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Did Harvard Violate Federal Securities Law? The Campaign Against Classified Boards of Directors

Daniel M. Gallagher
United States Securities and Exchange Commission

Joseph A. Grundfest
Stanford Law School, Rock Center for Corporate Governance

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Rock Center for Corporate Governance at Stanford University
Stanford Graduate School of Business
655 Knight Way, C214
Stanford, CA 94305-7298 USA
rockcenterinfo@law.stanford.edu • http://www.law.stanford.edu/

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Daniel M. Gallagher*
Commissioner
United States Securities
and Exchange Commission

and

Joseph A. Grundfest**
Stanford Law School and
The Rock Center for Corporate Governance

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* Commissioner, United States Securities and Exchange Commission. The views expressed herein are those of Commissioner Gallagher and do not necessarily reflect the views of the U.S. Securities and Exchange Commission, or his fellow Commissioners.

** William A. Franke Professor of Law and Business, Stanford Law School; Senior Faculty, The Rock Center for Corporate Governance at Stanford University; Commissioner, United States Securities and Exchange Commission (1995-2000). We are grateful to John Cook, Kristen Savelle, and Fay Krewer for valuable research assistance in preparing this article.

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Abstract: The Harvard Shareholder Rights Project ("Harvard SRP") has, on more than 120 occasions, invoked SEC Rule 14a-8 to propose precatory shareholder resolutions calling for the de-staggering of corporate boards of directors (the "Harvard Proposal"), and claims to have contributed to de-staggering at approximately 100 of America's largest publicly traded corporations. The Harvard Proposal relies on a summary of academic research that portrays staggered boards as categorically detrimental to shareholder interests, and cites only one study reaching a contrary conclusion, while dismissing that study's analysis.

The academic research contradicting the Harvard Proposal is, however, far more substantial, but the Proposal omits any mention of that larger body of opposing research. The opposing research concludes that studies relied on by the Harvard Proposal are in error because of flawed analytic techniques. This research also documents heterogeneous effects indicating that classified boards are more likely to be beneficial for identifiable categories of corporations.

Rule 14a-8 requires that shareholder proposals not be materially false or misleading in violation of Rule 14a-9. The Harvard Proposal's failure accurately to describe the current state of the academic literature can be characterized as a material omission that violates Rule 14a-9. Companies should therefore be able to exclude the Harvard Proposal from the corporate proxy either by seeking no-action relief or through motions for declaratory judgment. Under the principle of *respondeat superior*, the SEC could bring enforcement proceedings against Harvard University alleging violations of Rule 14a-9. Private party plaintiffs should also be able to prevail in 14a-9 actions against Harvard. Courts have the authority to void prior votes that caused boards to de-stagger, but it is a matter of judicial discretion -- and a subject for conjecture -- as to whether such a remedy would be imposed as a cure for the material omissions in the Harvard Proposal.

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I. Introduction

The battle over classified boards of directors plays a central role in the corporate governance debate. Classified boards, also known as staggered boards, typically have directors stand for re-election on a three-year cycle, so that only one-third of board seats are up for election in any given year. To gain majority control of a classified board, an insurgent would have to engage in at least two separate proxy contests, each likely separated by at least a year. In a unitary board structure, each director stands for re-election on an annual basis. To gain majority control of a unitary board, an insurgent need only prevail at a single proxy contest.[1]

The dispute as to whether classified boards are inimical to shareholder interests has generated a large literature.[2] It has also stimulated more shareholder proposals[3] than any other corporate governance proposition put to a shareholder vote.[4] Opponents of classified boards

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[1] Lucian A. Bebchuk, John C. Coates, IV, and Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STANFORD L. REV. 887, 893 (2002). ("The default law in all states requires that directors stand for election at each annual shareholder meeting," but the states permit corporations to adopt classified board structures either through charter and/or bylaw provisions.) The assertion that all states have a default rule imposing a unitary board structure is technically incorrect. As of 2002, only one state had a classified board default rule. *See* Mass. Gen. Laws Ann. ch. 156B, § 50A, ch. 156D, § 8.06(b)-(g) (West 2005 & Supp. 2011). Since then, three other states have adopted such a rule. *See, e.g.*, Ind. Code Ann. § 23-1-33-6(c) (LexisNexis 2010); Iowa Code § 490.806A (Supp. 2011); Okla. Stat. Ann. tit. 18, § 1027(D)(2) (West 1999 & Supp. 2012).

[2] For a review of leading articles in the academic debate over the merits and drawbacks of classified boards, see *infra*, Sections III.C, III.D, and IV.

[3] For a description of the shareholder proposal mechanism, see *infra*, Section II.A.

[4] The Conference Board, *Proxy Voting Analytics (2010-2014)* 56-57, Table 9, Shareholder Proposals by Topic (indicating that, over the measurement period, proposals to declassify corporate boards accounted for 88 of 670

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complain that, when combined with a poison pill, a classified board structure dramatically reduces the incentive for hostile bidders to mount takeover attempts because of the requirement that they wait, and therefore incur economic risk, over two proxy vote cycles.[5] Bidders are either deterred from making hostile offers, or fail to consummate transactions, and shareholders are prevented from receiving takeover premia. Opponents also argue that classified boards make it impossible for shareholders to register their views regarding each individual director's performance on an annual basis. The absence of annual re-election arguably renders directors less accountable to shareholders, and entrenches boards and management, thereby harming the firm's financial performance. Indeed, opponents assert that classified boards are among the most damaging corporate governance practices that entrench management at the expense of shareholders.[6]

Supporters of classified boards respond that the combination of a poison pill and a classified board is necessary to provide boards with sufficient bargaining power so that they can extract higher bids in hostile takeover situations, thereby advancing shareholder interests. Supporters explain that classified boards also promote valuable boardroom continuity, and generate incentives to engage in long-term investment strategies that are not as susceptible of harmful "short-termism." Supporters also explain that shareholders have myriad channels through which they can express disaffection with management and board performance. Annual director elections are therefore unnecessary for shareholders to express their views regarding the quality of corporate governance.[7]

Academics have long observed that the controversy over classified boards cannot be resolved through theory or introspection because there is potential merit on both sides of the debate.[8] Whether the costs of classified boards exceed their benefits is, instead, an empirical

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governance proposals, or 13.2 percent of the population. The second most frequent governance proposal called for a change from plurality to majority voting and accounted for 76 of 670 governance proposals, or 11.3 percent of the population.). The incidence of destaggering proposals, particularly among the S&P 500, is likely to decrease over time because the number of publicly traded corporations with staggered boards has been in decline. *See* note 11, *infra*. *See also* Janet Geldzahler and Glen Schleyer, *Maximizing the Off-Season, Lessons from the 2014 Proxy Season and Preparing for 2015*, Sullivan & Cromwell Client Webinar 15 (Sept. 18, 2014) (The decline in the number of destaggering proposals in 2013 and 2014 "reflects the decreasing number of large companies remaining as targets.")

[5] For an early description of the relationship between board structure and the presence of a poison pill, see Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STANFORD L. REV. 857, 858-68 (1993). For a more recent and nuanced explanation of the relationship between poison pills and classified boards, see Guhan Subramanian, *Delaware's Choice*, 39 DEL. J. CORP. L. 1 (2014).

[6] *See, e.g.,* Lucius A. Bebchuk, Alma Cohen, and Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783 (2009). *See infra*, Sections III.A, III.C, and III.D for a more detailed explanation of the arguments against staggered boards.

[7] Sections III.A and IV *infra*, presents a more detailed review of the arguments in favor of classified boards.

[8] *See, e.g.*, Alma Cohen and Charles C. Y. Wang, *How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment*, 110 J. FIN. ECON. 627, 628 (2014) ("The theoretical literature cannot fully resolve the ongoing debate as it identifies both cost and benefits of staggered boards (and of takeover defenses more

[Footnote continued on next page]

question. The empirical literature has historically been dominated by studies concluding that classified boards are categorically harmful to shareholder interests.[9] More recent findings, however, rely on larger datasets and apply alternative statistical techniques to reach a contrary conclusion.[10] This more recent research concludes that classified boards are, in the aggregate, beneficial for shareholders and that the effect of staggered boards is heterogeneous along predictable dimensions.

Notwithstanding these recent findings, opponents of classified boards have held the upper hand in the real world governance debate. The number of Standard & Poor's 500 (S&P 500) companies with classified boards has declined from 300 in the year 2000 (60 percent of the S&P 500) to 60 in 2013 (12.0 percent of the S&P 500).[11] This 80.0 percent decline in the incidence of classified boards, from 300 in 2000 to 60 in 2013, is perhaps among the most significant changes in corporate governance practice over the past decade. This trend toward destaggering is also consistent with the substantial support expressed by shareholders for precatory destaggering proposals.[12]

The trend to de-staggering is not (yet) as powerful among smaller publicly traded firms.[13] In 2000, of the 600 smallest issuers in the S&P1500 (also known as the S&P SmallCap 600), 349 (58.2 percent) had classified boards. In 2013, 285 (47.5 percent) had classified boards.[14] This 18.3 percent decline in the number of classified boards among these smaller firms, from 349 to 285, is far less dramatic than the corresponding 80.0 percent decline observed among S&P 500 firms over the same period. Classified boards also remain common among firms conducting

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generally."); Michael D. Frakes, *Classified Boards and Firm Value,* 32 DEL. J. CORP. L. 113, 113 (2007) ("[E]conomic theory offers an ambiguous prediction as to the effect of that classified boards have on bottom line value. A resolution of this ambiguity will require sound and convincing empirical methodology."); Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501, 502 (2007) ("the question of whether classified boards benefit or hurt shareholders is largely on empirical matter").

9 *See infra*, Section III.C and III.D for a review of this literature.

10 *See infra*, Section IV for a review of this literature.

11 Subramanian, *Delaware's Choice*, *supra* note 5, at 10 (citing Sharkrepellent.net).

12 *See 65 Successful Precatory Proposals by SRP-Represented Investors*, SHAREHOLDER RIGHTS PROJECT, *available at* http://srp.law.harvard.edu/companies-voting-on-proposals.shtml (last visited Dec. 8, 2014) (reporting majority votes in favor of destaggering at 39 of 41 companies in 2012, with the successful proposals garnering 82% of votes cast. In 2013, 19 of 20 proposals received majority support, with an average 79% support at those 19 companies. In 2014, 7 of 7 proposals passed with majorities averaging 88% of votes cast.).

13 *See*, *e.g.*, Cohen and Wang *supra*, note 8, at 633, 636. *See also* Maxwell Murphy, *Classified Boards Remain in the Crosshairs*, WALL ST. J., Sept. 5, 2012 ("Smaller companies are more likely to have classified boards than larger ones. Among members of the broader Russell 3000 index, about 45% have a staggered board today, down from 55% six years ago….").

14 Sharkrepellent.net, *Classified Boards Year over Year* (last viewed July 30, 2014).

initial public offerings. More than 70 percent of newly public filings from 2007 through 2013 were by companies with classified boards.[15]

The question of whether classified boards are harmful thus continues to have particular salience to hundreds of publicly traded companies that maintain classified boards and who can expect shareholder pressure to de-stagger. The question is also relevant to the hundreds of companies that have de-staggered under activist shareholder pressure, and who might reconsider that decision if circumstances permit. In addition, institutional and individual stockholders who cast votes on proposals to declassify boards, as well as proxy advisory firms who recommend positions on these votes, have strong reason to pay close attention to the evolving empirical evidence regarding the classified board debate, particularly when advisers are subject to fiduciary duties that call on them to cast votes in the best interests of the ultimate shareholders or beneficiaries.

The Harvard Shareholder Rights Project (the "Harvard SRP") has played central role in the debate over classified boards, and claims to have contributed to the declassification of boards at "about 100 S&P 500 and Fortune 500 companies."[16] By its own count, the Harvard SRP would thus have contributed to the overwhelming majority of S&P 500 declassifications since the program initiated its efforts in the 2010 proxy season.[17] This trend toward de-staggering is consistent with the substantial shareholder support typically garnered by the Harvard Proposal.[18]

The Harvard SRP uses the shareholder proposal mechanism to pressure boards to de-classify.[19] Exchange Act Rule 14a-8 provides that a shareholder can, under certain circumstances, compel a company to include a proposal, typically precatory, and a supporting

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[15] Richard J. Sandler and Joseph A. Hall, *Corporate Governance Practices in IPOs*, 22 CORP. GOV. ADVISOR 17, 18 (July/Aug. 2014).

[16] *News Alert,* SHAREHOLDER RIGHTS PROJECT (March 11, 2014), http://srp.law.harvard.edu/newsletters/3-11-2014_SRP_newsletter.shtml ("By the end of 2014, the work of the SRP and SRP-represented investors will have resulted in movements toward board declassification by about 100 S&P 500 and Fortune 500 companies.").

[17] As of year-end 2009, 164 of the S&P 500 had classified boards. The comparable figure for year-end 2013 was 60, indicating a decline of 104 in the number of S&P 500 companies with classified boards. This figure is closely comparable to the "about 100" declassifications for which the Harvard SRP claims credit.

[18] *See, e.g., 65 Successful Precatory Proposals by SRP-Represented Investors*, HARVARD SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/companies-voting-on-proposals.shtml (last visited November 4, 2014) (reporting majority votes in favor of de-staggering boards at 39 of 41 companies voting on the Harvard Proposal in 2012, with successful proposals garnering 82 percent of the votes cast. In 2013, 19 of 20 Harvard Proposals received majority support, with an average 79 percent support at these 19 companies. In 2014, 7 of 7 proposals received majorities averaging 88 percent of the votes cast).

[19] *About,* HARVARD SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last visited July 15, 2014) ("The SRP's work for the three proxy seasons from 2012 to 2014 has focused on board declassification proposals. Such proposals have been submitted for a vote at the 2012, 2013, and/or 2014 annual meetings of 129 S&P 500 and Fortune 500 companies … [and] 121 of the companies receiving proposals … have agreed to move toward annual elections following the submission of board declassification proposals.").

statement in the company's proxy statement.[20] The proposal and the accompanying statement in support cannot, among other conditions, exceed 500 words in length[21] and cannot be "contrary to any of the Commission's proxy rules, including [Rule] 14a-9, which prohibits materially false or misleading statements in proxy soliciting materials."[22] The proposal submitted by the Harvard SRP on at least 129 occasions[23] (the "Harvard Proposal") relies substantially on empirical academic research to support the proposition that classified boards are associated with inferior corporate financial performance and shareholder valuations.[24] The Harvard Proposal uses 35 percent of its limited word count to present its description of the empirical literature.[25] The Harvard Proposal is categorical in its description of the literature as suggesting no exception to the proposition that declassification benefits shareholders. The Harvard Proposal mentions only one article suggesting a contrary finding, and brushes aside that article's analysis.

But is the Harvard Proposal's characterization of the empirical evidence accurate? Or, to frame the question in a more pointed manner, is the Harvard Proposal materially false or misleading in violation of Rule 14a-9? Materiality "does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote."[26] Instead, the test for the materiality of an omission in a voting context is whether there is "a substantial likelihood that a reasonable shareholder would consider [the information] important in deciding how to vote."[27] In the context of a vote to de-classify a board, the significance of the empirical research is clear: if declassification categorically improves a corporation's financial performance then a reasonable shareholder would likely consider that information as important to a voting decision.[28] The fact that the Harvard Proposal uses 35 percent of its limited word count to describe the empirical literature also underscores the significance of the empirical research for the consideration of declassification proposals. Put differently, if a description of the empirical literature relating board declassification to corporate financial performance is not important to shareholders, why would the Harvard SRP devote so

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[20] *See infra*, Section II.A for a more detailed description of the Rule 14a-8 proxy mechanism.

[21] 17 CFR 240.14a-8(d).

[22] 17 CFR 240.14a-8(i)(3).

[23] *About,* HARVARD SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last visited July 15, 2014) ("Such proposals have been submitted for a vote at the 2012, 2013, and/or 2014 annual meetings of 129 S&P 500 and Fortune 500 companies.").

[24] The full text of the Harvard Proposal is presented *infra* in Section III.B.

[25] *See infra*, note 274.

[26] TSC Industries, Inc. v., Northway, Inc., 426 U.S. 438, 449 (1976).

[27] *Id*. at 449.

[28] For a more detailed discussion of the materiality of the omissions from the Harvard Proposal, see Section V.A, *infra*.

much space to the subject matter? Moreover, the empirical research is the *only* hard evidence cited in support of the proposal; the only other numerical "evidence" is a description of the other companies that have already declassified—including those doing so after votes on shareholder proposals that are themselves potentially influenced by material omissions.

The Harvard Proposal, and its description of the literature, could, however, be viewed as materially false and misleading, at least as of January 2014,[29] for at least two distinct reasons. First, the Harvard Proposal's description of the relevant empirical literature is severely incomplete. At least five recent studies conclude that classified boards are associated with inferior financial performance, and that declassification is harmful to shareholder interests. These studies are emphatic that the research relied upon by the Harvard Proposal is in error.[30] None of these studies, however, are cited in the Harvard Proposal. The Harvard Proposal can therefore be criticized as cherry picking the literature in order to generate the false and misleading impression that the data supporting its position are far stronger than is in fact the case.

Second, recent research concludes that classified boards have heterogeneous effects and identifies specific sub-categories of firms at which the effects of classified boards are more likely to be beneficial.[31] The Harvard Proposal's categorical assertion opposing classified boards fails to admit the possibility of such heterogeneity. It therefore also fails to consider the possibility that some companies that declassify in response to pressure from the Harvard SRP are within the category of firms at which classified boards are more likely to have beneficial effects and that shareholders may therefore be harmed by the success of the Harvard Proposal. The Harvard Proposal's categorical nature is thus a further and independent cause for concern that it is materially false and misleading.[32]

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[29] There are at least five studies that contradict the position advocated by the Harvard Proposal and that are not cited by the proposal. See Section IV, *infra*. The first of these articles to be posted to the SSRN, William C. Johnson, Jonathan M. Karpoff, & Sangho Yi, *The Bonding Hypothesis of Takeover Defenses: Evidence from IPO Firms* (working paper, Feb. 4, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1923667, appeared on September 7, 2011. The most recent, Martijn Cremers, Lubomir P. Litov, and Simone M. Sepe, *Staggered Boards and Firm Value, Revisited* (working paper, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=236416, appeared on SSRN on December 7, 2013. To be conservative in our position, we assume that the contradictory literature did not become material in the aggregate until a month after the last of the five articles was posted to SSRN. It is possible to argue that the contradictory research was material before then, but it is unnecessary to press that point to proceed with our analysis.

[30] *See* Section IV, *infra*.

[31] *See* Section IV, *infra*.

[32] The Harvard Proposal can also be characterized as materially misleading on three additional grounds. First, the Proposal describes the Harvard SRP as the shareholder proponent's "representative and advisor in connection with [the] resolution." In fact, the shareholder delegates to the SRP all authority to act on behalf of the shareholder, including the authority to negotiate a resolution, amend the proposal, and to withdraw the proposal. The SRP thus has ultimate authority over the proposal's content and prosecution and becomes the "maker" of the statement for purposes of the Supreme Court's analysis in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296 (2011). *See* Section V.C. *infra*. Second, several of the studies upon which the Harvard Proposal relies employ a metric known as Tobin's Q, which describes a ratio of a firm's market value to its book value, and says nothing

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Corporations have two mechanisms whereby they can attempt to prevent false and misleading shareholder proposals from appearing on the corporation's proxy statement. They can either apply for no action relief from the SEC's staff,[33] or they can file a federal action seeking a declaratory judgment that excluding the allegedly defective shareholder proposal will not violate Rule 14a-8.[34] Simply establishing that the Harvard Proposal omits material information should be sufficient to cause the Commission's staff to grant no-action requests allowing companies to exclude the Harvard Proposal, as currently worded, from corporate proxies.[35] Similarly, a simple showing that the omitted literature is material should be sufficient to support a grant of declaratory relief allowing companies bringing federal lawsuits to exclude the Harvard Proposal, as it is currently worded.[36]

The no-action and declaratory relief remedies are prospective in nature: they are of no avail to issuers who have already included the Harvard Proposal in their proxies, or to the Commission, if it determines to seek a remedy for the past inclusion of shareholder proposals that are materially misleading. Here, the potentially false and misleading nature of the Harvard Proposal exposes Harvard, as a university, to liability in SEC enforcement proceedings, as well as in private actions alleging violations of Rule 14a-9. The Courts of Appeal have held that negligence establishes the requisite culpability for purpose of Rule 14a-9,[37] and a straightforward analysis supports the conclusion that it is negligent for the Harvard SRP not to be aware of -- or, if it is aware, to not address -- contradictory studies that are broadly disseminated among academics.[38]

The Supreme Court's decision in *Janus*[39] can be interpreted as imposing Rule 14a-9 liability only on the "maker" of the fraudulent statement. Assuming, without deciding, that *Janus* applies to Rule 14a-9, the extensive control the Harvard SRP over the content and management of the proposal leaves no doubt that the Harvard SRP holds "ultimate authority" over the

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about a firm's stock price valuation or its market capitalization. The Harvard Proposal, however, describes Tobin's Q as measuring "firm valuation," a term that gives no indication to the reasonable investor that the studies are measuring a complex financial ratio that is distinct from actual stock market prices or from firm capitalization. The opportunity for confusion is apparent. *See* note 119, *infra*. Third, the Harvard Proposal's effort to distinguish one opposing study can be criticized as misleading because it appears to contradict the authors' own description of their findings. *See* Section III.C, *infra*. We do not emphasize any of these three additional points, and focus instead on the incomplete and categorical nature of the Harvard Proposal's characterization of the literature.

33 *See* Section V, *infra*.

34 *Id.*

35 *See* note 258, *infra.*

36 *See* note 259, *infra.*

37 *See* note 282, *infra*.

38 *See*, *infra*, Section V.B.

39 *Janus*, 131 S.Ct. 2296 (2011).

proposal, and therefore qualifies as the proposal's "maker" even under the strictest reading of *Janus*.[40] Further, given the employment status of persons directing the SRP, the SRP's position in Harvard's curriculum, and the fact that propagating the Harvard Proposal is part of the SRP's function, principles of *respondeat superior* should impute liability for the SRP's actions to the University itself.[41] Efforts by the SRP to disclaim liability on the University's part are to no avail under the federal securities laws.[42]

The University's potential liability under these circumstances does not constrain academic freedom. The Harvard Proposal's incomplete and categorical analysis of the academic literature could be published in any academic journal without raising any risk of violating the federal securities laws. But when scholars avail themselves of SEC regulations to force issuers to place statements describing academic research in the corporation's proxy materials, the scholars voluntarily subject themselves to standards of legal liability that do not apply in other venues. There is no "professor exemption" from the requirement that a proxy proposal not be materially false or misleading.

Establishing materiality and negligence, demonstrating the SRP's status as a "maker" of the challenged statement, and demonstrating that *respondeat superior* applies to Harvard and the SRP, suffices to support an SEC action for injunctive relief against Harvard as a university.[43] Private plaintiffs alleging violations of Rule 14a-9 must, however, additionally demonstrate causation.[44] The challenge of establishing causation in a private action alleging a violation of Rule 14a-9 in the context of a Rule 14a-8 proposal is that Rule 14a-8 proposals are precatory. Rule 14a-8 proposals therefore cannot, by themselves, cause anything to happen. Courts have addressed this challenge, and have held that in the context of a Rule 14a-8 proposal causation is established if the misrepresentation "had a significant prosperity to affect the voting process."[45] A stricter reading of the causation requirement would, as a practical matter, immunize false statements in Rule 14a-8 proposals from any private party liability under Rule 14a-9, and has therefore been rejected by the courts.[46] With respect to the Harvard Proposal, causation may be relatively easy to establish under the "propensity" test because of the SRP's own description of the role that it, and the Harvard Proposal, have played in causing the destaggering of boards at approximately 100 large publicly traded corporations.[47]

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[40] *See* Section V.C., *infra*.

[41] *See* Section V.D *infra*.

[42] *See* Section V.D, *infra*.

[43] See Section V, *infra*.

[44] *See* Section V.E *infra.*

[45] United Paperworkers Int'l Union v. Int'l Paper Co., 801 F.Supp. 1134,1146 (SDNY 1992).

[46] *See* Section V.E, *infra.*

[47] *See* Section V.E, *infra*.

As for the recourse available to a plaintiff in a private action, courts have broad discretion to fashion appropriate remedies, and have issued orders invalidating shareholder votes and undoing charter amendments that resulted from materially misleading proxy statements.[48] Precedent therefore supports the proposition that some managements that have destaggered in response to the Harvard Proposal could petition the court for an order invalidating both the precatory shareholder vote in favor of destaggering, and the binding board and shareholder votes that subsequently caused the actual destaggering.[49] Whether a court would exercise its discretionary authority to enter such an order is, however, a matter of conjecture.

These challenges to the Harvard Proposal also raise significant questions for the SEC's administration of the proxy proposal process, for proxy advisory firms, for investors subject to fiduciary obligations when voting shares, and for the larger corporate governance campaign against staggered boards. The Commission's Staff operating under the Commission's authority,[50] has taken a narrow view regarding no action requests seeking to omit proposals on grounds that they are materially false or misleading.[51] Rather than act as an arbiter of accuracy or materiality, the staff prefers that the company address potential misrepresentations or omissions in its response in the proxy statement.

This approach is, we fear, an abdication of responsibility by the Commission, not its Staff, that damages the integrity of the proxy process and places an unnecessary burden on registrants forced to respond to potentially misleading proxy statements.[52] It also reflects a fundamental misapprehension of the operation of Rule 14a-8. "[U]se of the statement in opposition is sometimes an incomplete remedy" and "[t]aking valuable space to correct misstatements distracts from a substantive discussion about the proposal itself…."[53] Litigating to exclude a proposal is also more time consuming and expensive than seeking a no-action request.[54] Moreover, if proponents anticipate that the Commission Staff will refuse to grant no-

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[48] *See* Section V.F, *infra*.

[49] *Id.*

[50] Although much of the precedent governing the operation of the proxy proposal process and of the no-action letter process is governed by staff interpretations, releases and no-action letters that are not technically binding on the Commission, and that do not formally express the views of the Commission, see note 76, *infra,* we observe that the Commission has direct control over the staff that issues these interpretations, releases, and no-action letters. The Commission therefore cannot, in our view, disclaim responsibility for actions of the staff that can be easily amended or reversed, if the Commission so decided. We recognize the distinction between staff action and Commission action in this article only to respect the formal distinction, which can have legal consequence. .

[51] *See infra* note 56.

[52] *See* Daniel M. Gallagher, Commissioner, U.S. Securities and Exchange Commission, Remarks at the 26th Annual Corporate Law Institute, Tulane University Law School: Federal Preemption of State Corporate Governance II.2.b (March 27, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370541315952.

[53] *Id*.

[54] Keir D. Gumbs and Daniel S. Alzerbach, *To Litigate or Not to Litigate Over Shareholder Proposals*, 28 INSIGHTS 9, 12 (April 2014) (citing an SEC estimate of the average cost of a no-action request as $37,000, and of the median

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action relief to exclude false or misleading proposals then proponents have diminished incentives to ensure the accuracy of their statements. Indeed, in a recent judicial proceeding, a company successfully sued to exclude from its proxy statement a proposal that directly contradicted statements of fact disclosed in the company's SEC filings.[55] The salient observation is not that the plaintiff prevailed in excluding a materially false and misleading statement, but that the proponent would think that the room for creative writing under the Commission's proxy rules is so broad that it could suggest a proposal containing obviously inaccurate materials, calculating that the company would be constrained to react to false statements in its responsive materials, or by seeking declaratory relief.

The articulated defense of this position is that a "hands-off" policy helps conserve "the extensive Staff resources that were being consumed in their line-by-line review of shareholder proposals."[56] However, after years of passivity, the danger arises that "the pendulum has swung too far in the direction of non-intervention."[57] Indeed, given the Commission's emphasis on the integrity of the disclosure process, it is more than passing strange that the Commission's Staff exercises its regulatory authority to require that publicly traded firms include false or misleading information in their proxy statements, with the only recourse either being federal litigation to prevent the propagation of a falsehood, or the insertion of a corrective statement in hopes that the company's explanation adequately responds to the proposal's misrepresentations.

The "hands-off" policy with regard to the integrity of Rule 14a-8 proposals is also at odds with the SEC Chair's recently announced "broken windows" enforcement policy, which is based on the theory that "minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines."[58] Under this policy, "it is important to pursue ever the smallest infractions."[59] Toward that objective the SEC intends to "pursue all types of wrongdoing. Not just the biggest frauds, but also violations such as control failures, negligence-based offenses, and even

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cost as $10,000, Amendments to Rules on Shareholder Proposals, Release No. 34-40018, 1998 WL 354809 at 144 (May 21, 1998), and estimating the cost of litigating a motion for declaratory relief as "in excess of $300,000.")

[55] Express Scripts Holding Co. v. Chevedden, No. 13–2520, 2014 WL 631538, at *4 (E.D. Mo. Feb. 18, 2014).

[56] Gallagher, *supra* note 52, at II.2.b. n.xx (observing "that of 90 denials of exclusion during the 2013 proxy season, 63% of them had raised" arguments regarding the proponents' compliance with Rule 14a-8(i)(3). "While there could be several reasons for this trend, it calls for further examination." (citing Gibson, Dunn & Crutcher, LLP, *Shareholder Proposal Developments During the 2013 Proxy Season* at 2 (July 9, 2013))); *see also* SEC Law Bulletin No. 14B at B.1 (Sept. 15, 2004) (noting that "we spend an increasingly large portion of our time and resources each proxy season responding to no-action requests regarding asserted deficiencies in terms of clarity, relevance, or accuracy in proposals and supporting statements.").

[57] *Id*.

[58] Mary Jo White, Chair, U.S. Securities and Exchange Commission, Remarks at the Securities Enforcement Forum, October 9, 2013, *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#.

[59] *Id*.

violations of prophylactic rule with no intent requirement…."[60] It would be consistent with the broken windows policy for the SEC to pursue violations of Rule 14a-9. Stronger policing of misstatements and omissions in Rule 14a-8 and 14a-9 would be a net benefit to shareholders as a whole who are casting votes on proposals, and in addition a specific benefit to shareholder-proponents, whose valid use of the shareholder proposal mechanism would not be devalued by the perception that shareholder proposals as a whole are rife with problems.

Recent findings that classified boards can be beneficial in the aggregate and that they have heterogeneous effects also raise challenges for proxy advisory firms, for shareholders who rely on those firms, for investors subject to fiduciary obligations when casting proxy votes, as well as for the larger campaign against classified boards. The major proxy advisory firms have been categorical in their opposition to classified boards,[61] and "major investor trade groups (including the Council of Institutional Investors) and major funds … all have policies to vote in favor of board declassifications."[62]

However, "[a]s a fiduciary, an investment adviser owes each of its clients a duty of care and loyalty with respect to services undertaken on the client's behalf, including proxy voting."[63] When acting in a fiduciary capacity, the institutional investor, has an obligation to adopt and implement procedures "reasonably designed to assure that the investment adviser votes proxies in the best interest of its clients."[64] The Commission's Staff recommends that proxy advisers "review, no less frequently than annually, the adequacy of its proxy voting policies … including whether they continue to be reasonably designed to ensure that proxies are voted in the best interests of its clients."[65] Clients of these proxy advisory firms also have legal obligations to

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[60] *Id*.

[61] *See, e.g.*, Institutional Shareholder Services, *2014 U.S. Proxy Voting Summary Guidelines* at 17 (March 12, 2014), *available at* www. issgovernance.com/file/2014_policies/isssummaryguidelines2014march12.pdf ("Classification/Declassification of the Board: Vote against proposals to classify (stagger) the board. Vote for proposals to repeal classified boards and to elect all directors annually."); Glass Lewis & Co., LLC, Guidelines: 2015 Proxy Season, An *Overview of the Glass Lewis Approach to Proxy Advice* at 20-21 (2014), *available at* http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf.

[62] Fried Frank Client Memorandum, *A New Approach for Classified Boards* at 2, April 1, 2014, *available at* http://www.friedfrank.com/siteFiles/Publications/Final_04-1-2014%20-%20TOC%20Memo%20-%20A%20New%20Approach%20for%20Classified%20Boards%20.pdf.

[63] U.S. Securities and Exchange Commission, Division of Investment Management, Division of Corporate Finance, Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exceptions from the Proxy Rules for Proxy Advisory Firms, Staff Legal Bulletin No. 20, at Question 1 (June 30, 2014) (citing Proxy Voting by Investment Advisors, Release No. 1A-2016, at n.2 and accompanying text (Jan. 31, 2003); SEC v. Capital Gains Research Bureau, 375 U.S. 180, 194 (1963) (interpreting Section 206 of the Investment Advisers Act of 1940)). For further discussion of fiduciary obligations with respect to the proxy voting process, see Section VI, *infra*.

[64] *Id*. at Question 1 (*citing* Rule 206(4)-6 of the Advisers Act).

[65] *Id*. at Answer to Question 1 (*citing* Rule 206(4)-7 under the Advisers Act and Rule 38a-1 under the Investment Company Act of 1940).

monitor the advisory firms to assure that their voting policies are "in the best interests of … clients."[66]

But there is no public indication of which we are aware that proxy advisory firms or institutional investors have considered the implications of recent empirical research concluding that classified boards can have beneficial or heterogeneous effects.[67] A question thus arises as to whether, how, and why, proxy advisory firms and investors subject to fiduciary obligations can continue to maintain categorical opposition to classified boards. To be sure, proxy advisory firms and institutional investors could well conclude that broad-based opposition to classified boards continues to be warranted. But they will then bear the burden of explaining why these policies are in the best interests of shareholders, given the new state of the empirical research.

Part II of this article describes the shareholder proposal rules and the requirement that a proposal not be false or misleading. Part III summarizes the debate over classified boards. It describes the Harvard Proposal, the empirical literature on which it relies, and additional literature not cited in the Harvard Proposal that is consistent with the Harvard Proposal's conclusions. Part IV describes the recent literature omitted from the Harvard Proposal. Part V develops the formal legal argument that the Harvard Proposal is false and misleading in violation of the SEC's proxy rules; that companies should be able to prevail in no-action requests and in motions for declaratory relief seeking to exclude the Harvard Proposal from the corporate proxy; that the SEC should be able to prevail in an enforcement proceeding against Harvard University alleging violations of Rule 14a-9; and that precedent supports a court's authority to void prior votes that caused boards to destagger, but that because the nature of the remedy is a matter of judicial discretion, whether a court would in fact reinstate a classified board is a matter of conjecture. Part VI addresses potential implications of the recent empirical research for proxy advisory firms and for institutional investors. Part VII concludes.

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[66] *Id*. at Answer to Question 4.

[67] To the contrary, the policies of major proxy advisory firms and institutional investors appear entirely consistent with categorical position asserted in the Harvard Proposal. *See* Lucian A. Bebchuck, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013).

II. Shareholder Proposals

SEC Rule 14a-8 defines the conditions under which a company must include a precatory proposal submitted by one of its shareholders in the company's proxy statement.[68] Under Rule 14a-8, the proponent and the proposal must meet certain basic eligibility criteria, and the proposal must not fall within certain enumerated grounds for exclusion. This rule confers a benefit on a shareholder who is able to compel the corporation to present the shareholder's proposal on the corporation's proxy statement, at no expense to the shareholder. Because Rule 14a-8 confers on individual shareholders the power to set agenda items at the annual meeting even if the corporation opposes, it is a rare mechanism that allows shareholders to bypass the board's control over the proxy statement and therefore plays a significant role in the debate over corporate governance. It is particularly important in the shareholder movement to eliminate classified boards.[69]

A. Rule 14a-8

Under Rule 14a-8, a shareholder may submit a proposal (defined as a "recommendation or requirement that the company and/or its board of directors take action") that the shareholder intends to present at the company's next shareholder meeting.[70] The shareholder must have held either $2000 in market value, or at least 1%, of the company's securities entitled to vote on the proposal for at least one year before the proposal is submitted, which securities must be held through the date of the meeting.[71] The 1% threshold is *de facto* irrelevant because the $2000 market-value test is much more easily satisfied. The proposal, and any accompanying statement in support, cannot exceed 500 words,[72] and must be submitted at least 120 calendar days before the company's proxy statement for a regularly-scheduled annual meeting is released to shareholders.[73]

Assuming compliance with those procedural requirements, the proposal must also satisfy several substantive requirements. It (1) must be a proper subject for action by shareholders under the laws of the company's state of incorporation; (2) must not, if implemented, cause the company to violate state, federal, or foreign law; (3) must not be contrary to any of the Commission's proxy rules, including Rule 14a-9, which prohibits materially false or misleading statements in proxy soliciting materials; (4) must not seek to redress a grievance or further an interest not shared by all shareholders; (5) must not be irrelevant by relating to less than 5% of

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[68] *See* 17 C.F.R. § 240.14a-8 for a detailed summary of the rule and its operation, see, e.g., 3 THOMAS L. HAZEN, THE LAW OF SECURITIES REGULATION §10.8, *available at* 3 Law Sec. Reg. § 10.8.

[69] *See* note 12, *supra*. *See also* Geldzahler & Schleyer, *supra* note 4, at 15 (The decline in the number of destaggering proposals in 2013 and 2014 "reflects the decreasing number of large companies remaining as targets.")

[70] 17 C.F.R. § 240.14a-8(a).

[71] *Id.* at § 240.14a-8(b).

[72] *Id.* at § 240.14a-8(d).

[73] *Id.* at § 240.14a-8(e)(2).

total assets, net earnings, or gross sales; (6) must be within the company's power to implement, if adopted; (7) must not relate to the company's ordinary business operations; (8) must not relate specifically to the election of directors; (9) must not conflict with an item the company has placed on the proxy; (10) must not have been substantially implemented already; (11) must not duplicate another proponent's proposal that will be included in the proxy; (12) must not deal with a matter voted on in prior years unless a certain percentage of votes were cast in favor in those years; and (13) must not relate to specific amounts of dividends.[74]

If a company believes that any of these requirements are not satisfied, then it is permitted to exclude the proposal if it submits a list of reasons therefor to the Commission at least 80 days prior to the company's filing of its definitive proxy.[75] At that time, a company will typically request that the staff concur in the company's determination that the proposal is defective by providing "no-action" relief to the company (*i.e.*, the staff's commitment not to recommend enforcement action if the company does not include the proposal).[76] A company may also seek declaratory relief from a court to permit it to exclude a proposal.[77] Absent one of these forms of

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[74] *Id.* at 240.14a-8(i)(1) – (13).

[75] *Id.* at 240.14a-8(j).

[76] As a formal matter, because no-action relief expresses the views of the staff, a no-action position is not binding on the Commission itself; 3 HAZEN, *supra* note 68, at **§** 10.8[1][A][2] ("Although not providing precedential authority, no action letters are properly viewed as persuasive as to the appropriate interpretation of securities law. Most no action letters are signed by a single staff member and thus do not reflect action of the full Commission although the Commission does give guidance to the staff on how to respond to various issues.")."The no-action relief is limited to the requestor and to the specific facts and circumstances set forth in the request. In addition, the SEC staff reserves the right to change the positions reflected in prior no-action letters." *No Action Letters*, SECURITIES AND EXCHANGE COMMISSION, **Error! Hyperlink reference not valid.**http://www.sec.gov/answers/noaction.htm (last viewed Nov. 29, 2014). In considering a no-action request under Rule 14a-9, "the company has the burden of demonstrating that it is entitled to exclude a proposal, and [the staff] will not consider any basis for exclusion that is not advanced by the company . . . . Unless a company has demonstrated that it is entitled to exclude a proposal, we will not concur in its view that it may exclude that proposal from its proxy materials." SEC Staff Legal Bulletin No. 14 (CF) at B.5 (July 13, 2001), *available at* http://www.sec.gov/interps/legal/cfslb14.htm.

[77] "Only a court such as a U.S. District Court can decide whether a company is obligated to include shareholder proposals in its proxy materials." *Informal Procedures Regarding Shareholder Proposals*, SECURITIES AND EXCHANGE COMMISSION, *available a*t http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8-informal-procedures.htm (last viewed Dec. 4, 2014). "In practice, companies have generally eschewed litigation in favor of the no-action process" largely because the no-action relief process is likely to be more prompt and predictable, and less expensive than litigation over a motion for declaratory relief. Gumbs & Alterbaum, *supra*, note 54, at 12-13. To underscore this point, between October 1, 2012 and June 24, 2013, the SEC received almost 400 requests for no-action relief related to shareholder proposals, although 68 of those requests were ultimately withdrawn. *See* Gibson, Dunn & Crutcher, LLP, *Shareholder Proposal Developments During the 2013 Proxy Season* at 2 (July 9, 2013). A search of the Westlaw database shows only one opinion issued during that same period in a declaratory relief action related to shareholder proposals, and the plaintiff in that action was not even seeking exclusion of the allegedly misleading proxy statement. *See* La. Mun. Police Emps. Ret. Sys. v. Cooper Indus. Plc, No. 12 CV 1750, 2012 WL 4958561, at *4 (N.D. Ohio Oct. 16, 2012) (seeking "declaratory and injunctive relief in the action, including: (i) enjoining defendants from consummating the Proposed Acquisition. . .(ii) a directive to the individual defendants to obtain a transaction which is in the best interests of Cooper shareholders; and (iii) rescission of, to the extent already implemented, the Merger Agreement or any of its terms."). In calendar year 2014, five such actions had been filed and resolved as of April. Gumbs & Alterbaum, *supra*, note 54, at 10. For an example of a successful motion for

[Footnote continued on next page]

relief, a company is required to include the proposal in its proxy statement.[78] The company may also include its own statement in opposition, seeking to persuade shareholders not to vote in favor of the proposal, provided that the opposition statement is not materially false or misleading, and a copy of the statement is sent to the proponent.[79]

B. The Prohibition on Materially False and Misleading Proposals: Rule 14a-9

As noted above, a company may seek to exclude a shareholder proposal supporting statement "that is contrary to any of the Commission's proxy rules, including [Rule] 14a-9, which prohibits materially false or misleading statements in proxy soliciting materials."[80] Specifically, Rule 14a-9(a) provides that:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, *is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not misleading*[,] or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.[81]

In an SEC enforcement proceeding alleging a violation of Rule 14a-9, the Commission must establish the materiality of the alleged omission or misrepresentation; that the statement was made with the requisite degree of culpability, which has generally been defined as negligence; and, arguably, that the defendant is the "maker" of the statement for purposes of *Janus*.[82] In a private action seeking to establish a violation of Rule 14a-9, a plaintiff must, in addition, establish causation.

The treatment of Rule 14a-9 for purposes of enforcing Rule 14a-8 in the context of no-action and declaratory relief differs materially from the procedures that govern SEC enforcement or private actions seeking to establish retrospective violations of Rule 14a-9. In particular, neither the SEC's staff in considering whether to grant no-action relief, nor the courts, in considering whether to grant declaratory relief, consider the proponents' level of culpability or

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declaratory relief filed by a company seeking to exclude a proposal on grounds that it is false and misleading in violation of Rule 14a-9, see Express Scripts Holding Co. v. Chevedden, No. 13–2520, 2014 WL 631538, at *5 (E.D. Mo. Feb. 18, 2014).

[78] 17 C.F.R. § 240.14a-8 (introductory paragraph).

[79] *Id.* at § 240.14a-8(m).

[80] *Id.* at § 240.14a-8(i)(3).

[81] *Id.* at § 240.14a-9(a) (emphasis supplied).

[82] *See* Section V, *infra*.

the casual link between the solicitation and the accomplishment of the transaction.[83] The irrelevance of these two elements in the context of a proceeding seeking to determine whether a shareholder proposal should be required to be presented in proxy yet to be distributed is entirely sensible. The purpose of Rule 14a-8(i)(3), which prohibits proposals that violate Rule 14a-9, is to assure that the proponents' proposal is neither false nor misleading. But once the staff or a court determine that the proposal is materially false or misleading, there is no need to inquire as to the proponents' state of mind as of the time the proposal was initially presented. After all, once the staff or a court have determine that a statement is false or misleading, a proponent would be on actual notice that it is propounding a false and misleading proposal. Thus, in the anticipatory context of a no-action request or motion for declaratory relief, the finding that a statement is materially false or misleading effectively obviates the need for any inquiry into the proponents' state of mind. The causation requirement also quickly falls by the wayside because the very question at issue in a no-action request or motion for declaratory relief is whether to cause the company to include the allegedly defective proposal in its proxy statement. Forcing a company to include a materially false or misleading shareholder proposal in its proxy statement would obviously be an essential link in causing any harm that follows from the proposal's inclusion.[84]

The essential issue in any dispute as to whether a shareholder proposal should be excluded pursuant to Rule 14a-8(i)(3) thus boils down to a single simple question: is the proposal materially false and misleading?

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[83] In explaining the operation of Rule 14a-8(i)(3), which allows companies to exclude proposals that violate Rule 14a-9,. the Commission's staff nowhere refers to the need to inquire as to the proponents' state of mind, or as to any considerations related to causation. *See* SEC Staff Legal Bulletin No. 14B (CF) (Sept. 15, 2004); SEC Staff Legal Bulletin No. 14 (July 13, 2001). Simply demonstrating "objectively that a factual statement is materially false or misleading" will suffice to exclude or force modification of a statement. SEC Staff Legal Bulletin No. 14B (CF) at B.4 (Sept. 15, 2004). Similarly, in granting declaratory relief permitting a company to exclude a shareholder proposal on grounds that it is materially false or misleading, courts focus exclusively on the materiality of the allegedly defective proposal, and do not consider the proponents' state of mind, or any questions of causation. *See, e.g.*, *Express Scripts,* 2014 WL 631538, at *5.

[84] *See* Section V.E, *infra*, for a more detailed discussion of causation in the context of Rule 14a-8 litigation.

III. The Classified Board Debate and the Harvard Proposal

Scholars have long observed that the debate over the merits of classified boards cannot be resolved through theory or introspection. Careful analysis of empirical data is necessary in order to form a view as to whether the practice is beneficial or detrimental to shareholders.[85] Many studies suggest that classified boards are inimical to shareholder interests, and based in part on these findings, the Harvard SRP has conducted a vigorous and successful campaign to cause de-staggering at many S&P 500 and Fortune 500 firms.

A. The Classified Board Debate

The debate over classified boards plays out in two distinct scenarios: the first is dominated by takeover situations, and the second is concerned with governance away from takeover threats. In the takeover context, classified boards have the greatest impact when considered in conjunction with the operation of a shareholder rights plan, commonly known as a "poison pill." Hostile bidders go to great lengths to avoid triggering the pill. The one sure strategy to avoid triggering a pill in the course of a successful hostile bid is for a majority of the board of the target company to agree to rescind the pill. But if a target's board remains opposed to a bid, the bidder's only recourse is to rely on a proxy contest to replace a majority of the incumbent board with new directors who are unopposed to the transaction. When a board is not classified, that process can be completed in a single election cycle. When the board is classified, the process takes at least two cycles, and there is no reported instance of a bidder successfully persevering through a two-election cycle to replace a board.[86] Viewed from this perspective, a classified board with a poison pill has *de facto* veto power over any hostile bid, regardless of the size of the premium offered and without regard to the wishes of the shareholder community.

This entrenching effect can work either to benefit or harm shareholders. If boards use the stronger negotiating position created by the board stagger to extract higher prices for shareholders, without generating larger offsetting costs by deterring bids, then classified boards can be beneficial for shareholders. But, if the combination of the poison pill and classified board deters bids that are beneficial for shareholders, or if classified boards refuse to accept bids that are beneficial for shareholders, then classified boards can harm shareholders. As a matter of theory, there is no reason to predict that either view prevails. Only careful examination of relevant data can resolve the dispute.

Away from the takeover context, opponents complain that "staggering board terms undermines the accountability that is created by providing an annual opportunity to vote for or

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[85] *See supra* note 8.

[86] Subramanian, *Delaware's Choice, supra* note 5, at 5 ("there is not a single instance where a bidder has successfully won two proxy contests, one year apart, in order to gain control of a target company "); Bebchuk, Coates, & Subramanian, *Theory, Evidence, and Policy, supra* note 1, at 890 ("to overcome an [effective staggered board] a bidder must win two elections, far apart in time, rather than one up-or-down referendum conducted at a single point in time. We show that the two-election problem is a serious one that, combined with the delay problem, makes an ESB a powerful, even if not insurmountable, antitakeover device.").

against each member of the board." [87] Institutional investors complain that they regularly face situations where, for example, none of the members of an audit or compensation panel stand for election at a meeting due to the stagger and the stockholders are frustrated because they want to register opposition to the actions of the audit or compensation committees by withholding votes for the re-election of individual committee members. That leaves investors with "little recourse."[88]

A response to the argument that shareholders require "recourse" on annual basis against specific directors is that "this is precisely the phenomenon that fuels a short-term focus in the boardroom,"[89] and that opponents of classified boards assume, with no evidence, that annual recourse is an unambiguous benefit that has no adverse collateral consequences. Even a critic of traditional classified board structures observes that "the idea that [shareholders] need to be able to use that club [the annual shareholder vote] in order to improve boardroom decision-making is questionable at best."[90] Shareholders also have many different mechanisms through which they can express their views even if they cannot vote on every director every year. They can, for example, vote against directors they actually support, but make clear that their opposition is driven by concerns related to directors who are not standing for re-election. This mechanism, a form of collective responsibility, could increase pressure on directors who draw shareholder ire because it creates reputational concern among directors who would otherwise not be challenged by stockholders. Shareholders could also submit shareholder proposals, communicate directly with senior management and directors, or act on "say on pay" votes, all without regard to the existence of a classified board.

The emergence of shareholder activists who propose short slates adds another dimension to the debate.[91] If a full board is standing for re-election, then the activist can target the minority of incumbent directors most likely to be viewed as vulnerable. However, if only a third of the

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[87] Subramanian, *Delaware's Choice, supra* note 5, at 12 n. 55 (quoting from an email from Patrick McGurn, Special Counsel, Institutional Shareholders Services (Feb. 2007)).

[88] *Id.* at 12.

[89] *Id.* at 13 ("[D]irectors regularly bemoan the pressure that they perceive from the ISS to do what is optically the right thing. Those who attempt to do otherwise, because they believe in good faith that a different course of action is in the best long-term interests of the company are rewarded with a threatened, or actual, withhold-vote campaign against them."}.

[90] *Id.* (noting that "several recent trends have conspired to make director elections far more meaningful" and that "taken together, they give ISS and other shareholder advocates a larger club with which to police corporate board rooms.")

[91] Short-slate proxy contests, in which a dissident is soliciting proxies in support of nominees that, if elected, would constitute a minority of the board of directors, have become increasingly popular. "During the 2012 proxy season, dissidents sought majority control at only five companies, out of 19 proxy fights. This is an increase from the 2011 proxy season, when dissidents sought a majority of the board in only one contest out of 20 proxy fights." *See* AMY L. GOODMAN, JOHN F. OLSON, & LISA A. FONTENOT, A PRACTICAL GUIDE TO SEC PROXY AND COMPENSATION RULE 9-30 (5th ed. 2013 Suppl.). In 2013, dissidents sought majority or full control of the board at fifteen companies, out of 24 total proxy fights. *See* ISS, *2013 Proxy Season Review*, at 48 (Aug. 22, 2013).

board is standing for re-election, then the activist has to run against the directors who happen to be standing for re-election that year, and cannot target the weakest members of the board. Also, if the activist's objective is to take majority control of the board without mounting a formal takeover bid, the process will take at least two election cycles. Again, whether these effects are beneficial or harmful to shareholders cannot be resolved as a theoretical matter because, absent data, there is theoretical merit to both sides of the debate.

A Manichean characterization of the debate as presenting a stark choice between a traditionally staggered board and a board at which every director stands for election every year accurately describes the current state of the controversy. But this need not be the case.[92] Staggered boards of directors can be of two types: an "effective staggered board" (ESB) or an "ineffective staggered board" (ISB).[93] An ESB is structured so that a hostile bidder must conduct two proxy contests in order to gain majority control over a board. An ISB maintains all the characteristic of a staggered board except that, when confronted with a qualifying hostile takeover bid, the classified board becomes subject to a unitary vote that would allow hostile bids to rise or fall based on the bidders' ability to garner electoral support from a majority of the issuer's shares, while preserving the benefits of board classification in all other contexts.

The distinction between ESBs and ISBs originally arose in the context of an academic recommendation that *Unocal*'s "reasonableness" review be applied when a target firm has both a poison pill and a classified board. The proposal was that if the Delaware court found that, in a specific circumstance, the combination of the pill and the classified board was not reasonable in relation to the threat posed, then the courts could require an annual vote on all directors, thereby effectively converting a staggered board into a unitary board.[94] The Delaware courts have not, however, acted on that recommendation.[95] Significantly, there is no legal barrier to a board adopting a classified structure subject to the condition that, in the event of a bid that satisfies certain pre-specified conditions, all members of the board would stand at the next following election,[96] but no public company seems to have adopted this "intermediate form" of classified board.[97]

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[92] Subramanian, *Delaware's Choice*, *supra* note 5, at 5-6; Bebchuk, Coates, & Subramanian, *Theory, Evidence, and Policy, supra* note 1, at 912-13; Lucian A. Bebchuk, John C. Coates, IV, and Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STANFORD L. REV. 885, 886 (2002).

[93] Subramanian, *Delaware's Choice*, *supra* note 5, at 5-6.

[94] Subramanian, *Delaware's Choice*, *supra* note 5, at 5-6.

[95] Subramanian, *Delaware's Choice*, *supra* note 5, at 8-9 (citing Yucaipa vs. Reggio, 1 A.3d 310 (Del. Ch. 2010) and Air Products v. Airgas, 16 A.3d 48 (Del. Ch. 2011).

[96] *Id.* at 9.

[97] *Id*. *See also id.* at 9-10 (noting criticism of the proposal by Dan Neff, Co-Chairman of the Executive Committee of Wachtell, Lipton, who observed that "your compromise on the staggered board will not work, because the relevant parties will see the target company as effectively having annual elections of all directors").

Observers have suggested other modifications to traditionally classified boards. "The classified board structure could be modified so that the board would become automatically declassified in the event the company underperforms its peer group over a period of time."[98] Alternatively, "a company might declassify its board, but provide for automatic re-classification on the occurrence of specified events, such as the company's receiving a non-qualified bid or its outperforming its peer groups for at least a specified period."[99] But because these intermediate forms have not been adopted in practice, and because their costs and benefits cannot be determined as a matter of theory, little can be said about the practical merits of these alternatives. Further, the Harvard Proposal and the larger campaign against classified boards does not contemplate a shift to any of these intermediate structures. The goal of the declassification campaign is, instead, to assure that classified boards convert to plain-vanilla unitary board structures.

B. The Harvard Shareholder Rights Program and the Harvard Proposal

The Harvard Shareholder Rights Project ("Harvard SRP") is an academic program at Harvard Law School.[100] It is listed as among the school's clinical and *pro bono* programs.[101] The Project's clinical director is a tenured member of the Law School's faculty.[102] The project is run by a "lecturer of law"[103] and a "Professor" and "Administrative Director,"[104] both of whom are listed in the Harvard directory.[105] "In addition to clinical work" students participating in the SRP "will participate in classroom sessions to provide background and knowledge that compliments the work undertaken in the clinic."[106]

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98 Fried Frank Memo, *supra* note 62, at 3.

99 *Id.* at 4.

100 *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014).

101 *Id.*

102 *Id.; Lucian Ayre Bebchuk,* HARVARD LAW SCHOOL, http://www.law.harvard.edu/faculty/bebchuk/ (last viewed Dec. 5, 2014).

103 *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014); *Scott Hirst*, HARVARD LAW SCHOOL, http://hls.harvard.edu/faculty/directory/11134/Hirst (last viewed Dec. 5, 2014) (lecturer of law and Associate Director of the SRP).

104 *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014); *Lucian Ayre Bebchuk,* HARVARD LAW SCHOOL, http://www.law.harvard.edu/faculty/bebchuk/ (last viewed Dec. 5, 2014).

105 *Lucian Ayre Bebchuk,* HARVARD LAW SCHOOL, http://www.law.harvard.edu/faculty/bebchuk/ (last viewed Dec. 5, 2014); *Scott Hirst*, HARVARD LAW SCHOOL, http://hls.harvard.edu/faculty/directory/11134/Hirst (last viewed Dec. 5, 2014.

106 *Course Catalog*, HARVARD LAW SCHOOL, http://hls.harvard.edu/academics/curriculum/catalog/index.html?o=65866 (last viewed Dec. 5, 2014).

The Harvard SRP "is representing and advising five institutional investors, four public pension funds, and one foundation."[107] The Harvard SRP states that "[a]nnual elections are widely viewed as corporate governance best practice. Board declassification and the resulting annual elections could make directors more accountable and thereby contribute to improving performance and increasing firm value."[108] "The SRP's work for the three proxy seasons from 2012 to 2014 has focused on board declassification proposals. Such proposals have been submitted for a vote at the 2012, 2013, and/or 2014 annual meetings of 129 S&P 500 and Fortune 500 companies."[109] The Harvard SRP explains that "121 of the companies receiving proposals in 2012, 2013 and/or 2014 – over 80% of such companies – have agreed to move toward annual elections following the submission of board declassification proposals for 2012, 2013 and/or 2014 meetings"[110] and that "[a] total of 98 S&P 500 and Fortune 500 companies have already declassified during 2012-2014 as a result of the work by the SRP and SRP-represented investors."[111]

The Harvard SRP relies primarily on the SEC's Rule 14a-8 shareholder proposal mechanism. In a typical campaign, an SRP client who is a shareholder in a company with a staggered board invokes the authority of Rule 14a-8 to submit a shareholder proposal together with a supporting statement for inclusion in the company's proxy materials.[112] The text of the proposal and of the supporting statement appears to be a form common to all proposals submitted by Harvard SRP clients.[113] The SRP client-shareholder explains in writing that it "authorizes the SRP to act on behalf of [the client] in relation to the Proposal, including, without limitation, forwarding the Proposal to the Company, corresponding with the Company and the Securities and Exchange Commission with respect to the Proposal, engaging with the Company

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[107] *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (viewed July 25, 2014).

[108] *Id.*

[109] *Id.* "For the 2014 proxy season, the Shareholder Rights Project (SRP) is representing and advising five institutional investors in connection with the submission of shareholder proposals: The Illinois State Board of Investment (ISBI), the Nathan Cummings Foundation (NCF), the North Carolina Department of State Treasurer (NCDST), the Ohio Public Employees Retirement System (OPERS), and the Florida State Board of Administration (SBA). *SPR Represented Investors,* SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/clients.shtml (last viewed Dec. 5, 2014).

[110] *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (viewed July 25, 2014).

[111] *Id.*

[112] Letter from Michael P. McCauley, Senior Officer, Investment Programs & Governance, State Board of Administration of Florida, to Netflix, Inc. (Oct. 1, 2013) (on file with author) (hereinafter, "Netflix Letter").

[113] A review of SRP-sponsored proposals included in the proxy solicitation materials distributed to shareholders at ten different companies between 2012 and 2014 reveals that the language used in each of these proposals is substantially similar. The only differences noted among the various proposals concerns the identity of the sponsoring shareholder, the role of the SRP, and the number of declassification proposals brought and passed to date, which unsurprisingly varied according to the date of the proposal. The proposals were culled from proxy statements filed with the SEC on Forms DEF 14A.

to reach a negotiated outcome, withdrawing the Proposal, presenting the Proposal, or arranging for its presentation by a designee of the SRP, at [the company's] Annual Meeting."[114] The authorization does not grant the SRP the power to vote any shares owned by the client.[115] The letter requests that its receipt be acknowledged to and that "all subsequent written communications relating to the Proposal" be directed to the tenured faculty member serving as director of the SRP. Thus, while the proposal is nominally submitted by the Harvard SRP client who owns the issuer's shares, control over the substance, prosecution, and negotiation of the proposal resides with the Harvard SRP.

The Harvard Proposal, in its entirety, reads as follows:[116]

PROPOSAL TO REPEAL CLASSIFIED BOARD

RESOLVED, that shareholders of Netflix, Inc. urge the Board of Directors to take all necessary steps (other than any steps that must be taken by shareholders) to eliminate the classification of the Board of Directors and to require that all directors elected at or after the annual meeting held in 2015 be elected on an annual basis. Implementation of this proposal should not prevent any director elected prior to the annual meeting held in 2015 from completing the term for which such director was elected.

SUPPORTING STATEMENT

This resolution was submitted by the Florida State Board of Administration. The Shareholder Rights Project served as the proponent's representative and advisor in connection with this resolution.

The resolution urges the board of directors to facilitate a declassification of the board. Such a change would enable shareholders to register their views on the performance of all directors at each annual meeting. Having directors stand for elections annually makes directors more accountable to shareholders, and could thereby contribute to improving performance and increasing firm value.

According to data from FactSet Research Systems, during the period January 1, 2012 to June 30, 2013:

- More than 90 S&P 500 companies brought management proposals to declassify their boards to a vote at annual meetings;
- More than 50 precatory declassification proposals passed at annual meetings of S&P 500 companies; and

[114] Netflix Letter, *supra* note 112, at 1.

[115] *Id.*

[116] This version of the Harvard Proposal is transcribed from the submission to Netflix, Inc. *Id.* at 2.

- The average percentage of votes cast in favor of shareholder proposals to declassify the boards of S&P 500 companies exceeded 75%.
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The significant shareholder support for declassification proposals is consistent with empirical studies reporting that:

- Classified boards are associated with lower firm valuation (Bebchuk and Cohen, 2005; confirmed by Faleye (2007) and Frakes (2007));
- Takeover targets with classified boards are associated with lower gains to shareholders (Bebchuk, Coates, and Subramanian, 2002);
- Firms with classified boards are more likely to be associated with value-decreasing acquisition decisions (Masulis, Wang, and Xie, 2007); and
- Classified boards are associated with lower sensitivity of compensation to performance and lower sensitivity of CEO turnover to firm performance (Faleye, 2007).

Although one study (Bates, Becher and Lemmon, 2008) reports that classified boards are associated with higher takeover premiums, this study also reports that classified boards are associated with a lower likelihood of an acquisition and that classified boards are associated with lower firm valuation.

Please vote for this proposal to make directors more accountable to shareholders.

The operation of the Harvard SRP has not been without controversy. Opponents of the SRP's mission have questioned whether it is appropriate for a law school to engage in this form of shareholder activism, while supporters have strongly defended its mission as appropriate for a law school.[117] We take no position on this debate. We focus exclusively on the narrow question

[117] *See, e.g.,* Richard Painter, *Harvard's Shareholder Rights Program*, Legal Ethics Forum, Nov. 1, 2013 (available at www.legalethicsforum.com/blog/2013/11/harvard-s-shareholder-rights-project.html) ("My broader concern is whether SRP, an affiliate of Harvard Law School that uses the Harvard name, should take a position on controversial issues such as board classification, and whether this is consistent with the mission of a university, which is teaching and research, not advocacy…. SRP's publicity campaign is also unusual because generally universities do not endorse, or allow an affiliate using their name, to endorse particular conclusions from scholarly research, particularly if the conclusions are controversial…. Universities and their institutional affiliates also do not advocate for particular research conclusions before courts, legislative bodies and other branches of government, except in the few instances where the University's own interests are at stake, for example in issues such as affirmative action and immigration reform."); Wachtell Lipton Rosen & Katz, *Harvard Stockholder Rights Program is Wrong*, March 23, 2012 (available at blogs.law.harvard.edu/corpgov/2012/03/23/harvards-shareholder-rights-project-is-wrong/) ("It is surprising that a major legal institution would countenance the formation of a clinical program to advance a narrow agenda that would exacerbate the short-term pressures under which American companies are forced to operate. This is, obviously, a far cry from clinical programs designed to provide educational opportunities while benefiting impoverished or underprivileged segments of society for which legal services are not readily available."). The Harvard SRP's activities have also been defended as perfectly legitimate conduct for an academic institution. *See, e.g.,* Jeffrey N. Gordon, *Wachtell Lipton's Critique of Harvard Law School*, April 3, 2012 (available at blogs.law.harvard.edu/corpgov/2012/04/03/wachtell-lipton-critique-of-harvard-law-school/) (suggesting that Wachtell Lipton has engaged in an "unfair attack on the Harvard SRP clinic based on a straitjacketed conception of clinical legal education not followed by leading American law schools…. Clinics at

[Footnote continued on next page]

of whether the substance of the Harvard Proposal is materially false or misleading in violation of Rule 14a-9.

C. The Empirical Literature Cited in the Harvard Proposal

The weight of the empirical evidence was, until recently, consistent with the Harvard Proposal's suggestion that staggered boards are correlated with inferior financial performance. Each of the five studies cited in support of the Harvard Proposal can be briefly summarized as follows, in the sequence in which they are cited by the Harvard Proposal.

1. Bebchuk and Cohen, in The Cost of Entrenched Boards,[118] examine a sample over the period 1995 to 2002, and document that "staggered boards are associated with an economically meaningful reduction in firm value (as measured in Tobin's Q)."[119] The correlation with reduced firm value "is stronger for staggered boards that are established in the corporate charter (which shareholders cannot amend) than for staggered boards established in the

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major American law schools commonly engage in cause-based representation of governmental and non-profit organizations" and citing examples of clinics at New York University School of Law, Columbia Law School, and Yale Law School.).

[118] 78 J. FIN. ECON. 409-433 (2005).

[119] *Id.* at 409. Bebchuk and Cohen define Tobin's Q as "equal to the market value of assets, divided by the book value of assets plus the market value of common stock less the sum of book value of common stock and balance-sheet deferred taxes," in accordance with Kaplan and Zingales, *Do Investment Cash Flow Sensitivities Provide Useful Measures of Financial Constraints*?, 112 QUART. J. ECON. 169 (1997) and Gompers, Ishii, and Metrick, *Corporate Governance and Equity Prices*, 118 QUART. J. ECON. 107 (2003). *Id.* at 420. Bebchuck and Cohen's analysis applies an "industry-adjusted Tobin's Q, which is a firm's Q minus the median Q in the firm's industry in the observation year." *Id.* at 420. They explain that "this measure, and simpler ones that drop deferred taxes, have been regularly used in light of the complexities cited in more sophisticated measures of Q and the evidence of a very high correlation between this proxy and those more sophisticated measures" *Id* (citing Chung and Pruitt, *A Simple Approximation of Tobin's Q*, 23 FIN. MGMT. 70 (1994)).

The text of the Harvard SRP, however, nowhere mentions Tobin's Q. It refers instead to "firm valuation." That term, standing on its own, is susceptible of multiple interpretations including, without limitation, the firm's stock price or market capitalization. Thus, to the extent that the phrase "firm valuation" fails to reflect the distinction between stock market valuation and valuation as measured by Tobin's Q (which is a measure of the firm's value to book ratio, and not of either the firm's book value or market value), and to the extent that a reasonable investor would find that distinction important in forming a view as to how to vote on the Harvard Proposal, the usage of the phrase "firm valuation" may also be materially false and misleading.

We further observe that , although Tobin's Q is certainly a widely used variable in the economic analysis of corporate governance, *see, e.g.,* Philip G. Berger & Eli Ofek, *Diversification's Effect on Firm Value*, 37 J. FIN. ECON. 39, 40 (1995); Larry H.P. Lang & Rene M. Stulz, *Tobin's q, Corporate Diversification, and Firm Performance*, 102 J. POL. ECON. 1248, 1249-50 (1994); Randall Morck et al., *Management Ownership and Market Valuation: An Empirical Analysis*, 20 J. FIN. ECON. 293, 294 (1988), the academic literature's extensive reliance on Tobin's Q is subject to significant criticism. *See. e.g.,* Philip H. Dybvig & Mitch Warachka, *Tobin's Q Does Not Measure Firm Performance: Theory, Empirics, and Alternative Measures* 4-5 (unpublished working paper, 2014), *available at* http://papers.ssrn.com/abstract=1562444, and articles cited therein. For example, Tobin's Q can be inflated by under-investment that can actually reduce future earnings. *Id.* at 4-5.

company's bylaws (which shareholders can amend)."[120] The analysis also provides "suggestive evidence that staggered boards bring about, and not merely reflect, a reduced firm value."[121] This suggestion of causation is based on the observation that "since the beginning of the 1990's, shareholders of existing public companies have generally been unwilling to approve charter amendments that establish a staggered board."[122] The authors find that, focusing on firms that went public prior to 1990, and "controlling for 1990 firm value, [there is] a negative correlation between firms' market values during 1995 to 2002 and whether they had a staggered board in 1990. This correlation is consistent with staggered boards having a negative effect on firm value."[123]

2. Faleye, in Classified Boards, Firm Value, and Managerial Entrenchment,[124] identifies 2,072 firms with continuously classified or declassified boards during the period spanning 1996-2002,[125] and finds that the presence of a classified board has a statistically significant negative effect on Tobin's Q. A classified board "reduces the typical firm's q-ratio by 13.15% after controlling for other factors that could affect firm value."[126] Faleye examines the relationship between firm complexity, as proxied by R&D intensity, sales growth, and firm size, and find that "even among firms subject to a higher degree of complexity and operational uncertainty, classified boards are associated with a significant reduction in firm value,"[127] again as measured by Tobin's Q.

Faleye also finds that the turnover rate for CEOs at firms with classified boards was 16.4 percent while the comparable percentage at firms with non-classified boards was 30.3%, with the difference being statically significant at the 1 percent level.[128] Multivariate regression analysis confirms the significance of this finding. In addition, "firms with classified boards provide significantly lower compensation incentives for their chief executives,"[129] indicating a lower sensitivity of CEO compensation to company performance. Faleye interprets these data as

[120] Bebchuk & Cohen, *supra* note 118, at 409.

[121] *Id.* at 409.

[122] *Id.* at 411.

[123] *Id.* at 411.

[124] Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, *supra* note 8.

[125] *Id.* at 504.

[126] *Id.* at 509.

[127] *Id.* at 518.

[128] *Id.* at 522.

[129] *Id.* at 526.

suggesting that "classified boards benefit CEOs at the expense of shareholders by shielding them and their compensation packages from the effects of poor firm performance."[130]

Faleye also conducts an event study for firms that adopt classified boards and firms that repeal classified boards.[131] He reports statistically significant negative stock price responses for firms adopting classified board structures,[132] as well as statistically significant negative stock price responses for firms repealing classified board structures.[133] "These results show that investors react negatively to the establishment of classified boards and welcome their elimination, which contradicts the claim that classified boards are beneficial to shareholders."[134] Faleye finds no statistically significant correlation between a board's classified structure and its operating performance as measured by "return on assets, sales margin, return on equity, and dividend and total … payment ratios."[135]

3. Frakes, in Classified Boards and Firm Value,[136] studies a period spanning 1990 to 2004 and controls for a range of governance factors in order to examine the effects of classified boards on Tobin's Q.[137] Frakes reports that "the incidence of classified boards remains quite stable across all years of the panel, ranging from 59% in 1990 to 63% in 1996, and that among all firms in the analysis, roughly 95% did not change their classified board status."[138] Applying advanced econometric techniques, "the results largely confirm the findings of Bebchuk and Cohen. That is … a negative relationship between classified board status and firm value."[139] Frakes also applies a variant of "difference-in-difference" regression methodology, based on the observation that the 1995 Delaware decisions in *Unitrin*[140] and *Wallace*[141] "strengthened the potential impact of classified boards, given that the power of such structures derives largely from their combined use with poison pills."[142] This difference-in-difference analysis supports the

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[130] *Id.*

[131] *Id.* at 514-15.

[132] *Id.* at 514.

[133] *Id.*

[134] *Id.*

[135] *Id.* at 514-15.

[136] Frakes, *supra* note 8.

[137] *Id.* at 124-126.

[138] *Id.* at 132-133.

[139] *Id.* at 136.

[140] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).

[141] Moore Corp. v. Wallace Computer Servs., Inc., 907 F. Supp. 1545 (D. Del. 1995).

conclusion that "the mid-1990's change in Delaware law had a negative effect on firm value for those Delaware firms likely to have classified boards."[143]

Frakes' application of quantile regression techniques,[144] however, suggests a more nuanced interpretation. These estimates suggest heterogeneity in the data and that "while the positive effects of classified boards are, on average, overwhelmed by the negative, the quantile regression results, nonetheless, suggest that some positive forces do exist and that such forces may even outweigh the negative in certain circumstances. That is, the general findings do not necessarily support a complete rejection of the notion that classified boards benefit shareholders."[145] More precisely, at "low levels of Tobin's Q, the association between classified boards and firm value is either negligible or positive in sign, supporting the possibility that classified boards, in certain circumstances, actually generate countervailing benefits to shareholder wealth."[146] These findings of potential heterogeneity are nowhere mentioned in the Harvard SRP.

4. Bebchuk, Coates, and Subramanian, in The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy,[147] examine hostile takeover bids spanning 1996-2000 and document that no hostile bid during this period was successful against an effective staggered board. The presence of an ESB "nearly doubled the odds of remaining independent"[148] and "the shareholders of targets that remained independent were made worse off compared with accepting the bid and that ESB's did not provide sufficient countervailing benefits in terms of increased premiums to offset the costs of remaining independent."[149] The authors estimate that during their sample period "ESBs reduced the returns of shareholders of hostile bid targets on the order of 8-10%."[150] The major policy implication of the analysis is that "at least in the absence of explicit shareholder authorization, managers who lose one election

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142 Frakes *supra* note 8, at 139 (citing Bebchuk and Cohen, *supra* note 11, at 412).

143 *Id.* at 143.

144 *Id.* at 145-150.

145 *Id.* at 149-150.

146 *Id.* at 149. Firms with low Tobin's Q might, according to Frakes "face greater pressure to behave properly. With weak investment opportunities, managers and directors may have less leeway to extract private benefits and engage in other destructive behaviors. Consequently, the entrenchment afforded by classified boards may be immaterial at the low tail of the value distribution." *Id.*

147 Bebchuk, Coates, & Subramanian, *Theory, Evidence and Policy, supra* note 1.

148 *Id.* at 887.

149 *Id.*

150 *Id.*

over an outstanding bid should not be allowed to further block the bid with a pill-ESB combination."[151]

5. Masulis, Wang and Xie, in Corporate Governance and Acquirer Returns,[152] examine 3,333 acquisitions made by 1,268 firms between 1990 and 2003.[153] They find that, after controlling for governance and financial factors, "acquirers with staggered boards experience abnormal returns approximately 0.52% lower than those experienced by acquirers without staggered boards. For the average bidder in our sample, this translates into a loss of close to $30 million in shareholder value."[154] This finding is consistent with the authors' broader thesis that "managers protected by more [anti-takeover provisions] are more likely to indulge in value-destroying acquisitions since they are less likely to be disciplined for taking such actions by the market for corporate control."[155]

The one partially conflicting academic study cited by the Harvard Proposal is, Bates, Becher and Lemmon, Board Classification and Managerial Entrenchment: Evidence from the Market for Corporate Control.[156] The Harvard Proposal describes that article is as finding that while "classified boards are associated with higher takeover premiums, this study also reports that classified boards are associated with lower firm valuation."[157] The authors, well aware of the offsetting effects of higher takeover premia and lower firm valuation, nonetheless conclude that "classified boards neither entrench managers in the context of takeover bidding nor facilitate managerial self-dealing in completed deals," and that the "significant bid deterrence effect associated a lower likelihood of an acquisition and that classified boards are associated with classified board provisions, … provides an incomplete explanation for the differences in firm value commonly attributed to managerial entrenchment."[158] They further explain that "it remains unclear whether the takeover bids that might obtain in the absence of board classification would be efficient for target stockholders," and that "the results of this paper challenge the common perception that these factors, independently or as indexed, provide a reliable proxy for

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[151] *Id.*

[152] 42 J. FIN. 1851 (2007).

[153] *Id.* at 1855.

[154] *Id.* at 1869. We observe that the Harvard SRP describes the results in Masulis, Wang, and Xie, which are based on stock price returns, as being "value-decreasing," while describing studies that rely on Tobin's Q, a measure that is very different from stock price, as reflecting "firm valuation." The Harvard SRP thereby conflates the notion of stock price and Tobin's Q as both reflecting valuation, without drawing any distinction between the two measures. *See* note 119, *infra*.

[155] *Id.* at 1853.

[156] 87 J. FIN. ECON. 656 (2008).

[157] Netflix Letter, *supra* note 112, at 2.

[158] Bates at al., *supra* note 156, at 658.

managerial entrenchment or a firm's exposure to the market for corporate control."[159] The authors conclude that "given a notable dearth of research concerning the possible shareholder benefits of classified boards that might accrue outside of the market for corporate control, our results suggest a circumspect policy approach be applied when considering the adoption or dissolution of [classified boards]."[160]

Comparing the authors' characterization of their own work to the Harvard Proposal's characterization suggests a distinct difference in perspective. A proposal that mischaracterizes an external source can violate Rule 14a-9 if the mischaracterization is material. We put this question aside in order to focus on larger, more clear cut concerns.

[159] *Id.*

[160] *Id.*

D. Additional Literature Consistent with the Harvard Proposal

Several recent studies not cited in the Harvard Proposal are consistent with its perspective and could also be cited to support its conclusions.[161]

1. Jankensgård and Andrén, in A Tide of Cash: Corporate Governance and the Management of Large Cash Windfalls,[162] find that firms in the petroleum sector that have classified boards retained larger cash balances following cash windfalls caused by increasing oil prices over the period 2000-2008. Based on an analysis of 73 oil and gas firms, the authors find that the presence of a classified board increases cash holdings by an average of 39% and that for "the sub-sample of firms with total assets above the industry median, for which the cash windfalls were the most pronounced, the corresponding number is 113%."[163] Firms with classified boards "return less money to shareholders through share repurchases, which was the preferred way of returning cash to shareholders,"[164] and also have lower re-investment rates.[165] The authors also found that "both the tendency to underinvest and engage less in share repurchases intensify over time as the cash windfalls materialized. This suggests that the association does not simply reflect simultaneity or reverse causality, but that classified boards were a cause of the different cash management policies observed."[166]

The authors conclude that "having a classified board is the single most powerful governance-related predictor of the decision whether to keep excess cash within the firm or return it to shareholders."[167] This finding "provides strong support for the managerial risk aversion-theory of excess cash holdings … according to which corporate managers derive utility from the flexibility and freedom from capital market discipline that comes from holding cash."[168]

2. Faleye, in Classified Boards, Stability, and Strategic Risk Taking,[169] relies on data spanning 1995-2002 to find that there is no statistically significant difference in the rate at which directors turn over at classified and non-classified boards, "which indicates that classified boards

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[161] This summary of additional research is not intended to be encyclopedic. The objective is to recognize that the Harvard Proposal could have cited to additional research in support of its policy perspective.

[162] Hakån Jankensgård and Niclas Andrén, Lund University and Knut Wicksell (Centre for Financial Studies, Working Paper 2014:1, 2014).

[163] *Id.* at 4.

[164] *Id.*

[165] *Id.*

[166] *Id.*

[167] *Id.* at 5.

[168] *Id.*

[169] Olubunmi Faleye, *Classified Boards, Stability, and Strategic Risk Taking*, 65 Fin. Analysts J. 54 (2009).

are no more stable than nonclassified boards,"[170] at least outside of the hostile takeover context.[171] Faleye suggests that "these results contradict the position of classified-board proponents"[172] but observes that "they are not entirely surprising"[173] because "most companies nominate the same slate of directors year after year,"[174] thereby preserving board continuity without regard to the board's classified structure.

Faleye also finds that firms with classified boards are associated with less strategic risk taking as measured by investments in R&D and other company-specific long-term assets. Faleye suggests that these results are "difficult to reconcile with the notion that classified boards enhance a company's ability to focus on long-term strategy"[175] and "are not consistent with the idea that classified boards are beneficial to shareholders."[176]

3. Cohen and Wang, in How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment,[177] focus on the stock price implications of two Delaware court rulings that had opposite effects on the ability of staggered boards at some Delaware firms "to impede shareholders seeking to replace a majority of directors."[178] On October 8, 2010, Delaware's Chancery court issued an opinion upholding a bylaw approved by a majority of stockholders accelerating the date of the next annual shareholder meeting of a target with a staggered board.[179] This decision significantly shortened the time period necessary for a hostile bidder to win two elections to take control of the staggered board.[180] Commentators observed that this ruling " 'blows a hole in the defenses of many companies with staggered boards' " and that these companies " 'will have to live with the fact that a staggered board can be weakened by forcing a subsequent annual meeting to occur much sooner than people thought.' "[181]

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[170] *Id.* at 57.

[171] *Id.*

[172] *Id.*

[173] *Id.*

[174] *Id.*

[175] *Id*. at 59.

[176] *Id*..

[177] Cohen & Wang, *supra* note 8.

[178] *Id.* at 628.

[179] Airgas, Inc. v. Air Products & Chemicals, Inc., No. 5817-CC, 2010 WL 3960599, at *13-14 (Del. Ch. Oct. 8, 2010).

[180] Cohen & Wang, *supra* note 8, at 630-31.

[181] *Id.* (quoting Steven Davidoff, *Air Products Wins Round in Battle with Airgas*, N.Y. TIMES, Oct. 8, 2010).

Chancery's decision was quickly appealed to Delaware's Supreme Court which, on November 23, 2010,[182] ruled that "the standard language of the staggered board provisions should be understood to require that directors serve for three years and thus to preclude"[183] bylaws that significantly shorten director terms of service. This reversal of Chancery's decision effectively "returned the insulating power" of staggered boards to the level that existed prior to Chancery's decision.[184]

Cohen and Wang examined the stock price response of 1,649 firms, of which 801 (49%) had staggered boards. They divided their sample of firms with staggered boards into a control group of firms with staggered boards and that have "their annual meetings in the earlier part of the year" (*i.e.* March or earlier), and firms in the treatment group with staggered boards that have annual meetings later in the calendar year (*i.e.* September or later)".[185] The purpose of this research design is to control for the presence of staggered boards. They find that the Chancery opinion, which weakened the anti-takeover effect of staggered boards, was correlated with an decrease of less than 1 percent in the stock price of firms with staggered boards that had late-year meeting dates, but that the result was statistically significant only at the 10% confidence level, not at the 5% level more commonly relied upon in the academic literature.[186]

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[182] Airgas, Inc. v. Airproducts and Chemicals, Inc, 8 A.3d 1182 (Del. 2010).

[183] Cohen & Wang, *supra* note 8, at 632.

[184] *Id.*

[185] *Id.* at 633.

[186] *Id.* at 634-35. A propensity score methodology also yielded estimates of an approximate 1% price effect with statistical significance of 11%. *Id.* at 637.

IV. The Harvard Proposal and the Omitted Research

The Harvard Proposal relies on the categorical assertion that staggered boards are associated with inferior financial performance. It cites only one study suggesting a contrary result, and perfunctorily dismisses that study's conclusions with contestable language.[187] This characterization of the literature could be described as materially false and misleading for two distinct reasons.

First, recent research concludes that staggered boards are associated with improved financial performance. These studies directly contradict the proposition advocated by the Harvard Proposal, and are unambiguously forceful in their challenge. The Harvard Proposal mentions none of these results. The Harvard Proposal therefore generates the materially false and misleading perception that the empirical literature supporting its proposition is well settled, and that findings to the contrary are easily dismissed or non-existent.

Second, recent research documents that staggered boards have heterogeneous effects. Therefore, even if one assumes, against the recent evidence, that staggered boards have a negative effect in the aggregate, it does not follow that staggered boards have an equally powerful negative effect for all categories of firms. The categorical nature of the Harvard Proposal, however, propounds the materially false and misleading proposition that the literature concludes that staggered boards are harmful without exception.

Five recent empirical studies, each conducted by an independent research team, strongly refute the categorical conclusion advocated by the Harvard Proposal. These studies suggest that staggered boards are associated with improved financial performance. They also found that the traditional correlation between staggered boards and inferior financial performance, even if true for some publicly traded firms, is not an accurate characterization of the relationship among significant subsets of firms.

More precisely, the Harvard Proposal's recommendation relies on a collection of studies based on cross-sectional regressions. However, when time series analyses are conducted over larger data sets it appears that financial performance, again measured by Tobin's Q, improves after a firm adopts a staggered board and declines after a firm de-staggers. These effects appear to be both statistically and financially significant. More advanced statistical techniques also suggest that the relationship is causal, and not merely a correlation. This more recent literature also suggests that there is significant heterogeneity in the financial effect of staggered boards. In particular, the decision to retain a staggered board may be more beneficial for firms with greater R&D intensity,[188] firms that are more innovative (as measured by patent citations),[189] firms with

[187] *See* Netflix Letter, *supra* note 112, at 2.

[188] Cremers, Litov & Sepe, *supra* note 29, at 7; Weili Ge, Lloyd Tanlu, & Jenny Li Zhang, Board Destaggering: Corporate Governance Out of Focus?4, 36 (AAA 2014 Management Accounting Section Meeting Paper, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2312565; Seoungpil Ahn & Keshab Shrestha, *The Differential Effects of Classified Boards on Firm Value*, 37 J. Banking & Finance 3993, 3995 (2013).

[189] Cremers, et al., *supra* note 29, at 7.

more intangible assets,[190] firms that are larger in size,[191] and firms that display low monitoring costs and high advisory needs at the board level.[192]

1. The most comprehensive recent contribution to the literature on staggered boards is Cremers, Litov, and Sepe, *Staggered Boards and Firm Value, Revisited.* The authors explain that they "replicate the existing evidence that *cross-sectionally*, firms with staggered boards tend to have lower firm values as measured by Tobin's Q."[193] However, when analyzed "in the *time series*, staggering up is associated with an increase in firm value and de-staggering is associated with a decrease in firm value."[194] In other words, "the negative cross-sectional association between staggered boards and firm value is reversed in the time series."[195] This finding "calls into question the interpretation of the [empirical] evidence in this literature, *i.e.*, as supporting the managerial entrenchment view of staggered boards."[196] Instead, the time-series data suggest that "causation might go from low firm value to the decision to adopt a staggered board rather than in the opposite direction."[197]

The finding that "firm value goes up if the board changes from a single class of directors to a staggered board (and the reverse for de-staggering)" is "robust and both economically and statistically significant."[198] More precisely, "staggering up (down) is associated with a permanent increase (decrease) in Tobin's Q of 6.3%."[199] The stock price performance of the portfolio of

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[190] Ahn & Shrestha, *supra* note 188, at 3994.

[191] Cremers, et al., *supra* note 29, at 7.

[192] Ahn & Shrestha, *supra* note 188, at 3995.

[193] Cremers, et al., *supra* note 29, at 3 (emphasis in original).

[194] *Id.* (emphasis in original).

[195] *Id.*

[196] *Id.*

[197] Cremers, Litov, and Sepe explain that the literature has historically been dominated by studies that consider the staggered board question from a cross-sectional perspective only and that these studies examine a time span that limits the power of the analysis because of a lack of variation in the data. CLS collect the most comprehensive database in the literature, spanning a period from 1978 to 2011 (*id.* at 4) which includes, as a subset, the 1995-2002 time period "used in much of the recent literature," (*id.*) and during which "there are very few instances of firms adopting a staggered board or de-staggering." *Id.* The data indicate that staggering activity tended to dominate during the period 1978-1989, and de-staggering tended to dominate during the period 2005-2011. *Id.* Cross-sectional analysis focusing on the period 1995-2002 misses both of these time periods and would therefore be unable to measure the time series effects that result from changes in staggered boards both because the sample size of these changes would be small and because the cross-section methodology employed by the researchers was not designed to search for these time series effects.

[198] *Id.*

[199] *Id.*

firms that stagger up also demonstrates a positive abnormal return whereas the stock price of the portfolio of firms that stagger down exhibits a negative abnormal return. A long-short portfolio of these two cohorts "has an annualized 4-factor alpha of about 16% (with a t-statistic of 2.24) if equally weighted and about 18% (with a t-statistic of 2.35) if value-weighted."[200] As the authors explain, "[t]hese results challenge the managerial entrenchment view of staggered boards."[201]

The authors suggest that asymmetric information explains this pattern in the data. "In some cases a relatively low firm value may be attributable to the difficulty of firm insiders to share information about the firm's prospects (rather than poor managerial performance). One example is the case where considerable firm-specific capital expenditures are required in order to enhance long-term firm value."[202] Expenditures of this sort can lower firm value in the near term "if shareholders are less convinced about their need and/or may ascribe them to empire building tendencies."[203] Consistent with this observation, the authors cite to research showing that "while significant increases in R&D investments are beneficial for the firm in the long run on average, the stock market tends to underreact to their announcement, leading to positive abnormal stock returns for such firms on average over the next 12 months."[204] To the authors, these results suggest that "some shareholders may initially not recognize the benefits of R&D investments, as they usually have a long-term nature."[205]

The authors therefore test whether the "positive association between adopting a staggered board and firm value is stronger for firms with more long-term and firm-specific investments, more complexity, and stronger executive compensation incentives to take on more risk (and vice versa for de-staggering)."[206] The data "strongly support such positive account."[207] They document that "the positive association between the adoption of a staggered board and firm value is significantly stronger among firms with higher R&D expenses as a fraction of their revenue, among firms with more intangible assets, among firms that are more successful in innovation (as measured by their patent citation counts) and among firms with larger size."[208]

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[200] *Id.* at 5.

[201] *Id.* at 6.

[202] *Id.*

[203] *Id.*

[204] *Id.*

[205] *Id.*

[206] *Id.* at 7.

[207] *Id.*

[208] *Id.* ("with firm size used as a proxy for complexity as in Faleye, 2007 and Core, Holthausen, and Larcker, 1999").

2. Similar findings are reported in Ge, Tanlu, and Zhang, *Board Destaggering: Corporate Governance Out of Focus?*. The authors also adopt a time-series approach in examining a sample of 384 firms that de-staggered from 1991 through 2011.[209] They conclude that, "contrary to the implications of the extant research on staggered boards and claims made by active investors, destaggering does not appear to always lead to improved firm performance; on the contrary, destaggering could lead to managerial short-termism and less effective board monitoring."[210] In particular, "firms that destagger tend to have poorer accounting performance, particularly after a year subsequent to destaggering."[211] In addition, "long-term accounting performance, measured by ROA [return on assets], is lower after destaggering, while Tobin's Q remains unchanged."[212] The data also show that "investment in R&D decreases after the decision to destagger" in a manner "consistent with the reduced incentive horizon for directors following destaggering."[213] Further, "pay-for-performance sensitivity is lower after a firm destaggers its board, consistent with the hypothesis that monitoring quality decreases post-destaggering."[214] These findings are "contrary to some of the earlier cross-sectional studies on destaggered boards, and are consistent with the view held by proponents of keeping the previously more popular staggered board structure."[215]

3. Much in the same vein, Ahn and Shrestha,[216] in *The Differential Effects of Classified Boards on Firm Value* conclude that "previous studies which document the adverse effects of classified boards on firm value, provide an incomplete picture of the role of classified boards."[217] They observe that boards perform both monitoring and advisory functions and

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[209] Ge, et al., *supra* note 188.

[210] *Id.* at 4-5.

[211] *Id.* at 6.

[212] *Id.* at 35.

[213] *Id.* at 4.

[214] *Id.* at 36.

[215] Methodologically, Ge, Tanlu, and Zhang first establish that staggering firms differ in a systematic manner from firms that fail to destagger. Destaggering firms are usually subject to more pressure from active shareholders, larger in size, and display "poor prior performance (measured as both accounting based return on assets and annual market-adjusted stock returns for the prior year)." *Id.* at 3. They also have larger boards and longer tenured CEOs. (GTZ at 4.) The authors then "generate a matched control sample by matching each destaggering firm to a non-destaggering firm using the probability of destaggering" based on the authors' models determinants. *Id.* at 3. The authors utilize these two samples to "perform a difference-in differences analysis to examine how board destaggering influences board attitudes, firm performance, and investment decisions."

[216] Ahn & Shrestha, *supra* note 188.

[217] *Id.* at 4011.

document "that classified boards are positively associated with Tobin's *q* in firms with low monitoring cost and greater advising needs."[218]

The logic behind this finding is straightforward. If a firm has low monitoring costs, then the presence of a staggered board does not promote a significant degree of entrenchment. If a firm has high advisory needs, then the presence of a staggered board can help promote stability in board-management relationships in a manner that enhances performance. The confluence of low monitoring costs and high advisory needs creates a situation in which the presence of a staggered board is well-situated to contribute to economic performance. It also follows that firms with high monitoring costs and low advising needs are more likely to see their economic performance impaired by the presence of a staggered board. Both propositions are consistent with the authors' findings.

The authors reinforce these findings by documenting that "when the advisory role of boards is more important than monitoring, firms appoint outside directors possessing diverse attributes and expertise,"[219] including "financial expertise, legal and legislative expertise, gender and ethnic diversity, academic background, board memberships in other firms, and industry expertise."[220] This conclusion is "consistent with the view that complex firms appoint outside directors by matching the required qualifications for advisory services with their attributes and expertise."[221] The authors also find that, when analyzing forced CEO turnovers, "the total effect of classified boards on performance sensitivity… is significantly negative only in firms with high advising needs. Thus, when outside directors are protected by staggered terms, they are willing to discipline the CEO for poor stock market performance."[222] In addition, the data indicate that "the adverse impact of board classification on CEO incentives"[223] as documented in studies cited in the Harvard Proposal[224] "is relevant only for firms with high monitoring cost, but not for firms

[218] These findings are based on analysis of 7,809 firm year observations from 1998 to 2006 and rely on "the ratio of intangible assets to total assets (asset intangibility) as [the] primary measure for monitoring costs." *Id.* The authors also examine alternate definition of information cost, such as "R&D intensity, firm age, and the variance of stock returns and generate consistent results under all these alternatives. *Id.* The authors suggest that advisory needs "increase with firm size, age, and the number of segments." *Id.* at 3996. Significantly, the authors also accentuate that, in the aggregate, these segments are "consistent with previous studies" and find that "classified boards are negatively associated with Tobin's *q*." *Id.* at 3999.

[219] *Id.* at 4004.

[220] *Id.*

[221] *Id.* at 4005.

[222] *Id.* at 4006.

[223] *Id.* at 4007.

[224] *See, e.g.,* Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, *supra* note 8, at 503 ("classified boards reduce the sensitivity of CEO compensation to firm performance").

with high advisory needs. This confirms that the impact of classified boards on CEO incentives is one of the channels through which they generate differential effects on firm value."[225]

4. Duru, Wang, and Zhao, in *Staggered Boards, Corporate Opacity and Firm Value*[226] draw a distinction between "transparent" and "opaque" firms and document that "the negative impact of staggered boards on firm performance" as measured by Tobin's Q and future accounting performance, "declines as the firm's overall opacity increases."[227] They document that "the negative effect of staggered boards on firm performance appears to be limited to transparent firms and that staggered boards are instead positively associated with firm value for highly opaque firms."[228] The authors also "find evidence of a staggered board discount for firms included in the S&P 500 or Fortune 500 rankings, but no evidence of such discount outside of these highly visible and transparent firms."[229] These findings lead to the conclusion that "staggered boards do not appear to be harmful to shareholder interests in *all* firms."[230]

The authors measure transparency as a function of share turnover, bid-ask spread, analyst following, and analyst forecast error, as well as inclusion in the S&P 500 or Fortune 500.[231] Among other mechanisms of action, the authors find that "as opacity increases, a staggered board firm invests more in R&D relative to a firm with a unitary board" and that there is a "higher pay-performance sensitivity in firms with the staggered board structure than those with unitary boards in an opaque environment."[232] These observations lead the authors to conclude that "regulators and large investor groups should exercise caution concerning the single minded efforts to repeal all staggered boards."[233]

5. Johnson, Karpoff, and Yi in *The Bonding Hypothesis of Takeover Defenses: Evidence from IPO Firms*[234] engage in a detailed examination of takeover defenses, including staggered boards, among firms that conduct an initial public offering (IPO). Their analysis

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[225] Ahn & Shrestha, *supra* note 188, at 4007.

[226] Augustine Duru, Dechun Wang, and Yijiang Zhao, *Staggered Boards, Corporate Opacity and Firm Value*, 37 Journal of Banking and Finance 341 (2013). The study relies on a sample of 4,991 firm years from 2002 through 2008.

[227] *Id.* at 342.

[228] *Id.*

[229] *Id.*

[230] *Id.* (emphasis in original).

[231] *Id.* at 344.

[232] *Id.* at 359.

[233] *Id.* at 359.

[234] Johnson, Karpoff, & Yi, *supra* note 29.

proposes a detailed solution to a puzzle that has not been successfully addressed in the previously dominant literature. "If the conventional view of takeover defenses [including staggered boards] is correct, IPO firms would not have defenses because they lower firm value and decrease the firm's proceeds from the IPO. Why do IPO firms nonetheless have takeover defenses?"[235]

The authors suggest that the solution to this puzzle is to be found in a "bonding hypothesis." They observe that some IPO firms have important business relations with customers, suppliers and counterparties in which the counterparties make valuable commitments to the IPO firm and where the IPO firm reciprocates by making valuable commitments to the counterparty. This creates relation-specific capital. The presence of these commitments makes it rational for the IPO firms to invest in strategies that help assure counterparties that the IPO firm's management will be stable and will not act opportunistically.[236] Anti-takeover measures, such as staggered boards, are one such device and the authors find that for firms with sufficiently strong bonding relationships, IPO valuation is actually increased by the presence of takeover defenses.[237]

To test this hypothesis, the authors focus on three measures of quasi-rents that are potentially appropriable by IPO firms and that indicate the potential presence of a bonding relationship: (1) the presence of a large customer upon whom the firm relies for a significant portion of its sales; (2) the existence of large supplier for whom the IPO firm is a large and dominant customer; and (3) the presence of a strategic alliance, such as a joint venture or long term contracts, between the IPO firm and other firms.[238] "The bonding hypothesis implies that IPO firms with significant trading partners are more likely to deploy takeover defenses than other IPO firms, and that takeover defenses are more likely to create value when the IPO firms have such trading partners."[239]

The data strongly support the bonding hypothesis. An "IPO firm's number of takeover defenses is positively related to all three measures of appropriable quasi-rents"[240] in a manner consistent with "the hypothesis that takeover defenses are deployed to help bond the firm's commitment when it has important trading relationships that create appropriable quasi-rents."[241]

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[235] *Id.* at 6 (citing Daines and Klausner (2001)).

[236] *Id.* at 1-6.

[237] *Id.* at 39-40 (arguing that "takeover defenses increase the value of managers' commitments to maintain their promised operating strategy and not to opportunistically exploit their counterparties' investments in the IPO firm. This bond, in turn, encourages the firm's counterparties to invest in the business relationship, yielding benefits for the IPO firm. We call this the bonding hypothesis of takeover defenses.").

[238] *Id.* at 4.

[239] *Id.*

[240] *Id.*

[241] *Id.*

The IPO firm's announcement of its decision to go public also "has a spillover effect on its large customers' values that is positively related to the IPO firm's use of takeover defenses."[242] This spillover effect is positively related to the IPO firm's own stock price valuation, but "only when the IPO firm has a large customer, dependent supplier, or strategic partner."[243] Thus, for firms that satisfy the bonding hypothesis, the presence of anti-takeover measures at the IPO stage can cause an increase in the value of the IPO firm's own stock price as well as in the stock price of its committed trading partners. As the authors observe, "[t]his result is inconsistent with the conventional view that takeover defenses decrease firm value, and indicates that IPO firms benefit from their use of defenses when they have important business relationships."[244]

The authors also document that takeover defenses are associated with high operating performance after the IPO but only among firms with bonding relationships.[245] "These results indicate that the higher valuations observed when IPO firms deploy takeover defenses are consistent with these firms' subsequent operating performance. They also show how IPO firms benefit from their takeover defenses, as they also earn quasi-rents from their ongoing relationships with their counterparties."[246]

More detailed statistical techniques support the further inference that "takeover defenses not only are correlated with higher value and performance, but also are a cause of the higher value and performance."[247] Thus, the results of the analysis "are consistent with the hypothesis that takeover defenses help to bond the IPO firm's guarantees to its counterparties by decreasing the probability that current management will be replaced, and company policy changed, through a hostile takeover."[248] The bottom line is that "many IPO firms adopt takeover defenses precisely because pre-IPO shareholders benefit from them."[249]

The authors also observe that their findings can be reconciled with the literature suggesting that, in the aggregate, takeover defenses can reduce shareholder value at seasoned firms.[250] They hypothesize that, over time, the benefits of bonding relationships may decline while the costs of entrenchment increase, but that "exactly how and when such changes occur,

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[242] *Id*. at 5.

[243] *Id*.

[244] *Id*.

[245] *Id*.

[246] *Id*.

[247] *Id*. at 6.

[248] *Id*. at 6.

[249] *Id*. at 7.

[250] *Id*. (citing Bebchuk., *The Myth that Insulating Boards Serves Long-Term Value*, *supra* note 67).

however, is a topic for further research."[251] Previously cited studies, however, suggest the additional possibility. With regard to staggered boards as a specific defensive measure even after an IPO is completed, the benefits of the bonding relationship may be correlated with R&D, intangible assets, low monitoring costs, high advisory needs, and other factors consistent with the observation that staggered boards do not reduce financial performance. If these observations are correct, it does not necessarily follow that the benefits associated with bonding relationships must dissipate over time provided that those bonding relationships are correlated with other factors consistent with a positive relationship between staggered boards and financial performance.

[251] *Id*.

V. Did Harvard Violate Federal Securities Law?

The question of whether the Harvard, as a university, violated federal securities law can be approached from three perspectives. The first is prospective. It asks whether a challenge to the inclusion of the Harvard Proposal in the form of a request for a no-action letter or a motion for declaratory relief, based on the exemption under Rule 14a-8 for proposals that violate the federal proxy laws, including Rule 14a-9, would prevail. The second is retrospective. It asks whether the SEC would prevail in an injunctive (or administrative cease and desist) proceeding under Rule 14a-9 against Harvard based on the SRP's prior practice of repeatedly propounding the Harvard Proposal. The third is also retrospective. It asks whether a private party plaintiff, most particularly a company that had the Harvard Proposal appear on its proxy and subsequently de-staggered its board, could prevail in a private action alleging a Rule 14a-9 violation. That inquiry also considers the nature of the remedy the company might obtain if successful in its challenge.

The requisite evidentiary showing in each of these instances is quite different. A private party plaintiff seeking a judgment that a previously included shareholder proposal violated Rule 14a-9 faces the most difficult challenge,[252] and would have to demonstrate that: "(1) the proxy solicitation contains either a false or misleading statement of fact or omits a material fact; (2) the misstatement or omission was made with the requisite level of culpability; and (3) the solicitation was an essential link in accomplishing the proposed transaction."[253] The Supreme Court's decision in *Janus*[254] also raises the possibility that the private party plaintiff will have to demonstrate that the defendant is formally the "maker" of the challenged statement.[255] Further, to

[252] The courts recognize a private right of action under Section 14(a) for a violation of Rule 14a-9. Koppel v. 4987 Corp., 167 F.3d 125, 131 (2d Cir. 1999) ("A private right of action under Rule 14a–9 is well established. *See J.I. Case Co. v. Borak,* 377 U.S. 426, 431, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964); *United Paperworkers Int'l Union,* 985 F.2d at 1197–98.").

[253] Allergan, Inc. v. Valeant Pharm. Int'l, Inc., No. SACV 14–1214 DOC, 2014 WL 5604539, at *14 (C.D. Cal. Nov. 4, 2014) (citing Desaigoudar v. Meyercord, 223 F.3d 1020, 1022 (9th Cir. 2000)). *See also* Lone Star Steakhouse & Saloon, Inc. v. Adams, 148 F.Supp.2d 1141, 1151 (D. Kan. 2001) (same); Berkman v. Rust Craft Greeting Cards, Inc., 454 F. Supp. 787, 791 (S.D.N.Y. 1978) (same). Courts articulate slightly different standards for what must be proved to establish a violation of Section 14(a) or Rule 14a-9, but those differences are immaterial to this analysis. *Compare* cases cited *supra with* Tracinda Corp. v DaimlerChrysler AG, 502 F. 3d 212, 228 (3d Cir. 2007) (to establish a claim under Section 14(a), the plaintiff must prove "(1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction.") *and* Lane v. Page, 727 F. Supp. 2d 1214, 1227 (D.N.M. 2010) ("There are four basic elements of a claim under § 14(a) and rule 14a-9. The plaintiff must establish that: (i) the proxy statement contains a material misrepresentation or omission; (ii) the defendants were at least negligent; (iii) the misrepresentations or omissions caused the loss of which the plaintiff complains; and (iv) the proxy statement was an essential link in the completion of the transaction at issue.").

[254] Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011).

[255] *See* Section V.C., *infra*.

hold Harvard, as a university, liable for the SRP's actions, the doctrine of *respondeat superior* would have to apply.[256]

In contrast, the Securities and Exchange Commission, in an enforcement proceeding, has an easier task. It would have to establish materiality and culpability, but it would not have to establish causation.[257] If *Janus* applies, the SEC might also have to establish that the defendant is the "maker" of the challenged statement, and to hold the university responsible, it too would have to establish liability under the doctrine of *respondeat superior*.

In a request for no-action relief or on a motion for declaratory judgment under Rule 14a-8, alleging a violation of Rule 14a-9, the dispute is resolved exclusively with reference to the materiality of the alleged omission or misrepresentation. No-action relief will be granted when "the company demonstrates objectively that a factual statement is materially false or misleading" without any regard to the proponent's state of mind, without regard to any person's status as a "maker," and without regard to causation.[258] The same rule governs in litigation seeking declaratory relief.[259]

One analysis therefore proceeds by first examining the materiality of the omission in the Harvard Proposal, and observes that the Commission's staff and federal courts could conclude that the Harvard Proposal is materially misleading. The analysis then proceeds to consider the additional elements that the SEC would have to establish in an enforcement proceeding against Harvard, as a university. With regard to culpability, the dominant position among the lower courts is that negligence suffices to establish liability.[260] The analysis suggests that it would be possible to establish that the Harvard SRP was negligent in failing to include in the Harvard Proposal a description of the contradictory research. Assuming, without deciding, that the Supreme Court's decision in *Janus* applies to SEC enforcement proceedings that allege a violation of Rule 14a-9, it is also possible to conclude that the Harvard SRP is the "maker" of the defective statement.[261] Further, under the doctrine of *respondeat* superior, Harvard, as a university, could also be held liable for the activities of the SRP. It follows that the SEC should be able to succeed in an enforcement proceeding against Harvard University seeking injunctive relief prohibiting future violations of Rule 14a-9.

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[256] *See* Section V.D., *infra*.

[257] *See* note 318, *infra*.

[258] *See, e.g.,* SEC Staff Legal Bulletin No. 14B § B.4 (2004).

[259] Express Scripts Holding Co. v. Chevedden, No. 13–2520, 2014 WL 631538, at *5 (E.D. Mo. Feb. 18, 2014) ("Having found the misstatements in the four supporting statements material and, therefore, not in compliance with SEC rules and regulations, the Court concludes that the criteria for exclusion under SEC Rules 14a–8 and 14a–9 have been met, and grants Express Scripts' motion for summary judgment.").

[260] *See* note 282, *infra*.

[261] *See* Section V.C., *infra.*

A private party contemplating an action against Harvard University would, in addition, have to establish causation. Here the analysis is more complex because, among other reasons, Rule 14a-8 shareholder proposals are precatory and therefore cannot, as a formal matter, directly cause anything to happen. Instead, for a company to decide to de-stagger its board, the incumbent staggered board must present to the shareholders a proposal to amend the corporation's charter, and the shareholders then address that proposal in a binding vote. The precatory Harvard Proposal is formally not before the board or the shareholders when they consider the binding destaggering proposal. However, in the context of Rule 14a-9 litigation, courts require only that private party plaintiffs establish that the misleading statement have a "significant propensity to affect the voting process."[262] Given the statements by the Harvard SRP that strongly link its precatory proposal to the subsequent binding decisions to destagger at approximately one hundred publicly traded firms,[263] establishing the requisite level of causation is straightforward.[264]

As for the question of a remedy in a private action, precedent supports the proposition that courts have the authority to nullify corporate actions taken on the basis of false or misleading statements in violation of Rule 14a-9.[265] Predicting whether a court would exercise its discretion to issue an order nullifying a vote to destagger a board and enter an order reinstating a staggered board structure is a more difficult challenge.

A. Materiality

Materiality "does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote."[266] The test is instead whether there is "a substantial likelihood that a reasonable shareholder would consider [the omitted information] important in deciding how to vote."[267] In other words, "the information need not be so important that it would change the outcome, but it cannot be so trivial that it would not affect the total mix of information."[268] Although judgments about materiality are often difficult to reach[269] and are susceptible of hindsight bias,[270] the materiality of the Harvard

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[262] United Paperworkers Int'l Union v. Int'l Paper Co., 801 F. Supp. 1134, 1146 (S.D.N.Y. 1992).

[263] *See* notes 326-328, *infra*.

[264] *See* Section V.E., *infra*.

[265] *See* Section V.F., *infra.*

[266] TSC Industries, Inc. v. Northway, Inc. 426 U.S. 438, 449 (1976).

[267] *Id.* at 449; *accord*, Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988) ("We now expressly adopt the *TSC Industries* standard of materiality for the § 10(b) and Rule 10b–5 context.").

[268] Richard A. Booth, *The Two Faces of Materiality*, 38 DEL. J. CORP. L. 517, 518 (2013).

[269] *See* 3 HAZEN, *supra* note 68, at §10.4 ("materiality is not suitable for a bright line test as it is a highly factual determination based on a wide spectrum of surrounding circumstances including the total mix of information that is available to investors generally;" "since the issues are highly factual, summary judgment will rarely be

[Footnote continued on next page]

Proposal's omission of contradictory recent research seems clear. Propositions regarding the value of a company's stock are likely to be significant to reasonable shareholders because they go to the heart of the reason a person is a shareholder: the opportunity for financial gain.[271] The Harvard Proposal frames the empirical literature as relating to "lower firm valuation," "lower gain to shareholders," and "value decreasing acquisition decisions."[272] The literature upon which the Harvard Proposal itself relies also states that the merits of the declassification debate cannot be resolved as a matter of theory, and explains that careful empirical research is necessary to determine the effects of classified boards on shareholder welfare.[273] The Harvard SRP also dedicates 35 percent of its limited word count to a discussion of the academic literature,[274] and thereby reinforces the significance of the empirical literature to the shareholders' decision-making process. Indeed, apart from citations to other companies who have adopted destaggered boards, the empirical literature is the only evidence put forth in favor of the proponent's assertions.

The fact that the contradictory literature is available in the public domain does not alter this conclusion. A proponent's obligation under Rule 14a-8 is to submit a proposal and supporting statement that, within the four corners of the document, is not materially false or misleading.[275] "Even if it is true that a shareholder would have to be "living under a rock not to

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appropriate.")*; see also* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450 (1976) (noting that "[t]he issue of materiality may be characterized as a mixed question of law and fact" and that "the determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality' is the ultimate issue of materiality appropriately resolved 'as a matter of law' by summary judgment." (quoting Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970))); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) ("The determination of materiality is a mixed question of law and fact that generally should be presented to a jury."); *Express Scripts*, 2014 WL 631538, at *3 ("In many circumstances materiality presents a factual question for a jury to decide; however, where a reasonable juror could determine that the information would have 'assumed actual significance in the deliberation of the reasonable investor,' materiality can be determined as a matter of law." (quoting *Press,* 166 F.3d at 538)).

[270] *See, e.g.*, G. Mitu Gulati, Jeffrey J. Rachlinski, Donald C. Langevoort, *Fraud by Hindsight*, 98 N.W.U. L. REV. 773 (2003).

[271] "A fact is material if it affects stock price." Booth, *supra* note 268, at 519 (citing Basic v. Levinson, 485 U.S. 224, 247 (1988)).

[272] Netflix Letter, *supra* note 112, at 2.

[273] *See supra* note 8.

[274] The total word count of the Harvard Proposal, including the accompanying statement, is 400 words, and 140 of those words, or 35 percent, discuss the state of the academic literature.

[275] The text of Rule 14a-8(i)(3) states that "[i]f the *purpose* or *supporting statement* is contrary … to Rule 14a-9" then the company may exclude the proposal. 17 C.F.R. § 240.14a-8(i)(3) (emphasis applied.) The rule, as drafted, does not contemplate supplementation by additional materials outside the text of the proposal or supplementary statement, particularly if those supplemental materials contradict the positions asserted in the proposal or supporting statement. *Accord*, SEC Staff Legal Bulletin No. 14B (2004) § B.4 ("[T]he staff will concur in the company's

[Footnote continued on next page]

know about" the omitted information, "that does not change Defendants' obligation to make their own required disclosures" in a proxy statement.[276] Similarly, the ready availability of corrective information in the SEC's own records will not cure an omission or misrepresentation in a proponent's Rule 14a-8 proposal, and courts will grant declaratory relief when a proponent misstates the SEC's records.[277]

The fact that the contradictory literature exists in the form of working papers that have yet to appear in peer reviewed journals does not alter the conclusion. The Harvard Proposal itself relies on publications that are not peer reviewed,[278] and it is common practice among scholars, in peer-reviewed journals and in non-peer-reviewed working papers alike, to cite to research materials that have not yet appeared in peer-reviewed journals.[279]

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reliance on Rule 14a-8(i)(3) to exclude or modify a proposal or statement only when that company has demonstrated objectively that the proposal or statement is materially false or misleading.").

[276] Allergan, 2014 WL 5604539, at *15; *see also* Kohn v. Am. Metal Climax, Inc, 458 F.2d 255, 265 (3d Cir. 1972) (holding that "any otherwise material violation of the disclosure rules is not obviated by referring to materials of an opposing soliciting party."), *partially overruled on other grounds en banc by* Kershner v. Mazurkiewicz, 670 F.2d 440, 448 (3d Cir.1982).

[277] *Express Scripts*, 2014 WL 631538, at *4 (excluding a stockholder proposal that misstated information that was available in public SEC filings). The "four corners" approach to the interpretation of the accuracy of Rule 14a-8 proposals is also consistent with the staff's approach to the exclusion of proposals based on "vagueness." There, the staff permits exclusion when key terms in the proposal are not adequately defined within the text of the proposal or supporting statement. The ability to locate a more precise definition on the Internet or in other reference sources is irrelevant to the staff's position. *See, e.g.,* John F. Olson and Amy L. Goodman, Gibson Dunn & Crutcher LLP, *Assessing Vague Shareholder Proposals Under Rule 14a-8(i)(3)* (March 28, 2013), http://www.securitiesregulationmonitor.com/Lists/Posts/Post.aspx?ID=197; McKesson Corp., SEC No-Action Letter, 2013 WL 1343574 (Apr. 17, 2013) (permitting exclusion of a proposal calling for an independent Chairman of the Board of Directors; defining the term "independent" by reference to the NYSE definition in its listing standards, but not providing sufficient information in the proposal itself to adequately define "independent").

A reference to a website address is, however, permitted, and the reference counts as only one word of the 500 permitted the proponent. SEC Staff Legal Bulletin No. 14G (Oct. 16, 2012). The staff will permit exclusion of the website reference "if the information contained on the website is materially false or misleading, . . .or otherwise in contravention of the proxy rules, including Rule 14a-9." *Id.*at D. The *de facto* effect of incorporating a website reference into a Rule 14a-8 proposal thus appears to be to expand the proponent's 500 word limit, but not to allow the inclusion of statements that are materially misleading because of omissions, where these omissions are cured by reference to an exogenous source, such as a website. The distinction appears to hinge on whether "the information on the website only supplements the information contained in the proposal and in the supporting statement." SEC Staff Legal Bulletin No. 14G, at D.1.

[278] *See* Netflix Letter, *supra* note 112, at 2 (citing Bebchuk, Coates & Subramanian, *supra* note 1, which appeared in Volume 54 of The Stanford Law Review. The Stanford Law Review is not a peer-reviewed journal.).

[279] *See, e.g.,* Bebchuk & Cohen, *supra* note 118, at 431 (citing Lucian A. Bebchuk & Oliver Hart, *Takeover Bids v. Proxy Fights in Contests for Corporate Control* (NBER Working Paper No. 8633, 2002); Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, *supra* note 8, at 528 (citing to J.L. Coles, N.D. Daniel, & L. Naveen, *Boards: Does One Size Fit All?* (Working Paper, 2004); Frakes, *supra* note 8, at n.25 (citing Marianne Bertrand &,Sendhil Mullainathan, *Executive Compensation and Incentives: The Impact of Takeover Legislation* (NBER Working Paper No. 6830, 1998)); Masulis, Wang, & Xie, *supra* note 152, at1886 (citing Lucian A.

[Footnote continued on next page]

Accordingly, there is a path by which a court could conclude, as a matter of law, that a reasonable shareholder would consider it important in deciding how to vote that the Harvard Proposal omits all mention of recent scholarship that directly contradicts the position advocated by the Harvard Proposal.[280]

B. Culpability: The Negligence Standard

The Supreme Court has reserved its views regarding the requisite level of culpability in Section 14a-9 actions.[281] The dominant position in the lower courts, however, is that negligence suffices to establish culpability.[282] "[A]n individual who participates in a solicitation which utilizes materially false or misleading statements is liable if he knew or should have known that the statements were false or misleading."[283] Moreover, "the liability of any individual defendant is dependent upon *his* due diligence or exercise of reasonable care, and therefore, the negligence standard embodies a criterion which would permit consideration of the individual's particular

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Bebchuk, John C. Coates IV, and Guhan Subramanian, *The Power of Takeover Defenses* (Working Paper, Harvard Law School and NBER, 2003)).

[280] Consistent with this analysis, in 1999 the staff granted no action relief permitting Freeport-McMoRan Copper & Gold, Inc. to exclude portions of the supporting statement advancing a de-staggering proposal because the proponent cited to one article that was irrelevant, and to a second article that was later retracted and reversed. Freeport-McMoRan Copper & Gold Inc., SEC No Action Letter, 1999 WL 95481 (1999). Significantly, Freeport-McMoRan predates Staff Legal Bulletin No. 14B, thereby indicating that a "true" interpretation of 14a-8 -- one that actually enforces the provisions of 14a-8(i)(3), rather than the "hands-off" expedient adopted in Staff Legal Bulletin No. 14B --is one that requires citations to external evidence to be accurate.

[281] Va Bankshares Inc. v., Sandberg, 501 U.S. 1083, 1090 n.5 (1991) ("In *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 444, n. 7, 96 S.Ct. 2126, 2130, n. 7, 48 L.Ed.2d 757 (1976), we reserved the question whether scienter was necessary for liability generally under § 14(a). We reserve it still.").

[282] *See, e.g.*, Gould v. Am.-Hawaiian S.S. Co., 535 F.2d 761. 777-78 (3d Cir. 1976); Gruss v. Curtis Publ'g Co., 534 F.2d 1396, 1403 (2d Cir. 1976); Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1300-1301 (2d Cir. 1973); Knollenberg v. Harmonic, Inc., 152 F. App'x 674 682-83 (9th Cir. 2005) (quoting *In re* McKesson HBOC, Inc. Sec. Litig., 126 F. Supp. 2d 1248, 1267 (N.D. Cal. 2000) ("negligence is sufficient to support a claim for a violation of Section 14(a)")); Shidler v. All Am. Life & Fin. Corp., 775 F.2d 917, 926-27 (8th Cir. 1985). Beck v. Dobrowski, 559 F.3d 680, 682 (7th Cir. 2009) ("Section 14(a) requires proof only that the proxy solicitation was misleading, implying at worst negligence by the issuer."); Wilson v. Great Am. Indus. Inc., 855 F.2d 987, 995 (2d Cir. 1988) ("Liability can be imposed for negligently drafting a proxy statement."); Herskowitz v. Nurti/Sys., Inc., 857 F.2d 179, 190 (3d Cir. 1988) (rejecting scienter standard for officers and directors); Kennedy v. Venrock Assocs., 348 F.3d 584, 593 (7th Cir. 2003). The Sixth Circuit has imposed a scienter requirement for claims against outside directors and accountants. Adams v. Standard Knitting Mills, Inc. 623 F.2d 422, 428 (6th Cir. 1980), *cert denied*, 449 U.S. 1067 (1980). The Eighth Circuit followed the Sixth in SAEC v. Shananan, 646 F.3d 536, 546-47 (8th Cir. 2011), but recently refused to extend the scienter requirement to corporate insiders and continues to hold them liable on a negligence standard. SEC v. DAS, 723 F.3d 943, 953 (9th Cir. 2013). The circuit split regarding the need for scienter in claims against outside directors and accountants is, however, irrelevant to this article's analysis because the Harvard SRP's role is directly analogous to inside management's role, and the university's liability rests on principles of *respondeat superior* that are irrelevant to the liability of outside directors or auditors.

[283] Gould, 351 F.Supp. at 860.

position with the corporation and his relationship to the pertinent information held to be erroneously or incompletely stated in the proxy materials."[284]

The relevant question then is whether, by omitting any mention of the recent contradictory literature, the Harvard SRP, exercised the level of care that would be expected of faculty and students at Harvard Law School. The Commission and private party plaintiffs could establish that the Harvard SRP failed to satisfy that standard when all of the omitted conflicting research had been posted to the Social Science Research Network ("SSRN"), an online research depository widely relied upon by academics, including those affiliated with the SRP.[285] Indeed, the Harvard SRP is directed by leading scholars who are demonstrably knowledgeable regarding the process of conducting a literature review and who recognize that the publication of a non-peer reviewed article on the SSRN website will lead to rapid, widespread citation and reliance in other research studies.[286] Law students at leading educational institutions also have the skills necessary to search the SSRN database.[287] The failure to identify the conflicting literature would thus seem squarely to satisfy a negligence standard.

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[284] *Id.* at 865 (emphasis in original); *see also* GARY LOCKWOOD, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES § 15:26 (2014), *available at* Law of Corp. Offs. & Dirs.: Rts., Duties & Liabs. § 15:26 (2014) ("Under a negligence standard, the position of a particular defendant and his access to information will be important in assessing whether such defendant should have known of the misstatement or omission.").

[285] Lucian A. Bebchuk and Allen Ferrell, *Rethinking* Basic, 69 BUS. LAW. 671, 691 n.62 (2014) (citing Allen Ferrell & Atanu Saha, *Event Study Analysis: Correctly Measuring the Dollar Impact of an Event* (working paper, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_ id=1814236); Lucian A. Bebchuk, Alon Brav, Robert J. Jackson, Jr., and Wei Jiang, *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy,* 39 J. CORP. L. 1, 7 n.16 (2013) (citing Alon Brav et al., *The Real Effects of Hedge Fund Activism: Productivity, Risk, and Product Market Competition* (working paper, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2022904); *Id.* at 21 n.38 (citing Pierre Collin-Dufresne & Vyacheslav Fos, *Do Prices Reveal the Presence of Informed Trading?* 50 (working paper, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_ id=2023629.

[286] In particular, scholars recognize that the publication of a "discussion paper version" of an article can lead to extensive citation in other academic research. *See, e.g.,* Bebchuk, Cohen, & Ferrell, *What Matters in Corporate Governance, supra* note 6, at 786 (observing that "more than 75 papers have already used our E index in their analysis" since the publication of the discussion paper version of the article). For additional examples of literature reviews conducted by faculty affiliated with the Harvard SRP, see, e.g., Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value, supra* note 67, at 1638-46.

[287] *See, e.g., Legal Scholarship Network Site Subscriptions*, SSRN, http:// www.ssrn.com/update/lsn/lsn_site-licenses.html (last visited Dec. 3, 2014) (listing the 364 schools, university departments, firms and other organizations, including Harvard University, with site licenses to SSRN's Legal Scholarship Network); J. PAUL LOMIO, HENRIK S. SPANG-HANSSEN & GEORGE D. WILSON, LEGAL RESEARCH METHODS IN A MODERN WORLD: A COURSEBOOK 95-96 (3d ed. 2011) (noting that "[t]he Legal Scholarship Network of the Social Science Resource Center (<www.ssrn.com>) is a resource for seeing the future," and that "[l]aw schools, such as Stanford, pay SSRN" for access to its journal of abstracts); Olufunmilayo B. Arewa, *Open Access in a Closed Universe: Lexis, Westlaw, Law Schools and the Legal Information Market*, 10 LEWIS & CLARK L. REV. 797 (2006) (discussing the electronic dissemination of legal scholarship through SSRN, and noting that "law schools, law firms, and other institutions may pay SSRN for sponsored research paper series where SSRN users may download faculty papers at no cost."); *see also* THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION 162, 170 (Columbia Law Review Ass'n et al. eds., 19th ed. 2010) (identifying proper citation format for articles posted on SSRN).

C. *Janus*: Who Is the "Maker" of the Statement?

In *Janus*[288] the Supreme Court held that liability under Rule 10b-5(b) was limited to the "maker" of the fraudulent statement because the rule expressly states that it shall be unlawful "[t]o make any untrue statements…."[289] *Janus* holds that the "maker" is the person or entity with "ultimate authority"[290] over the statement, *i.e.* "authority over the content of the statement and whether and how to communicate it."[291] We assume *arguendo* that *Janus* also applies to Rule 14a-9 because the rule states that "[n]o solicitation subject to this regulation shall be made….," where "made" is simply the past tense of "makes." There is no basis in *Janus* to conclude that the tense of the verb alters the Court's analysis. It can therefore be argued that just as the "maker" requirement applies to Rule 10b-5(b), it also applies to Rule 14a-9, but there is no significant body of precedent on point.[292]

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[288] Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011).

[289] *Id.* at 2301 (citing 17 CFR § 240.10b–5(b)).

[290] *Id.* at 2302.

[291] *Id.* at 2303.

[292] There is little precedent addressing the application of *Janus* to Rule 14a-9. In *S.E.C. v. Mercury Interactive, LLC*, 5:07–cv–02822–WHA, 2011 WL 5871020 (N.D. Cal. Nov. 22, 2011, the court declined to extend *Janus* to § 14(a) of the Exchange Act and § 17(a) of the Securities Act, stating that "[t]his Court agrees with those decisions that have concluded that *Janus* may not be extended to statutes lacking the very language that *Janus* construed." *Id.* at *3; *see also* 5A ARNOLD S. JACOBS, DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 4:6 (2014) ("Janus is not relevant to Rule 14a-9 given the difference in language between the two provisions."); *see also id.* § 12:113.99 (same). At least one commentator has argued that *Janus* should extend to Section 14(a) and other sections addressing misrepresentations. *See* Thomas A. Hanusik and Megan Louise Wolf, Janus: *The Supreme Court's Statement About Ultimate Authority,* 27 CRIM. JUSTICE 4, 9 (2013), *available at* 27-WTR Crim. Just. 4 ("Given the danger of eviscerating *Janus* by refusing to extend it, and the fact that it has already been applied outside the rule 10b-5(b) context, there is a strong argument that *Janus* extends to every other section applicable to material misstatements or omissions.").

The lower courts are split as to the application of *Janus* to Section 17(a), and the split is present even within the Southern District of New York. The courts that apply *Janus* tend to use the straightforward reasoning that nothing in *Janus* itself limits the holding to rule 10b-5, and, because "the elements of a claim under Section 17(a) are essentially the same as those for claims under Rule 10b-5," it would be inconsistent not to extend *Janus* to section 17(a). *See* SEC v. Kelly*,* 817 F.Supp.2d 340, 345 (S.D.N.Y. 2011) (applying *Janus* to § 17(a) claim based upon conclusion that "[a]lthough the language of subsection (2) of Section 17(a) is not identical to that of subsection (b) of Rule 10b–5, both provisions have the same functional meaning with it [sic] comes to creating primary liability"); *accord* SEC v. Perry, No. CV–11–1309 R, 2012 WL 1959566, at *8 (C.D. Cal. May 31, 2012) (holding that the *Janus* "requirement applies to claims under both Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 promulgated thereunder, and Section 17(a) of the Securities Act of 1933."). On the other hand, courts that view *Janus* as inapplicable to Section 17(a) generally focus on the policy concerns underlying the decision, specifically, concerns regarding the potential expansion of the Section 10(b) private right of action. Because the policy concerns implicated by private suits do not apply to SEC enforcement actions under section 17(a), these courts find it inappropriate to extend *Janus* to Section 17(a) actions pursued by the SEC. *See, e.g.,* SEC v. Stoker, 865 F.Supp.2d 457, 466 (S.D.N.Y. 2012) (*Janus* is inapplicable to Section 17(a) claims because the wording of Rule 10b–5 and Section 17(a) are different, and the policy concerns applicable in *Janus* do not apply to Section 17(a) claims); SEC v. Sentinel Mgmt. Grp., Inc., No. 07 C 4684, 2012 WL 1079961, at *15 (N.D. Ill. Mar. 30, 2012)

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Even under the strictest interpretation of *Janus*, the Harvard SRP appears to be the maker of the statement at issue. Although the Harvard Proposal is formally submitted by one of the SRP's clients, and it is the client who is the shareholder for purposes of Rule 14a-8, the client authorizes the Harvard SRP "to act on behalf of" the client "in relation to the Proposal, including, without limitation, forwarding the Proposal to the company, corresponding with the Company and the Securities and Exchange Commission with respect to the Proposal, engaging with the Company to reach a negotiated outcome, withdrawing the Proposal, presenting the Proposal, or arranging for its presentation by a designee of the SRP, at the Annual Meeting."[293] The SRP's client thus effectively cedes all authority over the "content of the statement and whether and how to communicate it"[294] to the Harvard SRP. The client thereby delegates to the SRP "ultimate authority" and casts the SRP as the statement's maker.[295]

D. Is Harvard, as a University, Responsible for the Actions of the Shareholder Rights Program?

The doctrine of *respondeat superior* applies under the federal securities laws, so that employers are held responsible for violations committed by their employees in the course of employment.[296]

(same). Others simply conclude that the language of section 17(a) and rule 10b-5 differ, and because a statement is not literally required to be "made" for section 17(a) liability, *Janus* does not apply. *See* SEC v. Mercury Interactive, LLC, No. 5:07–cv–02822, 2011 WL 5871020, at *3 (N.D. Cal. Nov. 22, 2011) ("*Janus* may not be extended to statutes lacking the very language that *Janus* construed"); SEC v. Daifotis, No. C 11–00137 WHA, 2011 WL 3295139, at *5 (N.D.Cal. Aug. 1, 2011) (declining to apply *Janus* to Section 17(a) claims because the word "make" does not appear in the language of Section 17(a)); SEC v. Geswein, No. 10–cv–1235, 2011 WL 4565861, at *2 (N.D. Ohio Sept. 29, 2011) (same).

[293] Netflix Letter, *supra* note 112, at 1 (authorizing "the SRP to act on behalf of Florida SBA in relation to the proposal, including, without limitation … engaging with the Company to reach a negotiated outcome, withdrawing the Proposal, presenting the Proposal, or arranging for its presentation by a designee of the SRP at the Annual Meeting.").

[294] *Janus,* 131 S. Ct. at 2303.

[295] The supporting statement submitted in conjunction with the precatory declassification proposal at Netflix explains "[t]his resolution was submitted by the Florida State Board of Administration. The Shareholder Rights Project served as the proponent's representative and advisor in connection with this resolution." Netflix, Inc., Proxy Statement at Proposal 5 p.16 (Form 14A) (Apr. 28. 2014). The accuracy of this description is subject to challenge because the Florida State Board of Administration has ceded all control over the wording and negotiation of the Proposal to the SRP. The SRP is thus much more than a simple representative and advisor: it becomes the *de facto* decision maker as it assumes all the authority that could otherwise be exercised by the shareholder. If the proxy statement's mischaracterization of the relationship between the Florida State Board of Administration and the Harvard SRP is deemed material, then that misstatement constitutes an independent basis upon which to challenge the Harvard Proposal.

[296] *See, e.g.,* 4 HAZEN, *supra* note 68, at § 12.24[5]; In re Atl. Fin. Mgmt., Inc. Sec. Litig., 784 F.2d 29, 35 (1st Cir. 1986); Marbury Mgmt., 629 F.2d at 716; Paul F. Newton & Co. v. Tex. Commerce Bank, 630 F.2d 1111, 1118 (5th Cir. 1980); Holloway v. Howerdd, 536 F.2d 690, 694-95 (6th Cir. 1976); Henricksen, 640 F.2d at 887; Commerford v. Olson, 794 F.2d 1319, 1323 (8th Cir. 1986) (*en banc*); Hollinger, 914 F.2d 1564, 1676-77 (*en banc*); Kerbs v. Fall River Indus., Inc., 502 F.2d 731, 741 (10th Cir. 1974); Atl. Fin. Mgmt., Inc., 784 F.2d at 30-31 (citing *Kerbs* in

[Footnote continued on next page]

> A corporation is liable, therefore, whenever a tortious act is committed by an agent within the scope of the agent's authority and in the course of the agent's employment. A corporation cannot defend against a tort claim on the ground that its agent or employee was not expressly authorized to commit the wrongful act, nor on the ground that such an act was contrary to or in violation of the instructions or orders given by it to the offending agent or employee, nor on the ground that the injury resulted from willful or wanton wrongdoing on the part of its employees in the course of their employment. [297]

Respondeat superior imputes liability to the principal "not because it committed some wrongdoing outside the purview of the statute which assisted the wrongdoing prohibited by the statute, but because its *status* merits responsibility for the tortious actions of its agent."[298] *Respondeat superior* also does not require that the principal have actual knowledge or that it act with recklessness.[299] "*Respondeat superior* imposes liability for public policy reasons upon masters through they are not at fault in any way."[300] Liability arises when an employment

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support of vicarious liability); Seolas v. Bilzerian, 951 F. Supp. 978, 983 (D. Utah 1997) (*respondeat superior* is viable theory of liability under § 10(b)); Castleglen, Inc. v. Commonwealth Sav. Ass'n, 689 F.Supp. 1069, 1071-72 (D. Utah 1988) (noting differing interpretations of *Kerbs* and holding securities laws do not preempt common law remedies), *aff'd sub nom.* Castleglen, Inc. v. Resolution Trust Corp., 984 F.2d 1571 (10th Cir. 1993).

The argument has been raised that Central Bank, 511 U.S. 164 (1994), which rejected aiding and abetting liability under Section 10(b), challenges the validity of *respondeat superior* claims under federal securities law. Lower courts have largely rejected those arguments. *See, e.g.,* Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 101 (2d Cir. 2001) (holding that *Central Bank* did not shield business entities from being held liable for misstatements of their agents); AT&T Co. Winback & Conserve Program, Inc. 42 F.3d 1421, 1430-31 (3d Cir. 1994) (concluding, based on detailed comparison of aiding and abetting liability and agency liability, that *Central Bank* did not preclude the latter); Elbit Sys., Ltd. 917 F. Supp. 2d at 227 (holding *respondeat superior* survived *Central Bank* as a theory of liability); In re Lernout & Hauspie Sec. Litig., 230 F. Supp. 2d 152, 172 (D. Mass. 2002) ("[A]gent liability remains a viable theory of liability after *Central Bank*…."); Gabriel Capital, L.P. v. NatWest Fin., Inc., 122 F. Supp 2d 407, 430-31 (S.D.N.Y. 2000) (concluding that agency liability survived *Central Bank*, but holding that "a principal can be liable under §10(b) for the misrepresentations of its agent only if the person to whom the misrepresentations were made knows that the agent is acting under the actual or apparent authority of the principal"), *abrogated on other grounds by* In re Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281 (S.D.N.Y. 2003); *cf.* Southland Sec. Corp. v. INSpire Ins. Solutions Inc., 365 F.3d 353 (5th Cir. 2004) (sustaining a *respondeat superior* liability claim without referring to *Central Bank*). For examples of courts holding that *respondeat superior* liability under the securities law does not survive *Central Bank*. *See, e.g.*, In re Fidelity/Micron Sec. Litig., 964 F. Supp. 539, 543-44 (D. Mass. 1997); Converse Inc. v. Norwood Venture Corp., 1997 U.S. Dist. LEXIS 19106, at *7-11 (S.D.N.Y. Nov. 26, 1997); ESI Montgomery Cnty., Inc. v. Montenay Int'l Corp., 1996 U.S. Dist. LEXIS 592, at *7-8 (S.D.N.Y. 1996).

[297] 10 Fletcher Cyc. Corp. § 4877.

[298] *In re* Parmalat Sec. Litig., 474 F.Supp.2d 547, 551 (SDNY 2007).

[299] *In re* Network Equip. Techs., Inc., Litig., 762 F. Supp. 1359, 1365 (N.D. Cal. 1991).

[300] Dodds v. Richardson, 614 F.2d 1185, 1195 (10th Cir. 2010) (emphasis in original).

relationship exists and the employee is acting in furtherance of the employer's business.[301] Indeed, " 'the servant need not be acting for the 'exclusive benefit' of the principal, it is enough that the agent intended his acts to produce some benefit to himself and to the principal second,' "[302] and if the employee acts with intent to benefit the employer, then actual benefit is largely irrelevant.[303]

In the context of the relationship between the Harvard SRP and Harvard University, the public record seems to establish that an employment relationship links the SRP and its Harvard employees to the University, and that the SRP is acting in furtherance of the University's business. The Harvard SRP describes itself as "a clinical program operating at Harvard Law School and directed by" a tenured member of the Harvard University faculty.[304] The program is listed on the Harvard Law School website under "Courses and Academic Programs."[305] The Shareholder Rights Clinic is also listed in the Harvard Law School online course catalog,[306]and students who participate in the clinic receive two clinical credits toward their Harvard Law School requirements.[307] Student participants are also automatically enrolled in the Shareholder Rights Clinical Seminar, a companion course at Harvard Law School.[308] The course meets on the Harvard Law School campus,[309] is open only to Harvard Law School 2L, 3L, and LLM students,[310] and its website is hosted by Harvard University.[311] The program is run by a Clinical

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301 Clickner v. City of Lowell, 422 Mass. 539, 542 (1996); Dias v. Brigham Medkal Associates, 438 Mass. 317, 322 (2002).

302 Adams v. Hyannis Harborview, Inc., 838 F. Supp. 676, 691 (D. Mass. 1993) (quoting Fed. Sav. & Loan Ins. Corp. v. Shearson–American Express, 658 F.Supp. 1331, 1338 (D. Puerto Rico 1987)).

303 *Fed. Sav. & Loan*, 658 F. Supp. at 1338.

304 *About,* SHAREHOLDER RIGHTS PROJECT, http://SRP.law.harvard.edu/ (last viewed Dec. 8, 2014).

305 *Courses and Academic Programs,* HARVARD LAW SCHOOL, http://www.law.harvard.edu/academics/clinical/clinics/SRP (last viewed Apr. 3, 2014).

306 *Course Catalog,* HARVARD LAW SCHOOL, http://hls.harvard.edu/academics/curriculum/catalog/index.html?type=Clinic&type=Course&type=Reading+Group&type=Seminar&keywords=shareholder+rights&rows=10&year=2013-2014 (last viewed Dec. 7, 2014).

307 *Id.*

308 *Id.*

309 Harvard Law School, *Clinical Skills Matrix* at 2, *available at* http://www.law.harvard.edu/academics/clinical/documents/skills-matrix.pdf (last viewed Dec. 8, 2014).

310 *Course Catalog,* HARVARD LAW SCHOOL, http://hls.harvard.edu/academics/curriculum/catalog/index.html?type=Clinic&type=Course&type=Reading+Group&type=Seminar&keywords=shareholder+rights&rows=10&year=2013-2014 (last viewed Dec. 7, 2014).

311 *About,* SHAREHOLDER RIGHTS PROJECT, http://SRP.law.harvard.edu/ (last viewed Dec. 8, 2014).

Director who is a tenured member of Harvard's faculty and who holds an endowed chair;[312] an Associate Director who is a lecturer at law listed in the Harvard Law School faculty directory;[313] a counsel who is a Fellow at Harvard Law School;[314] and an administrative director who is a Harvard Law School employee.[315] Under these circumstances, both the Law School and the University would seem responsible for any violation of the federal security law committed by the Harvard SRP.

The Harvard SRP seeks to distance itself and its views from Harvard Law School and from Harvard University by stating that "[a]ny views expressed and positions taken by the SRP and its representatives should be attributed solely to the SRP and not to Harvard Law School or Harvard University."[316] This statement is insufficient to absolve Harvard, as a university, or the Law School, for the actions of the Harvard SRP, because the test for *respondeat superior* liability is not whether the employee publicly proclaims or denies that he is acting within the scope of employment or for the employer's benefit, but whether he is in fact so acting. Consistent with the observation, it is well established in other contexts that employees cannot disclaim their employee status in an effort to absolve their employer of responsibility for the employees' actions.[317]

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[312] *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014); *Faculty, Lucian Ayre Bebchuk,* HARVARD LAW SCHOOL, http://hls.harvard.edu/faculty/directory/10058/Bebchuk (last viewed Dec. 5, 2014).

[313] *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014); *Faculty, Scott Hirst*, HARVARD LAW SCHOOL, http://hls.harvard.edu/faculty/directory/11134/Hirst (last viewed Dec. 5, 2014) (lecturer of law and Associate Director of the SRP).

[314] *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014); June Rhee, LINKEDIN, http://www.linkedin.com/pub/June-Rhee/12/322/780 (last viewed April 3, 2014) (identifying Ms. Rhee as a "Fellow at Harvard Law School").

[315] *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014); Emily Lewis, LINKEDIN, https://www.linkedin.com/profile/view?id=24635519 (last viewed Dec. 8, 2014) (identifying Ms. Lewis as the Program Manager/Administrative Director at Harvard Law School).

[316] *About*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/index.shtml (last viewed July 25, 2014).

[317] An employee is not permitted to waive employee status. *See, e.g.,* Donovan v. American Airlines, Inc. 686 F.2d 267, 269 n.3 (5th Cir. 1982); *see also* First Liberty Inv. Group v. Nicholsberg, 145 F.3d 647, 652 (3d Cir. 1998) (finding employment agreement's use of the term "independent contractor" and its disclaimer of an "agent" relationship was not dispositive); N.L.R.B. v. Amber Delivery Service, Inc., 651 F.2d 57, 63 n.7 (1st Cir. 1981) ("That each driver expressly disclaimed the status of employee in his contract with Amber although relevant as evidence of "an assumption of control by the one and submission to control by the other," Restatement (Second) of Agency's 220, comment m, at 492 (1957) is by no means dispositive."); *Usery v. Pilgrim Equipment Co., Inc.*, 527 F.2d 1308, 1315 (5th Cir. 1976) ("We reject both the declaration in the lease agreement that the operators are 'independent contractors' and the uncontradicted testimony that the operators believed they were, in fact, in business for themselves as controlling FLSA employee status. Neither contractual recitations not subjective intent can mandate the outcome in these cases. Broader economic realities are determinative."). *Accord*, Painter, *supra* note 117, ("The fact that Harvard Law School expressly disclaims endorsement of SRP's viewpoint does little to mitigate the problem when SRP uses Harvard's name, buildings, students and faculty as well as money raised by Harvard, to endorse a particular viewpoint and there is no other affiliate of Harvard endorsing the opposing viewpoint."); Lebron

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Thus, having established a basis to support the conclusion that the omission of the conflicting literature is material, that the omission was negligent, that the Harvard SRP is the "maker" of the misleading statement, and that Harvard, as a university, is liable for the actions of the Harvard SRP, it follows that the Commission would have a basis upon which to seek injunctive relief as against Harvard University.

E. Causation

Considerations of causation are irrelevant in requests for no-action relief, in motions for declaratory judgment, and in Commission injunctive proceedings. In contrast, private party plaintiffs must establish causation to prevail in actions alleging a Rule 14a-9 violation.[318]

The law of causation in private actions under the proxy rules is complex, and has been described as an "elusive concept."[319] The application of causation analysis in the context of Rule

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v. Nat'l R.R. Passenger Corp., 513 U.S. 374, 392 (1995) (ruling that, despite a statutory disclaimer of agency status, the National Railroad Passenger Corp. ("Amtrak") was nonetheless a government entity; "it is not for Congress to make the final determination of Amtrak's status as a government entity for purposes of determining the constitutional rights of citizens affected by its actions."); Beverly Enter.-Massachusetts, Inc. v. NLRB, 165 F.3d 960, 962-63 (D.C. Cir. 1999) (rejecting the notion that mere job titles or management's desires could be determinative of an employee's supervisory status, and requiring in the absence of the exercise of supervisory authority that there be tangible examples demonstrating the existence of such authority); Chevron, U.S.A., Inc., 309 NLRB 59, 69, 1992 WL 280497 (1992) (no weight given "job descriptions that attribute supervisory authority where there is no independent evidence of its possession or exercise"; Advanced Mining Grp., 260 NLRB 486, 1982 WL 24261 (1982) ("What is relevant is the authority possessed and not the conclusory assertions of a company's officials.").

[318] Schellenbach v. S.E.C., 989 F.2d 907, 913 (7th Cir. 1993) ("An action brought by the Commission, however, unlike a private damage suit, need not include proof of harm."); S.E.C. v. Blavin, 760 F.2d 706, 711 (6th Cir.1985) ("Unlike private litigants seeking damages, the Commission is not required to prove that any investor actually relied on the misrepresentations or that the misrepresentations caused any investor to lose money"); S.E.C. v. Lowery, 633 F.Supp.2d 466, 491 n.8 (W.D. Mich. 2008) ("[U]nlike a private litigant seeking damages, when the SEC brings an action under anti-fraud provisions of the federal securities laws, it need not prove that any investor actually relied on such misrepresentations or omissions. [Citations]. Nor does the SEC need to prove that the misrepresentations or omissions caused any investor to lose money. . .").

[319] 3 HAZEN, *supra* note 68, at §10.5 (2014), *available at* WESTLAW, 3 Law Sec. Reg. § 10.5[1]; *see also* United Paperworkers Int'l Union v. Int'l Paper Co., 801 F. Supp. 1134, 1144 (S.D.N.Y. 1992) (same); *Lane v. Page,* 727 F.Supp.2d 1214 , 1240-41 (D.N.M. 2010) (noting the confusion surrounding loss causation and transaction causation in Section 14(a) actions); Thomas M. Madden, J.D., *Causation in Private Civil Actions by Minority Shareholders Under Proxy Provisions of § 14(a) of the Securities Exchange Act of 1934 (15 U.S.C.A. § 78n(a)) and Securities Exchange Act (SEC) Rules Thereunder—Post* Virginia Bankshares, 137 A.L.R. FED. 293 (1997) (collecting and analyzing cases decided subsequent to Virginia Bankshares v Sandberg, 501 US 1083 (1991), that consider whether loss or transaction causation exists to warrant a private civil action by minority shareholders based upon false or misleading proxy solicitations under § 14(a) of the Securities Exchange Act of 1934). For examples of situations in which courts conclude that plaintiffs have failed to satisfy the Rule 14a-9 causation requirement, see, e.g., Gen. Elec. Co. v. Cathcart, 980 F.2d 927, 933 (3d Cir. 1992) (causal connection between misleading proxy statements soliciting directors' reelection and directors' subsequent misconduct was too attenuated to state claim for damages); *In re* Diamond Foods, Inc. Derivative Litig., No. C 11–05692 WHA, 2012 WL 1945814, *4, *7 (N.D. Cal. May 29, 2012) (concluding that "Section 14(a) claim fails as to the 2010 proxy because plaintiffs' allegations are insufficient to meet the 'essential link' requirement of Section 14(a)" and noting that "[a] 'claim that the reelection of the directors was an essential link to loss-generating corporate action because of the directors' subsequent

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14a-8 proposals that violate Rule 14a-9 is particularly thorny because Rule 14a-8 proposals are generally precatory and therefore cannot, in and of themselves, cause anything to happen or not to happen. Instead, the board must decide to act or not to act, arguably because of the vote, or threatened vote, in response to the nonbinding proposal – an intervening cause. Therefore, at one level, because Rule 14a-8 proposals do not formally force anything to happen, the strictest possible interpretation of a causation requirement suggests that a false and misleading 14a-8 proposal can never create liability in a private action.

The precedent that most clearly addresses this challenge, and that rejects the conclusion that false Rule 14a-8 proposals are immune to private enforcement under Rule 14a-9, is United Paperworkers International Union v. International Paper Company, 801 F. Supp. 1134 (S.D.N.Y. 1992). There, the court confronted an allegation that management had made materially false and misleading statements in response to a precatory Rule 14a-8 proposal. The Court observed that, because the proposal is precatory,

> the shareholder plaintiff never will be able to demonstrate that the proxy solicitation itself was an 'essential link' in the accomplishment or prevention of any 'transaction'; that is, the nexus between the proxy solicitation process and an independent requirement found in state law or corporate charter or by-law, that the underlying 'transaction' be approved by a certain percentage of the shares eligible to vote, will always be lacking.[320]

The result of this logic would be "the effective denial of a federal statutory remedy to a shareholder plaintiff"[321] and a license to management to make false and misleading statements in response to shareholder proposals all without fear of private actions seeking to enforce federal securities fraud liability. Because this outcome "would undermine the purposes of both the statute and the shareholder proposal rule,"[322] the court held that a plaintiff challenging the accuracy of management's response to a shareholder proposal "need only establish that the board knowingly made misleading statements or omissions [that] … had a 'significant propensity to affect the voting process.'"[323] The court found that the misstatement at issue did have a significant propensity to affect the voting process, and voided the shareholder proposal. It

mismanagement, cannot form the basis of liability under Section 14(a)"); Britton v. Parker, Civ. Action Nos. 06–cv–01797–MSK–KLM, 06–cv–1922–MSK–KLM, 06–cv–02017–MSK–KLM, 2009 WL 3158133, at *11 (D. Colo. Sept. 23, 2009) (concluding that "the Plaintiff's § 14(a) claim fails to adequately allege an essential link between the transactions contemplated and the injuries sustained by Delta stockholders").

[320] *United Paperworkers*, 801 F.Supp. at 1145 (emphasis in original); *see also* Trans World Corp. v. Odyssey Partners, 561 F.Supp. 1315, 1322 (S.D.N.Y. 1983) (alleged violations of section 14(a) relating to precatory shareholder proposal can provide basis for injunctive relief).

[321] *Id.*

[322] *Id.*

[323] *Id.* at 1146 (quoting *Mills*, 396 U.S. at 384).

ordered the corporation's board to "resubmit the proposal to a vote of the shareholders at the company's next Annual Meeting."[324]

In reaching this conclusion, the court also observed that "it would be strange indeed if the proponent of a shareholder proposal could sue under Rule 14a-8 to compel the Company to place its proposal on the ballot, but then could not challenge under Rule 14a-9 material misstatements or omissions in the Company's response to its proposal, simply because as worded, it means nothing in terms of the governance of the corporation whether it passes or is defeated."[325]

Technically, United Paperworkers addresses fraud by a management in its response to a Rule 14a-8 proposal, whereas the Harvard Proposal involves a potential violation of Rule 14a-9 by the proponent. This is a distinction without a difference because, given United Paperworkers' logic a management that can demonstrate that a shareholder proposal violates Rule 14a-9 would also be able to establish the requisite causation if the misstatement had a "significant propensity to affect the voting process." There is also no support for the proposition that management must, as a practical matter, resort to the no-action or declaratory relief process as the exclusive remedies for false and misleading shareholder proposals, because that would be the practical consequence of any rule treating management differently from shareholders in the treatment of causation analysis in the context Rule 14a-8 proceedings.

On the facts of the Harvard Proposal, a private party challenger should be able to establish that the omission had a significant propensity to affect the voting process, particularly given the materiality of the omissions at issue and the SRP's own statements linking its activities to the widespread destaggering of corporate boards. The Harvard SRP describes itself as having participated in "about 121 successful engagements *resulting* in companies agreeing to move

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[324] *Id.* at 1147. As least one court has adopted a different view of transaction causation in the context of a precatory shareholder proposal. In *Sisters of the Precious Blood, Inc. v. Bristol-Myers Co.,* 431 F.Supp. 385, 386 (S.D.N.Y.1977), Bristol-Myers included the plaintiff's precatory shareholder proposal in its proxy solicitation material, along with a management statement opposing the proposal. *Id.* at 386. After the proposal failed to gain a majority, plaintiff filed suit alleging that Bristol-Myers' proxy statement violated Rule 14a-9 and sought injunctive relief requiring the issuer to resubmit the proposal at a special meeting of stockholders. *Id.* The court granted summary judgment in favor of the defendant, finding that Bristol-Myers' proxy solicitation did not cause plaintiff irreparable harm sufficient to warrant injunctive relief. *Id.* Specifically, the court found that "[p]laintiff's proposal was precatory only" and that "[r]egardless of the outcome of the shareholder vote, management was entirely privileged to ignore the request and retained complete discretion not to" take the requested corporate action. *Id.* Plaintiff could therefore "point to no corporate action or transaction to which the challenged proxy solicitation or resulting vote was an essential link." *Id.* at 386-87. The *United Paperworkers* court expressly rejected this approach, finding that "the strict rule of causation" advocated by *Sisters of the Precious Blood* "effectively would deny a shareholder plaintiff *any* remedy under Rule 14a–9 for misleading statements or omissions made by a Board in response to a shareholder proposal which has no direct economic effect." *United Paperworkers,* 801 F.Supp. at 1145.

[325] *Id.* at 1146. The court also rejected the argument that the availability of staff no-action review would argue against a finding causation because the review is entirely discretionary and the SEC's opinion as to the accuracy of the challenged proxy materials is neither binding nor entitled to any deference under *Chevron USA Inc. v. NRDC, Inc*., 467 U.S. 837 (1984). *Id.* Thus, plaintiffs are free to sue and to demonstrate causation even if there is no voluntary request for staff review.

toward annual elections following the submission of board declassification proposals for 2012, 2013 and 2014 meetings."[326] The Harvard SRP also explains that "the work of the SRP and SRP-represented investors *produced* 50 S&P 500 companies agreeing to move toward annual elections. . .following the submission of proposals for 2012 annual meetings and for the passage of 2012 declassification proposals by SRP-represented investors"[327] with an additional 52 such companies in 2013, and 24 in 2014. The Harvard SRP thus itself claims that its actions resulted in or produced destaggering at about 121 companies. Where activities result in or produce consequences, they cause those consequences.[328]

Policies implemented by proxy advisory firms further reinforce the existence of a relationship between the Harvard Proposal and the ultimate decision to declassify a board. ISS is the largest proxy advisor.[329] Historically, ISS's position was that if a precatory destaggering proposal gained a majority of the votes cast, and if the board did not, at its next annual shareholder meeting, present a binding proposal to de-stagger, then ISS would recommend that shareholders withhold their votes for the election of all incumbent directors.[330] ISS recently amended this position to suggest that it would make recommendations on a case-by-case basis in these situations.[331] Nonetheless, "the prevailing view is that ISS will generally continue to recommend against incumbent directors who do not act to eliminate a classified board structure in response to a precatory proposal that attracts a majority of the votes cast."[332] A failure to take action in response to the precatory declassification proposal thus has the potential consequences

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[326] *121 Companies Agree to Move Toward Annual Elections*, SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/companies-entering-into-agreements.shtml (last viewed Dec. 12, 2014) (emphasis supplied).

[327] *Id.* (emphasis supplied).

[328] *See also Negotiated Agreements*, HARVARD SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/companies-entering-into-agreements.shtml (last visited Nov. 25, 2014) ("This page provides information about 121 successful engagements resulting in companies agreeing to move toward annual elections following the submission of board declassification proposals for 2012, 2013 and 2014 meetings."); *Successful Proposals,* HARVARD SHAREHOLDER RIGHTS PROJECT, http://srp.law.harvard.edu/2014-declassification-proposals.shtml (last visited Nov. 25, 2014) (noting that "the boards of eight companies where proposals passed [] have already announced moves in the direction recommended by the shareholders. . .It is expected that a significant number of additional companies will also move towards annual elections during the course of 2013."). Third parties confirm the existence of a causal link between the Harvard Proposal and the decision to de-stagger. *See, e.g.,* The Conference Board, *Proxy Voting Analytics (2010-2014)*, *supra* note 4, at 12 ("In 2014, the board [of QEP Resources] had no choice but to back yet another proposal formulated by the Harvard Clinic.").

[329] Andrew Ackerman, Joann S. Lublin and Theo Francis, *ISS, Other Proxy Advisers Pressed to Disclose Conflicts*, WALL ST. J., June 3, 2014, http://online.wsj.com/articles/sec-to-pressure-proxy-advisers-on-disclosures-1401798780 (characterizing ISS as "the biggest U.S. proxy adviser in a small field").

[330] Institutional Shareholder Services Inc., *U.S. Corporate Governance Policy 2014 Updates*, at 4 (Nov. 21, 2013), http://www.issgovernance.com/file/2014_Policies/2014USPolicyUpdates.pdf .

[331] *Id.* at 5.

[332] Fried Frank Client Memo, *supra* note 62.

of stimulating a shareholder campaign against the re-election of directors who refuse to comply with the Harvard Proposal, if it is supported by a majority of the votes cast. The influence of a recommendation to withhold votes for the re-election of directors is further compounded by the growing prevalence of majority vote re-election provisions,[333] and by the concomitant recognition that a failure to support a destaggering proposal will increase the probability that a director fails to gain a majority of the votes cast for re-election. This linkage between the Harvard Proposal and campaigns to withhold votes for the re-election of directors who fail promptly to recommend board declassification reinforces the influence of the precatory Harvard Proposal, and strengthens the argument for the existence of a causal link between the proposal and the actual declassification of the board.

F. Remedies

In a successful SEC enforcement action, the traditional remedy is a district order enjoining future violations or an administrative cease and desist order.[334] Here, a successful SEC enforcement proceeding would likely result in an order enjoining Harvard and the Harvard SRP from future violations of Rule 14a-9.

The courts have a broad range of discretion in fashioning remedies in private actions that establish a violation of Rule 14a-9.[335] The most intriguing question is whether a company that

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[333] In a "majority vote" election, directors are elected only if they receive a majority of the shares voting or present at the meeting. *See Spotlight on Proxy Matters – The Mechanics of Voting*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/spotlight/proxymatters/voting_mechanics.shtml (last visited Nov. 25, 2014). Eighty-six percent of S&P 500 companies have majority voting in director elections. *See* Sullivan & Cromwell LLP, *2014 Proxy Season Review*, at 2 n.5 (June 25, 2014), *available at* http://www.sullcrom.com/siteFiles/Publications/SC_Publication_2014_Proxy_Season_Review.pdf.

[334] Daniel J. Morrissey, *SEC Injunctions,* 68 TENN. L. REV. 427, 430 (2001) ("Since the Commission's creation, the injunction has been its principal enforcement tool."); Exchange Act § 21(d) (codified at 15 U.S.C. § 78u(d)(1) (1999)) ("Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter ... it may in its discretion bring an action in the proper district court of the United States ... to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond."); Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, §§102, 203-04, 104 Stat. 931 (codified at scattered sections of 15 U.S.C.) (granting to the SEC the authority to issue cease and desist orders); James T. Parkinson, *The National Association of Securities Dealers Should Possess Authority to Issue Temporary- Cease-and-Desist Orders,* 51 ADMIN. L. REV. 301, 312 (1999) (noting that "[s]ince 1990, the SEC has frequently exercised its cease-and-desist authority.").

[335] Mills v. Electric Auto-Lite Co., 396 U.S. 375, 436 (1970) ("Possible forms of relief [for violation of the proxy rules] will include setting aside the merger or granting other equitable relief. . .In selecting a remedy the lower courts should exercise 'the sound discretion which guides the determinations of courts of equity,' keeping in mind the role of equity as 'the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims.' (citing Hecht Co. v. Bowles, 321 U.S. 321, 329-330 (1944))); Reschini v. First Fed. Sav. and Loan Ass'n of Indiana, 46 F.3d 246, 249 (3d Cir. 1995) (noting that if the defendant was found to have circulated misleading proxy materials in violation of regulations adopted by the federal Office of Thrift Supervision, the court "would have the authority to deploy a full range of equitable remedies including—if deemed feasible and appropriate—a requirement that the [defendant] take steps to reverse" the corporate action implemented as a result of the proxy solicitation); Dillon v. Berg, 326 F.Supp. 1214, 1235 (D. Del. 1971), *aff'd* 453

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successfully demonstrates that the Harvard Proposal was materially misleading, and that the proposal caused the board to destagger, could then persuade a court to enter an order invalidating the decision to destagger and ordering that a staggered board be reinstituted. Precedent supports a court's authority to enter such a judgment, but the imposition of remedies of this sort relies substantially on the exercise of judicial discretion. There is no basis upon which to predict how a federal judge might respond to the facts presented in the wake of the Harvard Proposal.

For example, in *Edelman v. Salomon*,[336] management falsely understated the number of shares it controlled in a proxy vote seeking to amend the corporate charter to eliminate cumulative voting and to institute a classified board. To remedy the fraud, the court entered a decree invalidating the charter amendment that eliminated cumulative voting. It ordered that cumulative voting not be used in future elections unless and until shareholders adopted cumulative voting pursuant to a fully accurate proxy statement.[337] The court explained that the "decree nullifying the corporate action taken on the basis of management proxies" is the form of relief that "the Delaware courts have traditionally given in situations of this kind."[338] The grant of such relief is the "general rule" in response to misrepresentations in proxies.[339] Although the false proxy statement also amended the corporate charter to institute a classified board, the directors subsequently proposed an amendment eliminating the newly staggered board, and shareholders approved that amendment. Because the corporation had already de-staggered on its own initiative, there was no need for the court to address the potentially improper board classification in its remedy.

In *Reschini v. First Federal Savings & Loan Association of Indiana*,[340] plaintiffs alleged that a false proxy statement caused an institution to convert from a federally-chartered mutual

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F.2d 876 (3d Cir. 1971) ("No question exists that this Court has the power to grant any and all relief necessary and appropriate to redress violations of Section 14(a) of the Act.")

[336] 559 F.Supp. 1178 (D. Del. 1983).

[337] *Id.* at 1189.

[338] *Id.* at 1184 (citing *Berg*, 326 F.Supp. at 1235 (holding that proxy solicitation contained material misrepresentations which required setting aside annual meeting and convening of new meeting); Bertoglio v. Texas Int'l Co., 488 F.Supp 630, 663 (D. Del. 1980) (where proxy materials violated Section 14(a) of the Securities and Exchange Act of 1934, the court set aside the election of directors and required resolicitation of proxies to fill those seats); Dillon v. Scotten, Dillon, Co., 335 F.Supp. 556, 572 (D. Del. 1971), aff'd 453 F.2d 876 (3d Cir. 1971) ("In view of the violations of Section 14(a) referred to above, the proxies used at the March 31, 1971 Annual Shareholders Meeting of Scotten, Dillon must be declared void and the election of Prifti and Bean as directors declared null and void."); Schnell v. Chris-Craft Industries, Inc. 285 A.2d 437, 439-40 (Del. 1971) (after finding that the directors' advancement of the date of the stockholders' meeting was for "the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management," the court nullified the advanced date and reinstated the original date for the annual shareholders' meeting).

[339] *Id.* at 1185.

[340] 46 F.3d 246 (3d Cir. 1995).

savings and loan association to a Pennsylvania-chartered mutual savings bank. Management contended that an appeal of the dismissal of the complaint to the Third Circuit was moot because the conversion had already occurred. The Third Circuit disagreed because "setting aside the conversion remains a possible remedy should Reschini prevail on his claim."[341] The Third Circuit emphasized that "the district court would have the authority to deploy a full range of equitable remedies – if deemed feasible and appropriate [including] a requirement that the Association … take steps to reverse the conversion."[342] In *Parsons v. Jefferson-Pilot Corporation*,[343] the court found that a proxy statement was materially false in describing certain stock grants. As a remedy, the court ordered that the grants be rescinded, and nullified all votes cast in favor of the charter amendment that allowed the grant.[344] And, in *Morris v. Bush*,[345] plaintiff demonstrated a substantial likelihood of success in showing that a notice of a special meeting intended to remove and replace certain corporate directors violated Rule 14a-9. The court voided the results of the election and re-installed the directors ousted as a consequence of the defective proxy statement.[346]

Because the corporation bears no responsibility for the content of a Rule 14a-8 shareholder proposal, and because the proponent is responsible for the proposal's substance,[347] the same logic that supports the voiding of corporate action when management makes a misrepresentation in a proxy should apply with equal force when shareholder-proponents engage in a misrepresentation. In both instances, voiding the corporate action is arguably necessary in order to assure that the action was adopted by a fully and adequately informed shareholder electorate. Further, because the Harvard Proposal could also influence the directors' own conceptualization of the evidence regarding the financial consequences of a classified board, voiding the board resolution that proposed the declassification could also be described as a measure necessary to assure that the board's action was fully and adequately informed.

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341 *Id.* at 250.

342 *Id.* at 249 (citing Mills v. Electric Auto-Life Co., 396 U.S. 375, 386 (1970) (where a merger is obtained through fraudulent proxy statements "[p]ossible forms of relief will include setting aside the merger or granting other equitable relief"); Edelman v. Salomon, 559 F.Supp. 1178, 1184 (D. Del. 1983) (stating that "a decree nullifying the corporate action taken on the basis of management's proxies" is a traditional form of relief in suits alleging fraudulent proxy materials")).

343 789 F.Supp. 697 (M.D.N.C. 1992).

344 *Id.* at 704.

345 No. A.3:98–CV–2452–G, 1999 WL 58857 (N.D. Tex. Jan. 28, 1999).

346 *Id.* at *4. *See also* Plant Indus. v. Bregman, 490 F.Supp. 265, 271 (S.D.N.Y. 1980) ("To allow an election to proceed in the face of allegations of improper solicitations and misleading proxy materials does not in and of itself work an irreparable injury on the party challenging the materials. The Court possesses the power, if necessary, to void the election, order resolicitation and otherwise 'unscramble' this kind of transaction.").

347 17 C.F.R. § 240.14a-8(l)(2) ("The company is not responsible for the contents of your proposal or supporting statement.").

The precise wording of any order voiding a binding vote to declassify would also be very significant as a practical matter. If an order voids the binding shareholder vote declassifying the board, but does not mandate that the board put the question to a new binding shareholder vote, then the newly re-staggered board could exercise its discretion to decide not to propose that the board be re-staggered. Shareholders could surely object to this outcome but, absent a proxy contest to elect new directors who favor de-staggering, shareholders would have no mechanism to force the vote. On the other hand, if the order voiding the declassification vote also calls for a new shareholder vote on a binding declassification proposal – and eliminates the board's discretion to determine whether such a proposal should be put to the shareholders – then management's victory could be entirely Pyrrhic, as the shareholders could then proceed to approve a binding de-staggering proposal. An order voiding a declassification vote because of material omissions in the Harvard Proposal is therefore most likely to have a lasting real-world effect only if it allows the board to exercise its discretion as to whether to offer a binding declassification proposal and if the board is willing to resist shareholder pressure by not proposing such a charter amendment.[348]

The decision as to whether to void board declassification is, however, left to the discretion of the court, and there are many instances in which courts have refused to invalidate corporate action induced by a false statement in a proxy.[349] A common reason for such refusal is that following the vote the corporation engaged in certain transactions and it is now impossible to "unscramble the eggs."[350] Unscrambling the eggs should not, however, be a challenge in the context of an order voiding declassification because re-staggering does not implicate any

[348] This is a temporary remedy, while the effect of the misleading information in the Harvard Proposal persists in the public. After the dissemination of full and accurate information, followed by an opportunity for shareholders to consider whether such information causes them to reevaluate their previously-expressed position, a board may eventually be able to put the matter to a fair vote.

[349] Calamore v. Juniper Networks Inc., 364 Fed. Appx. 370, 371-72 (9th Cir. 2010) (finding plaintiff who sought to void a shareholder vote approving a stock option plan, and to cancel the plan and all awards issued thereunder, had failed to plead a type of relief that could be granted; plaintiff did not file the action until nearly a year after the complained-of vote, and this delay "allowed the 'eggs' to be 'irretrievably scrambled,' especially considering that, by the time of filing, the defendant had issued millions of options to thousands of employees under the plan."); Justin Indus., Inc. v Choctaw Secs., L.P., 920 F2d 262, 268-69 (5th Cir. 1990) (declining to set aside an election and order a new election in the wake of company's failure to disclose its bylaw amendments and golden parachutes in the proxy solicitations); Yamamoto v Omiya, 564 F2d 1319 (9th Cir. 1977) (in an action under § 14(a) of the Exchange Act, declining to void a sale of real property by an issuer due to an allegedly misleading proxy statement by the issuer concerning the sale); Kass v Arden-Mayfair, Inc., 431 F Supp 1037, 1047-48 (C.D. Cal. 1977) (denying a motion by proxy contestants for a preliminary injunction voiding the results of an election of directors and prohibiting the directors from serving as such by reason of alleged violations of § 14(a) of the Exchange Act where, among other things, "it is not clear that the plaintiffs will suffer irreparable injury if preliminary relief is not granted pending a trial on the merits").

[350] Ronson Corp. v. Liquifin Aktiengesellschaft, 483 F.2d 846, 851 (3d Cir.1973) ("Prior to consummation of the offer the court still has a variety of methods available to it for correction of the misstatements or omissions. But once the tender offer has been consummated it becomes difficult, and sometimes virtually impossible to 'unscramble the eggs.'"); *see also In re* J.P. Morgan Chase & Co. S'holder Litig*.,* 906 A.2d 808, 825 (Del.Ch. 2005), *aff'd,* 906 A.2d 766 (Del. 2006) (noting that proxy disclosure claim, "if proven, could have supported a claim for equitable relief," but that once "the 'eggs' have been irretrievably 'scrambled' [] there is no possibility of effective equitable relief.").

transaction with any third party or any financial transfer of value. No eggs were ever scrambled, so there are none to unscramble. There is, however, no basis upon which to predict, in the abstract, whether a court would exercise its judgment to enter an order re-staggering a board.

VI. Proxy Advisers and Institutional Investors

The empirical literature documenting that classified boards can be beneficial for shareholders also has implications for investment advisers, proxy advisory firms, institutional investors, and other market participants who are subject to fiduciary obligations in the exercise of the shareholder franchise. Pension fund advisors are subject to fiduciary obligations when voting shares.[351] Investment advisers must vote shares in a manner consistent with governing fiduciary duties under state and federal law.[352] Investment advisers may rely on the recommendation of proxy advisory firms, but must ascertain that the proxy advisory firm has the ability to analyze proxy issues and to make impartial recommendation that are in the best interests of the ultimate client.[353] In particular, an investment adviser must assure that the proxy advisory firm "has the ability to make voting recommendations based on materially accurate information."[354] Toward that end, the Commission's Staff recommends that investment advisers "review, no less frequently than annually, the adequacy of its proxy voting policies … including whether they continue to be reasonably designed to ensure that proxies are voted in the best

[351] Letter on Fiduciary Standards from Alan D. Lebowitz, Deputy Assistant Secretary, Department of Labor to Helmuth Fandl, Avon Products, Inc. (February 23, 1988), *available at* http://www.lens-library.com/info/dolavon.html (reminding pension fund advisors subject to the Employee Retirement Income Security Act of 1974 that their fiduciary obligations to manage plan assets include decisions as to how proxies should be voted.).

[352] Letter on Fiduciary Standards from Harvey L. Pitt, SEC Chairman, to John P. M. Higgins, President, Ram Trust Services (February 12, 2002**)** (noting lack of explicit guidance in the Advisers Act regarding investment advisers' obligations with respect to voting proxies on behalf of clients, and stating that "[w]e believe, however, that an investment adviser must exercise its responsibility to vote the shares of its clients in a manner that is consistent with the general antifraud provisions of the Advisers Act, as well as its fiduciary duties under federal and state law to act in the best interests of its clients.").

[353] Letter from Douglas Scheidt, Associate Director and Chief Counsel, U.S. Securities and Exchange Commission, to Kent S. Hughes, Managing Director, Egan-Jones Proxy Services (May 27, 2004), *available at* http://www.sec.gov/divisions/investment/noaction/egan052704.htm (warning that "[a]n investment adviser should not, however, conclude that it is appropriate to follow the voting recommendations of an independent proxy voting firm without first ascertaining, among other things, whether the proxy voting firm (a) has the capacity and competency to adequately analyze proxy issues, and (b) can make such recommendations in an impartial manner and in the best interests of the adviser's clients."); Letter from Douglas Scheidt, Associate Director and Chief Counsel, U.S. Securities and Exchange Commission, to Mari Anne Pisarri, Esq., Pickard and Djinis LLP (Sept. 15, 2004) ("Consistent with its fiduciary duty, an investment adviser should take reasonable steps to ensure that, among other things, the [proxy voting] firm can make recommendations for voting proxies in an impartial manner and in the best interests of the adviser's clients.").

[354] SEC Staff Legal Bulletin No. 20, *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exceptions from the Proxy Rules for Proxy Advisory Firms*, at Answer to Question 5 (June 30, 2013) (citing Letter to Egan Jones and Letter to Anne Pisarri, *supra* note 353).

interests of its clients."[355] Clients of proxy advisory firms also have a legal obligation to monitor the advisory firms to assure that voting policies are "in the best interests of … clients."[356]

A review of documents made publicly available by ISS and Glass Lewis, the two leading proxy advisory firms,[357] that describe their proxy voting policies governing precatory and binding declassification proposals offers no indication that, as of November 2014, either firm has considered the implications of recent research findings for their proxy voting policies.[358]

A question thus arises as to whether, how, and why, proxy advisory firms subject to fiduciary obligations, and other fiduciaries who rely on proxy advisory firms, can continue to maintain categorical opposition to classified boards without at least considering the implications of the more recent literature suggesting that declassification can be inimical to shareholder interests. Recent criticism of proxy advisory firms point to two possibilities, neither of them satisfying: (1) their business model, with its thin profit margins, does not permit for this type of in-depth and current thinking about corporate governance issues; and (2) their method for soliciting comment on their voting positions does not permit for a full and fair reflection on the issues.[359] Either of these possibilities raises a question whether the proxy advisory firms are in fact in compliance with SEC guidance and therefore whether investment advisers are able to rely

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[355] *Id.* at Answer to Question 1 (citing Rule 206(4)-7 under the Advisers Act and Rule 38a-1 under the Investment Company Act of 1940).

[356] *Id*. at Answer to Question 4. For a discussion of the influence wielded by proxy advisory firms, and the SEC's approach to the regulation of those firms, see Daniel M. Gallagher, *Outsized Power and Influence: The Race of Proxy Advisers* (Washington Legal Foundation, Critical Legal Issues Working Paper Series, No. 187, 2014). For a defense of the proxy advisory business, *see, e.g.,* George W. Dent Jr., *A Defense of Proxy Advisors* (Case Research Paper Series in Legal Studies, Working Paper 2014-13, 2014).

[357] Together, these firms together control approximately 97% of the market. U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *Best Practices and Core Principles for the Development, Dispensation and Receipt of Proxy Advice* 3 (March 2013), www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Best-Practices-and-Core-Principles-for-Proxy-Advisors.pdf.

[358] In the most recent publicly available documents explaining their policies opposing classified boards, Both ISS and Glass Lewis cite to academic literature documenting a negative economic effect associated with classified boards. The citations are to sources also cited in the Harvard Proposal. Neither cite to any research challenging the benefits of classified boards . *See* Risk Metrics Group, *U.S. Proxy Voting Manual* 39-41 (2010), www.governanceexchange.com/repository/knowledgegateway/pubs/matrix/2010_proxy_voting_guidelines_united_states.pdf; Glass Lewis & Co., *Guidelines: 2015 Proxy Season, An Overview of the Glass Lewis Approach to Proxy Advice* 20-21 (2014), http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf.

[359] *See, e.g.,* Letter from Tom Quaadman, Vice President, Center for Capital Markets Competitiveness, to Mr. Gary Retelny, President, ISS (Sept. 2, 2014), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/09/2014-9.2-ISS-Survey-Letter-.pdf (noting that ISS's policy positions are based primarily on the results of its policy surveys, which themselves are inherently flawed, and moreover are not used in conjunction with rigorous empirical research). Also, these surveys tend to act as a one-way ratchet—*i.e.*, they explore whether voting recommendations should be changed for new corporate governance topics (*e.g.*, in 2014, ISS focused its proxy voting policy survey on Board diversity, ESG reporting, and pay for performance)—rather than reevaluating the appropriateness of past positions.

on their voting recommendations, at least with respect to this issue.[360] To be sure, proxy advisory firms and institutional investors could conclude that broad-based opposition to classified boards continues to be warranted for a broad range of reasons, including considerations unrelated to shareholder valuation concerns, but in order to reach this conclusion, these fiduciaries will have to bear the burden of explaining why these policies continue to best serve the interests of shareholders, given the new state of the empirical research.

VII. Conclusion

We take no position as to the merits in the ongoing debate regarding board classification. Shareholder proposals submitted pursuant to Rule 14a-8 should, however, comply with the requirement that they not be materially false or misleading in violation of Rule 14a-9. The Harvard Proposal categorically opposes classified boards, and has played a central role in the campaign to declassify boards. In advocating this position, the Harvard Proposal relies heavily on empirical research concluding that classified boards are adverse to shareholder interests.

Recent research, however, suggests that empirical propositions upon which the Harvard Proposal relies are contestable. This recent research documents that firms that de-stagger experience inferior economic performance while firms that adopt a staggered board experience improved performance. The recent research also documents the existence of heterogeneous effects that are inconsistent with the categorical quality of the Harvard Proposal's assertion. The Harvard Proposal makes no mention of the recent empirical research that directly contradicts its policy position, and could therefore be described as materially false and misleading.

A conclusion that the Harvard Proposal is materially false and misleading should be sufficient basis for the staff of the Securities and Exchange Commission to issue no-action letters allowing companies to exclude the Proposal from a company's proxy statement, assuming the Proposal is not modified. It should also be sufficient to support the grant of declaratory relief in a federal action challenging the inclusion of the Harvard Proposal in the company's proxy.

The Commission should also be able to demonstrate that the omission of the contradictory research was at least negligent, that the Harvard SRP is the "maker" of the statement for purposes of *Janus*, and that the doctrine of *respondeat superior* applies so as to make Harvard, the university, liable for the action of the Harvard SRP. The Commission should therefore be able to prevail in proceeding against Harvard University seeking an injunction or cease and desist order against future violations of Rule 14a-9.

Private party plaintiffs additionally have to establish causation to prevail on a Rule 14a-9 action. However, given the Harvard SRP's own statements describing the significant causal

[360] Proxy advisory firm policies should, in theory, react accordingly. For example, if institutional investors were to determine that the best interests of their shareholders demands a more contextualized analysis, in line with the support in the literature articulated above for heterogeneity of effect of staggered boards, then proxy advisory firm policies should seek to determine the factors that would make staggered boards appropriate or not, and apply those to the facts of each company. Investment advisers would in turn have a duty, *see* Question 5 of Staff Law Bulletin No. 20, to ascertain that the proxy advisor is making its determinations accurately.

effect its Rule 14a-8 proposals have had on destaggering decisions at leading publicly traded firms, private party plaintiffs should be able to make the requisite showing. Predictions as to the remedy likely to be obtained in private party actions are difficult. Precedent supports the grant of an order vacating a vote to destagger if the destaggering vote was affected by materially false statements in the proxy. The grant of such an order is, however, subject to judicial discretion. Absent far more detailed information regarding the specific circumstances affecting an individual company, it would be speculation to suggest how a remedy might be fashioned in a hypothetical private party claim against Harvard.

The recent literature suggesting that classified boards are beneficial for shareholders also has implications for investment advisers, proxy advisory firms, institutional investors, and other fiduciaries responsible for the exercise of the shareholder franchise. These fiduciaries are under a legal obligation to consider the implication of the recent empirical findings for their proxy voting policies. Publicly available information regarding the policies of the two largest proxy advisory firms, which together account for 97% of the market, suggests, however, that these two firms have, as of November 2014, failed to consider the implication of this literature.

A quote often attributed to John Maynard Keynes, but perhaps mistakenly so,[361] observes "[w]hen the facts change, I change my mind. What do you do?" The facts regarding the empirical support for the campaign against classified boards have changed. No participant in the corporate governance debate is obligated to change their position regarding the advisability of classified boards as a consequence of these research findings. Every participant in the debate is, however, either legally required or well-advised to study the recent research findings and to consider whether, how, and why those findings implicate their shareholder voting policies on matters related to classified boards.

[361] This quotation is commonly attributed to John Maynard Keynes, but there appears to be no citation to primary source material containing this quotation. *See, e.g.,* Jason Zweig, Keynes*: He Didn't Say Half of What He Said. Or Did He?,* WALL ST. J., Feb 11, 2011 (citing Lord Robert Skidelsky, the eminent Keynes biographer, as stating that the quote is "apocryphal."). Observers have suggested that the quote "really needs to exist" even if Keynes didn't utter it. *See*, Kevin Drum, *Who Put Words in Keynes' Mouth*? MOTHER JONES, Feb 13, 2011, http://www.motherjones.com/kevin-drum/2011/02/who-put-words-keynes-mouth.