Securing Our Nation's Economic Future: A Sensible, Nonpartisan Agenda to Increase Long-Term Investment and Job Creation in the United States

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These days it has become fashionable to talk about whether the incentive system for the governance of American corporations optimally encourages long-term investment, sustainable policies, and therefore creates the most long-term economic and social benefit for American workers and investors. Many have come to the conclusion that the answer to that question is no. As these commentators note, the investment horizon of the ultimate source of most equity capital—human beings who must give their money to institutional investors to save for retirement and college for their kids—is long. That horizon is much more aligned with what it takes to run a real business than that of the direct stockholders, who are money managers and are under strong pressure to deliver immediate returns at all times. Americans want corporations that are focused on sustainable wealth and job creation. But there is too little talk accompanied by a specific policy agenda to address that incentive system.

This article proposes a genuine, realistic agenda that would better promote a sustainable, long-term commitment to economic growth in the United States. This agenda should not divide Americans along party lines. Indeed, most of the elements have substantial bipartisan support. Nor does this agenda involve freeing corporate managers from accountability to investors for delivering profitable returns. Rather, it makes all those who represent human investors more accountable, but for delivering on what most counts for ordinary investors, which is the creation of durable wealth by socially responsible means.

The fundamental elements of this strategy to promote long-term American competitiveness include: (i) tax policy that discourages counterproductive behavior and encourages investment and work; (ii) investment policies to revitalize our infrastructure, address climate change, create jobs, and close our deficit; (iii) reforming the incentives of and enhancing the fiduciary accountability of institutional investors; (iv) reducing the focus on quarterly earnings estimates and improving the quality of information provided to investors; and (v) an American commitment to an international level playing field to reduce incentives to offshore jobs, erode the social safety net, and pollute the planet.

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These days it has become fashionable to talk about a subject some of us have been addressing for some time[1]: whether the incentive system for the governance of American corporations optimally encourages long-term investment, sustainable policies, and therefore creates the most long-term economic and social benefit for American workers and investors. Many commentators have come to the conclusion that the answer to that question is no.[2] They bemoan the pressures that can lead corporate managers to quick fixes like offshoring, which might give a balance sheet a short-term benefit, but cut our nation's long-term prospects. They lament the relative tilt in corporate spending toward stock buybacks and away from spending on capital expenditures. They look at situations where corporations took environmental or other regulatory short-cuts, which ended up in disaster, and ask whether anyone is thinking about sustainable approaches. They rightly point to the accounting gimmickry involved in several high-profile debacles and ask what it has to do with the creation of long-term wealth for human investors.

As these commentators note, the investment horizon of the ultimate source of most equity capital—human beings who must give their money to institutional investors to save for retirement and college for their kids—is long. That horizon is much more aligned with what it takes to run a real business than that of the direct stockholders, who are money managers and are under strong pressure to deliver immediate returns at all times. Why can't we, people ask, have corporations focus on the creation of sustainable wealth, by engaging in fundamentally sound and sustainable business investment and operations? And by doing that, create jobs that investors, their children, and grandchildren can have to live well. By that means, end-user investors will have the

1. This paper draws together ideas from a prior series of writings, including: Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759 (2006); Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1 (2007); Leo E. Strine, Jr., *Human Freedom and Two Friedmen: Musings on the Implications of Globalization for the Effective Regulation of Corporate Behaviour*, 58 TORONTO L.J. 241 (2008); Leo E. Strine, Jr., *Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward*, 63 BUS. LAW. 1079 (2008); Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135 (2012); Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449 (2014); Leo E. Strine, Jr., *Making It Easier for Directors to "Do the Right Thing"?*, 4 HARV. BUS. L. REV. 235 (2014); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761 (2015).

2. For a good example of a distinguished academic's succinct thoughts, see Bill George, *Activists Seek Short-Term Gain, Not Long-Term Value*, N.Y. TIMES DEALBOOK (Aug. 26, 2013, 10:56 AM), http://dealbook.nytimes.com/2013/08/26/activists-seek-short-term-gain-not-long-term-value/. For longer arguments of this kind, see COLIN MAYER, FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT (2013); LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS (2012). For an analysis of some of the debate about the evidence, see John C. Coffee, Jr. & Darius Palia, *The Impact of Hedge Fund Activism: Evidence and Implications* 79–80 (Columbia Law & Econ. Working Paper No. 489, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2496518; K.J. Martijn Cremers et al., Hedge Fund Activism and Long-Term Firm Value 27–28 (Nov. 2015) (unpublished manuscript available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231).

main thing they really need, which is a good job. And they will also have a solid investment portfolio to provide for themselves in retirement and to pay for their kids' education. Wouldn't we all be a winner, they ask, with this sort of alignment?

But, too little of that talk is accompanied by a specific policy agenda to address that incentive system. Rather, it is more typical to hear moaning about the bad behavior of certain hedge funds, or the weaknesses of corporate directors who "don't do the right thing." Very little is said about what is really needed to address the incentive system for all the relevant players so that it rationally promotes the alignment of interests that in fact exists between the investment horizon required to optimally run a business and that of ordinary investors seeking to save for retirement.

In this article, I am going to set forth what a genuine, realistic agenda might be that would better promote a sustainable, long-term commitment to economic growth in the United States. This agenda, I will stress, is not one that should divide Americans along party lines. Indeed, most of the elements have substantial bipartisan support. Nor does this agenda involve freeing corporate managers from accountability to investors for delivering profitable returns. Rather, it makes all those who represent human investors more accountable, but for delivering on what most counts for ordinary investors, which is the creation of durable wealth by socially responsible means.

As with any serious policy agenda, it will threaten some vested interests. For those on the right who believe that any measure that might increase taxes on any interest is unthinkable, there will be elements to dislike. For those on the political left who are in the thrall of certain interests, too, such as hedge funds and activist pension funds and their trial lawyer allies, some of the measures proposed would require them to put the interests of the human being investors they represent ahead of moneyed interests that make large political expenditures. But none of what this agenda asks of any interest group would render those interests unable to make large profits or exercise fair influence in the corporate governance realm. It does, however, involve subjecting them to measures that deny them preferential benefits now unavailable to other Americans and changing their incentives so as to diminish the rents they can reap from speculation and skimming.

Because this agenda is serious, it does not duck the key issue of whether tax policy is important if we are going to promote the most long-term investment in American jobs and wealth. The answer to that question is for sure yes.

For one thing, it is impossible to align the incentives of all those whose behavior is relevant without tax policy. As important, our nation has long-term economic challenges that must be addressed by public investment and incentives that can be implemented only if we have the funds to pay for them. Most notably, we have a huge infrastructure and basic research gap that is eroding our competitiveness and diminishing our quality of life. We also cannot be blind to the reality that we need to accelerate our efforts to address climate change and to set an example for the world. With real investments in basic research and infrastructure, we can create jobs in the United States, spark innovation, and enhance the long-term international competitiveness of American companies. At the same time, by good tax policy that addresses behavior we want to have less of, we can use the savings to reform approaches to corporate taxation that are out of line with the rest of the world and that create perverse incentives for American corporations to move operations offshore.

One notable exception to the tendency toward generalities in talking about so-called long-termism was the *Overcoming Short-Termism* report, put out by the Aspen Institute's Business and Society Program and its Corporate Values Strategy Group in 2009. In that short paper, an impressive number of CEOs, leading corporate lawyers, and nonprofit and foundation leaders embraced an agenda to promote America's long-term economic growth. That well-thought out agenda was designed to promote the nation's long-term growth. The Aspen agenda was based on several key principles: (1) creating market incentives to encourage patient capital; (2) clarifying, enhancing, and rigorously enforcing the fiduciary duties of financial intermediaries to better align the interests of the intermediaries and the long-term interests of investors; and (3) giving investors greater and more timely information about the interests of activists who seek to influence corporate policies.[3]

Perhaps because of the inability of Congress to do anything moderately difficult during the period since that paper issued, the Aspen *Overcoming Short-Termism* paper has sat gathering dust. But the increase in rhetoric reflecting support for policies to make sure our society can meet the challenges of the future suggests that a new Administration of either party might, if it had intestinal fortitude and political skill, be able to forge a sensible bipartisan agenda to create jobs, tackle climate change, and ensure America's economic preeminence. Indeed, the question is not whether our nation has the capacity to do this. The question is whether we have the will. If we believe, as I do, that our nation retains the capacity to do great things, then the real question is whether we will muster the maturity and courage to realize that nothing comes easy that is worth having. With minor sacrifices in comparison to prior generations like those who fought a war to end slavery or to defeat fascist aggression, we can secure the American dream for generations to come.

Now, of course, it is my duty to deliver what I have criticized others for failing to do. What are the specifics of an agenda to enhance the long-term competitiveness of the United States for the benefit of American workers and investors, and their children and grandchildren? What will align the mutual interests of ordinary investors and corporate managers in business strategies that involve substantial investment and socially responsible and sustainable practices?

3. Aspen Inst., Overcoming Short-Termism: A Call for a More Responsible Approach to Investment and Business Management 3 (2009) [hereinafter Overcoming Short-Termism].

In my view, such an agenda requires focusing on the fundamental issues identified in the 2009 Aspen report, but with more policy specificity. As I frame things, these are some of the critical elements of any genuine strategy to promote long-term American competitiveness.[4]

A. Tax Policy that Discourages Counterproductive Behavior and Encourages Investment and Work

One problem we have in the United States in any serious discussion of economic progress is our unwillingness to confront a basic truth: you have to pay for things. No one likes to pay taxes. In our weakest moments, each of us would offload the pain of progress on others, and just take the advantages of it for ourselves.

But, prior generations of Americans of both parties were capable of acknowledging the reality that we have to pay for our military, our police, our infrastructure, our social safety net, and others things vital to our well-being as Americans. Any serious effort to make our nation competitive in the long run and to make our corporate governance system one that facilitates long-term investment in the United States itself must be premised on that simple reality.

Without pricing incentives that are sound, it is unrealistic to expect optimal behavior. Without the revenues to pay for them, public investments that are indispensable to continued American preeminence and to meeting the daunting challenge of climate change will not happen.

Happily, though, there are approaches to taxation that are wiser than others. So-called Pigouvian taxes[5] that discourage socially suboptimal behavior can be used to promote more responsible behavior, and to provide the revenues needed for investment and for tax reform that will give businesses more incentives to invest in the United States itself. Central to any responsible tax plan would be measures to discourage speculative trading and to end the oxymoronic definition of a long-term capital gain as involving holding an asset for only one year. So, too, would be reforms to end the windfall to money managers, who are able to

4. In this article, I do not address another key competitiveness risk, which is the failure of our nation to overcome its history of racial discrimination and to promote greater educational and economic opportunity for all its citizens. A long-term risk for our nation is growing divisiveness from unequal outcomes and continuing black poverty. A national strategy to establish, among other things: i) universal pre-kindergarten; ii) full day kindergarten; iii) a 210–220 day school year and schools that are open until 5:30 p.m. and require after-school activities; iv) strategies to support working parents with better work and home balance, such as stable working hour regimens, better quality childcare, and parental leave; and v) a genuine national healthcare system that does not require American employers to bear costs their OECD competitors do not, is essential. American children cannot expect to outcompete their international counterparts with less time on-task. And children with educational deficits and socioeconomic deficits cannot overcome them without more effort. Sweat cannot be avoided.

5. "[A] Pigouvian, or corrective, tax, . . . is a tax designed to make the person who engages in an activity with negative externalities or public harms internalize the costs associated with that activity. The goal is not necessarily to raise revenue but rather to influence behavior." Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. Rev. 440, 474 (2009).

call normal income capital gains. And we cannot duck the duty to do the first best approach to climate change, by taxing carbon directly.

What would a sensible and responsible package look like? First, it would involve a form of a trading tax, as was called for by the Aspen Institute in its 2009 report, and by many economists for years.[6] Such a tax would involve the imposition of less than a 1 percent tax on any securities or derivative trade, whether within or without the retirement system. The average sales tax in the United States on retail purchases is 5.45 percent.[7] In the EU, a VAT tax of 21.6 percent—yes 21.6 percent—is the average.[8] Hysterical claims that a tax of say, one quarter of 1 percent on securities trades and even less on derivative trades, will shut down trading and make our securities markets illiquid are just, that, hysterical and not empirical.[9] Now, it of course may be true that the tax will discourage some trades.

But that is also the point. If there are economic transactions—such as trades based on computer models playing marginal movements in the markets—that depend on pricing so precise that a tax of less than 1 percent will make them not worth doing, I would argue that is a huge benefit. Such trades are not based on sound, fundamental economic thinking; they are ways to seek speculative rents. They increase the volatility and risks of markets without contributing to social welfare. This kind of fractional tax will also put some very modest pricing friction in the equation for ordinary investors, who can now "fund hop" at

6. Overcoming Short-Termism, *supra* note 3, at 1; Letter from Economists in Support of Financial Transaction Taxes (Dec. 3, 2009), http://www.cepr.net/documents/publications/economists-letter-ftt-2009-12.pdf (explaining that "[a] modest set of financial transaction taxes could raise a substantial amount of needed revenue while having little impact on trades that have a positive economic impact"); Alain Sherter, *Time for a Financial Transactions Tax*, CBS Moneywatch (Nov. 4, 2011, 4:48 p.m.), http://www.cbsnews.com/news/time-for-a-financial-transactions-tax/ (noting that "a small tax on securities trades" is supported by, among others, former Federal Reserve Chief Paul Vocker, former Goldman Sachs Chairman John Whitehead, and Bill Gates); Joseph E. Stiglitz, *Using Tax Policy to Curb Speculative Short-Term Trading*, 3 J. Fin. Servs. Res. 3, 5 (1989) (advocating for a "turnover tax," which would "serve to promote economic efficiency by discouraging the excessive expenditures on . . . 'rent seeking'" and would "improve[] economic efficiency at the same time that it raises revenues"); Lawrence H. Summers & Victoria P. Summers, *When Financial Markets Work Too Well: A Cautious Case for a Securities Transactions Tax*, 3 J. Fin. Servs. Res. 163, 174 (1989) ("A transactions tax . . . would not have much impact on long-term investors who invest on the basis of judgments about the true value of assets, it would have significant impact in making it less attractive to invest resources in various short-term prediction activities, since the tax cost would increase the frequency of trading. By encouraging investment research directed at long-term rather than short-term prediction, such a tax might help to solve the conflict noted by Keynes between the privately and socially most desirable investment strategies."); James Tobin, *A Proposal for International Monetary Reform*, 4 E. Econ. J. 153, 155 (1978) (proposing "an internationally uniform tax on all spot conversions of one currency into another, proportional to the size of the transaction").

7. Isaac M. O'Bannon, *National Average Sales Tax at 5.45%, While 201 Localities Changed Indirect Tax Policies*, CPA Prac. Advisor (Jan. 26, 2015), http://www.cpapracticeadvisor.com/news/12038461/national-average-sales-tax-at-545-while-201-localities-changed-indirect-tax-policies.

8. *2015 European Union EU VAT Rates*, Vatlive, http://www.vatlive.com/vat-rates/european-vat-rates/eu-vat-rates/ (last updated Oct. 21, 2005).

9. Many nations already have some version of a trading tax. *See* Leonard E. Burman et al., Financial Transaction Taxes in Theory and Practice 7 (2015) (observing that the majority of G-20 nations have some trading tax, including a tax on stocks in the United Kingdom, China, and Indonesia of 0.5 percent, 0.1 percent, and 0.1 percent respectively).

will.[10] These ordinary investors often sell low and buy high, based on backward-looking news. And the ability to fund hop puts unproductive pressure on mutual fund managers to pursue short-term returns, because however much they should focus on the long term because they are managing retirement savings money, they must also be aware of the short-term ratings that inspire many 401k investors to move their money.

Responsible estimates of what this kind of tax at only 0.1 percent could raise range from an annual average of $44 billion to $130 billion.[11] Coupled with a trading tax, the oxymoronic definition of a long-term capital gain—which is now one year[12]—should be changed to something that is more worthy of the term, such as four or five years. The original Reagan era rate of 28 percent or, even better, a rate equal to the tax imposed on money earned by sweat[13] could be imposed for an investment held for only one year. Primary home sales could be treated differently and given more favorable tax treatment, as the focus here again should be on the capital markets. Consistent with putting sweat and capital on a more level playing field, "2 and 20" reform should be implemented to make sure money managers pay what they should, like other working Americans. A proposal by Republican Congressman David Camp to reform the taxation of carried interest indicated that it would generate over three billion dollars in revenue over a ten-year period.[14]

Another thing that we know, if we are willing to listen to scientists and insurance actuaries who are in total agreement that climate change is real and is driven in large measure by the intensive use of carbon by billions of humans,[15] is that we have to do something substantial to cut our use of carbon. It is hypocritical for the western world, broadly conceived as the OECD nations, to argue

10. *See* Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 Bus. Law. 1, 18 (2010).

11. *See* Dean Baker et al., *The Potential Revenue from Financial Transactions Taxes* (Ctr. for Econ. & Policy Research, Amherst, MA), Dec. 2009, at 1, http://www.cepr.net/documents/publications/ftt-revenue-2009-12.pdf (predicting that "a tax of 0.5 percent on each stock transaction would raise almost $220 billion a year"); Press Release, Office of Rep. Peter DeFazio (D-Ore), Memo: Joint Tax Committee Finds Harkin, DeFazio Wall Street Trading and Speculators Tax Generates More than $350 Billion (Nov. 9, 2011), http://1.usa.gov/KgULbb (estimating that a 0.03 percent trading tax would raise $352 billion over nine years); Burman, *supra* note 9, at 4 ("We find that [a financial transactions tax] could raise a maximum of about $50 billion per year currently in the United States, allowing for behavioral responses in trading.").

12. 26 U.S.C. § 1222 (2012).

13. In 2015, the highest long-term capital gains tax rate was 28 percent. *Id.* § 1(h)(1)(F).

14. William Alden, *House Proposal Would Raise Taxes on Private Equity Income*, N.Y. Times DealBook (Feb. 26, 2014, 4:10 PM), http://dealbook.nytimes.com/2014/02/26/house-proposal-would-raise-taxes-on-private-equity-income/?_r=0; *see also* Andrew Ross Sorkin, *The Surprising Target of Jeb Bush's Tax Plan: Private Equity*, N.Y. Times (Sept. 14, 2015), http://www.nytimes.com/2015/09/15/business/dealbook/jeb-bushs-tax-plan-is-brimming-with-surprises.html?_r=0 (explaining that Republican presidential candidates Jeb Bush and Donald Trump have both advocated closing the carried interest loophole).

15. *See* Ryan Bradley, *Economists, Biologists and Skrillex on How to Predict the Future*, N.Y. Times Mag. (Nov. 10, 2015), http://www.nytimes.com/2015/11/15/magazine/economists-biologists-and-skrillex-on-how-to-predict-the-future.html.

that the way to deal with climate change is to keep the developing world from becoming like us. It will also be ineffective. If the west cannot both set an example and engage in real reductions in carbon usage, our grandchildren and their children will face potential catastrophes and global instability of a kind that would be shameful and nightmarish.

Interestingly, the easiest way to get a carbon tax adopted would be if Congress were comprised entirely of conservative, Republican economists. There is a consensus among them that pricing the externality directly and letting the market respond is the most efficient approach. Often forgotten is that cap and trade was not President Obama's idea; it was the second-best alternative proposed by Republican economists who could not get elected officials to do the first best by the nation.[16] With a mature national discussion, especially during a time of falling gas prices, of this topic, there should be no reason why elected officials of both parties cannot do what is best for the nation. In 2011, the Congressional Budget Office estimated that imposing a carbon tax of $20 per metric ton and increasing it around 5–6 percent a year would yield over a trillion dollars in revenue over a ten-year period.[17]

Taken in its entirety, these tax proposals would do three fundamentally important things: 1) discourage speculative trading and promote long-term thinking by investors; 2) discourage the use of carbon and encourage the development of market strategies for our society to do business and live life in a more environmentally responsible manner; and 3) raise revenues vital to making important public investments and reforming the tax system to make investment in the United States more attractive.

B. Investment Policies to Revitalize Our Infrastructure, Address Climate Change, and Promote the Competitiveness of American Industry

I will now pivot directly from that last point and explain what could be done with the resulting revenues that would promote long-term investment in the United States economy. The first and most obvious use of the resulting revenues would be to revitalize America's infrastructure. For decades now, there has been a bipartisan recognition that the state of our national infrastructure is embarrassing, a drag on our economic efficiency, a contributor to our inability to address environmental issues, and a signal that we no longer can do big things well.[18]

16. *See, e.g.*, Jonathan Zasloff, *Courts in the Age of Dysfunction*, 121 Yale L.J. Online 479, 484 (2012) ("Republicans attacked 'command-and-control' environmental regulation and proposed cap-and-trade systems instead: as soon as Democrats embraced the idea, Republicans opposed it as central planning.").

17. Cong. Budget Office, Reducing the Deficit: Spending and Revenue Options 205–06 (Mar. 2011), www.cbo.gov/publication/22043.

18. *See* Earl Blumenauer & Jim Renacci, *Save America from Falling Apart*, CNN (May 19, 2015), http://www.cnn.com/2015/05/19/opinions/blumenauer-renacci-infrastructure/; Greg Shimokawa, *America's Infrastructure: Can We Smooth Out the Bumpy Regulatory Road?*, 47 Creighton L. Rev. 287, 304–11 (2014).

The American Society of Civil Engineers has given our national infrastructure a grade of D+.[19] Across the board, our report card is not one we would like to bring home to our parents: We received a C grade for rails and ports, a C+ for bridges, and a D grade for roads, schools, energy, transport, and aviation.[20]

Just think what growth, job creation, and ingenuity we could spark if we tackled these challenges. With a smart approach, we could revitalize the ability of American industries to do big things. I don't know about you, but I'm sick and tired of hearing that we cannot build bridges or do big projects anymore without hiring foreign companies. That is pathetic.

Precisely because we know we have to do these things, we should take the opportunity to do them well. We should make sure that infrastructure improvements use green technology that promotes the international competitiveness of American businesses, because they will then be able to take what they have learned in revitalizing American infrastructure and compete to do projects abroad.

These investments will also create American jobs for an obvious reason: when we make investments in our own infrastructure, a major portion of the work must be done here. By addressing a genuine economic and social need of our nation—to make our infrastructure more efficient and environmentally clean—we can therefore provide employment opportunities to American workers, opportunities that will help them gain skills.[21] With deepening concerns about inequal-

19. *America's Infrastructure Report Card 2013*, AM. SOC'Y CIVIL ENGINEERS, http://www.infrastructurereportcard.org/ (last visited June 10, 2016); *see also* AM. SOC'Y OF CIVIL ENG'RS, FAILURE TO ACT: THE IMPACT OF CURRENT INFRASTRUCTURE INVESTMENT ON AMERICA'S ECONOMIC FUTURE 5 (2013), http://www.asce.org/uploadedFiles/Issues_and_Advocacy/Our_Initiatives/Infrastructure/Content_Pieces/failure-to-act-economic-impact-summary-report.pdf ("Overall, if the investment is not addressed throughout the nation's infrastructure sectors by 2020, the economy is expected to lose almost $1 trillion in business sales, resulting in a loss of 3.5 million jobs. Moreover, if current trends are not reversed, the cumulative cost to the U.S. economy from 2012–2020 will be more than $3.1 trillion in GDP and $1.1 trillion in total trade.").

20. *America's Infrastructure Report Card 2013*, *supra* note 19 ; *see also* NAT'L ASS'N OF MFRS., CATCHING UP: GREATER FOCUS NEEDED TO ACHIEVE A MORE COMPETITIVE INFRASTRUCTURE 11 (2014), http://www.supplychain247.com/images/pdfs/NAM_Infrastructure_Full_Report_ 2014.pdf ("In 2012–2013, the United States was ranked seventh overall in competitiveness, trailing mainly northern European nations and Singapore. Its ability to supply basic requirements, such as infrastructure, was lower, at 14th among nations, and its infrastructure quality ranked 25th. Roads, railroads and ports faired similarly, with rankings of 20, 18 and 19, respectively. Aviation infrastructure lagged with a ranking of 30. As our trading-partner nations continue to develop modern, efficient and well-maintained infrastructure systems, the United States will face growing competitive pressures. Despite currently strong competitiveness in general, deficient infrastructure will make it increasingly difficult for domestic firms and workers to compete.").

21. *See* AM. SOC'Y OF CIVIL ENG'RS, *supra* note 19, at 5 (predicting that investing in the United States's infrastructure could create 3.5 million jobs, which is more jobs than have been created in the United States over the previous twenty-two months); Beth Ann Bovino, *U.S. Infrastructure Investment: A Chance to Reap More than We Sow* (Standard & Poor's Rating Servs., New York, NY), May 5, 2014, at 2, http://images.politico.com/global/2014/05/05/sp-usinfrastructure201405.html ("A $1.3 billion investment in real terms in 2015 would likely add 29,000 jobs to the construction sector and will add even more jobs to other infrastructure-related industries. That investment would also likely add $2.0 billion to real economic growth and reduce the federal deficit by $200 million (constant dollars) for that year.").

ity in our economy, generating well-paying jobs for working people is no small benefit in itself.

But investments in infrastructure itself are not all that is needed. As many economists and businesspersons have pointed out, U.S. investment in basic research has declined over the decades.[22] That decline in basic research has involved both the public and private sectors.[23] To address climate change, we ought to be making much greater investments in basic research into solutions that will help us generate the energy we all need and cherish, but in ways that do not use carbon. At this point, we make less real investment in basic research than we did in the Carter years. As Bill Gates and others have argued, this won't cut it.[24]

The economic and human threat posed by climate change may be the world's greatest challenge. We are not moving at nearly the clip necessary. Investments

22. *See* Ashish Arora et al., *Killing the Golden Goose? The Decline of Science in Corporate R&D* 12, 25 (Nat'l Bureau of Econ. Research Working Paper No. 20902, 2015), https://faculty.fuqua.duke.edu/~sb135/bio/w20902.pdf (finding that "the willingness of large firms to invest in scientific capability has declined," including a 66 percent plunge in one research and development metric, "number of publications, weighed by citations received, over R&D stock," between 1980 and 2007); Eduardo Porter, *American Innovation Lies on Weak Foundation*, N.Y. TIMES (May 19, 2015), http://www.nytimes.com/2015/05/20/business/economy/american-innovation-rests-on-weak-foundation.html ("Investment in research and development has flatlined over the last several years as a share of the economy, stabilizing at about 2.9 percent of the nation's gross domestic product in 2012 . . . . That may not be far from the overall peak. But other countries are now leaving the United States behind. And even more critically, investment in basic research—the fundamental building block for innovation and economic advancement—steadily shrank as a share of the economy in the decade to 2012 . . . ."); *National Patterns of R&D Resources: 2011–12 Data Update*, NAT'L SCI. FOUND. (Dec. 2013), http://www.nsf.gov/statistics/nsf14304/pdf/tab01.pdf (observing that although over 50 percent of basic research was federally funded every year from 1953 to 1955, that percentage has decreased from 46 percent in 1985 to 34 percent in 1995 to just 29.8 percent in 2012); *Basic Research: A Declining National Commitment*, NAT'L SCI. BOARD (2008), http://www.nsf.gov/statistics/nsb0803/start.htm?CFID=19504947&CFTOKEN=77172906&jsessionid=f030358c3b740804c2902d346f67587c7e34 ("In 2006 the total expenditure for R&D conducted in the U.S. was about $340B in current dollars. Of this total, basic research account[ed] for about 18% ($62B), applied research about 22% ($75B), and development about 60% ($204B). Over the past decades the U.S. institutions contributing to the output of basic research have shifted dramatically. Although industrial contributions to national R&D now far outpace Federal R&D support, only about 3.8% of industry-performed R&D can be classified as 'basic,' with the remainder devoted to applied R&D. For industry-funded and performed R&D, the basic percentage is about the same for 2006, 3.7%.").

23. *See* Brad Plumer, *The Coming R&D Crash*, WASH. POST (Feb. 26, 2013), http://www.washingtonpost.com/news/wonkblog/wp/2013/02/26/the-coming-rd-crash/ (explaining that "[t]hanks to budget pressures and looming sequester cuts, public spending on basic research "is set to stagnate in the coming decade" and "the private sector won't necessarily be able to pick up the slack" because "private companies tend to under-invest in very basic scientific research, since it's hard for one firm to reap the full benefits from those discoveries"); MIT COMM. TO EVALUATE THE INNOVATION DEFICIT, THE FUTURE POSTPONED: WHY DECLINING INVESTMENT IN BASIC RESEARCH THREATENS A U.S. INNOVATION DEFICIT (2015); Alan Miller, *Why We Must Engage the Private Sector in Climate Change Adaptation Efforts*, WORLD BANK BLOG (Jan. 9, 2014), http://blogs.worldbank.org/climatechange/why-we-must-engage-private-sector-climate-change-adaptation-efforts.

24. *See* James Bennet, *"We Need an Energy Miracle,"* THE ATLANTIC, Nov. 2015, at 56 (explaining Bill Gates's belief that the current investment in research and development regarding carbon emissions are not enough to cut emissions by the necessary amount, which would require that "wealthy nations like China and the United States, the most prodigious belchers of greenhouse gases, must be adding no more carbon to the skies").

in the research and information required to respond to this critical challenge are urgently needed.[25]

But, the cuts in basic research have gone beyond the energy space. These cuts are just as short-sighted. One of America's ongoing strengths is our knowledge base. In a world where we don't want to ever be the cheapest source of labor, we need innovation and the ability to do things smarter. Many of the most important developments in technology of all kinds, be it the Internet, drugs that cure diseases, or in transportation, resulted from government investments in research.[26] A commitment to a great American future requires more substantial investments in research.

With the revenues that could come with smart tax policy would also come the ability to reform our system of corporate taxation to reduce the incentives that our corporations have to offshore operations. Without debating whether the American system of taxing corporations is better than that used in the European Union and other regions, we must acknowledge that our approach is out of step.[27] By adopting the Pigouvian taxes I have mentioned, we would have the revenue to reform corporate tax policies and eliminate the incentive for tax arbitrage that now exists. This will take away an excuse for corporate management to make investments in the United States itself and to create jobs here.

Finally, we do face a long-term challenge of paying for our government, including for the costs that come with an aging population.[28] Revenues raised

25. By responsible accounts, current commitments to reduce carbon emissions fall well short of the reductions that would be required to prevent global temperatures from rising two degrees Celsius. *See, e.g.*, *id.*

26. *See* Christopher Fedeli, *Carpool Lanes on the Internet: Effective Network Management*, COMM. LAW., July 2009, at 1 (noting that "the nation's modern broadband internet network" has "its roots in government research"); Daniel J. Gervais, *The Patent Target*, 23 FED. CIRCUIT B.J. 305, 315 n.52 (2013) ("Computer chips and GPS technology, the Internet—all these things grew out of government investments in basic research. And sometimes, in fact, some of the best products and services spin off completely from unintended research that nobody expected to have certain applications. Businesses then used that technology to create countless new jobs." (quoting Remarks by the President on the BRAIN Initiative and American Innovation (Apr. 2, 2013, 10:04 AM), www.whitehouse.gov/the-press-office/2013/04/02/remarks-president-braininitiative-and-american-innovation)); Howard Mann, *Reconceptualizing International Investment Law: Its Role in Sustainable Development*, 17 LEWIS & CLARK L. REV. 521, 534–35 (2013) (observing the government's large role in the past in investing in research that has resulted in "new technologies, new production facilities, new product chains, etc." and calling on both the government and industry to continue to invest in research); Plumer, *supra* note 23 ("One of the few things Republicans and Democrats have been able to agree on in recent years is that the government should be spending more on basic scientific research—the sort of research that, in the past, has played a role in everything from mapping the human genome to laying the groundwork for the Internet.").

27. *See* Kyle Pomerleau, *Corporate Income Tax Rates Around the World, 2014*, TAX FOUND. (Aug. 20, 2014), http://taxfoundation.org/article/corporate-income-tax-rates-around-world-2014 ("The United States has the third highest general top marginal corporate income tax rate in the world at 39.1 percent . . . . The worldwide average top corporate income tax rate is 22.6 percent (30.6 percent weighted by GDP). By region, Europe has the lowest average corporate tax rate at 18.6 percent.").

28. *See* Cynthia A. Baker, *Governing Choices in the Face of a Generational Storm*, 48 IND. L. REV. 103, 109–10 (2014); Rebecca C. Morgan, *What the Future of Aging Means to All of Us: An Era of Possibilities*, 48 IND. L. REV. 125, 126–28 (2014).

in smart, sensible ways will help us reduce the federal deficit and fund entitlement programs.

As I will point out, these collective moves could also form the basis for OECD-wide discussions to eliminate counterproductive regulatory arbitrage, to reduce carbon usage, discourage speculation and encourage investment, and to fund important entitlement and clean energy programs.

C. Reforming the Incentives of and Enhancing the Fiduciary Accountability of Institutional Investors

The tax and investment moves are, however, not the only policy measures necessary if we are to better position our nation for long-term economic success. In the realm more familiar to those of us in this room—corporate governance—there is much that we know needs doing and has not gotten done. The main problem is in the middle of the corporate governance system. The problem these days is not primarily the separation of ownership from control; it is the separation of ownership from ownership. Human investors saving to pay for college for their children and retirement for themselves have investment horizons that match up sensibly with those of corporate managers trying to develop the next generation of goods and services and create profits from sustainable business plans. But in between these human investors are the money managers who are in fact the fiduciaries of most investors. And these money managers face incentives that are often not consistent with the best interests of either their investors or society as a whole. These incentives incline them toward obsessing over momentary opportunities for advantage and running with the herd, even if that type of behavior is unlikely to be what is ultimately best for their investors.

1. The Need for the Most Rational Investors to Think and Be Heard

Even worse, the voice of the most rational investor—those who invest in index funds and patiently save for retirement—is the quietest in the tumultuous American corporate governance debate. The investment funds that deviate the most from what corporate finance principles suggest is rational—activist hedge funds—are the loudest voices, followed by other funds that engage in active trading.[29] Now, some view this as a healthy dynamic, with the activists proposing, management reacting, and the voice of the center-of-the-plate mutual fund investor deciding on the ultimate outcome. They view the danger that activist hedge funds may induce corporations to take actions that generate short-term stock price increases at the expense of greater risk of firm failure and lower long-term investment as minimized by the reality that the bulk of the stock-

29. *See* Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. Corp. L. 51, 82 (2011); Paul H. Edelman et al., *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. Cal. L. Rev. 1359, 1408–09 (2014).

holder vote is wielded by mainstream mutual funds, most of whose investors are retirement savers. As they see it, mutual funds will tend to vote on the business merits, with an orientation toward supporting only changes that will make the corporation more valuable in a sustainable and fundamentally sensible manner, and not corporate finance gimmicks that involve excess leverage or shell games that do not generate truly greater durable value.[30]

But the segment of the investment community that is best positioned to vote with an eye toward sustainable value creation is the least active in exercising voice and judgment in American corporate governance: index funds. Although the huge mutual fund complexes have systems in place to make voting decisions, these decisions generally flow down to all funds on an issuer by issuer basis. In the past, this has led to index funds voting both yes and no on the same merger—voting their target shares yes because of the premium and voting their acquirer shares no because the merger is deemed to be value destructive for the acquirer. This is, of course, incoherent, stupid, and reflective of a lack of judgment being exercised by the index fund on behalf of its specific investors and their interests.

Precisely because index funds do not sell stocks in their target index, those funds have a unique interest in corporations pursuing fundamentally sound strategies that will generate the most durable wealth for stockholders. Index fund investors do not benefit by bubbles that burst. Index fund investors also have a more durable interest in the prospects of the corporations in the index than investors in actively traded funds. Actively traded funds turn over at a rate which makes it difficult to believe that their managers are basing their decisions on a genuine assessment of the corporations' long-term cash flow prospects as opposed to their speculation about where the market is heading. When these funds are unlikely to hold a stock for much longer than a year,[31] it is not obvious why they would think deeply about the implications of proposed action on a time horizon that in the real world of business is not that long term—five years—much less that they would consider where the proposed action would leave the corporation in a decade. Of course, in many mutual fund complexes, voting on issues that do not involve specific transactions such as mergers, but rather ongoing issues like corporate governance proposals, executive compensation, and even director elections, is not directed by the actual fund managers who buy and sell stocks, but by less highly compensated employees who work on proxy voting.[32] At smaller mutual fund complexes, voting is

30. *See* 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, 896–99 (2013) (arguing that activist proposals are successful only when mainstream institutional investors support them).

31. *See* Martijn Cremers, Ankur Pareek & Zacharias Sautner, Stock Duration and Misvaluation 2–4, 10–13 (Dec. 2014) (unpublished manuscript available at http://ssrn.com/abstract=2190437) (finding that the weighted average length of time that *all* institutional investors, *including index funds*, held a stock in their portfolio was only 1.5 years in 2010); *see also* Strine, *Can We Do Better*, *supra* note 1, at 478–79.

32. See Charles M. Nathan, *The Parallel Universes of Institutional Investing and Institutional Voting*, HARVARD L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 6, 2010, 9:01 AM), http:// blogs.law.harvard.edu/corpgov/2010/04/06/the-parallel-universes-of-institutional-investing-and-institutional-

more likely to be influenced by outside proxy advisory firms, such as ISS and Glass Lewis.[33]

If the mainstream investor community is to act as the sensible representative of durable stockholder value, it must represent investors more faithfully in the corporate voting process. Modest steps in that direction would include:

- Requiring index funds to do independent thinking and to vote in a manner that reflects the distinct investment philosophy of their investors and their strong interest in sustainable value creation;
- Precluding index funds from relying upon proxy advisory firms that do not provide index-fund-specific guidance; and
- Requiring mutual funds accepting 401(k) and college savings investments to have voting policies that take into account the long-term focus of their investors and their need for durable wealth creation.

These mundane changes are critical if our corporate governance system is not to become one in which more influence is wielded by the definitionally irrational, in a market where more of the actual invested capital is invested in the rational way, through index funds.

There are, of course, ideas in this area that might be more powerful. For example, oceans of ink have been spilled on making sure that the managers of listed corporations are paid in a manner that is linked to the performance of their companies' stock price, and increasing attention paid to making sure that they are only rewarded for durable increases in stock value. Most ordinary investors' fiduciaries are the managers of their mutual funds.[34] Little has been done to encourage, much less require, that mutual fund manager compensation be tied in large measure to the durable increase in value of the fund they manage or that the mutual fund managers be compensated largely in restricted shares of their funds. Increasing the alignment of interests between mutual fund investors and mutual fund managers in increasing the durable value of the fund would seem to be a useful avenue to go down.

As Americans are forced, as a matter of reality, to give their money to mutual fund complexes to save for retirement, the percentage of the voting power held

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voting/#10b (noting that many larger investment managers have internal staffs dedicated to voting all portfolio companies' shares and that this staff "typically is entirely separate from the portfolio managers and reports either to the general counsel or senior compliance officer of the investment manager, not to the investing function").

33. *See* Stephen Choi, Jill Fisch & Marcel Kahan, *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 Harv. Bus. L. Rev. 35, 52–53 (2013) (finding that small funds were more likely to rely on recommendations from proxy advisors such as ISS than were larger funds).

34. *See* John C. Bogle, The Clash of the Cultures: Investment vs. Speculation 29–31 (2012) (explaining that the giant aggregations of capital by mutual funds and pension funds resulted in a "second agency" and that "[t]oday, these agents have become by far the dominant owners of U.S. corporations" and they owe a fiduciary duty to their principals, the mutual fund shareholders and pension beneficiaries).

by index funds will continue to grow.[35] This can be a very positive thing, because it aligns the interests of the end-user investors, corporations, and society as a whole in sustainable wealth creation. But that alignment will produce positive results only if those who control the index funds are required to think and vote in a way that is faithful to the interests of those whose money they control.

2. The Need to Make More Appropriate Investment Opportunities Available to 401(k) Investors Focused on Long-Term Gains

For the longer term, it would also be useful to try to provide ordinary 401(k) investors with additional investment choices that better fit their interest in sustainable returns for sound investing, rather than more chances to invest in actively traded mutual funds that chase above-market returns. Aside from index funds and variable annuities, most of the investment products offered to 401(k) investors are not well tailored to their investment horizons. When you are twenty-five years old and putting away money that you effectively will be unable to touch until you are at least fifty-nine unless you are willing to pay confiscatory rates of taxation, you are well positioned to be an investor whose capital is committed for a lengthy period of time. There is a type of institutional investor whose investment approach fits well with retirement investors—private equity funds—but regulatory barriers effectively lock 401(k) investors out of that market.

If 401(k) investors were permitted to contractually commit a percentage of their retirement funds for periods of up to ten years, then the private equity industry might be incentivized to develop vehicles in which ordinary investors could participate, because the overall inflows into 401(k) funds every month are massive and growing.[36]

Compared to the typical actively traded mutual fund, private equity funds are much more patient investors.[37] They are not focused on quarterly earnings growth, but on making the companies they purchase more valuable over a period of several years, if not a decade.[38] For 401(k) investors, the investment ap-

35. *See* Choi, Fisch & Kahan, *supra* note 33, at 37 (noting that mutual funds currently have 29 percent of the voting power in publicly traded companies, a percentage that continues to grow).

36. See Peter Brady, Kimberly Burham & Sarah Holden, The Success of the U.S. Retirement System 30 (2012), http://www.ici.org/pdf/ppr_12_success_retirement.pdf (noting that, in mid-2012, there was $3.3 trillion in assets in 401(k) plans in the private sector, and that the number of active participants in 401(k) plans increased from 17 million in 1989 to 51 million in 2010).

37. *See, e.g.*, Josh Lerner et al., *Private Equity and Long-Run Investment: The Case of Innovation* 29–32 (Nat'l Bureau of Econ. Research Working Paper No. 14623, 2008), http:// www.nber.org/papers/w14623.pdf (finding that firms pursue more influential innovations and that patent quality increases following investments by private equity firms, indicating a focus on long-term research and development).

38. Although this article is largely directed at the incentive system for the boards of public companies, and not their conduct itself, that is not to say that public company boards could not do better. For example, many public companies continue to give quarterly earnings guidance and engage in disparate ways of accounting for their cash flow. Several years back, I advocated what I continue to consider a sensible requirement: no company should be able to give quarterly earnings guidance unless that guidance is within the framework of a publicly disclosed long-term plan for the company's future

proach and horizon of private equity—which focus on a period of five to seven years[39]—make more sense intuitively and from a matter of corporate finance theory than actively traded mutual funds that turn over their portfolios rapidly and that do not buy stakes influential enough to change corporate policies. If investors are going to try to exceed the market average, why not do it in a way that makes sense, by investing in a private equity fund that takes nondiversifiable risks by buying control and trying to improve the value of portfolio companies and, if successful in that effort, obtaining an above market return in exchange for taking on that risk? No doubt that the private equity industry would have to itself consider how it could structure vehicles that would allow it to raise the sums of committed capital necessary for it to pursue its traditional technique of buying actual companies and transforming their operations in a manner intended to increase their profitability.[40] But, given the massive and growing cash flows into 401(k) plans, and the decline of traditional defined benefit pension plans, the industry would seem to have a strong incentive to do that, whether by facilitating the formation of "funds of funds" for 401(k) investors, or creating innovative models for accepting capital directly from smaller investors.[41]

3. The Need to Reduce the Number of Votes so that Good Decisions Can Be Made and Unnecessary Costs Can Be Avoided

If stockholder input is to be useful and intelligent, it needs to be thoughtfully considered. Not only that, it simply raises the cost of capital to require corporations to spend money to address annually an unmanageable number of ballot measures that the electorate cannot responsibly consider and most investors do not consider worthy of consideration. Although certain institutional investors have staffs who have jobs and influence largely because of the proliferating number of votes that stockholders are asked to cast and although this proliferation

operations. *See* Strine, *Toward Common Sense*, *supra* note 1, at 16 (suggesting "a requirement that quarterly earnings estimates be deemed misleading and therefore prohibited unless they come in the context of a fully disclosed long-term plan for the growth of corporate earnings").

39. Ronald W. Masulis & Randall S. Thomas, *Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives on Corporate Governance*, 76 U. Chi. L. Rev. 219, 222 (2009) (noting that private equity funds are generally set up as private limited partnerships with ten-year terms and seek to exit their investments by the end of their terms).

40. For example, there are difficult timing issues for an investor entering a fund in midstream given valuation issues, dilution problems, diversification, and disclosure.

41. To further protect long-term investors, we also ought to consider "restoring the sophisticated investor exception to allowing Thurston Howell to lose his fortune, and requiring pension, charitable, and governmental investment funds to invest only through investment advisors covered by the 1940 Act." Strine, *One Fundamental Corporate Governance Question*, *supra* note 10, at 18–19. The reality is that this exception was intended to allow really rich people to do whatever they wished. It was not for regional pension funds or charities to risk their beneficiaries' fate on unregistered investments. Given the mountain of money in this sector, the investment fund community would have to adapt to become more transparent. That would be a good thing. At the very least, we ought to consider "prohibiting pension, charitable, and governmental investment funds from relying on the advice of proxy advisory services unless those services give voting advice based on the economic perspective and goals of an investor intending to hold her stock for at least five years." *Id.* at 19.

guarantees that proxy advisory firms will have a market for their services, those are classic examples of agency costs that stockholder activists would deplore if they were caused by corporate managers rather than money managers. How actual end-user investors or corporate performance are aided by having a ridiculous number of votes each year is harder to understand. Mainstream mutual fund managers deplore the number of votes and recognize that they cannot rationally focus on all of them.[42]

One obvious answer involves the radical notion that if stockholders can be trusted how to vote, they should also be trusted to determine whether it makes sense to vote at all. One fundamental test for those who say they believe in stockholder choice, therefore, is whether they would be prepared to eliminate the mandate imposed by federal regulators in the 1980s that essentially required institutional investors to vote on every measure.[43] That mandate generated the market for ISS, not because institutional investors believed that ISS would improve their investment performance, but because ISS gave them a way to meet a regulatory mandate under ERISA. That mandate also created, along with other recent changes, a change in inertia from one favoring the status quo (because any proponent of change had to mobilize the electorate to actually come out and vote in favor of their proposals) to one making change easier (because the electorate had to vote and the proxy advisory firms empowered by that reality were responsive to the most activist investors).[44] If advocates of stockholder choice truly trust stockholders, they should permit them to make a considered decision when to vote, including the categorical decision that they will not vote on certain types of proposals.

42. *See* Susanne Craig, *The Giant of Shareholders, Quietly Stirring*, N.Y. Times (May 18, 2013), http://www.nytimes.com/2013/05/19/business/blackrock-a-shareholding-giant-is-quietly-stirring.html (noting that "[d]uring the 2012 proxy season, BlackRock voted shares on 129,814 proposals at 14,872 shareholder meetings worldwide" and because of the huge volume of votes BlackRock must cast, they are not able to assign an analyst to every proposal and use advisory services of ISS and Glass Lewis to help identify issues).

43. *See* 29 C.F.R. § 2509.08-2 (2016).

44. Another example of the change in inertia includes the 2009 amendments to the New York Stock Exchange rules that eliminated discretionary broker voting for the election of directors. *See Self-Regulatory Organizations, Exchange Act Release No. 34-60215*, U.S. Sec. & Exchange Commission 1–2 (July 1, 2009), http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf (approving "proposed rule change . . . to eliminate broker discretionary voting for all elections of directors at shareholder meetings held on or after January 1, 2010"). Before the 2009 amendments, brokers were given the discretion to vote the shares of beneficial owners who did not return voting instructions to the broker. *Id.* at 2. Brokers almost always voted those shares with management. *See id.* at 6 ("In the view of some commenters, brokers tend to vote in accordance with management's recommendation."). That was an intuitively sensible voting decision because a stockholder who elected to purchase stock in a specific individual company probably did so because she liked the company and its management's direction and believed that the stock was a good investment. Because getting all the small investors to turn in proxies is difficult, the result of the rule change is to reduce the pro-management vote. Indeed, the rule change was described by the *Wall Street Journal* as "a major win for activist investors." Kara Scannell & Dan Fitzpatrick, *SEC Plans to Win Broker Vote Rule in Win for Activists*, Wall Street J. (Apr. 24, 2009), 12:01 AM), http://online.wsj.com/news/articles/SB124052371403949911(noting because many small shareholders do not vote their shares, the rule change will give more power to activist and institutional investors).

At the very least, however, if we are going to continue to mandate that institutional investors vote on everything, then it is important that they be mandated to vote in a manner consistent with their investors' interests and also that the number of stockholder votes not overwhelm the capacity of the institutional investor community to actually think in a serious manner about how to vote. But, the present system involves too many votes for the institutional investor community to address thoughtfully and creates a rational basis to suspect that even proxy advisory firms cannot afford to employ enough qualified analysts to provide a genuinely studied recommendation on every vote. Modest moves toward a more sane approach follow.

4. Having Stockholders Vote on Executive Compensation on a Triennial or Quadrennial Basis Consistent with the Rational Time Frame for Employment Arrangements

When the non-binding say-on-pay vote was mandated by Congress, flexibility was granted to hold the votes on less than an annual basis.[45] Because executive compensation should be designed to provide top executives with appropriate incentives to manage well and create sustainable increases in corporate value, it seems counterintuitive and counterproductive that compensation arrangements should run on annual terms, with constant tinkering and changing of key provisions. Rather, one would think that what the compensation committees should do is to bargain for and set employment contracts with a reasonable length during which to assess the contribution of management to the corporation. Likewise, if stockholders are going to be given voice in those arrangements, their voice should be exercised in a mature fashion consistent with the actual arrangements that will be binding on the corporation and their sensible length.

Having a say on pay vote at each corporation every third or fourth year not only would be more consistent with the appropriate contractual term, it would also allow for more thoughtful voting by institutional investors. Because a third to a quarter of firms would have their arrangements come up for a vote every year, institutions could concentrate their deliberative resources more effectively. And because the votes would come periodically, the institutions would have developed a track record regarding the corporation's prior approach to compensation, which would provide useful context for considering the new compensation plan up for approval.

But, at the urging of ISS and more activist institutions, the "market" standard is to have say-on-pay votes annually on a schedule that bears no rational relation to the time frame for the contracts granted to top managers.[46] This has led to

45. *See* 15 U.S.C. § 78n-1 (2012) (requiring that "[n]ot less frequently than once every 3 years" a company "include a separate resolution subject to shareholder vote to approve the compensation of executives" in proxy materials for a shareholder meeting).

46. *See* James F. Cotter, Alan R. Palmiter & Randall S. Thomas, *The First Year of Say-on-Pay Under Dodd-Frank: An Empirical Analysis and Look Forward*, 81 Geo. Wash. L. Rev. 967, 983 (2013) ("ISS almost always recommended in favor of annual say-on-pay votes and . . . shareholders at 1347 companies in our sample . . . supported annual say-on-pay voting, compared with shareholders at only

situations where in one year, a corporation's executive compensation plan was approved by over a 90 percent margin, but voted down the next year despite the terms of the plan itself being materially unchanged.[47] This is immature and counterproductive. It is not a vote on pay policy, it is a vote on current company performance and the outcome is heavily dictated by ISS's recommendation.

There are two rational explanations for this and neither is comforting. The first is that the negative vote in the second year was not a reflection on whether the terms of the executive compensation plan were fair and appropriate, but rather on the fact that the corporation had suffered some economic adversity and the stockholders were expressing their generalized outrage by voting no on the pay plan. The second is that the prior year's vote on the compensation plan had been "mailed in" by the electorate who had not focused upon it, and so it was only in the succeeding year when they (or, as the data suggests, the leading proxy advisory firm) bothered to examine carefully the terms of the plan. Neither scenario reflects well on our corporate governance system, especially when that system gives stockholders an annual right to vote for directors. The strong empirical evidence that the most influential explanatory factor for the outcome of say-on-pay votes is the recommendation made by the most influential proxy advisory firm instead of any factor directly related to the design of a pay plan suggests that the capacity of investors to think carefully about how to vote currently is overwhelmed by having annual say-on-pay votes at almost all listed companies. If the say-on-pay vote was really intended by its advocates to just be an outlet for stockholders to express generalized dismay, then they should say so and confess that they did not share their real motivations with Congress. By contrast, if the purpose of the say-on-pay vote was to provide stockholders with a powerful and reasoned voice about a key area of corporate decision making that has an important incentive effect on corporate policy—the terms on which top managers are paid—its advocates should want a system of say-on-pay voting that optimizes the chances that compensation committees will develop sound

123 companies supporting triennial voting. In other words, say-on-pay promises to be an annual event at most larger public companies."); *see also* Equilar, 2013 Voting Analytics Report 19 (2013), http:// www.equilar.com/knowledge-network/research-reports/2013-research-reports/2013-voting-analytics-report.php ("There has been overwhelming support for the annual vote on compensation, particularly at the largest public companies. While nearly 81% of Russell 3000 companies have an annual advisory vote on compensation, 94% of the S&P 500 holds the Say on Pay vote annually.").

47. As I observed on a previous occasion:

> The say on pay votes at a number of companies changed radically from 2012 to 2013. What seems to have changed most was not the underlying compensation plans themselves, which remained materially unchanged, but ISS's reaction to the actual pay generated by the terms of the plan it had recommended in favor of the previous year in comparison to how well the corporation's stock price had performed. At Biglari Holdings, Inc., for example, eighty-seven percent of stockholders voted in favor of the compensation plan in 2012 but only thirty-three percent of the stockholders voted in favor of the plan in 2013 after ISS recommended against the plan.

Strine, *Can We Do Better*, *supra* note 1, at 486 n.107 (citing Georgeson, Facts Behind 2013 Failed Say on Pay Votes tbl.II (July 29, 2013), http://www.georgeson.com/us/resource/Pages/Georgeson-Reports/July-29-2013.aspx).

long-term compensation plans for consideration by stockholders, and that stockholders themselves—and not just proxy advisory services—will give thoughtful feedback about them, both in advance of and in the form of a vote.

5. Ensuring that Proponents of Corporate Action Share in the Costs They Impose on Other Stockholders

Law and economics adherents understand that when someone can take action that is personally beneficial and shifts the costs to others, he will tend to do so more than is optimal for anyone other than himself. Most investors would prefer that corporate managers not be distracted by the need to address shareholder votes unless those votes are about issues, such as a merger, that are economically meaningful to the corporation's bottom line. Under current law, however, a stockholder need only own $2,000 of a corporation's stock to put a nonbinding proposal on the ballot at the annual meeting of an American public corporation and need pay no filing fee.[48] By putting a proposal on the ballot in this way, a stockholder will necessarily require the corporation to spend hundreds of thousands of dollars on legal, administrative, and other costs, and require all other investors to bear the costs of having to have their money manager agents spend time and money considering how to vote and ultimately casting a vote. And even a stockholder whose proposal has failed miserably can resubmit an identical proposal at the expense of the company's other stockholders.[49] The SEC requires the company to put a proposal that has failed once before on the ballot again unless it has been defeated within the past five calendar years by a vote of more than 97 percent—redolent of Ceausescu-style vote rigging.[50]

These nonbinding votes, of course, come on top of the plethora of other votes shareholders are called upon to cast each year, including the annual vote on directors, the say-on-pay vote, votes to approve performance-based compensation required by federal tax law,[51] binding votes on certain equity issuances that are required by the stock exchanges,[52] votes to retain the company's

48. 17 C.F.R. § 240.14a-8(b)(1) (2016); *see also* Strine, *Breaking the Corporate Governance Logjam*, *supra* note 1, at 1100 (citing 17 C.F.R. § 240.14a-8(b)(1)).

49. 17 C.F.R. § 240.14a-8(i)(12) (2016) (detailing requirements for resubmission).

50. *Id.* The SEC permits a company to exclude a submission from its proxy materials only in very limited circumstances. If the proposal has only been proposed once within the preceding five calendar years and received less than 3 percent of the vote, then it can be excluded. *Id.* If the proposal has failed twice within the preceding five calendar years, and on its last submission received less than 6 percent of the vote, the company can exclude the proposal. *Id.* The company can also exclude a proposal that has failed three times within the preceding five calendar years if on its last submission it received less than 10 percent of the vote. *Id.* No matter how many times a proposal has failed in the more distant past, a company cannot exclude a proposal if it has not been submitted within the preceding five calendar years. *Id.*

51. 26 U.S.C. § 162(m) (2012) (requiring shareholders of public companies to approve any performance-based compensation, including options, for CEO and four highest paid employees for compensation to fall within an exception that allows public companies to deduct that compensation even if it exceeds general limit on deductible compensation for those employees of $1 million).

52. *E.g.*, NYSE Listed Company Manual § 312.03(c) (2015) (requiring, for example, a shareholder vote to approve an issuance of common stock equal to or in excess of 20 percent of the voting power outstanding before the issuance).

auditors,[53] as well as state law requirements that stockholders approve certain key transactions, such as mergers[54] and very substantial asset sales.[55]

In many states, candidates for office are required to pay a filing fee tied to a percentage of the salary of the office they seek. In California, for example, a United States Senate candidate must pay a fee equal to 2 percent of the salary of a Senator, or $3,480, and a candidate for even the State Assembly must pay a filing fee equal to 1 percent of his or her salary, or nearly $1,000.[56] Given the economic motivation of investors and the absence of larger reasons that exist to foster candidacies in election in actual polities, requiring sponsors of economic proposals filed under Rule 14a-8 to pay a reasonable filing fee to bear a tiny fraction of the much larger costs their proposal will impose on the corporation (and therefore other stockholders) seems a responsible method to better recalibrate the benefit-cost ratio of Rule 14a-8. For example, the SEC could impose a modest filing fee of $2,000, or even $5,000, for any stockholder proposal addressing economic issues and increase the holding requirement to a more sensible $2,000,000,[57] while still allowing proposing stockholders to aggregate holdings if they make appropriate disclosures. If the advocates of a proposal cannot put up $2,000 to $5,000 and find other investors with an ownership interest of at least $2,000,000, they have no right to force other stockholders to subsidize the cost of their desire for voice, when our free society gives them many other ways to exercise their free expression rights. Likewise, corporations should be permitted to exclude from the Rule 14a-8 proxy proposals in later years if they do not get at least 20 percent affirmative support in their first year, and if after the first year, they obtain less than 30 percent support. None of these proposals, of course, would preclude proponents from using their own resources to fund a proxy contest to propose a bylaw, but it would reduce the ability of stockholders to use corporate funds (and thus indirectly the capital of other stockholders) on a subsidized basis to press initiatives that the electorate has soundly rejected and help to temper the proliferation of votes that overwhelm the institutional investor community's capacity for thoughtful deliberation.

53. Although the SEC does not require shareholders to vote on the retention of the company's auditors, such a vote has become standard. *See* Ernst & Young, Audit Committee Reporting to Shareholders: Going Beyond the Minimum 1 (Feb. 2013), http://www.ey.com/Publication/vwLUAssets/Audit_committee_reporting_to_shareholders:_going_beyond_the_minimum/$FILE/Audit_committee_reporting_CF0039.pdf (reporting more than 90 percent of Fortune 100 Companies seek annual shareholder ratification of auditor chosen by audit committee).

54. Del. Code Ann. tit. 8, § 251(c) (2013).

55. *Id.* § 271.

56. Cal. Elec. Code § 8103(a) (West 2015); *see also* Tex. Elec. Code Ann. § 172.024 (West 2015) (charging filing fee of $5,000 to be candidate for U.S. Senate, and $750 to be candidate for state representative). It is common for a state to charge 1 percent of the salary of the office sought as a filing fee, as is done in Delaware, Kansas, Nebraska, North Carolina, and Washington. Del. Code Ann. tit. 15, § 3103 (2014); Kan. Stat. Ann. § 25-206 (2014); Neb. Rev. Stat. § 32-608 (2013); N.C. Gen. Stat. § 163-107 (2013); Wash. Rev. Code § 29A.24.091 (2013). In Virginia, the fee is 2 percent. Va. Code Ann. § 24.2-523 (2013).

57. In reality, this number could be rationally increased to $20 million or higher so long as aggregation was permitted.

6. Creating a More Credible and Responsible Director Election Process

Stockholders now have considerable, undisputed authority to adopt reforms to the electoral processes of Delaware corporations.[58] These reforms can take the form of so-called majority voting rules, which require a director to be elected with an affirmative majority of the votes cast, regardless of the fact that he had no human opponent.[59] Majority rules have thus turned a decision to withhold a proxy vote for a director into a non-retention vote. This allows activist investors to seek to unseat directors without proposing their own candidates, who, because they would be humans, would have flaws, too. Institutional investors can essentially launch recall elections based on some discontent with corporate decisions or results, but without having to propose anyone who would do a better job.

It would seem more responsible for stockholders to take advantage of the chance to create a genuine choice between actual candidates by adopting bylaws that would provide a reimbursement of expenses to a proxy contestant whose slate achieved victory or a credible percentage of the vote, such as 35 percent. Under Delaware law, stockholders could combine this approach with a form of proxy access, in which qualifying nominees would appear on a company-prepared proxy ballot. In keeping with the need to balance benefits and costs responsibly, one could imagine having such a reimbursement and proxy access scheme operate in the same year that the company had the required say-on-pay vote. If a triennial approach to proxy reimbursement at companies without a classified board and voting on pay were adopted, that would create a vibrant accountability mechanism that would operate on a sensible schedule and give the stockholders a chance to observe how the board had performed during a reasonable number of years in considering whether to continue them in office.

In between, stockholders would still be protected by the American approach to corporate law, which, unlike most of Europe,[60] mandates annual director elections. Because hedge funds, moreover, prefer to run their own proxy contests using their own proxy cards, the possibility for proxy fights would exist every

58. *E.g.*, Del. Code Ann. tit. 8, § 112 (2013) ("The bylaws may provide that if the corporation solicits proxies with respect to an election of directors, it may be required . . . to include in its proxy solicitation materials . . . , in addition to individuals nominated by the board of directors, 1 or more individuals nominated by a stockholder."); *id.* § 113 ("The bylaws may provide for the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors . . . ."); *id.* § 216 ("A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.").

59. Michael S. Kang, *Shareholder Voting as Veto*, 88 Ind. L.J. 1299, 1311 (2013).

60. *See* Holly J. Gregory & Robert T. Simmelkjaer, II, Discussion of Individual Corporate Governance Codes Relevant to the European Union and Its Member States, Annex IV (2002), http://ec.europa.eu/internal_market/company/docs/corpgov/corp-gov-codes-rpt-part2_en.pdf (reviewing corporate governance codes of European Union member states which show it is common for directors to serve for a term of multiple years, with terms of four years or more being common); *see also Index of Codes*, Eur. Corp. Governance Index, http://www.ecgi.org/codes/all_codes.php (last visited Oct. 25, 2015) (collecting codes of various EU member states).

year, as the increase in such contests illustrates. Furthermore, because of the concentration of institutional ownership and the ease of communication facilitated by the Internet, the affordability and viability of a proxy contest have been enhanced.

If a system of this kind were adopted at a corporation, stockholder power advocates would have to consider why the traditional plurality voting rule for elections—the candidate getting the most votes is seated—should not be restored and someone seeking to unseat a director should not have to do so in the manner that enables for the most open and responsible choice by all the stockholders: which is to require that person to nominate an actual human who will serve in place of the incumbent who is targeted for removal. If proponents of board change prefer the withhold technique because it enables them to put pressure on the board to add candidates of their choice (or drop their withhold campaign in exchange for substantive changes in corporate policy such as a special dividend financed by reductions in future capital spending) after secret, backroom discussions to which all investors are not privy, that should lead supposed champions of all stockholders to be suspicious.

7. The Need for the Voting Electorate to Know More About the Economic Interests of Activist Stockholders Proposing to Influence and Alter Corporate Business Strategies

There is a vigorous debate about whether section 13(d) of the Securities Exchange Act of 1934 should be reformed to require public disclosure within twenty-four hours rather than ten days of when someone acquires more than 5 percent of any equity security of a public company. Advocates of such change argue that the United States lags behind other nations by keeping a filing time period crafted in 1968, when it took much longer to prepare and file public disclosures with the SEC.[61] These advocates also note that market and technological developments[62] make it possible for an investor to acquire much more stock within a ten-day period than was possible in 1968 when the Williams Act was enacted, and thus when investors go public, it can be with ownership stakes far in excess of the 5 percent level that triggers the requirement for public filing.[63] They argue that all stockholders should know as soon as practicable

61. *See* Letter from Wachtell, Lipton, Rosen & Katz to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n 4 (Mar. 7, 2011), www.sec.gov/rules/petitions/2011/petn4-624.pdf [hereinafter Wachtell Lipton Petition] (arguing that changes in technology, acquisition mechanics, and trading practices have rendered a ten-day reporting window outdated, "shortened deadlines have been required for years" in other developed financial markets, and "[t]he U.S. should . . . offer investors an equivalent level of available information on as timely a basis as other markets").

62. *See id.* at 3 (noting that "[t]he advent of computerized trading has upended traditional timelines for the acquisition of shares, allowing massive volumes of shares to trade in a matter of seconds" so "[i]n today's world, ten days is an eternity").

63. *See id.* ("[Aggressive] investors may—and frequently do—secretly continue to accumulate shares during [the ten-day] period, acquiring substantial influence and potential control over an issuer without other shareholders (or the issuer) having any information about the acquiror or its plans and purposes at the time stockholders sell their shares." (footnote omitted)).

when an investor crosses the 5 percent threshold, and not wake up to find that a quarter of the company's stock is now in the hands of a particular investor.[64] Hedge funds, by contrast, argue that despite technological changes enabling easy filing of a public disclosure within a short period, they should not be deprived of the opportunity to purchase as much stock as they can within a ten-day period so as to have an adequate incentive to propose business plans to the company that if adopted, will increase the value of the corporation for all stockholders.[65]

It is long overdue for this debate to be resolved. Five percent is not a magic number, but certainly the marketplace should know before a stockholder emerges with over 20 percent of the voting power. Pick a number between 5 percent and 12.5 percent and make public disclosures happen within twenty-four hours of hitting that threshold and require that there be no further purchases until that happens. Then, like all other modern markets, require that position to be updated in real time if it moves by a percent or more.

Even less understandable is the debate over what must be reported. Reforming section 13(d) in one critical respect is essential, which is to require that filers have to disclose completely their ownership interests in instruments of any kind tied to the value of the company's stock.[66] If there is no reason to fear that hedge funds or other activist investors can threaten long-term value because longer-term investors will hold the balance of voting power, it logically follows that the voting electorate should have up-to-date complete information about the economic interests of a large bloc-holding hedge fund proposing that a corporation make business strategy changes it is suggesting. Precisely how "long" the fund's investment in the company is and in what manner the hedge fund is long is relevant information for the electorate to consider in evaluating the hedge fund's interest. So is how "long" the activist is committed to owning its shares. This is consistent with the belief that corporate managers should fully disclose their interests. When an investor is seeking to influence corporate strategies, especially by seeking status as a fiduciary or by using threat of an election campaign to gain concessions, that investor is taking action that affects all the company's investors. The electorate should therefore have up-to-date, complete

64. *Id.* at 7 (explaining that a shortened reporting window would be more in line with "the overall purposes of the 13D reporting requirements—namely, to inform investors and the market promptly of potential acquisitions of control and influence so that investors have equal access to this material information before trading their shares").

65. Letter from Lucian A. Bebchuk & Robert J. Jackson, Jr. to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n 6 (July 11, 2011), www.sec.gov/comments/4-624/4624-3.pdf ("It has long been recognized in the literature that an important source of incentives to become an outside blockholder is the blockholder's ability to purchase shares at prices that do not yet fully reflect the expected value of the blockholder's future monitoring and engagement activities."); *id.* ("Once the presence of an outside blockholder is publicly disclosed, prices rise . . . [and] the returns to becoming an active outside blockholder would fall, and shareholders would lose the benefits of blockholders' presence.").

66. *See, e.g.*, Wachtell Lipton Petition, *supra* note 61, at 8 ("[T]he current definition of beneficial ownership does not account for the realities of how derivatives and other synthetic instruments and ownership strategies are used today in complex trading strategies.").

information about the proponents' economic holdings and interests. And once the proponent has had the initial period to gather their stake and make their initial filing, there is no further basis to argue that they should not have to meet filing standards consistent with current technological and market developments, by updating their filing within twenty-four to forty-eight hours if their ownership interest changes by 1 percent in any direction, long or short.[67]

8. The Need for Institutional Investors to Get Smart and Learn to Love the Pill at Companies Without Classified Boards

There is an interesting debate about the utility of classified boards. Some scholars have argued that classified boards are harmful to stockholders and are leading a movement to get rid of them.[68] But other scholars believe that classified boards have their place.[69] The reality is that institutional investors as a class, including the mainstream mutual funds, prefer an open market for corporate control and believe that classified boards act as a genuine impediment. Whether that is in fact true is a matter for another time, for now another more important point can be made.

The debate is becoming increasingly marginal because classified boards are becoming rare and are on their way toward endangered species status.[70] Within the next few years, "at the end of the day" as it were, classified boards will be rarer than novel turns of phrase by political pundits. The typical company now does not have a classified board. When a corporation lacks a classified board, it risks bordering on malpractice for it not to have a standard form of poison pill to allow the board, in the event of an offer for the company, to: i) negotiate on behalf of the stockholders to secure a better price; ii) encourage market competition by seeing whether other bidders will pay a higher price; iii) educate the stockholders about the board's view of the merits of the offer in light of the company's standalone prospects; and iv) channel the debate over

67. Schedule 13D must be amended "promptly" to reflect any change of 1 percent or more. *See* Filing of Amendments to Schedules 13D or 13G, 17 C.F.R. § 240.13d-2 (2016). The SEC has refused to define what "promptly" means, see *Amendments to Beneficial Ownership Reporting Requirements, Exchange Act Release No. 34-39538*, U.S. Sec. & Exchange Commission 8–9 n.14 (Jan. 12, 1998), https://www.sec.gov/rules/final/34-39538.txt (noting it is "based upon the facts and circumstances"), but it is generally interpreted to mean the following business day. *See* Wachtell Lipton Petition, *supra* note 61, at 5 (recommending "Schedule 13D filing be made within one business day" to mirror "'prompt' disclosure standard that the Commission requires with respect to material amendments to existing Schedule 13D filings"). The United Kingdom requires the disclosure of any material change, defined as 1 percent or more, within two days. Disclosure Rules and Transparency Rules, 2013, DTR 5.6.1 (U.K.).

68. *See, e.g.*, Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 Colum. L. Rev. 1637, 1680–82 (2013).

69. *See, e.g.*, Coffee & Palia, *supra* note 2, at 78–79; K.J. Martijn Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 Stan. L. Rev. 67, 123–34 (2016).

70. *See* Spencer Stuart, Spencer Stuart Board Index 7 (2014) (noting 93 percent of S&P 500 companies now have declassified boards, up from 55 percent in 2004); *Classified Boards Year Over Year*, SharkRepellent.net (2013) (observing that the number of S&P 1500 companies with classified boards dropped from 904 in 1998 to 555 in 2012); Strine, *Dangers of Denial*, *supra* note 1, at 792 (citing evidence regarding the declining incidence of classified boards).

whether a bid represents a better value for the stockholders than if the company remains independent into the less coercive context of an election contest for control of the board. Without a pill, a bidder can act quickly under the tender offer rules without the board having the chance to act for stockholders to get the highest price reasonably available. Without a pill, it is also possible for ordinary investors to suffer a creeping takeover in which de facto control is acquired without payment of a control premium.

Despite these obvious realities, it remains the case that certain proxy advisors and institutional investors continue to oppose poison pills even by corporate boards that are not classified. This is an example of the need for the now powerful institutional investor community to mature, and to strike a more sensible balance for those they represent. Once a board is declassified, the chance for a bidder to secure control at the ballot is never more than a year away. That being the case, it is counterproductive to the interests of stockholders for a board of that kind not to have a solid, well-designed standard rights plan in place and not be distracted by predatory proposals regarding the plan. As important, it is silly for a board to have to waste time in the important period following the receipt of a takeover bid on "taking a pill off the shelf" simply because institutional investors have a reflexive hostility to the pill, when the board's time would be much better spent considering how to react to the offeror in a substantive manner that is designed to achieve the best economic outcome for stockholders.

9. Improve the Benefit to Cost Ratio of Representative Litigation

The ability of investors to use the litigation process to hold corporate fiduciaries accountable for fulfilling their legal and equitable duties is important to our system of corporate governance. Judicial review has limited the ability of conflicted corporate managers to engage in self-dealing, to entrench themselves, or to take other forms of self-interested action at the expense of other stockholders.

But at precisely the time when American boards are the most independent in structure and in fact, litigation is filed whenever any major transaction is announced.[71] And much of this litigation is filed by so-called fiduciaries themselves, in the form of certain pension funds. Regrettably, this litigation is not limited to suits against deals where there is serious reason for concern. Rather, most of this litigation is filed in the wake of third-party sales transactions that have involved an open market check. Much of it is filed by pension funds with no forethought, as they have outsourced the ability to bring litigation to certain law firms. Worst of all, in many instances, the actual professionals who invest

71. *See generally* Adam B. Badawi & David H. Webber, *Does the Quality of the Plaintiffs' Law Firm Matter in Deal Litigation?*, 41 J. Corp. L. 359 (2015); Robert M. Daines & Olga Koumrian, Recent Developments in Shareholder Litigation Involving Mergers and Acquisitions (Mar. 2012), http://securities.stanford.edu/research-reports/1996-2012/Cornerstone-Research-Shareholder-MandA-Litigation-03-2012.pdf.

the fund's money do not support the suit, and allow the fund to commit only a token number (like 100) of shares to the litigation, because the fund manager herself does not believe the deal is unfair or that the suit has merit.

Excessive litigation filed solely for the benefit of lawyers with whom certain fund managers have friendly relations hurts investors and American competitiveness. Bringing litigation is a fiduciary decision and should be made with care.

To reduce the toll on capital costs in the United States, reform should require that ERISA fiduciaries authorize suits only after a vote by the fund trustees, and a decision that the litigation raises an important economic or corporate governance issue of materiality to the fund and that the costs of litigation are outweighed by the benefits of the litigation to the fund beneficiaries. Consistent with that, one would hope that market leaders like ISS and center-of-the-plate investors would support the sensible tool of a choice of forum provision. Forum selection clauses do not insulate corporate fiduciaries from suit. But what they do is to guarantee that unfair rents are not extracted by the too common tool of suing on the same transaction in three or four judicial systems simultaneously. This multi-forum approach has yielded no demonstrable benefits to stockholders, as the lawyers and funds that bring the suits almost always settle within weeks for this basic deal: the stockholders get nothing but the original deal terms. Meanwhile, the lawyers for the fund get their fees.

The United States is viewed internationally as too litigation intensive an environment. That criticism may be overstated, to be sure, but it is also certain that we can and should do better.

10. Support the Development of the Benefit Corporation Model, Which Requires Corporations to Pursue Profit in a Socially Responsible Manner

Consistent with the private ordering approach that exists in American corporate governance, a new form of corporation has emerged that in a measured way changes the rules of the game to put some teeth behind corporate social responsibility. The so-called Benefit Corporation Model explicitly involves a form of corporation in which boards must operate the corporation in a socially responsible manner.

Although this model is conservative in the sense that it does not give other constituencies the right to elect directors or to sue, and limits that to stockholders, the model does, through the use of super-majority requirements and the ability to sue directors for not honoring their legal and equitable duties to act in a socially responsible manner, give corporate managers the ability to take a more long-term approach to corporate investment that better balances the interests of investors in long-term growth and society in business practices that do not externalize costs to workers, the environment, or consumers.

Just as investors have been willing to invest in Google with dual class shares protecting the founders' control or in alternative entities that waive fiduciary duties, there is no reason to believe that investors will not invest in benefit corporations with charters that require them to behave in a socially responsible manner. Many of the emerging generation of entrepreneurs believe that a sustainable approach is not only the right way to do business, but the smart way to make the most profit in the long run.

Learning about this new model and deploying it with clients when it seems fitting can be a way for intermediaries to promote a greater focus on long-term growth in our economy.

* * *

Imagine an American market in which these ideas became "market," where it was more common than not that:

- Corporate boards were not classified but could protect their stockholders from inadequate bids and creeping takeovers and maximize stockholder value by using the combination of a poison pill and a campaign in a later proxy fight to, among other things, convince stockholders that they are better off if the bid is rejected and the company remains independent, bargains for price increases, or finds a better deal;
- Say-on-pay votes occurred triennially or quadrennially and stockholders had a track record by which to assess how the corporation's pay policies had worked and had more time to focus on casting an informed vote because only a third to a quarter of the companies would have a vote every year;
- The election process was enhanced by proxy reimbursement and access in the year of the corporation's periodic say-on-pay vote.

Imagine further that the interests of American representatives were better represented in the corporate electoral process and better protected from excess costs imposed by institutional investors and individual stockholders with idiosyncratic interests in proliferating votes on myriad issues because:

- Proponents of economic proposals had to pay a filing fee of $2,000 to $5,000 and own at least $2 million or 1 percent of the company's stock;
- Proposals that did not receive at least 20 percent in the first year could be excluded in later years and proposals not receiving 30 percent over a three-year period could be similarly excluded;
- Institutional investors, including mutual and pension funds, had to have voting policies that were specifically tailored to the investment horizons of their investors;
- Index funds were required to have voting policies reflecting the unique permanent investment philosophy of their investors and thus their particular interest in ensuring that corporations implement responsible strategies to generate durable increases in corporate profitability;

- Institutions holding the capital of investors saving to pay for retirement and college were required to have voting policies reflecting their investors' need for sound and durable value creation;
- Institutional investors could not rely upon proxy advisory firms' recommendations that did not reflect the investment horizons and investing strategy of their investors, and in particular, index funds could not rely upon proxy advisory firms that did not provide index fund specific voting recommendations;
- There was complete, up-to-date information about the economic interests of stockholders who have to file under Schedule 13(d), thus providing the voting electorate with a more adequate understanding of the economic interests of activist investors proposing changes in corporate business strategy affecting all investors;
- Litigation was filed by institutional investors only when it promised real benefits to investors and not just rents for the trial bar; and
- Socially responsible entrepreneurs could use a model of corporate law that put some enforceable teeth behind sustainable approaches to capitalism.

* * *

Along with the tax and investment policies I outlined, these measures would better align all the critical elements of our corporate governance economic system around a common and sensible objective: increasing our national prosperity through fundamentally sound, sustainable approaches to investment and business planning.

Because most American investors have to entrust their capital to the market for decades to fund college tuitions and retirements, and because most Americans are still more dependent on their ability to get good jobs than on equity returns, their narrower interests as investors and broader economic interests are harmonious in the sense that both are advanced by policies that facilitate durable increases in American wealth, productivity, and job creation, through sustainable, nongimmicky business plans. Tax policies that discourage speculation and encourage the thoughtful deployment of capital would therefore seem to be a useful element of a corporate governance system that works in their interest.

Taken as a whole, it is difficult to see how this would be a system that would insulate corporate managers from accountability to their equity investors. Rather, it would be one that made them strongly accountable to stockholders in a form of republican democracy supplemented by required stockholder votes on many important items, but in a more rational framework where end-user investors focused on sustainable, long-term growth were better represented, where there was fuller information for the electorate to consider, and where there was more time for them to give thoughtful consideration to how to vote without being overwhelmed by an unmanageable number of annual votes. Likewise, this strong but more sensible approach would better balance costs and benefits, by reducing the externalization of the costs of sport from those who enjoy making proposals for the sake of the process to the actual investors dependent on corporate America's success to fund their retirements and children's college educations.

D. An American Commitment to an International Level Playing Field to Reduce Incentives to Offshore Jobs, Erode the Social Safety Net, and Pollute the Planet

But, a final element is required if we are truly to succeed as a nation. That is a commitment to an active international agenda to work with our partners in the EU and OECD to globalize the managed form of capitalism that has made our nations not only prosperous, but ones that take care of their elderly and vulnerable, provide a social safety net, and protect the safety of consumers, workers, and the environment.

Whether we like it or not, capital and product markets are now international. But the regulatory standards that apply in the United States, the EU, and in the OECD nations like Australia, Japan, and Canada to protect workers, consumers, and the environment are not co-extensive with those markets. Likewise, the OECD nations find their ability to raise revenues being undercut by tax arbitrage by nations seeking to act as tax havens for their own advantage.[72] Such advantage-seeking is short-sighted and cuts into the sinew of the enlightened market economies.

What we have in common with our friends in the OECD far exceeds our differences. We all agreed a long time ago that children should not work, but should go to school. We all agreed a long time ago that excessive hours should not be required of workers. We all agreed a long time ago that society should help make sure that everyone has access to healthcare and that the elderly and vulnerable are provided with means of support. We all agreed a long time ago that corporations should be responsible for consumer safety. We all agreed a long time ago that the environment of our planet deserved protection and that businesses had to operate in a responsible manner.

But, right now, we find these enlightened policies under strain. By globalizing capital and product markets without globalizing regulatory standards protecting workers, consumers, and the environment, we are undermining the quality of life and social harmony of the OECD nations as a whole. It is one thing to compete with workers in other nations who are willing to work for a lower wage. It is another thing to compete with child labor, workers who have no right to join a union, and workers whose employers can pollute and run unsafe facilities.

The lessons of history must now be applied at the faster pace necessary when billions and billions of people are engaged in intensive economic activity that af-

72. *See* Annelise Riles, *Managing Regulatory Arbitrage: A Conflict of Laws Approach*, 47 Cornell Int'l L.J. 63, 76 (2014).

fects our planet. We must encourage the developing world to develop, but there is no reason why that development process has to involve child labor, unsafe working conditions, or irresponsible environmental harm. Rather, we must set an example by our own willingness to tackle climate change and to help the developing world progress, so that we have credibility when we seek, as we should, to ensure that labor, consumer safety, and environmental regulations are respected internationally. We should not apologize for demanding that these human rights be as respected as the right of a product to enter a market.

Of course, it will not be easy to achieve everything that we should. But we must commit to an international floor extensive with capital and trading markets. Our OECD friends face challenges common to our own. They all need to pay for the investments needed to address climate change and to preserve their social safety net in the face of aging populations. They all wish to ensure that jobs are available for middle-class workers in comparatively prosperous nations. They all desire to go forward, not backward, in areas like work hours, consumer safety, and overall quality of life.

Many of the specific policies I have outlined—such as the carbon and trading taxes—would provide a useful source of revenue and better incentives for our economic allies, and could be implemented OECD-wide. The patient capital incentives outlined would, with jurisdiction specific tinkering, be a model for our OECD friends to address their own articulated concerns about short-termism. We must think in a more "we" oriented fashion about our international friends, if our own nation is to be able to provide the kind of economic opportunity we want for all Americans.

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With that, I want to end on what for me is a rare optimistic note. There is nothing I have outlined that should be ideologically divisive. It is a centrist agenda that reflects the application of common sense, mainstream economic thinking. We have the capacity to do great things as a nation. All we really need is the will to put our common interests as Americans ahead of petty partisan politics.