Shareholder Cultivation and New Governance

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SHAREHOLDER CULTIVATION AND NEW GOVERNANCE

BY TAMARA C. BELINFANTI*

ABSTRACT

Several formal proposals have been made to address shareholder short-termism and speculative behavior. These include the imposition of a financial transaction tax, changes to the U.S. capital gains tax rate, and the adoption of an Investor Stewardship Code in the United Kingdom. This Article reverses the focus from top-down solutions and instead, focuses on bottom-up grass root solutions that corporations can employ, and in some cases do already employ to achieve substantially the same effect of rewarding certain types of shareholder behavior while discouraging others—a process I refer to as "Shareholder Cultivation." While many of the techniques and strategies discussed in this Article are not new and in fact many have been used by companies and investor relation professionals for years, the Article is the first to conceptualize a prescriptive framework for assessing which techniques and strategies should be allowed. Additionally, the Article utilizes new governance theory to examine the concept of Shareholder Cultivation with a fresh lens: as a corporate governance benefit.

*Associate Professor, New York Law School; Aspen Ideas Scholar. I am grateful for the support of my colleagues at New York Law School. This Article benefited greatly from the insights and comments of corporate governance practitioners, institutional investors, shareholder relation firms, in-house investor relation departments, and business policy institutions. Most notably, I must thank the Aspen Business & Society Program; Gary Kraut, President of G.A. Kraut Company Inc.; Brian Walsh, Executive Director of Liquidnet For Good; and Marjorie Kelly, author of Owning Our Future: The Emerging Ownership Revolution, for their selfless and valuable feedback. Special thanks for the useful comments received from attendees at the Emerging Approaches to Corporate Governance session at the 2013 Law & Society annual meeting and fellow members of the New York Areas Scholars Group. Jennifer Wang provided truly exceptional research assistance. Finally, special and (ironic?) thanks to the "cultivated" shareholder who told me "corporate governance is b****s**t; if companies really want governance they go out and get people like me to help hold the ship steady." And from that, this Article began.
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I. INTRODUCTION

In a 2012 article in the Harvard Business Review, the authors asked: "What good are shareholders?" The traditional response to this question is that shareholders are the owners of the firm, they contribute financial capital, in addition to which they serve a monitoring and disciplining function that in theory controls managerial shirking. Post 2008, however, there has been an intense focus on the role of shareholders in the 2008 financial crisis and a recognition that short-termistic speculative behavior played a key role in the global financial market demise. As a result, several formal proposals have been made to address these short-termistic and speculative tendencies. These include the imposition of a financial transaction tax, changes to the United States ("U.S.") capital gains tax rate, and the adoption of an Investor Stewardship Code in the United Kingdom ("UK").

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1 See Justin Fox & Jay W. Lorsch, What Good are Shareholders?, HARV. BUS. REV., July-Aug. 2012.
2 See id.
3 See infra Part II.
4 See infra note 5 and accompanying text.
While these formal proposals have tremendous merit, this Article reverses the focus from looking to top-down solutions, and instead, focuses on bottom-up grass root solutions that corporations can employ, and in some cases do already employ, to achieve substantially the same effect of rewarding certain types of shareholder behavior while discouraging others—a process I refer to as "Shareholder Cultivation." As more fully developed herein, the aim of Shareholder Cultivation is to identify, attract, and cultivate a core of committed shareholders stewards who understand the firm's purpose and value proposition, rather than settling for a shareholder base composed entirely of "faceless members of an ever-shifting crowd." While many of the techniques and strategies discussed herein are not new, and in fact many have been used by companies and investor relation professionals for years, the Article is the first to conceptualize a prescriptive framework for assessing which techniques and strategies should be allowed. Additionally, the Article utilizes new governance theory to examine the concept of Shareholder Cultivation with a fresh lens: as a corporate governance benefit.

For public corporations that care about developing and achieving long-term value, Shareholder Cultivation will become increasingly important. As a leading report on the importance of stewardship argues, "the success of companies and the societies in which they operate depends on the exercise of 'stewardship.'"

Public corporations express this desire to cultivate shareholder stewards in many ways. For example, in its 2004 Owner's Manual for
Shareholders, Google Inc.'s founders, Larry Page and Sergey Brin, included a plea to their shareholders to avoid a short-term and impatient mindset saying,

[i]n our opinion, outside pressures too often tempt companies to sacrifice long term opportunities to meet quarterly market expectations. . . . If opportunities arise that might cause us to sacrifice short term results but are in the best long term interests of our shareholders, we will take these opportunities. . . . We would request that our shareholders take the long term view.10

Similarly, Berkshire Hathaway Inc., in a letter to its shareholders, stated that the firm tries to attract investors who "understand [its] operations, attitudes and expectations. . . . [a]nd, fully as important, . . . dissuade those who won't."11

Admittedly, the notion of cultivating some subset of loyal shareholders causes intellectual unease. It raises significant concerns such as entrenchment, abuse, diminished monitoring, creation of a class of lapdog shareholders, and unequal treatment for shareholders not deemed worthy of cultivation.12 The cultivation framework developed in this Article attempts to minimize and temper these concerns and on balance, the Article argues that any perceived costs of Shareholder Cultivation are outweighed by the benefits of having an engaged core of shareholder stewards.13

In his article Shareholder Eugenics in Public Corporations, Professor Edward Rock argues that there is "a link between the shareholders of a company and its cost of capital."14 Based on this premise, Professor Rock investigates traditional capital market tools for engineering the shareholder base "[f]rom the perspective of financial economics."15 While some of the traditional capital market tools discussed by Professor Rock are also referenced herein, this Article is

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10Google Inc., Amendment No. 9 to Form S-1 Registration Statement (Form S-1/A), 27 (Aug. 18, 2004).
12See infra Part V.B.
13See infra Part V.B.
15Id.
distinct in at least two respects. First, in terms of approach, this Article anchors Shareholder Cultivation in the new governance school, and in doing so provides a theoretical frame for conceptualizing and assessing Shareholder Cultivation as a corporate governance practice. Second, this Article expands the frontier for future cultivation strategies and directly connects the promise of Shareholder Cultivation to the increasing calls for stewardship.

The remainder of the Article proceeds as follows. Part II first examines some of the practical dynamics of shareholder behavior that have led to calls for shareholder stewardship, but at the same time make stewardship challenging. These dynamics include an increasingly heterogeneous and transient shareholder pool; the presence of third-party intermediaries like proxy advisors that can change the tenor of the relationship between a firm and its shareholder base; the increased prevalence of activist investors; and the use of automated trading algorithms, which make the benefits of personal outreach from management to shareholders all the more necessary. Most of these dynamics have not been addressed by corporate governance regulations, such as the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Part II posits that Shareholder Cultivation bridges the gap between top-down corporate governance rules and the changing realities of share ownership on one hand, and the actualization of stewardship, on the other.

Part III employs new governance theory to unpack the corporate governance benefits of Shareholder Cultivation and develops a framework for assessing which cultivation techniques and strategies should be allowed. The term "new governance" captures a range of regulatory activities and processes, which challenge the conventional wisdom that effective regulation should involve top-down regulation and command-and-control rules, while simultaneously rejecting a complete shift from top-down regulation towards pure market or self-regulation.

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16See infra Part III.
17See generally The UK Stewardship Code, supra note 5 (outlining principles of effective investor stewardship in the United Kingdom); SKIPPER ET AL., supra note 9 (detailing current challenges in investor stewardship and proposing strategies for improving stewardship going forward).
18See infra Part II.
19See infra Part II.
20See infra Part II.
21See infra Part II.
22See infra Part III.
23See infra Part III.
The new governance paradigm seeks to identify both regulatory failures and market failures in a given space, and from this, devises complementary or "third-way" approaches that address these failures and enhance outcomes. Additionally, recognizing that Shareholder Cultivation could be subject to abuse, Part III employs the Ayers-Gertner "immutable rule-default rule" construct to develop a prescriptive framework for determining the bounds and limits of acceptable Shareholder Cultivation activity. As developed herein, the outward limits of cultivation would consist of immutable corporate law rules (inviolate rules that the parties cannot contract around), such as the rule that shareholders have a right to elect directors. These immutable rules would be off limits to cultivation experimentation, and at the risk of stating the obvious, a violation of any of them would be considered illegal. By contrast, all default rules of corporate law (rules that the parties can contract around within the bounds of the rules—for example, the rules related to quorum whereby quorum can be increased or decreased beyond the statutory default, but in no event can it be less than one third) would be open to experimentation up to the point that they are limited by one or more of the immutable rules.

Part IV transitions from theory to practice and provides a comprehensive analysis of actual and potential Shareholder Cultivation strategies. Specifically, Part IV develops a taxonomy of cultivation tools and dissects the legal framework that makes deployment of these cultivation tools possible. As described in Part IV, Shareholder Cultivation strategies can be visualized as falling along a cultivation

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26 See, e.g., DEL. CODE ANN. tit. 8, § 141(d) (2011) (permitting shareholders of a corporation to elect its directors for staggered terms); N.Y. BUS. CORP. LAW § 603 (McKinney 2003) (providing provisions for shareholders to elect directors in the event of a failure to elect a sufficient number of directors under normal circumstances).
27 See, e.g., DEL. CODE ANN. tit. 8, § 216 (2011), which reads in full: [T]he certificate of incorporation or bylaws of any corporation authorized to issue stock may specify the number of shares and/or the amount of other securities having voting power the holders of which shall be present or represented by proxy at any meeting in order to constitute a quorum for, and the votes that shall be necessary for, the transaction of any business . . . .
Id.
28 See infra Part IV.
29 See infra Part IV.A-F.
spectrum. The first point on the cultivation spectrum consists of "pre-cultivation" activities, which include the firm's articulation of its purpose and value proposition. The second spectrum point consists of identification tools, which assist firms in identifying potential shareholder stewards, and the third point consists of "enlistment and reinforcement tools," which include cultivation techniques to attract and enlist stewardship shareholders.

In addition to providing a comprehensive treatment of current activities in which companies engage and which serve a cultivation purpose, Part IV also proposes future Shareholder Cultivation strategies that firms could employ to cultivate shareholder stewards. Among the strategies proposed in Part IV are (i) the issuance of shares that have superior voting rights and economic rights, and which could be issued to targeted shareholders who commit to fulfilling certain mission-sustaining criteria (what I term "MY Shares" or "Mission-Yield Shares"); (ii) the implementation of a "time-weighted dividend" policy whereby the dividends that a shareholder receives would be dependent on the length of time that the shareholder owns stock in the company, so that long-term shareholders would be rewarded more than short-term shareholders; (iii) the implementation of a "mission-weighted" dividend policy, which would be similar to a time-weighted dividend policy, except that the amount of dividend received would be contingent on whether the shareholder fulfilled certain mission-sustaining criteria; (iv) a shareholder loyalty rewards point program, whereby shareholders could earn points based on their length of time as shareholders or on the basis of satisfying specified mission-sustaining criteria, and such points could be "redeemed" for additional shares or for certain products or services produced by the firm; (v) a transaction tax as incentive for stewardship; (vi) integrated reporting of financial, environmental, and social performance; and (vii) within the confines of existing law, the suspension of shareholder voting rights for the extreme case where

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30 See infra Part IV.A.
31 See infra Part IV.B.
32 See infra Part IV.C.
33 See infra Part IV.D.
34 See infra Part IV.F.
35 See infra Part IV.F.1.
36 See infra Part IV.F.2.
37 See infra Part IV.F.3.
38 See infra Part IV.F.7.
39 See infra Part IV.F.6.
40 See infra Part IV.F.5.
shareholders abuse their status *qua* shareholders.41 For each of the proposed cultivation strategies discussed, Part IV analyzes the legal framework across state law, federal law, and stock exchange listing rules and provides an outline for implementation.42

Part V assesses the benefits and costs of Shareholder Cultivation both to individual firms and in the aggregate.43 Key benefits of Shareholder Cultivation include the encouragement of stewardship capital,44 enhanced thought-partnering between shareholders and managers,45 and the use of Shareholder Cultivation as a potential anti-takeover device.46 Simultaneously, however, Part V recognizes that the arguments put forth in this Article are subject to critique, such as whether Shareholder Cultivation will lead to entrenched interests;47 whether Shareholder Cultivation will increase the transaction costs of share ownership;48 suspicion about the effectiveness of Shareholder Cultivation for a large public corporation, especially in light of the fact that most shares are held through institutional intermediaries;49 and whether Shareholder Cultivation runs afoul of agency theory by diminishing the monitoring function that corporate governance wants shareholders to serve.50 Part V addresses each of these critiques in turn and demonstrates that corporate law's existing package of immutable rules and default rules help to constrain these costs and risks of abuse, and that on balance, Shareholder Cultivation could enhance governance outcomes.51

In conclusion, Shareholder Cultivation is poised to play an active role in future governance design. It represents a bottom-up, collaborative, "third-way" approach to governance design, which can help overcome some of the market failures and regulatory failures that have proven problematic for traditional corporate governance approaches.52

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41See infra Part IV.F.4.
42See infra Part IV.F.1-7.
43See infra Part V.
44See infra Part V.A.1.
45See infra Part V.A.5.
46See infra Part V.A.3.
47See infra Part V.B.2.
48See infra Part V.B.1.
49See infra Part V.B.3 for further discussion on the need for institutional investor-specific cultivation strategies.
50See infra Part V.B.2.
51See infra Part V.B.3.
52See infra Part III.
II. THE CURRENT STATE OF PLAY

The Organisation for Economic Co-operation and Development (the "OECD") defines corporate governance as "the system by which business corporations are directed and controlled," and notes that a "corporate governance structure specifies the distribution of rights and responsibilities among different participants in the company, such as the board, managers, shareholders, and other stakeholders, and spells out the rules and procedures for making . . . decisions on corporate affairs." One of the goals of corporate governance is to design governance structures and systems which encourage boards and managers to make decisions that benefit the long-term interests of the firm and its shareholders. However, recurrent episodes of firm actions that proved detrimental to the long-term interests of both the firm and its shareholders (and oftentimes, to the economy as a whole) highlight the need for constant re-evaluation of the efficacy of corporate governance rules and policies. Examples of such episodes include the 1980s saving and loan crisis; the catastrophic demises of companies like Enron, Worldcom, and Global Crossing in 2001-2002, largely blamed on abuses of power and lack of accountability, transparency, and oversight of corporate executives; and the 2008 financial crisis. As the OECD

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54See Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (holding the board's considerations of community effects are rational business decisions that support the long-term viability of the company); Adrian Cadbury, Report of the Committee on the Financial Aspects of Corporate Governance, EUR. CORP. GOVERNANCE INST. § 6.6 (Dec. 1, 1992), http://www.ecgi.org/codes/documents/cadbury.pdf (stating that boards are accountable to shareholders who comply with the code because the board acts as stewards on behalf of the shareholders); Aspen Inst., Long-Term Value Creation: Guiding Principles for Corporations and Investors §§ 1-2 (2007), http://www.aspeninstitute.org/sites/default/files/content/docs/bsp/ bsp/FinalPrinciples.pdf (presenting that a company's and an investor's implementation of long-term incentives and measures benefit one another); Robert Charles Clark, Corporate Law 18 n.46 (Little, Brown & Company, 1986) (explaining that maximizing profits means accounting for the "long-range results" of a business); Org. for Econ. Co-operation & Dev., OECD Principles of Corporate Governance 58-61 (2004) [hereinafter OECD Principles], http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf (discussing the responsibilities of the board to include acting in good faith and with due diligence and high ethical standards for the benefit of the company and the shareholders).

55See infra note 56 and accompanying text.

56See Davita Silfen Glasberg & Dan Skidmore, The Dialectics of White-Collar Crime: The Anatomy of the Savings and Loan Crisis of Silverado Banking, Savings and Loan...
acknowledged in its "Principles of Governance," "[t]he [2008] financial crisis revealed severe shortcomings in corporate governance. When most needed, existing standards failed to provide the checks and balances that companies need in order to cultivate sound business practices."\(^5\) In response to these "revealed shortcomings" the OECD developed an "ambitious action plan" which identified four "priority areas" for improvement—"remuneration, risk management, board practices, and the exercise of shareholder rights."\(^6\)

Additionally, several voices from both the public and private sectors have drawn attention to other simmering problems, which regulators have either not addressed or have been slow to address.\(^9\) Such problems include: absentee share ownership, which manifests in the form of empty voting;\(^6\)\(^0\) the perceived abuses of shareholder privileges by some activist investors;\(^6\)\(^1\) the unease with the practices and influence of third-party proxy advisors;\(^6\)\(^2\) the increased presence of short-term arbitrageurs;\(^6\)\(^3\) and the vulnerabilities created by high-speed trading platforms.\(^6\)\(^4\)

\(^{57}\)OECD PRINCIPLES, supra note 54, at 58-61.

\(^{58}\)See infra notes 60-64 and accompanying text.


\(^{61}\)See Tamara C. Belinfanti, The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control, 14 STAN. J.L. BUS. & FIN. 384, 438 (2009) (arguing that third-party proxy advisors are less accountable and more problematic to corporate management); see also Proxy System, Exchange Act Release No. 34-62495 (explaining that third-party proxy advisors do not always possess the requisite vote information for shareholders).

\(^{62}\)See BOGLE ET AL., supra note 5, at 2 (presenting the problems associated with short-term investors).

Furthermore, the notion of shareholders as owners has become more nebulous and attenuated as shareholders become more heterogeneous and transient. For example, a single company's shareholder base could include individual shareholders who invest because they like the company's goods or services; institutional investors such as pension funds or mutual funds, whose primary duty is to their respective investors; index funds whose managers may not necessarily care about the individual company's performance, but are more concerned about matching the index; short-term speculators who benefit from market fluctuations and instability; and "tape readers," who trade in bursts and have minimal interest in understanding the business of the companies behind the shares. Thus the concern for companies is that share ownership has become disembodied from the long-term health and interests of the firm. Shareholder Cultivation attempts to reconnect ownership to the firm, so that ownership becomes what Marjorie Kelly terms more "rooted" in the values and interests of the firm, rather than being connected solely in the intangible realm of the Committee on Uniform Securities Identification Procedure ("CUSIP") and stock registers.

Moreover, a larger point emerges from the above picture: the fast-paced, interconnected, and dynamic nature of today's capital markets and share ownership place corporate governance policymakers in the uncomfortable position of having constantly to play regulatory catch-up. The capital market landscape, like the broader society of which it is

millions of dollars because of a slight glitch).

See infra note 66 and accompanying text.


See infra note 68 and accompanying text.

MARIORIE KELLY, OWNING OUR FUTURE: THE EMERGING OWNERSHIP REVOLUTION 104-05, 167-68 (2012) (stating that firms engaging in rooted membership create an environment in which employees' work and stewardship become a tangible connection to the success of the firm). The CUSIP is a nine character alphanumeric code assigned to all North American financial securities that facilitates the clearance and settlement of security trades. See LOAN SYNDICATION & TRADINGS ASSN CUSIP GUIDELINES 3 (2011), http://www.1sta.org/WorkArea/DownloadAsset.aspx?id=15110. While CUSIPs obviously serve an important clearance and settlement function, the point is that stewardship share ownership should involve a more tangible and meaningful connection to the underlying company and its mission. See id.

a part, is more interconnected, more digitized, more virtual, and more
dynamic with the result of a gulf widening between regulatory
prescriptions and present reality.70 As new technologies, new investment
vehicles, and new trading strategies emerge, one can only expect that the
gap between regulatory responses and perceived on-the-ground problems
will continue to widen in an unprecedented way.71

One solution to filling the gap between problem and response lies
in engaging private parties and bottom-up, collaborative initiatives that
respond to a given problem. Shareholder Cultivation arguably serves
this gap-filling function and normatively meshes with the new
governance paradigm, which advocates for a complementary approach in
interconnected and dynamic environments, such as the corporate
governance space.

III. NEW GOVERNANCE AND A FRAMEWORK FOR CULTIVATION

New Governance is "a school of thought that focuses on the
significance of institutional design and culture for effective and
legitimate regulation."72 New governance scholars simultaneously
challenge the conventional wisdom that effective regulation should
involve top-down and command-and-control rules, while rejecting a
complete shift from top-down government toward pure market or self-
regulation.73 In doing so, new governance provides a "third-way
approach" that bridges the divide between self-governance and
unregulated markets on one hand, and top-down government controls on

catch-up to organizations).

70 See id.
71 See id.
72 Lobel, supra note 24, at 65.
73 Id. See generally IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION:
TRANSCEndING THE DEREGULATION DEBATE (1992) (discussing the government's need to
adopt a new approach to deregulation to increase market efficiency); Cristie Ford, New
Governance in the Teeth of Human Frailty: Lessons from Financial Regulation, 2010 WIs. L.
REV. 441, 445 (arguing for the adoption of a pragmatist approach involving empirical
experiences, flexibility, and humility); Orly Lobel, The Renew Deal: The Fall of Regulation
and the Rise of Governance in Contemporary Legal Thought, 89 MINN. L. REV. 342, 466-67
(2004) (arguing for the adoption of the Renew Deal approach requiring economic efficiency,
political legitimacy, and social democracy); Charles F. Sabel & William H. Simon,
Destabilization Rights: How Public Law Litigation Succeeds, 117 HARV. L. REV. 1015,
1100-01 (2004) (arguing that the adoption of the experimentalist approach avoids the defects
of rule-bound intervention and is responsive to judicial concerns); Joanne Scott & Susan
Sturm, Courts as Catalysts: Re-thinking the Judicial Role in New Governance, 13 COLUM. J.
EUR. L. 565, 567 (2007) (arguing for the adopting of a catalyst approach, as used by European
courts, to promote legitimate-and-effective governance decisions).
the other.\textsuperscript{74} In analyzing a given context, new governance scholars often begin with a critical examination of both market failures and governance failures that exist in a given space, with the hope of developing a systematic map of the "range of possibilities in the interaction between regulation and regulated actors . . . ."\textsuperscript{75} While "new governance strategies spring from a discontent with the results produced by traditional [top-down] techniques . . . . [i]n their willingness to synthesize an emerging social vision, [new governance] scholars and policy-makers move beyond entrenched and failed government structures while resisting simplistic attacks on the role of government intervention."\textsuperscript{76}

In a new governance frame, regulated entities are not simply regulatory objects, but instead are recognized and become engaged as "norm-generating subjects."\textsuperscript{77} In doing so, new governance aims to create a participatory, cooperative, and collaborative form of governance that responds to the failures of both markets and regulators, and which is both effective and legitimate.\textsuperscript{78} New governance can be conceptualized as a governance paradigm that "attempts to renew and intervene in otherwise stalemated debates."\textsuperscript{79}

One schema for conceptualizing the new governance approach was developed by noted new governance scholar, Orly Lobel.\textsuperscript{80} Professor Lobel "describe[s] the new governance model of regulation as consisting of eight clusters of approaches[: . . . (1) increased participation of non-state actors; (2) public–private collaboration; (3) diversity and competition within the market; (4) decentralization; (5) integration of policy domains; (6) non-coerciveness ('soft law'); (7) adaptability and constant learning; [and] (8) coordination."\textsuperscript{81} First, the new governance frame explicitly requires the participation of private actors in the creation, implementation, and enforcement of regulatory norms and rules because it "challenges the conventional assumptions" that traditional regulatory bodies have "superior knowledge, information, and expertise" than the private actors which they seek to regulate.\textsuperscript{82} The second approach of public–private collaboration is a natural corollary to the first

\textsuperscript{74}Lobel, supra note 24, at 68-69.
\textsuperscript{75}Id. at 65.
\textsuperscript{76}Id. at 70.
\textsuperscript{77}Id. at 67 (emphasis added).
\textsuperscript{78}See Lobel, supra note 24, at 67.
\textsuperscript{79}Id. at 69.
\textsuperscript{80}See infra notes 81-91 and accompanying text.
\textsuperscript{81}Lobel, supra note 24, at 66.
\textsuperscript{82}Id.
and furthers the recognition that cooperation and collaboration between regulatory bodies and regulated entities should lead to enhanced governance outcomes.\textsuperscript{83} Similarly, the "diversity and competition" approach refers to the idea "that a sustainable legal regime must encompass a multitude of values, account for conflict and compromise, acknowledge the diversity and changing interests of many participants, and recognize the legitimacy of private economic interests while appealing to public values."\textsuperscript{84} Relatedly, the concept of decentralization reflects the notion that the locus of regulation is not solely the state, but that the private sector has regulatory agency in the creation and promotion of governance norms and values.\textsuperscript{85} The fifth approach in new governance—"integration of policy domains"—attempts to connect seemingly dispersed issues across seemingly distinct domains with the view that often these issues are "nonetheless connected at the level of those who are most influenced by them . . . ."\textsuperscript{86} Thus, for example, in a traditional regulatory model, laws are fragmented into different domains, such as securities regulation, environmental regulation, and food and safety.\textsuperscript{87} In a new governance frame, the involvement of private actors, the collaboration between public and private, the decentralization of agency, and the principle of diversity and competition, "all potentially lead to revealing the ways in which dispersed issues . . . are nonetheless connected at the level of those who are most influenced by them."\textsuperscript{88} Continuing the theme of collaboration, the principle of non-coerciveness refers to new governance's aim to create a more flexible, open, and collaborative environment that is "more conducive to participation and

\textsuperscript{81}See id. at 67. The recognition of the importance of input from private actors and the benefits of public–private collaboration are not unique to the new governance frame. See, e.g., Rulemaking, How It Works, U.S. SEC. & EXCH. COMM’N, http://www.sec.gov/answers/rulemaking.htm (last modified Apr. 6, 2011). For example, administrative agencies like the SEC often invite collaboration and private-actor input in their rulemaking process through their "notice and comment" framework, which allows any interested party to formally contribute their thought to the proposed rule. See id. Where the new governance frame differs, however, is that new governance views the "different sectors" of society—"state, market, and civil society—as part of one comprehensive, interlocking system. . . . [in which] individuals are . . . involved in the process of developing and changing the norms of behavior, in contrast to [a top-down model], under which private actors are the objects of regulation." Lobel, supra note 24, at 67.

\textsuperscript{82}Lobel, supra note 24, at 67.

\textsuperscript{83}See id.

\textsuperscript{84}Id.

\textsuperscript{85}See id.

\textsuperscript{86}Lobel, supra note 24, at 67.
dialogue." The adaptability and constant learning strand echoes this notion of flexibility and recognizes that questions of "what works and what fails . . . must be constantly examined and re-examined." Finally, the eighth approach of coordination primarily refers to a key role of the state and regulatory agencies in the new governance frame, which is to facilitate "the communication of local knowledge and the structured interactions of separate groups[,]" both to "foster a culture of compliance within regulated industries," and to "promote and standardize innovations that began locally and privately." A.

A. New Governance in Corporate Governance

In applying new governance learning to the corporate governance space we confront the question of identifying market and governance failures that occupy the space. Examples of market failures include the aforementioned savings and loans crisis in the 1980s, the accounting scandals that led to the demise of several large corporations in the early 2000s, the subprime mortgage crisis, which has been blamed on unscrupulous lending practices by banks, and the 2008 financial crisis. In each of these instances of market failure, government intervened with new laws and regulations intended to prevent a recurrence of market breakdown.

In identifying regulatory failures in the corporate governance space, the description espoused by Professor Saule Omarova is

89 Id.
90 Id. at 67, 71.
91 See infra notes 93-97 and accompanying text.
92 See generally FED. DEPOSIT INS. CORP., THE SAVINGS AND LOAN CRISIS AND ITS RELATIONSHIP TO BANKING, ch. 4 (1997) [hereinafter S&L CRISIS], available at http://www.fdic.gov/bank/historical/history/167_188.pdf ("The vast number of actual and threatened insolvencies of savings and loan associations in the 1980s was predictable because of the interest-rate mismatch of the institutions' balance sheets.").
93 See Petrick & Scherer, supra note 56, at 38.
95 See Glasberg & Skidmore, supra note 56, at 445.
Professor Omarova categorizes regulatory failures as the "inability [of government] to design appropriately sophisticated and effective legal and policy instruments to address complex social problems (instrument failure), inadequate implementation of the rules (implementation failure), and failure to motivate the regulated entities and individuals to comply with the rules (motivational failure)." With respect to instrument failure in the corporate space, one might point to the 2003 U.S. Securities and Exchange Commission ("SEC") rule—which in an effort to encourage mutual funds to exercise their fiduciary duties in a more responsible way, mandated that mutual funds publicly disclose how they vote. The SEC did not, however, anticipate that the effect of this rule would be to incentivize mutual funds to further outsource voting logistics to third-party proxy advisor intermediaries, who in turn have brought a whole new slew of governance problems.

Similarly, the reaction by regulated entities to the 1993 federal tax law amendments is illustrative of implementation failure. The amended tax provisions were intended to curb perceived excesses in executive compensation and provided that companies could not deduct, as a business expense, compensation paid to an executive in excess of one million dollars unless such compensation was linked to an objective measure of corporate performance. Instead of curbing the amount of compensation, the 1993 tax amendments simply had the effect of limiting the salary portion to one million dollars, while the incentive pay portion skyrocketed. Of the three regulatory failures articulated by Omarova, motivational failure is most difficult to measure. However, indicators of motivational failure, such as a failure to comply with insider

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98 See infra note 99 and accompanying text.
101 See Belinfanti, supra note 62, at 393-94. While mutual funds and other registered management investment companies are required to disclose their proxy voting records on an annual basis on Form N-PX, the concern here is not with disclosure but with the potential influence that proxy advisors may have on the mutual funds' voting decision. Annual Report of Proxy Voting Record of Registered Management Investment Company (Form N-PX), available at http://www.sec.gov/about/forms/formn-px.pdf.
103 See id. at 128-29.
104 See id. at 131.
105 See Omarova, supra note 99, at 672.
trading rules, may also be symptomatic of both implementation and instrument failures.\textsuperscript{106}

More broadly speaking, corporate governance may have a "stalemate" problem both in terms of approach and in terms of the inability of its regulated constituents, i.e., corporate executives and shareholders, to agree on what is needed to enhance governance outcomes.\textsuperscript{107} In general, shareholders view the solution as more "shareholder rights" and "shareholder democracy," while executives view the solution as controlling abusive shareholder practices and honoring corporate law's default choice that assigns the power to manage the "business and affairs" to the board and officers.\textsuperscript{108} Thus, while corporate governance aims to design rules that encourage alignment between the interests of shareholders and those of managers, the current relationship between managers and shareholders in general can hardly be described as aligned or effective.\textsuperscript{109} There is mutual mistrust between both groups and this mistrust may be further aggravated by corporate governance rules and policies that do not necessarily address the realities of the relationship (what new governance's "diversity and competition" approach would view as a failure to "acknowledge the diversity and changing interests of [a multitude of] participants . . . .").\textsuperscript{110} Moreover, the accusations that shareholders and managers levy at each other have not changed significantly—shareholders accuse managers of being greedy, unmotivated, and self-interested, while managers accuse shareholders of both being self-interested and not understanding the company's business (the aforementioned "stalemate" problem).\textsuperscript{111} Top-down corporate governance policies, such as Sarbanes-Oxley and Dodd-Frank, while in many ways necessary to address certain market failures, have formalized and sanitized the shareholder–manager

\textsuperscript{106}See id.

\textsuperscript{107}See Stephen M. Bainbridge, The Board of Directors as Nexus of Contracts, 88 IOWA L. REV. 1, 5-6 & n.16 (2002).

\textsuperscript{108}See id. at 25; Lisa M. Fairfax, The Future of Shareholder Democracy, 84 IND. L.J. 1259, 1260 (2009); see also DEL. CODE ANN. tit. 8, § 141 (2011) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.").

\textsuperscript{109}See Fox & Lorsch, supra note 1, at 50.

\textsuperscript{110}Lobel, supra note 24, at 67.

\textsuperscript{111}See Fox & Lorsch, supra note 1, at 50, 56; see also supra note 107 and accompanying text.
relationship, but have arguably done very little to improve the underlying quality of the relationship.¹¹²

B. Shareholder Cultivation as New Governance

While the new governance paradigm often focuses on the interplay between the regulators and the regulated, Shareholder Cultivation primarily involves the interplay between a firm and its shareholders. Nonetheless, viewing Shareholder Cultivation through a new governance frame has analytical currency. In new governance parlance, Shareholder Cultivation is an example of an "innovation[ ]that began locally and privately" in response to this stalemate problem and in response to the changing dynamics of share ownership.⁴ Similarly, Shareholder Cultivation can be conceptualized as part of the "norm generating process," which in turn can then inform and influence how firms and policymakers think about corporate governance design. It potentially offers a "third-way approach" in corporate governance design, whereby managers leverage the heterogeneous dynamics of a firm's shareholder base to identify and cultivate a core of committed shareholders.¹¹⁵

More specifically, Shareholder Cultivation activates all "eight clusters" of the new governance approach described above¹¹⁶—first, it engages private actors and, through their collaboration, an innovative means of actualizing corporate governance can emerge;¹¹⁷ second, it invites public or private collaboration;¹¹⁸ third, it is arguably born out of the realization of the "diversity and competition" in capital markets, and as such, it recognizes the "diversity and changing interests of many stakeholders" and seeks to legitimize the private interests of the parties

¹¹²See Fox & Lorsch, supra note 1, at 56-57; see also Lobel, supra note 24, at 76.
¹¹³Lobel, supra note 24, at 67.
¹¹⁴See id. at 69 (explaining that new governance tries to "renew and intervene" in disputes that are at a standstill as well as respond to the changes in the type of goods, commerce, work, and additional threats).
¹¹⁵See id. ("[P]olicymakers and scholars are focusing their attention on new governance as a set of legal strategies outside the traditional command-and-control toolbox that has the potential to increase the effectiveness and legitimacy of social regulation.").
¹¹⁶See infra Part III.
¹¹⁷See, e.g., Lobel, supra note 73, at 371, 373-74 ("Increased participation [of private actors] permeates the many levels and stages of legal process . . . . [I]t enhances the ability of citizens to participate in political and civic life."); see also Lobel, supra note 24, at 66-67.
¹¹⁸See Lobel, supra note 73, at 376-77 ("It signifies a move to partnership, to horizontal relationships, and to two-way communications. The goal is to create microsystems of open communication in which policy is imagined, managed, and maintained.").
"while appealing to public values," such as long-term value creation and sustainability; fourth, it decentralizes corporate governance practices and activities from state agencies back to the affected private parties; fifth, in terms of "integration of policy domains," collaboration and knowledge-sharing between shareholder stewards and firm management could lead to enhanced thinking on how seemingly dispersed issues are connected and can be solved; sixth, Shareholder Cultivation embodies new governance's "non-coerciveness approach" in that successful Shareholder Cultivation "create[s] an environment more conducive to participation and dialogue[]" finally, the seventh and eighth approaches of "adaptability and constant learning" and "legal coordination" highlight the need to constantly assess Shareholder Cultivation practices and costs, as well as the role of regulatory bodies in capitalizing on—and scaling—successful cultivation practices and innovations. As discussed in Part IV.D.3., there are various levers, such as communication rules or reporting best practices, that regulatory agencies can utilize to "promote and standardize" these cultivation practices and innovations.

C. The Cultivation Framework

As previously noted, a necessary role of government under a new governance approach is to "foster a culture of compliance within regulated industries," and to "promote and standardize innovations that

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119 See id. at 379-80.
120 See id. at 381-85 (discussing four functions of decentralization including the following: encouraging governance interests, confirming the concept of subsidiarity, producing "relational density and synergy," and maintaining a setting conducive to democratic involvement).
121 See id. at 385. The new governance theory considers the interrelationships of the multiple legal areas when faced with resolving an issue. See id. at 385-86.
122 See Lobel, supra note 73, at 388 ("The [non-coerciveness approach] aims to create a flexible and fluid policy environment that fosters 'softer' processes that either replace or complement the traditional 'hard' ordering of the regulatory model.").
123 For discussion on the seventh approach, see id. at 395-96, which stresses the need to continue learning in governance. For discussion on the eighth approach, see id. at 400-01, which notes that "[s]caling up, facilitating innovation, standardizing good practices, and researching and replicating success stories from local or private levels are central goals of government."
124 See infra Part IV.D.3.
125 Lobel, supra note 24, at 71 (explaining the various ways in which government agencies encourage compliance with the rules).
began locally and privately.\textsuperscript{126} This Sub-Part contemplates how this could be achieved in the corporate governance space.\textsuperscript{127} Chief among the concerns is how to determine which cultivation efforts on the part of private firms will be allowed and which ones are off limits. To facilitate this exercise of delineating the boundaries of cultivation and permissible cultivation practices (which can be visualized as a "cultivation zone" or "cultivation playing field"), the Ayres-Gertner construct of immutable rules and default rules is particularly helpful.\textsuperscript{128}

In a 1989 law review titled \textit{Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules}, Professors Ayres and Gertner argue that "\textit{[t]he legal rules of contracts and corporations [could] be divided into two distinct classes"—immutable rules and default rules.\textsuperscript{129} "Immutable" rules consist of those rules that the parties could not change by contractual agreement."\textsuperscript{130} "Default" rules, on the other hand, consist of those classes of rules that "parties can contract around by prior agreement . . . ."\textsuperscript{131} Ayres and Gertner conceptualize default rules as "fill[ing] the gaps in incomplete contracts," i.e., these default rules will govern unless the parties contract around them.\textsuperscript{132} As Ayers and Gertner note, corporate law rules can also be divided between these two classes of immutable rules and default rules.\textsuperscript{133} For immutable rules, the authors cite, as an example, the rule regarding the rights of shareholders to "elect directors annually"; however, a default rule prescribes that most corporate statutes "allow the articles of incorporation to contract around the default rule of straight voting."\textsuperscript{134} Other immutable corporate rules include the rule that shareholders have a right to vote on an amendment to the corporation's articles of incorporation and the rule that shareholders have a right to vote on a transaction that will result in the

\textsuperscript{126}Id. at 67; see also supra Part III.
\textsuperscript{127}See infra Part III.C.
\textsuperscript{128}See Ayres & Gertner, supra note 25, at 87-88 (describing the differences between immutable rules and default rules and including examples of each rule).
\textsuperscript{129}Id. at 87.
\textsuperscript{130}Id.
\textsuperscript{131}Id.
\textsuperscript{132}Ayres & Gertner, supra note 25, at 87.
\textsuperscript{133}See id. at 91 (explaining that default rules can be divided into three categories: (1) penalty defaults, created to encourage at least one party to contract around the default rules; (2) tailored defaults, created to afford the parties with exactly what they would have asked for in the contract; and (3) untailored defaults, created to offer the parties to a contract a generic standard that is intended to represent what most parties to a contract would desire).
\textsuperscript{134}Id. at 87-88.
sale or change of control of the firm. Examples of other default corporate rules include rules regarding the setting of a record date, rules regarding the reimbursement of proxy expenses, and rules regarding special shareholder meetings.

While Ayres' and Gertner's analysis centers on how lawmakers should choose among various default rules, it is beyond the scope of this article to question corporate law's choice of existing default rules. The argument here is simply that an immutable-default rule construct is a useful analytical tool for thinking about the outer boundaries of Shareholder Cultivation and relatedly, the creation of permissible cultivation zones. Thus, immutable corporate law rules would demarcate the outer boundaries of cultivation activities, while default corporate law rules would be within the zone of play.

Finally, in a new governance frame, the immutable-default rule construct provides both regulators and regulated private parties with an operable framework for assessing the appropriateness of a given cultivation activity. A key role of regulators would consist of promoting and coordinating appropriate cultivation activities—through such actions as policy statements, SEC "no-action" letters, or best practice

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135See DEL. CODE ANN. tit. 8, § 242(b)(1) (2011) ("At the meeting a vote of the stockholders entitled to vote thereon shall be taken for and against the proposed amendment."); Id. § 271(a) ("Corporate[s] may at any meeting . . . sell, lease or exchange all or substantially all of its property and assets . . . when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon . . . ").

136Section 213(a) of the Delaware General Corporation Law provides:

If no record date is fixed by the board of directors, the record date for determining stockholders entitled to notice of and to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held.

Id. § 213(a); see also id. § 113(a) ("The bylaws may provide for the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors, subject to such procedures or conditions as the bylaws may prescribe . . . "); Id. § 211(d) ("Special meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws.").

137See Ayres & Gertner, supra note 25, at 89, 91 (discussing the need to confirm the theory utilized when faced with selecting default rules).

138See infra Part III.C.

139For both immutable and default rules, such rules include not only "hard" rules formalized by statute or regulation, but would also include soft law, general norms, and policies, which, although not formalized, are generally recognized to be inviolate. See Lobel, supra note 73, at 388.
prescriptions—to create a safe zone for companies to engage in Shareholder Cultivation.

IV. FROM THEORY TO PRACTICE: SHAREHOLDER CULTIVATION TOOLS AND STRATEGIES

To be clear, the suggestion is not that a public corporation could cultivate its entire shareholder base. Rather, Shareholder Cultivation is about leveraging existing market conditions and legal rules to cultivate a stabilizing core of committed shareholders.¹⁴⁰ Several CEOs recognize this and openly express their views on the types of shareholders that are welcomed in their base and those who are not.¹⁴¹ Warren Buffett, chairman of Berkshire Hathaway, is a prime example of a manager who explicitly embraces a Shareholder Cultivation ethos.¹⁴² In June 1996, Buffett issued a manifesto to Berkshire’s stockholders titled "An Owner's Manual" which laid out the company’s business principles and managerial approach as well as the expectations Berkshire had of its shareholders.¹⁴³ The first principle outlined addressed Berkshire’s view of the relationship it aspired to have and maintain with its shareholders.¹⁴⁴ Buffett wrote:

[We] think of our shareholders as owner-partners . . . . [We] hope that you [the shareholder] do not think of yourself as merely owning a piece of paper whose price wiggles around daily and that is a candidate for sale when some economic or political event makes you nervous. We hope you instead visualize yourself as part owner of a business . . . . For our part, we do not view Berkshire shareholders as faceless members of an ever-shifting crowd, but rather as co-venturers . . . . Obviously, [we] can't control Berkshire's price. But by our policies and communications, we can

¹⁴⁰ See infra Part IV.D.
¹⁴¹ See, e.g., BUFFETT, supra note 6, at 1 (1996), http://www.berkshirehathaway.com/ownman.pdf (explaining the expectations Buffett has for his shareholders).
¹⁴² See id.
¹⁴³ See id.
¹⁴⁴ See id.
encourage informed, rational behavior by owners that, in
turn, will tend to produce a stock price that is also rational.\footnote{BUFFETT, supra note 6, at 1, 4.}

Similarly, in his 1983 annual letter to shareholders, Buffett wrote, "Through our policies and communications . . . we try to attract investors who will understand our operations, attitudes and expectations. (And, fully as important, we try to dissuade those who won't)."\footnote{Letter from Warren E. Buffett to Berkshire Hathaway Inc., supra note 11.}

Buffett's expressed sentiment of striving to "attract investors who will understand [Berkshire's] operations, attitudes and expectations" and of seeking out "co-venturers" is precisely what Shareholder Cultivation is about.\footnote{\textit{Id.}; BUFFETT, supra note 6, at 1 ("[W]e view Berkshire shareholders as . . . co-venturers who have entrusted their funds to us for what may well turn out to be the remainder of their lives.").} What counts as a "co-venturer" will differ from firm to firm, but it captures the concept of a shareholder steward. There is not, and there cannot be, one homogenous set of specific characteristics. Two characteristics of a shareholder steward, however, that should be invariable and constant across firms include: (1) the shareholder's investment behavior meshes with the firm's vision and operational strategy; and (2) the shareholder understands and is supportive of the firm's mission and management's long-term strategy. As discussed below, there are various techniques and heuristics that firms use to identify potential co-venturers.\footnote{See infra Part IV.C.}

Conversely, for purposes of Shareholder Cultivation, it is equally important for a firm to determine and identify those shareholders whose investment behavior and belief system tend to indicate non-co-venturer characteristics. Indicators of non-co-venturer characteristics will also differ from firm to firm, but generally speaking, firms seem to have a preference for limiting shareholder arbitrageurs,\footnote{See iman Anabtawi, Some Skepticism About Increasing Shareholder Power, 53 UCLA L. REV. 561, 580 & n.88 (2006) (noting that arbitrageurs take short-term gains at the expense of long-term performance to attract and retain investors).} shareholders who engage in empty voting,\footnote{See Anabtawi & Stout, supra note 61, at 1280 ("[A] hedge fund can buy . . . stock and vote the shares while simultaneously entering a derivatives contract that hedges away its economic interest in stock. . . . and then seek to profit from using its power as a formal shareholder to push for business policies that drive the stock price down.").} and activist shareholders who seek to impose their personal business judgment on management.\footnote{See id. at 1270 (concluding a minority shareholder imposes its personal business}
of short-term trading is beneficial to the firm in terms of, *inter alia*, increased liquidity and visibility for the firm's stock, as discussed below, firms tend to prefer a lower turnover rate to a higher one.\(^{152}\)

**A. The Cultivation Spectrum**

Shareholder Cultivation tools can be conceptualized as falling along a spectrum—starting with pre-cultivation activities such as the art of effectively using narrative to engage a firm’s mission;\(^{153}\) through the identification and selection of potential shareholder stewards;\(^{154}\) employing strategies to recruit potential stewards and in many cases, re-enforce or activate stewardship norms among existing shareholders;\(^{155}\) and to de-cultivation efforts that attempt to shake or limit the attractiveness of the firm's shareholder base to gamblers and non-co-venturers.\(^{156}\) Thus, in general one could visualize a cultivation spectrum as follows:

**Cultivation Spectrum:**

![Cultivation Spectrum Diagram]

The assignment of tools to specific segments of the cultivation spectrum should be thought of as liminal rather than fixed. As discussed below, certain tools such as the adoption of a time-weighted dividend policy, for example, serve different purposes for different shareholders or would-be investors.\(^{157}\) Thus, they occupy multiple points along the spectrum at any given period in time, or vacillate across different points of the spectrum at different points in time.\(^{158}\)

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\(^{152}\) *See*, e.g., Fox & Lorsch, *supra* note 1, at 52 (finding the more influence short-term traders have on the market prices the more volatile those prices will be since short-term traders are less interested in the fundamental value of the corporation they are trading).

\(^{153}\) *See infra* Part IV.B.

\(^{154}\) *See infra* Part IV.C.

\(^{155}\) *See infra* Part IV.D.

\(^{156}\) *See infra* Part IV.E.

\(^{157}\) *See infra* Part IV.F.2.

\(^{158}\) *See infra* Part IV.F.2.
B. Pre-Cultivation Tools: Defining Narrative and Embodying Mission

The first step in the cultivation process is for the firm to define its mission and to systematically strive to ensure that its practices and policies embody and reflect that mission.159 The firm's mission or purpose is its "raison d'être."160 A corporate purpose or mission should serve as a blueprint for the firm's decisions and actions.161 State corporate laws give firms wide latitude in defining their purpose and mission.162 For example, the Delaware General Corporation Law ("DGCL") provides that ":[a] corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes . . . ."163 Similarly, the Pennsylvania Business Corporations Act provides that "every business corporation has as its corporate purpose the engaging in lawful business for which corporations may be incorporated under the BCL."164 Thus, state corporate laws leave a wide zone of play for firms to define their mission and purpose.165

The attendant benefits of defining a corporation's purpose and mission have been robustly dealt with in the managerial literature.166 Those benefits can be summarized as "provid[ing] direction to strategy . . . bring[ing] meaning to the work of others . . . infus[ing] the

159See PETER F. DRUCKER, MANAGEMENT: TASKS, RESPONSIBILITIES, PRACTICES 75 (1974) [hereinafter DRUCKER, MANAGEMENT] ("Only a clear definition of the mission and purpose of the business makes possible clear and realistic business objectives.").
161See, e.g., DRUCKER, MANAGEMENT, supra note 159, at 75.
162See infra notes 163-64 and accompanying text.
163DEL. CODE ANN. tit. 8, § 101(b) (2011).
16419 PA. CODE § 23.4(b) (2013).
165Although the terms "mission" and "purpose" are often used interchangeably, in practice a firm's "purpose" can be found in its articles of incorporation and is often more terse and concise than its "mission," which is often put forth in its mission statement and which tends to be more expansive than the "purpose" stated in the firm's articles of incorporation. See ELLSWORTH, supra note 160, at 97 ("Purpose defines the cause. The mission gives it depth and richness.").
166See generally CHESTER I. BARNARD, THE FUNCTIONS OF THE EXECUTIVE 42 (Harvard Univ. Press, 30th Anniversary ed. 1966) ("A formal system of cooperation requires an objective, a purpose, an aim."); PETER F. DRUCKER, CONCEPT OF THE CORPORATION 176 (Harper & Row, 2d rev. ed. 1983) ("If the corporation does not have a clear policy and a definite organ of policy decision, its actions and behavior become unpredictable."); DRUCKER, MANAGEMENT, supra note 159, at 74 ("A clear, simple, and penetrating theory of the business rather than intuition characterizes the truly successful . . . organization that can endure and grow . . . ."); ELLSWORTH, supra note 160, at 2 ("[L]eadership's failure to define a clear purpose . . . explains much of the tension, conflict, and ambivalence that inflict American companies today.").
organization with value, and consequently . . . stimulat[ing] commitment and action."167

One chief executive officer expressed the sentiment as such:

I believe a clear purpose is an essential building block in the foundation of a more responsible capitalism. You can't achieve your purpose in a quarter, or a year. It serves as a statement of why a company exists, and more fundamentally why a company merits having a corporate charter and receive the protections of society.168

For Shareholder Cultivation, "a clear purpose is an essential building block" for attracting and recruiting shareholder stewards — but for it to serve this role, the firm's purpose must actually become embodied in its practices and policies.169

A firm's mission should then inform the narrative that the firm develops to explain its value proposition and operational strategies to shareholders, other stakeholders, and society at large.170 For many corporations their narrative is often memorialized in their mission statements.171 However, to be an effective cultivation tool, it should also carry through to communications with shareholders and other stakeholders, the company's annual reports, sell-side-analyst calls, executive compensation practices, and any other points of interface that the company has with stakeholders and external constituents which provide an opportunity for the company to reiterate its story and its value proposition.172

PepsiCo, Inc.'s interwoven approach to mission and narrative provides a case in point. PepsiCo divides its narrative into three component parts: (1) "Our Mission"; (2) "Our Vision"; and (3)

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167ELLSWORTH, supra note 160, at x.
168David H. Langstaff, President and CEO of TASC, Inc., Address at the Kellogg School of Management/Aspen Institute Business and Society Conference: Rethinking Shareholder Value, the Purpose of the Corporation (March 7-8, 2013), http://www.aspeninstitute.org/sites/default/files/content/upload/Tomorrow%27s%20Corporation-March%202013.pdf?width=100.
169See id.
170Telephone Interview with Julie Tracy, Senior Vice President and Chief Commc'ns Officer, Wright Med. Grp. (Jan. 14, 2013).
171See infra notes 173-75 and accompanying text.
172See ELLSWORTH, supra note 160, at 327-28 (finding the leader is responsible for presenting the firm's characteristics, including its mission, to the marketplace, customers, employees, shareholders, and communities).
"Performance With Purpose." The details of its narrative are found in its mission statement, which, under the "Performance With Purpose" sub-heading, states that:

At PepsiCo, we're committed to achieving business and financial success while leaving a positive imprint on society - delivering what we call Performance with Purpose.

Our approach to superior financial performance is straightforward - drive shareholder value. By addressing social and environmental issues, we also deliver on our purpose agenda, which consists of human, environmental, and talent sustainability.

The company's mission is thus embedded in its narrative, and in turn, its narrative threads through to its annual report, which repeatedly uses terms such as "organic revenue," "growth," "sustainability," and "long-term," which all capture and convey the spirit of Pepsi's mission statement and signal to the market that Pepsi is about "shareholder value" and value to society. Similarly, Pepsi's narrative of financial success, along with societal benefit, is reflected in its approach to executive compensation where at least some portion of compensation is tied to non-financial metrics.

As pre-cultivation tools, mission-embodying and successfully weaving a narrative are important for attracting and retaining shareholder stewards in several ways and can be effective along different points of the cultivation spectrum. First, mission and narrative can serve as recruiting tools to explain the firm's value proposition and vision to potential shareholders. In this regard, they serve both a framing and benchmarking function in that they provide target shareholders with a reference point and framework for thinking about and assessing the

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174 Id.
175 See PepsiCo, Annual Report (Form 10-K), at 2, 7 (Feb. 21, 2013).
177 See Langstaff, supra note 168, at 9.
178 See DRUCKER, MANAGEMENT, supra note 159, at 75 (emphasizing only a clear definition of the mission will make possible realistic business objectives).
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firm's financial and non-financial value. Similarly, for the firm's agents (for example, managers, directors, or its investor-relations department), a tightly written mission and narrative provide a rhetorical frame that can be used to shape discussion with both current shareholders and potential investors, and advance the firm's goals and value proposition in a consistent and effective way. As is well-documented in the behavioral literature, the way we frame and name things affect how they are perceived by others. A classic example is that when an identical scenario is framed as a loss rather than as a gain, people are more incentivized to avoid the scenario because the fear of loss has a more powerful grip over a person's psyche than the possibility of gain.

Secondly, mission and narrative can also serve as identification tools because when successfully executed, they can incentivize self-identification and self-selection by potential shareholder stewards with whom the firm's mission and narrative resonate. Moreover, because self-identifying by shareholders involves significantly less cost outlay on the part of the company compared to the cost of the company engaging in separate identification strategies (as discussed below), mission and narrative that result in shareholder self-identification have the benefit of lowering transaction costs to the firm.

Finally, in terms of the immutable and default rule construct developed in Part I, pre-cultivation tools of mission and narrative operate within a wide zone of latitude with the outward bounds being defined by immutable rules such as the requirement that the firm be operated for a "lawful" purpose.

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179 See GEORGE LAKOFF, DON'T THINK OF AN ELEPHANT!: KNOW YOUR VALUES AND FRAME THE DEBATE 3-4 (2004); Amos Tversky & Daniel Kahneman, The Framing of Decisions and the Psychology of Choice, 211 SCI. 453, 453 (1981); see also George Lakoff, Simple Framing: An Introduction to Framing and Its Uses in Politics, ROCKRIDGE INST., (Apr. 3, 2007) http://archives.evergreen.edu/webpages/curricular/2006-2007/languageofpolitics/files/languageofpolitics/Simple%20Framing%20Rockridge%20Institute.pdf ("Communication itself comes with a frame. The elements of the Communication frame include: A message, an audience, a messenger, a medium, images, a context, and especially, higher-level moral and conceptual frames. The choice of language is, of course, vital, but it is vital because language evokes frames—moral and conceptual frames.").

180 See Lakoff, supra note 179.

181 Id. For an example of framing techniques in corporate law, see Tamara C. Belinfanti, Beyond Economics in Pay for Performance, 41 HOFSTRA L. REV. 91, 149-50 (2012), which explores the potential use of framing to encourage certain outcomes in executive compensation policies.

182 See Belinfanti, supra note 181, at 150.

183 See infra Part VI.B.1.

184 DEL. CODE ANN. tit. 8, § 101(b) (2011).
Once a corporation has defined its mission and narrative (as discussed above), it is in a position to narrow the universe of investors that it seeks to target and cultivate. Thus, the logical next step in the Shareholder Cultivation process is sorting the investor base and identifying a target group of potential shareholder stewards to cultivate. To borrow Buffett’s terminology, a firm should be looking for shareholders who exhibit "co-venturer" characteristics that mesh with the firm's vision, mission, and strategy.

Traditional identification techniques run the gamut, from combing through stock ledger lists to identifying retail versus institutional investors, to segregating investors by fund type (e.g., growth fund, value fund, index fund), to the application of more complex analytical tools that seek to gauge and predict shareholders' investment behavior and average length of ownership in the firm's stock. Firm size, firm industry, and the firm's view of its value proposition are three of the key factors that will determine how a firm defines its co-venturers and the tools that the firm can employ to attract and recruit these co-venturers.

According to Julie Tracy, Senior Vice President and Chief Communications Officer at Wright Medical Group, the size of the firm (whether large cap, mid cap, small cap, or microcap), will "determine the levers you can pull... and the levers that one can pull to try and attract [the right shareholders] are not equally available to everyone."

Similarly, in terms of firm industry, different industries are thought to attract different types of investors. For example, slow-growth industries like utilities and manufacturing are generally thought to attract so-called "income" investors who focus primarily on the stream of dividends a given stock is likely to generate. In contrast,
high-growth industries, such as emerging technologies or green-building construction, tend to attract "growth" investors, who focus primarily on the underlying quality of the business and the rate of expected growth, as opposed to immediate value and so-called "GARP" ("growth at a reasonable price") investors, who combine the approaches of value investors and growth investors to identify companies with "solid growth prospects and current share prices that do not reflect the intrinsic value of the business. . . ."192 Finally, in terms of the firm's value proposition, the story a firm tells about its business and its future will determine the types of investors the firm attracts. A story of future growth and no immediate payoff, for example, would detract income investors but attract growth and some GARP investors.

Another identification technique that corporations employ to identify potential co-venturers is to compare their shareholder base with that of peer firms with the hope of (1) identifying potential shareholders to target; and (2) being able to compare the company's shareholder base turnover profile to that of its competitors.193 For example, after going through a series of financial restatements, in 2007 Canadian-based Nortel Networks embarked on a peer review and benchmarking process, which compared Nortel's shareholder base and level of shareholder engagement with that of other S&P 500 and S&P/TSX 60 companies.194 Nortel compared its shareholder base and its processes for communicating with shareholders to those of peer firms, with a particular focus on "benchmarking Nortel's schedule of one-on-ones, investor conferences and analyst days" against those of its peers.195 Similarly, consider the case of Advanced Micro Devices ("AMD"), an innovative technology company who wanted to attract more long-term investors and decided to "monitor[ ] and measur[e] the 'quality' of AMD's institutional investor base."196 According to AMD, the company "had a crummy shareholder base. . . . [t]here were a lot of fast-money hedge funds and momentum investors actively trading the stock and [they] were not attracting long-term investors."197 AMD came to this conclusion after "monitoring and

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192 Id.
193 Telephone Interview with Julie Tracy, Senior Vice President and Chief Commc'ns Officer, Wright Med. Grp. (Jan. 14, 2013).
195 Id.
196 Id.
197 Id.
measuring the quality of [its] institutional investor base," which included calculating "[t]he weighted average turnover of AMD's top 50 mutual fund holders[,]" which turned out to be 107 percent.198 This translated to a holding period of approximately eleven months.199 When AMD compared this number to peer firms, it realized that peer companies had a more patient shareholder base with an average holding period of "between 15 and 30 months."200 AMD then targeted shareholders whose turnover profile matched its story of long-term growth and value and was able to increase its weighted average holding period from eleven months to twenty-seven months in the space of five years—a feat that AMD viewed as a success.201

More contemporary identification tools attempt to drill down further beyond the conventional shareholder categorizations of retail versus institutional, and long-term versus short-term, and catalog shareholders using different dimensions such as "intrinsic" or "dedicated" shareholders versus "transient" shareholders.202 A recent study by Professor Brian Bushee on institutional investor behavior and the relationship between observed behaviors and the types of companies in which certain investors choose to commit capital, is illustrative of the kinds of insight that can emerge from moving beyond traditional shareholder categorizations.203 In his work, Professor Bushee identifies three categories of institutional investors: (1) "transient" institutional investors, who exhibit a high rate of portfolio turnover and hold a small stake in portfolio companies; (2) "dedicated" investors, who take large...

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198Stewart, supra note 194 (internal quotations omitted).
199 id.
200 id.
201 id.
203 See generally Bushee, supra note 202, at 35 ("[C]hanges in disclosure practices have the potential to shift the composition of a firm's investor base away from transient investors and toward more patient capital.").
stakes in portfolio companies and exhibit more stable ownership patterns; and (3) "quasi-indexers," which are institutions that also own small stakes but exhibit infrequent trading behavior. According to Professor Bushee, as might be expected, "[t]he disproportionate presence of transient institutions in a company's investor base appears to intensify pressure for short-term performance while also resulting in excess volatility in the stock price.

Similarly, the consulting firm McKinsey & Company classifies shareholders in three categories—intrinsic investors, mechanical investors, and traders. For each of these classifications, McKinsey then analyzes the trading behavior of shareholders along six axes—(1) trading characteristics; (2) percentage of total (publicly listed) U.S. equity; (3) percentage of total trading volume in U.S. equity markets; (4) portfolio concentration; (5) average holding period; and (6) average number of portfolio positions monitored by analyst. The ultimate takeaway for McKinsey is that management should "dedicate" its "engagement efforts" to "intrinsic investors," which McKinsey defines as those shareholders that "[s]upport the . . . management and strategy through short-term volatility.

To summarize, identification techniques run the gamut from the traditional to more contemporary and nuanced modes of analysis. At base, such techniques seek to dissect and mine a company's shareholder base to provide management with insight on shareholder behavior patterns. This insight can reveal points of departure in shareholder characteristics and behavior, which in turn allows for a more informed approach to cultivation. From a cultivation standpoint, more nuanced breakdowns of shareholder behavior like that of McKinsey's is helpful because such analysis when mapped onto a company's shareholder base reveals more sophisticated pathways for exploiting shareholder heterogeneity to cultivate shareholder stewards.

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204 Id. at 29.
205 Id.
206 See Palter et al., supra note 202, at 58-59.
207 Id. at 58-60.
208 Id. at 59, 61.
209 Several third-party market-intelligence firms exist that provide various analytical models and tools to perform this sorting and identification function, and these firms often interface with the corporation's investor relations department. See, e.g., Deal Making Intelligence, THOMSON REUTERS, http://dni.thomsonreuters.com (last visited Jan. 11, 2014); Press Release, Computershare, Computershare Analytics To Provide StreetSight.net Buy-side Intelligence to Track Data's NewsWatch Users (Jun. 18, 2003), https://www-us.computershare.com/Content/download.asp?docId=%7B6E1F40F7-AD89-4D52-9A3C-
While identification and sorting primarily involve the firm's investor-relations department, and in many cases one or more third-party shareholder-relation firms, the enlisting and re-enforcing point on the cultivation spectrum is where investor-relation functions, internal corporate governance practices, the realities of today's capital markets, and external law interact; hence, it is where the proverbial rubber hits the road. The cultivation tools that a firm has in its artillery and is able to deploy will depend on firm characteristics and the heterogeneous characteristics of its shareholder base detected in the identification and sorting prong, and such cultivation tools must be designed within governing legal frameworks and against the practical backdrop of modern share ownership.

Enlisting and re-enforcing tools can be loosely classified into three sub-categories, although among the three, there is some slippage and overlap. The first sub-category includes organizational tools, which engage organic documents such as bylaws and articles of incorporation, and organizational frameworks, such as the laws of the state of incorporation or stock exchange listing rules as cultivation tools. The second sub-category consists of capital market tools, which leverage financial securities products and processes to sort, recruit, and cultivate shareholder stewards. Finally, the third sub-category can be loosely defined as rhetorical tools, such as analyst calls and disclosure reports, which utilize communication channels and points of interface not only to speak to the entire shareholder base, but also to recognize the inherent


210 See infra Parts IV.D.1-3.
211 See infra Parts IV.D.1-3.
212 See infra Parts IV.D.1-3 (explaining three sub-categories of enlisting and re-enforcing tools).
213 See infra Part IV.D.1 (explaining organization tools available to corporations).
214 See infra Part IV.D.2 (examining capital market tools).
heterogeneity in the base, to speak to current and potential shareholder stewards.\textsuperscript{215}

1. The Role of State of Incorporation, Stock Exchange Listings, and Organic Documents in Defining Cultivation Zone

The choice of where to incorporate, whether to list on a particular exchange, and the information included in a corporation's bylaws or articles of incorporation, affect the default rules and immutable rules that a company has at its disposal to cultivate shareholders.\textsuperscript{216} In turn, the default rules and immutable rules to which a company is subject define the outward bounds of cultivation opportunities and regulate acceptable behavior within the zone of play.\textsuperscript{217}

a. \textit{State of Incorporation}

A company's choice of state of incorporation affects the topography of its cultivation zone.\textsuperscript{218} Different states provide different legal frameworks, default rules, and a body of jurisprudence that affect the relationship between the corporation and its shareholders.\textsuperscript{219} The state of Delaware, for example, adopts an enabling framework that leaves significant discretion to the board to \textit{inter alia}, define the corporation's mission and purpose, provide additional rights to the corporation's shareholders (such as improved proxy access procedures), and determine the rights of shareholders to call special shareholder meetings.\textsuperscript{220} In contrast, consider California's corporate law framework, which is generally deemed more shareholder-friendly than Delaware's, and which among other things, has as a default rule that shareholders who are "entitled to cast not less than 10 percent of the votes at the meeting" are entitled to call a special shareholder meeting.\textsuperscript{221} Thus, a company's election to incorporate in Delaware or California, or more broadly

\textsuperscript{215}See infra Part IV.D.3 (examining rhetorical tools).
\textsuperscript{216}See infra Part IV.D.1.a-c (discussing how location of incorporation, listing on a particular exchange, and the corporations bylaws and articles of incorporation affect the default rules and immutable rules that a company has at its disposal).
\textsuperscript{217}See supra Part III.C (examining how default rules and immutable rules define the outward bounds of cultivation opportunities and regulate acceptable behavior within the zone of play).
\textsuperscript{218}See infra text accompanying notes 220-21.
\textsuperscript{219}See infra text accompanying notes 220-21.
\textsuperscript{220}See DEL. CODE ANN. tit. 8, § 141 (2011).
\textsuperscript{221}See CAL. CORP. CODE § 600(d) (West 2007).
speaking, in one state over another, has practical implications for the way in which power and rights are distributed between shareholders and the board of directors, the limits on board action vis-à-vis shareholders, which in turn impact the types of cultivation techniques that the firm can employ.\textsuperscript{222}

Moreover, under the doctrine of internal affairs, which holds that the law of the state of incorporation will govern internal disputes among the directors, officers, and shareholders of the corporation, the choice of state of incorporation has significant doctrinal implications.\textsuperscript{223} Thus, the state of incorporation affects the range of Shareholder Cultivation tools that a company has at its disposal,\textsuperscript{224} and relatedly it could affect how potential investors view the company and whether they decide to invest in the company's stock.\textsuperscript{225} A new wrinkle is that with the advent of new options for corporations to elect to become "social purpose" corporations or "benefit corporations," the choice of state of incorporation is not all that matters.\textsuperscript{226} For corporations that opt to incorporate or that are already incorporated in a state that now offers this social-purpose opt-in, the decision on whether to opt into the social purpose/public benefit statutory scheme will further serve a signaling function to potential investors and may also hurt or enhance the corporation's ability to cultivate shareholders.\textsuperscript{227}

b. Choice of Stock Exchange

Similarly, a corporation's choice of stock exchange listing has implications for the immutable-default rule construct and the types of cultivation tools that it has at its disposal.\textsuperscript{228} For example, consider the

\textsuperscript{222}See supra text accompanying notes 217-19.
\textsuperscript{223}See, e.g., Vantagepoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1117-18 (Del. 2005) (explaining that under the internal affairs doctrine a company's state of incorporation governs the choice of law to be applied in certain disputes).
\textsuperscript{224}See supra text accompanying notes 217-19.
\textsuperscript{225}This is particularly true if vigorous competition develops among states for incorporation. See, e.g., Elizabeth Lopatta, 'Virgin' North Dakota Draws Billionaire Icahn in Raider Quest, BLOOMBERG (Feb. 20, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXgfseyKwJml ("The state has adopted a law . . . that lets shareholders more easily gain control of any company incorporated there.").
\textsuperscript{226}See, e.g., DEL. CODE ANN. tit. 8, §§ 361-368 (2013); N.Y. BUS. CORP. LAW § 1704(b) (McKinney 2003); WASH. REV. CODE ANN. § 23B.25 (West 2012).
\textsuperscript{227}See supra text accompanying notes 223-26.
\textsuperscript{228}See infra text accompanying notes 229-31 (showing how the choice of stock exchange listing affects the immutable-default rule construction and types of cultivation tools
case of two companies in the same industry—Hennes & Mauritz AB (also known as "H&M") and Gap, Inc. ("Gap"). H&M is a Swedish company (with several hundred stores throughout the U.S.) whose stock is listed on the Swedish stock exchange, but actively trades in the U.S. on the OTC pink sheets. In contrast, Gap is a U.S. company whose stock is listed on the New York Stock Exchange ("NYSE"). Even though both are public companies with a presence in the U.S. equity markets, because of differences in stock exchange listing requirements, H&M's shareholders are given a binding vote on executive compensation matters under the newly enacted Swedish stock exchange listing rules, but Gap's shareholders do not have a binding vote on executive compensation matters because neither NYSE listing rules nor U.S. law requires it.

The difference in the treatment of shareholder rights vis-à-vis executive compensation could cut both ways. First, for a company that is open to having a mandatory vote on executive compensation, a listing on the NYSE versus the Swedish stock exchange allows them a chance to distinguish themselves from competitors who are not so inclined and perhaps signal to potential shareholders the importance of their voice and vote on compensation matters. On the other hand, shareholders may self-select and self-identify based on these differences, all things being equal. In a similar vein, one could contrast differences in cultivation that a company has at its disposal).

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233See Articles of Association, H&M (April 28, 2011), http://about.hm.com/AboutSection/en/About/Corporate-Governance/Other/Articles-of-Association.html#cm-menu (indicating that at the Annual General Meeting shareholders determine the fees payable to the board of directors and the auditors).

234See The Gap, Inc., Amended and Restated Bylaws of The Gap, Inc. (Form 8-K, Ex. 3(ii)) ("The salary, bonus, and long-term incentive compensation of all executive officers of the Corporation . . . shall be fixed by the Board of Directors or a committee thereof from time to time.").

235See supra notes 233-34 and accompanying text (noting how the Swedish stock exchange requires a vote on executive compensation whereas the NYSE allows companies to choose and therefore distinguish themselves from other NYSE companies).

236See supra notes 233-34 and accompanying text.
strategy that arise between corporations listed on the NYSE or Nasdaq and those listed on the London Stock Exchange. As discussed below, those in the former categories would be allowed under the exchange listing requirements to issue up to twenty percent of stock in a private transaction without the need for shareholder approval, while those in the latter category would be allowed to issue no more than ten percent of securities of an existing class. Thus, stock exchange listing requirements potentially change the boundaries and the content of the immutable-default rule construct, which in turn impacts the types of cultivation tools that a firm can employ to attract and curate shareholder stewards.

c. Organic Documents

Finally, in terms of organizational tools, a firm's articles of incorporation and its bylaws serve key cultivation functions. Most state corporate statutes provide a limited number of mandated requirements of items that must be included in the corporation's charter or in its bylaws, with wide latitude left to the corporation to tailor its organic documents to its particular purpose and needs. For example, Delaware requires that the certificate of incorporation include the name of the corporation; the address of the registered office and name of the registered agent; the nature and purpose of the business of the corporation; the number of authorized shares; and the names and mailing addresses of the incorporators. Beyond these four requirements, Delaware does not dictate how the corporation may use its certificate of incorporation and instead provides significant discretion to the board in the substance of the provisions that it chooses to include. Similarly, Delaware's corporate code does not specify the substance of what should be included in the bylaws. Instead, the applicable provision of the statute simply states that "[t]he by-laws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the

\[\text{See infra Part IV.D.2.b (discussing listing limitations on the amount of shares that can be sold in one private transaction without shareholder approval).}\]
\[\text{See infra Part IV.D.2.b.}\]
\[\text{See, e.g., DEL. CODE ANN. tit. 8, § 102 (2011) (providing the minimum requirements for the certificate of incorporation).}\]
\[\text{See id. §102(a)(1)-(5).}\]
\[\text{See id.}\]
\[\text{See id. § 109(b).}\]
rights or powers of its stockholders, directors, officers or employees."\textsuperscript{243} Thus, as cultivation tools, the organic documents provide for corporations to among other things, define and in some cases, refine their purpose; memorialize the corporation's governance processes and aspirations; and specify the procedures for shareholder engagement.\textsuperscript{244} For existing corporations, this is particularly true with respect to the bylaws, which in general can be amended by the board without the consent of the shareholders,\textsuperscript{245} as compared to the articles of incorporation, which would require a shareholder vote for amendment.\textsuperscript{246}

2. Capital Market Cultivation Tools

For Shareholder Cultivation, capital markets provide a forum for a firm to connect to potential shareholder stewards through the use of targeted financial tools and processes.\textsuperscript{247}

a. IPOs

From the firm's perspective, going public represents a transition from being surrounded by a core base of founders, initial investors, venture capitalists, and employees who are hopefully supportive of the firm's mission and value proposition, to being surrounded by a new group of shareholders who may or may not support the firm's value proposition.\textsuperscript{248} One way to smooth this transition and ensure some cohort

\textsuperscript{243} \textit{Del. Code Ann. tit. 8, §109(b) (2011).} Case law does add some color by specifying that the bylaws should serve a "process creating function" and should not be used for substantive purposes. \textit{See Auer v. Dressel, 118 N.E.2d 590, 598 (N.Y. 1954).}

\textsuperscript{244} To avoid implicating the ultra vires doctrine, most corporations declare their mission and purpose in a mission statement rather than in the certificate of incorporation. \textit{See David A. Drexler, et al., Delaware Corporation Law and Practice § 11.05 (2011) ("Where the general language authorized by Section 102(a)(3) is utilized, the ultra vires doctrine should be totally dead, even with respect to Section 124's three limited exceptions.").}

\textsuperscript{245} \textit{See, e.g., Del. Code Ann. tit. 8, § 109 (2011) (granting the board the power to amend the corporation's bylaws without the consent of the shareholders).}

\textsuperscript{246} \textit{See, e.g., id. § 242 (providing that a vote of the shareholders is needed to amend a corporations articles of incorporation).}

\textsuperscript{247} \textit{See infra Parts III.D.2.a-f.}

\textsuperscript{248} \textit{See Bernard S. Black & Ronald J. Gilson, Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets, 47 J. Fin. Econ. 243, 252-53 (1998) (discussing the benefits provided by venture capital providers that would be lost or diminished after the firm goes public); Scott J. Davis, Would Changes in the Rules for Director Selection and Liability Help Public Companies Gain Some of Private Equity's Advantages?, 76 U. Chi. L. Rev. 83, 87 (2009) ("[O]nce [a] startup becomes a public company . . . [i]t begins to be assumed that the public investors have different goals than the original backers.").}
of shareholders that will invest for the long run is to target shareholders who do just that.249

The literature on initial public offerings ("IPO") suggests that in an IPO, underwriters do sell some portion of the allotted shares by allocation rather than by open auction.250 The idea behind selling shares by allocation is to attract enough shareholders who will hold long-term instead of quickly selling the stock and driving the stock price down.251 A stylized example of this occurred when Goldman Sachs went public in 1999.252 According to the *Wall Street Journal*, Goldman placed its shares "with a group of institutional investors and rich individuals who Goldman believed would remain loyal, long-term holders and not 'flip' the stock after its opening."253

Goldman's IPO story also highlights that a company's choice to utilize the "traditional" Wall Street allocation route during the IPO process, as opposed to other legally sanctioned methods such as a modified Dutch auction, may affect the company's ability to tailor its shareholder base at the outset.254 In the case of Goldman, the company was careful to allocate shares in a way that minimized the chances of short-term "flippers" buying its stock.255 In contrast, when Google Inc. went public in 2004, Google opted to sell its shares through a modified Dutch auction where underwriters gathered bids from investors irrespective of the investor's connection to the underwriters or the size of

249 See Bharat A. Jain & Omesh Kini, *Venture Capitalist Participation and the Post-Issue Operating Performance of IPO Firms*, 16 MANAGERIAL & DECISION ECON. 593, 593, 600 (1995) ("[V]enture capitalists are typically active investors who try to add value to their portfolio companies through ongoing longer-term involvement with continuing business development[.]") (citation omitted).


251 See Jenkinson & Jones, supra note 250, at 1480 (stating that in determining allocation, long-term shareholder status is considered a very important feature of investors).

252 See infra note 253 and accompanying text.


254 See Anand, supra note 250, at 245 (stating that a firm may choose the traditional bookbuilt process rather than a Dutch auction in order to gain certain long-term benefits not offered by the Dutch auction).

255 Gasparino, supra note 253.
their holding. While a modified Dutch auction approach is viewed as "more fair" than the traditional allocation approach, in terms of a cultivation tool, the allocation approach allows a company to maintain more control over the initial construction of its shareholder base.

b. The Twenty Percent Rule and Select Private Placements

The private placement of shares by already-public companies is yet another cultivation tool that corporations can employ to attract and recruit identified co-venturers. Both NYSE and Nasdaq rules allow listed companies to sell up to twenty percent of a given class of securities without shareholder approval and, in terms of SEC regulations, these sales would typically fall under private placement exemptions and would not require registration.

The ability to sell up to twenty percent of a firm's equity without triggering shareholder approval and without SEC registration (assuming such issuance complies with applicable SEC rules and regulations) essentially gives public corporations listed on the NYSE or Nasdaq the leeway to cultivate at least twenty percent of their shareholder base to secure a critical mass of shareholder stewards. When combined with the identification and sorting techniques discussed above, corporations effectively have twenty percent of their equity that they can control and allot to shareholders who they have identified as co-venturers. This twenty percent could be sold to one investor or to multiple investors who exhibit investment behavior and characteristics attractive to the corporation. Stated differently, this twenty percent could serve as a stabilizing shareholder core committed to holding the corporation's shares for some length of time. Such a stabilizing core also signals to the

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256 See Anand, supra note 250, at 240.
257 See id. at 247-48.
258 NYSE Market Rules: Listed Company Manual, N.Y. Stock Exch. § 3, http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp%5F1%5F4%5F10&manual=%2Fcm%2Fsections%2Fcm%2Dsections%2F (last visited Nov. 8, 2013) [hereinafter NYSE Manual] (requiring stockholder approval before a listed company can issue twenty percent or more of its outstanding common stock or voting power); see also Section 5600 Corporate Governance Requirements, NASDAQ Stock Mkt., http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F4%5F3&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2Dequityrules%2F (last visited Nov. 8, 2013) (requiring that under certain circumstances, stockholder approval of transactions that may result in the issuance or sale of twenty percent or more of a listed company's outstanding common stock or voting power).
259 See infra Part VI.A.1 for a discussion on critical mass.
market and to other potential shareholders that the corporation has a significant shareholder-supporter base on board who, colloquially speaking, "has its back."

To use the previous, but admittedly somewhat extreme example of Goldman Sachs and Warren Buffett, in 2008, Goldman needed a fresh injection of capital and to steady the ship, so it sought out Buffett (who has a reputation for being a steward). Buffett agreed to invest up to $5 billion, in exchange for perpetual preferred stock. The arrangement was beneficial to both parties because Goldman was able to secure Buffett's support for management's strategy and ward off further attacks, and for Buffett's part, Buffett was able to earn a handsome return on his investments.

Similarly, on a less grandiose level than the Goldman-Buffett alliance, private equity funds are often brought in to invest in public companies for similar reasons (referred to as "PIPE" investments or private investment in public equity). Although private equity investors are sometimes criticized for being "asset strippers," private equity can play a tremendous role in the cultivation space. While private equity firms have different investment strategies and focus, they all share the common goal of investing with an eye to enhancing the value of the company in which they have invested. In exchange for injecting capital into a company, the private equity firm receives a stake in ownership, along with one or more seats on the company's board, and

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261 Id.
262 See generally id.
265 See Brian Cheffins & John Armour, The Eclipse of Private Equity, 33 DEL. J. CORP. L. 1, 9 (2008) (internal citation omitted) ("[O]ver the past few years [private equity] has become popularly associated with the buying out and taking private of public companies, with the objective being to deliver superior risk-adjusted returns by improving the financial performance and growth profile of the acquired companies."); Davis, supra note 248, at 87 (expressing that the primary goal common to venture capitalists is the continuing creation of shareholder value); Trevor M. Gomberg, After the Storm: Unmasking Publicly-Traded Private Equity Firms to Create Value Through Shareholder Democracy, 73 ALB. L. REV. 575, 577 (2010) ("The goal of private equity is to create value through investments in unproven or mismanaged companies which likely need help in order to become profitable.").
any rights or benefits included in the relevant acquisition agreement. In addition, the private equity firm has a vested interest in helping company management successfully execute its strategic plan. Thus for cultivation purposes, a private equity investor offers more rooted interest than transient ownership.

c. Dual-Class Share Structures

Yet another capital market cultivation tool is the use of dual-class share structures, where targeted shareholders may be given superior voting and dividend rights. The most prevalent form of dual-class share structure is the use of preferred stock. Dual-class shares structures have a long history in corporate law and are explicitly recognized in state corporate codes. To illustrate, the DGCL explicitly sanctions the use of dual-class share structures and provides that a company may specify such a structure in its certificate of incorporation. Corporations maintain dual-class share structures for a variety of reasons, but these types of arrangements can also be used as cultivation tools. For example, when Facebook Inc. went public, it did so with a dual-class share structure of Class A and Class B shares. Only the Class A shares were offered in the IPO. The Class B Shares were sold separately to a targeted group of shareholders, which consisted in part of the founder, initial investors, and initial supporters. Facebook's Class A Shares and Class B Shares are identical in all respects, except for voting rights and conversion rights. According to Facebook's prospectus,

The rights of the holders of Class A common stock and Class B common stock are identical, except with respect to

265Cheffins & Armour, supra note 265, at 9.
266See id.
267Douglas C. Ashton, Revisiting Dual-Class Stock, 68 ST. JOHN'S L. REV. 863, 865 (1994) ("In most cases, the firm selects a capital structure that is characterized by a combination of debt and equity, the equity portion typically consisting of one class of common stock and one or more classes of preferred stock.").
268See generally id. at 904-05.
269DELCODE ANN. tit. 8, § 151(a) (2011).
270See Ashton, supra note 268, at 866.
271See Facebook, Inc., Registration Statement (Form S-1) (Feb. 1, 2012).
272See Id.
274See Facebook, Inc., Registration Statement (Form S-1) (Feb. 1, 2012).
voting and conversion. Each share of Class A common stock is entitled to one vote per share. Each share of Class B common stock is entitled to ten votes per share and is convertible at any time into one share of Class A common stock.\(^{276}\)

The dual-class share structure is beneficial to Facebook's initial investors because it helps them maintain control over the company's vision and future trajectory after the IPO.\(^{277}\) Of course, this strategy by Facebook was not without critique, but it is perfectly legal in terms of a cultivation technique, and it does allow the firm to (a) maintain some control over its decisions and strategic choices and (b) signal to the market that the firm has a core group of shareholder stewards.\(^{278}\) Even for companies who have been public for a long time, the dual-class share structure serves as an enlistment tool to entice and reward targeted shareholders to become owners in the firm.\(^{279}\)

d. **Time-Weighted Voting**

Another cultivation technique that firms have at their disposal is the use of time-weighted voting, also known as tenured voting or time-phased voting, whereby a shareholder's voting power increases based on the length of time he or she has been a shareholder.\(^{280}\) Under state law, tenured voting is generally permissible.\(^{281}\) For example, in *Williams v. Geier*, the Delaware Supreme Court held that the board's decision to

\(^{276}\) *Id.*

\(^{277}\) See Davidoff, *supra* note 274 (exploring how Facebook's dual-class share structure and voting agreements with other Class B shareholders enables Zuckerberg to retain control over the company).

\(^{278}\) See, e.g., Michael J. De La Merced, *I.S.S. Adds to Criticism of Facebook's Governance*, N.Y. TIMES, Feb. 13, 2012, http://dealbook.nytimes.com/2012/02/13/i-s-s-adds-to-criticism-of-facebooks-governance/. Facebook's proposed governance plan signals to Class A that its role is primarily financial capital contribution, and the locus of decision-making will rest firmly with the board, the founder, and initial investors. *See id.*

\(^{279}\) *See White, supra* note 260.

\(^{280}\) *See infra* notes 281-82 and accompanying text.

\(^{281}\) *See, e.g., Hu & Black, supra* note 60, at 1059 (explaining that under Delaware law, corporations are not explicitly constrained in how they depart from the default one-vote-per-share rule); *see also* DEL. CODE ANN. tit. 8, § 212(a) (2011) ("[U]nless otherwise provided in the certificate of incorporation, each stockholder shall be entitled to 1 vote for each share of capital stock.") (emphasis added). *But see* Mercier v. Inter-Tel, Inc., 929 A.2d 786, 815 n.82 (Del. Ch. 2007) ("The concept of time-weighted voting has been around for many years. The DGCL does not embrace it.").
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

\(^{282}\) See Williams v. Geier, 671 A.2d 1368, 1376, 1382 (Del. 1996).

\(^{283}\) See NYSE Manual, supra note 258, § 313.00(A).

\(^{284}\) Id.

\(^{285}\) See id.


\(^{287}\) See 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.").

\(^{288}\) See 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.\textsuperscript{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.\textsuperscript{290} Moreover, with more attention being focused on the negative impacts caused by shareholder short-termism and some shareholder activists,\textsuperscript{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."\textsuperscript{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."\textsuperscript{293}

\footnotesize{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. \textit{Id. at 76.}}

\textsuperscript{289} \textit{See} 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.").

\textsuperscript{290} \textit{See supra} notes 149-51, 185-86, 255 and accompanying text.


\textsuperscript{292} \textit{NYSE Manual, supra} note 258, § 313.00(A).

\textsuperscript{293} \textit{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." 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. 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 . . . ." As a cultivation strategy, the "sit down" 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.


See id.

Id.

Id.

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.\(^{307}\)

\(^{299}\)For 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).


\(^{303}\)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.\textsuperscript{308} In response to the announcement, Whole Foods stock price increased by approximately eight percent the day after the announcement.\textsuperscript{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.\textsuperscript{310} According to the \textit{Wall Street Journal}, the split was "a way for [the] company to signal [that] it thinks its future is bright."\textsuperscript{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.\textsuperscript{312}

\begin{itemize}
  \item \textsuperscript{309}Christopher Freeburn, \textit{Whole Foods Announces a 2-for-1 Stock Split}, \textit{InvestorPlace}, May 8, 2013, http://investorplace.com/2013/05/whole-foods-announces-a-2-for-1-stock-split/.
  \item \textsuperscript{310}See Lahart, supra note 308.
  \item \textsuperscript{311}id.
  \item \textsuperscript{312}\textit{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." \textit{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." \textit{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. \textit{Understanding Stock Splits—Factoring in Commissions}, \textit{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).}
\end{itemize}
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. 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.

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. 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. 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. Similarly, Rule 10b-5 makes it unlawful for any person "[t]o make any untrue statement of a material fact or to omit to

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317 17 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 communication\(^{319}\) 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-

\(^{318}\) 17 C.F.R. § 240.10b-5 (2013).

\(^{319}\) See 17 C.F.R. § 243.100.

\(^{320}\) See 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].

\(^{321}\) Excluding 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.


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

\(^{324}\) Brochet et al., supra note 322.
term approach are a largely self-selecting group who like what they hear.\textsuperscript{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.\textsuperscript{326}

In addition to language choice on earning calls, the choice of \textit{when} and \textit{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 \textit{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.\textsuperscript{327} However, the purported benefits of earnings calls such as enhanced shareholder returns are dubious.\textsuperscript{328} In a 2006 report published by McKinsey\&Company, the authors make the case that quarterly earnings guidance may be a "misguided practice."\textsuperscript{329} In the report, the authors note that:

\begin{quote}
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 . . . .\textsuperscript{330}
\end{quote}

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

\textsuperscript{325}Id.

\textsuperscript{326}See generally LAKOFF, supra note 179; Tversky \& Kahneman, supra note 179, at 453.


\textsuperscript{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).

\textsuperscript{329}Id. at 1.

\textsuperscript{330}Id.
concluded that companies should "shift their focus away from short-term performance and toward the drivers of long-term company health . . .\" Indeed several large corporations, such as Coca-Cola, Inc., Motorola, Inc., and Intel Inc., 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. 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. 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.

\[331^\text{Hsieh et al., supra note 327.}\]
\[332^\text{See Earnings Guidance, ASPEN INST. 2 (Nov. 2007), http://www.aspeninstitute.org/sites/default/files/content/docs/bsp/EGInFocus.pdf.}\]
\[333^\text{See Hsieh et al., supra note 327.}\]
\[334^\text{Id.}\]
\[335^\text{See Marc Goedhart & Tim Koller, How to Attract Long-Term Investors: An Interview with M&G's Aled Smith, MCKINSEY&CO. (June 2013), http://www.mckinsey.com/insights/corporate_finance/how_to_attract_long-term_investors_an_interview_with_m_and_gs_aled_smith (discussing the challenge of attracting quality, long-term investors).}\]
\[336^\text{Telephone Interview with Julie Tracy, Senior Vice President and Chief Commc'ns Officer, Wright Med. Grp. (Jan. 14, 2013).}\]
\[337^\text{Id.}\]
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. 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.”

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. Under a share repurchase plan, management offers to buy back some portion of the company's outstanding shares in exchange for cash. The company either retires the repurchased shares or keeps them as treasury stock for re-issuance. Under U.S. corporate law, there

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


341 See 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).

342 See 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. Share repurchases are often conducted for financial reasons, such as increasing a company's earnings per share. 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. 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. 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. 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.

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 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).
On the extreme end of the de-cultivation spectrum would be a "going private" transaction,\(^\text{349}\) 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.\(^\text{350}\) 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."\(^\text{351}\) 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."\(^\text{352}\) 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

\(^{349}\)See 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).


\(^{351}\)Dell 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.

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

353 Going 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).

354 See infra Part IV.F.1-7.

355 See infra Part IV.F.1.

356 See infra Part IV.F.2.

357 See infra Part IV.F.3.

358 See infra Part IV.F.4.

359 See infra Part IV.F.5.

360 See infra Part IV.F.6.

361 See infra Part IV.F.7.

362 See supra Part III.
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 Code\(^{363}\) 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" feature\(^{367}\) (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.

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\(^{368}\)The 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).


\(^{370}\)See Bolton & Samara, supra note 369, at 11-12.

\(^{371}\)Alex 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#axzz2bGXoU9nc. 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.


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,
illegality, or a lack of good faith, courts will generally not second guess a board's business decision. 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. 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. 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

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.

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

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. 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.

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. 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

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

Under state corporate law, the decision on whether to issue a dividend is in the sole discretion of the board. 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. 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

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384 See infra notes 387-92 and accompanying text.
385 See infra notes 387-92 and accompanying text.
386 See infra notes 387-92 and accompanying text.
387 See supra notes 377-79 and accompanying text.
389 See id.
earnings. 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[,]" so long as the dividend payments are either paid out of surplus 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." 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". 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.

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, so that dividend payments not only vary based on length of holding, but on the quality of

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390 DEL. CODE ANN. tit. 8, § 170(a).
391 Id. § 170(a)(1).
392 Id. § 170(a)(2).
393 See, 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.").
394 See NYSE Manual, supra note 258, § 204; see also 17 C.F.R. § 240.10b-5, 240, 249 (2013).
395 See 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. Further assume that this company has clearly defined these characteristics and has come up with a list of mission-sustaining criteria. 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, 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, 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, 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

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396 See, e.g., The UK Stewardship Code, supra note 5 (providing examples of shareholder stewardship characteristics).
398 See supra Part IV.F.2.
399 See supra notes 377-79 and accompanying text.
400 See supra Part IV.F.1.
corporation's commitment to sustainability. 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.

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.

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 Shares or mission-weighted

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401 See GLOBAL REPORTING INITIATIVE, supra note 397, at 2.
403 See Seinfeld, 909 A.2d at 125; Marathon, 2004 WL 1728604, at *3.
404 See supra Part IV.F.1.
dividends for example, because corporate law views the shareholder right to vote as sacrosanct. 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. 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." 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." 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.

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. 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. 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. 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

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405 See supra Part IV.F.2.
407 See id. See also Stroud v. Grace, 606 A.2d 75, 78-79 (Del. 1991) (applying the Blasius "compelling justification" standard).
408 See Blasius, 564 A.2d at 659.
409 Id. at 661.
410 Id.
411 Id.
412 See Blasius, 564 A.2d at 661.
413 See supra notes 408-10 and accompanying text.
voting (which in a political construct is akin to committing voting fraud at the polls),\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{419} For Natura, "integrated reporting [was] the best way to

\textsuperscript{414}See supra note 60 and accompanying text.
\textsuperscript{416}See WENDY TNG, STRATEGIC SUSTAINABILITY CONSULTING, SUSTAINABILITY REPORTING AND SMES: A CLOSER LOOK AT THE GRI, 1 (2010), http://static.squarespace.com/static/4f9c3ba1e4b5036a61fbde6ff/t/50e68b5e4b0a7200de60c49/135577037036/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).
\textsuperscript{418}See ECCLES & KRZUS, supra note 417, at 18-19.
\textsuperscript{419}See id. at 21.
signal its management's focus on environmental and social stewardship and to ensure leadership's commitment to those goals.\textsuperscript{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.\textsuperscript{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.\textsuperscript{422} For example, South Africa has recently mandated that all companies transition to using integrated reports.\textsuperscript{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."\textsuperscript{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.\textsuperscript{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.\textsuperscript{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 . . . ."\textsuperscript{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

\textsuperscript{420}Robert G. Eccles & George Serafeim, The Performance Frontier: Innovating for a Sustainable Strategy, HARV. BUS. REV., May 2013, at 50, 55.
\textsuperscript{422}See id. at 27 (suggesting governance principles are a key consideration in shareholder voting).
\textsuperscript{424}See PETER DESIMONE, IRRC INST. & SUSTAINABLE INVS. INST., INTEGRATED FINANCIAL AND SUSTAINABILITY REPORTING IN THE UNITED STATES 1 (2013).
\textsuperscript{425}See id.
\textsuperscript{426}See id.
\textsuperscript{427}See id.
SEC's disclosure and reporting regulations. 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. 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. The first U.S. corporation to produce an integrated report was United Technologies Corporation. Other U.S. companies, such as Microsoft, have expressed interest in considering such a model.

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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.\textsuperscript{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.\textsuperscript{434} The proposal on the table is for the government to implement a financial transaction tax on such trading activity.\textsuperscript{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.\textsuperscript{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."\textsuperscript{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.\textsuperscript{438}


\textsuperscript{435}France Wants Changes to EU Financial Transaction Tax, supra note 5.


\textsuperscript{437}BOGLE ET AL., supra note 5, at 3.

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

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. As in the case of a customer rewards program, terms and limits of use of these shareholder loyalty rewards

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439 See supra Part IV.F.2.
441 Id.
442 Id. (according to Jane Ambachtsheer, "[o]utside of France" loyalty shares are a relatively unknown concept (quoting Jane Ambactsheer, Mercer Partner)).
could be specified by contract. 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.

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. However, like any endeavor, Shareholder Cultivation has attendant costs and is subject to critique. 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.

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

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446 See infra Part V.A.  
447 See infra Part V.A.  
448 See infra Part V.B.  
449 See infra Parts V.A-B.
have regular dialogues with between 10 and 20 investors who represented that holding." 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. For shareholders, having a critical mass of shareholder stewards should lead to enhanced accountability on the part of boards and managers.

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. 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." 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

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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.\textsuperscript{455} Assuming that Patagonia is sincere in its mission and is not engaged in "green washing,"\textsuperscript{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.\textsuperscript{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.\textsuperscript{458} Notably, landmark cases like \textit{Unocal Corp v. Mesa Petroleum Co.},\textsuperscript{459} \textit{Revlon v. MacAndrews & Forbes Holding, Inc.},\textsuperscript{460} and \textit{Unitrin Inc. v. American General Corp.},\textsuperscript{461} as well as the recent case of \textit{Air Products & Chemicals, Inc. v. Air Gas, Inc.},\textsuperscript{462} establish that management has significant leeway in devising strategies to protect the firm from so-called "abusive tender offer tactics."\textsuperscript{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."\textsuperscript{464}

\textsuperscript{455}See \textit{Patagonia}, supra note 454.
\textsuperscript{457}See \textit{Patagonia}, supra note 454.
\textsuperscript{458}See infra notes 459-60 and accompanying text.
\textsuperscript{459}See \textit{Unocal Corp. v. Mesa Petroleum Co.}, 493 A.2d 946, 958 (Del. 1985).
\textsuperscript{462}See \textit{Air Prods. & Chems., Inc. v. Airgas, Inc.}, 16 A.3d 48, 92 (Del. Ch. 2011).
\textsuperscript{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." \textit{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).
\textsuperscript{464}See, e.g., \textit{Moran v. Household Int'l, Inc.}, 500 A.2d 1346, 1357 (Del. 1985); see also \textit{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." Metaphorically speaking, while the poison pill poisons the chances of a successful takeover, 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. 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." 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 . . . ."

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." This

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465 See ALLEN, KRAAKMAN & SUBRAMANIAN, supra note 463, at 523.
470 See infra notes 468-69 and accompanying text.
465 Id. at 489-90.
470 Rock, supra note 14, at 851, 914 (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." 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. 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.

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. 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.

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

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

475 See 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).
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. 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. 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).

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. 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. 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).

477Id.

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", "Kickstarter", or "Airbnb"); the Slow Money movement; the renewed interests in the power of cities as the source of innovation and solution; and local food movements such as "farm-to-table." 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. These transaction costs include information-gathering costs as Shareholder Cultivation requires that firms gather and sort through information about shareholders to detect potential stewards, bargaining costs as shareholder stewards and firms must now negotiate the terms of exchange for tangible rewards or experiences.

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481 See 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).


483 See 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/2013/07/20/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).

484 Similarly, 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.


488 See supra notes 210-11, 214 and accompanying text.
stewardship engagement, including, if applicable, defining agreed upon mission-sustaining criteria; 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.

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." Williamson argues that transaction costs depend on frequency, specificity, uncertainty, limited rationality, and opportunistic behavior. 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. 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." 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.

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489 See supra Part IV.F.1.
490 See supra Part V.A.5.
492 Id. at 52, 56.
493 Id. at 75-78.
494 ALLEN, KRAAKMAN & SUBRAMANIAN, supra note 463, at 9-10 (describing Williamson's transaction cost theory of the firm).
495 See Weinberger v. UOP, Inc., 457 A.2d 701, 705 (Del. 1983); In re John Q.
Like the fiduciary duties that attach to controlling shareholders, 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. 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.

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. 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.

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

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497 See 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).
498 See Anabtawi & Stout, supra note 61, at 1260.
500 Id.
to corporate policy and effectiveness existed"; and (2) that their response was "reasonable in relation to the threat posed." If the board satisfies both prongs then their actions will be judged under the business judgment rule. If, however, the board fails to satisfy the Unocal test, the board's actions will be judged under the more exacting entire fairness standard. 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.

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. 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.

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. However, this concern may be misplaced as large
institutional investors like BlackRock, Inc., the world's largest asset manager, have openly expressed commitment to the concept of stewardship. 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." 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." 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. 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.

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. The ability to have shareholders whose investment behavior and (in some cases) whose


908See SKIPPER ET AL., supra note 9 (signifying BlackRock's commitment to investor stewardship).

909Id. at 7.

910Id. at 9.

911See HEINEMAN & DAVIS, supra note 507, at 25 (providing a few examples of how to convince institutional investors to support stewardship).

912See SKIPPER ET AL., supra note 9, at 10 (recommending institutional investors to communicate internally about potential competing perspectives between different fund managers).

913See 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.