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How Corporate Governance is Made: The Case of the Golden Leash

Matthew D. Cain Ph.D.

U.S. Securities and Exchange Commission, mdcain@outlook.com

Jill E. Fisch

University of Pennsylvania Law School, jfisch@law.upenn.edu

Sean J. Griffith

Fordham University School of Law, sgriffith@law.fordham.edu

Steven D. Solomon

UC Berkeley School of Law, steven.solomon@law.berkeley.edu

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ARTICLE

HOW CORPORATE GOVERNANCE IS MADE:
THE CASE OF THE GOLDEN LEASH

MATTHEW D. CAIN†
JILL E. FISCH††
SEAN J. GRIFFITH†††
STEVEN DAVIDOFF SOLOMON††††

This Article presents a case study of a corporate governance innovation: the incentive compensation arrangement for activist-nominated director candidates colloquially known as the “golden leash.” Golden leash compensation arrangements are a potentially valuable tool for activist shareholders in election contests. In response to their use, a number of issuers adopted bylaw provisions banning incentive compensation arrangements. Investors, in turn, viewed director adoption of golden leash bylaws as problematic and successfully pressured issuers to repeal them.

This study demonstrates how corporate governance provisions are developed and deployed, the sequential responses of issuers and investors, and the central role played by governance intermediaries—activist investors, institutional advisors, and corporate law firms.

† Financial Economist, U.S. Securities and Exchange Commission, Division of Economic and Risk Analysis. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author’s colleagues on the staff of the Commission.

†† Perry Golkin Professor of Law, University of Pennsylvania Law School.

††† T.J. Maloney Chair and Professor of Law, Fordham Law School.

†††† Professor of Law, University of California, Berkeley School of Law.

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The golden leash also presents an opportunity to test the response of share prices to governance innovation. We conducted two cross-sectional event studies around key dates that affected the availability of the golden leash. Our core finding is that share prices of firms facing activist intervention reacted positively to events that make golden leashes more available and negatively to events that make golden leashes less available. Moreover, we found that this governance innovation did not affect every firm in an identical manner. Only the share prices of those firms most likely to be subject to activist attention experienced statistically significant share price reactions.

Our research contributes to the debate over how corporate governance is made and its economic significance. Although we found that corporate governance provisions may be priced, at least in some circumstances, our study also suggests that corporate governance is a complex story involving the actions and reactions not merely of the firm and its shareholders but of a variety of intermediaries and interest groups that have agendas of their own.

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INTRODUCTION

How is corporate governance made? In one telling, corporate governance is endogenous and closely tailored to firm-specific needs.¹ Companies adopt those governance provisions that are designed to create the greatest value given the firm's particular situation.² Alternatively, governance mechanisms may be adopted by or imposed upon firms without regard to firm value in order to insulate self-interested executives or directors, or to respond to interest group pressures.³ Between these two poles lies a spectrum of other tales about corporate governance and its impact on firm value. And yet, in spite of the persistent disagreement surrounding these accounts, there is an increasing emphasis on adherence to the "right" governance principles espoused by activist hedge funds and institutional investors, even though these principles are often unproven and difficult to evaluate empirically.⁴

We use a case study of a corporate governance innovation—the golden leash—to shed light on how corporate governance originates and how it is valued. Activist hedge funds invented the golden leash as a tool for attracting and incentivizing director candidates in a proxy contest. Under the terms of the golden leash, these hedge funds agreed to pay their director nominees millions of dollars if the nominees were successful both in winning board seats and achieving the hedge fund's desired objectives.

The golden leash burst onto the scene in 2012⁵ when JANA Partners, LLC (JANA) offered to pay its nominees to the board of Agrium, Inc. (Agrium) an

¹ See generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

² *Id.*

³ See, e.g., Stephen M. Bainbridge, *Dodd–Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1786 (2011) (maintaining that Congress passed the Dodd–Frank Act in a hasty reaction to the events of the 2008 financial crisis without properly assessing its impact); Roberta Romano, *The Sarbanes–Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1585 (2005) (arguing that Congress enacted the Sarbanes–Oxley governance mandates as a result of political pressure and without adequately evaluating their efficiency).

⁴ See, e.g., Steven Davidoff Solomon, *A Lack of Consensus on Corporate Governance*, N.Y. TIMES: DEALBOOK (Sept. 29, 2015), <http://www.nytimes.com/2015/09/30/business/a-lack-of-consensus-on-corporate-governance.html> [<http://perma.cc/BUZ6-ZW72>] (criticizing institutional investors for "advocating whatever the conventional wisdom of the moment says is good corporate governance").

⁵ JANA first entered into a golden leash compensation agreement in 2007 in connection with the 2008 annual meeting at CNET Networks and JANA's attempt to elect a number of dissident directors to the CNET board. See Letter Agreement Between Jon Miller and JANA Partners (Dec. 23, 2007), http://www.sec.gov/Archives/edgar/data/1015577/000090266408000019/p07-1802exh_7.txt [<http://perma.cc/QPS3-9ATL>]. JANA disclosed the compensation agreement in the proxy materials that it filed with the SEC, but the agreement did not receive any public attention and became moot when CNET decided to sell itself before the culmination of the proxy contest. See *CBS–CNET Deal is Good News for JANA*, N.Y. TIMES: DEALBOOK (May 16, 2008), <http://dealbook.nytimes.com/2008/05/16/cbs-cnet-deal-is-good-news-for-jana> [<http://perma.cc/38QB-A4QN>]; see also JANA Master Fund, Ltd.

additional \$50,000 each, if elected, plus a collective total of 2.6% of JANA's net gain on the investment.⁶ Around the same time, Elliott Management (Elliott) agreed to pay its dissident nominees to the Hess Corp. (Hess) board an additional \$30,000, if elected, for each percentage point by which Hess outperformed its peers over a three-year period.⁷ These pay arrangements offered potential compensation in the millions to be paid directly by the activists to their nominees. As such, the arrangements had the potential to tie the interests of the nominees, once elected, to the activists that had nominated them. Accordingly, opponents of the arrangements dubbed them "golden leashes."⁸

The golden leash was immediately controversial. JANA and Elliott justified the golden leash by the need, first, to get the right people onto their slates and, second, to incentivize those people, once elected, to push the company to outperform.⁹ According to this account, golden leashes empower shareholders by providing directors committed to unlocking hidden value and increasing market returns. Critics of the golden leash, however, derided these arrangements as pernicious innovations that merely emboldened those who would "jeopardize a company's ability to generate sustainable long-term returns" and "destroy jobs."¹⁰

Opponents of activist shareholders soon responded with an innovation of their own. On May 10, 2013, Martin Lipton of Wachtell, Lipton, Rosen & Katz (Wachtell), a prominent law firm known for defending firms against activist interventions and hostile takeovers, issued a public memorandum recommending that corporations adopt bylaws prohibiting golden leash compensation arrangements (the "Wachtell Bylaw").¹¹ In relatively short

v. CNET Networks, Inc., 954 A.2d 335, 337, 339-40 (Del. Ch. 2008) (describing JANA's intended proxy contest and holding that CNET could not block the contest by invoking its advance-notice bylaw).

⁶ See *infra* notes 83-92 and accompanying text.

⁷ See *infra* notes 93-97 and accompanying text.

⁸ To our knowledge, Agrium's Board Chair, Victor J. Zaleschuk, was the first to use the term "golden leash" to describe these compensation arrangements. See Press Release, Agrium, Agrium Urges Shareholders to Vote the White Proxy for Agrium's Director Nominees (Mar. 4, 2013), <http://www.agrium.com/en/investors/news-releases/2013/agrium-urges-shareholders-vote-white-proxy-agriums-director-nominees> [<http://perma.cc/687W-ASVQ>]; see also David Benoit & Joann S. Lublin, 'Golden Leash' Payments Fuel Debate, WALL ST. J. (Nov. 26, 2013), <http://www.wsj.com/articles/SB10001424052702304281004579220094112755708> [<http://perma.cc/X32N-QNHA>] (calling the "golden leash" issue one of the "hottest topics in corporate governance").

⁹ See *infra* notes 104-05 and accompanying text.

¹⁰ Martin Lipton, *The Threat to Shareholders and the Economy from Activist Hedge Funds*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 14, 2015), <http://corpgov.law.harvard.edu/2015/01/14/the-threat-to-shareholders-and-the-economy-from-activist-hedge-funds> [<http://perma.cc/EV24-2F7C>] (quoting Laurence Fink, CEO of Blackrock).

¹¹ Martin Lipton, *Bylaw Protection Against Dissident Director Conflict/Enrichment Schemes*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 10, 2013), <http://corpgov.law.harvard.edu/2013/05/10/bylaw-protection-against-dissident-director-conflictenrichment-schemes> [<http://perma.cc/N3MT-WVX4>].

order, more than thirty public companies adopted the Wachtell Bylaw.¹² Moreover, because it could be adopted by any company virtually overnight, the Wachtell Bylaw had a market-wide effect.¹³

The Wachtell Bylaw was challenged, but not in any court of law.¹⁴ Instead, it provoked the wrath of a prominent proxy advisory firm, Institutional Shareholder Services (ISS). On November 12, 2013, ISS recommended that shareholders withhold their votes from directors at Provident Financial Holdings, Inc. (Provident) because the bank had adopted the Wachtell Bylaw.¹⁵ At the subsequent annual meeting, Provident's director nominees received a substantial number of withhold votes, and ISS threatened more withhold recommendations, publishing a list of other firms that had adopted the Wachtell Bylaw.¹⁶

Corporate America got the message. By May 20, 2014, twenty-eight of the thirty-two companies known to have adopted the Wachtell Bylaw prior to the Provident meeting had removed it in whole or in part.¹⁷ The golden leash, in contrast, is far from dead: it has been used in several recent activist attacks, notably those involving Dow Chemical (Dow) and General Motors.¹⁸ In November 2014, Dow agreed to seat two Third Point, LLC (Third Point)

¹² See CHRIS CERNICH ET AL., INSTITUTIONAL S'HOLDER SERVS. INC., WHEELING OUT THE PROCRUSTEAN BED: BYLAW RESTRICTIONS ON DISSIDENT NOMINEE COMPENSATION 1 (2013), http://www.thedeal.com/first_word/Wheeling_Out_the_Procrustean_Bed_-_Bylaw_Restrictions_on_Dissident_Nominee_Compensation-1.pdf [<http://perma.cc/D46B-RGLH>]. This figure is as of the date of the Provident meeting discussed *infra* Section II.B, and excludes bylaw amendments adopted by spinoff companies. See *infra* note 122 and accompanying text.

¹³ Essentially, every company has the power to adopt the bylaw at any time unless it made a binding commitment not to do so. See DEL. CODE ANN. tit. 8, § 109 (2015).

¹⁴ To date, no court has issued an opinion evaluating the legality of golden leash compensation arrangements or bylaws prohibiting their use.

¹⁵ The withhold recommendation was a direct response to the adoption of the Wachtell Bylaw. As ISS explained, "ISS recommended 'withhold' votes for the election of the members of [Provident Bank's] nominating committee because its board adopted—without shareholder approval—a corporate bylaw that barred director nominees from accepting compensation from anyone other than the company during their candidacy or service as a board member." JONES DAY, GOVERNANCE PERSPECTIVES: ISS QUESTIONS DIRECTOR COMPENSATION BYLAW (2013), <http://www.jonesday.com/files/Publication/e38a7775-2224-4d95-b2bf-c25e51340098/Presentation/PublicationAttachment/e006df6f-96eb-4b41-9ddf-c6fbo696d82d/GP-ISS%20Questions%20Director%20Compensation%20Bylaw.pdf> [<http://perma.cc/BW5R-N9LQ>].

¹⁶ See CERNICH ET AL., *supra* note 12, at 2.

¹⁷ See *infra* Table I and accompanying text.

¹⁸ For a description of the compensation arrangement in the GM activist intervention, see Press Release, Gen. Motors, GM Statement Regarding Receipt of Director Notice and Shareholder Proposal from Harry J. Wilson (Feb. 10, 2015), <http://media.gm.com/media/us/en/gm/news.detail.html/content/Pages/news/us/en/2015/feb/0210-corp.html> [<http://perma.cc/T8PB-5H2W>] (describing Wilson as "indicat[ing] a fee arrangement under which [the activist group's nominee] will receive a percentage of the group's profits from their investment in GM"). On Third Point's use of a golden leash arrangement in its attack on Dow, see Benoit & Lublin, *supra* note 8.

nominees who became the first directors to be compensated pursuant to a golden leash.¹⁹

The back and forth on the golden leash and the Wachtell Bylaw provides a case study of how corporate governance originates and is tested by the marketplace. The golden leash shows that corporate governance in many cases is a product of “governance intermediaries,” each with its own agenda and interests.²⁰ Activist hedge funds may have invented the golden leash, but the shape of the governance arrangements that ultimately emerged has as much to do with the counseling of a corporate law firm and the advocacy of an institutional proxy advisor as it does with the activists themselves. The success or failure of a governance innovation may often depend upon the position taken by such intermediaries.

While intermediaries may introduce these provisions, the question remains whether they are beneficial to the companies adopting them. With respect to the golden leash, this can be studied empirically. We did so by first examining each company and the circumstances of its adoption and repeal of the golden leash bylaw. We found that while some firms were reacting directly to activist threats, others had no apparent rationale for adopting the Wachtell Bylaw.²¹ Second, if the golden leash is economically good or bad, one would expect to see stock price reactions—either positive or negative—in response to firms’ adoption and repeal of the Wachtell Bylaw. We therefore ran a time series analysis to determine how the market reacted to firms’ adoption and repeal of the new corporate governance terms. We found no statistically significant share price effect for those companies that adopted—and subsequently repealed—the Wachtell Bylaw.²²

19 See David Benoit, *Proxy Adviser ISS Blesses Pay for Activist’s Directors at Dow*, WALL ST. J. (Apr. 22, 2015), <http://www.wsj.com/articles/proxy-adviser-iss-blesses-pay-for-activists-directors-at-dow-1429725478> [<http://perma.cc/QL6M-9ZPS>] (describing ISS’s “cautious” approval of the compensation arrangement for the Third Point directors); see also Dow Chem. Co., *Soliciting Material Pursuant to § 240.14a-12 (Schedule 14A)* (Nov. 13, 2014), <https://www.sec.gov/Archives/edgar/data/29915/000119312514411302/d820869ddf14a.htm> [<https://perma.cc/RJ6L-VNR4>] (describing the nominees’ compensation agreement as tied to the appreciation of Third Point’s shares). Shareholders elected the negotiated slate of director candidates in May 2015. Press Release, Dow Chem. Co., *Dow Announces Results from Annual Stockholder Meeting (May 14, 2015)*, <http://www.dow.com/news/press-releases/dow%20announces%20results%20from%20annual%20stockholder%20meeting%20may%202015> [<http://perma.cc/QDV5-XENP>].

20 See, e.g., Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 867 (2013) (describing activist hedge funds as “governance intermediaries” whose role is “to monitor company performance and then to present to companies and institutional shareholders concrete proposals for business strategy through mechanisms less drastic than takeovers”).

21 See *infra* Section III.B.

22 See *infra* Section III.C.

We then looked further. Because a golden leash bylaw can be adopted unilaterally at any time by the board of directors, we posited that what matters is not the *actual* adoption of the bylaw but rather the bylaw's *availability* for adoption if and when the board decides that it is needed. Additionally, we reasoned that the availability of a golden leash may not matter for all companies, but only for those that face the imminent prospect of a proxy contest or other activist intervention.

We examined this possibility by looking at the companies that experienced shareholder activism during the period from one year prior to the Wachtell Memorandum to one year after the Provident annual meeting. We assumed market discrimination in pricing corporate governance terms and hypothesized that we would find a share price reaction to the Wachtell Memorandum in this subset of companies. Our results are consistent with our hypothesis. We found a statistically significant decline in the share price of "targeted firms" on the release of the Wachtell Memorandum and a statistically significant increase in share price after the Provident vote. Consistent with our theoretical predictions, these price effects were limited to those companies most affected by the governance innovation in question—that is, those companies most likely to experience activism. Companies not subject to activist intervention had no statistically significant share price reactions.

Our findings contain several important implications for corporate governance. First, they provide evidence that intermediaries play an important role in channeling corporate governance innovation. Second, they show that, at least in this case, corporate governance may be priced by the market. Although our results suggest that investors responded to developments regarding the golden leash, we note that the value assigned by the market may not reflect the economic value of the leash itself, but may instead indicate more general investor or market anticipation of potential activist intervention. Third, our empirical findings provide evidence that investor reactions may be based largely on salience, and governance intermediaries play a critical role in creating this salience.

Ultimately, our findings are cause for caution regarding what constitutes "good" corporate governance and how studies of governance are conducted. While our case study examines only one event, it offers reasons to question the relationship between short-term share price reactions and long-term economic value. More generally, the evolution of corporate governance innovations is a complex story involving the actions and reactions not merely of the firm and its shareholders, but of a variety of intermediaries and interest groups with their own agendas.

This Article proceeds as follows: Part I reviews the academic debate over how corporate governance is made and what value it adds. Part II presents

our case study of the golden leash. Part III reports the results of our empirical tests. Part IV considers the implications of our findings for corporate governance scholarship. Part V closes with a brief summary and conclusion.

I. THE MAKING OF CORPORATE GOVERNANCE

Much of the literature on the creation of corporate governance is premised on a contractarian model of the firm, according to which governance mechanisms reflect the terms of a bargain struck between investors and managers.²³ Although public company shareholders and managers typically do not meet at a bargaining table, corporate governance can nevertheless be modeled as the product of an investor–manager bargain, provided that governance terms are priced in the capital market.²⁴ Understanding that investors are willing to pay more for favorable governance structures, managers have an incentive to adopt these structures in order to lower the company’s cost of capital.²⁵ Investors, for their part, get the governance they pay for. Much of the prior work on the production of corporate governance therefore focuses centrally on the question of whether governance terms are priced. Section I.A, below, reviews this literature.

But *whether* governance terms are priced is only half of the story. Answering this question does not reveal how governance terms are made or the considerations that ultimately factor into the pricing of corporate governance. To answer the question of *how* corporate governance is made, the roles of various institutional actors with a stake in corporate governance must be considered. These capital market intermediaries—activists, corporate law firms, and proxy advisors—have an important role to play in making corporate governance. Section I.B, below, examines how these intermediaries interact to create corporate governance reform.

A. Which Governance Terms Are Adopted?

According to mainstream corporate law theory, firms adopt governance terms to maximize firm value, implying that governance terms have value and

²³ See, e.g., EASTERBROOK & FISCHER, *supra* note 1, at 15 (stating that “corporate law should contain the terms people would have negotiated” and that it “almost always conforms to this model”).

²⁴ See *id.* at 17 (“All the terms in corporate governance are contractual in the sense that they are fully priced in transactions among the interested parties. They are thereafter tested for desirable properties; the firms that pick the wrong terms will fail in competition with other firms competing for capital.”).

²⁵ See *id.* at 6 (“[S]elf-interested entrepreneurs and managers, just like other investors, are driven to find the devices most likely to maximize net profits. If they do not, they pay for their mistakes because they receive lower prices for corporate paper.”).

that they are priced by the market.²⁶ Corporate governance research has therefore focused on the empirical question of whether and how particular governance terms are priced as a necessary first step in answering whether particular governance provisions are good or bad. Unfortunately, whether and how the market prices corporate governance remains subject to dispute, as a review of the recent literature shows.

Studies have shown that some governance provisions that weaken shareholder rights and insulate managers from challenge are negatively correlated with firm value. For example, publicly traded shares of firms with a controlling shareholder trade at a so-called “minority discount.”²⁷ Because minority shares in a controlled corporation lack the ability to influence the management of the firm, they trade at a discount relative to other shares.²⁸ Moreover, studies have found a negative relationship between staggered board provisions and share price, suggesting that obstacles to a change of control have a negative effect on firm value.²⁹ Likewise, studies have found a negative relationship between the adoption of state antitakeover statutes and stock price.³⁰

In a similar vein, a line of studies has attempted to quantify a firm’s overall corporate governance package by constructing indices of good corporate governance and comparing the performance of firms with different ratings according to the index. The first such study—by Gompers, Ishii, and Metrick—incorporated twenty-four governance terms into a “Governance Index” and found that firms that were more protective of shareholder rights significantly outperformed those with fewer shareholder protections throughout the 1990s.³¹ Building on this study, Bebchuk, Cohen, and Ferrell narrowed the Governance Index to a six-factor “Entrenchment Index” and found that high scores for entrenchment were negatively associated with firm value.³² Meanwhile, Brown and Caylor built a broader index that included a number

²⁶ See, e.g., Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1327 (2013) (explaining that, under the contractarian model, “market forces would lead the parties to create governance arrangements and adopt legal rules that would minimize agency costs and thereby maximize firm value”).

²⁷ Michael J. Barclay & Clifford G. Holderness, *Private Benefits from Control of Public Corporations*, 25 J. FIN. ECON. 371, 372 (1989).

²⁸ John C. Coates IV, “Fair Value” as an Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions, 147 U. PA. L. REV. 1251, 1262 (1999).

²⁹ See, e.g., Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 418-30 (2005); Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 804-05 (2009).

³⁰ See, e.g., Jonathan M. Karpoff & Paul H. Malatesta, *The Wealth Effects of Second-Generation State Takeover Legislation*, 25 J. FIN. ECON. 291, 308-20 (1989).

³¹ Paul Gompers et al., *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107 (2003).

³² Bebchuk et al., *supra* note 29, at 788-90; accord K. J. Martijn Cremers & Vinay B. Nair, *Governance Mechanisms and Equity Prices*, 60 J. FIN. 2859, 2871-78 (2005) (focusing on the relationship between corporate governance terms and the market for corporate control).

of variables not included in other indices, such as compensation practices, independence, and meeting attendance, and found that their index was correlated with firm value.³³

Other studies, however, have produced inconsistent results concerning the price effects of corporate governance variables. Black and Bhagat, for example, extensively studied board independence and found no correlation between independence and price,³⁴ a result that Hermalin and Weisbach confirmed in a review of a broader sample of the literature.³⁵ Other studies have found no universal, statistically significant wealth effects of poison pill adoptions³⁶ and at least one study found a significant *increase* in share value attributable to poison pills in some circumstances.³⁷ Moreover, recent work by Cremers, Litov, and Sepe challenges the conclusion that staggered boards have uniformly negative wealth effects.³⁸ Instead, using time series analysis, they find that staggered board provisions appear to contribute share value for firms where a commitment to long-term value is more important—specifically, more complex firms with greater research and development and more intangible assets.³⁹ Further, staggered boards do not seem to be priced in the IPO market.⁴⁰ Meanwhile, the share price effect of the corporate governance

33 Lawrence D. Brown & Marcus L. Caylor, *Corporate Governance and Firm Valuation*, 25 J. ACCT. & PUB. POL'Y 409, 428-29 (2006).

34 Bernard Black & Sanjai Bhagat, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 262-63 (2002).

35 Benjamin E. Hermalin & Michael S. Weisbach, *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature*, FED. RES. BANK N.Y. ECON. POL'Y REV., Apr. 2003, at 7, 12.

36 See, e.g., James A. Brickley et al., *Outside Directors and the Adoption of Poison Pills*, 35 J. FIN. ECON. 371, 388 (1994) (“[T]he average stock-price reaction to the announcement of the adoption of a poison pill is positive and significant when outside directors comprise a majority of the board and negative and significant when they do not.”); Sudip Datta & Mai Iskandar-Datta, *Takeover Defenses and Wealth Effects on Security Holders: The Case of Poison Pill Adoptions*, 20 J. BANKING & FIN. 1231, 1232-33 (1996) (“[T]he impact [of the announcement of adoption of a poison pill] on stockholders is insignificant.”); Wallace N. Davidson III et al., *The Importance of Board Composition and Committee Structure: The Case of Poison Pills*, 1 CORP. OWNERSHIP & CONTROL, Spring 2004, at 81, 81-82 (“[W]hether poison-pill adoption hurts or benefits shareholders may be situationally dependent.”).

37 Gary L. Caton & Jeremy Goh, *Corporate Governance, Shareholder Rights, and Shareholder Rights Plans: Poison, Placebo, or Prescription?*, 43 J. FIN. & QUANTITATIVE ANALYSIS 381, 390 (2008).

38 K. J. Martijn Cremers et al., *Staggered Boards and Firm Value*, Revisited 3 (July 14, 2014) (unpublished manuscript), <http://ssrn.com/abstract=2364165> [<http://perma.cc/Y6K9-QXWM>].

39 *Id.* at 7; accord Seoungpil Ahn & Keshab Shrestha, *The Differential Effects of Classified Boards on Firm Value*, 37 J. BANKING & FIN. 3993, 4011 (2013) (finding that in complex firms the benefits of staggered boards may outweigh the costs).

40 Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 J.L. ECON. & ORG. 83, 107 (2001).

indices appears to have disappeared, a fact that has recently been acknowledged by several of the authors who constructed the original indices.⁴¹

This diversity of results could be due in part to the well-known methodological problems associated with measuring the wealth effects of corporate governance terms. Principal among these is the endogeneity problem—the difficulty of separating the propensity of bad firms to select a particular corporate governance term from the bad effects of the term itself.⁴² Moreover, the negative effect when bad companies adopt staggered boards for entrenchment reasons may swamp the positive effect that staggered boards provide to good companies as a commitment device.⁴³ Another complication is that some provisions may have market-wide effects depending upon the mechanisms of adoption. To the extent that a governance term can be adopted through unilateral board action—such as a bylaw amendment or a poison pill—whether a company actually adopts the provision is unimportant in light of the provision’s availability for adoption at any moment.⁴⁴ In such cases, only corporate acts credibly *opting out* of such provisions should have any effect on price.⁴⁵ Event studies may be particularly useful in such situations.⁴⁶ We therefore turn to this technique in Part III below.

41 See Lucian A. Bebchuk et al., *Learning and the Disappearing Association Between Governance and Returns*, 108 J. FIN. ECON. 323, 324 (2013).

42 See, e.g., Renée B. Adams et al., *The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey*, 48 J. ECON. LITERATURE 58, 59 (2010) (highlighting the endogeneity problem in corporate governance); Matthew D. Cain et al., *Do Takeover Laws Matter? Evidence from Five Decades of Hostile Takeovers* 19 (July 21, 2015) (unpublished manuscript), <http://ssrn.com/abstract=2517513> [<http://perma.cc/72NC-D3PF>] (discussing endogeneity issues in prior studies of corporate governance).

43 See Cremers et al., *supra* note 38, at 29-30 (explaining that although the traditional view is that staggered boards are used to entrench management, for firms where longer-term commitments are relevant, the adoption of a staggered board is associated with an increase in firm value).

44 See, e.g., John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271, 277-78 (2000) (noting that because “every firm has a ‘shadow pill[.]’ . . . adoption of an actual pill has no effect on a target’s legal takeover”); accord Emiliano M. Catan, *The Irrelevance of Active Poison Pills* (Nov. 14, 2014) (unpublished manuscript) (on file with author) (analyzing poison pill adoptions and renewals and finding no discernible economic effect).

45 It may be that *opting in* signals an underlying firm characteristic to which the market reacts, but in this case the price effect is caused by the firm characteristic signaled by the governance arrangement, not the governance arrangement itself. For example, the decision to adopt majority voting may be a signal of a better-governed firm, leading the market to react favorably to firms that adopt majority voting independent of whether a majority voting rule adds firm value. See Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. (forthcoming 2016) (exploring the extent to which different behavior by firms adopting majority voting is explained by a selection effect).

46 See, e.g., Alma Cohen & Charles C.Y. Wang, *How Do Staggered Boards Affect Shareholder Value? Evidence From a Natural Experiment*, 110 J. FIN. ECON. 627 (2013) (analyzing share price reactions to two important Delaware court decisions affecting the stringency of antitakeover provisions).

B. How Does Corporate Governance Change?

Just as the question of what governance terms are adopted implicates whether the market prices such terms, the question of how corporate governance changes are made depends largely on the institutional intermediaries. The conventional contractarian account of corporate governance is premised on disintermediated capital markets through which shareholders exert influence on corporate governance through their buy and sell decisions.⁴⁷ Even this model, however, reserves a place for investment bank underwriters and other capital market intermediaries in determining the allocation of governance rights when the firm seeks outside capital.⁴⁸ But how does corporate governance change once this initial allocation is set?⁴⁹ Which actors push firms to adopt new governance terms? Recent literature has considered the distinctive role played by intermediaries, focusing principally on institutional investors and hedge fund activists.⁵⁰

Institutional intermediaries are especially important now that the disintermediated capital market, on which the original contractarian account is premised, has disappeared. Today, a substantial percentage of U.S. equity is held by institutional investors.⁵¹ Many institutions are long-term investors who hold the market through index funds, exchange-traded funds, and other broadly diversified investment vehicles. They do not, typically, move into and out of a stock based on corporate governance. This is not to say that institutional investors are indifferent to corporate governance, especially in their voting decisions.⁵² They are, however, subject to significant resource

⁴⁷ See *supra* notes 23–25 and accompanying text. The collective pressure of shareholders' investment decisions triggers managers to adopt governance terms consistent with shareholder interests. "It is almost as if there were an invisible hand." EASTERBROOK & FISCHER, *supra* note 1, at 4.

⁴⁸ EASTERBROOK & FISCHER, *supra* note 1, at 293.

⁴⁹ See, e.g., Klausner, *supra* note 26, at 1346 (distinguishing mid-stream governance changes from the treatment of governance provisions at the initial public offering stage).

⁵⁰ See, e.g., Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 914 (2013) (arguing that changes in the legal regime governing pension funds has shifted U.S. corporate governance toward a shareholder primacy norm).

⁵¹ See BEN W. HEINEMAN, JR. & STEPHEN DAVIS, MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, ARE INSTITUTIONAL INVESTORS PART OF THE PROBLEM OR PART OF THE SOLUTION?: KEY DESCRIPTIVE AND PRESCRIPTIVE QUESTIONS ABOUT SHAREHOLDERS' ROLE IN U.S. PUBLIC EQUITY MARKETS 1 (2011), http://web.law.columbia.edu/sites/default/files/microsites/millstein-center/80235_CED_WEB.pdf [<http://perma.cc/G58Q-3ZYW>].

⁵² See Stephen Choi et al., *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35, 37–38 (2013) (exploring the voting behavior of mutual funds); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1317–28 (1991) (noting that institutional investors have "limited interest in corporate governance issues . . . because the expected gains from most such governance issues are small, deferred, and received by investors, while the costs are potentially large, immediate, and borne by money managers"); Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 354 (2009) ("Institutional investors, despite having greater

constraints, which often lead them to follow shortcuts and heuristics in deciding how to vote on corporate governance issues.⁵³

In a market dominated by largely passive and resource-constrained institutional investors, third-party intermediaries play a large role in manufacturing and modifying corporate governance terms. Gilson and Gordon have modeled activist hedge funds as one such third-party intermediary.⁵⁴ In their account, activists function as arbitrageurs of undervalued governance rights, creating value not by taking over the firm, but by persuading institutional investors to support their position and, if necessary, their slate of nominees.⁵⁵ Activists thus function as governance intermediaries, bringing governance change by mobilizing the institutional investor constituency.

Activists are not the only important intermediaries when it comes to corporate governance reform. Indeed, the story of the golden leash demonstrates that, in addition to activists, proxy advisors and corporate law firms may perform an equally important role as governance intermediaries. The dominant proxy advisory firm is ISS.⁵⁶ Like activists, proxy advisors exert influence by mobilizing institutional investors. Unlike activists, proxy advisors have no ownership stake in the recommendations they make. Instead, proxy advisors provide company-specific research and voting recommendations to institutional investor clients, effectively allowing institutions to outsource much of their portfolio monitoring function.⁵⁷ In connection with these services, proxy advisory firms communicate corporate governance policy positions and viewpoints to their institutional investor clients. ISS's policies have significant

capacity to monitor and gather information, may have too small a stake in a company or too limited industry expertise to monitor it actively.”); Jennifer S. Taub, *Able but Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights*, 34 J. CORP. L. 843, 845-46 (2009) (“[T]he greater the dependency of [mutual fund advisers] upon [corporate clients] for asset management business, the less likely the fund family will be to support shareholder-sponsored governance resolutions.”).

⁵³ See Choi et al., *supra* note 52, at 50-55.

⁵⁴ Gilson & Gordon, *supra* note 20, at 901.

⁵⁵ *Id.* at 897.

⁵⁶ See JAMES R. COPLAND, MANHATTAN INST. CTR. FOR LEGAL POL'Y, PROXY MONITOR 2012: A REPORT ON CORPORATE GOVERNANCE AND SHAREHOLDER ACTIVISM 3 (2012), http://www.proxymonitor.org/pdf/pmr_04.pdf [<http://perma.cc/Y7XX-H6KK>]. The other major proxy advisory firm is Glass Lewis. See *id.* at 23.

⁵⁷ Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 870-71 (2010).

influence on investors' voting behavior.⁵⁸ As a result, proxy advisors have been subject to substantial criticism and even calls for regulatory oversight.⁵⁹

Institutional investors do not treat every recommendation of proxy advisory firms with equal regard. Proxy advisors have adopted elaborate voting policies with regard to a great many corporate and social issues.⁶⁰ These policy positions often take the form of market-wide pronouncements on a particular issue, such as the ISS pronouncement on the Wachtell Bylaw.⁶¹ Institutional investors may disagree with the basis underlying a proxy advisor's recommendation—as they often do, for example, in the context of withhold recommendations in director elections—in which case the recommendation will have little or no effect on voting outcomes.⁶² On other issues, however, the proxy advisor's recommendation is largely outcome determinative.⁶³

In addition to discussing activists, institutional investors, and their advisors, our account illuminates the intermediary role played by corporate law firms. The legal literature customarily treats lawyers as advocates or counselors in particular cases or controversies, but some prominent law firms play an important policy role as well. In the corporate law context, this is especially true of Wachtell, which has a specific set of clients with an identifiable perspective—acquisition targets and boards subject to unwelcome attention from shareholder activists. Wachtell is particularly well-known for inventing the poison pill and thereby fundamentally changing the tactics of

⁵⁸ See Jie Cai et al., *Electing Directors*, 64 J. FIN. 2389, 2401 (2009) (finding negative ISS recommendation reduced votes “FOR” the election of a director nominee by approximately twenty percent); Choi et al., *supra* note 57, at 906 (“[W]e find that the impact of an ISS recommendation ranges from 6% to 13% for the median company.”); James Cotter et al., *ISS Recommendations and Mutual Fund Voting on Proxy Proposals*, 55 VILL. L. REV. 1, 55 (2010) (finding that institutions “voted in line with ISS recommendations much more frequently than with contrary management recommendations”).

⁵⁹ See, e.g., SEC Staff Legal Bulletin No. 20 (June 30, 2014), <https://www.sec.gov/interps/legal/cfs1b20.htm> [<https://perma.cc/SL2N-F69N>].

⁶⁰ See, e.g., INSTITUTIONAL S'HOLDER SERVS. INC., 2014 U.S. PROXY VOTING SUMMARY GUIDELINES (2014).

⁶¹ See *infra* notes 129–31 and accompanying text. By contrast, ISS at other times issues research recommendations with regard to a shareholder vote at a particular company. See, e.g., CHRIS CERNICH & NELSON SERACI, INSTITUTIONAL S'HOLDER SERVS. INC., ALLERGAN (AGN)—CONSENT SOLICITATION BY PERSHING SQUARE TO CALL A SPECIAL MEETING 2 (2014), <http://blogs.reuters.com/alison-frankel/files/2014/09/iss-comparables.pdf> [<http://perma.cc/F6AD-RNLM>] (detailing ISS's recommendation with respect to a special meeting at Allergan).

⁶² See, e.g., Yonca Ertimur et al., *Understanding Uncontested Director Elections: Determinants and Consequences* 3 (June 9, 2014) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2447920 [<http://perma.cc/SH44-M46X>] (finding significant variation in voting outcomes when ISS makes a withhold recommendation and relating that variation to shareholder consideration of the rationale underlying the recommendation).

⁶³ See Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 582–83 (2015) (finding that an ISS recommendation for or against an acquisition transaction can influence approximately 15% to 23% of the shareholder vote on a merger).

hostile takeovers and defenses.⁶⁴ But the firm is also influential through its regular publication of public “client memos.”⁶⁵

It was one such memorandum that led nearly three dozen firms to adopt the Wachtell Bylaw in short order.⁶⁶ Like the poison pill, the Wachtell Bylaw could be adopted at any time through unilateral board action. Thus, like the poison pill, the potential availability of the Bylaw had a market-wide effect that was not limited to actual adopters.⁶⁷

Wachtell and other similar law firms clearly exert a role in corporate governance beyond the advising of individual clients in discrete circumstances. They are, like proxy advisors and activist investors, governance intermediaries. Unlike proxy advisors and activist investors, however, law firms exert their governance leverage primarily on corporations and corporate boards rather than institutional investors.

With Part I having reviewed the literature on each of these intermediary roles in the adoption of corporate governance terms, the next Part turns to a case study of this process in action.

II. THE CASE OF THE GOLDEN LEASH

A. *Background*

The golden leash has its roots in the evolution of hedge fund activism in the United States. In the 1970s and 1980s, hostile control contests typically involved an attempt by an acquirer to purchase an entire company.⁶⁸ Legal innovations such as the poison pill as well as economic developments that increased the cost of financing takeovers shifted takeover strategy to the proxy contest.⁶⁹ At first, activists ran full slate proxy contests in which they

⁶⁴ Name Partner Martin Lipton typically receives credit for the invention. *See, e.g.*, Martin M. Cohen, Note, “Poison Pills” as a Negotiating Tool: Seeking a Cease-Fire in the Corporate Takeover Wars, 1987 COLUM. BUS. L. REV. 459, 460 n.3.

⁶⁵ For example, in a set of famous memoranda from the height of the hostile takeover era, the firm threatened to advise clients to reincorporate out of Delaware if the state did not allow boards to employ takeover defenses. *See* Jeffrey N. Gordon, *Corporations, Markets, and Courts*, 91 COLUM. L. REV. 1931, 1959 & n.95 (1991) (quoting memoranda issued by Wachtell asserting that in light of recent Delaware court decisions it may be necessary for corporations to “leav[e] Delaware for a more hospitable state of incorporation” and suggesting that it may be “time to migrate out of Delaware”).

⁶⁶ *See infra* Section III.C.

⁶⁷ *See supra* notes 44–46 and accompanying text.

⁶⁸ *See, e.g.*, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176–77 (Del. 1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949–50 (Del. 1985).

⁶⁹ *See, e.g.*, Ronald J. Gilson, *Unocal Fifteen Years Later (and What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 503–07 (2001) (explaining that the widespread use and validation of the poison pill shifted unsolicited takeover attempts to proxy contests coupled with tender offers); Joseph A. Grundfest, *Just Say No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN.

sought to obtain control of the target company by replacing all or a majority of the board of directors.⁷⁰ However, as further innovation in takeover protection took root, most notably the poison pill–staggered board combination, activists gradually shifted to partial slate elections.⁷¹ Partial slate elections, in which the activist does not seek control but merely representation on the board, typically in the form of two to four seats, have now largely replaced control contests.⁷²

There were several possible reasons for this shift. One was regulatory: in 1992, the SEC revised the federal proxy rules to allow shareholders to run a short slate election contest.⁷³ Another was increased support by shareholders for short slate contests. The short slate election strategy offers activists the opportunity to take their proposal for change into the boardroom and enables their directors, if elected, to persuade the rest of the board to embrace the activist agenda. At the same time, institutional investors and their advisors seem to view short slate contests as presenting less of a threat of destabilization than replacing the entire board.⁷⁴ In addition, the incumbent directors operate as a check on the merits of the activist proposal because the activist nominees, even if elected to the board, cannot implement the activist's agenda without persuading their fellow directors of its merit. Perhaps as a

L. REV. 857, 860 n.6 (1993) (“Bidders, like tulips, must now sprout in the spring, with offers orchestrated to coincide with the April-May cycle of annual board elections.”).

⁷⁰ See Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CALIF. L. REV. 1071, 1074 (1990).

⁷¹ See Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 890-92 (2002) (describing the powerful antitakeover effect of a staggered board in combination with a poison pill); William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1403-05 (2007).

⁷² See SEC Grants No-Action Relief to Activist Shareholders Seeking to “Round Out” Short Slates with Each Other’s Nominees, GIBSON DUNN (Apr. 2, 2009), <http://www.gibsondunn.com/publications/pages/SECGrantsNo-ActionReliefToActivistShareholdersSeekingtoRoundOutShortSlates.aspx> [<http://perma.cc/F542-6NDG>] (stating that running a “short slate” has become “the preferred approach for dissidents seeking board representation”). This is not to say that contests to unseat the entire board do not happen, just that they are rare. See, e.g., Julie Jargon et al., *Starboard Succeeds in Replacing Entire Darden Board: Hedge Fund to Have Two of Its Own Partners on Board of Olive Garden*, WALL ST. J. (Oct. 10, 2014, 4:24 PM), <http://www.wsj.com/articles/darden-shareholders-elect-all-12-starboard-nominated-directors-1412949459> [<http://perma.cc/75LG-N6PE>] (reporting on Starboard’s successful campaign to replace the entire Darden board through a proxy contest).

⁷³ See Regulation of Communications Among Shareholders, Exchange Act Release No. 34-31326, 57 Fed. Reg. 48,276 (Oct. 22, 1992) (to be codified at 17 C.F.R. pts. 240 & 249).

⁷⁴ See MARC WEINGARTEN, SCHULTE, ROTH & ZABEL, SHORT SLATES, MAJORITY SLATES AND FULL SLATES: STRATEGIC AND VOTING CONSIDERATIONS 2 (2008), http://www.srz.com/files/News/a4b75e18-db59-4c29-9c3a-8b3856c73f5b/Preview/NewsAttachment/f4fba66e-93db-467d-b2a5-92f6b8814405/filesfilesAI_Spring_2008_Weingarten_Short_Slates_Majority_Slates_Full_Slates.pdf [<http://perma.cc/8FFA-DPM3>] (“[T]he hurdle to obtaining support from Risk Metrics/Institutional Shareholder Services (‘ISS’) and the other proxy advisory firms is considerably higher for a control slate than it is for a short slate.”).

result of these advantages, activists have enjoyed high success rates in their bids for short slate board representation.⁷⁵

Even with short slate election contests, the identity of the activist nominees can become a source of controversy. In the past, it was the norm for hedge fund principals to serve as activist director candidates. Prominent activists such as Bill Ackman, Carl Icahn, and Dan Loeb have frequently taken seats on the boards of their target companies in an effort to advocate for their proposed strategic changes.⁷⁶ Critics meanwhile have questioned whether a hedge fund representative can adequately serve the interests of all shareholders or will instead function inappropriately as a “constituency director.”⁷⁷ They have also raised concerns that hedge fund principals will make improper use of corporate information.⁷⁸ In addition, particular hedge fund representatives have been characterized as divisive presences on a corporate board and lacking the ability to interact appropriately with the incumbent directors.⁷⁹

Responding to this concern as well as the general preference for independent directors by many institutional investors, some activists have

⁷⁵ According to SharkRepellent, shareholder activists had a 73% success rate in board seat campaigns in 2015, up from 60% in 2014. *An Early Look at 2015 US Proxy Fight Statistics*, SHARKREPELLENT (June 8, 2015), https://www.sharkrepellent.net/request?an=dt.getPage&st=undefined&pg=/pub/trs_20150608.html&rnd=486544 [<https://perma.cc/ZJ>]P9-QH4F].

⁷⁶ See, e.g., Michael J. de la Merced, *2 Big Investors Get Their Say at J.C. Penney*, N.Y. TIMES: DEALBOOK (Jan. 24, 2011), <http://dealbook.nytimes.com/2011/01/24/2-big-investors-get-their-say-at-j-c-penney> [<http://perma.cc/3HP6-JWKE>] (reporting Bill Ackman’s appointment to the board of J.C. Penney); Michael J. de la Merced, *Icahn to Get Boards Seats in Settlement with Manufacturer Manitowoc*, N.Y. TIMES: DEALBOOK (Feb. 9, 2015), <http://dealbook.nytimes.com/2015/02/09/manitowoc-to-give-icahn-board-seats-in-settlement> [<http://perma.cc/WX7H-CXZ8>] (describing settlement giving Carl Icahn seats on the boards of two Manitowoc companies); Antoine Gara & Nathan Vardi, *Billionaire Dan Loeb Wins Board Seats at Dow, His Second Victory this Week*, FORBES (Nov. 21, 2014, 10:08 AM), <http://www.forbes.com/sites/nathanvardi/2014/11/21/billionaire-dan-loeb-wins-board-seats-at-dow-his-second-victory-this-week> [<http://perma.cc/4W2E-HH2T>] (recounting Dan Loeb’s successful win of two board seats at Dow).

⁷⁷ See, e.g., E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761, 763 (2008) (expressing concern over “individuals who may be elected to the board by . . . particular constituencies of the corporation”); Steven Seiden, *Calling Those with Fortitude: So You Need a Dissident Director*, BUS. L. TODAY, Jan.–Feb. 1999, at 29, 29 (arguing that “only independent directors with no connection to the activist ought to be nominated by him”). Often the chief critic is the company itself which is opposing this nominee. See Press Release, Forest Labs., Inc., Forest Laboratories Sends Letter to Shareholders (July 16, 2012), <http://news.frx.com/press-release/corporate-news/forest-laboratories-sends-letter-shareholders-o> [<http://perma.cc/P69W-6U2M>] (“[Daniel Ninivaggi] is a salaried employee and President of Icahn Enterprises, and as such, you can fairly question whether he will put your interests above the financial objectives of Icahn Enterprises.”).

⁷⁸ See, e.g., David A. Katz & Laura A. McIntosh, *Boardroom Confidentiality Under Focus*, N.Y. L.J., Jan. 23, 2014, at 5.

⁷⁹ Cf. Third Point LLP v. Ruprecht, No. 9469-VCP, slip op. at 51 (Del. Ch. May 2, 2014) (stating in dictum that hedge fund activist Dan Loeb conducted himself in an “aggressive and domineering manner . . . in relation to Sotheby’s”).

chosen to nominate director candidates who are not employed by or affiliated with the activist.⁸⁰ Air Products took this approach to an extreme in its 2010 attempt to take over Airgas, nominating three director candidates who had no ties at all to Air Products. Air Products then touted the independence of its candidates as a strength in the election contest.⁸¹

The challenge for an activist in a short slate election is that, even if the activist is successful in having its short slate nominees elected, there is no guarantee that the activist nominees will be able to persuade the rest of the board. The risk increases if the activist nominees are truly independent. Air Products represents the extreme case. Not only did the Air Products nominees fail to persuade the rest of the board to accept Air Products' tender offer, but the reverse happened; after being elected, the Air Products nominees sided with the incumbent directors and voted against the takeover.⁸²

The Airgas situation—a short slate campaign with truly independent director candidates—thus presents a challenge for the activist. To be successful, the activist must identify independent and well-qualified director nominees. The activist must then provide those nominees—who are not employees of or investors in the activist hedge fund—with sufficient motivation to go through an election contest and, if elected, serve on a possibly divided and hostile target company board. At the same time, the activist would like to provide its nominees with an incentive to remain loyal to the activist's agenda. To achieve these objectives, several hedge funds developed novel pay packages—golden leashes—to compensate their nominees in the context of proxy fights.

B. *An Activist Innovation—The Golden Leash*

In 2012, JANA, a New York-based hedge fund, acquired a significant position in Agrium, a Canadian fertilizer manufacturer, and announced a

⁸⁰ It is not always easy for activists to find independent directors willing to serve as activist nominees. Accepting such a candidacy may tarnish the nominee's reputation with issuers. See, e.g., JoAnn S. Lublin, *Activists Enlist Help of Recruiters: Search Firms Gingerly Wade into Finding Potential Directors for Dissident Slates*, WALL ST. J. (Sept. 3, 2013), <http://www.wsj.com/articles/SB10001424127887324324404579045431388717494> [<http://perma.cc/RB3W-YPKP>] (explaining increasing use by activists of director search firms to identify truly independent and qualified directors to temper the "activists' reputation as buccaneers").

⁸¹ Steven M. Davidoff, *A Case Study: Air Products v. Airgas and the Value of Strategic Judicial Decision-Making*, 2012 COLUM. BUS. L. REV. 502, 513 (2012).

⁸² *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 88-89 (Del. Ch. 2011). This may have been strategic on the part of the new directors. By appearing to join a majority that was inevitably going to reject the Air Products offer, the new directors appeared to be willing to listen to the other Airgas directors and could remain a part of the negotiation.

proxy contest to elect five members to Agrium's twelve member board.⁸³ In its proxy statement, JANA disclosed that, if its nominees were elected, they would receive additional compensation paid directly by JANA.⁸⁴ In addition to a flat payment of \$50,000 each, the JANA-nominated directors would collectively be paid 2.6% of JANA's net gain on its Agrium investment.⁸⁵ At the time of the proxy fight, JANA's investment in Agrium was approximately \$1 billion, so the dissident nominees had the potential to be compensated millions of dollars by the fund.⁸⁶ These payments were far greater than standard directors' fees.⁸⁷ This compensation was also derived from a different source—from the activist hedge fund rather than from the company.⁸⁸

Agrium responded by filing its own proxy solicitation materials in which it termed the JANA pay plan a "golden leash" and attacked the arrangement as "unheard of in Canada."⁸⁹ Agrium argued that the golden leashes undermined the JANA nominees' independence and were "structured to

83 Nadia Damouni & Rod Nickel, *Exclusive: Activist Jana Digs In for Long Agrium Battle*, REUTERS (Oct. 26, 2012, 1:30 PM), <http://www.reuters.com/article/2012/10/26/us-agrium-jana-idUSBRE89Po5Z20121026> [http://perma.cc/6M8X-C4MN].

84 JANA PARTNERS LLC, SOLICITATION BY AND ON BEHALF OF JANA PARTNERS LLC FOR THE SUPPORT OF THE HOLDERS OF COMMON SHARES OF AGRIMUM INC. 8 (2012), <http://www.infomine.com/index/pr/PB/25/44/PB254436.pdf> [http://perma.cc/NKT5-ADSF].

85 Steven M. Davidoff, *Upping the Ante in a Play for a Stronger Board*, N.Y. TIMES: DEALBOOK (Apr. 2, 2013), <http://dealbook.nytimes.com/2013/04/02/upping-the-ante-in-a-play-for-a-stronger-board> [http://perma.cc/FTC6-J8Q6].

86 See Rob Gillies, *Agrium Nominees Elected to the Board*, YAHOO! (Apr. 9, 2013, 3:51 PM), <http://news.yahoo.com/agrium-nominees-elected-board-193008279.html> [http://perma.cc/N9UJ-W2UL] ("The hedge fund spent more than \$1 billion for a 7.5 percent stake in Agrium . . .").

87 See AGRIMUM, NOTICE OF ANNUAL GENERAL MEETING OF SHAREHOLDERS AND MANAGEMENT PROXY CIRCULAR 78 (2013) (stating that the incumbent Agrium directors received on average \$43,490 Canadian dollars plus \$149,348 in incentives for their service in 2012, and that the average director made \$134,000 in annual cash and incentive compensation). See generally Steven M. Davidoff et al., *Do Outside Directors Face Labor Market Consequences? A Natural Experiment from the Financial Crisis*, 4 HARV. BUS. L. REV. 53 (2014) (surveying total director compensation during the period from 2006 to 2010 for the S&P 1500 and finding average director compensation to be \$133,000). It is worth noting, however, that the incumbent Agrium directors held tens of thousands of shares of Agrium stock through option grants and that, as a result of these grants, they too stood to receive millions of dollars in compensation if Agrium's stock price increased substantially. See AGRIMUM, *supra* note 87, at 36 (stating that as of March 2012, eight of ten Agrium directors had more than a million dollars of Agrium equity at risk, and that four of ten had over two million).

88 When Agrium raised this as a reason to oppose JANA's nominees in the context of the proxy fight, the director nominees defended the arrangement by noting that "[i]t is true that Jana bears this expense, but that is true of every expense in this effort Despite Agrium's misleading claims, none of us will be bound by any duty other than our fiduciary duty as directors." Lauren Krugel, *Agrium Wins bcIMC Support in Battle with Jana Partners*, GLOBE & MAIL (Mar. 15, 2013, 5:24 PM), <http://www.theglobeandmail.com/globe-investor/agrium-wins-bcimc-support-in-battle-with-jana-partners/article9838651> [http://perma.cc/2H8X-3YAE].

89 Press Release, Agrium, Agrium Urges Shareholders to Vote the White Proxy for Agrium's Director Nominees (Mar. 4, 2013), <http://www.agrium.com/en/investors/news-releases/2013/agrium-urges-shareholders-vote-white-proxy-agriums-director-nominees> [http://perma.cc/L5SV-VUNT].

incentivize short-term actions, even if they are taken at the expense of greater long-term value.”⁹⁰ JANA ultimately lost the election for reasons that likely had little to do with the golden leash arrangements.⁹¹ The issue of the golden leash, for Agrium at least, became moot.⁹²

At around the same time, Elliott offered a similar compensation arrangement to its dissident nominees to the board of Hess, an oil company. Elliott’s nominees would receive \$50,000 up front and an additional \$30,000 for each percentage point by which Hess shares outperformed the stock of a group of peer companies over a period of years, up to nine million dollars for each director.⁹³ Again, these payments were to be made by the nominating hedge fund, not the company itself. If made, the payments could result in the dissident directors being compensated more than either their peers on the board or other directors generally.

Not surprisingly, as in the Agrium dispute, the pay arrangement came under fire during the ensuing proxy fight.⁹⁴ Unlike the prior situation, however, the Elliott nominees reacted by waiving their right to the compensation package.⁹⁵ Although Hess initially argued that this concession proved the underlying self-interest of Elliott’s nominees,⁹⁶ the company

⁹⁰ *Id.* In fact, Agrium engaged in some questionable tactics of its own, at least from a U.S. perspective. For example, Agrium paid twenty-five cents per share to investment advisors whose clients voted in support of the full Agrium slate, a common tactic in Canada, but one certainly raising conflict issues. Stephen Erlichman, *The Agrium Fight: Agrium Payments Don’t Pass the ‘Smell Test,’* GLOBE & MAIL (July 4, 2013, 6:45 PM), <http://www.theglobeandmail.com/report-on-business/payments-dont-pass-the-smell-test/article13010420> [<http://perma.cc/CXA6-MSC2>].

⁹¹ See Ronald Barusch, *Dealpolitik: Agrium Lesson for Activists: Don’t Underestimate the Adversary*, WALL ST. J.: DEAL J. (Apr. 12, 2013, 4:08 PM), <http://blogs.wsj.com/deals/2013/04/12/dealpolitik-agrium-lesson-for-activists-dont-underestimate-the-adversary> [<http://perma.cc/TL89-YE9A>] (describing JANA as outgunned by Agrium’s aggressive tactics).

⁹² JANA was hardly gracious in its loss. Barry Rosenstein, a JANA managing partner and nominee to the Agrium board, addressed the incumbent board at an annual meeting: “You are a Board that proved that if you play dirty enough, violate all precepts of good corporate governance, fair play, ethical behavior, and democracy, you can still lose the campaign but then barely manufacture a victory after the voting is supposed to be over.” *Id.*

⁹³ Hess Corp., Definitive Additional Materials (Schedule 14A) (Mar. 26, 2013).

⁹⁴ See Press Release, Hess Corp., Hess Sends Letter to Shareholders (Mar. 26, 2013), <http://phx.corporate-ir.net/phoenix.zhtml?c=101801&p=irol-newsArticle&ID=1800473> [<http://perma.cc/2BHK-AUFW>] (“We find the prospect of Paul Singer, a shareholder, potentially paying directors millions of dollars in contingency fees for pre-determined outcomes to be highly troublesome from a governance perspective, and have concerns about the Singer directors’ ability to act as fiduciaries on behalf of all Hess shareholders.”).

⁹⁵ Hess Corp., Soliciting Material Pursuant to § 240.14a-12 (Schedule 14A) (May 13, 2013).

⁹⁶ Press Release, Hess Corp., Hess Comments on Elliott Letter: Notes that Elliott’s Nominees Finally Have Acknowledged that Their Short-Term, Conflicted Compensation Agreement Was Wrong (May 13, 2013), <http://phx.corporate-ir.net/phoenix.zhtml?c=101801&p=irol-newsArticle&ID=1818618> [<http://perma.cc/BS83-3U9S>].

eventually capitulated to shareholder pressure and settled with Elliott, ultimately allowing three of the five nominees onto the board.⁹⁷

Carl Icahn followed suit, nominating a candidate⁹⁸ for the board of Forest Laboratories (Forest)⁹⁹ who stood to receive \$65,000 per month for the proxy contest as well as 1% of Icahn's profits on Forest stock above \$47.50 per share for profits earned within thirty months of the candidate being elected to the board.¹⁰⁰ Forest described this arrangement as creating "significant and obvious conflicts" that would compromise the candidate's independence and ability to represent all stockholders.¹⁰¹ Forest ultimately elected one of Icahn's candidates to the board, but the candidate with the golden leash arrangement was not elected.¹⁰²

Although golden leash compensation arrangements ultimately were not triggered at Agrium, Hess, or Forest, the innovation attracted considerable attention in the media and among legal commentators, leading to strong arguments both for and against such arrangements.¹⁰³ The most basic argument in favor of activist compensation arrangements is that proxy contests are expensive and time-consuming and can damage a dissident nominee's reputation; therefore, qualified independent nominees will avoid them unless offered a significant inducement in the form of additional compensation. For example, the JANA slate for Agrium included officers and directors of publicly traded agriculture and chemical companies as well as a

⁹⁷ *Hess and Elliott Reach Resolution to End Proxy Contest*, BUS. WIRE (May 16, 2013, 8:30 AM), <http://www.businesswire.com/news/home/20130516005692/en/Hess-Elliott-Reach-Resolution-Proxy-Contest#.U5xhv7HGB04> [<http://perma.cc/6Nj9-X86B>].

⁹⁸ The candidate, Eric Ende, was one of four Icahn nominees in 2012. Press Release, Forest Labs., Inc., *Forest Laboratories Sends Letter to Shareholders* (July 16, 2012), <http://news.frx.com/press-release/corporate-news/forest-laboratories-sends-letter-shareholders-o> [<http://perma.cc/288P-6CFU>].

⁹⁹ Icahn had waged an unsuccessful proxy contest at Forest the previous year. Michael J. de la Merced, *Forest Labs Defeats Icahn in Proxy Fight*, N.Y. TIMES: DEALBOOK (Aug. 18, 2011), <http://dealbook.nytimes.com/2011/08/18/forest-labs-defeats-icahn-in-proxy-fight> [<http://perma.cc/FK99-HL75>].

¹⁰⁰ Press Release, Forest Labs., Inc., *supra* note 98; *see also* Paritosh Bansal & Lewis Krauskopf, *Icahn Dangles Bounty for Nominee in Forest Fight*, REUTERS (June 29, 2012, 5:25 PM), <http://www.reuters.com/article/2012/06/29/us-forest-icahn-idUSBRE85SoRX20120629> [<http://perma.cc/H8PY-8QCZ>]. The terms of the leash were disclosed in Icahn's proxy statement. *See* Forest Labs., Inc., *Definitive Proxy Statement (Schedule 14A)* (July 23, 2012).

¹⁰¹ Press Release, Forest Labs., Inc., *supra* note 98.

¹⁰² David Benoit, *Icahn Lands One Seat on Forest Labs Board*, WALL ST. J.: DEAL J. (Aug. 15, 2012, 11:21 AM), <http://blogs.wsj.com/deals/2012/08/15/icahn-lands-one-seat-on-forest-labs-board> [<http://perma.cc/DP8S-R236>]. The following year, Forest agreed to nominate an additional Icahn representative to its board to avoid a third election contest. Ransdell Pierson & Bill Berkrot, *Forest Labs to Add Icahn Rep to Board, Avert Proxy Fight*, REUTERS (June 11, 2013, 2:44 PM), <http://www.reuters.com/article/2013/06/11/us-forestlaboratories-icahn-idUSBRE95AoOZ20130611> [<http://perma.cc/4WLY-ZQ5U>].

¹⁰³ For a detailed examination of these arguments and a defense of the golden leash, *see* generally Edward M. Iacobucci, *Special Compensation Arrangements for Dissident Directors in Proxy Contests: A Policy Analysis*, 55 CANADIAN BUS. L.J. 365 (2014) and Yaron Nili, *Servants of Two Masters? The Feigned Hysteria over Activist-Paid Directors*, 18 U. PA. J. BUS. L. (forthcoming 2016).

Canadian former Member of Parliament and minister of agriculture.¹⁰⁴ The Elliott slate for Hess meanwhile consisted of petroleum company chief executives and board members.¹⁰⁵

Furthermore, the golden leash packages were structured to create incentives for the activist nominees, once seated, to push the company to outperform. Were the newly-seated directors successful in doing so, all shareholders would have profited. Even better, from the unaffiliated shareholders' perspective, the cost of the incentive compensation was to be borne entirely by the activist, not the company itself. Shareholders were thus put in the position of free riders, enjoying the positive externality of the nominees' incentive to perform without bearing any of the cost.

The leading argument against activist compensation arrangements is that such arrangements pose a threat to a director's fiduciary duty by providing an incentive for the director to favor the interests of the shareholder that is paying him or her rather than the interests of all shareholders. A seated nominee might seek to curry favor with the activist in hopes, perhaps, of earning additional compensation. In those situations where the activist's interest conflicts with that of other shareholders, the special pay arrangement might cause the director to push the activist's agenda. It is worth pointing out that most golden leash compensation arrangements, including the ones in Hess, Agrium, and Forest, are hardwired. The activists had already agreed, in a binding contract, to make the supplemental payments if their nominees, once seated, hit the specified performance hurdles, leaving the activists with no subsequent discretion as to whether or not to make the payments—the payments would be required if the profit hurdles were achieved. As a result, the nominees would have no need to curry favor with the activist.

Even if the promise to pay is binding and nondiscretionary, opponents might still argue that the terms of the compensation arrangement are problematic because they originate outside the firm and are set by a party with no fiduciary duty to shareholders. In other words, the compensation arrangement itself may not be in shareholders' best interests. Opponents of activism may argue that such arrangements do not in fact serve the interests of all shareholders because they over-incentivize directors to push for short-term returns over long-term profitability. Here the debate over activism recycles, in slightly altered form, familiar tropes from the takeover debate.¹⁰⁶ Emphasis on short-term returns may result in greater risk taking or leverage or the

104 JANA PARTNERS LLC, *supra* note 84.

105 Hess Corp., *supra* note 93.

106 See Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 521-23 (2002) (outlining debate about whether takeovers are value-increasing).

avoidance of investment opportunities with longer time horizons. Normally, the board of directors is thought to counterbalance the short-term interests of such shareholders. However, if these shareholders are able to put their nominees on the board and use potentially lucrative pay packages to ensure that those nominees continue to focus on short-term rewards, the activists damage the long-term health of the corporation.

No corporate authority has passed judgment on whether golden leash compensation arrangements are good for shareholders. The terms of the debate were set by non-fiduciaries with their own (arguably short-term) agendas.¹⁰⁷ In the context of a takeover, at least, minority shareholders have the chance to sell for a control premium. In the context of activism, minority shareholders do not receive a control premium but are nevertheless subject to the activist's managerial whims. Thus, according to this view, it is problematic to have a fiduciary's compensation set by a nonfiduciary notwithstanding the binding, nondiscretionary nature of its terms.

C. The Advisors Strike Back

On May 9, 2013, Wachtell publicly released a memorandum attacking the golden leash. The memorandum recited several of the above-described arguments against activist compensation arrangements and cited to several other commentators who had criticized the use of the golden leash.¹⁰⁸ The memorandum went on to suggest that issuers could protect themselves from the risk of nominees coming forward under the terms of such preferential compensation packages by adopting a bylaw prohibiting golden leash arrangements.¹⁰⁹ The memorandum went so far as to propose a model golden leash bylaw:

No person shall qualify for service as a director of the Corporation if he or she is a party to any compensatory, payment or other financial agreement, arrangement or understanding with any person or entity other than the Corporation, or has received any such compensation or other payment from any person or entity other than the Corporation, in each case in connection with candidacy or service as a director of the Corporation; provided that agreements providing only for indemnification and/or reimbursement of out-of-pocket expenses in connection with candidacy as a director (but not, for the avoidance of doubt, in connection with service as a director) and any

¹⁰⁷ Hedge funds may be short-term oriented due to the need to demonstrate performance to their investors, or as a result of liquidity concerns. Other shareholders, not subject to these considerations, may take a longer view of corporate performance.

¹⁰⁸ Lipton, *supra* note 11.

¹⁰⁹ *Id.*

pre-existing employment agreement a candidate has with his or her employer (not entered into in contemplation of the employer's investment in the Corporation or such employee's candidacy as a director), shall not be disqualifying under this bylaw.¹¹⁰

The bylaw, as proposed, was written to cover a broader range of compensation arrangements than those reflected in the Elliott and JANA golden leashes. It disqualified a nominee who received *any* compensation in connection with his or her candidacy or service (other than indemnification or reimbursement of expenses) from a source other than the corporation itself. Thus, not only would the rich incentive packages offered to nominees in cases like Agrium and Hess lead to nominee disqualifications under such a bylaw, but so too would small cash payments intended simply to induce dissident nominees to go through the painful process of a proxy fight.

Wachtell defended the legality of the disqualification bylaw by pointing to the statutory authority of boards to "prescribe other qualifications for directors" through a charter or bylaw provision.¹¹¹ The firm further argued that the business judgment rule should protect the decision to adopt such a bylaw or that, should a heightened standard of review be found to apply, the board's decision "should withstand scrutiny as a measured response to the threat posed by these inappropriate schemes."¹¹²

In the months following the release of the Wachtell Memorandum, the boards of thirty-two issuers amended their bylaws to adopt provisions prohibiting golden leash compensation arrangements.¹¹³ Most of the bylaws were similar or identical to the Wachtell model, and their rapid adoption threatened to limit activists' ability to use golden leashes.

The adoption of these bylaws triggered a response by ISS. ISS, the predominant proxy advisory firm, provides information and recommendations to its institutional investor clients in connection with their voting decisions.¹¹⁴ Notably, ISS's voting recommendations are based, in part, on its evaluation of an issuer's corporate governance.¹¹⁵ In its proxy voting policy guidelines, ISS explains that its voting recommendations "are intended to assist

¹¹⁰ *Id.* (emphasis omitted).

¹¹¹ DEL. CODE. ANN. tit. 8, § 141(b) (2015). The legality of the bylaw, however, is unclear; while Delaware courts have generally upheld a range of takeover defenses, they have applied greater scrutiny to board actions that interfere with the electoral process. *See* *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 652, 655 (Del. Ch. 1988) (holding that board actions taken primarily to interfere with the shareholder franchise must have "compelling justification").

¹¹² Lipton, *supra* note 11.

¹¹³ *See infra* Table I.

¹¹⁴ *See Proxy Voting Services*, ISS, <http://www.issgovernance.com/governance-solutions/proxy-voting-services> [<http://perma.cc/G93M-4EUH>] (last visited Nov. 21, 2015).

¹¹⁵ *See ISS Global Voting Principles*, ISS, <http://www.issgovernance.com/policy-gateway/iss-global-voting-principles> [<http://perma.cc/2j4V-7R45>] (last visited Nov. 21, 2015).

institutional investors in meeting their fiduciary requirements with respect to voting by promoting long-term shareholder value creation and risk mitigation at their portfolio firms through support of responsible global corporate governance practices.”¹¹⁶

On November 12, 2013, ISS recommended that shareholders withhold their votes from the members of the Nominating and Governance Committee of Provident, a firm that had adopted the disqualification bylaw.¹¹⁷ ISS stated that it constituted a “material governance failure” for the Provident board to adopt a bylaw that significantly impacted shareholder rights without seeking shareholder input.¹¹⁸ As ISS explained, the disqualification bylaw would “unduly restrict investors’ ability to nominate and elect otherwise qualified individuals via a proxy contest.”¹¹⁹

On November 26, 2013, ISS released a further explanation of its position. In a public memorandum, ISS identified “the potentially chilling effect of this bylaw on the quality of dissident candidates in future proxy contests.”¹²⁰ Hence, according to ISS, the bylaw could “have a detrimental effect on the quality of dissident candidates, without providing shareholders any reasonable benefit.”¹²¹ Importantly, ISS signaled that its concern about golden leash bylaws extended beyond the single case of Provident. In the memorandum, ISS included a list of all of those companies known to it to have adopted such bylaws, implicitly suggesting that these companies could expect future withhold recommendations if they did not reconsider their bylaws.¹²²

Not every ISS policy position generates a voting response by investors.¹²³ Nevertheless, investors responded to the concerns ISS raised regarding the Wachtell Bylaw. On November 27, 2013, Provident announced the voting results from its annual meeting.¹²⁴ Provident’s director nominees received a withhold vote of 34%.¹²⁵ High withhold votes are of particular concern, even in uncontested elections, because they signal widespread investor dissatisfaction.¹²⁶

¹¹⁶ 2015 Policy Information, ISS, <http://www.issgovernance.com/policy-gateway/2015-policy-information> [<http://perma.cc/HZZ4-KU7K>] (last visited Nov. 21, 2015).

¹¹⁷ ISS PROXY ADVISORY SERVS., REPORT ON PROVIDENT FINANCIAL HOLDINGS, INC. (Nov. 12, 2013). The report was released after the close of business.

¹¹⁸ *Id.* at 1.

¹¹⁹ *Id.*

¹²⁰ CERNICH ET AL., *supra* note 12, at 2.

¹²¹ *Id.*; see also ISS, DIRECTOR QUALIFICATION/COMPENSATION BYLAW FAQs 1 (2014) [hereinafter ISS FAQs] (“The adoption of restrictive director qualification bylaws without shareholder approval may be considered a material failure of governance because the ability to elect directors is a fundamental shareholder right.”).

¹²² CERNICH ET AL., *supra* note 12, at 2; see also ISS FAQs, *supra* note 121, at 1.

¹²³ See *supra* note 62 and accompanying text.

¹²⁴ Provident Fin. Holdings, Inc., Annual Meeting Results (Form 8-K) (Nov. 26, 2013).

¹²⁵ *Id.*

¹²⁶ Choi et al., *supra* note 52, at 63.

A 34% withhold vote would certainly be characterized as “high,”¹²⁷ and boards often respond to high withhold votes by complying with activists’ requests.¹²⁸

On January 13, 2014, ISS released new policy updates formalizing its position.¹²⁹ In those updates, ISS announced that it would treat the Wachtell Bylaw, along with any other bylaw amendment unilaterally adopted by the board that had the effect of materially diminishing shareholder rights, as a “material failure of [corporate] governance.”¹³⁰ Barring extraordinary circumstances, ISS now recommends withhold for directors of companies exhibiting a material failure of corporate governance.¹³¹ ISS, in other words, recommends withhold against directors who adopt the Wachtell Bylaw.

Investors took the ISS position seriously, not only at Provident, but also at other companies that had adopted the Wachtell Bylaw. Table I sets forth the results of director elections at companies that had adopted the Wachtell Bylaw and held a shareholder meeting prior to repealing the Bylaw. The middle two columns report the averages of the percentage of yes votes cast for each director up for election at the given fiscal year’s annual meeting.

¹²⁷ *Id.*; see also Diane Del Guercio et al., *Do Boards Pay Attention When Institutional Investor Activists “Just Vote No”?*, 90 J. FIN. ECON. 84, 89 (2008) (describing “withhold” votes of more than 20% as “substantial”).

¹²⁸ Del Guercio et al., *supra* note 127, at 89 (“[A] strong showing of withheld support increases the probability that the board will comply with activists’ requests.”).

¹²⁹ ISS FAQs, *supra* note 121, at 1.

¹³⁰ *Id.*

¹³¹ *Id.*

Table I: Voting Results (2013 & 2014) Wachtell Bylaw Adopters

N	Name	Date of Meeting	Average Vote Yes %		Golden Leash Bylaw Repealed Prior to 2014 Meeting?	Golden Leash Bylaw Subsequently Repealed? (as of January 1, 2015)
			(2013 Season)	(2014)		
1	Provident Fin. Holdings, Inc.	11/26/2013	96.59%	66.35%	No	Yes
2	Schnitzer Steel Indus., Inc.	1/29/2014	97.79%	87.46%	Yes	
3	Rockwell Automation, Inc.	2/4/2014	87.47%	70.75%	No	Yes
4	Joy Glob, Inc.	3/4/2014	98.95%	96.81%	Yes	
5	Int'l Game Tech.	3/10/2014	88.62%	97.78%	Yes	
6	Nat'l Fuel Gas Co.	3/13/2014	98.58%	95.81%	No	No
7	TIBCO Software, Inc.	4/3/2014	97.05%	94.04%	Yes	
8	C. R. Bard, Inc.	4/16/2014	97.44%	98.83%	Yes	
9	Centene Corp.	4/22/2014	96.85%	96.98%	Yes	
10	McGraw Hill Fin., Inc.	4/30/2014	96.42%	98.89%	Yes	
11	Marathon Oil Corp.	4/30/2014	99.19%	92.68%	Yes	
12	Eastman Chem. Co.	5/1/2014	96.55%	97.90%	Yes	
13	Alexion Pharm., Inc.	5/5/2014	97.10%	97.89%	Yes	
14	Leggett & Platt, Inc.	5/7/2014	98.62%	97.62%	Yes	
15	Peabody Energy Corp.	5/8/2014	97.68%	96.30%	Yes	
16	Insperty, Inc.	5/13/2014	96.04%	72.83%	Yes	

Table I: Voting Results (2013 & 2014) Wachtell Bylaw Adopters (Continued)

N	Name	Date of Meeting	Average Vote Yes %		Golden Leash Bylaw Repealed Prior to 2014 Meeting?	Golden Leash Bylaw Subsequently Repealed? (as of January 1, 2015)
			(2014 Season) Cast (2013)	Cast (2014)		
17	Monmouth Real Estate Inv. Corp.	5/13/2014	97.91%	94.76%	Yes	
18	Tinken Co.	5/13/2014	96.36%	98.32%	Yes	
19	Serv. Corp. Int'l	5/14/2014	84.53%	96.01%	Yes	
20	Entropic Commc'ns, Inc.	5/14/2014	96.32%	69.90%	No	No
21	The WhiteWave Foods Co.	5/15/2014	70.46%	77.04%	Yes	
22	Invacare Corp.	5/15/2014	97.53%	98.44%	Yes	
23	Key Energy Servs., Inc.	5/15/2014	96.96%	75.10%	Yes	
24	Wynn Resorts, Ltd.	5/16/2014	93.92%	96.46%	Yes	
25	Halliburton Co.	5/21/2014	93.88%	97.16%	Yes	
26	Chatham Lodging Tr.	5/22/2014	80.52%	53.43%	No	Yes
27	Wayne Sav. Bancshares, Inc.	5/22/2014	99.81%	95.60%	Yes	
28	WPX Energy, Inc.	5/22/2014	93.19%	99.15%	Yes	
29	FBR & Co.	6/3/2014	94.52%	99.52%	Yes	
30	First Reliance Bancshares	6/5/2014	97.70%	97.00%	No	No*
31	UMH Props., Inc.	6/12/2014	90.63%	97.81%	Yes	
32	Penn Nat'l Gaming, Inc.	6/12/2014	83.30%	76.43%	No	Yes

* First Reliance asked shareholders to ratify the bylaw at the June 2014 Annual meeting. Over 80% voted in favor. It has still not been repealed. DAVIS, POLK & WARDWELL, LLP, 2014 PROXY SEASON REVIEW AND RECENT DEVELOPMENTS: CORPORATE GOVERNANCE UPDATE 19 (2014), <http://www.governanceprofessionals.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=40761591-1cbf-4f3a-97e0-53e7f79cdef> [https://perma.cc/4ZNM-LWSW].

Table I shows that companies that did not immediately repeal the Wachtell Bylaw typically suffered a significant reduction in yes votes cast as a result of increased withhold votes. The median number of yes votes cast for these companies was 70.75% compared to 96.98% for those that had repealed the Wachtell Bylaw by the time of the shareholder vote. This difference is highly statistically significant at the 1% confidence level based on a Wilcoxon rank-sum test. The difference appears to be driven by the ISS position on the Wachtell Bylaw. The average votes cast for those companies with significant withhold votes in 2014 differ from the 2013 figures for all but two of those companies.¹³² For example, Chatham Lodging Trust had an average yes vote for its directors of 80.52% in 2013 compared to 53.43% in 2014 when the Wachtell Bylaw was in effect. Chatham Lodge subsequently repealed its golden leash bylaw.

Issuers responded rapidly to the ISS warning and the demonstrated shareholder support for the ISS position. By May 20, 2014, twenty-eight of thirty-two companies had retracted the bylaw in whole or in part, many on the eve of their shareholder meetings. Even Wachtell acknowledged that issuer adoption of the bylaws was risky in light of both the ISS position and widespread institutional opposition.¹³³ As of January 15, 2016 only three issuers retain director compensation bylaws.¹³⁴

The golden leash, by contrast, is far from dead. In November 2014, activist shareholder Third Point disclosed that it had agreed to a golden leash arrangement with its two nominees for the Dow board of directors.¹³⁵ Third Point's nominees would each receive \$250,000 for agreeing to serve as a nominee and an additional \$250,000 if elected, which would be invested in Dow stock.¹³⁶ In addition, each nominee would receive two additional cash payments from Third Point based on the appreciation of approximately 400,000 shares of Dow common stock following October 2, 2014.¹³⁷ Dow and Third Point settled the matter, avoiding a public proxy contest, on terms that

¹³² We note that National Fuel Gas Co., First Reliance Bancshares, and Entropic Communications, Inc. all had below-average levels of institutional ownership.

¹³³ See Martin Lipton, *ISS Addresses Dissident Director Compensation Bylaw*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 21, 2013), <http://corpgov.law.harvard.edu/2013/11/21/iss-addresses-dissident-director-compensation-bylaw> [<http://perma.cc/4MRP-NNFB>]; see also Holly J. Gregory, *Using Board-Adopted Bylaws to Reduce Corporate Threats*, PRAC. L. (July 1, 2014), <http://us.practicallaw.com/6-572-8667> (noting that "some large institutional shareholders, the Council of Institutional Investors (CII) and key proxy advisors have expressed concerns" over the adoption of the Wachtell Bylaw).

¹³⁴ See *supra* Table I. Entropic Communications was acquired on April 30, 2015.

¹³⁵ David Benoit & Joann S. Lublin, *Third Point Revives 'Golden Leash' Pay Plan in Dow Chemical Fight*, WALL ST. J. (Nov. 16, 2014, 4:00 PM), <http://www.wsj.com/articles/third-point-revives-gold-en-leash-pay-plan-in-dow-chemical-fight-1416171616> [<http://perma.cc/T5HV-ZUYB>].

¹³⁶ *Id.*

¹³⁷ *Id.*

involved Dow's agreement to add Third Point's nominees to the board as well as two additional independent directors.¹³⁸ Under the terms of the agreement, the Third Point nominees kept their compensation packages, making them the first sitting directors compensated pursuant to a golden leash.¹³⁹

Moreover, in the February 2015 attack on General Motors by a group of four activist hedge funds, the activists disclosed that their nominee, Harry Wilson, would "receive a percentage of the group's profits from their investment in GM."¹⁴⁰ The Wilson golden leash was novel in that it consisted of separate contracts with each of the four hedge funds, and each contract had different terms.¹⁴¹ The GM contest was settled when GM agreed to buy back \$5 billion worth of stock and Wilson did not receive a board position.¹⁴² Nonetheless, the golden leash lives.

III. EMPIRICAL ANALYSIS

The saga of the golden leash, the Wachtell Bylaw, and the ISS recommendation presents a natural experiment to test how investors value corporate governance. We begin, in Sections A and B, by analyzing the thirty-two companies that had adopted the Wachtell Bylaw to determine if there is any clear pattern to explain their actions. In Section C, we then conduct time series analysis of the share prices of the thirty-two companies around principal dates surrounding the adoption and repeal of the Wachtell Bylaw. Our goal is to discern if investors value these governance changes, and if so, whether they assign them negative or positive values. Finally, in Section D, we consider the effects of the Wachtell Bylaw on a wider set of firms subject to activist attack.

A. Data Description

We obtained from ISS a list of companies that adopted a Wachtell Bylaw on or after May 9, 2013, the date Wachtell first proposed a model director compensation bylaw. To confirm that no other corporations belong in this list, we searched 10-K Wizard for bylaw amendments addressing director compensation; we then cross-checked the companies against a similar list that Innisfree, a proxy solicitation service, had compiled and provided to us. We

¹³⁸ David Benoit & Joann Lublin, *Dow Chemical, Loeb Settle Board Dispute*, WALL ST. J. (Nov. 21, 2014, 1:10 PM), <http://www.wsj.com/articles/dow-chemical-third-point-settle-board-dispute-1416578708> [<http://perma.cc/2Z9Z-J3EX>].

¹³⁹ *Id.*

¹⁴⁰ Press Release, Gen. Motors, *supra* note 18.

¹⁴¹ Mark Rogers, *GM, Harry Wilson, and the Disturbing Rise of the Golden Leash*, FORBES LEADERSHIP F. (Mar. 11, 2015, 2:31 PM), <http://www.forbes.com/sites/forbesleadershipforum/2015/03/11/gm-harry-wilson-and-the-disturbing-rise-of-the-golden-leash> [<http://perma.cc/JR9P-CRLG>].

¹⁴² *Id.*

confined our search to the period from May 8, 2013, the date of the Wachtell Memorandum, until November 27, 2013, the date when Provident published the voting results for its annual meeting. We excluded companies that adopted the bylaw in conjunction with an initial public offering or as a prelude to being spun off from a parent company. The majority of companies adopting a bylaw during this time period used the Wachtell language. We arrived at a list of thirty-two companies.

We also obtained from ISS a list of all companies that subsequently repealed their director compensation bylaw. We confirmed that there were no other repeals by searching the 10-K Wizard database, confining our search to any repeals implemented between November 26, 2013 and June 30, 2014. Our search returned a list of twenty-seven companies.

We then searched the SEC EDGAR database to confirm the date that each company publicly filed its disclosure of an adoption or repeal. Incorporation data for each of these companies is obtained from the EDGAR database. Institutional Ownership information is obtained from Thomson Reuters while information on staggered boards and shareholder activism is obtained from FactSet SharkRepellent.¹⁴³

We measured activism by searching the FactSet SharkRepellent database for any proposal by an institutional shareholder for substantive changes to corporate organization or operations from May 8, 2012 (one year prior to the Wachtell Memorandum) through November 25, 2014 (the one year anniversary from the day before the Provident annual meeting). Voting results and majority voting policies are also obtained from the FactSet database as well as from filings in the SEC EDGAR database. Accounting information is obtained from Compustat. Stock price information is obtained from the Center for Research in Security Prices database and Yahoo! Finance. Compensation data is obtained from Execucomp. Institutional Ownership information is obtained from Thomson Reuters. Finally, information on staggered boards and shareholder activism is obtained from Factset SharkRepellent.

B. *Analysis—Adopters and Repealers*

In this subsection, we examine the characteristics of the thirty-two companies that adopted the Wachtell Bylaw. Table II, Panel A describes certain accounting and compensation data for these companies.

¹⁴³ FactSet SharkRepellent is a database which records activists' actions and other information concerning takeover defenses and shareholder voting. See generally SHARKREPELLENT, <https://www.sharkrepellent.net> [<https://perma.cc/C3R8-QNGM>] (last visited Nov. 21, 2015).

Table II: Sample Descriptive Statistics
 Panel A: Accounting and Compensation Information (\$MM)¹⁴⁴

	Mean	Std. Dev.	Min.	25th %	Median	75th %	Max
Assets	\$16,884	\$62,278	\$295	\$1154	\$3423	\$7298	\$355,408
Revenues	\$4076	\$5732	\$15	\$665	\$2549	\$4944	\$29,402
Market Cap.	\$7162	\$9939	\$8	\$604	\$3961	\$8087	\$43,087
Net Income	\$256	\$657	-\$1185	\$3	\$96	\$403	\$2125
ROA	0.023	0.117	-0.364	0.005	0.042	0.074	0.227
Total CEO Comp.	\$7.182	\$5.935	\$.260	\$2.235	\$6.354	\$8.966	\$23.294

There is no pattern in terms of size, income, or revenue linking the companies which adopt these bylaws. The median market capitalization of these companies as of year-end 2013 is \$3.961 billion but the mean market capitalization is \$7.162 billion, with a standard deviation of \$9.939 billion, which indicates a significant right-skewed range of size for the companies in our sample. Similarly, the assets and revenue figures for the sample have a wide range which is right-skewed. Companies in our sample have, as of year-end 2013, median total assets of \$3.423 billion. The mean asset size for companies in our sample is \$16.884 billion and the standard deviation is \$62.278 billion. The median revenue of these companies in fiscal year 2013 is \$2.549 billion with a standard deviation of \$5.732 billion and a mean of \$4.076 billion.

The majority of companies in our sample are profitable, and the median net income for fiscal year 2013 for these companies is \$96 million. To further explore the profitability of these companies, we calculated their return on assets (ROA). ROA measures profitability relative to total assets by dividing net income by total assets. The average ROA in fiscal year 2013 for the companies in our sample is 2.3%, and the median is 4.2%, which is below the average for companies in the Russell 2000 index.¹⁴⁵ In our sample, the median chief executive officer (CEO) compensation for the last fiscal year prior to adoption of an amendment is \$6.354 million, and the average is \$7.182 million.

Institutional ownership is one factor that may influence the adoption of director compensation bylaws. Low institutional ownership may provide

¹⁴⁴ All accounting numbers are for fiscal year 2013. All numbers except ROA are in millions of U.S. dollars. Market Capitalization is as of year-end 2013. ROA is return on assets measured as Net Income divided by Total Assets for the fiscal year 2013. Total CEO Compensation is as recorded in the company's SEC filing for the annual meeting held immediately prior to the adoption of the bylaw and prepared in accordance with SEC rules.

¹⁴⁵ See RUSSELL INVS., SMALL CAP PERSPECTIVES: RUSSELL 2000 INDEX QUARTERLY ANALYSIS 10 (2013), <http://www.methodologymatters.com/pdfs/R2000%20Small%20Cap%20Perspectives%204Q13%20FINAL%20POSTED.pdf> [<http://perma.cc/LU5P-MYF4>] ("Profitability as measured by return on assets (ROA) ended the year at approximately 5.1% . . .").

companies leeway to take actions which might be disfavored by shareholders. If institutional ownership is low, there is no concentrated shareholder base which can act effectively to overcome the free rider problem of dispersed shareholder ownership. On the other hand, companies with a high number of institutional owners may wish to adopt these bylaws because they can prevent a small number of shareholders from supporting a shareholder activist. Panel B sets forth information on institutional ownership in our sample.

**Table II: Sample Descriptive Statistics
Panel B: Institutional Share Ownership¹⁴⁶**

	Mean	Std. Dev.	Min.	25th %	Median	75th %	Max
Total Inst. Ownership %	66.88%	17.95%	15.74%	61.69%	69.94%	78.74%	92.60%
Top 5 Inst. Ownership	26.00%	6.90%	8.78%	21.97%	27.06%	29.62%	41.86%
Top 10 Inst. Ownership	36.60%	10.23%	11.49%	28.82%	36.79%	43.97%	59.91%
Max Single Inst. Ownership	8.28%	2.54%	3.39%	6.37%	8.39%	10.03%	14.00%

The median institutional ownership for the companies in our sample as of year-end 2013 is 69.94%, showing a high level of institutional involvement. The maximum level of institutional ownership for a firm in our sample is 92.6%. In the sample, the median ownership of Top 5 Institutional Ownership—the amount held by the top five institutional holders—is 27.06%. There are no controlling shareholders in our sample and the maximum amount held by a single institutional holder for the median firm is 8.39%, with a maximum of 14% of the company. Panel C of Table II shows other aspects of corporate governance.

¹⁴⁶ Total Institutional Ownership % is the percentage of total institutional ownership. Top 5 Institutional Ownership is the percentage ownership of the five largest institutional owners. Top 10 Institutional Ownership is the percentage ownership of the ten largest institutional owners. Maximum Institutional Ownership is the percentage ownership of the largest institutional owner. Institutional ownership for each of these variables is as of the year-end 2013.

Table II: Sample Descriptive Statistics
Panel C: Corporate Governance¹⁴⁷

	Number	%
DE Incorpor.	15	46.88%
Staggered Board	18	56.26%
Activism	4	12.50%

Companies incorporated in Delaware have been found to trade at a premium as compared to other companies.¹⁴⁸ This may be due to self-selection bias; that is, better companies may opt to incorporate in Delaware. But, it also may be that Delaware companies have historically traded at a premium due to the better laws and corporate governance apparatus that Delaware arguably provides.¹⁴⁹ Approximately 47% of our sample (fifteen companies) is incorporated in Delaware.

A staggered board has been found to reduce firm value around the time of its adoption.¹⁵⁰ For these and other reasons, it has been opposed by corporate governance advocates and proxy advisory services, and may be an indicator of poor corporate governance practices.¹⁵¹ In recent years this has

¹⁴⁷ As discussed in Section II.A, *supra*, activism is measured by whether an institutional shareholder brought a proposal for substantive changes to corporate organization or operations after January 1, 2010, as recorded in the Factset Sharkrepellent database.

¹⁴⁸ See Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 527 (2001) (“I find that Delaware firms are worth more than similar firms incorporated elsewhere . . .”). *But see* Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32, 57 (2004) (reporting evidence that the results found by Professor Daines did not continue over a later time period); K.J. Martijn Cremers & Simone M. Sepe, *The Financial Value of Corporate Law: Evidence from (Re)-Incorporation 47* (Oct. 14, 2015) (unpublished manuscript), <http://ssrn.com/abstract=2519238> [<http://perma.cc/T96W-PY86>] (“In the time series the Delaware reincorporation effect has a negative association with firm value, while reincorporation into Managerial States[, or management friendly jurisdictions,] has a positive association with firm value.”).

¹⁴⁹ See, e.g., Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1064 (2000) (describing possible reasons for the superiority of Delaware law, including the benefits of the Delaware courts).

¹⁵⁰ See Bebchuk et al., *supra* note 71, at 939 (finding that having staggered boards reduces shareholder returns by 8-10% “in the nine months after a hostile bid is launched”); *see also* Cohen & Wang, *supra* note 46, at 628 (“We find evidence consistent with market participants viewing the antitakeover force of staggered boards as bringing about, and not merely reflecting, reduced shareholder value.”).

¹⁵¹ See Cohen & Wang, *supra* note 46, at 628 (“Certain institutional investors have over time become increasingly opposed to staggered boards.”). The repeal of staggered boards is responsive, in part, to the Shareholder Rights Project at Harvard Law School. *See* Daniel M. Gallagher & Joseph A. Grundfest, *Did Harvard Violate Federal Securities Law? The Campaign Against Classified Boards of Directors* 22-24 (Rock Ctr. for Corp. Governance, Working Paper Series No. 199, 2014), <http://ssrn.com/abstract=2536586> [<http://perma.cc/JJ4E-G73E>] (discussing the impact of the Harvard project on the trend for S&P 500 companies to repeal staggered boards).

led many S&P 500 companies to “destagger” and repeal their staggered boards. As of 2013, only 9.75% of S&P 500 companies had a staggered board.¹⁵² However, this number rises to 50.66% of the Russell 2000 and 41.96% of the Russell 3000.¹⁵³ In our sample approximately 56%, or eighteen companies, have a staggered board which is above all three metrics.

One spur to adopting director compensation bylaws may be an ongoing or recent encounter with a shareholder activist.¹⁵⁴ We measured activism by searching the Factset SharkRepellent database for any proposal by an institutional shareholder for substantive changes to corporate organization or operations brought after January 1, 2012, but before release of the Wachtell Memorandum, with respect to the companies in our sample. We found that approximately 12.5% of our sample had an activist event under these parameters.¹⁵⁵ This is significantly higher than the general rates of activism for the S&P 500, Russell 2000, and Russell 3000 companies as measured by Factset SharkRepellent. Table III sets forth more in-depth information concerning shareholder activism and the companies in our sample for the time period from May 8, 2012 (one year prior to the Wachtell Memorandum) through November 25, 2014 (approximately one year after the shareholder vote for Provident Financial).¹⁵⁶

¹⁵² SHARKREPELLENT, *supra* note 143.

¹⁵³ *Id.*

¹⁵⁴ See *infra* Table III.

¹⁵⁵ The types of activism include campaigns to maximize shareholder value, efforts to obtain board representation and acquisition activity.

¹⁵⁶ Notably, Table III only reports activist activity that rises to the level reflected in the SharkRepellent database. We note that media reports during this time period reflected rumors of activism or some lesser level of activist activity for these companies. For example, Eastman Chemical was rumored to be a potential JANA activism target in October 2013. Stephen Taub, *Taking Barry Rosenstein up on his Teaser*, INSTITUTIONAL INV.'S ALPHA (Oct. 14, 2013), <http://www.institutionalinvestorsalpha.com/Article/3266536/Taking-Barry-Rosenstein-Up-on-His-Teaser.html> [<http://perma.cc/55VK-7VBH>]. Similarly, in March 2013, the media reported that Marathon Oil's intended CEO resigned amidst a wave of shareholder rebellions in the oil and gas industry. Jeff Green et al., *Marathon Said to Join Oil CEO Search as Bid War Looms*, BLOOMBERG BUS. (Mar. 4, 2013, 10:46 AM), <http://www.bloomberg.com/news/articles/2013-03-04/marathon-said-to-join-oil-ceo-search-as-bid-war-looms> [<http://perma.cc/H9RZ-QUPX>]. This activism may have been a factor motivating the adoption of the Wachtell Bylaw. It is difficult, however, to gauge the potential economic significance of activist activity based on rumors reported by the media, which may contribute to the market's inability to price the significance of the bylaw adoption at these 32 companies. See, e.g., Anna Prior, *Icahn Denies Having Stake in Peabody Energy*, WALL ST. J.: MONEYBEAT (May 30, 2013, 1:28 PM), <http://blogs.wsj.com/moneybeat/2013/05/30/icahn-denies-having-stake-in-peabody-energy> [<http://perma.cc/Y7JT-ZY9A>] (reporting that Icahn denied the rumors that he had acquired a stake in Peabody).

Table III: Incidence of Significant Shareholder Activism
(May 8, 2012 through November 25, 2014)

Name of Company	Activist Event Prior to Wachtell Bylaw Adoption	Activist Event After Wachtell Bylaw Adoption
Marathon Oil Corp.	No	No
FBR & Co.	No	No
Rockwell Automation, Inc.	No	No
Nat'l Fuel Gas Co.	No	No
McGraw Hill Fin., Inc.	No	Yes
Monmouth Real Estate Inv. Corp.	No	No
UMH Props., Inc.	No	No
Tibco Software, Inc.	No	Yes
Halliburton Co.	No	No
First Reliance Bancshares, Inc.	No	No
Peabody Energy Corp.	No	No
Provident Fin. Holdings, Inc.	No	No
Invacare Corp.	No	No
Schnitzer Steel Indus., Inc.	No	No
Service Corp. Int'l	No	No
Insperty, Inc.	No	No
Whitewave Foods Co.	No	No
Centene Corp.	No	No
Wynn Resorts Ltd.	No	No
Joy Glob., Inc.	No	No
Wayne Sav. Bancshares, Inc. (DE)	No	No
Entropic Commc'ns, Inc.	No	No
Eastman Chem. Co.	No	No
C. R. Bard, Inc.	Yes	No
Alexion Pharm., Inc.	No	No
Leggett & Platt, Inc.	No	No
Penn Nat'l Gaming, Inc.	No	No
Chatham Lodging Trust	Yes	Yes
Int'l Game Tech.	Yes	No
WPX Energy, Inc.	Yes	No
Key Energy Servs., Inc.	No	No
Timken Co.	No	No

Notably, while these companies experienced a high rate of shareholder activism before their adoption of the Wachtell Bylaw, they also experienced shareholder activism at the same rate thereafter. This may mean that

companies adopted the Wachtell Bylaw in anticipation of future activism. Still, based on the SharkRepellent data, there appears to be no discernable pattern in the adoption of the Wachtell Bylaw.

C. Price Effects

For each of the thirty-two companies—listed in Tables I and III above—that had adopted the Wachtell Bylaw, we examined the wealth effects of firm-specific decisions to adopt and repeal a golden leash bylaw. Table IV sets forth our cross-sectional event studies for companies adopting and repealing the Wachtell Bylaw.

Table IV: Event Studies of Adoption and Repeal Dates

	Adoptions		Repeals	
	(1)	(2)	(3)	(4)
Constant	-0.003 (0.657)	-0.012 (0.135)	0.004 (0.306)	-0.004 (0.430)
DE Incorp.		0.019 (0.141)		0.016** (0.036)
N	32	32	27	27
R ²	0.00%	7.24%	0.00%	16.49%

A cross-sectional event study examines the effect of share price movements for a set of firms over a single period of time. We conducted the analysis by calculating the excess returns of each company on the date of their adoption of a director compensation bylaw over the three day period from the date of adoption against the Russell 2000 index.¹⁵⁷ The three-day period includes the trading days before and after the relevant date. Excess returns are the amount by which a company in our sample had returns that were different than the Russell 2000 Index. We selected this index because it most comports with the characteristics of the companies in our sample. We hypothesized that if golden leash compensation arrangements facilitate value-increasing shareholder activism, companies that adopt the Wachtell Bylaw would experience a share price decline upon adoption. Alternatively, if golden leash arrangements are bad for issuers—consistent with the position articulated by target company management and Wachtell—we would expect to see a share price increase upon adoption of a bylaw.

¹⁵⁷ Our analysis was conducted in accordance with Kothari & Warner. S.P. Kothari & Jerold B. Warner, *The Econometrics of Event Studies*, in 1 HANDBOOK OF CORPORATE FINANCE 3 (2007).

Columns 1 and 2 examine the share price returns of *adopting* companies. In column 1 we regress these excess returns to determine whether there is a statistically significant price movement.¹⁵⁸ In other words, in general, did companies adopting the golden leash experience a statistically significant share price movement? We then regressed in column 2 the excess returns against the independent variable Delaware incorporation expressed by *DE Incorp.*¹⁵⁹ This allowed us to examine whether share prices of Delaware companies in particular, a place known for its well-ordered corporate law, experienced any unique movement.

We found in column 1 that the coefficient for the returns upon adoption is negative for the entire sample, indicating a decline in value for companies that adopt a Wachtell Bylaw. However, the coefficient is not statistically significant. In column 2 the coefficient for Delaware companies is positive meaning that these companies experience a share price gain upon adoption of a Wachtell Bylaw, but again this variable is not statistically significant at conventional levels.

We thus did not find that the adoption of a Wachtell Bylaw had a statistically significant effect on a company's share price either for the sample as a whole or for Delaware companies. This result is inconsistent with each of our hypotheses—that is, first, that we would witness some market reaction on each of our event dates and second, that the reaction would be negative on May 9, 2013 but positive on November 27, 2013.

There are several possible explanations for this null finding. The sample size may be too small, or the adoption may send countervailing signals that cancel each other out. For instance, adoption of the bylaw may signal to the market that the issuer's board anticipates future activist activity, which might lead to the higher share prices are typically associated with anticipation of activism. On the other hand, adoption may signal a corporation's unwillingness to cooperate with such an activist, or otherwise imply governance practices which the market may view as value-decreasing. Because these effects run in opposing directions, they may cancel each other out. To further explore this hypothesis, we ran an unreported model including the independent variable *shareholder activism* which reflects whether the company experienced any type of shareholder activism during the one year period before the Wachtell Memorandum through November 25, 2014 (the day before the first anniversary of the Provident meeting).¹⁶⁰ We found no statistical significance

¹⁵⁸ P-values from robust standard errors are shown below the coefficients in parentheses.

¹⁵⁹ The independent variable *DE Incorp.* is added and is coded 1 if the company is incorporated in Delaware and 0 otherwise.

¹⁶⁰ This variable is coded 1 if there is any type of shareholder activism as denoted in the FactSet SharkRepellent database and 0 otherwise.

in this model, which likely underscores the sample size problem. This problem is addressed in Section III.D.

Columns 3 and 4 of Table IV examine the wealth effects of a company's *repeal* of the Wachtell Bylaw. In column 3, the coefficient on the constant is not statistically significant, which shows that for the sample as a whole there is no meaningful share price decline when a company repeals its bylaw. When the independent variable *DE Incorp.* is added in column 4, the coefficient is positive and significant for that variable at the five percent level, meaning that Delaware companies increase in value upon repealing these bylaws. Thus, for repeals, Delaware companies have a larger increase in value than do other companies in the sample. These effects are discussed below.¹⁶¹

We also examined other corporate governance variables for both repeals and adoptions, including variables for the presence or absence of a staggered board. We adopted the same model as in columns 2 and 4, but substituted the variable *DE Incorp.* with a dummy variable indicating the presence or absence of a staggered board. As an added check on our results, we examined whether the level of institutional ownership affects share price reactions using the same model. We found no statistically significant returns related to either of these variables.

These results as a whole show no statistically significant negative reaction to the adoption of these bylaws for the companies in our sample. Delaware companies, however, do increase in value upon repeal of these provisions, perhaps suggesting that for Delaware companies, the bonding to ISS recommendations adopted by institutional shareholders signals a greater adherence to corporate governance practices valued by shareholders.

The small sample size is a substantial limitation for these tests, because it is difficult to exclude the possibility that it is contributing to the lack of significance in our results. We therefore modified our empirical tests to address this problem. This adaptation to our empirical method is described in the next Section.

D. *Companies Subject to Shareholder Activism*

In light of the limitations associated with the small size of our sample of adopters and repealers, we devised an alternative empirical approach.

¹⁶¹ As a robustness check, we ran the same cross-sectional analysis using the S&P 500 and Russell 3000 indices to benchmark for expected returns. For adoptions, we found that companies have negative excess returns when they adopt these bylaws, statistically significant at the 10% level. However, we also found that Delaware companies adopting these bylaws have positive returns, statistically significant at the 10% level. For repeals, the results are similar to those shown in Table III, though with less statistical significance.

While we cannot simply gather a larger sample—as far as we can tell, only the thirty-two companies discussed above adopted the Wachtell Bylaw before the Provident vote—we were able to examine the effect of the availability of the Wachtell Bylaw on a wider set of firms. Because the Wachtell Bylaw is likely to have the most pronounced effect on those firms most likely to undergo an activist challenge, we isolated a set of those firms using the SharkRepellent database. Because the Wachtell Bylaw, like a poison pill, can be adopted immediately if needed, we hypothesized that the share price of firms most subject to activist attack would react to changes in its availability regardless of whether they had in fact adopted it. More specifically, we hypothesized that these firms would experience a reduction in share price on May 13, 2013, when the Wachtell Bylaw became available, and an increase in share price on November 27, 2013, when the availability of the Wachtell Bylaw was constrained by a combination of ISS's policy against it and the demonstrated willingness of shareholders to act in a manner consistent with that policy.

This revised empirical strategy has several advantages. First, by focusing on all companies subject to shareholder activism, we were able to identify a sample of 486 firms experiencing activism from May 8, 2012 (one year prior to the Wachtell Memorandum) through November 25, 2014 (the one-year anniversary of the day before the Provident annual meeting), thus increasing our sample size more than tenfold. Second, by focusing on all activist targets, we eliminated a possible selection effect—that is, that firms adopting the Wachtell Bylaw may be less well governed than those that do not. Third, we also eliminated the possibility of signaling effects—that is, that by adopting the Wachtell Bylaw, firms signaled their general susceptibility to activist attack to the market. Table V reports the frequency of different types of activism for these firms.

Table V: Descriptive Statistics of Activism Types¹⁶²

		Number	%
Proxy Fight	Yes	110	22.63%
	No	376	77.37%
13D Filer	Yes	79	16.26%
	No	407	83.74%
Exempt Solicitation	Yes	54	11.11%
	No	432	88.89%
Other Campaign	Yes	329	67.70%
	No	157	32.30%

Table V shows that hedge funds have at their disposal, and indeed employ, a variety of strategies in shareholder activism campaigns. Proxy Fights, or shareholder activism involving a proxy contest by the activist to either unseat directors or adopt a shareholder proposal, constituted 22.63% of all activism. Activists filing a Schedule 13D with the SEC announcing that they had

¹⁶² The sample is taken from FactSet SharkRepellent as discussed *supra* Section III.A. The variables are defined by FactSet SharkRepellent as follows: Proxy Fight is a campaign

under which a stockholder or group of stockholders solicits the proxy or written consent of fellow stockholders in support of a resolution it is advancing. This usually involves the election of dissident nominees to the company's Board of Directors in opposition to the company's director nominees but may also involve campaigns to approve a stockholder proposal or to vote against a management proposal (including approving a merger).

13D Filer is a "[c]ampaign whereby a member of the SharkWatch⁵⁰ has filed a Schedule 13D with the SEC but the filing does not include any publicly disclosed activism." Exempt Solicitation is a campaign

pursuant to Rule 14a-2(b)(1) of the Securities Exchange Act of 1934 . . . under which a dissident can communicate its views to stockholders without having to comply with SEC proxy filing and disclosure rules. Unlike a contested solicitation (proxy fight), the dissident is not seeking the power to act as proxy for a stockholder and does not provide its own proxy card in its materials.

Other Campaign is

corporate activism made public by activist investors, including hedge funds, and most commonly involve[s] a dissident agitating for changes with the goal of maximizing stockholder value or enhancing corporate governance practices. The value maximizing campaigns attempt to pressure a company to take action to enhance stockholder value, whether by increasing dividends and stock buybacks or by even calling for the breakup or sale of the company itself. These campaigns usually take the form of making communications and letters sent to management at the targeted companies publicly via 13D filings and press releases, and they often also include the threat of a proxy fight for Board seats.

acquired more than five percent of the target company's stock, but who took no further action, constituted 16.26% of all activist cases. Exempt Solicitations, or shareholder activism where the activist communicates to stockholders pursuant to an exemption in the proxy rules to avoid filing a proxy statement, constituted 11.11% of activism. Finally, Other Campaigns, which includes public agitation for change at the target not accompanied by a proxy contest, constituted 67.70% of activism. These numbers exceed 100% because some companies experienced more than one kind of activism.

Table VI contains cross-sectional event studies examining the wealth effects of the Wachtell Memorandum, the ISS recommendation, and Provident shareholder vote on companies subject to shareholder activism during the selected time period.

Table VI: Companies Subject to Shareholder Activism¹⁶³

	Wachtell Memo (5/9/13) (1)	ISS Memo (11/13/13) (2)	Provident Vote (11/27/13) (3)	ISS FAQ (1/13/14) (4)
Constant	0.005 (0.397)	-0.001 (0.808)	0.013 (0.136)	-0.000 (0.980)
Proxy Fight	-0.008* (0.084)	0.002 (0.658)	0.016** (0.020)	-0.000 (0.928)
13D Filer	-0.005 (0.435)	-0.001 (0.850)	0.019** (0.040)	0.004 (0.430)
Exempt Solicitation	-0.003 (0.656)	0.004 (0.480)	-0.009 (0.394)	-0.001 (0.870)
Other Campaign	-0.001 (0.903)	0.003 (0.536)	0.000 (0.960)	-0.001 (0.813)
N	486	457	454	450
R ²	0.85%	0.28%	3.43%	0.35%

We conducted the analysis in accordance with the models in Table IV by calculating the excess returns of each company on the date indicated in each column heading. We then regressed the firm's excess stock return (over the

¹⁶³ Variables are as defined *supra* note 162. P-values are in parentheses with ***, **, and * representing statistical significance at the 1%, 5%, and 10% levels, respectively.

Russell 2000 index return) on the given date against an independent variable denoting whether the firm had been subject to the given type of shareholder activism from May 8, 2012 (one year prior to the Wachtell Memorandum) through November 25, 2014 (the day before the first anniversary of the Provident meeting).¹⁶⁴

We analyzed four event dates in this test. The first is May 9, 2013, the date of the Wachtell Memorandum. The second is November 13, 2013, the first trading date after ISS made its recommendation concerning Provident.¹⁶⁵ The third is November 27, 2013, the date that the results of the voting at Provident were first publicly disclosed. November 27, 2013 was also the day after ISS released a report for its M&A Edge customers, again criticizing these bylaws and releasing the number and names of companies who had adopted them to date. The fourth is January 13, 2014, the date that ISS published a question and answer memorandum in which it definitively announced its policy to recommend a withhold vote for all companies adopting the Wachtell Bylaw or a variation thereof.

We selected each of these four dates because they are significant events with respect to companies' and the market's views on the Wachtell Bylaw. The May 9, 2013 date is the first broad-based announcement that issuers had a mechanism for limiting an activist's ability to adopt a golden leash compensation arrangement. The November 13, 2013 date is theoretically the first signal to the market that ISS, the leading proxy advisor, may consistently oppose the Wachtell Bylaw. The November 27, 2013 date is the first report to the market indicating that institutional shareholders took the ISS recommendation seriously and would incorporate it into their voting decisions on the election of directors. The January 13, 2014 date is the date on which ISS formalized its policy of recommending withhold votes for companies adopting a form of the Wachtell Bylaw. Each of these events could conceivably have informed the market as to whether companies would adopt these bylaws and, depending upon the market's perception of the value of these bylaws, affected stock prices.

The results of these event studies are as follows. The coefficient for the variable Proxy Fight is significant and negative in column 1 of Table VI, indicating that upon publication of the Wachtell Memorandum, firms that had experienced a recent proxy fight or that were about to experience a proxy fight suffered negative returns. This indicates that the market assigned a

¹⁶⁴ In these models, the choice of benchmark returns is irrelevant because all returns are measured on the same date in a given regression. The independent variables are all dummy variables marked as 1 if the firm experiences the type of shareholder activism and 0 otherwise.

¹⁶⁵ ISS issued its recommendation at 5:30 p.m. on November 12, 2013. E-mail from ISS Representative to Provident (Jan. 14, 2015) (on file with authors).

negative value to these bylaws, and perhaps that the market believed that the Wachtell Bylaw would chill wealth-enhancing shareholder activism. In column 3 (the November 27 model), the coefficient for the variable Proxy Fight is positive and significant at the 5% level. However, there is no significance on the variable Proxy Fight in columns 2 or 4.

The net result is that stock prices of companies in our sample decreased upon the release of the Wachtell Memorandum, but increased upon the publication of the results of the Provident annual meeting. This finding is consistent with the theory that the market believed the Wachtell Bylaw to be value-decreasing in companies subject to shareholder activism. In particular, the fact that there is significance in column 3, but not columns 2 and 4, is consistent with the theory that the market viewed the ISS recommendation as a credible force only after institutional shareholders had actually shown a willingness to support it.

Similarly, the independent variable 13D Filer is positive and significant at the 5% level in column 3 and negative in column 1 (though not significant). Though it carries the potential for greater activism, a 13D Filer reflects a lesser form of activism than a Proxy Fight. Therefore, the market reactions for these companies may not be as strongly consistent with our findings.

In comparison, variables for lesser shareholder activism—Exempt Solicitation and Other Campaign—are not significant in any columns. This accords with the theory that only companies greatly impacted by shareholder activism were affected by the change. Because the golden leash directly affects the conduct of a proxy contest, the stock prices of companies subject to such a contest (either historically or prospectively) were more likely to be influenced by the events studied in Table VI.

Table VII reports similar event studies to those in Table VI, but with one exception. The samples are based on firms subject to some form of shareholder activism announced on or after May 9, 2013, the date of the Wachtell Memorandum. Firms subject to activism before this date are included in Table VI but excluded from the analysis in Table VII.

Table VII: Companies Subject to Future Shareholder Activism

	Wachtell Memo (5/9/13) (1)	ISS Memo (11/13/13) (2)	Provident Vote (11/27/13) (3)	ISS FAQ (1/13/14) (4)
Constant	-0.000 (0.972)	0.002 (0.718)	0.013 (0.143)	-0.004 (0.417)
Proxy Fight	-0.008 (0.247)	-0.004 (0.498)	0.017** (0.025)	0.003 (0.422)
13D Filer	-0.001 (0.905)	-0.005 (0.386)	0.019** (0.036)	0.006 (0.272)
Exempt Solicitation	-0.001 (0.899)	-0.000 (0.963)	-0.010 (0.395)	0.003 (0.608)
Other Campaign	0.004 (0.554)	0.001 (0.918)	-0.002 (0.822)	0.000 (0.968)
N	355	342	340	336
R ²	1.08%	0.62%	5.21%	0.81%

In this table, in contrast to Table VI, the coefficient for Proxy Fight is negative but not significant in column 1, and there is no other statistically significant variable in the model. This means there is no statistically significant market reaction to the Wachtell Memorandum (column 1) for the subset of companies that experienced shareholder activism *after* the issuance of the memorandum. However, those companies that experienced shareholder activism after the issuance of the Wachtell Memorandum had a similar reaction to the Provident vote (column 3); the variables Proxy Fight and 13D Filer are positive and significant at the 5% level.

The implication of this finding is that the reaction to the Wachtell Memorandum appears to be concentrated in those firms that had already experienced shareholder activism—perhaps because the immediacy of such activism led the market to anticipate that those issuers were most likely to deploy the Wachtell Bylaw. In contrast, for those companies at which the market simply anticipated future activism, the Provident vote may have conveyed information not just about the availability of the golden leash but also about investors' receptiveness to an activist event.

In unreported results, we also examined the adopters and repealers of the Wachtell Bylaw set forth in Table IV using the same models as Table VII to

determine if the market reacted similarly. We found no significant results, implying that the market assigned different value effects to companies based on their susceptibility to shareholder activism.

Finally, in Appendix A, we conducted a robustness check to further examine our initial findings about the wealth effects of the Wachtell Bylaw, the effect of ISS, and the announcement of the Provident results by performing a matched pair analysis—that is, examining the performance of similarly situated companies with and without shareholder activism. A matched pair analysis allowed us to perform a more precise comparison of how the market perceived the Wachtell Bylaw by eliminating variability due to differences in companies.

Our findings are similar to (or perhaps even stronger than) our main results. In the matched pair analysis, we found that, as in Table VI, the coefficient for the variable Proxy Fight is negative and significant in column 1 of Table A-I, indicating that firms that experienced a proxy fight or that were about to experience a proxy fight suffered negative returns relative to their matched firms that did not experience activism. As in Tables VI and VII, in column 3 the coefficients for the variables Proxy Fight and 13D Filer are positive and significant in both Tables A-I and A-II. However, in Table A-II the coefficient for Proxy Fight in column 1 is also negative and significant, implying that companies subject to future activism also experienced negative returns following the release of the Wachtell Memorandum. This finding suggests that the market may be anticipating the activist events at these firms and valuing the potential of a golden leash compensation arrangement in light of that anticipation.

To summarize our empirical results as a whole, while we could not find a price reaction for those firms that did in fact adopt and repeal the Wachtell Bylaw—due perhaps, to the small number of firms involved—we *did* find evidence in our matched pair analysis of a statistically significant decrease in stock price on the date the Wachtell Bylaw became available to those firms that would later become targets of proxy fights (this evidence was contrary to our findings in Table VII which found that our results were driven by companies targeted for shareholder activism before the Wachtell Memorandum). Similarly, we found that the announcement of the Provident meeting vote was associated with a statistically significant increase in stock price for firms that would become targets of proxy fights as well as those firms that would be subject to 13D filings. We confirmed this finding in a matched pair analysis robustness check.

IV. IMPLICATIONS

Our core findings portray a complex and multidimensional view of corporate governance. Our analysis of the thirty-two adopters and repealers

does not identify a single factor explaining which companies adopted the Wachtell Bylaw. Our empirical analysis fails to demonstrate a price effect for those firms that adopted the Wachtell Bylaw. Nevertheless, we found evidence of a price impact in our analysis of a larger sample of those firms that were most likely to become the targets of future activism. The implications of these findings are presented in greater detail below.

*A. Governance Intermediaries and the Differential
Pricing of Governance Terms*

In Section II.B above, we sketched the role of governance intermediaries in contemporary capital markets where large blocks of shares are held by predominantly passive institutional investors. Unlike disintermediated capital markets in which shareholders actively influence firms' corporate governance choices through the collective pressure of their buy and sell decisions, in contemporary capital markets, governance intermediaries are indispensable agents of innovation and change. On the one hand, our findings support this account, demonstrating the significant influence enjoyed by both Wachtell and ISS, and highlighting areas in which their input is critically needed. On the other hand, our findings suggest a basis to criticize how governance intermediaries presently conduct this vital role.

Our findings reveal the power of both Wachtell and ISS. On May 13, 2013, Wachtell made a public suggestion that was quickly adopted by thirty-two firms. Moreover, our findings show that the Wachtell recommendation influenced far more than the thirty-two firms that ultimately adopted the bylaw. Because the firm made its policy recommendation in the form of a bylaw that could be adopted by any firm at any time, the policy had an immediate market-wide effect, observable even in the share price of firms that had not adopted the bylaw.

However, our findings show that the companies first adopting this bylaw did not appear to have a single or predictable rationale. Although many of the firms were subject to some type of activist interest, the company-specific response may also be explained by network effects or saliency in the market. Perhaps because of this, we did not find significant direct evidence of an immediate price effect associated with the adoption or repeal of the bylaw.

Our findings show that ISS wields similar wide-ranging influence. Not only did its recommendation lead to a large number of withhold votes for Provident directors, its threat to make withhold recommendations against other firms that had adopted the Wachtell Bylaw led to widespread rescission of the bylaw. ISS's threat also led to a statistically significant and economically meaningful increase in share price for those companies that seemed likely to

adopt the bylaw before the Provident vote but that now, following the threat, likely would not.

With regard to ISS, our findings also support the view that investors do not treat everything ISS says with equal weight.¹⁶⁶ We found no market reaction, for example, to the November 13, 2013 policy pronouncement concerning the Wachtell Bylaw that ISS made at the same time ISS issued its withhold recommendation for the upcoming Provident vote. Only on November 27, after 34% of shareholders voted to withhold their votes from the Provident board and ISS threatened withhold recommendations against all other directors who had adopted the Wachtell Bylaw, did the market give effect to the ISS position. Perhaps the initial ISS position did not move the market because the market was unable to gauge how seriously shareholders would take it. Once shareholders validated the ISS position by voting against the Provident board, the market accepted the ISS policy as a meaningful constraint on the Wachtell Bylaw. It is not just what ISS says, in other words, that moves the market. It is when the market believes ISS has credible influence with investors—that is, when investors have demonstrated a willingness to incorporate the ISS position into their voting decisions.

Perhaps most interesting is the way in which these intermediaries interacted to provoke governance reform. The case of the golden leash presents an activist invention (the golden leash), which provoked a corporatist response (the Wachtell Bylaw), which in turn provoked a proxy advisory recommendation, followed by a demonstration by institutional investors that they took the recommendation seriously (the Provident vote). But these roles may be interchangeable. There is no reason, for example, that the corporatist intervention could not come first, as indeed it did with respect to fee-shifting bylaws. In that context, following a decision of the Delaware Supreme Court that seemed to authorize fee-shifting,¹⁶⁷ a group of important corporate law firms—notably, excluding Wachtell—publicly recommended that corporations adopt fee-shifting bylaws.¹⁶⁸ ISS subsequently took a position against the bylaw provisions.¹⁶⁹ Before the issue could be decided by governance intermediaries, however, the Delaware legislature banned the adoption of fee-shifting bylaws.¹⁷⁰

¹⁶⁶ See *supra* notes 62–63 and accompanying text.

¹⁶⁷ *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 559–60 (Del. 2014).

¹⁶⁸ See Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 26–27 (2015).

¹⁶⁹ ISS, UNITED STATES PROXY VOTING GUIDELINES UPDATES: 2015 BENCHMARK POLICY RECOMMENDATIONS 3, 6–7 (2014).

¹⁷⁰ See S.B. 75, 148th Gen. Assemb., Sec. 2 (Del. 2015), [http://legis.delaware.gov/LIS/list148.nsf/vwLegislation/SB+75/\\$file/legis.html?open](http://legis.delaware.gov/LIS/list148.nsf/vwLegislation/SB+75/$file/legis.html?open) [<http://perma.cc/CSD2-2E74>].

Aside from demonstrating their influence and importance, our findings also pose a challenge for governance intermediaries. Presently, governance intermediaries offer market-wide pronouncements. Wachtell, for example, inveighs against activism in all of its forms, and ISS, for its part, applies its governance policies on a marketwide basis.¹⁷¹ Yet our findings suggest that one size does not fit all when it comes to corporate governance. Rather, if markets and companies react heterogeneously to corporate governance terms, the claim that a particular governance term is universally harmful (or beneficial) to shareholders is suspect, and governance intermediaries' marketwide pronouncements to that effect are likely untrue.

Ultimately, our study supports the proposition that corporate governance should be decided on a firm-by-firm basis. Governance intermediaries should not make claims about the universal merits or deficiencies of specific governance provisions or structures, but instead should evaluate the needs of particular firms. Firms, for their part, should engage with governance intermediaries to explain their specific circumstances and demonstrate how their governance structure is responsive to those circumstances. Moreover, firms should assess the impact of governance terms and perhaps adopt them, not in response to governance intermediaries, but based on their relevance to value creation.

B. *Price Discrimination in the Market for Governance Terms*

While we did find evidence for skepticism that companies are correctly adopting corporate governance terms, we also found evidence that the market is reacting to these terms. For the broader sample we observed a statistically significant price effect. Our results thus provide some measure of evidence supporting a key pillar of corporate law theory—at least since Easterbrook and Fischel—that the market prices governance terms.¹⁷²

A more interesting implication of our study, however, lies not in what it says about *whether* the market prices governance terms, but in what it shows us about *how* the market prices governance. Different firms, we found, reacted differently.¹⁷³ Much of the literature discussed above assumes, for example, that separation of the chairman and CEO roles or adoption or repeal of a staggered board provision will have much the same effect across all firms in the market.¹⁷⁴ Our study suggests a contrary conclusion: that governance provisions have heterogeneous effects depending upon firm-specific characteristics and

¹⁷¹ See *supra* note 60 and accompanying text.

¹⁷² See *supra* notes 23–25 and accompanying text.

¹⁷³ See *supra* notes 31–33 and accompanying text.

¹⁷⁴ See James A. Brickley et al., *Leadership Structure: Separating the CEO and Chairman of the Board*, 3 J. CORP. FIN. 189 (1997) (conducting an identical analysis on a set of companies to examine the pros and cons of separating the CEO and Chairmanship role).

investor perception of those characteristics. It offers evidence that in pricing governance terms, investors may focus on those firms most clearly affected by the relevant provision. In our case, protections against activism matter most for firms that investors perceive as likely to be subject to activism, where that perception may be based on recent or anticipated activist activity.

We hesitate to accord great weight to our general pricing conclusions because our study is confined to only one provision in a small subsample of companies. Still, our research both supports existing corporate law theory and provides a basis for further research.

Our fundamental finding is that the market reacted to the availability of the golden leash specifically at those companies that were most likely to experience shareholder activism. This suggests that the market both values and prices governance changes. Our finding that this price effect is limited to potential activist targets, however, raises a broader concern. If investors do not respond to a governance innovation unless and until its effect on a specific firm is both salient and foreseeable, managers may get a free pass for adopting terms that, on a clear day, are viewed as economically insignificant, but that ultimately prove harmful to shareholders.

C. *Activism*

We found a statistically significant and economically important negative price reaction to the Wachtell Bylaw. When the Bylaw was first made available, the price of those firms most likely to implement it declined by 0.8%.¹⁷⁵ And when significant obstacles arose to the adoption of the Wachtell Bylaw, the price of those firms most affected increased by over 1%.¹⁷⁶ What are we to make of the dim view the market seems to take of the Wachtell Bylaw?

One possibility is that the market seems to have a generally favorable view of activists, and is skeptical of tools that weaken them. The Wachtell Bylaw is, as we have shown, a protective measure against a specific activist tactic—namely, the golden leash. It takes away the power to offer special compensation arrangements to director nominees, a power that may be useful to activists challenging recalcitrant boards. As such, the Wachtell Bylaw may be viewed as a board entrenchment tool. The market's consistently negative response to it may be seen as a vote in favor of activism and against entrenchment.

But does the market's apparently favorable view of activism imply that activism is socially desirable? Our results do not address this question. All participants in the debate over activism agree that activist interventions

¹⁷⁵ See *supra* Table VI, Column 1.

¹⁷⁶ See *supra* Table VI, Column 3 (showing a 1.6% increase in price for firms subject to proxy fights and a 1.9% increase for firms subject to a 13D filing).

typically lead to at least a short-term increase in share price.¹⁷⁷ The debate is largely over whether this short-term increase in share price is associated with a longer-term increase in firm value or if, instead, a short-term reshuffling of the business that tends to jeopardize the long-term health of the firm. The debate, in other words, cannot be settled by reference to short-term price effects. Because the debate over the social value of activism takes a longer-term view, our findings cannot and do not address it, and thus cannot assess the social utility of golden leashes.

CONCLUSION

This Article has presented the golden leash compensation arrangement and the bylaw proposed in response to it as a case study of corporate governance innovation in contemporary capital markets. It demonstrates the crucial role played by governance intermediaries—here, law firms and proxy advisors—and documents the role of each in transmitting governance information to the market. Our pricing study shows evidence that share prices reacted to the availability of the golden leash, but primarily at firms that investors perceived as activist targets. Moreover, share prices reacted to the actions of key intermediaries, rather than firm-specific adoptions or repeals. These findings portray a complex picture of corporate governance that is, in some ways, contrary to traditional notions. Governance innovations appear to be filtered through intermediaries that advocate for governance provisions without necessarily considering their effects on a company-by-company basis. Meanwhile, markets seem to pay limited attention to governance innovations that are not viewed as having an immediate payoff.

All of this has important implications for the literature on the price effects of corporate governance terms, the proper role of governance intermediaries, and the ongoing academic debate over shareholder activism. In particular, investors should be skeptical of the sweeping claims of governance intermediaries, and boards should work harder to explain their firm-specific needs both to governance intermediaries and to their shareholder base. Our findings also demonstrate some basis for skepticism of empirical studies that make broad claims about wealth effects that may result from the adoption or repeal of corporate governance provisions.

¹⁷⁷ See Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1087-89 (2015) (reviewing the literature on shareholder activism and noting the general agreement as to short term gains which typically result from such activism); Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 4 J. FIN. 1729, 1756 (2006) (finding short term abnormal returns surrounding the period of announcement).

APPENDIX—MATCHED PAIR ANALYSIS

In this appendix we examined our initial findings about the wealth effects of the Wachtell Bylaw, the effect of ISS, and the announcement of the Provident results by performing a matched pair analysis—that is, by examining the performance of similarly situated companies with and without shareholder activism. A matched pair analysis allows us to perform a more precise comparison of how the market perceived the Wachtell Bylaw by eliminating variability due to differences in companies. Table A-I reports the results of this analysis for all of the companies in our sample.

Table A-I: Companies Subject to Shareholder Activism,
Plus Matched Sample of Non-Activism Firms¹⁷⁸

	Wachtell Memo (5/9/13) (1)	ISS Memo (11/13/13) (2)	Provident Vote (11/27/13) (3)	ISS FAQ (1/13/14) (4)
Constant	0.001 (0.435)	0.004** (0.011)	0.017*** (0.000)	0.001 (0.298)
Proxy Fight	-0.006* (0.083)	-0.001 (0.789)	0.014* (0.053)	-0.001 (0.727)
13D Filer	-0.002 (0.640)	-0.005 (0.278)	0.015* (0.076)	0.003 (0.478)
Exempt Solicitation	-0.000 (0.987)	-0.001 (0.923)	-0.013 (0.199)	-0.002 (0.614)
Other Campaign	0.003 (0.313)	-0.002 (0.472)	-0.004 (0.472)	-0.002 (0.280)
N	972	924	919	913
R ²	0.42%	0.19%	1.03%	0.24%

We again examined each of the four dates analyzed in Tables VI and VII. The dependent variable in each model is the firm's excess stock return on the given date. Independent variables are 0/1 binary indicators of whether a firm was subject to the given type of shareholder activism from May 8, 2012 (one

¹⁷⁸ Variables are as defined *supra* note 162. P-values are in parentheses with ***, **, and * representing statistical significance at the 1%, 5%, and 10% levels, respectively.

year prior to the Wachtell Memorandum) through November 25, 2014 (the day before the release of the ISS recommendation).

Each column adds a matched sample of firms that were not subject to shareholder activism since 2009. Matching firms are based on the closest equity market capitalization of a firm in the same two-digit SIC code on April 8, 2013 (one month prior to the Wachtell Memorandum). Activism firms and/or their matching firms are not replaced if one is delisted after the first event study date.

Similar to our findings in Table VI, the coefficient for the variable Proxy Fight is negative and significant in column 1 of Table A-I, indicating that firms that experienced a proxy fight or that were about to experience a proxy fight suffered negative returns relative to their matched firms that did not experience activism. Again, in column 3 the coefficients for the variables Proxy Fight and 13D File are positive and significant as in Table VI above.

To test the robustness of these findings, in Table A-II we perform a matched pair analysis for companies subject to activism after to the issuance of the Wachtell Memorandum.

Table A-II: Companies Subject to Future Shareholder Activism, Plus Matched Sample of Non-Activism Firms¹⁷⁹

	Wachtell Memo (5/9/13) (1)	ISS Memo (11/13/13) (2)	Provident Vote (11/27/13) (3)	ISS FAQ (1/13/14) (4)
Constant	0.001 (0.487)	0.005** (0.011)	0.017*** (0.000)	0.001 (0.399)
Proxy Fight	-0.009* (0.082)	-0.005 (0.270)	0.015** (0.016)	0.000 (0.913)
13D Filer	-0.002 (0.673)	-0.007 (0.141)	0.016** (0.019)	0.002 (0.682)
Exempt Solicitation	-0.003 (0.704)	-0.003 (0.687)	-0.013 (0.154)	-0.001 (0.783)
Other Campaign	0.003 (0.366)	-0.002 (0.568)	-0.005 (0.207)	-0.004* (0.056)
N	710	682	679	674
R ²	0.58%	0.54%	2.31%	0.59%

Our results mirror those found in Table A-I. As with Table VII, the implication of this finding is that our results in Table A-II are being driven predominantly by companies that experienced shareholder activism after the issuance of the Wachtell Memorandum.

¹⁷⁹ Variables are as defined *supra* note 162. P-values are in parentheses with ***, **, and * representing statistical significance at the 1%, 5%, and 10% levels, respectively.