

Tenure Voting and the U.S. Public Company

March 1, 2016

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This paper was coauthored by David J. Berger, Steven Davidoff Solomon, and Aaron Jedidiah Benjamin. It was prepared with the help of an advisory group sponsored by the University of California, Berkeley School of Law and Wilson Sonsini Goodrich & Rosati (the “Advisory Group”) comprised of:

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The Advisory Group played an important role in helping formulate the ideas and principles put forth in this paper. However, the views expressed herein, including but not limited to the suggested “best practices,” are solely the personal opinions of the coauthors and may not be those of the members of the Advisory Group or the entities with which the coauthors and Advisory Group members are affiliated. The coauthors wish to thank the advisory group for their participation. For further information, please contact:

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INTRODUCTION

In today's capital markets, the principle of "one share, one vote" is increasingly under scrutiny. The rise of high-vote and no-vote stock has created a popular alternative for companies at the initial public offering ("IPO") stage. According to Dealogic, approximately 14% of IPOs in the past year used some form of dual-class stock, compared to only 1% in 2005.⁵ Prominent companies that have adopted a separate class of high-vote stock in recent years include Alibaba, Facebook, First Data, Google (now Alphabet), Pure Storage, and Square.⁶

The rise of dual-class stock has created a culture of "haves" and "have-nots." Companies with dual-class stock may be more insulated from shareholder activism and other shareholder demands than companies with a single class of stock. Supporters often claim that dual class structures provide companies greater ability to plan and act for the long term, taking into account shareholder considerations but also avoiding actions that result in a short-term increase in the company's stock price but harm the company's ability to create long-term value.

In contrast, many public companies with one share, one vote structures assert that they are unable to shield themselves from short-term shareholder pressure to increase their stock price. They complain that this forces them to take myopic actions such as financial engineering that may limit the company's ability to grow and innovate for the long term. It should be noted that many leading institutional investors and other advocates of increased shareholder rights strongly dispute these claims of short-termism. They argue that these claims lack empirical

⁵ Kristin Lin, *The Big Number – Share of IPOs This Year With Dual-Class Stock Structures*, WALL ST. J., Aug. 17, 2015, <http://www.wsj.com/articles/the-big-number-1439865699>.

⁶ Companies with a separate class of high-vote stock have existed for many years and are not limited to technology companies. For example, other prominent companies with a separate class of high-vote stock include: Ford, Box, Inc. ("Box"), CBS Corporation, FitBit, Inc., LinkedIn Corporation, News Corporation, The New York Times Company, Viacom Inc., and Zynga Inc. ("Zynga").

support, and that short-termism is undefined, non-existent, or due to simple market misperceptions.⁷ Still, many prominent institutional and other investors take the opposite position, criticizing what they perceive as the market’s increased focus on short-term results.

The purpose of this white paper is not to resolve or take sides in this debate. Rather, the purpose is to examine an innovative response to the rise of dual-class stock: the use of tenure voting by U.S. public companies. Tenure voting is the award of an additional number of votes to shareholders depending upon the duration of their ownership. There are a variety of different models of tenure voting, but the core principles driving consideration of and support for tenure voting are: (1) giving long-term shareholders increased voting power over corporate decisions, and (2) incentivizing shareholders to be long-term investors. Tenure voting has gained support in many countries in recent years. For example, France recently passed the Florange Act, which makes tenure voting the default option for its public companies. In addition, with the significant increase in proxy access adoptions over the last year, tenured rights have, at least in this context, become an accepted practice in the United States.⁸ This may signal an increased willingness by

⁷ George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 122–28 (2010) (arguing that short-term shareholders “favor steps that increase long-term value”); Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 1005 (2013) (“Overall, the evidence that financial markets are excessively short-term is widely believed but not proven, and there is much evidence pointing in the other direction.”); Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE L. J. 1554 (2015) (arguing that favoring the interests of long-term stockholders over short-term stockholders can negatively affect a corporation’s value); see also Charles Nathan, *Observations on Short-Termism and Long-Termism*, HARVARD LAW SCHOOL FORUM ON CORP. GOV. AND FIN. REG., Oct. 12, 2015, <http://corpgov.law.harvard.edu/2015/10/12/observations-on-short-termism-and-long-termism/> (arguing that “[t]he duration of any investor’s holding period in a company’s stock is simply not relevant to issues involving corporate value creation.”); Liz Murrall, *De-bunking the myths of short-termism*, INV. ASS’N, <http://www.theinvestmentassociation.org/assets/files/articles/2011/20111214-ArticleforIPE.pdf>.

⁸ Most proxy access bylaws require three years of continuous ownership to assert the right. See *infra* at II.D.1.

investors to consider more broadly tenure-based rights, such as tenure voting. Moreover, a small number of companies in U.S. markets currently use tenure voting.

Tenure voting has the potential to be a more palatable alternative to high-vote and no-vote shares while also addressing current arguments about long- and short-termism in U.S. markets. By design, tenure voting rewards all shareholders who hold their shares for an extended period. This could better align incentives with long-term value creation without being unduly punitive toward those shareholders more interested in trading, since all shareholders who wish to take action for the long term will have greater influence in those decisions, while shorter term shareholders will still have a meaningful voice.

Again, we want to be clear that the purpose of this white paper is not to decide the debate between long- and short-termism. The purpose is also not to promote tenure voting as a preferred alternative to dual-class stock, single-class stock, or any other structure. We understand that the wisdom of using tenure voting may ultimately depend upon the particular circumstances of the company involved.

Rather, the purpose is to highlight the effects of tenure voting and to differentiate it from other voting structures. A further goal is to outline possible features of a tenure voting structure, and to suggest some features as “best practices.” The white paper also aims to show why we believe that the adoption of tenure voting is currently permitted under U.S. stock exchange rules. Ultimately, this white paper is designed to provide a roadmap of the issues and considerations for companies and market participants considering tenure voting under current market conditions and regulations.

The white paper proceeds as follows. Part I discusses the current state of the market and shareholder voting. It focuses on the perceived problems that have led many companies,

investors, and others to question the continued benefits of the one share, one vote system. It includes a brief analysis of the perceived trend toward increased shareholder short-termism and existing solutions. Part II describes tenure voting and its historical use, potential benefits to companies and shareholders, effect on shareholder short-termism, and shareholder appeal. It also explores practical considerations with the adoption and use of tenure voting. Part III explores the legal framework for adopting tenure voting under state law and exchange listing rules. Part IV identifies possible features of a tenure voting plan, and suggests certain features as part of a “best practices” standard. The white paper concludes that U.S. companies and exchanges may consider tenure voting plans as an alternative to either one share, one vote and/or high-vote and no-vote capital structures.

I. CURRENT STATE OF THE MARKET

A. The Debate over Short-termism

The debate over shareholder voting is part of the larger debate over whether investors in the U.S. securities markets have become too short-term oriented, such that companies and managers do not have a real opportunity to make the type of long-term investment necessary to create long-term, sustainable growth. There are two factual foundations to this argument. First, there is no doubt that over the past few decades, holding periods have significantly compressed. Second, the “deretailization” of the market has concentrated investment power with institutional investors. Most institutional investors today tend to hold shares for shorter periods than was historically the case, while at the same time wielding increased influence over the actions of the board and management.

According to New York Stock Exchange (“NYSE”) data, between 1960 and 1980, the average holding period of public company stocks ranged from about three to five years.

Beginning in the early 1980s, with the rise of the takeover boom, this holding period began to decline. By 1990, the period had fallen to about two years, and by the mid-2000s it was less than a year. The average holding period today for individual stocks across all U.S. markets is about seventeen weeks.⁹

The holding period is shorter still for certain types of institutional investments. Last year, the twenty largest Exchange Traded Funds (“ETF”s) traded at an average turnover rate of 1,244%—implying a 29-day average holding period. The average hedge fund turns over its holdings more than three times a year. Even so-called longer-term institutional investors such as mutual funds in reality have short time horizons. Average portfolio turnover at actively managed mutual funds is estimated to exceed 100% per year. Pension funds typically turn over all of their equity holdings each year. In sum, the institutional investors who own well over 50% of publicly traded stock in the United States tend to hold shares for a much shorter period than is commonly believed.¹⁰

The rise in short-term ownership of securities is tied in part to the increased ownership of stocks by institutional investors. In 1950, institutions held between seven and eight percent of U.S. stocks. Six decades later, in 2010, their holdings had increased to 67%. In 1980, institutions held \$473 billion in U.S. stocks. By 2010, their holdings had increased to \$11.5 trillion.¹¹ The

⁹ Jason Zweig, *Why Hair-Trigger Traders Lose the Race*, WALL ST. J., Apr. 10, 2015, <http://blogs.wsj.com/moneybeat/2015/04/10/why-hair-trigger-stock-traders-lose-the-race/>.

¹⁰ Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 11 n.34 (2010).

¹¹ Luis A. Aguilar, Comm’r, U.S. Sec. & Exch. Comm’n, *Institutional Investors: Power and Responsibility*, Address at Georgia State University and J. Mack College of Business, Center for Economic Analysis of Risk (CEAR), CEAR Workshop, Apr. 19, 2013, <http://www.sec.gov/News/Speech/Detail/Speech/1365171515808>; Marshall E. Blume & Donald B. Keim, *Institutional Investors and Stock Market Liquidity: Trends and Relationships* (The

reality is that today most individuals do not invest directly in stocks. Instead, individuals invest in mutual funds, exchange traded funds, and other pooled-investment vehicles, and rely on these entities to directly invest in and monitor publicly traded firms. Institutional control is even greater among large, publicly traded companies. For example, it is estimated that institutional investors own about 75% of the companies in the S&P 1000.¹²

The decline in holding periods for large investors (particularly mutual funds, institutional investors, and activist hedge funds) has been cited in support of claims that shareholder pressure is forcing companies to take more short-term actions, at the expense of long-term investment and growth. We recognize that what exactly is short-termism is difficult to agree upon or define.¹³ Theoretically, if a company takes actions that result in a short-term increase in the company's stock price but harm the company's long-term prospects, that company should eventually see a decline in its share price to the extent the market recognizes these maneuvers. In practice, however, short-term investors sell the stock following the actions that have the effect of temporarily increasing the company's stock price, and do not hold the stock long enough to suffer any consequences from the actions' long-term effects. What may be seen as short-term behavior may not immediately be perceived by the market as causing long-term harm to the

Wharton School, University of Pennsylvania Working Paper, Aug. 21, 2012), http://finance.wharton.upenn.edu/~keim/research/ChangingInstitutionPreferences_21Aug2012.pdf.

¹² Aguilar, *supra* note 11.

¹³ See, e.g., Lynne L. Dallas & Jordan M. Barry, *Long-Term Shareholders and Time-Phased Voting*, at 19 (DEL. J. CORP. L. (2015), San Diego Legal Studies Paper No. 15-194, Jul 2, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2625926 (“short-termism is not defined by the type of action or length of its effect; the key question is whether the action is intended to enhance short-term profits at the expense of long-term value. Thus, in some instances, overinvestment in long-term projects may constitute short-termism”).

company. In addition, shorter-term actions tend to be more likely to externalize corporate behavior on other constituencies.

Regardless of this debate, there has been a shift in corporate practices in response to these market changes which some have characterized as short-termist. Even the world's largest companies have not been immune to this shift. For example, though DuPont successfully defeated a proxy challenge from Nelson Peltz's Trian Partners ("Trian") in the spring of 2015, by the end of the year DuPont's CEO had chosen to step down, and the company had adopted policies supported by Peltz, including increasing stock buybacks and returning capital to shareholders, resulting in a downgrade of the company's credit rating by Moody's.

Trian has also recently been pushing General Electric ("GE") to take on more debt to buy additional shares, over and above the company's current \$35 billion share buyback plan. Seemingly in response to these pressures, and as recognized by Moody's, GE has "been increasing cash payments to shareholders without achieving commensurate increases in operating earnings and cash flow, a credit negative. . . . The activist's involvement further elevates the event risk to creditors."¹⁴ Even Apple, the world's largest company by market capitalization and also one of the world's most innovative companies, has not been immune to these pressures. To the contrary, Apple has responded to the demands of activists such as Carl Icahn by announcing a \$100 billion program to return cash to shareholders, including issuing \$17 billion of bonds in various currencies to fund share buybacks and dividends. More broadly, the technology sector—arguably the most successful sector of the U.S. economy—continues to be

¹⁴ Ciara Linnane, *Activist Shareholders Were Busier and More Aggressive Than Ever in 2015*, MARKETWATCH, Nov. 11, 2015, <http://www.marketwatch.com/story/activist-shareholders-were-busier-and-more-aggressive-than-ever-in-2015-2015-11-10>; see also Russell D. Solomon & Robert P. Jankowitz, *Rating Action: Moody's Downgrades GE's Senior Unsecured Debt Rating to A1*, MOODY'S INVESTORS SERVICES, INC., Apr. 10, 2015, https://www.moody's.com/research/Moodys-Downgrades-GEs-Senior-Unsecured-Debt-Rating-to-A1--PR_322434.

the most attractive sector for activist involvement, accounting for 33% of North American companies targeted by activists since the start of 2015, with activist demands typically focusing on increasing payouts to shareholders and cutting spending in areas such as research and development.¹⁵

These actions have led the leaders of some of the largest institutional shareholders to cite short-termism as a potential threat to companies and, more broadly, the long-term health of the U.S. economy. For example, Larry Fink, Chairman and CEO of BlackRock, one of the world's largest investment funds with over \$4 trillion invested in U.S. public companies, cautioned executives in a 2015 letter that “[t]he effects of the short-termist phenomenon are troubling both to those seeking to save for long-term goals such as retirement and for our broader economy.”¹⁶ Earlier this month, Mr. Fink reiterated that “[r]educing [short-termist] pressures and working instead to invest in long-term growth remains an issue of paramount importance for BlackRock's clients, most of whom are saving for retirement and other long-term goals, as well as for the entire global economy.”¹⁷

Many business leaders, practitioners, and scholars agree (though this remains subject to vigorous debate).

For example, the Aspen Institute Business and Society Program published a report entitled “Overcoming Short-termism: A Call for a More Responsible Approach to Investment

¹⁵ Linnane, *supra* note 14.

¹⁶ Andrew Ross Sorkin, *BlackRock Chief, Laurence Fink, Urges Other C.E.O.s to Stop Being So Nice to Investors*, N. Y. TIMES, Apr. 13, 2015, http://www.nytimes.com/2015/04/14/business/dealbook/blackrocks-chief-laurence-fink-urges-other-ceos-to-stop-being-so-nice-to-investors.html?_r=0.

¹⁷ Matt Turner, *Here is the letter the world's largest investor, BlackRock CEO Larry Fink, just sent to CEOs everywhere*, BUSINESS INSIDER, Feb. 2, 2016, <http://www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2>).

and Business Management.” This report, whose signatories include business leaders (including John Bogle and Warren Buffett), practitioners (including Martin Lipton and Ira Millstein), scholars (including Jay Lorsch and Bill George of the Harvard Business School), and even institutional investors (including Jack Ehnes of CalSTRS), is devoted to tackling the problem of short-termism. “[A] healthy society requires healthy and responsible companies that effectively pursue long-term goals. Yet in recent years, boards, managers, shareholders with varying agendas, and regulators, all, to one degree or another, have allowed short-term considerations to overwhelm the desirable long-term growth and sustainable profit objectives of the corporation.”¹⁸

More recently, the Chief Justice of the Delaware Supreme Court, Leo E. Strine, Jr., warned of “the pressures that can lead corporate managers to quick fixes . . . , which might give a balance sheet a short-term benefit, but cut our nation’s long-term prospects” and “the relative tilt in corporate spending toward stock buybacks and away from spending on capital expenditures.”¹⁹ He noted that “[i]t is jejune to demand that CEOs and boards manage for the long term when the stockholders who can replace them buy and sell based on short-term stock price movements, rather than the long-term prospects of firms.”²⁰ As summarized by The Conference Board’s Matteo Tonello, “Market short-termism . . . undermines confidence in the

¹⁸ *Overcoming Short-termism: A Call for a More Responsible Approach to Investment and Business Management*, ASPEN INSTITUTE (2009), www.aspeninstitute.org/sites/default/files/content/docs/pubs/overcome_short_state0909_0.pdf.

¹⁹ Leo E. Strine, Jr., *Securing our Nation’s Economic Future: A Sensible, Nonpartisan Agenda To Increase Long-Term Investment And Job Creation In The United States*, Keynote Address at the First Annual American College of Governance Counsel Dinner, Oct. 30, 2015, <http://corpgov.law.harvard.edu/wp-content/uploads/2015/11/Securing-Our-Nation-Intermediate-Final.pdf>.

²⁰ Strine, *supra* note 10, at 17.

soundness of the underlying economy, favors opacity on strategic goals, and encourages opportunistic behaviors by a few to the detriment of the many.”²¹

Related to this argument, there has been debate about whether growth companies are avoiding the public markets in part to avoid short-termist pressures. Some have argued that these companies are inherently unsuited to the public markets. A business model based on innovation and disrupting existing technologies requires significant near-term investment in new, experimental technologies, training employees, and growing to scale. Private markets arguably are more “patient” than public markets, and afford these companies greater latitude to take the costly steps up front so they can be successful in the long term. According to leading venture capitalist Marc Andreessen, it is the public market’s short-termism that is deterring companies from going public: “In the modern era, public market time horizons have never been shorter, and private market time horizons have never been longer.”²²

The bottom line is that whatever one’s view on the existence of short-termism, U.S. companies increasingly are making decisions as if they are under pressure to meet short-term expectations. Some companies have responded by taking steps to insulate the board of directors from the demands of outside shareholders.

²¹ Matteo Tonello, *Revisiting Stock Market Short-Termism* (Conference Board Research Report No. R-1386-06-RR, Apr. 1, 2006), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=938466.

²² Rolfe Winkler & Telis Demos, *Tech Firms Are Notably Scarce in IPO Market*, WALL ST. J., Sept. 10, 2015, <http://www.wsj.com/articles/ipo-parade-continues-without-many-tech-companies-1441929152>. Likewise, some argue that short-termist activist pressures inhibit technology companies from pursuing growth-oriented mergers and acquisitions. Scott Kuper, *What’s Holding Tech M&A Back?*, a16z.com, April 10, 2015, <http://a16z.com/2015/04/10/whats-holding-tech-ma-back/>.

B. The Current State of Voting

One response to the changing markets has been through voting mechanisms. An increasing number of companies going public, particularly in the technology sector, have chosen a dual-class or multi-class capital structure that limits outside investor influence, often in the name of curbing short-termism. There are two commonly utilized structures: dual-class stock and nonvoting stock.

Dual Class. Under this structure, the company issues two classes of stock. One class (usually “Class A”) is publicly tradeable common stock that will typically have one vote per share. A separate class of stock (usually “Class B”) is issued to insiders (i.e., founders, directors, and senior management), generally is not publicly tradeable (or, if it is tradeable, immediately converts to Class A when it is traded), and typically has multiple votes per share. In this way, the company can raise capital by offering shares on the public markets without sacrificing the control of visionary insiders who are focused on the long term. Historically, media companies such as the New York Times, Dow Jones, Washington Post, and others frequently utilized this type of structure, so that the founding family could guarantee the independence of the media.

More recently, dual-class stock gained new popularity among technology companies following its use by Alphabet (then Google) in its IPO, and has since been emulated by companies such as LinkedIn, Zynga, and Facebook, and more recently by Alibaba, Box, FitBit, and Square. Alibaba CEO Jack Ma’s preference for a high-vote structure led to the company’s decision to list in the United States as opposed to on the Stock Exchange of Hong Kong, which currently prohibits the listing of dual-class stock.

Nonvoting stock. Some companies have begun issuing a new class of stock that has no voting rights (usually “Class C”). Alphabet, and more recently Zillow in connection with its

merger with Trulia, took this path. This enables the company to continue to raise capital through offerings of nonvoting stock without diluting the control of existing holders.

The present consensus is that moving from a single class to a dual class structure is only available to companies prior to or at the IPO stage, notwithstanding approval by shareholders who will receive the lower voting stock. This is because of the current interpretation of the nearly identical Nasdaq and NYSE rules which purport to prohibit mid-stream recapitalizations. These rules were passed in the late 1980s, in response to the decision by the D.C. Circuit striking down SEC Rule 19c-4. Rule 19c-4 would have required a one share, one vote structure for all publicly traded companies.²³

The SEC adopted Rule 19c-4 to prevent companies from adopting dual-class stock in response to the growing threat of hostile takeovers; after the D.C. Circuit held that the Rule exceeded the Commission's regulatory authority, the exchanges (at the urging of the SEC) adopted virtually identical rules that largely implemented Rule 19c-4. However, in their interpretive rules adopting these provisions, the exchanges explicitly noted that their voting policies were "more flexible" than former Rule 19c-4, and further recognized the need for additional flexibility in "light of the reality that both capital markets and the needs of companies change over time."²⁴

While these rules have generally been interpreted to prohibit the adoption of dual-class stock, the rules have also been interpreted by the exchanges to permit companies to adopt nonvoting stock, even where companies already have an existing dual-class stock structure. This

²³ *Bus. Roundtable v. SEC*, 905 F.2d 406, 411 (D.C. Cir. 1990).

²⁴ Nasdaq Rule 5640, IM-5640; NYSE Rule 313.00; NYSE MKT Company Guide § 122; Order Granting Approval to Rule Changes Relating to the Exchanges' and Association's Rules Regarding Shareholder Voting Rights, 59 Fed. Reg. 66570-01, at III.D.1 (Dec. 27, 1994) [hereinafter SEC Approval].

could allow companies to issue a third class of stock for other business purposes which may have the effect of maintaining the voting control of existing shareholders. This alternative, however, is available only to companies that already have dual-class stock, such as Alphabet and Zillow.

II. TENURE VOTING AND ITS HISTORICAL USE

The adoption of high-vote and no-vote stock has engendered concern, particularly among some institutional investors. The primary reason given for this concern is that the high-vote stock is typically owned by founders/insiders, and there is no opportunity for ordinary investors to also own these shares. For example, some have argued that the stock price of dual class companies can be negatively impacted (relative to single class companies) in part as a result of shareholders' lower voting power. We do not take a position here on this issue. Nor do we consider whether dual-class stock is an economically positive or negative development. We simply note that the effect of a dual class structure is to potentially place voting authority with the founders/insiders for an extended period and, because most public shareholders are typically unable to own high-vote shares, some perceive this as unfair. We believe the perceived hostility to dual class structures informs the efficacy of tenure voting as an alternative.

A. Tenure Voting: An Alternative Voting Structure

An alternative to these voting mechanisms may be for a company to adopt a tenure voting plan. A company that recapitalizes its shares under a tenure voting plan would give long-term shareholders more votes per share than short-term shareholders. There are two basic ways it could work.

Low-High. On the day of the recapitalization, all shares outstanding would be worth one vote. After a share is held by the same beneficial owner for a defined holding period (i.e., three years), the share's voting power appreciates, and will be worth more than one vote (i.e., three

votes). The plan might provide for further increases, for example, after five consecutive years of ownership, the share will be worth five or even ten votes.

High-Low. On the day of the recapitalization, each share outstanding immediately becomes high-voting (i.e., three votes per share). If the share subsequently changes beneficial ownership, it reverts to one vote. The new owner would then begin to accrue additional per-share votes after defined holding periods—just like under the Low-High plan—until eventually the share would be worth the same number of votes as it was at the time of the recapitalization (i.e., three votes per share).

Whether Low-High or High-Low, a tenure voting plan has the same fundamental effect: it rewards long-term shareholders with more votes per share than short-term shareholders.

B. Historical Use

In recent years, tenure voting has rarely been used in U.S. markets. A recent study identifies twelve U.S. companies that used tenure voting in the last 30 years. Of these twelve, seven no longer have tenure voting plans. The companies’ primary reason for adopting tenure voting was to “decrease the influence of short-term investors” and “increase the relative influence of long-term investors.”²⁵

COMPANY	STATUS OF TENURE VOTING PLAN
Aflac Inc.	Intact
Carlisle Companies Inc.	Intact
CenturyTel Inc.	Rescinded 1991
Milacron Inc.	Rescinded 2003
Church & Dwight Co., Inc.	Rescinded 2003
J.M. Smucker Company	Intact
Potlatch Corporation	Rescinded 2005
Pioneer Hi-Bred International, Inc.	Terminated when acquired by DuPont in 1999
Quaker Chemical Corporation	Intact
Roper Industries, Inc. (“Roper”)	Rescinded 2006

²⁵ Dallas & Barry, *supra* note 13, at 72.

Shaw Group Inc. (“Shaw”)	Rescinded 2007
Synovus Financial Corp.	Intact

Ten of the companies adopted tenure voting after they had already gone public. Specifically, they adopted tenure voting between 1985 and 1987, after the NYSE declared a moratorium on its one share, one vote policy but before the SEC enacted Rule 19c-4. *See supra* at I.B, *infra* at III.B. The remaining two companies—Roper and Shaw—went public with tenure voting in place. They did so in 1992 and 1993, after the courts struck down Rule 19c-4 but before the SEC succeeded in encouraging the exchanges to adopt a similar voting rights policy. *See infra* at III.B.

The companies bear certain similarities. All twelve had at some point been listed on the NYSE. They were predominantly headquartered in the southeastern United States at the time they had tenure voting. There were director-level connections between nine of the companies. The ten companies that adopted tenure voting while already public were all family controlled, and adopted tenure voting pursuant to a shareholder vote. All twelve companies had been in business for more than twenty years prior to adopting tenure voting.

Despite those similarities, the companies represent a variety of industries, including insurance, telecommunications, consumer products, banking, agriculture, industrial manufacturing, and energy. They include both consumer- and industrial-facing brands, with both regional and global footprints.

All of these companies adopted a High-Low plan. However, upon change in beneficial ownership, the plans varied both as to the length of the holding period and the number of votes per share awarded after the holding period was complete. The most common plan required a holding period of four years, upon which ten votes were awarded. Further, all of the plans presumed that shares held in street name were short-term, unless that presumption was rebutted

by the shareholder proving that there had been no change in beneficial ownership during the holding period.

There are several findings based on these companies' experience that have potential implications for companies considering adopting tenure voting. Although tenure voting increased insider control in the short term, all twelve companies saw a decrease in insider control within ten years after adopting tenure voting. Principal outside shareholder ownership increased over time while the companies had a tenure voting plan. Tenure voting had no significant effect on institutional shareholder ownership. Insiders were more likely than other investors to be holders of long-term (i.e., high-vote) shares. This created a "wedge" between insider ownership and control, but a smaller wedge than in dual class companies. Notably, there was no evidence that tenure voting increased ownership of long-term shareholders or reduced ownership of short-term shareholders. Overall, these companies outperformed the market. An investment in 1980 in an index of these twelve companies would in 2013 be worth six times an identical investment in the S&P 500. However, this is a small sample size and these companies outperformed the market both before adopting and after rescinding their tenure voting plans. Accordingly, these companies' results may not be indicative of tenure voting's likely impact on a company's stock price.

C. Potential Benefits of Tenure Voting²⁶

Tenure voting may have several effects that address both company and shareholder concerns. It has the potential to provide companies with a core base of investors who are interested in the long term, while also giving shareholders who meet the provided thresholds

²⁶ At the outset, it is worth reiterating that like multi-class stock, tenure voting targets only *shareholder* short-termism. It does not address other factors that may also contribute to short-termism in the market, such as executive compensation design and quarterly earnings reporting.

greater input into voting decisions. At the same time, it allows shareholders who are not as interested in the long-term future of the company to sell their shares without liquidity concerns. While we think that many shareholders may not value this voting right over and above other items such as liquidity or returns, we do believe it may create a dynamic which empowers companies and shareholders to focus on long-term metrics.

1. Benefits to the Company

Adds incentive to hold. In certain situations, tenure voting may incentivize a shareholder to hold rather than trade. Certainly, when a shareholder is no longer interested in being an investor in the company it makes sense for the shareholder to sell. However, the added voting rights (or the soon-to-be-added voting rights) may raise the net present value of a long-term share (or a soon-to-be long-term share), which in turn may raise the threshold at which it makes sense to trade.

For example, consider a rational holder of one share who is presented with an alternative investment worth more than x but less than y , where x = the value of a one-vote share with no prospect of appreciating (i.e., a share without tenure voting rights), and y = the value of a one-vote share guaranteed to appreciate to five votes in a defined period (i.e., a share with tenure voting rights). If the share does not have tenure voting rights, the shareholder will trade it in for the alternative investment. If it has tenure voting rights, the shareholder will hold.

In some respects this calculation and conclusion reduces to the value of that vote. In many situations that value may not overcome other considerations. But for shareholders who believe that their enhanced votes can further influence the company to create value, this may make a difference. At a minimum, we do note that there is some value to these increased votes—companies with both voting and nonvoting shares see these shares trade at different prices. For

example, Alphabet’s Class C nonvoting shares (“GOOG”) trade at a discount to its Class A one-vote shares (“GOOGL”) (though voting control is held by neither of those classes, but by the Class B shareholders).

Counteracts myopic bias. Tenure voting could help companies attract and retain shareholders who are truly focused on the long-term value of their investment. Behavioral economics shows that rational actors are irrationally biased in favor of short-term gains, even when long-term gains yield a higher net present value. A shareholder might be unable or unwilling to accurately calculate the net present value of a long-term investment whose outcome is abstract and uncertain, and so only considers the short-term result. However, under a tenure voting plan, the promise of receiving the definite and concrete reward of additional voting rights upon completing the holding period puts the long term into focus. This could help a shareholder recalibrate and give a harder look to long-term prospects, ultimately aligning the shareholder mindset with the long-term interests of the company.

Attracts patient capital. Similarly, a company with tenure voting may be more likely to attract long-term investment capital (“patient capital”) than one where shareholders have the same voting control regardless of how long they own (or borrow) their shares. Originally, the stock market attracted patient investment capital, consistent with a focus on long-term value. In the 1940s, the average stock on the NYSE was held for seven years. Even as recently as 1991, Warren Buffett viewed the stock market as “a relocation center at which money is moved from the active to the patient.”²⁷ By contrast, the current average holding period of stocks across all

²⁷ Warren E. Buffett, *Letter to the Shareholders of Berkshire Hathaway Inc.*, Feb. 28, 1992, <http://www.berkshirehathaway.com/letters/1991.html>.

U.S. marketplaces is seventeen weeks.²⁸ Today, the market arguably serves more as a trading platform than as a center for patient investment. By rewarding patience, tenure voting could help attract patient capital back to the public markets.

Commitment device. Tenure voting can also be viewed as a commitment device. By rewarding long-term shareholders with potentially more influence over the company's governance, those shareholders are more likely to get involved in the company's decision-making. As their proportionate voting control increases over time, they presumably will have a greater self-interest in becoming more engaged with the company, and will provide better oversight of management and the board. At the same time, their longer ownership and apparent greater interest in the company should give them deeper insight into the company's long-term prospects, and as a result, they will be more willing to support long-term internal investment.

Cultural impact. Tenure voting may have implications beyond the capital markets. According to Larry Fink, short-termism is "not just a corporate problem," but "a societal problem, whether it's health care, or politics or business."²⁹ By rewarding those who take a long-term view, tenure voting could help counter the societal trend toward shortsightedness. Obviously this type of societal benefit is far beyond the scope of our analysis, but we do believe that the concerns raised by Mr. Fink and others are worthy of further consideration.

2. Benefits to the Shareholder, Including Institutional Investors and Supporters of Dual Class Voting Structures

Democratic. Tenure voting is consistent with notions of shareholder democracy and equal rights. It treats each share and shareholder exactly alike: each share held for the defined holding period will gain the prescribed votes, without regard to the type of share or identity of its

²⁸ Zweig, *supra* note 9.

²⁹ Sorkin, *supra* note 16.

holder. Tenure voting grants all stockholders *equal* per share voting rights and *equal* opportunity to gain additional voting rights by holding their shares over time.

May appeal to institutional investors. Likewise, tenure voting empowers investors who hold their shares. Historically, outside shareholder voting control appeared to increase over time after a company adopted a tenure voting plan. For large institutional investors willing to hold their shares, tenure voting represents an unprecedented opportunity to gain outsized influence over corporate decision-making. They may also appreciate tenure voting's protection against the influence of short-term shareholders less interested in the company's long-term value.

The role of shareholder activists. We are aware that this type of plan may be viewed as discriminatory or inhibiting of shareholder activism. However, shareholder activists today frequently argue that they are actually long-term holders, given that they hold their shares substantially longer than average.³⁰ In addition, activists are often able to gain support while holding small amounts of stock (such as in the recent Microsoft and DuPont activism campaigns). We therefore think that while these plans may have an effect on shareholder activism, in many cases the effect may be to enhance value-creating activism rather than to burden it.

3. Potential Downsides

We recognize that there may be downsides to tenure voting. It may not reward the smartest or best investors, but rather those who simply hold shares. Shareholders as a whole may

³⁰ The debate over whether activists are long-term holders is robust and unsettled, and beyond the scope of this paper. For a sample of some of the various views, *compare generally*, Lucian Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COL. L. REV. 1085 (2015), *with* Martin Cremers et al., *Hedge Fund Activism and Long-Term Value*, Nov. 19, 2015, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231, *and* John C. Coffee & Darius Palia, *The Impact of Hedge Fund Activism: Evidence and Implications*, Sep. 15, 2014, <http://www.valuwalk.com/wp-content/uploads/2014/10/SSRN-id2496518.pdf>.

not value their votes. Investors who hold for the long term are not necessarily any wiser about what is best for the company in the long term than short-term investors, or even more patient than short-term investors—but instead would just use their tenure voting rights to deprive wiser short-term investors of the chance to influence corporate decisions.

We believe that this last point is likely to be the biggest obstacle to tenure voting, particularly among some institutional and activist investors. At the same time, many activist investors reject the notion that they are only interested in short-term results, while institutional investors frequently state that they must “own the market” and for this reason are even more focused on long-term results than most management teams. For these reasons, while we recognize the potential controversy of tenure voting among some types of investors, we believe that many investors, including institutions and activists, may find tenure voting more inviting than dual-class stock.

We also recognize that tenure voting has the potential to place additional control with founders who have decided to hold the company’s stock for the long term. However, *the key to the tenure voting structure we envision is that it will place everyone in the same position: all shareholders, whether founders or activists, institutions or retail investors, will be able to have the same voting rights, dependent solely on how long they own the company’s stock.*³¹

D. Practical Considerations

Institutional shareholder support. Any proposal to adopt tenure voting will require shareholder approval. To that end, it is important to consider the likely positions of institutional investors.

³¹ Because of this, a tenure voting system may also be considered superior from a governance perspective to a staggered board, which directly reallocates power from shareholders to board members.

Generally, the institutional investor community favors the basic one share, one vote policy in place in most publicly listed U.S. companies. After the courts in 1990 blocked the SEC from imposing a one share, one vote requirement (*supra* at I.B, *infra* at III.B), institutional investors strongly supported the SEC’s efforts to informally pressure the exchanges to codify one share, one vote policies in their listing rules. More recently, the large proxy advisory services such as Institutional Shareholder Services, Inc. (“ISS”) and Glass, Lewis & Co., LLC (“Glass Lewis”), as well as certain large French institutional investors, have opposed France’s Florange Act and recommended that companies opt out to maintain a one share, one vote policy. ISS and Glass Lewis have stated that they will recommend in some cases that shareholders not vote for directors of companies that do not opt out of the otherwise mandatory tenure voting law.³²

Notwithstanding the positions taken by ISS and Glass Lewis on the Florange Act, we believe it is plausible that institutional shareholders, particularly some of the largest institutional investors who “own the market,” could support tenure voting (*see supra* at II.C.2). We believe that a documentation of the pluses and minuses make it less than certain that the proxy advisory services would oppose tenure voting in the United States.

Tracking beneficial ownership. Historically, a major problem with tenure voting was the difficulty in identifying with complete confidence the actual holders of a company’s stock. Under the street name registration system, shares are generally not registered in the investor’s name. Beneficial ownership can (and often does) occur through layers of intervening legal entities, and as a result can be difficult to track. Several U.S. companies which had adopted (and rescinded) tenure voting plans noted that tracking beneficial ownership imposed administrative

³² Institutional Shareholder Services, Inc., Nov. 6, 2014, European Proxy Voting Guideline Updates, 2015 Benchmark Policy Recommendations; Glass, Lewis & Co., LLC, 2015, Proxy Paper Guidelines, 2015 Proxy Season, An Overview of the Glass Lewis Approach to Proxy Advice – France.

burden and expense, and led to confusion over distributions of voting power. When Roper rescinded its tenure voting plan in 2006, it cited among other reasons the “impracticality of policing [tenure voting] because of difficulties in determining whether there has been a change of beneficial ownership.”³³

One way companies have dealt with this difficulty is by offloading the tracking burden to shareholders. By presuming street name holders to be short-term shareholders, companies put the onus on the street name holders to track their beneficial ownership and represent that they are long-term holders. However, as this approach relies on individual shareholder representations, it can be difficult to administer efficiently and accurately. Further, it may be viewed as effectively disenfranchising street name shareholders, undermining the democracy benefit of tenure voting.

1. The Blockchain Solution

Recent technological developments could make it easier for companies to track beneficial ownership.

Blockchain. A blockchain is a shared ledger that records digital transactions made over its peer-to-peer software network. When a transaction occurs over the network, it is recorded in a “block.” Then, a decentralized network of computers running the software mathematically verifies and validates the transaction. Once verified, the block is added to the chain in chronological order. This forms a chain of blocks, or *blockchain*. The blockchain functions as a reliable, public record of every transaction that occurred since it and the network were created, with no need for a centralized recording authority.

Blockchain technology developed around the digital cryptocurrency Bitcoin. Bitcoin transactions occur over the Bitcoin network and are recorded in the Bitcoin blockchain. Because

³³ Dallas & Barry, *supra* note 13, at 76 n.282.

the blockchain is decentralized and reliable, there is no need for a “trusted third party” such as a central bank to issue or record transactions. Once a transaction occurs, it clears and settles almost instantaneously. The transaction essentially *is* the record in the blockchain; there is almost no lag between execution and settlement. Within minutes (or possibly even sooner) after a transaction occurs, it is verified and added to the blockchain. In this way, every Bitcoin transaction that ever occurred is immutably recorded in the Bitcoin blockchain available to any computer running the Bitcoin network.

Digital securities. Blockchain technology has the potential to “disrupt the \$1.6 quadrillion securities settlement and clearing market.”³⁴ If securities are digitized and issued over a blockchain platform, transactions could clear and settle within minutes. The blockchain could potentially supplant existing centralized third-party intermediaries such as Broadridge Financial Solutions, Inc. and the Depository Trust & Clearing Corporation. It could eliminate the gap between execution and settlement. Compared to existing settlement and clearing methods, Blockchain has the potential to be significantly cheaper, faster, and more reliable.

In 2015, Nasdaq introduced Linq, a platform for managing shares of private companies using blockchain ledger technology. Linq was used for the first time in December 2015 to complete and record a private securities issuance. The SEC recently approved the issuance by Overstock.com (“Overstock”) of digital shares using blockchain technology. On December 9, 2015, the SEC declared effective a Registration Statement on Form S-3 filed by Overstock offering \$500 million shares, any of which “may be issued in the form of digital securities.” On December 11, 2015 Overstock filed its Prospectus on Form 424B3 (“Prospectus”). Overstock’s

³⁴ Consensus 2015, Schedule & Agenda, 10 TIMES, Sept. 10, 2015, <http://10times.com/consensus-newyork>.

Prospectus is informative in understanding how a digital securities blockchain platform could work.

No “street name” registration.

Institutional and retail customers . . . will be able to utilize [an] interface to directly purchase and sell our digital securities, which will be held directly in that customer’s name, rather than in “street name.”

Definitive ownership record.

A transaction in our digital securities will be recorded on an electronic database, referred to in this prospectus supplement as the proprietary ledger, which . . . will reflect the definitive ownership record with respect to such digital securities and will be electronically published.

Mathematical validation.

This mathematical validation through the cryptographically-secured distributed ledger network technology serves to independently corroborate the validity of the publicly available proprietary ledger regarding digital securities transactions.

De minimis transaction costs not borne by shareholders.

The transaction costs associated with th[e verification] process relate to the de minimis costs. . . . The [digital trading platform]—rather than us or holders of our digital securities—will bear such minimal costs . . .

Transparency of anonymized transaction data.

. . . anyone with basic cryptographic technical skills will have access on a near real-time basis to the embedded data necessary to prove the validity of any publicly available copy of the proprietary ledger. As a result, there will be robust and transparent trading data (specifically, the number of securities traded by each anonymized account, the price of each trade and the balance of the securities held in each anonymized account) available to the general public.

Personal identifying information not public, but available to the transfer agent.

In addition, the transfer agent, . . . will be able to use the [software] to access personal identifying information . . . with respect to Overstock digital securities in order to match . . . customers to transactions recorded on the proprietary ledger. . . . As a result, such agent will have all information necessary to complete our books and records with respect to each digital securities transaction (specifically, the identity of each digital security's owner, the number of securities traded in each transaction, the price of each trade and the balance of securities held by each owner).

Prospectus at 34-36.

Experts recognize that Overstock's filing "opens the door for other companies" to issue digital securities using blockchain technology.³⁵

Benefits for tenure voting. Blockchain technology can reduce the burdens of tracking beneficial ownership. For companies that follow Overstock's example and issue digital securities over a blockchain platform, tenure voting becomes much easier.³⁶ This process could be expedited if and when clearance and settlement processes are modernized to interact with blockchain technology. Once that has happened, securities issuances and transactions will be definitively recorded in the blockchain. A given security's beneficial ownership history can be accessed at any time, almost in real-time. The actual identity—not street name—of any owner, along with the ownership period, can be easily determined at any time. The absence of street name registration obviates the need for presumptions with respect to street name holders. No shareholders will be burdened because the blockchain treats all shares alike and bears virtually all costs. Presumably, the software can be programmed to automatically award additional votes to securities held for the requisite period. The blockchain's mathematical verification system

³⁵ Tom Zanki, *SEC Approval Of Digital Shares Could Spur Experimentation*, LAW360, Dec. 18, 2015, <http://www.law360.com/securities/articles/739837/sec-approval-of-digital-shares-could-spur-experimentation> (quoting Jeffrey Steiner).

³⁶ The digital securities proposed for issuance by Overstock were not going to be listed on either Nasdaq or the NYSE.

protects against error and fraud. The so-called “trust machine” has the potential to be cheaper, quicker, fairer, and more reliable than the existing “honor system” approach based on individual shareholder representations as to their ownership period.

Other benefits. Another area of corporate governance that could benefit from blockchain technology is proxy access. Proxy access allows shareholders to list board candidates on ballots for annual meetings. While we do not take a position on the advisability of proxy access, we note that it is becoming increasingly common. In 2015, 21% of S&P 500 companies adopted proxy access, compared to 1% in 2014. Companies typically adopt proxy access by changing their bylaws to open their ballots to those who have held at least 3% of the company’s shares for three years. Currently, these companies rely on individual shareholders’ representations as to their ownership period. This kind of individualized, “honor system” approach can be inefficient, inaccurate, and costly. Blockchain technology can help these companies easily and accurately track share ownership to determine which shareholders meet the holding requirements to be eligible for proxy access.³⁷

Challenges remain. There remain concerns with using blockchain technology for digital securities shares. Digital shares not interchangeable with common shares could have limited liquidity and lower trading volume. That could skew pricing. There could be technological flaws or regulatory changes. The blockchain could potentially be hacked. The private cryptographic keys used to verify transactions could be stolen. The notion of publishing every transaction raises privacy concerns.

³⁷ Blockchain ownership could also solve thorny legal problems in appraisal actions and securities fraud class actions, both of which are in some measure dependent on tracing securities ownership.

Despite these challenges, we remain optimistic. The work by Nasdaq and other market participants makes it likely that it will soon be possible for more companies to issue digital shares using blockchain technology. This could allow companies to track stock ownership and award tenure votes in a cost-effective, efficient, fair, and reliable manner.

III. LEGAL FRAMEWORK

The SEC in 1988 attempted to regulate shareholder voting rights. Its efforts were blocked by the courts.³⁸ The courts reaffirmed that state law, not federal law, governs shareholder voting. As a result, companies generally need not consider federal law in adopting voting rights plans. Instead, companies must comply with state law and exchange listing rules. Both arguably permit tenure voting.

A. State Law

State law³⁹ views the corporate charter or other organic document as a contract between the company and its shareholders. Although state law generally provides one share, one vote as a default standard, a company and its shareholders can agree to any number of votes per share by amending the charter.

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. If the certificate of incorporation provides for more or less than 1 vote for any share, on any matter, every reference in [the Delaware General Corporations Law (“DGCL”)] to a majority or other proportion of stock, voting stock or shares shall refer to such majority or other proportion of the votes of such stock, voting stock or shares.⁴⁰

³⁸ *Bus. Roundtable*, 905 F.2d at 407.

³⁹ References to “state law” are to Delaware law, which is followed by most public companies. The white paper does not consider the law of other states.

⁴⁰ 8 Del C. § 212(a) (2015).

This provision makes clear that on all matters requiring a vote under the DGCL, the voting arrangement provided in the certificate of incorporation—even when it contemplates “more . . . than 1 vote for any share” as under a tenure voting plan—is valid.

In addition to the Delaware statute, the Delaware Supreme Court in *Williams v. Geier* has ruled on precisely this issue, and upheld a company’s adoption of a tenure voting plan. In 1985, the board of Cincinnati Milacron proposed and approved a charter amendment that, upon shareholder approval, would have recapitalized the company’s stock under a tenure voting plan.

The company’s objectives in the recapitalization were, among other things, to “promote long-term planning and values by enhancement of voting rights of long-term shareholders,” “[m]aintain [the] ability to maximize long-term value for shareholders,” enable the company to raise capital “without impairing [the] ability of management to maintain focus on long-term values rather than short-term business cycles,” and “[p]rotect long-term commitment to continued growth and investment in [the] business.”⁴¹

The proposed tenure voting plan was High-Low. All common shareholders would receive ten votes per share on the plan’s effective date. Upon a change in beneficial ownership, each share would revert to one vote until held for three years. Shares held in street name were presumed to be short-term and given one vote.

Insiders—who supported the tenure voting plan—held over 50% of the company’s voting power. Shareholder approval was virtually assured. The company informed shareholders in its proxy statement that insiders controlled more than 50% of the votes, and cautioned that the recapitalization would concentrate voting control in the hands of long-term shareholders, including the insiders. Ultimately, a majority of shareholders voted for the amendment, but less

⁴¹ *Williams v. Geier*, 671 A.2d 1368, 1372, 1376 (Del. 1996).

than half of the outside shareholders voted for the amendment. Finding that a fully informed majority of shareholders voted for the amendment, the court held that the board had lawfully exercised its reasonable business judgment in adopting tenure voting.

The court rejected claims that the board's actions constituted a breach of fiduciary duty or impermissible entrenchment. The court based its holding in part on the fact that the tenure voting plan did not create a "non-pro rata or disproportionate benefit which accrued to the [insiders]," even though the plan "in practice had the effect of strengthening the [insiders'] control."⁴²

Geier is consistent with other Delaware cases upholding alternative voting arrangements that deviate from one share, one vote principles. For example, in *Providence & Worcester Co. v. Baker*,⁴³ the Delaware Supreme Court reversed the Court of Chancery and upheld a voting arrangement under which the number of votes per share would decline if a shareholder owned a large enough number of shares ("scaled voting"). Similarly, in *Sagusa, Inc. v. Magellan Petroleum Corp.*,⁴⁴ the Delaware Supreme Court affirmed the Court of Chancery's ruling upholding a provision that required not only the approval of a majority of shares, but a majority of shareholders ("per capita voting").

We recognize that *Geier*'s continued viability has been questioned by some members of the Delaware bar and bench. Still, the case seems to remain good law. Moreover, even if the standard of review for a board's adoption of tenure voting—at issue in *Geier*—were to change, Delaware's enabling system of corporate law would still seem to permit companies to adopt a tenure voting system.

⁴² 671 A.2d at 1378.

⁴³ 378 A.2d 121 (Del. 1977).

⁴⁴ No. 12,977, 1993 Del. Ch. LEXIS 268 (Del. Ch. Dec. 1, 1993), *aff'd*, No. 78,1994, 1994 Del. LEXIS 294 (Del. Sept. 28, 1994).

B. Exchange Listing Rules⁴⁵

Historical development of the one share, one vote standard and SEC Rule 19c-4. As early as 1926, the NYSE announced that it was unlikely to list companies that did not adopt a one share, one vote policy. In 1940, the NYSE formally adopted a rule that barred the listing of no-vote common stock. Nasdaq, however, did not restrict the voting rights of its listed companies. As the takeover market heated up in the 1980s, companies sought disparate voting rights structures that could help ward off hostile takeover attempts. NYSE-listed companies began filing proposals to adopt disparate voting rights plans. Competitive pressure from Nasdaq increased. In response, the NYSE changed course. In 1984, it declared a moratorium on its one share, one vote policy. In 1986, it announced that it would end its one share, one vote standard. However, the NYSE needed the SEC's approval to adopt a new policy, so it filed a proposal with the SEC to formally modify its voting rights policy to permit shareholder-approved disparate voting rights plans.

Instead of approving the NYSE's proposal, the SEC in 1988 enacted Rule 19c-4, which required all U.S. exchanges—Nasdaq, NYSE, and Amex—to adopt a uniform voting rights policy that reflected one share, one vote principles.

Rule 19c-4 is overturned. The SEC's success was short-lived. Two years after Rule 19c-4 was enacted, it was overturned by the D.C. Circuit Court of Appeals in *Business Roundtable v. SEC*. First, the court held that the SEC had exceeded its authority by attempting to regulate voting rights. "Congress acted on the premise that shareholder voting could work, so long as investors secured enough information . . . [Congress] did not seek to regulate the stockholders'

⁴⁵ The views expressed in this Section are solely those of the coauthors, and do not represent the views of the Nasdaq Private Market (which is separate from the Nasdaq Stock Market), the New York Stock Exchange, or their representatives who were members of the Advisory Group.

choices. If the Commission believes that premise misguided, it must turn to Congress.”⁴⁶ Second, the court held that the SEC’s attempt to regulate voting power infringed on “a part of corporate governance traditionally left to the states.”⁴⁷ The court agreed that the SEC does not have “*carte blanche* to adopt federal corporate governance standards through the back door by mandating uniform listing standards.”⁴⁸

After its efforts were stymied by the courts, the SEC mounted an informal campaign to pressure the exchanges into adopting a uniform voting rights policy modeled on the unlawful former Rule 19c-4. After being “encouraged” by SEC Chairman Arthur Levitt, the exchanges complied and, in 1984, proposed a uniform voting rights policy (the “Policy”).⁴⁹ The SEC approved the Policy within months. To this day, the Policy remains part of the exchanges’ listing rules, and governs voting rights of listed companies.

The Voting Rights Policy.

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

The exchange rules offer further guidance regarding the Policy:

The [Policy] is based upon, but more flexible than, former Rule 19c-4 under the Act. Accordingly, [the exchanges] will permit corporate actions or issuances by [listed] companies that would have been permitted under former Rule 19c-4, as well as other

⁴⁶ 905 F.2d at 411.

⁴⁷ 905 F.2d at 408.

⁴⁸ 905 F.2d at 412 (citation omitted).

⁴⁹ SEC Approval, *supra* note 24, at II.

actions or issuances that are not inconsistent with this policy. In evaluating such other actions or issuances, [the exchanges] will consider, among other things, the economics of such actions or issuances and the voting rights being granted. [The exchanges'] interpretations under the policy will be flexible, recognizing that both the capital markets and the circumstances and needs of [listed companies] change over time.⁵⁰

The Policy specifies “time-phased voting plans” as an example of a prohibited “corporate action or issuance.” Tenure voting, which awards voting rights based on duration of ownership, might be viewed as inconsistent with the Policy. For this reason, companies should “consult with their respective [exchanges]”⁵¹ before committing to a tenure voting plan. Ultimately, however, we believe for the following reasons that tenure voting is consistent with the Policy.

No disparate impact. The plain language of the Policy permits corporate action that does not “disparately reduce[] or restrict[]” the voting rights of existing shareholders. Tenure voting treats all stockholders alike. It does not “disparately reduce” the per share voting rights of *any* stockholder. Instead, it grants *all* stockholders *equal* per share voting rights and *equal* opportunity to gain additional voting rights by holding their shares over time.

In addition to not *disparately* reducing voting rights of existing shareholders, tenure voting does not reduce voting rights *at all*. After the adoption of a Low-High plan, all shareholders retain the exact same voting rights. All that changes is that now they have an (equal) opportunity to *gain* voting rights. Likewise under a High-Low plan, what changes is that all shareholders instantly *gain* the exact same voting rights. Under either plan, tenure voting does not *reduce* votes. The only way to lose voting rights is by selling a share—but selling a share *always* reduces voting rights, even under a one share, one vote structure.

⁵⁰ Nasdaq Rule 5640, IM-5640; NYSE Rule 313.00; NYSE MKT Company Guide § 122.

⁵¹ SEC Approval, *supra* note 24, at III.A.

The Policy’s reference to “time-phased voting plans” does not contemplate today’s tenure voting plans. At the time the Policy was enacted in 1994, all U.S. tenure voting plans were (1) High-Low, and (2) presumed that shares held in street name were short-term. *Supra* at II.B. At the moment a company recapitalized under a tenure voting plan, the street name shareholders were de facto reduced to one vote (because of the presumption that they were short-term holders), while all other shareholders instantly gained high votes. Thus, tenure voting might have been understood to disparately reduce the effective per share voting rights of the shares held in street name.

By contrast, a tenure voting plan today would *not* necessarily include the street name presumption. Under a blockchain digital ledger platform, no shares would be held in street name. All shares would be held in the owner’s actual name. Ownership would be digitally tracked, with no burden or cost to any shareholder. *Supra* at II.D.1. A modern, blockchain-enabled tenure voting system would treat all shareholders equally. No shareholder’s voting rights would be reduced *at all*, let alone *disparately* reduced.

Business or economic reasons. When the SEC approved the Policy, it suggested that an underlying business rationale would support the listing of tenure voting stock.

There may be valid business or economic reasons for corporations to issue disparate voting rights stock. The [Voting Rights] Policy provides [the Exchanges] with a voting rights standard which will provide issuers with a certain degree of flexibility in adopting corporate structures, so long as there is a reasonable business justification to so doing, and such transaction is not taken or proposed primarily with the intent to disenfranchise.⁵²

Before consulting with their exchanges, companies should consider whether they have a business or economic reason for adopting tenure voting. Obviously, there are strong business reasons why

⁵² *Id.* at n.30.

long-term value creation is in the best interests of a company and its shareholders. Some companies may also be able to demonstrate a unique business model for which managing for the long term is crucial (such as new technologies or long product cycles). Companies can also highlight growing concerns over short-termism as part of the rationale for adopting tenure voting. *See supra* at I.A.

Circumstances have changed. Both the SEC and the exchanges have clarified that the exchanges’ “interpretations under the Policy will be flexible, recognizing that both the capital markets and the circumstances and needs of [listed companies] change over time.”⁵³ Current levels of (perceived) short-termist activism and influence neither existed nor were anticipated when the Policy was adopted over two decades ago. To the contrary, capital markets have fundamentally changed from repositories of patient capital to short-term trading platforms, creating changed circumstances for many companies.⁵⁴ Companies’ needs have also changed. First, the changed market conditions have created an acute need for companies to align investors with the companies’ long-term interests. Second, today’s disruptive growth technology businesses need more upfront investment and longer-term management than more traditional business models.⁵⁵ Tenure voting—which addresses these concerns without disparately treating any shareholder—should be permitted.

Case-by-case approach. Even if one interpreted the Policy’s reference to “time-phased voting” plans to include tenure voting, the exchanges could still permit tenure voting on a case-by-case basis. The SEC has made clear that unlike former Rule 19c-4, the Policy provides

⁵³ Nasdaq IM-5640; NYSE Rule 313.00; NYSE MKT Company Guide § 122; SEC Approval, *supra* note 24, at III.D.1.

⁵⁴ *Supra* at I.A.

⁵⁵ *See id.*

“greater flexibility” for companies seeking to “alter[] their existing capital structure in such a fashion that might otherwise be prohibited under the Policy. . . . The [exchanges] will evaluate the application of the Policy to such transactions on a case-by-case basis.”⁵⁶ By demonstrating a unique need to manage for the long term and highlighting concerns over market short-termism, many companies could have a strong argument for “flexible” treatment by the exchanges that would permit tenure voting.

IV. POSSIBLE FEATURES OF A TENURE VOTING PLAN

In any tenure voting plan, there are several structural features that must be decided.

- Low-High vs. High-Low;
- Length of holding period;
- Number of votes awarded after each holding period;
- Number of step increases;
- Which transactions constitute changes in beneficial ownership (i.e., transfers without valuable consideration or which do not change voting ownership); and
- How to track beneficial ownership.

Beyond the underlying structure, there are additional features a company may consider.

- Voting rights cap: limit the percentage voting power attainable by any single holder;
- Exempt matters: certain agenda items on which shares will not have high votes (i.e., hostile takeovers and other core corporate changes or changes that materially diminish the rights of the class);
- Transfer rights: permit shareholders to transfer high votes;

⁵⁶ SEC Approval, *supra* note 24, at III.C.2 (emphasis added).

- Sunset provision: condition that terminates the tenure voting structure (i.e., departure of key personnel, long-term ownership falls below a specified threshold);
- Excluded parties: certain shareholders not eligible (i.e., index funds, to avoid shareholder entrenchment);
- Employee stock: include options and restricted stock units to preserve democratic appeal or exclude them to prevent management entrenchment; and
- Voting agreement restriction: entry into voting agreement in change of control situation forfeits high votes.

We believe that, in most instances, a tenure voting structure should have the following features, as part of a “best practices” standard:

High-Low. Shareholders should own high-vote shares immediately after they have voted to approve the tenure voting plan. First, there will likely be substantial delay between the announcement of a plan and the shareholder vote. That delay should provide ample time for shareholders to consider their interest in the company and to make their voting and purchasing decisions. There is no need to further delay the benefits of tenure voting. Moreover, it is likely that initially, tenure voting plans will be subject to litigation. Companies may be reluctant to implement any plan until litigation is resolved (just as Alphabet chose not to implement its no-vote Class C stock until it resolved the related litigation), which adds further delay. A High-Low plan will help save companies and shareholders from waiting years before obtaining the benefits of tenure voting.

Holding period of three to five years. We recognize that at this early stage in the development of tenure voting structures, determining a specific holding period is more art than

science. We further recognize that company-specific needs may play a role in this determination. Still, we believe that a core aim of tenure voting is to attract long-term interest in the company. *Supra* at II.C. That interest should be balanced against the need to review investment horizons to avoid complacency. We think that a holding period of three to five years strikes an appropriate balance, while still leaving companies with flexibility to customize within this range.

Three to five votes. A three-year holding period should yield no less than three votes. A five-year holding period should yield no more than five votes. We think this strikes an appropriate balance between incentivizing long-term investment and avoiding entrenchment concerns.

Voting rights cap. As a general rule, a plan should limit the number of votes available to any individual shareholder (or group of shareholders) to a specified threshold percentage of outstanding votes. Institutional investors may prefer a lower threshold. Companies with dual-class stock in which founders/insiders have outsized influence compared to their economic interest may prefer a higher one. Ultimately, the specific threshold will depend on a company's particular needs and circumstances.

Blockchain tracking. Companies adopting tenure voting should also consider the potential benefits of using blockchain technology, as it develops, to track beneficial ownership. We recognize that currently this technology may not be ready for large-scale use by publicly traded companies, and that there may not yet be adequate systems for this technology as a trading platform. We also recognize that there are many potential regulatory challenges and other issues that need to be considered and resolved before widespread adoption of this technology can be achieved. Yet blockchain technology holds the potential to be more cost-effective, efficient, and reliable than existing methods. It can eliminate the need for street name registration and

presumptions against high votes for outside shareholders. Accordingly, it can dramatically enhance the democratic appeal and administrability of any tenure voting plan.⁵⁷

CONCLUSION

As an alternative to high-vote and no-vote capital structures, we believe that U.S. companies and exchanges may also consider tenure voting plans. Such plans may address real and perceived issues concerning short-termism while giving shareholders a continued say in the company. A U.S. company interested in adopting tenure voting needs to develop an underlying business rationale, engage with its exchange to ensure compliance with the Policy, consider how it will track beneficial ownership and other plan features, and gain shareholder approval. If adopted, tenure voting plans can help shareholders, companies, the marketplace, and society return to a disciplined, long-term approach to investment and growth.

⁵⁷ *Supra* at II.D.1.