomberglaw.com/employee-benefits/sec-reverses-position-regarding-proof-of-ownership-for-rule-14a-8-shareholder-proposals [https://perma.cc/7VZK-GJNV].

enforcement.[319] Most (if not all) brokerages impose a leverage limit on individuals shorting stocks.[320] A short position, after all, is a position where the investor borrows a security or an option, instead of money, and sells it at the market price.[321] In return, the investor holds the money obtained from the transaction in hopes of repurchasing the asset they sold at a lower price and returning the borrowed asset to the lender.[322] This type of transaction requires a loan, which ordinarily carries interest charges.[323] Moreover, and more importantly, brokerages set limits to prevent investors from taking more risk than they can afford to take.[324]

These leverage limits protect the brokers and the investors because without them the investor would potentially incur limitless liability due to poor bets.[325] When the investor is unable to pay and declares bankruptcy, the burden would fall to the brokerage.[326] When the brokerage is unable to pay and declares bankruptcy, other investors with this brokerage might lose their money.[327] If taken to the extreme, with many investors partaking in the irresponsible behavior, the activity risks a liquidity crisis—which is often at the heart of many financial collapses and economic recessions and depressions.[328] That scenario is precisely the rationale for limits on borrowing to short assets; limits ordinarily based on the amount of assets an investor holds in a particular account.[329]

The greater the value of assets in one account, the more room the investor has to borrow under the margin requirements.[330] Therefore,

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319. Chad Langager, *Why Do You Need a Margin Account to Short Sell Stocks?*, INVESTOPEDIA (Nov. 3, 2020), https://www.investopedia.com/ask/answers/05/marginaccountshortsell.asp [https://perma.cc/7L62-7SUH].

320. *Id.*

321. James Chen, *Short (Short Position)*, INVESTOPEDIA (Jan. 28, 2021), https://www.investopedia.com/terms/s/short.asp [https://perma.cc/6ARJ-RD4C]; Langager, *supra* note 319.

322. The investor then pockets as profit the difference between the asset price when they sold it and the asset price when they repurchased it. Langager, *supra* note 319.

323. *Id.*

324. These limits are often legally required. *Id.*

325. *Id.*

326. *Id.*

327. *Id.*

328. Such liquidity crises are often at the heart of financial collapses. Press Release, U.S. Sec. & Exch. Comm'n, SEC Halts Short Selling of Financial Stocks to Protect Investors and Markets (Sept. 19, 2008), https://www.sec.gov/news/press/2008/2008-211.htm [https://perma.cc/K2HD-K2S7].

329. Langager, *supra* note 319.

330. These requirements include concepts like the Regulation T margin and/or portfolio margin. *See* Will Kenton, *Regular T (Reg T)*, INVESTOPEDIA (Nov. 24, 2020), https://www.investopedia.com/terms/r/regulationt.asp [https://perma.cc/2VT7-M85X]; *Portfolio Margin*, INTERACTIVE BROKERS, https://www.interactivebrokers.ca/en/trading/marginRequirements/PortfolioMargin.php [https://perma.cc/EL7Z-FYQB]. We leave the discussion of the concepts and formulas behind these limitations on trading to other scholars. What is important about these margins is that, given identical assets in accounts subject to either of these margin rules, the greater the value of the assets within the account, and the more room the trader has to take out margin loans.

splitting accounts just to short a particular security, while simultaneously filing proposals intended to harm that security, adds additional cost to the nefarious activity. If the investor is diversified in their investments and strategy, they would need to maintain a separate $2,000 account for every stock they wish to harm by way of proposal while shorting that stock in a different account.[331] Eventually, this would become so cumbersome that the small market declines in stock price may not be worth shorting for some investors, even if they could create those declines through nefarious shareholder proposals.[332] Therefore, adding the requirement that each brokerage certify the investor's eligibility to make shareholder proposals based on short positions would hamper at least the marginal stock manipulator from engaging in the activity. Some individuals might simply create a large number of $2,000 accounts for the express purpose of shareholder proposals, but this regulation cannot hope to stop all misconduct.[333] The existence of such accounts, however, could serve as strong circumstantial evidence that the shareholder is misbehaving.

Shareholder intent may be difficult to prove and, even with the aid of search warrants, private accounts may be difficult for investigators to access. Thus, opponents might suggest that this rule would only serve to chill the legitimate exercise of shareholder rights without dissuading the individuals actually gaming the system.[334] Whether it would truly chill the exercise of shareholder rights might be a difficult argument to advance, because so few shareholders exercise this right even without the restriction—the SEC typically receives only a few hundred filings per year seeking a no-action letter regarding a shareholder proposal.[335] This number should be compared to the tens, if not hundreds of millions, of individuals who might otherwise qualify to file shareholder proposals due to their long-standing ownership of at least $2,000 in a particular stock. Hence, policymakers should not concern themselves with chilling a right so rarely exercised.[336]

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331. 17 C.F.R. § 240.14a-8 (2020).

332. Shareholders are limited to only one proposal per annual shareholder meeting. *Id.*

333. *Id.*

334. Ganesh Setty, *Shareholders Would Have Tougher Time Submitting Resolutions Under SEC's Proposed Rule*, CNBC (Nov. 5, 2019), https://www.cnbc.com/2019/11/05/rule-change-would-make-it-harder-to-submit-shareholder-resolutions.html [https://perma.cc/P3S3-GH6R].

335. SEC Proposes Amendments, *supra* note 160; *2015 No-Action Letters*, *supra* note 160; *2016 No-Action Letters*, *supra* note 160; *2017 No-Action Letters*, *supra* note 160; *2018 No-Action Letters*, *supra* note 160; *2019 No-Action Letters*, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

336. SEC Proposes Amendments, *supra* note 160; *2015 No-Action Letters*, *supra* note 160; *2016 No-Action Letters*, *supra* note 160; *2017 No-Action Letters*, *supra* note 160; *2018 No-Action Letters*, *supra* note 160; *2019 No-Action Letters*, *supra* note 160; *2019–2020 No-Action Responses*, *supra* note 160.

The lack-of-detection argument remains, however, and it is one that can be raised against almost every criminal or civil law or regulation. Enforcement is difficult work, and it would be hard to determine the number of culprits that actually escape the clutches of enforcers.[337] After all, not only is it difficult to know whether an offense has been committed, but it is difficult to ascertain the number of people involved. We cannot even formulate a detection rate for virtually any white-collar crime because we can never know the denominator of that equation. Similarities exist between provisions barring stock price manipulation through shareholder proposals and crimes like insider trading and stock manipulation.[338] Perhaps we should at least attempt to enforce these regulations intended to reduce instances of traders "burning" their own property for the "insurance" money they would receive on account of their shorts.

With respect to insider trading, we are confident that it occurs more often than it is reported, and finance scholars often write papers about its likelihood in various instances.[339] However, in many cases, insufficient proof of misconduct exists resulting in few arrests.[340] This will probably be true with stock manipulation through shareholder proposals. Nonetheless, the existence of a regulation or statute against it on the books will give regulators the power to seek evidence, obtain search warrants, and prosecute individuals who brazenly violate the rules of the marketplace. If nothing else, at least this regulation would eliminate open exploitation of the process.

B. Adding a "Good Faith" Requirement

We propose shareholders be held to a good faith requirement. It would be a step in the right direction if we illegalized short selling a security while simultaneously sending in shareholder proposals, thus reducing the possibility of stock manipulation. However, unscrupulous traders may find other reasons to lower the price of a company that is unconnected to shortselling. Companies may be sabotaged by shareholder

337. Tom Dreisbach, *Under Trump, SEC Enforcement of Insider Trading Dropped to Lowest Point in Decades*, NAT'L PUB. RADIO (Aug. 14, 2020), https://www.npr.org/2020/08/14/901862355/under-trump-sec-enforcement-of-insider-trading-dropped-to-lowest-point-in-decade [https://perma.cc/8X6G-7UPL].

338. 17 C.F.R. § 240.10b5-1 (2021).

339. Thomas Franck, *Insider Trading Is Still Rampant on Wall Street, Two New Studies Suggest*, CNBC (Feb. 14, 2018), https://www.cnbc.com/2018/02/14/insider-trading-is-still-rampant-on-wall-street-two-news-studies-suggest.html [https://perma.cc/3PNY-WJ93].

340. *Why Insider Trading Is Hard to Define, Prove and Prevent*, WHARTON SCH. U. PENN. (Nov. 11, 2009), https://knowledge.wharton.upenn.edu/article/why-insider-trading-is-hard-to-define-prove-and-prevent/ [https://perma.cc/9Y3U-QN4N].

investors in exchange for collective bargaining agreements, to advance an agenda entirely incompatible with company policies, and/or to harm a company incompatible with a particular ideology.[341] The existence of these possibilities creates the need for a good faith requirement that, if not met, should lead to the exclusion of a particular proposal from the ballot at the annual meeting. This would, at the very least, prevent short sellers from citing as an excuse some alternative motive other than the deliberate attempt to devalue the stock.

It is true that good-faith requirements are notoriously difficult to nail down.[342] The definition of "good faith" is frequently an open question for scholars and practitioners. Some definitions contain contradictory terms, while others omit terms that might properly be included, and others say more about the phrase than necessary.[343] We would adopt the following definition: honesty and the absence of any intent to defraud, harm, or act maliciously toward the corporation, its management, or any of its shareholders. This does not greatly vary from the definition of good faith already employed in corporate law.[344]

Of course, the existence of this definition still leaves some questions about what the term means when applied to shareholder proposals. Hence, we suggest that violations of this requirement *not* result in any criminal prosecution. Instead, companies can request a no-action letter based on a lack of good faith, and the SEC can issue no-action letters with respect to proposals found, by a preponderance of evidence, to be in bad faith. This would still leave the shareholder the option of litigating the matter in civil court, if the shareholder believes otherwise, while protecting the company from having to spend time dealing with clearly harmful proposals on the day of the shareholder meeting.[345]

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341. Harming a company through a particular ideology may include environmental activists buying oil stocks only to flood them with proposals about closing all oil-drilling facilities. *See generally* Bebchuk, *supra* note 5; Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5; Cuñat, Gine & Guadalupe, *supra* note 5; Denes, Karpoff & McWilliams, *supra* note 5.

342. *See, e.g.*, Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968); Daniel S. Kleinberger, *From the Uniform Law Commission: In the World of Alternative Entities What Does 'Good Faith' Mean?*, A.B.A. (Mar. 23, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2017/03/ulc/ [https://perma.cc/97BP-2WX6].

343. *See, e.g.*, Summers, *supra* note 342; Kleinberger, *supra* note 342.

344. "[G]ood faith . . . A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage." *Good Faith*, BLACK'S LAW DICTIONARY (11th ed. 2019).

345. *See generally* Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

A civil recovery against the bad faith shareholder proponent should be available, which the company would be able to raise as either a cause of action or a counterclaim in the event of a shareholder lawsuit. After all, nefarious actors deliberately attempting to damage the governance of a company is a real threat, whether they do so out of a desire to profit from short selling or otherwise.[346] This cause of action would create at least some deterrence for shareholders who do not act blatantly enough to be criminally responsible but who do not have the corporations' best interests in mind.[347]

Permitting a corporation to sue the shareholder on the grounds of bad faith would be a major step away from current corporate law. However, the shareholder burden to avoid liability is low: All the shareholder has to do is file a claim in good faith, or at the very least, not in bad faith. The corporation would have the burden of proof to demonstrate that the shareholder acted in bad faith, and we suggest a heightened burden above the "preponderance of the evidence" standard typically used in civil proceedings.[348] Given the need to protect shareholder rights, it should be necessary that the company show by "clear and convincing evidence" that the proponent of a proposal acted in bad faith.[349]

This suggestion raises the bar from what would be necessary to prove to the SEC that a proposal should be excluded. Right now, the SEC need only be convinced of *the lack of good faith* by a *preponderance of the evidence*.[350] In an action for damages against the activist shareholder, the plaintiff corporation would have to establish *bad faith* by *clear and convincing evidence*. This would greatly increase the corporation's burden

346. Matsusaka, *Opportunistic Proposals*, *supra* note 5.

347. We should note that omitting criminal liability for violating the good faith requirement is quite important. Given the hard-to-define nature of what "good faith" is, we would strongly oppose extending anything beyond civil liability to individuals accused of filing shareholders proposal without good faith. As we have argued in prior works, American prisons are already too full to permit unrestrained prosecutors from twisting the good faith requirement to pursue the unpopular. William N. Clark & Artem M. Joukov, *The Criminalization of America*, 76 ALA. LAW. 224 (2015); Samantha M. Caspar & Artem M. Joukov, *The Case for Abolishing Absolute Prosecutorial Immunity on Equal Protection Grounds*, 49. HOF. L. REV. 315, 347–48 (2021); Samantha M. Caspar & Artem M. Joukov, *Mental Health and the Constitution: How Incarcerating the Mentally Ill Might Pave the Way to Treatment*, 20 NEV. L.J. 547, 577 (2020) ("The United States is the world leader in incarceration."). Moreover, criminalizing proposals for their contents may even rise to the level of viewpoint discrimination, which the First Amendment prohibits. Artem M. Joukov & Samantha M. Caspar, *Comrades or Foes: Did the Russians Break the Law or New Ground for the First Amendment?*, 39 PACE L. REV. 43, 79 (2018).

348. *Preponderance of Evidence Explained*, VALIENTE MOTT BLOG (Apr. 10, 2020), https://valientemott.com/blog/blog-preponderance-of-evidence/ [https://perma.cc/Y53Y-44EX].

349. CLEAR AND CONVINCING EVIDENCE, Westlaw Glossary (database updated 2021).

350. Russell G. Ryan, *The SEC's Low Burden of Proof*, WALL ST. J. (July 14, 2013), https://www.wsj.com/articles/SB10001424127887323297504578582213820533922 [https://perma.cc/4XYW-V2R8].

of proof and hopefully remove any fear felt by shareholders of the possibility that they may be sued for nefarious shareholder conduct. Therefore, many shareholder proposals might be properly excluded by the SEC for lack of good faith without precluding bad faith litigation and without guaranteeing that the shareholder would be liable. An additional fees provision could be imposed upon the corporation if it loses: In the event the corporation brings such litigation against a shareholder but does not prevail, the shareholder's costs and attorney's fees should be paid by the corporation.

CONCLUSION

This Article has surveyed the various rights and duties of shareholders, board members, and corporate executives with respect to shareholder proposals and has identified a loophole in the rules that permits stock price manipulation.[351] Current regulations permit shareholders to short the very corporations to which they submit shareholder proposals.[352] This loophole allows bad faith actors to potentially influence the corporation's governance and the way markets perceive the corporation's future prospects.[353] Because economic and financial studies indicate shareholder proposals may be harmful to corporations, we suggest at least two additional rules.[354]

First, we suggest that individuals certify and partially prove that neither they nor their relatives, business affiliates, or close friends hold (to the shareholder's knowledge) a short interest in the corporation. Failure to follow this rule should be subject to criminal, civil, and perhaps even administrative penalties, similar to how the SEC and other federal agencies currently handle cases of insider trading and security manipulation.[355] Second, proposals filed by shareholders must be filed in good faith. This rule, which would be accompanied by only a civil penalty (assuming the company can establish a violation under a heightened burden of proof),

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351. *See generally* SPAMANN & SUBRAMANIAN, *supra* note 1; Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955); *In re* Delphi Fin. Grp. S'holder Litig., 2012 WL 729232 (Del. Ch. Mar. 6, 2012); Guth v. Loft, 5 A.2d 503 (Del. 1939); Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009); Weinberger v. UOP., Inc., 457 A.2d 701 (Del. 1983); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006); DEL. CODE tit. 8, ch. 1.

352. 17 C.F.R. § 240.14a-8 (2020).

353. *See* Langager, *supra* note 319.

354. *See generally* Matsusaka, *Shareholder Proposals*, *supra* note 5; Matsusaka, *Opportunistic Proposals*, *supra* note 5; Matsusaka, *Shareholder Approval*, *supra* note 5.

355. *See* Swiers, *supra* note 248.

would serve as a catch-all provision to exclude proposals from annual shareholder meetings that might be intended to harm the company. Adding these rules by statute or regulation should secure stocks from manipulation by shareholder proposals and perhaps help market outcomes for all participants.

Undoubtedly, the rules we propose are not perfect and would not prevent all shareholder misconduct with respect to proposals. Nevertheless, the current gap in SEC regulation of malicious proposals leaves more to be desired. Even though the SEC is apparently aware of this problem, the recently implemented measures do not address the problems that unrestrained shareholder proposals pose for companies.[356] Therefore, policymakers should consider additional steps to resolve the conflict. The rules we suggest above could be helpful in preventing stock price manipulation and ensuring that a small minority of shareholders in a given corporation do not use their activism to harm the other shareholders and the company as a whole.

356. 17 C.F.R. § 240.14a-8; *see also* Clayton, *supra* note 7; Lee, *supra* note 7; Roisman, *supra* note 7; Leaf & Bartlett, *supra* note 7.