

TOO MANY NOTES AND NOT ENOUGH VOTES: LUCIAN BEBCHUK AND EMPEROR JOSEPH II KVETCH ABOUT CONTESTED DIRECTOR ELECTIONS AND MOZART'S *SERAGLIO*

*Jonathan R. Macey\**

INTRODUCTION

PROFESSOR Lucian Bebchuk argues that U.S. public corporations should adopt a default rule requiring elections every two years in which shareholders have access to the corporate ballot and the power to replace all directors and in which candidates who receive a significant number of votes are reimbursed for the expense of launching a corporate election campaign. His proposal raises the intriguing question of whether shareholder interests would be better served under this proposal than under the admittedly anemic system of shareholder democracy that currently characterizes U.S. corporate governance.

There is nothing wrong with Bebchuk's policy proposal. Indeed, since it is framed as a default rule that firms would be free to contract around, the proposal seems wholly unremarkable, bordering on uninteresting. Despite the tepid nature of the proposal, it contains several analytical flaws that, while not necessarily fatal, deprive it of much of its appeal. In other words, when stripped of rhetorical flourishes, there is good news and bad news for shareholders in Bebchuk's proposal. The bad news is that it appears to offer little, if anything, that will promote his broad objective of advancing shareholder welfare. The good news is that the proposal is sufficiently modest that it is unlikely to do much damage.

---

\* Sam Harris Professor of Corporate Law, Corporate Finance and Securities Law, Yale University. I am grateful for conversations with Ian Ayres, John Donohue, Yair Listokin, and Alan Schwartz, for the comments and edits of Katie Burke, Norah Cooney, Christine Hyojin Kim, and Jim Zucker, and to the editors of the *Virginia Law Review* for giving me the opportunity to respond this time (see Jonathan R. Macey, *Displacing Delaware: Can the Feds Do a Better Job Than the States in Regulating Takeovers?*, 57 *Bus. Law.* 1025 (2002)).

Due to constraints of time and space, I will focus on what I view to be the three basic but fundamental analytical flaws in the essay's reasoning. These are (a) shortcomings in empirical methodology; (b) failure to recognize the vast difference between the issues involved in removing directors and the issues involved in replacing directors; and (c) failure to understand the true source of legitimacy for U.S. corporate directors. This Response will discuss each of these flaws in turn.

### I. EMPIRICAL METHODOLOGY

"The Myth of the Shareholder Franchise" is based on a particular, succinct empirical claim, namely that shareholder voting power is a myth and that the reality is that shareholders lack the power to replace directors.<sup>1</sup> Bebchuk supports his claim by analyzing the results of an "empirical examination of the frequency and outcome of" contested corporate elections.<sup>2</sup> Bebchuk looks at the ten-year period between 1996 and 2005 and finds that there were 303 contested elections, some of which did and some of which did not involve director contests in which rival slates of directors sought to manage the company that was the target of the contested election.<sup>3</sup>

Thus, in Table 2, the key table in the essay, Bebchuk identifies 118 contested elections for directors in which there were election contests "focusing" on an alternative team for governing the company.<sup>4</sup> In attempting to interpret these empirical findings, Bebchuk asserts out of the blue that "[w]e have seen that the incidence of electoral challenges by a rival team seeking to run the company better is quite small—and successful such challenges are quite rare."<sup>5</sup> The problem is that Bebchuk offers no statistical theory but rather only his own strong intuition to support the implicit existence of the *baseline* necessary to permit him to conclude that there are too few, rather than too many, or just enough electoral challenges in corporate elections.

---

<sup>1</sup> Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 Va. L. Rev. 675, 711 (2007).

<sup>2</sup> *Id.* at 682.

<sup>3</sup> *Id.* at 682–686 & tbl.2.

<sup>4</sup> *Id.* at 686 tbl.2.

<sup>5</sup> *Id.* at 688.

The lack of any baseline for his empirical claim is extremely problematic. He has no explanation for why he thinks 118 contested elections is too few. Still more troubling is the lack of any suggestion whatsoever in the essay that Bebchuk reached the normative conclusion that the number of contested elections was too low *before* he obtained his results rather than in response to them. His argument would be more plausible if he had estimated a baseline prior to starting his analysis.

In fact, it is quite plausible that the number of contested elections is sufficient. Observing the same landscape as Bebchuk, a prestigious business group,<sup>6</sup> a prominent law firm,<sup>7</sup> and a task force of the American Bar Association<sup>8</sup> all reached the opposite conclusion. They found not only that “shareholders do run election contests on a regular basis,” but also that “under the existing [proxy] rules, running an election contest . . . is already a viable alternative and a viable threat.”<sup>9</sup> Significantly, there is no empirical dispute between Bebchuk and these other groups: they do not disagree about what the numbers are, only about what the numbers mean. In Bebchuk’s personal, subjective opinion, the number of contested director elections is too low. Although he does not go so far as to suggest how many contested elections would be sufficient, he obviously thinks the number should be higher, although how much higher is anybody’s guess.

Of course, Bebchuk is entitled to his opinion regarding how many contested director elections there should be. It is not objectionable that Bebchuk holds or defends such a view. The problem is his inference that he has legitimate support in empirical or social science for his opinion. What Bebchuk does is simple: he counts the number of contested elections for directors and asserts that this number is too small. This opinion may be as titillating as, but is entitled to no more deference than, the opinion expressed by Em-

---

<sup>6</sup> Statement of Stephen A. Odland, Chairman, Corporate Governance Task Force, Bus. Roundtable, to the SEC (Mar. 10, 2004), <http://www.businessroundtable.org/newsroom/document.aspx?qs=56A6BF807822B0F13D3419167F75A70478154>.

<sup>7</sup> Letter from Wachtell, Lipton, Rosen & Katz to Jonathan G. Katz, Sec’y, SEC (June 11, 2003), available at <http://www.sec.gov/rules/other/s71003/wachtell061103.htm>.

<sup>8</sup> Letter from the Comm. on Fed. Regulation of Sec., ABA’s Section of Bus. Law to the SEC (Jan. 7, 2004), available at <http://www.sec.gov/rules/proposed/s71903/aba010704.htm>.

<sup>9</sup> Letter from Wachtell, Lipton, Rosen & Katz to Jonathan G. Katz, *supra* note 7.

peror Joseph II and others in the eighteenth century that Mozart's *Abduction from the Seraglio* had "too many notes."<sup>10</sup>

Bebchuk finds further support for his baseline claim that there is not enough competition in elections for corporate directors by finding that smaller corporations tend to be the target of electoral challenges more often than larger corporations.<sup>11</sup> Of course, given that there are far more small companies than large companies, it is hardly surprising that we observe more contested elections among smaller companies. In other words, the reliability of his results is undermined by his failure to control for firm size. Moreover, even if it were true that small firms are more likely to experience contested elections than large firms, this disparity might fully be explained by other factors, such as the existence of alternative disciplinary forces for managers of larger companies that are less costly and more effective than elections.

Bebchuk suggests some other reasons to support his view that there are too few contested director elections. First, he asserts that in light of the "hundreds of firms that restated earnings in recent years, and the large number of companies whose boards elect not to follow majority-passed shareholder resolutions, one would expect to see more challenges by rival teams."<sup>12</sup> With regard to the incidence of restatements, Bebchuk's analysis is incomplete because it fails to consider the obvious fact that the market has a plethora of other ways to discipline weak management that are likely to be both cheaper and more efficient than contested elections for directors. Such elections are expensive and do not lead directly to the desired result: replacement of the management team responsible for the erroneous or fraudulent earnings reports. Specifically, research by Professors Desai, Hogan, and Wilkins found that sixty percent of a sample of public firms that restated earnings in 1997 and 1998 experienced a turnover of at least one senior manager (defined as the chairman, CEO, or president) within twenty-four months of the restatement, compared to only thirty-five percent of comparable firms. Moreover, this research shows

---

<sup>10</sup> A. Peter Brown, *Amadeus and Mozart: Setting the Record Straight*, 61 *Am. Scholar* 49, 53 (1992).

<sup>11</sup> Bebchuk, *supra* note 1, at 686–87 & tbl.3.

<sup>12</sup> *Id.* at 688.

that eighty-five percent of these displaced managers were unable to secure comparable employment with rival firms later.<sup>13</sup>

Similarly, Professor Srinivasan examined the turnover of outside directors who restate their earnings and found that directors of firms that experience financial reporting failures are more likely to lose their jobs. He also reports that outside directors in general, and especially outside directors who are members of the audit committee of the board of a company that is forced to restate its earnings, are not only more likely to leave the board of that company, but also to lose directorships at other companies.<sup>14</sup>

Along these lines, it is worth observing that any shareholder who accumulates more than fifty percent of the shares in a corporation can ultimately obtain control of the board of directors, including complete control, provided that the company does not have cumulative voting. Bebchuk and others argue convincingly in previous work that staggered boards of directors can delay changes in control.<sup>15</sup> But staggered boards are a matter of shareholder choice, and the incidence of staggered boards has been on the decline, indicating that shareholders' preferences are reflected in corporate policy.<sup>16</sup>

Even more problematic is Bebchuk's suggestion that directors should be replaced in the "large number of companies whose boards elect not to follow majority-passed shareholder resolutions."<sup>17</sup> It is not at all clear why directors should be replaced for

---

<sup>13</sup> Hemang Desai et al., *The Reputational Penalty for Aggressive Accounting: Earnings Restatements and Management Turnover 3* (Aug. 17, 2004) (unpublished paper, on file with the Virginia Law Review Association), available at <http://www.fma.org/NewOrleans/Papers/1401148.pdf>.

<sup>14</sup> Suraj Srinivasan, *Consequences of Financial Reporting Failure for Outside Directors: Evidence from Accounting Restatements and Audit Committee Members*, 43 *J. Acct. Res.* 291, 293-94 (2005).

<sup>15</sup> Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 *J. Fin. Econ.* 409, 409 (2005); Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 *Stan. L. Rev.* 887, 887 (2002).

<sup>16</sup> Incidentally, Bebchuk's empirical scholarship on staggered boards does not reflect the baseline bias problem that characterizes his current work on shareholder elections because he is able to look at the incidence of various things (like takeovers) that happen to companies with staggered boards and see how that compares with what happens at companies that do not have staggered boards. In other words, in his previous work on staggered boards, unlike here, there is a control group that provides a baseline. See Bebchuk et al., *supra* note 15, at 926 tbl.2.

<sup>17</sup> Bebchuk, *supra* note 1, at 688.

failing to implement a single-issue resolution. Shareholders may well approve of thousands of decisions made by managers and therefore be unwilling to remove directors who decline to implement a single proposal, despite its approval by a majority. Moreover, the very existence of a large set of companies whose boards elect not to follow majority-passed shareholder resolutions is itself evidence for the vitality of shareholder democracy because it indicates that, at least on occasion, a majority of shareholders are both paying attention to the issues and willing to register their views on those issues. The mere fact that a majority of shareholders occasionally disagrees with directors on particular, discrete issues, however, does not necessarily imply that the shareholders actually want to *oust* the directors entirely. Just as in ordinary politics, reasonable voters may choose to reelect their representatives even if they disagree with those representatives about certain individual issues.

Bebchuk also asserts that there should be “substantial shareholder dissatisfaction in a significant number of the companies that belong, say, to the set of firms performing in the bottom ten percent of their peers.”<sup>18</sup> Bebhuk may well be correct in this observation. However, he fails to provide any insight as to why such dissatisfaction should manifest itself in efforts to remove directors by contested elections, as opposed to other means, such as hostile takeover, failure of the nominating committee to renominate incumbent directors, or pressure from key investors leading to “voluntary” resignation.

With regard to establishing a meaningful baseline, there are several questions worth asking. One question that immediately comes to mind is whether dishonest or incompetent managers already are being replaced through market mechanisms that are cheaper and faster than corporate elections. It is far from clear that it matters *how* poor performers are replaced: whether by internal governance mechanisms; pressure from private equity investors, venture capitalists, or other institutions; hostile takeover; or the mere threat of a contested election (whether or not such a threat ever materializes).

Another question that comes to mind is whether the worst-performing directors are more likely to be replaced than the worst-

---

<sup>18</sup> Id.

performing incumbents in Congress. During the period between 1990 and 2000, House incumbents were reelected at an average rate of 94.1%.<sup>19</sup> And, unlike the data that Bebchuk reports, the reelection trend in congressional elections has been increasing.<sup>20</sup> This trend is particularly interesting given the political context in which rival political parties actually generate rivals for incumbents. In corporate elections there is no similar institutional mechanism for automatically generating opposition candidates. Presumably, these statistics would lead Bebchuk to the conclusion that the U.S. House of Representatives lacks legitimacy due to the lack of evidence that elections to Congress are contested.

## II. REMOVAL VERSUS REPLACEMENT

Another significant disappointment is Bebchuk's failure to recognize the vast difference between the issues involved in removing directors and the issues involved in replacing directors. Removing directors presents few analytical problems, as long as there are enough remaining directors to constitute a quorum. In particular, removing directors avoids the very difficult problem of identifying and recruiting replacement directors. Perhaps Bebchuk is right that directors should be removed more often than they are and that fixing the problem would not be difficult. A default rule requiring majority voting and the use of "withhold" votes, as was done in the Disney election in March 2004, should do the trick.<sup>21</sup>

---

<sup>19</sup> Norman J. Ornstein et al., *Vital Statistics on Congress: 2001–2002*, at 69 tbls.2–7 (2002).

<sup>20</sup> Reelection rates for the U.S. House of Representatives between 1992 and 2004 were as follows: 1992, 88%; 1994, 90%; 1996, 94%; 1998, 98%; 2000, 98%; 2002, 96%; 2004, 98%. See *The Big Picture: Reelection Rates Over the Years*, <http://www.opensecrets.org/bigpicture/reelect.asp?cycle-2004> (last visited Mar. 3, 2007); *American Politics: Congress Reelection Rates, 1966–2004*, <http://www.laits.utexas.edu/gov310/VCE/conreelection/index.html> (last visited Mar. 3, 2007).

<sup>21</sup> Corporate voting rules require that public corporations give shareholders three alternatives: to vote for all of the board's nominees for directors, to withhold support for all such candidates, or to withhold support from certain specified nominees. See 17 C.F.R. § 240.14a-4(b)(2) (2006). In March 2004, Michael Eisner was stripped of his post as chairman of Disney Corporation when forty-three percent of Disney shareholders withheld their votes from the embattled Disney chair, resulting in a decision by the Disney board to split the posts of board chair and CEO. See Michael McCarthy, *Disney Strips Chairmanship from Eisner*, *USA Today*, Mar. 4, 2004, at B1.

Bebchuk does not fully account for two problems with replacing rather than merely removing incumbent board members. First, he provides no explanation for how outside challengers to incumbent boards are to be identified and recruited. Second, even if such directors can be identified and recruited, Bebchuk provides no guidance on the crucial question of how outside challengers for board positions will be able to send a credible signal that they will be able to outperform the incumbent directors.

As for the recruitment problem, it is not easy to find able, experienced, and competent people who are eager to become directors of public companies. In the political framework, democracies have a highly developed system in which two or more political parties recruit, screen, and legitimize potential nominees for political office. There is no analogous process for corporate elections, and it is not obvious how one could be created. Unlike rival politicians, rival board candidates compete along vectors such as competence, experience, and integrity, rather than along vectors such as ideology, interest-group identification, and loyalty. As such, it is far from clear what sort of signaling function might be played by rival parties who nominate candidates in corporate elections.

The role of corporate director is both more time consuming and riskier than ever before. Presumably Bebchuk would not change this trend. Nor would he wish for directors to be held less accountable either to regulators or shareholders than they are now. But in the current environment, a significant number, perhaps as many as half of all prospects, decline offers to serve on boards, even when such offers are made by the companies, not by insurgents.<sup>22</sup> Bebchuk appears to assume away the acute problems of identifying, recruiting, and performing due diligence for potential challengers to incumbent directors.

Second, even to the extent that we are able to locate challengers for board incumbents, it is far from clear how to make such challengers credible candidates for office. As Bebchuk acknowledges, corporate elections are plagued by a variety of collective action and signaling problems. People launching proxy contests for con-

---

<sup>22</sup> See Key Considerations for Serving on a Board of Directors, Advantage (RSM McGladrey, Minneapolis, Minn.), Jan. 2006, ¶ 4, <http://advantage.hanleywood.com/default.aspx?page=article236>.



trol are unable to capture all of the gains that might be realized by shareholders in the event of a change in control because such gains inevitably will be shared among all of the equity claimants. Potential rivals for board seats will not fully internalize the potential benefits from launching such a contest.<sup>23</sup> To the extent that challengers bear the full costs of launching a proxy contest but do not reap the full rewards, some worthwhile challenges will not be launched. Moreover, challengers in proxy contests have a difficult time signaling credibly to shareholders that they are seeking to displace the incumbent directors because they are better managers, rather than for more nefarious reasons.

Bebchuk generally recognizes the existence of these sorts of problems when he writes that:

[S]hareholders cannot infer from a rival team's mounting a challenge that the rival directors would perform better. To begin, even a rival team that believes it would perform better may be acting out of hubris. Furthermore, and very important, a rival's decision to mount a challenge does not even imply that the rival itself believes it would perform better. After all, a challenge could be motivated instead by a desire to obtain the private benefits associated with control.<sup>24</sup>

Bebchuk is absolutely correct in this analysis of signaling problems facing challengers to incumbents in corporate elections. My problem here is not with Bebhuk's analysis, but with his failure to see its implications. First, the signaling and free-rider problems identified here go a long way towards explaining any perceived "deficiency" in the incidence of challenges to board incumbents. Challengers do not fully internalize the benefits of corporate control and thus cannot credibly signal their motivations for seeking such control. If challengers cannot persuade voters that they are not crooks out to loot the target company, it is extremely unlikely that they will be able to persuade voters that they will be able to run the company better than the incumbents.

Second, Bebhuk suggests that the free-rider problem can be addressed by making it easier for challengers to obtain reimburse-

---

<sup>23</sup> See Bebhuk, *supra* note 1, at 689–90.

<sup>24</sup> *Id.* at 692.

ment for the costs associated with mounting a proxy contest.<sup>25</sup> The problem with this proposed solution is that it fails to recognize that, whatever the other merits of reimbursing rivals who attract significant support, such reimbursement will exacerbate, not mitigate, the credibility problems facing challengers. Rational shareholders will understand that if Bebchuk's reimbursement proposal is implemented, challengers will internalize an even smaller share of the costs of mounting a proxy contest for control, but will internalize the same benefits. This, in turn, will provide less-qualified, lower-probability candidates with greater incentives to run, particularly since those candidates with the lowest opportunity costs to their time and effort will benefit most by the prospect of reimbursement for their election expenses.

### III. SOURCES OF LEGITIMACY FOR CORPORATE DIRECTORS

According to Bebchuk, shareholders' lack of meaningful democratic voice, particularly in replacing boards of directors, is a problem because it deprives directors of "legitimacy."<sup>26</sup> This is a deep and fascinating claim, and one wishes that Bebchuk had developed it, at least a little.

Presumably, Bebchuk would acknowledge the reality that corporate directors of public companies in the United States are elected pursuant to established, legitimate state and federal law rules governing the election process. Bebchuk does not, in other words, suggest that the process by which directors are elected does not conform to applicable state or federal statutes or common law rules. Thus, Bebchuk's implicit assertion is that the process by which directors are elected is illegitimate *despite* the fact that it is the very process provided for by state and federal lawmakers.

Perhaps Bebchuk is saying that the elaborate, long-standing, carefully considered statutes pursuant to which corporate directors are elected in the United States are themselves illegitimate. At a minimum, he is making the profound claim that acting pursuant to these statutes is not sufficient to confer legitimacy on corporate di-

---

<sup>25</sup> *Id.* at 693 (suggesting that free-rider problems make it "worthwhile to consider . . . providing reimbursement of costs to rivals who attract significant support but fall short of winning").

<sup>26</sup> *Id.* at 676.

rectors. This assertion raises the question of what election procedures would be sufficient to convey legitimacy in his view. As with the absence of a baseline empirical measure specifying how many contested elections is “enough,” Bebchuk fails to provide any description of what is necessary to convey the legitimacy that he complains is lacking in elections for corporate directors in the United States.

Similarly disappointing is the lack of discussion of whether Bebchuk thinks that *everything* done by U.S. directors is illegitimate, or whether he thinks that some of what they do is legitimate, while other activities are not because of the absence of a legitimate election process. For example, are the managers of U.S. corporations also illegitimate in Bebchuk’s view, because they were appointed to their positions by directors who are not legitimate?

It appears plausible that capital market performance, rather than election results, confers legitimacy on directors. The legitimacy of corporate managers and directors like Jack Welch and Warren Buffett is derived not from their ability to garner votes at election time from shareholders. Rather, their legitimacy comes from their ability to deliver strong returns to investors, after they have been elected in a manner consistent with applicable law. Thus, being elected in a manner consistent with the minimum legal requirements would seem to be a necessary condition for legitimacy of corporate directors, with competence and integrity also being required.

Thus, the development of institutions that prove their effectiveness over time and fulfill the necessary legal prerequisites is both necessary and sufficient to establish the legitimacy of an institution like the corporate board of directors. In contrast, under Bebchuk’s reasoning about legitimacy, federal judges would lack legitimacy because they enjoy life tenure, are never elected, and cannot be removed from office by voters. In fact, federal judges in general, and Supreme Court Justices in particular, have a great deal of legitimacy, yet voters have far less power to replace members of the Supreme Court than shareholders have to replace directors. The prestige and legitimacy of the judiciary in general, and individual judges in particular, depend on judges’ ability to reason effectively and to present powerful and effective arguments for their opinions. As with judges, there is no reason to think that directors’ legiti-

macy comes from the fact of their election rather than from the quality of their performance while in office.<sup>27</sup>

Further support for this point can be found by looking at the legitimacy of currencies like the dollar, the euro, and the yen. Complex factors, including economic strength, underlying political stability, and the perceived independence of the monetary authority contribute to the strength and legitimacy of a particular currency. But there is no evidence or argument supporting the proposition that the legitimacy of an institution like a currency—or a board of directors—depends on whether the underlying currency is subject to democratic constraints. Indeed, the opposite appears to be true: the more independent monetary policy is from democratic institutions, the more stable the underlying currency is likely to be.<sup>28</sup>

Finally, in addition to performance measures of the kind just described, the legitimacy of directors and other important figures in society derives from attaining their positions of power and authority through legitimate means. Thus, for example, when Ben S. Bernanke became Chairman of the Board of Governors of the Federal Reserve System, like his predecessor Alan Greenspan, his initial legitimacy came not from his record of success in effectuating monetary policy, but from the fact that he was properly nominated and confirmed in a process generally conceded to confer democratic legitimacy on nominees.

---

<sup>27</sup> Of course, it is undeniable that a benevolent dictator who stages a violent coup d'état but thereafter abides by the rule of law and promotes equality and prosperity is, nevertheless, an illegitimate ruler. No matter how skillfully a person performs her self-appointed role, the issue of whether she obtained her office via legitimate means, both substantively and procedurally, is always relevant. However, Bebchuk cannot seriously claim that U.S. directors cannot make legitimate claims on their offices because of the insufficiencies that he asserts plague the electoral system. The ineluctable reality is that shareholders support directors in elections that are, as a positive matter, entirely legal and therefore legitimate from the perspective most closely associated with H.L.A. Hart, which is that "law and morality are best kept separate; that rules are the heart and soul of the legal process." Allan C. Hutchinson, *A Postmodern's Hart: Taking Rules Sceptically*, 58 *Mod. L. Rev.* 788, 788 (1995). In other words, because there is an appropriate legal infrastructure that establishes procedures for electing directors, and those procedures generally are followed, the necessary conditions for the legal validity of the election of U.S. directors clearly have been met. Thus, while Bebchuk is free to contest the desirability of the current process for electing directors, his claims about legitimacy are unconvincing.

<sup>28</sup> See Geoffrey P. Miller, *An Interest-Group Theory of Central Bank Independence*, 27 *J. Legal Stud.* 433, 434 (1998).

Interestingly, throughout much of U.S. history, and even in 1913 when the Federal Reserve Act was passed, the idea of a central bank was highly controversial. It was not clear to many whether Congress had the constitutional authority to create a central bank. And initially, as with the move to a single European currency, it was not clear to many whether centralized monetary policy was advisable.<sup>29</sup> The legitimacy of the U.S. central bank does not lie in the Constitution, or even in the democratic foundations of the institution, but rather in the strong historical record of performance and integrity generated over time by the institution. The same is true for boards of directors. In other words, Bebchuk's claim that directors are illegitimate because they are not popularly elected by shareholders and because elections are not transparent or contested goes too far because the same claims can be made with even more force against a host of other institutions, including central banks, cardinals of the Catholic Church, and Supreme Court Justices.

### CONCLUSION

Under U.S. law in all fifty states, shareholders have the power to elect directors and to govern the director nomination process. If desired, shareholders could cause a corporation's organizational documents to align with the voting arrangements that Bebchuk advocates. However, the default rule is not what Bebchuk would like it to be. Under extant state law, there is no statutory shareholder right of subsidized access to a corporation's ballot box of the kind Bebchuk advocates.

Bebchuk argues that the absence of such a right results in too few challenged corporate elections, although he presents no theory or evidence to support this assertion. He presents no method or tool with which to gauge what the optimal number of contested elections would be. Apparently, from Bebchuk's point of view, the more elections the better, regardless of the additional cost. The absence of a baseline for analysis makes it impossible to analyze this claim.

---

<sup>29</sup> See Federal Reserve Bank of Chicago, *Money Matters: The American Experience with Money*, [http://www.chicagofed.org/consumer\\_information/money\\_matters.cfm](http://www.chicagofed.org/consumer_information/money_matters.cfm) (last visited Mar. 3, 2007).

Bebchuk recognizes that rational shareholders have compelling reasons to doubt the motives of outsiders who mount contests to remove incumbent directors. Subsidizing losing contestants will not solve this problem, and would probably make it worse. Moreover, the inability of shareholders to distinguish candidates who will use their control to increase firm value from candidates who will diminish firm value through ineptitude or looting may provide a complete explanation for why we observe so few contested elections.

Bebchuk also argues that flaws in the process of electing directors mean that the election process does not give directors the legitimacy it should. But the legitimacy of corporate directors comes, in the first instance, from the fact that state law confers upon directors both the power and the obligation to manage the business and the affairs of the corporation.<sup>30</sup> Beyond that, legitimacy comes from demonstrating integrity and competence over extended periods of time. A glance at the prestige of national currencies, central banks, and elected and nonelected judges raises serious questions about Bebhuk's assertion that a link exists between legitimacy and the extent to which incumbents are effectively contested by rivals in elections.

Finally, a purely practical note is in order. As Bebhuk correctly observes, the market for corporate control in the United States is hampered by legal rules that make it too easy for boards of directors to enact antitakeover defenses. Such antitakeover defenses exist despite sound economic arguments in favor of robust corporate control. They exist because of the triumph of special interest politics in both state legislatures and judiciaries.<sup>31</sup> In light of the triumph of special interest groups in regulating takeovers, and the lack of any realistic prospects for deregulatory reform of that market, one must ask whether there is any reason to believe that an increased number of director elections will improve accountability in the way Bebhuk speculates that it will.

---

<sup>30</sup> See Model Bus. Corp. Act § 8.01(b) (2005).

<sup>31</sup> See Jonathan R. Macey, *The Politicization of American Corporate Governance*, 1 Va. L. & Bus. Rev. 10, 24–36 (2006).