Volume 16 | Issue 4 Article 4

5-15-1989

The New Shareholder Power

John C. Carter

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I. Introduction

The increased activism of pension funds, colleges, universities, and other institutions that own equities in publicly held corporations is now well established. This activism apparently arose from concern by such institutions that they were being deprived by corporate managers of the opportunity to profit from contests for corporate control. Irrespective of whether corporate managers were acting to protect the corporation or their own incumbency, many institutions objected to the adoption of tender offer defensive devices that made it difficult, unlikely, or impossible for the shareholders to act upon a bona fide proposal to take over the corporation. As a result, a growing number of institutions have begun actively opposing such defenses, as well as peripheral matters such as golden parachutes. In order to protect themselves from pressure and retribution by corporate managers, such institutions are also campaigning for a secret ballot. Because of the growth in institutional equity holdings in recent years, these campaigns are a threat to management control and perhaps to the corporations themselves.

II. The Institutionalization of the Market

A. *In General*

In hindsight one can faintly discern some of the factors leading to the waxing shareholder power in the governance of public-issue corporations. The first factor has been the significant growth in institutional holdings of the equity securities of large public-issue corporations. Charts 1 and 2[1] dramatically illustrate this growth since 1950 and project it at an ever-accelerating rate to the year 2000.

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* Professor of Law, Memphis State University School of Law. L.L.B., Chicago-Kent College of Law; M.A., B.A., Lake Forest College.

1. Nussbaum & Dobrzynski, *The Battle for Corporate Control; Management is Be-*

CHART 1
PENSION PLAN ASSETS

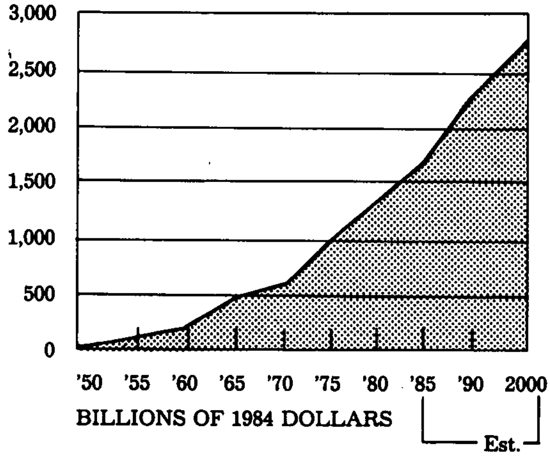
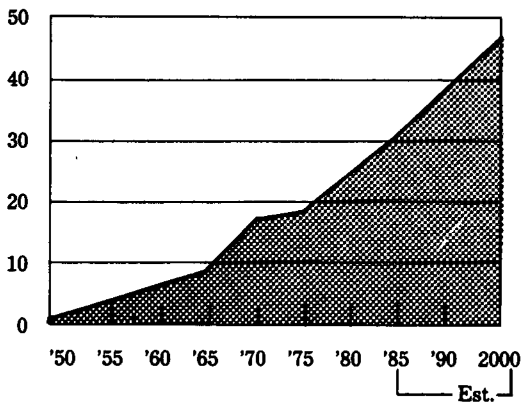


CHART 2
PENSION FUND SHARE AS A
PERCENT OF ALL OUTSTANDING
CORPORATE EQUITY



DATA: *PENSION ECONOMICS AND PUBLIC POLICY*, FEDERAL RESERVE BOARD, INVESTOR RESPONSIBILITY RESEARCH CENTER INC., SALOMON BROS.

At the present time institutions own about 45% of the $3 trillion of public-issue corporation stock outstanding. The percentage is much larger among the Fortune 500 companies.[2] Furthermore, institutions account for between 70% and 80% of market trading.[3] Institutions thus dominate United States securities markets and securities ownership.

A second factor that has led to increased shareholder power has been the increase in contests for corporate control. The liquidation values of many large United States companies became much greater than their earnings value although the market price of the stock of many such corporations generally reflected earnings value. Entrepreneurs recognized that corporations were sheltering underutilized and undervalued assets and determined that they could purchase the corporations for more than the market value of the stock and turn them over at a profit. This discovery also led many shareholders to question the ability of corporate managers to manage corporate assets in such a way that the market price of the stock would properly reflect both asset and earnings value.

B. *The Institutions and Corporate Governance*

Basic shareholder expectations, as well as the expectations of management, can be profoundly affected in several ways by a takeover contest. In the first place, just as in the case of a merger, a takeover bid represents a potential change of control. Secondly, the shareholder who retains his interest in the target company faces the prospect of future organizational changes over which he will have little, if any, control. Lastly, and probably most significantly, the contest will undoubtedly cause a substantial temporary advance in the market price of the stock. Additionally, with respect to corporate managers, an unfriendly tender offer contest puts careers at risk. It is not surprising, therefore, that corporate managers have designed a variety of takeover defenses and that such defenses have caused concern to some large shareholders.

In view of the extent of their ownership of corporate equities, institutions are in a position to take action to protect their perceived interests. The tactics they have used include: (1) using the proxy

ing Assailed from All Sides. Who's in Charge Here?, BUS., May 18, 1987, at 104 [hereinafter Nussbaum].

2. D. Ruder, Remarks at the 27th Annual Corporate Counsel Institute (Oct. 11, 1988) (available from Securities and Exchange Commission).

3. *Id.*

system to oppose poison pills, cumulative voting, staggered boards of directors, fair price amendments and golden parachutes, and to promote secret ballots and give shareholders access to the proxy machinery; (2) supporting raiders in specific contests; (3) attempting to organize takeovers; (4) investing in leveraged buyouts.[4]

In comparison with past shareholder efforts, the use of the proxy system by institutions has met with a substantial degree of success. Table 1[5] lists the results in 1987 of shareholder proposals on corporate governance sponsored by selected institutions.

TABLE 1
Proxy Resolutions Filed

TARGET	SPONSOR	TOPIC	% HELD BY INSTITUTIONS	MOST RECENT VOTE
American Cyanamid	CREF	Poison Pill	55	28.4
AMR	CalSTRS	Poison Pill	75	45.9
Champion International	UBC	Poison Pill	59	33.2
Emery Air Freight	SWIB	Poison Pill	42	41.4
Great Northern Nekoosa	CalPERS	Poison Pill	68	40.2
International Paper	CREF	Poison Pill	57	27.7
J.C. Penney	CREF	Poison Pill	61	31.6
Pitney-Bowes	CREF	Poison Pill	68	32.6
United Technologies	SWIB	Poison Pill	51	32.9
Upjohn	CalSTRS	Poison Pill	56	40.0
Santa Fe Southern Pacific	N/A	Poison Pill	N/A	61.2
US Air	CalPERS	Poison Pill	N/A	51.9
Gillette	CalPERS	Greenmail	40-50	55.0

CalPERS - California Public Employees Retirement System
CalSTRS - California State Teachers Retirement System
CREF - College Retirement Equities Fund
SWIB - State of Wisconsin Investment Board
UBC - United Brotherhood of Carpenters

When one compares the results revealed in the table to the results that were typically obtained in votes on shareholder proposals relating to social issues (rather than corporate governance issues), the record is quite impressive. The writer does not know of one instance in which a social issue received a majority of the votes cast. In fact, seldom has such an issue received a vote of more than 10%. With respect to corporate governance issues, however, in 1987 alone, issues

4. Eleven state retirement funds have provided a substantial fraction of the Kohlberg, Kravis Roberts leveraged buyout fund. Kibbe, *LBOs Cause Conflicts for Institutional Investors*, News for Investors, Jan. 1989, at 4, 5. In addition, various college and university endowment funds have also invested in the fund. *Id.* Governors Cuomo and Dukakis have each called for an end to such investments by their respective state pension funds. *Id.*

5. Turnbow, The New Role of Institutional Investors—Positive or Negative 16 (Nov. 1988) (unpublished manuscript available in Memphis State University Law Library).

opposing poison pills were successful at Santa Fe and US Air Group, and an anti-greenmail issue succeeded at Gillette. Furthermore, with the projected increase in institutionally-owned assets and the commensurate future growth of institutional equity holdings, the institutional influence over business corporations will inexorably strengthen.

Table 2 shows some of the resolutions sponsored by institutions in 1988.[6] As of this writing the results are not available; however, in view of the large institutional holdings in some of the companies listed, it is likely that many of the resolutions will fare well.

The success of the institutions can be understood by analogy to the close corporation. In the close corporation the shareholders, or at least the majority group or individual, have control. This is because corporate ownership is sufficiently concentrated so that a cohesive group with a common interest can be identified. With the concentration of corporate ownership in institutions, similar circumstances in publicly held corporations are arising. Shareholders, at least institutional shareholders, are attempting to exercise a degree of control hitherto unheard of in publicly held corporations.

C. The Corporate Response

1. In General

Corporate managers who oppose such institutional activity have offered two general responses. First, they question the right of institutional shareholders to participate fully in corporate governance. For instance, Andrew C. Sigler, Chairman of Champion International Corporation, has queried: "What right does someone who owns the stock for an hour have to decide a company's fate?"[7] Implicit in this statement is the assumption that short-term shareholders have differing interests from long-term shareholders and that the corporation should be managed in the interest of long-term shareholders. Secondly, some corporate managers have asserted the right to manage the corporation for the benefit of constituents, such as employees and the communities in which company facilities are located, in addition to the shareholders themselves.

Consistent with the concept expressed by Sigler, many corporate managers have questioned whether institutional shareholders should have all of the rights of other shareholders. It is not completely clear

6. *Id.* at 18-19.
7. Nussbaum, *supra* note 1, at 103.

TABLE 2
Proxy Resolutions Filed in 1988

TARGET	SPONSOR	TOPIC	% HELD BY INSTITUTIONS
Allied Signal	SWIB	Poison Pill	45
Alcoa	CalPERS	Poison Pill	70
Alcoa	NYCERS	Voting	70
American Cyanamid	CREF	Poison Pill	55
AMR	CalSTERS	Poison Pill	75
Bell & Howell	CalPERS	Poison Pill	71
Boise Cascade	UBC	Poison Pill	64
Champion International	NYCERS	Voting	59
Champion International	UBC	Poison Pill	59
Coleman	SWIB	Poison Pill	48
Consolidated Freightways	CalPERS	Poison Pill	76
Dayton Hudson	CalSTRS	Greenmail	56
Dayton Hudson	CREF	Poison Pill	56
Emery Air Freight	SWIB	Poison Pill	42
General Mills	NYCERS	Voting	60
Georgia Pacific	UBC	Golden Parachutes	60
Gillette	CalPERS	Greenmail	43
Great Northern Nekoosa	CalPERS	Poison Pill	68
Honeywell	NYCERS	Voting	67
International Paper	CREF	Poison Pill	57
J.C. Penney	CalSTERS	Greenmail	61
J.C. Penney	CREF	Poison Pill	61
Kerr-McGee	CREF	Poison Pill	77
Koppers	CREF	Poison Pill	66
Lockheed	NYCERS	Voting	65
Loral	NYCERS	Voting	56
Martin Marietta	SWIB	Poison Pill	42
MCA	UBC	Poison Pill	50
Panhandle Eastern	SWIB	Poison Pill	56
Phelps Dodge	NYCERS	Voting	68
Pitney-Bowes	CREF	Poison Pill	68
Ryder System	CalPERS	Voting	77
Sara Lee	NYCERS	Voting	40
Telex	NYCERS	Voting	43
United Technologies	SWIB	Poison Pill	51
Upjohn	CalSTRS	Poison Pill	56
Upjohn	NYCERS	Voting	56
Upjohn	NYCRF	Voting	56
US Air Group	CalPERS	Poison Pill	90
Weyerhauser	UBC	Super-majority for Mergers	49

CalPERS - California Public Employees Retirement System
CalSTRS - California State Teachers Retirement System
CREF - College Retirement Equities Fund
NYCERS - New York City Employees Retirement System
NYCRF - New York State Common Retirement Fund
SWIB - State of Wisconsin Investment Board
UBC - United Brotherhood of Carpenters

how those who criticize voting by institutional shareholders would restrict that voting power. One way is to give corporate managers, by legislation or court decision, the power to take into consideration the interests of employees and customers, even though such interests may be opposed to the interests of shareholders. Another method is a leveraged buyout by management or the "going private" transaction. Such actions, however, would impinge on the rights of all shareholders, not just the institutional shareholders.

2. In the Creation of Tender Offer Defenses

Most limitations on takeover contest tactics are found in federal rather than state statutes, although recently enacted state takeover statutes appear to be gaining in significance.[8] These statutes, known as "Control Share Acquisition Acts," provide that one who acquires a specified substantial percentage of the voting shares of a corporation incorporated under the laws of that state may not vote those shares unless a majority of the remaining outstanding shares approve of the acquisition. One such statute, the Indiana Control Share Acquisition Act, has recently been upheld by the United States Supreme Court.[9]

This is not to say, however, that states exercise little other control of tender offer tactics. Many cases decided under state law have found directors in violation of their fiduciary duties in their use of tender offer defensive tactics.[10] A variety of defensive tactics based on state law have been employed by target companies. Almost every state permits staggered terms for directors,[11] cumulative voting,[12] the issue of "poison pill" redeemable or convertible stock,[13] and supermajority voting requirements for shareholders.[14] Furthermore, it would appear that most state statutes also permit corporations to provide for generous severance benefits, sometimes called "golden parachutes," for their executives and to take other action, such as the

8. *See, e.g.*, IND. CODE ANN. § 23-1-17-3 (Burns Supp. 1988).

9. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).

10. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

11. Every state except California permits staggered terms for directors.

12. Every state makes cumulative voting either mandatory or optional, with the exceptions of Massachusetts and Wisconsin, both of which have no statutory provision regarding cumulative voting for directors.

13. Every state follows the general pattern of the Model Business Corporation Act, which provides that corporations may authorize the creation and issuance of shares with different rights, preferences, or limitations. MODEL BUSINESS CORP. ACT § 15 (2d ed. 1981). However, the majority of states limit conversion and redemption to shares with preferential rights.

14. Hawaii, Illinois, and Nevada do not have a general section authorizing supermajority voting requirements for shareholders but do provide for them in separate sections referring to specific shareholder actions. Puerto Rico has no provisions for supermajority voting requirements for shareholders.

sale of a particularly valuable property, known as the sale of a "crown jewel"; the payments of "greenmail"; and the making of "standstill agreements" calculated to make the company less attractive to a raider. Other defenses, like the issuance of super-voting stock and stock with less than one vote per share are permitted under some state statutes but not under others.[15]

It is not clear whether statutes that are permissive with respect to tender offer defenses are in the interests of shareholders. The defenses, which generally can be waived or avoided by directors, can be in the interest of shareholders, provided that state courts enforce the fiduciary duty of directors to act in the best interests of the shareholders in response to a raider. So far there have been only a few cases enforcing such a responsibility, and Delaware has clearly led the way in recognizing that the duty exists.[16] However, one can only speculate whether, under the circumstances that have been presented to Delaware courts, any modern court would reach the same conclusion.

Another device that has been used as a tender offer defense is the issuance of non-voting or super-voting stock. The issuance of non-voting stock gives the controlling shareholders the ability to raise equity capital without any loss of control. The issuance of super-voting stock gives those holding such stock a disproportionate influence in shareholder votes. Super-voting stock comes in many varieties. For example, the super-voting rights may take effect only upon the occurrence of a certain event or only with respect to certain issues.[17]

15. The issuance of shares with fractional voting rights is prohibited in Connecticut. All other jurisdictions, except Hawaii and Puerto Rico, have a statute expressly authorizing the issuance of fractional shares. Louisiana requires that holders of fractional shares be given the rights of shareholders except voting rights. The District of Columbia, Maryland, Nevada, Ohio, and Pennsylvania do not expressly designate the rights of fractional shareholders.

16. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

17. The use of super-voting stock as a shark repellent is illustrated in Packer v. Yampol, No. 8432, slip op. (Del. Ch. Apr. 11, 1986). In *Packer*, a corporation controlled by the defendant issued to the defendant and another preferred stock having 140 votes per share. The preferred stock also voted as a separate class on any proposed merger. At the time of issuance, plaintiff had already commenced a proxy contest. The result of issuing the super-voting preferred stock was that the defendant could block any merger. Furthermore, options to purchase more of the preferred stock were issued to defendant. They were fully exercisable in the event of a public tender offer. These provisions were deemed by the court to make a successful tender offer extremely unlikely.

The court observed that super-voting stock was statutorily permissible under Delaware law, and that the decision of the directors would not be disturbed attributable to rational business purposes. Defendant argued that the purpose of the issue was to raise capital and that they were therefore protected by the business judgment rule. The court noted, however, that the business judgment rule was available only to directors who are independent or disinterested with respect to the transaction under challenge, and found that the defendants did not qualify. The court went on to find the purpose of the issue to be the maintainance of incumbent management control.

The existence of non-voting stock or super-voting stock by a listed company appears to be at odds with the so-called "one share-one-vote" rule. In recent times there has been much discussion of this rule, and one might have the impression that this rule either existed at common law or is commonly found in state statutes. Neither is true, however. At common law both per capita voting and other voting arrangements established by charter were permitted; however, it was the rule that in the absence of any special charter provision, the rule of one vote per share would be followed.[18]

Today, variations of the "one-share-one-vote" rule are permitted by the statutes of every state except Illinois[19] and Hawaii,[20] while earlier statutes simply permitted the issue of non-voting common stock. Illinois requires one vote per share, but permits cumulative voting and voting by class. The Hawaii corporate laws do not mention the subject. Statutes generally acknowledge the right of the corporation to issue shares with fractional or multiple voting rights.[21]

Although it is true that issuing non-voting or super-voting common stock has not been proscribed by common law or state statutes, for many years the New York Stock Exchange (NYSE) prohibited the issue of such stock by listed companies, whether or not the non-voting stock itself was to be listed.[22] Furthermore, the NYSE reserved the right to refuse to list stock with "unusual voting provisions which tend to nullify or restrict its voting, or which is subject to unusual voting provisions of another class of stock having such effect, as, for example, a situation in which one class of stock has the right to veto the actions of another class."[23]

The criteria for trading by the National Association of Securities Dealers (NASD) on the National Association of Securities Dealers Automated Quotation (NASDAQ) system or the American Stock Exchange, however, did not include any restriction on the ability of corporations to issue non-voting or super-voting stock. As a consequence, where the issue of such stock became popular as a tender offer defense, several NYSE listed companies issued such stock[24] in spite of the NYSE rules and the Exchange came under

18. HENN & ALEXANDER, LAWS OF CORPORATIONS § 124 (1983).
19. ILL. ANN. STAT. ch. 32, para. 7.40 (Smith-Hurd 1985 & Supp. 1988).
20. Hawaii has no statutory provision on the subject of one vote per share.
21. *See supra* note 15.
22. NYSE Company Manual § A-15, at A-280 (1977).
23. *Id.* at A-282.
24. Brandow, *The NYSE's One Share/One Vote Rule*, N.Y.L.J., Dec. 9, 1985, at 33;

pressure to repeal the rule.

The response of the NYSE was to pressure the Securities and Exchange Commission (SEC) to force the adoption of a similar rule by the NASD and the other exchanges. This effort was successful. The SEC has now promulgated a regulation providing that, with certain specific exceptions a uniform one-share-one-vote rule shall apply to shares to be listed on any exchange or the NASD.[25]

Another means by which corporations might restrict non-management voting power is to create non-voting securities that are attractive to public investors. This evidently is the strategy on which the recent proposal to market "unbundled stock units" is based. Such units, consisting of a bond, a preferred share, and a warrant to purchase a share of common stock, are issued in exchange for a portion of the company's outstanding stock. The theory of the exchange is to give the shareholder income protection by holding preferred stock, capital protection by holding the bond, and the right to participate in appreciation by exercising the warrant. However, the unbundled securities have no voting rights; they remain with the common stock.

There are many unanswered questions concerning the sale of unbundled stock units, the first and foremost being whether the institutions will be interested in buying them. Other questions concern the extent of regulation and restrictions that will be imposed on the use of unbundled stock units. The NYSE has already proposed restrictions intended to prevent an insider group from obtaining control by using such a device and to prevent the disenfranchising of shareholders.[26] If the marketing of unbundled stock was conceived of as a means of protecting the corporate managers from the shareholders, institutional or otherwise, it is doubtful that it will succeed.

One other way corporate managers can neutralize institutional voting is by exercising pressure of their own. The following report from *Business Week* is illustrative:

> Indeed, corporate managers are fighting back. By the time this spring's proxy season drew near, many had appealed to their counterparts around the country for help in fighting the resolutions introduced by CREF [College Retirement Equities Fund] and its fellow interventionists. Dozens of CEO's sent letters to their colleagues urging them to persuade their own pension fund managers to vote with management on anti-takeover issues.[27]

The response to such pressure has been a campaign by institutional investors to compel corporations to adopt confidential voting proce-

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see also O'Brien, *Actions by Corporations Threaten Big Board Listing*, N.Y.L.J., Oct. 1, 1985, at 17.

25. Exchange Act Release No. 34-25891 [1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 26,376 (July 12, 1988).

26. N.Y. Times, Dec. 28, 1988, at 27.

27. Nussbaum, *supra* note 1, at 106.

dures. According to the Investor Responsibility Research Center, Inc., this emphasis "reflects the view of many shareholders that confidential voting is fundamental to ensuring the integrity of the proxy voting process."[28]

The federal agencies have acted to encourage this new activism on the part of institutions. A major step taken by the SEC in December 1987, was the removal of a limitation that had previously kept the institutions from soliciting holders of more than twenty-five percent of a company's stock in support of an issue.[29] The Department of Labor also has stressed to private pension fund managers that they are required to vote "in the best ultimate economic interest of the plan."[30]

III. THE SHAREHOLDER V. OTHER CONSTITUENCIES—THE PRIMACY OF THE SHAREHOLDER

One of the responses to this heightened institutional activism has been the claim by corporate managers that they have obligations beyond the interests of shareholders and the corporation. This idea is not new. In 1929, Owen D. Young, then Chairman and Chief Executive Officer of General Electric Company, made the following statement:

> If there is one thing a lawyer is taught it is knowledge of trusteeship and the sacredness of that position. Very soon he saw rising a notion that managers were no longer attorneys for stockholders; they were becoming trustees of an institution.
>
> If you will pardon me for being personal, it makes a great difference in my attitude toward my job as an executive officer of the General Electric Company whether I am a trustee of the institution or an attorney for the investor. If I am a trustee, who are the beneficiaries of the trust? To whom do I owe my obligations?
>
> My conception of it is this: That there are three groups of people who have an interest in that institution. One is the group of fifty-odd thousand people who have put their capital in the company, namely, its stockholders. Another is a group of well toward one hundred thousand people who are putting their labor and their lives into the business of the company. The third group is of customers and the general public.
>
> Customers have a right to demand that a concern so large shall not only do its business honestly and properly, but, further, that it shall meet its public obligations and perform its public duties—in a word, vast as it is, that it should be a good citizen.

28. *Secret Ballot is a Growing Corporate Governance Concern*, News for Investors, Dec. 1988, at 225.

29. *See* Exchange Act Release No. 34-25217 [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 48,977 (Dec. 29, 1987).

30. Franklin, *1988 Proxy Season: New Players, Rules May Aid Institutional Investors*, N.Y.L.J., Jan. 7, 1988, at 5.

> Now, I conceive my trust first to be to see to it that the capital which is put into this concern is safe, honestly and wisely used, and paid a fair rate of return. Otherwise we cannot get capital. The worker will have no tools.
>
> Second, that the people who put their labor and lives into this concern get fair wages, continuity of employment, and a recognition of their right to their jobs where they have educated themselves to highly skilled and specialized work.
>
> Third, that the customers get a product which is as represented and that the price is such as is consistent with the obligations to the people who put their capital and labor in.
>
> Last, that the public has a concern functioning in the public interest and performing its duties as a great and good citizen should.
>
> I think what is right in business is influenced very largely by the growing sense of trusteeship which I have described. One no longer feels the obligation to take from labor for the benefit of capital, nor to take from the public for the benefit of both, but rather to administer wisely and fairly in the interest of all.[31]

Fifty-one years later Reginald H. Jones, a remote successor to Young at General Electric, spoke before the Economic Club of Chicago as follows:

> It has been very difficult for management to stick to the business of managing in the past decade. We have had to devote an inordinate amount of our time and energy to the problems caused by our critics, by our legislators, and by our bureaucrats. We have been buried under an avalanche of paperwork by new agencies. We've been running to Washington and the state capitals to explain our needs, and very often, just to prevent legislative disaster. We have made substantial and costly efforts to respond to the critics representing single interest groups. . . . They all have significant points to make, but their passionate concerns have had the result of distracting management from its central task of running a successful and productive business.[32]

Although it cannot be said that these two statements are contradictory, it must be realized that they emphasize different aspects of the duty of a chief executive of a publicly held company. It is interesting that the older concept expressed by Young is now being espoused by many corporate executives in their opposition to takeovers and institutional shareholder activism.

Not only has the concept expressed by Young been held by many corporate executives for many years, the same concept has found its way into the courts. In *Herald Company v. Seawell*,[33] shareholders brought a derivative action claiming misuse of corporate assets by defendant's implementation of an employee stock option plan, a newspaper, evidently at least in part as a takeover defense. Sustaining the plan, the court stated that it considered the company's obligation to be threefold: to the stockholders, to the employees, and to the pub-

31. Carter, *The Limit of Corporate Social Responsibility*, 33 MERCER L. REV. 519, 535-36 (1982) (quoting Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1145, 1154-55 (1931-32)).

32. R. Jones, Management Malaise (Dec. 16, 1980) (speech before the Economic Club of Chicago).

33. 472 F.2d 1081 (10th Cir. 1972).

lic.[34] The court also observed:

> 'We have long since passed the stage in which stockholders, who merely invest capital and leave it wholly to management to make it fruitful, can make absolutely exclusive claim to all profits against those whose labor, skill, ability, judgment, and effort have made profits available.' . . . There is no question but the . . . stock was purchased primarily to benefit the employees; this benefit eventually gave monetary gain to the shareholders.[35]

Another case, *Kelly v. Bell*,[36] recognized but limited the right of the corporation to take into consideration the interests of constituents other than shareholders. In *Kelly*, an agreement under which the United States Steel Corporation made an annual payment to Allegheny County, Pennsylvania in lieu of taxes, was challenged by a shareholder as a waste of corporate assets. In upholding the agreement the court declared it valid insofar as the expenditures were made in the "reasonable belief that it would aid the public welfare and advance the interests of the . . . corporation and as part of the community in which it operates."[37] The court thus expressed very clearly that, whereas a corporation might use corporate resources to benefit the community in which it existed, it could do so only if the action also resulted in a corporate benefit. Generally speaking, in order to avoid being considered waste or ultra vires, the corporation itself, or its shareholders, must be one of the intended beneficiaries of any corporate act. Thus, a corporation cannot make a charitable contribution where it can be shown that such contribution is not related to the interests of the corporation. Early cases seemed to require evidence of a direct benefit;[38] however, later cases have relaxed this requirement.

An example of this relaxed requirement is found in *A. P. Smith Manufacturing Co. v. Barlow*.[39] The court in *Barlow* observed that

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34. *Id.* at 1091.

35. *Id.* at 1096-97 (quoting Gallin v. National City Bank of N.Y., 152 Misc. 679, 703, 273 N.Y.S. 87, 113 (1934)).

36. 254 A.2d 62 (Del. Ch. 1969).

37. *Id.* at 74 (quoting A. P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 161, 98 A.2d 581, 590 (1953)).

38. In fact, many early cases held corporate contributions to be ultra vires. *See generally* Brinson Ry. Co. v. Exchange Bank of Springfield, 16 Ga. App. 425, 85 S.E. 634 (1915); Stacy v. Glen Ellyn Hotel & Springs Co., 223 Ill. 546, 79 N.E. 133 (1906); Western Md. R.R. Co. v. Blue Ridge Hotel Co., 102 Md. 307, 62 A. 351 (1905); Davis v. Old Colony R.R. Co., 131 Mass. 258 (1881); George v. Nevada Cent. R.R. Co., 22 Nev. 228, 38 P. 441 (1894); Memphis Grain & Elevator Co. v. Memphis & Charleston R.R. Co., 85 Tenn. 703, 5 S.W. 52 (1887); Carter, *The Limit of Corporate Social Responsibility*, 33 MERCER L. REV. 519, 523-24 & n.12 (1982) (citing Military Interstate Ass'n of Savannah v. Savannah Thunderbolt & Isle of Hope Ry., 105 Ga. 420, 31 S.E. 200 (1898)).

39. 13 N.J. 145, 98 A.2d 581 (1953).

"modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate."[40] The court also said that "such expenditures may likewise readily be justified as being for the benefit of the corporation; indeed, if need be the matter may be viewed strictly in terms of actual survival of the corporation in a free enterprise system."[41]

In *Barlow*, the court perceives a benefit furthering the corporation's long-term goals. The basic issue that runs through modern cases concerning the power of a corporation to make contributions is one of business judgment: is there a sufficient potential benefit to justify the expenditures under the business judgment rule?

It is apparent from the cases that the law demands that corporate resources be used in the corporation's own self-interest. As a consequence it is difficult to see how a corporation can make an expenditure for the benefit of employees, customers or the community, unless there is some benefit to the corporation itself. For instance, it is hard to understand how a corporation can be said to have any social responsibility to keep open an unprofitable plant. To do so would run counter to the very reason for the corporation's existence. The for-profit corporation is not the mechanism to solve the social problems caused by the corporation's proper pursuit of profit. The corporation cannot act in a significant way to solve social problems when the solution would be to its detriment.

The obligation of managers to act in the interests of the corporation has its limits. Under certain circumstances they have an obligation to shareholders which transcends their obligation to the corporation. Cases such as *Smith v. Van Gorkom*[42] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[43] define rather clearly those circumstances. In brief, the obligation is present where the liquidation or sale of the corporation is imminent. Then, as the *Revlon* court said, "[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[44]

The dispute between managers and institutional shareholders has usually arisen in connection with the sale or takeover of a corporation. In such circumstances, courts have unequivocally found that the corporate managers have a direct duty to shareholders. Neither statutes nor case law impose on corporate managers similar duties to other constituents such as employees or customers. Of course, how-

40. *Id.* at 154, 98 A.2d at 586.
41. *Id.*
42. 488 A.2d 858 (Del. 1985).
43. 506 A.2d 173 (Del. Super. Ct. 1986).
44. *Id.* at 182.

ever, the corporation itself has only those duties to constituents, that it assumed by contract or that were imposed by legislation. The writer concludes, therefore, that there is little, if any, basis in the law for finding that corporate managers owe a duty to anyone other than the corporation and its shareholders. Not only does a manager's responsibility under the law not extend to any of the other so-called corporate constituents' the use of corporate funds for the constituents' sole benefit would undoubtedly constitute corporate waste.

IV. SHAREHOLDER PARTICIPATION IN CORPORATE GOVERNANCE

A. *In General*

The other response of corporate managers to the increased institutional activity in corporate affairs has been to suggest that institutional shareholders should not have voting rights as extensive as those of other shareholders.

Although the laws of every state contain language to the general effect that the business affairs of the corporation shall be managed by or under the direction of its board of directors, the shareholders are also provided certain management rights. Shareholders' rights include: the right to elect directors;[45] the right to form shareholders' agreements affecting the management of the corporation;[46] the right to enforce by litigation the rights of the corporation;[47] and the right to participate in decisions affecting organic changes in the corporation.[48] In addition, the right to have proposals for shareholder action included in proxy statements is provided to shareholders of companies subject to the Securities Exchange Act of 1934.[49]

B. *The Historical Ineffectiveness of the Shareholder*

The idea that shareholders, voting in proportion to their ownership interest in a corporation, should have the right to elect the corporate

45. The corporation statutes of every state and the common law that existed prior to their enactment provide for the election of directors by shareholders. In the earliest corporations, the voting power of each shareholder was equal, rather than proportionate to his share ownership. *See* Ratner, *The Government of Business Corporations: Critical Reflections on the Rule of "One Man, One Vote"*, 56 CORNELL L. REV 1 (1970). Although today the shareholder generally has voting power proportionate to his share ownership, two devices to restrict it, super-voting and non-voting stock, have been developed, while one means of enhancing it, cumulative voting, has arisen.

46. *See, e.g.*, TENN. CODE ANN. § 48-17-302 (1988).

47. *See, e.g.*, TENN. CODE ANN. § 48-17-401 (1988).

48. *See infra* notes 67-72 and accompanying text.

49. 17 C.F.R. § 240.14a-8 (1988).

managers has existed throughout modern times.[50] Furthermore, the corporation was conceived of as an organization in which shareholders had exchanged their property right in corporate assets for a contractual right against the corporation.[51] Over time it came to be recognized that, at least with respect to publicly held corporations, the shareholder had to a large extent lost the ability, or desire, to enforce this consensual right.[52]

This circumstance probably evolved naturally. One of the characteristics of the corporate form is transferability of ownership, and the securities markets in the United States were sufficiently organized to make such transfer particularly easy. As a result, corporate owners increasingly came to be investors with little, if any, interest in the corporation itself. They abdicated their position of control, a role corporate managers occupied in their stead. Thereafter, corporate managers alledgedly tended to give priority to their own interests.[53]

This was the state of affairs at the time of the enactment of the Securities Exchange Act of 1934 (the Act).[54] One of the underlying themes of the Act was the revival of corporate democracy, and the means chosen to accomplish this end was the requirement that, in a broad variety of circumstances, material information be disclosed to shareholders at the time their vote was solicited.[55] The theory was that shareholders would read and consider this information before taking action and that corporate democracy would flower because the owners would be informed before having to act.

It is doubtful, however, that this aspect of the Act ever had the desired effect. In the 1970s, after several major instances of corporate mismanagement were revealed—including the marketing of defective products, unlawful political action and foreign bribery—a movement arose, usually described as the corporate accountability movement, to place some controls on corporate managers.[56]

Although many changes in corporate practices were proposed, they had no substantive impact on federal or state laws relating to shareholder voting rights. Some companies modified prior practice by providing more information concerning director independence from management and director committee activity in connection with the

50. BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 196 (1932).

51. *Id.* at 64.

52. *Id.* at 129.

53. *Id.* at 119-31.

54. Securities Exchange Act of 1934, 15 U.S.C § 78a (1982).

55. *See, e.g., id.* § 78m-n.

56. *See* SEC Release No. 34-13482 [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,130 (Apr. 28, 1977); SEC Release No. 34-13901 [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,296 (Aug. 29, 1977).

solicitation of proxies.[57] Also, NYSE rules were amended to require the existence of certain oversight committees of boards of directors;[58] but legislative initiatives were largely unsuccessful.[59] Furthermore, much of the reformers' efforts were directed to the imposition of restraints on corporate managers rather than the improvement of the shareholder franchise. For this reason one gets the impression that although an informed shareholder vote was recognized as one possible form of restraint on the corporate managers, it was not considered to be a very effective one. Instead, the SEC and Congress attempted to induce corporate managers themselves to make substantial changes in the manner in which corporations were operated through disclosure requirements. Enhancement of the shareholder franchise appeared to be only incidental at best.

It must be admitted that the 1934 Act placed the shareholder in a better position to exercise his right to vote by requiring that registered companies provide certain minimal information to those shareholders from whom proxies are solicited. For the most part, however, shareholders did not use the information to their advantage. The writer knows of no recent instance in which a management nominee for director of a publicly held corporation failed to obtain shareholder approval, except where an organized proxy contest was waged by an opposing group vying for control. At most, the enhancement of the shareholder franchise, appeared to be incidental.

This ineffectiveness has been widely recognized. In his book *The American Stockholder*, published in 1963, J. A. Livingston quotes a report of the Temporary National Economic Committee which states that "unless there is a powerful nucleus of some sort, it is practically impossible for hundreds of thousands of scattered holders of a majority of stock of a giant corporation to get together even by proxy in order to exercise a degree of control."[60]

As mentioned earlier, seldom, if ever, has a proxy vote resulted in

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57. For example, some companies established nominating committees made up of outside directors and indicated the membership of the committees in their proxy statements.

58. NYSE Company Manual § A-2, at A-29 (1977).

59. Notable exceptions, however, do exist. The Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78a, 78m, 78dd-1, 78dd-2, 78ff (1982), was adopted in response to disclosures of corrupt political activity overseas. It was also directed to disclosure. The Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1982), was also a response to certain types of corporate corruption. Both pieces of legislation were directed at the abuses themselves and made no attempt to affect corporate governance.

60. J. A. LIVINGSTON, THE AMERICAN STOCKHOLDER 38 (Collier rev. ed. 1963).

the unseating of a director unless there was an organized opposition seeking control. In the latter case the shareholder could simply choose one control group over another, with no assurance that a new control group would operate the corporation any more in the interests of the shareholders than the former group. The interest of the contending group would very likely be the value of control to themselves. Whichever group prevails, the shareholder remains an outsider. As this article suggests, however, significant changes are occurring.

C. *Shareholder Power and Cumulative Voting*

The idea of corporate cumulative voting has an interesting history. The idea flowered from the argument of the philosopher, John Stuart Mill, on minority representation in government. Its first appearance on the corporate scene was in the Illinois Constitution of 1870. The principal advocate for its application to corporate governance was the editor of the Chicago Tribune, Joseph Medill, who was also a member of the Constitutional Convention.[61] Cumulative voting became quite popular, at one time appearing in the constitutions of thirteen states and being mandated by statute in many others. Today, however, although permitted in every state, it is mandated in only seven.[62] Its theoretical effect is to enhance proportional representation among shareholders by providing power over corporate affairs commensurate with a shareholder's ownership interest. The device is of great utility in close corporations, but historically is of very limited value in publicly held corporations.

In the close corporation there usually is no difference in identity between managers and majority owners. As a consequence, a vote by the owners is a vote by those in control. However, in the publicly held corporation this is generally not true. The owners in a publicly held corporation typically are in that weak position attributed to them by Berle and Means.[63] As a consequence, the rules relating to voting for directors of publicly held corporations have been of relatively little significance. With respect to the close corporation, however, they can be of great importance, especially with cumulative voting.

The importance of cumulative voting in the close corporation is apparent. In such an organization, all limitations in, or extensions of,

61. Campbell, *The Origin and Growth of Cumulative Voting for Directors*, 10 BUS. LAW. 3 (Apr. 1955).

62. States in which cumulative voting is mandated are Arizona, Arkansas, Kansas, Missouri, South Dakota, West Virginia, and Wyoming.

63. *See* BERLE & MEANS, *supra* note 50, at 128.

shareholder voting rights are important because, as stated above, the vote of the shareholders is, in effect, the vote of the managers.

The advisability and utility of cumulative voting in publicly held corporations is not as clear; however, those who have supported it have argued it is the only way of assuring minority shareholder representation: the owners have a right to a voice in corporate control; the minority is assured that its views will be presented; it stimulates shareholder interest; and it will have a healthy effect on corporate management.[64] Conversely, the arguments of those opposed to cumulative voting are: board continuity on significant long-range action is needed; the presence of cumulative voting thwarts corporate operations and development; the majority position is superior because it is generally based on more accurate information; corporate confidence might be breached by the minority; and shareholders have other means of protecting their rights.[65]

As categorical statements, these pro and con arguments are not compelling. It is difficult to understand how one can deny the value of cumulative voting in some circumstances or the futility of it in others.

With respect to publicly held corporations, until recently the concept of cumulative voting was probably considered anti-management, and there is historical justification for this view.[66] Interestingly, in the recent past there has been a revival of interest in cumulative voting. This time, however, it is the corporate managers, rather than the outsiders, proposing the adoption of the device.

Actions such as the adoption of cumulative voting and a classified board, on the recommendation of corporate management, have been

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64. Dodd & Warner, *On Corporate Governance: A Study of Proxy Contests*, 11 J. FIN. ECON. 401 (1983).

65. Sell, *Cumulative Voting, a Seemingly Endless Debate Topic*, 2 CORP. PRAC. COMMENTATOR 23, 27-28 (1960).

66. *See, e.g.*, Campbell, *supra* note 61, at 5-6, quoting a Chicago Tribune editorial which appeared a few days prior to the vote on the Illinois Constitution of 1870:

> The 3rd clause on "corporations" will forever prevent those confiscations of the rights of stockholders by directors of which the Erie Railroad is a conspicuous and infamous example. The history of the Erie case shows that the blunder of having the majority only represented in any of the votes which decide its government, results in ruling out, 1st, of a minority of all the stockholders, in choice of directors, then of a minority of the chosen directors in the appointment of officers and an executive committee, and so on until at last, the so-called "majority" consists of three persons, Gould, Fisk and Lane, who owns not a thousandth part of the stock, and whose opportunities as thieves immeasurably outweighs their nominal interest as stockholders.

Id.

used as so-called "shark repellent" defenses. The purpose of the defense is to delay the corporate raider's assumption of control for two or three years, thereby frustrating real acquisition and dramatically increasing the cost. However, such actions have not been taken to increase the power of the shareholders. Instead, their purpose has been to protect the corporation, or, perhaps, its managers, from a corporate raid.

Although the use of cumulative voting for directors as a shark repellent has not been very effective, it has been the only use by a publicly held corporation that has had any effect whatsoever. As noted, the device has not been used to protect the interests of shareholders; however, with the increase in institutional voting power, it could conceivably be used for that purpose.

D. The Shareholder's Right to Vote on Basic Corporate Changes

It has long been recognized that the corporation is a product of contract. In its earliest consideration of the corporate form, the United States Supreme Court held that the relationship between a corporation and the state that granted its charter was contractual and that, pursuant to principles of contract law, its terms could not be altered by unilateral action.[67]

Furthermore, the relationship between the corporation and its shareholders, and among the shareholders themselves, is also contractual. The terms of this contract are found in state corporation statutes, in the general body of corporation law,[68] and in the discretionary terms adopted by the incorporators or shareholders. The powers and duties of directors are also based on contract, the terms of which are derived from the same sources. Though officers and other employees are also governed by the law of agency, all relationships within the corporation are essentially contractual.

If the shareholder derives his right from a contract it would seem that his rights cannot be altered without his consent, unless the contract itself provides for a means of altering such rights, and statutes of every state provide such means. Specific procedures are set out for the accomplishment of charter amendments, share exchanges, sales of assets, corporate combinations and corporate dissolutions. Because most modern state statutes reserve to the state the power to amend its corporate statutes, states now generally have the power to make unilateral amendments to the compact between the state and the cor-

67. Trustees of Dartmouth College v. Woodward, 17 U.S. 518 (1819). *But see infra* note 68 and accompanying text.

68. L.C.B. GOWER, THE PRINCIPLES OF MODERN COMPANY LAW (3d ed. 1969). Behind [corporation statutes] is the general body of law and equity applying to all companies irrespective of their nature, and it is there that most of the fundamental principles will be found." *Id.* at 8.

poration and, through it, to the relationship between the corporation and its shareholders.[69]

Absent a statutory provision, directors should not lack power to participate in the amendment of the terms of a contract that is, for all practical purposes, between the state and the shareholders. Furthermore, the powers of directors have long been recognized to "extend only to the management of the regular business of the corporation."[70] Still, every state statute provides such power to directors.[71]

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69. The Model Business Corporation Act (MBCA) provides that "the [name of state legislature] has power to amend or repeal all or part of this Act at any time . . . ." MODEL BUSINESS CORP. ACT § 1.02 (2d ed. 1981 & Supp. 1986). Only Virginia has adopted § 1.02 of the MBCA without change. *See* VA. CODE ANN. § 13.1-602 (1981 & Supp. 1988). All other states except Hawaii and West Virginia have provisions which specifically authorize the legislature to amend or repeal state corporation laws. In 10 states, these provisions are found in the state constitution, while 24 states expressly authorize the legislative body to prescribe regulations, provisions and limitations it deems advisable. An amendment to state corporation law can affect the vested rights of shareholders. Constitutional arguments based on the injunction against impairment of the obligation of contracts, or the prohibition of the taking of property without due process of law, have generally been unsuccessful. For older cases holding that the state may not destroy vested rights by amendment of its corporate statutes, see Clearwater v. Meredith, 68 U.S. 25 (1863); Schaffner v. Standard Boiler & Plate Iron Co., 150 Ohio St. 454, 83 N.E.2d 192 (1948); Schaad v. Hotel Easton Co., 369 Pa. 486, 87 A.2d 227 (1952). For representation of the modern view, see Mobile Press Register, Inc. v. McGowin, 271 Ala. 414, 124 So. 2d 812 (1980).

70. V. MORAWETZ, THE LAW OF PRIVATE CORPORATIONS 479 (2d ed. 1886). Morawetz comments as follows:

> [T]he exclusive powers of the board of directors extend only to the management of the regular business of the corporation. Even an express provision that the powers of the corporation shall be exercised by its board of directors does not deprive the majority of the power of directing the general policy of the corporation, and of deciding upon the propriety of important changes in the company's business. . . .
>
> The general authority of the directors of a corporation extends merely to the supervision and management of the company's ordinary or regular business. A board of directors has no implied authority to make a material and permanent alteration of the business or constitution of a corporation, even though the alteration be within the company's chartered powers. Such an alteration can be affected only by authority of the shareholders at a general meeting.

Id. See also Eisenberg, *The Legal Roles of Shareholders & Management in Modern Corporate Decision Making*, 57 CALIF. L. REV. 1 (1969). In his article, Eisenberg observes that "the corporate statutes were enacted in the context of this common-law pattern, and generally served to perpetuate it". *Id.* at 89.

71. For example, the Model Business Corporation Act provides: "All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of its board of directors . . . ." MODEL BUSINESS CORP. ACT § 8.01 (2d ed. 1981 & Supp. 1986). *See* COLO. REV. STAT. § 7-5.101 (1986 & Supp. 1988). "The business and affairs of a corporation shall be managed by a

However, directors can serve an appropriate function in the amendment of the contract among the shareholders. Because directors are charged with the responsibility to act in the interests of all shareholders, they can stand as a buffer for the minority against the will of the majority. Majorities of varying size have the power under all corporate statutes to amend the terms of their contracts with the minority—a power unheard of at common law—this additional barrier to the power of the majority seems appropriate as a result.

The right to vote on basic structural changes to the corporation is probably the only shareholder's governance right that has been of any real value to shareholders of publicly held corporations. Even so, the individual shareholder has seldom had the opportunity or the power to make truly effective use of it. Instead, a single shareholder has voted with corporate management, depending on them to make the evaluation he is either unable or unwilling to make himself. The fact that institutions are in a position to make their own evaluations is unsettling to management, particularly where their evaluation is contrary to management's.

E. Summary

The right of the shareholder of the publicly held corporation to vote on basic corporate changes, as well as for directors, has been protected by federal regulation and by state law,[72] and is consistent with the basic concept of the corporation. Although not all of those who supply capital to the corporation need be given the right to vote in all circumstances, there is certainly no basis for providing the right to vote to one owner of stock of a particular class and denying it to another. Although under state law corporations have the right to issue classes of stock with differing voting rights, corporations listed on an exchange or registered under the 1934 Act may not freely exercise that right. There have been various proposals for denying voting rights to short-term shareholders; however, such arrangements do not seem to be legally possible at the present time. Recognizing that the proposal is aimed at institutional voting, one must ask whether it is advisable.

V. THE FUTURE ROLE OF INSTITUTIONS IN CORPORATE GOVERNANCE

Concerning the future role of institutions in corporate governance, one fact of overriding importance is apparent. Today institutions own almost a majority of the shares of American corporations and their

board of directors except as otherwise provided in this code or by its articles of incorporation."

72. *See supra* notes 18-23 and accompanying text.

percentage of ownership is expected to grow very rapidly in the next decade. In the future, institutions and corporate managers are likely to be jointly involved in questions of corporate control and management, as the voice of institutional investors will continue to grow.

It is also apparent that the corporate takeover movement has acted as a catalyst which has hastened the reaction of many corporate managers to this new shareholder power. By identifying interests that many institutions have in common, but which might be contrary to the interests of corporate managers, the takeover movement has polarized and solidified the positions of the opposing parties, and has particularly contributed to organizing the institutions into effective power blocs.

It follows, therefore, that the debate concerning the proper role of institutions in corporate governance has been carried out in the wrong context. The question is not how institutions should act as players in a takeover contest, but rather, how institutions should conduct themselves as the majority owners of many American corporations. In the most important sense the institutions are not the short-term owners that they were characterized to be by Sigler.[73] Instead, institutions have more at stake in the future of American corporations than any other identifiable segment of the economy.

There has been much criticism of the short-term investment outlook characteristic of institutions. It is true that institutional portfolios turn over many times annually and that institutional trading accounts for the bulk of market activity today. It is not clear, however, that longer term investment strategies would change the attitudes of the institutions toward the opportunity to obtain a quick 25% to 100% return as a result of an unfriendly tender offer. Furthermore, the overwhelming majority of non-institutional shareholders would undoubtedly also welcome such an opportunity. In fact, among shareholders, the only discernable group that would likely want to discourage such offers is management shareholders. One cannot even assume with certainty that other employee shareholders would oppose such an offer. It appears, therefore, that the actions for which institutions are being criticized are simply those that most shareholders would, in all propriety, take if it were within their power. In any case, theoretically, the tender offer movement will continue only so long as there are bargains in the securities markets and, thereafter, the institutions will become more interested in the

73. *See supra* note 7 and accompanying text.

long term health of the publicly held corporations as they should be. According to the projections contained in charts 1 and 2 above, at the end of this century, institutions will be twice as committed to corporate equities as they are today.

In view of the critical stake institutions have and will continue to have, in American corporations, it would not be in their interests to harm the American corporate structure. Further, it is not readily apparent that either a short-term investment strategy[74] or a strategy in support of takeover contests is fundamentally detrimental to American corporations or the American economy.

Perhaps what is being observed is a basic realignment of corporate power with the shareholder finally emerging as a force in the publicly held corporation. As it always has, the law protects the primacy of the shareholder as the beneficiary of the corporation and provides a structure for the shareholder to govern. In the past, however, economic factors have denied the shareholder the power to exploit this position. Today, the institutional investor gives to the body of shareholders some of the strength it has lacked, and it can only grow stronger.

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74. There now seems to be little doubt that institutional trading practices were a major contributor to the market crash in October of 1987.

The 1987 October crash also revealed that there are limits to the liquidity of the market. Consequently, any investment strategy based on unlimited market liquidity is flawed, and it is understood that many institutions have revised market strategies to avoid reliance on unlimited market liquidity; yet, they still have a short term orientation. However, they cannot avoid a long-term commitment to corporate equities.