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COMMENT

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THE CORPORATE PRACTICE OF GERRYMANDERING  
THE VOTING RIGHTS OF COMMON  
STOCKHOLDERS AND THE CASE  
FOR MEASURED REFORM

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*“In collective bodies, votes are necessary to ACTION: absences may produce INACTION.” –Alexander Hamilton<sup>1</sup>*

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<sup>1</sup> ALEXANDER HAMILTON, PUBLIC CREDIT, (1795), reprinted in 3 THE WORKS OF ALEXANDER HAMILTON 199, 251 (Henry Cabot Lodge ed., 1904).

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## INTRODUCTION

The voting rights of common stockholders have been gerrymandered through the use of dual-class and multiclass governance structures, which drive a wedge between the economic interests and voting entitlements of shareholders. These corporate governance structures are designed to preserve control for corporate insiders, including founders and family members. Insiders can secure majority voting power in corporate affairs without needing to retain a proportionate economic interest in the enterprise. The corollary is that ordinary shareholders are not afforded a commensurate amount of voting rights with their economic interest. Main Street investors

have a diminished voice, and their ability to influence the decisionmaking of firms is diluted. Although dual-class structures date back nearly a century, this practice has been on the rise in American corporations—especially following Google’s debut as a public company.

Google, Inc., a leading multinational technology firm now known as Alphabet, Inc., established a dual-class ownership structure comprised of two classes of common stock with different voting entitlements as part of its initial public offering (IPO) in 2004.<sup>2</sup> Class A common stock was issued to the public and “entitled to one vote per share” whereas Class B common stock was reserved for insiders including “founders, executive officers, directors . . . and employees” and “entitled to ten votes per share.”<sup>3</sup> As the company explained in a preamble to its prospectus entitled “Letter from the Founders: ‘An Owner’s Manual’ for Google’s Shareholders,”

Google is not a conventional company. We do not intend to become one . . . . [T]he standard [“one share, one vote”] structure of public ownership may jeopardize [our] independence . . . . Therefore, we have designed a corporate [dual-class] structure that will protect Google’s ability to innovate and retain its most distinctive characteristics . . . . By investing in Google, you are placing an unusual long-term bet on the team . . . . In the transition to public ownership, we have set up a corporate structure that will make it harder for outside parties to take over or influence Google.<sup>4</sup>

Thus, Google’s cofounders made it patently clear to potential investors that its dual-class voting structure would make it difficult for external parties to interfere with or exercise control over its insiders, who would retain disproportionate voting power relative to their economic interest.

Just eight years following its IPO, Google announced a recapitalization plan to install a novel tripartite class ownership structure.<sup>5</sup> Google sought to effectuate a two-for-one stock split by creating Class C nonvoting capital stock and distributing one Class C share for each and every Class A and Class B share outstanding.<sup>6</sup> Google’s cofounders explained that they wished to maintain their “founder-led approach” and to continue shielding Google

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<sup>2</sup> See Google Inc., Registration Statement (Form S-1) at iii (Apr. 29, 2004) (stipulating that Class A and Class B shares of common stock “have identical economic rights and differ only as to voting rights”).

<sup>3</sup> *Id.* at \*21, 85 n.1. Common shares with relatively greater voting entitlements are colloquially referred to as “high-vote stock.”

<sup>4</sup> *Id.* at i, iii.

<sup>5</sup> See Google Inc., Current Report (Form 8-K) at 2 (Apr. 12, 2012) (disclosing that Google’s “Board of Directors . . . unanimously approved a proposal . . . to amend [its] certificate of incorporation to create a new class of capital stock, subject to stockholder approval”).

<sup>6</sup> See Larry Page & Sergey Brin, 2011 *Founder’s Letter*, ALPHABET (Apr. 12, 2012), <https://abc.xyz/investor/founders-letters/2011> [<https://perma.cc/8BL5-ZANJ>] (announcing Google’s plan “to create a new class of non-voting capital stock” which would be “distributed via a stock dividend”).

“from outside pressures.”<sup>7</sup> Although the voting power of insiders would remain unchanged immediately following the recapitalization, this proposed transaction would enable insiders to retain substantial voting control over time, as the company would use Class C nonvoting shares for “routine equity-based employee compensation” and “stock-based acquisitions” going forward.<sup>8</sup> In other words, this new tripartite class structure would preserve voting influence among insiders “for decades to come.”<sup>9</sup> Google shareholders promptly brought suit seeking to enjoin the recapitalization effort by alleging breach of fiduciary duties and arguing that the stock split was in reality a “thinly veiled attempt to entrench [the founders by] preserv[ing] their voting power into perpetuity.”<sup>10</sup> The parties eventually reached a settlement pretrial, and the substantive issues in this matter were never litigated.<sup>11</sup> The recapitalization was finally consummated in 2014, cementing Alphabet’s current tripartite class ownership structure.<sup>12</sup>

Dual-class and multiclass stock governance structures<sup>13</sup> are employed to secure control for insiders who would otherwise lack majority control of the corporation based on their economic interest alone.<sup>14</sup> These voting structures are considered to be “the most extreme example of antitakeover protection” since “these companies are virtually immune to a hostile takeover.”<sup>15</sup> The use of dual-class common stock regimes by Alphabet, Facebook,<sup>16</sup> Snap,<sup>17</sup>

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> Verified Class Action Complaint at 1-2, *Brockton Ret. Bd. v. Page*, No. 7469, 2012 WL 1497439 (Del. Ch. Apr. 27, 2012).

<sup>11</sup> See Order and Final Judgment at 4, *In re Google Inc. Class C S’holder Litig.*, No. 7469-CS, 2013 WL 5949928 (Del. Ch. Nov. 6, 2013) (“[T]his Court hereby fully and finally approves the Settlement . . . .”); see also Google Inc., Current Report (Form 8-K) (Oct. 30, 2013) (indicating that “the Delaware Court of Chancery approved the settlement” of the civil litigation).

<sup>12</sup> See, e.g., Google Inc., Quarterly Report (Form 10-Q) at 8 (Apr. 24, 2014) (“In January 2014, our board of directors approved a distribution of shares of the Class C capital stock as a dividend to our holders of Class A and Class B common stock . . . .”)

<sup>13</sup> Hereafter in this Comment, I use the phrase “dual-class” to encompass any dual-class and multiclass stock arrangement that legally separates cash-flow rights from voting rights.

<sup>14</sup> When a dual-class structure has ten-to-one voting entitlements reserved for high-vote stock, it can be mathematically shown that a holder of such shares only requires less than ten percent economic ownership to maintain majority voting control. Consider a firm with one million shares of common stock, consisting of 90,910 high-vote shares and 909,090 low-vote shares. Each share has the same cash flow rights, but high-vote stock is entitled to ten votes per share and low-vote stock is entitled to one vote per share. The 90,910 high-vote shares are entitled to 909,100 votes whereas the 909,090 low-vote shares are entitled to 909,090 votes. The high-vote shares, representing just 9.1% of the total number of shares, would secure voting control. Table 1 in the Appendix presents these numbers and percentages.

<sup>15</sup> Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUD. 1051, 1052 (2010).

<sup>16</sup> See *infra* note 105 and accompanying text.

<sup>17</sup> See *infra* note 26 and accompanying text.

Spotify,<sup>18</sup> Lyft,<sup>19</sup> and other prominent technology firms has thrust the issue of disproportionate voting structures into the spotlight and has raised pressing questions about whether this is a desirable or problematic development.

Issues posed by nonvoting stock have been raised and explored for nearly a century now.<sup>20</sup> Interrelated topics of dual-class shares and nonvoting shares have gained renewed interest in academic circles,<sup>21</sup> law firm client memos,<sup>22</sup> business news outlets,<sup>23</sup> and the investing community at large.<sup>24</sup> A trade organization

<sup>18</sup> See *infra* note 107 and accompanying text.

<sup>19</sup> See *infra* note 108 and accompanying text.

<sup>20</sup> See, e.g., Milton M. Bergerman, *Voting Trusts and Non-Voting Stock*, 37 YALE L.J. 445, 445 (1928) (“The practice of depriving stockholders of the right to participate in the management of large corporations by means of . . . non-voting stock has become so widespread that the legal status of these methods of disenfranchising shareholders assumes a new importance.”); A. A. Berle, Jr., *Non-Voting Stock and “Bankers’ Control”*, 39 HARV. L. REV. 673, 677 (1926) (“[T]he problem of ‘bankers’ control’ ordinarily arises only where there is a capital structure including a class of non-voting stock actually . . . non-preferential in character, simultaneously with another class of stock vested with voting power.”).

<sup>21</sup> See, e.g., Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 589-90 (2017) (exploring the benefits and costs of dual-class structures from a temporal perspective and finding that potential costs exceed potential advantages with the passage of time following an IPO).

<sup>22</sup> See, e.g., James Moloney, Sean Sullivan & Alon Sachar, *Non-Voting Shares and Judicial Scrutiny*, 31 INSIGHTS, May 2017, at 10-13 (questioning what standard of review the Delaware courts would apply to actions taken by Snap’s board of directors in light of its exclusive use of nonvoting public shares); Steven M. Haas & Charles L. Brewer, *Nonvoting Common Stock: A Legal Overview*, HUNTON & WILLIAMS LLP (Nov. 2017), <https://www.hunton.com/images/content/3/4/v2/34138/nonvoting-common-stock.pdf> [<https://perma.cc/R6DU-BQ22>] (intending to “provide an overview of the legal issues associated with nonvoting common stock of Delaware corporations”).

<sup>23</sup> See, e.g., Benjamin Robertson & Andrea Tan, *Why Facebook to Snap Make Investors Feel Second-Class: QuickTake*, WASH. POST (Jan. 21, 2018), [https://www.washingtonpost.com/business/why-facebook-to-snap-make-investors-feel-second-class-quicktake/2018/01/21/21bba666-ffof-11e7-86b9-8908743c79dd\\_story.html](https://www.washingtonpost.com/business/why-facebook-to-snap-make-investors-feel-second-class-quicktake/2018/01/21/21bba666-ffof-11e7-86b9-8908743c79dd_story.html) (“Supporters say dual-class shares enable executives to focus on the long term and resist expectations by major investors that each quarter’s earnings will be better than the previous one’s. . . . Detractors say dual-class shares subvert the traditional system that’s designed to give equal treatment to all shareholders.”); Andrea Tan & Benjamin Robertson, *Why Investors Are Fretting over Dual-Class Shares*, BLOOMBERG (July 10, 2017), <https://www.bloomberg.com/news/articles/2017-07-10/why-investors-are-fretting-over-dual-class-shares-quicktake-q-a> (discussing potential merits and contemporary issues with dual-class common stock structures).

<sup>24</sup> See, e.g., J.P. MORGAN ASSET MANAGEMENT, GLOBAL PROXY VOTING PROCEDURES AND GUIDELINES: NORTH AMERICA, EUROPE, MIDDLE EAST, AFRICA, CENTRAL AMERICA, SOUTH AMERICA, AND ASIA 67 (2017), [https://am.jpmorgan.com/blob-gim/1383433248923/83456/2017\\_Global%20Procedures%20and%20Guidelines\\_FINAL.pdf?segment=AMERICAS\\_US\\_RET&locale=en\\_US](https://am.jpmorgan.com/blob-gim/1383433248923/83456/2017_Global%20Procedures%20and%20Guidelines_FINAL.pdf?segment=AMERICAS_US_RET&locale=en_US) [<https://perma.cc/NVW8-96TW>] (“JPMAM believes in the fundamental principle of ‘one share, one vote.’ . . . We are opposed to all mechanisms that skew voting rights . . . . Directors should represent all shareholders equally and voting power should accrue in direct proportion to a shareholder’s economic interest . . . .”); Patrick Danner, *Biglari Holdings Shareholders Drop Effort to Stop Special Meeting*, SAN ANTONIO EXPRESS-NEWS (Apr. 10, 2018), <https://www.expressnews.com/business/local/article/Biglari-Holdings-shareholders-drop-effort-to-stop-12823122.php> [<https://perma.cc/KNB5-CRMT>] (“There’s pretty broad consensus among investors and people who study investments that multiple share classes with different voting rights are not a positive for firm value or shareholder value . . . .”); Letter from Anne Sheehan, Dir. of Corp. Governance, California State Teachers’ Retirement System,

called the Council of Institutional Investors (CII), whose members collectively manage over three trillion dollars in assets, has been actively lobbying to curtail dual-class structures.<sup>25</sup> More recently, the 2017 IPO for shares of the social media company Snap Inc., which granted public investors no voting rights at all, caused a major uproar in the investment community.<sup>26</sup>

Much theoretical legal and empirical economic scholarship supports arguments on both sides of whether dual-class voting structures should be allowed at all.<sup>27</sup> The policy justifications for regulating dual-class structures are rooted in the presence of collective action problems, agency cost issues, and potential for abuse, such as the insider's ability to secure perquisites at the expense of other shareholders.<sup>28</sup> Perhaps the best counterargument against prohibiting dual-class stock structures altogether is that they ought to be considered in the broader context: the declining number of public companies in the United States and private enterprises choosing to remain private longer to pursue growth and create value without fear of interference from public markets, which can be more short-term oriented.<sup>29</sup> Even though dual-class structures can be good, nonvoting shareholders are underprotected.

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to Hong Kong Exchanges and Clearing Limited (Aug. 17, 2017), [https://www.calstrs.com/sites/main/files/file-attachments/2017-08-17\\_hkex\\_listing\\_std\\_new\\_board\\_main\\_board.pdf](https://www.calstrs.com/sites/main/files/file-attachments/2017-08-17_hkex_listing_std_new_board_main_board.pdf) [<https://perma.cc/BH9T-V77H>] (“CalSTRS believes equal voting and control rights proportional to economic interest represents [sic] best governance practice. We believe a structure that sustains ‘one-share one-vote’ equally aligns shareowners’ economic interests.”).

<sup>25</sup> COUNCIL OF INSTITUTIONAL INVESTORS, <http://www.cii.org> [<https://perma.cc/H6R9-JXNB>] (last visited Oct. 19, 2018) (declaring the elimination of dual-class stock as one of the organization's top “priorities” and proclaiming that “[e]ach share of a public company's common stock should have one vote”).

<sup>26</sup> See, e.g., Snap Inc., Registration Statement (Form S-1) (Feb. 2, 2017) (“This is an initial public offering of shares of non-voting Class A common stock of Snap Inc.”); Trevor Hunnicutt, *S&P 500 to Exclude Snap After Voting Rights Debate*, REUTERS (July 31, 2017 9:44 PM), <https://www.reuters.com/article/us-snap-s-p/sp-500-to-exclude-snap-after-voting-rights-debate-idUSKBN1AH2RV> (“Snap's \$3.4 billion March IPO was the third-largest ever for a U.S. tech company but some investors were taken aback by the company's unusual decision to offer new investors a class of common stock with no voting rights.”); Steven Davidoff Solomon, *Snap's Plan Is Most Unfriendly to Outsiders*, N.Y. TIMES DEALBOOK (Feb. 3, 2017), <https://www.nytimes.com/2017/02/03/business/dealbook/snap-ipo-plan-evan-spiegel.html> (“Snap Inc. is aiming to adopt the most shareholder-unfriendly governance in an initial public offering, ever.”).

<sup>27</sup> See *infra* notes 120–142 and accompanying text.

<sup>28</sup> See generally ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). For an extensive summary of the academic literature, see Renée Adams & Daniel Ferreira, *One Share—One Vote: The Empirical Evidence*, 12 REV. FIN. 51, 52 (2008), which notes that the dominant view in the literature is that “the ‘one share—one vote’ principle is desirable” and that “concentrated control in the hands of a few leads to agency and entrenchment problems.”

<sup>29</sup> See Steven Davidoff Solomon, *A Dearth of I.P.O.s, but It's Not the Fault of Red Tape*, N.Y. TIMES (Mar. 28, 2017), <https://www.nytimes.com/2017/03/28/business/dealbook/fewer-ipo-regulation-stock-market.html> (documenting that “the total number of companies listed on the United States stock market

In this Comment, I predominately focus on the extreme example of nonvoting common stock and argue that this amounts to disenfranchisement of public shareholders and necessitates modest reform.<sup>30</sup> Part I considers the traditional protections of ordinary shareholders and provides relevant background information on dual-class structures. Part II explores the legal rights and entitlements for nonvoting shares of common stock. Part III studies and suggests potential solutions to the issues posed by nonvoting stock. Current forms of regulation, whether supported by private ordering arguments or external regulation arguments, do not accomplish enough in addressing the problems posed by nonvoting stock. I advance a novel multipronged framework for regulating nonvoting stock. First, federal securities laws could enable nonvoting shares to cast nonbinding votes. Second, state corporate laws ought to legally mandate that nonvoting shareholders have the right to attend annual meetings in an observer role. Third, state courts should impose a heightened standard of judicial review for companies with dual-class structures to encourage the use of procedures that empower shareholder votes. Fourth, nonvoting shares ought to have additional voting rights in some specific contexts as a matter of positive law.

## I. BACKGROUND

Part I explores the traditional protections of ordinary shareholders and provides relevant background information on dual-class structures. Section I.A explores voting rights, fiduciary duties, and statutory appraisal rights as the three primary shareholder protections. Section I.B provides a historical perspective on unequal voting arrangements. Section I.C studies the rising popularity of dual-class structures. Section I.D examines the empirical performance of dual-class structures vis-à-vis “one vote, one share” arrangements based on financial and economic data. Section I.E provides the normative arguments for and against such devices.

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plummeted by nearly half” between 1996 and 2016); *see also* Adena Friedman, *The Promise of Market Reform: Reigniting America’s Economic Engine*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (May 18, 2017), <https://corpgov.law.harvard.edu/2017/05/18/the-promise-of-market-reform-reigniting-americas-economic-engine> [<https://perma.cc/3M7F-VSNZ>] (stating that “[Nasdaq] support[s] dual class structures in appropriate situations” and that to maintain America’s status as a “magnet for entrepreneurship and innovation . . . we must offer entrepreneurs multiple paths [including the choice of employing dual-class stock structures] to participate in public markets”).

<sup>30</sup> Perhaps unsurprisingly, “disenfranchise” in the corporate law context has entered the financial lexicon. *See* ERIK BANKS, *THE PALGRAVE MACMILLAN DICTIONARY OF FINANCE, INVESTMENT AND BANKING* 159 (2010) (defining “disenfranchise” as “[t]he process of removing voting rights from a class of common stock so that investors in that class are only entitled to rent rights”).

### A. Three Traditional Stockholder Protection Devices

Decisionmaking authority in corporations is allocated between shareholders and managers, including directors and executive officers. One key attribute of all business corporations is the delegation of formal authority to a board of directors to manage corporate affairs.<sup>31</sup> As Delaware General Corporation Law (DGCL) stipulates: “The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . .”<sup>32</sup> In other words, “corporate law typically vests principal authority over corporate affairs in a board of directors or similar body that is periodically elected . . . by the firm’s shareholders.”<sup>33</sup> As Chancellor Bill Allen famously wrote in the 1980s amidst the backdrop of a merger wave, “While corporate democracy is a pertinent concept, a corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of the corporation, subject however to a fiduciary obligation.”<sup>34</sup>

In our American model of corporate governance, shareholders have three essential protections under state corporate law: voting rights, fiduciary principles imported from agency law,<sup>35</sup> and statutory appraisal remedies.

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<sup>31</sup> See John Armour, Henry Hansmann, Reinier Kraakman & Mariana Pargendler, *What Is Corporate Law?*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 1, 5 (3d ed. 2017) [hereinafter *ANATOMY OF CORPORATE LAW*]; see also *id.* (“[T]he five core structural characteristics of the business corporation are: (1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of equity capital.”).

<sup>32</sup> DEL. CODE ANN. tit. 8, § 141(a) (2018).

<sup>33</sup> Armour et al., *supra* note 31, at 12.

<sup>34</sup> *TW Servs., Inc. v. SWT Acquisition Corp.*, Civ. A. No. 10298, 1989 WL 20290, at \*8 n.14 (Del. Ch. Mar. 2, 1989).

<sup>35</sup> One example of such principles goes as far back as 1928:

Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior . . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

*Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928). More recently, the Delaware Chancery Court has announced:

Fiduciaries are held by the common law to a high standard in fulfilling their stewardship over the assets of others, a standard that . . . may not be the same as that contemplated by ideal corporate governance . . . . Fiduciaries who act faithfully and honestly on behalf of those whose interests they represent are indeed granted wide latitude in their efforts to maximize shareholders’ investment.

*In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 697-98 (Del. Ch. 2005).

### 1. Traditional Voting Rights of Voting Shares

“Generally, the right to vote is a right that is inherent in and incidental to the ownership of corporate stock.”<sup>36</sup> Not surprising then, “one share, one vote” is the default rule in U.S. corporate law.<sup>37</sup> Voting rights include two distinct types of privileges, appointment rights and decision rights, which enable shareholders to exert direct influence over managers.<sup>38</sup> Voting shareholders are generally entitled to vote on the election of directors;<sup>39</sup> the removal of directors;<sup>40</sup> any proposed amendments to the certificate of incorporation;<sup>41</sup> the approval of major transactions, including mergers or consolidations,<sup>42</sup> substantial sales of assets,<sup>43</sup> and general dissolution;<sup>44</sup> as well as other governance matters brought to stockholder meetings.<sup>45</sup> The fact that the board is elected by shareholders “help[s] assure that the board remains responsive to the interests of the firm’s owners, who bear the costs and

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36 5 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2025 (perm. ed., rev. vol. 2017).

37 See, e.g., DEL. CODE ANN. tit. 8, § 212(a) (2018) (“Unless otherwise provided in the certificate of incorporation . . . each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder.”); MODEL BUS. CORP. ACT § 7.21(a) (AM. BAR ASS’N 2016) (“[U]nless the articles of incorporation provide otherwise, each outstanding share, regardless of class, is entitled to one vote on each matter voted on at a shareholders’ meeting.”); see also FLETCHER ET AL., *supra* note 36, § 2026 (“Generally, each outstanding share of corporate stock, regardless of class, is entitled to one vote, unless the articles of incorporation provide otherwise.”).

38 See generally John Armour, Luca Enriques, Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure: The Interests of Shareholders as a Class*, in ANATOMY OF CORPORATE LAW, *supra* note 31, at 49, 49-77. These two rights are particularly strong in countries where the presence of controlling shareholders is common. *Id.* at 49.

39 See DEL. CODE ANN. tit. 8, § 216(3) (2018) (stating that “[d]irectors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and *entitled to vote* on the election of directors” (emphasis added)).

40 See § 141(k) (stating that “[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then *entitled to vote* at an election of directors” (emphasis added)).

41 See § 242(b)(2) (“The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment . . .”).

42 See § 251(c) (“[T]he agreement [of merger or consolidation] shall be considered and a vote taken for its adoption or rejection. If a majority of the outstanding stock of the corporation *entitled to vote* thereon shall be voted for the adoption of the agreement, that fact shall be certified on the agreement . . .” (emphasis added)).

43 See § 271(a) (“Every corporation may at any meeting of its board of directors . . . sell, lease or exchange all or substantially all of its property and assets . . . when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation *entitled to vote* thereon . . .” (emphasis added)).

44 See § 275(b) (“[A] vote shall be taken upon the proposed dissolution. If a majority of the outstanding stock of the corporation *entitled to vote* thereon shall vote for the proposed dissolution, a certification of dissolution shall be filed . . .” (emphasis added)).

45 See § 216(2) (“In all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and *entitled to vote* on the subject matter shall be the act of the stockholders . . .” (emphasis added)).

benefits of the firm's decisions."<sup>46</sup> Moreover, the right to remove directors even more than the power to elect directors is considered an effective mechanism for managing agency costs.<sup>47</sup>

Furthermore, voting rights of individual shareholders must also be considered in the context of the diffusion of ownership or the lack thereof. Described in quintessential Berle and Means fashion, "[t]he . . . governance structure of the large American firm—distant shareholders, a board of directors that has . . . deferred to the CEO, and powerful, centralized management—is usually seen as a natural economic outcome arising from specialization: shareholders would specialize in riskbearing but wanted diversification, and firms needed specialized, professional management."<sup>48</sup> However, diffuse, fragmented ownership is not necessarily the norm for large, modern American corporations.<sup>49</sup> On the contrary, during the twenty-first century, we now observe that ownership of publicly traded American enterprises has been reconcentrated among a few large institutional investment intermediaries, including pension funds and mutual funds.<sup>50</sup> Mutual funds hold approximately one-fourth of the stock of publicly traded companies in the U.S. and thus "have the power to be a significant force in the governance of large U.S. corporations."<sup>51</sup> In fact, when considered together, just three firms (BlackRock, Vanguard, and State Street) represent the single largest shareholder in forty percent of all listed American corporations and eighty-eight percent of S&P 500 member firms.<sup>52</sup> Furthermore, a comprehensive analysis of Institutional Shareholder Services (ISS) data demonstrates that there is "remarkably high" internal agreement in proxy voting by each of these "Big Three" firms and suggests each firm implements a coordinated voting strategy across the various mutual funds

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<sup>46</sup> Armour et al., *supra* note 31, at 12.

<sup>47</sup> Armour et al., *supra* note 38, at 55.

<sup>48</sup> MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* at ix (1994).

<sup>49</sup> See John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 *YALE L.J.* 1, 3 (2001) (describing the "polarization of corporate structure" between a "*Dispersed Ownership System*, characterized by strong securities markets, rigorous disclosure standards, and high market transparency, in which the market for corporate control constitutes the ultimate disciplinary mechanism" and a "*Concentrated Ownership System*, characterized by controlling blockholders, weak securities markets, high private benefits of control, and low disclosure and market transparency standards, with only a modest role played by the market for corporate control, but with a possible substitutionary monitoring role played by large banks").

<sup>50</sup> See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 *COLUM. L. REV.* 863, 865 (2013) ("In 2011, for example, institutional investors owned over 70% of the outstanding stock of the thousand largest U.S. public corporations.").

<sup>51</sup> *Id.* at 886.

<sup>52</sup> Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 *BUS. & POL.* 298, 313 (2017).

that they manage.<sup>53</sup> Also, these “Big Three” firms “side with management in more than ninety percent of votes.”<sup>54</sup>

## 2. Fiduciary Duties and Judicial Standards of Review

Directors and officers owe fiduciary duties to the corporation and its shareholders.<sup>55</sup> Shareholders may seek to enjoin the actions of directors or officers for behavior that is inimical to their duties. Shareholders may also recover monetary damages for losses sustained for breaches of fiduciary duties. The two traditional duties owed to shareholders are the duty of care and the duty of loyalty.<sup>56</sup>

The duty of care generally requires directors to exercise reasonable care when making business decisions.<sup>57</sup> Duty of care violations are analyzed under a “business judgment rule” standard of review.<sup>58</sup> The business judgment rule is a rebuttable legal presumption that directors discharged their duties of care

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<sup>53</sup> *Id.* at 316-17.

<sup>54</sup> *Id.* at 316.

<sup>55</sup> See, e.g., *Klaassen v. Allegro Dev. Corp.*, No. 8626-VCL, 2013 WL 5967028, at \*11 (Del. Ch. Nov. 7, 2013) (emphasizing that “corporate directors do not owe fiduciary duties to individual stockholders” but rather “to the entity and to the stockholders as a whole” and stressing that “[t]his is true even if a single stockholder holds a controlling block”); see also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (“[A] board of directors is not a passive instrumentality.”).

<sup>56</sup> See *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 745 n.400 (Del. Ch. 2005) (“[O]utside the recognized fiduciary duties of care and loyalty (and perhaps good faith), there are no other fiduciary duties. In certain circumstances, however, specific applications of the duties of care and loyalty are called for, such as so-called ‘Revlon’ duties and the duty of candor or disclosure.”).

<sup>57</sup> See MODEL BUS. CORP. ACT § 8.30 (AM. BAR ASS’N 2016) (“Each member of the board of directors, when discharging the duties of a director, shall act: (i) in good faith, and (ii) in a manner the director reasonably believes to be in the best interests of the corporation.”); PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(a) (AM. LAW INST. 1994) (“A director or officer has a duty to the corporation to perform the director’s or officer’s functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.”). But see DEL. CODE ANN. tit. 8, § 102(b)(7) (2018) (allowing corporations to have exculpatory “provision[s] eliminating or limiting the personal liability of a director to the corporation . . . for monetary damages for breach of fiduciary duty” in certain contexts, namely duty of care violations that do not amount to duty of good faith violations).

<sup>58</sup> See, e.g., *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 927 (Del. 2003) (“The business judgment rule, as a standard of judicial review, is a common-law recognition of the statutory authority to manage a corporation that is vested in the board of directors.”). Compare Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 *FORDHAM L. REV.* 437, 439-449 (1993) (describing the duty of care as a standard of conduct and the business judgment rule as the applicable standard of review), with Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 *VAND. L. REV.* 83, 90 (2004) (“[T]he business judgment rule can [also] be seen as an abstention doctrine . . . [that] does not state a standard of liability but rather establishes a presumption against judicial review of duty of care claims.”).

and loyalty.<sup>59</sup> This puts the burden on the challenging plaintiff to proffer evidence for believing that there was a breach.<sup>60</sup> In the absence of a showing, courts will give deference to directorial decisionmaking.<sup>61</sup> It is very difficult for plaintiffs to make a showing and overcome the presumption.<sup>62</sup>

The duty of loyalty includes a cluster of duties and generally applies when there is a conflict of interest of some sort.<sup>63</sup> Duty of loyalty violations are evaluated under the “entire fairness” standard of review.<sup>64</sup> Entire fairness doctrine is the most exacting level of judicial review since the corporation must prove that both the process it undertook and price it achieved are fair to its stockholders.<sup>65</sup> In practice, this ends up being a very difficult burden for a board of directors or

<sup>59</sup> See *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 124 (Del. Ch. 2009) (“The business judgment rule is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” (internal quotation mark omitted) (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000))).

<sup>60</sup> See *id.* (“The burden is on plaintiffs, the party challenging the directors’ decision, to rebut this presumption.”).

<sup>61</sup> See *id.* (“Thus, absent an allegation of interestedness or disloyalty to the corporation, the business judgment rule prevents a judge or jury from second guessing director decisions if they were the product of a rational process and the directors availed themselves of all material and reasonably available information.”); see also *Dodge v. Ford Motor Co.*, 170 N.W. 668, 678 (Mich. 1919) (“The management of the corporation and its affairs rests in the board of directors, and no court will interfere or substitute its judgment so long as the proposed actions are not ultra vires or fraudulent. They may be ill advised . . . but this is no ground for exercise of jurisdiction.”).

<sup>62</sup> See *Citigroup*, 964 A.2d at 124 (“The standard of director liability under the business judgment rule ‘is predicated upon concepts of gross negligence.’”).

<sup>63</sup> See PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS §§ 5.02, 5.05 (AM. LAW INST. 1994) (codifying duties owed to shareholders in transactions involving self-dealing and corporate opportunities); see also *Aronson*, 473 A.2d at 812 (“[D]irectors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.”). *But see* *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (“[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.”).

<sup>64</sup> See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) (“The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.”).

<sup>65</sup> The Delaware Supreme Court in *Weinberger* stated that

[t]he concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company’s stock. However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.

*Id.* at 711 (citations omitted).

controller to carry and induces parties to settle the litigation. Thus, it is evident that the applicable standard of review is often outcome determinative.<sup>66</sup>

Fiduciaries also owe a duty of good faith,<sup>67</sup> a duty of candor or disclosure in certain transaction settings,<sup>68</sup> and other intermediate duties in particular takeover defense situations<sup>69</sup> and sale of control contexts.<sup>70</sup>

However, Delaware courts have recently accepted arguments rooted in the principle of shareholder ratification. Under *Kahn v. M&F Worldwide*, a case referred to as *MFW* in the corporate lexicon, conditioning a transaction on the fully informed approval of *both* an empowered and independent special

<sup>66</sup> See, e.g., *Stroud v. Grace*, 606 A.2d 75, 90 (Del. 1992) (“The choice of the applicable ‘test’ to judge director action often determines the outcome of the case.”).

<sup>67</sup> As the Delaware Supreme Court discussed in *In re Walt Disney Co. Derivative Litigation*,

The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty, . . . but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders. A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.

906 A.2d 27, 67 (Del. 2006); cf. *Stone*, 911 A.2d at 370 (“[T]he obligation to act in good faith does not establish an independent fiduciary duty [equal to] the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly.”).

<sup>68</sup> See *Stroud v. Milliken Enterprises, Inc.*, 552 A.2d 476, 480 (Del. 1989) (“[W]hen a board of directors is required or elects to seek shareholder action, it is under a duty to disclose fully and fairly pertinent information within the board’s control.” (internal quotations omitted)); *Lynch v. Vickers Energy Corp.*, 383 A.2d 278, 279 (Del. 1977) (requiring complete candor and full disclosure of “all the facts and circumstances” in a situation involving a controlling shareholder); cf. *Malpiede v. Townson*, 780 A.2d 1075, 1086 (Del. 2001) (“[T]he board’s fiduciary duty of disclosure . . . is not an independent duties [sic] but the application in a specific context of the board’s fiduciary duties of care, good faith, and loyalty.”). *But see* *IRA Tr. FBO Bobbie Ahmed ex. rel. Class A Stockholders of NRG Yield, Inc. v. Crane*, No. CV 12742-CB, 2017 WL 6335912, at \*14 (Del. Ch. Jan. 26, 2018) (“Delaware law does not require management to discuss the panoply of possible alternatives to the course of action it is proposing.” (internal quotations omitted)).

<sup>69</sup> As explained by the Delaware Supreme Court in *Unocal Corp. v. Mesa Petroleum Co.*,

Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred . . . . We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult.

493 A.2d 946, 954-55 (Del. 1985).

<sup>70</sup> See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (“The directors’ role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.”).

committee of directors *and* the informed vote of a majority of the unaffiliated stockholders can shift the standard of review from entire fairness to business judgment review in *controlling* shareholder transactions.<sup>71</sup> Delaware has been willing to extend its “*MFW* framework,” applicable to squeeze-out transactions by controllers, to dismiss shareholder litigation and allow directors to avoid the entire fairness standard of review in dual-class recapitalization transactions.<sup>72</sup> Under *Corwin*, the informed vote of disinterested stockholders can shift the standard of review from enhanced scrutiny to business judgment review in *noncontrolling* shareholder transactions.<sup>73</sup> Transactions riddled with conflict and defective process can be cleansed by shareholders as long as there is adequate disclosure of “troubling” director behavior.<sup>74</sup> With *Corwin*, a shareholder voting mechanism can otherwise cleanse a transaction where the board of directors would be deemed to have breached their fiduciary duties had the shareholder action been brought *preclosing* rather than *postclosing*.<sup>75</sup> These recent doctrinal developments substantially weaken fiduciary duties as a shareholder protective device and purport to entrust the shareholder voting mechanism as a counterbalance. However, the voting mechanism is deficient and especially problematic for nonvoting shares.

### 3. Appraisal Rights

Finally, shareholders may have statutory appraisal rights under certain circumstances. Appraisal rights are essentially put rights requiring the

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<sup>71</sup> See *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (holding that the business judgment rule “should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders”).

<sup>72</sup> See *NRG Yield*, 2017 WL 6335912, at \*9 (deciding reclassification transactions should be analyzed as a conflicted controller transaction).

<sup>73</sup> *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 305-06 (Del. 2015) (holding that the business judgment rule, as opposed to intermediate standards of review under *Unocal* or *Revlon*, is “invoked as the appropriate standard of review for a *post-closing* damages action when a merger that is not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of the disinterested stockholders” (emphasis added)).

<sup>74</sup> *Id.* at 312.

<sup>75</sup> As further stated in by the court in *Corwin*,

[T]his Court has never held that the stockholders had to be asked separately to “ratify” the board’s actions for that effect to be given. Rather, it has been the ability of an uncoerced group of informed stockholders to freely accept for themselves whether a transaction was good for them that gave rise to the effect on the standard of review applied in any *post-closing* challenge.

*Id.* at 312 n.24 (emphasis added).

corporation to buy out a dissenting shareholder's stock at a court-determined price in specific merger transaction contexts.<sup>76</sup>

However, there has been increased uncertainty around appraisal rights due to recent Delaware Court of Chancery decisions.<sup>77</sup> Specifically, Delaware has been willing to recognize efficient capital markets theory in the appraisal context for companies with widely traded public stock and absent a controlling shareholder.<sup>78</sup>

### B. History of Unequal Voting Structures

Unequal voting structures are not a recent phenomenon. Alexander Hamilton is perhaps prescient for articulating the tension between utilizing “one share, one vote” and “one shareholder, one vote” rules.<sup>79</sup> Reporting to the House of Representatives in 1790 on a National Bank, Hamilton argued that

[a] vote for each share renders a combination between a few principal stockholders, to monopolize the power and benefits of the bank, too easy. An equal vote to each stockholder, however great or small his interest in the institution, allows not that degree of weight to large stockholders which it is reasonable they should have, and which, perhaps, their security and that of the bank require. A prudent mean is to be preferred.<sup>80</sup>

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<sup>76</sup> See DEL. CODE ANN. tit.8, § 262(a) (2018) (“Any stockholder . . . who has otherwise complied with [the conditions set forth in this statute] . . . shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder’s shares of stock . . .”).

<sup>77</sup> See, e.g., *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, No. 11448-VCL, 2018 WL 922139, at \*2, \*54 (Del. Ch. Feb. 15, 2018) (using unaffected thirty-day average market price for estimating going concern value in an appraisal action, which represented a thirty percent discount to the merger consideration). *But see* *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd*, No. 565, 2016, 2017 WL 6375829, at \*5 (Del. Dec. 14, 2017) (finding that the trial court failed to adequately consider the deal price in determining the fair value of corporation’s stock).

<sup>78</sup> See *Aruba*, 2018 WL 922139 at \*24 (noting the Delaware Supreme Court’s consideration of the unaffected trading price in appraisals where a “company’s shares trade in a market having attributes consistent with the assumptions underlying a traditional version of the semi-strong form of the efficient capital markets hypothesis”); see also Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 414 (1970) (“[T]here is consistent evidence of positive dependence in day-to-day price changes and returns on common stocks, and the dependence is of a form that can be used as the basis of marginally profitable trading rules.”). *But cf.* *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 57 (Del. Ch. 2011) (rejecting efficient markets theory and accepting “substantive coercion” as a valid threat for *Unocal* purposes in the takeover context). Substantive coercion is defined as “the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management’s representations of intrinsic value.” *Id.* at 96 (quoting Ronald Gilson & Reinier Kraakman, *Delaware’s Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 258 (1989)).

<sup>79</sup> SEC. & EXCH. COMM’N, CORPORATE OWNERSHIP AND CONTROL IN THE UNITED STATES: CONGRESSIONAL INVESTIGATION 1971–1980, 393 app. G, (W.S. Hein 1981).

<sup>80</sup> ALEXANDER HAMILTON, REPORT ON A NATIONAL BANK (1790), reprinted in 3 THE WORKS OF ALEXANDER HAMILTON, *supra* note 1, at 388, 423. Hamilton may have been more concerned with consumer protection than investor protection. See Henry Hansmann & Mariana

It has been documented that “[p]rior to the beginning of the [twentieth] century there existed but little restriction of the voting rights of shareholders.”<sup>81</sup> An early instance of publicly traded nonvoting common stock in the United States concerned the International Silver Company, which employed such an equity security between 1898 and 1902—long before Snap Inc. offered nonvoting shares to the public.<sup>82</sup> By May 1926, nine public companies in the United States employed a dual-class common stock structure with “two classes, alike . . . in all respects except that one class ha[d] voting power and the other none.”<sup>83</sup>

One of the first known critics of the practice of corporations issuing nonvoting common shares to the public was William Z. Ripley, a Harvard professor of political economy.<sup>84</sup> Ripley described the Wall Street practice of issuing nonvoting Class A common stock to the public while simultaneously reserving Class B common shares with voting rights for management as a “plague.”<sup>85</sup> Years before Berle and Means famously examined the problem of “separation of ownership and control” in American corporations in the 1930s, Ripley reasoned that “the trouble has to do with the growing dissociation of ownership of property from responsibility for the manner in which it shall be put to use.”<sup>86</sup>

It is said that the 1934 creation of the Securities and Exchange Commission (SEC) was in part due to Ripley’s muckraking.<sup>87</sup> By the 1980s, the New York Stock

Pargendler, *The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption*, 123 YALE L.J. 948, 979 (2014) (“[Hamilton] seemed particularly concerned with mitigating profit-maximizing behavior by the Bank’s shareholders to the detriment of consumers, as well as with preventing favoritism in lending decisions.”).

<sup>81</sup> W.H.S. Stevens, *Stockholders’ Voting Rights and the Centralization of Voting Control*, 40 Q.J. ECON. 353, 353 (1926).

<sup>82</sup> *Id.* at 355.

<sup>83</sup> *Id.* at 360-61. These companies included “three of the leading tobacco companies: American, Liggett and Myers, and R. J. Reynolds.” *Id.* at 360.

<sup>84</sup> See Berle, *supra* note 20 at 674 (“Forcibly called to the attention of the public by a recent address of Professor Ripley, [non-voting shares] form one of the major problems which lie on the border line between corporation law and financial practice.”); *When Ripley Speaks, Wall Street Heeds: From His Quiet Study This Harvard Professor Issues Sensational Indictments That Force Reforms*, N.Y. TIMES, Sept. 26, 1926, at 7 (documenting Ripley’s concern for “non-voting stocks which . . . make still more secure the position of the professional financier as against the amateur speculator or investor”); see also, Stephen Mihm, *Non-Voting Shares Don’t Have a Pretty History*, BLOOMBERG (Mar. 16, 2017, 10:00 AM), <https://www.bloomberg.com/view/articles/2017-03-16/non-voting-shares-don-t-have-a-pretty-history> (“The man who became the most vocal and effective opponent of non-voting shares was a largely forgotten Harvard economist named William Zebina Ripley.”). Professor Ripley, despite his accomplishments, has since been discredited on other grounds. See *id.* (“His obscurity may have been earned by his earlier work as a promoter of ‘scientific racism’ at the turn of the century.”).

<sup>85</sup> WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET 86-89 (1927).

<sup>86</sup> *Id.* at 116.

<sup>87</sup> William Z. Ripley, *Stop, Look, Listen! The Shareholder’s Right to Adequate Information*, ATLANTIC, <https://www.theatlantic.com/magazine/archive/1926/09/stop-look-listen-the-shareholders-right-to-adequate-information/308240/> [<https://perma.cc/T9GY-76F6>].

Exchange (NYSE) mandated that listed companies adopt “one vote, one share” policies.<sup>88</sup> Then, in 1984, General Motors sought to implement a dual-class voting structure by issuing common stock to the public with diminished voting entitlements of one-half vote per share.<sup>89</sup> The NYSE lobbied the SEC to modify its policy.<sup>90</sup> The SEC declined and proffered its own rule to regulate dual-class structures in 1988.<sup>91</sup> Rule 19c-4 purported to prohibit “disenfranchisement” by banning national securities exchanges “from listing stock of a corporation that takes any corporate action with the effect of nullifying, restricting or disparately reducing the per share voting rights of existing common stockholders.”<sup>92</sup> Ultimately, however, the D.C. Circuit struck down this rule and held that the SEC had overstepped its authority as granted under section 19 of the Securities Exchange Act of 1934.<sup>93</sup> Further, the D.C. Circuit held that “the SEC’s authority over shareholder voting is limited to disclosure and process; the SEC has no authority over the substance of shareholder voting, including the number of votes shares can possess. The substance of shareholder voting thus is solely and exclusively a matter for state corporate law.”<sup>94</sup> In the aftermath, securities exchanges “adopted new listing standards governing the use of dual class stock.”<sup>95</sup>

### C. Prevalence of Unequal Voting Structures

Today, publicly traded dual-class companies have an aggregate market capitalization in excess of three trillion dollars.<sup>96</sup> The prevalence of dual-class voting structures has been on the rise.<sup>97</sup> In fact, nearly 20% of 2017 IPOs in

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<sup>88</sup> Bus. Roundtable v. SEC, 905 F.2d 406, 407 (D.C. Cir. 1990).

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* (internal quotations omitted).

<sup>93</sup> *Id.*

<sup>94</sup> Stephen M. Bainbridge, *Perpetual Dual Class Stock Versus the SEC’s Dubious Raised Eyebrow Power*, WLF LEGAL PULSE (Feb. 23, 2018), <https://wlflegalpulse.com/2018/02/23/perpetual-dual-class-stock-versus-the-secs-dubious-raised-eyebrow-power/> [<https://perma.cc/3XQ7-M5YY>].

<sup>95</sup> *Id.*

<sup>96</sup> See Bebchuk & Kastiel, *supra* note 21, at 594.

<sup>97</sup> See, e.g., John Plender, *Dropbox IPO Is Yet Another Corporate Governance Low Point*, FINANCIAL TIMES (Mar. 19, 2018), <https://www.ft.com/content/4333c554-279a-11e8-b27e-cc62a39d57a0> (“[Dual-class] listings increased in the US from 487 in 2005 to 701 in 2015, an eye-catching 44 per cent rise. Among those issuers have been high-profile tech companies such as Facebook, Groupon, LinkedIn, TripAdvisor and Zynga.”); Tom Zanki, *More Cos. Authorizing No-Vote Shares Despite Resistance*, LAW360 (July 12, 2017, 8:37 PM), <https://www.law360.com/articles/943458/more-cos-authorizing-no-vote-shares-despite-resistance> [<https://perma.cc/4C3R-CWXU>] (“More companies are establishing the right to issue nonvoting shares at their initial public offering through a triple-class stock structure, venturing beyond dual-class setups that already contain unequal voting rights favoring management’s ability to maintain long-term control, despite objections from institutional groups who say the practice erodes accountability.”).

the United States employed a structure with disproportionate voting rights.<sup>98</sup> By some estimates, 10% of all publicly traded companies in the U.S. “have some form of dual-class structure.”<sup>99</sup> More specifically, as of March 2018, over two hundred Russell 3000 U.S. incorporated companies “have at least two outstanding classes of common stock with unequal voting rights.”<sup>100</sup> Further, approximately 25% of these Russell 3000 dual-class stock companies have at least one class of common stock that is completely nonvoting.<sup>101</sup> Snap Inc. appears to be the only company today that exclusively uses nonvoting stock for its publicly traded shares.<sup>102</sup>

When Google went public, its insiders readily admitted that its then dual-class structure was considered “unusual” for a technology business, although not uncommon for a modern media enterprise.<sup>103</sup> Less than one decade later, Google’s

<sup>98</sup> *Large Majority of 2017 IPOs were One Share, One Vote*, COUNCIL OF INSTITUTIONAL INV., <https://www.cii.org/files/Board%20Accountability/2017%20IPO%20Stats%20for%20Website.pdf> [<https://perma.cc/GHN5-7Q3R>] (last visited Oct. 20, 2018). Specifically, of the 124 IPOs launched in 2017—excluding foreign private issuers, special purpose acquisition companies, and master limited partnerships—twenty-three utilized dual-class structures with unequal voting rights, and four employed nonvoting shares. *Id.*

<sup>99</sup> DAVID LARCKER & BRIAN TAYAN, *CORPORATE GOVERNANCE MATTERS: A CLOSER LOOK AT ORGANIZATIONAL CHOICES AND THEIR CONSEQUENCES* 65 (2d ed. 2016). This statistic is based on 2014 data. *Id.* at 76 n.24.

<sup>100</sup> *Dual Class Companies List*, COUNCIL OF INSTITUTIONAL INV., <https://www.cii.org/files/Board%20Accountability/Dual%20Class%20Company%20List%202018.pdf> [<https://perma.cc/3SZC-MTGZ>] (last visited Oct. 20, 2018). Interestingly, there is a handful of companies with dual-class stock structures that have two equity securities that are both publicly traded on major market exchanges, including Alphabet Inc. (tickers GOOG and GOOGL); Under Armour Inc. (tickers UA and UAA); Twenty-First Century Fox Inc. (tickers FOXA and FOX); Discovery Communications, Inc. (tickers DISCA and DISCK); Viacom, Inc. (tickers VIA and VIAB); and News Corp. (tickers NWS and NWSA). See Karen Wallace, *Which Stock Share Class Should You Buy?*, MORNINGSTAR (Aug. 8, 2017, 5:00 AM), <http://news.morningstar.com/articlenet/article.aspx?id=820137> [<https://perma.cc/TV8M-XLK7>] (listing companies with multiple share classes and tickers); Bermuda Meister, *FOX vs. FOXA: Unusual Disparity Between Voting and Non-Voting Shares*, SEEKING ALPHA (Dec. 26, 2016), <https://seekingalpha.com/article/4032703-fox-vs-foxa-unusual-disparity-voting-non-voting-shares> [<https://perma.cc/2959-XYV2>] (listing public companies with public voting stock and public nonvoting stock).

<sup>101</sup> *Dual Class Companies List*, *supra* note 100. This descriptive statistic was based on a computational analysis of CII’s compiled raw data.

<sup>102</sup> See Snap Inc., Final Prospectus (Form 424B4) at 7 (Mar. 1, 2017) [hereinafter Snap Prospectus] (“We are not aware of any other company that has completed an initial public offering of non-voting stock on a U.S. stock exchange.”).

<sup>103</sup> See Google Inc., Registration Statement (Form S-1) at iii (Apr. 29, 2004) (“The New York Times Company, the Washington Post Company and Dow Jones, the publisher of The Wall Street Journal, [as of 2004] all have similar dual class ownership structures.”). Media companies used dual-class structures to protect journalistic integrity and “focus on journalism ahead of profit.” Andrew Ross Sorkin & Geraldine Fabrikant, *Big Holder Sells Stake in Times Co.*, N.Y. TIMES (Oct. 18, 2007), <http://www.nytimes.com/2007/10/18/business/media/18paper.html>; see also Katie Bentel & Gabriel Walter, *Dual Class Shares* (Spring 2016) (unpublished seminar paper, University of Pennsylvania), [http://scholarship.law.upenn.edu/fisch\\_2016/2](http://scholarship.law.upenn.edu/fisch_2016/2) [<https://perma.cc/V33L-CX7R>] (“Dual class stocks were first utilized in media companies as a means to protect the journalistic integrity of the news.”).

cofounders professed that “[g]iven Google’s success, it’s unsurprising that this type of dual-class governance structure is now somewhat standard among newer technology companies.”<sup>104</sup> Notable examples of technology businesses that launched IPOs with dual-class structures besides Alphabet and Snap include Blue Apron, Facebook, and Zynga<sup>105</sup> as well as Dropbox<sup>106</sup> and Spotify.<sup>107</sup> Most recently, in 2019, Lyft<sup>108</sup> and Pinterest<sup>109</sup> are the latest nascent technology businesses to utilize dual-class governance structures.

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<sup>104</sup> Page & Brin, *supra* note 6.

<sup>105</sup> See, e.g., Caitlin Huston, *Snap Backlash, Facebook Capitulation Won't Stop Founder-Friendly Stock Structures*, MARKETWATCH (Sept. 27, 2017, 7:24 AM), <https://www.marketwatch.com/story/snap-backlash-facebook-capitulation-wont-stop-multi-class-stock-structures-2017-09-22> [<https://perma.cc/2WDB-QBBN>] (arguing that “dual-class structures that offer limited voting powers are likely here to stay”).

<sup>106</sup> See Dropbox, Inc., Registration Statement (Form S-1) at 158 (Feb. 23, 2018) (“The rights of the holders of Class A common stock, Class B common stock, and Class C common stock are identical, except with respect to voting and conversion.”); see also Maureen Farrell & Jay Greene, *Dropbox Files for Its Initial Public Offering*, WALL ST. J. (Feb. 23, 2018, 5:54 PM), <https://www.wsj.com/articles/dropbox-files-to-go-public-1519419035> [<https://perma.cc/48JB-PWES>] (“Despite a pushback against dual-class shares from index funds and the SEC in recent months, Dropbox will have a dual-class structure that gives the founders and some investors 10 votes a share, compared with one vote a share for investors buying shares in the public markets.”).

<sup>107</sup> See Spotify Technology S.A., Registration Statement (Form F-1) at 2 (Feb. 28, 2018) (“Each outstanding ordinary share entitles the holder thereof to one vote. In addition, we have issued ten beneficiary certificates . . . [to] our founders . . . . The beneficiary certificates carry no economic rights and are issued to provide the holders of such beneficiary certificates additional voting rights.”); see also Lucas Shaw, *Spotify’s Founders Aren’t Giving Up Control Any Time Soon*, BLOOMBERG (Feb. 20, 2018, 8:22 PM), <https://www.bloomberg.com/news/articles/2018-02-21/spotify-s-founders-aren-t-giving-up-control-any-time-soon> (“[Spotify’s founders] own a class of stock that assures their hold on the company after the shares begin trading . . . . Another class will be tradeable by investors.”).

<sup>108</sup> See Lyft, Inc., Registration Statement (Form S-1) at 11 (Mar. 1, 2019) (“The dual class structure of our common stock will have the effect of concentrating voting power with our Co-Founders . . . which will limit your ability to influence corporate matters, including the election of directors, amendments of our organizational documents and any merger, consolidation, sale of all or substantially all of our assets or other major corporate transactions.”); see also Shannon Bond, *Investors Call for Lyft to Scrap Dual-Class Share Structure Plans*, FINANCIAL TIMES (Mar. 17, 2019), <https://www.ft.com/content/7d26dca6-4747-11e9-b168-96a37d002cd3> (“With a dual-class structure, Lyft is basically shielding itself and company insiders against shareholders who deserve a voice.”).

<sup>109</sup> See Pinterest, Inc., Registration Statement (Form S-1) at 7 (Mar. 22, 2019) (“The dual class structure of our common stock will have the effect of concentrating voting control with those stockholders who held our capital stock prior to the completion of this offering, including our cofounders, executive officers, employees and directors and their affiliates. This will limit or preclude your ability to influence corporate matters.”); see also Olivia Zaleski & Selina Wang, *Pinterest Joins U.S. IPO Wave with Fast Revenue Growth*, BLOOMBERG (Mar. 22, 2019), <https://www.bloomberg.com/news/articles/2019-03-22/pinterest-joins-wave-of-upcoming-unicorn-ipos-with-u-s-filing> (“Pinterest will have a dual-class structure, with its Class B shares carrying the voting rights of 20 ordinary shares.”).

#### D. Empirical Analysis of Unequal Voting Structures

Statistical analysis has long revealed that when a corporation has two classes of common stock outstanding that differ only with regards to voting rights, the class with superior voting rights often trades at a premium relative to the class with inferior voting rights.<sup>110</sup> Such price differentials have historically been found to be within a range of three to five percent across various empirical studies.<sup>111</sup>

One recent study conducted by Institutional Shareholder Services Inc. (ISS) found that “[c]ontrolled companies generally underperformed non-controlled firms . . . in terms of total shareholder returns, revenue growth, and return on equity.”<sup>112</sup> Still, the explanation for these findings is not necessarily causal in nature since the results may be subject to omitted variable bias and fraught with endogeneity issues. For example, the premium for superior voting shares may be due to confounding factors such as family control.<sup>113</sup> In fact, an empirical study of stock market returns found that dual-class firms with controlling families generate excess returns while dual-class firms without family owners “bear no significant relation to stock returns.”<sup>114</sup> This same study concludes “that a super voting arrangement—in-and-of itself—does not appear to be inconsistent with the goal of shareholder wealth maximization.”<sup>115</sup>

Nonetheless, one statistical analysis of dual-class shares used clever empirics to mitigate endogeneity concerns and “disentangle the incentive and entrenchment effects in the relationship of insider ownership and firm value.”<sup>116</sup> On average, “insiders have approximately 60% of the voting rights

<sup>110</sup> See Ronald C. Lease, John J. McConnell & Wayne H. Mikkelson, *The Market Value of Control in Publicly-Traded Corporations*, 11 J. FIN. ECON. 439, 458 (1983) (finding that “when corporations have only voting and non-voting common stock outstanding, the voting stock trades at a premium” and that when corporations have two classes of voting common stock but one class has “voting rights that can be identified as being superior . . . , the one with superior voting rights trades at a premium”).

<sup>111</sup> Aaron Stumpf & Andrew Cline, *Price Differentials Between Voting and Nonvoting Stock*, STOUT, <https://www.stoutadvisory.com/insights/article/price-differentials-between-voting-and-nonvoting-stock> [https://perma.cc/8LUD-KN97] (last visited Oct. 20, 2018). *But cf.* Ronald J. Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807, 808-09 (1987) (“A stock’s limited voting rights are reflected in a reduced price, so that the company’s owners at the time it goes public, and not the purchasers, bear the cost.”).

<sup>112</sup> Press Release, Inv’r Responsibility Research Ctr. Inst., *Controlled Companies Generally Underperform and Boards Less Diverse, New Study Finds* (Mar. 17, 2016), <http://irrinstitute.org/news/controlled-companies-generally-underperform-and-boards-less-diverse-new-study-finds/> [https://perma.cc/M3WM-U2RA].

<sup>113</sup> See Ronald Anderson, Ezgi Ottolenghi & David Reeb, *The Dual Class Premium: A Family Affair 2*, 5 (Fox Sch. Bus., Research Paper No. 17-021, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3006669](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3006669) (finding an “association between founding family ownership and dual class firms” and further “suggesting [that] the premium centers on family control rather than dual class shares”).

<sup>114</sup> *Id.* at 5.

<sup>115</sup> *Id.* at 8.

<sup>116</sup> Gompers, Ishii & Metrick, *supra* note 15, at 1084.

and 40% of the cash-flow rights in dual-class firms.”<sup>117</sup> Further, in approximately “one-third of all dual-class firms, the insiders have a majority of the voting rights [amounting to effective control] but do not have a majority of the cash-flow rights.”<sup>118</sup> The researchers found that “firm value is positively associated with insiders’ cash-flow rights and negatively associated with insiders’ voting rights, and negatively associated with the wedge between the two.”<sup>119</sup> As the disparity between voting rights and economic rights for insiders’ ownership interest in the firm grows, firm value decreases. With unequal voting structures, not only does the class of stock with inferior voting rights trade at a relative discount to the class of stock with superior voting rights, but *all* shareholders, regardless of class of stock held, suffer from lower valuations.

#### E. Normative Arguments For and Against “One Share, One Vote”

There are reasonable arguments on both sides of the “one share, one vote” debate. Dual-class stock structures enable entrepreneurs to retain corporate control while focusing on long-term value creation without fear of shareholder retribution for short-term performance hiccups. However, the risk is that dual-class structures can also misalign incentives, promote entrenchment, and expropriate resources because founders with corporate control can outvote ordinary shareholders.

##### 1. Arguments in Favor of “One Share, One Vote”

Arguments for “one share, one vote” regimes are often viewed through an economic lens by adopting a contractarian theory and surmising that “a corporation is just a name for a great web of contractual arrangements.”<sup>120</sup>

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<sup>117</sup> *Id.* at 1053.

<sup>118</sup> *Id.* at 1056-57.

<sup>119</sup> *Id.* at 1084. “Wedge” is defined as “insider voting rights minus insider cash-flow rights.” *Id.* at 1073; cf. Lucian A. Bebchuk & Alma Cohen, *The Cost of Entrenched Boards*, 78 J. FIN. ECON. 409, 410-11 (2005) (finding that staggered boards—arrangements that protect incumbent board members—are associated with a statistically significant and economically meaningful reduction in firm value, while controlling for other governance provisions).

<sup>120</sup> Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 401 (1983) [hereinafter Easterbrook & Fischel, *Voting*] (citing Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976)). But see LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* 8 (2012) (listing “incorrect factual claims about the economic structure of corporations, including the mistaken claims that shareholders ‘own’ corporations, that they have the only residual claim on the firm’s profits, and that they are ‘principals’ who hire and control directors to act as their ‘agents’”); Anat R. Admati, *A Skeptical View of Financialized Corporate Governance*, 31 J. ECON. PERSP. 131, 132 (2017) (asserting that “[t]he important real-world issues around corporate governance do not fit neatly into most common economic frameworks and models”). See generally FRANK H. EASTERBROOK & DANIEL R.

Judge Easterbrook and Professor Fischel, proponents of shareholder value maximization theory as well as “one share, one vote” voting policies, assert that the “shareholders are the residual claimants to the firm’s income” and claim that “the shareholders are the group with the appropriate incentives . . . to make discretionary decisions.”<sup>121</sup> They go on to argue that “[t]he shareholders receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise discretion.”<sup>122</sup>

To put it succinctly, “[t]he case for the one share, one vote rule turns primarily on its ability to match economic incentives with voting power and to preserve the market for corporate control as a check on bad management.”<sup>123</sup> Dual-class governance structures promote the shifting of control “from good hands to bad because those who are willing to abuse control will often value it more than those who will not.”<sup>124</sup> As Easterbrook and Fischel argue,

[A]lthough the collective choice problem prevents dispersed shareholders from making the decisions day by day, managers’ knowledge that they are being monitored by those who have the right incentives, and the further knowledge that the claims could be aggregated and votes exercised at any time, tends to cause managers to act in [the] shareholders’ interest in order to advance their own careers and to avoid being ousted.<sup>125</sup>

The fact that coalitions of shareholders may gain control for any period of time is seen as advantageous since this can minimize the collective choice problem that remains.<sup>126</sup> Although a coalition of shareholders may collectively amass effective control, economic efficiency is achieved when minority shareholders have an *equal* opportunity of joining a succeeding coalition.<sup>127</sup> As disparity between voting rights and economic rights grows, agency costs and monitoring costs increase.<sup>128</sup>

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FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 1-39 (1991) (arguing that the rules and enforcement mechanisms of corporate law replicate contractual provisions governing managers, investors, and other constituencies involved).

<sup>121</sup> Easterbrook & Fischel, *Voting*, *supra* note 120, at 403.

<sup>122</sup> *Id.*

<sup>123</sup> Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1945-46 (1996).

<sup>124</sup> *Id.* at 1946.

<sup>125</sup> Easterbrook & Fischel, *Voting*, *supra* note 120, at 403.

<sup>126</sup> *Id.* at 406.

<sup>127</sup> See *id.* (“So long as each share has an *equal chance* of participating in a winning coalition, the gains from monitoring will be apportioned so as to preserve appropriate incentives at the margin.” (emphasis added)).

<sup>128</sup> *Id.* at 409 (“The greater the departure from equal weighting of votes among residual claimants, the greater the (unnecessary) agency costs.”).

## 2. Arguments Against “One Share, One Vote”

In contrast, viewed through this same economic lens and given the collective choice problem, opponents may argue that voting rights ought to “be held by a small group with good access to information—the managers themselves.”<sup>129</sup> Some scholars oppose the conventional wisdom evinced by Easterbrook and Fischel and argue that the “one share, one vote” paradigm is rooted in flawed assumptions since shareholders do not necessarily have uniform preferences.<sup>130</sup> Others pose the “question of whether dual-class firms possess . . . countervailing governance mechanisms such as outside directors, family ties, stronger pay-for-performance, or stronger monitoring by outside blockholders.”<sup>131</sup>

Those who promote dual-class regimes and the ability of companies to deviate from the “one share, one vote” rule put forth private ordering arguments and contend that “informed parties will choose optimal arrangements on their own.”<sup>132</sup> With dual-class voting structures, “[m]anagement . . . is protected from losing their positions without their consent” and “non-controlling shareholders are . . . protected from coercive takeover tactics and from making the mistake of selling the company too cheaply because they lack information possessed by the controlling shareholders.”<sup>133</sup> Additionally, controllers “may use super voting shares to mitigate asymmetric information problems [and] protect firm specific investments.”<sup>134</sup> Simply stated, “the founder of a company may have the special skills and deep knowledge of a specific industry and business to make her uniquely fit to be at the helm.”<sup>135</sup>

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<sup>129</sup> *Id.* at 403.

<sup>130</sup> See generally Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775 (2005) (arguing that the preferences of shareholders are not likely to be homogenous, particularly when they hold “economically encumbered” or “legally encumbered” shares).

<sup>131</sup> Gompers, Ishii & Metrick, *supra* note 15, at 1059 (internal citations omitted). For example, some researchers have suggested that debt may be used as an “alternative control mechanism” in firms with dual-class structures. *Id.*

<sup>132</sup> Black & Kraakman, *supra* note 123, at 1946; see also Bernard Sharfman, *A Private Ordering Defense of a Company’s Right To Use Dual Class Structures in IPOs*, 63 VILL. L. REV. 1 (2018) (“[T]he use of the dual class share structure in IPOs is a value-enhancing result of the bargaining that takes place in the private ordering of corporate governance arrangements . . . .”); David J. Berger, *Dual Class Stock and Private Ordering: A System That Works*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (May 24, 2017), <https://corpgov.law.harvard.edu/2017/05/24/dual-class-stock-and-private-ordering-a-system-that-works> [<https://perma.cc/KR7V-FXUF>] (“Private ordering allows boards, investors, and other corporate stakeholders to determine the most appropriate capital structure for a particular company, given its specific needs.”).

<sup>133</sup> Gilson, *supra* note 111, at 811. See generally *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011) (providing a more in-depth discussion on the threat of substantive coercion and the use of poison pills as an alternative defensive measure).

<sup>134</sup> Anderson et al., *supra* note 113, at 4.

<sup>135</sup> Bebchuk & Kastiel, *supra* note 21, at 604.

Some opponents of “one share, one vote” regimes have further advanced such private ordering arguments by reasoning that “nonvoting shares can be used to allocate voting power to informed investors who value their voting rights and are motivated to use them to maximize the firm’s value.”<sup>136</sup> These opponents conjecture that the use of nonvoting shares may be used to *reduce* agency and transaction costs.<sup>137</sup> The underlying rationale is that

there may be companies that are made worse off when all shareholders vote. Some shareholders, including many retail investors, have no interest in learning about the company and prefer to free-ride off informed investors. Other passive shareholders, such as index funds, may lack financial incentives to vote intelligently because of their investment strategy.<sup>138</sup>

In other words, passive shareholders may contribute to agency costs by choosing to vote if they are uninformed or apathetic.

However, these same advocates of nonvoting shares admit that one complication is that “the effect of issuing nonvoting stock has generally been to keep voting control with company insiders, rather than empower outside investors.”<sup>139</sup> They further point out that “the presence of nonvoting shares could exacerbate the collective action, free riding, and passivity problems inherent in dispersed ownership” but still conclude that this issue is ultimately unlikely.<sup>140</sup>

SEC Commissioner Robert J. Jackson, Jr., summarizes the debate over “one share, one vote” and dual-class structures quite succinctly: “On one hand, you have visionary founders who want to retain control while gaining access to our public markets. On the other, you have a structure that undermines accountability: management can outvote ordinary investors on virtually anything.”<sup>141</sup>

## II. THE SCOPE OF LEGAL RIGHTS FOR NONVOTING SHARES

Part II explores the legal rights and entitlements for nonvoting shares of common stock. Specifically, Section II.A examines legal rights under state law and Section II.B explores legal rights under federal law and stock exchange rules.

<sup>136</sup> Dorothy Shapiro Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STANFORD L. REV. (forthcoming 2019) (manuscript at 5) (available at <https://ssrn.com/abstract=3028173>).

<sup>137</sup> *Id.* at 4 (“[A] company that offers nonvoting shares to the public can lower its cost of capital in certain cases . . . because it reduces inefficiencies associated with voting.”).

<sup>138</sup> Dorothy Shapiro Lund, *The Case for Nonvoting Stock*, WALL ST. J. (Sept. 5, 2017, 7:10 PM), <https://www.wsj.com/articles/the-case-for-nonvoting-stock-1504653033>.

<sup>139</sup> Lund, *supra* note 136, at 7.

<sup>140</sup> *Id.* at 34.

<sup>141</sup> Robert J. Jackson, Jr., Comm’r, U.S. Sec. & Exch. Comm’n, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty* (Feb. 15, 2018) (transcript available at <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty> [<https://perma.cc/KMN6-LQQU>]).

### A. State Law Protections for Nonvoting Stockholders

State law provides enormous flexibility for corporations to issue stock with different voting entitlements, including stock with no voting rights at all.<sup>142</sup> As a general matter, a “shareholder cannot be deprived of the right to vote . . . her stock nor may the right be essentially impaired, either by the legislature or by the corporation, without the shareholder’s consent.”<sup>143</sup> Thus, it follows that nonvoting shares must be either established at the moment of incorporation or when an amendment proposal altering voting entitlements is put to a vote and agreed upon by affected shareholders.

Nonvoting stock is accurately defined as “[s]tock that has no voting rights *under most situations*.”<sup>144</sup> This begs the question of which circumstances can give rise to voting entitlements for nonvoting stock. Expectedly, holders of nonvoting common stock are granted *some* substantive voting rights in the narrowest of circumstances.<sup>145</sup>

#### 1. Appointment Rights

Nonvoting shareholders lack appointment rights altogether as they do not participate in the election or removal of directors.<sup>146</sup> The vestigial check that remains is the ability for a nonvoting shareholder to petition the Court of Chancery to determine the validity of any election<sup>147</sup> or result of any shareholder vote.<sup>148</sup> Thus, the use of nonvoting stock in extreme examples can effectively turn a traditional business corporation into what may look more like a business trust or nonprofit corporation.<sup>149</sup> This is concerning because states employ a director-centric model of corporate governance, and the

<sup>142</sup> See, e.g., DEL. CODE ANN. tit. 8, § 151(a) (2018) (“Every corporation may issue 1 or more classes of stock . . . any or all of which . . . may have such voting powers, full or limited, or *no voting powers* . . . , as shall be stated and expressed in the certificate of incorporation.” (emphasis added)); MODEL BUS. CORP. ACT § 6.01(c) (AM. BAR ASS’N 2016) (“The articles of incorporation may authorize one or more classes or series of shares that . . . have special, conditional, or limited voting rights, or *no right to vote* . . . .”) (emphasis added)).

<sup>143</sup> FLETCHER ET AL., *supra* note 36, § 2025.

<sup>144</sup> *Stock*, BLACK’S LAW DICTIONARY (10th ed. 2014) (emphasis added).

<sup>145</sup> For example, just six DGCL sections appear to affirmatively bolster statutory provisions with language containing “whether voting or nonvoting” or “whether or not entitled to vote.” DEL. CODE ANN. tit. 8, §§ 204, 242, 251, 266, 355, 390 (2018).

<sup>146</sup> See *supra* notes 39–40 and accompanying text.

<sup>147</sup> See tit. 8, § 225(a) (“Upon application of any stockholder . . . the Court of Chancery may hear and determine the validity of any election, appointment, removal or resignation of any director or officer of any corporation . . . .”).

<sup>148</sup> See tit. 8, § 225(b) (“Upon application of any stockholder . . . , the Court of Chancery may hear and determine the result of any vote of stockholders upon matters other than the election of directors or officers.”).

<sup>149</sup> Armour et al., *supra* note 31, at 12 (“Th[e] requirement of an elected board distinguishes the corporate form from other legal forms, such as nonprofit corporations or business trusts, which permit or require a board structure, but do not require election of the board by the firm’s (beneficial) owners.”).

inability to vote in directorial elections eradicates a fundamental check shareholders have on directors and directorial decisionmaking.<sup>150</sup>

## 2. Decision Rights

Shareholders of nonvoting common stock have only minimal decision rights. They cannot vote to approve many major transactions, including mergers, asset sales, or dissolution.<sup>151</sup> Nonvoting stockholders can vote in only the most extreme fundamental change resolutions such as business entity conversions<sup>152</sup> and transfers of domestication.<sup>153</sup> Holders of nonvoting stock can affirmatively vote on proposed amendments to a certificate of incorporation in a few enumerated contexts.<sup>154</sup>

## 3. Information Rights

Shareholders of nonvoting stock enjoy limited information rights. The default rule is that holders of nonvoting shares are generally not entitled to notice of a shareholders' meeting unless they are entitled to vote on a matter at such a meeting.<sup>155</sup> Instead, such shareholders are only specifically entitled to notice of defective corporate acts<sup>156</sup> and of merger agreements.<sup>157</sup>

<sup>150</sup> See *supra* notes 123–125 and accompanying text.

<sup>151</sup> See *supra* notes 42–44 and accompanying text.

<sup>152</sup> See tit. 8, § 266(b) (“[A] resolution [of conversion] shall be submitted to the stockholders . . . . If all outstanding shares of stock of the corporation, whether voting or nonvoting, shall be voted for the adoption of the resolution, the conversion shall be authorized.”).

<sup>153</sup> See tit. 8, § 390(b) (“[A] resolution [to transfer to, or domesticate, or continue in a foreign jurisdiction] shall be submitted to the stockholders . . . . If all outstanding shares of stock of the corporation, whether voting or nonvoting, shall be voted for the adoption of the resolution, the corporation shall file . . . a certificate of transfer . . .”).

<sup>154</sup> See tit. 8, § 242(b)(2) (specifying that nonvoting shareholders can cast votes if an amendment would change the number of authorized shares, change the par value of their shares, “or alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely”); see also MODEL BUS. CORP. ACT § 10.04(b) (AM. BAR ASS’N 2016) (“If a proposed amendment would affect a series of a class of shares in one or more of the [specifically enumerated] ways . . . the holders of shares of that series are entitled to vote as a separate voting group on the proposed amendment.”).

<sup>155</sup> See tit. 8, § 222(b) (“[W]ritten notice of any meeting shall be given . . . to each stockholder entitled to vote at such meeting . . . .” (emphasis added)); see also R. FRANKLIN BALOTTI ET AL., MEETINGS OF STOCKHOLDERS, § 9.4 (3d ed., Supp. 2017) (“[T]he determination of whether or not a class vote is required may under applicable state law determine which stockholders are entitled to notice of a meeting.”).

<sup>156</sup> See tit. 8, §§ 204(d), 204(g) (specifying that notice must be given to stockholders “whether voting or nonvoting”).

<sup>157</sup> See tit. 8, § 251(c) (“Due notice of the time, place and purpose of the meeting shall be mailed to each holder of stock, whether voting or nonvoting, of the corporation . . . .” (emphasis added)).

Interestingly, state corporate law does not address whether nonvoting shareholders have a right to attend annual shareholder meetings.<sup>158</sup> The fact that nonvoting shareholders generally do not have a right of notice or a right to vote in shareholder meetings seems to support the conclusion that such shareholders do not have a right to attend.<sup>159</sup> On the flip side, it is unclear whether a nonvoting shareholder plaintiff could ever successfully argue that controlling shareholders or directors breached their duty of candor or disclosure in the event she is barred from attending a shareholder meeting.<sup>160</sup> Directors of corporations with voting shares in the hands of insiders and nonvoting shares in the hands of the public could conceivably dodge annual shareholder meetings if all directors are perpetually elected by unanimous written consent.<sup>161</sup> Although any shareholder may petition the Court of Chancery in an attempt to compel an annual meeting under certain circumstances,<sup>162</sup> a nonvoting shareholder is likely to be unsuccessful under DGCL section 211 if the voting shareholders regularly act by unanimous written consent.<sup>163</sup>

#### 4. Inspection Rights

Likewise, it is unclear whether and to what extent nonvoting stockholders may be entitled to inspection rights, where the burden of proof is on the

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<sup>158</sup> See BALOTTI ET AL., *supra* note 154, § 8.3 (“[O]nly those who have the right to vote at the meeting have an enforceable right to attend the meeting . . . . Others with legitimate interests in the business of the corporation . . . also may be admitted to the meeting. . . . [But] any decision by management to extend admission to others is purely discretionary.”); see also tit. 8, § 228(a) (referencing a hypothetical “meeting at which all shares *entitled to vote* . . . were present” and leaving open the possibility that nonvoting shareholders may be present on a discretionary basis (emphasis added)); Snap Prospectus, *supra* note 102, at 5 (indicating that Snap “will *invite* holders of . . . [nonvoting] common stock to attend [the] annual meeting of stockholders” and implying that such invitation is discretionary rather than mandatory (emphasis added)); cf. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985) (“Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited.”).

<sup>159</sup> Haas & Brewer, *supra* note 22, at 2.

<sup>160</sup> See *supra* note 68 and accompanying text.

<sup>161</sup> See tit. 8, § 211(b) (“Stockholders may . . . act by [unanimous] written consent to elect directors . . .”).

<sup>162</sup> See tit. 8, § 211(c) (“[I]f no date has been designated, for a period of 13 months after . . . [either] its last annual meeting or the last action by written consent to elect directors . . . , the Court of Chancery may . . . order a meeting to be held upon the application of any stockholder or director.”).

<sup>163</sup> See Haas & Brewer, *supra* note 22, at 3 n.22 (“[Section 211] does not specify that the ‘unanimous’ written consent only pertains to the voting stockholders, but that is the natural conclusion because nonvoting stockholders would not be entitled to vote to elect directors if the corporation were to hold an annual meeting.”). On the contrary, section 228 explicitly frames written consent in terms of requisite voting power. See tit. 8, § 228(a) (stating that actions may be taken without a meeting only where a consent is “signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted”). *But cf.* BALOTTI ET AL., *supra* note 155, § 2.10 (“Attempts by companies, even in exceptional circumstances, to avoid annual meetings, have rarely succeeded.”).

corporation to demonstrate that the requesting shareholder has an “improper purpose”<sup>164</sup> or “a purpose not germane to the meeting.”<sup>165</sup> Any shareholder has the statutory right to inspect a company’s books and records “for any proper purpose.”<sup>166</sup> However, the Chancery Court “has wide latitude in determining the proper scope of inspection . . . [and bears] the responsibility of . . . tailor[ing] the inspection to the stockholder’s stated purpose.”<sup>167</sup> All shareholders also have the statutory right to examine the list of shareholders entitled to vote “for any purpose germane to the meeting.”<sup>168</sup> Depending on the facts and circumstances, it is unclear whether a corporation could successfully argue that a nonvoting shareholder does not have a “purpose germane to the meeting” simply because she cannot vote.<sup>169</sup> The best counterargument would be that a nonvoting shareholder would like to examine the shareholder list so she can identify and appeal to the shareholders who *can* vote—including the controlling group.<sup>170</sup>

## 5. Exit Rights

What remains then is the prospect of exit rights.<sup>171</sup> That is, one backstop to severely limited voting rights is the ability of the nonvoting stockholder to sell her shares in the open market—as long as the marketplace for secondary shares is sufficiently liquid. For seasoned companies listed on major exchanges, adequate free float generally supports liquidity in their stocks.

<sup>164</sup> See tit. 8, § 220(c)(3) (“The burden of proof shall be upon the corporation to establish that the inspection such stockholder seeks is for an improper purpose.”).

<sup>165</sup> See tit. 8, § 219(b) (“The burden of proof shall be on the corporation to establish that the examination such stockholder seeks is for a purpose not germane to the meeting.”).

<sup>166</sup> Tit. 8, § 220(b).

<sup>167</sup> Sec. First Corp. v. U.S. Die Casting & Dev. Co., 687 A.2d 563, 569 (Del. 1997); see also tit. 8, § 220(c) (“The Court of Chancery is hereby vested with exclusive jurisdiction to determine whether or not the person seeking inspection is entitled to the inspection sought.”); tit. 8, § 220(c)(3) (“The Court may, in its discretion, prescribe any limitations or conditions with reference to the inspection, or award such other or further relief as the Court may deem just and proper.”).

<sup>168</sup> Tit. 8, § 219(a).

<sup>169</sup> See Haas & Brewer, *supra* note 22, at 4 n.32 (remarking that a “corporation could take the position that the only purpose ‘germane to the meeting’ is voting, and that only a holder of voting stock can have that purpose”). But see 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 7.15 (3d ed. 2018 & Supp. 2018) (“The purpose of a stockholder list is to give stockholders information necessary to making *or influencing* voting decisions . . .” (emphasis added)).

<sup>170</sup> See Magill v. N. Am. Refractories Co., 128 A.2d 233, 237 (Del. 1956) (“Until the polls are closed a stockholder may change his vote, and one stockholder has the right to attempt to persuade another to do so.”).

<sup>171</sup> Cf. Armour et al., *supra* note 38, at 49 (noting that “where share ownership is dispersed in the hands of passive, uninformed investors, . . . appointment and decision rights are less effective, and more work is done by agent incentives” supported by standards of conduct and “disclosure rules to ensure more informed share prices and greater liquidity, which in turn make *exit rights* . . . more effective”).

However, empirical research suggests that shares of dual-class firms may suffer from higher premiums demanded by marketmakers and greater order execution difficulty.<sup>172</sup> It is evident then that exit rights alone are a weak form of protection for shareholders, and more must be done to facilitate liquidity and promote greater market efficiency.<sup>173</sup>

### *B. Other Legal Privileges for Nonvoting Stockholders*

The scope of other legal privileges and entitlements for nonvoting shares stems from various stock exchange rules and federal regulations, most notably securities laws.

#### 1. Stock Exchange Rules

To start, the major stock exchanges in the U.S. mandate that listed companies hold annual shareholder meetings.<sup>174</sup> The NYSE employs additional protections for holders of nonvoting common stock that go beyond the bounds of both state corporate law and federal securities laws. Specifically, the NYSE mandates that listed shares of nonvoting stock “meet all original listing standards”; all rights, apart from voting entitlements, should be “substantially the same” for both nonvoting and voting common stock; and “holders of any listed nonvoting common stock must receive all communications . . . sent generally to the holders of the voting securities of the listed company.”<sup>175</sup> However, the Nasdaq contains no comparable provisions.<sup>176</sup> On the contrary, the Nasdaq has been vocal in advocating for the use of dual-class stock structures.<sup>177</sup>

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<sup>172</sup> See Joonghyuk Kim et al., *Dual-Class Stock Splits and Liquidity* 22 (Apr. 24, 2007) (unpublished manuscript), [https://weatherhead.case.edu/departments/banking-and-finance/Documents/Dual-classstockplits\\_04242007.pdf](https://weatherhead.case.edu/departments/banking-and-finance/Documents/Dual-classstockplits_04242007.pdf) [<https://perma.cc/UGH7-ELCU>] (“[I]nvestors face higher effective spreads, trades have larger price impact, and order execution difficulty increases following dual-class splits.”).

<sup>173</sup> See *supra* note 171.

<sup>174</sup> See NASDAQ STOCK MARKET, LISTING RULES Rule 5620(a) (“Each Company listing common stock or voting preferred stock . . . shall hold an annual meeting of Shareholders no later than one year after the end of the Company’s fiscal year-end . . .”); NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL Rule 302.00 (“Listed companies are required to hold an annual shareholders’ meeting during each fiscal year.”).

<sup>175</sup> NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL, Rule 313.00.

<sup>176</sup> See Haas & Brewer, *supra* note 22, at 3 n.26 (“Nasdaq does not appear to have a comparable rule [to that of the NYSE].”).

<sup>177</sup> See Friedman, *supra* note 29 (noting that Nasdaq believes dual-class structures can be beneficial since they “allow investors to invest side-by-side with innovators and high-growth companies”).

## 2. Federal Laws

Federal securities laws do little to enlarge the rights of nonvoting stockholders, particularly when a company exclusively issues nonvoting stock to the public.<sup>178</sup> Federal securities laws significantly constrain the information rights and entitlements of nonvoting shareholders and even limit legal causes of action and remedies for nonvoting shareholders.

Federal securities laws generally require companies with equity securities registered under section 12 of the Exchange Act to disseminate proxy materials or equivalent information statement when soliciting shareholder action.<sup>179</sup> However, under section 14(c) of the Exchange Act, this mandate is inapplicable to corporations that only register nonvoting common stock.<sup>180</sup> Consequentially, “legal causes of action and remedies under Section 14 . . . for inadequate or misleading information . . . may not be available to holders of [nonvoting] common stock.”<sup>181</sup> Snap Inc., which only issued nonvoting stock to the public, aptly disclosed these issues in its prospectus to investors.<sup>182</sup> Snap Inc. further revealed that material information would be shared with investors through Form 8-K filings *after* corporate actions are taken—rather than through proxy statements or information statements which would otherwise contain more information and be shared *before*

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<sup>178</sup> In other contexts, it is interesting to note that federal regulations prohibit nonvoting shares altogether. The Bankruptcy Reform Act of 1978 prohibits nonvoting shares in reorganized companies. *See* 11 U.S.C. § 1123(a)(6) (2012) (“[A] plan shall . . . provide for the inclusion in the charter of the [corporate] debtor . . . of a provision prohibiting the issuance of nonvoting equity securities . . .”). The Investment Company Act of 1940 prohibits nonvoting shares in registered management companies. *See* 15 U.S.C. § 80a-18(i) (“[E]very share of stock hereafter issued by a registered management company . . . shall be a voting stock and have equal voting rights with every other outstanding voting stock . . .”).

<sup>179</sup> *See generally* 15 U.S.C. § 78n(a)(1) (“It shall be unlawful for any person . . . to solicit . . . any proxy or consent or authorization in respect of any security (other than an exempt security) . . .”).

<sup>180</sup> *See* Exchange Act Rule, 17 C.F.R. § 240.14c-2(a) (“[T]he registrant shall transmit [an information statement] to every security holder of the class that is entitled to vote . . . in regard to any matter to be acted upon . . .” (emphasis added)); *see also* Johnston v. Wilbourn, 682 F. Supp. 879, 883 (S.D. Miss. 1988) (“[S]ection 14(a) applies only to securities registered pursuant to section 12 of the 1934 Act . . .”); R. FRANKLIN BALOTTI ET AL., *supra* note 155, § 4.3 (“Issuers subject to the reporting requirements solely by virtue of having filed a registration statement under the Securities Act of 1933 are not subject to the proxy rules.”).

<sup>181</sup> Snap Prospectus, *supra* note 102, at 40; *see also* J. I. Case Co. v. Borak, 377 U.S. 426, 431 (1964) (stating that Section 14(a) is intended to prevent “management . . . from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation” and to “control the conditions under which proxies may be solicited” to prevent abuses that frustrate the free exercise of stockholders’ voting rights (internal quotations and citations omitted)).

<sup>182</sup> *See* Snap Prospectus, *supra* note 102, at 5 (explaining that because the common stock is nonvoting and the “only class of stock registered under Section 12 of the Exchange Act,” Snap would “not be required to file proxy statements or information statements under Section 14 of the Exchange Act unless a vote of the Class A common stock is required by applicable law”).

corporate actions are taken.<sup>183</sup> This delay in reporting material information can be injurious to investors who may trade shares “after a material event has taken place but before [the company has] disclosed any information about that event.”<sup>184</sup> Snap’s rationale for dissemination of *any* information is perhaps rooted in its desire to discharge its duty of candor or disclosure.<sup>185</sup>

Another cause for alarm is the fact that when a company exclusively issues nonvoting stock to the public, its significant shareholders are exempt from reporting obligations under sections 13(d) and 13(g) of the Exchange Act and can therefore lawfully evade periodic disclosure of beneficial ownership.<sup>186</sup> Further, “significant stockholders, other than directors and officers, are exempt from the ‘short-swing’ profit recovery provisions of Section 16(b) of the Exchange Act.”<sup>187</sup>

In the case of Snap, consistent with Delaware corporate law, nonvoting stockholders are barred from nominating directors and from bringing matters before the annual meeting of shareholders.<sup>188</sup> To make matters worse, nonvoting stockholders are not eligible to submit shareholder proposals under rule 14a-8 of the Securities Exchange Act of 1934.<sup>189</sup>

Furthermore, a corporation that is classified as an “emerging growth company” under the Jumpstart Our Business Startups (JOBS) Act of 2012 may elect to conform with reduced reporting requirements.<sup>190</sup> For example, Snap is not required to have its independent registered public accounting firm audit internal controls over financial reporting under the Sarbanes-Oxley Act, has reduced disclosure requirements regarding executive compensation, and is not required to hold nonbinding advisory votes on

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> *Id.* (indicating that material information would be disclosed “to ensure equal access and fair disclosure”).

<sup>186</sup> See Exchange Act Rule, 17 C.F.R. § 240.13d-1(i) (2018) (“[T]he term ‘equity security’ . . . shall not include securities of a class of non-voting securities.”); see also Snap Prospectus, *supra* note 102, at 40.

<sup>187</sup> Snap Prospectus, *supra* note 102, at 40; see also 15 U.S.C. § 78p(b) (2012) (“[A]ny profit realized by [a director or officer] from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . .”); *Gibbons v. Malone*, 703 F.3d 595, 604 (2d Cir. 2013) (“[W]e hold that an insider’s purchase and sale of shares of different types of stock in the same company does not trigger liability under § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), where those securities are separately traded, nonconvertible, and come with different voting rights.”); Exchange Act Rule, 17 C.F.R. § 240.16b-3 (setting forth conditions by which a transaction between an issuer and its officers or directors would be exempt from Section 16(b)).

<sup>188</sup> See Snap Prospectus, *supra* note 102, at 40 (“[H]olders of our Class A common stock will be unable to bring matters before our annual meeting of stockholders or nominate directors at such meeting . . .”).

<sup>189</sup> See 17 C.F.R. § 240.14a-8(b) (“In order to be eligible to submit a proposal, you must have continuously held at least \$2,000 in market value, or 1% of the company’s securities *entitled to be voted* on the proposal at the meeting for at least one year by the date you submit the proposal.” (emphasis added)).

<sup>190</sup> See Pub. L. No. 112-106, § 101(a)(19), 126 Stat. 306, 309 (codified at 15 U.S.C. §§ 77a(19), 78a note (2012)) (defining an “emerging growth company” as a business with “total annual gross revenues of less than \$1,000,000,000”).

executive compensation under the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010.<sup>191</sup> Further, as long as a company exclusively has publicly traded, nonvoting stock outstanding, it will effectively bypass “say-on-pay” and “say-on-frequency” provisions of Dodd–Frank.<sup>192</sup>

### III. POTENTIAL SOLUTIONS TO ISSUES POSED BY NONVOTING SHARES

Current forms of regulation do not adequately address the problems posed by nonvoting stock. I advocate for the use of a novel multipronged framework for regulating nonvoting stock. Part III explores current and prospective solutions to the issues posed by nonvoting stock. Section III.A canvases approaches that are already in the marketplace and argues that they are deficient. Section III.B advances a new multipronged framework for regulating nonvoting stock.

#### A. *Current Approaches to Regulating Dual-Class Structures*

There are a variety of ways that the current marketplace regulates the use of dual-class shares. Two forms of regulation, namely sunset provisions and guaranteed minimum board seat representation, are supported by private ordering arguments since corporate stakeholders—rather than an external regulating body—determine the capital structure. Other approaches include notions of requiring nonvoting stock to be a form of preferred stock with some type of cash flow preference and prohibiting dual-class companies from participating in stock market indices. These last two forms of regulation are supported by arguments favoring some manner of external regulation.

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<sup>191</sup> Snap Prospectus, *supra* note 102, at 40, 44.

<sup>192</sup> See Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899 (2010) (codified at 15 U.S.C. § 78n-1 (2012)); 17 C.F.R. § 240.14a-21; Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Exchange Act Release No. 33-9178, 100 SEC Docket 868 (Jan. 25, 2011); Paresch Dave, *Snap Says Shareholders Won't Have a 'Say on Pay' for Executives*, L.A. TIMES (Feb. 9, 2017 6:40 AM), <http://www.latimes.com/business/la-fi-live-updates-snap-ipo-snap-says-shareholders-won-t-have-a-1486650128-htlmstory.html> (“[S]hares with no votes are not subject to federal proxy rules designed to give shareholders a say in corporate matters . . . .”); Haas & Brewer, *supra* note 22, at 1-2 (“[H]olders of nonvoting shares cannot vote on . . . corporate governance matters, including say-on-pay votes . . . .”). In the case of Alphabet, which has a tripartite class structure, for example, nonvoting stock does not participate in such advisory votes. See Alphabet Inc., Proxy Statement (Schedule 14-A) at 7 (Apr. 28, 2017) (indicating that “[h]olders of Class C capital stock have no voting power as to any items of business that will be voted on at the Annual Meeting” and that say-on-pay vote and say-on-frequency votes shall be held at the Annual Meeting).

### 1. Mandate Sunset Provisions for Dual-Class Companies

One potential solution to regulating dual-class structures concerns mandating the use of “sunset provisions.” Sunset arrangements only permit dual-class structures for a set definite amount of time—subject to potential extensions and certain triggering events.<sup>193</sup> Examples of companies that adopted fixed duration sunset provisions as of their IPOs include Fitbit, Groupon, Kayak, and Yelp.<sup>194</sup> Advocates for sunset provisions argue that “even if a dual-class structure were to be efficient at the time of the IPO, it would likely become inefficient many years down the road.”<sup>195</sup> In other words, a reduction in efficiency of dual-class companies over time necessitates the use of “finite-life” structures vis-à-vis “perpetual” arrangements at the IPO stage.<sup>196</sup> To allow for flexibility, the duration of dual-class structure could be extended if approved by a majority of the shareholders unaffiliated with the controller.<sup>197</sup>

A second form of sunset provision in the marketplace is a “triggering-event sunset” which mandates common stock unification from a dual-class structure into a unitary class upon the occurrence of a stipulated event, “such as the founder’s disability, death, or reaching of retirement age.”<sup>198</sup> Examples of companies that adopted triggering-event sunset provisions as of their IPOs include Google, Groupon, LinkedIn, and Zynga.<sup>199</sup> These arrangements implicitly support the contention that healthy founders ought to run the business for the foreseeable future.

A third form of sunset provision is called an “ownership-percentage sunset” which mandates common stock unification into a single-class structure when a controller crosses a certain predetermined ownership percentage.<sup>200</sup> Examples of companies that adopted such provisions include LinkedIn and Zynga.<sup>201</sup> These arrangements support the view that a controller ought to maintain a baseline level of economic interest to maintain sufficient “alignment of interest” with public investors.<sup>202</sup> In practice, these provisions are largely symbolic in nature because thresholds are often set too low.<sup>203</sup>

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<sup>193</sup> See Bebhuk & Kastiel, *supra* note 21, at 601-02 (defining sunset provisions as mechanisms that make the life of a dual-class structure finite).

<sup>194</sup> *Id.* at 618.

<sup>195</sup> *Id.* at 601.

<sup>196</sup> *Id.*

<sup>197</sup> *Id.* at 601-02.

<sup>198</sup> *Id.* at 619.

<sup>199</sup> *Id.* at 619 n.98.

<sup>200</sup> *Id.* at 620.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> *Id.* Recall that a controller of high-vote stock entitled to ten-to-one voting rights can hold 9.1% of the total number of shares to secure majority control. See *supra* note 14 and accompanying

Both “triggering-event sunsets” and “ownership-percentage sunsets” can be useful in conjunction with other regulations. However, mandating plain vanilla sunset provisions with fixed dual-class durations is problematic. It is difficult to identify the efficiency “sweet spot” for how long a company ought to maintain a dual-class structure *ex ante*. A collective action problem arises *ex post* when shareholders unaffiliated with the controller are allowed to vote to extend the company’s unification date. This is because an individual shareholder may believe it is in the best interests of the corporation to maintain a dual-class structure but may nonetheless vote to empower herself by voting against an extension. Additionally, in a tripartite class company, like Alphabet or Blue Apron, it is unclear whether unaffiliated low-vote shareholders and nonvoting shareholders ought to be treated the same or differently for voting purposes. Further, voting on extensions could lead to concerns of empty voting.<sup>204</sup> For example, shrewd shareholders can borrow shares just prior to the record date and unwind their shares immediately following the record date so that they can vote while maintaining no economic interest.

## 2. Guarantee a Minimum Level of Board Representation for Low-Vote Stockholders

An alternative approach is to have a certain fixed percentage of board seats determined by shareholders who hold nonvoting stock or low-voting stock. This would at least give low-voting or nonvoting shareholders a dissenting voice on the board of directors even if their nominees would always get overruled on matters voted upon by the board.

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text. If a threshold is set at 9%, it will have no bearing on majority voting control, but will still substantially impact voting power once triggered. Consider the same hypothetical firm discussed previously: there are 1,000,000 shares of common stock, consisting of 90,910 high-vote shares entitled to 10 votes per share and 909,090 low-vote shares entitled to 1 vote per share. The 90,910 high-vote shares are entitled to 909,100 votes whereas the 909,090 low-vote shares are entitled to 909,090 votes. The high-vote shares, representing just 9.1% of the total number of shares, would secure voting majority control. Now, consider an ownership-percentage sunset provision set at 9%. This means that if the controller fails to own at least 90,000 shares, its high-vote shares will be converted to low-vote shares. Assume that the controller’s holdings of high-vote shares fall to 89,999 shares (representing 899,990 votes) and the public’s holdings of low-vote shares rise to 910,001 shares (representing 910,001 votes). At this point, the controller would have retained approximately 49.7% voting power and fallen short of majority control. However, with this ownership-percentage sunset provision, the controller’s shares would be converted to the same type of shares that the public enjoys, and her voting power would fall to just under 9%. In either case, with or without this ownership-percentage sunset provision, the controller would not have majority voting control. A low threshold is seen as ineffective since the controller already has a strong disincentive to go below 9.1%. Table 2 in the Appendix presents these numbers and percentages.

<sup>204</sup> See generally Henry T.C. Hu & Bernard S. Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) (discussing issues where investors hold disproportionately more votes than their economic interest as well as situations where investors possess the ability to acquire votes when needed).

For example, Beasley Broadcast Group, Inc. has a novel dual-class structure whereby Class A stock is entitled to one vote per share and Class B stock is entitled to ten votes per share with respect to all matters subject to a stockholder vote—with one notable exception.<sup>205</sup> The one voting exception is remarkable: all common stock holders are entitled to vote on eight of ten board seats whereas *only* the low-vote Class A stockholders are entitled to vote on the remaining two board nominations.<sup>206</sup> This fascinating structure accomplishes two things: it expressly guarantees low-vote stockholders to vote on 20 percent of the board of directors<sup>207</sup> and effectively increases the ownership threshold for a controller to maintain majority control.<sup>208</sup> When used in conjunction with low-voting stock, this mechanism is functionally similar to ownership-percentage sunset provisions, except that the “trigger” only relates to voting in the context of director elections and not voting in all general corporate matters.<sup>209</sup> Beasley Broadcast Group, Inc. appears to be unique in that only low-vote stock is entitled to a minimum fixed percentage of board seats with the potential for even greater representation.<sup>210</sup>

In the case where the low-vote stock is generally nonvoting except for directorial elections, such a structure would only guarantee a fixed percentage of board seats, but have no bearing on the ownership threshold for a controller to maintain majority control.<sup>211</sup> This same result is achieved if the corporation

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<sup>205</sup> Beasley Broadcast Group, Inc., Proxy Statement (Schedule 14-A) at 17 n.3 (Apr. 28, 2017).

<sup>206</sup> *Id.* at 1.

<sup>207</sup> *Id.*

<sup>208</sup> Recall that a controller of high-vote stock entitled to ten-to-one voting rights can hold 9.1% of the total number of shares to secure majority control. *See supra* notes 14 and 203 and accompanying text. Consider a new hypothetical firm with 1,000,000 shares of common stock, consisting of 230,770 high-vote shares entitled to ten votes per share and 769,230 low-vote shares entitled to 1 vote per share. Additionally, assume that there are 10 board seats and the dual-class structure is modified such that all shareholders can vote on eight seats and only low-vote shareholders can vote on the remaining two seats—just like Beasley Broadcast Group. The 230,770 high-vote shares are entitled to 2,307,700 votes whereas the 769,230 low-vote shares are entitled to 769,230 votes. The high-vote shares would represent approximately 23.1% of the firm’s cash flow rights and secure just over 75.0% of the firm’s voting rights over general corporate matters. Here, high-vote stockholders could guarantee six of ten board seats (i.e., 75% of eight board seats for which all shareholders can vote) and the low-vote stockholders would control the remaining four board seats (i.e., the two guaranteed board seats, plus 25% of the eight board seats). This means that a controller would need to own 23.1% of outstanding shares—as compared to 9.1% of outstanding shares absent such a rule—to maintain board control.

<sup>209</sup> *See supra* notes 200–202 and accompanying text.

<sup>210</sup> Although it is impossible to prove a negative, this descriptive statistic was based on an analysis of CII’s comprehensive dataset of Dual Class Companies. *See Dual Class Companies List, supra* note 100.

<sup>211</sup> Consider an extreme hypothetical firm with 1,000,000 shares of common stock, consisting of just one high-vote “golden share” entitled to one vote per share and 999,999 low-vote shares entitled to no votes per share. *See Golden Share*, INVESTOPEDIA, <https://www.investopedia.com/terms/g/goldenshare.asp> [<https://perma.cc/T35C-M9ZD>] (defining a “golden share” as “[a] type of share that gives its shareholder veto power over changes to the company’s charter”). The one high-vote share, mathematically representing just one-millionth of the total shares outstanding, would

chooses to affix the percentage of board seats for both the low-vote and high-vote classes' stock. In fact, at least nine public companies have this sort of arrangement, including The Madison Square Garden Co., The New York Times Company, Nike, and Scholastic.<sup>212</sup> These mechanisms are functionally similar to what we observe with cumulative voting arrangements.<sup>213</sup> The justification for their use is also identical: enable minority shareholders to have directorial representation on the board despite the presence of a controller.<sup>214</sup> Establishing a minimum fixed percentage of board seats to be determined by nonvoting shares and employing a voting arrangement like that of Beasley Broadcast can be tremendously useful for nonvoting shareholders to have board member influence.

### 3. Require Nonvoting Shares to Have Certain Liquidity Rights

Another potential solution is to mandate that nonvoting shares have at least *some* sort of liquidity preference vis-à-vis voting common stock to compensate shareholders for giving up their votes. Preferential shares are generally seen as a hybrid security with debt- and equity-like characteristics.<sup>215</sup> There can be a wide variety of rights and entitlements for preferred shares.<sup>216</sup>

Preferred stockholders may be given a priority claim on cash flows in the event a company declares and pays a dividend or distributes assets to shareholders.<sup>217</sup> In this way, preferred shares are entitled to preferential dividend rights and senior claims on assets in the event of a liquidation

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secure 100% voting control. Again, assume that there are ten board seats and the dual-class structure is modified such that all shareholders can vote on eight seats and only low-vote shareholders can vote on the remaining two seats. The controller's one "golden share" could guarantee eight of ten board seats (i.e., 100% of eight board seats) and the low-vote stockholders would control the remaining two board seats (i.e., the two guaranteed board seats, plus 0% of the eight board seats).

<sup>212</sup> This descriptive statistic was also based on a computational analysis of CII's compiled raw data. See *Dual Class Companies List*, *supra* note 100.

<sup>213</sup> Under cumulative voting, each shareholder may cast a total number of votes equal to the number of voting shares she owns multiplied by the total number of director seats open for election. There is just one vote en masse—rather than voting for each director one by one. Candidates who get the most votes win. The majority cannot outvote minority voters for *every* director. *Cumulative Voting*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/fast-answers/answers-cumulativevotehtm.html> [<https://perma.cc/PNP5-XQJU>] (last updated Oct. 14, 2014).

<sup>214</sup> See *id.* ("Cumulative voting is a type of voting system that helps strengthen the ability of minority shareholders to elect a director.").

<sup>215</sup> See *Preferred Stock*, FIDELITY INV., <https://www.fidelity.com/learning-center/investment-products/stocks/preferred-stock> [<https://perma.cc/R35C-JGWU>] (noting that preferred stock "has investment performance characteristics that could combine some degree of exposure to both equity and debt of a particular issuer").

<sup>216</sup> See *id.* ("The exact terms of preferred shareholders' economic preference may vary from company to company.").

<sup>217</sup> See *id.* ("Preferred shares . . . give their owners a priority claim whenever a company pays dividends or distributes assets to shareholders.")

event.<sup>218</sup> In the event that the company fails to pay a preferred dividend, “the preferred stockholders generally gain some voting rights, so that the common stockholders are obliged to share control of the company with the preferred holders.”<sup>219</sup> Furthermore, “[d]irectors are also aware that failure to pay the preferred dividend earns the company a black mark with investors, so they do not take such a decision lightly.”<sup>220</sup>

Alternatively, in the case of “convertible preferred stock,” the holder has the option to convert their preferential shares into common shares of the company.<sup>221</sup> If the firm underperforms or runs into financial trouble, then preferred stockholders will preserve their security and retain their senior claim on the company’s assets in relation to the common stockholders. If the firm performs well, then preferred stockholders will choose to convert their investment into ordinary common stock and enjoy the upside in valuation. In other words, preferred stockholders will only exercise the conversion option embedded in their security if it is economical to do so.<sup>222</sup>

Interestingly, many countries in continental Europe have implemented restrictions on dual-class structures.<sup>223</sup> First, nonvoting publicly traded common stock is prohibited in a majority of all OECD countries.<sup>224</sup> Instead, nonvoting preference shares are generally permitted in most OECD countries except for a few countries of northern Europe.<sup>225</sup> Again, a holder of such financial instruments “obtains voting rights only in extreme circumstances such as neglect of the preferential rights or bankruptcy proceedings against the issuer.”<sup>226</sup> For example, Germany allows nonvoting preferred shares with preferential dividend cash flow rights “to compensate for the absence of voting rights.”<sup>227</sup> Many countries that prohibit nonvoting common shares and permit nonvoting preferential shares, however, still

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<sup>218</sup> See JONATHAN BERK & PETER DEMARZO, *CORPORATE FINANCE* 810 (3d ed. 2014) (“Preferred stock . . . usually has a preferential dividend and seniority in any liquidation . . .”).

<sup>219</sup> RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, *PRINCIPLES OF CORPORATE FINANCE* 350 (10th ed. 2011).

<sup>220</sup> *Id.*

<sup>221</sup> See BERK & DEMARZO, *supra* note 218, at 810 (“[T]his preferred stock usually gives the owner an option to convert it into common stock on some future date, so it is often called convertible preferred stock”).

<sup>222</sup> *Id.*

<sup>223</sup> See generally OECD STEERING GRP. ON CORP. GOVERNANCE, *LACK OF PROPORTIONALITY BETWEEN OWNERSHIP AND CONTROL: OVERVIEW AND ISSUES FOR DISCUSSION* (2007), <http://www.oecd.org/daf/ca/corporategovernanceprinciples/40038351.pdf> [<https://perma.cc/S4XY-P9KU>] (analyzing restrictions on multiple share classes and voting entitlements across member countries of the Organisation for Economic Co-operation and Development (OECD)).

<sup>224</sup> See *id.* at 15 (“[T]he 17 countries that do not allow such shares are mostly the ones that prohibit either multiple-class/differentiated voting right shares or non-voting preference shares.”).

<sup>225</sup> See *id.* (finding that only three OECD member countries prohibit nonvoting preference shares—Denmark, Netherlands, and Sweden).

<sup>226</sup> *Id.*

<sup>227</sup> Bebchuk & Kastiel, *supra* note 21, at 600 n.50.

impose restrictions on the percentage of equity capital that may be represented by preferential shares.<sup>228</sup>

In some sense, apart from having a liquidity preference, nonvoting preferred shares are not functionally dissimilar from triggering-event sunset provisions, except that the “trigger” relates to the financial health of the firm’s operations rather than the physical and mental health of the firm’s controller.<sup>229</sup> Mandating that low-voting public common stock receive some form of liquidity preference is too severe, as it would completely halt the use of dual-class structures which must be considered in the broader context of private companies choosing to remain private for longer.<sup>230</sup>

#### 4. Prohibit Dual-Class Companies from Participating in Stock Market Indices

One solution implemented by stock market index providers has been to exclude new issuers of dual-class stock from participating in their market indices. The FTSE Russell indices proposed in 2017 that “companies that have 5% or less of their voting rights in the hands of unrestricted shareholders . . . have their securities rendered ineligible for index inclusion.”<sup>231</sup> This measure appeared to be aimed directly at Snap Inc. given that its public shareholders had no voting power.<sup>232</sup> Similarly, the S&P Dow Jones Indices announced in 2017 that the S&P Composite 1500<sup>®</sup> and component indices, including the widely recognized S&P 500 index, will no longer include dual-class companies on a prospective basis.<sup>233</sup>

Clearly, these exclusions are intended to have a deterring effect. As one news commentator put it, “[j]oining the Standard & Poor’s 500—an index of

<sup>228</sup> See *id.* at 621 n.103 (“The size of the cap varies from jurisdiction to jurisdiction. It is 33% of the company equity capital in Belgium and Estonia; 40% in Greece; and 50% in Germany, Luxembourg, and Spain.”).

<sup>229</sup> See *supra* notes 199–200 and accompanying text.

<sup>230</sup> See *supra* note 29 and accompanying text.

<sup>231</sup> FTSE Russell *Voting Rights Consultation—Next Steps*, FTSE RUSSELL 3 (July 2017), [http://www.ftse.com/products/downloads/FTSE\\_Russell\\_Voting\\_Rights\\_Consultation\\_Next\\_Step\\_s.pdf](http://www.ftse.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Step_s.pdf) [<https://perma.cc/Z7E3-ZDWU>].

<sup>232</sup> See Ross Kerber & Noel Randewich, *FTSE Russell to Exclude Snap from Stock Indexes over Voting Rights*, REUTERS (July 26, 2017 4:39 PM), <https://www.reuters.com/article/us-snap-russell/ftse-russell-to-exclude-snap-from-stock-indexes-over-voting-rights-idUSKBN1AB2TW> (indicating that the CEO of FTSE Russell believed that “voting rights are an important issue” and proclaimed that “[s]hareholders won’t be able to hold boards accountable if they don’t have voting rights”).

<sup>233</sup> Press Release, S&P Dow Jones Indices, S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules (July 31, 2017), [https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162\\_spdjmulti-classsharesandvotingrulesannouncement7.31.17.pdf](https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162_spdjmulti-classsharesandvotingrulesannouncement7.31.17.pdf) [<https://perma.cc/5PRG-EPHC>]. Existing multiple-class companies were “grandfathered in.” *Id.* Snap Inc., however, was excluded. See e.g., Anita Balakrishnan, *Snap Is Falling Again as Wall Street Worries About the Company’s Corporate Structure*, CNBC (Aug. 31, 2017, 11:55 AM), <https://www.cnbc.com/2017/08/01/snapchat-excluded-from-sp-500-what-does-it-mean.html> [<https://perma.cc/TQ4R-VL6T>] (“The [exclusion] prevents Snap from being included in most major S&P indexes.”).

the nation's biggest and most popular stocks—has long been an important mark of validation for businesses. It signals that a company has ascended to corporate America's elite and boosts its share price by about 5%.”<sup>234</sup>

However, consider a controlling shareholder–founder of a large private enterprise that is contemplating the implementation of a dual-class structure upon IPO, but is also absolutely insistent that her company is included in a major stock market index. She could consider a tripartite class structure like Alphabet or Blue Apron such that five percent of voting power is in the hands of the public and become eligible for the Russell 3000 index but not the S&P 500 index. Alternatively, she could abandon her plans of installing a dual-class structure but implement a poison pill and classified board instead. Such defensive measures would still provide incredibly strong antitakeover protection without jeopardizing stock market index participation.<sup>235</sup> It is apparent then that these stock market index policy measures are too blunt a tool since they can be easily circumvented. Index provider policy measures are an inferior solution to issues posed by dual-class structures as compared to more systematic forms of regulation which could be imposed through state corporate law and federal securities regulation.

It is evident then that current forms of regulation do not adequately address the problems posed by nonvoting stock.

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<sup>234</sup> Paresh Dave & Ethan Varian, *S&P 500 Will Exclude Snap Because Its Stock Gives New Shareholders No Power*, L.A. TIMES (Aug. 1, 2017, 1:55 PM), <http://www.latimes.com/business/hollywood/la-fi-snap-sp-20170801-story.html>.

<sup>235</sup> For an example of this kind of strategizing, see generally *Air Prods. and Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 57 (Del. 2011), in which the court recognized substantive coercion as a legally cognizable threat despite the fact that its stockholders were “sophisticated” and could make an informed decision concerning a tender offer; the court then allowed the use of a poison pill in combination with a staggered board as an acceptable defensive action for purposes of the two-part *Unocal* test. See also *Third Point LLC v. Ruprecht*, No. CIV.A. 9469-VCP, 2014 WL 1922029, at \*21-22 (Del. Ch. May 2, 2014) (recognizing the potential for negative control at low ownership levels as a legally cognizable threat to justify the adoption of a poison pill as a proportionate response under *Unocal* and finding that shareholder disenfranchisement claims under *Blasius* will fail when any impact on electoral rights is incidental to the board's defensive action). However, David J. Berger of Wilson Sonsini Goodrich & Rosati has argued that there is an essential difference between companies that adopt both a poison pill and staggered board and companies that employ dual-class structures. Namely, the former type of company can still succumb to short-termism in an effort to keep activist investors at bay during two years of proxy fights. The latter type of company is free to pursue long-term objectives at the expense of short-term financial performance without risk of shareholder retribution. See Lowell Milken Institute for Business Law and Policy, *Corporate Governance and Founder Control Panel*, YOUTUBE (Mar. 9, 2018), <https://www.youtube.com/watch?v=TugLT2qQHZ4> [<https://perma.cc/6FQR-U6VP>] (“To be clear, the appeal in a staggered board isn't even close to what dual-class stock provides.”).

### B. *Unimplemented Novel Approaches to Regulating Nonvoting Shares*

Given recent decisions where Delaware has recognized the theory of efficient capital markets in the appraisal rights context and principle of shareholder ratification in the fiduciary duty context, it is especially important that shareholder voting rights be fortified—and enlarged in the case of nonvoting shares altogether.<sup>236</sup> I advance a new multipronged framework for regulating dual-class structures and nonvoting stock. Broadly speaking, effective regulations ought to enlarge voting powers or enlarge fiduciary protections in certain contexts. In order from least invasive to most forceful, federal securities laws could enable nonvoting shares to cast nonbinding votes; state corporate laws ought to legally mandate that nonvoting shareholders have a right to attend annual meetings in an observer capacity; state courts should impose a heightened standard of judicial review for companies with dual-class structures to encourage the use of procedures that empower shareholder votes; and nonvoting shares ought to have additional voting rights in some specific contexts as a matter of positive law.

#### 1. Enable Nonvoting Shares to Cast Nonbinding Votes

One means of regulating nonvoting shares is to allow for nonbinding votes—recorded and disclosed just like any other votes. This device is similar to the “say-on-pay” and “say-on-frequency” provisions of Dodd–Frank, which are nonbinding.<sup>237</sup> This would entitle nonvoting shareholders to cast a protest vote and enable them to broadcast strong signals of dissent to controllers and the marketplace in general.<sup>238</sup> A nonbinding vote of nonvoting shareholders may help to discipline controlling shareholders and directors, to reduce agency costs and monitoring costs of directors by shareholders, and to assure that the board remains responsive to shareholder interests.<sup>239</sup>

#### 2. Enable Observer Rights and Information Access

Another form of regulation would be to legally permit nonvoting shareholder participation in annual meetings in terms of observer rights and

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<sup>236</sup> See *supra* notes 71 and 78 and accompanying text.

<sup>237</sup> See *supra* notes 192 and accompanying text.

<sup>238</sup> See Ronald Orol, *Activist Investors Target Snapchat Parent Snap over Non-Voting IPO Shares*, THESTREET (Feb. 8, 2017, 8:51 PM), <https://www.thestreet.com/story/13993165/1/insurgents-rail-against-snap-over-non-voting-ipo-shares.html> [<https://perma.cc/V7HY-D8L2>] (“Activist hedge funds can . . . target dual-class companies with unequal voting structures by nominating director candidates in the hopes that a large vote of the noninsider shareholders will back their nominees, sending an embarrassing message to the company that change is needed. *However, companies with nonvoting shares will be impervious . . .*” (emphasis added)).

<sup>239</sup> See *supra* notes 28, 46–47 and accompanying text.

minimum information rights. Shareholders ought to be able to evaluate a company and its management team.

One rationale for allowing dual-class structures is that “nonvoting shares can be used to allocate voting power to informed investors who value their voting rights.”<sup>240</sup> If one is to accept this argument, nonvoting shareholders ought to have the ability to inform themselves, so they can choose among voting shares, nonvoting shares, or no shares at all. Appropriate disclosure underpins the duty of candor,<sup>241</sup> securities fraud regulation,<sup>242</sup> and recent Delaware doctrinal developments revealed in *MFW* and *Corwin*.<sup>243</sup>

### 3. Impose a More Stringent Standard of Review for Dual-Class Companies to Encourage “One Share, One Vote” Voting in Specific Contexts

Practitioners and academics have recently suggested that state courts could modify their judicial standards of review for dual-class companies.<sup>244</sup> As previously explored in Part I, fiduciary duties and voting power are two primary mechanisms by which common stockholders are protected by state corporate law, and there is a strong interplay between judicial standards of review for fiduciary duty allegations and degree of shareholder protection.

Specifically, Professor Albert H. Choi argues that courts ought to apply a heightened standard and determine whether it is more likely than not that a controlling shareholder made decisions for private benefits rather than for the benefit of the corporation as a whole.<sup>245</sup> When applying such a heightened scrutiny standard, Professor Choi asserts that “at least two factors should come into play. First is whether the separation of control from cash flow rights is

<sup>240</sup> Lund, *supra* note 136, at 5.

<sup>241</sup> See *supra* note 68 and accompanying text.

<sup>242</sup> See Exchange Act Rule, 17 C.F.R. § 240.10b-5 (2018) (“It shall be unlawful for any person . . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading . . . in connection with the purchase or sale of any security.”).

<sup>243</sup> See *supra* notes 71–75 and accompanying text.

<sup>244</sup> See e.g., Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53, 74 (2018) (“[L]egal mechanisms, such as dual class, stock pyramids, and cross ownership, should be subjected to heightened judicial scrutiny . . . .”); Haas & Brewer, *supra* note 22, at 4 (“[One] interesting question is whether conditioning an interested transaction on, among other things, the approval of a majority of the outstanding nonvoting shares would cause a court to invoke the business judgment rule.”); Moloney, Sullivan & Sachar, *supra* note 22, at 13 (“In the end, however, Snap may have substituted one nuisance for another: frequent and protracted litigation under potentially heightened judicial scrutiny.”).

<sup>245</sup> See Choi, *supra* note 244, at 79 (“To the extent that decisions made or dictated by a controlling shareholder have a higher probability of being for personal benefit rather than for the corporation as a whole and that there is a strict separation between control rights and cash-flow rights under dual class structure, one possibility is for the courts to apply a heightened standard . . . in reviewing the transactions.”).

extreme . . . . Second, an emphasis should be put on the long-term return for the minority shareholders and for the firm as a whole.”<sup>246</sup> While theoretically thorough, implementing this type of heightened scrutiny is likely to be problematic for a Delaware court. What does it mean for the wedge between voting rights and cash flow rights to be “extreme”?<sup>247</sup> This sort of standard unsoundly introduces line-drawing problems, and a court of equity is unlikely to adopt hard and fast rules to do justice. How will a court determine “whether the firm has in fact produced value in the long run”?<sup>248</sup> This invites a battle of experts to make arguments around what the appropriate industry benchmarks are and what the correct performance metrics are.<sup>249</sup> Further, is “value” purely financial in nature or is there scope to consider nonfinancial interests<sup>250</sup> as well as the impact on other constituents?<sup>251</sup> Delaware courts are more equipped to grapple with issues of process and procedure rather than disputes over substance when creating new common law.<sup>252</sup> A heightened standard of review is nonetheless warranted in the dual-class company context.

Practitioner James Moloney of Gibson Dunn has focused on different aspects of heightened judicial scrutiny and argued that

[w]hile the presence of non-voting shares does not itself preclude a review under the business judgment standard, it seems one practical effect of Snap’s voting structure is that it may deprive the Company of the basic mechanisms and tools to implement procedural safeguards, such as subjecting a proposed

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<sup>246</sup> *Id.* at 79-80.

<sup>247</sup> *Id.* at 79.

<sup>248</sup> *Id.* at 80.

<sup>249</sup> *Cf.* LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* 68 (2012) (“‘Heterogeneous expectations’ asset-pricing models (which differ from conventional financial-pricing models by assuming, realistically, that people disagree about the future) also suggest a number of ‘financial engineering’ tricks that short-term investors can push corporate managers to adopt to raise share price without improving long-term performance.”).

<sup>250</sup> See generally Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 249, 270 (2017) (arguing that “shareholder welfare is not equivalent to market value” and concluding that “[o]ne way to facilitate [welfare maximization] is to let shareholders vote on the broad outlines of corporate policy”). Applying the Hart & Zingales framework to companies with dual-class structures presents a dilemma: if welfare maximization is achieved by allowing shareholders to vote on corporate policies, then companies that deviate from “one share, one vote” cannot achieve welfare maximization.

<sup>251</sup> Compare *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (allowing directors in a hostile takeover battle to consider “the impact on ‘constituencies’ other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)”), with *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176 (Del. 1986) (“[W]hile concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the stockholders.”).

<sup>252</sup> This assertion is consistent with the business judgement rule presumption, the burden shifting mechanism of *Kahn v. Lynch*, and the standard of review shifting mechanism of both *MFW* and *Corwin*.

transaction to a vote of the minority public shareholders (e.g., ‘majority-of-the-minority’ approval). Such mechanisms would help shield some future business decisions from heightened judicial scrutiny.<sup>253</sup>

On the contrary, however, I argue that nonvoting shareholders could introduce procedural safeguards in an attempt to comply with *MFW* and secure business judgement review in the context of controlling shareholder transactions. As a strict matter, *MFW*—not *Corwin*—ought to apply to corporations with dual-class structures.<sup>254</sup> A blockholder with high-vote stock that has majority voting rights and a less-than-majority cash flow rights will always satisfy the definition of “controlling shareholder.”<sup>255</sup> Recall, *MFW* shifts the standard of review from entire fairness to business judgment when a merger is conditioned upon the “approval of [both] an independent, adequately-empowered Special Committee . . . and the uncoerced, informed vote of a majority of the minority stockholders.”<sup>256</sup> Thus, dual-class companies must *replicate* both of these protective measures.

First, starting with the “majority-of-the-minority” provision, I argue that the *relevant* shareholder vote would be based on a majority of *all* shares across *all* classes of common stock, including nonvoting shares, adjusted for economic rights and unweighted for voting power. In this manner, “one share, one vote” would be implemented in specific conflicted or defective transaction contexts faced by a dual-class company. As long as the controller would not have control under a “one share, one vote” methodology, the controller could participate in the vote on equal terms such that cash flow

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<sup>253</sup> Moloney, Sullivan & Sachar, *supra* note 22, at 12.

<sup>254</sup> In determining whether *Corwin* or *MFW* applies, the threshold question is whether the transaction involves a controlling shareholder. *See generally*, Steven M. Haas & Meghan Garratt, *The Importance of Alleging Control: Between Corwin and MFW*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Apr. 19, 2018), <https://corpgov.law.harvard.edu/2018/04/19/the-importance-of-alleging-control-between-corwin-and-mfw/#more-106215> [<https://perma.cc/J77G-LLGW>] (“If [a party is] deemed a controlling stockholder, then it would trigger heightened judicial scrutiny and require certain additional deal procedures to qualify for business judgment rule protection.”).

<sup>255</sup> A “controlling stockholder” is one who either controls a majority of a corporation’s voting power or wields “a combination of potent voting power and management control such that the stockholder could be deemed to have effective control of the board without actually owning a majority of stock.” *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 307 (Del. 2015). For a minority blockholder, the inquiry is highly fact intensive, and one must not conflate mere influence with control. The percentage ownership for a less-than-majority shareholder is not dispositive. *Compare In re Rouse Properties, Inc.*, C.A. No. 12194-VCS, 2018 WL 1226015, at \*1 (Del. Ch. Mar. 9, 2018) (finding a 33.5% blockholder to not be a controller) *with In re Tesla Motors, Inc. Stockholder Litig.*, C.A. No. 12711-VCS, 2018 WL 1560293, at \*1 (Del. Ch. Mar. 28, 2018) (finding a 22.1% shareholder to be a controller). A court will also consider whether a minority blockholder could exercise veto rights and secure negative control when bylaws provide for supermajority voting requirements. *Id.* at \*15.

<sup>256</sup> *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014).

rights would align with voting entitlements for the purposes of such a vote.<sup>257</sup> If the controller would still retain control under a “one share, one vote” methodology, the rule would revert to a majority-of-minority or majority-of-unaffiliated regime. Furthermore, the voters would have to be uncoerced and informed so there would be need for adequate disclosure. In the case of nonvoting stock, such disclosure would have to be consistent with proxy statement admissions rather than minimal Form 8-K filings, even if it went beyond the information to which stockholders would otherwise be entitled.<sup>258</sup> Second, moving on to the “adequately empowered Special Committee,” I argue that director independence could be achieved if the low-vote or nonvoting shareholders were empowered to elect a certain proportion of directors.<sup>259</sup> This would encourage dual-class companies to empower such shareholders to have directorial representation on the board, and these directors would form the basis for the Special Committee.

I believe these two implementations could successfully *reproduce* the protective devices evinced by *MFW*. Although the business judgment rule review may seem to harm shareholders, it would benefit them on the whole since they would become empowered to make their own decisions in all sorts of conflicted transactions. This judicially imposed form of regulation would encourage—but not necessarily require—shareholder voting empowerment.

#### 4. Expressly Mandate “One Share, One Vote” Voting in Specific Contexts

Next, I argue that “nonvoting shares” ought to have additional voting rights in some specific contexts mandated by positive law rather than stipulated by a corporation’s articles of incorporation. Specifically, “nonvoting shares” ought to have additional voting rights in fundamental transactions where the fear is heightened that a controller lacks appropriate incentives given the wedge between his voting rights and his cash flow rights. Under Delaware corporate law, nonvoting shareholders are not entitled to vote in the event of dissolution, mergers, consolidations, or substantial sales of assets.<sup>260</sup> Using a contractarian argument, shareholders of dual-class companies agreed to low-vote or nonvoting stock on the premise that the controlling founders have the unique skills to manage the enterprise and that the multiclass structure protects shareholders when there is a risk of influence from outside investors.<sup>261</sup> However, upon a proposed sale of control to a third-party acquirer

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<sup>257</sup> This is contrary to majority-of-minority or majority-of-unaffiliated voting schemes.

<sup>258</sup> See *supra* note 185 and accompanying text.

<sup>259</sup> See *supra* notes 205–214 and accompanying text.

<sup>260</sup> See *supra* notes 42–44 and accompanying text.

<sup>261</sup> When Google settled its shareholder litigation concerning its stock recapitalization plan, Chancellor Strine, in approving the settlement, adopted a contractarian view and said, “[T]he

these presumptions are no longer valid. Once a company is for sale, this should not only trigger *Revlon* duties for directors but should also trigger voting rights for nonvoting shareholders. In other words, “the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.”<sup>262</sup>

#### CONCLUSION

The voting rights of common stockholders have been gerrymandered through the use of dual-class stock structures which reshuffle voting entitlements and drive a wedge between voting rights and cash flow rights. The extreme case of nonvoting common stock amounts to disenfranchisement of public shareholders and necessitates modest reform. Current forms of regulation inadequately address the problems posed by nonvoting stock. I have advanced a novel multipronged framework for regulating nonvoting stock. First, federal securities laws could enable nonvoting shares to cast nonbinding votes. Second, state corporate laws would legally mandate that nonvoting shareholders have the right to attend annual meetings in an observer role. Third, state courts could impose a heightened standard of judicial review compliant with *MFW* for companies with dual-class structures to encourage the use of procedures that empower shareholder votes. Fourth, nonvoting shares would have additional voting rights in some specific contexts as a matter of positive law.

As SEC Chairman Jay Clayton recently conceded in public remarks,

The engine of economic growth in this country depends significantly on the willingness of Main Street investors to put their hard-earned capital at risk in our markets over the long term. If our system of corporate governance is not ensuring that the views and fundamental interests of these long-term retail investors are being protected, then we have a lot of work to do to make it so.<sup>263</sup>

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founders' continued control of Google seemed to be something of an understanding among . . . the firm's investors.” Matt Chiappardi, *Google Stock Split Settlement OK'd, but Fees Cut To \$9M*, LAW360 (Oct. 28, 2013, 6:29 PM), <https://www.law360.com/articles/483819/google-stock-split-settlement-ok-d-but-fees-cut-to-9m> [https://perma.cc/QWU3-M5KT].

<sup>262</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

<sup>263</sup> Jay Clayton, Chairman, Sec. & Exch. Comm'n, Opening Remarks to SEC–NYU Dialogue on Securities Markets #4: Shareholder Engagement (Jan. 19, 2018), <https://www.sec.gov/news/speech/clayton-2018-01-19> [https://perma.cc/Q49P-RTYV].

I expect nonvoting shares to be a renewed area of focus for founders and boards of directors,<sup>264</sup> plaintiff's attorneys and state law jurists,<sup>265</sup> U.S. Congress and federal securities regulators,<sup>266</sup> and stock exchanges and marketmakers in the decades to come.

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<sup>264</sup> See e.g., Nick Wingfield & Jack Nicas, *Tech Founders Embraced Control Over Companies: This One Is Giving It Up*, N.Y. TIMES (May 2, 2018), <https://www.nytimes.com/2018/05/02/technology/zynga-shares.html> (explaining that the founder of Zynga intends to unify his superior voting stock “partly because of growing criticism of dual- and multiclass share structures”).

<sup>265</sup> See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957 (Del. 1985) (“[O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs.”).

<sup>266</sup> Chairman Clayton recently indicated, however, that he was not putting dual-class structures at the forefront of the SEC’s agenda and further noted that he is “not persuaded by absolutists on either end” of the debate. Meaghan Kilroy, *CII Conference Panelists Dish on Corporate Culture, Voting Structures*, PENSIONS & INV. (Mar. 16, 2018, 11:47 AM), <http://www.pionline.com/article/20180316/ONLINE/180319890/cii-conference-panelists-dish-on-corporate-culture-voting-structures> [<https://perma.cc/4CEB-QDH5>].

## APPENDIX

Table 1: High-Vote, Low-Stock with 10-to-1 Voting Ratio

Share Class	Number of Shares	Percent of Cash Flow Rights	Number of Votes per Share	Total Number of Votes	Percent of Voting Rights
Class B: High-Vote Stock	90,910	9.0910%	10	909,100	50.0003%
Class A: Low-Vote Stock	909,090	90.9090%	1	909,090	49.9997%
<b>Total</b>	<b>1,000,000</b>	<b>100.0%</b>		<b>1,818,190</b>	<b>100.0%</b>

Table 2: High-Vote, Low-Stock with 10-to-1 Voting Ratio and an Ownership-Percentage Sunset Threshold at 9%

Share Class	Number of Shares	Percent of Cash Flow Rights	Number of Votes per Share	Total Number of Votes	Percent of Voting Rights
<b>Without Trigger</b>					
Class B: High-Vote Stock	89,999	8.9999%	10	899,990	49.7235%
Class A: Low-Vote Stock	910,001	91.0001%	1	910,001	50.2765%
<b>Total</b>	<b>1,000,000</b>	<b>100.0%</b>		<b>1,809,991</b>	<b>100.0%</b>
<b>With Trigger</b>					
Class B: High-Vote Stock	89,999	8.9999%	1	89,999	8.9999%
Class A: Low-Vote Stock	910,001	91.0001%	1	910,001	91.0001%
<b>Total</b>	<b>1,000,000</b>	<b>100.0%</b>		<b>1,000,000</b>	<b>100.0%</b>

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