

# SHAREHOLDER VOTING OVER THE INTERNET: A PROPOSAL FOR INCREASING SHAREHOLDER PARTICIPATION IN CORPORATE GOVERNANCE

## I. INTRODUCTION

"I early learned that one of the chief reasons against doing the logical, the evident, or even the necessary was that it had never been done before."<sup>1</sup>

Since the rise of the proxy in shareholder voting, corporate law has undergone a metamorphosis from a uniquely democratic system to one in which there is a strong tension between the interests of corporate directors and shareholders. The result has been a see-saw battle for control of the corporation. Corporate governance reformers argue for increased shareholder participation<sup>2</sup> while pro-management forces argue for the status quo.<sup>3</sup>

One argument the reformers advance is that under the present conditions, the individual shareholder is hamstrung by cost barriers to information about his company.<sup>4</sup> Federal regulation seeking to improve the shareholder's position has done little more than create an area of unpredictability in the law regarding the amount of input the shareholder may have in corporate decision-making.<sup>5</sup>

In the last two decades, the expansion of the Internet has

---

1. LEWIS D. GILBERT, *DIVIDENDS AND DEMOCRACY* 34 (1956).

2. See, e.g., John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443 (1994); William W. Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861 (1995).

3. See, e.g., Robert N. Leavell, *Corporate Social-Reform, the Business Judgment Rule and Other Considerations*, 20 GA. L. REV. 565 (1986).

4. Joseph E. Calio & Rafael X. Zahralddin, *The Securities and Exchange Commission's 1992 Proxy Amendments: Questions of Accountability*, 14 PACE L. REV. 459, 521-23 (1994).

5. See Kevin W. Waite, *The Ordinary Business Operations Exception to the Shareholder Proposal Rule: A Return to Predictability*, 64 FORDHAM L. REV. 1253 (1995) (arguing for elimination of the ordinary business exclusion in shareholder proposal rule because of the lack of predictability of shareholder access).

made information distribution over the entire globe extremely cheap and has facilitated interaction among large groups of people. This expansion has not gone unnoticed in the political arena. In the 1996 presidential primary race, the Reform Party allowed its members to vote for their party nominee over the Internet,<sup>6</sup> thus marrying a powerful information distribution system with a group of voters otherwise systemically deprived of information.

This Article looks at the possibility of shareholder voting over the Internet and its effects on shareholder participation in corporate governance. First, it examines the history and effectiveness of the current system to determine if there is a need for increased shareholder input into corporate control. Next, it analyzes how the Internet has been employed in the securities context. Finally, it proposes two possible methods of incorporating change, evaluates their relative strengths and weaknesses, and analyzes their potential effect on the current system.

## II. THE ARGUMENT FOR INCREASED SHAREHOLDER PARTICIPATION

### A. *The Effectiveness of the Current Proxy System in Promoting Shareholder Participation*

When the corporation first developed, the shareholders, as residual owners of the corporation, typically were relatives or members of the local community.<sup>7</sup> Shareholders' meetings were important because they provided a forum for discussion about the conduct of the business and a sharing of the collective wisdom.<sup>8</sup> In that era, a shareholder's vote was considered a property right by the courts, so precious and personal that it could not be delegated.<sup>9</sup> Then, as now, the corporation was a creature

---

6. Leslie Goff, *The Webbing of the President: Populism or Propaganda?*, *COMPUTERWORLD*, Sept. 2, 1996, at 79, available in 1996 WL 2373390.

7. FRANK D. EMERSON & FRANKLIN C. LATCHAM, *SHAREHOLDER DEMOCRACY: A BROADER OUTLOOK FOR CORPORATIONS* 5-6 (1954).

8. *Id.* at 6.

9. GILBERT, *supra* note 1, at 27.

of state law.<sup>10</sup> State common law and statutory law gave shareholders the right to make proposals and vote at corporation meetings.<sup>11</sup> As corporate ownership became widely dispersed, with greater numbers of shareholders spread across a growing geographic area, it became more and more inconvenient for shareholders to attend meetings, and the absent shareholder was effectively disenfranchised.<sup>12</sup> Thus, the delegation of one's voting right, or proxy, was developed out of state law to enable the shareholder to exercise her voting right in the corporation.<sup>13</sup>

However, in contrast to the pre-proxy shareholder meetings where corporate information flowed freely, the absent shareholder was left in "dangerous ignorance"<sup>14</sup> because state statutes granting the right to vote by proxy did not provide that the shareholder was entitled to receive information about the corporation.<sup>15</sup> The shareholder who could not attend the meeting in person was still effectively disenfranchised.<sup>16</sup> This development allowed management to take advantage of an uninformed owner and entrench itself in corporate control.<sup>17</sup> Abuses of the

---

10. See, e.g., ALA. CODE §§ 10-2B-1.01 to 10-2B-17.03 (1994) (The Alabama Business Corporation Act is based upon the Revised Model Business Corporation Act.).

11. Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1134 (1993). Also, presence at the annual meeting carried common-law rights to nominate directors and propose changes to corporate policy or to the bylaws or other transactions within the province of the shareholder. However, the role of the shareholder was decreased in importance in the early twentieth century by, among other things, statutory limitation of the scope of the shareholder's control over the business of the corporation, and by increased judicial reluctance to allow a shareholder to challenge a director's business judgment. See *id.* at 1136-38.

12. *Id.* at 1138 ("This development . . . diminished the importance of shareholder voting as a means of supervising the management of the corporation because it hampered both the ability of shareholders to attend annual meetings and their ability to become informed about corporate affairs in order to exercise their franchise intelligently.").

13. See EMERSON & LATCHAM, *supra* note 7, at 7.

14. GILBERT, *supra* note 1, at 206.

15. See *id.*

16. EMERSON & LATCHAM, *supra* note 7, at 7.

17. GILBERT, *supra* note 1, at 29.

If a stockholder is to vote at all, he must do so by proxy, or agent. Therefore, management appoints several men as proxies who are to vote for shareholders at the coming meeting upon nominees for directorship and other issues, in management's favor, of course. Stockholders are solicited to make these men their proxies. The cost of soliciting the stockholders is borne by the corporate

control of the corporation, such as exorbitant executive compensation, bled the dividends away from the shareholders and arguably led, in part, to the Great Depression.<sup>18</sup>

Responding to the strong public outcry for corporate reform, Congress passed the Securities Act of 1934.<sup>19</sup> The intent behind the Act was to restore shareholders to their pre-proxy position as owner of the company by enabling them to retain "the same state and common-law rights of corporate governance that they had exercised previously through attendance and participation at the annual meeting."<sup>20</sup> The statute delegated responsibility for regulating corporate proxy voting to the newly created Securities and Exchange Commission (SEC).<sup>21</sup>

With respect to shareholder democracy, the key provision of the Securities Act of 1934 is Section 14(a), which gives the SEC the ability to regulate the corporate proxy process.<sup>22</sup> Pursuant to the Congressional mandate, the SEC promptly promulgated Rule 14a,<sup>23</sup> which today governs the proxy solicitation process as well as the form and content of proxies. Advocates of corporate reform hailed the rule as enabling the shareholder to take control of the corporation back from management.<sup>24</sup>

Rule 14a entitles the shareholder to accurate corporate

---

treasury. In this way management is usually able to maintain a close control over the corporation.

*Id.* See also EMERSON & LATCHAM, *supra* note 7, at 17 (explaining that management sometimes drew shareholder proxies to remain effective for a period of three years thereby disenfranchising the shareholder for three annual meetings and whatever special meetings occurred in that period).

18. Fisch, *supra* note 11, at 1138.

19. Now codified at 15 U.S.C.S. § 78 [hereinafter Securities Exchange Act of 1934].

20. Fisch, *supra* note 11, at 1142. See also GILBERT, *supra* note 1, at 30-31. The Act was designed to eliminate

the countercheck of shareholder democracy. If management had gone astray, it was because management had been all-powerful, withholding voice, information, and the possibility of effective action from the shareholders. . . . This law was written and passed in the belief that shareholders could not vote effectively until they had adequate information and the right to communicate with each other.

GILBERT, *supra* note 1, at 30.

21. See Securities Act of 1934, ch. 404, § 14(a) 48 Stat. 881 (1934).

22. *Id.*

23. 17 C.F.R. § 240.14a (1997).

24. EMERSON & LATCHAM, *supra* note 7, at 9-10.

information and increased communication among shareholders by requiring disclosure of both annual and post-meeting reports,<sup>25</sup> requiring statements to be included in proxy materials disclosing the nature of the issue before the voters,<sup>26</sup> and allowing shareholders who wish to make a proposal and solicit proxies to either have access to the corporation's shareholder list or to have the corporation itself mail the proxy materials.<sup>27</sup> However, over its turbulent history, the rule evolved to effectively cut off the small shareholder from the governance process through restrictions on the methods a shareholder is permitted to use to communicate with fellow shareholders.

As it stands now, the rule places many obstacles in the path of shareholders who wish to participate in the debate over the control of the corporation. The most obvious of these, and the most contentious, is the shareholder proposal rule, Rule 14a-8.<sup>28</sup> The rule provides that the corporation, or "registrant," must include a shareholder's proposal in its own proxy materials if certain prerequisites are met by the proponent.<sup>29</sup> The first prerequisite, eligibility,<sup>30</sup> is a rational restriction. A shareholder is eligible to make a proposal at a meeting and have that proposal included in the corporation's materials if two criteria are met: (1) he has owned at least 1% or \$1000 worth of stock entitled to vote for at least one year, and (2) he will hold such stock through the date of the meeting.<sup>31</sup> This restriction makes the proxy solicitation process and the meeting less cumbersome by allowing only those who have a substantial interest in the outcome of the debate to make a proposal. For the same reason, Rule 14a-8 also restricts the shareholder to making only one proposal per proxy cycle<sup>32</sup> and limits the number of words in the proposal statement to 500.<sup>33</sup> Since the materials are delivered by ordinary mail, the word limit is a practical restriction which cuts down on the bulk of proxy materials. However, the

---

25. 17 C.F.R. § 240.14a-3(b) (1997).

26. 17 C.F.R. § 240.14a-3(a) (1997).

27. 17 C.F.R. §§ 240.14a-7, -8 (1997).

28. 17 C.F.R. § 240.14a-8 (1997).

29. 17 C.F.R. § 240.14a-8(a) (1997).

30. 17 C.F.R. § 240.14a-8(a)(1) (1997).

31. *Id.*

32. 17 C.F.R. § 240.14a-8(a)(4) (1997).

33. 17 C.F.R. § 240.14a-8(b)(1) (1997).



limit also restricts the amount of information a shareholder can receive in the voting process.

Even if the shareholder meets the aforementioned conditions, the rule grants management the authority to exclude the proposal from its proxy materials for a wide variety of reasons.<sup>34</sup> These reasons may be grouped in the following categories: (1) exclusions to facilitate orderly proxy process, or "anticlog" exclusions, (2) exclusions which omit illegal or personal proposals, and (3) exclusions based upon the content of the proposal, or "merit-based exclusions."<sup>35</sup>

The first of the anticlog exclusions allows management to omit from its proxy materials any proposal that would be "counter to a proposal to be submitted by the registrant at the meeting."<sup>36</sup> One might think that, in a democratic system, countering a management proposal is well within the shareholder's right.<sup>37</sup> However, this exclusion reduces the expense of running a proxy contest because the most efficient way to counter a management proposal is by voting it down. The rule further facilitates the process by allowing management to omit proposals which substantially duplicate another shareholder proposal that will be included.<sup>38</sup> Those proposals which substantially duplicate previously rejected proposals may also be omitted from the proxy materials.<sup>39</sup> Other anticlog exclusions include moot proposals,<sup>40</sup> proposals that relate to specific amounts of cash or stock dividends,<sup>41</sup> and proposals that relate to election to office.<sup>42</sup>

Again, one might think that nominations for office are well within the province of shareholder authority.<sup>43</sup> However, the

---

34. See 17 C.F.R. § 240.14a-8(c) (1997).

35. See Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 886-89 (1994).

36. 17 C.F.R. § 240.14a-8(c)(9) (1997).

37. See John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837, 901 (1994).

38. 17 C.F.R. § 240.14a-8(c)(11) (1997).

39. 17 C.F.R. § 240.14a-8(c)(12) (1997).

40. See 17 C.F.R. § 240.14a-8(c)(10) (1997).

41. See 17 C.F.R. § 240.14a-8(c)(13) (1997). This is presumably because state law generally provides that the declaration of dividends is exclusively the prerogative of the board of directors. See, e.g., DEL. CODE ANN. tit. 8, § 170 (1991).

42. See 17 C.F.R. § 240.14a-8(c)(8) (1997).

43. See Fisch, *supra* note 11, at 1162 ("[T]he area of director elections seems to

shareholder must follow a particular procedure for nomination.<sup>44</sup> The problem is that when a shareholder seeks to nominate a slate of directors, he must do so at his own expense while management-backed director campaigns are paid for by the corporate treasury.<sup>45</sup> This discrepancy tends to limit the ability of the insurgent shareholder to wage a fair battle for control and allows management to remain entrenched regardless of whether its directors are value-enhancing to the corporation.<sup>46</sup>

The second category of exclusions permits management to exclude proposals that, if implemented, would cause the corporation to violate either the law<sup>47</sup> or the proxy rules,<sup>48</sup> or that would serve as personal vendettas against the corporation.<sup>49</sup> Proposals beyond the power of the corporation to implement are also excluded.<sup>50</sup> The reason for these restrictions on shareholder proposals is obvious. In addition to wasting corporate resources on issues of limited interest to other shareholders, such as the personal grievance proposal, the corporation would be falling on its own sword were it to include and implement illegal proposals.

The final exclusionary category judges the content of the shareholder's proposal based on its merits according to the criteria provided by the rule. The rule allows omission of a shareholder proposal if it is not a proper subject for shareholder action,<sup>51</sup> if it is not substantially related to the corporation's business,<sup>52</sup> or if it deals with the conduct of the company's ordinary

---

be one in which shareholder participation is most legitimate because state corporation statutes vest in the shareholders the authority to elect the board of directors.").

44. See 17 C.F.R. § 240.14a-4(d)(4) (1997).

45. See MICHAEL D. WATERS, PROXY REGULATION 164 (1992). However, the nominating shareholder was required to nominate an entire slate of directors. See Meredith M. Brown, *The Impact of the SEC's 1992 Proxy Rule Amendments*, in *CONTESTS FOR CORPORATE CONTROL, 1996: THE NEW ENVIRONMENT* 177, 184-85 (1996). The amended rules now provide that a shareholder wishing to nominate directors may include management's nominees as well as minority nominees. *Id.*

46. See GILBERT, *supra* note 1, at 29.

47. See 17 C.F.R. § 240.14a-8(c)(2) (1997).

48. See 17 C.F.R. § 240.14a-8(c)(3) (1997).

49. See 17 C.F.R. § 240.14a-8(c)(4) (1997).

50. See 17 C.F.R. § 240.14a-8(c)(6) (1997).

51. 17 C.F.R. § 240.14a-8(c)(1) (1997).

52. See 17 C.F.R. § 240.14a-8(c)(5) (1997).

business.<sup>53</sup> Perhaps due to the broad terms used to describe the exclusions, this area has been fraught with ambiguity throughout its history.<sup>54</sup> Furthermore, it has been argued that none of these exclusions are grounded in state law.<sup>55</sup> Considering that the original intent of the proposal rule was to assure that shareholders could exercise their rights under state law while voting by proxy, these exclusions seem ironic.

The "proper subject" exclusion is an exception to the above argument. It was born primarily out of an assumption that state law uniformly gave directors the exclusive power to run the company.<sup>56</sup> Therefore any shareholder proposal directing or mandating board action on a matter that fell within the ambit of a director's authority under state law was not proper.<sup>57</sup> However, proposals that request board action on a particular matter have been held to be includable.<sup>58</sup> Thus, the precatory proposal does give the shareholder some measure of access to the board.

The two remaining management exclusions are the "not substantially related to the business" exclusion and the "related to ordinary business" exclusion.<sup>59</sup> By their very terms, these exclusions seem to create a no-man's land where shareholder proposals seeking inclusion must be specific enough to overcome the first obstacle, and yet not so specific as to be blocked by the second.<sup>60</sup> Indeed, these terms have led to a lack of predictability in the shareholder governance debate. Prior to 1972, shareholders seeking to reform corporate policy with respect to social or political causes were deterred from utilizing the ballot by management's use of the 14a-8(c)(5) and (c)(7) exclusions.<sup>61</sup> In

---

53. See 17 C.F.R. § 240.14a-8(c)(7) (1997).

54. See Waite, *supra* note 5, at 1262-76.

55. Palmiter, *supra* note 35, at 914.

56. See *generally id.* at 890-91.

57. 17 C.F.R. § 240.14a-8(c) (1997).

58. Fisch, *supra* note 11, at 1150.

59. 17 C.F.R. § 240.14a-8(c) (1997).

60. Palmiter, *supra* note 35, at 892.

61. See, e.g., SEC v. Medical Comm. for Human Rights, 404 U.S. 403, 405 (1972) (stating that the SEC permitted exclusion of a proposal that had sought to prohibit company's sales of napalm for use against humans); Peck v. Greyhound Corp., 97 F. Supp. 679, 680 (S.D.N.Y. 1951) (The court refused to enjoin management from excluding a proposal from an owner of 3 shares of stock to ban racial segregation on Southern bus routes, stating "[i]t was not the intent of [the rule] to



1972, the SEC amended the rule to allow inclusion of causes that promoted the general welfare of the public, both socially and politically.<sup>62</sup> Since that time, large institutional investors have used this rule to initiate significant corporate reforms.<sup>63</sup> To some degree, small shareholders have been successful in reshaping corporate policies even when their proposals fail on a vote.<sup>64</sup> However, the SEC rules and judicial interpretations of these rules have not produced a stable guideline for defining the grey area between causes producing significant public good and matters of ordinary corporate business.<sup>65</sup> To overcome the barriers to accessing the corporation's proxy materials, a proposal must now relate to matters that have risen to the level of significant public awareness and welfare. Thus, the proponent of such a cause must be able to either predict what will become a generally significant concern or wait until such a concern becomes significant enough. The first option is arguably too speculative for the shareholder of limited means to risk the resources necessary for a proxy campaign. The second option allows the harm that the proposal seeks to eliminate to continue until action is taken.

At this point, it must be noted that social or political propos-

---

permit stockholders to obtain consensus of other stockholders with respect to matters which are of a general political, social or economic nature.").

62. Solicitation of Proxies, Exchange Act Release No. 9784, 37 Fed. Reg. 23,178-79 (Oct. 31, 1972).

63. Mark J. Loewenstein, *The SEC & the Future of Corporate Governance*, 45 ALA. L. REV. 783, 797-98 (1993).

64. Palmiter, *supra* note 35, at 917.

65. See, e.g., *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc.*, 821 F. Supp. 877, 892 (S.D.N.Y. 1993) (requiring inclusion of proposal to request management prepare study and report on company's equal employment opportunity and affirmative action posture); *New York City Employee's Retirement Sys. v. Dole Food Co.*, 795 F. Supp. 95 (S.D.N.Y.), *vacated*, 969 F.2d 1430 (2d Cir. 1992) (holding that shareholder's proposal of a commission study on health care reform impacts on company not excludable as an ordinary business matter nor as insignificantly related to the business); *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554, 562 (D.D.C. 1985) (holding that proposal seeking to have management conduct study of practice of force-feeding geese by makers of pate de foie gras was "otherwise significantly related"); *Cracker Barrel Old Country Store, Inc.*, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 76,418 (Oct. 13, 1992) (allowing exclusion of proposal to eliminate discriminatory hiring policies with respect to sexual orientation because hiring policy is an ordinary business matter). See also Palmiter, *supra* note 35, at 912-14 (analyzing recent SEC No-Action letters and finding a trend that social and political proposals are now more likely to be excluded than proposals relating to corporate governance issues).

als do not necessarily cure the problems at issue. In fact, most social or political proposals that do make it to the ballot fail.<sup>66</sup> For this reason, supporters of exclusion of these proposals argue that they merely waste the corporation's resources and interfere with the proxy process.<sup>67</sup> However, the benefits to be gained from including the proposals are potentially greater than an across the board ban on them because:

[E]ven if more social/political proposals end up on the ballot . . . it is difficult to see the harm. If they force management to define a position or alert shareholders to a dimension of their investment they had not considered, it is hard to see how the corporation is hurt. [A rule abolishing the exclusion] would offer shareholders, in an era of increasing identity between equity ownership and political citizenship, another means of political discourse. The costs are minimal, the gains potentially large.<sup>68</sup>

Thus, the lack of predictability in the proposal rules and the lack of a valid reason to exclude certain proposals erect significant barriers to shareholder communication.

In 1992, the SEC enacted a major revision to Rule 14a in order to increase shareholder communication with management and with fellow shareholders.<sup>69</sup> The new rules did away with the proxy filing requirement for shareholders communicating with each other when not seeking proxy authority.<sup>70</sup> Before the amendment, shareholders who communicated with other shareholders were required to file proxy statements with the Commission due, in part, to the expansive definition of "solicitation" in Rule 14a-1.<sup>71</sup> Now, a shareholder not seeking proxy

---

66. Loewenstein, *supra* note 63, at 798.

67. Palmiter, *supra* note 35, at 923.

68. *Id.* at 925. See also WATERS, *supra* note 45, at 171 n.117 ("It has been observed that management 'has little to lose' by including most shareholder proposals in its proxy statement as most proposals have 'virtually no chance of success.'") (citation omitted).

69. See Regulation of Communications Among Securityholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85,051 at 83,355 (Oct. 16, 1992).

70. 17 C.F.R. § 240.14a-2(b) (1997).

71. 17 C.F.R. § 240.14a-1(l) (1997). See also SEC v. Okin, 132 F.2d 784, 786 (2d Cir. 1943) (stating that proxy solicitation "extends to any other writings which are part of a continuous plan ending in solicitation and which prepare the way for its

authority may communicate by written solicitations without filing as long as his holdings that are the subject of the solicitation are less than \$5 million.<sup>72</sup> All oral solicitation is exempted.<sup>73</sup>

Detractors of the change say that it makes it more attractive for dissatisfied shareholders to conduct "stealth negotiations" in smoky back rooms, keeping management in the dark about the problem.<sup>74</sup> But this change has the beneficial effect of indirectly monitoring management conduct, for even the self-interested manager who is intent only on keeping his job might be more receptive to shareholder concerns.<sup>75</sup> The change also tends to turn the tables on the board, who can restrict the flow of corporate information to the shareholders. What are now potential "smoked-filled back room" discussions were once "smoked-filled board room" discussions.<sup>76</sup>

The SEC also eliminated the requirement that a shareholder wishing to engage in a full proxy solicitation file preliminary statements with the commission prior to distributing them to fellow shareholders.<sup>77</sup> This change increases shareholder communication by reducing the overall expense to some degree;<sup>78</sup> however, the cost of full proxy campaigns still keeps them out of reach for the average shareholder.<sup>79</sup>

Finally, as noted above,<sup>80</sup> the rules now allow a shareholder wishing to nominate directors to draft his own slate using both management and minority nominees, a technique known as "short-slating."<sup>81</sup> This change purportedly makes it easier for dissident shareholders to obtain minority representation on the

---

success").

72. Brown, *supra* note 45, at 180.

73. Brown, *supra* note 45, at 180.

74. Brown, *supra* note 45, at 180-82.

75. Brown, *supra* note 45, at 182.

76. See Calio & Zahralddin, *supra* note 4, at 495-96 (noting that the business community criticized the new exemption as promoting "secret back-room lobbying" among institutional investors).

77. See 17 C.F.R. § 240.14a-6(a) (1997).

78. Brown, *supra* note 45, at 183.

79. Loewenstein, *supra* note 63, at 797.

80. See *supra* note 45 and accompanying text.

81. Charles I. Cogut et al., *Short Slates*, in CONTESTS FOR CORPORATE CONTROL, 1996: THE NEW ENVIRONMENT 191 (1996). See also Brown, *supra* note 45, at 185 (commenting on the shareholder's plight to elect a minority of the board).

board by allowing a voter to decide on one proxy card between an incumbent slate and the new slate.<sup>82</sup>

The effect this change has on increasing shareholder participation is debatable. While the new rules have eased management's hold on the proxy process somewhat by making it easier for shareholders to receive information both from management and from each other, management still has in its arsenal the daunting array of exclusions which can keep the shareholder at bay. With the erratic interpretations of the exclusions by the courts and by the SEC, that area is still in chaos. Furthermore, even with short-slating, management still controls the nomination process because a nominating shareholder must pay for a full proxy campaign.<sup>83</sup> This has the potential of keeping management and its interests in power in spite of incompetency and reduces the possibility of better managers being elected.<sup>84</sup> Thus, assuming that shareholder participation and free discussion is more efficient and value-enhancing, the current system still fails to realize the promise of the original Securities Act of 1934 to replicate shareholder meetings through the proxy process.<sup>85</sup>

### *B. The Argument for Increased Shareholder Participation*

The idea of participation at the shareholder meeting is fundamental to American corporation law.<sup>86</sup> Voting at the meeting is the only means the shareholder has available to protect his status as residual owner of the corporation.<sup>87</sup> Although state law mandates that shareholder action by vote is necessary for certain corporation activities,<sup>88</sup> the shareholder's vote has in

---

82. Cogut et al., *supra* note 81, at 200.

83. See Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late*, 43 AM. U. L. REV. 379, 388 (1994).

84. See Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1073, 1081 (1990).

85. See Fisch, *supra* note 11, at 1197.

86. David C. Bayne et al., *Proxy Regulation and the Rule-Making Process: The 1954 Amendments*, 40 VA. L. REV. 387, 390-91 (1954).

87. See Bebchuk & Kahan, *supra* note 84, at 1073.

88. See, e.g., ALA. CODE § 10-2B-12.02(b)(2) (1994) (requiring shareholder approval required for sale of assets other than in regular course of business).

some cases been rendered meaningless because of significant barriers to the proxy and voting process.<sup>89</sup>

Some commentators argue that since the proxy system for shareholder participation emerged, corporate directors have enjoyed virtually unfettered control of the company domain.<sup>90</sup> This power has resulted in some startling examples of abuse such as economic and political corruption, rushes of risky leveraged buy-outs for short-term gain, and excessive executive compensation.<sup>91</sup> The primary reason for this lack of control is that management enjoys certain advantages once it comes to power, such as control over the proxy process, so that it is rare for a pro-management director to be removed from office.<sup>92</sup> Management also enjoys significant advantages over the shareholder with regard to shareholder concerns.<sup>93</sup> Additionally, the judicial construct of the business judgment rule protects the board from shareholder claims of negligent mismanagement.<sup>94</sup> Thus insulated from the shareholder by seeming pro-management regulation and judicial deference, an incumbent board has less incentive to be responsive to shareholder issues.

Attempts at correcting the situation have shown limited success. Early successes in efforts to gain minority representation on boards through cumulative voting amendments to corpo-

---

89. See Bebchuk & Kahan, *supra* note 82, at 1073-74 (arguing that "[s]hareholder voting rights are meaningful only as long as a 'real possibility exists that shareholders will vote against incumbent management'").

90. See, e.g., Calio & Zahralddin, *supra* note 4, at 537-38.

91. Loewenstein, *supra* note 63, at 785.

92. See *supra* notes 83-84 and accompanying text.

93. Loewenstein, *supra* note 63, at 799.

94. See Fisch, *supra* note 11, at 1148-49. Such a decision may be attacked on the grounds that it violated the board's substantive duty of care, i.e., when the decision is obviously unreasonable, or that it violated the board's procedural duty of care, when the decision-making process was unreasonable irrespective of the outcome. See, e.g., *Joy v. North*, 692 F.2d 880 (2d Cir. 1982), *cert. denied sub nom. Citytrust v. Joy*, 460 U.S. 1051 (1983) (holding that a company's decision to continue making bad loans was a "no-win situation" and violative of substantive due care); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (holding directors liable for decision to accept tender offer on under-valued stock after little deliberation and investigation). However, many states enacted laws shortly after *Van Gorkom* to remove a director from monetary liability for such decisions. See Loewenstein, *supra* note 63, at 794; ALA. CODE §§ 10-2B-8.50 through 8.58 (1994) (regarding indemnification of directors). Furthermore, this is not an efficient check on director actions because the shareholder must act *ex post* via costly derivative litigation after the harm has been done.



rate charters have now been eroded by recent changes in corporate law.<sup>95</sup> Amending the shareholder proposal rule to permit more proposals that seek to advance social or political interests has resulted in a lack of predictability in the results.<sup>96</sup>

Compounding the phenomenon is shareholder apathy. As observed by Professor Palmiter:

Public shareholders have little incentive to determine whether initiatives not supported by management have merit. The natural tendency is to assume that the proponent, a self-appointed representative of shareholder interests, has a personal agenda and that if the proposed reform were in the corporation's best interests management would already have initiated it. That is, the chance of an outright voting victory is slim even in the case of value-producing proposals.<sup>97</sup>

The reason for this lack of incentive is that the costs of obtaining more information with respect to a proposal or an opposition slate of directors is high for the average shareholder.<sup>98</sup> The proposal statement in the proxy materials sent to the shareholder is limited to 500 words,<sup>99</sup> and this is all the information he is likely to receive about the proposal. Notwithstanding the new exemption from filing for shareholders communicating with other shareholders,<sup>100</sup> the average shareholder doesn't have the resources to fully investigate a particular issue, and the cost to the proponent of transmitting more information is high. Recently, institutional shareholders, which were the impetus for the 1992 reforms,<sup>101</sup> have made significant strides in activism.<sup>102</sup> However, the smaller shareholders or shareholder groups remain largely disenfranchised because institutional investors are primarily concerned with fulfilling their duties to their beneficia-

---

95. See Douglas M. Branson, *Recent Changes to the Model Business Corporation Act: Death Knells for the Main Street Corporation Law*, 72 NEB. L. REV. 258, 263-65 (1993).

96. See *supra* notes 62-68 and accompanying text.

97. Palmiter, *supra* note 35, at 896.

98. See Bebchuk & Kahan, *supra* note 84, at 1080.

99. 17 C.F.R. § 240.14a-8(b)(1) (1997).

100. See *supra* notes 69-72 and accompanying text.

101. See WATERS, *supra* note 45, at 4737-78.

102. Jayne W. Barnard, *The Institutional Investors and the New Corporate Governance*, 69 N.C. L. REV. 1135, 1135-37 (1991); Goforth, *supra* note 83, at 409-10.

ries rather than to their fellow shareholders.<sup>103</sup> Thus, the individual shareholder would be required to hope for the coincidental alignment of his interests with those of the institutional group.

But is there really a need for increased shareholder participation? Several benefits may be gained from relaxing the restrictions on shareholder participation. First, from a societal perspective, increased access to the corporate board and to more information would increase value.<sup>104</sup> In the contest for control, a director faced with a real threat of being replaced by the electorate will tend to direct in a beneficial manner.<sup>105</sup> Inferior management will presumably be replaced by superior managers, thus increasing value.<sup>106</sup> Also, group dynamics will be improved because more truly outside directors will be elected to the board providing a check on insider interests.<sup>107</sup>

Furthermore, in the context of issue contests, increased access will likely result in better decision-making in corporate policy. Similar to the electoral contest, directors faced with the threat of increased participation by the shareholders would rationally choose to be more responsive to shareholder issues and avoid self-interested actions such as excessive compensation increases.<sup>108</sup> Thus, with either better performance before the contest, or beneficial change as a result of the contest, an overall increase in value inures not only to the shareholder but also to the public at large.<sup>109</sup>

One significant consideration in the debate is that the great-

---

103. See John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1479 (1990).

104. See Bebchuk & Kahan, *supra* note 84, at 1077.

105. Bebchuk & Kahan, *supra* note 84, at 1077.

106. Bebchuk & Kahan, *supra* note 84, at 1077.

107. See Goforth, *supra* note 83, at 438. Inside directors are those that are also employees of the company. Outside directors, therefore, means non-employee directors. However, even outside directors are nominated by the incumbent board. I use the modifier "truly" to indicate outside directors nominated by shareholders.

108. See Goforth, *supra* note 83, at 432-33.

109. See Palmiter, *supra* note 35, at 898 ("Rising institutional equity ownership has spread indirect corporate ownership to a wider range of Americans, so that today there is a significant identity between equity owners and beneficiaries of social-enhancing gains. To turn an old adage on its head: 'What's good for America is good for Wall Street.'").

er the size of the decision-making body, the more difficult it is to make a decision.<sup>110</sup> In the early days of the corporation, the shareholders were few in number compared to the large corporations of today whose shareholders can number in the millions. Such a large body would naturally be comprised of a wide array of competing interests, making it improbable to assume that all the shareholders will act in unison. However, a completely authority-based decision structure has shown itself to be susceptible to abuse by those in authority.<sup>111</sup> A wider range of ideas being brought to bear on a particular issue enhances the process by increasing the information with which the body can make its decision. Nevertheless, there must be a limit on the information made available because there is a limit on the amount of information a person can absorb and process. But, the value to be gained from increased participation does not "assume or require that all eligible shareholders will become intimately involved in the governance of public corporations. The theoretical ideal of corporate democracy . . . does not require that shareholders exercise their rights; it merely requires that shareholders have the opportunity to participate."<sup>112</sup>

Another argument against increasing shareholder participation is the "Wall Street Rule," which provides that the stock market is the best check on management because dissatisfied shareholders will "vote with their feet" and sell their shares, thus driving the stock prices down.<sup>113</sup> The "Wall Street Rule," however, has the unfortunate result of pressuring management to make ill-advised decisions to increase short-term gain at the expense of longer term concerns. Additionally, high share turnover rates may create rising market prices, leading to inflation and a reduction in consumption, which is usually damaging to the company in the long run.<sup>114</sup> Increased participation in the

---

110. See Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 665-67 (1996) (arguing that, because of the large size of the body, it is more efficient to maintain centralized decision making).

111. See *supra* notes 90-91 and accompanying text.

112. Goforth, *supra* note 83, at 434.

113. See Palmiter, *supra* note 35, at 901-02.

114. See Tamar Frankel, *What Can Be Done About Stock Market Volatility?*, 69 B.U. L. REV. 991 (1989).

process may reduce the desire to sell off ownership interests by giving the shareholder another option.<sup>115</sup>

### III. THE INTERNET

#### A. *Internet Basics*

Although it has been in existence since the early 1970s,<sup>116</sup> the expanding availability of the Internet over the past decade has dramatically altered our perceptions of how we receive and transmit information. Now gone are the traditional notions of geographic and time limitations to conversing with one another. The amount of information exchanged on the Internet continues to increase. The technologies associated with the Internet, telecommunications, computers, and now integrated video seem to improve at an exponential rate, making today's state-of-the-art obsolete within a few years.<sup>117</sup> For those who have not been able to keep up with the expansion, who have never had an introduction to the Internet other than what they have seen or read in the news, the idea of jumping on the "Information Superhighway" can be as daunting as it would be for a teenager taking his first driving lesson on a Los Angeles freeway. The following is a very basic overview of the Internet.

To begin, the Internet is merely a group of computers that is able to exchange information over ordinary phone lines.<sup>118</sup> The Internet began as the exclusive domain of American University, and Department of Defense scientists, but now is accessible to anyone with a personal computer and a phone line.<sup>119</sup> The Internet has two pertinent subregions: (1) the Usenet, the last vestige of the original network which is used primarily to transfer electronic mail and files between computers and to facilitate

---

115. See Goforth, *supra* note 83, at 441; Mark J. Loewenstein, *Making America Competitive*, 18 DEL. J. CORP. L. 453, 473 (1993) (reviewing MICHAEL T. JACOBS, *SHORT-TERM AMERICA: THE CAUSES AND CURES OF OUR BUSINESS MYOPIA* (1991)).

116. DINTY W. MOORE, *THE EMPEROR'S VIRTUAL CLOTHES: THE NAKED TRUTH ABOUT INTERNET CULTURE* 3 (1995).

117. See Chaim Yudkowsky, *Are Students Well Educated for Future Technologies*, BUS. FIRST OF LOUISVILLE, Sept. 22, 1997.

118. See MOORE, *supra* note 116, at 5.

119. MOORE, *supra* note 116, at 3-4.

discussion groups,<sup>120</sup> and (2) the World Wide Web which is a network that has the capability to exchange text and graphic images and has become the predominate mode of exploring the Internet.<sup>121</sup>

Estimates of Internet use predicted that in 1997 there would have been over 120 million individual users on the network.<sup>122</sup> With all that activity, how does the computer know how to route the signal to the correct place? The answer is a mechanism called Internet Protocol (IP), which is analogous to traditional envelopes in paper mail.<sup>123</sup> In order to communicate with other computers, a computer is assigned a unique IP address.<sup>124</sup> Internet Protocol then records the address of the sending computer and the address of the receiving computer, envelopes the message, and takes it to its destination.<sup>125</sup> In the context of the Web, the destination is known as the host computer.<sup>126</sup> The host computer houses the file that contains the text or graphics.<sup>127</sup>

Considering all of the Internet users in the world, one potential problem is the maintenance of security. This problem can be overcome by keeping a record of all of the IP addresses allowed to access the host computer and correlating them with the permissible unique user identifications. Then, as a final measure, each user is assigned a password which, taken together with the foregoing information, allows a user to access the host.<sup>128</sup> Implicit in this arrangement is that to maintain proper security, the host computer records the user and the IP address of the computer that has accessed the host. One pitfall of this

---

120. See MOORE, *supra* note 116, at 12.; G. BURGESS ALLISON, *THE LAWYER'S GUIDE TO THE INTERNET*, 46 (1995). Discussion groups are simply groups of people that post electronic messages on an electronic bulletin board for the rest of the group and invite response.

121. See ALLISON, *supra* note 120, at 339.

122. *PCs Need Networks Too*, INTERNETWORK, Dec. 1, 1994, 1994 WL 13345490.

123. See ED KROL, *THE WHOLE INTERNET* 23-25 (2d ed. 1992).

124. *Id.*

125. *Id.*

126. LEWIS S. EISEN, *THE CANADIAN LAWYER'S INTERNET GUIDE* 13 (1996).

127. See *id.*

128. See, e.g., Mike Grandinetti, *Developing a Network Security Policy*, INTERNETWORK, Sept. 1, 1996, available in 1996 WL 13659754.



arrangement is that the host cannot guarantee that the user will not inadvertently or otherwise divulge his password to a unintended accessor.

The development of the internet has enabled communication to expand beyond traditional boundaries. Yesterday, when meetings had to be attended in person, the costs associated with conducting a meeting were sometimes prohibitive. Today, internet software makes real time discussions possible among people in remote locations.<sup>129</sup> Not only may attendees transfer text data, but they may also "attend" using remote video links and voice communication,<sup>130</sup> thus approximating the exchange of information normally associated with a face-to-face meeting.

Perhaps the most significant feature of Internet communication is low cost. Individual users generally either access the Internet through a "provider" such as America Online (AOL), Prodigy, or Compuserve. These providers give the user gateways to the various regions of the Internet, including e-mail and the Web, for a fee usually based upon time.<sup>131</sup> These fees can range from \$16 to \$30 per month, depending on the amount of time spent on the Internet and the different services used.<sup>132</sup> Larger institutions such as corporations, schools, and the government generally provide services to their employees at no cost to the individual.<sup>133</sup> The cost of doing this is feasible because of the huge corporate and organization presence on the Web.<sup>134</sup>

Because the reason for instituting corporate proxy was that widely dispersed shareholders could not feasibly attend corporate shareholder meetings,<sup>135</sup> the development of remote conferencing technology may have interesting implications for

---

129. See, e.g., Lenny Bailes, *Virtual Meetings: New Software and Hardware are Bringing Businesses Together with Internet Based Conferencing*, WINDOWS MAGAZINE, Jan. 1, 1997, available in 1997 WL 3691342.

130. See, e.g., *Windows95.com: Conferencing Tools* (visited Mar. 7, 1997) <<http://www.windows95.com/apps/conf.html>>.

131. See MOORE, *supra* note 116, at 6. AOL has recently gone to flat monthly fees for Internet use. The subsequent rush of people using the service overloaded the system and caused many to lose service.

132. DANIEL P. DERN, *THE INTERNET GUIDE FOR NEW USERS* 33 (1994).

133. See *id.* at 26.

134. See Clifford Lynch, *Searching the Internet*, SCIENTIFIC AMERICAN, Mar. 1997, at 52, 53 (citing the fact that 63% of the over 650,000 Web sites are commercial entities).

135. See *supra* notes 12-13 and accompanying text.

the continued use of the proxy as a form of shareholder participation. Additionally, the increasing amount of information available and the low cost of transmitting and obtaining that information has the potential to mitigate many of the problems with shareholder participation today.<sup>136</sup>

### B. Proxy Activities on the Internet

The advantages of digital delivery have not gone unnoticed by the securities world. Early attempts to take advantage of digital delivery involved the delivery of proxy material electronically. In *Parshalle v. Roy*,<sup>137</sup> the court faced a situation in which proxies for the election of dissident directors were solicited over the telephone and the data transmitted to the registrant corporation.<sup>138</sup> The court ruled that the so-called "datagram proxies" were invalid because they lacked requisite signature or other shareholder identifying mark.<sup>139</sup> The Delaware legislature subsequently changed the law to allow electronic transmission of the proxy to the proxy holder provided that they have some indication that the shareholder did in fact authorize the proxy.<sup>140</sup>

Furthermore, there have been organizations that have allowed the shareholder to either assign a proxy or to vote via computer.<sup>141</sup> This is little more than what the shareholder has now in terms of participation, because he still does not necessarily get his issues on the ballot.

On October 6, 1995, the SEC issued a release interpreting the current delivery rules for securities material.<sup>142</sup> Realizing the potential for the Internet and other electronic delivery ser-

---

136. See *supra* notes 98-103 and accompanying text.

137. 567 A.2d 19 (Del. Ch. 1989).

138. *Id.* at 25-26.

139. *Id.* at 28. Most state laws provide that a corporation may deny to accept a vote or proxy if there is doubt about the authenticity of the signature. See, e.g., ALA. CODE § 10-2B-7.24(c) (1994).

140. DEL. CODE ANN. tit. 8, § 212(c)(2) (West 1997).

141. See WATERS, *supra* note 45, at 276.

142. See Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 34,36345, available in 1995 WL 588462 (Oct. 6, 1995) [hereinafter Release].

VICES to serve as valuable tools to enhance investor's ability to "access, research, and analyze information, and in facilitating the provision of information by issuers and others,"<sup>143</sup> the Commission believed that use of such media "should not be disfavored."<sup>144</sup>

The SEC's apparent reason behind this release was the belief that electronic media provides a low cost method for small investors to obtain more information than traditional methods.<sup>145</sup> This result, the SEC reasoned, was commensurate with its general policy of requiring disclosure of certain information in order to promote a more efficient market by allowing investors to make better informed investment and voting decisions.<sup>146</sup> However, the SEC provided that delivery will not be considered sufficient under the current rules unless that mode of delivery meets certain standards; adequate notice to the recipient, adequate recipient access to the electronic medium, and evidence of the delivery.<sup>147</sup>

Notice would be considered adequate if the deliverer sent a separate message to the recipient that the required materials were to be delivered electronically.<sup>148</sup> The Release does not specify, however, how that notice must be sent.<sup>149</sup> Accessibility refers to both the recipient having the means to receive the material and to the material itself being accessible for a sufficient amount of time for the recipient to retrieve it.<sup>150</sup> With the number of Internet users increasing exponentially, it is not inconceivable that someday all investors will have some sort of Internet access.<sup>151</sup> Finally, evidence of delivery is considered sufficient if, for example, in the case of e-mail delivery, automatic confirmation of receipt is used, or, in the Web context, evidence exists that an investor has accessed a document.<sup>152</sup>

---

143. *Id.* at \*1.

144. *Id.*

145. *See id.* at \*2.

146. *Id.* at \*3.

147. *See Release, supra* note 142, at \*4-\*5.

148. *See id.* at \*4.

149. *Id.* The author suggests that a separate e-mail might suffice.

150. *Id.* at \*5.

151. *See John Simons, Stress, Strain and Growing Pains as Usage Soars, the Net Could Face Brownouts*, U.S. NEWS & WORLD REP., May 6, 1996, at 59, 60 (describing the exponential growth of the Internet).

152. *Release, supra* note 142, at \*5. Recall that when using the Web, the host

Those companies choosing to use electronic delivery must obtain informed consent from their investors identifying the specific medium, warn investors of the access costs, and notify investors of the period for which consent will be effective.<sup>153</sup>

Some proxy battles have already been waged on the Internet. Soon after the Release was promulgated, a solicitor for an institutional investor put proxy statements on a Web site and allowed shareholders accessing the site to vote in that manner.<sup>154</sup> The site was established on December 29, 1995, and as of January 17, 1996, the site had received 174 hits, or accesses.<sup>155</sup> The site remained active until March 12, of 1996.<sup>156</sup> The solicitor hailed the use of the site as much less expensive than the traditional methods of solicitation.<sup>157</sup> Then in March of 1996, a company used its Web site to post statements in opposition to a proxy battle.<sup>158</sup>

Proponents argue that the availability of the information is a great leveler, bringing smaller investors to the same level of access as institutional investors.<sup>159</sup> Some, however, remain leery about the prospect of proxy fighting over the Web.<sup>160</sup> They feel that if the site provided for e-mail or chat rooms<sup>161</sup> outrageous questions could be propounded and a discoverable record of the discussion created without the benefit of counsel.<sup>162</sup> However, the site doesn't have to provide for chat rooms. Furthermore, since e-mail may be answered at a later time, a company receiving investor e-mail could respond with benefit of counsel. Considering these recent events, the trend in

---

computer can record a user id and his unique IP address, thus providing evidence of access.

153. Release, *supra* note 142, at \*5 n.29.

154. Karen Donovan, *The Web—A Valid Proxy for Proxy-Fight Notices?*, NAT'L L. J., Jan. 29, 1996, at B1.

155. *Id.* at B2.

156. *Id.*

157. *Id.*

158. Brian J. McCarthy et al., *Takeover Activity in a High Tech Environment*, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, 483, 492-93 (1996).

159. *Id.* at 493.

160. *Id.*

161. Unlike e-mail, chat rooms are real time discussions over the Internet. See MOORE, *supra* note 116, at 160.

162. See Donovan, *supra* note 154, at B2.

American corporation law seems to be heading for the Internet and greater shareholder access.

#### IV. PROPOSAL FOR SHAREHOLDER VOTING ON THE INTERNET

In the area of shareholder participation in corporate governance, the problems with the proxy system as it is today and the utility of the Internet for wide distribution of information make a natural marriage. The following section describes two proposals for using the Internet to get more shareholders involved in the decision process. Each proposal is evaluated according to the extent it facilitates the shareholder's access to communication with management and other shareholders, the degree to which management can monitor shareholder concerns, and its potential for increasing shareholder activism.

##### A. *Voting through a Corporate Homepage*

The structure for this proposal is simple. First, the corporation establishes a homepage on the Web.<sup>163</sup> From this page the shareholder may access an exclusive shareholder page that can be used to publish pertinent corporate information, to make proposals to the corporate management, and to vote. To ensure that only registered shareholders can access this page, it will be necessary to set up a "firewall," or a security gate.<sup>164</sup> This gate can be set up by registering the shareholder's unique IP address and assigning her a password when she invests. When a shareholder attempts to access the page, the corporation host computer will recognize the IP address and correlate it to the proper user through the password. This procedure should suffice to ensure authenticity of the vote as well as identify any maker of a proposal.

This page may also have a device similar to the Usenet described above that allows the shareholder to post messages and respond to messages from other shareholders. Similar communication can already be accomplished on the Web.<sup>165</sup> This

---

163. Most large corporations already have done so. See Lynch, *supra* note 134, at 52-53.

164. John Mayes, *Corporate Connections*, INTERNET WORLD, Mar. 1996, 66, 67.

165. See, e.g., *Monty Python's Swedish Message Board* (visited March 10, 1997)



method of communication provides several benefits that alleviate the concerns of a real time chat room.<sup>166</sup> A record of discussions among shareholders can be maintained for the review of shareholders and management alike. The ability for an Internet discussion facilitates communication among shareholders and alerts management to potential shareholder concerns. Management may decide to respond to concerns raised in this discussion and, unlike the chat rooms, this response can have the benefit of input by legal counsel.<sup>167</sup>

In preparation for an electronic meeting, the annual report may be published on the page ahead of time, allowing every shareholder to read it at her leisure. Proposals may be made electronically either through the messaging system or on the page itself; however, this may pose a potential problem. Larger corporate constituencies will likely have a greater number of proposals.<sup>168</sup> A large number of proposals can result in a "digital cacophony" for the corporation and the other shareholders.

To remedy this problem the corporation has two options. First, the company may rely on the current proposal rules of 14a-8 to determine what it can omit from distribution. However, this option would only perpetuate the regulatory indecisiveness of the current system. The other option is to provide for what is a properly excludable proposal *ex ante* in the bylaws,<sup>169</sup> which has the benefit of removing management and shareholder action from bureaucratic scrutiny. To complement this result, management may choose to publish the proposal along with reasons why it should be omitted from the ballot.<sup>170</sup> This choice would invite comment from other shareholders and then management can gauge the relative support.<sup>171</sup> If chosen to be placed on the

---

<<http://www.pythonline.com/chitchat/chat/messageboard>>.

166. See Donovan, *supra* note 154, at B2; MOORE *supra* note 116, at 160.

167. See Donovan, *supra* note 154, at B2.

168. See Bainbridge, *supra* note 110, at 665-67.

169. WATERS, *supra* note 45, at 285-87. In this scheme, the bylaws may also be published on the Web as a feature of the shareholder site so that the shareholder has adequate notice of what is a proper subject for proposal.

170. Publishing the proposal would serve to notify the proponent of omission as the registrant is required to do under Rule 14a. 17 C.F.R. § 240.14a-8(d) (1997).

171. To comport with the SEC notice requirements referred to in the Release, the company would have to e-mail shareholders every time the page was updated. See

ballot, a statement of the proposal should be published well ahead of the meeting to allow time for everyone to access it. One advantage of using the Internet over traditional delivery systems is that since more information may be transferred on the Internet, there is no reason why the supporting statements for the proposal should be limited to 500 words, as is the case in paper transfers.<sup>172</sup>

Then, notice of the time for voting and procedures may be sent via electronic mail and/or published on the site. The actual voting may be conducted on the site page itself and, as the site is only accessible by registered shareholders, the corporation can be reasonably secure in the validity of the outcome. It must, however, be conducted over a period of time to ensure that a quorum of shareholders has voted.

This system has the advantage of enhancing information flow to both the shareholder and to management at a substantially lower cost than the present system, which will in turn promote more efficient decision-making.<sup>173</sup> It allows shareholders to communicate with each other without high transactional costs and it allows management to communicate more directly with shareholders than under the current system. It also provides avenues for increased shareholder activism and for increased management responsiveness to shareholder issues.

This design is probably better suited to the larger public corporations because of the accessibility of the Internet over a wider area. However, with such a large voting populace, one drawback is the potential for information overload. Some shareholders will likely be dissuaded from reading everything if there are megabytes of proposals and supporting statements to review. Furthermore, it requires every shareholder to have access. This is concededly an assumption of this model, relying on the rapid increase in Internet usage.<sup>174</sup> It is conceivable that for some

---

Release, *supra* note 142, at \*4. If the page is updated frequently, it may be cumbersome to notify every shareholder of each update. However, software mechanisms are available that will automatically notify a regular homepage customer any time the page is updated. Use of this device would make it very easy for the corporation to handle the notice problem.

172. See *supra* note 33 and accompanying text.

173. See *supra* notes 102-106 and accompanying text.

174. See Simons, *supra* note 151, at 59-60.

smaller public corporations, every shareholder will have access. Lastly, interested companies should note that it takes time to make this system work—time to prepare and respond to proposals; time to vote and to tabulate the results; and time to implement the changes decided upon.

### *B. Video Teleconferencing Over the Internet*

Video teleconferencing provides virtually face-to-face real time meeting capability expanded to include remote locations, which makes the meeting accessible to more people and eliminates the cost of traveling to a central meeting location. The problem with public corporations is that, depending on the number of shareholders entitled to vote, it may be impractical to assume or require that every member have video teleconference capability on their personal computer because of high cost.<sup>175</sup> In addition, it could create problems with shareholder participation in that the central corporate location would have the capability to allow a myriad of shareholders with individual videoconferencing ability to have input. These problems are overcome if there are teleconferencing facilities at several locations where shareholders may come and attend the meeting. In fact, the best place may be the shareholders local brokerage firm which itself would realize certain advantages. First, brokerages are often located central to various groups of shareholders, making the meeting less inconvenient. Second, the brokerage is in a better position to afford the high cost of installation and maintenance of such a system.<sup>176</sup>

Under this system, the meeting could be conducted as it is now and the shareholders in attendance would be entitled to the same rights as they enjoy now as meeting attendees, such as making proposals from the floor and nominating directors.<sup>177</sup> Proposals could also be limited in the same way as they are in

---

175. See Joe Paone, *Video Meets Ethernet; Desktop Videoconferencing Catches On In TCP/IP and PC-Based LANs*, INTERNETWORK, Nov. 1, 1994, at 1, available in 1994 WL 13345418.

176. The broker could lease the facility to several different corporations for meetings each year.

177. See Fisch, *supra* note 11.

current meeting procedure,<sup>178</sup> making the meeting run smoothly. Voting may still be accomplished electronically at the brokerage with the brokerage being responsible for assuring that those in attendance are entitled to vote.<sup>179</sup>

This method would increase shareholder communication among colleagues. However, the shareholder still may be cut off from management information beyond the required disclosures. Management, on the other hand, would be able to receive more information on shareholder concerns because more shareholders can participate. For the same reason, this system promotes increased shareholder activism. This method has another advantage in that because shareholders may attend meetings virtually in person, the need for proxies and the morass of regulation and cost associated with them is eliminated.

## V. CONCLUSION

The above proposals represent two extremes in the use of the Internet. The first proposal represents a minimum in cost to both the shareholder and management, which cost is a significant barrier to effective corporate decision-making under the current system.<sup>180</sup> However, it has the potential to maximize the amount of information exchanged between the participants, which can be problematic.<sup>181</sup> Furthermore, trying to bring order out of the chaos by using the current proposal rules may not improve the shareholder's position.

The second proposal represents a maximum of cost and a relative minimum of information flow. However, it will most likely provide a greater benefit to individual shareholders and management than exists under the current form.

Possibly, the optimal use of Internet technology is a hybrid of the two proposals, combining the best of both. For example, the corporation may use a Web site to distribute information

---

178. See WATERS, *supra* note 45, at 285-87.

179. This can be done rather easily by checking identification at the door as a prerequisite for admission. Brokerages could obtain a list of those entitled to attend from the registrant to ensure authenticity.

180. See Bebchuk & Kahan, *supra* note 84, at 1080.

181. See Bebchuk & Kahan, *supra* note 84, at 1073-74; Bainbridge, *supra* note 110, at 665-67; Calio & Zahraiddin, *supra* note 4, at 537-38.

and allow shareholder communication prior to the annual meeting. This use would hopefully air out any significant issues so that the need for prolonged discussion during the meeting would be reduced. The meeting, conducted through teleconferencing, would potentially be more orderly and yet permit the shareholder to retain the benefits of attendance. In either case, shareholder activism is facilitated, which may result in overall social utility.<sup>182</sup>

*George Ponds Kobler*

---

182. See Palmiter, *supra* note 35, at 886-89.