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Author(s): Bo Becker, Daniel Bergstresser, and Guhan Subramanian

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Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable's Challenge

Bo Becker *Harvard University*

Daniel Bergstresser *Brandeis University*

Guhan Subramanian *Harvard University*

Abstract

We use the Business Roundtable's challenge to the Securities and Exchange Commission's (SEC's) 2010 proxy access rule as a natural experiment to measure the value of shareholder proxy access. We find that firms that would have been most vulnerable to proxy access, as measured by institutional ownership and activist institutional ownership, lost value on October 4, 2010, when the SEC unexpectedly announced that it would delay implementation of the rule in response to the Business Roundtable's challenge. We examine intraday returns and find that the loss of value occurred just after the SEC's announcement on October 4. We find similar results for July 22, 2011, when the U.S. Court of Appeals for the District of Columbia Circuit ruled in favor of the Business Roundtable. These findings are consistent with the view that financial markets placed a positive value on shareholder access, as implemented in the SEC's 2010 rule.

1. Introduction

Shareholder access to the company's proxy statement has been one of the most heated—if not the most heated—topics in corporate governance over the past

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decade.¹ Opponents of proxy access argue that it would shift a dangerous amount of power to certain kinds of shareholders (for example, union pension funds) who could pursue objectives counter to shareholder value maximization (see, for example, Bainbridge 2003). They also argue that high-quality directors may be less willing to serve on boards if they must face competition from shareholder-sponsored candidates (see, for example, Lipton and Rosenblum 2003). Proponents of shareholder access argue that competition in the election process for directors is desirable and that giving institutional investors more influence in the director election process will likely benefit all shareholders (Bebchuk 2003; Bebchuk and Hirst 2010).

We use the Business Roundtable's challenge to the proxy access rule as a natural experiment to measure the value of shareholder proxy access. On August 25, 2010, under authority provided by section 971 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, 124 Stat. 1376 [2010]), the Securities and Exchange Commission (SEC) enacted shareholder proxy access rule 14a-11. This rule was intended to go into effect on November 15, 2010. On September 29, however, the Business Roundtable filed a petition in the U.S. Court of Appeals for the District of Columbia Circuit (D.C. Circuit) challenging the new rule, alleging that it was arbitrary and capricious, exceeded the SEC's authority, and would reduce overall shareholder wealth. In a move that surprised most observers, the SEC announced on October 4 that it would delay implementation of the new rule until the Business Roundtable's challenge was resolved. On July 22, 2011, the D.C. Circuit struck down the rule under the Administrative Procedure Act, accepting the Business Roundtable's argument that the SEC was insufficiently deliberate and rational in adopting the rule. In September 2011, the SEC announced that it would not appeal the D.C. Circuit's ruling but rather would permit shareholders to pursue access on a company-by-company basis.

The Business Roundtable's challenge to the SEC's proxy access rule provides the basis for an event study. If shareholder access increases value to shareholders, then the value of companies that would have been most vulnerable to the new rule should decline, relative to the value of companies that would have been more insulated from the rule, in response to the SEC's unexpected stay on proxy access (October 4, 2010) and the (arguably) unexpected decision by the D.C. Circuit to invalidate proxy access (July 22, 2011). If instead shareholder access decreases value to shareholders, then the value of companies that would have been most vulnerable to the rule should increase, relative to the value of those that would have been more insulated, on these dates. This natural experiment allows a rough quantification of the value of shareholder proxy access. In addition, the experiment allows testing of hypotheses about board influence. If

¹ According to the Business Roundtable, "Few issues in corporate governance have generated more disagreement or stronger passions" (*Business Roundtable and U.S. Chamber of Commerce v. U.S. Securities and Exchange Commission*, No. 10-1035 [D.C. Cir. complaint filed September 29, 2010], p. 2).

there is heterogeneity across firms in the value of shareholder influence through the board of directors, or across different types of shareholders in their ability to improve the value of firms, our natural experiment provides an opportunity to quantify those differences.

We use measures of institutional ownership, and activist institutional ownership in particular,² as a proxy for vulnerability to the rule. Using a 1-day event window around October 4, 2010,³ we find that share prices of companies that would have been most vulnerable to the rule declined significantly compared to share prices of companies that would have been most insulated from the rule. In particular, we find a 44-basis-point spread between firms with high levels of institutional ownership and firms with low levels of institutional ownership for that day's returns. The pattern of lower returns for firms with higher levels of institutional ownership holds true for equal-weighted excess-return portfolios (a 37-basis-point differential) as well as portfolios based on activist ownership (a 43-basis-point differential). All three of these estimates are statistically significant. In a regression setting, we confirm that institutional ownership, and especially activist institutional ownership, is correlated with negative returns on October 4. For July 22, 2011, we find results that are directionally similar to those of October 4, 2010, slightly smaller in magnitude, and statistically significant. Taken as a whole, these findings are consistent with the view that financial markets placed a positive value on shareholder access, as implemented in the SEC's August 2010 rule. Presumably, the stock market perceived the stay as a reduced likelihood of proxy access in the short run as well as in the long run, perhaps seeing the stay as an indication of the SEC's own perception of its ability to defend the rule in court.

We also use intraday data on October 4 to determine whether our overall results can be attributed to shareholder proxy access. We find that virtually all of the observed activist effect comes after the 12:21 p.m. announcement of the SEC stay—a period during which the overall market hardly moved. The loss in value in activist-held firms appears to have accelerated substantially after a Bloomberg.com news story about the SEC stay appeared at 3:20 p.m. These intraday results suggest that the relative drop in the market value of equity for firms with large activist ownership can be attributed to the SEC's announcement delaying shareholder proxy access.⁴

² By "activist hedge fund," we refer to hedge funds with a history of corporate activism and intervention (see Greenwood and Schor 2009; Brav et al. 2008). We discuss the motivation for this in more detail later.

³ Using a 1-day event window to study proxy access is tantamount to focusing on the market's short-term view of the announcement's effect on value. Unfortunately, the event study methodology is much less suitable for identifying the market's long-term views (since long-term stock returns are more variable than short-term stock returns).

⁴ We use the intraday findings to respond to critics of an earlier version of our paper, who expressed skepticism about the validity of event study methodology in general and the causal inferences that can be drawn from such a methodology. For example, "[R]eaders with little understanding of and less confidence in the black art of regression analysis may well be skeptical of a paper that claims

The paper proceeds as follows. Section 2 summarizes the evolution of shareholder access in the United States, Section 3 reviews the existing related literature on proxy access and corporate governance more generally, Section 4 explains our empirical strategy, and Section 5 describes our data and methodology. Section 6 presents our results, and Section 7 discusses potential interpretations. Section 8 concludes.

2. Background: Proxy Access and Boards of Directors in the United States

The corporate law of every U.S. jurisdiction requires that corporations hold an annual meeting to elect directors. In this election, the company invariably nominates exactly the number of candidates to fill the available seats—for example, seven candidates for seven seats. Shareholders of the corporation have the right to nominate his or her own candidates to the board. Any shareholder can propose a nominee to the board's nominating committee, but if the board refuses to put the shareholder's candidate on the company's slate (which is by far the more common outcome), the shareholder would have to engage in a time-consuming and expensive process in order to get the candidate seated. In particular, a shareholder who wants to nominate one or more candidates would have to file schedule 14A with the SEC, hire a proxy solicitor, and often engage in an expensive public campaign to support the nominee or nominees. These expenses are reimbursed only if the shareholder gains control of the board (for the classic statement of this rule, see *Rosenfeld v. Fairchild Engine and Airplane Corp.*, 128 N.E. 2d 291 [N.Y. 1955]). Moreover, the shareholder must share the benefits of any improvement in corporate performance pro rata with the other shareholders. As a result of these obstacles, contested director elections outside the context of a hostile takeover bid have been exceedingly rare in corporate America (Bebchuk 2003).⁵

Against this backdrop, many commentators have viewed shareholder access to the company's proxy statement as an essential step to make director elections more meaningful and, by extension, to improve overall corporate governance. After decades of discussion,⁶ and not coincidentally in the wake of corporate scandals at Enron, WorldCom, and other large U.S. public companies, the SEC proposed a shareholder access rule in October 2003. Under the 2003 rule, share-

to be able to assign a value measured in basis points to a single amorphous factor on a single trading day among the dozens that affect the value of stocks" (Marcus 2010, p. 28).

⁵ In July 2007, the Securities and Exchange Commission (SEC) (Release No. 34-56135, July 26, 2007, p. 1) promulgated its long-awaited eProxy rules, which allow insurgents to post their proxy materials online and simply mail shareholders a Notice of Internet Availability of Proxy Materials. In theory, eProxy rules should reduce the costs of proxy solicitation and increase the number of contested director elections. However, the early empirical evidence suggests that the number of contested director elections did not increase substantially in the 2009 or 2010 proxy seasons.

⁶ The SEC first considered proxy access in 1942 (see SEC, Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,029 n.73 [June 18, 2009]).

holders would gain the right to place one or more nominees on the company's proxy statement after one of two trigger events had occurred: a level of withhold votes of more than 35 percent of those cast for one or more directors or a majority vote for a rule 14a-8 shareholder access proposal from a shareholder or shareholder group that had held at least 1 percent of the company's shares for at least 1 year. The Business Roundtable and other groups representing director and management interests engaged in a lobbying effort against the proposed rule. By early 2005, the SEC had issued a series of no-action letters permitting companies to omit shareholder proposals based on the 2003 rule, effectively withdrawing that rule.

In 2006, the American Federation of State, County, and Municipal Employees (AFSCME) submitted a shareholder proposal to American International Group (AIG) to amend AIG's bylaws so that a 3 percent shareholder could place one nominee on AIG's proxy materials—in effect, trying to do at AIG what the SEC's proposed rule 14a-11 had tried to do more generally. Surprising many commentators, the U.S. Court of Appeals for the Second Circuit held that this proposal was not excludable under the rule 14a-8(i)(8) exclusion, which at the time permitted companies to exclude proposals “relat[ing] to an election for membership on the company's board of directors.” The court found that the proposal related to board elections broadly and not to “an election” of directors (*AFSCME v. AIG*, 462 F.3d 121 [2d Cir. 2006]). The holding seemed to open up the possibility of proxy access on a company-by-company basis. But in December 2007, the SEC (Release No. 34-56914, December 6, 2007, p. 28) amended the rule 14a-8(i)(8) exclusion to permit corporations to exclude proposals “relat[ing] to . . . an election for membership on the company's board” or to “a procedure for such nomination or election.” This amendment was intended to reverse the Second Circuit's holding in *AFSCME v. AIG*.

Shareholder proxy access remained dormant until May 2009, when the SEC returned to the issue with a new shareholder access proposal. The SEC explained: “The nation and the markets have recently experienced, and remain in the midst of, one of the most serious crises of the past century. This crisis has led many to raise serious concerns about the accountability and responsiveness of some companies and boards of directors to the interests of shareholders, and has resulted in a loss of investor confidence” (SEC, Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,025 [June 18, 2009]). Under the proposed rule 14a-11, a shareholder or shareholder group that owned more than 1 percent of a large U.S. public company (defined as having a market capitalization of greater than \$700 million), more than 3 percent of a midsize public company (market capitalization of \$75–\$700 million), or more than 5 percent of a small public company (market capitalization of less than \$75 million) would have the ability to place nominees on the company's proxy statement for up to one-quarter of the total board seats.

In an effort to preempt or at least shape the SEC's consideration of shareholder access, Delaware amended its corporate code to confirm that shareholders could

amend the company's bylaws to permit proxy access. Section 112 of the Delaware General Corporation Law (Del. Code Ann., tit. 8, sec. 112 [2013]), enacted in May 2009, has the provision that "[t]he 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 . . . 1 or more individuals nominated by a stockholder." Section 112 reflects one application of the Delaware Supreme Court's holding in *CA v. AFSCME* (953 A.2d 227 [Del. 2008]), handed down in July 2008, which permits shareholders to regulate procedural aspects of corporate governance (for example, how decisions are made) but not substantive aspects, which are left to the board. Thus, section 112 confirmed the shareholders' right to opt in to proxy access (a so-called voluntary proxy access regime).

In July 2010, the U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Notwithstanding Delaware's efforts to preempt federal action, section 971 of the act amended section 14(a) of the Securities Exchange Act of 1934 (Pub. L. No. 73-291, 48 Stat. 881) to provide the SEC with explicit authority to adopt proxy access rules. By confirming that the SEC had the authority to issue shareholder access rules and signaling Congress's support for such rules, section 971 made shareholder proxy access inevitable, according to most observers.

On August 25, 2010, by a 3–2 vote, the SEC announced the adoption of a final rule 14a-11, mandating proxy access at all U.S. public companies. Any shareholder or shareholder group that held more than 3 percent of a U.S. public company's shares for more than 3 years would be eligible to nominate candidates for up to 25 percent of the company's board seats. The new rule 14a-11 was planned to go into effect on November 15, 2010, well in time for the April–May 2011 proxy season.⁷

On September 29, the Business Roundtable, along with the U.S. Chamber of Commerce, filed a complaint in the D.C. Circuit, alleging that the SEC's proxy access rules were unlawful under U.S. securities laws and "arbitrary and capricious."⁸ The Business Roundtable complaint also asserted—but did not explain—that the SEC's proxy rules "do not promote efficiency, competition, and capital formation" (*Business Roundtable and U.S. Chamber of Commerce v. U.S. Securities and Exchange Commission*, No. 10-1035 [D.C. Cir. complaint filed September 29, 2010], p. 2). The complaint was widely anticipated by the marketplace, if we judge from public statements, including the comment letters submitted by these two groups to the SEC on the proxy access proposal. Nevertheless, Congress's authorization of the SEC under section 971 of the Dodd-Frank Act was intended to largely shut down this kind of challenge; perhaps as a result, the

⁷ The 3-year rule excluded many investors with shorter holding periods. However, the rule would have allowed investors with 2-year holdings, for example, to qualify relatively soon. Cella (2012) shows that activist investors have longer holding periods than other investors in the United States.

⁸ For ease of exposition, we refer to this litigation as the "Business Roundtable complaint" or the "Business Roundtable challenge" hereafter.

filing of the Business Roundtable complaint did not attract significant media attention.

However, on October 4, the SEC unexpectedly announced that it would stay implementation of rule 14a-11, pending resolution of the Business Roundtable litigation in the D.C. Circuit. The SEC explained, "Among other things, a stay avoids potentially unnecessary costs, regulatory uncertainty, and disruption that could occur if the rules were to become effective during the pendency of a challenge to their validity" (In re the Motion of Business Roundtable and the Chamber of Commerce for the United States of America for Stay of Effect of Commission's Facilitating Shareholder Director Nominations Rules, File No. S7-10-09 [D.C. Cir. order granting stay filed October 4, 2010], p. 2). News accounts noted that the SEC's announcement was a surprise (see, for example, the memo from Wachtell, Lipton, Rosen & Katz, which describes it as an "unexpected development").⁹ Commentators also noted that the SEC's stay meant that proxy access rules would not go into effect for the 2011 proxy season (see, for example, the Wachtell memo; Westbrook 2010).

On July 22, 2011, the U.S. Court of Appeals for the D.C. Circuit struck down rule 14a-11 under the Administrative Procedure Act. The D.C. Circuit accepted the Business Roundtable's argument that the SEC's process in considering and adopting the new rule was insufficiently deliberate and rational (*Business Roundtable and Chamber of Commerce v. SEC*, 647 F.3d 1144 [D.C. Cir. 2011]).

In September 2011, the SEC announced that it would not appeal the D.C. Circuit's ruling but instead would reinstate its amendments to rule 14a-8, which would allow shareholders to vote on a resolution recommending or requiring the inclusion of shareholder-sponsored board candidates in the next year's corporate proxy statement. The SEC thus moved away from comprehensive proxy access to a two-step, company-by-company approach. Shareholders at several major companies, including Bank of America, Goldman Sachs, Hewlett-Packard, Sprint Nextel, and Wells Fargo, proposed proxy access resolutions for the 2012 proxy season (Zweig 2012).

3. Literature

The delegation of control over firms to professional managers is a defining feature of modern capitalism (see Berle and Means 1932) and one that raises the possibility of agency problems. Estimating the economic impact of boards and board structure on shareholder wealth has been difficult because of econometric identification challenges. Hermalin and Weisbach (1998) point out that one reason that much of the corporate governance literature finds weak correlations between board characteristics and firm performance may be that board characteristics are endogenous; that is, across firms, board characteristics are

⁹ SEC Stays Shareholder Access—for Now, Wachtell, Lipton, Rosen & Katz memorandum to clients, October 5, 2010.

likely not assigned at random. This makes the effect of any board characteristic (for example, the presence of outsiders, the number of directors) impossible to identify on the basis of only the observed correlation between that characteristic and firm performance.

Shareholder access to the company's proxy statement is one specific dimension of corporate governance that has been heavily debated over the years. As an illustration, more than 700 different comment letters were submitted to the SEC when proxy access was proposed in 2003, more than 200 different comment letters were submitted during the 2007 rule-making process, and more than 500 different comment letters were submitted when proxy access was proposed again in 2009. Proponents of shareholder access (see, for example, Bebchuk 2003; Bebchuk and Hirst 2010) point out that proxy contests under the existing regime are exceedingly rare and argue that a meaningful director election process would improve corporate governance. Opponents of shareholder access argue that shareholders already have sufficient voice in the election of directors (see, for example, Bainbridge 2010), that shareholder access rules would likely shift too much power to shareholders or shareholders with specific agendas, and that high-quality directors may be less willing to serve on boards if they must face competition from shareholder-sponsored candidates (see, for example, Lipton and Rosenblum 2003).¹⁰ A third set of commentators object to the one-size-fits-all approach of mandatory shareholder access (see, for example, Grundfest 2010b). These commentators propose that shareholders should be able to opt in, or at least opt out, of the SEC's proxy access rules.

A recent theory paper by Harris and Raviv (2010) addresses the optimal extent of control to place in the hands of shareholders versus managers. Their model includes strategic communication between self-interested and potentially privately informed managers and shareholders as well as delegation. Harris and Raviv find that when shareholders seek to maximize firm value and are not misinformed, it is optimal to place the delegation decision in the hands of shareholders, allowing them to decide *ex ante* which decisions to leave to management and which to make directly. Owners will then delegate decisions when management's information advantage outweighs its agency costs to managers. The authors view this result as being consistent with Bebchuk's (2005) recommendation to allow shareholders to set the rules of the game regarding decision power and corporate governance.

Kahan and Rock (2011) argue that proxy access would be unlikely to yield a significant number of shareholder-nominated candidates and unlikely to have a meaningful effect on corporate governance more generally. Drawing inferences from past behavior, the authors argue that neither mutual funds nor private pension funds would make significant use of shareholder access. Large public

¹⁰ This argument is related to the idea proposed by Burkart, Gromb, and Panunzi (1997) that closer oversight may weaken managerial incentives. Adams and Ferreira (2007) argue that management-friendly boards are sometimes optimal because they pose a weaker monitoring threat, which enables them to solicit more information from CEOs.

pension funds “may make some nominations” (Kahan and Rock 2011, p. 1347), but hedge funds and union-affiliated funds, which historically have been more activist, would generally not satisfy the ownership and holding-period requirements under the rule. In addition, Kahan and Rock argue that the proxy access rule would not substantially lower the costs of running a short-slate contest and that, in some respects, the costs of running a candidate using the company’s proxy statement would be greater than running a candidate in the traditional manner.

While we agree with Kahan and Rock that the number of actual candidates under a shareholder access regime may very well be small, we believe that Kahan and Rock give too little weight to the potential for more meaningful constructive engagement between large shareholders and the company under a proxy access regime, when the stick of a proxy access candidate is lurking in the background. Moreover, Kahan and Rock’s predictions about shareholders’ willingness to use proxy access are based on past behavior and do not account for the possibility that shareholder behavior would change in response to a new regime.¹¹ Leaving aside the hypothetical future role of proxy access, our study focuses on a set of investors with a track record of activism (that is, we study the changes in value for firms held by such investors). In any event, we agree with Kahan and Rock that proxy access would have both costs and benefits; the question then becomes how best to predict whether the benefits outweigh the costs and the magnitude of the net benefits, if any.

The idea of empirically evaluating regulatory changes with stock market data was introduced by Schwert (1981) (see Hochberg, Sapienza, and Vissing-Jørgensen [2009] for a recent example). Two prior studies and one contemporaneous study use this methodology to examine the wealth effects of shareholder proxy access. Akyol, Lim, and Verwijmeren (2010) examine 17 events between September 2006 and December 2009 that, in their interpretation, increased¹² or

¹¹ In a recent presentation of this paper alongside Kahan and Rock, one of us observed that Kahan and Rock’s approach to proxy access could similarly be used to predict that texting is unlikely to be a significant mode of communication: texting is just slightly less costly than e-mail (for example, there is no need for a header, as is the convention with e-mail), and in some ways texting is more costly than e-mail (for example, you need to know the phone number rather than just the e-mail address). Of course, this prediction would be highly inaccurate because behavior has in fact changed in response to the new technology, at least in part because text messages go to a space (the phone number) that is far more sacrosanct than the e-mail inbox. The analogy to proxy access should be apparent: a simple cost-benefit analysis ignores the possibility for behavior change because a proxy access candidate goes to a sacred space, namely, the company’s own proxy statement.

¹² The 11 events that, according to the authors, increased the likelihood of shareholder proxy access were the Second Circuit’s holding in *AFSCME v. CA* (September 5, 2006), the SEC announcement of a roundtable discussion on proxy access (April 24, 2007), the SEC’s disclosure of a proposed rule on proxy access (July 27, 2007), a speech by SEC commissioner Elisse Walter on proxy access (February 18, 2009), a speech by SEC chair Mary Schapiro on proxy access (April 6, 2009), the SEC’s announcement that it would vote on a proposed rule (May 12, 2009), the SEC’s announcement of the content of the proposed rule (May 14, 2009), the introduction of the Schumer bill in the U.S. Senate (May 19, 2009), the SEC’s vote in favor of the proposed rule on proxy access (May 20, 2009), a *Wall Street Journal* article (August 5, 2010), and the approval by the SEC (August 25, 2010).

decreased¹³ the likelihood of shareholder proxy access. For each event date, they compare the returns from a portfolio of U.S. firms to the returns from a global market portfolio (excluding U.S. firms) and from a Canadian market portfolio. They also isolate U.S. financial firms from other U.S. firms, on the theory that financial firms might be more likely to be targeted by shareholders for proxy access. Eight of the events taken individually produce statistically significant abnormal returns around the event dates (at 95 percent confidence), and when the events are aggregated, the returns are highly significant and inversely correlated with shareholder proxy access. In particular, the authors find that an increased likelihood of shareholder access reduced returns for the U.S. portfolio relative to the non-U.S. portfolios and reduced returns for U.S. financial firms relative to those for nonfinancial U.S. firms. The authors conclude that “increasing shareholder rights . . . may actually be detrimental to shareholder wealth” (Akyol, Lim, and Verwijmeren 2010, p. 33).

Larcker, Ormazabal, and Taylor (2011) similarly use an event study approach to examine 10 events between March 2007 and June 2009 that arguably increased¹⁴ or decreased¹⁵ the likelihood of shareholder proxy access. The authors use the number of institutions with 1 percent or more ownership (NLargeBlock) and the number of possible coalitions that would control 1 percent or more of the shares outstanding (NSmallCoalitions) as proxies for a company’s vulnerability to a shareholder access rule. For five out of the 13 events, the authors find a statistically significant (at 95 percent confidence) negative correlation between NLargeBlock and events that increased the likelihood of shareholder proxy access. For a (somewhat different) five out of 13 events, the authors find a statistically significant negative correlation between NSmallCoalitions and events that increased the likelihood of proxy access. Similar to the results in the

¹³ The eight events that, according to the authors, decreased the likelihood of shareholder proxy access were the SEC’s publication of a final rule 14a-8 with no substantial changes (November 28, 2007), the SEC’s publication of a final rule 14a-8(i)(8) with no substantial changes (December 12, 2007), the introduction of an opt-in shareholder proxy access bill in the Delaware House of Representatives (March 10, 2009), the passage of this bill in the Delaware House (March 18, 2009), the passage of this bill in the Delaware House (March 10, 2009) and in the Delaware Senate (April 8, 2009), the reopening of the comment period on the SEC proposed rule on shareholder access (December 14, 2009), and the U.S. Chamber of Commerce’s suit against the SEC (September 29, 2010).

¹⁴ The five events that, according to the authors, increased the likelihood of shareholder proxy access are the SEC announcement of a roundtable discussion on proxy access (April 24, 2007), the SEC announcement of amendments to rules 14a-8 and 14a-8(i)(8) (July 27, 2007), first mention of potential amendments to rule 14a-11 (April 6, 2009), the SEC’s vote in favor of the proposed rule on proxy access (May 20, 2009), and the publication of the SEC’s draft proposal for rule 14a-11 (June 10, 2009).

¹⁵ The five events that, according to the authors, decreased the likelihood of shareholder proxy access are the SEC’s publication of a final rule 14a-8 with no substantial changes (November 28, 2007), the SEC’s publication of a final rule 14a-8(i)(8) with no substantial changes (December 6, 2007), the introduction of an opt-in shareholder proxy access bill in the Delaware House of Representatives (March 10, 2009), the passage of this bill in the Delaware House (March 18, 2009), the passage of this bill in the Delaware Senate (April 8, 2009), and the reopening of the comment period on the SEC proposed rule on shareholder access (December 14, 2009).

study by Akyol, Lim, and Verwijmeren (2010), the coefficients for both *N*LargeBlock and *N*SmallCoalitions become highly significant and inversely correlated with increased likelihood of shareholder access when all 13 events are pooled. The authors conclude that their findings are consistent with the view that shareholders of 1 percent or more “will use the privileges afforded to them by proxy access regulation to manipulate the governance process to make themselves better off at the expense of other shareholders” (Larcker, Ormazabal, and Taylor 2011, p. 447). Larcker and Tayan (2010, p. 2) summarize this literature as suggesting that “regulation of corporate governance is viewed negatively by shareholders.”

One problem inherent in these prior event studies is that at least some of the events being studied are of questionable importance. For example, both the Akyol, Lim, and Verwijmeren (2010) study and the Larcker, Ormazabal, and Taylor (2011) study identify the announcement of an SEC roundtable discussion series on April 24, 2007, as an event that increased the likelihood of proxy access. With the SEC having considered proxy access off and on for most of the prior decade (and having already promised to take up proxy access after the *AFSCME* decision the prior year), it is not clear why the announcement of a roundtable discussion—with, of course, no prediction on what conclusions the discussants would reach—should convey meaningful information to the marketplace, much less increase the likelihood of proxy access.

In fact, the impact of the April 24 announcement on the likelihood of proxy access is not even directionally clear. At the time of the announcement, the *AFSCME* decision permitted proxy access on a company-by-company basis. In the press release announcing the roundtable series, SEC chairman Christopher Cox noted generally, “This roundtable will explore the relationship between the federal proxy rules and state corporation law, and pose questions to the participants about whether this relationship can be improved” (SEC 2007). After the roundtable, the first move from the SEC, proposed in October 2007 and finalized in December 2007, was to issue amendments to rule 14a-8(i)(8) that overruled the *AFSCME* decision and eliminated proxy access. To the extent that investors interpreted Cox’s general statement to mean that the *AFSCME* decision was vulnerable (which, in retrospect, would have been an accurate interpretation), the April 24 announcement should have decreased the likelihood of shareholder access rather than increased it as the Akyol, Lim, and Verwijmeren (2010) and Larcker, Ormazabal, and Taylor (2011) studies assume.

A second potential problem with these two studies is that many of the events were predicted in advance, at least in part, by the marketplace. For example, it is well known that the Corporate Law Section of the Delaware Bar Association, not the Delaware legislature, creates Delaware corporate law. Once the Corporate Law Section voted in favor of a shareholder access amendment on February 26, 2009, its implementation in Delaware became virtually a foregone conclusion. Both the Akyol, Lim, and Verwijmeren (2010) and Larcker, Ormazabal, and Taylor (2011) studies examine the introduction of the shareholder access bill in

the Delaware House of Representatives (March 10, 2009), the passage of the bill in the House (March 18), and the passage of the bill in the Delaware Senate (April 8) but fail to examine the recommendation from the Corporate Law Council that occurred on February 26. Similarly, the promulgation of the final rule on August 25, 2010, was very accurately predicted in press reports ahead of its actual announcement. If the marketplace fully anticipates an event, then empirical evidence based on wealth effects around that event date can be meaningless.

Despite these deficiencies, the Akyol, Lim, and Verwijmeren (2010) and Larcker, Ormazabal, and Taylor (2011) studies have led some commentators to conclude that shareholder proxy access reduces shareholder wealth. For example, Grundfest (2010a, p. 2) summarizes the “consistent conclusion” from the two studies as follows: “[P]roxy access, as currently proposed by the Commission, reduces shareholder wealth, and, even if preferred by vocal institutional investors, is inimical to the best interests of the shareholder community as a whole. . . . The best currently available empirical data indicate that, given a choice between the current regime and the Commission’s proxy access rules, shareholders seeking to maximize returns would prefer the status quo because the proposed rules appear to destroy shareholder wealth.”

It should also be noted that the Akyol, Lim, and Verwijmeren (2010) and Larcker, Ormazabal, and Taylor (2011) studies were submitted to the SEC as comment letters during the rule-making process and were referenced by the SEC in the final rule. We find the reliance on these prior event studies to be troubling because many of the events were widely anticipated, confounded, directionally unclear, and/or not meaningful, for the reasons given above.¹⁶ In contrast, we study a main event that in our view was unanticipated, unconfounded, directionally clear, and highly meaningful with respect to proxy access. Our second event, the Supreme Court ruling in 2011, was arguably unanticipated and also directionally clear.

Cohn, Gillan, and Hartzell (2011) also use an event study methodology to study proxy access and focus on firms with activist investors (but use a classification scheme for investors that differs from ours). They use three event dates, all more recent than those in the Akyol, Lim, and Verwijmeren (2010) and Larcker, Ormazabal, and Taylor (2011) studies: a refinement of the proxy access rule that clarified the position size requirements for proxy access (June 16–17, 2010), an additional refinement that led to the dropping of the 5 percent threshold from the Dodd-Frank bill (June 24–25, 2010), and the ultimate passage of the proxy access rule (August 25, 2010). Cohn, Gillan, and Hartzell argue that the 5 percent size requirement introduced on June 16–17 was a higher threshold

¹⁶ “What is remarkable about these arguments is the lack of empirical evidence about the actual effect that proxy access would have on the value of public corporations. That is, there is no scientific evidence either way on the impact that shareholder proxy access will have on the stock prices of public corporations. Will it make these companies more or less valuable? Behind this question is whether proxy access has positive or negative worth. Until this month, there have only been two empirical studies even purporting to look at these issues” (Davidoff 2010).

than had been expected in the marketplace and therefore should be interpreted as a negative event for proxy access. When this 5 percent requirement was dropped on June 24–25 this was, in turn, a positive event for proxy access. On August 25, when the final rule was announced, Cohn, Gillan, and Hartzell argue that the surprise event was the 3-year holding period rather than the 2-year version expected by the marketplace; therefore, this was a negative event for proxy access. The authors find a positive correlation between proxy access and shareholder wealth; that is, the two negative events reduced value for companies most vulnerable to proxy access, and the one positive event increased value for companies most vulnerable to proxy access. These findings stand in contrast to the findings from the Akyol, Lim, and Verwijmeren (2010) and Larcker, Ormazabal, and Taylor (2011) studies. The Cohn, Gillan, and Hartzell paper is similar to our study in that it examines the differential return between firms with and without activist owners. We use different event dates and sources of the set of activists. Like us, Cohn, Gillan, and Hartzell conclude that the stock market assigned a positive value to proxy access.

4. Empirical Strategy

The unexpected delay that occurred on October 4, 2010, provides the basis for an empirical test of the wealth effects of shareholder access. We apply the idea of Schwert (1981) that stock price changes following an announcement can be informative about the market's evaluation of the impact of regulation on value. While our focus is on October 4, 2010, we also examine July 22, 2011, when the D.C. Circuit invalidated proxy access.

For an event to be useful as a natural experiment, there are several requirements. First, it has to be unexpected. By all accounts, the SEC's delay was unexpected and therefore not predicted in advance by the marketplace. Second, the effect has to affect stock prices—that is, it must be a relatively significant event. The degree of debate and press coverage around shareholder proxy access suggests that implementation of the rule was a significant event and, by extension, the delay of the rule was also significant. The fact that the SEC had already implemented shareholder access means that a specific rule was on the table, and all companies reacted to the same rule. Finally, evading the proposed regulatory reform must be difficult or impossible. Rule 14a-11 is a mandatory rule, with no prospect for opting out. For this reason, market prices before October 4 likely did not reflect any possibility that companies might evade the rule.

If the marketplace perceived that shareholder access would increase value to shareholders, then companies that would have been most vulnerable to the new rule should decline in value relative to companies that would have been more insulated from the rule. If the marketplace perceived that shareholder access would decrease value to shareholders, then companies that would have been most vulnerable to the rule should increase in value relative to those that would

have been more insulated. Furthermore, we can use the event to test if the perceived effect on value of shareholder access depends on the features of a firm or its shareholders. For example, the possibility of board representation may be more valuable when shareholders are sophisticated or more willing to get involved with the governance of a firm. Board representation may be less valuable if the board already represents the views of outside investors well.

We use several proxies for determining which companies were more and less likely to be affected by the SEC's proxy access rule. First, and most important, we examine the institutional ownership of the companies in our sample, under the assumption that institutions, particularly institutions that held 3 percent or more of the company's stock, would be most likely to make use of proxy access. We also distinguish between activist institutions, such as hedge funds, and traditionally passive institutions, such as index funds, under the assumption that activist institutions would be more likely to make use of proxy access. Many institutions are reluctant to exercise control rights and participate in activism (Pozen 2003; Kahan and Rock 2011). Examples include index funds and some pension funds (see, for example, Del Guercio and Hawkins 1999). Other institutions are much more prone to activism and direct influence on corporate governance. For example, Kahan and Rock (2007) argue that hedge funds have stronger financial incentives and fewer regulatory constraints than mutual funds and may therefore be better able to monitor firms in their portfolios. Greenwood and Schor (2009) also suggest that hedge funds may be better able to identify underperforming companies. Finally, because the SEC's rule would have given proxy access to investors who had held their positions for at least 3 years, we explore empirical specifications that capture the length of time that the firms' existing investors, activist or otherwise, have held their stakes.

We also use three other governance-related measures for determining which companies were more impacted by the SEC's proxy access rule. First, we distinguish between companies incorporated in Delaware and those that are not. At least since May 2009 and likely before, shareholders in Delaware companies have had the ability to opt into shareholder access, while shareholders of companies incorporated in other states do not clearly have this right. It seems possible, therefore, that Delaware companies would have benefited less from SEC-mandated shareholder access than did companies incorporated in other states.

Second, we differentiate companies according to whether they have a staggered board, perhaps the most important antitakeover defense (Bebchuk, Coates, and Subramanian 2002). Finally, we distinguish among companies according to their governance index (Gompers, Ishii, and Metrick 2003). Both of these measures test the theory that companies with greater entrenchment might be more vulnerable to the SEC's rule.

The impact of shareholder proxy access may also depend on the scope for improvement in firm performance. A firm with strong current performance and a high stock price may offer fewer opportunities for intervention. We therefore sort firms on the basis of lagged stock returns and valuation ratios to test whether

the impact of institutional and activist institutional ownership is strongest among the firms with the worst recent performance.

Because our empirical results are based on a single event and stock returns have patterns of cross-sectional correlation, our approach and our measures of statistical significance must be adjusted accordingly. Our baseline regressions use risk-adjusted returns, which control for market performance and the two additional risk factors identified by Fama and French (1993) (see Section 5 for details). Using risk-adjusted returns means that we control for the overall pattern of market movements on October 4. We also report results from regressions using raw returns as the dependent variable for the sake of completeness.

We also need to address cross-sectional correlation among stock returns. Incorrectly assuming independence in stock movements can yield standard error estimates that are biased downward (Fama and French 2000). Therefore, we do not rely on typical regression standard error estimates to assess the significance of our coefficient estimates. Instead, we assess the significance of our results in two ways: generalized least squares (GLS) standard errors and nonparametric assessment using the empirical distribution of coefficient estimates. To calculate GLS standard errors, we follow Greenwood (2005) and use pre-event return data for our sample stocks to estimate the covariance matrix for individual stock returns. We then use this estimated covariance matrix to calculate standard error estimates that adjust for the observed correlations between different stocks.¹⁷ We find that GLS standard error estimates applied to this setting are approximately twice as large as ordinary least squares standard errors. In all tables reporting regressions, we report the GLS standard errors as well as *p*-values from the empirical distribution of coefficient estimates.

As a less parametric approach to assessing statistical significance, we reestimate each regression in the 67 trading days after June 30, 2010. We do not use earlier dates because our key variables of interest are based on institutional holdings as of June 30. We then use the empirical distribution of coefficient estimates to test the significance of each of our regression coefficients. In other words, we empirically estimate how many days other than the event day would have delivered estimated coefficients equal in magnitude to the coefficient we estimate for October 4. Because our significance estimates from this empirical approach are very similar to the GLS-based estimates, our tables report only the GLS standard errors.

5. Data

We collected stock price data from Datastream and define each stock's return as the log of the closing stock price on Monday, October 4, minus the log of

¹⁷ To estimate standard errors, we use in matrix notation $V = (XX)^{-1}(X\Omega X)(XX)^{-1}$, where X is a vector of return data and Ω is the pre-event covariance matrix of returns. This differs from basic ordinary least squares standard errors, which use the identity matrix in place of Ω . An underlying assumption in this approach is that the pre-event covariance matrix is an appropriate estimate for the true underlying covariance matrix on October 4.

the closing stock price on Friday, October 1. We use a 1-day event window because the SEC's announcement on delaying shareholder access came out during the trading day on October 4.¹⁸ We estimate factor-adjusted returns with the Fama and French (1993) three-factor model, which controls for firms' exposure to overall stock market movements as well as a value/growth effect and a small firm effect. We use daily stock returns for the period between January 1, 2009, and December 31, 2009, to estimate firm betas on the Fama and French factors. We use the daily factor returns from French's data library.¹⁹ We winsorize all three beta estimates at the fifth and ninety-fifth percentiles.

We take the Gompers, Ishii, and Metrick (2003) governance measure for each Standard & Poor's (S&P) 1500 firm in 2006, the last year for which the index has been calculated. From RiskMetrics, we identify firms with staggered board provisions and collect data on the number of board members. We collect data on each firm's equity value from the Center for Research in Security Prices (CRSP); doing this allows us to run both value-weighted and equal-weighted empirical tests.

Institutional ownership data come from Thomson Reuters, which summarizes data from 13F filings by institutional investors. We use data from the second quarter of 2010, because later data are incomplete.²⁰ We look exclusively at shares held by U.S. institutions. For each investment manager, we calculate total holdings, in both dollars and number of stocks. For each firm in the sample, we construct the following measures of institutional ownership: the number of institutional owners, the number of institutional owners above the 3 percent ownership threshold (the requirement for proxy access under the rule), a dummy variable equal to one if a firm has at least one institutional owner with a 3 percent stake, and the total ownership by institutions.

Activist institutional investors are more willing to intervene in corporate governance than institutions overall. Because these investors are particularly aggressive about influencing firm management and board composition, they are more likely to have made use of proxy access (see, for example, Brav et al. 2008). We use the classification of activist investors identified by Greenwood and Schor (2009), who construct a sample of activists based on schedule 13D filings and form DFAN 14A filings with the SEC. Investment managers and other investors must file a schedule 13D with the SEC within 10 days of acquiring 5 percent or more of any class of a company's securities. These filings also include a Purpose of Transaction section, which allows Greenwood and Schor to identify activist purposes and exclude investors whose 13D filings reflect passive strategies. The DFAN forms are filed with the SEC by investors intending to engage in a proxy fight with firm management. These filings allow Greenwood and Schor to con-

¹⁸ The SEC announcement was time stamped at 12:21 p.m. on October 4. The announcement appeared on Bloomberg.com at 3:20 p.m. that day.

¹⁹ See Ken French, Data Library (http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html).

²⁰ An earlier draft of the paper used holdings data from the first quarter of 2010.

struct a list of activist investors, which they identify as investors whose 13D or DFAN filings indicate activist intent. They identify 177 investment managers as activists, of which 139 are hedge funds and 38 are not. Many of the activist investors in Greenwood and Schor's sample are serial activists. In particular, 11 hedge funds account for more than two-thirds of the activist activity in their sample.²¹ The Greenwood and Schor classification is narrow in the sense that some activist investors do not appear because their stakes were too small to trigger the 13D filing requirement or because the purpose statements may not be accurate or may become less accurate over time for a given holding (since the filing is done at initial acquisition).

We collected firm data from the CRSP/Compustat merged database. For each firm, we calculate its 2009 end-of-year book-to-market ratio (the book value of common equity divided by the stock price times the number of shares outstanding) and subtract the mean of its ranking in the Fama and French (1993) 48-sector industry classification. Similarly, we use the Fama and French 48-sector industry classification to calculate the industry-adjusted calendar year 2009 stock return.²²

6. Results

Our main sample is the S&P 1500 because these firms are large, liquid, and heavily traded, but our results also hold for the larger universe of all publicly traded companies. In the S&P 1500, we have ownership data for 1,388 firms. Table 1 shows that there is substantial variation in mean institutional ownership and activist institutional ownership. Institutional ownership overall amounts to about half of the typical company's shares, but in the bottom decile, institutional ownership averages about 25.3 percent. In the top decile, it averages almost 70 percent. Activist institutional ownership averages .05 percent of the shares in the bottom decile but more than 13 percent of shares in the top decile.

6.1. Institutional Ownership

Table 2 presents summary statistics for four measures of institutional ownership. Table 3 sorts firms by institutional ownership and presents data on returns on October 4 across the different levels of institutional ownership (Figures 1–3 present the same information).²³ The average equal-weighted return was –124 basis points, but firms in the highest ownership decile dropped 44 basis points

²¹ They are Farallon Capital Management, Steel Partners, VA Partners, Wynnefield Capital Partners, Blum Capital Partners, Icahn Enterprises, Chapman Capital, Newcastle Partners, JANA Partners, Third Point, and Pirate Capital.

²² Results are similar when we use 12 Fama and French industries, two-digit North American Industry Classification System codes, and S&P industry sectors.

²³ Figures 1–3 show equal-weighted returns in basis points for firms in each decile of institutional ownership or activist institutional ownership. The 95 percent confidence intervals are plotted around each mean return, and we assume independence. Returns outside of [–.3, .3] are excluded.

Table 1
Mean Institutional Ownership

Decile	Institutional Ownership	Activist Institutional Ownership	Firms
1	25.3	.05	139
2	37.9	.32	138
3	42.1	.77	140
4	45.4	1.33	139
5	48.4	1.98	138
6	51.0	2.63	139
7	53.7	3.57	138
8	56.9	4.89	139
9	61.3	7.40	138
10	69.6	13.20	139
All	49.2	3.60	1,388

Note. The data are for all firms in the Standard & Poor's 1500 index. Returns outside of $[-.3, .3]$ are excluded. Ownership data are based on June 2010 13(f) filings.

more than did firms in the lowest ownership decile. The difference is statistically significant at the 1 percent confidence level.

For the data on excess returns, we control for firms' exposure to the market, size, and value factors. Using this return measure, we find that the difference between the returns of high and low institutional ownership stocks is 37 basis points. Sorting on activist owners produces a differential of 43 basis points. Both of these differences are statistically significant.

Table 4 presents the baseline regression results. First, we present results for a regression of the excess returns for the day of each stock in the S&P 1500 index on institutional ownership. The coefficient estimate in this specification is -137 basis points, significantly different from zero at the 10 percent confidence level. Here and throughout the paper, our reported standard errors account for the observed correlation of individual stock returns, as discussed in Section 4. The value for R^2 in this regression is low, which reflects the noisy nature of stock returns and the many factors that affect individual securities. Although our event clearly affected a subset of firms (that is, the t -statistic is significant), it was not the major mover of stock prices that day (this also applies to the specifications we report below). The coefficient estimate implies that a 10-percentage-point increase in institutional ownership was associated with an additional 14-basis-point loss of value on October 4. In Table 4 we also present results for a similar regression for activist institutions. The estimated coefficient is larger in magnitude and statistically significant at the 1 percent confidence level. The coefficient estimate implies that a 10-percentage-point increase in activist ownership is associated with a 55-basis-point drop in value on October 4.²⁴

²⁴ Results with the time window $[0, 2]$ or $[-1, 2]$ —that is, returns of October 2 and October 5—are similar to baseline results in magnitude and statistical significance. Results with the $[0, 3]$ time window, which incorporates returns on October 5 and October 6, are similar in magnitude but insignificant.

Table 2
Summary Statistics for Institutional Ownership

Variable	Mean	SD	10th Percentile	Median	90th Percentile
Institutional ownership (%)	49.1	12.6	35.0	49.8	64.4
Activist institutional ownership (%)	3.6	4.0	.1	2.3	9.1
Number of activist owners with at least 3% stake	.32	.57	0	0	1
Highest activist stake (%)	2.52	3.10	.12	1.40	6.69

Note. The data are for all firms in the Standard & Poor's 1500 index. Returns outside of $[-.3, .3]$ are excluded. Ownership data are based on June 2010 13(f) filings. $N = 1,388$.

Table 3
Equal-Weighted Stock Returns for October 4 by Institutional Ownership

	Returns	Excess Returns	Excess Returns for Activist Owners	N
Decile:				
1	-95.4	12.5	-17.9	139
2	-96.2	9.9	14.1	138
3	-112.6	-6.3	47.1	140
4	-108.2	2.0	-11.9	139
5	-136.7	-26.7	-15.7	138
6	-122.7	-11.3	-16.8	139
7	-134.9	-23.3	-18.9	138
8	-140.7	-23.8	-31.8	139
9	-157.8	-37.6	-17.6	138
10	-139.3	-24.4	-60.4	139
Total				1,388
Average	-124.4	-10.2	-12.9	
Decile 10 - decile 1	-43.9**	-36.9**	-42.5**	
Deciles 9 and 10 - deciles 1 and 2	-52.8**	-42.2**	-37.1**	

Note. The data are for Standard & Poor's 1500 firms for Monday, October 4, 2010. Returns outside of $[-.3, .3]$ are excluded. Return data are from Datastream and are measured in basis points. The excess returns are the residuals after regressing returns on betas from the Fama and French (1993) three-factor model, with betas estimated over the first 6 months of 2010. The weighted average returns are weighted by market capitalization according to outstanding shares of the first quarter of 2010 reported by the Center for Research in Security Prices.

** Statistically significant at 99% confidence.

For the data in columns 3 and 4, we use excess returns and repeat these tests. Our excess-return measures adjust returns on the basis of the Fama and French three-factor model. Betas for the three-factor model are estimated from daily data from 2009. The coefficient estimate with the comprehensive institutional ownership measure is -113 basis points, again significant at the 10 percent confidence level. The coefficient estimate for the activist institutional ownership measure is -527 basis points, significant at the 1 percent confidence level. From this point on, we report only results of regressions with excess returns. This approach is more conservative and controls for any differences in factor exposures

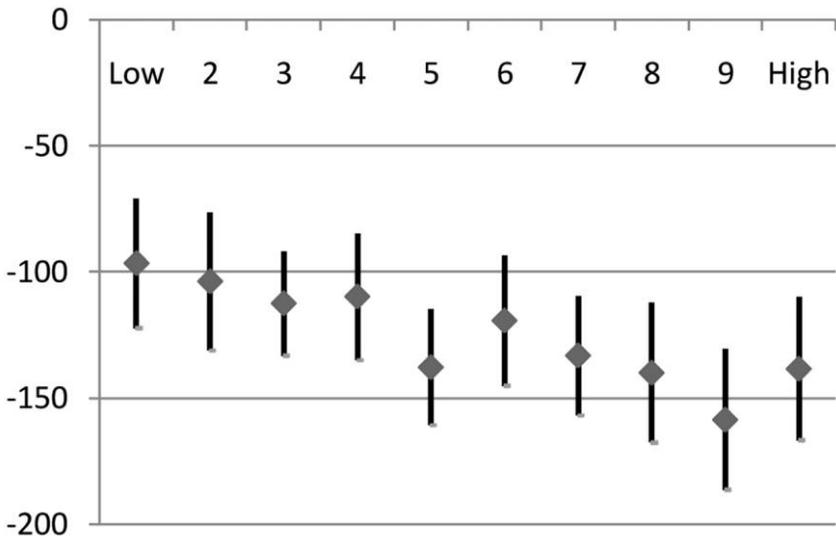


Figure 1. October 4 raw returns by institutional ownership decile

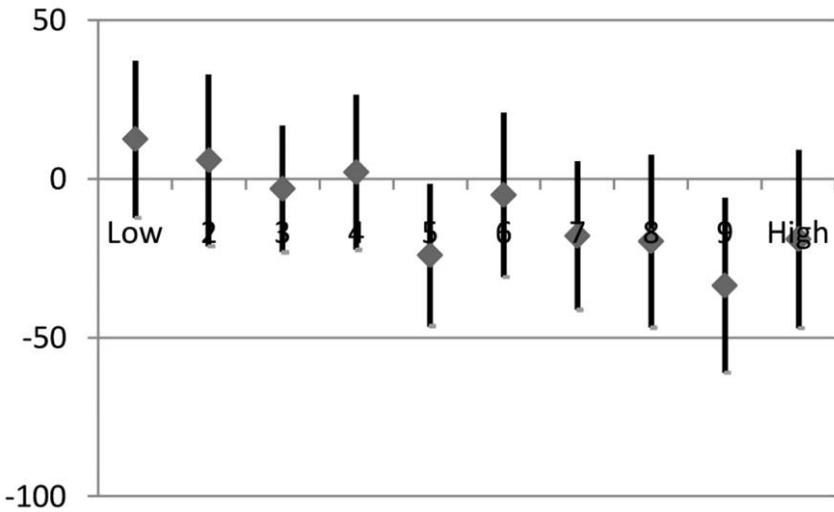


Figure 2. October 4 excess returns by institutional ownership decile

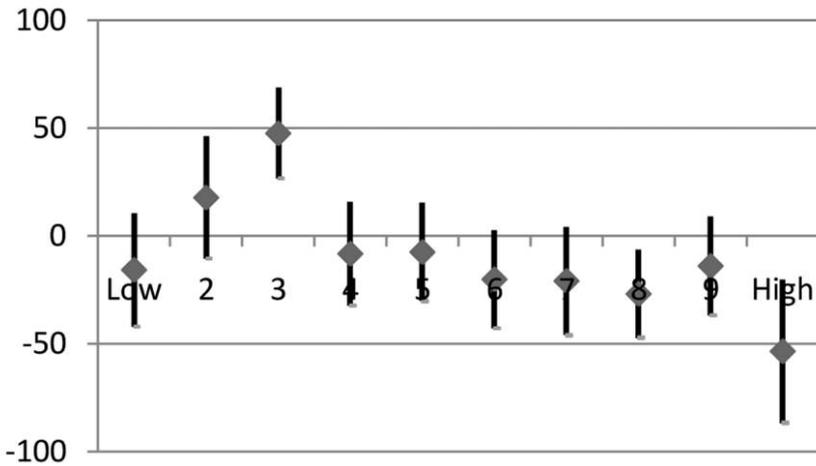


Figure 3. October 4 excess returns by activist institutional ownership decile

across stocks. Coefficient estimates for value-weighted excess returns are slightly larger, but the estimated statistical significance decreases.²⁵

These results are consistent with a loss in value for those firms expected to benefit from proxy access in the future. Is it possible that the ruling resulted in a general loss of faith in SEC enforcement? We believe that this is possible. However, such a loss of faith does not appear to explain the lower returns for firms that were more likely proxy access targets, since there is no reason that SEC enforcement generally should affect precisely those firms that had high levels of activist ownership. Put differently, we cannot evaluate the extent to which the case was perceived to be bad news for the SEC's ability to enforce more generally, as long as that effect was marketwide (or affected a different set of firms than those we identified as having activist ownership), but it seems unlikely that this could explain our findings.

6.2. Intraday Returns

We now turn to intraday returns to assess the extent to which our 1-day results can be attributed to the SEC's announcement on proxy access. We start with within-day trading data from Bloomberg.com for all available firms from the S&P 1500 for October 4, 2010. We divide the trading day into 5-minute windows

²⁵ If the observed price drop for firms with high levels of activist ownership reflected temporary price pressure as activists dumped their positions, we might expect smaller responses for large institutions since these have deeper and more liquid trading and can be expected to have smaller price responses to idiosyncratic trading. The fact that the point estimates in the value-weighted regression are larger suggests that we are not necessarily measuring a temporary price movement. We discuss this issue, and try longer time windows to address this concern, later.

Table 4
Baseline Regression Results of Stock Returns for October 4

	Equal-Weighted Raw Returns		Equal-Weighted Excess Returns		Value-Weighted Excess Returns	
	(1)	(2)	(3)	(4)	(5)	(6)
Institutional ownership	-136.6 ⁺ (72.7)		-112.9 ⁺ (60.7)		-170.3 (112.6)	
Activist institutional ownership		-553.2 ^{**} (189.8)		-527.3 ^{**} (161.8)		-601.8 ⁺ (323.9)
Constant	-57.3 (168.4)	-104.5 (172.9)	42.6* (36.8)	6.1 (26.7)	-7.2 (6.5)	13.2 (37.2)
R ²	.010	.020	.006	.018	.006	.004

Note. Return data are from Datastream and are measured in basis points. Returns outside of $[-.3, .3]$ are excluded. The excess returns are the residuals after estimating a Fama and French (1993) three-factor model. The value-weighted returns are based on market capitalization, which is defined according to outstanding shares of the first quarter of 2010 reported by the Center for Research in Security Prices. Institutional ownership is measured in June 2010. Standard errors allow for cross-sectional correlation. $N = 1,388$.

⁺ Statistically significant at 90% confidence.

* Statistically significant at 95% confidence.

** Statistically significant at 99% confidence.

and calculate for each stock the average trading price during each window. We then take the price from the previous day's closing and the price observed within that window and use the difference to calculate a cumulative return measure for each 5-minute window. We then estimate 79 different regressions of cumulative returns on our activism measure: one for each of the 78 within-day windows and one for the return based on the market closing price.

Figure 4 shows the results of our analysis.²⁶ The aggregate market movement that we document in Table 3 occurs mostly during the morning hours, while the divergence between the activist-owned firms and other firms appears to have come mostly in the afternoon, after the SEC's announcement. The effect appears to have accelerated at the end of the day, after the Bloomberg.com coverage of the SEC's announcement. This intraday analysis suggests that our observed activism effect is not a spurious result arising from insufficient control for the overall market movement; in addition, the timing also appears consistent with the hypothesis that the SEC's announcement caused the underperformance of activist-held firms on October 4, 2010.

6.3. Alternative Specifications

In Table 5, we examine alternative measures of institutional ownership. We measure the largest institutional stake (as a share of firm equity value), including

²⁶ Figure 4 shows cumulative returns relative to the closing price on Friday, October 1, for 5-minute intervals throughout the trading day on October 4, in basis points. Each return is calculated from trade-level data from Bloomberg.com. The dashed line shows the equal-weighted average returns for S&P 1500 firms for each period. The solid line shows the regression coefficients on activist ownership. The timing of key news events is indicated with shaded vertical lines.

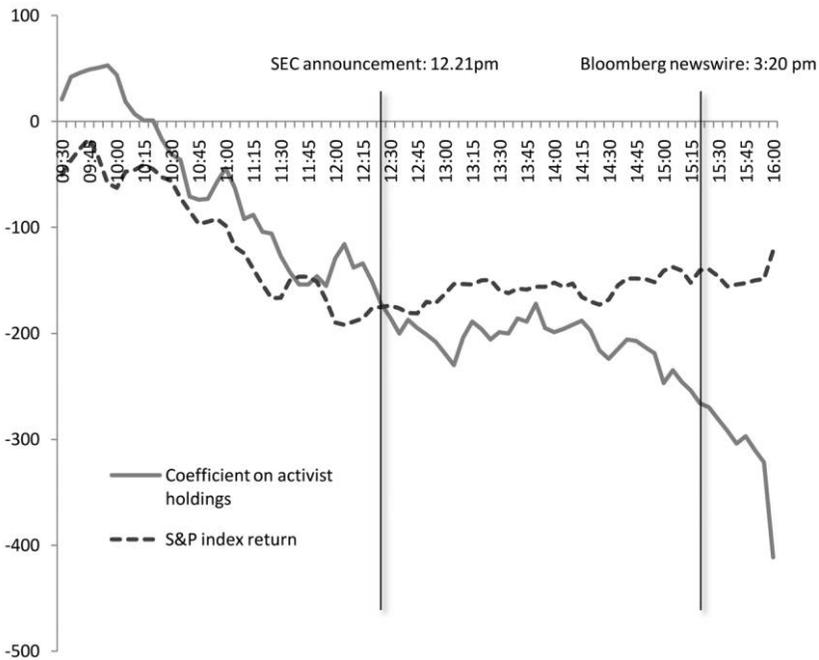


Figure 4. October 4 intraday returns

both activist and nonactivist institutions. The estimated coefficient is negative and not statistically significant. We also regress the October 4 excess returns on the largest single activist stake, and our estimated coefficient of -642 basis points is statistically significant at the 1 percent confidence level. The fact that this coefficient is larger than the coefficient for total activist ownership highlights the role of large single activist investors. This is consistent with an important role for concentrated institutional ownership and may reflect coordination costs or free riding (see, for example, Grossman and Hart 1980; Shleifer and Vishny 1986).

The third alternative measure is motivated by the details of the SEC's rule, which would have required an owner to have a 3 percent stake to qualify for proxy access. Although the rule would have allowed investors to combine for the purpose of proxy access, having an individual owner above the 3 percent threshold means that proxy access was feasible without coordination. Having more such owners might increase the likelihood further (this number ranges from 0 to 4). The coefficient on the number of institutional owners with stakes above 3 percent is negative and significant at the 1 percent level. The coefficient estimate implies that each additional large institutional owner in a firm is associated with a reduction of equity value by 33 basis points on October 4.

Table 5
 Regression Results of Excess Stock Returns for October 4
 by Institutional Ownership

	(1)	(2)	(3)
Largest institutional stake	-110.3 (159.5)		
Largest institutional stake for activist firms		-642.3** (220.5)	
Activist institutional owners above 3% stake			-32.9** (10.5)
R^2	.001	.017	.015

Note. Return data are from Datastream and are measured in basis points. Returns outside of $[-.3, .3]$ are excluded. The excess returns are the residuals after estimating a Fama and French (1993) three-factor model. Intercepts are included but not reported. Standard errors allow for cross-sectional correlation. $N = 1,388$.

** Statistically significant at 99% confidence.

6.4. Firm Heterogeneity

Having established that activist ownership is associated with negative returns on October 4, we now test hypotheses about the relationship between firm characteristics and the value of proxy access. Table 6 presents the results of this analysis. All of these results use excess-return measures, use the S&P 1500 sample, and control for activist institutional ownership. In general, the evidence of any role for governance metrics is weak.

Our first test looks at the impact of staggered boards, as a proxy for corporate governance at each firm. The regression results in Table 6 suggest that our staggered-board variable does not predict stock returns on the event day. For the results in column 2, we use the Gompers, Ishii, and Metrick (2003) governance index. The hypothesis is that firms with poor governance measures (high governance index values) may see larger potential benefits from shareholder proxy access. Again, the results are close to zero, and we cannot reject a zero effect at standard confidence levels.²⁷

We next turn to Delaware incorporation. Because Delaware corporate law already facilitates opt-in proxy access, the SEC rule might have had a smaller effect for Delaware companies.²⁸ Alternatively, if investors perceived that a proxy access proposal would not be prohibited in other states, notwithstanding their lack of explicit recognition of the possibility of opting in, then Delaware firms should react no differently than firms in other states. We test these competing

²⁷ We have also included the interaction of the governance index with activist ownership. This interaction is not related to returns, which suggests that the value of the governance index does not mediate the importance of proxy access.

²⁸ The same argument would also hold for companies in North Dakota, where the corporate law since 2007 has provided mandatory proxy access for any 5 percent shareholder that has held shares for at least 2 years (Publicly Traded Corporations Act, chap. 102, 2007 N.D. Laws 497, codified at North Dakota Cent. Code sec. 10-35-08). However, there are no North Dakota firms in the S&P 1500.

Table 6
Regression Results of Excess Stock Returns for October 4 on Firm Characteristics

	(1)	(2)	(3)	(4)
Activist institutional ownership	-526.8** (159.5)	-461.1* (186.4)	-810.4** (241.4)	-502.3** (157.8)
Staggered board	-2.2 (12.6)			
Governance index		.2 (.3)		
Delaware incorporation			-58.9** (24.1)	
Delaware incorporation × activist institutional ownership			496.6 ⁺ (279.6)	
Board size				45.3 (41.3)
R ²	.014	.014	.037	.023
N	1,388	1,075	1,373	1,373

Note. Return data are from Datastream and are measured in basis points. Returns outside of [-3, .3] are excluded. The excess returns are the residuals after estimating a Fama and French (1993) three-factor model. Only Standard & Poor's 1500 firms are included. Institutional ownership is measured in June 2010. Staggered board is a dummy variable that is equal to one if the board is classified. The governance index of Gompers, Ishii, and Metrick (2003) is based on data from 2006 (the last date for which the components are reported). Delaware incorporation is a dummy variable that is equal to one if the firm is incorporated in Delaware. Board size is the log of the number of board members. Intercepts are included but not reported. Standard errors allow for cross-sectional correlation.

⁺ Statistically significant at 90% confidence.

* Statistically significant at 95% confidence.

** Statistically significant at 99% confidence.

hypotheses by including a dummy variable for Delaware incorporation and institutional ownership and the interaction of a dummy variable for Delaware incorporation and institutional ownership. The coefficient estimate on the Delaware dummy is negative and significant. The interaction of the Delaware dummy with institutional ownership is positive and significant at the 10 percent confidence level. The different coefficients imply that non-Delaware firms saw their value drop by 81 basis points for every 10 percentage points of activist ownership, while Delaware-incorporated firms dropped by only 31 basis points per 10 percentage points of activist ownership [.1(-810 + 497) basis points]. Thus, the estimated effect of institutional ownership is much smaller for Delaware firms, consistent with our prediction that the marketplaces considered explicit recognition of opt-in proxy access at Delaware firms to be meaningful.

We also examine board structure, in particular, board size. Yermack (1996) argues that smaller boards are more effective than large boards. If this is true, there may be less scope for improvement for firms with small boards, and so the proxy rule announcement return might be larger (that is, smaller losses for firms that were already well managed). In contrast, shareholder nominees might have more influence on a smaller board than on a larger board (even though the fraction of directors remains the same, at one-quarter), and so the withdrawn

rule might have had more impact on firms with small boards. We test these competing hypotheses for board size. The coefficient on the board size variable is positive and statistically insignificant, which indicates that the loss in value on October 4 did not depend on board size.²⁹

6.5. *Investor Heterogeneity: Holding Periods*

We next examine the effect of institutional holding periods. The proposed SEC rule would have given proxy access to investors whose stakes had been held for 3 years or more. We thus construct two additional measures of institutional ownership. The first measure includes only the institutional stakes that have been held for more than 3 years. The second measure is based on a weighting scheme in which a 1/12 weight for holdings held for only 3 months up through a 12/12 weight for holdings held for 12 quarters are applied. Therefore, the variable puts progressively more weight on holdings that are closer to qualifying under the rule. As can be seen from Table 7, coefficient estimates are higher when we use the measures of ownership that control for holding duration and, as before, are borderline significant for institutions overall and highly significant for activists. This finding is consistent with the market reaction on October 4 reflecting holding periods as well as the amount of institutional ownership.

6.6. *Lagged Firm Performance*

Our final analysis examines the relationship between lagged firm performance and the results we have described so far. The scope for improvement by activist investors should vary across firms and be related to firms' previous performance. We test this hypothesis by sorting firms on the basis of variables related to recent performance: the end of 2009 book-to-market ratio (the ratio of equity book value to market value) and the stock return over 2007–9. For each of these variables, we demean by the Fama and French industry ranking and use all firms in the same 48-industry classification. Our assumption is that poor performance relative to a firm's industry is a good proxy for the available scope of potential improvements. Table 8 presents the results of this analysis.³⁰ The impact of activist institutional ownership is larger in firms with poor recent performance. The differences between the coefficient estimates in the subsamples are large but insignificant for both splits.

²⁹ We replicated this finding with alternative measures of board size, such as the number of directors per million dollars of equity market value (unreported).

³⁰ Because we split our sample by whether a firm is above or below average, not median, industry performance, and because we define averages for all Compustat firms, not just the S&P 1500 group, the subsamples are not exactly of equal size. The logic of the test seems to suggest that the best possible split into strong and weak performers is more important than is getting equal-size samples. Splitting so that samples are of equal size provides qualitatively similar results. We also performed splits into more groups (quartiles) with similar results.

Table 7
Regression Results of Excess Stock Returns for October 4 by Length of Holdings

	(1)	(2)	(3)	(4)	(5)	(6)
Institutional ownership	-112.9 ⁺ (60.7)					
3-Year-old positions		-172.5 (112.3)				
Holding period weighted ^a			-198.6* (89.5)			
Activist institutional ownership				-527.3** (161.8)		
3-Year-old positions					-735.6** (276.0)	
Holding period weighted ^a						-711.7** (229.7)
<i>R</i> ²	.008	.006	.011	.019	.011	.017

Note. Return data are from Datastream and are measured in basis points. Returns outside of $[-.3, .3]$ are excluded. The excess returns are the residuals after estimating a Fama and French (1993) three-factor model. Only Standard & Poor's 1500 firms are included. Institutional ownership is measured for each of the 12 quarters ending in June 2010. Intercepts are included but not reported. Standard errors allow for cross-sectional correlation. $N = 1,388$.

^a This measure of institutional ownership weights holdings according to the duration continuously held: 1/12 weight for positions held for 1 quarter, 2/12 weight for positions held for 2 quarters, and so on to 12/12 weight for positions continuously held for 3 years.

⁺ Statistically significant at 90% confidence.

* Statistically significant at 95% confidence.

** Statistically significant at 99% confidence.

6.7. The District of Columbia Circuit Decision Event Date

We repeat our event study methodology on July 22, 2011, when the D.C. Circuit invalidated the proxy access rule. Results are reported in Table 9 and reflect measures of activist holdings in the second quarter of 2010. The estimate for an equal-weighted excess return (the smallest estimate of the three) is -463 basis points, which implies that a 10 percent difference in activist holdings corresponds to a 4.6 percent loss in value. The loss in value for firms with activist owners is, therefore, slightly smaller on July 22 than on October 4 of the previous year but is directionally similar. To the extent that the court's ruling was an additional negative surprise regarding the availability of proxy access going forward, these results are consistent with the results reported with respect to the October 4 event date; companies that were more vulnerable to shareholder proxy access suffered declines on both dates. The smaller estimated effect might be due to the fact that the July 22 event changed expectations on proxy access less than the October 4 event. On October 4, the likelihood of proxy access went from virtually 100 percent to 0 percent, at least for 2011 and maybe for longer. On July 22, the likelihood of proxy access went from something substantially less than 100 percent to 0 percent, at least for 2012 and maybe for longer.³¹

³¹ By way of comparison, Bebchuk, Cohen, and Wang (2011) find a positive and significant stock market reaction when the Delaware Chancery Court (in effect) unexpectedly weakened staggered

Table 8
Regression Results of Excess Stock Returns for October 4 by
Subsamples of Industry-Adjusted Performance

	2007–9 Stock Return		Book-to-Market Value	
	Low	High	High	Low
Activist institutional ownership	-682.1* (277.0)	-463.0* (176.0)	-172.6 (308.7)	-442.0** (167.2)
R^2	.025	.018	.025	.013
N	432	909	264	1,096

Note. Return data are from Datastream and are measured in basis points. Returns outside of $[-.3, .3]$ are excluded. The excess returns are the residuals after estimating a Fama and French (1993) three-factor model. Only Standard & Poor's 1500 firms are included. Institutional ownership is measured in June 2010. All performances are measured relative to the mean for the Fama and French 48-sector industry to which the firm belongs. The cutoff between high and low stock return values is zero. Intercepts are included but not reported. Standard errors allow for cross-sectional correlation.

* Statistically significant at 95% confidence.

** Statistically significant at 99% confidence.

7. Discussion

We find that the companies that would have been most vulnerable to the SEC's shareholder proxy access rule experienced a statistically significant drop in value after the unexpected delay in application of the rule was announced on October 4, 2010. The magnitude of the implied positive effect of proxy access that we find is economically significant. We estimate that firms that would have been most affected by proxy access, as measured by overall institutional ownership, lost 12 basis points of value for each standard deviation of ownership. For firms that had large ownership stakes held by historically activist institutions, the value loss was almost five times as large. The results highlight the importance of the process for nominating and electing directors.

This loss in value is particularly striking because the October 4 event created only some probability (less than 1) of losing shareholder proxy access. We find a directionally similar, though not statistically significant, drop in value to shareholders on July 22, 2011, when the D.C. Circuit invalidated the SEC's proxy access rule. To the extent that the market did not anticipate the D.C. Circuit's decision, our October 4 results measure the loss in value from delaying shareholder proxy access by only 1 year. That is, the value of shareholder proxy access is likely to be larger than what is captured in our event study.

Our findings are consistent with those of Cohn, Gillan, and Hartzell (2011), who use three event dates from 2010 (though not October 4). They find that the events they selected as potentially increasing the likelihood or impact of shareholder proxy access increased firm equity value and that the events they

boards and then a negative and statistically significant stock market reaction when the Delaware Supreme Court unexpectedly reversed the Chancery Court decision. The two events in the Bebchuk, Cohen, and Wang study operated in opposite directions.

Table 9
Regression Results of Stock Returns for July 22

Returns	Equal-Weighted Returns		Value-Weighted Excess Returns
	Raw	Excess	
Activist institutional ownership	-490.7** (139.6)	-463.3** (128.6)	-667.0* (317.9)
R ²	.009	.008	.011

Note. Return data are from Datastream and are measured in basis points. Returns outside of $[-.15, .15]$ are excluded. The excess returns are the residuals after estimating a Fama and French (1993) three-factor model. Weighted returns are based on market capitalization defined according to outstanding shares of the first quarter of 2010 reported by the Center for Research in Security Prices. Institutional ownership is measured in June 2010. Intercepts are included but not reported. Standard errors allow for cross-sectional correlation. $N = 1,389$.

* Statistically significant 95% confidence.

** Statistically significant at 99% confidence.

selected as potentially decreasing the likelihood or impact of shareholder access decreased firm equity value.

Our findings are inconsistent with those of Larcker, Ormazabal, and Taylor (2010) and Akyol, Lim, and Verwijmeren. (2010). These prior papers found that events that (arguably) increased the likelihood of shareholder proxy access reduced firm value and events that decreased the likelihood or impact of shareholder access increased firm equity value. The difference between our findings and those of these prior papers might be explained by time differences. For example, in 2006–9, the market might have had a negative view of shareholder proxy access, but this view might have changed by 2010. Alternatively, or in addition, in 2006–9, the market did not have clarity on what the final rule would look like, but by October 2010 the market reacted to a well-defined rule.

Another possibility that would explain the differences between the findings in our paper and those in prior related work might be the different methodologies used or the nature of the events themselves. For reasons explained in Sections 3 and 4, we believe that the October 4 event provides the cleanest test on the value of shareholder proxy access. In our view, the October 4 event, unlike all prior events, was material, directionally clear, and not expected by the marketplace.

In order to examine the influence of methodological differences, we examined some of the dates proposed in other papers and used our methodology: we regressed three-factor excess returns on our measure of activist holdings. In our sample of large firms (S&P 1500), coefficient estimates (the return difference for a 100-percentage-point change in institutional ownership) for June 16–17, June 24–25, and August 25, 2010, were 156, 17, and 279 basis points, respectively.³² The t -statistics for these coefficients, when we use the Greenwood (2005) GLS standard errors, are $-.78$, $.11$, and 1.77 , respectively. In other words, by our methodology, these dates do not deliver significant returns at the 95 percent

³² These dates are included by Cohn, Gillan, and Hartzell (2011).

statistical confidence level, a result that is consistent with our view (as discussed in Section 3) that these events were unlikely to have surprised the market. If instead of using the Greenwood (2005) GLS standard errors, we use standard error estimates that do not control for cross-stock correlations, our estimated t -statistics become -1.37 , $.17$, and 3.25 , respectively. With these less precise standard errors, one out of three events appears to be statistically significant. When we use raw returns as the dependent variable (that is, returns that are not adjusted for the impact of broad market movements, as captured by the three-factor Fama and French model), the coefficients and t -statistics (still unadjusted) are 57 ($t = 6.47$), 26 ($t = 2.48$), and -837 ($t = 2.91$). Using raw rather than factor-adjusted returns amounts to ignoring the factor and market exposures of activist-held firms and is not, in our view, an appropriate econometric approach. These differences highlight the importance of addressing econometric concerns related to cross correlation when dealing with individual stock returns.

Regardless of the underlying explanations for the differences between our findings and those in prior work, our paper, along with the study by Cohn, Gillan, and Hartzell (2011), challenges the conventional wisdom that the market believed that shareholder access reduced equity values. The causal mechanism for this alternative view is straightforward: enhancing activist investors' voice in corporate governance increases firm value. This effect on value was a consistent theme among proponents of the shareholder access rule during the SEC's comment period. For example, Roy Katzovicz, general counsel for Bill Ackman's Pershing Square Capital Management, noted in his comment letter: "Engaged shareholders with meaningful stakes in the companies in which they invest have the potential to regulate corporate conduct through private and market behavior. The existing tools of shareholder engagement, however, have not proven to be sufficient or optimally suited for that task. We believe that the SEC's proposal to require public companies to include shareholder nominees in corporate proxy materials goes a long way toward better equipping shareholders to be more effective monitors of corporate behavior and, as a result, another force for good corporate governance" (Katzovicz 2009, p. 1).³³

An alternative interpretation is that activist investors dumped shares on October 4. As a starting point in assessing this claim, we find no evidence (in unreported analyses) of abnormal trading volumes on October 4, either overall or at companies that would have been particularly vulnerable to the rule. Indeed, it would be unusual for an activist investor to have held shares for 3 years in anticipation of proxy access and then to have dumped shares within hours when there was a delay in gaining access to this right. But even if we take this theory

³³ See also the comment letter from Capital Research and Management (an activist fund with \$775 billion in assets under management): "As long-term investors actively engaged in voting proxies in the interest of our funds' shareholders, we support a process which allows for meaningful director elections, particularly in cases where corporate boards historically have been unresponsive to investor concerns" (Chapman and Norton 2009, p. 1).

at face value, it would be important to understand why activist investors dumped shares. If they did so because their future voice had been unexpectedly reduced and therefore future cash flows were diminished, then this motivation would be consistent with the conclusion that shareholder access improves firm equity value. If instead activists dumped shares because they would be delayed in their ability to extract private benefits at the expense of other shareholders and the company overall, then this motivation would be consistent with the conclusion that shareholder access reduces firm equity value. As noted above, our analyses thus far cannot rule out this alternative explanation.

8. Conclusion

This paper uses a relatively clean natural experiment to assess the shareholder wealth implications of shareholder proxy access. Contrary to the prior event studies on proxy access, we find significant negative abnormal returns for companies that were most vulnerable to shareholder access on October 4, 2010, when the SEC unexpectedly delayed proxy access for U.S. public companies. We find directionally similar, but slightly smaller, results for July 22, 2011, when the D.C. Circuit ruled in favor of the Business Roundtable. These findings are consistent with the view that financial markets placed a positive value on shareholder access, as implemented in the SEC's 2010 rule. The difference between our results and those of earlier work may reflect different methodologies and, in particular, the different events used. Our view is that the October 4 announcement makes a particularly useful event for empirical work because it was both material and unexpected.

With the rise and fall of comprehensive proxy access, the battle has now shifted to a company-by-company approach for the 2013 proxy season and going forward. Our research points in favor of a properly designed proxy access regime. However, a company-by-company approach, unlike a comprehensive approach, raises countervailing concerns regarding the market for corporate directors. Proxy access at any particular company may be detrimental for that company because qualified directors would be less willing to serve on the boards of such companies relative to companies that do not offer proxy access to their shareholders.

If proxy access became the norm, then the negative effects on director recruitment would be diminished. But if instead proxy access did not proliferate, then the negative effects on director recruitment may be significant, and companies might reasonably reject proxy access in order to attract qualified individuals to serve on their boards. Ultimately, this question cannot be resolved at the level of theory and will depend on our experience with a company-by-company approach over the next few years.

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