

award superior voting rights to long-term shareholders fell within the ambit of a reasonable business decision and reasonable corporate policy.²⁸²

For companies listed on the NYSE, however, the stock exchange listing requirements effectively prohibit companies from adopting tenured voting once that company has issued stock with a certain package of voting rights.²⁸³ The NYSE listing rules provide in relevant part that:

Voting rights of existing shareholders of publicly traded common stock registered under Section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issuance. Examples of such corporate action or issuance include, but are not limited to, the adoption of time phased voting plans, the adoption of capped voting rights plans, the issuance of super voting stock, or the issuance of stock with voting rights less than the per share voting rights of the existing common stock through an exchange offer.²⁸⁴

The NYSE standards thus effectively function as immutable rules and bar the use of time-weighted voting for existing public companies.²⁸⁵ However, for non-public companies and companies about to go public, tenured voting is a viable cultivation tool. In addition, even for listed companies the NYSE has signaled in its interpretive documents that it will allow some exceptions for corporate actions, which have a disparate impact on stockholder voting rights if the exchange finds that these actions have a "reasonable business justification."²⁸⁶ Examples of public corporations that currently have a time-weighted voting policy include Aflac Incorporated,²⁸⁷ J.M. Smucker Company,²⁸⁸ and Quaker Chemical

²⁸²See *Williams v. Geier*, 671 A.2d 1368, 1376, 1382 (Del. 1996).

²⁸³See *NYSE Manual*, *supra* note 258, § 313.00(A).

²⁸⁴*Id.*

²⁸⁵See *id.*

²⁸⁶Para. 313.00 Interpretation No. 95-01, N.Y. STOCK EXCH. (Jan. 10, 1995), http://nysemanual.nyse.com/LCM/pdf/voting_rights.pdf.

²⁸⁷See Aflac Inc., Notice and Proxy Statement (DEF 14A), at 2 (May 6, 2013) ("In accordance with the Company's Articles of Incorporation, shares of the Company's Common Stock . . . are entitled to one vote per share until they have been held by the same beneficial owner for a continuous period of greater than 48 months . . . at which time they become entitled to 10 votes per share.").

²⁸⁸See The J.M. Smucker Co., Proxy Statement for the Annual Meeting of

Corporation, although all three of these companies appear to have been grandfathered in under the NYSE tenure voting rules.²⁸⁹

For Shareholder Cultivation, time-weighted voting allows companies to distinguish among shareholders based on the shareholders' level of commitment in owning the firm's stock. As a cultivation tool, it rewards stewardship capital on one hand, and potentially discourages the aforementioned flippers and short-term gamblers.²⁹⁰ Moreover, with more attention being focused on the negative impacts caused by shareholder short-termism and some shareholder activists,²⁹¹ the NYSE's ban on time-weighted voting may be ripe for reconsideration. In articulating its policy to ban "time phased voting plans" and their ilk, the NYSE does acknowledge in its listing manual that: "[t]he Exchange's interpretations under [its voting rights policy] will be flexible, recognizing that both the capital markets and the circumstances and needs of listed companies change over time."²⁹² With the growing presence and clout of shareholder-gamblers in corporate governance and corporate elections, there is a strong case to be made that for the NYSE to re-evaluate its voting policy, which treats all shareholders as equal, and "recogniz[e] that both the capital markets and the circumstances and needs of listed companies [have] change[d] over time."²⁹³

Shareholders, (DEF 14A), at 75-76 (July 3, 2012). In general, common shareholders are entitled to one vote per share but in the event that common shareholders have been beneficially owned for approximately five years, then such common shareholders are entitled to ten votes per share. *Id.* at 76.

²⁸⁹See Quaker Chem. Corp., Notice of Annual Meeting of Shareholders, (DEF 14A), at A-1 (Mar. 28, 2013) ("[H]olders of the Company's . . . Common Stock . . . became entitled to 10 votes per share of Common Stock with respect to such shares, and any shares of Common Stock acquired after the Effective Date, subject to certain exceptions.").

²⁹⁰See *supra* notes 149-51, 185-86, 255 and accompanying text.

²⁹¹See Roberta S. Karmel, *Voting Power Without Responsibility or Risk: How Should Proxy Reform Address the Decoupling of Economic and Voting Rights?*, 55 VILL. L. REV. 93, 94 & n.160 (2010) (noting that empty voting undermines shareholder franchise); Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1267 (2008) (noting that intentional empty voting may lead to reduction of a company's value). But see Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 896-97 (2013) (arguing that activist investors may prove beneficial to overall governance because they serve a "governance arbitrageur" function). For a discussion of concerns about empty voting, see *Proxy System*, Exchange Act Release No. 34-62495, July 14, 2010.

²⁹²NYSE Manual, *supra* note 258, § 313.00(A).

²⁹³*Id.*

e. *Leveraging Current Shareholders*

In addition to recruiting shareholder stewards, corporations also leverage *current* shareholders as a cultivation tool to help shape the views of the existing shareholder base. An example of this technique in action is JPMorgan Chase's response to pressure by some shareholders and their advisors to separate the roles of "chairman" and "chief executive."²⁹⁴ In addition to publicly voicing its disagreement with the proposal to split the posts, JPMorgan board members launched an outreach campaign to its largest shareholders as well as to its smaller shareholders whom the bank viewed as key allies in advocating its views.²⁹⁵ One news report stated that, "[JPMorgan's] board members [were] planning to sit down with some of the bank's biggest shareholders to make their case that JPMorgan's . . . chief executive, Jamie Dimon, should keep his chairman title . . ."²⁹⁶

As a cultivation strategy, the "sit down"²⁹⁷ with these shareholders would be beneficial in at least two ways. First, if the targeted shareholders agree with the board's judgment, the outreach could help ensure that they cast their votes in support of management's recommendations—increasing the chances of allowing management to pursue JPMorgan's defined purpose and vision with Dimon in both leadership roles. Second, the outreach to the targeted shareholders could incentivize them to become active ambassadors and communicate the reasons for management's decision to other shareholders from the firm's point of view. This would likely educate more shareholders on the benefits of management's position, which in turn, should also lead to the goal of procuring more votes to maintain Dimon's dual leadership role. In terms of the cultivation framework, the federal proxy rules and Regulation FD would be examples of two immutable rules that would form the outer boundaries of such outreach and determine the form and scope of discussions.²⁹⁸

²⁹⁴See Susanne Craig & Jessica Silver-Greenberg, *JP Morgan Works to Avert Split of Chief and Chairman Roles*, N.Y. TIMES, Apr. 5, 2013, <http://dealbook.nytimes.com/2013/04/05/behind-the-scenes-jpmorgan-works-to-sway-shareholders-on-dimon-vote/>.

²⁹⁵See *id.*

²⁹⁶*Id.*

²⁹⁷*Id.*

²⁹⁸17 C.F.R. § 240.14a (2014); 17 C.F.R. § 243.100 (2011).

f. *Dividend Policy and Stock Splits*

A firm's dividend policy and use of stock splits also provide a means of cultivation, primarily by serving a signaling function to current shareholders and the market, and thus potentially attracting shareholders to buy or hold the company's stock. Both are in the discretion of the corporation's board of directors and both may be used as a signaling tool to indicate to the market that the company's future prospects seem promising. Although dividends are in the discretion of the board, payments have to comply with legal capital rules under state corporate law.²⁹⁹ As discussed below, these state legal capital rules, which provide both the method for calculating dividend payments and a cap on the amount of dividends that can be paid, serve as markers for the immutable rule boundaries that cannot be violated within the dividend space.³⁰⁰ Within these boundaries, however, corporate law default rules allow boards a wide degree of discretion to determine how a firm's dividend policy should be structured.³⁰¹

Similarly, stock splits may be used as a signaling function and cultivation technique for firms who want to reward existing shareholders or attract smaller investors into the firm's stock.³⁰² In a stock split, the firm increases the number of shares outstanding by issuing additional shares to existing shareholders.³⁰³ Thus in a two-for-one stock split, every shareholder with one stock is given one additional share.³⁰⁴ So if a company had five million shares outstanding before the split, it would have ten million shares outstanding after a two-for-one stock split.³⁰⁵ After a stock split, the firm's stock price will be reduced as a result of the increase in the number of shares outstanding.³⁰⁶ In turn, one effect of this is that the firm's stock appears more affordable to the market and more attractive to smaller investors.³⁰⁷

²⁹⁹For example, in Delaware, the DGCL provides that dividends may be paid out of surplus, which is defined as total assets less total liabilities, less paid in capital, or if there is no surplus for a given year then dividends may be paid out of net profits for that year and/or from net profits from the preceding year. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 154, 170 (2011).

³⁰⁰*See infra* Part III.F.2.

³⁰¹*See* DEL. CODE ANN. tit. 8, § 170 (2011).

³⁰²*See* 3 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 20:20 (2d. ed. 2003).

³⁰³*See id.*

³⁰⁴*See id.*

³⁰⁵*See id.*

³⁰⁶*See* COX & HAZEN, *supra* note 302, § 20:20.

³⁰⁷*See id.*

Whole Foods Market recently employed the stock split technique, when it announced a two-for-one stock split in the spring of 2013.³⁰⁸ In response to the announcement, Whole Foods stock price increased by approximately eight percent the day after the announcement.³⁰⁹ News coverage of the Whole Foods stock split suggested that the split primarily served a signaling function as to the company's future prospects.³¹⁰ According to the *Wall Street Journal*, the split was "a way for [the] company to signal [that] it thinks its future is bright."³¹¹

Compared to other capital market cultivation tools, the use of dividends and stock splits are arguably somewhat weak as cultivation strategies because they do not involve targeting a particular group of shareholders based on demonstrated or potential stewardship behavior. Thus, while both the payment of dividends and the stock split theoretically signal the growth prospects of the company, the problem is that this signal is "noisy" as a cultivation strategy. The target recipients for the message are not well defined or sorted to ensure that shareholders who are enticed to buy the stock based on this information are in fact the type of shareholders that the company would want to cultivate. In the case of stock splits, however, this problem of untargeted recruiting goes away if the target recipient is a small investor.³¹²

³⁰⁸Justin Lahart, *Whole Foods Decides to Party Like It's 1999*, WALL ST. J., May 9, 2013, <http://online.wsj.com/news/articles/SB10001424127887324059704578471242897872354>.

³⁰⁹Christopher Freeburn, *Whole Foods Announces a 2-for-1 Stock Split*, INVESTORPLACE, May 8, 2013, <http://investorplace.com/2013/05/whole-foods-announces-a-2-for-1-stock-split/>.

³¹⁰See Lahart, *supra* note 308.

³¹¹*Id.*

³¹²*Id.* ("The thing is, the signal probably works best on individual investors. Institutions are more interested in signals backed with cash, like share buybacks and dividend increases. And since individual investors have retreated from direct ownership of stocks over the past decade, the views of institutional investors are more important to companies."). The article does, however, go on to note that splits may "still have value" because "[i]f a company signals its faith in the future through a split, and then falters, it merely looks stupid." *Id.* On the other hand, if it signals its faith in the future through a share buyback or dividend payment, "it not only looks stupid, [but] it has less cash to get through the rough patch." *Id.* Another concern is that because of discount brokers and fee structures, except for very expensive stocks, splits may not make a company more appealing to the small individual investor. *Understanding Stock Splits—Factoring in Commissions*, INVESTOPEDIA.COM (Feb. 26, 2010), <http://www.investopedia.com/articles/01/072501.asp> (stating that the increase in flat-fee billing by brokers instead of traditional commissions has largely extinguished the advantage of purchasing stock prior to a split for investors).

3. Rhetorical Tools and Technique

A third category of action that companies engage in that is—or can be—used as a cultivation technique is communicating with shareholders and their other stakeholders. For shareholders, the primary methods or points of communication include: the annual meeting; the company's website; quarterly earnings guidance; sell-side analyst calls; shareholder outreach; periodic reports; proxy statements; offering memoranda; press releases; and most recently, communications via social media.³¹³ The choice of communication channel, the invited group of participants, and the substance of the message communicated, all provide a means for management to reach, recruit, educate, and cultivate a targeted group of shareholders, and curate an acceptable shareholder base.³¹⁴

In the immutable-default rule construct, SEC rules and regulations like Regulation FD and Rule 10b-5, which govern the form, manner, and substance of communications between the firm and its shareholders, provide a framework and the outer limits within which a firm can effectively formulate and deliver its message to shareholder constituents.³¹⁵ In general, Regulation FD bans the "selective disclosure" of material nonpublic information by mandating that an issuer who discloses such information to investors or analysts disclose this information to the general public.³¹⁶ For "intentional" selective disclosures, disclosures to the public must be made simultaneously, while for a "non-intentional" disclosure, the issuer must make a public disclosure promptly.³¹⁷ Similarly, Rule 10b-5 makes it unlawful for any person "[t]o make any untrue statement of a material fact or to omit to

³¹³See Press Release, U.S. Sec. & Exch. Comm'n, SEC Says Social Media OK for Company Announcements if Investors Are Alerted (Apr. 2, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171513574>.

³¹⁴See Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L.REV. 821, 833-34 (2013).

³¹⁵17 C.F.R. § 240.10b-5 (2013); 17 C.F.R. § 243.100 (2011); *see also* Litigation Release, Sec. & Exch. Comm'n, Federal Court Approves Global Research Analyst Settlement, Litigation Release No. 18438, (Oct. 31, 2003), available at <http://www.sec.gov/litigation/litreleases/lr18438.htm> (discussing a settlement of enforcement actions against twelve investment banking firms approved by the U.S. District Court for the Southern District of New York).

³¹⁶See 17 C.F.R. § 243.100. For discussion of Regulation FD, see WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING 283-90 (Aspen Law & Bus. ed., 2nd prtg. 1996). For discussion of tipping by the company in violation of Rule 10b-5, see *id.* at 302-05.

³¹⁷17 C.F.R. § 243.100. See WANG & STEINBERG, *supra* note 316, § 5.2.3[C][3] (discussing that Regulation FD only applies to selective disclosure to certain categories of person).

state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security."³¹⁸ Thus, Regulation FD is generally thought to regulate the process of communication³¹⁹ while Rule 10b-5 regulates the substance of the communications.³²⁰ However, both still leave broad latitude for a firm to shape and deliver its message.³²¹

Some companies do realize the value to be gained from rhetorical choice, the framing of their message, and message consistency.³²² A lead investor relations officer for a small-cap firm described it as the importance of the "three Cs"—"consistency; credibility; clarity."³²³ Relatedly, in a recent research study published in the *Harvard Business Review*, researchers "analyzed the transcripts of 70,042 earnings conference calls held by 3,613 firms from 2002 to 2008" and found that executives, who through their language conveyed short-termist views (consistently used phrases such as "next quarter" and the "latter half of this year"), attracted more short-term investors than companies whose executives conveyed a long-term message to the market (with phrases such as "years" and "long run").³²⁴ Based on these findings, the authors concluded that:

Managers can take actions and structure their communications to offset [short-term tendencies]. [Managers] should be aware that to a large degree, they are setting the tone. The language a company uses when talking to investors is a meaningful indicator of its orientation—and the investors listening in on calls that emphasize a short-

³¹⁸17 C.F.R. § 240.10b-5 (2013).

³¹⁹See 17 C.F.R. § 243.100.

³²⁰See 17 C.F.R. § 240.10b-5. Some scholars believe that Regulation FD regulates both process and substance, as does Rule 10b-5. See WANG & STEINBERG, *supra* note 316, § 5.2.3[C][3].

³²¹Excluding the SEC Form 8-K provision, neither statute defines how the communications shall be delivered, only how they should not be delivered. See *id.*; 17 C.F.R. § 243.100.

³²²See Francois Brochet et al., *Short-Termism: Don't Blame Investors*, HARV. BUS. REV., June 2012, available at <http://hbr.org/2012/06/short-termism-dont-blame-investors/ar/1> (finding that companies that use words and phrases associated with short-term goals and projections when communicating to current and prospective shareholders attract more short-term-minded investors).

³²³Telephone Interview with Julie Tracy, Senior Vice President and Chief Commc'n Officer, Wright Med. Grp. (Jan. 14, 2013).

³²⁴Brochet et al., *supra* note 322.

term approach are a largely self-selecting group who like what they hear.³²⁵

For Shareholder Cultivation, the implications are intriguing—knowing the words or phrases that attract certain shareholders could enable a firm to strategically employ language and rhetorical choices that maximize cultivation efforts.³²⁶

In addition to language choice on earning calls, the choice of *when* and *how often* to provide earnings guidance has cultivation implications. While management's rhetorical choices could code and condition shareholder expectations, so too could management's decision *ex ante* of whether to even communicate. Although the law does not require earnings calls, most public corporations provide earnings guidance in a rote-like and ritualistic way because they view earnings calls as a necessary part of investor relations.³²⁷ However, the purported benefits of earnings calls such as enhanced shareholder returns are dubious.³²⁸ In a 2006 report published by McKinsey&Company, the authors make the case that quarterly earnings guidance may be a "misguided practice."³²⁹ In the report, the authors note that:

Our analysis of the perceived benefits of issuing frequent earnings guidance found no evidence that it affects valuation multiples, improves shareholder returns, or reduces share price volatility. The only significant effect we observed is an increase in trading volumes when companies start issuing guidance—an effect that would interest short-term investors who trade on the news of such announcements but should be of little concern to most managers . . .³³⁰

The report also found that companies who stopped giving quarterly earnings guidance were not penalized by the market and the report

³²⁵*Id.*

³²⁶See generally LAKOFF, *supra* note 179; Tversky & Kahneman, *supra* note 179, at 453.

³²⁷Peggy Hsieh et al., *The Misguided Practice of Earnings Guidance*, MCKINSEY&CO. (2006) http://www.mckinsey.com/insights/corporate_finance/the_misguidedpractice_of_earnings_guidance.

³²⁸*Id.* at Exhibit 2 (finding that there is no difference in returns to shareholders between companies do not issue guidance and those that do).

³²⁹*Id.* at 1.

³³⁰*Id.*

concluded that companies should "shift their focus away from short-term performance and toward the drivers of long-term company health . . ."³³¹ Indeed several large corporations, such as Coca-Cola, Inc.,³³² Motorola, Inc.,³³³ and Intel Inc.,³³⁴ have all stopped issuing earnings guidance. From a cultivation perspective, the decision not to provide quarterly earnings guidance is a decision to not pander to fair-weather shareholders who oftentimes are not interested in performing a stewardship role in the firm.

E. *De-Cultivation Tools*

A necessary component in the Shareholder Cultivation process is the "de-cultivation" of non-co-venturers and gamblers. For public corporations, stopping unwanted investors from owning their stock is nigh impossible and for obvious reasons much more difficult than recruiting shareholder stewards to purchase the stock.³³⁵ However, public companies do have some de-cultivation techniques at their disposal.

1. Non-Engagement Techniques

On the softer end of the spectrum are "non-engagement" techniques, which are actions by the company that signal to a particular class of investors that the company does not wish to engage with them.³³⁶ These non-engagement techniques include soft tactics like not returning an investor's phone call, not inviting an investor to meet with management, and rebuffing any overtures by the would-be investor or current shareholder to engage with management.³³⁷

³³¹Hsieh et al., *supra* note 327.

³³²See *Earnings Guidance*, ASPEN INST. 2 (Nov. 2007), <http://www.aspeninstitute.org/sites/default/files/content/docs/bsp/EGInFocus.pdf>.

³³³See Hsieh et al., *supra* note 327.

³³⁴*Id.*

³³⁵See Marc Goedhart & Tim Koller, *How to Attract Long-Term Investors: An Interview with M&G's Aled Smith*, MCKINSEY&CO. (June 2013), http://www.mckinsey.com/insights/corporate_finance/how_to_attract_long-term_investors_an_interview_with_m_and_gs_aled_smith (discussing the challenge of attracting quality, long-term investors).

³³⁶Telephone Interview with Julie Tracy, Senior Vice President and Chief Commc'n's Officer, Wright Med. Grp. (Jan. 14, 2013).

³³⁷*Id.*

2. Natural Inverse Techniques

Further along the spectrum of de-cultivation tools is the inverse of several of the cultivation tools discussed above. For example, short-term shareholders would receive diminished voting rights under a time-phased voting plan, while a shareholder who attaches little value to sustainability concerns (often short-handed as "ESG" or environmental, social, and governance initiatives) would probably not be attracted to, or cultivated by, a company who elected to become a "social purpose" corporation.

In addition, narrative and messaging could serve a de-cultivation function that encourages certain shareholders to exit the firm's stock. A poignant example of this can be found in a statement made by Howard Schultz, CEO of Starbucks, Inc., at the company's 2013 annual meeting.³³⁸ When taken to task by a current shareholder about Starbucks' support for gay marriage, Schultz sharply responded that "[n]ot every decision is an economic decision" and that if the shareholder disagreed with Starbucks' policy on gay marriage, the shareholder should "sell [his or her] shares in Starbucks and buy shares in another company."³³⁹

3. Share Repurchases

In terms of a more aggressive de-cultivation approach, the firm could engage in share repurchases, also known as share buybacks or stock buybacks.³⁴⁰ Under a share repurchase plan, management offers to buy back some portion of the company's outstanding shares in exchange for cash.³⁴¹ The company either retires the repurchased shares or keeps them as treasury stock for re-issuance.³⁴² Under U.S. corporate law, there

³³⁸See Frederick E. Allen, *Howard Schultz to Anti-Gay-Marriage Starbucks Shareholder: 'You Can Sell Your Shares'*, FORBES (Mar. 22, 2013), <http://www.forbes.com/sites/frederickallen/2013/03/22/howard-schultz-to-anti-gay-marriage-starbucks-shareholder-you-can-sell-your-shares/> (reporting a conversation between Howard Schultz and a Starbucks shareholder at Starbucks' annual meeting).

³³⁹*Id.* (quoting Howard Schultz, CEO of Starbucks).

³⁴⁰See *Dividends vs. Share Repurchases*, DIVIDENDMONK.COM, <http://dividendmonk.com/dividends-vs-share-repurchases/> (last visited Aug. 7, 2013).

³⁴¹See Laurie Simon Bagwell & John B. Shoven, *Cash Distributions to Shareholders*, 3 J. ECON. PERSPS. 129, 129 (1989) (examining the effects on corporations when cash is transferred to shareholders in return for the corporation's shares under a share repurchase program).

³⁴²See B.S. Padmashree & N.S. Nigam, *Buy Back of Shares by a Company: An Analysis*, 7 STUDENT ADVOC. 31, 31 (1995) (explaining that treasury stock is repurchased shares that remain assets of the company and that share repurchases can lead to a reduction of share capital thus an extinguishment of shares).

are three primary means of conducting a share buy-back: open market purchases; private negotiations; or block transactions.³⁴³ Share repurchases are often conducted for financial reasons, such as increasing a company's earnings per share.³⁴⁴ However, repurchases could theoretically serve a de-cultivation function, especially when done through private negotiations. Selective repurchases are allowed under U.S. law and thus the company could theoretically identify the shareholders whose shares they wish to buy back. Realistically, the problem will be the cost. For starters, there is evidence that share repurchases are more financially beneficial to the company and more successful with individual investors than institutional investors.³⁴⁵ Individual investors are more likely to jump at the opportunity to sell their shares to the company when they perceive the stock to be undervalued.³⁴⁶ On the contrary, as one might expect, institutional investors are generally more financially savvy and sophisticated in their decision-making and are not as easily swayed to relinquish their shares to the company at the company's offered price.³⁴⁷ Thus, for a company whose de-cultivation is targeted at institutional investors, the use of share repurchases as a de-cultivation tool could create substantial transaction costs and become cost prohibitive.³⁴⁸

³⁴³ See Ok-Rial Song, *Hidden Social Costs of Open Market Share Repurchases*, 27 J. CORP. L. 425, 426 & n.3 (noting the various methods of stock buybacks). Other methods of conducting share repurchases include the use of repurchase put rights (whereby the holder of the put has a right to sell their shares to the company at a certain price), fixed price tender offer, and a Dutch auction tender offer. *Id.*

³⁴⁴ Earnings per share, or "EPS", is calculated by dividing a company's retained earnings by the number of shares outstanding. *See, e.g.*, Thomas Boyd & Teresa M. Cortese-Danile, *A Better Understanding of Earnings Per Share*, 16 COM. LENDING REV. 58, 58 (2001) (explaining the formula for computing earnings per share). Because share repurchases reduce the denominator, the EPS figure increases. *See id.* at 59 (discussing how share repurchases reduce the number of shares outstanding).

³⁴⁵ *See, e.g.*, Edward S. Adams, *Bridging the Gap Between Ownership and Control*, 34 J. CORP. L. 409, 422 (2009) (discussing the difference between individual investors and institutional investors).

³⁴⁶ *See id.*

³⁴⁷ *See id.*

³⁴⁸ *See, e.g.*, *Dividends vs. Share Repurchases*, DIVIDENDMONK.COM, <http://dividendmonk.com/dividends-vs-share-repurchases/> (providing examples of companies, such as Chubb, Costco, and National Presto Industries, who have announced share repurchase plans) (last visited Aug. 7, 2013).

4. So Long! We're Going Private!

On the extreme end of the de-cultivation spectrum would be a "going private" transaction,³⁴⁹ which would allow a public corporation to cull its shareholder base, leaving in place only those shareholders who management views as supportive of its mission and its long-term vision. With respect to the legal framework, state law primarily focuses on the fiduciary obligations of the board to shareholders while federal law focuses on disclosure obligations.³⁵⁰ When Dell, Inc. announced in early February 2013 that it was going private, Michael Dell, the company's CEO and founder, said that going private would "give the company 'more time, investment and patience' as it seeks to turn itself around."³⁵¹ One news outlet expressed Dell's sentiment more pointedly, saying, "Going private will . . . give Dell the time and breathing room it needs, without having to explain to impatient shareholders every quarter why it hasn't built a better [sic] iPad."³⁵² These statements by Michael Dell and the media reflect the value of going private from a Shareholder Cultivation perspective. Interestingly, going private transactions could also be viewed as the ultimate cultivation tool because those taking the

³⁴⁹See Cox & HAZEN, *supra* note 302, § 23.04 ("[A] . . . going-private transaction [is] any organic corporate change, such as . . . repurchase of shares . . . that results in a publicly traded company being delisted or closely enough held so as no longer to be subject to the 1934 Exchange Act's reporting requirements."); see also Z. Jill Barclift, *Governance in the Public Corporation of the Future: The Battle for Control of Corporate Governance*, 15 CHAP. L. REV. 1, 3 (2011) (describing the relationship between federal securities laws, which focus on disclosure obligations, and state law, which focuses on fiduciary duties of the board to shareholders).

³⁵⁰See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986) (stating that the board owes fiduciary duties of care and loyalty to shareholders); see also Brittany M. Giusini, Note, *Pure Resources' "Fair Summary" Standard: Disclosures Away From Obtaining Clarity in the M&A Context*, 38 DEL. J. CORP. L. 595, 619-25 (2013) (discussing the costs and benefits of increasing disclosure requirements in Delaware); Lawrence A. Hamermesh & Peter I. Tsotflias, *An Introduction to the Federalist Society's Panelist Discussion Titled "Deregulating the Markets: The JOBS Act"*, 38 DEL. J. CORP. L. 453, 472 (2013) (discussing recent disclosure requirements under the JOBS Act).

³⁵¹Dell Goes Private; Personal Computing, ECONOMIST, Feb. 9, 2013, at 63; see also Sharon Terlep, *Facing Defeat, Michael Dell Tries One Last Gambit*, WALL ST. J., July 25, 2013, at B1 (discussing Michael Dell's current battle to save the company that he founded from falling into the hands of activist investor Carl Icahn). The interesting question from a cultivation perspective is whether Dell (the company) could have done anything ex ante to further lessen the chances of Icahn succeeding in taking over Dell.

³⁵²Ted Samson, *Good-Bye PC Maker Dell and Hello Cloud Company Dell*, INFOWORLD (Feb. 4, 2013), <http://www.infoworld.com/t/cloud-computing/good-bye-pc-maker-dell-and-hello-cloud-company-dell-212203>.

company private usually plan on playing a stewardship role in the newly created entity.³⁵³

F. Future Shareholder Cultivation Tools for Recruiting Shareholder Stewards

Future cultivation tools contemplated in this Sub-Part all recognize and exploit shareholder heterogeneity to encourage shareholder stewards.³⁵⁴ Such future cultivation tools include: (1) nuanced financial products like "MY Shares," which offer superior voting rights and distribution rights to steward shareholders;³⁵⁵ (2) time-weighted dividends whose dividend stream is dependent on a shareholder's length of ownership;³⁵⁶ (3) mission-weighted dividends whose dividend stream depends on the *quality* of share ownership;³⁵⁷ (4) suspending the rights of shareholders who exhibit "improper" behavior in violation of corporate law;³⁵⁸ (5) engaging regulatory agents such as stock exchanges and the SEC to develop best practices around integrated reporting;³⁵⁹ (6) implementing a transaction tax on shareholders who exhibit non-co-venturer behavior;³⁶⁰ and (7) shareholder "rewards" point programs, which reward shareholder stewards with points that may be applied to additional shares or towards the purchase of the company's products or services.³⁶¹ As developed below, each of these future cultivation tools pattern the intent and design developed in Part IV—they act as gap fillers within the immutable-default rules of corporate law to devise modes of engagement and collaboration between shareholders and managers as a third-way approach to improved governance design.³⁶²

³⁵³Going private does, however, entail significant costs, such as reduced liquidity and marketability of the securities. See Robert P. Bartlett III, *Going Private but Staying Public: Reexamining the Effect of Sarbanes-Oxley on Firms' Going-Private Decisions*, 76 U. CHI. L. REV. 7, 9 (2009) (noting that problems with going private include a reduction in financial market liquidity and periods of depressed stock prices).

³⁵⁴See *infra* Part IV.F.1-7.

³⁵⁵See *infra* Part IV.F.1.

³⁵⁶See *infra* Part IV.F.2.

³⁵⁷See *infra* Part IV.F.3.

³⁵⁸See *infra* Part IV.F.4.

³⁵⁹See *infra* Part IV.F.5.

³⁶⁰See *infra* Part IV.F.6.

³⁶¹See *infra* Part IV.F.7.

³⁶²See *supra* Part III.

1. "MY" Shares

First, companies could elect to create a class of shares that reward shareholders for being stewards of the company. These mission-yield shares, which I shall call "MY Shares," could be created as a separate class of shares similar to other dual class share structures. The MY Shares could offer superior voting rights and economic rights, which rights would be contingent not only on the length of ownership, but also on fulfillment of the firm's mission-sustaining criteria.

In terms of designing such mission-sustaining criteria, the United Kingdom ("UK") Stewardship Code³⁶³ provides a helpful starting point. "The UK Stewardship Code [attempts to] set[] out the principles of effective stewardship by investors."³⁶⁴ The Code highlights that "stewardship is more than just voting" and extends to such "[a]ctivities [like] monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration."³⁶⁵

Thus a firm's mission-sustaining criteria could include a combination of the following: (i) whether the shareholder constructively engages with management on a continuous and proactive basis across a range of matters such as "strategy, performance, risk, capital structure, and corporate governance",³⁶⁶ (ii) whether the shareholder has remained a continuous owner of the firm's stock for some minimum length of time (for example, at least three years); and (iii) in the case of institutional shareholders, whether the shareholder's internal remuneration policies encourage portfolio managers to actively engage with portfolio companies and invest for some minimum length of time. Interestingly, firms could also devise their individual shareholder stewardship codes, which could include broader principles and policy statements beyond those contained in its mission-sustaining criteria. MY Share owners could have the option of signing on to the firm's stewardship code, or negotiating for a specific set of mission-sustaining criteria. MY Share owners who fail to fulfill their agreed upon mission-sustaining criteria would not be eligible to exercise their superior voting and economic rights. Additionally, in the event that a firm distributed payment to a MY Share owner based on the owner's superior economic rights and it

³⁶³ *The UK Stewardship Code*, supra note 5.

³⁶⁴ *Id.* at 1.

³⁶⁵ *Id.*

³⁶⁶ *Id.* at 6.

was determined *ex post* that the owner had not fulfilled agreed-upon mission-sustaining criteria, the MY Shares could include a "claw back" feature³⁶⁷ (similar to what is already being utilized in executive compensation) that would allow the firm to recoup any unwarranted payments.³⁶⁸

MY Shares would be distinct from so-called "loyalty shares" because their superior rights would not be solely dependent on length of ownership, but would also be dependent on fulfilling the aforementioned mission-sustaining criteria.³⁶⁹ Loyalty shares have gained greater traction in Europe than in the U.S.³⁷⁰ In France, for example, according to the *Financial Times*, "it is common for companies to grant double voting rights to ordinary shareholders who have registered for at least two years."³⁷¹ However, in the U.S., discourse surrounding loyalty shares has increased.³⁷²

In terms of substantive corporate law, MY Shares would be permissible under state corporate law.³⁷³ MY Shares leverage untapped resources in corporate default rules regarding share ownership design, while playing well within the outer boundaries of immutable rules.

³⁶⁷Dan Awrey et al., *Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?*, 38 DEL. J. CORP. L. 191, 236-38 (2013).

³⁶⁸The process and criteria for determining non-fulfillment or breach of the mission-sustaining criteria would have to be negotiated and included in the governing contract. If the contract was silent in this respect, then courts would employ traditional interpretive heuristics such as trying to discern the parties' intent, if applicable allowing parole evidence, and drawing on the doctrine of good faith. See, e.g., Lorillard Tobacco Co. v. Am. Legacy Found., 903 A.2d 728, 739 (Del. 2006) (illustrating these concepts).

³⁶⁹See COLIN MAYER, FIRM COMMITMENT 206-14 (2013); see also Patrick Bolton & Frédéric Samara, *L-Shares: Rewarding Long-Term Investors* 10-12 (Eur. Corp. Governance Inst., Finance Working Paper No. 342/2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2188661.

³⁷⁰See Bolton & Samara, *supra* note 369, at 11-12.

³⁷¹Alex Barker, *Brussels Aims to Reward Investor Loyalty*, FIN. TIMES, Jan. 23, 2013, <http://www.ft.com/intl/cms/s/0/167e60fc-6574-11e2-8b03-00144feab49a.html#axzz2bGX0U9nc>. The widespread use of loyalty shares in France may be linked to the fact that in contrast to the U.S. where share ownership is dispersed, in France share ownership tends to be concentrated in block holders. See *id.*

³⁷²See, e.g., Jane Ambachtsheer, ROTMAN INT'L J. PENSION MGMT., http://www.rijpm.com/pre_reading_files/Jane_Ambachtsheer_Loyalty_rewards_project_31_May.pdf (previewing an upcoming report on loyalty shares).

³⁷³See DEL. CODE ANN. tit. 8, § 151 (2011); NY BANKING LAW §§ 5001-5002 (McKinney 2013); 15 PA. CONS. STAT. §§ 1521-1522 (2013).

For example, the DGCL provides that:

Every corporation may issue 1 or more classes of stock . . . which classes or series may have such voting powers . . . and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions . . . as shall be stated and expressed in the certificate of incorporation or of any amendment thereto, or in [any] resolution . . . adopted by the board . . .³⁷⁴

The DGCL further provides that:

Any of the voting powers, designations, preferences, rights and qualifications, limitations or restrictions of any such class or series of stock may be made dependent upon facts ascertainable outside the certificate of incorporation or of any amendment thereto, or outside [any] resolution . . .³⁷⁵

The establishment of mission-sustaining criteria squarely falls within this ambit. Exactly what constitutes mission-sustaining criteria would be at each firm's discretion, but presumably would include such criteria as holding for a certain length of time and supporting management's initiatives that the investor in good faith reasonably determines would fulfill the firm's enunciated goals in its mission statement or other similar document.³⁷⁶ One potential proxy for measuring the extent of a shareholder's support for management's initiatives would be to track whether the shareholder exits the stock in response to market news or reactions.

Additionally, a board would be afforded wide latitude in designing the contours of its MY Shares under the judge-made doctrine of the business judgment rule, which creates a rebuttable presumption "that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."³⁷⁷ Absent a showing of waste,

³⁷⁴ DEL. CODE ANN. tit. 8, § 151.

³⁷⁵ *Id.*

³⁷⁶ See *supra* Part IV.

³⁷⁷ See *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985) (explaining the business judgment rule under Delaware law); *Shlensky v. Wrigley*, 776 N.E.2d 776, 779 (Ill.

illegality, or a lack of good faith, courts will generally not second guess a board's business decision.³⁷⁸ Moreover, the standard for proving waste and lack of good faith is significantly high, which means that as a practical matter, board business decisions that are otherwise legal will be given protection by the courts.³⁷⁹ Thus, the design of MY Shares and implementation of mission-sustaining criteria could be structured squarely within the ambit of current corporate law.

To structurally implement MY Shares, the company would have to make provisions for such shares in its articles of incorporation.³⁸⁰ In addition, MY Shares would be issued pursuant to a privately negotiated agreement between the firm and the targeted investors. The agreement could contain enforcement mechanisms that discourage the shareholder from engaging in non-mission-sustaining activities and also discourage the firm from straying from its mission or from retaliating against the shareholder should that shareholder determine in good faith that an initiative from management would not be in the best interests of the firm. MY Shares could also be subject to restrictions on transfer, chief among them being that they could not be sold without the firm's consent and that the new holder would have to commit to satisfying the mission-sustaining criteria. Alternatively, the rights that attach to the MY Shares

App. Ct. 1968) ("The judgment of the directors of corporations enjoys the benefit of a presumption that it was formed in good faith and was designed to promote the best interests of the corporation they serve." (quoting *Davis v. Louisville Gas & Elec. Co.*, 142 A. 654, 659 (Del. Ch. 1928)); *see also In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) ("[W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational', provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a *good faith* effort to advance corporate interests.").

³⁷⁸ See *Aronson v. Lewis*, 473 A.2d 805, 812 (1984) ("It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts." (internal citation omitted)). One semi-counter to the courts' general deference is *Zapata Corp v. Maldonado*, 430 A.2d 779, 787-89 (Del. 1981), which directs a court to apply its own independent business judgment to balance legitimate corporate claims if the board of directors satisfies its burden of proof.

³⁷⁹ See *Smith*, 488 A.2d at 873 (setting forth a standard of gross negligence).

³⁸⁰ To the extent a firm's articles of incorporation need to be amended to provide for MY Shares, this could prove challenging since existing shareholders have an immutable right to vote on changes to the articles of incorporation. DEL. CODE ANN. tit. 8, § 212 (2011). Existing shareholders may resist an amendment to allow for the issuance of My Shares since such shares would potentially dilute their existing voting and economic rights. See, e.g., *Gentile v. Rossette*, 906 A.2d 91, 99-100 (Del. 2006) (explaining that a shareholder claim for a breach of fiduciary duty may arise for "overpayment" or "over-issuance" when the existing voting and economic rights are diluted).

could automatically terminate upon resale. MY Shares would be structurally similar to other dual class share structures, and would be based on many of the same rationales behind the use of founders' shares and loyalty shares. MY Shares are, however, substantively distinct because their superior voting rights and economic rights would be subject to the shareholder fulfilling the enunciated mission-sustaining criteria.

While I intend to develop the details of the MY Shares proposal in future work, two significant drawbacks are worth noting. First, is that developing a system to track and manage fulfillment of MY Shares criteria would increase the transaction costs of steward stock ownership. A potential counter to this is that as long as the net benefits accruing to the firm and shareholders exceed the increase in transaction costs, such a system would be worth contemplating.³⁸¹ The second drawback is that aesthetically MY Shares raise a disparate treatment problem. However, one potential solution would be to use a warrant structure as proposed for Loyalty-Shares whereby all shareholders would be issued the warrant, but only those who fulfilled the mission-sustaining criteria would be able to exercise the warrant and reap the benefits.³⁸²

2. Time-Weighted Dividends

A second cultivation tool would be the use of a time-weighted dividend policy, whereby the amount of dividend due to each shareholder would be dependent on how long that shareholder has owned the firm's stock, as opposed to current dividend policies where a flat per share dividend amount is paid to all shareholders irrespective of the length of their ownership commitment to the firm.³⁸³ Under a time-weighted dividend policy a short-term shareholder (however defined) would not receive the same per share dividend amount as a long-term shareholder (however defined). The company would have the freedom to elect where to draw the line between short-term and long-term holders, and the ability to determine the proportional increase in dividends based on length of share ownership. Dividend bump-ups could occur at set time intervals (for example, one year, two years, three years, five years, and beyond), or they could occur at shorter time intervals, or they could

³⁸¹See R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 392, 394-95 (1937) (describing the balancing of transaction costs and benefits by a firm).

³⁸²See Bolton & Samara, *supra* note 369.

³⁸³See *infra* notes 387-92 and accompanying text.

be based on a sliding scale. A dividend ceiling could be established so that a shareholder would "top out" beyond some pre-established amount (for example, five years), which would minimize the risk of discouraging new shareholders from owning the company's stock. Time-weighted dividends would be subject to the same general rules and practices that apply to flat dividend payments, including the need to establish a declaration date, record date, and ex-dividend date.³⁸⁴ Where time-weighted dividends would differ from flat dividends is in the formula used for calculation.

To illustrate, consider a Delaware corporation (which we shall call "Figurative Firm A") that adopted a time-weighted dividend policy which said that, "Should the company decide to declare a dividend, any shareholder who is entitled to receive such dividend and who has continuously held its shares for a year or more shall be entitled to a dividend amount equal to the product of 1.5 times the declared dividend amount." Thus, if after calculating the amount of dividends the company could pay under the relevant sections of the DGCL, the company determines that it will pay \$2.00 per share, any eligible shareholder who has met the time-weighted dividend ownership requirement of holding continuously for a year or more, will be entitled to \$3.00 per share (\$2.00 x 1.5). The additional \$1.00 per share represents the shareholder's reward for fulfilling a stewardship commitment.

Legally, a time-weighted dividend policy would be permissible under state law, federal law, and stock exchange listing rules.³⁸⁵ Like MY Shares, the decision to adopt a time-weighted dividend policy would be protected by the business judgment rule and the existing immutable and default rules surrounding dividend payments and dividend policies would allow a board to implement a time-weighted dividend policy.³⁸⁶

Under state corporate law, the decision on whether to issue a dividend is in the sole discretion of the board.³⁸⁷ State law provides the outer limits of the amount that may be declared as dividends, but still leaves the directors with a wide swath of latitude to determine timing, frequency, amount, and other specifications.³⁸⁸ Most state statutes allow dividends to be paid out of "surplus" and some states also permit the payment of "nimble dividends," which are dividends paid out of current

³⁸⁴See *infra* notes 387-92 and accompanying text.

³⁸⁵See *infra* notes 387-92 and accompanying text.

³⁸⁶See *supra* notes 377-79 and accompanying text.

³⁸⁷See, e.g., DEL. CODE ANN. tit. 8, § 170 (2011).

³⁸⁸See *id.*

earnings.³⁸⁹ The DGCL, for example, allows dividends to be paid out of either surplus or current earnings and provides that "[t]he directors of every corporation, subject to any restrictions contained in its certificate of incorporation, may declare and pay dividends upon the shares of its capital stock[,]"³⁹⁰ so long as the dividend payments are either paid out of surplus³⁹¹ or if there is no surplus, then the board may pay dividends "out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year."³⁹² The DGCL does not contain any other substantive proscriptions on the declaration of dividends. Moreover, the Delaware judiciary has repeatedly affirmed that a company's dividend policy is within the discretion of its board of directors and that the courts will not second-guess a board's decision absent a showing of "fraud or gross abuse of discretion".³⁹³ With regard to federal law and stock exchange listing rules, the relevant SEC rules and regulations along with the relevant stock exchange listing requirements address the procedural and disclosure requirements related to dividends and do not regulate the substantive aspects of a company's dividend policy.³⁹⁴

In sum, time-weighted dividends provide an interesting cultivation strategy with relatively minimal legal constraints and a broad zone of play for a board to design such a policy.

3. Mission-Weighted Dividends

A third and related cultivation tool would be to tweak the time-weighted dividend structure discussed above,³⁹⁵ so that dividend payments not only vary based on *length* of holding, but on the *quality* of

³⁸⁹See JEFFREY D. BAUMAN ET AL., CORPORATIONS LAW AND POLICY 226-38 (6th ed. 2007).

³⁹⁰DEL. CODE ANN. tit. 8, § 170(a).

³⁹¹*Id.* § 170(a)(1).

³⁹²*Id.* § 170(a)(2).

³⁹³See, e.g., *Baron v. Allied Artists Pictures Corp.*, 337 A.2d. 653, 658-59 (Del. Ch. 1975) ("The determination as to when and in what amounts a corporation may prudently distribute its assets by way of dividends rests in the honest discretion of the directors in the performance of [their] fiduciary duty. Before a court will interfere with the judgment of a board of directors in refusing to declare dividends, fraud or gross abuse of discretion must be shown.") (internal citations omitted). See also *Dodge v. Ford Motor Co.*, 170 N.W. 668, 682 (Mich. 1919) ("The board of directors declare the dividends, and it is for the directors, and not the stockholders, to determine whether or not a dividend shall be declared.").

³⁹⁴See NYSE Manual, *supra* note 258, § 204; see also 17 C.F.R. § 240.10b-5, 240, 249 (2013).

³⁹⁵See *supra* Part IV.F.2.

holding. Shareholders who exhibit some amount of stewardship characteristics would receive superior dividend rewards as compared to a non-co-venturer shareholder. I refer to these as "mission-weighted dividends." A simplified example of how these mission-weighted dividends could work is as follows: Imagine a company that cares about having shareholders who exhibit stewardship characteristics.³⁹⁶ Further assume that this company has clearly defined these characteristics and has come up with a list of mission-sustaining criteria.³⁹⁷ Now let us assume that the amount of dividends a shareholder receives will vary depending on whether the shareholder satisfies all, or a substantial portion, of the mission-sustaining criteria. Using the example above,³⁹⁸ assume Figurative Firm A had a mission-weighted dividend policy, which provided that eligible shareholders who satisfy mission-sustaining criteria, would be entitled to a dividend amount equal to two times any declared dividend amount. Then, if the company declared a dividend of \$2.00 per share, shareholders who satisfied the mission-sustaining criteria would receive a dividend of \$4.00, with the additional \$2.00 representing their reward for fulfilling the stated criteria.

While a mission-weighted dividend policy, like a time-weighted dividend policy, would arguably fit within the bounds of corporate law's framework and not infringe on any immutable rules,³⁹⁹ the challenge will be in the logistics of the design. For instance, measurement of whether a shareholder fulfills certain mission-sustaining criteria will involve developing objective proxies for assessing and quantifying the shareholder's behavior. As in the case of MY Shares,⁴⁰⁰ this will increase the transaction costs of the shareholder relationship, but if the benefits of a mission-weighted dividend policy outweigh these costs, then such mission-weighted design should be explored. In addition, the exercise of assigning objective metrics to measure shareholder fulfillment of mission-sustaining criteria is conceptually similar to the ongoing exercise in the corporate sustainability space where firms and some third party institutions have devised metrics to measure the strength of a

³⁹⁶See, e.g., *The UK Stewardship Code*, *supra* note 5 (providing examples of shareholder stewardship characteristics).

³⁹⁷See, e.g., GLOBAL REPORTING INITIATIVE, SUSTAINABILITY REPORTING GUIDELINES 3 (2000-11), <https://www.globalreporting.org/resourcelibrary/G3.1-Guidelines-Incl-Technical-Protocol.pdf> (providing examples of sustainability reporting guidelines).

³⁹⁸See *supra* Part IV.F.2.

³⁹⁹See *supra* notes 377-79 and accompanying text.

⁴⁰⁰See *supra* Part IV.F.1.

corporation's commitment to sustainability.⁴⁰¹ Thus, while mission-weighted dividend design may initially involve significant cost outlay, it is not improbable and the initial cost outlay should be recouped over time.

4. The Future of De-Cultivation: Suspend Voting Rights for the Worst Case Offenders?

A fourth potential cultivation tool, which falls in the de-cultivation category, would be to suspend the voting rights of shareholders who overstep the role that law assigns to them *qua* shareholders. Admittedly, this is a tricky suggestion, but there are other areas of corporate law where courts do not allow shareholders to avail themselves of certain shareholder rights when those shareholders exhibit behavior that the court deems to be not in their "proper purpose" as shareholders or outside the scope of a "proper subject" for shareholder action.⁴⁰²

For example, in the area of inspection rights, although all shareholders have a right to inspect the corporate books and records, shareholders who exhibit behavior that indicates to courts that those shareholders may have an "improper purpose" in requesting inspection, are barred from exercising their right of inspection.⁴⁰³ One could argue that the suspension of shareholder rights based on a shareholder exhibiting "improper" shareholder qualities is something that corporate law already does, and this suspension technique could be extended to voting rights. Stated differently, the "improper" conduct by the shareholder is itself in violation of corporate law's immutable rules regarding shareholder behavior and thus the suspension of voting rights is simply a sanction (albeit, a steep one) to discourage such behavior.

In terms of existing law and immutable rules, a firm's unilateral suspension of a shareholder's voting rights is significantly more dubious than other cultivation tools, like MY Shares⁴⁰⁴ or mission-weighted

⁴⁰¹ See GLOBAL REPORTING INITIATIVE, *supra* note 397, at 2.

⁴⁰² There are many examples of cases involving inspection rights and shareholder proposals. See, e.g., *Seinfeld v. Verizon Comm'ns*, 909 A.2d 117, 118 (Del. 2006) ("[S]tockholders seeking inspection under section 220 [of the Delaware Code] must present 'some evidence' to suggest a 'credible basis' from which a court can infer that mismanagement, waste or wrongdoing may have occurred."); *Marathon Partners v. M&F Worldwide Corp.*, 2004 WL 1728604, at *3-*4 (Del. Ch. July 30, 2004) (explaining stockholder inspection rights under Delaware law); *Auer v. Dressel*, 118 N.E.2d 590, 594 (N.Y. 1954) (discussing shareholder proposal rights).

⁴⁰³ See *Seinfeld*, 909 A.2d at 125; *Marathon*, 2004 WL 1728604, at *3.

⁴⁰⁴ See *supra* Part IV.F.1.

dividends⁴⁰⁵ for example, because corporate law views the shareholder right to vote as sacrosanct.⁴⁰⁶ Thus, of all the cultivation techniques discussed so far, the unilateral suspension of shareholder voting rights comes the closest to skimming the immutable rule boundaries.

In Delaware, for example, a board is prohibited from using its assigned powers to impinge on the shareholders' right to vote, in certain circumstances.⁴⁰⁷ In *Blasius Industries Inc. v. Atlas Corp.*, the Delaware Court of Chancery wrote that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."⁴⁰⁸ In *Blasius* and its progeny, the Delaware courts have repeatedly held that a board cannot unilaterally act with "the primary purpose of impeding the exercise of stockholder voting power" unless the board demonstrates a "compelling justification for [its] action."⁴⁰⁹ Thus, for a corporation incorporated in Delaware, suspending a shareholder's right to vote would fall under the ambit of "impeding the exercise of stockholder voting power" and would have to pass muster under *Blasius*.⁴¹⁰

Why even contemplate vote suspension as a potential de-cultivation technique? There are several reasons. First, it could be argued that board action that infringes on a shareholder's right to vote is not per se illegal so long as the board demonstrates that it had a "compelling justification" for its action.⁴¹¹ One could envision an argument that barring shareholders who the board can demonstrate exhibit "improper" behavior—behavior that is potentially damaging to corporate existence and policy—should count as a "compelling justification" under *Blasius*.⁴¹² Second, it could be argued that in other areas such as inspection rights, corporate law already limits when and how shareholders can exercise their rights and the suspension of voting rights is merely an extension of this history.⁴¹³ Moreover, in light of how some shareholders currently manipulate their position as shareholders to extract private profit at the expense of the firm and other shareholders, and abuse their right to vote by engaging in techniques such as empty

⁴⁰⁵See *supra* Part IV.F.2.

⁴⁰⁶See, e.g., *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988).

⁴⁰⁷See *id.* See also *Stroud v. Grace*, 606 A.2d 75, 78-79 (Del. 1991) (applying the *Blasius* "compelling justification" standard).

⁴⁰⁸See *Blasius*, 564 A.2d at 659.

⁴⁰⁹*Id.* at 661.

⁴¹⁰*Id.*

⁴¹¹*Id.*

⁴¹²See *Blasius*, 564 A.2d at 661.

⁴¹³See *supra* notes 408-10 and accompanying text.

voting (which in a political construct is akin to committing voting fraud at the polls),⁴¹⁴ the suspension of voting rights to discourage damaging shareholder behavior merits consideration by corporate policymakers.

5. Integrated Reporting

A fifth potential tool for cultivation would be for a company to move to integrated reporting. Currently, the vast majority of U.S. corporations provide standard annual reports and some elect to provide so-called sustainability reports, in addition to the required standard annual report.⁴¹⁵ Not surprisingly, the companies that opt to produce sustainability reports are the same companies that have taken environmental or social initiatives, and wish to highlight this for the market and signal their commitment to sustainability initiatives.⁴¹⁶ A handful of companies worldwide go one step further and elect to produce integrated annual reports, which are reports that capture financial—as well as environmental and social—performance.⁴¹⁷

One of the first companies to move toward an integrated reporting model was Natura, a Brazilian cosmetic and fragrance company that implemented integrated reporting starting in fiscal year 2002.⁴¹⁸ For companies such as Natura that view sustainability as a core part of their firm's mission and purpose, integrated reporting provides a clear signal to the market about the company's commitment to environmental and social concerns.⁴¹⁹ For Natura, "integrated reporting [was] the best way to

⁴¹⁴See *supra* note 60 and accompanying text.

⁴¹⁵See, e.g., PEPSICO, INC., 2012 ANNUAL REPORT, available at http://www.pepsico.com/download/PEP_Annual_Report_2012.pdf (dedicating a section of the annual report to a discussion of human, environmental, and talent sustainability).

⁴¹⁶See WENDY TNG, STRATEGIC SUSTAINABILITY CONSULTING, SUSTAINABILITY REPORTING AND SMEs: A CLOSER LOOK AT THE GRI, 1 (2010), http://static.squarespace.com/static/4ffc3ba1e4b036a61fbde6ff/t/50cf68b5e4b0a7200de60c49/1355770037036/White%20Paper_Sustainability%20Reporting%20and%20SMEs_052610.pdf (pointing out that companies who report environmental and social initiatives do so to gain a competitive edge).

⁴¹⁷See SAMUEL A. DiPIAZZA JR. & ROBERT G. ECCLES, BUILDING PUBLIC TRUST: THE FUTURE OF CORPORATE REPORTING 13 (2002); ROBERT G. ECCLES & MICHAEL P. KRZUS, ONE REPORT: INTEGRATED REPORTING FOR A SUSTAINABLE STRATEGY 3 (2010); ROBERT G. ECCLES ET AL., THE VALUEREPORTING™ REVOLUTION: MOVING BEYOND THE EARNINGS GAME 5 (2001).

⁴¹⁸See ECCLES & KRZUS, *supra* note 417, at 18-19.

⁴¹⁹See *id.* at 21.

signal its management's focus on environmental and social stewardship and to ensure leadership's commitment to those goals.⁴²⁰

For cultivation purposes, integrated reporting could be used as a signal to attract, recruit, educate, and keep shareholders whose investment values include a focus on ESG issues.⁴²¹ In terms of the role of regulators in a new governance framework, integrated reporting is an example of an area in corporate governance where regulators can play a coordinating and norm-enforcing function.⁴²² For example, South Africa has recently mandated that all companies transition to using integrated reports.⁴²³

In the U.S., integrated reporting is optional, and as a report by the IRRC and the Sustainability Institute noted, it is a "partial reality."⁴²⁴ The SEC has slowly been accreting sustainability and other ESG issues into its reporting framework since the 1970s, but it has not done so in a systematic way.⁴²⁵ For example, the SEC first began by promulgating rules for disclosing environmental liabilities and contingencies as well as material impacts of environmental laws and regulations.⁴²⁶ "More recently, the SEC has addressed climate change, board diversity, mine safety, conflict minerals, payments to governments by resource extraction firms, and other sustainability topics in rulemakings and guidance to companies for Form 10-Ks and proxy statements"⁴²⁷ While the SEC has yet to explicitly adopt an integrated reporting framework, the SEC's stance on sustainability issues would suggest that integrated reporting would be allowed so long as it complied with the

⁴²⁰ Robert G. Eccles & George Serafeim, *The Performance Frontier: Innovating for a Sustainable Strategy*, HARV. BUS. REV., May 2013, at 50, 55.

⁴²¹ See Peter Ellsworth & Kirsten Snow Spalding, *The 21st Century Investor: Ceres Blueprint for Sustainable Investing*, CERES 9 (June 2013), <http://www.ceres.org/resources/reports/the-21st-century-investor-ceres-blueprint-for-sustainable-investing-summary> (noting that companies that integrated sustainability principles perform better, and produce superior returns over time).

⁴²² See *id.* at 27 (suggesting governance principles are a key consideration in shareholder voting).

⁴²³ See Eric Hespenheide & Nick Main, *Integrated Reporting: The New Big Picture*, DELOITTE REV. 123, 127 (2012), http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Deloitte%20Review/Deloitte%20Review%2010%20-%20Summer%202012/US_deloittereview_Integrated_Reportin_The_New_Big_Picture_Jan12.pdf.

⁴²⁴ See PETER DESIMONE, IRRC INST. & SUSTAINABLE INVS. INST., INTEGRATED FINANCIAL AND SUSTAINABILITY REPORTING IN THE UNITED STATES 1 (2013).

⁴²⁵ See *id.*

⁴²⁶ See *id.*

⁴²⁷ See *id.*

SEC's disclosure and reporting regulations.⁴²⁸ Thus, for firms that actively wish to distinguish themselves from competitors and attract ESG investors, switching to an integrated reporting model would aid in this cultivation effort and would be allowed under current law.⁴²⁹ In addition, several policy groups, most notably the International Integrated Reporting Council ("IIRC"), the Global Reporting Index ("GRI"), and the Sustainability Accounting Standards Board ("SASB"), have developed or are currently refining new frameworks and metrics to help companies capture ESG issues and initiatives and report them in a systematic and meaningful way.⁴³⁰ The first U.S. corporation to produce an integrated report was United Technologies Corporation.⁴³¹ Other U.S. companies, such as Microsoft, have expressed interest in considering such a model.⁴³²

⁴²⁸See JIM COBURN ET AL., *DISCLOSING CLIMATE RISKS & OPPORTUNITIES IN SEC FILINGS: A GUIDE FOR CORPORATE EXECUTIVES, ATTORNEYS & DIRECTORS* 4-5 (2011) (suggesting that the SEC released guidance as to public companies' obligatory disclosures to investors). *But see* Bill Schneider, *SEC Pushes-Pulls Back on Integrated Reporting*, INDUSTRY ISSUES (Sept. 10, 2012), <http://industryissues.wordpress.com/2012/09/10/sec-pushes-pulls-back-on-integrated-reporting/> (discussing how the SEC cannot decide whether it supports the movement to integrate reporting).

⁴²⁹See, e.g., DELOITTE, *INTEGRATED REPORTING: A BETTER VIEW?* 3 (2011), http://www.deloitte.com/assets/Dcom-MiddleEast/Local%20Assets/Documents/Services/ERS/me_ers_integrated_reporting_sept11.pdf (indicating the vast amount of companies using integrated reporting to attract investors).

⁴³⁰See generally IIRC *Publishes 'Consultation Draft' on Integrated Reporting*, DELOITTE (Apr. 16, 2013), available at <http://www.iasplus.com/en/news/2013/04/iirc> (presenting draft framework and fundamental concepts for the integrated reporting process). Similarly, the SASB "provides standards for use by publicly-listed corporations in the U.S. in disclosing material sustainability issues for the benefit of investors and the public. SASB standards are designed for disclosure in mandatory filings to the Securities and Exchange Commission (SEC), such as the Form 10-K and 20-F." SUSTAINABILITY ACCOUNTING STANDARDS BOARD, <http://www.sasb.org/> (last visited Oct. 19, 2013). For example, in 2013, SASB developed a set of provisional sustainability standards for health care companies. See *SASB Releases Accounting Standards for Health Care*, SUSTAINABLE INDUSTRIES (Aug. 4, 2013), available at <http://www.sustainableindustries.com/articles/2013/08/sasb-releases-sustainability-accounting-standards-health-care> (announcing the release of provisional standards for the health care sector).

⁴³¹Robert Eccles, *Get Ready: Mandated Integrated Reporting Is The Future of Corporate Reporting*, MIT SLOAN MGMT. REV., Mar. 13, 2012, at 2, available at <http://sloanreview.mit.edu/article/get-ready-mandated-integrated-reporting-is-the-future-of-corporate-reporting/>.

⁴³²See *Pilot Programme Business Network*, INTEGRATED REPORTING (Oct. 11, 2013), <http://www.theiirc.org/companies-and-investors/pilot-programme-business-network/>.

6. Transaction Tax as Incentive for Stewardship

As others have suggested both in the U.S. and across the European Union, one potential way to encourage more patient capital is for the government to design tax policies that incentivize long-term share ownership and stewardship behavior.⁴³³ For example, in the UK, much of the focus has been on discouraging high-frequency traders who use technology to trade short in rapid fits and bursts.⁴³⁴ The proposal on the table is for the government to implement a financial transaction tax on such trading activity.⁴³⁵ The proposal of a financial transaction tax did not come out of nowhere. In a 1989 article published in the *Journal of Financial Services Research*, economist Joseph Stiglitz argued that a stock transfer tax could be used to increase overall efficiency in the American economy by discouraging short-term speculative trading, and in a separate article also published in 1989, Lawrence Summers contemplated the use of a securities transaction tax as a way to discourage speculation in the market.⁴³⁶ Similarly, a 2009 report prepared by the Business & Society Program of the Aspen Institute articulated a related concept, which called for a revision to the "capital gains tax provisions" or for the implementation of an "excise tax in ways that are designed to discourage excessive share trading and encourage longer-term share ownership."⁴³⁷ While the UK is further along than the U.S. in implementing this type of tax incentive, as of the time of this Article, efforts in the UK have been stalled as regulators continue to work through the details of implementation and the policy implications of a financial transaction tax.⁴³⁸

⁴³³John Kay, The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report, EUR. CORP. GOVERNANCE INST. 62 (July 23, 2012), available at http://www.ecgi.org/conferences/eu_actionplan2013/documents/kay_review_final_report.pdf.

⁴³⁴See James McRitchie, *Kay Review Recommendations*, THE SHAREHOLDER ACTIVIST, <http://theshareholderactivist.com/corporate-governance/kay-review-recommendations/> (last visited Oct. 19, 2013) (reviewing several suggestions to promote long-term investing).

⁴³⁵France Wants Changes to EU Financial Transaction Tax, *supra* note 5.

⁴³⁶See Joseph E. Stiglitz, *Using Tax Policy to Curb Speculative Short-Term Trading*, 3 J. FIN. SERVS. RES. 101, 101-02 (1989); Lawrence H. Summers & Victoria P. Summers, *When Financial Markets Work Too Well: A Cautious Case for a Securities Transaction Tax*, 3 J. FIN. SERVS. RES. 261, 261-62 (1989). Special thanks to William Wang for urging me to consider this literature.

⁴³⁷BOGLE ET AL., *supra* note 5, at 3.

⁴³⁸Tom Fairless, *Financial-Transaction Tax in Europe Hits Obstacles*, WALL ST. J., June 26, 2013, at A8.

Although the idea of a government-imposed transaction tax that recognizes the heterogeneous nature of share ownership and is designed to incentivize stewardship is not an example of cultivation vis-à-vis the firm and its shareholders, it is yet another example of a role regulators can and should play as suggested by the new governance literature—i.e., that of coordinator and re-enforcer of norms, in this case that of stewardship.

7. Shareholder Rewards Points Program

Currently, a handful of corporations award shareholders with "loyalty rewards" of extra dividends (as discussed under "Time-Weighted Dividends"),⁴³⁹ additional voting rights, and warrants as incentives to encourage long-term share ownership.⁴⁴⁰ Two examples of such corporations are L'Oreal Group and L'Air Liquide SA (both French companies).⁴⁴¹ Through these loyalty rewards programs, shareholders who hold shares for a given length of time are rewarded for their commitment.⁴⁴² In the U.S., the use of such "loyalty rewards" represents an untapped area for future Shareholder Cultivation efforts.⁴⁴³

Going a step further, one can envision a loyalty rewards program that is not limited to receiving additional shareholder rights, but which also extends to rights to participate in other areas of the firm's enterprise. Conceivably, loyalty rewards given to shareholder stewards could be expanded to include awards of points that could be put towards the purchase of the firm's products or services. In terms of design, a shareholder loyalty rewards program that functions in this way would be akin to such reward cards and points programs that companies already use with their customers.⁴⁴⁴ As in the case of a customer rewards program, terms and limits of use of these shareholder loyalty rewards

⁴³⁹ See *supra* Part IV.F.2.

⁴⁴⁰ See Barry B. Burr, *Mercer Seeks Long-Term Shareholder Rewards Program from Corporations, PENSIONS & INVS.* (Dec. 6, 2012), <http://www.pionline.com/article/20121206/DAILYREG/121209930>.

⁴⁴¹ *Id.*

⁴⁴² *Id.*

⁴⁴³ *Id.* (according to Jane Ambachtsheer, "[o]utside of France" loyalty shares are a relatively unknown concept (quoting Jane Ambachtsheer, Mercer Partner)).

⁴⁴⁴ See, e.g., Melissa Allison, *Starbucks Moves Rewards Program into Grocery Stores*, SEATTLE TIMES, Mar. 21, 2013, http://seattletimes.com/html/businesstechnology/2020600667_starbucksshareholdersxml.html (discussing the reward-points program).

could be specified by contract.⁴⁴⁵ Designing such an expanded shareholder loyalty rewards program would have the benefit of deepening the shareholder's commitment to—and level of engagement with—the firm.

In sum, Part IV provided a comprehensive analysis of a range of current and future Shareholder Cultivation techniques that firms could employ and where applicable, regulators could adopt, as a third-way approach to governance design in light of shareholder heterogeneity.⁴⁴⁶

V. BENEFITS AND COSTS OF SHAREHOLDER CULTIVATION

The ability of public corporations to engage in ownership design and actively cultivate some portion of their shareholder base is a necessity in light of shareholder heterogeneity, and is a necessary step in the direction of stewardship. In addition to providing a timely and collaborative gap-filling response that forges a path from heterogeneity to stewardship, Shareholder Cultivation has other practical and theoretical advantages.⁴⁴⁷ However, like any endeavor, Shareholder Cultivation has attendant costs and is subject to critique.⁴⁴⁸ While the specific benefits and costs of Shareholder Cultivation will differ from firm to firm, the remainder of Part V highlights the key benefits and costs created by this cultivation.⁴⁴⁹

A. *Potential Benefits of Shareholder Cultivation*

1. Encourages Stewardship Capital

First, as a practical matter, Shareholder Cultivation gives firms an opportunity to create a critical mass or stabilizing core of shareholder stewards. According to one estimate, most companies view "a critical mass of investors [as] being between 25% and 35% — although some went as high as 50% — and in most cases they felt it was possible to

⁴⁴⁵See generally *Sony Rewards: Terms and Conditions*, SONY CORP. OF AM. http://www.sonystyle.com/en/footer/terms_of_use/ (last visited Oct. 26, 2013); *Marriott Rewards Terms & Conditions*, MARRIOTT INT'L, INC., <http://www.marriott.com/rewards/terms/earning.mi> (last visited Oct. 26, 2013) (providing examples of customer reward programs which have been specified in contract).

⁴⁴⁶See *supra* Part IV.

⁴⁴⁷See *infra* Part V.A.

⁴⁴⁸See *infra* Part V.B.

⁴⁴⁹See *infra* Parts V.A-B.

have regular dialogues with between 10 and 20 investors who represented that holding.⁴⁵⁰ For firms, having this critical mass is beneficial because it provides executives with a stable group of shareholder advisors and supporters who become especially important in times of difficulty.⁴⁵¹ For shareholders, having a critical mass of shareholder stewards should lead to enhanced accountability on the part of boards and managers.⁴⁵²

2. Mission-Sustaining

Second, Shareholder Cultivation serves a mission-sustaining function in that it provides an approach to ensuring that the firm has a shareholder polity that supports and advocates for its mission. This mission-sustaining function of Shareholder Cultivation is critical for corporations who view themselves more broadly than maximizing shareholder value—the view that has long dominated corporate law doctrine and its normative underpinnings, even though profit maximization is not generally required by law.⁴⁵³ An example of one such corporation is Patagonia, Inc. whose stated mission is to "[b]uild the best products, cause no unnecessary harm, [and to] use business to inspire and implement solutions to the environment crisis."⁴⁵⁴ In its mission statement, Patagonia also states, "[w]e donate our time, services and at least 1% of our sales to hundreds of grassroots environmental

⁴⁵⁰ SKIPPER ET AL., *supra* note 9, at 7.

⁴⁵¹ *Id.*

⁴⁵² *Id.* at 9.

⁴⁵³ Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919); see also ALI PRINCIPLES OF CORPORATE GOVERNANCE § 2.01 (1994) ("Subject to the provisions of Subsection (b)[,] . . . a corporation . . . should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain."). Subsection (b) tempers this statement by stating that the corporation "[m]ay take into account ethical considerations" and that it "[m]ay devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes." *Id.* The profit maximization mindset is probably best captured by Milton Friedman, who wrote more than forty years ago that the "[a corporation has] one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits . . ." Milton Friedman, *The Social Responsibility is to Increase its Profits*, N.Y. TIMES, Sept. 13, 1970.

⁴⁵⁴ *Our Reason for Being*, PATAGONIA, <http://www.patagonia.com/us/patagonia.go?assetid=2047> (last visited Oct. 26, 2013). Of course there is an argument to be made that cultivation might not be necessary because investors who are not interested in environmental responsibility would simply not buy Patagonia's stock. This is true and it highlights the necessity of the "Narrative" cultivation tools discussed in Part IV. See *supra* Part IV. Similarly, a company's mission statement can and should serve a cultivation function. See *supra* Part IV.B.

groups all over the world who work to help reverse the tide.⁴⁵⁵ Assuming that Patagonia is sincere in its mission and is not engaged in "green washing,"⁴⁵⁶ Patagonia has an interest in ensuring that at least some portion of its shareholder base is comprised of investors who share the company's environmental sensibilities.⁴⁵⁷ Thus, for Patagonia, these types of shareholders fall into the stewardship category.

3. Anti-takeover Devices

Third, Shareholder Cultivation buttresses the firm's chances of withstanding a hostile takeover. Limits on the form and scope of anti-takeover devices that management can employ are established by corporate law's package of immutable and default rules.⁴⁵⁸ Notably, landmark cases like *Unocal Corp v. Mesa Petroleum Co.*,⁴⁵⁹ *Revlon v. MacAndrews & Forbes Holding, Inc.*,⁴⁶⁰ and *Unitrin Inc. v. American General Corp.*,⁴⁶¹ as well as the recent case of *Air Products & Chemicals, Inc. v. Air Gas, Inc.*,⁴⁶² establish that management has significant leeway in devising strategies to protect the firm from so-called "abusive tender offer tactics."⁴⁶³ In turn, the private bar has devised, and courts have blessed various anti-takeover measures, most notably the use of shareholders' rights plans or "poison pills."⁴⁶⁴ Shareholder Cultivation

⁴⁵⁵ See PATAGONIA, *supra* note 454.

⁴⁵⁶ "Greenwashing" means "disinformation disseminated by an organization so as to present an environmentally responsible public image . . ." OXFORD DICTIONARY, *Definition of greenwash*, http://oxforddictionaries.com/us/definition/american_english/greenwash (last visited Sept. 3, 2013).

⁴⁵⁷ See PATAGONIA, *supra* note 454.

⁴⁵⁸ See *infra* notes 459-60 and accompanying text.

⁴⁵⁹ See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985).

⁴⁶⁰ See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 185 (Del. 1986).

⁴⁶¹ See *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995).

⁴⁶² See *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 92 (Del. Ch. 2011).

⁴⁶³ The counterargument to anti-takeover measures is well developed in the academic literature and view hostile takeovers as providing "a useful device for disciplining corporate management, managers themselves believe that vulnerability to hostile bids is a profound weakness in the corporate governance structure because it exposes disaggregated and disorganized shareholders to abusive tender offer tactics." WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, *COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION* 523 (3d ed. 2009) (noting, at the same time, that firm managers need flexibility when devising strategies to protect the firm from inadequate tender offers).

⁴⁶⁴ See, e.g., *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1357 (Del. 1985); see also DEL. CODE ANN. tit. 8, § 141(d) (2011) (permitting corporations to implement staggered boards).

provides a complementary defensive technique to such traditional strategies. A critical mass of shareholder stewards potentially dissuades hostile attacks, in addition to addressing the concern of "disaggregated and disorganized shareholders."⁴⁶⁵ Metaphorically speaking, while the poison pill poisons the chances of a successful takeover,⁴⁶⁶ Shareholder Cultivation fortifies the firm to endure a contest for control.

4. Financial Economics

From a financial economics perspective, Shareholder Cultivation offers at least two advantages. First, outreach by the firm to targeted steward shareholders will reduce the "set up costs" of such shareholders, which in turn will reduce the firm's cost of capital and enhance the value of the firm.⁴⁶⁷ The concept of "set up costs" was developed by Robert Merton who noted that "[i]f an investor does not follow a particular firm, then an earnings or other specific announcement about that firm is not likely to cause that investor to take a position in the firm."⁴⁶⁸ According to Merton, "for each firm, investors must pay a significant 'set up' (or 'receiver') cost before they can process detailed information released from time to time about the firm . . .".⁴⁶⁹

Shareholder Cultivation thus creates a bifurcated set-up cost structure that lessens the set-up costs for potential stewards, but leaves the set-up costs for non-co-venturers unchanged. Moreover, as discussed by Edward Rock in *Shareholder Eugenics in the Public Corporation*, drawing on two seminal financial works by Yakov Amihud and Haim Medelson which developed models for understanding the relationship between firms and shareholders, the relationship between "the shareholders of a company and its cost of capital" and thus "the identity of the shareholders and their fit with the board of directors and the managers . . . are potentially important to firm value."⁴⁷⁰ This

⁴⁶⁵See ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 463, at 523.

⁴⁶⁶See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986).

⁴⁶⁷See *infra* notes 468-69 and accompanying text.

⁴⁶⁸Robert C. Merton, *A Simple Model of Capital Market Equilibrium with Incomplete Information*, 42 J. FIN. 483, 489 (1987) (noting the concept of "set up costs").

⁴⁶⁹*Id.* at 489-90.

⁴⁷⁰Rock, *supra* note 14, at 851, 904 (noting the relationship between "the shareholders of a company and its cost of capital" and the resulting importance to firm value); Merton, *supra* note 468, at 487-509; see also Yakov Amihud & Haim Mendelson, *Asset Pricing and the Bid-Ask Spread*, 17 J. FIN. ECON. 223, 223-47 (1986).

observation that the composition of a firm's shareholder base will affect its cost of capital applies with equal force to Shareholder Cultivation.

The second advantage from a financial economics perspective is that private equity placements often result in "positive announcement returns."⁴⁷¹ This finding has been well-documented in the financial literature and different rationales have been offered to justify this finding, such as positive-price-effects evidence that changes in ownership concentration better align the interests of owners and managers, or private equity shareholders help to resolve asymmetric information flows which in turn impact firm value.⁴⁷² While the underlying rationales for the market's response to PIPE investing remains contested, the larger point for Shareholder Cultivation is that to the extent a firm elects to use PIPE investing as a cultivation strategy, the successful recruitment of a PIPE shareholder steward should generate positive price reactions in the market.⁴⁷³

5. Enhance Thought-Partnerships & Monitoring Expertise

Successful Shareholder Cultivation will bring increased knowledge and monitoring expertise from shareholders to the firm. The financial economic literature is replete with findings of a connection between block holdings and monitoring expertise.⁴⁷⁴ In sum, the argument is that large block holders in a company's stock will have an increased incentive to invest in monitoring activities that should be beneficial to all shareholders, and in the governance construct, should lessen agency concerns of manager's interests diverging from those of shareholders.⁴⁷⁵

⁴⁷¹See Indraneel Chakraborty & Nickolay Gantchev, *Does Shareholder Coordination Matter? Evidence from Private Placements*, 108 J. FIN. ECON. 213, 213-14 (2013) (discussing the positive price reaction of private equity placements).

⁴⁷²See Karen H. Wruck & YiLin Wu, *Relationships, Corporate Governance, and Performance: Evidence from Private Placements of Common Stock*, 15 J. CORP. FIN. 30, 32-33 (2009) (noting that private equity placements can attenuate information asymmetry); see also Karen H. Wruck, *Equity Ownership Concentration and Firm Value: Evidence from Private Equity Financings*, 23 J. FIN. ECON. 3, 12-15 (1989) (showing that private changes in ownership can better align the interests of owners and managers and increase firm value).

⁴⁷³See *supra* Part IV.D.2.b for discussion on PIPE.

⁴⁷⁴See, e.g., Chakraborty & Gantchev, *supra* note 471, at 214 (comparing the relationship between block holdings and monitoring expertise found in existing literature).

⁴⁷⁵See *id.* at 228-29 (suggesting that PIPE managers have higher incentives to maximize shareholder value); Alex Edmans & Gustavo Manso, *Governance Through Trading and Intervention: A Theory of Multiple Blockholders*, 24 REV. FIN. STUD. 2395, 2423 (2011).

6. Recalibrates "Exit Voice Loyalty"

Shareholder Cultivation could theoretically recalibrate the distribution of shareholders across Hirschman's classic "exit, voice and loyalty" typology to better reflect the firm's ideal shareholder base.⁴⁷⁶ Hirschman conceptualized shareholder action in the face of "firm decline" as falling into two categories: "exit" (i.e., sell their stock); and "voice" (i.e., engage with management and "voice" their opinions), with a shareholder's degree of "loyalty" to the firm being the deciding factor between whether a shareholder chose to exit or voice.⁴⁷⁷ Shareholder Cultivation explicitly increases the voice and loyalty of shareholder stewards and diminishes their desire to exit, while simultaneously encouraging gamblers to exit the firm's stock. Of course, a fine and careful line would need to be drawn between cultivating stewards without alienating the rest of the shareholder base, or creating a barrier to entry for future shareholders. One potential way to draw this line would be to actively cultivate up until the point that a critical mass of stewards is achieved (as discussed above), or for a firm whose concern is more about long-term versus short-term shareholders, to actively cultivate up until the point that the firm achieves its targeted turnover rate (as previously discussed).⁴⁷⁸

7. Broader Societal Trend

Shareholder Cultivation converts share ownership from transient to rooted, an effect that will become increasingly beneficial as more computers rather than people pick stock.⁴⁷⁹ Moreover, this conversion of transient to rooted parallels a broader sociological trend, which is an emphasis on interconnectivity, community, and local specificity in the face of technology and globalization.⁴⁸⁰ Examples of this trend include

⁴⁷⁶See generally ALBERT O. HIRSCHMAN, EXIT VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES 4, 77 (1970) (describing the roles of exit, voice, and loyalty on the part of shareholders).

⁴⁷⁷*Id.*

⁴⁷⁸See *supra* Part IV for turnover rate discussion. See *supra* Part IV.A.1 for critical mass discussion.

⁴⁷⁹Of course, people are behind the computer algorithms and thus, their preferences are embedded in the algorithm. While this is true, once the algorithm is set and until it is adjusted, it runs on auto pilot. See Popper, *supra* note 64 (explaining that Knight Capital Group lost \$440 million due to a computer glitch which led to rapid sell off of stocks last year).

⁴⁸⁰See *infra* notes 481-86 and accompanying text.

the rise of the so-called "sharing economy" (like "car2go",⁴⁸¹ "Kickstarter",⁴⁸² or "Airbnb"⁴⁸³); the Slow Money movement,⁴⁸⁴ the renewed interests in the power of cities as the source of innovation and solution,⁴⁸⁵ and local food movements such as "farm-to-table."⁴⁸⁶ Shareholder Cultivation parallels these broader organizational patterns in society and taps into a broader set of values that is beginning to emerge in today's economy.

B. *Potential Costs and Critiques*

1. Increased Transaction Costs

A notable critique of Shareholder Cultivation is that it will increase the transaction costs associated with share ownership.⁴⁸⁷ These transaction costs include information-gathering costs as Shareholder Cultivation requires that firms gather and sort through information about shareholders to detect potential stewards;⁴⁸⁸ bargaining costs as shareholder stewards and firms must now negotiate the terms of

⁴⁸¹See Stephanie Steinberg & Bill Vlasic, *Car-Sharing Services Grow, and Expand Options*, N.Y. TIMES, Jan. 25, 2013, <http://www.nytimes.com/2013/01/26/business/car-sharing-services-grow-and-expand-options.html> (explaining that Car2go is one of about two dozen car-sharing services in the U.S., renting only two-seat Smart cars and charging customers by the minute instead of the hour).

⁴⁸²See Jenna Wortham, *A Web Edge for Makers of Real Stuff*, N.Y. TIMES, Apr. 20, 2011, <http://www.nytimes.com/2011/04/21/technology/21make.html> (explaining that Kickstarter is an American company providing tools to raise funds by crowd funding in exchange for tangible rewards or experiences).

⁴⁸³See Susan Fournier et al., *Learning to Play in the New "Share Economy"*, HARV. BUS. REV., at 125, 128, 130, July-Aug., 2013 (quoting Marc McCabe, founder of Airbnb) ("In the sharing economy, community is a bond around a common ideal."). See generally Thomas L. Friedman, *Welcome to the 'Sharing Economy'*, N.Y. TIMES, July 20, 2013, <http://www.nytimes.com/2013/07/21/opinion/sunday/friedman-welcome-to-the-sharing-economy.html> (explaining that Airbnb is an online service based in San Francisco which provides a platform for individuals to rent unoccupied rooms and residences all over the world to guests).

⁴⁸⁴Similarly, the Slow Money movement aims to "bring money back down to earth" through "direct investments into farmers and businesses that make healthy food possible, at relatively low rates of return." KELLY, *supra* note 68, at 197.

⁴⁸⁵See BRUCE KATZ & JENNIFER BRADLEY, THE METROPOLITAN REVOLUTION: HOW CITIES AND METROS ARE FIXING OUR BROKEN POLITICS AND FRAGILE ECONOMY 2-4 (2013).

⁴⁸⁶Mario Batali, *Mario Batali on Farm-to-Table Dining*, GOTHAM MAG., May 10, 2013, <http://gotham-magazine.com/dining/articles/back-to-basics>.

⁴⁸⁷See R.H. COASE, THE FIRM THE MARKET AND THE LAW 45-46 & n.31, 114-16 (Univ. Chi. Press, 1988).

⁴⁸⁸See *supra* notes 210-11, 214 and accompanying text.

stewardship engagement, including, if applicable, defining agreed upon mission-sustaining criteria,⁴⁸⁹ and policing and enforcement costs, as now both firms and shareholders need to monitor whether the other is keeping up its end of the bargain.⁴⁹⁰

While the transaction costs associated with Shareholder Cultivation would increase at the outset for each individual negotiation, Shareholder Cultivation could also result in what Nobel Prize laureate, Professor Oliver Williamson, terms transaction-cost-reducing "governance structures."⁴⁹¹ Williamson argues that transaction costs depend on frequency, specificity, uncertainty, limited rationality, and opportunistic behavior.⁴⁹² One aspect of Williamson's work that is particularly salient is that relationship-specific contracts are more cost-reducing than repeated case-by-case bargaining.⁴⁹³ Williamson views an advantage of the firm as providing a forum in which "owners of various resources . . . commit[] to some 'contractual' governance arrangement . . . in order to reduce their transaction costs and share the resulting efficiency gains."⁴⁹⁴ Thus, while Shareholder Cultivation could increase transaction costs at the outset, because it involves commitment to a contractual governance arrangement, i.e., the stewardship relationship, a plausible alternative is that Shareholder Cultivation creates a transaction-cost-reducing relationship.

2. Entrenchment and Abuse

A second critique is that Shareholder Cultivation is subject to abuse since cultivation runs the risk of creating (i) an entrenched board and (ii) a powerful class of shareholders who have management's ear and attention, which in turn could lead to management giving undue credence to the will of these shareholders to the detriment of other shareholders. One doctrinal solution to this concern would be to treat shareholder stewards as similar to controlling shareholders, such that they would owe fiduciary duties to the corporation and other shareholders if they exploit their position to reap benefits at the exclusion of the other shareholders.⁴⁹⁵

⁴⁸⁹See *supra* Part IV.F.1.

⁴⁹⁰See *supra* Part V.A.5.

⁴⁹¹OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 41 (1985).

⁴⁹²*Id.* at 52, 56.

⁴⁹³*Id.* at 75-78.

⁴⁹⁴ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 463, at 9-10 (describing Williamson's transaction cost theory of the firm).

⁴⁹⁵See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 705 (Del. 1983); *In re John Q.*

Like the fiduciary duties that attach to controlling shareholders,⁴⁹⁶ fiduciary duties for stewards would become activated when such shareholders are exercising their control. A breach of fiduciary duty would only be found if the shareholder steward used its position to obtain a benefit that other shareholders did not receive.⁴⁹⁷ The extension of fiduciary duties to steward shareholders is similar to the proposal by Professors Stout and Anabtawi to extend the controlling shareholder fiduciary duty frame to activist shareholders.⁴⁹⁸

Similarly, another doctrinal solution to address the potential problem of board entrenchment would be for courts to adopt an enhanced duty of care standard similar to the standard adopted for judicial review of board responses to takeover threats.⁴⁹⁹ For example, in *Unocal Corp. v. Mesa Petroleum Co.*, in evaluating whether the board's decision to pursue a selective exchange offer was entitled to business judgment rule protection, the Delaware Supreme Court stated that

[b]ecause of the omnipresent specter [in the takeover context] that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.⁵⁰⁰

In light of this "omnipresent specter" that boards may be acting with the "sole or primary purpose to entrench themselves in office" when responding to a takeover threat, the *Unocal* court articulated an intermediate standard of review, which required that the directors first prove: (1) "that they had reasonable grounds for believing that a danger

Hammons Hotels Inc. S'holder Litig., 2009 WL 3165613, at *17 (Del. Ch. Oct. 2, 2009); Kahn v. Lynch Commc'n Sys., Inc., 1993 WL 290193, at *788 (Del. Ch. July 9, 1993), reprinted in 19 DEL. J. CORP. L. 784 (1994), *rev'd on other grounds*, 638 A.2d 1110, 1113-14 (Del. 1994).

⁴⁹⁶See Kahn, 638 A.2d at 1113-14 (quoting *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989) (citing *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987))).

⁴⁹⁷See *id.* To elaborate briefly, the alleged breach of a controlling shareholder's fiduciary duties could be protected by sufficient procedural safeguards—for example, if the transaction was recommended by a disinterested and independent special committee functioning at an arm's length basis, and was approved by all of the minority shareholders in a non-waivable vote. See, e.g., *Zapata Corp. v. Maldonado*, 430 A.2d 779, 785 (Del. 1981) (describing the ability to delegate authority to a committee).

⁴⁹⁸See Anabtawi & Stout, *supra* note 61, at 1260.

⁴⁹⁹*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

⁵⁰⁰*Id.*

to corporate policy and effectiveness existed"; and (2) that their response was "reasonable in relation to the threat posed."⁵⁰¹ If the board satisfies both prongs then their actions will be judged under the business judgment rule.⁵⁰² If, however, the board fails to satisfy the *Unocal* test, the board's actions will be judged under the more exacting entire fairness standard.⁵⁰³ The entrenchment concern, which animated the court in *Unocal* and gave rise to the heightened intermediate review, is similar in spirit to the entrenchment concern, which Shareholder Cultivation presents. One way to deal with the concern of board entrenchment in the cultivation context would be to adopt an enhanced standard of review similar to the *Unocal* test.⁵⁰⁴

Additionally, existing insider trading rules, which prohibit trading on non-public information, provide an immutable boundary that would deter shareholder stewards from abusing their stewardship status.⁵⁰⁵ While imposing fiduciary duties on shareholder stewards and treating them as covered by insider trading rules may create a disincentive to stewardship; shareholder stewards are compensated for this increased risk by the superior economic rights, voting rights, and other terms that they negotiate in exchange for stewardship.⁵⁰⁶

3. Institutional Investors May Pose a Problem

A third concern presented by Shareholder Cultivation is that its chances of success are limited by the fact that the vast majority of shares are held through institutional intermediaries, and these intermediaries often have a business model or trading strategy that makes stewardship incompatible.⁵⁰⁷ However, this concern may be misplaced as large

⁵⁰¹*Id.* at 954-55.

⁵⁰²*Id.* at 958.

⁵⁰³*See Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1371 n.7 (Del. 1995) (citing *Grobow v. Perot*, 539 A.3d 180, 187 (Del. 1988)) (explaining that the entire fairness standard applies once it has been determined that the business judgment rule is not applicable).

⁵⁰⁴*Unocal*, 493 A.2d at 954-55.

⁵⁰⁵*See* 17 C.F.R. § 240.10b5-1(a) (2013); *see also* 17 C.F.R. § 243 (2013) (requiring an issuer, or an issuer's agent, to publicly disclose the intentional or accidental disclosure of material nonpublic information to holders of the issuer's securities); 7 C.F.R. § 249 (2013) (providing that Form 8-K should be used for "reports of nonpublic information required to be disclosed" by § 243).

⁵⁰⁶*See supra* Part IV.D.2 (explaining various forms of possible stewardship compensation including separate share classes with superior voting and economic rights as well as time-weighted voting).

⁵⁰⁷*See, e.g.*, BEN W. HEINEMAN, JR. & STEPHEN DAVIS, MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE & COMM. FOR ECON. DEV., ARE INSTITUTIONAL INVESTORS

institutional investors like BlackRock, Inc., the world's largest asset manager, have openly expressed commitment to the concept of stewardship.⁵⁰⁸ Thus, institutional investors as a whole are not a lost cause when it comes to stewardship.

One particular class of institutional investor that presents a more interesting dilemma for Shareholder Cultivation is that of the index funds whose stock portfolio is constructed to match or track a market index. Since these investors are investing in an index, and not in a particular stock per se, some executives view these funds as "automatically incapable of being stewardship investors."⁵⁰⁹ On the contrary, according to one report, index investors are interested in being stewards and are "pivotal to the success of stewardship given their long-term commitment to companies in their index."⁵¹⁰ This latter view seems more apropos since index funds do hold for relatively longer periods of time and continue to invest in the stock so long as the stock remains in the relevant index.

One potential cultivation strategy that could be used for institutional investors (including index funds) would be to devise a reduced fee structure for institutional investors who commit to stewardship.⁵¹¹ In addition, for index funds, another point of leverage may be to engage with the organization of which the fund is a part (since several index funds are part of a larger institution with active holdings) to encourage integration of stewardship behavior on an organization-wide level.⁵¹²

Thus, while Shareholder Cultivation has several advantages, its practices, processes, and outcomes are not without critique. However, as argued in Part V, existing doctrinal and market-based mechanisms can be employed to effectively counter these critiques.⁵¹³ The ability to have shareholders whose investment behavior and (in some cases) whose

PART OF THE PROBLEM OR PART OF THE SOLUTION? 29 (2011), <http://www.ced.org/pdf/Are-Institutional-Investors-Part-of-the-Problem-or-Part-of-the-Solution.pdf>; (questioning whether it is possible for an institutional investor, with short-term trading strategies, to step into a stewardship role).

⁵⁰⁸See SKIPPER ET AL., *supra* note 9 (signifying BlackRock's commitment to investor stewardship).

⁵⁰⁹*Id.* at 7.

⁵¹⁰*Id.* at 9.

⁵¹¹See HEINEMAN & DAVIS, *supra* note 507, at 25 (providing a few examples of how to convince institutional investors to support stewardship).

⁵¹²See SKIPPER ET AL., *supra* note 9, at 10 (recommending institutional investors to communicate internally about potential competing perspectives between different fund managers).

⁵¹³See *supra* Part V.A.1-7.

moral compass meshes with the corporation's long-term mission, vision, and purpose, is immensely beneficial to the specific corporation and to society, and is necessary in today's equity markets with their heterogeneous and transient shareholders.

VI. CONCLUSION

Shareholder Cultivation plays an important gap-filling role in corporate governance, and should be allowed within the confines of corporate law's immutable-default rule construct. It provides a third-way approach for corporations to rewrite the terms of their engagement with certain shareholders to cultivate stewardship partners in the face of gaps between top-down corporate governance rules and changing dynamics of share ownership. This is particularly important in today's economy as public corporations face immense pressure to balance the competing interests of shareholders and deliver long-term value.

The public corporate form is arguably one of the greatest innovations for aggregating resources (in all of its dimensions—financial, human, intellectual, and social), and using this combination to generate profits, create employment, and develop products and services that meaningfully impact and, in some cases, transform the way we interact. Examples include the railroad, the automobile, and the iPhone. However, public corporations are at an inflection point that presents an opportunity for devising enhanced models and processes for conducting business. Share ownership design and in particular, Shareholder Cultivation, is a necessary part of this equation.

I believe that Shareholder Cultivation holds significant promise for restructuring the way we think about corporate governance and the necessary conditions for a sustainable public corporate form. Shareholder Cultivation offers a new governance approach to corporate governance that emphasizes connectivity and collaboration, and re-conceptualizes existing business norms and practices to pivot towards a new normal.