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Optional Cumulative Voting & Staggered Terms of Directors: Is the California Climate Warming to Corporations?

Historically, California's legislature has stood steadfastly behind policies designed to protect shareholders and creditors, at the expense of corporate management, in the development of the state's corporation laws. At the same time, other jurisdictions, primarily Delaware, have adopted less restrictive corporation laws to make their states attractive corporate domiciles. After decades of watching corporations flock to other states to incorporate, the California legislature decided to act. Recent legislation suggests that California has made a concerted effort to provide a hospitable environment for corporations.

Although California is a leader in other areas of law, in the realm of corporate governance of public companies California is relatively powerless. A corporation is generally controlled by the laws of the state of incorporation. California, while boasting the world's sixth largest economy, is the state of incorporation of only three Fortune 500 companies and less than four percent of the companies listed on the New York Stock Exchange.

By contrast, more than half of the publicly traded Fortune 500 companies are domiciled in Delaware. This concept is referred to as the "internal affairs doctrine." The internal affairs doctrine historically established jurisdiction over corporations. The modern view casts the doctrine as a choice of law rule. See, e.g., Kaplan, Foreign Corporations and Local Corporate Policy, 21 Vand. L. Rev. 433, 461 (1968); Oldham, Regulating the Regulators: Limitations Upon A State's Ability to Regulate Corporations With Multistate Contacts, 5 Del. J. Corp. L. 181 (1980) [hereinafter Oldham, Regulating the Regulators]. A corporation's domicile is generally considered its state of incorporation, and will be treated as such here. See, e.g., Kaplan, supra, at 461.

The Commission, comprised of "prominent members of the business, academic, investment and political communities," is charged with evaluating California's role in governance, with an eye toward maintaining stability among California corporations, and avoiding further loss of California corporations to other states. Id. at 5.
companies are domiciled in Delaware. This gap between California and Delaware further widened in the early 1980s when, of forty publicly held companies that reincorporated in Delaware fourteen were previously California corporations. Delaware's enviable position results from a body of laws favoring corporate management over shareholders, and a wealth of judicial decisions supporting this policy.

Most states have participated in this "race to the bottom" and have patterned their corporation statutes after Delaware's. California, sometimes called the "lone rebel," has steadfastly stood by its policy of protecting "creditors, security holders, and prospective purchasers of securities rather than facilitat[ing] corporate operations." Thus, notwithstanding the physical presence of these large companies within the state, it is not surprising that California is home to so few public corporations. To regain control over these foreign corporations, the California legislature enacted a statute whereby California law governs corporations with significant operations within the state. However, this statute is now known as a "paper tiger" because it expressly excludes publicly held companies.

California's lack of control over publicly held companies has become obvious in the context of corporate takeovers. Other states with more liberal corporation statutes are better able to attract and retain

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4. Hawley, supra note 3. Some of the companies that were previously incorporated in California, and subsequently reincorporated in Delaware include Potlatch, Occidental Petroleum, Times-Mirror, Disney, and Wells Fargo. SENATE COMMISSION, supra note 2, at 40.


6. This term, which describes an effort by states to provide the least restrictive corporation law to insure that their corporations will not flee to Delaware, has been attributed to the late Professor Cary. See Cary, supra note 5, at 666. For an earlier view, see Liggett v. Lee, 288 U.S. 517, 559-60 (1933) (Brandeis, J. dissenting) (Justice Brandeis characterized New Jersey's permissive statute as creating a race to laxity). See also Comment, The Pseudo-Foreign Corporation in California, 28 HASTINGS L.J. 119 (1976) ("most states have to some extent acquiesced and followed Delaware's lead").

7. See Cary, supra note 5, at 665-66; Kaplan, supra note 1, at 435-36; Comment, supra note 6, at 119.

8. Oldham, Regulating the Regulators, supra note 1, at 215.


10. A corporation incorporated elsewhere but authorized to do business in California by the Secretary of State is "foreign."


12. Comment, supra note 6, at 129-30.

public companies, and they have passed anti-takeover legislation to protect their corporate citizens. Similar legislation in California would be ineffective because arguably it would not apply to the large corporate giants involved in these takeovers. Therefore, California is faced with the choice of either (1) doing nothing and continuing to abrogate authority over large corporations with substantial business contacts within the state, or (2) entering the “race to the bottom” by relaxing its corporation law in favor of management to encourage those public companies already incorporated here to stay, to cause new entities to choose California as their domiciles, or to lure existing companies to the state. If California enters the “race to the bottom” and becomes the corporate domicile of choice for companies with significant operations within the state, it will be able to retain legislative control over these companies. However, to achieve this objective California will have to shift from a pro-shareholder position to a position favoring corporate management. Thus, the historic policies of the state will still not apply to these large corporations.

On September 15, 1989, California overwhelmingly passed new corporate legislation, adding one new code section and amending three others. The new law allows listed companies to stagger terms of directors, and to make cumulative voting optional. This recent legislation suggests that perhaps California has entered the proverbial race. Cumulative voting and one-year, non-staggered
terms for directors were previously mandatory provisions of California's corporation law, long considered pro-shareholder positions.

This Comment focuses on this recent legislation and discusses whether these changes signal a dramatic shift in California's attitude toward public companies. In doing so, this Comment first addresses the origin of corporation statutes, the application of the internal affairs doctrine, and the viability of a federal corporation law. Second, it discusses California's historical approach to corporations. Third, the specifics of this new legislation are described, along with a discussion of the criticisms of the prior provisions. Finally, this Comment highlights other recent developments in California's corporation law. Its conclusion is that California has entered the race by virtue of these recent changes.

I. HISTORICAL PERSPECTIVE: CORPORATE GOVERNANCE

A. Origin of Corporation Statutes

Corporation law originated historically as restrictions and control over corporate charters. In 1896 New Jersey was the first state to promulgate a "modern liberal corporation statute." Subsequently, other states' corporation statutes changed the corporate law emphasis through what have become known as "enabling acts" which allow "management to operate with minimum interference." Delaware, seeking to raise revenues, enacted a liberal corporation statute in 1899. Delaware's act made it very easy for corporations doing business out-of-state to be domiciled within the state, so long as the corporation's charter allowed for out-of-state operations. Through franchise taxes, Delaware began to reap the benefits of its liberal statute.

To achieve this objective, Delaware's statute was decidedly pro-

Corp. Code § 708 (West 1977 & Supp. 1990). The converse of cumulative voting is straight voting wherein each director is elected by a majority vote. Under straight voting, even a 49% minority holder has virtually no say in corporate elections.

25. With one year terms, all directors are elected each year. The reasons for non-staggered terms are to keep directors accountable to their shareholders, and to prevent directors from becoming too comfortable in their positions. Id. § 301.


27. See Kaplan, supra note 1, at 433; Cary, supra note 5, at 666.


29. Kirk, supra note 26, at 252-53; Cary, supra note 5, at 664.

30. In 1899, the first year that the statute was effective, Delaware chartered only 421 corporations and brought in franchise taxes and filing fees of $36,000 (roughly seven percent of the state's total revenues). By 1919, however, total taxes from corporate charters were $1.2 million, out of total state revenues of $3.5 million. Kirk, supra note 26, at 254-55. In fiscal year 1984, Delaware brought in over $92 million in fees and taxes (roughly 28% of the state's total revenue). Id. at 259.
management. For example, early provisions of the statute reduced directors' exposure to liability and allowed for lenient dividend distribution schemes.\(^{31}\) Thus Delaware took the lead in the world of corporate governance and has never looked back.\(^{32}\)

B. The Internal Affairs Doctrine & The "Race to the Bottom"

Delaware's rise in the area of corporate governance was aided by the internal affairs doctrine. Under this doctrine, a corporation is deemed a creation of the state of its incorporation and, therefore, is governed by that state's laws, notwithstanding the company's geographical location.\(^{33}\) The main policy reasons advanced for the internal affairs doctrine are uniformity and certainty in choice of law questions for corporations with contacts in more than one state.\(^{34}\) The result of this doctrine, in conjunction with Delaware's liberal statute, is that Delaware law now governs a great portion of public corporations.\(^{35}\) Furthermore, Delaware law is considered by some to be the de facto law of corporations in the United States.\(^{36}\)

Some commentators view this race to the bottom as the quintessence of the free market theory that "well-informed participants will choose what is best for themselves."\(^{37}\) Others contend this competition is unhealthy, and only leads to a decidedly pro-management

\(^{31}\) Id. at 255.

\(^{32}\) See id. at 233; Cary, supra note 5, at 668. See generally Kirk, supra note 26, for a detailed history on and the development of Delaware's corporation law, which is beyond the scope of this Comment.

\(^{33}\) See Kaplan, supra note 1, at 440; Oldham, Regulating the Regulators, supra note 1, at 181.

\(^{34}\) See Kaplan, supra note 1, at 441; Oldham, Regulating the Regulators, supra note 1, at 187; Oldham, California Regulates Pseudo-Foreign Corporations—Trampling Upon the Tramp?, 17 SANTA CLARA L. REV. 85, 99 (1977) [hereinafter Oldham, Trampling Upon the Tramp]; see also RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 41 comment a (1971).

\(^{35}\) See supra text accompanying note 1.

\(^{36}\) See, e.g., Senate Commission, supra note 2 at 40. Today, many states have patterned their corporation statutes after Delaware's code in an attempt to retain public companies within their jurisdictions and, therefore, under their control. This effort by most states has been termed the "race to the bottom." See supra text accompanying notes 6-7; see also Cary, supra note 5, at 666 ("only two or three jurisdictions have resisted this temptation at all").

\(^{37}\) Herzel & Richman, Foreword to R. BALOTTI & J. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS at lix (1988). But see Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 NW. U.L. REV. 913, 920 (1982). Professor Fischel calls the competition for corporations the "climb to the top," rather than the race to the bottom, on the premise that Delaware's "corporation law maximizes, rather than minimizes shareholders' welfare." Id.
point of view, while ignoring other implications. Nonetheless, Professor Cary points out that if Delaware had not sought to be the leader in corporate charters, some other state would have begun the race in the hopes of attracting “the lucrative business of incorporating.”


Some writers have suggested that the best way to end the race to the bottom would be to provide one uniform federal corporation law that would preempt state law. According to Professor Cary, to compete in the area of corporate governance, states now have no choice but to place management in a position of omnipotence, to the detriment of a public policy favoring shareholders and creditors. Thus, in order to “escape from the present predicament in which a pygmy among the 50 states prescribes, interprets, and indeed denigrates national corporate policy,” federal legislation is required. This viewpoint is echoed by Professor Kaplan:

If . . . state corporation laws are trending toward virtual uniformity, then . . . such uniformity [should] be prescribed by Congress rather than by emulation of Delaware’s Corporation Act. There is no more reason for the corporation law in the United States to be set by the standards of Delaware than there is for the conflicts rules of the world to be promulgated by the Island of Tobago.

Professor Cary cites several reasons for a federal corporation law. The two reasons most relevant here are (1) the “need for uniformity, so that states shall not compete with each other by lowering standards,” and (2) “there should be as much federal concern about the management of the public issue company and about its share owners as about the investor engaged in the purchase and sale of its stock.” It is said that because “[t]he largest corporations are not restricted to any one state, . . . the problems they cause [also are not] so restricted.”

While these arguments are appealing, especially to a state like

41. Cary, supra note 5, at 666, 698.
42. Id. at 701.
43. Kaplan, supra note 1, at 480.
44. Cary, supra note 5, at 697. Professor Cary here refers to the federal Securities and Exchange Acts of 1933 and 1934, intended to provide investor protection in the purchase and sale of securities.
45. Comment, supra note 40, at 898.
California with little corporate control,46 other writers have staunchly opposed a federal corporation law.47 It is argued that a federal law would do no more than codify Delaware's law as a federal standard.48 It is also urged that a federal law would remove the element of competition, seen as a positive force, from the area of corporate governance.49 Concerning the interests of shareholders, some commentators argue that shareholders "have shown no aversion to incorporation in Delaware."50

Although the arguments on both sides have merit and possibly warrant future consideration, in the near term it has been observed that any such legislation is "politically unrealistic."51 Thus, without an immediate prospect of federal preemption, it is important to review California's historical position and to predict where California is headed in the area of corporate governance.

II. CALIFORNIA'S HISTORICAL APPROACH TO CORPORATIONS

A. The California Code

California's corporation law, unlike Delaware-type codes of other states, has traditionally placed the interests of shareholders and creditors above the interests of management.52 However, some writers previously believed that in spite of differing policy goals, the differences between Delaware and California law did not overwhelm-
ingly dictate Delaware as the domicile of choice. Today, the situation has changed dramatically.

The control exercised by Delaware and liberal states over public companies has put California in a relatively powerless position due to application of the internal affairs doctrine and the lack of public companies domiciled in California. While the internal affairs doctrine applies to all corporations doing business in California but incorporated elsewhere, its effects are particularly pronounced with pseudo-foreign corporations. These pseudo-foreign corporations operate exclusively within the state, yet they are regulated by the laws and policies of their state of incorporation which may be at odds with those of California. For this reason, the internal affairs doctrine is criticized for failing to reflect the social costs of denying control to the state where business is conducted.

B. Section 2115: The Paper Tiger

In an attempt to remedy this lack of control, the California legislature added section 2115 which requires the application of California law if the corporation does over one-half of its business in the state and over one-half of its shareholders have addresses in California. Although it has not been tested by the California Supreme Court, section 2115 was held to be constitutional by a state appellate court. However, this statute does not apply to public companies with common stock traded on the American or New York exchanges, or with stock traded over-the-counter with at least 800 shareholders. Therefore, because the statute only applies to companies whose shares are not widely traded, which are often smaller companies that usually limit their activities to one state, the very ills that the statute attempted to combat have remained untouched.

53. See, e.g., Comment, supra note 9, at 532.
54. See Senate Commission, supra note 2, at 2.
55. See supra text accompanying note 1.
56. The pseudo-foreign corporation is defined as a corporation that operates entirely within one state, while maintaining corporate domicile elsewhere. See, e.g., Kaplan, supra note 1, at 438; Comment, supra note 6, at 124.
57. See Oldham, Trampling Upon the Tramp, supra note 34, at 99. "[T]he social policies of the principal place of business of a pseudo-foreign corporation are supplanted by those of the state of incorporation." Id.
60. Cal. Corp. Code § 2115(e) (West 1977 & Supp. 1990). This exemption is premised on the theory that "when a corporation lists its shares on a national exchange, it subjects itself to federal securities regulations and exchange requirements which supposedly provide protection for investors equivalent to that provided under California law." Comment, supra note 6, at 129. In reality, however, the federal securities regulations only serve disclosure functions and do not provide the shareholder any remedy for corporate mismanagement. See Cary, supra note 5, at 699-700.
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C. Corporate Governance and the Hostile Takeover

The problem of corporate governance became increasingly evident with the rise in takeover activity observable among corporations in the last decade. When corporations located in California but incorporated elsewhere are taken over, the effect is often “loss of jobs, resources and disruptions to the economy.” Over the last four years, twenty-three other states, including Delaware, faced with similar losses, have passed anti-takeover statutes to protect their corporations. Furthermore, the United States Supreme Court has basically given the states carte blanche in anti-takeover legislation. Any such legislation in California, like section 2115, would be ineffective because California law does not apply to the vast majority of the corporations it would be intended to protect. Perhaps this is why attempts in the California legislature to pass anti-takeover legislation have failed.

A recent example of California’s precarious position was the potential hostile takeover of Chevron Corp. by Pennzoil Corp. Chevron, incorporated in Delaware, is the largest company located in California. The takeover could have had a significant impact on California’s economy, due to future plant closings and consolidations into Pennzoil’s operations. If Chevron had been a California corporation, the California legislature could have enacted emergency legislation to prevent a hostile takeover.

Some commentators suggest that one remedy is to enlarge the

61. Senate Commission, supra note 2, at 5.
62. High Court, supra note 9, at A1, col. 2. This article also points out that these 23 states in the aggregate “are home to 784 of the nation’s 1000 largest companies.” Id.; see also, Anti-Takeover Laws, supra note 3, at D1, col. 2 (“These laws became popular in the mid-1980s as companies and their allies in state legislatures became alarmed at the seeming ease with which corporate raiders could sell high-yield junk-bonds, take control of a target company and sell off divisions.”); Schwartz, Federal Chartering Revisited, 22 U. Mich. J.L. Rev. 7, 13 (1988) (“A majority of states now have antitakeover laws . . .”).
63. Most recently, the Court denied certiorari in a challenge to a Wisconsin anti-takeover law wherein a takeover cannot be accomplished until three years have passed after the initial takeover attempt if the proposed takeover is opposed by the corporate board. See Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984 (E.D. Wls. 1988), aff’d, 877 F.2d 496 (7th Cir.), cert. denied, 110 S. Ct. 367 (1989). Another provocative aspect of the Wisconsin statute is that it applies to “resident domestic corporations,” where residence is defined by physical presence, not by the state of incorporation. Wis. Stat. Ann. § 180.726(1)(l), (2) (West Supp. 1989).
64. Anti-Takeover Laws, supra note 3, at D1, col. 2.
66. Id.
67. See, e.g., supra text accompanying note 63.
scope of section 2115 to include public as well as privately held companies. There is some question, however, whether such a law could withstand a constitutional challenge based on the commerce clause. Furthermore, the risk associated with section 2115, which is triggered by the volume of business conducted within California, is that companies seeking to avoid the application of California law will take their business elsewhere.

III. THE NEW LEGISLATION: CUMULATIVE VOTING & STAGGERED TERMS

A. Prior Law

Mandatory cumulative voting and annual election of all directors were historically considered the two provisions of the California code most favorable to shareholders and most detrimental to management. This section will explore the origin, operation, and intent of these two provisions.

1. Cumulative Voting

Under section 708, shareholders at any election of directors may cumulate their votes, as long as the candidates they intend to vote for have been nominated prior to the election, and all shareholders are given notice of the intent to cumulate. This provision gives a shareholder a number of votes equal to the number of shares owned multiplied by the number of directors to be elected. These votes can then be allocated among one or more directors up for election.

Cumulative voting was adopted in California in its Constitution of 1879. Although the constitutional provision was repealed in 1930, the legislature reinstated the right to vote cumulatively in 1931 and it has existed ever since. The theory behind cumulative voting is

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68. See Senate Commission, supra note 2, at 44; see also, Oldham, Regulating the Regulators, supra note 1, at 249 (such a rule “would provide certainty in corporate choice of law while permitting the state with clearly the predominate interest in regulating a corporation to do so.”).

69. Senate Commission, supra note 2, at 39 (such a law might adversely affect interstate commerce by “subjecting activities to inconsistent regulations”).

70. See Comment, supra note 6, at 146.

71. See supra text accompanying notes 18-19.


73. Corporations Committee, Business Law Section of the State Bar of California, Memorandum on Legislative Proposal to Permit Classification of Directors by Term of Office and Elimination of Cumulative Voting for Corporations with Publicly Traded Securities 4 (June 18, 1987) (available at the State Bar of California) [hereinafter Memorandum].

74. Id. at 4; see also Sturdy, Mandatory Cumulative Voting: An Anachronism, 16 Bus. Law. 550, 572 (1961). California's official position on the repeal of cumulative voting in 1930 was that because of the burden of this provision, "[t]housands of corporations, organized by California citizens to transact business in California, incorporate

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that it provides the common shareholder with "power over and representation on the board of directors." 75. Under the straight voting alternative method, the majority will always rule and the minority shareholder will be at a distinct representational disadvantage. 77. While the majority still controls a majority of the board with cumulative voting, the minority maintains a voice in director elections.

To fully understand this concept, an example of cumulative voting in the election of directors is instructive. The first step is to determine the number of shares a minority shareholder must vote to elect one director. 78. The formula for this determination is as follows: \( S / (D+1) + 1 \), where \( S \) represents the number of shares being voted, and \( D \) represents the total number of directors to be elected. Therefore, if a company is electing five directors, and the number of shares voted is one hundred, the number of shares necessary to elect one director is seventeen. 80. It is important to note that this formula sets up a reciprocal relationship: the greater the number of directors to be elected, the fewer minority shares required to elect one director. Likewise, if a small number of directors is to be elected, a greater number of voting minority shares would be required.

2. Annual Election of Directors

Cumulative voting in California operates in conjunction with section 301. Section 301 provides that each director shall be elected under the laws of other states, because they can not [sic] obtain reasonable corporate facilities at home." 77. Comment, supra note 9, at 524. Illinois was the first state to adopt cumulative voting, both in the contexts of shareholder voting and voting for members of the state legislature. See Memorandum, supra note 73, at 5.

76. Straight voting is election by a pure majority of votes cast, where the number of votes cast per shareholder is simply the number of shares held. See also supra note 24.

77. Note that with straight voting only a bare majority of fifty-one percent is required to elect a director. Therefore, a minority faction could be significant (e.g., 49%) and still be precluded from gaining representation on the board. See, e.g., Glazer, Glazer & Grofman, Cumulative Voting in Corporate Elections: Introducing Strategy Into the Equation, 35 S.C.L. Rev. 295, 296 (1984) [hereinafter Glazer].

78. Note that unless the minority shareholder alone owns a substantial minority of shares, the minority shareholder may have to combine with other minority shareholders to achieve the desired result.


80. \( 100/(5+1) + 1 = 100/6 + 1 = 16 + 1 = 17 \) shares (not counting fractional shares). By way of contrast, under straight voting each shareholder receives a vote for each share owned; the shareholder may cast that number of votes for each of the directors to be elected. See R. HAMILTON, supra note 50, at 425. Thus, a simple majority of the voting shares will elect all directors, even if a minority faction held 49% percent of the shares.
annually for a one year term. Delaware takes the opposite approach and allows for staggered terms of directors. Under Delaware's approach, each year only a portion of the board is up for re-election. Under the cumulative voting formula it is easily seen that staggered terms can circumvent the policy behind cumulative voting. Assume, for example, that a corporation has three directors, each serving a different term. Each year at the annual meeting shareholders will elect only one director. Applying the formula \( S/(D+1) + 1 \), one director under a staggered term system is still elected by a simple majority of the voting shares. Thus, cumulative voting is completely ineffective with the election of one director. Furthermore, its effects are somewhat diluted with any election of a small number of directors.

California law provides further assurance that cumulative voting will not be rendered ineffective. For example, under section 212 a corporation generally cannot have fewer than three directors. Also, any action to decrease the size of the board must be in the form of an amendment to the articles of incorporation, a process requiring a shareholder vote. Moreover, an amendment to decrease the size of a five-director board will not pass if more than sixteen and two-thirds percent of the voting shares vote against the amendment.

### B. Criticism of Cumulative Voting and Annual Election of Directors

#### 1. Cumulative Voting

It has been said that cumulative voting is "the greatest burden of California law." Many corporations with significant operations in California have incorporated in Delaware primarily to avoid California's mandatory cumulative voting provision.

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83. See supra text accompanying note 79.
84. Id.
85. \( 100/(1+1) + 1 = \frac{1}{2} \) of the shares voting + 1.
87. Id. §§ 901-903.
88. Id. §§ 194.5, 212(a). Note that this rule provides a sense of symmetry since 16 2\% of the voting shares is the number of shares required to elect one director of a board comprised of five directors. See Friedman, supra note 79.
89. Comment, supra note 6, at 137. California was in the minority before its new legislation in mandating cumulative voting. Thirty-four states and the Model Business Corporation Act either provide permissive cumulative voting or make no provision for it at all. Memorandum, supra note 73, at 6.
90. See, e.g., Cary, supra note 5, at 669; Kaplan, supra note 1, at 436. Cumulative voting is optional in Delaware. DEL. CODE ANN. tit. 8, § 214 (1974 & Supp. 1988). Also, staggered terms are allowed. See supra text accompanying note 82. This observation is supported by the recent reincorporations in Delaware of California corporations.
Some writers believe that the fundamental problem with cumulative voting is that it treats the corporate board of directors as a legislative body, rather than considering board management as an executive function. This conclusion is supported by five reasons. First is the nature of the board’s duties. The corporate board is charged with determining the company's long and short term policies and decisions and prescribing the means for reaching its goals. Cumulative voting poses a risk to successful management of a corporation by creating a danger of factionalism when directors are elected by minority interests adverse to management. "While a healthy diversity of opinion and experience, as represented by independent directors, is desirable, factionalism is not appropriate in the board's essentially

for the express purpose of avoiding cumulative voting. See, e.g., Hawley, supra note 3 (wherein Mr. Hawley wrote that the “reason for reincorporation in Delaware is to prevent The Limited Inc. from gaining representation on the company’s board through the use of California’s cumulative voting procedures”); Glazer, supra note 77, at 296-97 (In 1983 Union Oil Company of California presented a proposal to its shareholders to reincorporate in Delaware to avoid cumulative voting).

91. See Memorandum, supra note 73, at 5; Sturdy, supra note 74, at 552.
92. Sturdy, supra note 74, at 552.
93. Memorandum, supra note 73, at 5.
94. Id.; see also Sturdy, supra note 74, at 552-53. Sturdy sets forth an extensive list of the types of activities in which the corporate board participates. This list includes making decisions on (1) what products or services should be offered or discontinued; (2) what the company's debt and equity position should be; (3) plant expansion; (4) profit margins and pricing structures; and (5) dividend distributions.
95. Sturdy, supra note 74, at 553. Sturdy analogizes the presence of an “antagonistic” director on the board to a stranger participating in a family argument. Sturdy reasons that while family members may argue among themselves, the presence of an outsider will cause the family to unite against that outside force. Thus, the presence of hostile interests on the board will promote factionalism and stymie the board’s decision making process. Id. at 554. Sturdy wrote (in 1961): “This is why security analysts, investment bankers, lawyers whose principal practice is in the corporation field, advisers to institutional investors, security brokers and, more recently, the university scholars with actual experience in the business world are practically unanimous in their opposition to mandatory cumulative voting.” Id. Sturdy supports this thesis with quotes from letters written by the New York law firm of Sullivan & Cromwell, and by Dean Neil H. Jacoby of the U.C.L.A. Business School, to the California Commissioner of Corporations in opposition to cumulative voting. Dean Jacoby’s letter stated in part:

“[C]umulative voting is wrong because it increases the probability of a divided Board of Directors, and such division stultifies action. . . . A board of uncongenial persons with divided views on basic policies will delay or prevent action which can have even worse consequences than taking the wrong action because it defers the day when a change of policy must occur.”

Id. Sturdy also cites a 1947 publication of the Graduate School of Business Administration of Harvard University and a letter from Mr. Guy Witter of Dean Witter & Co., both objecting to the use of cumulative voting because of its negative effect on the corporate board. Some contend that these views are still widely held today by those active in the area of corporation law. See Memorandum, supra note 73, at 6.
executive function."  

The second reason for considering board management as an executive rather than a legislative function is that "the principal objective of a business enterprise should be profit and gain for its shareholders, not political accommodation of competing interests." If corporate board meetings become breeding grounds for conflict and hostility, then the board is hampered in its efforts to maximize the company's assets. Third, it is contended that the typical shareholder in a public company is an investor who, by definition, holds the stock for the purpose of economic gain and not for the right to vote for directors (i.e. not for a political purpose). Shareholders "vote primarily by moving their investment dollars." If an investor in a publicly held company is dissatisfied with board actions and thus fears a loss in share value, the shareholder will choose to invest in another corporation. This "power of voting by selling off shares" has particular import when an institutional investor is involved, because these investors control large blocks of stock. The sale of an individual investor's shares may not send shockwaves through a corporation. However, any changes in holdings of institutional investors are likely to send a strong message to the corporate board and could adversely affect stock prices.

A fourth problem associated with cumulative voting is the existence of factionalism on the board which may give rise to threatened litigation, thus discouraging independent directors from serving on corporate boards. Finally, cumulative voting is sometimes used as

96. Memorandum, supra note 73, at 5.
97. Id. Director liability for board actions usually only results from economic loss to the corporation or its shareholders.
98. See supra text accompanying notes 94-97.
99. See Memorandum, supra note 73, at 5.
100. An investment is defined as "[a]n expenditure to acquire property or other assets in order to produce revenue." BLACK'S LAW DICTIONARY 741 (5th ed. 1979).
101. Memorandum, supra note 73, at 5. This premise is supported by Professor Fischel who queries "why would shareholders ever voluntarily invest in firms located in Delaware, given its alleged promanagement bias which supposedly exacerbates the detriment to shareholders?" Fischel, supra note 37, at 917.
102. Memorandum, supra note 73, at 5; see also supra note 50 for a discussion of the "Wall Street Option."
103. Institutional investors "[a]s a group . . . are now the largest single owner of publicly held corporations; their holdings in the aggregate are in excess of forty per cent of the outstanding shares of listed publicly held corporations, and in specific corporations the percentage may run over fifty percent." R. HAMILTON, THE LAW OF CORPORATIONS IN A NUTSHELL 273 (2d ed. 1987).
104. When an institutional investor decides to liquidate its holdings in a particular security the result may be an artificially depressed stock price. Further, in the takeover context, shares held by institutional investors "are often absolutely critical, and . . . [these investors] often effectively determine who should ultimately control the corporation." Id. at 274.
105. Memorandum, supra note 73, at 6.
“a prelude for ‘greenmail.’”106 Furthermore, even if the above problems fail to cast sufficient doubt on the advisability of cumulative voting, the mechanical aspects may be reason enough to dispense with it.107 Cumulative voting may confuse the shareholder and may create the opposite of the desired result.108 The example above which illustrated how cumulative voting works109 was intentionally made simple. However, in the public company environment the process is much more complex.110

The main problem in a large public entity is lack of knowledge on the part of both minority and majority shareholders.111 Until all proxies are counted at the annual meeting, the number of voting shares is unknown. However, even after the number of voting shares is determined, neither the majority nor the minority knows how the proxies were voted, nor how those shareholders voting in person will vote.112 Thus, this “[l]ack of knowledge of either of these unknowns may cause a substantial difference in the eventual make-up of the board of directors.”113

As noted above in the context of greenmail,114 cumulative voting can have substantial adverse effects on hostile takeovers, which may be detrimental to the very minority interests cumulative voting purports to protect.115 Using greenmail tactics, corporate raiders buy up shares of a corporation to force the corporation to pay a premium to reacquire those shares to avoid takeover.116 Thus, even if a corpora-

106. Id. A hostile faction may buy up a substantial minority of the corporation's shares and threaten to place minority directors on the board just to induce the corporation to buy back those shares at a premium to fend off the attack. See, e.g., R. HAMILTON, supra note 103, at 456. This concept is referred to as “greenmail.”
107. Sturdy, supra note 74, at 565. Sturdy calls cumulative voting “the numbers racket.” Id.
108. Id.; see, e.g., Pierce v. Commonwealth, 104 Pa. 150 (1883) (majority used straight voting in election for six directors, while minority voted cumulatively, spreading its votes over four directors, which resulted in the minority electing four out of six directors); see also, Chicago Macaroni Mfg. Co. v. Boggiano, 202 Ill. 312, 67 N.E. 17 (1903) (minority elected two out of three directors); Schwartz v. State ex. rel. Schwartz, 61 Ohio St. 497, 56 N.E. 201 (1900) (minority elected five of nine directors).
109. See supra text accompanying notes 79-80.
110. See supra note 106.
111. Id. at 566.
112. Id.
113. Id.
114. See supra note 106.
115. Memorandum, supra note 73, at 7. This problem has been magnified in recent years with the significant increase in takeover attempts in the 1970s and 1980s. See R. HAMILTON, supra note 50, at 788. But see infra note 119 and accompanying text for a view that takeovers actually benefit minority shareholders.
116. See supra note 106.
tion is successful in staving off a takeover, the corporate treasury is depleted, thereby reducing per-share value and negatively impacting the investor.117

In other situations, cumulative voting is utilized to gain control of the corporate board in preparation for a takeover attempt.118 It is argued that minority shareholders benefit from cumulative voting not through its purported democratic effects but rather because of an efficient market.119 Others argue, however, that there are other factors to consider in the context of corporate takeovers besides shareholder wealth.120 Some of these factors are the effect on the community due to the loss of one of its corporate citizens, the waste of corporate resources, disruption to the corporation in management’s attempt to fend off a takeover bid,121 and the ultimate disbanding by a profit-motivated acquirer of “money losing but beneficial activities.”122 Some also contend corporate takeovers are injurious to the economy as a whole through the extensive use of debt to finance takeovers.123 However, there is evidence that because of the

117. For a classic example of greenmail in operation, see Heckmann v. Ahmanson, 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985) (efforts by Saul Steinberg to purportedly gain control of Walt Disney Productions, which resulted in a profit to Steinberg of approximately $60 million when Disney purchased his shares).

118. See, e.g., Hawley, supra note 3 (wherein it was noted that The Limited Inc. was attempting to obtain representation on Carter-Hawley-Hale’s board as a prelude to a tender offer). A tender offer is one method of acquisition whereby the acquirer offers either shares of its company or cash to existing holders of the target company’s stock. See R. HAMILTON, supra note 103, at 478.

119. See, e.g., Note, Fear of the Hostile Takeover: Having Tamed and Reined the Beasts, State Regulation Would Kill Them as Well, 14 J. CORP. L. 133, 140 (1988) (“Most studies indicate that shareholders of the acquired firm profit from the acquisition.”). The argument is that a company will be a target for takeover when “[t]he purchaser . . . believes that it can manage the assets of the firm more profitably than incumbent management.” Fischel, supra note 37, at 926. “Transfers of control, therefore, facilitate the movement of assets to more highly valued uses and thereby benefit shareholders and society as a whole.” Id. at 927.

120. See Note, supra note 119, at 143.

121. For a classic example of the disruption cumulative voting can cause when there are conflicting factions seeking to control the board of directors, see Campbell v. Loew’s, Inc., 36 Del. Ch. 563, 134 A.2d 852 (1957). In Loew’s, because of a threat to wrest control through the use of cumulative voting by insurgents, incumbent management agreed to a board of equal members from each faction with one neutral director. Trouble began when several directors from the management faction resigned, leaving the insurgents with a majority on the board, although management still had control of operations. The insurgent faction wanted to remove the president of the company, but was unable to hold a board meeting for lack of a quorum because the management directors carefully stayed away from board meetings. The insurgents sued, but the matter was ultimately decided by the shareholders who voted in favor of management, although the insurgents were able to gain board representation through cumulative voting. Management later proposed that the corporation abandon cumulative voting and the shareholders agreed. See R. HAMILTON, supra, note 50, at 858.

122. Note, supra note 119, at 143.

123. Id. at 144.
problems in the junk bond market, the highly leveraged takeover is on the decline. In short, although cumulative voting was originally created to protect minority shareholder voting power, it may actually operate to maximize shareholder wealth, albeit at the possible expense of incumbent management and the community at large.

2. Annual Election of Directors

As noted above, the use of non-staggered, annual terms for directors has maintained the integrity of cumulative voting. However, just as mandatory cumulative voting has disappeared from most states' corporation laws, California was, until the new legislation, "one of only two states" to mandate annual, non-staggered terms. The advantages that longer, staggered terms offer a corporation will now be explored.

For on-going corporate governance, longer terms provide greater continuity on the corporate board which benefits the corporation. Longer terms afford outside directors an opportunity to become familiar with "the affairs of the corporation and to concentrate on . . . the long term growth and well-being of the enterprise." Moreover, a corporation with a stable board will be better able to "attract independent outside directors." A more compelling argument for staggered terms of directors arises with corporate takeovers. Staggered terms are often considered a "shark repellent," used by companies seeking to avoid a

124. Junk bonds are unsecured debt instruments of a corporation, often issued to finance a takeover attempt.
125. See Anti-Takeover Laws, supra note 3, at D1, col. 2.
126. See supra text accompanying notes 81-86.
127. See supra text accompanying notes 89-90.
128. Memorandum, supra note 73, at 2. The other state is Arkansas. Id.
129. Id. at 3.
130. Outside directors are those members of a corporate board who are not members of corporate management, although they may have other ties to the corporation. Those directors who are also employed by the corporation are called inside directors. See, e.g., R. HAMILTON, supra note 103, at 457, 464.
131. Memorandum, supra note 73, at 3.
132. Id.
133. While the above mentioned advantages for staggered terms have logical appeal, in reality the corporate board, even with annual terms, often remains fairly constant. Incumbent management's slate in the annual proxy statement often contains directors currently serving out a one-year term, and those directors are virtually assured of reelection. See Comment, supra note 6, at 136.
134. A shark repellent is a tactic whereby the corporation, either through amendment of its bylaws or corporate charter, in advance of a takeover bid, makes it more difficult for the potential acquirer to gain control. The goal is to encourage the "shark to
takeover attempt.\footnote{135} Staggered terms ensure that the acquiring entity cannot garner a majority of the board for at least two years, depending on the size of the board, unless directors can be removed without cause.\footnote{138} Some writers argue that staggered terms actually benefit the minority shareholders by protecting “against a radical and rapid unconsented [sic] change in the enterprise to [their] detriment.”\footnote{137}

C. New Legislation

1. The Statutory Language

Recent legislation in California allows for optional cumulative voting and staggered terms of directors. This major change to California’s Corporations Code appears in newly created section 301.5, which is incorporated by reference into sections 301 and 708. It also appears in substantial changes to section 303.\footnote{138}

Section 301 previously provided for election of directors at each year’s annual meeting, with those directors serving until the next annual meeting.\footnote{138} The amended statute incorporates section 301.5\footnote{140} which allows staggered terms.\footnote{141} Similarly, section 708, which mandated cumulative voting at the shareholder’s option in election of directors, now also incorporates section 301.5\footnote{142} which allows a corporation to opt out of cumulative voting.\footnote{143} In other words, section

\footnote{135} See R. Hamilton, supra note 103, at 466; Bogen, State Law Considerations: California, in 1 ACQUISITIONS AND MERGERS 1987, TACTICS, TECHNIQUES, AND RECENT DEVELOPMENTS 533 (Corporate Law and Practice No. 567, 1987) [hereinafter Bogen]; Memorandum, supra note 73, at 4.

\footnote{136} See R. Hamilton, supra note 103, at 464.

\footnote{137} Memorandum, supra note 73, at 4. But see supra note 119 (takeovers actually benefit shareholders under the efficient market theory).

\footnote{138} See supra text accompanying notes 18-25.

\footnote{139} CAL. CORP. CODE § 301 (West 1977 & Supp. 1990).

\footnote{140} The pertinent part of section 301 which provided for annual terms of directors is amended as follows: “(a) Except as provided by Section 301.5, at each annual meeting of shareholders, directors shall be elected to hold office until the next annual meeting. However, to effectuate a voting shift (Section 194.7) the articles may provide that directors hold office for a shorter term . . . .” Id. § 301(a) (italics indicate amendment).

\footnote{141} See infra note 146.

\footnote{142} Section 708 now reads in pertinent part as follows: (a) Except as provided in Section 301.5, every shareholder complying with subdivision (b) and entitled to vote at any election of directors may cumulate such shareholder’s votes and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which the shareholder’s shares are normally entitled, or distribute the shareholder’s votes . . . among as many candidates as the shareholder thinks fit . . . . Id. § 708(a) (italics indicate amendment).

\footnote{143} See infra note 146.
301.5 now stands as the "exception to the general rule" stated in these two code sections.\textsuperscript{144}

The inclusion of section 301.5 in these sections substantially alters their effect. Under section 301.5, a listed corporation\textsuperscript{146} now has the option of eliminating or opting out of cumulative voting and creating staggered terms of directors. This is accomplished by amendment to either the bylaws or the articles of incorporation.\textsuperscript{146} However, these changes "may only be adopted by the approval of the board and the outstanding shares (section 152) voting as a single class, notwithstanding Section 903."\textsuperscript{147}

This new legislation only applies to listed companies, as defined by statute. The rationale for this limitation is that shareholders of publicly traded securities may take advantage of the "Wall Street Option" if they are unhappy with the corporation's actions.\textsuperscript{148} The minority shareholder of a closely-held corporation generally does not have this option due to the lack of a market for a close corporation's

\textsuperscript{144} Memorandum, supra note 73, at 10. Whether the "exception" will become the "general rule" remains to be seen.

\textsuperscript{145} The text of section 301.5(d) is as follows:

For purposes of this section, a "listed corporation" means any of the following:

(1) A corporation with outstanding shares listed on the New York Stock Exchange or the American Stock Exchange.

(2) A corporation with outstanding securities designated as qualified for trading as a national market system security on the National Association of Securities Dealers Automatic Quotation System (or any successor national market system) if the corporation has at least 800 holders of its equity securities as of the record date of the corporation's most recent annual meeting of shareholders. For purposes of determining the number of holders of a corporation's equity securities under this paragraph, there shall be included, in addition to the number of recordholders reflected on the corporation's stock records, the number of holders of the equity securities held in the name of any nominee holder which furnishes the corporation with a certification equivalent to the certification permitted by subdivision (a) of Section 2115, provided, that the corporation retains the certification with the record of shareholders and makes the certification available for inspection and copying in the same manner as provided in Section 1600.

\textsuperscript{146} The statutory language is as follows: "A listed corporation may, by amendment of its articles or bylaws, adopt provisions to divide the board of directors into two or three classes to serve for terms of two or three years respectively, or to eliminate cumulative voting, or both." Id. § 301.5(a).

\textsuperscript{147} Id. Under section 152, approval of the outstanding shares means a majority vote at a meeting of all outstanding shares entitled to vote, not just approval by a majority of shares represented at the meeting. CAL. CORP. CODE § 152 (West 1977 & Supp. 1990). Section 903 provides that articles amendments which affect a particular class of shares must receive the approval of the outstanding shares of that class. Id. § 903.

\textsuperscript{148} Memorandum, supra note 73, at 8; see also supra note 50 for an explanation of the "Wall Street Option."
Section 301.5(a) does allow nonlisted companies to prospectively create staggered terms or to opt out of cumulative voting by amending bylaws or articles. However, such amendments will not become effective until the corporation meets the statutory definition of a listed company in section 301.5(d). The purpose of this provision is to allow small companies to put into place their desired corporate policies and procedures in advance of an initial public offering. Currently, privately held companies incorporate in other states (even though they are now subject to California law by the operation of section 2115) to take advantage of those states’ lenient laws for public companies in the event of future growth.

Under section 301.5(b), a corporation that chooses to stagger terms is subject to provisions to insure “that a sufficient number of directors will be elected each year and that each class on the board of directors will be approximately the same size.” This subsection also provides that staggered terms may originate at the same meet-

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149. See, e.g., Sturdy, supra note 74, at 557. Sturdy recognizes that a close corporation presents quite a different picture from the large publicly held corporation. In the close corporation there are typically a few owners, probably each with a substantial percentage of the stock. . . . There is unlikely to be a market for his shares, except to the other owners, and he probably doesn’t desire to sell out in any event.

150. The pertinent statutory language is as follows:

After the issuance of shares, a corporation which is not a listed corporation may, by amendment of its articles or bylaws, adopt provisions to be effective when the corporation becomes a listed corporation to divide the board of directors into two or three classes to serve for terms of two or three years respectively, or to eliminate cumulative voting, or both.


Subsection (e) provides that a listed corporation has to include in the certificate of amendment “a statement of the facts showing that the corporation is a listed corporation within the meaning of subdivision (d).” Id. § 301.5(e). Also, if a corporation is not a listed corporation and decides to effect these changes, the following statement is required:

“This provision shall become effective only when the corporation becomes a listed corporation within the meaning of Section 301.5 . . . .” Id.

151. Memorandum, supra note 73, at 9. An initial public offering (commonly referred to as an IPO) is synonymous with “going public,” which is defined as “the first public distribution of securities by an issuer pursuant to registration under the securities acts.” R. HAMILTON, supra note 103, at 456.

152. See supra text accompanying notes 58-60.

153. Memorandum, supra note 73, at 8. Subsection (b) reads as follows:

If the board of directors is divided into two classes pursuant to subdivision (a), the authorized number of directors shall be no less than six and one-half of the directors or as close an approximation as possible shall be elected at each annual meeting of shareholders. If the board of directors is divided into three classes, the authorized number of directors shall be no less than nine and one-third of the directors or as close an approximation as possible shall be elected at each annual meeting of shareholders.

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ing at which the vote to amend the articles or bylaws under subsection (a) takes place. However, the amendments must receive shareholder approval.\textsuperscript{164}

Finally, section 301.5(c) applies to companies that adopt staggered terms but keep cumulative voting. Under this section, when directors of more than one class are up for election, votes can only be cumulated within each class.\textsuperscript{168} While this provision may limit the effectiveness of cumulative voting,\textsuperscript{166} "as a practical matter . . . [it] will apply only on the initial division of the board of directors into classes and if the entire board is removed."\textsuperscript{167}

The new legislation also significantly changed section 303. First, under section 303(a)(3), if a company chooses to stagger terms under section 301.5, a director cannot be removed without cause if the votes against removal would have been sufficient to elect the director under cumulative voting.\textsuperscript{168} Before the amendment of section 303(a), a majority of the outstanding shares could remove the entire board without cause.\textsuperscript{169} Second, section 303 now provides that "an amendment to the Articles of Incorporation reducing the number of classes of directors does not remove a director prior to the expiration

\begin{footnotesize}
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\item The pertinent language is as follows:
Directors of a listed corporation may be elected by classes at a meeting of shareholders at which an amendment to the articles or bylaws described in subdivision (a) is approved, but the extended terms for directors are contingent on that approval, and in the case of an amendment to the articles, the filing of any necessary amendment to the articles pursuant to Section 905 or 910.
\textit{Cal. Corp. Code} \S 301.5(b) (West 1977 & Supp. 1990); \textit{see supra} note 147 for code provisions on shareholder approval.
\item Subsection (c) reads as follows: "If directors for more than one class are to be elected by the shareholders at any one meeting of shareholders and the election is by cumulative voting pursuant to Section 708, votes may be cumulated only for directors to be elected within each class." \textit{Id.} \S 301.5(c).
\item The smaller the number of directors to be elected, the larger the number of minority shares necessary to gain minority representation. \textit{See supra} text accompanying notes 80-81.
\item \textit{Memorandum, supra} note 73, at 9.
\item The code section reads as follows:
(3) A director of a corporation whose board of directors is classified pursuant to Section 301.5 may not be removed if the votes cast against removal of the director, or not consenting in writing to the removal, would be sufficient to elect the director if voted cumulatively (without regard to whether shares may otherwise be voted cumulatively) at an election at which the same total number of votes were cast (or, if the action is taken by written consent, all shares entitled to vote were voted) and either the number of directors elected at the most recent annual meeting of shareholders, or if greater, the number of directors for whom removal is being sought, were then being elected.
\item \textit{Id.} \S 303(a).
\end{enumerate}
\end{footnotesize}
of the director’s term of office.”\textsuperscript{160} This section gives the same protection to a classified board as that accorded to a non-classified board, such that directors currently serving out their terms cannot be eliminated by action to decrease the size of the board. The significance of these two amendments to section 303 is that “together they protect a classified board . . . from removal by direct vote or by elimination of classification by a majority shareholder following a hostile takeover, and sustain the function of a classified board . . . in protecting the interests of shareholders whose shares were not acquired.”\textsuperscript{161} Existing provisions for removal for cause remain unchanged.\textsuperscript{162}

2. Comparison with Delaware Law

With the passage of Assembly Bill 1929, California’s Corporations Code now substantially mirrors Delaware’s corporation laws with respect to cumulative voting, staggered terms, and removal of an entire board. For example, Delaware allows a corporation to permissively adopt cumulative voting in its certificate of incorporation.\textsuperscript{163} Likewise, Delaware permits a corporation to stagger directors’ terms with one, two, or three classes of directors serving one, two, or three year terms.\textsuperscript{164} However, Delaware’s provisions, unlike California’s, are not limited in their application to listed companies. This difference probably is not significant because companies not listed may adopt these provisions in anticipation of going public,\textsuperscript{165} and the closely held corporation may still benefit from the prior law remaining in effect as to them. Finally, the changes made to section 303 are almost identical to Delaware’s corresponding provision, which does not allow removal without cause of an entire, classified board.\textsuperscript{166}

IV. Other Recent Developments in California: Selected Legislation

The recent changes to California’s Corporations Code represent a dramatic shift in this state’s policies toward corporations. Other recent legislation suggests that perhaps California has entered the

\textsuperscript{160} Memorandum, supra note 73, at 10. The code section reads: “Any reduction of the authorized number of directors or amendment reducing the number of classes of directors does not remove any director prior to the expiration of the director's term of office.” CAL. CORP. CODE § 303(a)(3)(b) (West 1977 & Supp. 1990) (italics indicate amendment).

\textsuperscript{161} Memorandum, supra note 73, at 10.


\textsuperscript{164} Id. § 141(d).

\textsuperscript{165} See supra text accompanying notes 151-53.

race, but has stalled at the starting gate. For example, a new law was enacted in 1988, known as the “management buyout law,” to protect shareholders in the event of a proposed buyout from an “interested party.”

This statute requires that, in the event of a management buyout, an affirmative opinion in writing as to the fairness of the consideration to the shareholders of the corporation shall be delivered to the shareholders. In addition, management is now compelled to disclose competing outside offers to its shareholders. The purpose of this rule is to “protect[] investors’ interests in situations in which the very people responsible for representing the shareholders’ interests are the buyers.” This requirement deters management from undertaking a buyout that will not pass financial scrutiny. Also, the shareholders will receive enough information to make an informed decision on the value of their shares.

Although this new statute is decidedly pro-shareholder, it is not at odds with developments in Delaware. While Delaware does not have a similar statute, the courts in that state have judicially imposed similar requirements in the context of mergers and acquisitions. Therefore, even though California has codified its pro-shareholder position in management buyouts, this should not be considered an impediment to California’s efforts to attract and retain corporations. Delaware maintains a substantially similar position on this issue.

Another recent legislative development, unlike section 1203, is decidedly pro-management. This new statute limits or fully eliminates personal liability for directors in the event of a director’s

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169. An interested party is defined by the statute as one who: “(A) directly or indirectly controls the corporation . . . (B) is, or is directly or indirectly controlled by, an officer or director of the subject corporation, or (C) is an entity in which a material financial interest . . . is held by any director or executive officer of the subject corporation.” CAL. CORP. CODE § 1203(a)(5) (West Supp. 1990).
170. Id. § 1203(a).
171. Id. § 1203(b).
172. Bagley & Robertson, supra note 168, at S10, col. 2.
173. Id.
174. See, e.g., Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (directors found grossly negligent, and therefore outside the protection of the business judgment rule, for failing to properly ascertain the value of the company before approving a merger); Weinberger v. U.O.P., Inc., 457 A.2d 701 (Del. 1983) (court imposed duty of proving the “inherent fairness” of a merger when the approving directors were on both sides of the transaction).
breach of duty to the corporation.\textsuperscript{176} Section 204(a)(10) was enacted in direct response to a similar 1986 enactment in Delaware. After Delaware's law became effective "many public corporations changed their legal domicile from California to Delaware."\textsuperscript{177}

Some exceptions exist where a director may not escape liability under both the California and Delaware codes which for the most part are identical.\textsuperscript{178} The significant difference is that in California a director is not immune from personal liability for acts of gross negligence, whereas in Delaware a grossly negligent director may still have immunity. Therefore, a director of a California corporation may incur liability in some cases where a Delaware director may not.\textsuperscript{179} Nevertheless, with section 204(a)(10), just as in the enactment of the legislation that is the main focus of this comment, the California legislature seems to be reacting to the loss of California public corporations to other jurisdictions. The legislature seems willing to enter the "race" at the expense of the state's historic pro-shareholder bias.

V. CONCLUSION: IS CALIFORNIA ENTERING RACE TO THE BOTTOM?

This new legislation was enacted in the hopes of making "incorporating in California more attractive."\textsuperscript{180} The question remains whether these changes alone will help California to attain this goal. Whether or not this goal is attained, it appears that these changes were warranted.

Permissive cumulative voting is the best approach in this modern era. The basis on which cumulative voting began is clearly an anachronism in the public company.\textsuperscript{181} Further, cumulative voting has not really protected minority interests.\textsuperscript{182} Even the institutional investor, who might have the strength to successfully utilize cumulative voting, usually votes with incumbent management.\textsuperscript{183} Also, it was noted

\textsuperscript{176} Acterkirchen, Limitation of Directors' Liability and Indemnification of Officers and Directors—California's Response to Delaware, 9 CAL. BUS. L. REP. 63 (1987).
\textsuperscript{177} Id. Raychem Corporation, Lucky Stores, Inc., The Clorox Company, Ashton-Tate and MicroPro International Corporation were among the companies that changed their domiciles. Id.
\textsuperscript{178} Id.
\textsuperscript{179} Id.
\textsuperscript{180} SENATE INS., CLAIMS & CORPS. COMM., REPORT ON ASSEMBLY BILL NO. 1929 (Aug. 23, 1989) ("It is believed that as long as California restricts the use of staggered or classified boards and permits cumulative voting that California based corporations will continue to incorporate in foreign jurisdictions."). Id.
\textsuperscript{181} See supra text accompanying notes 91-105.
\textsuperscript{182} See supra text accompanying notes 106-22.
\textsuperscript{183} See Note, supra note 119, at 139. The State Teachers Retirement System (STRS) and Institutional Shareholder Services, Inc. (ISS) strongly opposed the new legislation on the grounds that "[s]hareholders with a significant stake in the corporation
as early as 1961, that when shareholders have the option to eliminate cumulative voting, they overwhelmingly vote to do so. Finally, California has other ways of ensuring that corporate boards operate in the best interests of the shareholders and the corporation.

As for staggered terms, opponents argue that this provision "can do serious harm to shareholder rights and share value," and that the company may suffer if it cannot remove an incompetent director for a period of years. This premise is faulty for two reasons. First, if a director's actions are truly injurious to the corporation, the director can be removed for cause under section 304. Second, the vast majority of companies with publicly traded securities are domiciled in Delaware, which allows staggered terms. Incorporation in Delaware has not negatively impacted share value, nor has it deterred investors from investing in those companies.

This new legislation is most provocative in the takeover context. If one supports the premise that takeover activity actually benefits minority shareholders through the premium realized on their shares, then this new legislation, perhaps, is detrimental to the shareholders' interests. Staggered terms and the elimination of cumulative voting are two notorious shark repellents. On the one hand, by deterring acquisition of California corporations, one could argue that the legislature has deprived the shareholder of the right to profit from a takeover. On the other hand, corporations with their domiciles in other, should, as a matter of right, be guaranteed that their interests will be heard by the board; the availability of cumulative voting is the only way to provide this right."

A noteworthy attempt at using the muscle of the institutional investor to effect change in the corporate arena was advocated by State Controller Gray Davis. Bus. Wire, Apr. 5, 1989. Davis urged the California Public Employees' Retirement System to vote against Exxon management's slate of directors if Exxon did not act "responsibly" in the aftermath of the Exxon Valdez oil spill. Id. Whether or not Davis' suggestion was put into effect, however, is unknown.

184. Sturdy, supra note 74, at 574-75.
185. See, e.g., Cal. Corp. Code § 309(a) (West 1977 & Supp. 1990) (fiduciary duty of care to the corporation and its shareholders); Id. § 310 (fiduciary duty of loyalty in interested director transactions); Id. § 1203 (provides protection to shareholders in the event of a management buyout); see also Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 110, 460 P.2d 464, 472, 81 Cal. Rptr. 592, 600 (1969) (Directors have a duty to act with "inherent fairness" to the corporation and its shareholders.).
186. CONCURRENCE, supra note 183, at 2.
187. See supra text accompanying note 162.
188. See supra text accompanying note 3.
189. See supra text accompanying notes 100-04.
190. See supra text accompanying notes 133-35.
more lenient, states have still been takeover targets. Shark repellents alone may deter but cannot thwart a hostile takeover attempt.\textsuperscript{191} Thus, it is somewhat ironic that provisions intended to provide shareholders with control over corporations have made a hostile takeover more feasible, thereby lessening the minority shareholder’s power. And yet the minority shareholder usually profits from takeover activity.

However, from the standpoint of social responsibility there is a broader goal to this new legislation than merely protecting incumbent management, perhaps at the expense of the minority shareholder. The California economy is in a perilous position unless the state strengthens its role in the area of corporate governance.\textsuperscript{192} The California legislature apparently has made a concerted effort to enter the “race to the bottom” in order to remedy this situation. Whether these changes are “too little, too late” remains to be seen as the corporate world continues to funnel down to a few corporate giants already firmly entrenched in Delaware and other jurisdictions.\textsuperscript{193}

Furthermore, the court system in Delaware has led, in part, to that state’s preeminence in corporate governance.\textsuperscript{194} Whether the California courts will take their cue from the legislature and become more hospitable to corporate management remains an open question. In the meantime, however, California has protected itself from any further loss of control over the corporations within its boundaries. If the remaining California corporations flock to adopt these new provisions, it will indicate that the legislature attained its goal and that California may have taken a step toward a position of prominence in the area of corporate governance.

\textbf{SUSAN A. ROSE}

\textsuperscript{191} \textit{Memorandum}, \textit{supra} note 73, at 4.
\textsuperscript{192} See \textit{supra} text accompanying notes 60-70. For an interesting side effect of the takeover trend see \textit{L.A. Times}, Nov. 25, 1989, at A26, col. 1. This article discusses a sixteen percent decline in donations to the needy by the giants in the food industry in 1989 and attributes this decline to the rise in corporate takeovers “that have left food industry executives glued to the bottom line and less concerned about the needy.” \textit{Id.}
\textsuperscript{193} See, e.g., \textit{The Role of Giant Corporations in the American and World Economies: Corporate Secrecy: Overviews, Hearings Before the Subcomm. on Monopoly of the Select Comm. on Small Bus.}, 92nd Cong., 1st Sess. (1971) reprinted in \textit{R. HAMILTON, supra} note 50, at 519-20 (“These few corporations have become much larger in economic size and power than either the States that chartered them or the markets in which they buy and sell.”) \textit{Id.}
\textsuperscript{194} See \textit{supra} text accompanying note 5.