CORPORATE GOVERNANCE UPDATE

Revitalizing U.S. Capital Markets: The Case for State-Led Reform

FOLEY & LARDNER LLP

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The United States capital markets are at a crossroads. As we approach the country's 250th anniversary, the health and competitiveness of its capital markets demand urgent attention. Paul Atkins, Chairman of the U.S. Securities and Exchange Commission (SEC), noted in a recent speech at the New York Stock Exchange on December 2, 2025 that the number of U.S. exchange-listed public companies has dropped sharply over the past two decades. This contraction, as the Chairman indicated, is not the result of diminished entrepreneurial ambition but the combined impact of overly complex regulations, excessive litigation, and the politicization of shareholder governance. Chairman Atkins identifies three pillars for reform to reverse this trend at the federal level: recalibrating SEC disclosure requirements; depoliticizing shareholder meetings; and reducing frivolous lawsuits. While federal reforms are important to accomplish these and other steps to make the U.S. capital markets attractive once again, meaningful changes can and must occur at the state level.

This paper makes the case for targeted state-level reforms as the most effective way to revitalize U.S. capital markets. States have the authority and flexibility to enact changes that address the litigation and governance challenges that are discouraging companies from going public. This paper examines a combination of recently enacted state-level reforms and additional prospective measures that may be adopted to make public offerings more attractive, including:

- Codification of the business judgment rule to protect companies from meritless claims and judicial second-guessing;
- Establishment of ownership thresholds for derivative lawsuits, ensuring only shareholders or groups of shareholders with a meaningful stake can bring such actions;
- Limitations on shareholder proposals, raising the bar for who may submit proposals and reducing distractions from activist agendas;
- Enacting legislation stating that precatory proposals are not a "proper subject" for shareholder actions under state law;
- Allowing corporate bylaws to require mandatory arbitration, allowing companies to resolve internal disputes efficiently and outside the public court system;
- Allowing for the adoption of loser-pays bylaw provisions for derivative suits, deterring frivolous litigation by shifting legal costs to unsuccessful litigants;
- Limiting attorneys' fee awards in derivative actions that result in disclosure-only settlements to discourage opportunistic litigation; and
- Reining in the power and influence of proxy advisors through increased transparency and accountability requirements.

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The following sections examine the rationale for these reforms, their impact in practice, and how state competition can incentivize legislatures to modernize corporate law statutes to make public offerings more attractive.

The Decline of U.S. Public Companies: Causes and Consequences

Over the past two decades, the number of U.S. stock exchange-listed companies has fallen from approximately 7,800 in 2007 to around 4,700 today. This decline reflects deep structural problems, which are driving companies to turn away from public markets and seek capital through private equity, venture capital, or foreign investment sources. Chairman Atkins emphasized that the story of American capital markets is inseparable from the story of American self-governance, enterprise, and prosperity. The regulatory frameworks that once made the United States the envy of the world, however, have drifted from their founding ideals.

The causes of the decline in U.S. public companies are multifaceted. First, the threat of meritless lawsuits—often brought by plaintiffs' lawyers seeking attorneys' fees rather than genuine shareholder recovery—has become a significant deterrent to going public. Public companies frequently face a range of shareholder-initiated lawsuits. The cost of defending even baseless claims can be staggering. And the uncertainty created by litigation undermines long-term business planning and contributes to an environment that is increasingly unattractive to companies considering a public filing.

Second, the proliferation of non-binding, or "precatory," shareholder proposals—many of which are focused on social or political issues unrelated to the company's business—has politicized shareholder meetings. Chairman Atkins has targeted precatory proposals as a particularly important issue that needs reform, as the inclusion of the proposals at shareholder meetings is time consuming, costly on the company, and diverts management attention.

Third, the regulatory environment, shaped by both federal and state law, has become increasingly complex and costly to navigate, particularly for smaller and emerging companies. For example, it is now common for proxy statements to exceed 100 pages, especially for S&P 500 companies. Investors and practitioners have noted that the inclusion of lengthy, repetitive, and non-material disclosures can bury important information, which makes it difficult for shareholders to identify key issues and vote intelligently.

Compounding these challenges is the dominance of two proxy advisory firms, Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co., which together control an estimated 97% of the market for proxy advice. This duopoly has outsized influence over the outcome of shareholder votes, often imposing a one-size-fits-all approach to governance that may not serve the interests of all shareholders or issuers.

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These issues are discouraging companies from pursuing public offerings and are, therefore, limiting the public's access to investment opportunities. We posit that there must be a course correction.

State-Level Reforms are Necessary

State law is the foundation of corporate governance. It is state law that determines the substantive rights and responsibilities of shareholders, directors, and officers. For example, state law determines:

- The standards for fiduciary duties owed by directors and officers;
- The scope of the business judgment rule and the circumstances under which liability may be imposed for breaches of fiduciary duty;
- The procedures shareholders must comply with to bring derivative suits; and
- The procedures for a company to respond to derivative suits, including the formation and independence of special litigation committees, and the ability to move for dismissal.

The path forward for revitalizing U.S. capital markets, therefore, includes significant steps that can be accomplished through state-level reforms that, properly aligned with the SEC rules, can enable private ordering and foster a legal environment that rewards innovation rather than litigation. These goals are interconnected. To reduce frivolous litigation, state laws must enable companies with the ability to adopt governance provisions that reflect their needs and risk profiles, which might mean mandatory arbitration clauses, loser-pay provisions, and ownership thresholds for shareholder actions.

State competition helps achieve these goals. When states compete for incorporations, they are incentivized to modernize their statutes, streamline procedures, and address emerging market challenges. This competitive dynamic ensures that corporate law evolves in response to real-world business needs.

This dynamic has become increasingly evident in recent years, as states including Texas and Nevada have enacted a variety of corporate governance reforms to attract businesses and challenge Delaware's historical dominance as a state for incorporations. Texas and Nevada, in particular, have demonstrated that legislative responsiveness can attract new business and foster a healthier public market ecosystem. Delaware, in response to these challenges has enacted its own legislative updates—heavily opposed by that state's powerful plaintiffs' bar, which has challenged these amendments in the statehouse and the courthouse—intended to facilitate private ordering and limit abuse by the plaintiffs' bar.

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States also have a role in depoliticizing shareholder meetings. Take, for instance, Chairman Atkins' commentary on "precatory proposals." Under Rule 14a-8, a company may exclude a shareholder proposal from its proxy statement if it is not a "proper subject" for shareholder action under state law. State law governs whether a proposal is a "proper subject," and Chairman Atkins stresses that the SEC will defer to state law on the issue—essentially alerting state legislatures and courts that only they can reform this aspect of shareholder meetings. In this regard, we believe states can and should take a more active role in defining the proper subjects for shareholder action, including considering whether "precatory proposals" are appropriate under state law.

States Must Enact Legislation That Limits Abusive Litigation

Excessive and meritless litigation is draining the life from public corporations. States should enact reforms that establish clear guidelines for derivative litigation and that provide greater latitude for private ordering.

1. **Guidelines to curb frivolous litigation**

   In contrast to Delaware, Texas and Nevada have both codified the business judgment rule into their respective corporate statutes, which provides directors and officers with a presumption that their decisions are made in good faith and in the best interests of the corporation. Codifying the business judgment rule reduces the uncertainty and inconsistency that can arise from judicial interpretation. While the business judgment rule is a staple of the common law of corporations in most states, the ability to create judge-made exceptions has increased the litigation risk to corporations. For example, although Delaware has the business judgment rule and allows corporations to exculpate claims alleging that directors breached their duty of care, the Caremark case and its progeny have been widely seen as creating a duty of loyalty claim for shades of negligence. By codifying the business judgment rule, states give clear guidance that courts should not second-guess legitimate business decisions or apply varying standards based on an individual judge's views.

   Texas has also taken steps to clarify and limit the circumstances under which directors and officers may be held liable for breach of loyalty. Section 21.419 of the Texas Business Organizations Code sets forth pleading requirements for shareholders seeking to bring a breach of loyalty claim. Under Section 21.419, a director or officer is presumed to act in good faith and in the best interests of the corporation. To overcome this presumption, a shareholder must allege "with particularity" that the director's or officer's conduct involved intentional misconduct, fraud, a knowing violation of the law, or an ultra vires act.

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This heightened pleading standard means that general allegations of poor judgment or negligence are insufficient. The shareholder must provide specific facts showing that the alleged breach falls into one of the enumerated categories. The statute's requirement for particularized pleading is designed to deter meritless claims and ensure that only serious allegations of disloyalty or wrongdoing proceed in court.

Another means for states to curb frivolous and abusive litigation is to limit or cap the available attorneys' fees. Texas, for example, passed legislation to prohibit the recovery of attorney's fees in cases where a derivative lawsuit results in a "disclosure-only" settlement, which reduces the incentive for opportunistic litigation.

2. **The need for permissible private ordering**

States should expand companies' private ordering rights. Private ordering allows managers and shareholders to adopt organizational documents that address issues such as dispute resolution, ownership thresholds for shareholder actions, and fee-shifting mechanisms. Companies may choose to include mandatory arbitration clauses to resolve internal disputes efficiently, or loser-pays provisions to deter frivolous derivative suits.

Texas, for example, passed legislation allowing corporations to set a minimum individual or group ownership threshold—which may not exceed three percent of outstanding common stock—for bringing derivative suits. This reform is designed to deter meritless claims brought by shareholders with negligible interests, while preserving the right of significant stakeholders or groups of stakeholders to hold management accountable. The Texas statute puts the power in the hands of the corporation and shareholders to decide for themselves who can bring derivative suits. And we have already seen notable companies adopting the threshold of 3% in their governing documents, reflecting the reality that when the majority of shareholders, as opposed to activists and so-called "governance experts", are given the chance to speak they express a wish to curb opportunistic and abusive derivative actions.

Similarly, Texas passed legislation permitting corporations to set ownership thresholds that shareholders, or groups of shareholders, must satisfy before submitting a proposal for consideration at a shareholder meeting. This change in the law allows companies to implement stricter requirements around shareholder proposals than under the Securities Exchange Act of 1934.

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Other measures that corporations may adopt—state law permitting—include “loser-pays” bylaws for derivative suits, requiring unsuccessful plaintiffs to pay the company’s legal fees. This fee-shifting mechanism is a powerful deterrent against meritless claims and aligns the incentives of corporations and shareholders toward the pursuit of only those cases with genuine merit. Mandatory arbitration clauses provided in corporate bylaws further allow internal disputes to be resolved efficiently, privately, and outside of the costly public court system. Permitting companies to adopt mandatory arbitration clauses in bylaws provides companies with greater control over dispute resolution and reduces the risk of protracted litigation.

States Should Adopt More Stringent Accountability and Transparency Laws for Proxy Advisory Services

The influence of proxy advisory firms over American public companies has reached unprecedented levels. Two firms—Institutional Shareholder Services (ISS) and Glass Lewis—control up to 97% of the proxy advice market, shaping the voting decisions of institutional investors. Their recommendations impact trillions of dollars in assets and the retirement security of millions of Americans.

Recognizing the risks posed by this duopoly, Texas enacted Senate Bill 2337, which requires proxy advisors to disclose when their recommendations are not purely in the financial interest of shareholders and imposes penalties for noncompliance. While the law faces constitutional challenges, it represents a critical step toward restoring accountability and transparency in the proxy advisory market. State-level regulation is essential to ensure that the interests of all shareholders are protected, especially when market concentration allows a handful of firms to set de facto standards for corporate America.

In addition, in November 2025, the Florida Attorney General filed a landmark lawsuit against ISS and Glass Lewis, alleging violations of the Florida Antitrust Act and the Florida Deceptive and Unfair Trade Practices Act. The complaint details how these firms have used their market power to push agendas that Florida argues may conflict with maximizing shareholder value. The lawsuit alleges that ISS and Glass Lewis deceived consumers about the objectivity and financial basis of their recommendations and failed to disclose material risks associated with their advice.

Federal policymakers have also taken notice. On December 2, 2025, the White House issued an executive order titled “Protecting American Investors from Foreign-Owned and Politically Motivated Proxy Advisors.”

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The order directs Chairman Atkins to, among other things, enforce the Federal securities laws' anti fraud provisions with respect to material misstatements or omissions contained in proxy advisors' proxy voting recommendations, assess whether to require proxy advisors whose activities fall within the scope of the Investment Advisers Act of 1940 to register as registered investment advisors, and consider requiring proxy advisors to provide increased transparency on their recommendations, methodology, and conflicts of interest.

Even more recently, JPMorgan Chase announced that its asset-management division is cutting ties with proxy advisory firms in the U.S. It remains to be seen whether this is the beginning of a trend.

These state, federal, and private actions underscore the concerns that proxy advisors do not advise solely on the basis of financial interest, but instead support agendas that are undisclosed. The concentration of market power in the hands of ISS and Glass Lewis give those entities outsized influence over the US capital markets with little oversight. By enacting legislation such as Texas's SB 2337, pursuing antitrust enforcement as in Florida, and implementing federal oversight, policymakers can restore transparency and accountability to the proxy advisory market. These reforms are essential to ensure that proxy voting advice reflects the financial interests of shareholders, supports sound corporate governance, and protects the long-term health of American capital markets.

Conclusion

The revitalization of U.S. capital markets is not a task for the SEC alone. States should take the lead. By embracing reform, states can help reduce frivolous and costly litigation, ease regulatory burden, and make going public an attractive option once again.

Authors

Christopher J. Babcock
Partner | Dallas

214.999.4370
cbabcock@foley.com

Christopher Converse
Partner | Dallas

214.999.4903
cconverse@foley.com

Brantley Smith
Associate | Dallas

214.999.4294
bsmith@foley.com

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