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RIP American shareholder capitalism

Toto, I have a feeling we're not in Delaware any more

Ann Lipton

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Ann Lipton is a professor in business law and entrepreneurship at Tulane University Law School and The Murphy Institute.

It hasn't made as many headlines as Elon Musk reshaping the federal government, but a series of legal changes at the SEC and in the corporate haven of Delaware could have enormous consequences.

Why? Well, the combination of the two constitute a violent regulatory swing that reallocates power away from shareholders and toward corporate insiders. Like Musk, conveniently.

The story of corporate governance over the past three decades has been the growth of the institutional investor. As retail money gushed into mutual funds, a formerly dispersed and pretty passive shareholder base coalesced into a sophisticated and powerful asset management industry.

Nudged along by the SEC, and the Department of Labor (which oversees retirement plans) these mutual funds gradually morphed into influential corporate overseers.

In fact, they became critical votes in activist campaigns and a wide variety of corporate governance arrangements, such as director independence, takeover defences, executive compensation, and, yes, ESG. BlackRock alone boasted of 3,384 "engagements" with its portfolio companies in 2024; Vanguard reported engagements with 486 companies last quarter alone.

Many founders that took their companies public responded by adopting dual-class share structures or other forms of insider control rights, only to find themselves stifled by the corporate law of Delaware, the premiere jurisdiction for chartering public companies.

Delaware courts began closely scrutinising relationships among board members — including personal and business ties — when evaluating whether insider transactions had been negotiated at arm's length.

They imposed even greater scrutiny when the transactions involved a controlling shareholder, two trends that culminated in a Delaware court's bombshell decision to strike down Elon Musk's $56bn pay package at Tesla. And last year, another Delaware court invalidated a shareholder agreement at Moelis & Co, on the ground that it handed the company's founder Ken Moelis too many powers that should have remained with the corporation's board of directors.

Faced with the ire of the venture capital and private equity firms, the Delaware legislature swiftly amended its corporation law to authorise the kind of agreement that had been invalidated in the *Moelis* case.

Nonetheless, the founder-led protests continued, with several companies — including Meta and Dropbox — threatening to decamp for more accommodating climes.

In response, the Delaware legislature rushed to propose a new package of reforms, bypassing its usual process of running corporate legislation through the Delaware bar's Corporation Law Council. This is potentially a huge deal for large swaths of American business.

If passed as proposed, the new statute will require courts to assume that board members are independent simply if the company designates them as independent under stock exchange listing rules; make it easier for boards to insulate conflicted transactions from judicial scrutiny; sharply curtail the rights of stockholders to access internal corporate information; and define "controlling stockholders" to exclude anyone with less than 1/3 of the company's voting power.

Conveniently, the latter move would not only take Elon Musk out of the category — just as his Tesla appeal reaches the Delaware Supreme Court — but also would leave out anyone who exerts control by the newly-authorised shareholder agreements rather than through voting shares.

Meanwhile, at the federal level, the SEC issued a flurry of new guidances limiting shareholder involvement in corporate governance, the most significant of which concerns whether large investors are deemed "active" or "passive."

The categorization matters: active investors who own more than 5 per cent of a particular company's stock must file prompt disclosures whenever their holdings increase or decrease by 1 per cent, including all trades made in the prior 60 days — a near impossible task for mutual fund complexes, given the volume of inflows and outflows they see regularly.

The giant asset managers therefore rely on the lighter disclosure regime applicable to "passive" investors, defined as those who do not acquire shares "for the purpose of or with the effect of changing or influencing the control of the issuer".

However, the new guidance treats governance interventions — even those on fairly traditional issues like executive pay and board declassification — as "active" if the investor explicitly or implicitly suggests that votes will be withheld from unresponsive directors. The new guidance could thus turn out to be a dagger aimed at the heart of mutual fund influence.

Tellingly, BlackRock and Vanguard temporarily cancelled meetings with corporate management, right at the start of the proxy season. And, if Trump 2.0 is anything like Trump 1.0, we can expect to see further regulation along these lines, including limits on proxy advisers and pension plan voting.

In sum, the mechanisms that enabled the rise of the institutional investor as a counterweight to insider control may be — well, if not completely unravelled, then at least significantly frayed — in the exact moment that Delaware is retrenching as well. The combination could be exceptionally disruptive.