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Disciplining Corporate Boards and Debtholders Through Targeted Proxy Access

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DISCIPLINING CORPORATE BOARDS AND DEBTHOLDERS THROUGH TARGETED PROXY ACCESS

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ABSTRACT

Corporate directors committed to a failed business strategy or unduly influenced by the company's debtholders need a dissenting voice—they need shareholder nominees on the board. This article examines the bias, conflicts, and external factors that impact board decisions, particularly when a company faces financial distress. It challenges the conventional wisdom that debt disciplines management, and it suggests that, in certain circumstances, the company would benefit from having the shareholders' perspective more actively represented on the board. To that end, the article proposes a bylaw that would give shareholders the ability to nominate directors upon the occurrence of predefined events. Such targeted proxy access would incentivize boards to manage difficult operational and financial situations more proactively, while creating a reasonable oversight mechanism for shareholders if those efforts fail. The article also discusses ways for shareholders to use general proxy access in distressed situations to strengthen the shareholder perspective in, and add value to, boards' negotiations with debtholders. Yet failing the utility of traditional, general proxy methodology, the article suggests that targeted proxy access is a more tailored solution that mitigates many of the concerns articulated in the proxy access debate and provides a better balance between management autonomy and accountability.

* Professor of Law, University of Maryland Francis King Carey School of Law. Drafts of this article were presented at the Law & Society Annual Meeting and the Southeastern Association of Law Schools Annual Meeting. The article benefitted from the comments of, or discussions with, Afra Afsharipour, Lynne Dallas, Lisa Fairfax, Michael Guttentag, Wulf Kaal, Jeremy Kidd, Joan MacLeod Heminway, Donald Langevoort, Dale Oesterle, and Robert Rhee, as well as many practitioners who represent activist investors or distressed companies. In addition, I appreciate the research assistance of Jason Hawkins and Robbie Walker. Nevertheless, all opinions, errors, and omissions in this Article are my own. Finally, I thank the University of Maryland Francis King Carey School of Law for financial support.

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INTRODUCTION

The corporate boardroom is not for the faint of heart. Corporate directors frequently are called upon to make real time decisions involving complex financial and operational matters. The stakes are high, and the choices are hard. Directors are required to act in the best interests of the company, but conflicts of interest, lenders or investors with different agendas, or other factors may influence their judgment.[1] And once directors have made a decision and committed to action, it is frequently difficult to reverse course.[2]

Consider RadioShack Corp., a 94-year old company sold through a chapter 11 bankruptcy case and now existing as a shell of its former self.[3] Prior to the bankruptcy, RadioShack was slow to innovate, suffered 11 consecutive quarters of losses, and experienced significant turnover in key executive positions. Yet despite these warning signs, RadioShack churned along and continued to hold onto hope of a turnaround. The company's last effort to achieve that objective was financed through a rescue loan package that ultimately led to the bankruptcy sale.

Perhaps RadioShack was destined to fail: the victim of an all-too-familiar creative destruction story of an industry (i.e., bricks and mortar electronics stores) that had outlived its useful life, being replaced by new, more modern forms of product delivery.[4] Alternatively, perhaps internal conflict or outside influences stymied the board of directors, which failed to implement a creative reconstruction plan that would have better positioned the company for the new economy. Could a new or different perspective have presented better prospects of saving RadioShack? This article suggests that the answer is "yes," and it underscores the value of, and the role for, shareholder nominees on the board in such a situation. It further suggests the use of a well-crafted proxy access bylaw to implement the proposal.[5]

Boards of directors do represent the interests of shareholders generally, but that perspective can become lost in the complex and often time-sensitive situations facing

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[1] *See infra* Parts I.A, I.B.

[2] The difficulties in changing course may stem from a variety of factors, including operational challenges and commitment bias on the part of the directors and management team. *See infra* notes 56-59 and accompanying text.

[3] For a detailed case study of RadioShack, see *infra* Part II.D. The purchaser in the bankruptcy sale bought RadioShack's trademark and 1,733 of RadioShack's more than 4,000 stores. *See id*. *See also* Lisa Fickenscher, *RadioShack Has a New Strategy After Its Brush with Death*, N.Y. POST, Nov. 26, 2015 (noting scope of bankruptcy sale). The remaining stores were closed, causing thousands of employees to lose their jobs, lessors to lose rental income, and suppliers to lose a customer.

[4] JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY (3d ed. 1950) (explaining creative destruction generally as the "process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one").

[5] In an ordinary election proxy, the company (through its current board) identifies individuals to nominate for open board seats and includes the names of these individuals in the company's proxy materials, including the company's proxy card. Shareholders may use the proxy card to vote for directors in lieu of attending the annual meeting. "Proxy access refers to shareholders' ability to nominate directorial candidates of their choice to the corporation's proxy statement." Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1260 (2009).

corporate boards, particularly in times of financial distress. A targeted proxy access bylaw would allow eligible shareholders to nominate candidates for the board precisely at a time when others—lenders, distressed debt investors, or special interest groups—may have the board's attention.[6] A more direct shareholder perspective could act as a counterbalance to the external, frequently biased interests represented by these other players, providing boards with greater leverage in negotiations and possibly more restructuring alternatives.

Shareholders of public companies are increasingly using shareholder proposals to seek bylaws that would grant proxy access to certain categories of shareholders in all director elections.[7] The most common proxy access proposals allow shareholders owning at least three percent of the company's stock for at least three consecutive years to nominate a certain number of director candidates.[8] The nominating shareholder typically must make specific representations and disclosures in connection with the nomination, and the company must include the nominating shareholder's statement in support of the nominees in its proxy materials.[9] Not all companies, however, are willing to adopt such bylaws; indeed, not even all shareholders support proxy access on such a blanket basis.

The views on proxy access vary both in the business community and academic literature. For example, Institutional Shareholder Services ("ISS") generally supports proxy access meeting certain criteria, including the three percent, three-year ownership provisions discussed above.[10] In fact, ISS released guidelines indicating that it may

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[6] *See infra* Part II.B.

[7] *See, e.g.,* Keir Gumbs, et al., *The 2015 Proxy Season: The Year of the Proxy*, 29 INSIGHTS 1, 2 (July 2015) ("For example, shareholders submitted only 22 proxy access proposals in 2012, 17 in 2013, and 17 again in 2014. In 2015, however, there has been a sharp increase in the number of proxy access shareholder proposals—as of July 8, 2015 at least 108 proxy access shareholder proposals have been submitted."). The change in approach during the 2015 proxy season was facilitated, in part, by the City of New York's Office of the Comptroller's Boardroom Accountability Project. *See* 2015 NEW YORK CITY PENSION FUNDS PROXY ACCESS SHAREOWNER PROPOSAL, CITY OF NEW YORK, OFFICE OF THE COMPTROLLER, available at http://comptroller.nyc.gov/wp-content/uploads/2014/11/Model-Proxy-Access.pdf.

[8] These guidelines generally follow the proxy access rules announced by the SEC in 2010. *See infra* Part III.B. *See also, e.g.*, SIMPSON THATCHER, PROXY ACCESS PROPOSALS, MEMO SERIES: THE 2015 PROXY SEASON, July 30, 2015, available at http://www.stblaw.com/docs/default-source/memos/firmmemo_07_30_15_proxy-access-proposals.pdf (outlining the general terms of proxy access bylaws proposed to, and adopted by, companies); Bo Becker & Guhan Subramanian, *Improving Director Elections*, 3 HARV. BUS. L. REV. 1, 33 (2013) (noting in the context of 2012 proxy season, "The two successful proposals both imposed an ownership threshold/holding period requirement of 3%/3 years, identical to the abandoned Rule 14a-11, while *all* of the unsuccessful proposals had lower thresholds, typically 1%/1 year.").

[9] *See generally* SULLIVAN & CROMWELL LLP, PROXY ACCESS BYLAW DEVELOPMENT AND TRENDS, Aug. 18, 2015 (providing a detailed explanation of common terms found in proxy access proposals), available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Proxy_Access_Bylaw_Developments_and_Trends.pdf. *See also* 17 C.F.R. § 240-14n-101 (this schedule, Schedule 14N, applies to nominations under proxy access bylaws and includes various disclosures by the nominating shareholder).

[10] *See* INSTITUTIONAL SHAREHOLDER SERVICES, U.S. PROXY VOTING POLICIES AND PROCEDURES (EXCLUDING COMPENSATION-RELATED), FREQUENTLY ASKED QUESTIONS (Dec. 18, 2016) ["ISS PROXY VOTING POLICIES FAQS"]. *See also* Howard B. Dicker, *ISS Proxy Access FAQs: Problematic Proxy Access Provisions*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL

recommend a vote against directors if a board's implementation of proxy access contains certain provisions that it views as problematic.[11] On the other side of the debate, the Business Roundtable has suggested that "'companies may have no choice but to consider litigation to keep shareholders' proxy access proposals off their ballots.'"[12] The voting results on proposed proxy access bylaws suggest that institutional shareholders tend to support such proposals more readily than retail shareholders.[13] Moreover, some large shareholders have adopted a case-by-case approach to assessing proxy access proposals.[14]

Academics and other commentators acknowledge various advantages and disadvantages to proxy access. Supporters argue that proxy access can facilitate greater director accountability, enhanced communications among directors and shareholders, and general governance efficiencies.[15] Those who oppose proxy access emphasize that it can distract directors and management, allow special interests to gain board representation, and add unnecessary cost and delay to the election process.[16] As with most worthy

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REGULATION, Jan. 5, 2016. The other well-know proxy advisory firm, Glass Lewis, takes a similar position, generally supporting proxy access but scrutinizing proposals before making recommendations. *See* SIMPSON THATCHER, *supra* note 8, at 9-10.

[11] ISS suggests that it "may issue an adverse recommendation if a proxy access policy implemented or proposed by management contains material restrictions more stringent than those included in a majority-supported proxy access shareholder proposal with respect to the following." *See* ISS PROXY VOTING POLICIES FAQS *supra* note 10, at 19. The examples provided include ownership requirements above the three percent, three-year levels, aggregation limits above 20 shareholders, and restrictions on the number of directors to be nominated by shareholders below 20 percent of the board*.* *See id.*

[12] Kaja Whitehouse, *Shareholders Threaten Boards Over 'Proxy Access',* USA TODAY, Jan. 27, 2015 (quoting a response letter by the Business Roundtable).

[13] *See, e.g.,* PRESS RELEASE, 2015 PROXY SEASON RESULTS SHOW THAT RETAIL INVESTORS VOTED AGAINST PROXY ACCESS PROPOSALS, ACCORDING TO NEW REPORT FROM BROADRIDGE AND PWC US, BROADRIDGE FINANCIAL SOLUTIONS, INC., Aug. 27, 2015 ("Of the over 80 proxy access proposals that came to a vote, 70% received the majority support of shareholders, averaging 57% of the shares voted. Retail investors voted their shares against proxy access in significant numbers, while institutions voted 61% of their shares in favor of such proposals.").

[14] Institutional shareholders and private funds typically scrutinize proposals and consider the need for the bylaw and the terms of the proposal. *See, e.g.,* David Benoit, *BlackRock Takes Its Own Advice on Proxy Access*, MONEYBEAT, WALL ST. J., Oct. 7, 2015 (noting that BlackRock was giving its shareholders an opportunity to vote on a proxy access proposal at its annual meeting and that, with respect to other companies, "BlackRock and others have said they'll review each company's proposed rule individually").

[15] *See, e.g.*, Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?,* 2013 U. ILL. L. REV. 821, 824-30 (highlighting benefits of proxy access in context of increasing board-shareholder dialogue); Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329 (2010) (advocating for proxy access as a default regulatory rule and outlining governance benefits); Fairfax, *supra* note 5 (positing that proxy access is more effective than other shareholder governance tools).

[16] *See, e.g.,* Marcel Kahan & Edward B. Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347 (2011) (arguing that proxy access would have little impact on corporate governance); Joseph A. Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 BUS. LAW. 361 (criticizing proxy access regulation); Bernard S. Sharfman, *Why Proxy Access is Harmful to Corporate Governance*, 37 J. CORP. L. 387 (2012) (highlighting structural deficiencies in proxy access that undercut its utility). *See also* J.W. Verret, *Defending Against Shareholder Proxy Access: Delaware's Future Reviewing Company Defenses in the Era of Dodd-Frank*, 36 J. CORP. L. 391, 397-404 (2011) (reviewing various perspectives on shareholder empowerment and proxy access); Jill E. Fisch, *Leave It to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731 (2013) (arguing that federal law should not regulate, among other things, proxy access).

debates, the truth likely lies somewhere in the middle and depends on the particular company, its unique circumstances, and the makeup of its shareholder base.

The targeted proxy access proposal suggested by this article strikes an appropriate balance among these competing considerations. It would not grant proxy access in all cases. To the extent a company is doing well, the management of the company should be in the hands of the board and management team without the potential distraction and costs of shareholder proxy access. If the company experiences difficulties that are not timely addressed, however, shareholders should have greater access to the ballot to facilitate and assist in the company's turnaround efforts. Both boards and shareholders may be able to support such a balanced approach.

Notably, the Securities and Exchange Commission ("SEC") proposed a kind of contingent proxy access in 2003 that would have given shareholders the ability to nominate directors through the proxy statement under certain circumstances unrelated to a company's financial health.[17] Although some opposed the concept, others supported such a refined approach to proxy access.[18] Similar to the SEC's 2003 proposal, the targeted proxy access discussed in this article rests on the notion that not all companies may benefit from proxy access in all cases. The targeted proxy access proposal, however, differs from the prior SEC proposal in two important respects: companies and shareholders would implement such proxy access through private ordering (and not federal regulation), and they would tailor the triggers to the particular company, avoiding the complexity and uncertainty that plagues a one-size-fits all approach.[19]

The effectiveness of targeted proxy access would depend largely on the terms of the bylaw itself, which should be drafted and evaluated on a company-by-company basis. In general, the triggers for proxy access should be objective and well-defined—e.g., a material default under a credit facility or bond issuance; a restructuring, refinancing, or forbearance to avoid a material default under a credit facility or bond issuance; a downgrade by one of the major ratings agencies; or a certain number of consecutive quarters of significant losses.[20] The article draws on concepts and terminology familiar to public companies under the disclosure guidelines established by the SEC for the Form 8-K, Current Report, to guide the applicable triggers.[21] The bylaw also should seek to align the interests of the company and the shareholders eligible to nominate directors once the bylaw is triggered.[22] Accordingly, both the percentage and duration of

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[17] *See* RELEASE NOS. 33-9136, 34-62764, FACILITATING SHAREHOLDER DIRECTOR NOMINATIONS, FINAL RULE, SECURITIES AND EXCHANGE COMMISSION, Aug. 25, 2010, at 46-47 (explaining the triggers under the 2003 proposal as (i) one of the company's nominees "received withhold votes from more than 35% of the votes cast at an annual meeting" or (ii) a shareholder proposal to adopt a shareholder nomination procedure "received more than 50% of the votes cast on that proposal at the meeting") ["SEC RELEASE NOS. 33-9136, 34-62764"].
[18] *Id.*
[19] *Id.*
[20] *See infra* Part III.B (including proposed language for a targeted proxy access bylaw).
[21] *See* Form 8-K, Current Report, 17 C.F.R. § 249-308 (requiring disclosures concerning, among other things, material definitive agreements and direct financial obligations).
[22] *See infra* Part III.B.

ownership should be considered, arguably following the three percent, three-year ownership model currently invoked in many proxy access proposals.

In addition to proxy access mechanics, the article emphasizes the importance of detailed shareholder disclosures and position statements to the utility of targeted proxy access. Shareholders nominating directors should be required to provide at least two kinds of individual disclosures: (i) information about their own holdings to allow boards and other shareholders to evaluate whether the interests of the nominating shareholders are generally aligned with the company, or whether the nominating shareholders instead hold an adverse agenda; and (ii) the qualifications, experience, and other relevant information about their nominee(s).[23] Shareholders also should endeavor to submit a position statement for the proxy materials that supports their nominees and explains their justifications for the requested change in leadership.

As discussed in Part I.B, information provided to shareholders by management may be biased or limited in scope and perspective.[24] The Darden Restaurants, Inc. case study set forth in Part II.C illustrates the problems posed by such limited disclosures and how more robust disclosures by a shareholder in the context of a proxy contest may assist a company and its shareholders.[25] Admittedly, boards and management resist competing informational disclosures in proxy materials. Nevertheless, on balance and in cases of underperforming management or distressed situations, such disclosures challenge management to make better decisions and encourage shareholders to hold management accountable if warranted.[26] The case studies and targeted proxy access discussed in this article highlight the potential value to proxy access in distressed situations, whether under a targeted or a more general proxy access bylaw. The design of targeted proxy access, however, offers incentives and benefits not available through more traditional, general proxy access methodology.

Despite the potential value of targeted proxy access, boards and shareholders may demur.[27] Boards may be hesitant to cede control even when their performance or the challenges faced by the company suggest a new approach or perspective is necessary. Likewise, shareholders may believe the proposal is too limited and that they should have greater access to the ballot regardless of how the board and company are performing. Importantly, the balance struck by the proposal rests on an objective that benefits both sides: a profitable and stable company. A board of directors of a company with a targeted proxy access bylaw will have every incentive to manage the company's operational and financial challenges more proactively and avoid the triggers of the bylaw. Shareholders of that company should be well served as a result, and they would have appropriate recourse if management fails in those efforts.

[23] *See id.* (discussing proposed disclosures in more detail and their relation to the disclosures required by the SEC's Schedule 14N under 17 C.F.R. § 240-14n-101).
[24] *See infra* Part I.B.
[25] *See infra* Part II.C.
[26] *See infra* Parts III.B and III.C.
[27] *See infra* Part III.C (examining the potential implementation challenges to the targeted proxy access proposal).

Part I of the article frames the primary underlying issue: potentially ineffective or conflicted decisionmaking by boards of directors, particularly in times of financial distress. This section provides an overview of directors' and officers' fiduciary duties and explains how those duties fail to provide adequate guidance in certain circumstances. Part II then discusses in more detail one such circumstance—boards making decisions in the presence or under the influence of activist investors. Notably, both shareholder and debtholder activism can impact board decisionmaking. This section sets forth two different case studies—one of Darden Restaurants, Inc. and one of RadioShack Corp.—to illustrate different approaches to activism and potential consequences for the targets. Part III draws on the prior sections, including the case studies, to develop the justifications for, and key features of, the targeted proxy access bylaw. The article concludes by discussing the potential value for all stakeholders of the additional information and new perspectives offered by targeted proxy access and the presence of shareholder nominees on the boards of distressed companies.

I. THE PROBLEM: FIDUCIARIES SERVING MULTIPLE MASTERS

A board of directors manages the affairs of the corporation for the benefit of the corporate entity and its shareholders.[28] This division of management and ownership creates agency costs, as no one shareholder necessarily has the economic incentive to monitor the board and hold it accountable.[29] Moreover, a board must possess a certain level of autonomy to govern a corporation effectively.[30] Striking the appropriate balance between board autonomy and accountability is an ongoing challenge in corporate governance law.[31]

A company experiencing financial distress perhaps illustrates this challenge most vividly.[32] The board of a distressed company needs the financial flexibility to, for

[28] State law generally delegates all management authority to the board of directors of the corporation. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors…"); MODEL BUS. CORP. ACT § 8.01(b) ("[A]ll corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction [of the board of directors]."). A company's insolvency may impact the beneficiaries of directors' duties. *See infra* note 36.

[29] *See*, *e.g.*, Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J. L. ECON. 327 (1983); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); Andrei Schleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997).

[30] *See, e.g.,* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 425 (2001) ("Rather than being agents, directors play a role that more closely resembles that of an autonomous trustee or fiduciary who is charged with serving another's interests."); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 787 (2001).

[31] *See, e.g.*, Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 109 (2004) ("Establishing the proper mix of deference and accountability thus emerges as the central problem in applying the business judgment rule to particular situations.").

[32] For a general discussion of issues facing boards of directors of financially distressed companies, see Michelle M. Harner & Jamie Marincic Griffin, *Facilitating Successful Failures,* 66 FLA. L. REV. 205

example, incur additional debt or refinance old debt; change operational course; and implement layoffs, consolidations, closures, or other restructuring decisions. Nevertheless, the extent of each of these measures and what is reasonable and appropriate under the circumstances are in many respects subjective determinations.[33] Many questions arise: Is the board jeopardizing the long-term health of the company by implementing short-term remedies? Is the board moving too slowly or too quickly? Who is benefiting most from the board's decisions—shareholders, creditors, or the board?

State corporate law attempts to guide a board's determinations in these and other scenarios through either common law or statutory fiduciary duties.[34] Board members and senior officers generally owe a duty of care and loyalty to the corporate entity and its shareholders.[35] Financial distress not only blurs the boundaries of these fiduciary duties,[36] but it also creates opportunities for conflicts of interest and self-dealing on the part of multiple parties. This section examines existing checks on a board's autonomy

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(2014). *See also* Stephen J. Lubben, *The Board's Duty to Keep Its Options Open*, 2015 ILL. L. REV. 817, 819 ("[S]tate corporate law imposes a duty on the board to carefully consider any decision that will foreclose a future board's choices. In times of financial distress, this duty includes an obligation to carefully consider the effects of a particular decision on future restructuring options.").

[33] *See, e.g.*, Russell C. Silberglied, *Litigating Fiduciary Duty Claims in Bankruptcy Court and Beyond: Theory and Practical Considerations in an Evolving Environment*, 10 J. BUS. & TECH. L. 181 (2015) (examining, among other things, board decisions underlying creditor and shareholder litigation in the distressed context).

[34] *See* TAMAR FRANKEL, FIDUCIARY LAW 7-13 (2010) (describing general duties of fiduciaries). Whether directors' and officers' fiduciary duties are based in common law or statute (or come combination of the two) varies by state. *See, e.g.,* VA. CODE ANN. § 13.1-690 ("A director shall discharge his duties as a director, including his duties as a member of a committee, in accordance with his good faith business judgment of the best interests of the corporation."); Willard v. Moneta Building Supply, Inc., 515 S.E.2d 277, 284 (1999) ("Code § 13.1-690(A) does not abrogate the common law duties of a director. It does, however, set the standard by which a director is to discharge those duties."). *See also* MODEL BUS. CORP. ACT §§ 8.30, 8.31 (2011) (standards of conduct and liability for directors); Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. REV. 701, 705 (2011) ("The [Delaware] General Assembly has never addressed the fiduciary duties of corporate officers, leaving that subject entirely to the judiciary, which has likewise largely neglected these duties. The General Assembly, however, has addressed the fiduciary duties of corporate directors, but not to permit curtailing or negating those duties.").

[35] *See generally* Silberglied, *supra* note 33. *See also* Gantler v. Stephens, 965 A.2d 695, 708–09 (Del. 2009) ("In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors. We now explicitly so hold."); Lyman P.Q. Johnson & David K. Millon, *Recalling Why Corporate Officers are Fiduciaries*, 46 WM. & MARY L. REV. 1597 (2005).

[36] Questions arise concerning whether directors continue to owe their fiduciary duties solely to the corporation and shareholders as the corporate entity approaches insolvency. Some courts suggest that such duties may be owed to the corporate enterprise, which includes stakeholders other than shareholders. The Delaware Supreme Court has clarified that "the creditors of a Delaware corporation that is either insolvent or in the zone of insolvency have no right, as a matter of law, to assert direct claims for breach of fiduciary duty against the corporation's directors." N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 94 (Del. 2007). *See also* Berg & Berg Enters., LLC v. Boyle, 100 Cal. Rptr. 3d 875, 894 (Cal. Ct. App. 2009) ("[W]e hold that there is no fiduciary duty prescribed under California law that is owed to creditors by directors of a corporation solely by virtue of its operating in the 'zone' or 'vicinity' of insolvency."). The Delaware Chancery Court has further explained that creditors may bring derivative claims against corporate officers and directors for alleged breaches of their fiduciary duties when the corporation is insolvent and that such standard does not require the corporation to be "irretrievably insolvent." Quadrant Structured Prods. Co., Ltd. v. Vertin, Case No. 6990-VCL (Del. Ch. May 4, 2015).

and accountability, highlighting weaknesses that often lead to corporate governance failures and shareholder loss.

A. Overview of a Board's Fiduciary Duties

Corporate board members and senior officers are fiduciaries.[37] These individuals generally owe fiduciary duties, including duties of care and loyalty, to the corporate entity and its shareholders.[38] In theory, such obligations should deter misconduct and produce beneficial outcomes. In practice, however, fiduciary duties are limited in scope and effect,[39] as well as by the reality that the decisionmakers are human,[40] and there rarely is one correct answer.

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[37] Silberglied, *supra* note 33.

[38] *See, e.g.,* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) ("It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders."); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986) ("[T]he directors owe fiduciary duties of care and loyalty to the corporation and its shareholders."). Although most commentators agree that directors and officers owe fiduciary duties to the corporation, they do not agree that such duties also run to the corporation's shareholders. *See, e.g.,* Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. CORP. L. 719, 731 (2006) ("There is very little in corporate law that supports [shareholder wealth maximization] and much that cuts against it."); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277 (1998) (arguing against a shareholder primacy norm). For a thoughtful review of the competing theories of corporate governance and a recommendation for a more nimble, less board-centric approach, see Anthony J. Casey & M. Todd Henderson, *The Boundaries of 'Team' Production of Corporate Governance*, 38 SEATTLE UNIV. L. REV. 365 (2015). *See also supra* note 36 (discussing directors' duties in the context of insolvency).

[39] *See* Kelli A. Alces, *Beyond the Board of Directors*, 46 WAKE FOREST L. REV. 783, 786 (2011) (arguing that "the board of directors in a large public corporation is ineffective to perform the functions assigned to it and should thus be eliminated in favor of a governance system that more accurately reflects corporate decision making"). For in-depth discussions of limitations on board effectiveness based on board composition, see Nicola Faith Sharpe, *The Cosmetic Independence of Corporate Boards,* 34 SEATTLE U. L. REV. 1435, 1453-56 (2011); Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127 (2010).

[40] A rich literature exists examining the human component of corporate boards. *See, e.g.*, Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance,* 55 VAND. L. REV. 1, 2–3 (2002); Margaret M. Blair & Lynn A. Stout, *Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1807–10 (2001); Regina F. Burch, *The Myth of the Unbiased Director*, 41 AKRON L. REV. 509, 510–14 (2008); James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, LAW & CONTEMP. PROBS., Summer 1985, at 83, 83–84, 99–108; Lawrence A. Cunningham, *Beyond Liability: Rewarding Effective Gatekeepers*, 92 MINN. L. REV. 323, 363–65 (2007); Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporations and Their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 RUTGERS L.J. 1, 2–4 (2003); Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 U.C. DAVIS L. REV. 581, 583–85 (2002); Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 107 (1997–1998); Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 288 (2004); Oliver Marnet, *Behavior and Rationality in Corporate Governance*, 39 J. ECON. ISSUES 613, 614, 619 (2005); Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237, 286–89 (2009). For an interesting proposal to use "board service providers" in

The duty of care requires board members and officers to serve the corporation in good faith and with the same level of diligence, care, and skill of a reasonably prudent businessperson.[41] Although the standard sounds stringent, a board's duty of care and resulting decisions are protected by the business judgment rule, which is a rebuttable presumption that the board acted in good faith, on an informed basis, and in the best interests of the corporation.[42] Plaintiffs typically find it difficult to overcome the business judgment rule and succeed in litigation against corporate directors and officers, unless the plaintiffs can demonstrate a breach of the duty of loyalty.[43] The duty of loyalty is fairly broad, and it encompasses self-dealing, conflicts of interest, and bad faith.[44] Importantly, alleged breaches of the duty of loyalty are not protected by the business judgment rule.

The literature concerning fiduciary duty litigation suggests that relatively few judgments are entered against corporate directors and officers.[45] Rather, such litigation often is resolved in favor of the defendants at the motion to dismiss or summary judgment stage, or settled prior to trial.[46] Most of the literature also questions the value of any judgment or settlement to the corporation because—particularly in the settlement context—the monetary component typically covers primarily attorneys' fees, and the promised corporate governance reforms are either of nominal impact or already in

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lieu of natural persons, see Stephen M. Bainbridge & M. Todd Henderson*, Boards-R-Us: Reconceptualizing Corporate Boards,* 66 STAN. L. REV. 1051 (2014).

[41] *See* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963) ("[I]t appears that directors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances. Their duties are those of control, and whether or not by neglect they have made themselves liable for failure to exercise proper control depends on the circumstances and facts of the particular case.").

[42] *See, e.g.*, Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000) ("The business judgment rule has been well formulated by *Aronson* and other cases that '[i]t is a presumption that in making a business decision the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation.' Thus, directors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available." (citation omitted)).

[43] *See, e.g.,* Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982) ("Whatever the terminology, the fact is that liability is rarely imposed upon corporate directors or officers simply for bad judgment and this reluctance to impose liability for unsuccessful business decisions has been doctrinally labelled [sic] the business judgment rule.").

[44] *See, e.g.,* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith. . . . '[a] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest.'") (quoting Guttman v. Huang, 823 A.2d 492, 506 n. 34 (Del. Ch. 2003)).

[45] *See* Ann M. Scarlett, *A Better Approach for Balancing Authority and Accountability in Shareholder Derivative Litigation*, 57 KAN. L. REV. 39, 40 (2008) ("Shareholder derivative litigation, however, rarely succeeds in holding directors liable for their decisions.").

[46] *Id.* at 59 ("Under any formulation of the business judgment rule, it operates as a defense asserted in shareholder derivative actions that challenge a decision made by a corporation's board of directors. Procedurally, defendants have been allowed to assert their business judgment defense on a motion to dismiss, a motion for summary judgment, and at trial.") (citations omitted).

place.[47] Two notable exceptions to this general rule are in the context of governance failures and securities litigation: the outside directors of Worldcom and Enron agreed to pay approximately $24 million and $13 million, respectively, to settle securities class action litigation against them relating to collapse of their companies.[48]

Despite its low success rate, fiduciary duty litigation arguably has a strong deterrent effect. No director or officer wants to be embroiled in years of very public litigation, even if they know they likely will succeed in the end.[49] Moreover, fiduciary duties do provide general guidance for directors and officers—a basic framework for making the tough decisions. Unfortunately, the flexibility in this framework may allow external factors to compromise its utility.

Consider the following two scenarios: In the first, the board is evaluating a sale of the company to an insider. In the second, the board is contemplating a rescue-financing package that will significantly increase the corporation's leverage and decrease its operational discretion. In both scenarios, the board must balance the interests of the company and its shareholders. Most boards also will at least analyze the impact of the transaction on employees, officers, creditors, and perhaps their own professional careers. The influence of each respective factor on the board's decision will depend to some extent on the governing law,[50] but likely also will be driven in some part by the parties at the negotiating table.

Notably, existing best practices treat these two scenarios very differently. Many corporations will utilize independent board committees or special approval procedures for interested party transactions to mitigate the influence of external factors in the first scenario.[51] Such protective measures are not the norm, however, in the second scenario.

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[47] *See generally* Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 UNIV. OF CHI. L. REV. 487 (2007) (studying risk factors relevant to directors' and officers' liability insurance markets and analyzing merits and results of director and officer litigation); Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749 (2010) (discussing general perception that shareholder derivative litigation lacks meaningful value for corporate shareholders and presenting evidence that such litigation may enhance corporate governance measures at targeted firms).

[48] *See, e.g.,* Bernard Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055, 1059 (study discusses Worldcom and Enron settlements, but finds that such personal liability for outside directors is the exception rather than the rule).

[49] *See id*. at 1056 ("The principal threats to outside directors . . . are the time, aggravation, and potential harm to reputation that a lawsuit can entail.").

[50] Although many states have statutes that permit boards to consider the interests of stakeholders other than shareholders in making decisions, commentators debate the impact of these statutes (and, notably, Delaware does not have a constituency statute). *See, e.g.,* ANDREW KEAY, THE ENLIGHTENED SHAREHOLDER VALUE PRINCIPLE AND CORPORATE GOVERNANCE 195 (2011); Leo E Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, ___ WAKE FOREST L. REV. ___ (forthcoming 2015), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2576389. *See also supra* note 36 (discussing directors' duties in the context of insolvency).

[51] *See, e.g.,* Scott V. Simpson & Katherine Brody, *The Evolving Role of Special Committees in M&A Transactions: Seeking Business Judgment Rule Protection in the Context of Controlling Shareholder*

Yet directors in the second scenario may face significantly more pressure from particular interest groups, increased opportunities for conflicts of interest and self-dealing, and arguments that some duties are owed to creditors if the company is in fact insolvent. The next section considers these competing factors and their potential consequences for the company and its shareholders.

B. Additional Challenges for a Board of a Distressed Company

A company experiencing financial distress can invoke a number of alternatives to ameliorate its distress and return to profitability.[52] It can implement operational changes that reduce costs and streamline production or the provision of services. It can sell non-core assets or pursue strategic partners. It also can explore balance sheet adjustments to enhance liquidity or obtain additional financing until the underlying source of the distress is resolved. Financing alternatives can include a new debt or equity offering, an out-of-court workout with existing lenders, a refinancing with new lenders, or an in-court reorganization under chapter 11 of the Bankruptcy Code.[53]

In any event, the board of a distressed company must make difficult choices. The board must, for example, weigh the interests of creditors and shareholders. Financial distress exemplifies the traditional conflict between creditors and shareholders, with creditors often desiring a more conservative course sufficient to pay off the debt and shareholders often wanting more aggressive action resulting in debt repayment and equity value for shareholders.[54] The board also likely will consider the interests of the company's employees and the company's relationships with suppliers and communities.[55] The one alternative that in theory could satisfy all of these competing interests—i.e., resolving the company's financial distress out-of-court through a workout or refinancing that does not require significant closures or layoffs—may not be attainable. Nevertheless, a board may pursue such an alternative at all costs.

Transactions and Other Corporate Transactions Involving Conflicts of Interest, 69 BUS. LAW. 1116 (2014); DEL. CODE ANN. tit. 8, § 141(a).

[52] *See generally* JOHN WILLIAM BUTLER, JR., NAVIGATING TODAY'S ENVIRONMENT: THE DIRECTORS' AND OFFICERS' GUIDE TO RESTRUCTURING (2010) (reviewing frequent causes of distress and alternatives for resolving it).

[53] *See* Michelle M. Harner, *The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing*, 77 FORDHAM L. REV. 703 (Fall 2008) (reviewing each alternative for resolving financial distress).

[54] *See* Rutheford B. Campbell, Jr. & Christopher W. Frost, *Managers' Fiduciary Duties in Financially Distressed Corporations: Chaos in Delaware (and Elsewhere),* 32 J. CORP. L. 491, 514 (2007) ("Once a corporation issues debt, shareholders have an incentive to over-invest in risky projects, while creditors have an incentive to avoid risk because shareholders, as residual claimants, share the risk of loss with creditors but reap the gains from success, they have an appetite for risk that increases with leverage."). *See also* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (discussing shareholder-bondholder conflict generally).

[55] *See supra* note 50 and accompanying text.

In such steadfast pursuit, a board may be justified in its approach, or it may be blinded by heuristics, denial, or the influence of a particular constituent.[56] For example, a board and the officers may believe that they have the talent and experience to turn around the company's financial situation if simply given enough time.[57] They may be committed to a particular course of action that they designed and implemented.[58] They may not recognize the severity of the company's financial condition.[59] Notably, some or all of these and similar conditions may cause a board to back the company into a negotiating corner with lenders, creating a "win-win" situation for the lender and a "partial win-complete loss" situation for the company and its stakeholders.

Why do these conditions create a win-win for the lenders only? It boils down to basic negotiating theory: the lenders have something that the board desperately wants and will give most anything to get; the board also likely has little to offer the lenders in return.[60] The result often is a workout or new financing package that stacks the deck in favor of the lenders, with extremely tight covenants for the company and veto rights for the lenders. If the company is able to use the financing to resolve the underlying distress, everyone wins, including the lenders, who will be repaid in full at extremely high rates. If the company is unsuccessful, the lenders still win, but in this scenario they do not share the victory. The lenders likely will be able to take over the company and either continue to run it for their own benefit (after downsizing or fixing any operational issues), sell it as a going concern (typically at a large profit), or foreclose on the assets for a recovery to the exclusion of all other stakeholders.[61]

From the lenders' perspective, the win-win scenario described above is fair and equitable, as all parties are getting exactly what they bargained for. Indeed, the lenders generally are entitled to the benefit of their bargain. From the company's perspective, a win for the lenders only likely means a loss—perhaps significant losses—for the

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[56] *See supra* note 40.

[57] *See, e.g.*, Hersh Shefrin, *Behavioral Corporate Finance*, J. APPLIED CORP. FIN., Fall 2001, at 113, 117–18 (discussing overconfidence bias and poor corporate decision-making); Dan Lovallo & Daniel Kahneman, *Delusions of Success: How Optimism Undermines Executives' Decisions*, HARVARD BUS. REV., July 2003, at 56, 58 (discussing impact of cognitive biases on business decisions).

[58] *See* Ian Weinstein, *Don't Believe Everything You Think: Cognitive Bias in Legal Decision Making*, 9 CLINICAL L. REV. 783, 796–97 (2003) ("[F]raming bias is the tendency to view a given problem in different terms depending on the perspective from which the problem is viewed.") (discussing framing and anchoring biases).

[59] *See* Harner & Griffin, *supra* note 32, at 208 (explaining management's tendency to deny signs of financial distress and noting that "[o]strich syndrome refers to management's tendency to stick its collective head in the sand and ignore the warning signs of financial distress until it is too late to effectively resolve that distress.").

[60] *See* Robert S. Adler & Elliot M. Silverstein, *When David Meets Goliath: Dealing with Power Differentials in Negotiations*, 5 HARV. NEGOTIATION L. REV. 1, 19 (2000) ("In most relationships, power flows from the more dependent to the less dependent party."). For a general discussion of negotiating leverage in transactional settings, see DAVID A. LAX & JAMES K. SEBENIUS, THE MANAGER AS NEGOTIATOR (2011).

[61] This strategy often is referred to as "loan to own." *See generally* Michelle M. Harner et al., *Distressed Debt Investing*, in ALTERNATIVE INVESTMENTS: INSTRUMENTS, PERFORMANCE, BENCHMARKS, AND STRATEGIES 303 (H. Kent Baker & Greg Filbeck eds., 2013) (exploring investment strategies with respect to distressed companies).

company's other stakeholders. In particular, the company's existing shareholders will be wiped out, existing creditors (other than the winning lenders) will receive little if any recovery on their claims, and many (if not all) of the company's employees will be laid off.[62] Absent fraud or misconduct, these losses are not the fault of the winning lenders; these losses are the risk for which the company bargained. The crux of the issue thus lies in the bargain itself. It also suggests that the board and officers need additional information and assistance in making pre-insolvency decisions.

This suggestion does not mean that boards are incapable of serving the corporation's interests. Many boards are very effective, and most directors work hard to try to get it right. The corporate governance landscape is, however, complicated. Particularly as a company approaches distress, directors are called upon to separate noise from substance. The presence of activists can blur this distinction. Accordingly, the article next analyzes the role of activists before evaluating tools to improve board decisions.

II. CONFOUNDING FACTORS: ACTIVIST SHAREHOLDERS AND DEBTHOLDERS

Historically, corporate activism has had a negative connotation and has been most frequently associated with corporate raiders and vultures.[63] "Activists" are viewed as threats to existing management with an interest only in short-term profitability and self-benefiting transactions. The corporate raiders of the 1980s often are held up as the face of activism, and "greed is good" is thrown out as its slogan.[64]

Although there is undoubtedly some truth to that notion, activists are not a monolithic group, and some of their tactics may work to benefit not only themselves, but also other corporate stakeholders. This part examines the role of shareholder and debtholder activists in corporate America and concludes with a detailed case study of each.

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[62] In a bankruptcy case or out-of-court liquidation scenario, creditors are generally paid according to federal bankruptcy law or state law priorities, which pays secured creditors first, followed by general unsecured creditors, followed last by equity holders. There are frequently multiple tranches of creditors within each general category, and each class of creditors must be paid in full before a lower class can receive any distributions. Consequently, in many instances, unsecured creditors receive nominal recoveries and equity holders receive nothing. In addition, employees lose their jobs and trade creditors lose business. *See, e.g., Circuit City Unplugged: Why Did Chapter 11 Fail to Save 34,000 Jobs?, Hearing before the H. Subcomm. on Commercial and Administrative Law*, 111th Cong. 96 (2009); *Written Testimony of David R. Jury: ACB Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 1 (Mar. 14, 2013) ("Between 1998 and 2003, the domestic steel industry experienced a crisis brought on by a tide of imports which flooded the market and drove steel prices down to 20-year lows. The result was 44 bankruptcies, 18 liquidations and the loss of 55,000 jobs."), available at www.commission.abi.org.

[63] For a general discussion of the characterization of activists as raiders, see Nicole M. Boyson & Robert M. Mooradian, *Corporate Governance and Hedge Fund Activism*, 14 REV. DERIVATIVES RESEARCH 169 (2011); Michelle M. Harner, *Activist Distressed Debtholders: The New Barbarians at the Gate*, 89 WASH. U.L. REV. 155, 164-67 (2011).

[64] *See generally* ROBERT SLATER, THE TITANS OF TAKEOVER (1999) (analyzing transactions pursued by activists in 1980s); Stuart L. Gillan & Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors*, 57 J. FINANCIAL ECONOMICS 275 (reviewing literature on activist transactions in 1980s).

A. Shareholder Activism

Most shareholders, particularly those owning stock in larger corporations, are passive investors.[65] They make a fixed monetary investment when they purchase their stock, and they then rely on the corporation's board and officers, and perhaps other investors, to manage and grow the value of their investment. Moreover, many shareholders hold stock in larger corporations through mutual funds or other third-party managed investment vehicles, thereby further removing them from active management of the company.[66] This passive investor model exacerbates the agency costs associated with the American model of the corporation (i.e., separation of ownership and management).[67]

Not all shareholders, however, are passive investors. Some shareholders strategically invest in companies where they perceive a need for change.[68] That change may involve replacing management or the board; pursuing acquisitions or asset dispositions; restructuring operations; or encouraging the company to adopt other measures that arguably would unlock value if implemented correctly. Although some such changes could improve the value of the company over the longer term, many changes have a shorter-term focus.[69]

[65] For an interesting commentary on the performance of activist versus passive shareholders in 2014, see Stephen Gandel, *Passive Investors Crushed the Activists in 2014*, FORBES, Jan. 9, 2015 ("If you put your money in the S&P 500 and let it sit there for the entirety of 2014, your portfolio would have gone up 12%. No proxy fights needed."), available at http://fortune.com/2015/01/09/activist-investors-performance-2014/.

[66] *See* Commissioner Luis A. Aguilar, *Institutional Investors: Power and Responsibility*, Apr. 19, 2013 ("For example, the proportion of U.S. public equities managed by institutions has risen steadily over the past six decades, from about 7 or 8% of market capitalization in 1950, to about 67% in 2010.1 The shift has come as more American families participate in the capital markets through pooled-investment vehicles, such as mutual funds and exchange traded funds (ETFs)"), available at http://www.sec.gov/News/Speech/Detail/Speech/1365171515808.

[67] *See supra* notes 28-31 and accompanying text.

[68] For a general overview of strategies pursued by activist shareholders, see Lucian A. Bebchuk et al., *The Long-Term Effects of Shareholder Activism*, 115 COLUM. L. REV. 1085 (2015); Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 58–59 (2011); Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008). *See also* ACTIVIST INSIGHT, ACTIVIST INVESTING: AN ANNUAL REVIEW OF TRENDS IN SHAREHOLDER ACTIVISM 10-12 (2015) (detailing strategies and targets of shareholder activism and observing, "Demands for board change have long accounted for the lion's share of activist campaigns, with M&A-related activity a close second. But a spike in balance-sheet activism in 2013 had returned to normal in 2014, with activists diversifying their objectives to include other governance and more business strategy demands.").

[69] For an example of the debate concerning the impact of activist shareholders and short-termism, compare Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM L. REV. 449 (2014) with Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013).

For example, some activist investors call upon boards to use cash reserves to repurchase stock or make larger dividend payments to shareholders.[70] This move pushes value out to shareholders, but may do so at the expense of the company's longer-term interests—e.g., the company accordingly may invest less in research and development, or in maintenance and upgrade initiatives. The company's cash reserves also may ultimately prove insufficient to sustain the company through an economic downturn or other unforeseen event. Moody's has warned bondholders that such uses of a company's cash may weaken the company's longer-term prospects and, consequently, its ratings.[71]

Activist investors also analyze a board's operational decisions, from the selection of director candidates to how the company makes its products. For example, Elliott Management sent a letter to the board of Citrix Systems suggesting a new plan for operational and managerial improvements.[72] This letter stated in part:

> Today, Elliott is formally requesting a meeting with the Board to share the details of an operational plan that we believe will create tremendous value for stockholders. What we call the "New Citrix" Operating Plan (the "New Citrix Plan") was developed through exhaustive research and with the help of a full team of operating partners with proven experience turning around software companies…. The New Citrix Plan is based upon two driving principles: the need for i) fundamental change and ii) effective oversight. The key components for fundamental change are as follows: 1) Implementation of Operational Best Practices: Citrix's cost structure is the result of years of layered complexity and expenses. The structure has become highly inefficient in terms of actual cost and is also ineffective at generating revenue growth. We have identified numerous opportunities throughout the organization for significant improvement, which we believe will result in both superior revenue performance and a more efficient use of resources….[73]

The letter identified product management as one such opportunity for operational improvement: "[Citrix's] product portfolio is too broad for its scale and contains far too many underperforming product lines that consume valuable resources, have low or negative (i.e., loss-making) return profiles, and serve as distractions."[74] Citrix's stock

[70] *See, e.g.,* Vipal Monga et al., *As Activism Rises, U.S. Firms Spend More on Buybacks Than Factories*, WALL ST. J., May 26, 2015, available at http://www.wsj.com/articles/companies-send-more-cash-back-to-shareholders-1432693805.
[71] Moody's Investors Services, Announcement: Moody's: Activist Shareholders Gain Momentum in 2015; Mainly Negative for Credit Investors, Apr. 9, 2015 ("'In many cases, shareholder activists pursue short-term initiatives like share buybacks or special dividends, which have negative implications for credit investors.'"). *See also* Monga, et al., *supra* note 70.
[72] *Elliott Sends Letter to Citrix Board of Directors*, BUSINESSWIRE, June 11, 2015, available at http://www.businesswire.com/news/home/20150611005626/en/Elliott-Sends-Letter-Citrix-Board-Directors#.VZ6jkmCIVFI.
[73] *Id.*
[74] *Id.*

price rose after Elliott announced its 7.1% ownership stake and its communications with the Citrix board.[75]

Activism that evaluates and questions a board's decisions may provide valuable oversight and discipline. For this reason, some commentators herald activism as a necessary and meaningful check on management that enhances management's accountability.[76] Others perceive activism as a channel for shareholder engagement with management. As SEC Chair Mary Jo White observed in her comments on activism: "Increasingly, companies are talking to their shareholders, including so-called activist ones. That, in my view, is generally a very good thing. Increased engagement is important and a growing necessity for many companies today."[77] Academic studies also suggest that activism can enhance shareholder value.[78]

Not all commentators agree, however, that shareholder activists are a positive influence on corporate boards.[79] These commentators raise concerns regarding, among other things, activists' motivation and their typical focus on short-term returns.[80] The potential misalignment among the interests of the activist, other shareholders, and corporate entity does undercut any generalization about constructive activism. Nevertheless, as discussed below in Part III, with appropriate safeguards, activism may circumstantially work to serve the interests of the corporation.

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[75] *See* Tiernan Ray, *Citrix Surges 7%: Price Targets Zoom as Activists Elliott Call for Change*, BARRON'S TECH TRADER DAILY, June 11, 2015, available at http://blogs.barrons.com/techtraderdaily/2015/06/11/citrix-surges-7-price-targets-zoom-as-activists-elliott-call-for-change/. Citrix responded to Elliott's letter with the following statement: "Citrix has always maintained an ongoing dialogue with our shareholders, and we welcome their input. We will review Elliott's suggestions and respond as we do with all shareholders who engage with us. The Citrix Board and management team continually evaluate ideas to drive shareholder value and are committed to acting in the best interests of all our shareholders." Financial Release, CITRIX COMMENTS ON LETTER FROM ELLIOTT MANAGEMENT, June 11, 2015, available at https://www.citrix.com/news/financial-releases/june-2015/citrix-comments-on-letter-from-elliott-management.html.

[76] *See supra* note 68.

[77] Chair Mary Jo White, A Few Observations on Shareholders in 2015, Tulane University Law School 27th Annual Corporate Law Institute, March 19, 2015, available at http://www.sec.gov/news/speech/observations-on-shareholders-2015.html.

[78] *See supra* note 68. *See also* Alon Brav et al., *Hedge Fund Activism: A Review*, 4(3) FOUNDATIONS AND TRENDS IN FINANCE 185 (2009) (reviewing literature). For a general description of data showing a short-termism effect, see Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977 (2013).

[79] *See, e.g.,* Martin Lipton, *Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy,* THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION, Feb. 26, 2013, available at http://corpgov.law.harvard.edu/2013/02/26/bite-the-apple-poison-the-apple-paralyze-the-company-wreck-the-economy/; P. Alexander Quimby, *Addressing Corporate Short-Termism Through Loyalty Shares*, 40 FLA. ST. U. L. REV. 389 (2013); Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265 (2012). *See also* Roe, supra note 78, at 987-991 (reviewing literature on short-termism and offering theoretical and factual counter-arguments).

[80] *See, e.g.,* Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?,* 66 BUS. LAW. 1, 26 (2010).

B. Debtholder Activism

Investors not only pursue activist agendas as shareholders, but also as debtholders.[81] In addition, an investor may hold both stock and debt and use that multi-tranche investment to further its activist interests and influence over the company.[82] An activist debtholder typically has the greatest leverage once the target company starts to experience financial distress or some kind of liquidity event. In those instances, the debtholder can try to extract governance or transactional concessions from the board in exchange for a forbearance agreement or restructuring of the underlying debt.[83]

One common activist debtholder strategy is the "loan-to-own" situation.[84] An investor will extend new or additional credit to (or agree to restructure its existing credit with) a company in exchange for covenants in the loan documents that provide the investor with indirect control over decisions such as whether the company can sell assets, pay certain other debt obligations, incur additional obligations, or file a bankruptcy case. The financial covenants also are set fairly tight, giving the company a chance—but not too great of a chance—of meeting its restructuring objectives. The failure of the company to do so basically turns over control of the company and ownership of the assets to the activist debtholder.

A loan-to-own strategy can be affected in or outside of a chapter 11 bankruptcy case. For example, in 2012, Aventine Renewable Energy Holdings, Inc., an ethanol producer in the Midwest, defaulted on its loan obligations and, after receiving a short forbearance agreement from its lenders, initiated a debt-for-equity exchange with its lenders to resolve the default.[85] The lenders received 92.5% of the company's stock, with the remaining equity held by pre-existing shareholders.[86] Aventine's lenders included

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[81] *See* Harner, *supra* note 53 (explaining activist debtholder strategies). *See also, e.g.,* Casey & Henderson, *supra* note 38 (discussing creditor influence on firm governance); Harner et al., *Activist Investors, Distressed Companies, and Value Uncertainty*, 22 AM. BANKR. INST. L. REV. 167 (2014) (empirical study of role of hedge fund investors in distressed debt; reviewing strategies and potential impact of such funds); Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 118 (2009) (discussing creditor influence on firm governance)]; Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL STUDIES 511 (2009).

[82] *See infra* Part II.D (RadioShack case study). *See also* Harner, *supra* note 63, at 162 (providing examples of such investment strategies).

[83] *See* Harner, *supra* note 53, at 712-18 (explaining strategies of activist debtholders).

[84] *See supra* note 50 and accompanying text. *See also* Harner, *supra* note 63, at 165-69 (providing examples of a loan-to-own strategy).

[85] *See* Press Release, AVENTINE RENEWABLE ENERGY HOLDINGS, INC. ENTERS INTO A SIGNIFICANT RESTRUCTURING TRANSACTION WITH MEMBERS OF ITS LENDER GROUP, Aug. 20, 2012, available at http://globenewswire.com/news-release/2012/08/20/483287/10002526/en/Aventine-Renewable-Energy-Holdings-Inc-Enters-Into-a-Significant-Restructuring-Transaction-With-Members-of-Its-Lender-Group.html; *Aventine Lenders Take Over Distressed Company in Out-of-Court Restructuring*, LEVERAGEDLOAN.COM, Aug. 21, 2012 (hereinafter "*Aventine Lenders Take Over*"), available at http://www.leveragedloan.com/aventine-lenders-take-over-distressed-company-in-out-of-court-restructuring/.

[86] *See Aventine Lenders Take Over*, *supra* note 85.

several hedge funds and private equity firms.[87] The CEO appointed by the lenders after the change in the ownership was a consultant to several private equity firms with extensive turnaround experience.[88] In July 2015, Aventine merged with Pacific Ethanol, an ethanol producer in the Western United States.[89]

Alternatively, lenders can extend postbankruptcy (a/k/a debtor in possession) financing to the company to fund a chapter 11 case designed to sell the company to the lenders under section 363 of the Bankruptcy Code.[90] A section 363 sale can be accomplished fairly quickly under existing law, and lenders can acquire exceptionally clean title to the assets through a sale free and clear of all liens and encumbrances under section 363(f) of the Bankruptcy Code.[91] The potential downside to this strategy under chapter 11 is that most bankruptcy courts require the company to subject the lenders' bid, which frequently is a credit bid of the amount owed by the company under the loan documents, to a public auction process. For example, an affiliate of Silver Point Capital, which was pursuing a loan-to-own strategy and was the stalking horse bidder in a chapter 11 sale process, lost its attempt to acquire print company Standard Register Co.[92] Silver Point's credit bid was $275 million, and the winning bid, submitted by the Taylor Company, was $307 million.[93]

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[87] *See id.*

[88] The biography of Mark Beemer, CEO of Aventine Renewable, explains that "Beemer is an advisor to numerous private equity firms in the ethanol space; he is a member of the Turnaround Management Association, the RFA, and the National Grain and Feed Association." Aventine Renewable Energy, Inc. Management Team, available at http://www.aventinerei.com/en/about/management_team/.

[89] *See* Press Release, STOCKHOLDERS APPROVE MERGER OF PACIFIC ETHANOL AND AVENTINE, June 11, 2015, available at http://www.marketwatch.com/story/stockholders-approve-merger-of-pacific-ethanol-and-aventine-2015-06-11; Press Release, PACIFIC ETHANOL COMPLETES AVENTINE MERGER, July 1, 2015, available at http://www.marketwatch.com/story/pacific-ethanol-completes-aventine-merger-2015-07-01.

[90] Section 364 of the Bankruptcy Code permits a debtor, with court approval, to provide certain protections to lenders extending credit to the debtor postpetition. 11 U.S.C. § 364. Accordingly, lenders often have an incentive to extend such credit. *See* David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905, 1906 (2004) ("[T]he generous terms offered to DIP financers have encouraged lenders to make loans to cash-starved debtors, and that these lenders have used their leverage to fill a governance vacuum that was created by the enactment of the 1978 Code."). This postpetition financing also may be necessary to fund the debtor's chapter 11 case to the point of a sale of the company in the case. In fact, the terms of the postpetition facility may require such a sale.

[91] 11 U.S.C. § 363(b), (f) (authorizing asset sales out of the ordinary course of business and free and clear of any liens and interests in such assets, respectively, under certain circumstances). Under Bankruptcy Rule 2002(a)(2), a debtor typically must provide 21 days' notice by mail of "a proposed use, sale or lease of property of the estate other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice." FED. R. BANKR. P. 2002(a)(2). Nevertheless, courts may approve proposed asset sales on a much quicker basis. *See, e.g.*, *In re* Lehman Bros. Holdings Inc., Case No. 08-13555 (Bankr. S.D.N.Y 2008) (sale approved within seven days of petition date); Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862 (2013) (discussing issues with quick asset sales in bankruptcy).

[92] *See* Motion for Sale of Property Free and Clear of Liens under Section 363(f), *In re* Standard Register Company, Case No. 15-10541, Docket No. 23 (Bankr. D. Del. June 19, 2015). *See also* Peg Brickley, *Standard Register Files for Bankruptcy with Plans for Sale*, THE WALL STREET JOURNAL, Mar. 12, 2015, available at http://www.wsj.com/articles/standard-register-files-for-bankruptcy-with-plans-for-sale-1426164844.

[93] *See* Order (A) Authorizing the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances, and Interests; (II) Authorizing the Assumption and Assignment of Certain

Similar to shareholder activism, commentators debate the utility of debtholder proactivity.[94] Debtholder activism that identifies and replaces ineffective or fraudulent management or helps management recognize the advantages of rightsizing the company's operations through a restructuring may add value for the corporate entity. Debtholder activism that is pursued, however, solely for the economic interests of the activist may significantly undervalue the company or dismantle a company with other viable restructuring alternatives, provided that the company was given sufficient time to restructure. These risks exist because a debtholder looking to buy the company wants to pay as little as possible, which frequently results in a low valuation that wipes out all junior creditors and shareholders.[95] Likewise, a debtholder that wants to own the company for strategic reasons (e.g., to prevent competition with another portfolio company, to capitalize on synergies with a certain aspect of the target company's business) may not only undervalue the company, but also significantly affect the company's employee and vendor relationships.

The following section details two different situations involving faltering companies and activist investors. These case studies illustrate the potential strengths and weaknesses of activism in this context. They also inform the proposal made in this article to enhance the prospects of distressed companies and their stakeholders through targeted proxy access.

C. Case Study: Darden Restaurants, Inc.

Darden Restaurants, Inc. traces its origins to Bill Darden, who opened his first restaurant at the age of 19 in 1938.[96] Since that time, the company has expanded and contracted and changed ownership several times. Activist investors have influenced at least some of these changes, particularly in recent years.

Executory Contracts and Unexpired Leases; and (III) Granting Certain Related Relief, *In re* Standard Register Company, Case No. 15-10541, Docket No. 698 (Bankr. D. Del. June 19, 2015). *See also* Randall Chase, *Judge Set to OK Sale of Standard Register to Taylor Corp.,* ASSOCIATED PRESS, June 17, 2015, available at http://www.startribune.com/judge-set-to-ok-sale-of-standard-register-to-taylor-corp/307984521/.

[94] *See*, *e.g.*, HILARY ROSENBERG, THE VULTURE INVESTORS (2000); Edith S. Hotchkiss & Robert M. Mooradian, *Vulture Investors and the Market for Control of Distressed Firms*, 43 J. FIN. ECON. 401 (1997); Alon Brav et al., *supra* note 68; Marcel Kahan & Edward Rock, *Hedge Fund Activism in the Enforcement of Bondholder Rights*, 103 NW. U. L. REV. 281–322 (2009).

[95] For example, an activist debtholder often will seek to purchase the company's assets in a going concern bankruptcy sale by credit bidding the amount of its debt claim against the company. 11 U.S.C. § 363(k) (authoring credit bidding by secured creditors). Unless the activist debtholder is also willing to pay cash in amount above its debt claim, the company will not have any cash or assets remaining after the sale to pay the claims of junior creditors or the interests of equity holders.

[96] *See History*, DARDEN, http://www.darden.com/about/photo_history.asp (last visited July 20, 2015). As described below, Darden, Inc. was not formed until 1995. Accordingly, references to Darden before 1995 are to the business operations ultimately owned by Darden after the 1995 spin-off. *Id. See also* Gen. Mills Inc., Quarterly Report (Form 10-Q) (April 8, 1996) ("During the fiscal year ended May 28, 1995 the company spun off its restaurant operations as a separate, free-standing company, Darden Restaurants, Inc.").

Darden's expansion started with the success of its Red Lobster restaurants in the 1970s.[97] Shortly after, General Mills acquired the restaurant chain and, in 1982, introduced The Olive Garden.[98] General Mills spun off Darden in 1995, with Darden becoming an independent publicly traded company on the New York Stock Exchange.[99] Although Darden is most commonly associated with Red Lobster and Olive Garden, Darden has owned (and in many instances continues to own) other well-known niche restaurants, including Bahama Breeze, LongHorn Steakhouse, Smokey Bones, The Capital Grille, and The Yard House.[100]

Darden's first major financial disappointment occurred in 1997, when the company recorded an annual loss of $91.03 million and closed fifty-five stores.[101] This setback was, however, temporary, and Darden was able to remedy most of the problem through operational improvements at its Red Lobster and Olive Garden restaurants.[102] The company then experienced a period of continuous growth and increased profits, with only minor interruptions, until late 2007.[103]

After that time, Darden struggled to meet investors' and management's expectations. Operational adjustments, such as opening new "combo" locations featuring Red Lobster and Olive Garden, did not succeed,[104] and expansion plans failed to boost revenues.[105]

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[97] Red Lobster opened in the late 1960s, but it did not expand significantly in popularity and locations until the 1970s. *See* Darden Rests., Inc., Annual Report (Form 10-K) (Aug. 16, 1996) (charting the dramatic rise of Red Lobster in the 1970s, from six restaurants in 1970 to 260 at the end of fiscal year 1980).

[98] *See id.*

[99] *See* Gen. Mills Inc., *supra* note 96.

[100] Darden Rests., Inc., Quarterly Report (Form 10-Q) (March 30, 2015).

[101] Darden Rests., Inc., Annual Report (Form 10-K) (Aug. 15, 1997) (see section "Expansion Strategy" noting that in fiscal year 1997, Darden closed 39 Red Lobster restaurants in the U.S. and Canada, and 16 Olive Garden restaurants in the U.S.).

[102] Darden Rests., Inc., Current Report (Form 8-K) (Sept. 25, 1998) (see press release discussing 50% growth in first quarter earnings and double-digit increases in comparable restaurant sales).

[103] The company acquired and sold various assets during this period in the hopes of increasing cash flows. *See Rare Hospitality Sold to Orlando Company for $1.4 billion*, THE BUSINESS JOURNALS (Aug. 31, 2014, 7:28 PM), http://www.bizjournals.com/atlanta/stories/2007/08/13/daily41.html?page=all (reporting that Darden had purchased Rare Hospitality, adding LongHorn Steakhouse and Capital Grille to Darden's line of Restaurants). *See also See Darden Restaurants Offers Barbecue Chain For Sale, Better Positioning Casual Dining Leader For Future Growth*, Darden (Aug. 31, 2014, 7:32 PM), http://investor.darden.com/investors/news-releases/press-release-details/2007/Darden-Restaurants-Offers-Barbecue-Chain-For-Sale-Better-Positioning-Casual-Dining-Leader-For-Future-Growth/default.aspx (reporting that Darden elected to sell its Smokey Bones chain of barbecue restaurants "as part of an overall effort by the company to better position Darden for future growth.").

[104] *See* Sandra Pedicini, *Darden Restaurants tests combo Olive Garden/Red Lobster for smaller markets*, Orlando Sentinel (August 31, 2014, 7:48 PM), http://articles.orlandosentinel.com/2011-01-24/business/os-hybrid-olive-garden-red-lobster-20110124_1_red-lobster-olive-garden-darden-restaurants (reporting that Darden was pairing its two marquee brands in single-building locations in markets that could not support separate locations for the two). *See also* Darden Rests., Inc., Annual Report (Form 10-K) (July 18, 2014).

[105] Darden also attempted to boost sales by adding two seafood chains to its line-up of specialty restaurants in 2012. *See* Alan Snel, *Darden Buys Two Seafood Brands*, NATION'S RESTAURANT NEWS (August 31, 2014, 8:00 PM), http://nrn.com/archive/darden-buys-two-seafood-brands (reporting that Darden acquired two small seafood chains, Eddie V's Prime Seafood and Wildfish Seafood Grille, in a $59 million cash transaction). *See also* Darden Rests., Inc., Annual Report (Form 10-K) 2 (July 18, 2014).

Darden entered a particularly tumultuous period in late 2012 and 2013.[106] Darden reported a 37.6% drop in first-quarter profit in 2013 compared with that same period in the previous year.[107] Although analysts had expected earnings of 70-72 cents per share in the first-quarter of 2013, the actual mark was well below that at 53 cents per share.[108] The company's stock dropped 7% the day the news of the weak earnings and job cuts broke and closed at $45.78 per share.[109] Notably, although Darden's bigger name brands struggled in the first quarter of 2013, Darden's specialty group out-performed them, showing a 0.5% rise in sales.[110] This likely fueled activist investors' later calls for big-brand spinoffs.

In December 2013, Darden tried to calm investors' unrest and calls for change with a restructuring plan aimed at increasing shareholder value.[111] The major prongs of Darden's plan included spinning off its Red Lobster brand and reducing new unit expansion.[112] Darden was under continuing pressure from one of its shareholders, Barington Capital Group, to spin off its under-performing chains.[113] News of the planned spin-off and worse-than-expected earnings drove the stock price down by 5% to $50.17.[114]

Shortly after the company's announcement, another shareholder, Starboard Values LP, came out against the Red Lobster spin-off.[115] Starboard owned approximately 6.2% of Darden's stock at the time, and it had been lobbying Darden to consider other options,

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[106] For example, on the same day in September 2013 that the company announced weak first-quarter earnings, the company also announced that it was cutting 85 jobs at its Orlando headquarters and the retirement of its second-in-command, COO Drew Madsen. *See* Sandra Pedicini, *Darden Restaurants reducing 85 corporate positions; COO Drew Madsen leaving*, Orlando Sentinel (August 31, 2014, 8:07 PM), http://articles.orlandosentinel.com/2013-09-20/business/os-darden-layoffs-20130920_1_darden-restaurants-olive-garden-central-florida-restaurant-professor. *See also* Darden Rests., Inc., Annual Report (Form 10-K) 21 (July 18, 2014) (describing and anticipating the economic conditions that could interfere with performance); Darden Rests., Inc., Current Report (Form 8-K) 2 (Sept. 20, 2013).

[107] *Id*. *See also* Darden Rests., Inc., Quarterly Report (Form 10-Q) 20 (Sept. 30, 2013).

[108] *See* Pedicini, *supra* note 106. *See also* Darden Rests., Inc., Quarterly Report (Form 10-Q) 20 (Sept. 30, 2013).

[109] *See* Pedicini, *supra* note 106.

[110] *Id*. Darden Rests., Inc., Current Report (Form 8-K) (Sept. 20, 2013) (see press release on first quarter sales from Darden's specialty restaurants reporting same-restaurant sales increases of 3.2% at The Capital Grille, 2.7% at Bahama Breeze and 2.1% at Eddie V's, offset partially by declines of 4.4% at Seasons 52 and 1.5% at Yard House).

[111] *See Darden Announces Comprehensive Plan to Enhance Shareholder Value*, Darden (August 31, 2014, 8:22 PM), http://investor.darden.com/investors/news-releases/press-release-details/2013/Darden-Announces-Comprehensive-Plan-to-Enhance-Shareholder-Value/default.aspx. *See also* Darden Rests., Inc., Event Report (Form 8-K) 2 (Dec. 19, 2013).

[112] *See* Darden Rests., Inc., Event Report (Form 8-K) 2 (Dec. 19, 2013).

[113] *See* David Benoit, *Darden's Red Lobster Split Gets Messy Reaction*, WSJ Blogs Money Beat (August 31, 2014, 8:41 PM), http://blogs.wsj.com/moneybeat/2013/12/19/dardens-red-lobster-split-gets-messy-reaction/. Barington also suggested that Darden should spin off Olive Garden. *Id.*

[114] *Id*.

[115] *See* Samantha Sharf, *Activists Turn Up Heat On Darden: Red Lobster Deal 'Unconscionable,' Board 'Misleading'*, FORBES (August 31, 2014), http://www.forbes.com/sites/samanthasharf/2014/05/22/activists-turn-up-heat-on-darden-red-lobster-deal-unconscionable-board-misleading/. *See also* Darden Rests., Inc., Annual Report (Form 10-K) 14-15 (July 18, 2014).

such as splitting off its property as an independent real estate investment trust.[116] Darden ignored Starboard's suggestions, even though Barington ultimately supported Starboard's request for a shareholder vote on the proposed spin-off.[117] Darden spun off Red Lobster without a shareholder meeting or vote.[118] Starboard ultimately pursued and won a proxy battle to take over Darden's board by nominating a slate of directors to replace all 12 members.[119]

To support its proxy contest, Starboard produced a 249-slide PowerPoint presentation that walked shareholders through Darden's missteps, both financial and operational, and offered concrete solutions to improve the company's performance.[120] For example, one slide, titled "Breadsticks: just one example of food waste," explained how Olive Garden's practice of serving its unlimited breadsticks in excessive quantities beyond the customers' requests or needs reduced margins and profitability.[121] Another slide then suggested the consequences: "Despite having far more stores than any of its peers, Darden does not show economies of scale in food costs. In fact, Darden's food costs are near the highest in the industry…. We believe that the primary driver of Darden's food cost problem is poor execution and discipline around food waste, portion

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[116] Starboard asserted that Darden was selling Red Lobster for just $100 million more than the value of the chain's real estate, which could be sold tax-free. Darden disagreed with Starboard's analysis, asserting that the proposed sale would generate about $1.6 billion in proceeds. Darden planned to use $1 billion of the proceeds to retire debt and the remainder to fund a share buyback program of as much as $700 million. *See* Sharf, *supra* note 115. *See also* Darden Rests., Inc., Proxy Statement (Schedule 14A) (Sept. 16, 2014) (see exhibit 99.2, a presentation discussing Starboard's proposal).

[117] *See Barington Group Sends Letter To The Independent Directors Of Darden Restaurants*, PR Newswire (August 31, 2014, 9:03 PM), http://www.prnewswire.com/news-releases/barington-group-sends-letter-to-the-independent-directors-of-darden-restaurants-252430861.html.

[118] *See Darden Completes Sale of Red Lobster to Golden Capital*, Seeking Alpha (August 31, 9:20 PM), http://seekingalpha.com/pr/10587495-darden-completes-sale-of-red-lobster-to-golden-gate-capital?source=email_rt_mc_body&app=n. *See also* Darden Rests., Inc., Event Report (Form 8-K/A) (Aug. 1, 2014). In the midst of finalizing the sale, Darden announced that Otis was stepping down as Chairman and CEO of Darden, either at the end of the year or before if a replacement was found. *See Darden Announces Leadership Succession Plan*, Seeking Alpha (August 31, 2014, 9:15 PM), http://seekingalpha.com/pr/10591835-darden-announces-leadership-succession-plan?source=email_rt_mc_body&app=n. *See also* Darden Rests., Inc., Event Report (Form 8-K) (July 29, 2014). This announcement appeared to be a move to try to appease shareholders prior to the annual shareholders' meeting.

[119] *See* Nick Turner, *Darden Activist Investor Starts Board Fight Over Red Lobster*, Bloomberg (August 31, 2014, 8:55 PM), http://www.bloomberg.com/news/2014-05-22/darden-investor-starboard-starts-proxy-battle-over-red-lobster.html. *See also* Darden Rests., Inc., Event Report (Form 8-K) (Oct. 16, 2014).

[120] Press Release, Starboard Releases Detailed Transformation Plan for Darden Restaurants, Sept. 12, 2014, available at http://www.prnewswire.com/news-releases/starboard-releases-detailed-transformation-plan-for-darden-restaurants-274867301.html. Starboard compiled a similar presentation to contest Darden's decision to sell Red Lobster. *See* StarboardValue, INVESTOR PRESENTATION, DARDEN RESTAURANTS, INC., Mar. 31, 2014, available at http://www.sec.gov/Archives/edgar/data/940944/000092189514000699/ex991dfan14a06297125_033114.pdf.

[121] StarboardValue, TRANSFORMING DARDEN RESTAURANTS 104-05, Sept. 11, 2014, available at http://www.shareholderforum.com/dri/Library/20140911_Starboard-presentation.pdf.

size, and preparation."[122] Starboard ended the slide presentation with a summary of why "Darden is compelling," Starboard's priorities, and its plan for the company.[123]

Although Darden reported losses for the second quarter of 2014 (i.e., the first quarter following the board's replacement), it has consistently outperformed since.[124] Darden reported improved revenue and sales for the third and fourth quarters,[125] and was identified as one of the "hottest dividend stocks of 2015."[126]

D. Case Study: RadioShack Corp.

Similar to Darden, RadioShack has a long history dating back to 1921, when it opened as a small shop in Boston.[127] The company initially focused on radios, expanding to other audio equipment in the 1950s and then to electronic calculators and computers in the 1970s. RadioShack experienced financial distress early in its lifecycle; in fact, the company was on the verge of bankruptcy when Tandy Corp. purchased it in 1963.[128] Tandy was able to turn around the company by branding it as a "hobby store"—a place where you could purchase whatever you needed to build the latest gadget. The strategy was successful, and the company grew from 100 stores in 1966 to over 1,000 stores by 1971. It also started generating a profit just two years after the Tandy acquisition.[129]

For most of the 1970s and 1980s, RadioShack was the store for everything electronic. It was able to stay ahead of the curve and capture the market on new innovations such as the electronic calculator, the CB radio, the personal computer, and the cellular phone.[130] RadioShack began to falter, however, in the 1990s, and it never really regained its footing.

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[122] *Id.* at 102.
[123] *Id.* at 286.
[124] Darden Rests., Inc., Quarterly Report (Form 10-Q) (Dec. 31, 2014) (announcing second quarter results).
[125] Darden Rests., Inc., Quarterly Report (Form 10-Q) (Mar. 30, 2015) and Darden Rests., Inc., Current Report (Form 8-K) (June 23, 2015) (see press release announcing fourth quarter results attached as exhibit 99.1).
[126] *See* Darden Rests., Inc., Current Report, *supra* note 129.
[127] *See, e.g.,* Joshua Brustein, *Inside RadioShack's Slow-Motion Collapse*, BLOOMBERGBUSINESS, BLOOMBERG.COM, Feb. 2, 2015, available at http://www.bloomberg.com/news/features/2015-02-02/inside-radioshack-s-slow-motion-collapse; *RadioShack Corporation—Company Profile, Information, Business Description, History, Background Information on RadioShack*, REFERENCE FOR BUSINESS, available at http://www.referenceforbusiness.com/history2/8/RadioShack-Corporation.html.
[128] *See* Brustein, *supra* note 127. Tandy was a leather company, which was trying to diversify in the 1960s. Tandy ultimately exited the leather industry in 1975 and focused on the electronics side of the business. Tandy was publicly traded on the New York Stock Exchange, and it changed its name to RadioShack in 2000, then trading under the symbol RHS. *See generally A Brief History of RadioShack*, RADIOSHACKCATALOGS.COM, available at http://www.radioshackcatalogs.com/history.html. *See also* Brustein, *supra* note 127.
[129] *See* Brustein, *supra* note 127; Steven Davidoff Solomon, *A History of Misses for RadioShack*, DEALBOOK, N.Y. TIMES, Sept. 16, 2014, available at http://dealbook.nytimes.com/2014/09/16/for-radioshack-a-history-of-misses/?_r=0.
[130] *See* Brustein, *supra* note 127; Davidoff Solomon, *supra* note 133.

RadioShack's management tried altering the company's offerings and business model to improve the company's overall performance. By the late 1990s, RadioShack stopped manufacturing personal computers and cellular phones, and it began opening big-box type retail stores that each specialized in certain electronic products.[131] The concept stores experiment failed, and each was shuttered or sold by the end of the 1990s.[132]

RadioShack's permanent decline began in 2005, with significant management turnover and increasing diminution in value. From 2005 to 2014, the company experienced six changes at the CEO position, and its shares lost almost all of their value.[133] The company also experienced 11 consecutive quarters of losses before filing for bankruptcy in early 2015.[134] Notably, RadioShack did not file for bankruptcy quietly—it tried vigorously to avoid it.[135] The question becomes whether those efforts and the prebankruptcy actions of its lenders helped or ultimately hurt the company and its shareholders.

As RadioShack struggled to rebrand itself in 2012 and 2013, it secured a financing package of $835 million to refinance its existing debt and provide additional liquidity.[136] The facility consisted of a $585 million secured credit facility provided by a group of lenders lead by GE Capital and a $250 million term loan provided by Salus Capital Partners, LLC and Cerberus Capital Management.[137] Both loans contained a number of restrictive covenants, including one that limited the number of stores that RadioShack could close in any one period.[138] This particular covenant would prove problematic.

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[131] *See id. See also* Tandy Corp., Annual Report (Form 10-K) (Mar. 30, 1994) (see sections on "Discontinued Operations" and "Sale of Joint Venture Interest" discussing divestiture of computer manufacturing businesses and cellphone manufacturing business; and see Item 1 discussing various stores).

[132] *See* Davidoff Solomon, *supra* note 133. *See also* Tandy Corp., Quarterly Report (Form 10-Q) 6 (May 12, 2000) (note 6, 1996 Business Restructuring).

[133] *See* Brustein, *supra* note 127; Barry Schlachter, *At RadioShack, A History of Hits and Missed Chances,* SEATTLE TIMES, Oct. 4, 2014 ("Sales have dropped 33 percent since 2005, when it recorded net profits of $267 million, compared with last year's loss of $400 million."), available at http://www.seattletimes.com/business/at-radioshack-a-history-of-hits-and-missed-chances/; d'Innocenzio & Chapman, *supra* note 126 ("RadioShack's stock closed below $1 per share Friday for the first time in its history, reflecting investors' concern over what lies in store for the long-struggling consumer electronics chain.").

[134] *See, e.g.,* Rebecca R. Ruiz & Michael J. de la Merced, *RadioShack Files for Chapter 11 Bankruptcy After a Deal with Sprint*, DEALBOOK, N.Y. TIMES, Feb. 5, 2015, available at http://dealbook.nytimes.com/2015/02/05/radio-shack-files-for-chapter-11-bankrutpcy/?_r=0. The losses also are documented in RadioShack's public filings for the period beginning in April 2012 and ending with the bankruptcy filing. *See, e.g.*, RadioShack Corp., Quarterly Report (Form 10-Q) (July 25, 2012); RadioShack Corp., Quarterly Report (Form 10-Q) (April 24, 2012); RadioShack Corp., Current Report (Form 8-K) (Feb. Feb. 11, 2015) (announcing filing of Chapter 11).

[135] RadioShack Corp., Current Report (Form 8-K) (Sept. 11, 2014) (see Exhibit No. 99.1, Press Release, "RadioShack Reports Second Quarter Financial Results" discussing restructuring efforts).

[136] RadioShack Corp., Current Report (Form 8-K) (Dec. 13, 2013) (announcing financing).

[137] *Id.*

[138] RadioShack Corp., Current Report (Form 8-K) (Dec. 13, 2013) (see sec. 5.2(d) of credit agreement between RadioShack and General Electric Capital (exhibit 10.1), and sec. 5.2(d) of credit agreement between RadioShack and Salus Capital Partners, LLC (exhibit 10.3)).

RadioShack's restructuring plan in 2014 included streamlining its operations and closing approximately 1,100 underperforming stores.[139] Unfortunately, the term loan permitted RadioShack to close only 200 stores per year, with 600 store closings over the life of the loan agreement.[140] Salus and Cerberus denied RadioShack's numerous requests for a waiver of the restriction without certain fees, terms, and conditions, which RadioShack found unacceptable (and expensive).[141] As one commentator observed, "'this is also a bit of a game of chicken — if the banks play hardball too much. RadioShack may end up being forced to file for Chapter 11 bankruptcy, which will leave the banks fighting over the scraps.'"[142]

Shortly thereafter, RadioShack began exploring financing and restructuring alternatives with one of its shareholders, Standard General, L.P. Standard General provided the following description of these discussions in its September 2015 Schedule 13D filing with the Securities and Exchange Commission:

> Standard General has been in discussions with the Company regarding a proposal on a business operating plan and certain ways to improve the Company's liquidity position in advance of the holiday shopping season. Proposals under discussion include Standard General and certain other investors (the "New Investors") purchasing loans and other commitments under the Company's asset backed credit facility (the "Credit Facility") from its existing lenders. Under such a proposed transaction, Standard General and certain other New Investors may propose to subordinate their investment in the Credit Facility to other investors in order to improve the near-term liquidity available to fund the Company's holiday working capital needs. Pursuant to such a proposal, the investment by the New Investors could be the first step of a broader recapitalization of RadioShack proposed to be completed by early 2015, which may include Standard General and certain other New Investors acquiring preferred equity convertible into common equity, board nomination rights and corresponding changes to the Company's structure….[143]

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[139] *See, e.g.,* Elizabeth Harris, *RadioShack Pulls Back on Size of Store Closings*, N.Y. TIMES, May 8, 2014, available at http://www.nytimes.com/2014/05/09/business/radioshack-pulls-back-on-size-of-store-closings.html; Motion of Official Committee of Unsecured Creditors for an Order, Pursuant to Section 105(a) of the Bankruptcy Code, Bankruptcy Rule 2004, and Local Bankruptcy Rule 2004-1, Authorizing and Directing the Examination of the Debtors and Certain Third Parties, *In re* RadioShack Corp., No. 15-10197, Docket No. 304, at 8 (Bankr. D. Del. Feb. 2, 2015) [hereinafter "Committee Rule 2004 Motion"].
[140] *Id.*
[141] *See* RadioShack Corp., Current Report, filed on form 8-K, dated May 8, 2014. *See also* Committee Rule 2004 Motion, *supra* note 139, at 12 ("In connection with the October 2014 Transaction, RadioShack incurred $31.8 million in financing fees as well as approximately $142 million in additional obligations, despite the fact that the company had suffered losses in the previous 11 quarters.") (citations omitted).
[142] *Id.* (quoting Anthony Chukumba, BB&T Capital Markets).
[143] Schedule 13D, filed by Standard General L.P. on September 26, 2014.

Standard General's Schedule 13D also revealed that it owned 9.8% of RadioShack's common stock, with related entities owning additional shares and with it having options to purchase 3 million additional shares.[144]

Standard General and a group of investors purchased RadioShack's $535 million credit facility from GE Capital and immediately amended the facility to provide the company with additional liquidity.[145] The investors also entered into a Recapitalization and Investment Agreement, under which the investors would convert their debt into a substantial percentage of RadioShack's equity if certain conditions were met.[146] This additional liquidity infusion allowed RadioShack to operate through the 2014 winter holiday season, but it did not solve RadioShack's underlying operational and financial problems. RadioShack also failed to satisfy the conditions of the Recapitalization and Investment Agreement.[147]

Accordingly, RadioShack filed for bankruptcy in February 2015.[148] The bankruptcy filing was premised on a prenegotiated sale of the entire company to Standard General and other investors through a credit bid of the prebankruptcy debt held by those investors.[149] The bankruptcy case took several different twists and turns, but Standard General ultimately was the successful bidder for substantially all of RadioShack's

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[144] *Id.*

[145] *See* Press Release, RadioShack Corporation, RadioShack Announces Milestone in Recapitalization Process, Oct. 3, 2014, available at http://www.prnewswire.com/news-releases/radioshack-announces-milestone-in-recapitalization-process-278065871.html. *See also* RadioShack Corporation, Form 8-K, Current Report, Oct. 6, 2014 (describing purchase of credit facility and amendments to that facility), available at http://secfilings.nyse.com/filing.php?doc=1&attach=ON&ipage=9837356&rid=23. Notably, the loans were purchased by General Retail Holdings L.P. ("GRH") and General Retail Funding LLC ("GRF"), each an affiliate of Standard General. Moreover, other investors were partners or members of GRH and GRF. *See* Declaration of Carlin Adrianopoli in Support of First Day Pleadings, In re RadioShack Corp., Case No. 15-10197, Docket No. 17, at 7 (Bankr. D. Del. Feb. 5. 2015) (explaining factors that contributed to RadioShack's bankruptcy and its failure to meet the conditions of the Recapitalization and Investment Agreement) [hereinafter "Adrianopoli Declaration"].

[146] *See* RadioShack Corporation, Form S-3 Registration Statement, Dec. 12, 2014 (describing terms of the rights offering to RadioShack's "legacy shareholders" [i.e., existing shareholders other than the investor group] and the issuance of convertible preferred stock to Standard General and others in the investor group that would be convertible into 20-50% of the company's common stock in exchange for debt cancellation if certain conditions were met), available at http://www.sec.gov/Archives/edgar/data/96289/000119312514441276/d836621ds3.htm.

[147] *See* Adrianopoli Declaration, *supra* note 145, at 14.

[148] *Id.*

[149] *See* Debtors' Combined Motion for Entry of Orders: (I) Establishing Bidding and Sale Procedures; (II) Approving the Sale of Assets; and (III) Granting Related Relief, *In re* RadioShack Corp., Case No. 15-10197, Docket No. 36 (Bankr. D. Del. Feb. 5, 2015). "General Wireless [i.e., Standard General] was the stalking-horse bidder for the stores with a bid valued at $145.5 million, comprised of $117.5 million in the form of a credit bid of the credit agreement loans, $18.6 million in cash, and $9.4 million in assumed liabilities." *See* Alan Zimmerman, *RadioShack Asset Sale to Standard General Nets Court OK*, FORBES, Mar. 31, 2015, available at http://www.forbes.com/sites/spleverage/2015/03/31/bankruptcy-radioshack-asset-sale-to-standard-general-nets-court-ok/. Standard General's credit bid was reduced to approximately $112 million based on a dispute with RadioShack's other prepetition lender, Salus. *Id*. For an example of the various allegations asserted against Standard General and others involved in RadioShack's prebankruptcy restructuring efforts, see Committee Rule 2004 Motion, *supra* note 133.

assets.[150] The sale generated little value for the majority of the company's prebankruptcy creditors and shareholders.[151] For purposes of this article, it is important to note that although some of the company's stores continue to operate in a modified form under the new ownership,[152] Standard General was the primary beneficiary of the sale. The corporate entity was not restructured in any meaningful way that benefited its long-term sustainability or the interests of its prebankruptcy shareholders, creditors, employees, and other stakeholders.

E. Takeaways from the Case Studies

The Darden and RadioShack case studies illustrate two very different approaches to activism. Some commentators may find both approaches troublesome, and some may view them as equally valuable. Undeniably, both activists were pursuing strategies that each believed to be in their own respective best interests; acknowledging the self-interest and general motivation to increase the investor's own return on investment, which are present in all activism, facilitates a more meaningful analysis.

Starboard approached Darden as an owner, offering critiques of management and operations that it believed were depressing the company's overall value.[153] Starboard not only criticized, but it also offered potential management and operational solutions. It disseminated its analysis and additional information to all of the company's shareholders. Starboard did not extract any fees or value that would not also be received proportionally by all of the company's shareholders. Although Starboard's slate of directors now runs the company, those directors were vetted with and voted on by Starboard's shareholders.[154] The company also is continuing to operate on a much stronger platform, with improved performance and likely returns to shareholders.[155]

Standard General, on the other hand, first approached RadioShack as a shareholder, but with a plan to own the company's debt—indeed, a secured position at the most senior level of the company's debt structure.[156] Standard General does not appear to have

[150] *See* Order Authorizing (I) the Sale of Certain Assets of the Debtors Free and Clear of All Claims, Liens, Liabilities, Rights, Interests and Encumbrances; (II) the Debtors to Enter Into and Perform Their Obligations Under the Asset Purchase Agreement and Certain Ancillary Agreements; (III) the Debtors to Assume and Assign Certain Executory Contracts and Unexpired Leases; and (IV) Granting Related Relief, *In re* RadioShack Corp., Case No. 15-10197, Docket No. 1672 (Bankr. D. Del. Apr. 1, 2015). *See also* Zimmerman, *supra* note 149 (explaining, among other things, that Standard General's winning bid also included an agreement with Sprint for a small cash infusion and a commitment to a "store within a store" concept going forward).

[151] *See, e.g.,* Zimmerman, *supra* note 149 ("Despite all the [turmoil] associated with the competition for the RadioShack assets, at the end of the day it would appear to mean little for the company's creditors, most of whom were destined to see a minimal, if any, recovery regardless of who was declared the winner.").

[152] At the time of its bankruptcy filing, RadioShack had 4,100 company-operated stores, 1,100 dealer-franchised outlets, and 21,000 full- and part-time employees. *See* Adrianopoli Declaration, *supra* note 149, at 4-6. Reports indicate that Standard General will maintain approximately 1,723 of those operating locations. *See* Zimmerman, *supra* note 149.

[153] *See supra* Part II.C.

[154] *Id.*

[155] *Id.*

[156] *See supra* Part II.D.

offered any operational or restructuring expertise to the company, and it did not facilitate the dissemination of information to other shareholders. Rather, Standard General appears to have situated itself in a position in which it would win regardless of whether the company restructured or not. In addition, at least based on allegations in the bankruptcy case, some investors participating in Standard General's prebankruptcy extension of credit to the company also sold credit default swaps on RadioShack that would have become payable if RadioShack defaulted prior to January 2015.[157] Consequently, Standard General held multiple positions throughout RadioShack's capital structure and was focused more on capturing returns—arguably to the exclusion of all others—through a takeover of the company as opposed to an operational or financial restructuring.

Notably, each of the above investment strategies is well known and used by various entities in the industry.[158] This article does not challenge the validity or propriety of either strategy. The article does suggest, however, that one form of activism may hold greater value for the corporate entity itself and more of the corporation's stakeholders. The challenge is identifying means to encourage a more Darden-like approach to distressed companies, recognizing that not all such efforts will prove successful and that all activism has the potential to reallocate value against the interests of a majority of the company's stakeholders. The following section considers the various alternative activist strategies and draws on the case studies to develop and propose the targeted proxy access bylaw—a tool that would utilize the discipline and expertise often present in activism and enhance value for the corporate entity and more of its stakeholders.

III. PROPOSED SOLUTION: PROXY ACCESS WHEN A COMPANY NEEDS IT MOST

Conventional wisdom posits that debt disciplines management.[159] Debt financing subjects management to, among other things, conduct covenants, financial and performance metrics, and active oversight by lenders. In theory, such provisions should encourage responsible management and reduce agency costs. In reality, debt financing can cause management to take excessive risks, limit the company's future operational and restructuring alternatives, and make the company vulnerable to takeover bids by distressed debt investors.[160] Accordingly, conventional wisdom may not hold true in

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[157] *Id.*

[158] *See supra* Parts II.A, B. In addition, a Darden-like approach is not always successful. *See, e.g.,* Svea Herbst-Bayless, *Ackman Turns Back on J.C. Penney, Sells Entire Stake in Retailer*, REUTERS, Aug. 27, 2013), available at http://www.reuters.com/article/2013/08/27/us-jcpenney-ackman-idUSBRE97P0TA20130827; William Alden et al., *The Activist Investor Scorecard*, DEALBOOK, N.Y. TIMES, Dec. 10, 2014, available at http://www.nytimes.com/interactive/2014/12/11/business/dealbook/the-activist-investors-of-wall-street.html.

[159] *See, e.g.,* Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in KNIGHTS, RAIDERS, AND TARGET: THE IMPACT OF THE HOSTILE TAKEOVER 314, 321-23 (John C. Coffee, Jr., et al. eds. 1988) (describing attributes of debt that discipline management).

[160] As a company incurs more debt to try to prolong its life and fix the financial or operational problems, directors may be more aggressive on the premise that the company and shareholders have nothing to lose. Such conduct, however, can damage any remaining value at the company. *See, e.g.,* Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340 (3d. Cir. 2001) (explaining dilemma faced by directors of distressed companies and basis for theory of deepening insolvency). *See also* U.S. Bank Nat.

every case. A company approaching or facing financial distress may need an appropriate dose of shareholder activism to discipline management and preserve value.

That said, not every kind of shareholder activism is value enhancing.[161] The activism needs to fit the problem. In the context of financial distress, the tool should encourage management to acknowledge the company's issues in a timely manner, explore all options, and be open to new approaches and perspectives. It also should strive to enhance management's leverage in negotiations with creditors and other stakeholders. All too often, management of a financially distressed company has waited too long to address the issues underlying the company's distress, has borrowed more money to buy additional time, and, as a result, ends up negotiating the end deal with lenders with little or no bargaining power.[162] As explained below, the targeted proxy access bylaw is designed to incentivize management to proactively manage operational and financial distress and to provide shareholders with access to the ballot when management fails in those efforts.

This Part provides a brief history of proxy access rules and regulations, and discusses the current state of proxy access initiatives. It explores the basic parameters of proxy access proposals and reviews the ongoing debate concerning the utility of proxy access. It then explains the targeted proxy access proposal in greater detail, identifying key elements of such a bylaw, proposed language, and potential implementation issues. It concludes by suggesting the tailored nature of the targeted proxy access proposal better addresses potential governance inefficiencies than more general proxy access initiatives.

A. An Overview of Proxy Access

The Darden case study illustrates how activist shareholders can use a proxy contest to effect change.[163] The typical proxy contest involves an activist shareholder, who likely owns more than five percent of the company's stock and has made required disclosures under section 13D of the 1934 Securities Exchange Act (the "Exchange Act").[164] The activist shareholder will initiate (or continue) conversations with management to glean knowledge and begin outreach to other shareholders on an informal basis.[165] The activist shareholder is careful not to trip the solicitation rules of the Exchange Act until it is ready

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Ass'n v. Stanley, 297 S.W.3d 815, 822 (Tx. App. 2009) (creditor brought action arguing that board approved excessive spending and citing expect report opining that "that despite numerous 'red flags,' the directors 'were in total support of the business strategy of "swinging for the fences" in order to try to pay off the Senior Preferred Stock and return control of [TransTexas] to Stanley'").

161 *See supra* notes 79-80 and accompanying text.

162 *See id. See also supra* Part II.B.

163 *See supra* Part II.C.

164 *See* 15 U.S.C. § 78m(d) (codifying section 13D of the Exchange Act); 17 C.F.R. § 240-13d. The rules also require a shareholder who files a Schedule 13D to update the filing as the shareholder's holdings and objectives change.

165 For an example of the start of a typical activist campaign, see David Benoit and Jacob Bunge, *Nelson Peltz Launches Proxy Fight Against DuPont*, WALL ST. J.,, Jan. 8, 2015.

to begin filing materials with the SEC.[166] Solicitations may begin prior to the filing of the proxy statement, but the activist shareholder must file any written materials used in the solicitation with the SEC.[167] These additional solicitation materials may contain significantly more information than the proxy statement, as disagreements between the company and the activist shareholder often play out more visibly in "fight letters" and other communications with shareholders that, under the rules, are filed with, but not pre-cleared by, the SEC.[168]

An activist shareholder pursuing a proxy contest may put forth a full or partial slate of directors to challenge the company's proposed slate.[169] The activist shareholder's proxy materials and proxy card are sent separately from that of the company. In the typical proxy contest, each side bears its own costs, and the contest can be quite expensive.[170] DuPont Chemical reportedly spent $15 million to defeat a proxy contest launched by an activist shareholder, Trian Fund Management.[171] Although some data suggest that proxy contests create value regardless of the outcome, proxy contests are rare and may not facilitate a change in the board.[172]

Not only are proxy contests expensive, they also are often quite ugly.[173] A proxy contest is by definition adversarial. The company's directors do not want the activist shareholder's nominee(s) on the board, and they likely disagree with the facts and arguments asserted by the activist shareholder to support the proxy contest. There are no pre-determined grounds for a valid or useful proxy contest. The activist shareholder's objectives may be bona fide and in the best interests of the company; they also may be purely self-motivated and based on agenda adverse to other stakeholders.[174] Regardless

[166] *See* 17 C.F.R. § 240-14a-1-3 (defining solicitation and establishing general solicitation rules); 17 C.F.R. § 240-14a-6 (setting forth the filing and pre-clearance process for proxy statements).
[167] *See* 17 C.F.R. § 240-14a-12 (allowing certain kinds of solicitations prior to the filing of the proxy statement).
[168] *See* John C. Wilcox, *Shareholder Nominations of Corporate Directors: Unintended Consequences and the Case for the Reform of the U.S. Proxy System*, in SHAREHOLDER ACCESS TO THE CORPORATE BALLOT (Lucian Bebchuk ed. 2005) (explaining tools often used by activist shareholders in intense proxy contests).
[169] 17 C.F.R. § 240-14a-4 (setting forth proxy requirements).
[170] *See* Michael J. Goldberg, *Democracy in the Private Sector: The Rights of Shareholders and Union Members*, 17 U. PA. J. BUS. L. 393, 409 (2015) ("The high cost of proxy fights have made them rare, and this is exacerbated by free rider problems, and rational apathy on the part of shareholders with easy exit available through the Wall Street Rule.").
[171] *See* Jeff Mordock, *DuPont Spent $15M to Keep Activist Off Board*, USA TODAY, May 19, 2015.
[172] *See* DONALD DEPAMPHILIS, MERGERS, ACQUISITIONS, AND OTHER RESTRUCTURING ACTIVITIES 84 (2013) ("Despite a low success rate, proxy fights often result in positive abnormal returns to target shareholders regardless of the outcome.") (citing studies). *See also* Christopher Takeshi Napier, *Resurrecting Rule 14a-11: A Renewed Call for Federal Proxy Access Reform, Justifications and Suggestions*, 67 RUTGERS U.L. REV. 843, 867-869 (2015) (reviewing studies assessing value of shareholder contests and suggesting more recent studies indicate value creation).
[173] The public opinion campaign that often accompanies a proxy battle can reach far and wide. *See, e.g.*, Stephen Gandel, *DuPont Activist Battle Spreads from Wall Street to Academia*, FORTUNE.COM, Apr. 21, 2015 (describing the public exchanges and accusations between the activist shareholder engaged in a proxy fight with DuPont and a Yale University professor).
[174] *See, e.g.*, Third Point LLC v. Ruprecht, 2014 WL 1922029, *7-*10 (May 2, 2014) (in the contest of a challenged shareholder rights plan, the court reviews exchanges between the company's Chair, President, and CEO, William Ruprecht, and the activist investor, Third Point; the court quotes Ruprecht as saying,

of the objective, the fight that ensues can be very disruptive for the company and its ongoing operations and should not be undertaken lightly.

Proxy access, which generally allows qualifying shareholders to nominate a certain percentage of the board through the company's proxy materials, does not eliminate the adversarial nature of the process. The simple act of a shareholder putting forth its own nominee suggests a lack of confidence in the current board and directly challenges the board's management of the company. In most cases, the board likely will oppose the shareholder nominees, and that effort still requires time and money that otherwise could be devoted to the company's operations. Nevertheless, proxy access can cabin the dispute and mitigate some of the costs associated with a proxy contest.

Proxy access initiatives are not new,[175] but they garnered increased attention after Congress passed the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act").[176] The Dodd Frank Act authorized the SEC to adopt proxy access rules,[177] and the SEC was quick to pass a rule—Rule 14a-11—that required public companies to include shareholder nominees in their proxy materials.[178] The legislation and the resulting rule were grounded in general concerns regarding the lack of board accountability during the 2008 financial crisis and a belief by some that proxy access could mitigate that problem.[179] Rule 14a-11 was short-lived, however, as it was

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"The motivation for that [proxy] fight is only peripherally about returning capital. It is about being on Sotheby's Board. Mick McGuire needs that as validation, and Loeb wants that for ego."); Joe Nocera, *Investor Exits and Leaves Puzzlement*, N.Y. TIMES, May 30, 2009 (noting that activist investor, William Ackman, "said that he had begun the proxy fight [at Target] not because he had a $1 billion-plus investment in Target shares that was seriously underwater—not at all!—but because 'we never want Target to be referred to as a "once-great company"'").

[175] *See, e.g.,* Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 465, 499-500 (2012) (describing history of proxy access); Bebchuk & Hirst, *supra* note 15 ("The ability of shareholders to place director nominees on the company's proxy materials is an issue that the U.S. Securities and Exchange Commission ('SEC') has been considering for over sixty years.").

[176] Pub. L. No. 111-203, 123 Stat. 1376 (2010). There is a rich literature on proxy access generally, including under the Dodd Frank Act and the SEC's proposed Rule 14a-11. *See, e.g.,* Joseph Grundfest, *Advice and Consent: An Alternative Mechanism for Shareholder Participation in the Nomination and Election of Corporate Directors*, in SHAREHOLDER ACCESS TO THE CORPORATE BALLOT (Lucian Bebchuk, ed. 2004); Stephen M. Bainbridge, *A Comment on the SEC Shareholder Access Proposal* (November 14, 2003), available at SSRN: http://ssrn.com/abstract=470121 or http://dx.doi.org/10.2139/ssrn.470121; Lucian A. Bebchuk, *Designing a Shareholder Access Rule*, 12 CORP. GOV. ADVISOR 28 (2004); Lucian A. Bebchuk, *The Business Roundtable's Untenable Case Against Shareholder Access*, 55 CASE WESTERN L. REV. 557 (2005); Brett McDonnell, *Setting Optimal Rules for Shareholder Proxy Access*, 43 ARIZ. ST. L.J. A67 (2011); Mark J. Roe, *The Corporate Shareholder's Vote and Its Political Economy, in Delaware and Washington,* 2 HARV. BUS. L. REV. 1 (2012). *See also supra* notes 15 and 16.

[177] *See id.* at 1915 (codified as amended at 15 U.S.C. § 78n(a)) (authorizing the SEC to adopt rules that, among other things, include "a requirement that a solicitation of proxy, consent, or authorization by (or on behalf of) an issuer include a nominee submitted by a shareholder to serve on the board of directors of the issuer").

[178] 17 C.F.R. § 240-14a-11, invalidated by Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).

[179] *See, e.g.*, Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1795-97 (2011) (discussing factors leading to passage of certain federal legislation, including the Dodd-Frank Act); Rachelle Younglai, *Shareholders Win More Rights to Influence Boards*, REUTERS, Aug. 25, 2010 (describing justifications for and arguments against Rule 14a-11 and quoting SEC

successfully challenged in court.[180] The SEC has not taken any further action on a definitive proxy access rule.

In connection with Rule 14a-11, the SEC also passed an amendment to Rule 14a-8 that authorized the use of shareholder proposals to initiate changes to the board nomination process. As the SEC explained, "[W]e are amending Rule 14a-8(i)(8) to preclude companies from relying on Rule 14a-8(i)(8) to exclude from their proxy materials shareholder proposals by qualifying shareholders that seek to establish a procedure under a company's governing documents for the inclusion of one or more shareholder director nominees in the company's proxy materials."[181] Under the shareholder proposal rules, a company must include the shareholder proposal in its proxy materials unless the company has grounds to exclude it under the rules.[182] Shareholders then vote on any shareholder proposals included in the company's proxy materials at the annual meeting.

Shareholders were slow to embrace the shareholder proposal alternative for gaining access to the company's proxy materials.[183] They are, however, using it more frequently, with varying degrees of success. The most common proxy access bylaw: (i) requires a shareholder to own a certain percentage of stock (i.e., three percent); (ii) requires the shareholder to have owned the stock for a continuous period of time (e.g., three years); (iii) limits the number of nominees that a shareholder may submit (e.g., twenty percent of the board); and (iv) may limit the number of shareholders that can act collectively as a group.[184]

Companies have responded in different ways to shareholder proposals concerning proxy access. Some have opposed the proposal; some have supported the proposal or reached a settlement with the shareholder; and some have tried to pre-empt the shareholder proposal by adopting a board-proposed proxy access bylaw.[185] Regardless of

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Chair Mary Schapiro, "As a matter of fairness and accountability, long-term significant shareholders should have a means of nominating candidates to the boards that they own.").

[180] *See* Business Roundtable, 647 F.3d at 1144.

[181] SEC RELEASE NOS. 33-9136, 34-62764, *supra* note 17, at 35.

[182] Companies have tried to exclude proxy access proposals under Rule 14a-8(i)(9) (direct conflict; SEC took no position on this exclusion during 2015 proxy season), Rule 14a-8(i)(10) (substantial implementation), and Rule 14a-8(i)(11) (duplication), as well as Rules 14a-8(i)(7) (ordinary business) and 14a-8(i)(3) (contrary to rule), with varying degrees of success. *See, e.g.,* Trinity Wall Street v. Wal-Mart Stores, Inc., 792 F.3d 323 (3d Cir. 2015) (discussing exclusions under Rules 14a-8(i)(7) and 14a-8(i)(3); SIMPSON THATCHER, *supra* note 8 (reviewing grounds for excluding proxy access proposals); Elizabeth A. Ising and Kelsey L. Robinson, *Recent Developments Related to the SEC's Shareholder Proposal Rule*, 2015 BUS. L. TODAY 1 (discussing exclusion of proxy access proposals and Third Circuit's *Wal-Mart* decision).

[183] *See supra* note 7 and accompanying text. For examples of the literature supporting proxy access, see *supra* note 15.

[184] *See supra* note 8 and accompanying text.

[185] For example, during the 2015 proxy season, 78 companies included a shareholder proposal on proxy access with an opposition statement; 16 companies voluntary adopted proxy access; six companies negotiated resolutions; seven companies included both a shareholder and a company proposal; two companies supported the shareholder proposal; and one company provided no board recommendation. *See* SIMPSON THATCHER, *supra* note 8, at 14-15.

approach, many companies appear concerned by, and skeptical of, proxy access bylaws.[186]

B. The Targeted Proxy Access Proposal

The current approach to proxy access is an all-or-nothing proposition.[187] Shareholders either have the ability to nominate directors in the company's proxy materials or they do not. But such an approach misses a valuable opportunity to tailor proxy access proposals to situations that objectively could benefit the company and strike a more appropriate balance between management autonomy and accountability.

A targeted proxy access bylaw would allow the board to manage the company, free of challenges through proxy access, so long as management of the company was well in hand. The board of a company that is profitable and stable—even if some shareholders believed the company could be doing even better—would not face a challenge through proxy access.[188] Notably, activist shareholders could still launch campaigns against management, but they would not have the benefit of the company's proxy materials.[189] To that end, a targeted proxy access bylaw may deter some campaigns prior to the targeted proxy access trigger. It also may color shareholders' perspectives of activist campaigns launched prior to a triggering event: Are such efforts for the primary benefit of the activist, or the company and larger shareholder body?

A targeted proxy access bylaw also could have a prophylactic effect by encouraging executives to manage difficult operational and financial situations more proactively.[190] Although management never intends to make decisions that worsen the company's performance or deepen the company's financial distress, directors and managers often are overly optimistic about their decisionmaking skills and will take that chance.[191] Directors and managers may, however, consider a broader range of options to mitigate potential distress knowing the consequences if they are too slow or too limited in their approach. Likewise, to the extent management tries and fails, the targeted proxy access bylaw would introduce a new perspective and arguably change the tenor of the discussions

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[186] For an example of the literature opposing or raising concerns with proxy access, see *supra* note 16.

[187] As noted in Part I and discussed further below, the SEC proposed contingent proxy access in 2003. The target access proposal discussed in this article, however, differs in significant ways from the prior SEC proposal. *See infra* note 17 and accompanying text. *See also* SEC RELEASE NOS. 33-9136, 34-62764, *supra* note 17, at 46-47.

[188] This approach mitigates concerns regarding conflicting interests among a diverse and very dispersed shareholder body, as well as potential short-term objectives of the activist investor. *See supra* notes 79-80 and accompanying text.

[189] For example, activist shareholders may launch a proxy campaign to encourage boards to distribute value to shareholders though dividends or share buy-back plans. *See supra* note 71 and accompanying text.

[190] In this respect, targeted proxy access is a form of "offensive" activism. *See, e.g.,* Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, 2014 B.Y.U. L. REV. 1015 (2014) (discussing potential value to offensive activism, including in the context of proxy access); Cheffins & Armour, *supra* note 68, at 58 (distinguishing between offensive and defensive forms of shareholder activism).

[191] For a discussion of cognitive biases impacting board decisions, see *supra* Part I.B.

earlier in the process. Shareholders no longer would have to wait or launch expensive standalone proxy contests to help management implement a turnaround plan. The triggers, if appropriately crafted, would allow more timely intervention.[192]

The terms of the targeted proxy access bylaw are key to its effectiveness. A board or shareholder proposing such a bylaw needs to consider not only the factors identified above in the context of a more general proxy access bylaw, but also the triggers that would grant the targeted proxy access to shareholders.[193] Although each company should tailor its bylaw to its particular situation and industry, a proponent of the bylaw should consider the following:

- *Triggers*. Use triggers that are objective and easy to identify. Triggers could include a material default under a credit facility or bond issuance; a restructuring, refinancing, or forbearance to avoid a material default under a credit facility or bond issuance; a downgrade by one of the major ratings agencies; or a certain number of consecutive quarters of significant losses (or misses on other significant financial metrics). The concepts of "material definitive agreement" and "direct financial obligation" under the SEC's Form 8-K, Current Report, could guide the kinds of agreements subject to the triggers.[194] A disclosure required by Form 8-K, Item 2.04, Triggering Events that Accelerate or Increase a Direct Financial Obligation, could also serve as a trigger.[195] In the case of RadioShack, the company experienced a loss of $139 million, suspended dividend payments to shareholders, and was downgraded by the ratings agencies in 2012-2013.[196] Any one or all of these events could have triggered a targeted proxy

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[192] As discussed supra Part I.B, a board may have "ostrich syndrome" with respect to the company's financial or operational distress. A board that ignores or delays addressing the company's financial or operational issues potentially impairs the company's ability to restructure effectively and subjects the company to significant outside influence from debtholders. *See supra* notes 56-59 and accompanying text.

[193] For examples of general proxy access bylaws, see Amended and Restated Bylaws of General Electric, dated February 6, 2015, at 7-11, available at http://www.ge.com/sites/default/files/GE_by_laws.pdf; Amended and Restated Bylaws of Whole Foods Market, Inc., dated June 26, 2015, at 12-19, available at http://assets.wholefoodsmarket.com/www/company-info/investor-relations/corporate-governance/20150630-Whole-Foods-Market-Inc-Amended-and-Restated-Bylaws_6_26_2015.pdf.

[194] *See* Form 8-K, Current Report, 17 C.F.R. § 249-308. The SEC's release concerning the 2004 amendments to Form 8-K explains that, in Item 101, the term "material definitive agreements" has the meaning used in Item 601(b)(10) of Regulation S-K. *See* RELEASE NOS. 33-8400, 34-49424, ADDITIONAL FORM 8-K DISCLOSURE REQUIREMENTS AND ACCELERATION OF FILING DATE, FINAL RULE, SECURITIES AND EXCHANGE COMMISSION, Aug. 23, 2004, *Section 1 - Registrant's Business and Operations* ["SEC RELEASE NOS. 33-8400, 34-49424"]. Item 601(b)(10) includes "[e]very contract not made in the ordinary course of business which is material to the registrant and is to be performed in whole or in part at or after the filing of the registration statement or report or was entered into not more than two years before such filing," as well as certain significant contracts "as ordinarily accompanies the kind of business conducted by the registrant." 17 C.F.R. § 229-601. Moreover, the SEC's 2004 release also explained that Item 203 "requires disclosure of the following information if the company becomes obligated under a direct financial obligation that is material to the company." RELEASE NOS. 33-8400, 34-49424, *supra*, at *Section 2 - Financial Information*. These terms are further explained in the Instructions included in Form 8-K. *See* Form 8-K, Current Report, available at https://www.sec.gov/about/forms/form8-K.pdf.

[195] See RELEASE NOS. 33-8400, 34-49424, *supra* note 194, at *Section 2 - Financial Information*.

[196] *See* Drew Fitzgerald et al., *RadioShack Gets Loan from GE Capital*, WALL STREET JOURNAL, Oct. 21, 2013, available at http://www.wsj.com/articles/SB10001424052702303902404579149800844793012.

access bylaw. In that instance, one or more shareholder nominees could have been seated prior to the company signing its subsequent financing agreements. The triggers should be designed to give the existing a board an opportunity to fix an identified problem, but not prolong and thereby exacerbate the problem. A board proposed bylaw would allow the board to establish reasonable parameters while recognizing some accountability if it fails. For example, a target proxy bylaw could provide:

> *Upon the occurrence of a Trigger Event, the Company shall include in its proxy statement for any [subsequent annual][197] meeting of shareholders, the name of any person timely[198] nominated for election (each a "Shareholder Nominee") to the Board of Directors by an individual Eligible Shareholder or a group of up to [20] Eligible Shareholders. The Company also shall include the Required Information[199] in any such proxy statement containing the names of any Shareholder Nominee.*
>
> *The term "Trigger Event" means (i) a material default or event of default under the Company's credit agreements, bond indentures, or other material financing agreements [or could use "material definitive agreements"] that is not cured within the grace period*

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[197] This language is bracketed for two reasons. First, companies and shareholders could specifically define the duration of proxy access. For example, the bylaw could provide that "Upon the occurrence of a Trigger Event, the Company shall include in its proxy statement for the immediate four annual meetings…." Such a durational restriction would "reload" the proxy access after the expiration of the trigger on the theory that the board used the more direct shareholder intervention for a period of time to assist the turnaround and then continues unless and until another triggering event. Second, timing matters in distressed situations. Depending on the kinds of triggers, the bylaw could contemplate a special meeting of shareholders within, for example, 90 days of the trigger event to facilitate more timely intervention. Trigger events designed to identify distress as early as possible may not need such accelerated proxy access.

[198] The timeliness of the submission is important. Many proxy access proposals use a timeframe similar to advance notice bylaws, i.e., "not more than one hundred fifty (150) calendar days and not less than one hundred twenty (120) calendar days prior to the anniversary date of the date (as specified in the Corporation's proxy materials for its immediately preceding annual meeting of shareholders) on which the Corporation first mailed its proxy materials for its immediately preceding annual meeting of shareholders." Amended and Restated Bylaws of Whole Foods Market, Inc., *supra* note 193, at 13.

[199] The term "Required Information" should include the Shareholder Information, Nominee Information, and Shareholder Position Statement described below. The following is an example of a definition for Required Information:

> "Required Information" that the Corporation will include in its proxy statement is the information provided to the Secretary concerning the Shareholder Nominee(s) and the Eligible Shareholder that is required to be disclosed in the Corporation's proxy statement by Section 14 of the Exchange Act, and the rules and regulations promulgated thereunder, and, if the Eligible Shareholder so elects, a written statement, not to exceed 500 words, in support of the Shareholder Nominee(s)' candidacy (the "Statement"). Notwithstanding anything to the contrary contained in this Article II, Section 15, the Corporation may omit from its proxy materials any information or Statement (or portion thereof) that it, in good faith, believes would violate any applicable law or regulation….

Amended and Restated Bylaws of Whole Foods Market, Inc., *supra* note 193, at 13.

> *provided by the applicable agreement;*[200] *(ii) the Company's entry into a refinancing agreement, restructuring agreement, forbearance agreement, or similar agreement to avoid or resolve a material default or event of default under the Company's credit agreements, bond indentures, or other material financing agreements [or could use "material definitive agreements"]; (iii) a downgrade of the Company's debt obligations of two or more ratings within a consecutive twelve month period by one of the major ratings agencies; or (iv) the Company sustaining net losses, as reflected on its income statement, for four or more consecutive quarters.*[201]

- *Shareholder Eligibility*. Include percentage ownership and holding period requirements that align the interests of the shareholder nominating directors with the company; limit the number of nominees that may be submitted by shareholders and included in the company's proxy materials; and permit, with reasonable limits, participation by groups to allow a more diverse representation of shareholders to participate. These requirements are very similar to the basic provisions included in general proxy access bylaws.[202]

- *Shareholder Disclosures*. Require detailed disclosures by the shareholder nominating directors. These disclosures should include not only information about its beneficial holdings in the company, but also any related derivative products, debt, or other interests it may hold, directly or indirectly, in the company. To supplement the disclosures required in Schedule 14N,[203] companies and the SEC may want to consider a definition of "economic interest" similar to the following definition of "disposable economic interest" under Rule 2019 of the Federal Rules of Bankruptcy Procedure: "any claim, interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right granting the holder an economic interest that is affected by the value, acquisition, or

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[200] A board and shareholders should identify triggers that work best for the company's business and capital structure and provide sufficient early warnings to allow meaningful intervention in the company's turnaround. Simply referencing the term "material definitive agreement" may cover all necessary agreements. *See supra* note 194 and accompanying text.

[201] A board and shareholders may want to use additional or alternative triggers. Such triggers could focus on Items 2.03 and 2.04 of Form 8-K, or even the company receiving a going concern qualification from its auditors. A company likely would not want to rely solely on the going concern qualification because, depending on the industry and the nature of the company's operations, such trigger may or may not provide sufficient early warnings of the company's distress.

[202] See *supra* notes 184, 193 and accompanying text.

[203] *See also* 17 C.F.R. § 240-14n-101. Schedule 14N and many proxy access bylaws focus on disclosures concerning the nominating shareholder's ownership in securities entitled to vote, and whether any such securities have been loaned or are subject to a short sale. Although this information is helpful, it does not necessarily provide the complete picture of the nominating shareholder's interest in the election. For thoughtful articles regarding the issues posed by conflicting and undisclosed ownership positions, see Roberta S. Karmel, *Voting Power Without Responsibility or Risk—How Should Proxy Reform Address the Decoupling of Economic and Voting Rights?,* 55 VILLANOVA L. REV. 93 (2010); Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN. L. REV. 1822 (2011).

disposition of a claim or interest."[204] Understanding the economic interests of the nominating shareholder and its potential agenda are particularly important in the distressed context, as evidenced by the RadioShack case study.[205]

- *Nominee Disclosures*. Require specific disclosures concerning the nominee, including all relevant information that is provided by the company with respect to its nominees.[206] Notably, the trigger allowing proxy access may help shareholders identify nominees offering skills relevant to the particular issues plaguing the company.

- *Shareholder Position Statement*. Define the scope (and word count) of the statement in support that the nominating shareholder may include in the proxy materials.[207] This may be one of the trickier aspects of a targeted or general proxy access proposal because the information should explain why the shareholder believes a new approach is necessary. Disseminating this competing perspective is important and valuable in the distressed context. Nevertheless, it may also be unpalatable to the board. A company should permit statements—even those adverse to, or critical of, management—provided they are grounded in facts supported by public documents and do not otherwise violate applicable law.[208]

The Darden case study illustrates the importance of both timely intervention and the dissemination of information to all shareholders.[209] Notably, companies and shareholders can benefit from these attributes of proxy access whether the company proposes a targeted proxy access bylaw or already has adopted a more general proxy access bylaw. Strategic and thoughtful use of proxy access—only when and as necessary—is an important consideration in assessing the value of shareholder intervention. The factors identified in this section with respect to targeted proxy access also can and should guide shareholders in using general proxy access to help companies in operational or financial

[204] FED. R. BANKR. P. 2019. The author is the Assistant Reporter to the Advisory Committee on the Federal Rules of Bankruptcy Procedure, but she was not serving in such capacity when Federal Rule 2019 was amended to include the definition of disposable economic interest in 2011. *See also* Harner, *supra* note 63 (suggesting that the SEC amend Schedule 13D and the related rules to require disclosure of information concerning debt, as well as, equity securities).
[205] *See supra* Part III.D.
[206] *See also* 17 C.F.R. § 240-14n-101.
[207] Many proxy access bylaws limit nominating shareholder statements to 500 words. *See, e.g.,* Amended and Restated Bylaws of General Electric, *supra* note 193, at 9; Amended and Restated Bylaws of Whole Foods Market, Inc., *supra* note 193, at 14.
[208] For example, General Electric's proxy access bylaw provides:

> The Eligible Shareholder may provide to the Secretary, within the time period specified in Article VII Section D for providing notice of a nomination, a written statement for inclusion in the Company's proxy statement for the meeting, not to exceed 500 words, in support of the Shareholder Nominee's candidacy (the Statement). Notwithstanding anything to the contrary contained in this Article VII, the Company may omit from its proxy materials any information or Statement that it believes would violate any applicable law, rule, regulation or listing requirement.

Amended and Restated Bylaws of General Electric, *supra* note 193, at 9.
[209] *See supra* Part II.C.

distress. A key benefit to a targeted proxy access bylaw, however, is that it focuses the use of proxy access on instances that more objectively warrant intervention.[210]

C. Potential Challenges to Targeted Proxy Access

Notwithstanding the suggested benefits to targeted proxy access, implementation may encounter resistance. For example, boards may oppose such a bylaw because it still impedes on autonomy and, unlike general proxy access, suggests that the board may fail at some point in the future. Likewise, shareholders may not believe the proposal goes far enough. And as with any new initiative, there are costs to being among the first to adopt the proposal, including risks associated with the untested effectiveness of the concept and increases in the cost of credit. This part briefly addresses the potential concerns of each side to this debate.

Proxy access (whether targeted or general) can subject management to increased scrutiny and challenge. General proxy access introduces the possibility that management will devote time and money defending its position and warding off proxy access contests on an annual basis.[211] Under the timeline used in many proxy access bylaws, that could consume three to four months out of every year.[212] That is a significant period of time during which management may be distracted by things arguably external to the core operations of the business. Although hopefully shareholders would be more selective and thoughtful in invoking proxy access rights, the concern has merit.

A targeted proxy access bylaw would mitigate this concern by defining the situations in which proxy access will be available. It would not be an annual contest. It also would be somewhat in the control of the board to manage. A board may not always be able to anticipate events causing operational or financial distress, but it does often have red flags warning of potential problems.[213] A targeted proxy access bylaw may encourage boards to more readily see and address such red flags. That said, the trigger of the targeted proxy access bylaw as the company is facing a distressed situation arguably could be more disruptive than in other circumstances. For this reason, the balance discussed above in defining the triggers is critical.

A shareholder likewise may oppose targeted proxy access in favor of a more general approach that would give shareholders access in any annual election.[214] This perspective is understandable, given that shareholders cannot predict in advance when they would like to intervene more directly in management's decisions. Activist shareholders do not

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210 *See* notes 192-197 and accompanying text (discussing competing considerations and balance struck by targeted proxy access).
211 *See supra* notes 185-186 and accompanying text (discussing opposition to general proxy access).
212 *See supra* note 193, 203 and accompanying text (providing example of language used in advance notice and general proxy access bylaws).
213 *See supra* notes 56-59 and accompanying text (discussing management's delay in addressing distress and harmful effects for company).
214 See *supra* notes 7, 15, 188 and accompanying text (discussing arguments of proponents of general proxy access).

limit their campaigns to distressed situations. Rather, they often seek changes at companies that otherwise are profitable and stable.[215] Notably, the targeted proxy access bylaw would not prevent them from pursuing those campaigns. It would, however, limit their ability to use the company's proxy materials to situations defined in the bylaw triggers.

These potential concerns are not new. In fact, some were raised with respect to the SEC's 2003 contingent proxy access proposal, which would have given shareholders the ability to nominate directors under certain circumstances unrelated to a company's financial health, as well as during its consideration of Rule 14a-11.[216] Supporters of triggers believed "that such a requirement would serve as a useful indicator of the companies with demonstrated governance issues."[217] Those who opposed triggers expressed "concern that triggering events would cause significant delays and introduce complexity into the rule."[218] The SEC ultimately elected not to include triggers in Rule 14a-11 because, among other things, it suggested that a limited federal proxy rule might not give full effect to shareholders' state law rights.[219]

The advantages and disadvantages to targeted proxy access noted in the context of the SEC's rulemaking process are generally valid points. The question in many ways becomes what are the objectives of federal proxy rules, and how can they best protect shareholders' rights. Shareholders should have the ability to exercise their state law rights to vote on directors. Should they also have the ability, however, to nominate directors in all cases?[220] Part of the related challenge is the diverse and often very dispersed nature of public company shareholders, as well as the fact that shareholders generally owe no fiduciary duties to the company or other shareholders.[221] A company and arguably even applicable law better protect the interests of all shareholders if the designated fiduciaries (i.e., boards) have the ability to nominate directors, subject to appropriate safeguards in situations where boards fail in their duties.

Targeted proxy access strikes that balance, pursing a path in the first instance that allows the company's fiduciaries to nominate directors and operate the business in the best interests of the company and all shareholders. Individual shareholders who potentially have competing interests or adverse agendas do not initially have those rights, but the board knows those shareholders may gain such rights in certain circumstances. As one proponent of triggers suggests, "'triggered' proxy access would give shareholders

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[215] See *supra* notes Parts II.A, II.B (discussing various objectives of activist campaigns).
[216] *See* SEC RELEASE NOS. 33-9136, 34-62764, *supra* note 17, at 46-47.
[217] *Id.* at 48.
[218] *Id.*
[219] *Id.*
[220] For a thoughtful exploration of shareholders' rights under state law and how the right to vote and the right to nominate interact, see Lawrence A. Hamermesh, *Director Nominations*, DEL. J. CORP. L. 117 (2014).
[221] *See, e.g.,* Ivanhoe Partners v. Newmont Min. Corp., 535 A.2d 1334, 1344 (Del. 1987) ("Under Delaware law a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation.").

an avenue for dealing with unresponsive boards, but protect companies from the threat of a proxy access challenge in the absence of serious governance or strategic matter."[222]

Interestingly, neither side necessarily wins by adopting a targeted proxy access bylaw, but each side has the potential to succeed in the long run. A board may also proactively adopt a targeted proxy access bylaw to signal strength and confidence to the market, backstopped by the shareholders' proxy access as defined in the bylaw triggers.[223] Although no board likes to admit the potential for failure, it is a reality of doing business. Targeted proxy access allows a board to define the parameters of the accountability tool and thereby eliminate the need for a more general proxy access bylaw.

Finally, boards may anticipate lenders increasing the cost of credit if the company adopts a board- or shareholder-proposed targeted proxy access bylaw. This concern, although understandable, does not withstand scrutiny, provided that the bylaw is adopted prior to any operational or financial distress. Lenders extending credit to a financially healthy company likely would view such a bylaw as a neutral or positive attribute.[224] To the extent the bylaw is appropriately designed, the bylaw also should protect the lenders' investment and strengthen the company's ability to repay the debt upon maturity. A distressed debt investor looking to take over the company through a bankruptcy or out-of-court restructuring may not approve of a targeted proxy access bylaw, but such investors often have a different agenda or assessment of the company's risk profile.[225] A distressed debt investor may view targeted proxy access as a potential impediment to a rescue loan or refinancing structure that protects the investor on the downside through significant lender control provisions. Notably, this is exactly the kind of leverage the proposal seeks in part to mitigate.

As with any proposal, the effectiveness of targeted proxy access lies in the details of each company's bylaw. The underlying objectives of incentivizing proactive management of financial or operational distress and increasing accountability for related failures should guide the development of the proposal. Moreover, these objectives and the balanced approached offered by targeted proxy access make it a useful tool for both boards and shareholders interested in the long-term success of the company.

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[222] ALLIANCE ADVISORS, ANOTHER BUSY YEAR AHEAD FOR PROXY ACCESS, NEWSLETTER, Jan. 2016 (describing position of the United Brotherhood of Carpenters Pension Fund).
[223] Ratings agencies could consider whether companies have adopted targeted proxy access as an appropriate oversight mechanism to protect the company's financial health in rating a company's debt.
[224] *See* Jayanthi Sunder et al., *Debtholder Responses to Shareholder Activism: Evidence from Hedge Fund Interventions*, 27 REV. FIN. STUDIES 3318 (2014) ("We compare loan spreads before and after intervention and show the effects of heterogeneous shareholder actions. Spreads increase when shareholder activism relies on the market for corporate control or financial restructuring. In contrast, spreads decrease when activists address managerial entrenchment.").
[225] *See supra* Part II.B.

CONCLUSION

Boards make hard decisions. They are called upon to vet various opportunities and alternatives for their companies and, in the process, must determine the best way forward. Although directors' fiduciary duties flow to the corporate entity and, in most situations, shareholders, directors' decisions affect numerous other individuals and entities.[226] The voices and interests of these other parties can make even simple decisions noisy and complex, and may influence directors' deliberations.

Noise and complexity grow as a company's profitability shrinks. Boards of distressed companies face competing demands from creditors, shareholders, and employees. The decisions at hand are of the "bet the company" nature, and the stakes are extremely high. Moreover, the directors' fiduciary duties typically remain unchanged, but the company's senior debtholders may be the only parties at the negotiating table.[227] Boards, their companies, and their shareholders would benefit from activism that balances leverage and also helps boards make better decisions.

The targeted proxy access bylaw would do exactly that.[228] The proposal would channel shareholder activism to situations in most need of intervention. It would allow qualifying shareholders to nominate a certain percentage of the board, thereby introducing new perspectives and potentially targeted expertise to the board. It also would facilitate the dissemination of additional information to shareholders—information that may counter management's story and challenge the status quo. Unlike a more general proxy access bylaw, however, directors would not be open to proxy access contests on an annual basis and would face such contests only if they fail to navigate any operational or financial distress in a timely manner.[229]

Although any proxy access can facilitate needed intervention in times of distress, a targeted proxy access bylaw strikes a better balance. It gives a board the autonomy necessary to run a company effectively, but provides a safety valve for shareholders in the event the board fails. Overall, such a bylaw offers a reasonable compromise to the proxy access debate and has the potential to help companies and shareholders preserve value in distressed situations.

[226] *See supra* Part I.B.
[227] *See generally supra* Parts I.B, II.B.
[228] *See supra* Part III.B.
[229] *See id*.