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Stimulating Long-Term Shareholding

Emeka Duruigbo

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STIMULATING LONG-TERM SHAREHOLDING

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ABSTRACT

This article answers, in the affirmative, two core research questions: do we need long-term shareholders and can we find them? The economy needs long-term shareholders to provide prudent and profitable patient capital, generate an antidote to corporate short-termism and spearhead managerial accountability. Finding these shareholders requires a structure that provides the right environment and incentives for such investment. The article presents a novel application of the trust fund theory – the dominant philosophical paradigm of American corporate finance in the 19th century - as a vehicle for stimulating long-term shareholding. The central features of the reformulated trust fund theory include the creation of relatively illiquid trust securities, a permanent fund financed by the sale of the securities, and long-term shareholders who, in exchange for less liquidity, receive an enhanced voice in corporate governance. Apart from addressing the need for long-term shareholding, the revised trust fund theory will also serve the additional functions of providing creditor protection and assuring regulatory compliance.

INTRODUCTION

Long-term shareholding is an essential, but increasingly scarce, commodity in a society currently consumed with a short-term orientation and an attention span that is mainly amenable to quick fixes.1 The economy needs long-term shareholders to provide prudent and profitable patient capital, generate an antidote to corporate short-termism and spearhead managerial accountability.2 However, finding shareholders who are willing to commit to a company for considerable periods of time and employ a long horizon approach to their investment is a difficult undertaking. It requires a structure that provides the right environment and incentives for such investment. A revised version of the trust fund theory would provide such a structure.3 Accordingly, this article presents a novel application of the trust fund theory and hypothesizes that its revival will stimulate long-term shareholding, facilitate effective governance and ensure business success based on a number of reasons developed below.4

The trust fund theory was the dominant philosophical paradigm in American corporate finance in the 19th century.5 Through the trust fund theory, the courts beginning in the 1820s

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1 Michael T. Jacobs, Short Term America: The Causes and Cures of Our Business Myopia (Harvard Business School Press 1991); Usha Rodrigues, Corporate Governance in an Age of Separation of Ownership from Ownership, 95 MINN. L. REV. 1822, 1826 (2011) (“In addition, one may question whether long-term investors exist at all today—if they ever did.”); Roberta S. Karmel, Should a Duty to the Corporation be Imposed on Institutional Shareholders?, 60 BUS. LAW. 1, 20 (2004) (urging policymakers to consider adoption of mechanisms to encourage long-term holding of securities by institutional investors, particularly pension funds and endowment funds that theoretically should be focused on the long-term) [hereinafter Karmel, Institutional Shareholders].

2 See Jonathan Macey, Uncle Sam and the Hostile Takeover, WALL ST. J. March 21, 2011 (stating that “the overall economy performs better when companies perform better”).

3 See infra Parts I & II.

4 See infra Part III.

5 See Daniel R. Kahan, Shareholder Liability For Corporate Torts: A Historical Perspective, 97 GEO. L.J. 1085, 1096-97 (2009) (stating that the trust fund theory was the dominant philosophical thinking in American law in the 19th century); James R. Ellis & Charles L. Sayre, Trust-Fund Doctrine Revisited: Part I, 24 WASH. L. REV. & ST. B.J. 44, 44 (1949) (stating that the trust fund theory was once termed the most important doctrine in the law of corporations).
postulated that capital contributions by shareholders to a corporation constituted a trust fund for the benefit of the corporation’s creditors. Further extension of the doctrine established that shareholders were also personally liable for the shortfall of portions of the stock price that remained unpaid or the difference between the stock’s par value and consideration provided for watered stock. Due to a number of problems, ranging from the conceptual to the practical, the theory received severe disapprobation of critics and fell into desuetude. The reformulated trust fund theory adopts and adapts the original theory by accepting its trust-premise and underlying creditor protection justification while taking into account valid criticisms of the theory.

Under this revived theory, the paid-in capital of some shareholders would constitute an expressly created trust fund for the benefit of creditors. Companies can create a separate class of common shares (“Class T”) to fund the trust. Holders of these securities will purchase the shares on the understanding that they will hold them for extended time periods, with ten-year restrictions on sale or transfer. Because of the limited liquidity of their holdings, the firm can readily count on the loyalty of these long term shareholders. This sense of loyalty and the

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6 John C. Coffee, Jr., The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role, 89 COLUM. L. REV. 1618, 1638 (1989) (stating that “the trust fund theory essentially held that the capital contributed by shareholders to a corporation in return for their shares constituted a trust fund for the benefit of creditors.”) [hereinafter Coffee, Balance in Corporate Law].

7 Sawyer v. Hoag, 84 U.S. (17 Wall.) 610, 21 L. Ed. 731 (1873) (establishing that the trust fund doctrine applied to unpaid stock subscriptions); James R. Ellis & Charles L. Sayre, Trust-Fund Doctrine Revisited: Part II, 24 WASH. L. REV. & ST. B.J. 134, 134 (1949); Norwood P. Beveridge, Jr., Does A Corporation’s Board of Directors Owe A Fiduciary Duty to Its Creditors?, 25 ST. MARY’S L.J. 589, 608 (1994) (“If paid-in capital stock is a trust fund, it takes but a short step to hold that an unpaid stock subscription agreement is property of a corporation which is held in trust for creditors…. and several courts in the 1800s took that step.”); Sam Denny & Edward S. Howell, Some Problems Raised by Issuing Stock for Overvalued Property and Services in Texas, 40 TEX. L. REV. 376, 379 (1962).

8 FRANKLIN A. GEVURTZ, CORPORATION LAW 130 (2d ed. 2010) (stating that the trust fund theory was developed early in the history of American corporate law as a basis for assigning liability to shareholders who received bonus, discount or watered stock). While the term ‘watered stock’ is used generically to refer to watered stock, bonus shares and discount shares, they are three different concepts. See ROBERT W. HAMILTON, JONATHAN R. MACEY & DOUGLAS K. MOLL, CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 282 (11th ed. 2010); MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 1260 (9th ed. Unabridged 2005) (showing that bonus shares refers to shares issued free of charge, possibly as a bonus for purchasing some other class of security; discount shares are shares issued for an amount below the par value, while watered shares are issued for property less than the par value).

9 See John W. Cioffi, Fiduciaries, Federalization, and Finance Capitalism: Berle’s Ambiguous Legacy and the Collapse of Countervailing Power, 34 SEATTLE U. L. REV. 1081, 1083 (2011) (stating that “[f]uture generations are free to refashion and use theories and analytical frameworks in new ways to address new problems, at least when their content and implications are not misstated.”).

10 Companies may also enter into similar arrangements with existing shareholders who purchased their stock from the external capital market and who accept the same conditions as Class T holders. Similarly, companies may allow current shareholders to convert their regular common stock into Class T shares. In these cases, there is no trust fund and the creditor protection angle will be missing, although other incidents and benefits of the proposed arrangement will be preserved. See Rebecca Wayland, The Case of Cummins Engine: Increasing Private Ownership in a Publicly Traded Company, HARV. BUS. REV., Sept.-Oct. 1992, at 74, 75 (illustrating with the case of a company some of whose major shareholders agreed not to sell their shares for six years in order to assist management in building long-term value).

attendant investment risk arising from the long, relatively illiquid holding, provide justification for affording these shareholders enhanced participation in the governance of the corporation, including allocating to them a number of seats on the board of directors, facilitating their nomination of candidates to fill those board positions and allowing them to vote on the corporation’s long-term strategy.\footnote{See Michael E. Porter, Capital Disadvantage: America’s Failing Capital Investment System, HARV. BUS. REV. Sept.-Oct. 1992, at 65, 81 (recommending that managers seek a smaller number of long-term or nearly permanent owners and give them a voice in corporate governance as a remedy to transient ownership which constitutes a major weakness in the American corporate system) [hereinafter Porter, Capital Disadvantage].}

In this reconstructed form, the trust fund theory can play a role in addressing several contemporary corporate law problems and assuring business success in several respects. For instance, the theory may be useful in serving its original creditor protection function. Creditors who feel more comfortable dealing with firms with a segregated pool of cash or who would otherwise require personal guarantees before transacting with firms may find the option palatable. This protection is even more critical for involuntary creditors whose claims result from the ultra-hazardous activities of the corporation. A trust fund approach may also be utilized by companies in certain industrial or commercial activities to meet regulatory requirements.\footnote{An example is the recently-debated imposition of a $10 billion cap for economic losses resulting from offshore drilling in the aftermath of BP’s Deep Horizon tragedy. See infra note 295 and accompanying text.}

A revised trust fund theory could offer a framework for effective shareholder monitoring of management through emphasis on voice instead of unlimited exit, proceeding on the understanding that voice is not likely to be amplified where exit is not substantially constrained.\footnote{Unless otherwise noted, this article uses the terms “management” or “managers” as shorthand ways of referring collectively to the corporation’s board of directors and senior officers. See David Millon, Theories of the Corporation, 1990 DUKE L.J. 201, 201 n.1 (1990).} In addition, it provides a pathway for creating the elusive class of permanent or quasi-permanent shareholders that has been viewed as key to ensuring corporate accountability, paralleling the practice that prevailed for a long time in Germany and Japan. Class T shareholders will improve board accountability by injecting into the boards nominees who share their view that the primary responsibility of the board is to build long-term shareholder value.\footnote{See REPORT OF THE NEW YORK COMMISSION ON CORPORATE GOVERNANCE 2 (Sept. 23, 2010) (“The board’s fundamental objective should be to build long-term sustainable growth in shareholder value for the corporation, and the board is accountable to shareholders for its performance in achieving this objective.”).} The re-focused board will accordingly prioritize managerial devotion to this goal. Class T shareholders will also improve management accountability by directly monitoring managers.\footnote{Id. (“[T]he Commission believes that shareholders have the right and responsibility to hold a board accountable for its performance in achieving long-term sustainable growth in shareholder value.”).}

Further, the “permanent owner” notion can contribute to entrenching a long-term shareholder primacy norm. This norm can promote a long horizon approach to investment and management, thereby presenting at least a partial panacea to shareholder short-termism and managerial myopia that has caused consternation in corporations and the investment community.\footnote{This objective could be strengthened by a complementary arrangement on the managerial side in the form of an executive compensation structure that involves further restricted stocks and stock options with holding periods of about 10 years. See Sanjai Bhagat & Roberta Romano, Reforming Executive Compensation: Focusing and Committing to the Long-Term, 26 YALE J. ON REG. 359 (2009) (proposing the adoption of restricted stock and stock}
option plans for certain companies to discourage a short-term focus and encourage a long-term perspective by managers; Janice Kay McClendon, Bringing the Bulls to Bear: Regulating Executive Compensation to Realign Management and Shareholders’ Interests and Promote Corporate Long-Term Productivity, 39 WAKE FOREST L. REV. 971, 994-95 (2004) (advocating longer holding periods for stocks held by corporate executives).

18 See Leo E. Strine, Jr., Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward, 63 BUS. LAW. 1079, 1082 (2008) (“Most individual investors are invested for the long term to accomplish two key objectives, having the funds necessary to pay for their children’s college education and to provide for themselves in retirement. These investors have little interest in short-term gimmicks . . . .”)

19 Amir N. Licht, Corporate Governance, in ENCYCLOPEDIA OF FINANCIAL GLOBALIZATION 1, 1 (Gerard Caprio ed., 2011) (“Corporate governance is the institutional framework that regulates the division and exercise of power in the corporation.”).


22 The SEC regulations require a larger investment threshold (at least 3 percent of the total voting power of the company’s securities) than the present proposal envisages. They also impose a requirement that the right is available only to shareholders who have held a company’s stock for at least 3 years. My proposal has no minimum holding period for eligibility to exercise any of the privileges accompanying the holding of these securities, but requires a firm and enforceable commitment to hold the stock for ten years. Unlike the SEC proposal, which is mandatory, this proposal relies on private ordering, leaving it up to corporations to adopt or amend as they see fit. See generally U.S. Securities and Exchange Commission, Final Rule: Facilitating Shareholder Director Nominations, Release No.33-9136; 34-62764 (August 25, 2010); Fisch, Proxy Access, supra note 20, at 54-59; Bernard S. Sharfman, Why Proxy Access (SEC Rule 14a-11) is Harmful to Corporate Governance, SOCIAL SCIENCE RESEARCH NETWORK 5 (June 27, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1873469 (last visited July 3, 2011) (assailing the SEC’s proxy access rule as wealth-reducing because it has no opt-in or opt-out provisions). For additional discussions of the importance of private ordering in corporate law and generally, see ROBERTA ROMANO, THE GENUS OF AMERICAN CORPORATE LAW 86-96 (1993); Henry N. Butler & Larry E. Ribstein, Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians, 65 WASH. L. REV. 1, 8 (1990) (stating that “private parties to the corporate contract should be free to order their affairs in whatever manner they find appropriate.”); Lucian A. Bebchuk & Scott Hirst, Private Ordering and the Proxy Access Debate, 65 BUS. LAW. 329 (2010); Joseph A. Grundfest, The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law, 65 BUS. LAW. 361 (2010);
incentives to adopting corporations and their shareholders. It responds to a lingering challenge to develop a model of corporate governance that incentivizes major shareholders to invest in a public corporation in the manner that shareholder-managers of a closely held corporation grow and nurture their enterprise for the long term. It also contributes to constructing a reformed system for American corporations that would assure the country’s competitive advantage. A number of managers of public corporations who long for long-term allies and large institutional shareholders, who want to hold stock for a long time, but also want better corporate risk management, are likely to respond favorably to the opportunity provided by the present proposal.

This article proceeds in four parts. Part I presents a historical synopsis of the trust fund theory. Part II focuses on the nature and structure of the revived trust fund theory. Part III advances arguments in favor of the revived theory while Part IV examines opposing arguments. This article concludes that the demands of modern investing and entrepreneurship present favorable opportunities for rediscovering the trust fund theory as a tool for addressing corporate problems. Therefore, it invites public corporations to adopt the revised version and urges public officials to further incentivize the adoption.

I. HISTORY OF THE CORPORATE TRUST FUND THEORY

The trust fund doctrine’s origins trace back to the early 19th century case of Wood v. Dummer, where Justice Story, while sitting on circuit, relied on public policy and presumed...
legislative intent to advance the notion that the capital stock of a corporation constituted “a pledge or trust fund” for creditors. In the words of the celebrated jurist:

It appears to me very clear upon general principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of the debts contracted by the bank. The public, as well as the legislature, have always supposed this to be a fund appropriated for such purpose. The individual stockholders are not liable for the debts of the bank in their private capacities. The charter relieves them from personal responsibility, and substitutes the capital stock in its stead. . . . To me this point appears so plain upon principles of law, as well as common sense, that I cannot be brought into any doubt, that the charters of our banks make the capital stock a trust fund for the payment of all debts of the corporation.

While the trust fund doctrine was enunciated in a case involving a bank, its application was not limited to financial institutions but extended to corporations engaged in other types of business. In Sawyer v. Hoag, the Supreme Court gave its imprimatur to the doctrine. The trust fund doctrine has been viewed as “a peculiar creature of equity, having no foundation in common law or general corporate law principles; an extraordinary device used to achieve fair and just results.” Thus, its nature called for circumspection in its application.

One striking feature of the trust fund idea is that it was pivotal in ensuring the lock-in of capital investments, which in turn helped assure a long-term focus. According to Professor Margaret Blair, through the doctrine, “the corporate form made it possible for investors in shares, as well as creditors, employees, and suppliers, to enter into long-term relationships with a firm with greater assurance that the pool of assets would remain in the business to keep the business going forward.” For many years, the doctrine was broadly applied to both solvent corporations

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29 Wood, 30 F. Cas. at 436.
31 84 U.S. 610, 620 (1873) (“Though it be a doctrine of modern date, we think it now well established that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund for the benefit of the general creditors of the corporation.”)
33 Norton, supra note 28, at 1066.
34 Id.
35 Margaret M. Blair, Reforming Corporate Governance: What History Can Teach Us, 1 BERKELEY BUS. L.J. 1, 15 (2004).
36 Id.
and those facing insolvency. Eventually, a preponderance of support, in terms of opinion and practice, gravitated toward applying the trust fund concept only to corporations grappling with insolvency or dissolution.

The notions of par value and legal capital were central to the application of the original trust fund theory. Companies issued stocks for a par value, the arbitrary amount below which the company could not sell those shares to subscribing shareholders. The sum received from the sale of the stock at that amount constituted the corporation’s legal capital. “Although the rules were incredibly complex, the underlying principles were clear: a corporation could not sell shares for less than par and always had to retain a sum at least equal to its legal capital for the benefit of creditors.” The firm was free to distribute the surplus, i.e., the amount above the legal capital, as dividends to shareholders.

Shrewd corporate managers and resourceful lawyers were able to skirt the par value and legal capital requirements, leading creditors to realize that legal capital did not offer any real protection, as the funds were not secured. Moreover, creditors tended to rely more on other indices, such as earnings, to measure the firm’s ability to repay money advanced to it. Modern corporation statutes made par value an anachronism and shares are routinely issued for nominal or no par value.

37 Union Nat. Bank v. Douglass, 1 McCra. 86, 96 (“The truth is that it makes no difference whatever whether a corporation is solvent or insolvent, so far as the doctrine is concerned that the property is a trust fund which cannot be withdrawn or appropriated by the stockholders until the debts are paid.”); see also Norton, supra note 28, at 1064; Beveridge, supra note 7, at 616.

38 See Norton, supra note 28, at 1065-66.

39 See WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE, 228 (11th ed. 2010); Coffee, Balance in Corporate Law, supra note 6, at 1638 (“The entire concept of par value was simply a means of implementing this theory through a mechanical rule for measuring the size of the trust fund.”); Reuven S. Avi-Yonah, The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility, 30 DEL. J. CORP. L. 767, 799 n.112 (2005) (stating that the advent of the no par stock in the early 20th century reinforced the fall of the trust fund doctrine into desuetude).

40 HAMILTON, MACEY & MOLL, supra note 8, at 279.


42 Wells, supra note 41, at 605-06.

43 A corporation may assign a par value of $1 to its shares. If it sells each share for $10, $1 of the realized amount will be deemed capital, while $9 may be considered surplus. Shareholders may receive dividends to the extent of the surplus, even if the corporation is not currently profitable. See GREGORY V. VARALLO, DANIEL A. DREISBACH & BLAKE ROHRBACHER, FUNDAMENTALS OF CORPORATE GOVERNANCE: A GUIDE FOR DIRECTORS AND CORPORATE COUNSEL 92 (2d ed. 2009).

44 Id. at 606; Hu & Westbrook, supra note 28, at 1333, THOMAS R. HURST & WILLIAM A. GREGORY, CASES AND MATERIALS ON CORPORATIONS 281 (2d ed. 2005) (stating that legal capital offered mainly illusory protection as a corporation could exhaust the funds paid in for shares in running its operations).


The trust fund doctrine acquired an important place in American jurisprudence, dominating corporate finance thinking in the 19th century. Courts and commentators eagerly embraced the concept, but criticisms were equally forthcoming with considerable speed. Only a few years after its enunciation, one commentator observed that the theory “has been alternately applied and rejected by courts and eulogized and condemned by text writers.” Some major complaints about the doctrine focused on the conceptual challenges it raised. In the first instance, critics considered the idea of a trust a “misleading misnomer,” as there was no express or constructive trust involved. It was not only a trust that was non-existent, there also was no fund. One author sums up these particular doctrinal impediments by noting that it is inapposite to use the term “trust fund” because “capital claims of shareholders are not a “fund” (there are no assets in the “capital stock” account; it is a claim notation only) and it is not a

the “outmoded” concepts of par value and stated capital set out in the MBCA in the apparent belief that the traditional legal capital doctrines were unduly complex, confusing and misleading.” (Citation omitted); Elliot Goldstein & Robert W. Hamilton, The Revised Model Business Corporation Act, 38 BUS. LAW. 1019, 1021 (1983); Changes in the Model Business Corporation Act – Amendments to Financial Provisions, 34 BUS. LAW. 1867, 1867-68 (1979) (explaining that the concepts of stated capital and par value were deleted from the revised Model Act by the Committee on Corporate Law because the concepts no longer served the original purpose of providing protection to creditors and senior security holders); Current Issues on the Legality of Dividends from a Law and Accounting Perspective: A Task Force Report, 39 BUS. LAW. 289, 304 (1984) (stating that California abandoned the concept of stated capital and par value even before the Model Business Corporation Act).

Beveridge, supra note 7, at 595; Kahan, supra note 5, at 1096-97.

15A WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §7369 (perm. ed., rev. vol. 2000) (stating that “perhaps no concept has created as much confusion in the corporate law as has the “trust fund doctrine”) (cited in Phillip I. Blumberg, Blumberg on Corporate Groups, Vol. 2, at 84.05 (C) (2005)); Comment, The Appointment of Receivers at the Instance of Creditors Upon the Mere Insolvency of a Corporation, 14 YALE L.J. 232, 233 (1905) (“The trust fund theory was established by Justice Story [and] has been greatly criticised and quite generally repudiated.”)

41 Note, The “Trust Fund” Theory, 9 HARV. L. REV. 481, 481 (1896) [hereinafter Trust Fund Theory]. See also Recent Cases, Corporations – Directors and Other Officers – Trust Fund Theory, 23 HARV. L. REV. 309, 309 (1910) (“This doctrine, formerly widely accepted in this country, has been rejected in many jurisdictions and is generally adversely criticized by legal writers.”); James C. Bonbright, No-Par Stock: Its Economic and Legal Aspects, 38 Q.J. ECON. 440, 443 (1924) (“Within recent years the “trust fund doctrine” has been rejected by the best legal authority.”) (citation omitted).


51 Trust Fund Theory, supra note 49, at 482.

52 See Hospes v. Northwestern Mfg. & Car Co., 48 MINN. 174, 50 N.W. 1117, 1119 (Minn., 1892) (calling it misleading); Gottlieb v. Miller, 154 ILL. 44, 48; 39 N.E. 992 (“The supposed trust does not fall within the definition of either an express trust, an implied trust, a resulting trust or a constructive trust.”); G.W. Pepper, The “Trust Fund Theory” of the Capital Stock of a Corporation, 41 AM. L. REG. 175, 180 (1893) (explaining that “the distinctive attributes of a trust fund were wanting in the case of the capital stock of a corporation, whether paid or unpaid and that the use of the term was an abuse of it.”) ; Norton, supra note 28, at 1067–1071; McRae, supra note 41, at 330 (“Since corporate assets are not held in trust by the corporation, the trust fund theory, as an explanation of the basis of liability, has been completely discredited . . . .”) James T. Johnson, Is the Trust Fund Theory of Capital Stock Dead? 34 ACCOUNT. REV. 609, 609 (1959) (“The corporation is not a formal trustee of the contributions made by shareholders, and the creditors are not beneficiaries”) [hereinafter Johnson, Trust Fund].

53 GEVERTZ, supra note 8, at 130 (stating that a “problem with the theory from a doctrinal standpoint is that it is difficult to speak of a trust fund when there is no fund.”); JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 503 (2d ed. 2003) (“There is in fact no true trust fund at all, but only a legal prohibition against withdrawal of corporate assets that reduce the margin of safety for creditors.”).
“trust.” There is not really a trustee holding assets of the firm for the benefit of creditor beneficiaries.”

Commenting on Justice Story’s statement that a corporation’s capital stock constitutes a trust fund for creditors, Professor Edward Warren calls it a “venerable utterance, sonorous, and of benevolent connotation,” but also untrue. Professor Warren argued that the proper approach would be to view the issues of watered stock and voluntary diminution of capital as a negation of the legislature’s intent and therefore illegal, instead of inventing a new doctrine of trust funds.

Other writers expressed similar sentiments, complaining that the theory’s questionable legal foundation led to inconsistencies in application. One court noted that the doctrine “has often been repudiated as a fiction unsound in principle and vexing in business practice.”

The mode of enforcement of the doctrine and the attendant uncertainty placed many shareholders in personal jeopardy while imperiling millions of dollars in investments. In one particular case, the U.S. Supreme Court held investors liable for the difference between the par value and the price for which they purchased their shares twenty-five years after the company’s failure. In addition, the Supreme Court while reaffirming the trust fund doctrine in \textit{Handley v. Stutz}, created a distinction between original subscription to shares and subsequent issue of shares by a corporation as it continued to operate in business. The trust fund doctrine, according to the Court, applied to the former but not the latter. This leeway enabled corporations to finance their operations by selling stock at a price the market was willing to pay, even if lower than the par value, without the fear of liability that would have dissuaded potential investors from purchasing the stock. Yet, the apparent “incoherence of the Court’s distinction

\footnotesize{\textsuperscript{54}} J.S. \textsc{Covington, Jr.}, \textit{Basic Law of Corporations: Cases, Text and Analyses} 284 (1989).


\footnotesize{\textsuperscript{56}} \textit{Id.; See also} Chas E. Carpenter, \textit{The Doctrine that the Assets of Corporation are a Trust Fund for the Benefit of Creditors}, 2 Or. L. Rev. 122, 122-23 (stating that the trust fund theory’s purpose of preserving corporate capital as a fund for the payment of creditors could be adequately explained and accomplished “without invoking any misleading phraseology by saying the law imposes an obligation upon the stockholders not to withdraw the fund which the statutes have required to be set up and maintained for the protection of creditors.”).

\footnotesize{\textsuperscript{57}} See Edwin S. Hunt, \textit{The Trust Fund Theory and Some Substitutes for It}, 12 Yale L.J. 63, 74 (1902); \textit{Trust Fund Theory, supra} note 252, at 482 (“Just what the doctrine is, even those who uphold it do not seem to know. It seems to be an accommodating judicial \textit{ignis fatuus}, which is present or absent as courts seem to require. No court has been able to describe it exactly, or to define its limits.”).

\footnotesize{\textsuperscript{58}} Reif v. Equitable Life Assur. Soc’y of the United States, 197 N.E. 278, 280 (N.Y. 1935).

\footnotesize{\textsuperscript{59}} See Horwitz, \textit{supra} note 32, at 207.

\footnotesize{\textsuperscript{60}} \textit{Id. at} 208. Legislative changes restricted the application of the doctrine in cases such as these. See Drew R. Fuller, Jr., \textit{Stockholder Liability – Article 7.12 of the Texas Business Corporation Act is the Exclusive Expression of the Trust Fund Theory in Texas}, 13 St. Mary’s L.J. 660 (1981) (discussing statutory modification of the trust fund doctrine to limit the time frame in which a shareholder could be held liable for obligations subsequent to the dissolution of the corporation).

\footnotesize{\textsuperscript{61}} 139 U.S. 417 (1891).

\footnotesize{\textsuperscript{62}} \textit{Id.} (holding that “an active corporation may, for the purpose of paying its debts and obtaining money for the successful prosecution of its business, issue its stock, and dispose of it for the best price that can be obtained.”)

\footnotesize{\textsuperscript{63}} See Horwitz, \textit{supra} note 32, at 211.

\footnotesize{\textsuperscript{64}} \textit{Id.} One writer explains the rationale in a case where a company wanted to raise money through new issuance of stock but its existing stock was trading at below par value and no new shareholder would be willing to pay par value for such devalued stock. In such a situation, an existing creditor can hardly complain because the money raised from the watered stock added to, instead of reducing, the capital of the corporation and improved, rather than diminished, the creditor’s chance of recovery. But there is still a problem as to the burden imposed on subsequent creditors. See Pepper, \textit{supra} note 52, at 176-77.
between the liability of different classes of shareholders” only provided additional fodder for those intent on abandoning the trust fund doctrine.65

One of the strongest attacks on the doctrine came from Justice Mitchell of the Minnesota Supreme Court in Hospes v. Northwestern Mfg. & Car Co.,66 who opted to replace the trust fund theory with a fraud, holding out or misrepresentation theory.67 Justice Mitchell’s reasoning was that shareholders were liable for the balance of the par value of their shares that remained unpaid because the business community relied on the corporate capital.68 Accordingly, only creditors who relied on the availability of capital stock in dealing with the corporation were entitled to a remedy.69 Those who dealt with the corporation before the issuance of watered stock or knew of the bonus shares but proceeded to enter into dealings with the corporation had no recourse.70 This approach presented a sharp contrast to the trust fund doctrine, which sought to protect all creditors, regardless of their knowledge or situation.71 Professor John Coffee elaborates on this point and the conceptual difficulties of viewing the corporate assets as a trust fund noting that “it was difficult to see how creditors who advanced their funds to the corporation before the issuance of “watered” stock were in any way injured by the later issuance, since they had not relied on the additional capital so contributed.”72

The criticisms mounted, and after 150 years of its articulation and application, one circuit court opinion agreed with the observation that the doctrine has generated confusion in corporate law.73 While the trust fund doctrine is not completely defeated, it ultimately succumbed to the weight of criticisms, the adoption of alternative means of accomplishing its objectives, and the absence of its respected progenitor to continually animate it.74 The reality is “today the once proud trust fund doctrine is but a tattered shadow of its former self.”75

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65 Horwitz, supra note 32, at 211.
66 48 N.W. 174, 50 N.W. 1117 (Minn., 1892).
67 See Kenneth B. Davis, Jr., The Status of Defrauded Securityholders in Corporate Bankruptcy, 1983 DUKE L.J. 1, 5 (stating that by the turn of the 20th century, courts had started substituting the trust fund theory with a reliance-based theory.); Eisenberg, supra note 8, at 1261 (stating that “Hospes substituted a new theory, known as the constructive-fraud, misrepresentation, or holding out theory.”)
68 Hospes, 48 MINN. at 198.
69 Id. at 197, (holding that “it is only those creditors who have relied, or who can fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of “bonus” stock.”).
70 Id. at 196-97.
71 It should be noted that the fraud theory has had its fair share of criticisms. See, e.g., Gevirtz, supra note 8, at 131 (stating that “while the legal premise behind the misrepresentation theory is unassailable, its factual premise is shaky.”); C. Robert Morris, Some Notes on “Reliance”, 75 MINN. L. REV. 815, 816-820 (1991); Comment, Shareholder Liability for “Watered” Stock – A Windfall to Creditors, 9 STAN. L. REV. 191, 201-202 (1956).
72 Coffee, Balance in Corporate Law, supra note 6, at 1638 n. 57.;
74 Bruce A. Markell, The Folly of Representing Insolvent Corporations: Examining Lawyer Liability and Ethical Issues Involved in Extending Fiduciary Duties to Creditors, 6 J. BANK. L. & PRAC. 403, 406 (1997) (“The trust fund theory rose to prominence primarily on the strength of Justice Story’s reputation. It then fell into disuse after his tenure on the Supreme Court, replaced by more detailed corporate statutes and by fraudulent transfer law.”); John C. McCoId, II, Corporate Preferences to Insiders, 43 S.C. L. REV. 805, 823-24 (1992) (“Even in its original context, the trust-fund theory generally has been rejected. . . . It was used over and over and is a good example of how a catchy phrase or the reputation of a jurist can stand in the way of thoughtful inquiry. Even today, the theory is not entirely dead, although its defects are widely recognized.”) (Citation omitted); Beveridge, supra note 7, at 600 (“Through the sheer force of Justice Story’s efforts, the trust fund doctrine entered legal history and became the
II. REVIVED TRUST FUND THEORY: NATURE AND STRUCTURE

Discussing the ostensible basis of Justice Story’s dicta in *Wood*, Professor Joseph Norton makes an observation that is analogous and germane to the status of many public corporations today. First, the public nature of the corporation involved in that case may have played a significant role and it appeared quite appropriate to use the term “trust” in reference to that type of institution. Also, there was widespread suspicion of corporations in 1824. This is not remarkably dissimilar from the level of mistrust defining public views of many large corporations today. The absence of trust has been linked to corporate short-termism: “Public suspicion and mistrust of large companies in particular is due to their lack of long-term responsibility or social conscience.”

The journey toward regaining respect, *ipso facto*, will incorporate a long-term focus and a mutually beneficial approach that encompasses interests within and outside the corporation. It is apposite to undertake an examination of today’s problems in light of the reaction of a previous era sharing similar characteristics. This part takes up that task in adapting the features and strong points of the trust fund to the resolution of some of the current problems plaguing corporations and the society. The nature and structure of the revived trust fund will encompass the following elements.

basis for countless decisions until the closing years of the nineteenth century, by which time, although still somewhat influential, it had generally fallen into intellectual disrepute.”) (Citation omitted).

75 STEPHEN M. Bainbridge, CORPORATE LAW 420 (2d ed. 2009); See also Johnson, Trust Fund, supra note 52, at 610 (adducing additional reasons for the decline of the trust fund theory).

76 Norton, supra note 28, at 1064.

77 Id.; see also Coffee, Balance in Corporate Law, supra note 6, at 1633 n. 36 (stating that the rule formulated by Justice Story “lacked precedent in the prior English case law, but reflected the skepticism then prevalent in the United States about use of the corporate form.”).

78 See Michelle M. Harner, Corporate Control and the Need for Meaningful Board Accountability, 94 MINN. L. REV. 541, 541-42 (2010) (stating that large corporations have the trust of only 13 percent of the American population and that this level of mistrust portends enormous economic consequences for firms and their stakeholders); Rakhi I. Patel, Facilitating Stakeholder-interest Maximization: Accommodating Beneficial Corporations in the Model Business Corporation Act, 23 ST. THOMAS L. REV. 135, 155 (2010).

79 Frederick Beale & Mario Fernando, Short-termism and Genuineness in Environmental Initiatives: A Comparative Case Study of Two Oil Companies, 27 EUR. MGt. J. 26, 28 (2009).

A. Express Creation

Unlike the original incarnation of the trust fund theory, which was a result of judicial promulgation, the revived trust fund will be expressly and voluntarily created as a trust by the corporation. The corporation will be the trustee while the beneficiaries will be the involuntary victims of the corporation’s acts and those that voluntarily transact business with the corporation, relying on a segregated amount kept secure for the purpose of meeting the legitimate expectations on the other side of the bargain.

B. Permanent Fund

Because business corporations were not “obliged to maintain a rigid and carefully guarded fund,” the idea of a trust fund for the benefit of creditors ran into conceptual and practical difficulties. Addressing this deficiency invites the existence and maintenance of a rigid and carefully guarded pool of money available to satisfy appropriate creditor claims, such as cases in which credit was advanced on the faith of the fund. The revived trust fund will adopt the original conception of legal capital in the sense that there will be a pool of assets that is identifiable and reachable by creditors in the event of a stated calamity arising from corporate operations. To provide a real, instead of rhetorical safeguard, this fund would be kept nearly under “lock and key” until needed to satisfy claims or to be returned to the investors by the corporation redeeming or repurchasing the shares. The fund may be invested in conservative instruments so that the principal is always secure and available. Accordingly, while the yield is expected to be low, it will not be a completely inefficient deployment of capital yet at the same time avoiding the predicament of the legal capital of yore that was not there when creditors needed it. The companies would raise and retain the funds as separate from their operating funds.

81 See Horwitz, supra note 32, at 208 (noting that the trust fund doctrine was promulgated by the courts); Trust Fund Theory, supra note 252, at 482 (conceding that the theory was an exercise in judicial legislation but noting that legislation by courts is often demanded by justice in addressing problems raised by insolvent corporations).
82 See Hollins v. Brielfield Coal & Iron Co., 150 U.S. 371, 381 (1893) (“While it is true language has been frequently used to the effect that the assets of a corporation are a trust fund held by a corporation for the benefit of creditors, this has not been to convey the idea that there is a direct and express trust attached to the property”); Graham v. Railroad Company, 102 U.S. 148, 160 - 161; 1880 WL 18935 (c (1880).
83 See Anna Fifield & Sylvia Pfeifer, BP Revenues to Secure Fund for Damages, FIN. TIMES, Aug. 12, 2010 (providing an example of a corporation serving as trustee of victims’ fund albeit for another corporation).
84 Frederick Dwight, Capital and Capital Stock, 16 YALE L.J. 161, 162 (1907).
85 The money may be returned, with interest, less the cost of settling eligible creditors, in exchange for the shares. Shareholders may opt to keep their stock and forfeit the money. Ultimately, they may sell at a price, to a person, and a time of their choosing. This feature makes the Class T stock a bit similar to preferred stock. See JOSEPH SHADE, BUSINESS ASSOCIATIONS IN A NUTSHELL 326 (3rd ed. 2010) (stating that preferred stock may usually be redeemed at a fixed price); see also HAMILTON, MACEY & MOLL, supra note 8, at 275-76 (discussing preferred stock that are redeemable at the option of the holder, objections to common shares that are redeemable at the option of the holder, common shares that are callable at the option of the corporation, and the MBCA approach that permits the creation of these types of shares without restrictions).
86 See Robert J. Rhee, Bonding Limited Liability, 51 WM. & MARY L. REV. 1417, 1466 (2010) (making a similar point with regard to a compensation fund to be established under a proposed bonded limited liability scheme).
87 Id. at 1466-67.
C. Class T Common Shares

The trust fund will be financed by creating a separate class of common shares, referred to as Class T shares. Thus, the contributing shareholders purchase a special class of shares designed for this particular purpose and on the understanding that the shares cannot be sold or otherwise transferred until the end of a designated period. Prohibition of transfer includes stock lending. In addition, holders of the stock will be prevented from hedging away their risks through derivatives and other instruments since, as illustrated by the case of equity-based executive compensation, such hedging has been an impediment to the effectiveness of restrictions on stock transfer within a specified period. In-built into the Class T arrangement is an explicit contractual provision against hedging of Class T stock within the applicable period, enforceable by revocation of all the privileges appurtenant to the Class T status. A hedging ban under statute or securities regulations is also an option worth considering. This article arbitrarily suggests a designated holding period of 10 years. This is consistent with the original conception of the trust fund doctrine, but with a stronger framework to ensure creditor protection.

D. Illiquidity and Control

In exchange for the loss of liquidity during the specified period, holders of the Class T shares will receive a measure of control in the corporation. Professor Coffee has persuasively argued that liquidity and control are tradeoffs. He observes that “American law has said clearly and consistently since at least the 1930s that those who exercise control should not enjoy liquidity and vice versa.” An investor generally has to surrender one in order to acquire or effectively utilize the other.

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88 See infra notes 255 – 261 and accompanying text.
91 See Schizer, supra note 90, at 502 (discussing mandatory bans of stock and stock option hedging through securities regulations).
92 See Craig A. Peterson & Norman W. Hawker, Does Corporate Law Matter? Legal Capital Restrictions on Stock Distributions, 31 AKRON L. REV. 175, 180 (1997) (“As originally conceived, the “trust fund” theory of legal capital simply prevented shareholders from withdrawing the assets they had contributed to the corporation until its creditors had been paid.”) (Citation omitted).
94 Coffee, Corporate Monitor, supra note 93, at 1287.
95 Id.
Some scholars see an interconnection between the demise of the trust fund theory and the erosion of shareholder power. To avoid the injustice of making dispersed innocent shareholders pay for the frauds of others, flowing from the growth of national stock markets, shareholders traded the power that comes from proprietorship for limited liability. Investing in a Class T stock exposes holders to greater personal loss than other shareholders, as they cannot bail out when their investments are endangered but would be compelled to swim or sink with the corporation. It stands to reason therefore that the greater exposure to personal liability invites a proportionate increase in shareholder power or control. Indeed, this notion is consistent with the evolution of the power allocation process in the corporation that indicates that shareholders' enjoyment of limited liability is a function of their surrender of control, in return, to the board of directors.

Exact details of what this control entails will require additional work. In the interim, a few suggestions may be proffered. One suggestion is that Class T shareholders be offered an opportunity to be part of the decision-making process regarding the corporation’s long-term strategy. A couple of seats on the board of directors may also be reserved for holders of the Class T stock. Thus, they are guaranteed board representation because only the holders of the stock are eligible for election to the reserved positions. The adopting company may also create an advisory director position to be filled by one of the long-term shareholder nominees. The advisory role is one of the principal functions of the board, in addition to monitoring, but greater focus has been on the latter, sometimes to the detriment of the corporation. The advisory director will assume limited or no monitoring role, making it easier for CEOs to be less antagonistic and share relevant strategic information with her.

Class T holders should also be able to nominate candidates for the allocated director positions. Nominations may be facilitated by the inclusion of Class T shareholders in the

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96 Bruce P. Frohnen, The One and Many: Individual Rights, Corporate Rights and the Diversity of Groups, 107 W. VA. L. REV. 789, 842-43 (2005);
97 Id. at 843; Horwitz, supra note 32, at 209.
102 See Lehrman v. Cohen, 222 A.2d 800 (Del. 1966) (validating a corporation’s creation of a separate class of voting stock with the right to vote for and elect one of five directors in order to prevent deadlock by the four directors elected by the other shareholders).
104 Id.
105 Id. at 1-2.
106 For a discussion of how the status quo makes it difficult for shareholders to effectively nominate and elect directors, see Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 VA. L. REV. 675 (2007) [hereinafter Bebchuk, Shareholder Franchise]; George W. Dent Jr., Toward Unifying Ownership and Control in the Public
Another option could consist of an adaptation of some recommendations on proxy access made in a slightly different context. Corporate managements have long mounted a strident resistance to proxy access reform. They have continued to oppose the SEC’s promulgation of proxy access regulations. Instead of the objections, a further concession in this area may be inevitable in order to attract the kind of commitment expected of the Class T investors. Insisting on the status quo, even after shareholders have made a long-term capital commitment, will only bolster the case of those who believe that the argument, basing support for the marginalization of some shareholders in corporate governance on the ground that they are transient investors who do not genuinely care about the firm’s future, has no honest foundation.

The revised trust fund proposal has a number of points in its favor. But it also raises legitimate concerns and faces significant constraints in its implementation. Parts III and IV below provide an in-depth evaluation of the proposal, examining its merits and addressing potential objections.

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III. ARGUMENTS IN FAVOR OF REVIVED TRUST FUND PROPOSAL

A. Patient Capital

The notion of patient capital attracted serious scholarly attention a couple of decades ago, particularly as corporate governance experts compared the experiences of Germany and Japan with that of the United States. After a while, the precepts of patient capital surrendered some of this prominence. However, with the financial crisis of the past few years, patient capital has re-surfaced in important discussions of corporate governance and broader economic policy. Jurists and commentators are beginning to lament the fact that patient capital is now a scarce staple of public equity markets.

Patient capital refers to capital provided by investors with longer exit horizons. It is defined as “capital that is willing to commit for a long period of time.” Patient capital is characterized by such features as length of holding, which may be five to ten years or beyond, and rate of return, which could be relatively low, even bond-like. There are various sources of

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113 Scott H. Mollett, Sarbanes-Oxley Section 307 Domestically and Abroad: Will Section 307 Lead to International Change?, 11 DUQ. BUS. L.J. 1, 11 (2008) (“The main bank model, formerly championed by Japan and Germany, has been in decline and the tenets of patient capital have lost their salience.”); Bliss Burdett Pak, National Markets and New Defenses: The Case for an East Asian Opt-in Takeover Law, 20 Colum. J. Asian L. 385, 391 (2007) (“In Asia more broadly, the strong preference for stability and non-confrontational, patient capital characteristic of main bank and state-directed systems of corporate finance are giving way to an active market for mergers and acquisitions . . .”.

114 Aspen Institute, Overcoming Short-Termism: A Call For A More Responsible Approach To Investment And Business Management (Sept. 9, 2009); Lawrence E. Mitchell, Financialism: A Lecture Delivered at Creighton University School of Law, 43 CREIGHTON L. REV. 323, 334 (2010).

115 See, e.g., Strine, Toward Common Sense, supra note 80, at 10 (“Ironic though it is, private equity investors are now viewed as the nurturing providers of patient capital compared to the public equity markets.”).

116 Darian M. Ibrahim, The (Not So) Puzzling Behavior of Angel Investors, 61 VAND. L. REV. 1405, 1438 n. 169 (2008) (referring to angel investors as providers of patient capital because their exit horizons are usually longer than those of the typical investor).


118 Stephen Lloyd, Transcript: Creating the CIC, 35 VT. L. REV. 31, 42 (2010); SVERRE DAVID ROANG, FAMILY AND BUSINESS SUCCESSION PLANNING, 2010 EDITION (July 2010), 2010 WL2828082, at *4; Thomas L. Friedman, ‘Patient’ Capital for an Africa That Can’t Wait, N.Y. TIMES, Apr. 20, 2007 (“Patient capital has all the discipline of
patient capital, including angel investors, venture capitalists, employee stock ownership plans, sovereign wealth funds, pension funds and other institutional investors, although each investor’s level of patience varies.

Corporate managers are constantly in search of patient capital. Patient capital is favored because the investor’s longer exit horizon provides the manager with the needed time to build value into the business. When stocks have high turnover rates, they “create greater volatility and uncertainty in equity prices than exist under a system of more patient capital” and this uncertainty militates against managerial involvement in long-term projects. By affording managers an opportunity to engage in long-term planning and investment, including acquisition of durable equipment, patient capital offers efficiency gains. Managers assailed an active venture capital — demanding a return, and therefore rigor in how it is deployed — but expecting a return that is more in the 5 to 10 percent range, rather than the 35 percent that venture capitalists look for, and with a longer payback period.

119 William K. Sjostrom, Jr., Relaxing the Ban: It’s Time to Allow General Solicitation and Advertising in Exempt Offerings, 32 FLA. ST. U. L. REV. 1, 6 (2004) (stating that angel investors supply patient capital, with investments that stay in place for five to ten years or even longer periods); Ibrahim, supra note 116, at 1438 n. 169 (referring to angel investors as providers of patient capital because their exit horizons are usually longer than those of the typical investor).


123 See Rich Ferlauto, Commentary on Leo Strine’s “Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance”, 33 J. CORP. L. 41, 41 (2007) (stating that public pension systems provide patient capital); but see Poonam Puri & P.M. Vasudev, Canadian Pension Funds: Investments and Role in the Capital Markets and Corporate Governance, 25 BANKING & FIN. L. REV. 247, 267 (2010) (noting that the level of portfolio turnovers of pension funds, discernable from revenue gained from securities trading, raises doubts about the popular notion that pension funds invest for the long term and provide patient capital).

124 Karmel, Institutional Shareholders?, supra note 1 at 2 (stating that while some institutional investors provide patient capital and hold stocks for the long term, a lot of institutions invest only for a very brief period).


128 See Nadine Hoser, Nanotechnology and Its Institutionalization as an Innovative Technology: Professional Associations and the Market as Two Mechanisms of Intervention in the Field of Nanotechnology, 7 NANOTECHNOLOGY L. & BUS. 180, 187 (2010); Dwight B. Crane & Ulrike Schaede, Functional Change and Bank Strategy in German Corporate Governance, 25 INT’L REV. L. & ECON. 513, 524 (2005) (stating that after World War II, companies in Germany “needed stable funding that would provide patient capital for highly leveraged plant and equipment investment.”); Thomas J. Andre, Jr., Some Reflections On German Corporate Governance: A
market for corporate control on that ground, deriding it as breeding inefficiency by fostering managerial myopia in response to investor short-term orientation.129 Ultimately, both the corporation, deprived of a long-term focus, and the society could suffer significant losses.130 On the other hand, investment and management strategies that emphasize the long-term are socially beneficial.131

Patient capital also benefits businesses because patient capital and voice are natural companions. A provider of long-term capital is likely to insist on having a voice in how the investment is managed.132 The converse is also true: one who is afforded a voice is likely to linger much longer than one who is not.133 When shareholders exit the corporation instead of

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129See, e.g., Corporate Governance and Enforcement Panel, HM Treasury: Remarks of Lord Myner at The UBS Corporate Governance Forum, October 6, 2009, 1783 Plu/CORP. 241, 244 (2010) (noting that fund managers generally do not supply patient capital and extolling the virtues of the investment approach of Warren Buffet, whose “record has shown the value of taking a longer view, accepting extended periods of relative under-performance as a fair price for avoiding extremes of market valuation or under-valuations; holding a concentrated, high conviction portfolio and taking a real interest in his companies, including in some cases taking Board seats.”) [hereinafter Lord Myner’s Remarks]. For similar observations made two decades earlier, see Lipton & Rosenblum, supra note 130, at 223-224.

130See Robert G. Vanecko, Regulations 14A and 13D and the Role of Institutional Investors in Corporate Governance, 87 NW. U. L. REV. 376, 382 (1992) (“Advocates of an increased voice for institutional investors argue that institutional investors could potentially provide the “patient” capital that American corporations need to enhance their long-term competitiveness.”) (citation omitted); Lord Myner’s Remarks, supra note 131, at 244.

131See Robert J. Klein, The Case of Heightened Scrutiny in Defense of the Shareholders’ Franchise Right, 44 STAN. L. REV. 129, 175 (1991) (“Institutional investors assured of access to the proxy system can develop the patient capital philosophy favored by managers.”); Vanecko, supra note 132, at 382 n. 42 (restating the arguments made by some commentators that “if institutional investors had more freedom to combine forces, seek representation on boards, and press for management changes, they would respond by voting their stock rather than selling it [and] that if pension funds could challenge management effectively, they might become permanent shareholders.”); Ball,
working within to address what is wrong, the corporation may be the worse for it. One commentator captures the sentiment succinctly: “[W]ealth creating organizations are built up over decades. Patient capital that can readily choose to rely on voice, not just exit, is an indispensable foundation for long-term wealth creation. If investors make this discovery, directors will not be far behind.”

Furthermore, with the spate of financial crises in the past decade and the resulting mistrust of corporations and undermining of public confidence in the markets, the importance of a long-term focus backed by patient capital can hardly be over-emphasized. Along those lines, the Conference Board recommended that the restoration of trust in public corporations would require the emergence of a base of shareholders with a long-term orientation to support a management focused on creating long-term economic growth.

The revised trust fund proposal will follow in the footsteps of the original trust fund theory which, at least tangentially, facilitated the lock-in of capital. It also seeks to create the desired base of shareholders, a permanent class of long-term investors, who have an owner’s mentality and disposition. Owners commit resources to their venture or property, taking enormous risks over a considerably long period of time, and adding their entrepreneurial skills to grow the enterprise when needed, while exercising utmost care to avoid activities that negatively affect its value. Renters, on the other hand, do not have that level of commitment or involvement, and are not as concerned about the effects of their activity on the ultimate value of

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supra note 125, at 196-97 (explaining that opportunity to exercise voice could lead to long-term investing with the resulting opportunity for management to utilize the patient capital to embark on long-term projects).

134 See infra, Part IIIB.
135 Id.
136 Elmer W. Johnson, Making the Board of Directors Function in the Age of Pension Fund Capitalism, in CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 601, 619 (Practising Law Institute, Nov. 2, 1989) [hereinafter Johnson, Fund Capitalism].
138 THE CONFERENCE BOARD, COMMISSION ON PUBLIC TRUST AND PRIVATE ENTERPRISE: FINDINGS AND RECOMMENDATIONS 17 (Jan. 9, 2003) (emphasizing the importance of long-term strategies and development of a base of long-term investors in creating corporate long-term growth and viability that would restore trust in public corporations).
139 Id.
140 See Blair, supra note 35, at 15.; but see Larry E. Ribstein, Should History Lock In Lock-In?, 41 TULSA L. REV. 523, 533 (2006) (arguing that the purpose of the trust fund theory was creditor protection not capital lock-in).
141 A proposal based on similar premises, but a different prescription, is the quinquennial election of directors made by Martin Lipton and Steven Rosenblum. See Lipton & Rosenblum, supra note 130, at 224 (stating that their proposal “seeks to make stockholders and managers think and act like long-term owners by combining the patient capital approach of Warren Buffett, the long-term monitoring approach of the Japanese and German ownership structures, and the financial incentives for managers of the [leveraged buyout ]”). See also Ronald J. Gilson, The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment, 61 FORDHAM L. REV. 161, 178 (1992) (discussing the virtue of replicating or combining features of existing, including foreign, systems).
142 Young, supra note 130, at 135.
the property. To them, the property presents an opportunity that they milk to their satisfaction and move on to another available one. Stephen Young has argued that in the true sense, ownership of shares in a company, based on its history, is a term that properly refers to “when stock-holding was not a mass phenomenon and when individuals were long-term owners in the style of Warren Buffet or the owner of a family company” while much of what goes on in Wall Street is better characterized as renting. Contrasting a renter’s mentality with that of an owner in a broader property context but also applicable to company shares, Young notes that “[t]he incentives around renting for both lessor and lessee tend to cut off rights from corresponding responsibilities, encouraging cavalier treatment of money and property, whereas ownership tends to bind property rights to responsibilities, with its incentive of profit over time and the inherent burden of care.”

Similar in some respects to relational investing, the present proposal creates “a class of enlightened investors who give companies patient capital [thereby freeing] management to focus on the long term. Over time, that should lift profits, productivity and prospects. And that would boost U.S. competitiveness.” More important, the Class T shares approach is better positioned to accomplish this objective because it provides a clear structure or framework, instead of the voluntary approach of relational investing that leaves room for uncertainty and lack of direction. In essence, it adopts the strong points of relationship investing without some of its weaknesses.

One concern with the concept of patient capital is that it could breed managerial indolence and enable management to use long investment horizons as a smokescreen for masking unproductive tenures. It is imperative, therefore, to mitigate this impediment by establishing an effective monitoring mechanism, which is also in-built into this proposal. Finally, the nurturing of patient capital does not depend only on shareholders. Management also

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143 Id.
144 Id. at 135-36. Renting, as used by Young, should not be confused with the practice of borrowing shares for a little while by those who want to use it for a variety of purposes, including empty voting, short selling and arbitrage strategies. See Reena Aggarwal, Pedro A.C. Saffi & Jason Sturgess, The Role of Institutional Investors in Voting: Evidence from the Securities Lending Market, SOCIAL SCIENCE RESEARCH NETWORK 13 (May 2011).
145 Young, supra note 130, at 136-37. Scholars have grappled with this problem for almost a century. See Antony Page & Robert A. Katz, Is Social Enterprise the New Corporate Social Responsibility? 34 SEATTLE U. L. REV. 1351, 1358 (2011) (discussing the observation made in the 1930s by Adolf Berle and Gardner Means that because shareholders showed little commitment or involvement in the affairs of the corporation, they had forfeited the prerogatives that accompany true ownership or property rights).
147 See id. at 70 (discussing the anticipation in relational investing that investors would make a voluntary commitment to hold their shares for the long-term, participate in corporate governance and generally act like owners, instead of investors).
148 In that sense, the proposal is closer to the political process proposed by Professor John Pound. See Pound, supra note 112, at 1069. For a critique of relational investing, see Edward B. Rock, Controlling the Dark Side of Relational Investing, 15 CARDozo L. REV. 987 (1994).
150 See Part IIIC, infra.
needs to abhor practices that dissuade patient capital, such as an unhealthy alliance with short-termist investors to institute harmful executive compensation schemes.\footnote{Damon Silvers, Commentary on “Toward Common Sense and Common Ground? Reflections on The Shared Interests of Managers and Labor in a More Rational System of Corporate Governance” by Leo E. Strine, Jr., 33 J. CORP. L. 85, 90-91 (2007) (stating that “excessive executive compensation has been the mechanism by which the management of American corporations has become captive to short-term market forces, while ignoring long-term patient capital.”); Kenneth R. Davis, Taking Stock—Salary and Options Too: The Looting of Corporate America, 69 MD. L. REV. 419, 447 (2010) (“A reckless corporate strategy, in the short term, may increase the market price of a stock, which is what short-term institutional investors need to cash out with a profit. Once out, they have no concern if the risky strategy later backfires and the stock price collapses. Thus, short-term institutional investors will not object to the immediate vesting of stock options, a favorite compensation arrangement which encourages reckless corporate decisionmaking.”); Jeong-Bon Kim, Yinghua Li, Liandong Zhang, CFOs versus CEOs: Equity Incentives and Crashes, SOCIAL SCIENCE RESEARCH NETWORK, 3 (March 10, 2011) (discussing a study that demonstrates that “incumbent investors use stock-based compensation to intentionally encourage managers to adopt short-termist behavior to boost the speculative component of the share price.”), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1732088 (last visited June 26, 2011). For a contrary view on executive compensation, see Steven N. Kaplan, Response, Weak Solutions to an Illusory Problem, 159 U. PA. L. REV. PENNUMBRA 43, 43 (2010) (arguing that current regime of executive compensation does not promote short-termism and that managers are not being compensated for short-term results that are not reflective of long-term performance), available at http://www.pennumbra.com/responses/11-2010/Kaplan.pdf.}

\section*{B. Exit, Voice and “Permanent Ownership”}

Under the model devised by the economist Albert Hirschman, shareholders have two empowerment tools in response to the management of the corporation, namely exit and voice.\footnote{ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970); J. H. W. Weiler, The Transformation of Europe, 100 YALE L.J. 2403, 2411 (1991) (“Exit is the mechanism of organizational abandonment in the face of unsatisfactory performance. Voice is the mechanism of intraorganizational correction and recuperation.”). A slightly different articulation of the concepts presents exit and voice as “variants of the same phenomenon”, rather than as alternate phenomena. See Andrew E. Taslitz, Judging Jena's D.A.: The Prosecutor and Racial Esteem, 44 HARV. C.R.-C.L. L. REV. 393, 428-29 (2009) (“A buyer having a real choice among a range of viable alternatives and the freedom to exit one potential deal for a better one gives the buyer some measure of voice.”); Sarah Maxwell, The Price Is Wrong: Understanding What Makes a Price Seem Fair and the True Cost of Unfair Pricing 76 (2008) (“Having a choice gives consumers voice by allowing them to express their opinion. They are not being forced to buy at one pre-set price or do without.”).}

Exit refers to the practice of abandoning a product or leaving an organization when conditions are unsuitable.\footnote{Peter C. Konstant, Exit, Voice and Loyalty in the Course of Corporate Governance and Counsel’s Changing Role, 28 J. SOCIO-ECON., 203, 207 (1999) (“Exit occurs in one of two ways, either by customers no longer buying a product, or by members leaving an organization.”).} A pertinent illustration is a shareholder’s exercise of the option to sell her stock when she is not satisfied with the corporation’s direction, often referred to as the Wall Street Rule.\footnote{The Wall Street Rule refers to the practice by stockholders of selling their stock at any point, especially when they are dissatisfied with the management of the corporation. See Carol Goforth, Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late, 43 AM. U. L. REV. 379, 406 (1994) (“The Wall Street Rule holds that shareholders who are dissatisfied with management decisions can ‘vote with their feet’ by selling their shares and finding a different enterprise in which to invest.”); William W. Bratton & Michael L. Wachter, Tracking Berle's Footsteps: The Trail of The Modern Corporation's Last Chapter, 33 SEATTLE U. L. REV. 849, 864 (2010).} Hirschman defines voice as “any attempt at all to change, rather than to escape from, an objectionable state of affairs, whether through individual or collective petition to the

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management directly in charge, through appeal to a higher authority with the intention of forcing a change in management, or through various types of actions and protests, including those that are meant to mobilize public opinion. Exit represents economics while voice typifies politics. The choice between voice and exit is a salient aspect of the corporate governance discussion. The position each of them occupies in public policy and shareholder minds affects the role shareholders can play in monitoring managers or in corporate governance generally. For years, scholars and market participants placed a lot of emphasis on the economic approach of exit. Yet this approach has not proven a complete panacea.

More often than not, a rational shareholder is likely to sell her shares when she is dissatisfied with corporate management or direction. This appears to be a basic human approach, not limited to the corporate world. Furthermore, exit has its merits as a constraining or disciplining mechanism, since “a party can often deter or escape another’s opportunism by withdrawing or threatening to withdraw its capital contribution.” The availability or threat of exit can also be deployed as an effective weapon for securing advantages. Moreover, exit is intuitive in a business setting because it is traditionally a market-oriented or economic approach while voice is more traditionally associated with the political process and therefore somewhat of a strange territory for corporate actors. Yet, there are times when exit is not in the best interest of the

155 Hirschman, supra note 152, at 30; Konstant, supra note 153, at 207 (stating that voice denotes “any attempt to change, rather than escape from an unsatisfactory situation.”)
156 Hirschman, supra note 152, at 15.
158 Konstant, supra note 153, at 210 (examining the weakness of exit in helping failing corporations in contrast to a more viable approach of combining economic exit and political voice processes).
159 See, e.g., Kenji Yoshino, The Gay Tipping Point, 57 UCLA L. REV. 1537 (2010) (stating that “[t]he availability of exit lessens the necessity of voice,” and thus reduces the incentive of gays to fight discrimination). For a similar reaction by employees, see Hilary K. Josephs, Measuring Progress under China’s Labor Law: Goals, Processes, Outcomes, 30 COMP. LAB. & POLY 373, 393 (2009) (stating that “[t]here are indications that workers will resort to “exit” rather than “voice” if confrontational tactics do not look promising.”). For an account from the lawyer-client relationship, see William L.F. Felstiner & Austin Sarat, Enactments of Power: Negotiating Reality and Responsibility in Lawyer-Client Interactions, 77 CORNELL L. REV. 1447 1464 (1992) (“In the face of lawyers' insistence that they accommodate themselves to the reality of what the law allows, clients generally persist, at least initially, in expounding their needs, explaining their notions of justice, or reiterating their objectives. But rarely do they insist that their lawyer make a particular demand, argue a particular position, or even endorse their view. Where dissatisfaction is great, the usual client response is exit rather than voice.”) Cf., David B. Wilkins, Team Of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship, 78 FORDHAM L. REV. 2067, 2071 (2010) (discussing how some clients and attorneys utilize voice in their relationship, although the threat of exit remains in the vicinity).
161 Apart from investment in the stock market, this phenomenon can also manifest in other areas, such as the real estate market. See Nicole Stele Garnett, Review: Unbundling Homeownership: Regional Reforms From The Inside Out, 119 YALE L.J. 1904, 1915 (2010) (“By virtue of their ability to enter and exit communities, homeowners exert market pressure on both local governments and private developers to offer policies that satisfy their preferences.”).
shareholder or the corporation. In some cases, exit amounts to a luxury that some shareholders can ill afford.

Scholars have long highlighted the danger of a constant preference of exit to voice. Professor Peter Konstant explains the pitfalls of shareholder penchant for exit, noting that since the exiting shareholders are replaced in an instant by new entrants, the exit serves as a weak disciplining mechanism. In essence, the Wall Street Walk is different from the type of exit that could improve an organization. Moreover, the problem is not simply that shareholders are exiting. It is that often, it is the type of shareholder that can make a real difference because it is well-informed and is likely to have the resources, motivation and determination to mount a serious fight for change if the alternative of investing elsewhere was not readily present. Acting in concert with the lack of adequate institutions to nurture voice, this type of exit often led to the entrenchment of ineffective managers. Overemphasizing exit or underemphasizing voice, therefore, may be inimical to the wellbeing of the corporation, its shareholders and other constituents.

However, opportunities to exercise shareholder voice are minimally existent in many corporations. Thus, the cycle of suboptimal action of exiting the firm, when engagement would be preferable, continues. Indeed, shareholder voice has sometimes been characterized

163 This result is not limited to corporations, but extends to other economic, or even political, institutions. See, e.g., Petros C. Mavroidis, Book Review: Lexcalibur: the House That Joe Built, 38 COLUM. J. TRANSNAT’L L. 669, 670 (2000) (discussing how the virtual absence of opportunity to exit by member states led to the amplification of voice and helped in the building of post-World War II Europe.).


165 See, e.g., HIRSCHMAN, supra note 152, at 46 n. 3 (quoting some scholars’ decision to “combat the traditional but harmful notion that if a stockholder doesn’t like the way his company is run he should sell his shares, no matter how low their price may be.”).

166 Id. Shareholders are beginning to see the relative ineffectiveness of the Wall Street Rule as a guiding principle. See Brett H. McDonnell, Setting Optimal Rules for Shareholder Proxy Access, 43 ARIZ. ST. L.J. 67, 67 (2011) (“Shareholders are getting feisty. They are no longer content simply to abide by the “Wall Street rule.” If they are unhappy with the performance of a company’s management, they do not simply sell their shares. Rather, they step in to try to change that management or to change some of the rules governing the corporation.”) (citation omitted).

167 See Konstant, supra note 153, at 210; Hirschman, supra note 152, at 47 (stating that the real tragedy is that “those customers who care most about the quality of the product and who, therefore, are those who would be the most active, reliable, and creative agents of voice are for that very reason are those who are apparently likely to exit first in case of deterioration.”) (emphasis in original).

168 Konstant, supra note 168, at 210-211.

169 HIRSCHMAN, supra note 152, at 46 (noting that easy exit perpetuates poor management and bad policies).

170 Dalia Tsuk Mitchell, The End of Corporate Law, 44 WAKE FOREST L. REV. 703, 725-28 (2009) (arguing that Delaware corporate law has weakened the shareholders’ rights of voice and exit); Konstant, supra note 153, at 211 (stating that corporate law made little efforts to design institutions to develop and support voice, considering that voice needs initial support to take off).

171 For an extensive discussion of the value of voice, albeit in a close corporation context, see Benjamin Means, A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation, 97 GEO. L.J. 1207, 1229-1238 (2009).
as a mere “whisper.” Yet voice can serve a corrective or ameliorative function, thereby addressing lapses in productive behavior in organizations. We can remedy the lapse by recourse to a revived and revised version of the trust fund theory. Under this version, corporations can create a class of common shares which are relatively illiquid but entitle shareholders to a stronger voice in corporate governance. In the face of illiquidity, activation of shareholder voice is inevitable. For obvious reasons, limiting shareholder exit without a corresponding increase in voice appears so dangerous that it would be a virtually impossible idea to sell to investors. As one commentator has aptly observed, “voice is handicapped . . . when exit is not an option, because the dissatisfied actor cannot threaten exit and thereby loses an important way of bringing influence to bear.”

The co-existence of voice and exit in an organization may be optimal for the entity, including a public corporation. However, it is difficult to achieve. Exit and voice can co-exist and both have important roles where the organization enjoys the loyalty of its members and those members believe that they have the ability to influence the organization. There are situations where both the shareholder and the corporation will be better off by the shareholder remaining loyal, but voicing concerns and engaging management in crafting effective solutions to identified problems or otherwise trying to induce change within the corporation. For instance, loyalty

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173 See Konstant, supra note 153, at 206 n. 16 and accompanying text.
174 Avital Margalit, “You’ll Never Walk Alone”: On Property, Community, And Football Fans, 10 THEORETICAL INQUIRIES L. 217, 227 (2009) (“Where exit is unthinkable or generates high costs, only a voice option remains . . . .”); HIRSCHMAN, supra note 152, at 34 (stating that the role of voice would increase as the opportunities for exit decline, up to the point where, with exit wholly unavailable, voice must carry the entire burden of alerting management to its failings.”); Rob Atkinson, Obedience as the Foundation of Fiduciary Duty, 34 J. CORP. L. 43, 66 (2008) (stating that in the context of a private trust where exit is not an option, the relevant parties have a greater incentive to exercise voice). See further, Alex Edmans, Vivian W. Fang & Emanuel Zur, The Effect of Liquidity on Governance, SOCIAL SCIENCE RESEARCH NETWORK 6 (September 15, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1905224 (last visited September 18, 2011) (stating that liquidity causes a hedge fund with a significant block of shares to opt for exit instead of voice as a governance channel); but see Oyvind Norli, Charlotte Ostergaard & Ibolya Schindele, Liquidity and Shareholder Activism, SOCIAL SCIENCE RESEARCH NETWORK 2 (April 26, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1344407 (last visited September 18, 2011) (linking liquidity to exercise of certain kinds of voice by shareholders).
175 See Stephen Colt, Alaska Natives and the “New Harpoon”: Economic Performance of the ANCSA Regional Corporations, 25 J. LAND RESOURCES & ENVTL. L. 155, 167 (2005) (viewing shareholders’ ability to exit the firm as their “discipline mechanism [the absence of which] clearly gives management, employees, and outside parasites more leeway to pursue their rent-seeking objectives, including shirking, empire-building, or nepotism.”) (citation omitted).
177 See Hirschman, supra note 152, at 120-126.
178 See Weiler, supra note 152, at 2411 (“Hirschman’s basic insight is to identify a kind of zero-sum game between the two. Crudely put, a stronger ‘outlet’ for Voice reduces pressure on the Exit option and can lead to more sophisticated processes of self-correction. By contrast, the closure of Exit leads to demands for enhanced Voice.”)
179 HIRSCHMAN, supra note 152, at 77; Konstant, supra note 153, at 208. The trust fund arrangement is a loyalty-grounded mechanism that is positioned to voluntarily limit exit while offering a strong potential to activate voice.
180 See Ruben J. Garcia, Labor as Property: Guestworkers, International Trade, and the Democracy Deficit, 10 J. GENDER RACE & JUST. 27, 36 n. 53 (2006) (discussing the point that on some occasions, voice is a more potent tool than exit in effecting organizational change); Rodwin, supra note 162, at 1067 (stating that “consumer voice could help build stronger organizations by putting managers in touch with the experiences and desires of their customers . . .”.

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“serves the socially useful purpose of preventing deterioration from becoming cumulative.”181 As the number of exiting actors escalates, so does the threat to an organization’s credibility and continued existence.182 Loyal shareholders will almost invariably utilize their voice.183 A loyal member would figure out ways to exert her energy to move the organization in the right direction.184 On the other hand, a member that perceives his position as strong enough that he can steer the organization in the desired direction “is likely to develop a strong affection for the organization in which he is powerful.”185 Holders of trust securities are likely to be in this position because their long-term commitment evidences loyalty.

Coupling the loyalty with an opportunity to play a significant role in corporate decision-making, directly or indirectly, will transform corporations that adopt the idea into a rare breed of organizations in which voice and exit hold important roles. In the first place, the two major recuperation mechanisms of exit and voice would be simultaneously available in such corporations, as most shareholders remain free to leave at any time. Second, trust securities create a structured loyalty186 that, as Hirschman would put it, “holds exit at bay and activates voice.”187 Third, as holders of the trust securities, relying on the enablement to do so, activate and exercise voice continuously, other shareholders may discover some attractive qualities in voice and reconsider the penchant for exit when things deteriorate in the corporation. The resulting long-term holdings would augur well for the corporation and its stakeholders, as several constituencies work together to improve things from within, instead of bolting.

Some scholars contend that some institutional investors already hold for the long-term and giving them an incentive in the form of meaningful voice in corporate governance will enable them not only to continue to so hold but also participate in the corporation’s affairs.188 The problem with this contention and belief is that management has no firm commitment from these shareholders that they will hold for the long-term and therefore may be a little hesitant to cooperate. Providing a meaningful voice also does not mean that shareholders will take advantage of it. The present proposal takes away this uncertainty and imposes a commitment to hold stocks for a defined, relatively lengthy period of time. This proposal is also tailored to those shareholders that are certainly motivated to take advantage of an enhanced opportunity to participate in corporate governance, as it is inbuilt to the structure of the trust securities. Thus, only investors interested in its terms would purchase those securities.

Shareholders who commit to hold stock for a long time, effectively becoming “permanent or quasi-permanent owners” are in a position to exercise a unique form of voice virtually unavailable to other shareholders. This is because management is more likely to respect the voice

181 HIRSCHMAN, supra note 152, at 79; See also Mark D. West, Legal Rules and Social Norms in Japan’s Secret World of Sumo, 26 J. LEGAL STUD. 165, 192 (1997) (discussing how loyalty can be collectively and individually rational).
183 See HIRSCHMAN, supra note 152, at 78 (stating that “[a]s a rule . . . loyalty holds exit at bay and activates voice.”).
184 Id. at 77-78.
185 Id. at 78.
186 I use the term ‘structured loyalty’ in the sense that it is simultaneously imposed by the nature of the securities that prohibit transfers and self-imposed because the holders of the securities make the choice to purchase with knowledge of the restriction.
187 HIRSCHMAN, supra note 152, at 78.
188 Matheson & Olson, supra note 24, at 1322.
of shareholders when it is confident that the shareholders are so bound to the enterprise that exit is almost infeasible.¹⁸⁹ As Hirschman observes, ‘the chances that voice will ever act in conjunction with exit would be poor and voice would be an effective recuperation mechanism only in conditions of full monopoly “when the customers are securely locked in.”’¹⁹⁰ The Class T approach will draw US corporations closer to the model that long prevailed in Germany and Japan, with notable success, as opposed to the dominance of the Wall Street Rule.¹⁹¹

C. Increased Managerial and Board Accountability

A classic problem of the public corporation, as identified by Adolf Berle and Gardiner Means, is the separation of ownership from control.¹⁹² Ever since their articulation of the problem, “commentators have searched for the corporate equivalent of the Holy Grail: a mechanism to bridge the separation by holding managers accountable for their performance.”¹⁹³ Where ownership and management of a property are in different hands, agency costs are inevitable, as managers would act to further their own interests at any given opportunity.¹⁹⁴ Monitoring provides an avenue for reducing these agency costs.¹⁹⁵ The revived trust fund theory, while not overstating its importance, offers a mechanism for narrowing the owner-manager gap. For instance, it promotes a form of partnership between shareholders and corporate managers, which in turn bridges the separation of ownership and control.¹⁹⁶ It also seeks to facilitate direct

¹⁸⁹  See Porter, Capital Disadvantage, supra note 12, at 70 (stating that long-term shareholders in Japan and Germany “command the respect of management, having access to inside information concerning the company, and, particularly in Germany, can exert considerable influence on management behavior.”).
¹⁹⁰  HIRSCHMAN, supra note 152, at 45.
¹⁹¹  See Sanford M. Jacoby, Corporate Governance in Comparative Perspective: Prospects for Convergence, 22 COMP. LAB. & POL’Y J. 5, 6 (2000) (stating that the German and Japanese approaches of less mobility and greater communication with management can be thought of as the voice model while the US approach of selling shares when dissatisfied with management is the exit model); MICHAEL E. PORTER, THE COMPETITIVE ADVANTAGE OF NATIONS 528 (Macmillan, 1990) (stating that while “institutional investors in nearly every other advanced nation . . . view their shareholdings as nearly permanent and exercise their ownership rights accordingly, American institutions are under pressure to demonstrate quarterly appreciation.”).
¹⁹³  Gilson & Kraakman, supra note 111, at 873.
¹⁹⁴  See Eric J. Pan, Rethinking The Board’s Duty to Monitor: A Critical Assessment of The Delaware Doctrine, 38 FLA. ST. U. L. REV. 209, 218 (2011). Agency costs include the cost of monitoring incurred by the principal, bonding costs to deter or compensate for harm incurred by the agent, and the residual loss occasioned by the agent’s opportunistic and non-diligent actions not captured by the monitoring and bonding activities. See Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. FIN. ECON. 305 (1976); STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 35-36 (2002) (“Agency costs are defined as the sum of the monitoring and bonding costs, plus any residual loss, incurred to prevent shirking by agents. In turn, shirking is defined to include any action by a member of a production team that diverges from the interests of the team as a whole. As such, shirking includes not only culpable cheating, but also negligence, oversight, incapacity, and even honest mistakes.”).
¹⁹⁵  Hawley & Williams, supra note 157, at 125 (“Monitoring in all of its forms fundamentally attempts to reduce agency costs that are inherent in the relationship between either owners and managers, or fiduciary agents and other (fiduciary) agents.”).
¹⁹⁶  See Jennifer G. Hill, Then and Now: Professor Berle and the Unpredictable Shareholder, 33 SEATTLE U. L. REV. 1005, 1011 (2010) (referring to a scenario in which some “shareholders might become full-scale partners with management in corporate decision-making, thereby bridging the historical divide between ownership and control.”) (citation omitted). The long-term shareholder model here also shares characteristics with the Japanese system of near-permanent shareholder-monitors that is viewed as bridging the separation of ownership and control. See Ronald
monitoring of managers by shareholders, which is an important mechanism for addressing the agency problem.  

Corporate accountability requires a critical mass of shareholders that are firmly committed to holding a corporation’s stock for the long haul. However, the chances of getting that core of shareholders are anemic without a change in the structure of the corporation to really empower shareholders in return for their loyalty. An incontrovertible fact is that shareholders are passive relative to matters pertaining to the governance of the corporation. Individual shareholders are not able or eager to engage management because of the dispersal of share ownership. Due to collective action problems and legal constraints to coordinated action, it is difficult to organize and unite a critical mass of shareholders for a common purpose. The free rider issue is particularly significant. A shareholder may be reluctant to engage in a cause alone that would


Pan, supra note 194, at 219 (“The most important mechanisms to address the agency problem, however, are those that facilitate direct monitoring of managers by shareholders.”).


LOUIS LOWENSTEIN, WHAT’S WRONG WITH WALL STREET: SHORT-TERM GAIN AND THE ABSENTEE SHAREHOLDER 12, 209-211 (1988) (noting that a “major obstacle has been that shareholders have no access to the nominating procedures or the proxy machinery, except by confrontation and contest,” and arguing for shareholder power to nominate and elect a percentage of directors that would be answerable to them).

For a general discussion of the problem, see Bernard S. Black, Shareholder Passivity Reexamined, 89 MICH. L. REV. 520 (1990); Christopher Gulinello, The Retail Investor Vote: Mobilizing Rationally Apathetic Shareholders to Preserve or Challenge the Board’s Presumption of Authority, 2010 UTAH L. REV. 547 (2010) (arguing that shareholder apathy is rational and proposing a mechanism to encourage retail investors to vote in director elections).

Douglas Litowitz, Are Corporations Evil? 58 U. MIAMI L. REV. 811, 817 (2004) (“Stockholders theoretically ‘owned’ the corporation, yet were so scattered and unorganized that they had virtually none of the control that typically comes with ownership of property. For perhaps the first time in history, it became common for persons to invest in an enterprise and remain totally passive . . . .”); Ian Ayres & Peter Cramton, Relational Investing and Agency Theory, 15 CARDOZO L. REV. 1033, 1041 (1994) (stating that individual shareholders generally do not hold a sufficient stake in a company to get involved or make a difference.).

Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 NW. U. L. REV. 547, 571 (2003); Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, 119 HARV. L. REV. 1735, 1751 (2006) (stating that “it is improbable that dispersed individual investors with small holdings will ever be anything other than rationally apathetic . . . .”) [hereinafter, Bainbridge, Shareholder Disempowerment]; Black, Watching Agents, supra note 26, at 821 (stating that shareholder passivity arises from two related collective action problems, namely the concern that other shareholders would free-ride on another shareholder’s efforts and the belief that because of fractional holdings, any shareholder’s efforts would unlikely affect the outcome of a proposal).

See Martin Gelter, The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance, 50 HARV. INT’L L.J. 129, 148 (2009) (“Dispersed shareholders are subject to collective action problems caused by rational apathy and the free rider phenomenon.”) (citation omitted); Klein, supra note 133, at 132 (“In the language of economics, shareholders of large public corporations suffer from both collective action and free rider problems.”) (citation omitted); Brian J. Bushee et al., Institutional Investor Preferences for Corporate Governance Mechanisms, SOCIAL SCIENCE RESEARCH NETWORK 6 (Jan. 2010) (referencing the argument that “the free rider problem makes it cost ineffective for small shareholders to act as monitors of management.”).
redound to the benefit of all. Similarly, a shareholder would prefer to wait for other shareholders to take charge of the battle, while she lurks in the sidelines, convinced that she cannot be excluded from its benefits that accrue to all.

The emergence of institutional shareholders as a strong force in share ownership was heralded as a solution to the collective action problems. The anticipated strong and effective voice from institutional shareholders has not materialized significantly. While these institutions do not face the same problem of pooling a sizeable number of shares, the problems of free riding and economic cost continue to loom large. In addition, because of relationships with corporations whose stocks they hold, many institutional shareholders and fund managers are hamstrung by the resulting conflicts of interests from playing an activist role. Moreover, some institutional investors, such as index funds, undoubtedly hold stock for a long term, they are structurally passive.

Paul Rose, Common Agency and the Public Corporation, 63 VAND. L. REV. 1355, 1356 (2010) (stating that “institutional ownership of public companies has tended to reduce some of the collective action problems that have impeded shareholder activism in the past.”); Jill Fisch, Relationship Investing: Will it Happen? Will it Work? 55 OHIO ST. L.J. 1009, 1012 (1994) (observing that where the result of an investor’s efforts would be beneficial to free-riding competitors, a rational investor would refrain from it); John C. Bogle, Reflections on the Evolution of Mutual Fund Governance, 1 J. BUS. & TECH. L. 45, 49-50 (2006) (“[P]assivity in governance may pay. Let others undertake the hard work and costs of activism. If their efforts are successful, the “passive-ists” . . . will not only reap rewards without spending a penny, they will also increase their chances of getting the pension and thrift business of the activists.”); For further discussion of the incentive problems of institutional investors, see Bainbridge, Shareholder Disempowerment, supra note 202, at 1751-54.
See Harner, supra note 78, at 552-53 (discussing the constraints facing individual and institutional shareholders); Thomas W. Briggs, Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis, 32 J. CORP. L. 681, 710-11 (2007) (“The arguments over why shareholders usually remain powerless are extraordinarily complex, but basically boil down to [ ]collective action problems . . . . insufficient incentives, conflicts of interest, legal obstacles, and management power. Institutional investors consequently generally remain unwilling to spend the time and money to exercise their voting rights fully . . . .”); Usha Rodrigues, Let the Money do the Governing: The Case for Reuniting Ownership and Control, 9 STAN. J. L. BUS. & FIN. 254, 278 (2004) (“The head of a pension fund or the manager of a mutual fund might not adequately guard shareholder interests, not because of interests divergent from those of small shareholders, but because of conflicting motives to maintain their reputation in the larger business community.”).
A Different Class: Would Giving Long-Term Shareholders More Clout Improve Corporate Governance?, THE ECONOMIST (Feb. 18, 2010) (stating that many long-term index investors that “hold shares for years without taking
Shareholder monitoring of the managerial class has evolved into an absolute necessity in today’s investing environment.\(^{211}\) In particular, shareholder monitoring promotes efficiency.\(^{212}\) While monitoring could take several forms, including the very aggressive type where controlling block owners determine corporate policy to the very passive where shareholders feebly endorse management’s recommendations, Class T holders can adopt an intermediate approach.\(^{213}\) This approach is suited for those who hold a significant number of shares for a long period of time and leverage that position to influence management.\(^{214}\) While third party providers of capital, like insurance companies and banks have an incentive to monitor the firms being financed or insured, the arrangement proposed here also provides a similar advantage by providing shareholders with the incentive and opportunity to vigorously monitor the firms.\(^{215}\) As some scholars posit, monitoring is likely to be effective when the monitor faces substantial financial harm which, in turn, motivates her to act.\(^{216}\)

Thus, because of their long-term commitment and the attendant vulnerability, these shareholders have a heightened incentive to be effective monitors.\(^{217}\) By virtue of their long-horizon approach to investment, Class T holders also have the incentive and ability to commit resources into information gathering about the companies they invest in, while also eliciting the respect of management that ordinarily disdains transient investors that are only driven by profit-

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211 See Iris H-Y Chiu, The Meaning of Share Ownership and the Governance Role of Shareholder Activism in the United Kingdom, 8 RICH. J. GLOB. L. & BUS. 117, 156 (2008); 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 5 (IRRC INSTITUTE, 2011) (“Investors, burned by scandals at companies such as Enron and WorldCom and more recently by the collapse of major financial services firms, are more sensitive to risks at their portfolio companies and less willing to simply trust boards to oversee management and leave it at that.”).

212 Jean Tirole, Corporate Governance, 69 ECONOMETRICA 1, 5 (2001) (stating that the exercise of voice by shareholders and other constituents make a firm more efficient because, among other things, “active monitors may turn down a negative NPV [net present value] project sponsored by management, force the divestiture of a noncore division, or remove management altogether.”); Klein, supra note 133, at 175 (“Accountability of managers to shareholders can actually encourage innovation. Entrenchment, on the other hand, lowers the incentives for risk-taking. More efficient monitoring may also lead to the improved competitiveness of U.S. companies.”).

213 Hawley & Williams, supra note 157, at 125; see also Cohn, Gillan & Hartzell, supra note 110, at 6 (describing a continuum of activist shareholders ranging from those who submit shareholder proposals to those who expend resources to mount a proxy contest to secure board representation).

214 Hawley & Williams, supra note 157, at 125.


216 Francesca Cornelli, Zbigniew Kominek & Alexander Ljungqvist, Monitoring Managers: Does it Matter?, SOCIAL SCIENCE RESEARCH NETWORK 1 (December 20, 2010) (“As monitoring benefits all investors while being costly to provide, directors are more likely to engage in monitoring if they have skin in the game.”); See also Macey, supra note 2 (stating that when investors make substantial investments in a target company “they have strong incentives to agitate vigorously for reforms that will increase the value of their investments.”)

217 See Matheson & Olson, supra note 24, at 1388 (stating that “certain fundamental corporate transactions so affect long term shareholders’ financial interests that only they possess the requisite incentives to monitor the integrity of these transactions.”).
taking, as opposed to a desire to continuously assess the corporation’s ongoing prospects.\textsuperscript{218} Also, as the preceding section affirms, shareholder voice is likely to be amplified where exit is difficult.\textsuperscript{219} Unlike other recent proposals for stemming short-termism such as a securities tax, capital gains tax reform and loyalty dividends which hope that long horizon investing and shareholder participation in corporate governance would result from the applicable inducement or punishment, this proposal offers a more tangible prospect of that outcome because the parties go into the transaction with that objective and expectation at inception.\textsuperscript{220} Shareholders who are not interested in both long-term holding and activism are unlikely to be attracted to the arrangement in the first place. Therefore, there is no room for a hollow hope.

Class T shareholders are also better positioned to monitor due to potential access to insider information. The argument has been made that effective monitoring of managers is dependent on, or enhanced by, having insider information.\textsuperscript{221} However, the law restricts access to such information, in order to “prevent short-term investors from profiting at the expense of less well-informed shareholders.”\textsuperscript{222} On the other hand, “long-term investors don’t trade short-term and, therefore, they cannot profit from short-term uses of short-term uses of insider information. Thus a distinction between traders and long-term investors would better govern insider information rather than the current blanket prohibition.”\textsuperscript{223} The positional advantage of Class T shareholders is reflected in the fact that the case can more easily be made for such relaxation for that class of shareholders than short-term shareholders and even other long-term shareholders. This is because the difficulty in sorting out short-term shareholders from long-term shareholders that affects such long-term holders as index funds does not apply to Class T shareholders, since it is clear beyond doubt that the latter would hold the stock for the long-term.\textsuperscript{224}

Significantly, the envisaged investors here would fit closely into what Professor Coffee has identified as the best example of a corporate monitor, namely one who has no conflicts of interest, holds a substantial stake in the company, and has a long-term investment horizon.\textsuperscript{225} It is envisioned that as much as practicable, these long-term shareholders will operate as the long-term investment equivalent of short term-oriented hedge funds, adopting a similar posture of clarity of purpose, aggressiveness, cooperation and solidarity to accomplish their mission.\textsuperscript{226}
Preferably, they can use their position to participate in constructive dialogue with corporate management, expressing and advocating in unmistakable terms their preference for long-term growth and sustainable corporate performance.\textsuperscript{227}

\textbf{D. Long-Term Equity Security}

The Class T shares are an attractive option for individual and institutional investors interested in holding equity securities for an extended period of time to accomplish certain goals, instead of engaging in the casino-like experience that the stock market sometimes looks like.\textsuperscript{228} Jurists and scholars have started weighing in on the need for an investment product geared toward investors that want to put money away for their children’s college education and to fund their retirement.\textsuperscript{229} According to Delaware Chancellor Leo Strine:

Although the challenge of addressing the misalignment between the interests of end-user investors and society in the long run and the incentives of the institutional investor community to think and act myopically is considerable, it is past time to begin. Areas that would be productive for examination include . . . a mandated separation of funds managing 401(k) and college savings investments from more liquid investments, and requiring investing practices consistent with retirement and college investment objectives . . . .\textsuperscript{230}

While the Chancellor favors an option mandated by the government, a market-based, private alternative may be more attractive.\textsuperscript{231} The challenge is in devising a private vehicle that is easily accessible, a challenge that this article responds to by proposing a form of equity security that is based on a revised version of the trust fund theory. Trust securities could be an investment instrument of choice for shareholders who want to hold stock for a long time, without succumbing to the negative pull and impact of the stock market roulette.

An obvious target of a Class T pitch would be institutional investors that can buy and hold large blocks of stock at a time, especially public pension funds.\textsuperscript{232} Wealthy individuals and sovereign wealth funds may also be interested.\textsuperscript{233} Of particular relevance is that regardless of the improve the performance of some target companies); WALTER EFFROSS, CORPORATE GOVERNANCE: PRINCIPLES AND PRACTICES 196 (2010) (describing hedge funds’ tactics and success record).

\textsuperscript{227} See Matteo Tonello, Revisiting Stock Market Short-Termism 13 (CONFERENCE BOARD, 2006).


\textsuperscript{229} Strine, Governance Logjam, supra note 18, at 1082.

\textsuperscript{230} Leo E. Strine, Jr., One Fundamental Corporate Governance Question We Face: Can Corporations be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term? 66 BUS. LAW. 1, 18 (2010).

\textsuperscript{231} Rodrigues, supra note 1, at 1862 (“Ideally the market would provide investment vehicles specifically designed for long-term holders.”) (citation omitted); N.Y. COMMISSION ON CORPORATE GOVERNANCE, supra note 15, at 4-5 (staking a preference for market-based solutions to corporate governance matters).


\textsuperscript{233} It is interesting that investors were attracted while the prospectus for the initial public offering of Google Inc., clearly expressed a vision for the long term and the benefits to shareholders of being a public-spirited company even
stripe in which the shareholders come, as individuals or institutions, nationals or foreigners, they should share certain core values, including a long-term perspective and an interest that goes beyond financial indicators, technically construed, to include “intangibles” and “extra-financial factors.” For instance, they would likely include the type of shareholders that subscribe to the notion that “actions that prevent environmental disasters or comply with legal and ethical rules can have a significant positive effect in preventing disastrous corporate calamities, even if they cost money in the short run.” Some of these shareholders would fit into Steve Lydenberg’s 3-component definition of long term investing that includes long holding periods, assimilation of environmental, social and corporate governance [ESG] factors into investing, and preparedness to add value to investments by engaging with management to minimize negative externalities or maximize positive externalities. They are likely to include “universal owners” – institutional shareholders characterized by highly diversified and typically long-term holdings, who are mindful of negative externalities and support the creation or expansion of positive externalities because of the overall effect on their portfolios.

While this proposal favors private ordering, it does not preclude public law initiatives or legislative reforms to strengthen the private arrangements. The proposal would benefit from, and endorses, such public policy tools as capital gains tax reform in favor of holders of the trust securities, tax breaks for companies that adopt the Class T structure and a tax advantage for beneficiaries of pension and other funds when payments are received from stocks held long-term. Ultimately, if corporations are slow to adopt this proposal, for whatever reason, and in


Avi-Yonah, supra note 39, at 814; Steven J. Haymore, Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma, 64 VAND. L. REV. 1311, 1343-44 (2011) (noting that there is a growing number of investors who are not overly interested in maximizing short-run profits but aim to affect society by the more public-oriented investment approach they adopt).


Hawley & Williams, supra note 157, at 3-5.

See generally, Duruigbo, supra note 220.

See Orenbach, supra note 108, at 369 (arguing for favorable tax policy to support a private reform initiative for the governance of corporations); Rebecca A. Crawford, Corporate Governance Reform: How to Promote the Long-term Health and Value of U.S. Corporations, 5 N.Y.U. J. L. & BUS. 905, 933 (2009) (proposing that positive incentives, including tax breaks or subsidies be granted to companies that adopt a proposal on representation of creditors on corporate boards).

See Porter, Capital Disadvantage, supra note 12, at 77-79 (proposing an equity investment incentive that consists of reduced tax rates for pension and annuity beneficiaries where the source of their pension income is stock held for at least 5 years with the aim of pushing beneficiaries and trustees to pressure their investment managers to deliver a greater proportion of their income from long-term equity gains).
the midst of these incentives, direct public policy intervention along the lines suggested by Chancellor Strine may be inevitable and acceptable.

E. Antidote to Short-termism

Short-termism refers to the investment approach in which investors “push managers to invest in short-term projects in order to keep earnings high. In this sense, investors who behave in a short-termistic manner may well have long holding periods, provided managers satisfy the investors’ need for high earnings period by period.”

Short-termism promotes a tendency to overvalue short-term rewards, invariably leading to an undervaluation of long term consequences. One observer contends that an excessive focus on the short-term engenders misallocation of assets by corporate managers, leads to harmful volatility in the financial markets and imposes a burden on society to channel productive resources into repairing environmental and social damage occasioned by an unbridled quest for profits.

Indeed, some market observers and legal commentators link the collapse, a few years ago, of giant energy company Enron and more recently some fabled financial firms to investors acting like traders and influencing corporate managers to make policy decisions based on quarterly earnings statements.

Short-termism may exist both in investing and in corporate management, necessitating a focus both on shareholder short-termism and the concomitant corporate myopia. Shareholder short-termism is said to manifest in two major ways, namely ‘pressure’ and ‘walk.’ Some shareholders’ penchant for quick returns on investment puts pressure on corporate managers to be fixated on short-term results, even at the expense of long-run performance.

Besides, as Part...
III.B above has demonstrated, shareholders often exhibit a tendency to prefer exit to voice. That is, they would rather sell their stock if dissatisfied with corporate management than stay in and affect direction of corporate policy. Ultimately, this works against good corporate performance.

Scholars have attributed the emergence and perhaps prevalence of short-termism to a number of more specific factors.\textsuperscript{247} One of these factors is the executive compensation system which motivated management to take and benefit from excessive risk-taking while offloading the damage on shareholders.\textsuperscript{248} Perhaps nothing exemplifies the link between short-termism and the recent financial collapse more than the famous statement by a former Citibank Chairman and CEO, Charles Prince: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing."\textsuperscript{249} By steering shareholders toward long horizon investing, this proposal provides a basis to demand a similar posture from management, including an executive compensation structure that rewards a long-term focus.\textsuperscript{250}

Another factor responsible for short-termism is the disconnect between the interests of asset owners and asset managers.\textsuperscript{251} This misalignment manifests, inter alia, in investment time horizon. “Presently, many owners evaluate their fund managers’ performance quarterly. It is unsurprising, therefore, that asset managers focus on delivering short-term returns, including pressuring investee companies to maximize near-term profits.”\textsuperscript{252} Since the core characteristic of the plan presented here is long-term holding, this problem is avoided, as the focus of interested parties will be on maximizing long-term value.\textsuperscript{253} Another area where interests of asset owners and asset managers are misaligned is in asset manager compensation. Because fund managers for some of the institutional investors, such as pension funds, are bound by a compensation system that does not particularly incentivize monitoring of corporate managers, they are not eager to engage in conduct that, while desirable to institutions they represent, does not confer adequate reward to the fund managers.\textsuperscript{254} A number of pension funds maintain a fee structure that involves non-payment of management fees, which could be assessed as a percentage of assets under

\textsuperscript{247} For an extensive and excellent discussion of the causes of short-termism, see Lynne Dallas, \textit{Short-termism, the Financial Crisis and Corporate Governance}, 37 J. CORP. L. (forthcoming) (2011).


\textsuperscript{249} Bonaci & Strouhal, supra note 248; see also Dallas, supra note 247, n. 4 and accompanying text.

\textsuperscript{250} See supra note 17 and accompanying text.


\textsuperscript{252}Wong, supra note 251.

\textsuperscript{253} See also Coffee, \textit{Corporate Monitor}, supra note 93, at 1325-26.

management, in exchange for a permission to lend the stocks and earn a financial return thereby.\footnote{Wong, supra note 251.} In the first place, this form of asset manager compensation further engenders shareholder passivity.\footnote{See id.} Further, from the perspective of interest alignment, “this is highly problematic because it removes the asset manager’s incentive to maximize portfolio value while creating severe conflicts of interest.”\footnote{Id.} For example, waging a successful proxy contest might require that the lent shares be recalled for the purpose of voting but the fund manager may be reluctant to do so because of the revenue loss that such recall would occasion.\footnote{Id.; but see Aggarwal, Saffi & Sturgess, supra note 144, at 3 (suggesting that “institutions take their responsibility to vote seriously, and are even willing to give up revenue from lending securities in order to exercise voting rights.”).} Worse still, the shares may be lent to activist short-term traders, whose interests differ from the supposedly long-term orientation of the institutional investors.\footnote{See Aggarwal, Saffi & Sturgess, supra note 144, at 10 (discussing research suggesting that securities borrowers include activist investors who are primarily motivated by a desire to gain control of a company); Henry T.C. Hu & Bernard Black, Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms, 61 BUS. LAW. 1011 (2006); Ferlauto, supra note 123, at 45 (“The main purchasers of lent shares are often hedge funds and short sellers interested in short-term transactional gains, not long-term value propositions.”).} Stock lending is unacceptable under the arrangement proposed here, as the stockholder specifically enters into the scheme with the express intention of exercising its power to vote, among other ways of participation in the corporation’s affairs.\footnote{Roberta S. Karmel, Voting Power Without Responsibility or Risk: How Should Proxy Reform Address The Decoupling of Economic and Voting Rights? 55 VILL. L. REV. 93-123 (2010).} Besides, the stock certificate would specifically state that the stock is not subject to any form of transfer, defined to include lending, within the holding period.\footnote{Technically, stock lending would be considered a form of transfer and therefore prohibited in the context of this proposal. See Aggarwal, Saffi & Sturgess, supra note 144, at 10, 11 (defining securities lending and stating that it involves actual transfer of ownership and voting rights); see also Onnig H. Dombalagian, Can Borrowing Shares Vindicate Shareholder Primacy?, 42 U.C. DAVIS L. REV. 1231, 1260-61 (2009) ; Hu & Black, supra note 259 passim.}

\textit{F. Long-Term Shareholder Primacy}

Long-term shareholder primacy denotes a model of corporate governance that gives priority to the interests of long-term shareholders. For years, there have been strident arguments on whether the goal of the corporation should be the furtherance of interests of shareholders or whether the competing interests of other corporate constituents – stakeholders – should be accommodated or even preferred.\footnote{Grant Hayden & Matthew Bodie, Shareholder Democracy and the Curious Turn Toward Board Primacy, 51 WM. & MARY L. REV. 2071, 2092-95; 2082 (2010) (“Scholars have referred to the notion that corporations should seek primarily, if not solely, to maximize returns to their shareholders as the shareholder primacy norm or the shareholder wealth maximization norm. This norm is much more than a descriptive account of shareholders' rights; it is instead a normative judgment on the most socially efficient way of organizing the economy. Proponents of this norm argue that we will maximize our utility as a society only through a system of corporate law that recognizes and perpetuates shareholder primacy.”) (citations omitted); Barnali Choudhury, Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm, 11 U. PA. J. BUS. LAW. 631, 635-40 (2009); D. Gordon Smith, The Shareholder Primacy Norm, 23 J. CORP. L. 277 (1998). Some commentators contest the characterization of the}
objection on the ground that many shareholders are short-term oriented and therefore promoting their interests could come at the expense of the long-run growth of the corporation.\textsuperscript{263} A model of long-term shareholder primacy marries the two competing interests by giving preference to shareholder interests, but only in the case of shareholders that are committed to the corporation for the long-term.\textsuperscript{264} To that extent, long-term shareholder primacy shares similarities with the enlightened shareholder model that is codified in the United Kingdom Company Act of 2006.\textsuperscript{265} Not only is this approach an additional antidote to short-termism as it cultivates a norm of long-term shareholder primacy permitting management to operate free of short-termist shareholder pressures, but it also virtually erases internal friction within the firm and enhances corporate profitability.\textsuperscript{266}

The model proposed in this article neatly provides the sort of framework that some scholars have cogently argued is necessary for the overall wellbeing of the corporation because it clearly identifies the long-term shareholders and, in the process, provides management with the needed guarantee of long-term holding by these shareholders.\textsuperscript{267} As the management gets the freedom to focus on long-term strategy and incentivized shareholders monitor the performance of the managers in the execution of both short and long-term goals, the corporation and all of its components profit.\textsuperscript{268} Even short-term shareholders are not left out because their ability to hold

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\textsuperscript{264} See Porter, \textit{Capital Disadvantage}, supra note 12, at 79 (calling for long-term shareholder to be identified as the explicit, not just appropriate, corporate goal); Alfred Rappaport, \textit{The Economics of Short-term Performance Obsession}, 61 \textit{FIN. ANALYSTS} J. 65, 69 (2005) (“The idea that management’s primary responsibility is to maximize long-term shareholder value is widely accepted in principle but imperfectly implemented in practice.”); Nina Walton, \textit{On the Optimal Allocation of Power Between Shareholders and Managers} UNIVERSITY OF SOUTHERN CALIFORNIA LAW SCHOOL LAW AND ECONOMICS WORKING PAPER SERIES, Paper 118 (2010), at 12 (stating that the goal of the corporation is “to maximize the wealth of shareholders in the aggregate, rather than to maximize the wealth of long-term shareholders only, a policy position embraced by [some commentators] but one that is narrower than the current legal conception of the proper goal of corporations.”) (emphasis in the original); Nadelle Grossman, \textit{Turning A Short-term Fling Into A Long-term Commitment: Board Duties in a New Era}, 43 \textit{U. Mich. J.L. Ref.} 905, 908 (2010) (“While some Delaware courts have expressed a preference for this type of long-term standard, they have generally not required it.”).


\textsuperscript{266} Matheson & Olson, supra note 24, at 1369 – 71.

\textsuperscript{267} See id.

\textsuperscript{268} See Fairfax, supra note 235, at 702 (“[P]roponents of the long-term view of shareholder primacy would contend that such a view accommodates non-shareholder issues. This accommodation occurs because “stakeholder” concerns, such as giving money to charity or behaving responsibly towards employees and customers, inure to the benefit of shareholders in the long-term.”) Citations omitted. Matheson & Olson, supra note 24, at 1326 (discussing the benefits of a long-term model to nonshareholders and society); Lipton & Rosenblum, supra note 130, at 217
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and sell stock profitably within a short horizon is dependent on the belief that the stock’s long term promise is robust.\textsuperscript{269}

\textit{G. Cost Internalization and Creditor Protection}

Creditor protection was at the heart of Justice Story’s formulation of the trust fund theory.\textsuperscript{270} The theory’s “supposed strength lay in preserving the fund intact, by giving creditors a lien in equity upon the fund against all but \textit{bona fide} holders.”\textsuperscript{271} There is hardly any doubt that the theory failed in this undertaking.\textsuperscript{272} The present proposal is designed to fulfill that original objective. It provides a framework for ensuring that a corporation’s voluntary creditors who contract on the basis of the fund, and its involuntary creditors, such as the ecological and human victims of corporate catastrophes receive timely and adequate financial redress. This advantage is inbuilt in the character of the trust fund, as a form of bonding.\textsuperscript{273} This role could become larger if bonding is made compulsory as part of broad public policy to ensure that corporations do not transfer their business risks to the society.\textsuperscript{274} Forced bonding “fosters cost internalization by mandating the existence of capital reserves dedicated to the satisfaction of liabilities, even after corporate dissolution.”\textsuperscript{275}

An additional advantage is that the generator of harm has an incentive to avoid the harm, thus giving the trust fund a preventative quality. According to some scholars:

Bonding has a decided advantage relative to extensions of liability to shareholders or business partners. Namely, it shifts the burden of recovery from victims to the risk generator. With extensions of liability victims must pursue compensation, sometimes years later, from former business partners and shareholders who are understandably reluctant to honor such claims. In contrast, bonding leaves the potential injurer as the “residual claimant” to the bond fund. This creates an unambiguous incentive for the producer to minimize its liabilities.\textsuperscript{276}


\textsuperscript{270} Covington, supra note 54, at 284 (noting that \textit{Wood v. Dummer} states a fundamental rule that protects creditors from withdrawal of capital contributions to their detriment). \textit{See also} Hyman Zettler, \textit{The Trust Fund Theory: A Study in Psychology}, 1 WASH. L. REV. 81 (1925) (discussing the evolution and extension of the trust fund doctrine to ensure equal protection of creditors during corporate insolvency, thereby increasing the confidence of widely dispersed creditors to continue to lend to corporations).

\textsuperscript{271} Note, \textit{The Present Status of the Trust Fund Doctrine}, 8 COLUM. L. REV. 303, 303 (1908).

\textsuperscript{272} Id. (“That it held any such effect while the corporation was solvent, is doubtful.”).

\textsuperscript{273} Boyd & Ingberman, supra note 215, at 224-25.

\textsuperscript{274} \textit{See} Eleanor Marie Lawrence Brown, \textit{Visa as Property, Visa as Collateral}, 64 VAND. L. REV. 1047, 1068-71 (2011) (discussing the advantages of bonding requirements, including ease of enforcement).

\textsuperscript{275} Boyd & Ingberman, supra note 215, at 224-25.

\textsuperscript{276} Id. at 226.
Relative to other forms of bonding, trust funds present cheaper implementation costs. While some of these other forms may require close monitoring of the quality of the financial instruments and their providers, a trust funded from share subscriptions is more transparent and easily verifiable. Creditor protection will also be beneficial to the corporation since the segregated pool of funds will make it easier for firms to access credit because creditors price in the risk of default, reflected in higher interest rates, when extending credit. Because correctly pricing this risk may be cumbersome for creditors, the trust fund also facilitates lending activity as it reduces the difficulty of determining the appropriate price for a given corporate risk.

IV. ARGUMENTS AGAINST REVIVED TRUST FUND PROPOSAL

A. Impairment of Interests and Disparate Treatment of Existing Shareholders

One impediment to the introduction of the proposed trust fund here is the legitimate concern that granting Class T shareholders superior rights would impair the interests of other common shareholders who do not enjoy such rights and privileges. As a threshold matter, it should be stated that a corporation can legally create senior securities that negatively affect the interest of existing security holders even without the consent of all the affected shareholders. While senior securities would normally refer to debt securities (such as bonds and debentures) and preferred stock, the same idea is relevant here, especially since the proposed securities diverge in some respects from the regular incidents of common shares. The SEC’s proxy access regulations that grants nominating powers in the corporate proxy statement to shareholders that own 3 percent of a company’s stock for a minimum of 3 years confirms the point about the legal permissibility of privileging some common shareholders over others. Given that the new class of shares is being created for the benefit of the corporation and, by extension, the existing shareholders, the fairness of the transaction provides an additional boost that would help in trumping any other consideration.

277 Bonding requirements or indication of financial responsibility can be met in different forms, including trust funds, letters of credit, surety bonds, insurance policies, or evidence of self-insurance. See id. at 225.

278 Id. at 226 n. 51.

279 Daniel R. Fischel, The Economics of Lender Liability, 99 YALE L.J. 131, 136 (1989) (“The greater the amount of anticipated debtor misconduct, the greater the compensation (i.e., the higher interest rate) that a lender will demand. To decrease the amount of compensation demanded, borrowers will attempt to allay lenders' concerns by agreeing to various monitoring and bonding mechanisms.”) (citation omitted); Crawford, supra note 239, at 932 (stating that a “decrease in risk will be priced into the cost of the loan, providing companies with lower-cost loans.”).

280 Fischel, supra note 205, at 133-34 (stating that a lender needs to access the risk of default by the borrower and the likelihood that the money would be recovered if default occurs, noting that "the ability of the lender to make correct assessments is severely limited, no matter how diligent the lender may be.").

281 See Coffee, Balance in Corporate Law, supra note 6, at 1640-41 (discussing the move away from the concept of vested rights toward permission to issue new classes of securities that could affect the rights of existing security holders).


283 See supra notes 25 & 26 and accompanying text.

284 See id. An additional advantage to the corporation and other shareholders is that the acceptance of illiquidity by Class T holders demonstrates a level of confidence in the company and its stock that would be beneficial to the
The point is that special treatment is permissible in circumstances where the objective is the protection of the firm and shareholders from major damage or serious threat to continuation of the company’s operations. It is not uncommon in an organizational setting, where the quick exit of members increases the burden on the remaining members or otherwise adversely affects the continued existence of the organization, to introduce incentives to encourage long-term commitment, such as senior pricing discounts. The present proposal falls squarely in this category. In the immediate aftermath of the Deep Horizon disaster in 2010, BP was constrained to suspend dividend payments to shareholders shortly after the oil spill worsened, which probably wrought hardship on those shareholders that depend on them. The price of BP shares plummeted, as investors expressed concern about the company’s ability to weather the storm. Assurance in the form of a pool of ascertainable assets to deal with the financial costs, if it existed, would have lessened the apprehension.

B. Heightened Vulnerability of Class T Shareholders

Another strong objection is that holders of the Class T shares will be exposed to greater vulnerability than the typical shareholder in the same company or elsewhere. Assuming a group of raiders or short-term oriented investors launch a successful bid for control of Company X and thereafter start running the company aground, other shareholders may cut their losses and dump their shares. The long-term shareholder who is locked into a ten-year commitment may be left with an empty bag. This outcome certainly puts the Class T shareholder in financial jeopardy that needs to be resolved to make investing in the shares worthwhile. One response is that the long-term shareholder is an investor, who by definition has decided to take a risk and should be rewarded accordingly. Thus, if the company succeeds in the long run, she shares in the upside benefits. And if it fails, she absorbs the consequences. A related response is that the risk can be priced into the shares.

However, a different approach may be to protect Class T investors, for example, by inserting a provision that in the event of a major change in the structure of the company, Class T shareholders would be released automatically from their commitment and thereby entitled to liquidate their holdings. Those responsible for the major structural change may also be obligated to purchase the long-term shares at a premium before the transaction can be finalized. In that sense, this added bottle-neck to change in control will be similar to a poison pill in effect, if not in design. However, it would be long-term shareholder-centric, unlike the poison pill that was


285 See Rey & Tirole, supra note 11, at 5.


287 Id.

288 Id. at 1825.

289 For good description of a shareholder rights plan, commonly known as the poison pill, and its effects, see Paul H. Edelman & Randall S. Thomas, Selectica Resets the Trigger on the Poison Pill: Where Should the Delaware Courts Go Next? 2 VANDERBILT UNIVERSITY LAW SCHOOL, LAW & ECONOMICS WORKING PAPER NUMBER 11-21 (June 2, 2011) (stating that poison pills “enable a target board to “poison” a takeover attempt by making it prohibitively expensive for a bidder to acquire more than a certain percentage of the target company’s stock (until recently 15-
invented to cater to the interests of the board of directors. On that point, it would escape some of the scathing criticisms of the pill and enjoy support from some constituencies, such as some shareholder groups, that are not enamored of it. A final protective mechanism is to include an insurance component. As an exception to the non-hedging restriction mentioned earlier, holders of Class T shares may be able to purchase an instrument akin to a credit default swap that allows them only in the instance of a takeover or similar fundamental change to protect themselves against loss. To make this class of shares attractive to some risk-averse investors, the corporation may undertake to pay or reimburse the cost or otherwise maintain the insurance policy on their behalf.

C. Difficulty Raising Funds

A critical challenge that the trust fund proposal faces is the ability of any corporation to generate from the sale of shares, the kind of funds needed to satisfy the claims of involuntary creditors in the event of a major catastrophe caused by the corporation’s activities or meet the huge amount required in some legislative reform proposals to evidence financial responsibility. There may only be a small pool of investors who are willing to commit funds of

290 See supra notes 89-90 and accompanying text.
291 For a similar proposal, see Peter Conti-Brown, Solving the Problem of Bailouts: A Theory of Elective Shareholder Liability, 26 (ROCK CENTER FOR CORPORATE GOVERNANCE, WORKING PAPER SERIES NO. 97; Feb. 16, 2011) (proposing a Shareholder Liability Swap (SLS) that guarantees an equity holder payment on the occurrence of the stated event, and noting that “an SLS is similar to a credit default swap, which pays a bondholder the value of the bond in the event the issuer of the bond defaults.”); see also Mark J. Flannery, Joel F. Houston & Frank Partnoy, Credit Default Swap Spreads as Viable Substitutes for Credit Ratings, 158 U. PA. L. REV. 2085 (2010).
292 This would be similar to policy taken out on behalf of directors. See James A. Fanto, Lawrence M. Solan & John M. Darley, Justifying Board Diversity, 89 N.C. L. REV. 901, 908 (2011) (stating that corporations purchase comprehensive directors’ and officers’ insurance policies that protect them in the execution of their functions). There is a slight possibility, however, that doing so would lessen the interest of the shareholders in monitoring the corporation’s affairs. See Conti-Brown. supra note 293, at 27.
293 See Ronen Perry, The Deepwater Horizon Oil Spill and The Limits of Civil Liability, 86 WASH. L. REV. 1, 68 (2011) (noting calls to raise liability caps under the Oil Pollution Act in the aftermath of BP disaster); Richard
that magnitude for extended periods of time.\textsuperscript{296} It is a truism that patient capital is difficult to find.\textsuperscript{297} On a closer look, however, it may not be as gargantuan as it appears. Although BP issued a denial, there were reports a few months after the Deepwater Horizon incident that BP was scouting for major investors to replenish its coffers and avoid the prospects of a takeover by any of its principal competitors.\textsuperscript{298} An effort of that kind not only demonstrates the possibility of raising substantial amounts of money in a short period of time but could also be viewed as a de facto Class T offering. Certainly, any investor coming in at that juncture, would demand some concessions and is not likely to rest content simply with the privilege of holding the company’s stock. It would be in the interest of management to undertake this kind of fundraising before any tragic incident when its bargaining hands are stronger - in line with the proposal here - instead of waiting for disaster to strike before embarking on the course, at a time that the company would invariably be negotiating from a weaker position.

D. Management’s Opposition

It is foolhardy to expect that managements across America would be overly excited about this proposal.\textsuperscript{299} Any effort that seeks to share existing power is likely to evoke strong resistance from the current wielders. Getting management buy-in entails convincing managers that this arrangement is not only beneficial to the corporation, but also holds benefits for the managers. Management may evince interest in the possibility of using the Class T structure as a basis for obstructing a takeover bid. That is, an incidental benefit of protecting long-term shareholders would be the room it provides managers to ward off insurgents. This additional arsenal presents an interesting incentive to managers.

The proposed arrangement is also attractive because it presents a corporate management focused on long-term strategy with a new cadre of allies that are committed for the long haul and have an incentive to ensure that short-term maneuvers do not jeopardize the company’s long-run


\textsuperscript{297} See Jeff Schwartz, \textit{Fairness, Utility, And Market Risk}, 89 OR. L. REV. 175, 214-15 (2010) (stating that because the law requires mutual funds to honor redemption requests by investors almost immediately, mutual funds necessarily tend to be liquid); Jeffrey N. Gordon, \textit{Institutions as Relational Investors: A New Look at Cumulative Voting}, 94 COLUM. L. REV. 124, 130 (1994) (“The shifting needs and investment preferences of the ultimate beneficial owners of institutional claims also militate against an institution’s holding a large, potentially illiquid stock position or committing to an indefinite holding period in any one company.”) [hereinafter Gordon, \textit{Cumulative Voting}].

\textsuperscript{298} Thomas Kelley, \textit{Law and Choice of Entity on the Social Enterprise Frontier}, 84 TUL. L. REV. 337, 355 (2009); Bebchuk, \textit{Troubled Assets, supra} note 117, at 347 (“In the aftermath of the financial crisis of 2008, obtaining capital that can be locked in for several years in funds dedicated to buying housing-related loans and securities is difficult.”)

\textsuperscript{299} \textit{BP Launches Search for New Investors: Report}, \textit{REUTERS} Jul. 5, 2010; \textit{BP Won’t Issue New Equity to Cover Spill Costs}, \textit{WALL ST. J. Online} (Jul. 6, 2010).

\textsuperscript{299} See Orenbach, \textit{supra} note 239, at 415 (“Corporate executives typically believe they deserve autonomy and control of their company. Measures that intrude upon their authority and influence are likely to be resented and actively opposed, even by executives of high moral rectitude.”) (citation omitted).
Managers have long anchored their objection to greater shareholder involvement in corporate governance on the fact that many of these shareholders are transient investors who demonstrate little interest in the corporation’s long-term future or act like owners in the true sense of the term. The situation and style of these investors sharply contrast with those of the small business proprietor or long-term investor of yore, thus, making it difficult to support their claim to an enhanced status. Class T shares re-introduces a proprietary approach to investment, thus taking away this complaint. In view of the foregoing, the proposal has a good chance to elicit management cooperation and overcome the elusive quest for shareholder-management cooperation to enhance long term value.

Generally, the level and length of shareholder commitment to the company is directly proportional to the extent of the management’s cooperation in treating shareholders as significant participants in the corporate enterprise. The reverse is also true: If the management does not trust shareholders with good quality information and an appropriate voice in governance, shareholders are unlikely to make longer capital commitments to the company, exiting at the

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300 See Mark J. Roe, A Political Theory of American Corporate Finance, 91 COLUM. L. REV. 10, 14 (1991) (“Management would more willingly reveal proprietary information to the large long-term shareholder, who has the incentive to maintain secrecy. The large shareholder would protect secrets and protect managers from outsiders who would second guess truly profitable long-run investments.”) (emphasis in the original).

301 Ball, supra note 125, at 196 (“This perspective is widely shared by corporate management, which has long viewed institutional investors as ‘transient shareholders’ and not ‘owners’ in the real sense.’ Pension funds, according to management, do not deserve a larger role in corporate governance, because they are not concerned with the long-term future of the corporations in which they invest.”) (citations omitted). See also Estreicher, supra note 130, at 544 (stating that shareholders in public corporations do not behave like owners, have no enduring relationship with the underlying business, and are generally drawn to shares because of the liquidity it offers compared to other asset classes).

302 Lipton & Rosenblum, supra note 130, at 204 (stating that self-interest based on largely immobile ties and need for survival propelled a proprietor to grow and keep the business successful for the long-term, whereas the modern owner in a public corporation, with separation of ownership and control, “highly liquid stake and betting-slip mentality”, could not be counted on to be automatically dedicated to the long-term health of the business); Tara J. Wortman, Unlocking Lock-in: Limited Liability Companies and the Key to Underutilization of Close Corporation Statutes, 70 N.Y.U. L. REV. 1362, 1368 (1995) (contrasting the nature of investment in public and close corporations and noting that “governance and livelihood are strongly at stake in a close corporation . . . .”).

303 Gordon, Cumulative Voting, supra note 296, at 129 (“A credible commitment to an extended holding period similarly increases management’s willingness to engage because it indicates that the investor shares management’s desired time-frame for the measurement of success.”) Lipton & Rosenblum, supra note 130, at 233 (“Only when these stockholders redefine success of their investment in terms of long-term operating returns, rather than takeover or other short-term premiums, will increasing their power to influence directors and managers promote the long-term health of the corporation.”).

304 Gordon, Cumulative Voting, supra note 296, at 129 (noting that managers should not mistake investors’ patient commitment of capital for a vow of passivity); see also Silvers, supra note 151, at 88 (calling for a deal uniting CEOs, workers and long-term investors on the understanding that CEOs and boards should be meaningfully accountable to investors with a long-time horizon)

305 See Roe, Pacification, supra note 125, at 650 (stating that “managers should more willingly reveal proprietary information to major long-standing shareholders than they do to the market as a whole [and] [t]hat this tightening of the bonds between managers and stockholders could well be beneficial).

306 Schacht, supra note 47, at 599.
earliest opportunity. This proposal presents a chance for management and a core base of shareholders who have a long-term disposition to give effect to their “need to coalesce around the appropriate long-term value creating strategies.”

The call for engagement and cooperation does not end with shareholders and management. Beneficiaries, i.e., the investing public that own stock through institutional intermediaries, naturally have a long-term perspective. Investors in pension and mutual funds have an important role to play in the successful entrenchment of long-termism “by demanding a longer-term perspective from [these institutions] that they have entrusted with their money.” Already, initiatives are emerging to keep beneficiaries informed and involved. The fusion of the energy of active long-term shareholders, responsive management, and vigilant beneficiaries is expected to yield positive results and avert disasters associated with a short term orientation.

E. Superfluity

Another objection focuses on what could be considered a fixation with equity securities. Critics would argue that there is no real distinction between equity and debt securities and therefore emphasis should be about stimulating long-term investing, not necessarily long-term shareholding. Another variant of the criticism dwells on the point that those interested in holding securities for a long time can scout for corporate bonds, debentures, preferred stock or a bucket of instruments specifically designed for long-term investors. In other words, there could be legitimate questions about the desirability of creating and experimenting with a new...

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307 Id.; see also Jacobs, supra note 1, at 10 (“Lack of communication prevents investors from understanding management’s long term goals and objectives.”).
308 Schacht, supra note 306, at 599; Garten, supra note 128, at 632 (discussing the “forging of temporary alliances between managers and permanent institutional owners.”). See also Lisa M. Fairfax, Government Governance and the Need to Reconcile Government Regulation with Board Fiduciary Duties, 95 MINN. L. REV. 1692, 1711 (2011) (stating that “reforms aimed at enhancing shareholder power may lead to a climate of more active engagement between shareholders and directors.”) (citation omitted) [hereinafter Fairfax, Government Governance].
309 See Strine, Governance Logjam, supra note 18, at 1082; Ho, supra note 265, at 64 (noting that pension fund beneficiaries have a long-term perspective).
310 A Different Class, supra note 210.
312 This indirect participation in corporate governance is imperative in view of the fact that the “retail” investor involvement can only be limited seeing that the individuals have already engaged the institutions to represent them in relating with the portfolio companies. See Eric John Finseth, Shareholder Activism by Public Pension Funds and the Rights of Dissenting Employees Under the First Amendment, 34 HARV. J.L. & PUB. POL’Y 289, 316-323 (2011) (arguing that employees that disagree with the positions taken by pension funds in particular corporate matters should have the right to limit pension funds’ voting to the extent of the dissenting employees’ holdings in the fund).
313 See P.M. Vasudev, Law, Economics, and Beyond: A Case for Retheorizing the Business Corporation, 55 McGILL L.J. 911, 940 (2010) (“Economic theory does not recognize any significant difference between share capital (equity) and debt. They are bracketed together as sources of corporate finance.”); Adam Feibelman, Commercial Lending and the Separation of Banking and Commerce, 75 U. CIN. L. REV. 943, 948 (2007) (demonstrating that equity and debt investments are functionally similar); but see Vasudev, id., at 942-43 (stating that debt is more perilous and destabilizing to the corporation than equity).
class of securities when existing debt and equity securities can serve the purpose. A corporation may issue, and investors may purchase, long-term bonds, debentures and preferred stock. This argument is further strengthened by the fact that holders of these securities can be positioned to participate in corporate governance or play a key monitoring role under contracts with the corporation.\textsuperscript{315}

From the company’s perspective, bonds and debentures are considered cheaper because interests paid on them are tax-deductible, as opposed to dividends.\textsuperscript{316} Debt would also allow managers (and indirectly shareholders) to gamble with other people’s money, with little risk to themselves.\textsuperscript{317} Also, equity holders stand a chance of sharing in the upside potential of the company, whereas, as soon as the debt is liquidated, debt holders have no future claim on the company.\textsuperscript{318} In that case, issuing more equity dilutes the interest of existing shareholders the way debt does not.\textsuperscript{319} From an investor’s perspective, equity is also riskier than debt since the debt holder is guaranteed regular interest payments and a full re-payment of the debt.\textsuperscript{320} All of the above factors make debt securities a more attractive option for a company looking for long-term capital and investors interested in providing it, while also enjoying the favor of existing shareholders who do not want to expand the circle of beneficiaries of future corporate growth.

However, debt securities lack the needed lock-in component that some companies need.\textsuperscript{321} For a company that needs immediate cash for on-going operations and continued


\textsuperscript{317} Jensen & Meckling, supra note 194 (discussing the agency costs of raising capital through debt).

\textsuperscript{318} Meredith R. Conway, With or Without You: Debt and Equity and Continuity of Interest, 15 STAN. J.L. BUS. & FIN. 261, 289 (2010) (“The traditional label of equity applies to an instrument held by a shareholder in a corporation, which bears the risk of the corporation but also reaps the rewards--greater risk for potentially greater reward. Conversely, the traditional debt holder is typically given more of a guarantee in his instrument and more protection that he will be paid back. Further, the debt holder typically receives a fixed return on his investment. However, less risk often comes at the cost of limited opportunity to share in the growth of the corporation.”) (citations omitted).

\textsuperscript{319} ROBERT W. HAMILTON & RICHARD D. FREER, THE LAW OF CORPORATIONS IN A NUTSHELL 266 (6th ed. 2011) (“Existing shareholders may worry when the corporation issues new stock to others, because their interests in the business will be diluted.”). Dilution may be mitigated by preemptive rights, which entitles existing shareholders to be issued a proportionate number of shares in the new issue to maintain the percentage of their holding. However, such right is unlikely to exist in many public corporations.

\textsuperscript{320} Conway, supra note 318, at 289; Hamilton & Freer, supra note 319, at 267, 269.

\textsuperscript{321} See Erik F. Gerdig, Code, Crash, and Open Source: The Outsourcing of Financial Regulation to Risk Models and the Global Financial Crisis, 84 Wash. L. Rev. 127, 196 (2009) (“Equity has other advantages for issuers. First,
growth, equity may be more favorable because interest on debt is regularly scheduled and needs to be paid out regardless of net income, \textsuperscript{322} while no obligation to pay dividends arises when the company is not profitable. \textsuperscript{323} Moreover, even when the company is profitable, it may still choose not to pay dividends to common shareholders and those preferred stockholders that have not bargained for an automatic right to dividends in the event of profitability. \textsuperscript{324} Issuing debt also does not remove the constraint that managers face when shareholder’s transient investing puts pressure on managers to manage for the short-term. \textsuperscript{325} There remains the need to get a critical mass of shareholders that are determined to hold stock for a long term and thereby act as a countervailing force to short-term trading. \textsuperscript{326} Debt and preferred stock cannot address that issue for management.

From the shareholder’s perspective, while more equity has a dilutive effect, more debt also somewhat imperils the interests of existing equity holders because in the event of liquidation or bankruptcy, debt holders stand in priority over equity holders. \textsuperscript{327} Moreover, it is normal for an investor to have a healthy mix of securities or assets that includes equity, a fact that is made more significant with the current quest for an investment vehicle designed for long-term shareholders. \textsuperscript{328} Some people simply may want to own a piece of an enterprise, not just lend derivatives, options and debt instruments allow counterparties to transfer or terminate their bearing of risk through the use of assignment provisions, margin calls and redemption provisions. By contrast, equity has the virtue of being what banking scholars call “patient capital.” Capital raised through equity is locked into a company for a longer time, increasing its capacity to absorb risk.” (citation omitted); Vasudev, \textit{supra} note 313, at 933 (“Shareholders’ funds represent the more stable portion of a corporation’s capital . . . .”).

\textsuperscript{322} There are exceptions to this rule. \textit{See} HAMILTON & FREER, \textit{supra} note 319, at 271 (“Not all debt instruments carry a fixed interest rate. Some corporations have issued “income bonds,” in which the obligation to pay interest is conditioned on adequate corporate earnings. Somewhat rarer are “participating bonds,” with which the amount of interest increases or decreases with corporate earnings.”).

\textsuperscript{323} Barring exceptional circumstances, the declaration of dividends is entirely at the discretion of the directors. \textit{See} Douglas K. Moll, \textit{Shareholder Oppression & Dividend Policy in the Close Corporation}, 60 WASH. & LEE L. REV. 841, 842 (2003) (“Under case law dating back to 1868, shareholders have not had the legal right to receive any dividend at all unless it was declared by the directors.”); Patton v. Nicholas, 154 Tex. 385 (1955); Gottfried v. Gottfried, 73 N.Y.S.2d 692 (N.Y. Sup. Ct. 1947); Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (Mich., 1919) (discussing one such exception, to wit, where there has been a huge accumulation of profits); see further Daniel R. Fischel, \textit{The Law and Economics of Dividend Policy}, 67 Va. L. Rev. 699, 700 (1981) (stating that the "legal rules giving management virtually unlimited discretion in making the dividend decision maximize shareholder welfare" in public corporations).

\textsuperscript{324} \textit{See} SHADE, \textit{supra} note 85, at 326 (stating that unlike bondholders, preferred stockholders do not have a right to be paid dividends and that the decision as to whether to pay dividends to common and preferred stockholders lies at the discretion of the board of directors).

\textsuperscript{325} \textit{See} Lord Myner’s Remarks, \textit{supra} note 131, at 244 (stating that “investors' emphasis on short-term return communicates itself to the thinking of business leaders who feel obligated to think and act short term - perhaps not as short as the perspective of fund managers, but shorter than many corporate leaders believe to be optimal.”).

\textsuperscript{326} \textit{See} N.Y. COMMISSION ON CORPORATE GOVERNANCE, \textit{supra} note 15, at 2 (articulating the importance of establishing relationships with a core base of long-term oriented investors for accomplishing the board’s job in creating long-term value); ROBERT A.G. MONKS & NELL MINOW, \textit{POWER AND ACCOUNTABILITY} 243-44 (1991).


\textsuperscript{328} \textit{See} \textit{supra} notes 229 - 231 and accompanying text.
money to it.\textsuperscript{329} Further, long-term common shareholders are the most vulnerable of the vulnerable risk bearers and therefore in a more plausible position than debt-holders and preferred stockholders to promote the long-term health of the corporation.\textsuperscript{330} Finally, common shareholders are the only corporate constituents with powers legally in-built into the corporate structure to participate in governance – such as voting on fundamental transactions and in the election or removal of directors.\textsuperscript{331} Other stakeholders obtain their rights by contract.\textsuperscript{332} Thus, common shares fit more neatly into the objective sought here, that is, investors who commit for a long time but also are properly positioned to monitor the managers of the investment.\textsuperscript{333}

\textbf{F. Unreasonable Restraint on Alienation}

A core characteristic of the corporate form, especially public corporations, is the free transferability of equity stakes.\textsuperscript{334} Restraints on alienation of shareholder interest in a corporation are permissible provided they meet the requirements of reasonableness and conspicuousness.\textsuperscript{335} An absolute restraint on alienation is \textit{per se} unreasonable and is void as against public policy.\textsuperscript{336} It may be argued that the restriction on transfer of Class T shares comes close to being an absolute restraint. But the arrangement does not cross the line into absolute prohibition. Holders of Class T stock are not permanently barred from alienating it, only for a certain period of time, after which they may sell the shares back to the company or convert them into other securities. From that angle, it resembles resale restriction agreements that govern the initial sale of homes and bind homeowners to refrain from selling their homes within a number of years after the purchase.\textsuperscript{337} It also shares similarities with the restricted stock or stock option plans that have

\textsuperscript{329} See Richard A. Booth, \textit{The Promise of State Takeover Statutes}, 86 Mich. L. Rev. 1635, 1644 (1988) ("There are other reasons for owning stock besides purely passive investment—for example, in order to control and manage the company or perhaps in order to cement a customer or supplier relationship.").


\textsuperscript{331} See \textit{Ho}, supra note 265, at 76 – 77; Vasudev, supra note 313, at 933 (“The shareholder capital’s greater exposure to risk and the shareholders’ proprietary position are the theoretical justifications for the powers that shareholders have in corporate law. These justifications also explain the absence of similar powers for creditors of all varieties, including bondholders, lending banks, and vendors who sell goods or services on credit.”).

\textsuperscript{332} See, e.g., Vasudev, supra note 313, at 933 (“Creditors, whose capital is also tied up in corporations, have no statutory powers of control . . . .”); Baird & Rasmussen, supra note 315, at 1212 (sating that creditors have acquired extensive control rights by contract).

\textsuperscript{333} See Feibelman, supra note 313, at 944 (lamenting that notwithstanding creditor activities that could be described as monitoring or managerial discipline, observations about creditor participation in control or governance “are still surprisingly peripheral to prominent accounts of corporate law and corporate governance.”).


\textsuperscript{335} Allen v. Biltmore Tissue Corp., 141 N.E.2d 812 (1957); Ling and Co. v. Trinity Sav. and Loan Ass’n., 482 S.W.2d 841 (Sup. Ct. Tex., 1972).

\textsuperscript{336} For the view that stock transfer restrictions should not be strictly construed, see Bruns v. Rennenbohm Drug Stores Inc., 151 Wis.2d 88, 442 N.W.2d 591, 596 (App. 1989).

\textsuperscript{337} See generally James J. Kelly Jr., \textit{Homes Affordable For Good: Covenants And Ground Leases As Long-Term Resale-Restricition Devices}, 29 St. Louis U. Pub. L. Rev. 9, 23-25 (2009); Laura M. Padilla, \textit{Reflections On Inclusionary Housing And A Renewed Look At Its Viability}, 23 Hofstra L. Rev. 539 (1995); Michael F. Keeley &
been proposed to steer managers away from speculative influences and elicit long-term commitment.\footnote{See supra note 17 and accompanying text.}

\section*{G. Shareholder Empowerment and Agency Costs}

There is a continuing debate on the desirability or otherwise of shareholder empowerment, a debate that has taken increasing significance with the recent global financial crisis.\footnote{William W. Bratton & Michael L. Wachter, \textit{The Case Against Shareholder Empowerment}, 158 U. PA. L. REV. 653 (2010) (arguing that shareholder empowerment could not have prevented the financial crisis of 2008, contrary to the claims of its proponents); Fenner Stewart, Jr., \textit{Berle’s Conception of Shareholder Primacy: A Forgotten Perspective for Reconsideration During Rise of Finance}, 34 Seattle U. L. Rev. 1457, 1493 (2011) (noting that “investor empowerment is evolving into a new and powerful layer of global governance that may not adequately meet social needs.”) (citation omitted); Daniel R. Fischel, \textit{The Corporate Governance Movement}, 35 VAND. L. REV. 1259, 1260 (1982) (criticizing the movement toward greater shareholder participation); Levitt, supra note 137, at 17 (arguing for increased shareholder voice as a tool for healing the mistrust in the markets arising from the 2008 financial crisis and for enhancing management accountability); Fenner Stewart, Jr., \textit{The Place of Corporate Lawmaking in American Society}, 23 LOYOLA CONSUMER. L. REV. 147, 163-164 (2010) (reviewing the positions of both sides of the debate); Gulinello, supra note 200, at 564-571 (presenting arguments in favor of, and against, shareholder empowerment); Lisa M. Fairfax, \textit{The Model Business Corporation Act at Sixty: Shareholders and Their Influence}, 74 LAW & CONT. PROBS 19 (2011) (providing a historical overview of the increase in shareholder influence); see further Lucian Ayre Bebchuk, \textit{The Case for Increasing Shareholder Power}, 118 HARV. L. REV. 833 (2005) (discussing the marginalization of shareholders under corporate law and proposing changes to reverse the situation); Cf. Bainbridge, \textit{Shareholder Disempowerment}, supra note 202 passim; Martin Gelter, \textit{The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance}, 50 HARV. INT’L L.J. 129, 194 (2009) (urging caution in proceeding with proposed legal reforms to increase shareholder influence); Martin Lipton & William Savitt, \textit{The Many Myths of Lucian Bebchuk}, 93 VA. L. REV. 733 (2007); Lynn A. Stout, \textit{The Mythical Benefits of Shareholder Control}, 93 VA. L. REV. 789 (2007).} Without question, the issue is quite complicated.\footnote{See, e.g., Rose, supra note 208, at 1417 (stating that while shareholder empowerment is often characterized as a form of democratic reaction and resistance to imperial CEOs and their collaborators on the board of directors, “a reactive reallocation of power in the name of corporation democracy may result in oligarchies in which managers and influential shareholders share power and occasionally act at the expense of passive shareholders and other corporate constituencies.”).} For instance, while some long-standing critics of investor short-termism are quite vocal in their opposition, they do not view further shareholder empowerment as the panacea.\footnote{For instance, Martin Lipton is a strong opponent of short-termism, but also strongly opposes shareholder empowerment. See, e.g., Martin Lipton & Paul K. Rowe, \textit{The Inconvenient Truth about Corporate Governance: Some Thoughts on Vice-Chancellor Strine’s Essay}, 33 J. CORP. L. 63, 63 (2007); Stephen M. Bainbridge, \textit{Shareholder Activism in the Obama Era}, UCLA SCHOOL OF LAW, LAW-ECON RESEARCH PAPER NO. 09-14 (2009) (arguing that shareholder empowerment is inefficient) [hereinafter Bainbridge, \textit{Shareholder Activism}]; Cf. Bebchuk, \textit{Shareholder Franchise}, supra note 106, at 678 (arguing that shareholder empowerment is efficient); James McConville, \textit{Shareholder Empowerment as an End in Itself: A New Perspective on Allocation of Power in the Modern Corporation}, 33 OHIO N.U. L. REV. 1013 (2007) (stating that shareholder empowerment is justified even on non-financial grounds because shareholders would be happier with participation than passivity); see Jennifer G. Hill, \textit{The Rising Tension Between Shareholder and Director Power in the Common Law World}, 16-25, Sydney Law School Research Paper No. 10/34 (2010) (discussing the divergent viewpoints on shareholder empowerment).} In fact, they rather tend to believe that the solution to the
problems associated with it lie in substantially disempowering shareholders. Professor Lawrence Mitchell has argued that shareholder power propels directors toward pleasing stockholders and that freeing directors from shareholder oversight would enable them to manage responsibly and with a focus on the long term. Yet, these arguments could be construed as opposition to shareholder power when shareholders are short term – oriented and that some of the objections would evaporate if shareholders are being empowered only to work for the long-term value of the corporation. Shareholder disempowerment is also supported on efficiency grounds, with financial theorists reasoning that shareholders should not influence firm decisions because the domain of shareholders is risk-bearing, not decision-making.

Opposition to shareholder empowerment is further strengthened by the fact of shareholder limited liability and liquidity. That being the case, shareholders that have taken additional risk by surrendering a significant measure of their liquidity ought not to be treated in the same manner as those who have not made similar sacrifices. Professor Lynne Dallas’ cogent argument is right on point: “All shareholders should not be disempowered or disenfranchised because of the behavior of some of their number.” Simply put, because these long-term shareholders have more skin in the game, their position and views would be met with greater trust and treated with more seriousness. Besides, the idea of complete freedom from shareholder oversight is not only utopian, it is also not necessarily in the best interests of the corporation, especially as it.


343 MITCHELL, supra note 342, at 101 & 119; see also id. at 3 (stating that accomplishing corporate long-term focus requires freeing managers from stockholder and capital markets pressures); see Michael Ilg, An Essay on Social Responsibility and the Limits of the Corporate Form: A Perspective on Environmental Protection, 17 J. ENV. L. & PRAC. 115, 130-33 (2007) (presenting a brief critique of Professor Mitchell and this management elite model of corporate governance).

344 See, e.g., John F. Olson, Is the Sky Really Falling? Shareholder-Centric Versus Director-Centric Corporate Governance, 9 TRANSACTIONS 295, 299 (2008) (stating that “the movements toward shareholder-centrism, director insecurity, and enhancing the power of activists who try to change management, might well have increased the pressure on management to produce “good” short-term financial results each quarter, rather than to focus on longer-term strategy and thoughtful assessment of risks.”); Martin Lipton, Corporate Governance in the Age of Finance Corporatism, 136 U. PA. L. REV. 1, 36 (1987) (“Although shareholders may be able to liquidate their investments quickly, those who choose to invest for the long-term are surely deserving of management consideration.”); Hayden & Bodie, supra note 262, at 2092-95; 2116-17; but see Lawrence E. Mitchell, The Legitimate Rights of Public Shareholders, 66 WASH. & LEE. L. REV. 1635 (2009) (arguing that public shareholders’ right to vote should be eliminated); Lawrence E. Mitchell, On the Direct Election of CEOs, 32 OHIO N.U. L. REV. 261, 263 (2006) (arguing for ending of shareholder exclusivity on the right to vote and for extending the right to creditors and employees).

345 Mark J. Roe, Some Differences in Corporate Structure in Germany, Japan, and the United States, 102 YALE L.J. 1927, 1933 (1993) [hereinafter Roe, Corporate Structure]; Johnson, Fund Capitalism, supra note 136; at 617 (addressing the question about the rationale for “making it easier for investment managers, who may be experts in investing but certainly not at corporate governance, to influence the make-up of boards and management).)

346 Dennis J. Block, Stephen A. Radin & Michael J. Maimone, Proxy Contests and Institutional Investors, in CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 161, 193, 217 (Attachment C; Letter of Richard H. Troy to Ms. Linda C. Quinn) (Practising Law Institute, Sep. 24-25 1990) (stating that the privileges of limited liability and liquidity enjoyed by shareholders dictate that they be less aggressive in seeking to be more directly involved in corporate governance).

347 Dallas, supra note 247, at 65.

allows managers almost a free rein to engage in actions that primarily benefit them.\(^{349}\) The key to ensuring effective governance is balance in the allocation of powers between shareholders and managers, not tilting it to favor one side over the other.\(^{350}\)

One additional concern with increasing the power of institutional investors in corporate governance is that it would result in identical or higher agency costs that characterize company directors and consequently have provided the rationale for proposing greater empowerment of shareholders.\(^{351}\) In other words, there would be a transition from separation of ownership from control to separation of ownership from ownership.\(^{352}\) One proposed solution for reducing or eliminating the resulting agency costs is to more closely align the interests of investors and fund managers through a more personally-rewarding compensation scheme.\(^{353}\)

Shareholder empowerment concerns are exacerbated by the fact that conflicts of interests abound in the universe of potential Class T shareholders. Unlike the case a few decades ago, when individual share ownership held sway, today’s equity investment sphere is dominated by institutions, including banks, insurance companies, public and private pension funds, hedge funds and mutual funds that pool resources from individuals and invest on their behalf.\(^{354}\) The

\(^{349}\) See Sanford M. Jacoby, Finance and Labor: Perspectives on Risk, Inequality, and Democracy, 30 COMP. LAB. L. & POL’Y J. 17, 26 (2008) (“[G]iving shareholders a larger role in corporate governance promotes efficiency. When shareholders lack influence, executives build overstuffed empires, pay themselves too much and, to avoid conflict and enjoy a quiet life, overpay and coddle employees. When shareholders gain power, the effects are attenuated.”); Julian Velasco, Taking Shareholder Rights Seriously, 41 U.C. DAVIS. REV. 605, 637 (2007) (stating that not only would insulation from shareholder accountability be an enormous price to pay to achieve director focus on the long term, it is questionable that the reduced accountability lead to directors adopting a long term perspective).

\(^{350}\) See Fisch, Proxy Access, supra note 20, at 48 (“Critically, to function well, corporate governance must maintain a balance between managerial and shareholder power. Excess managerial power increases managerial agency costs. Excess shareholder power creates inefficiency and may, in some cases, create intra-shareholder agency costs.”) (citation omitted).

\(^{351}\) See Stephen M. Bainbridge, The Politics of Corporate Governance, 18 HARV. J.L. & PUB. POL’Y 671, 722-24 (1995); Bratton & Wachter, supra note 93, at 662; Strine, Delaware Way, supra note 24, at 687 (stating that institutional intermediaries like mutual and pension funds have their own agency costs and often evidence a misalignment of interests between them and the individuals indirectly investing in stocks through them). For an examination of a similar issue in a slightly different context, see Roe, Corporate Structure, supra note 125, at 1931 (“Institutional ownership discourages entrepreneurial leadership, risks conflicts of interest, and may make adaption to change more difficult. Moreover, agency problems may simply shift from the firm to the intermediary.”).

\(^{352}\) See Strine, Toward Common Sense, supra note 80, at 6-7 (cautioning against this problem and calling for scholarly efforts in addressing it); see also Strine, Governance Logjam, supra note 18, at 1084 (stating that “there are forceful arguments that support doing more to constrain the ability of institutional investors to exploit the separation of ownership from ownership for their own ends.”); Jill E. Fisch, Securities Intermediaries and the Separation of Ownership from Control, 33 Seattle U. L. REV. 877, 881 (2010) (“The separation of ownership and control within the intermediary is analogous to that identified by Berle and Means. With respect to the underlying portfolio companies then, intermediation creates two levels of separation. The intermediary's separation of ownership from control creates a second layer of agency costs.”) (citations omitted) [hereinafter Fisch, Securities Intermediaries]. For a discussion of concerns of beneficiaries with institutional investors, see Peter Clapman, Walking the Walk on Corporate Governance, PENSIONS AND INVESTMENTS (Aug. 6, 2007), available at http://www.pionline.com/article/20070806/PRINTSUB/70803016 (last visited Jun. 18, 2010).

\(^{353}\) Illig, supra note 254, at 253.

\(^{354}\) See Roberta S. Karmel, Mutual Funds, Pension Funds, Hedge Funds and Stock Market Volatility – What Regulation by the Securities and Exchange Commission is Appropriate? 80 NOTRE DAME L. REV. 909, 909 (2005) (stating that about 7 decades ago, individuals constituted the bulk of investors in the public securities markets but that the situation has changed today with the dominance of institutions investing on behalf of their beneficiaries); John C. Bogle, Reflections on “Toward Common Sense and Common Ground?”, 33 J. CORP. L. 31, 31 (2007) (stating that financial intermediaries currently hold approximately 74 percent of the stock of U.S. corporations).
public recognizes and expects the role large institutional investors can play in advancing strategic long-termism.\textsuperscript{355} According to an Australian government report, a director may not easily be persuaded that it is in her true self-interest to jettison the market’s short-term expectations in favor of valuable projects that do not provide profit in the near-term.\textsuperscript{356} But the influence and direct action of longer-term institutional investors may embolden the director to adopt a socially and environmentally responsible approach to governance.\textsuperscript{357}

Nonetheless, institutional conflicts of interest threaten the realization of that expectation. For instance, while mutual funds, private pension funds, bank trusts and insurance companies may hold sizeable percentages and some do invest for a longer-term than most investors, they are hobbled by conflicts of interests and fear of economic loss.\textsuperscript{358} Public pension funds hold significant blocks of shares, are generally free from conflicts of interests and typically invest for a long-term. Moreover, their beneficiaries expect to survive their post-retirement years through their pension fund investments and presumably would prefer their trustees and asset managers to make investment decisions that reflect, enhance and assure that expectation.\textsuperscript{359} Yet, public pension funds face their own unique challenges in the form of political factors that affect their operations.\textsuperscript{360} Pension fund trustees are appointed by state governors who may want them to toe a line that favors their political interests; this is so, even when in conflict with the long-term orientation that the funds would be promoting.\textsuperscript{361} Similarly, some of the trustees, being politicians, may have their own causes to advance and constituencies to satisfy in furtherance of their own ambition.\textsuperscript{362}

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Fisch, \textit{Securities Intermediaries}, supra note 352, at 879–880 (“By 2009, institutional investors owned 50% of total U.S. equities, and retail investors (the household sector) held only 38%. Institutions own a higher percentage of the largest corporations; at the end of 2007, institutions owned 76.4% of the largest 1,000 corporations.”) (citation omitted).

Tonello, \textit{supra} note 227, at 13; Brian J. Bushee et al., \textit{Institutional Investor Preferences for Corporate Governance Mechanisms} 6 (Jan. 2010) (stating that the voting block of institutional shareholders confers on them the ability to influence the direction of corporations); \textit{INSTITUTIONAL INVESTMENT IN THE UNITED KINGDOM: A REVIEW} (2001) (emphasizing the importance of the intervention of long-term institutional shareholders at underperforming companies, engaging with their management with a view to improving them and enhancing returns).

\textsuperscript{355} \textit{PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES, CORPORATE RESPONSIBILITY: MANAGEMENT RISK AND CREATIVE VALUE}, 67 (Jun. 2006).

\textsuperscript{356} \textit{Id.}

\textsuperscript{357} \textit{See Illig, supra} note 254, at 249 (stating that private pension funds “are almost universally controlled by their corporate sponsors” and that “significant conflicts of interest make banks, insurance companies and private pension funds poor candidates as corporate monitors.”) (citation omitted).

\textsuperscript{358} David Hess, \textit{Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development}, 2 VA. L. & BUS. REV. 221, 235 (2007). Some recent works have addressed the nature and potential of increased participation of public pension funds in corporate governance; \textit{see id.} For a much earlier discussion of the role of the potential role of pension funds in corporate governance; \textit{see e.g.}, William H. Simon, \textit{The Prospects of Pension Fund Socialism}, 14 BERKELEY J. EMPL. & LAB. L. 251, 270 (1993) (suggesting coordination among pension funds to influence corporate governance); \textit{but see} Roberta Romano, \textit{Public Pension Fund Activism in Corporate Governance Reconsidered}, 93 COLUM. L. REV. 795 (1993).


\textsuperscript{360} \textit{Id.}; \textit{see also} Kahan & Rock, \textit{Hedge Funds}, supra note 5, at 1059 – 62.

\textsuperscript{361} \textit{See Inman Anabtawi, Some Skepticism about Increasing Shareholder Power}, 53 UCLA L. REV. 561, 574-76 & 590 (2006); \textit{See Bainbridge, Shareholder Disempowerment, supra} note 202, at 1755 (ascribing some activist efforts of California’s public employee retirement system, CALPERS, to the gubernatorial ambitions of the state’s former treasurer and fund trustee, Phil Angelides) \textit{but see} Hess, \textit{supra} note 359, at 230 (stating that it is an inappropriate
There is also the potential problem of rent-seeking, self-dealing, and other forms of opportunistic behavior. Class T shareholders could use their power and position to pursue their private interests by extracting concessions from management that redounds only to the benefit of these shareholders and consequently destroys shareholder value. While a counter-argument can credibly be made that shareholders cannot get their wishes unless they also secure the votes of other shareholders, the fact remains that some of these advantages may be secured through private negotiations requiring no shareholder vote. However, the criticism may be exaggerated because Class T shareholders would be squandering any latent influence and incinerating every potential for cooperation if they eviscerate their credibility upon the revelation that they secured such secret deals to the detriment of other interests within the corporation. Soon, the management would leak the information making it unwise for these shareholders to place themselves in the unsavory position of easy susceptibility to blackmail to avoid exposure of the secret bargains.

**H. Trigger Fiduciary Duties**

Institutional investors that have a long-term activist posture may face the complaint that “fiduciary duties require asset managers to stay away from long-term investment decisions whose financial return is not clearly assessable.” Fiduciary duties may need to be strengthened not only to clarify that it is safe for these institutional investors to focus on the long-term but also to untie the knot that misdirected political beliefs are driving the activism, and that such activism may actually harm long-term performance. For extensive counter-arguments and solutions to the politicization question, see Hess, supra note 359, at 260-63.

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363 See Bainbridge, Shareholder Activism, supra note 341, at 16 (stating, in the context of proxy access, that some shareholders may “use their position to self-deal—i.e., to take a non-pro rata share of the firm’s assets and earnings—or to otherwise reap private benefits not shared with other investors.”); Bainbridge, Shareholder Disempowerment, supra note 202, at 1754-55; Stacey Dahl, North Dakota’s Novel Approach to Corporate Governance: A Shifting Landscape in Corporate Management or a Futile Assertion of Large Shareholders’ Rights?, 84 N.D. L. REV. 1161, 1188-89 (2008). For a valuable definition of rent-seeking see Blair & Stout, supra note 106, at 249 n. 4 (stating that the term encompasses “situations where individuals expend time, money, and other resources competing for a fixed amount of wealth, in effect squabbling with each other over the size of their individual pieces of a fixed group pie” and adding that since “rent-seeking itself is costly, the net result is to reduce total wealth available for distribution.”).

364 See Anabtawi, supra note 362, at 574 -76 & 590; Gelter, supra note 203, at 154-55; Dombalagian, supra note 261, at 1242; Stewart, supra note 339, at 1494 (stating that “institutional investors “rent seek” at the expense of the long-term value of the corporation and society.”) (citation omitted); Rose, supra note 208, at 1359 (“The potential for inefficiencies and rent-seeking calls into question the expansion of shareholder power under the current regulatory model and raises the question of how existing shareholder power and influence should be regulated.”).


366 Anabtawi, supra note 362, at 596 (“Majority rule may also fail to check opportunistic behavior by shareholders if they can use private negotiations with management to obtain greenmail-type payments in exchange for agreeing to support managerial interests.”) (citation omitted).

367 Marcel Kahan & Edward B. Rock, The Insignificance of Proxy Access, NEW YORK UNIVERSITY LAW AND ECONOMICS WORKING PAPERS. PAPER 240 (Nov. 2010), at 86 (“Efforts to extract political concessions, or otherwise pursue personal interests, are unlikely to stay secret for long. For one, the company requested to make these concessions has a strong interest in revealing this request in order to discredit the dissident group.”), available at http://lsr.nellco.org/nyu_lawwp/240.

368 Tonello, supra note 227, at 44.
to actually require that a lack of a strong long-term orientation could be a breach of fiduciary duties.\textsuperscript{369} Also, the suggestion that investments that incorporate environmental and social values will generally underperform those that do not is not necessarily borne out by experience.\textsuperscript{370} Another fiduciary duty issue that may crop up pertains to whether there is a need for balancing the increased shareholder power with fiduciary duties to other shareholders and the corporation.\textsuperscript{371} While there is strong scholarly argument in favor of such imposition, formidable opposition also exists.\textsuperscript{372}

I. Board Cohesion and Effectiveness

Opponents of a vibrant shareholder role in the nomination and election of directors argue that the current system works better and should not be encumbered by a problematic alternative.\textsuperscript{373} They argue that shareholder-nominated directors create problems for board cohesion and effectiveness.\textsuperscript{374} In fact, so strong is the opposition to shareholder nomination that boards are already receiving advice on how to thwart the new rules on proxy access.\textsuperscript{375} Opponents argue

\textsuperscript{369} See Hess, \textit{supra} note 359, at 248 (stating that “an investment strategy based on utilizing environmental and social factors to increase value is clearly not a violation of a trustee's fiduciary duties” and that it might “be a violation of fiduciary duties not to consider environmental and social issues in certain situations.” (citations omitted); Stephen Viederman, \textit{Fiduciary Duty, in SUSTAINABLE INVESTING, supra} note 234, at 189, 190-194 (advocating a redefinition of fiduciary duty for long-term investors and corporations).


\textsuperscript{371} See Iman Anabtawi & Lynn Stout, \textit{Fiduciary Duties for Activist Shareholders, 60 STAN. L. REV. 1255 (2008)} (advocating the imposition of fiduciary duties on shareholders that exercise enormous influence over corporate policy, even when they do not hold a controlling stake); Karmel, \textit{Institutional Shareholders, supra} note 1, at 21 (“[P]erhaps those activist institutions that are demanding greater rights as shareholders should be more cautious. If they obtain some of their wishes, they may find that with new rights come new responsibilities and liabilities.”).

\textsuperscript{372} See Chiu, \textit{supra} note 211, at 158 (noting weaknesses in the argument for shareholder fiduciary duty); Paula J. Dalley, \textit{Shareholder (and Director) Fiduciary Duties and Shareholder Activism, 8 HOUS. BUS. & TAX. L.J. 301, 302 (2008)} (arguing against imposition of fiduciary duties on shareholders on the ground that “[s]hareholders may have indirect power or influence, but they have no legal power over corporate property, and certainly no legal power over other shareholders’ property.”); Paula J. Dalley, \textit{The Misguided Doctrine of Stockholder Fiduciary Duties, 33 Hofstra L. REV. 175 (2004)}; Rose, \textit{supra} note 208, at 1401 -1404 (reviewing arguments in favor of and against imposition of fiduciary duties on activist minority shareholders, including possible economic risks for the shareholders and states competing for incorporations); David A. Hoffman, \textit{The “Duty” to be a Rational Shareholder, 90 MINN. L. REV. 537, 538 (2006)} (stating that real experience indicates instances in which courts hold shareholders to responsibility analogous to a duty of care).

\textsuperscript{373} See, \textit{e.g.}, ELAINE BUCKBERG & JONATHAN MACEY, NERA ECONOMIC CONSULTING, REPORT ON EFFECTS OF PROPOSED SEC RULE 14A-11 ON EFFICIENCY, COMPETITIVENESS AND CAPITAL FORMATION: IN SUPPORT OF COMMENTS BY BUSINESS ROUNDTABLE(2009).

\textsuperscript{374} Ho, \textit{supra} note 265, at 69 (noting criticism that shareholder democracy would lead to the balkanization of boards, through the production of constituency directors that champion the interests of particular groups, instead of the interests of all shareholders).

that the resulting dissident board will lead to underperformance of the corporation. Another complaint is that “shareholder nominees will impede companies from achieving the skill and experience balances they need for their boards to function effectively.” The clear undertone in these objections is that shareholders, as a class, are either woefully ignorant or completely unconcerned about the well-being of the firm and anyone with a stake in it. It is hard to believe that this is true, sidestepping for a moment the notion that it smacks of patronizing condescension. Besides, concerns about the quality of shareholder-nominated directors could be ameliorated by corporate by-law amendments that set minimum qualifications for nominees. In any event, the opposition to shareholder nomination softens when the nominating shareholders have long-term holdings in the company, as is the case under the proposal in this article. That shareholder nomination will not necessarily be harmful is accentuated by the point that these constituency directors, like the other directors, owe fiduciary duties to the corporation and all its shareholders. Accordingly, they are under an obligation to act in the best interests of the corporation and not look out only for the interests of the nominating investors.

J. Class T Short-termism

376 BUCKBERG & MACEY, supra note 373, at 12 (“Several empirical studies establish that when dissident directors win board seats, those firms underperform peers by 19 to 40% over the two years following the proxy contest.”); Joseph A. Grundfest, Measurement Issues in The Proxy Access Debate, STANFORD UNIVERSITY LAW SCHOOL, LAW & ECONOMICS OLIN WORKING PAPER SERIES NO. 392 (2010).

377 BUCKBERG & MACEY, supra note 373, at 13; Fairfax, Government Governance, supra note 308, at 1718-19 (noting concerns that shareholders could "elect directors without the skill-set to tackle important problems, or that the overall board will not have the appropriate mix of skills necessary to perform its responsibility.") (citation omitted).

378 See McDonnell, supra note 167, at 80-81 (stating that shareholders may deliberately act against other shareholder interests in director elections or harm general shareholder interests unintentionally when they are not well-informed but notes that the shareholders likely to vote are institutional investors and they tend to be properly informed).


380 Jack Gravelle, Proxy Access For All Shareholders, 12 TRANSACTIONS 173, 185 (2011).

381 See BUCKBERG & MACEY, supra note 373, at 18 (stating that conditioning nomination on long-term shareholding ensures that shareholders would be careful about who they select to be on the board because they would be around to experience the effect of their decision).

382 Lazarus, supra note 101 (analyzing judicial decisions that demonstrate that “directors designated by particular stockholders or investors owe duties generally to the company and all of its stockholders.”); Grossman, supra note 205, at 906 (stating that every director owes fiduciary duties to the corporation and its stockholders).

383 Lazarus, supra note 101 (“Where the interests of the investor and the company and its common stockholders potentially diverge, the directors cannot favor the interests of the investor over those of the company and its common stockholders.”). See also Joshua P. Fershee, Different Fiduciary Obligations for LLC Managers and Corporate Directors, Business Law Prof. Blog, March 30, 2011, (“Sponsors generally can't bind directors to a specific vote, and they don't usually require notice of a director's intended votes.”) http://lawprofessors.typepad.com/business_law/2011/03/different-fiduciary-obligations-for-llc-managers-and-corporate-directors.html; But see Stephen Bainbridge, Constituency Directors, ProfessorBainbridge.com, March 29, 2011, (agreeing with the central point but noting that there may be instances where constituency directors are expected to vote in a manner consistent with the interest of the nominating investors), http://www.professorbainbridge.com/professorbainbridgecom/2011/03/constituency-directors.html.
While Class T shareholders are expected to have a long horizon approach to investment and bring this approach to bear in performing their governance functions, it is also possible that they would switch to short-term thinking toward the end of their holding period. At such point, their votes and other actions would be geared toward corporate ventures and measures that maximize profit and share price in the short run. In other words, they revert to regular shareholder thinking to ensure the best returns on their investment. This is a legitimate concern that could be confronted with available tools to counter shareholder opportunism. Moreover, Class T holders would need the support of other shareholders to actualize their short-termist tendencies. With the vigilance of other Class T holders who are at the earliest stage of investment, the exiting Class T holders could face significant opposition. Shareholder fiduciary duties may also provide a solution.

CONCLUSION

The trust fund theory was the dominant philosophical view of corporate finance in the 19th century until it was widely discredited and largely discarded. This work has advocated for the revival of the trust fund theory as a tool for stimulating long-term shareholding and addressing several contemporary corporate law problems. The revived theory is only applicable to a category of long-term shareholders who hold a separate, relatively illiquid class of common shares. Long-term shareholding is needed to provide patient capital, curb short-termism and energize managerial accountability. A core component of the revised theory is a trust fund that is financed by this class of shares that, in return for their relative illiquidity, enjoy special privileges in corporate governance, including voting on the corporation’s long-term strategy, nominating directors on the company’s proxy materials and holding a number of seats on the board of directors.

The trust fund will serve a plethora of purposes. It will serve a creditor-protection function and thereby increase confidence in, or satisfying condition for, dealing with the firm. Second, it could also provide at least a partial panacea to the short-termism problem that has caused consternation in corporations and the investment community. The proposed arrangement also provides an investment vehicle capable of meeting the needs of investors interested in holding equity securities for a long period of time to fund their retirement and children’s college education. Finally, the proposal will provide an opportunity for amplifying investor voice on the belief that a corporation would be better served by shareholders who exercise voice, instead of exiting at soon as the opportunity comes. On that point, the article proceeds on the understanding that voice is not likely to be amplified where exit is not substantially constrained. This model is compatible with the view that a system of active shareholder monitoring would necessarily incorporate a tradeoff between voice and exit. In essence, a successful scheme for increasing

384 I am grateful to Professor Jeff Schwartz for drawing my attention to this point.


386 See Anabtawi & Stout, supra note 371, at 1294-95 (proposing the use of fiduciary duties, particularly the duty of loyalty, to address the opportunism of influential minority shareholders).
shareholder influence may need to accompany a corresponding decrease in liquidity. This arrangement should be attractive to traditional long-term investors and corporate managers that seek such investors as allies in the promotion of long run, sustainable growth.