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MANDATING BOARD-SHAREHOLDER ENGAGEMENT?

Lisa M. Fairfax*

This Article not only argues that corporations must be encouraged to enhance the level of communication between shareholders and the board, but also maintains that the benefits of increased engagement are significant enough that we should consider developing standards for incentivizing, if not mandating, more robust board-shareholder engagement for corporations that fail to respond to such encouragement. In the last several years, shareholders not only have gained increased authority over corporate elections and governance matters, but also have demonstrated a willingness to use that authority to challenge, and even reject, management policies and practices. Shareholders also have begun to demand increased communication with the corporation in general, and the board in particular. This Article argues that corporations should be strongly encouraged, if not compelled, to meet that demand. While acknowledging the potential pitfalls associated with increased board-shareholder engagement, this Article further argues that many of those pitfalls have been overstated, or can be minimized. Moreover, in light of shareholders' enhanced influence over corporate affairs, the costs associated with enhanced engagement may be outweighed by the benefits. While it is not a panacea, increased board-shareholder engagement has the potential to dramatically increase the corporation's ability to promote understanding of its policies and programs, and otherwise avoid the negative repercussions of shareholder activism. Thus, this Article endorses proposals that encourage corporations to increase board-shareholder dialogue with two caveats. First, given the menu of communicative options and the various judgment calls that must be made when implementing particular options, deference should be given to corporations and the board with respect to which option or options to adopt. Second, the benefits of board-shareholder engagement are important enough that we should consider proposals that would more effectively incentivize and even mandate such engagement for

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those corporations that refuse to answer the calls to increase their dialogue with shareholders.

INTRODUCTION

As shareholders have garnered increased influence over corporate affairs, they also have sought increased interaction with the corporation in general, and the board in particular. Over the last several years shareholders have advocated for, and obtained, significant influence over director elections, executive compensation issues, and corporate affairs more generally.¹ Shareholders have used this influence to impact board structure as well as board composition, and even to reject corporate policies.² Coinciding with their increased influence, shareholders not only have begun to demand increased engagement with the corporation, but also have begun to demand more robust engagement with directors.³

This Article argues that corporations should accede to such demands. While some view board-shareholder engagement as crucial to promoting good corporate governance, there are others who continue to express concern with its value and desirability.⁴ Thus, although some corporations have been willing to increase their levels of board-shareholder engagement,⁵ studies and anecdotal evidence suggest continued reluctance on the part of many corporate officers and directors, particularly with respect to increasing the level of interaction between the board and shareholders.⁶ To be sure, there exist both legal and practical hurdles associated with shareholder communication, particularly at the board level. Effective communication involves a considerable time investment that part-time and overworked directors may be unable to af-

1. See LISA M. FAIRFAX, *SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION* 3–4 (2011) [hereinafter *SHAREHOLDER DEMOCRACY*].

2. See Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 61–79 (2008) [hereinafter *Making the Corporation Safe*] (noting shareholder success in altering voting standards and annual election of directors); see also *infra* note 27 (discussing shareholders' rejection of directors during the last several proxy season).

3. See *Dangerous Talk? When/How Should Directors Communicate with Shareholders?*, LATHAM & WATKINS (Latham & Watkins, San Diego, C.A.), at 1–2 [hereinafter *Dangerous Talk*], available at http://www.directorsforum.org/resources/pdf/cdf_dangerous_talk_program_outline_3-18.pdf?ID=3.362 (noting that activist-shareholders who perceive that directors are unwilling to act or believe that management has turned a deaf ear, now increasingly look to directors).

4. See *ViewPoints: Advancing Board-Shareholder Engagement*, TAPESTRY NETWORKS (Tapestry Networks, Ltd., London, U.K.), at 1 [hereinafter *ViewPoints*], available at http://www.tapestrynetworks.com/issues/corporate-governance/upload/Tapestry-ViewPoints-Advancing-board_shareholder-engagment-30-May-2012.PDF (describing April 2012 discussions between large institutional investors and directors exploring the topic of board-shareholder engagement).

5. See *id.* at 2.

6. See *id.* at 5; see also STEPHEN DAVIS & STEPHEN ALOGNA, MILLSTEIN CTR. FOR CORPORATE GOVERNANCE AND PERFORMANCE, *TALKING GOVERNANCE: BOARD-SHAREHOLDER COMMUNICATIONS ON EXECUTIVE COMPENSATION* 5 (2008), available at <http://www.uas.mx/cegc/consilium/doc/talking-governance-CE0310.pdf> (referring to two-way dialogue between boards and shareholders as rare); Brian V. Breheny, *Can We Talk? The Continuing Demand for Shareholder Engagement*, 14 CORPORATE GOVERNANCE REP., Apr. 4, 2011, at 1, 3.

ford. Moreover, directors may not have sufficient knowledge to effectively engage with shareholders. Finally, some forms of engagement may trigger legal liability.⁷ This Article, however, insists that these concerns can be addressed and minimized, if not overcome. More importantly, any potential disadvantages are far outweighed by the benefits to be gained from increasing board-shareholder engagement. Indeed, shareholders' increased power translates into an increased ability to challenge or reject director-sponsored policies and programs. By enhancing their engagement with shareholders, directors can better understand shareholder attitudes, gain support for their own policies and practices, learn vital information about potential shareholder concerns, and ultimately avoid contentious battles with their shareholders.⁸ From this perspective, failing to effectively engage shareholders may be a more costly option than enhancing board-shareholder engagement.

Thus, this Article concurs with calls to encourage such engagement, with two caveats. First, while any such engagement must move beyond the traditional channels of communication, boards should not be compelled to adopt any particular engagement strategy. On the one hand, a careful assessment of the existing communication platforms reveals that such platforms may not offer an opportunity for meaningful dialogue between shareholders and directors; instead communication too often falls along two axes: rote and formulaic, or antagonistic, adversarial, and reactive.⁹ Hence, any strategy for increasing board-shareholder communication must embrace alternative engagement mechanisms. On the other hand, this Article does not endorse a particular mechanism. Indeed, this Article points out that because there are potential benefits and drawbacks to the array of new engagement proposals, and implementing any proposal involves resolving a host of thorny issues, boards should have the discretion to determine which proposal or proposals best meet their communicative needs.¹⁰

The second caveat with this Article's endorsement of proposals for enhancing board-shareholder engagement is that any such proposals should include consideration of strategies that would encourage, if not require, boards to be more proactive in this area. Importantly, board-shareholder engagement is not a cure-all. It does, however, offer corporations the potential to diffuse hot-button issues before they transform into costly and distracting confrontations.¹¹ Evidence suggests that some

7. For example, inappropriate communications between corporations and shareholders could result in liability under Regulation Fair Disclosure (Regulation FD), which makes it unlawful for corporations and their agents to provide certain kinds of selective disclosure to shareholders. *See* Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716 (Aug. 24, 2000).

8. *See infra* Part II.A.

9. *See ViewPoints, supra* note 4, at 2.

10. *See infra* Part III.B.4.

11. *See infra* notes 99–103.

corporations may be avoiding board-shareholder engagement based on misconceptions or long-held, but misguided, aversions to board-shareholder dialogue.¹² To the extent such attitudes prevent those corporations from embracing more robust board-shareholder dialogue, this Article insists that it is appropriate to consider more proactive engagement strategies ranging from incentives to potential mandates.

Part I identifies the ways in which shareholder power has increased in recent years, and discusses how shareholders and others have argued that such increased power demands an increase in shareholder engagement, particularly with the board. Against this backdrop, Part II discusses the benefits and drawbacks of shareholder engagement, concluding that any drawbacks are sharply outweighed by the benefits. In light of this conclusion, Part III grapples with the best way for ensuring that enhanced board-shareholder engagement occurs. First, Part III demonstrates the need to move beyond the existing communication channels by illuminating the limitations with their inability to facilitate constructive dialogue between boards and shareholders. Second, Part III examines some of the new proposals for enhancing board-shareholder communication, identifies their strengths and weaknesses, and demonstrates why the decision regarding which proposal to adopt is best left to the board's discretion. Finally, Part III explains why we should be prepared to consider strategies for further incentivizing, or even mandating, board-shareholder engagement. It is entirely possible that with the passage of time, many more corporate boards will step up their efforts to interact with shareholders.¹³ If this occurs, further reforms may be unnecessary. If it does not, however, we should be willing to consider alternative measures for ensuring appropriate board-shareholder engagement.

I. SHAREHOLDER ACTIVISM AND CALLS FOR GREATER SHAREHOLDER ENGAGEMENT

By way of background, this Part discusses the manner in which shareholder power has increased in recent years, and how that increase has spurred calls for increased shareholder engagement. Corporate governance scandals and the financial crisis not only caused many shareholders to distrust corporate officers and directors, but also prompted shareholders to seek greater authority over corporate affairs.¹⁴ While there is significant disagreement about the benefits of increased share-

12. See *ViewPoints*, *supra* note 4, at 6; *infra* note 83.

13. See Proxy Season 2012: Board Priorities for Shareholder Engagement, PROXY PERSPECTIVES (Ernst & Young, London, U.K.), Feb. 2012, at 1, available at [http://www.ey.com/Publication/vwLUAssets/Proxy_season_2012:_board_priorities_for_shareholder_engagement_\(Proxy_perspectives\)/\\$FILE/Proxy%20season%202012%20board%20priorities.pdf](http://www.ey.com/Publication/vwLUAssets/Proxy_season_2012:_board_priorities_for_shareholder_engagement_(Proxy_perspectives)/$FILE/Proxy%20season%202012%20board%20priorities.pdf) (noting that the 2012 proxy season revealed that more boards are communicating with their shareholders).

14. See Lucien Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 842-43 (2005) [hereinafter *Increasing Shareholder Power*]; *Making the Corporation Safe*, *supra* note 2, at 55.

holder influence,¹⁵ many shareholders and advocates of increased shareholder power believe it is necessary to serve as a check against managerial malfeasance or board inattention.¹⁶ In their view, if shareholders have greater authority over boards and their decisions, there is a greater likelihood that boards will pay heed to their obligations to more closely and carefully monitor corporate affairs, while making decisions that are in the best interest of the corporation and its shareholders.¹⁷ As a result of this view, shareholders have waged an aggressive battle to gain more influence over directors and corporate affairs.¹⁸ This battle has resulted in victories on a number of fronts. Section A examines those victories, while Section B reveals how they have spurred calls for increased engagement at the board level.

*A. Shareholder Activism and the Emergence of
Increased Shareholder Power*

1. Majority Voting

Shareholders have recently achieved significant success in their battle to implement majority voting. Only a few years ago, the vast majority of public company directors were elected based upon a plurality system whereby a director was elected so long as that director received a plurality of the votes cast, without counting votes withheld or cast against.¹⁹ In an uncontested election, a plurality voting system means that directors can be elected so long as they receive any votes cast in their favor, even if a majority of shareholders vote against a director or otherwise withhold their votes.²⁰ Amidst concerns that plurality voting could undermine the impact of shareholder votes, shareholders began advocating for majority voting.²¹ Majority voting refers to a system whereby directors must receive a majority of the shareholder vote in order to be elected to the board.²² In 2005, when shareholders began their majority voting campaign, less than 150 companies had a majority voting system.²³ As a result of shareholder activism, by 2010 more than seventy-seven percent of

15. See Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1745 (2006) [hereinafter *Director Primacy*]; William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 666–67 (2010).

16. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 37–39; *Increasing Shareholder Power*, *supra* note 14, at 870.

17. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 37–39; *Increasing Shareholder Power*, *supra* note 14, at 870.

18. See *Making the Corporation Safe*, *supra* note 2, at 55.

19. See CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS 10 n.9 (last updated Nov. 20, 2007), available at <http://www.ngelaw.com/files/uploads/documents/majoritystudy111207.pdf> (noting that a “relatively limited” number of corporations had majority voting prior to 2006).

20. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 85.

21. See *id.* at 88–90.

22. See William K. Sjostrom, Jr. & Young Sang Kim, *Majority Voting for the Election of Directors*, 40 CONN. L. REV. 459, 472 (2007).

23. See ALLEN, *supra* note 19, at 10 n.9.

S&P 500 companies adopted some form of majority voting system for their director elections.²⁴

Majority voting augments shareholders' ability to impact board elections and board decision-making. A majority voting regime increases the likelihood that shareholders will have the ability to unseat incumbent directors or prevent new directors from holding office.²⁵ Such a regime also enhances the impact of withhold the vote campaigns. A withhold the vote or vote no campaign refers to a campaign seeking to encourage shareholders to withhold their vote or vote against a particular director or group of directors.²⁶ Shareholders have demonstrated an increased willingness to wage such campaigns, collaborating to target hundreds of directors, signaling their displeasure at such directors' performance or policies.²⁷ Under a plurality system, however, such campaigns may be merely symbolic because even when shareholders withhold a majority of their votes against a director, a director retains her board seat.²⁸ Under a majority vote system, however, such campaigns could significantly jeopardize a director's ability to serve on the board. To the extent the threat of losing a board seat impacts board behavior, majority voting increases shareholders' ability to influence board behavior.

2. *Broker Voting*

Shareholder activism also has prompted changes to the broker voting rules. A considerable number of public company investors purchase their shares through a broker who then holds the shares in an account for

24. Noam Noked, *2011 Annual Corporate Governance Review*, HARV. L. SCH. F. ON CORPORATE GOVERNANCE AND FIN. REG. (Jan. 12, 2012, 9:28 AM), <http://blogs.law.harvard.edu/corpgov/2012/01/12/2011-annual-corporate-governance-review/>. As of June 2008, more than sixty percent of Fortune 500 companies had some form of majority voting. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 90.

25. Under most majority voting systems a director does not automatically lose her seat as a result of a failure to receive a majority of the shareholder vote. Instead, the director either must tender her resignation which the board must then decide whether to accept, or the director remains in office for some time period until the board selects a new director. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 90–91. Hence, shareholders do not have absolute control over the election outcome. Nevertheless, a majority voting regime increases shareholders' ability to directly and indirectly impact board elections. See *id.*

26. See Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 908 (1993).

27. See TED ALLEN ET AL., INSTITUTIONAL S'HOLDER SERVS., PRELIMINARY 2011 U.S. POSTSEASON REPORT 3–4 (2011). During 2009 and 2010, eighty-nine and eighty-seven directors, respectively, did not earn majority support. *Id.* at 14. During 2011, only forty-three directors received less than majority support. *Id.* The ISS report attributed this decline to the implementation of say on pay and its impact on shareholder voting. See *id.* Importantly, however, the past few proxy seasons have also revealed that even when directors receive majority support, there are many directors who receive a high level of shareholder dissent.

28. There are some governance experts who believe that withhold the vote campaigns impact director elections even without majority voting. See Grundfest, *supra* note 26, at 908. Moreover, at least one study confirms this belief. See Diane Del Guercio et al., *Do Boards Pay Attention When Institutional Investor Activists "Just Vote No"?*, 90 J. FIN. ECON. 84, 85–86 (2008).

shareholders' benefit.²⁹ Under federal and securities exchange act rules, brokers can cast votes for shares held in their accounts (1) if they do not receive shareholder voting instructions within ten days of the shareholder meeting, and (2) if the vote relates to a matter deemed routine.³⁰ Because uncontested elections were deemed routine, brokers were able to cast uninstructed votes in such elections. Empirical evidence revealed that broker discretionary voting could account for as much as twenty percent of the total vote in such elections.³¹ Moreover, studies indicate that broker discretionary voting overwhelmingly follows management.³² Hence, shareholders contended that such voting distorted election outcomes and undermined shareholder influence.³³ As a result, shareholders began advocating for the prohibition of uninstructed broker voting in uncontested elections.³⁴ In 2009, the Securities and Exchange Commission (SEC) abolished discretionary voting in uncontested elections,³⁵ and in 2010 the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) codified that abolition into law and extended it to prohibit such voting in connection with certain other compensation matters.³⁶ Studies reveal that in some elections, if broker discretionary voting had not been allowed, the election result would have been more consistent with shareholder preferences.³⁷ Thus, like majority voting, the ban on broker discretionary voting could have a considerable impact on shareholders' ability to influence director elections and corporate affairs.³⁸

3. *Classified Boards*

Shareholder activism surrounding classified boards has led to changes that could impact shareholders' ability to influence director elections and corporate affairs. If a corporation has a staggered or classified

29. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 23–24.

30. See *id.* at 24.

31. CTR. ON EXEC. COMP., A CALL FOR CHANGE IN THE PROXY ADVISORY INDUSTRY STATUS QUO: THE CASE FOR GREATER ACCOUNTABILITY AND OVERSIGHT 5 (2011), available at <http://online.wsj.com/public/resources/documents/ProxyAdvisoryWhitePaper02072011.pdf>.

32. See Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 560–61 (1990).

33. See LARRY W. SONSINI ET AL., REPORT AND RECOMMENDATIONS OF THE PROXY WORKING GROUP TO THE NEW YORK STOCK EXCHANGE 14 (June 5, 2006) [hereinafter PROXY WORKING GROUP REPORT], available at http://www.nyse.com/pdfs/PWG_REPORT.pdf.

34. *Id.* at 7–8.

35. Order Approving Proposed Rule Change, Exchange Act Release No. 60,215, 74 Fed. Reg. 33,293 (July 1, 2009).

36. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 957, 124 Stat. 1376, 1906 (2010).

37. See PROXY WORKING GROUP REPORT, *supra* note 33, at 9.

38. However, at least one study questions the impact of the recently changed broker voting rules. Although it only studied a limited time-frame, the study indicated that the new rules did not appear to have any impact on director approval ratings. See Ali Akyol et al., *The Elimination of Broker Voting: Much Ado About Nothing?*, 2–3 (Dec. 15, 2011) (unpublished manuscript), available at <http://ssrn.com/abstract=1973558>.

board, shareholders only elect a portion of the board each year.³⁹ Shareholders have sought board declassification for decades, but only recently have their efforts proved successful.⁴⁰ A 2010 study indicated that seventy-two percent of boards elect directors annually, up from forty percent a decade ago.⁴¹ Declassifying a board enables shareholders to replace the entire board in one election cycle, enhancing their power over board elections.

4. *Proxy Access*

New proxy access rules also have the potential to enhance shareholders' influence. Proxy access refers to the ability to include shareholder nominated candidates on the corporation's proxy statement.⁴² In August 2010, after considerable debate and pressure from the investment community, the SEC passed proxy access rules for the first time in its history.⁴³ These rules granted shareholders two routes for obtaining proxy access. First, subject to certain conditions, the SEC mandated proxy access by requiring every public company to grant shareholders who held at least three percent of a company's voting securities for at least three years the right to nominate a candidate of their choice onto the corporation's proxy statement.⁴⁴ Second, the SEC allowed shareholders to propose bylaw amendments related to specific procedures for proxy access.⁴⁵ Such bylaws enabled shareholders to create their own proxy access requirements so long as they were not more restrictive than the rules related to mandated proxy access.⁴⁶ In July 2011, however, the D.C. Circuit overturned the provision in the rules mandating proxy access.⁴⁷ The D.C. Circuit left untouched the portion of the rules enabling shareholders to propose bylaw amendments requesting corporations to implement specific procedures for proxy access.⁴⁸ The most recent proxy data indicates that shareholders have taken advantage of their ability to submit proxy

39. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 80–81.

40. Compare *Increasing Shareholder Power*, *supra* note 14, at 854 (showing evidence of shareholder support for board declassification, coupled with evidence of company's refusal to change board structure), with SPENCER STUART, 2010 SPENCER STUART BOARD INDEX 14 (25th ed. 2010), available at <http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI2010.pdf> (showing dramatic increase in declassified boards).

41. See SPENCER STUART, *supra* note 40, at 4, 14. Another study reveals only twenty-nine percent of companies in the S&P 500 have classified boards, as compared to sixty percent in 2000. See John J. Madden, *The Shifting Landscape of Corporate Governance, and Four Steps Boards Should Take in an Era of Shareholder Ascendancy*, 14 CORPORATE GOVERNANCE REP., Feb. 7, 2011, at 2 (citing shark repellent study).

42. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 129.

43. Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29,384, 75 Fed. Reg. 56,668 (Sept. 16, 2010).

44. See *id.*

45. See *id.*

46. See *id.*

47. See *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148–51 (D.C. Cir. 2011).

48. *Id.* at 1153.

access proposals, with some success.⁴⁹ Thus, several shareholders have submitted proxy access proposals, and a few corporations have agreed to support proxy access at their companies.⁵⁰

While there is significant debate regarding the potential impact and propriety of a proxy access rule,⁵¹ shareholders contend that proxy access is vital to their ability to influence election outcomes and corporate practices.⁵² Prior to the SEC's proxy access rules, federal law prohibited shareholders from nominating candidates of their choice onto the corporation's proxy statement.⁵³ Instead, only management-supported candidates appeared on the proxy statement.⁵⁴ If shareholders wanted to elect a different set of candidates they had to wage a proxy contest by creating and distributing a separate proxy statement to shareholders.⁵⁵ Evidence suggests that the expense associated with such an endeavor proved prohibitive for all but a few shareholders.⁵⁶ As a result, most directors ran unopposed, undermining shareholders' ability to impact board candidate decisions.⁵⁷ Shareholders view proxy access as a cost-effective way for them to have a greater voice in the board nomination and election process.⁵⁸

5. *Say on Pay*

Shareholders also have experienced success in their efforts to play a greater role in compensation decisions. In the 2010 Dodd-Frank Act, Congress mandated say on pay—a shareholder advisory vote on executive compensation.⁵⁹ The mandate requires that every public corporation give its shareholders a say on pay vote, and that such corporations give

49. See *Considerations for Public Company Directors in the 2012 Proxy Season*, GIBSON DUNN, (Gibson, Dunn, & Crutcher LLP, New York, N.Y.), Jan. 3, 2012 (noting that at least fifteen companies have received proxy access proposals as June 2012).

50. See *id.*; see also Adam Piore, *US Proxy Season's Mid-Year Trends*, INSIDE INVESTOR RELATIONS (July 24, 2012), <http://www.insideinvestorrelations.com/articles/proxy-voting-annual-meetings/18867/us-proxy-seasons-mid-year-trends/> (noting that Hewlett-Packard agreed to implement proxy access in 2013 for shareholders who own at least five percent of the company's shares; and that at least two dozen companies had received proxy access proposals).

51. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 129–33.

52. *Id.* at 129–30.

53. See Shareholder Proposals, 17 C.F.R. § 240.14a-8(i)(8) (2007); see also SHAREHOLDER DEMOCRACY, *supra* note 1, at 128.

54. SHAREHOLDER DEMOCRACY, *supra* note 1, at 128.

55. See *id.* Shareholders could also recommend a director candidate to the board's nominating committee or attend the annual meeting to nominate a candidate, but neither alternative is likely to result in enabling shareholders to nominate a candidate of their choice to the board.

56. See Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29, 384, 75 Fed. Reg. 56,668 (Sept. 16, 2010); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 681–91(2007) [hereinafter *Shareholder Franchise*].

57. See *Shareholder Franchise*, *supra* note 56, at 688–89.

58. Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,668.

59. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 951(a)(1), 124 Stat. 1376, 1899 (2010).

shareholders a “say on frequency”—the ability to determine whether such a vote would occur annually, every other year, or once every three years.⁶⁰ Anecdotal and empirical evidence reveal that say on pay enhances shareholders’ ability to influence corporate pay practices in at least two respects. First, such votes appear to lead to increased interaction between shareholders and directors thereby increasing shareholders’ ability to influence decisions regarding the executive pay.⁶¹ Second, the votes increase the extent to which executive pay is aligned with performance in a manner approved by shareholders.⁶²

6. *Shareholder Activism and Shareholder Influence*

Through each of these reforms, shareholders garnered increased influence over director elections in particular, and corporate affairs more generally. Importantly, shareholder influence not only directly impacts board membership, but also directly impacts policies over which directors have primary, if not sole, responsibility. As Section B will explain, shareholders’ increased power related to these and other matters has repercussions for the importance of emphasizing board-shareholder engagement.

B. *Connecting Shareholder Activism with Shareholder Engagement*

Historically, shareholder engagement has not been a top priority of directors and officers. Studies reveal that twenty-five years ago, the topic of shareholder communication had not yet surfaced.⁶³ Shareholders were relatively passive, with neither the resources nor the inclination to seek to actively impact corporate governance.⁶⁴ Moreover, shareholders did not have many mechanisms at their disposal to influence corporate affairs.⁶⁵ As a result, few shareholders demanded interaction with corporations or the board.⁶⁶ Similarly, the board felt no significant compulsion to engage shareholders outside of their fairly routine presence at the annual meeting.⁶⁷

60. *Id.* § 951(a)(1)–(2).

61. See Jeffrey N. Gordon, “Say on Pay”: *Cautionary Notes on the U.K. Experience and the Case for Shareholder Opt-In*, 46 HARV. J. ON LEGIS. 323, 337–40 (2009); Stephen Davis, Does ‘Say on Pay’ Work?: Lessons on Making CEO Compensation Accountable 16 (2007) (unpublished manuscript) (on file with the Millstein Center for Corporate Governance and Performance, Yale School of Management); Fabrizio Ferri & David A. Maber, Say on Pay Votes and CEO Compensation: Evidence from the UK (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420394 (citing say on pay regulations in the U.K.).

62. See Davis, *supra* note 61, at 15.

63. See SPENCER STUART, *supra* note 40, at 3.

64. See *id.*

65. See *id.*

66. See *id.* at 4.

67. See *id.* at 3.

Increased shareholder activism, however, has led them to demand greater engagement, particularly with the board.⁶⁸ A recent survey revealed that a significant number of investors sought greater engagement with the board.⁶⁹ Shareholders and their advocates have proposed a range of different strategies for increasing their interactions with board members from annual corporate governance calls with directors, to periodic “investor days” at the corporation spearheaded by directors.⁷⁰

The SEC has indicated its support for increased communication between the board and its shareholders. The SEC recently dedicated a section of a concept release to issuer communication with shareholders, noting that many commentators have stressed the increased need for corporations to be able to communicate with their shareholders.⁷¹ The SEC sought guidance on ways to enhance the ability of corporations to effectively and efficiently communicate with shareholders,⁷² making clear that increased engagement should begin with board-shareholder communication.⁷³ Thus, in 2010, the SEC called for corporations to make board-shareholder engagement a priority.⁷⁴ SEC Chair Mary Schapiro implored directors to have “clear conversations with investors about how the company is governed.”⁷⁵

Along these same lines, several corporate governance experts and organizations have advocated making effective board-shareholder engagement a priority. To be sure, calls to prioritize shareholder engagement are not new. As early as 1992, Martin Lipton proposed that boards implement a process to meet annually with their largest shareholders.⁷⁶ Such a proposal was central to an overall proposal to strengthen board accountability and thereby enhance corporate governance.⁷⁷ Calls to prioritize board-shareholder engagement, however, have increased within the last few years. In 2003, the National Association of Corporate Direc-

68. See Breheny, *supra* note 6, at 48.

69. See Aarti Maharaj, *Governance During ‘Shareholder Spring,’* CORP. SEC’Y (May 31, 2012), <http://www.corporatesecretary.com/articles/corporate-secretary-week/12246/governance-during-shareholder-spring/> (noting that ninety-two percent of shareholders have called for more engagement with the board); FTI CONSULTING, *SHAREHOLDER VOICE GROWING LOUDER IN THE BOARDROOM: RESULTS OF FTI CONSULTING’S SECOND ANNUAL CORPORATE GOVERNANCE INVESTOR SURVEY 3 (2012)*, available at http://www.shareholderforum.com/e-mtg/Library/20120412_FTI-survey.pdf (finding that ninety-four percent of shareholders are calling for more engagement with the chairman of the board).

70. See *ViewPoints*, *supra* note 4, at 8–9.

71. See Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982, 42,998–99 (proposal July 22, 2010) (to be codified at 17 C.F.R. pts. 240, 270, 274, 275).

72. See *id.* at 42,998.

73. See *id.* at 43,000.

74. See Mary L. Schapiro, Chairman, SEC, Remarks at the NACD Annual Corporate Governance Conference (Oct. 19, 2010), available at <http://www.sec.gov/news/speech/2010/spch101910mls.htm>.

75. See *id.*

76. See Martin Lipton & Jay W. Lorsch, *A Modest Proposal for Improved Corporate Governance*, 48 BUS. LAW. 59, 74 (1992).

77. *Id.* at 61.

tors (NACD) established a task force on improving board-shareholder communications.⁷⁸ By 2008, a small group of corporations, corporate governance experts, and business organizations such as the Business Roundtable signed a set of guidelines, known as the Aspen Principles, urging greater board shareholder communication.⁷⁹ In 2009, the Committee on Capital Markets recommended that boards consult with shareholders on a range of governance matters.⁸⁰ That same year, an American Bar Association (ABA) task force recommended that boards “[e]mbrace their role as the body elected by the shareholders to manage and direct the corporation by . . . affirmatively engaging with shareholders to seek their views.”⁸¹ These efforts underscore a growing recognition that the new era of shareholder power requires more interaction between directors and shareholders.

II. THE VALUE OF ENHANCED SHAREHOLDER COMMUNICATION IN AN ERA OF ENHANCED SHAREHOLDER POWER

While there is a growing recognition of the importance of board-shareholder communication, there is no clear consensus on its benefits.⁸² Instead, some express skepticism regarding its value,⁸³ while surveys reveal continued reluctance on the part of corporate directors and officers to increase engagement with shareholders, particularly at the board level.⁸⁴ To be sure, increased engagement is not a panacea, nor does it guarantee positive outcomes. This Part insists that the costs associated with such engagement may have been over-emphasized, however, while the benefits may have been under-appreciated.

A. *The Benefits of Engagement*

Shareholders’ increased voice in corporate affairs makes shareholder engagement a priority for several reasons. First, it is increasingly important for the corporation to better understand shareholder concerns so that they can either better incorporate such concerns into their policies

78. See COUNCIL OF INSTITUTIONAL INVESTORS & NAT’L ASS’N OF CORPORATE DIRS., FRAMEWORK AND TOOLS FOR IMPROVING BOARD-SHAREHOLDER COMMUNICATIONS (2004) [hereinafter FRAMEWORK AND TOOLS], available at www.sec.gov/rules/proposed/s71903/nacd030904-attach.pdf.

79. See ASPEN INST., LONG-TERM VALUE CREATION: GUIDING PRINCIPLES FOR CORPORATIONS AND INVESTORS (2007), available at <http://www.aspeninstitute.org/sites/default/files/content/docs/business%20and%20society%20program/FINALPRINCIPLES.pdf>.

80. See DAVIS & ALOGNA, *supra* note 6, at 9.

81. See Holly Gregory, *Excerpts from Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee on Delineation of Governance Roles & Responsibilities*, in SEVENTH ANNUAL DIRECTOR’S INSTITUTION ON CORPORATE GOVERNANCE 107, 120 (2009).

82. See *Dangerous Talk*, *supra* note 3, at 2–3; *ViewPoints*, *supra* note 4, at 6 (noting some directors’ aversion to enhanced engagement); see also Breheny, *supra* note 6, at 3.

83. See *supra* note 82 and accompanying text.

84. See Breheny, *supra* note 6, at 3.

and practices or otherwise be better equipped to respond to those concerns.⁸⁵ For example, evidence reveals that some corporations have reached out to shareholders to determine their views regarding compensation issues and ensure that their pay practices incorporate such views.⁸⁶ In this respect, shareholder engagement enables corporations and the board to fashion policies and practices that better reflect shareholder interests.

Second, enhanced shareholder engagement gives corporations the ability to educate their shareholder base.⁸⁷ Such engagement provides corporations with the opportunity to explain their perspective and policies in a manner that could prevent misunderstandings.⁸⁸ It also enables the board to provide information to shareholders so that they can make more informed decisions.⁸⁹ Given that shareholders now have a voice over a range of corporate governance decisions,⁹⁰ this educational role is vital.

Third, shareholder engagement enables corporations to generate support for their policies, as well as support for the directors and officers who shape and approve those policies.⁹¹ In an era where shareholders have an increased ability to reject corporate pay packages⁹² and unseat directors,⁹³ ensuring such support is clearly vital. Indeed, recent proxy data reveals that one crucial difference between companies that have won shareholder support for their policies and those that have failed, is companies' willingness to engage directly with shareholders.⁹⁴ As a Wachtell Lipton memo recently noted, "no technique is more effective in winning the vote than direct shareholder outreach."⁹⁵

Fourth, engaging with shareholders could generate goodwill among the shareholder base that creates allies that may help repel takeovers or efforts from those seeking to threaten or undermine corporate policies.

85. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 115–16, 122.

86. See ALLEN ET AL., *supra* note 27, at 2.

87. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 124; IRA M. MILLSTEIN ET AL., WEIL GOTSHAL, TEN THOUGHTS FOR ORDERING GOVERNANCE RELATIONSHIPS IN 2010, at 2 (Jan. 2010) [hereinafter TEN THOUGHTS], available at <http://tinyurl.com/Weil10Thoughts>; see also REINHART INSTITUTIONAL INVESTOR SERVS. E-ALERT, ENHANCED SHAREHOLDER RIGHTS UNDER DODD-FRANK: TOOLS FOR ENSURING THAT PROXY VOTES ARE INFORMED AND INDEPENDENT 2 (MAR. 27, 2011) [hereinafter ENHANCED SHAREHOLDER RIGHTS], available at http://www.reinhartlaw.com/Publications/Documents/ea_20110527%20RIIS.pdf.

88. SHAREHOLDER DEMOCRACY, *supra* note 1, at 115.

89. See *id.* at 123; see also ENHANCED SHAREHOLDER RIGHTS, *supra* note 87, at 2; TEN THOUGHTS, *supra* note 87, at 2.

90. See *supra* Part I.A (noting shareholders' increased voice in board elections and executive pay).

91. See *Dangerous Talk*, *supra* note 3, at 2.

92. See *supra* Part I.A (noting impact of say on pay).

93. See *supra* Part I.A (noting shareholders' ability to impact board elections because of majority voting, broker voting, proxy access, and classified board exchanges).

94. See Jeremy L. Goldstein et al., *Say on Pay 2012*, HARV. L. SCH. F. ON CORPORATE GOVERNANCE & FIN. REG. (July 14, 2012, 10:28 AM), <http://blogs.law.harvard.edu/corpgov/2012/07/14/say-on-pay-2012/#more-30571>.

95. See *id.*

Indeed, if shareholder engagement increases the likelihood that shareholders will view management and their policies favorably, it also reduces the ability of other shareholders and even proxy advisory firms to influence the actions of their existing shareholder base. In other words, effective shareholder engagement can translate into shareholder support in times of turmoil.

Fifth, shareholder engagement enables corporations and the board to have a better appreciation for future issues, and therefore be better prepared to tackle potential problems that may arise with such issues.⁹⁶

Ultimately, shareholder engagement may enable corporations to avoid costly confrontations with shareholders. Some governance experts suggest that much of shareholder activism could be avoided with effective shareholder engagement.⁹⁷ This is because shareholder activism often reflects an effort to gain the attention of directors deemed to have ignored their concerns.⁹⁸ Consistent with this perspective, one proxy advisory firm representative emphasized that such firms do not target companies that engage in constructive dialogue with their shareholders.⁹⁹ Proxy advisory firm representatives also have indicated that even when boards do not implement particular processes, the fact that they have engaged in open dialogue with shareholders reduces the likelihood of shareholder actions against them.¹⁰⁰ Hence, increased shareholder engagement seems to be an obvious and even critical response to increased shareholder power.¹⁰¹

B. *Assessing and Debunking the Costs of Engagement*

1. *Regulation FD*

Existing research suggests that many corporate officers and directors view Regulation Fair Disclosure, known as Regulation FD, as a significant obstacle to more robust shareholder communication.¹⁰² Adopted in 2000, Regulation FD was designed to promote full and fair disclosure of important issues, and thus prohibit corporations from selectively dis-

96. See TEN THOUGHTS, *supra* note 87, at 1 (encouraging board-shareholder communication because of its ability to “get out ahead” of issues).

97. See *Dangerous Talk*, *supra* note 3, at 2 (noting one expert’s belief that “almost every hot button governance issue can be addressed through constructive communication between boards and management with shareholders”).

98. See DAVIS & ALOGNA, *supra* note 6, at 6.

99. See *Action Plan to Engage Shareholders, Improve Board Composition*, NACD DIRECTORSHIP (Dec. 21, 2010), <http://www.directorship.com/action-plan-to-engage-shareholders-improve-board-composition/>.

100. See *id.*

101. See Madden, *supra* note 41, at 4–5 (noting that to proactively respond to the shifting governance landscape, corporations must constructively engage with shareholders).

102. See DAVIS & ALOGNA, *supra* note 6, at 5; FRAMEWORK AND TOOLS, *supra* note 78, at 9.

closing information in a manner that could result in insider trading.¹⁰³ Regulation FD requires that when a public company or someone acting on its behalf discloses material nonpublic information to market professionals or its shareholders who may trade on the information, the company must publicly disclose such information.¹⁰⁴ Corporations therefore must be mindful of Regulation FD in all of their communications with shareholders, particularly communications with selective shareholders or communications during meetings that are not open to the public. Studies indicate that concern over potential violations of Regulation FD undermines corporations' willingness to enhance their engagement with shareholders.¹⁰⁵

In 2010 the SEC issued interpretive guidance on Regulation FD aimed at allaying such concerns.¹⁰⁶ The SEC emphasized that Regulation FD does not prohibit corporate directors and officers from engaging in private meetings with shareholders. In order to ensure that corporations do not convey material nonpublic information during such meetings, the SEC recommended that corporations implement procedures governing private meetings with shareholders such as pre-clearing discussion topics with counsel, or having counsel participate in the meetings.¹⁰⁷ The SEC further pointed out that corporations can discuss material nonpublic information with shareholders so long as such shareholders expressly agree to keep the information confidential.¹⁰⁸ Finally, even if corporations inadvertently disclose material nonpublic information, they can avoid violating Regulation FD by promptly disclosing the information to the public.¹⁰⁹ In its adopting release, the SEC noted that technological advances had made it much easier to broadly disseminate information, and thus corporations have a variety of different ways in which they can comply with their disclosure obligations under Regulation FD.¹¹⁰ The SEC's interpretative guidance confirmed that corporations could satisfy these obligations by posting information on the corporation's website.¹¹¹ In sum, the SEC has tried to make clear that with appropriate planning Regulation FD should not deter corporate dialogue with shareholders.

103. Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716 (Aug. 24, 2000).

104. *See id.* at 51,719.

105. *See supra* note 102 and accompanying text.

106. *See Regulation FD*, SEC (last updated June 4, 2010), <http://www.sec.gov/divisions/corpfin/guidance/regfd-interp.htm>.

107. *See id.*

108. *See id.*

109. *See id.*

110. Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716 (Aug. 24, 2000).

111. *See Regulation FD*, *supra* note 106.

Experts also have suggested that corporate concerns related to Regulation FD may be overstated.¹¹² Indeed, the SEC has identified seven categories of information or events that have an increased potential to be deemed material, and corporate governance matters are not so identified.¹¹³ Thus, experts contend that there is a reduced likelihood that the information about which shareholders are most concerned will run afoul of Regulation FD.¹¹⁴ Only the SEC can bring an action under Regulation FD, there is no private right of enforcement.¹¹⁵ Studies reveal less than ten Regulation FD enforcement actions, and no enforcement action or investigation related to companies that have had or are planning to have private meetings with shareholders.¹¹⁶ Thus, the SEC—through guidance and its enforcement practice—appears to have made clear its intent not to use Regulation FD to chill shareholder communication with boards, potentially reducing concerns about the impact of Regulation FD.

Moreover, companies seeking to engage with shareholders have adopted many of the procedures recommended by the SEC, which in turn has enabled them to avoid potential legal liability while having constructive conversations with their shareholders.¹¹⁷ These procedures include: (a) developing an agenda limited to publicly available information,¹¹⁸ (b) ensuring that legal counsel is present at any shareholder meeting,¹¹⁹ (c) pre-approving topics for the meeting,¹²⁰ (d) providing a publicly-available record or transcript of the meeting,¹²¹ and (e) encouraging shareholders to sign nondisclosure agreements.¹²²

Thus, both corporate experience and regulator inaction suggest that while corporations must be mindful of Regulation FD, it should not serve as a major impediment to communication with shareholders. Governance experts note that corporations have over-emphasized the obstacle presented by Regulation FD, with some even suggesting that boards may be using Regulation FD as a “crutch” to avoid speaking with shareholders.¹²³

112. See *ViewPoints*, *supra* note 4, at 5; see also MARC GOLDSTEIN, THE STATE OF ENGAGEMENT BETWEEN U.S. CORPORATIONS AND SHAREHOLDERS: A STUDY CONDUCTED BY INSTITUTIONAL SHAREHOLDER SERVICES FOR THE INVESTOR RESPONSIBILITY RESEARCH CENTER INSTITUTE 20 (2011), available at http://www.irrcinstitute.org/pdf/IRRC-ISS_EngagementStudy.pdf.

113. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716.

114. See DAVIS & ALOGNA, *supra* note 6, at 10.

115. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

116. See DAVIS & ALOGNA, *supra* note 6, at 10.

117. See *id.*

118. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 126; ENHANCED SHAREHOLDER RIGHTS, *supra* note 87, at 4.

119. See sources cited *supra* note 118.

120. See sources cited *supra* note 118.

121. See sources cited *supra* note 118.

122. See sources cited *supra* note 118.

123. See GOLDSTEIN, *supra* note 112, at 20 (noting one asset manager’s assertion that Regulation FD concerns were “more of an excuse cited by issuers than an actual obstacle”); *ViewPoints*, *supra* note 4, at 5.

2. Grandstanding?

Some directors may be concerned that shareholder activists will use any additional board-shareholder meetings simply as a means of being disruptive or grandstanding, and thus may not truly have an interest in meaningful communication.¹²⁴ To be sure, there is a lot of anecdotal evidence suggesting that often the few people who attend annual meetings do so in order to be disruptive.¹²⁵ These anecdotes support the notion that shareholder meetings have become, in one expert's words, a "[t]heater of the [a]bsurd."¹²⁶ Such anecdotes also may undermine directors' desire to engage in shareholder dialogue beyond the status quo.

Such evidence should not be used to condone all forms of board-shareholder meetings, however. First, it is clear that some shareholder groups are serious about effective communication, and legitimately desire to dialogue with the board.¹²⁷ Second, shareholder behavior at the annual meeting is not a useful proxy for determining how shareholders will conduct themselves in other settings. This is because, as will be discussed in Part III, the annual meeting is not a useful platform for engagement. Most issues are settled prior to the meeting.¹²⁸ This may make it more likely that shareholders who attend the meeting will engage in symbolic, if not confrontational, tactics. Hence, such behavior

124. See Christina Rexrode, *The Loudest Shareholder Activist Ready for a Break*, USA TODAY, <http://usatoday30.usatoday.com/money/media/story/2012-07-13/evelyn-y-davis-gadfly-retires/56203956/1> (last updated July 13, 2012, 5:03 PM) (noting concern that activist shareholders make a "mockery of shareholder advocacy" by "grandstanding for attention" rather than "talking about the issues"); see also James Kristie, *The Fix is In*, DIRS. & BDS., First Quarter 2011, at 6, available at http://www.shareholderforum.com/e-mtg/Library/2011Q1_Directors%20&%20Boards-articles.pdf (noting that annual meetings are often hijacked by the "shout and yell of gadflies"); David Shaw, *The Directors and Boards Survey: The Effectiveness of Annual Meetings*, DIRS. & BDS., First Quarter 2011, at 36, available at http://www.shareholderforum.com/e-mtg/Library/2011Q1_Directors%20&%20Boards-articles.pdf (noting the perceived "hijacking of meetings").

125. See Josh Harkinson, *Wells Fargo Turns Away Its Own Shareholders From Its Shareholder Meeting*, MOTHER JONES (Apr. 24, 2012, 2:28 PM), <http://www.motherjones.com/mojo/2012/04/wells-fargo-turns-away-its-own-shareholders-annual-meeting> (discussing strategy of targeting shareholder meetings, and actions by some 2000 shareholders of blocking entrances and inflating a smoking rate in front of the site of the annual meeting); Rexrode, *supra* note 124 (discussing shareholder who purchases stock in various companies for the primary reason of attending annual meetings and heckling CEOs, shouting at other shareholders, and bringing "entertainment value" to the meetings); Ann Saphir & Tom Polansek, *Annual Meeting Disrupted by Activist Shareholders*, CHI. TRIB. (May 23, 2012), http://articles.chicagotribune.com/2012-05-23/news/sns-rt-cmeannual-meeting--update-111e8gnh-u4-20120523_1_cme-group-cme-s-executive-chairman-exchange-operator (noting annual meeting disruption resulting from shareholders shouting and clapping at meeting headquarters); see also Suzanne McGee, *'Shareholder Spring?' Protesters Roil Annual Meetings*, FISCAL TIMES, May 10, 2012, available at <http://www.thefiscaltimes.com/Columns/2012/05/10/Shareholder-Spring-Protesters-Roil-Annual-Meetings.aspx#page1> (describing shareholder antics at various companies).

126. Carl T. Hagberg, *What to do About the Annual Meeting?*, DIRS. & BDS., First Quarter 2011, at 25, 27.

127. See Shaw, *supra* note 124, at 38 (noting that shareholders raised pay questions at the annual meeting); *Dangerous Talk*, *supra* note 3, at 1 (noting shareholders' increased desire to discuss governance issues); GOLDSTEIN, *supra* note 112, at 5, 16 (pinpointing shareholder engagement over various governance topics).

128. See Hagberg, *supra* note 126, at 26.

should not be used to negate the utility of board-shareholder communication; instead, it tends to support the assertion that such communication must occur outside of the boundaries of the annual meeting to be effective.

3. *No Good Deed . . .*

Some may object to increased shareholder engagement based on the potential for such engagement to go awry. Importantly, studies suggest that boards and shareholders have differing perspectives regarding what constitutes effective engagement as well as what constitutes a successful engagement.¹²⁹ These differing perspectives create the potential that shareholder engagement could produce negative results.¹³⁰ Indeed, ineffective engagement could increase shareholder frustration and discontent with corporate officers and directors.¹³¹ This is particularly true if shareholders have no desire for true engagement, but instead want to use interactions with directors to advance their own personal agenda, or otherwise act as a corporate gadfly.

This possibility should not prevent corporations from seeking to further their engagement efforts, however. Rather, it underscores the need for careful planning and preparation. Fortunately, not only have corporations begun to identify best practices for such planning and preparation, but there are many examples of companies that have experienced success when employing those practices.¹³² Because the potential for negative outcomes can be minimized, corporations should not rely on that potential to prevent them from taking advantage of the clear benefits of increased board-shareholder engagement.

4. *Board Specific Objections*

Importantly, even those who acknowledge the need for increased engagement with shareholders raise several objections to engagement at the board level.

a. *Resource Constraints*

As an initial matter, one may object to board-shareholder communication based on the notion that directors may not have the time and resources to devote to effective shareholder engagement. Successful and

129. See Breheny, *supra* note 6, at 3; *ViewPoints*, *supra* note 4, at 5; see also GOLDSTEIN, *supra* note 112, at 3, 22–26.

130. See GOLDSTEIN, *supra* note 112, at 22. The report notes that issuers are “happy to talk, but investors want to see concrete action.” *Id.* Such a divergent view of success may mean that investors become frustrated when dialogue does not move beyond simply talking while boards may view the dialogue as successful in itself and thus may not necessarily see a need to take specific actions.

131. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 116.

132. See *id.* at 125–26; see also GOLDSTEIN, *supra* note 112, at 28; *ViewPoints*, *supra* note 4, at 7–8.

effective engagement can take a considerable amount of time. Studies reveal that such engagement can last anywhere from a week to more than a month.¹³³ Timing concerns are particularly acute at the board level. A recent study of engagement found that all respondents reported resource and time considerations as the most significant impediment to engagement.¹³⁴ Indeed, recent reforms impose additional responsibilities on directors that require them to devote considerably more time to their director duties.¹³⁵ Given that the vast majority of directors are not employed by the companies on whose board they serve, and thus only serve on the board in a part-time capacity,¹³⁶ it may be both impractical and inappropriate to impose even more responsibilities on directors, and expect that they can effectively carry out those responsibilities.

The observation regarding time constraints is valid, and any reform should appropriately consider whether directors have the capacity for effective performance. It is entirely possible, however, that effective board-shareholder engagement could enable directors to conserve valuable time and resources, or otherwise ensure that directors are not compelled to expend additional resources unnecessarily. Indeed, anecdotal evidence suggests that directors' failure to effectively communicate with shareholders could cause shareholders to reject corporate policies, prompting directors to devote added resources toward those policies to regain the support of shareholders.¹³⁷ This suggests, in turn, that proactive engagement can save valuable time and resources.

b. The Need for Consistency

Some may object to board-shareholder communication based on the corporations' need to speak with one voice. In essence, objectors might argue that it is important for the corporation to have a unified voice to demonstrate a shared commitment to corporate goals as well as stability within the corporation.¹³⁸ That voice, because of informational advantages, has historically been management and not the board.¹³⁹ In fact, it is possible that when boards speak directly with shareholders, boards may create distance between directors and managers or otherwise cause dissension that may frustrate the board's ability to work productively

133. See GOLDSTEIN, *supra* note 112, at 4.

134. See *id.* at 20.

135. See SPENCER STUART, 2011 SPENCER STUART BOARD INDEX 26–27 (26th ed. 2011), available at http://content.spencerstuart.com/sswebsite/pdf/1:6/SSBI_2011_final.pdf (noting increase in board meetings and time commitment associated with board duties in 2011, post Dodd-Frank and other financial reforms).

136. *Id.* at 14.

137. See Piore, *supra* note 50.

138. See Lissa Perlman, *The Best Way to Lead: One Voice and a Consistent Message*, DIRS. & BDS., Second Quarter 2010, at 25, 25.

139. See James Kristie, *Who Speaks for the Board?*, DIRS. & BDS., Second Quarter 2010, at 18 (noting that the longstanding tradition of the corporation has been that the corporation speaks with one voice—management).

with management.¹⁴⁰ Moreover, increased communication between directors and shareholders could lead to inconsistent and conflicting messages regarding the corporation's goals and practices.¹⁴¹

The increasing trend towards focusing on board independence, coupled with the trend toward emphasizing board responsibility to oversee management, means that interaction with management can no longer be deemed to be a proxy for interaction with the board.¹⁴² Instead, shareholders increasingly have been encouraged to view directors as an independent voice and as a check on managerial behavior and policies.¹⁴³ Reforms ranging from mandates of director independence on board committees to calls for separation of the position of board chair and the CEO both embody and solidify the belief that directors are supposed to act independently from managers.¹⁴⁴ This changed understanding of the directors' role increases shareholders' desire to communicate directly with directors because it encourages shareholders to view them as a separate and distinct voice.¹⁴⁵

c. Informational Disadvantage

Some also may suggest that shareholder engagement with the board is not necessary because boards have an informational disadvantage vis-à-vis other corporate actors. That is, boards do not have sufficient understanding of corporate affairs to handle such engagement.¹⁴⁶ Instead, corporations may be deemed to have many other actors who are better equipped to interact with shareholders.¹⁴⁷ First, most large public corporations devote significant resources to their investor relations department¹⁴⁸ that presumably has the expertise necessary to field investor queries. Hence, one may contend that the bulk of shareholder communication should fall on their shoulders. Second, corporate secretaries also have increasingly played a role in interacting with shareholders and keeping abreast of their concerns.¹⁴⁹ Studies reveal that such sec-

140. See Perlman, *supra* note 138, at 25.

141. See *id.*

142. See Karen Kane, *Communicating by Proxy is No Longer Enough*, DIRS. & BDS., Second Quarter 2010, at 28.

143. See *id.*

144. See Jay W. Lorsch, *Expectations Have Changed*, DIRS. & BDS., Second Quarter 2010, at 18.

145. See Kane, *supra* note 142, at 28.

146. See Lorsch, *supra* note 144, at 18.

147. See GOLDSTEIN, *supra* note 112, at 15 (noting the number of actors who initiate engagement at corporations).

148. See Alexander V. Laskin, *Investor Relations Practices at Fortune 500 Companies: An Exploratory Study*, in *THE IMPACT OF PR IN CREATING A MORE ETHICAL WORLD: WHY CAN'T WE ALL GET ALONG?* 241, 246-247 (2005), available at http://www.academia.edu/870724/Investor_Relations_Practices_at_Fortune_500_Companies_An_Exploratory_Study.

149. See SOC'Y OF CORPORATE SEC'YS & GOVERNANCE PROF'LS, *COMPENSATION SURVEY REPORT 25* (2009); SOC'Y OF CORPORATE SEC'YS & GOVERNANCE PROF'LS, *RESPONSIBILITIES OF THE CORPORATE SECRETARY'S OFFICE* 8, 12-13 (2001) [hereinafter *RESPONSIBILITIES OF THE CORPORATE SECRETARY'S OFFICE*].

retaries play a critical role in corporate-shareholder engagement, managing shareholder communications and acting as a liaison between the board and shareholders.¹⁵⁰ Finally, senior officers, particularly the CEO, are responsible for the day-to-day affairs of the corporation,¹⁵¹ and thus they may be better positioned to both address and respond to shareholder concerns.¹⁵² Arguably, all of these actors are better-informed than the board, and hence they should be responsible for any engagement with shareholders. By contrast, directors may have very little firsthand knowledge of everyday corporate affairs, making them less-equipped to effectively interact with shareholders.¹⁵³

This relative informational disadvantage may mean that requiring directors to interact with shareholders could have negative repercussions. If directors must respond to queries about which they have no knowledge, their lack of knowledge could fuel shareholder discontent by fostering an image that directors are ill-informed regarding critical corporate governance matters.

These concerns may support the need to be cautious with respect to board-shareholder engagement, as well as the need for engagement to occur at other levels. Any engagement should occur after careful consideration and assessment of the issues to be discussed. Engagement also should only occur when directors are fully informed regarding such issues. Finally, directors and management should distinguish between those issues that are most appropriate for directors to address and those that are best addressed by other actors.

Directors, however, should not be excused from the conversation altogether, particularly because the informational disadvantage that may normally be present with respect to directors may not exist in the context of the kinds of issues around which shareholders are most likely to want engagement. To be sure, not every issue is appropriate for board-level engagement. Yet, many of the issues about which shareholders are most interested are precisely those that are most appropriate for the board to discuss. A Spencer Stuart study revealed that shareholders are most interested in discussing compensation issues and topics related to board composition and structure such as majority voting, board-chair independence, potential directors, and classified boards.¹⁵⁴ Consistent with this interest, corporate governance experts almost universally agree that appropriate topics for board-shareholder communications include issues

150. See RESPONSIBILITIES OF THE CORPORATE SECRETARY'S OFFICE, *supra* note 149.

151. Corporate Laws Comm., ABA Section of Bus. Law, *Corporate Director's Guidebook*, 66 BUS. LAW. 975, 985 (2011) [hereinafter *Corporate Director's Guidebook*].

152. See Lorsch, *supra* note 144, at 18; see also Norman R. Augustine, *Malice in Wonderland*, BOARDROOM BRIEFING, Fall 2005, at 8, 8.

153. See Lorsch, *supra* note 144, at 18.

154. See SPENCER STUART, *supra* note 40, at 31; see also SPENCER STUART, 2009 SPENCER STUART BOARD INDEX 27 (2009), available at <http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI2009.pdf>.

such as executive compensation and board compensation and structure.¹⁵⁵ Indeed, reforms have made boards—as distinct from any other corporate actor—increasingly responsible for such issues.¹⁵⁶ This suggests that issues of most concern to shareholders are those issues that fall within the purview of the board’s responsibility, making directors uniquely qualified to engage with shareholders on such issues. As a result, governance experts have noted that a “communications approach that relies exclusively on management is increasingly disfavored.”¹⁵⁷

5. *Objections Based on Increasing Shareholder Power*

Some may object to increased board-shareholder engagement because it expands shareholders’ role, and hence power over corporate affairs. Such an objection would be similar to the general objections being made concerning the broader effort to increase shareholder power.¹⁵⁸ At its core, opponents of engagement contend that increased shareholder power undermines the efficiency of the board-centric model of the corporate form, while increasing the likelihood that shareholders with special interests will advance their personal agenda at the expense of the long-term interests of the corporation and the broader shareholder class.¹⁵⁹ This objection cannot be used to undermine the validity of a proposal for increased board-shareholder communication. First, regardless of the merits of such an objection, the fact that shareholders have gained increased power within the corporation makes it largely academic at this point. Second, to the extent that increased board-shareholder engagement can be used to alleviate some of the negative repercussions of increased shareholder power, opponents of that increase should support such engagement. Shareholders’ increased power gives them the ability to act in ways that may have significant and negative repercussions for the corporation and the board.¹⁶⁰ Effective communication with share-

155. See FRAMEWORK AND TOOLS, *supra* note 78, at 14; Ira M. Millstein et al., *Rethinking Board and Shareholder Engagement in 2008* (Jan. 2008), available at <http://www.weil.com/news/pubdetail.aspx?pub=6382> (noting that boards “are well-advised to be open to shareholder communications on topics that bear on board quality and attention to shareholder value”).

156. See *supra* Part II.

157. See ALAN L. BELLER ET AL., CLEARY GOTTlieb, BOARD FOCUS 2010: ISSUES AND DEVELOPMENTS 9 (2010), available at <http://www.cgsh.com/files/News/c4421659-91ea-4b7e-a660-3cb0a0faffd3/Presentation/NewsAttachment/fbb0e902-6619-4557-a5d5-3dc38f3125c5/CGSH%20Alert%20-%20Board%20Focus%202010.pdf>.

158. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 39–42; see also Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 624 (2006) [hereinafter *Shareholder Voting Rights*]; Bratton & Wachter, *supra* note 15, at 666–67; *Director Primacy*, *supra* note 15, at 1746.

159. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 39–42.

160. For example, shareholders can use their say on pay power to reject executive pay packages, which many corporations seek to avoid. See ALLEN, *supra* note 19, at 5. Shareholders also can use proxy access to nominate and ultimately elect directors to the board who may have goals and interests at-odds with existing board and management, while the changes with regard to classified boards means that shareholders may be able to unseat an entire board in one election cycle. See *supra* Part I.A. Shareholders also can withhold their votes against directors, and in a governance world in which cor-

holders has the potential to address this phenomenon. Thus, board-shareholder communication is vital *precisely* because shareholders have increased power.

C. Concluding Assessment

This Part demonstrates that while there are potential costs associated with board-shareholder engagement, they may have been overstated. Moreover, those costs must be balanced against the potential benefits of such engagement, which are significant. While it is certainly no panacea, current evidence strongly suggests that board-shareholder engagement can be a powerful antidote for the potential ills that can occur when shareholders are frustrated by the lack of effective communication with corporate boards.¹⁶¹ Hence, such engagement should be a priority for all corporations and their boards.

III. CRAFTING SOLUTIONS FOR ENHANCED ENGAGEMENT

If board-shareholder engagement should be prioritized, what should such engagement look like? This Part responds to this query in three parts. First, this Part argues that such engagement must move beyond traditional channels of communication. After assessing the potential alternatives, however, this Part argues that the decision regarding which alternative to adopt is best left to the discretion of the board. Third, this Part maintains that we should at least consider proposals that would more properly incentivize those corporations that fail to enhance their engagement efforts.

A. The Existing Communication Regime and Its Shortcomings

This Section demonstrates that the existing channels of communication are inadequate for promoting constructive dialogue, and hence argues that alternative channels must be adopted. Traditionally, the annual meeting, proxy statement, and shareholder proposal process represented the primary, if not exclusive, methods of communication between shareholders and the corporation/board.¹⁶² While each of these methods is important, none of them is particularly conducive to constructive dialogue between boards and shareholders.¹⁶³ Although technology has enhanced the ability of boards and shareholders to communicate,

porations have increasingly embraced majority voting, such withholding power can lead to directors losing their seat on the board. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 89–90.

161. See *supra* note 160 and accompanying text; see also *supra* Part II.A.

162. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 63–65 (discussing the shareholder meetings and proposal process); David Silverman, *Open Your Mindset to the Bigger Picture*, DIRS. & BDS., First Quarter 2011, at 33.

163. See *infra* Part III.A.1–3.

such technological advances do not appear to overcome the shortcomings of the current communication apparatus.¹⁶⁴

1. *The Annual Meeting*

Although the annual meeting is the primary, if not sole, setting in which shareholders have the opportunity to interact with directors face-to-face,¹⁶⁵ it is not an ideal setting for constructive dialogue for a host of reasons. First, effective engagement with concerned shareholders may not be feasible because most shareholders in public corporations are dispersed and hence do not attend the annual meeting in person; instead they attend and vote by proxy.¹⁶⁶ As a result, it is not clear that engagement at the annual meeting would reach the appropriate audience.¹⁶⁷ Second, the effectiveness of any engagement effort is undermined by the fact that most shareholders vote by proxy, and thus most shareholders will already have cast their vote prior to the annual meeting date.¹⁶⁸ Third, the fact that most issues are resolved prior to the annual meeting, and that most shareholders do not attend the annual meeting, increases the likelihood that those who attend the annual meeting may do so for symbolic reasons related to expressing their discontent, rather than to promote meaningful dialogue.¹⁶⁹ Fourth, the very fact that the annual meeting requires shareholders to vote increases the likelihood that such meetings will be contentious. In other words, the high stakes nature of some director elections and other matters to be voted on during the annual meeting may create a tense and contentious atmosphere that is not conducive to meaningful communications. Finally, because there may be a number of important matters on the annual meeting agenda, it may be difficult for shareholders and the board to focus meaningfully on other business during the annual meeting.¹⁷⁰ Thus, the annual meeting is not an ideal environment for constructive discussion between directors and shareholders.

2. *Proxy Statements and Disclosure Documents*

Clearly the proxy statement and other relevant disclosure documents serve as one of the first lines of communication between share-

164. See *infra* Part III.A.4.

165. See *Hoschett v. TSI Int'l Software, Ltd.*, 683 A.2d 43, 45–46 (Del. Ch. 1996) (noting that the shareholder meeting represents a forum for deliberation and confrontation); Elizabeth Boros, *Virtual Shareholder Meetings: Who Decides How Companies Make Decisions?*, 28 MELB. U. L. REV. 265, 268 (2004).

166. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 127.

167. See Hagberg, *supra* note 126, at 26.

168. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 127–28.

169. See Hagberg, *supra* note 126, at 26.

170. See Shaw, *supra* note 124, at 38 (revealing that most communications with shareholders at the annual meeting occurs through speeches and reports).

holders and directors.¹⁷¹ Because most shareholders do not attend the annual meeting in person, the corporate proxy statement has taken the place of the annual meeting as the primary platform through which public corporations communicate with their shareholders.¹⁷² Such communication through disclosure documents is valuable precisely because it is written and allows for more nuanced and thoughtful explanations of board positions.¹⁷³ As a result, such communication may reduce shareholder concerns and anxiety that could lead to increased activism. Importantly, shareholders' enhanced power has caused corporations and boards to place renewed emphasis on ensuring that their disclosure documents are more informative and understandable.¹⁷⁴

Disclosure, however, cannot be the only mode of communication, particularly because it is not a two-way dialogue. Disclosure does not allow shareholders to respond to directors or otherwise provide their insights and perspectives on corporate policies in a way that may allow boards to take such matters into account. Most experts agree that disclosure is a necessary, but not sufficient, component of board-shareholder engagement.¹⁷⁵ Instead, communication through disclosure documents serves as a critical complement to more constructive board-shareholder dialogue.

3. *The Shareholder Proposal Process*

The shareholder proposal process plays a critical role in the current communication environment. By introducing proposals on particular topics, shareholders signal to the corporation the issues about which shareholders are concerned, while their vote reflects the strength of shareholder support for such issues.¹⁷⁶ Most importantly, shareholder proposals often serve as an important starting point in a dialogue between corporations and shareholders around pivotal issues.¹⁷⁷ From this perspective, the proposal process has played an important role in shareholder engagement.

Like the proxy statement and disclosure documents more generally, the proposal process may be an important component of board-shareholder engagement, but it is not sufficient on its own. To be sure, the proposal process is critical. Often the mere submission of a shareholder proposal prompts more detailed and meaningful dialogue be-

171. See TEN THOUGHTS, *supra* note 87, at 2 (noting that "shareholder communications start with the company's public filings").

172. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 63.

173. See BELLER ET AL., *supra* note 157, at 82 (noting that corporations can use disclosure related to compensation to communicate the company's story "succinctly and in plain English").

174. See TEN THOUGHTS, *supra* note 87, at 2; see also *supra* note 13 and accompanying text.

175. See TEN THOUGHTS, *supra* note 87, at 2.

176. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 63-65.

177. See *id.*

tween shareholders and the corporation.¹⁷⁸ It has important limitations, however. First, the proposal process does not allow for significant interaction between the board and shareholders. Instead, the formal proposal process involves shareholders submitting a proposal and the board offering its response.¹⁷⁹ Such a process is a very limited form of two-way dialogue. Second, the proposal process is a very blunt engagement vehicle because when shareholders submit proposals they are limited to five hundred words, which does not allow for shareholders to pinpoint nuances in the concerns they raise through the proposal process and otherwise have more detailed explanations regarding their concerns.¹⁸⁰ In this regard, the proposal process may be an important starting point for engagement, but cannot be the sole mechanism for engagement.

4. *Internet-Based Communications*

Outside of the annual meeting and disclosure documents, technology has greatly enhanced a corporation's ability to communicate with shareholders. Every major corporation has a website that conveys critical information to shareholders.¹⁸¹ Many corporations also have blogs and Twitter accounts.¹⁸² Corporations use such devices to facilitate ongoing communication with their shareholders.

Corporations also can participate in electronic shareholder forums. In 2008, the SEC passed rules aimed at facilitating the use of electronic shareholder forums.¹⁸³ Such forums can take many forms from websites to blogs, but are essentially platforms that allow shareholders and corporations to communicate through the Internet.¹⁸⁴ The SEC's 2008 rules were designed to facilitate the use of electronic shareholder forums by removing some of the hurdles associated with such use.¹⁸⁵ The SEC believed that electronic shareholder forums could provide a cost-effective means of more routine communications among shareholders and between shareholders and the corporation.¹⁸⁶

Unfortunately, these technologies have been limited in their use and utility. First, it does not appear that corporations have used electronic shareholder forums in any significant manner.¹⁸⁷ Second, it appears that

178. *See id.*

179. *See* Shareholder Proposals, 17 C.F.R. § 240.14(a)-8(m) (2007).

180. *See id.* § 240.14a-8(d).

181. *See* SHAREHOLDER DEMOCRACY, *supra* note 1, at 121.

182. *See id.*

183. *See* Electronic Shareholder Forums, Exchange Act Release No. 57,172, Investment Company Act Release No. 28,124, 73 Fed. Reg. 4450 (Jan. 25, 2008).

184. *See id.* at 4451, 4457.

185. *See id.*

186. *See id.* at 4451, 4455.

187. *See* Melissa Klein Aguilar, *Online Shareholder Forums Slow to Catch On*, COMPLIANCE WEEK (Sept. 23, 2008), <http://www.complianceweek.com/pages/login.aspx?return=/online-shareholder-forums-slow-to-catch->

devices such as blogs and Twitter accounts have been used primarily as bulletin boards or announcement platforms,¹⁸⁸ and thus do little to promote two-way dialogue between shareholders and the corporation. Such a use is understandable given the public nature of such vehicles. Regardless, such use reveals that corporate communication through the Internet may do little to enhance thoughtful discourse between corporations and their shareholders.

5. *Virtual Shareholder Meetings*

Technology has expanded the extent to which shareholders and corporations can interact during the annual meeting. Most corporations not only broadcast their annual meetings through the web, but also allow shareholders to participate remotely.¹⁸⁹ Some corporations even host remote-only or virtual shareholder meetings, pursuant to which all shareholders participate in the meeting remotely.¹⁹⁰ During such meetings, corporations provide a mechanism for shareholders to submit questions before or during the annual meeting.¹⁹¹ Modern technology has increased the potential for shareholder engagement during the annual meeting.

This remote interaction, however, does not appear to support constructive dialogue between directors and shareholders. In fact, shareholders have been extremely resistant to proposals for electronic-only shareholder meetings.¹⁹² Shareholder advocates argue that remote meetings run counter to the primary benefits of face-to face meetings: the ability to directly interact with the board and management.¹⁹³ Shareholders also express concern that remote interactions would enable the board and management to ignore difficult issues.¹⁹⁴ Indeed, corporations that host remote meetings do emphasize the fact that they could not guarantee that they would address all shareholder questions during the meeting.¹⁹⁵ This fed shareholder fears that management would ignore shareholder concerns or otherwise only respond to favorable inquiries.¹⁹⁶ Shareholder concerns regarding remote-only meetings have led to very

on/article/185986/&pagetypeid=28&articleid=185986&accesslevel=2&expiredays=0&accessAndPrice=0.

188. See Julie Jones & Cynthia McMakin, *Is Your Company Tweeting Towards Trouble?—Twitter and Securities Law Compliance*, 23 *INSIGHTS* 19, 20 (2009) (noting that companies primarily use tweeting for marketing, advertising, and disseminating information).

189. See Lisa M. Fairfax, *Virtual Shareholder Meetings Reconsidered*, 40 *SETON HALL L. REV.* 1367, 1368 (2010) [hereinafter *VSM*].

190. See *id.* at 1388.

191. See *id.*

192. See *id.* at 1392–93, 1396.

193. See Boros, *supra* note 165, at 268; see also *VSM*, *supra* note 189, at 1391.

194. See *VSM*, *supra* note 189, at 1392.

195. See *id.* at 1388.

196. See *id.* at 1392.

few corporations relying on such meetings.¹⁹⁷ Shareholders do not view such meetings as a substitute for genuine interaction with the board.

6. *Informal Interactions*

Board-shareholder engagement can occur informally, such as through brief phone calls, email exchanges, or even short meetings. Studies indicate that corporations do informally interact with their shareholders. Such interactions may be more productive because they allow shareholders and corporate officials to speak outside of the spotlight, and in a more casual manner.¹⁹⁸ Such interactions also can occur more frequently because they can occur without the trappings of, including the preparation related to, a formal meeting. These informal interactions have drawbacks, however, and are insufficient on their own to ensure meaningful board-shareholder dialogue. There is the possibility that their more casual nature may increase the likelihood that directors and others who engage in such interactions do not do so with the appropriate planning and care necessary for all board-shareholder engagement.¹⁹⁹ Moreover, it is likely that corporate officials cannot delve into more serious governance issues during informal exchanges because of their relative brevity and casualness. From this perspective, it is likely that informal interactions can serve as a supplement to more formal engagements—providing an important starting point, laying important groundwork, or enabling brief follow-ups—but cannot supplant those engagements.²⁰⁰ Perhaps most critically, it is less likely that such informal interactions can occur at the board level simply because board members are part-time, and thus may not have the time to engage in these more routine and casual exchanges.²⁰¹ Indeed, studies reveal that informal interactions do not often occur with directors.²⁰² In fact, even during the annual meeting, only a small portion of interactions occur via one-on-one meetings between directors and shareholders.²⁰³ This suggests that such information exchanges may be rare and limited in their ability to facilitate constructive dialogue. Importantly, this Article distinguishes between informal interactions and private meetings. Under this Article's view, such interactions involve brief, more casual, exchanges with shareholders. By contrast, private meetings are more structured and formal. Such meetings not only may be productive because they occur behind

197. See *id.* at 1396.

198. See Joseph W. Yockey, *On the Role and Regulation of Private Negotiations in Governance*, 61 S.C. L. REV. 171, 171–72 (2009) (emphasizing the importance of private negotiations); GOLDSTEIN, *supra* note 112, at 9 (noting sentiment regarding the relative effectiveness of private meetings).

199. See *supra* notes 119–124 and accompanying text.

200. See GOLDSTEIN, *supra* note 112, at 12 (noting that some sixty percent of engagement with companies starts with a telephone call).

201. See SPENCER STUART, *supra* note 135, at 14.

202. See GOLDSTEIN, *supra* note 112, at 15.

203. See SHAW, *supra* note 124, at 38.

closed doors, but also are precisely the forms of engagement advocated by this Article.

7. *Concluding Assessment*

The various limitations to effective communication associated with the current communication regime mean that a different approach may be necessary for boards and shareholders to reap the benefits of constructive engagement. The next Section examines potential approaches and the board's role in determining their viability.

B. *New Avenues of Engagement*

A variety of different alternatives have been proposed for enhancing meaningful discussion between directors and shareholders. This Section examines some of the most prevalent.

1. *The Fifth Analyst Call*

In 2010, a group of institutional investors began requesting that several corporations host a "Fifth Analyst" call.²⁰⁴ A Fifth Analyst call refers to a dedicated teleconference with shareholders focused exclusively on governance issues.²⁰⁵ Under the proposal, either the independent board chair or the lead director would be required to participate in the call, while board committee chairs also would be encouraged to participate.²⁰⁶ The agenda would be agreed upon in advance, but would revolve around matters covered in the proxy statement.²⁰⁷ The call would occur after publication of the proxy statement, but prior to the annual meeting.²⁰⁸ In April 2011, Occidental Petroleum Corporation became the first—and to date the only—corporation to host such a call.²⁰⁹

The primary benefit of such calls is that they would enable board-shareholder communication outside of, and prior to, the annual meeting. Thus, the hope is that such calls would allow directors and shareholders to exchange their thoughts and insights regarding important governance

204. See ALEXIS KRAJESKI ET AL., REQUEST FOR INVESTOR DIALOGUE: FIFTH ANALYST CALL ON CORPORATE GOVERNANCE AND THE PROXY STATEMENT (2010) [hereinafter REQUEST FOR INVESTOR DIALOGUE], available at http://www.shareholderforum.com/e-mtg/Library/20101201_FifthAnalyst.pdf; David A. Katz, *Investor Communication and "Fifth Analyst Call,"* HARV. L. SCH. F. ON CORPORATE GOVERNANCE & FIN. REG. (Feb. 15, 2011, 9:13 AM), <http://blogs.law.harvard.edu/corp gov/2011/02/15/investor-communication-and-fifth-analyst-call/>. Such calls would be in addition to the quarterly analyst calls that corporations routinely host after they have released their quarterly financial results.

205. See Katz, *supra* note 204.

206. See *id.*

207. See REQUEST FOR INVESTOR DIALOGUE, *supra* note 204, at 3.

208. See *id.* at 1.

209. See Shanny Basar, *Occidental Petroleum Hosts 'Fifth Analyst Call'*, FIN. NEWS (April 7, 2011), <http://www.efinancialnews.com/story/2011-04-07/occidental-fifth-call>.

matters.²¹⁰ Because they predate the annual meeting and proxy voting, such calls also are designed to allow the board to further explain their positions to shareholders, or otherwise address any shareholder concerns prior to the shareholder vote.²¹¹

Critics raise several concerns regarding the Fifth Analyst call.²¹² First, it is possible that such a call would be redundant because issues in the proxy statement are covered extensively by the proxy statement.²¹³ Of course, the fact that the proxy statement addresses an issue does not necessarily mean that the issue has been addressed in a clear manner, or otherwise in a manner that would alleviate shareholder concerns, particularly if corporations have not engaged their shareholders and hence do not have a sufficient understanding of shareholder concerns. A second concern relates specifically to directors' participation. Critics insist that it would place an undue and unfair burden on directors to require them to speak to the wide range of issues raised by the proxy statement, particularly when such directors do not participate in drafting the proxy statement.²¹⁴ On the one hand, there does appear to be a wide range of topics about which investors would like directors to address during the Fifth Analyst call,²¹⁵ which raises concerns about directors' capacity to effectively engage.²¹⁶ On the other hand, not only is there a growing expectation that directors be familiar with information in their company's proxy statement, but also directors can shape the agenda to include only those items that are appropriate for board-level discussions.²¹⁷ The potential breadth of the agenda is thus a concern, but there is a potential to minimize that concern. Relatedly, critics argue that Fifth Analyst calls will require directors to expend too much time and resources.²¹⁸ While such a concern can be minimized by curtailing some of the issues to be discussed at the meeting, it also must be considered in light of the potential benefits to be gained.

There may be additional drawbacks to such calls that have not been raised by critics. Like a virtual shareholder meeting, such calls do not allow face-to-face interactions. As a result, it is not clear if they can actually facilitate direct interaction between directors and shareholders, partic-

210. See REQUEST FOR INVESTOR DIALOGUE, *supra* note 204, at 1.

211. See *id.* at 3.

212. Critics also raise concerns regarding whether such calls would violate Regulation FD.

213. See Katz, *supra* note 204.

214. See *id.*

215. See REQUEST FOR INVESTOR DIALOGUE, *supra* note 204, at 2-3.

216. See Katz, *supra* note 204.

217. See REQUEST FOR INVESTOR DIALOGUE, *supra* note 204, at 3 (noting that the agenda would be agreed upon prior to the meeting).

218. See Jeff Cossette, *Debate Rages over Fifth Analyst Call*, INSIDE INVESTOR RELATIONS (April 4, 2011), <http://www.insideinvestorrelations.com/articles/proxy-voting-annual-meetings/18141/debate-rages-over-fifth-analyst-call/>.

ularly if a large group of shareholders participate in the call.²¹⁹ There also is a potential that such calls could become rote and formulaic, undermining their utility.²²⁰ A key criticism of traditional shareholders' meetings and quarterly analysts calls is that they have become too scripted, rendering them invaluable.²²¹ From this perspective, there is a danger that once a meeting becomes part of a corporation's routine, it could become highly scripted, and thus not offer shareholders and directors any meaningful opportunity to hold a constructive conversation.

2. *Shareholder Governance Meetings*

A shareholder governance meeting refers to a meeting between the board and shareholders outside of the annual meeting.²²² Proposals with respect to such meetings run the gamut. Some have suggested that investors meet with particular board committees.²²³ Others have proposed that the corporation host an "investor day," whereby board members invite shareholders to engage with them.²²⁴ Still others have proposed that corporations meet routinely with their large investors.²²⁵ In fact, Pfizer became the first company to announce its intention to meet with its largest shareholders on a more routine basis.²²⁶ Pfizer then held one meeting with thirty of its largest investors; a handful of other companies followed Pfizer's lead and held such meetings as well.²²⁷

Like the Fifth Analyst call, such meetings have potential benefits and drawbacks. Such meetings would enable directors to interact with shareholders and potentially exchange perspective and insights regarding critical corporate governance issues.²²⁸ Because the meetings would occur in person, there may be a greater potential for constructive dialogue.²²⁹ Still, these meetings raise concerns with respect to resources and costs as well as the possibility that they would lose their utility by becoming mechanical and scripted.²³⁰

219. See REQUEST FOR INVESTOR DIALOGUE, *supra* note 204, at 2. Meetings will be held by conference calls or conducted virtually. Thus, there is a potential that communication may be hampered, particularly if large numbers of shareholders participate.

220. See *ViewPoints*, *supra* note 4, at 3; Hagberg, *supra* note 126, at 26.

221. See *ViewPoints*, *supra* note 4, at 3; Hagberg, *supra* note 126, at 26.

222. See *ViewPoints*, *supra* note 4, at 8–9.

223. See *id.* at 9.

224. See *id.* at 8–9.

225. See *id.* at 9.

226. See SHAREHOLDER DEMOCRACY, *supra* note 1, at 124.

227. *Id.*

228. See REQUEST FOR INVESTOR DIALOGUE, *supra* note 204, at 1.

229. See BOROS, *supra* note 165, at 260 (pinpointing the benefits of face-to-face meetings).

230. See *ViewPoints*, *supra* note 4, at 3; Hagberg, *supra* note 126, at 6.

3. *Structural Changes*

Some have suggested facilitating board-shareholder communication by making structural changes to the board itself.²³¹ Such changes include the creation of a new board committee responsible for shareholder relations as well as creation of an advisory committee comprised of shareholders and other interested parties whose task would be to provide insight to the board with respect to important governance issues.²³²

One benefit of these kinds of structural changes is that they may signal to shareholders that the corporation places a high priority on shareholder engagement.²³³ Similar to the creation of other committees, such changes may enhance directors' ability to oversee the corporation's engagement efforts, giving directors a greater ability to monitor and coordinate with other actors responsible for shareholder engagement.²³⁴

Some may view the addition of yet another board committee as unnecessary. Moreover, these structural changes do not appear to serve as a substitute for other mechanisms. Instead, they may best be viewed as a coordinating vehicle for these other mechanisms.

4. *Board Discretion*

In addition to their costs and benefits, each of these mechanisms raises a host of issues that must be resolved. For example, should shareholder engagements be public or private, or some combination thereof? There are at least two benefits of a private meeting; both shareholders and directors may be able to speak more candidly, and such a meeting may be more conducive to constructive dialogue.²³⁵ Indeed, the more people involved, the less likely that constructive dialogue can occur.²³⁶ Yet private meetings pose their own set of challenges. There is a greater risk of violating Regulation FD.²³⁷ Private meetings also raise concerns regarding transparency. Indeed, the Fifth Analyst call held by Occidental was private and was sharply criticized on the basis of its lack of transparency.²³⁸ Second, if the meeting is private, who should be allowed to participate in such meetings or calls? Potential attendees include both

231. See *Dangerous Talk*, *supra* note 3, at 2; *ViewPoints*, *supra* note 4, at 9.

232. See *Dangerous Talk*, *supra* note 3, at 2 (noting that UnitedHealth group had established an advisory committee to allow shareholders to suggest new directors).

233. See *Corporate Director's Guidebook*, *supra* note 151, at 1012–13 (explaining the importance of committees to board governance).

234. See *id.* at 1016–22 (explaining the coordination and monitoring function of audit committees).

235. See Yockey, *supra* note 198, at 171–72 (emphasizing the importance of private negotiations); see also GOLDSTEIN, *supra* note 112, at 9 (noting sentiment regarding the relative effectiveness of private meetings).

236. See Yockey, *supra* note 198, at 171–72; see also GOLDSTEIN, *supra* note 112, at 9.

237. See Yockey, *supra* note 198, at 210.

238. See *ViewPoints*, *supra* note 4, at 8 (noting that the Occidental call would have been improved through more transparency).

institutional and retail investors as well as proxy advisors and other market participants that influence shareholder voting. A limitation geared at institutional investors or large investors increases the likelihood that participants would have a significant and long-term interest in the corporation, but some corporations have large retail investor bases that should not be ignored.²³⁹ Muddling the picture still further, directors must consider whether and to what extent boards should include representatives from proxy advisory firms in the meeting.²⁴⁰ Third, how frequently should such meetings occur? Fourth, which member or members of the board should participate? These and other issues must be properly resolved to ensure that any engagement is effective, which suggests that directors should be involved in the decision regarding the appropriate form of engagement.

Ultimately, there is no one size fits all model of engagement because they all involve trade-offs that the corporation should carefully consider. The board is likely in the best position to balance those tradeoffs.

C. *Considering a Mandate*

Many boards appear reluctant to move beyond the status quo with regard to shareholder engagement.²⁴¹ While some of the reluctance is understandable, it is also possible that boards are allowing a general aversion to engagement to outweigh a proper assessment of the costs and benefits of such engagement. Thus, surveyed directors and investors have expressed concern that some directors and managers have a mindset against engagement that impedes their ability to have constructive discussions about the topic.²⁴² In a recent study of engagement, while only a small number of respondents would “go so far as to accuse [boards and managers] of being generally unwilling to engage,” nearly thirty percent of respondents cited “philosophical considerations,” such as entrenched management, as an obstacle to engagement.²⁴³ While some respondents expressed satisfaction with their access to directors, the survey highlighted the fact that a number expressed frustration with such access, while noting a “widespread perception” that management often acted as

239. Realistically, however, it may be difficult to host an efficient meeting if the entire retail investor base is included in the discussions. And corporations may legitimately contend that, in light of such difficulties, retail investors should be excluded from these special governance meetings and thus limited to raising concerns at the annual meeting. A potential middle ground could be to enable the board to limit participants to a certain number of institutional investors, while either allowing retail investors to listen to the meeting or distributing to such investors a transcript of the meeting.

240. Although some corporations and investors note that one of the benefits of board-shareholder communication may be that it enables directors and shareholders to talk directly to one another, without going through an intermediary. Hence, the proposal for a Fifth Analyst call specifically excludes proxy advisors. See REQUEST FOR INVESTOR DIALOGUE, *supra* note 204, at 3.

241. See Breheny, *supra* note 6, at 3.

242. See ViewPoints, *supra* note 4, at 6.

243. See GOLDSTEIN, *supra* note 112, at 21.

a “gatekeeper,” whose mission was to keep shareholders away from directors.²⁴⁴ As a result, it is entirely possible that some directors simply will not enhance their engagement efforts even when there may be clear benefits to such engagement, and even when the failure to engage causes the corporation and its shareholders to incur unnecessary costs.²⁴⁵

In light of this possibility, to the extent that constructive communication between directors and shareholders is vital, we may need to consider measures beyond mere encouragement. Such measures can take a variety of different forms, and could stem from a variety of different sources.

On one end of the spectrum are proposals that would give shareholders the ability to require engagement. For example, one possibility is that corporations could be required to host a special governance meeting when a specified number of shareholders request such a meeting. At least one institutional investor has advanced such a proposal.²⁴⁶ To be sure, determining an optimal ownership threshold for shareholders who make such a request would prove challenging. The optimal level is one that is not preclusive, but ensures that the ability to call a special governance meeting is utilized only by shareholders with significant and long term-interests in the corporation.²⁴⁷ In the context of shareholder proposals related to special meetings, while corporations appear to prefer a higher threshold such as twenty-five percent or more, shareholders have advocated lower thresholds, with ten percent being the threshold generating the strongest amount of shareholder support.²⁴⁸ Despite disagreement with respect to the threshold, in the special meeting context, corporations have recognized the importance of hosting a meeting once a significant number of shareholders indicate their desire to call the meeting.²⁴⁹ Thus, there is some recognition that requiring a meeting with shareholders is appropriate once a sufficient number of shareholders express their desire for such a meeting.

244. See *id.*

245. See *ViewPoints*, *supra* note 4, at 25 (noting that “the current paradigm of board-shareholder engagement fails both boards and shareholders”).

246. See Breheny, *supra* note 6, at 2.

247. See Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29, 384, 75 Fed. Reg. 56,668 (Sept. 16, 2010) (discussing the purpose of ownership thresholds, and noting one experts comment that “only those long-term shareholders who are seriously concerned about the governance of portfolio companies will have a seat at the table”).

248. See Richard Sandler & Elizabeth Weinstein, *Spotlight on Shareholder Proposals: Special Meetings*, DAVIS POLK (July 30, 2012, 11:15 AM), <http://www.davispolk.com/briefing/corporate-governance/blog.aspx?entry=201>; see also SULLIVAN & CROMWELL LLP, 2012 PROXY SEASON REVIEW 4-6 (2012) [hereinafter 2012 PROXY SEASON REVIEW], available at http://www.sullcrom.com/files/Publication/fdd28332-7b79-4d37-9ada-89da9bc111a9/Presentation/PublicationAttachment/d546858a-ee4a-43af-b379-170d4995e41c/2012_Proxy_Season_Review-7-20-2012.pdf.

249. 2012 PROXY SEASON REVIEW, *supra* note 248 (noting proposals by Vanguard and T. Rowe Price).

This proposal has clear drawbacks along with potential benefits. With respect to drawbacks, a proposal that augments shareholder power in this area could be viewed as objectionable on its face because it further shifts the balance of power away from boards. It is possible, however, that such a proposal could be deemed appropriate because it gives shareholders the ability to influence the decision regarding what constitutes an optimal level and mix of engagement. In addition to concerns about resources and inappropriate use by shareholders seeking to advance their own agenda, implementation of such a proposal involves several resource and other logistical hurdles (particularly resolution of the ownership trigger) that could prove insurmountable. By contrast, one important benefit of such a proposal is that it would not require corporations to hold a meeting every year.²⁵⁰ Instead, it enables shareholders to opt into a meeting when other forms of communication have not been deemed sufficient.²⁵¹ This therefore could be viewed as a soft mandate, as well as one that is consistent with private ordering. Moreover, it is possible that such a proposal's primary benefit would be indirect. In other words, the shareholder power to call a special governance meeting may be sufficient to induce directors to proactively reach out to, and engage with, shareholders to avoid the necessity of such a meeting. From this perspective, one of the primary benefits would be to alter director behavior with respect to engagement, particularly with regard to those directors who may be opposed to such engagement based on rigid attitudes against dialogue with shareholders.

On the other end of the spectrum are proposals related to the SEC. For example, the SEC could require disclosure on whether and to what extent corporations engaged in outreach beyond traditional channels.²⁵² The SEC has adopted disclosure requirements in an effort to influence corporate conduct,²⁵³ and has experienced some success.²⁵⁴ Such a disclosure rule may be sufficient to incentivize companies to enhance their engagement. There are costs and unintended consequences associated with regulation by disclosure.²⁵⁵ This disclosure approach, however, may be the most practical and desirable first step when considering how best the

250. See Breheny, *supra* note 6, at 2. The proposal enables shareholders to call a special governance meeting whenever they deem appropriate—and they meeting the threshold requirements—and thus such meetings are not required to occur annually.

251. See *id.* Shareholders presumably would call such meetings at their discretion, and likely once other methods of communication have fallen short of resolving the issues or issues of concern.

252. Such a rule could be crafted similar to the SEC's recent rule related to disclosure on board diversity, that requires corporations to disclose "whether, and if so, how" the nominating committee considers board diversity. See Lisa M. Fairfax, *Board Diversity Revisited: New Rationale, Same Old Story?*, 89 N.C. L. REV. 855, 866–67 (2011) [hereinafter *Board Diversity Revisited*]. The rule can be found at Corporate Governance, 17 C.F.R. § 229.407(c)(2)(vi) (2012).

253. See Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1270 (1999).

254. See *Board Diversity Revisited*, *supra* note 252, at 873–74.

255. See Geoffrey A. Manne, *The Hydraulic Theory of Disclosure Regulation and Other Costs of Disclosure*, 58 ALA. L. REV. 473 (2007).

SEC can better ensure that corporations are willing to embrace board-shareholder engagement because it falls short of mandating a corporate governance change, and thus may be deemed a more moderate reform.

There may be a wide range of objections to each of these proposals, or any other that does more than seek to encourage board-shareholder engagement. Most notably, some may insist that board-shareholder engagement will reach optimal levels without the need for the imposition of mandates. While studies with respect to increased levels of engagement may support this insistence,²⁵⁶ other indicators suggest that some corporations may prove unwilling to engage despite its benefits.²⁵⁷ To the extent this is a valid suggestion, proposals that aim to better incentivize board-shareholder engagement should at least be discussed. Indeed, given their increased ability to influence board elections and corporate policy, the failure to respond to shareholder frustrations in this area could have repercussions in other areas.

CONCLUSION

Shareholders' increased influence over corporate affairs has made board-shareholder engagement a corporate governance priority. Even once reluctant and resistant corporate directors and officers are beginning to realize the importance of outreach efforts involving directors and shareholders. This Article confirms the importance of board-shareholder engagement. Indeed, this Article argues that both the costs and the risks of board-shareholder engagement may have been vastly overstated, and that the benefits to be gained may be well worth the costs. This Article also identifies the shortcomings of the existing communication channels, and therefore argues for the adoption of alternative models of communication.

This Article further argues for consideration of proposals that would do more than merely confirm or encourage the benefits of board-shareholder engagement. Indeed, evidence suggests that at least some boards appear to be extremely reluctant to meaningfully enhance their interactions with shareholders, particularly with regard to engagement beyond traditional settings. This reluctance is unfortunate because it means that directors, and by extension the corporation, are missing out on a critical opportunity to better address shareholder concerns, better educate the shareholder base, better understand future issues, better respond to shareholder activism, and ultimately avoid contentious shareholder battles that often stem from lack of communication or miscommunication. As a result, this Article contends that we should consider reforms that would require or at least better incentivize boards to engage with shareholders. While such an action may seem costly and even risky

256. See ALLEN, *supra* note 19, at 12.

257. See *supra* notes 244–248 and accompanying text.

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at first glance, in the long run it may be riskier to allow some corporations to opt out of engagement and the corresponding benefits that flow from it.

