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THE SHAREHOLDER FRANCHISE, TRANSFORMATIVE INVESTOR CHANGES, AND MOTIVATIONAL MISALIGNMENTS[♣]

HENRY T. C. HU AND LAWRENCE A. HAMERMESH [*]

ABSTRACT

The foundational corporate governance premise is that a shareholder's economic ownership will generally motivate her to use the associated voting rights to promote share value. Implicitly, the premise assumes that the voting rights and the economic rights of share ownership are inextricably linked—i.e., are "*coupled*." Transformative institutional investor changes are increasingly undermining the premise, animated in large part by an accelerating, but insufficiently recognized, severing of that link—"*decoupling.*"

Such institutional investor voting misalignments—from decoupling such as "empty voting" and "empty voting with negative overall economic interest"—are increasingly pervasive. They are no longer limited to hedge funds affirmatively deploying motivational misalignments as a strategy, based on decoupling through byzantine, often derivatives-laden, financial stakes and novel uses of longstanding organizational voting dynamics such as share borrowing. Our 2023 article showed that decoupling-related motivational misalignments were now also occurring with surprising frequency at mainstream institutional investors. With these investors, such decoupling-related misalignments are not matters of strategy, but instead are byproducts of transformative changes in financial stake patterns (e.g., the now-gargantuan size of certain asset managers and the rise of indexation) and in a variety of organizational voting dynamics (e.g., the emergence of value-destructive versions of ESG-based investing and voting) occurring for independent reasons.

This Article adds to the existing literature on decoupling-based motivational misalignments in four major ways.

First, this Article offers a baseline and terminology for the systematic analysis of the direction and magnitude of such misalignments. We show that to ascertain incentives of an institutional investor

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[*] This draft speaks as of April 21, 2024. Professor Hu holds the Allan Shivers Chair in the Law of Banking and Finance, University of Texas Law School. Professor Hamermesh is Professor Emeritus at Widener University Delaware Law School and the former Executive Director of the Institute for Law and Economics, University of Pennsylvania Carey Law School. We thank participants for their comments at events hosted by the [New York University Law School (Institute for Corporate Governance & Finance Spring Roundtable - May 2, 2024)], [Tilburg University (Law and Economics Center Seminar - Oct. 2, 2024)], Tulane Law School (Corp. & Sec. Roundtable - Mar. 9, 2024), University of Pennsylvania Carey Law School (Institute for Law and Economics Fall Roundtable - Dec. 8, 2023), University of Texas Law School (Faculty Colloquium - Oct. 5, 2023), and University of Western Ontario (Business & Law Scholars Series - Oct. 19, 2023). We also thank John Dzienkowski, John Golden, Harald Halbhuber, Jack B. Jacobs, David Katz, Michael Klausner, Travis Laster, Simon Lorne, John Morley, Ted Mirvis, Christopher Nicholls, Michael Ohlrogge, Jeff Strnad, Bob Thompson, and [to come] for their comments, and the assistance of Lei Zhang, Scott Vdoviak, and Michael W. Brown.

in this context, it is necessary to determine the combined effect of: (a) the investor's positive, negative, or zero "overall economic interest" in the host shares (flowing from the investor's holdings of "host shares," "coupled assets," and "related non-host assets"); and (b) the investor's "organizational voting dynamics."

Second, this Article refines our 2023 article's analysis of the failure of the core judicial response to departures from the foundational premise to come to grips with the transformative investor changes. That response is animated by the construct of a "disinterested shareholder"— in essence, a shareholder whose financial stakes incentivize them to vote or tender their shares in value-maximizing ways. In challenges to transactions otherwise subject to judicial review under enhanced scrutiny or entire fairness standards, Delaware courts have long given validating effect only to uncoerced, informed "disinterested" stockholder votes.

Our 2023 article warned that institutional investors—including the largest asset managers—would be disqualified from being considered "disinterested" with surprising frequency. This would, ironically, and through complete inadvertence, shift voting power to individual investors, the very group at the core of Berle-Means concerns, as well as to activist investors.

Beyond urging a reconceptualization of "disinterestedness" to comprehend misalignments flowing both from financial stakes and from organizational voting dynamics, this Article shows that there is an even more basic problem with the doctrine. It is close to impossible to accurately and comprehensively assess the disinterestedness of most large institutional investors. The gap between the information that would be needed and the information that is readily available is too severe, and voluntary and subpoenaed information cannot fill the gap.

Third, this Article shows that, notwithstanding the power of the vision for the role of the stockholder franchise and its ostensible foundational premise, in reality, the law insists only erratically on alignment of voting power and economic interest. We offer a taxonomy showing contexts reflecting varying degrees of such insistence.

This taxonomy helps unveil new insights as to the entirety of the shareholder franchise. We show, for instance, how the relatively stringent judicial constraints on transfers of "decoupled" voting rights could be interpreted to not only limit certain misalignments in the *direction* of incentives but also certain misalignments in the *magnitude* of incentives flowing from such transfers. Such constraints would potentially affect all contexts in which shareholder voting occurs, even extending to the exercise of statutory voting rights (e.g., voting as to election of directors and fundamental transactions such as mergers)

Fourth, and most important, this Article offers a focused, scaled, and cost-effective solution that overcomes the daunting informational challenges posed by insistence on shareholder disinterestednedess. That solution begins with a presumption of disinterestedness. Failing to adopt such a presumption – in effect, requiring affirmative proof of disinterestedness – would be tantamount to a blanket rejection of decades of precedent giving validating effect to shareholder approval in important contexts. Such a striking diminution of the role of shareholders and a corresponding enhancement of the roles of judges and boards should occur, if at all, only after careful debate--not by fluke.

The Article further outlines a workable, focused process that, notwithstanding the daunting informational challenges, would help identify material instances of institutional investor departures from disinterestedness. The proposed presumption would be rebuttable through the use of readily available public information about institutional investor holdings, and would allow for a full evidentiary review of disinterestedness where such an investor's holdings or disinterestedness are not clearly too insignificant to affect its vote or to influence the overall outcome of a shareholder vote.

CONTENTS

Introduction

I: Motivational Alignment, the Foundational Premise, and the Rise of Decoupling

A. Motivational Alignment and the Foundational Premise
- 1. Overview
- 2. Financial Stakes: Decoupling Framework's "Overall Economic Interest in Host Shares"
- 3. Organizational Voting Dynamics: Decoupling Framework's "Record Date Capture Strategy" as Example

B. Transformative Institutional Investor Changes and Decoupling
- 1. Transformative Changes: Hedge Funds – Decoupling and Motivational Misalignment as Strategy
- 2. Transformative Changes: Mainstream Institutional Investors – Decoupling and Motivational Misalignment as By-Products of Changing Financial Stake Patterns and Organizational Voting Dynamics
  - a. Financial Stakes
    - (i) Increase in Passive Investment, with Inflection in Mid-2010s
    - (ii) Increase in Absolute Size and Market Share of Largest Asset Managers: Inflection in Mid-2010s
  - b. Organizational Voting Dynamics
    - (i) Shift Away from Share-Value-Enhancing Motivated Voting
    - (ii) Increasing Awareness of Effect of Share Lending on Voting Rights and Supply of Shares Available to be Borrowed

C. The Judicial "Disinterested Shareholder" Response

II: Decoupling Voting Rights from Economic Rights: A Substantive Law Taxonomy

A. Statutory Voting Rights

B. Transfers of Voting Rights Decoupled from Economic Rights
- 1. Vote Buying
- 2. Irrevocable Proxies
- 3. Voting Trusts and Voting Agreements
- 4. Judicial Constraints on Misalignments in Magnitude and Direction Flowing from Transfers of Decoupled Voting Rights

C. Voting as Measure of Merits of Challenged Transaction

D. The Policy and Logic of the Taxonomy

1. Statutory Voting Rights
2. Transferring Voting Rights Decoupled from Economic Rights
3. Voting as Measure of Merit of Challenged Transactions

III. The Informational Impossibility of Requiring Affirmative Proof of Shareholder Disinterestedness

A. Overview
B. The Information Needed and the Information Available
1. Nature and Synchronicity of Information Needed
2. Individual Investors
3. Institutional Investors: Financial Stakes
a. Host Shares
b. Coupled Assets: Derivatives and Short-Selling
c. Related Non-Host Assets
4. Institutional Investors: Organizational Voting Dynamics
a. Share Borrowing, Share Lending, and Share Recalls
b. To What End? Host Share Value Maximization versus Portfolio Value Maximization
c. To What End? Non-Value Enhancing Motivations for ESG and Other Reasons
d. To What End? House View versus Individual Portfolio Manager View?
e. Indexed Funds versus Actively Managed Funds
f. Externally Managed Funds versus Internally Managed Funds
D. Limits to Relying on Voluntarily Supplied Information and Subpoenaed Information

IV. Proposal: A Measured Solution for Implementing the Disinterested Shareholder Doctrine

A. Overview
B. Rebuttable Presumption of Disinterestedness as Starting Point and Justifications
1. Means-End Rationality and Delaware's Approach Elsewhere to Decoupling
2. Incrementalism
3. Empirical Basis
a. Individual Investors
b. Institutional Investors
C. Process for Identifying and Resolving Issues of Departures from Disinterestedness
1. Rebutting the Presumption of Disinterestedness
2. Applying a Materiality (Predictability and Magnitude) Filter
a. Probability
b. Magnitude
3. Examining a Limited Number of Shareholders on Full Information About Financial Stakes and Organizational Voting Dynamics

Conclusion

Introduction

"The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[1] In the generation since Chancellor William Allen's soaring rhetoric in *Blasius*, the "transcending significance" of the franchise has become corporate governance catechism.[2] His hope, if not expectation, was that the rise of the institutional investor would help the franchise transition from an "unimportant formalism" to an important source of discipline. The Berle-Means separation of ownership and control is reduced and, so too, the classic principal-agent problems of corporate governance.[3]

This catechism has motivational alignment as its foundational premise: the shareholders' economic ownership will generally motivate them to vote in ways that promote their common interests—e.g., increasing the value of the shares.[4] The premise assumes that the voting rights and economic rights of share ownership are inextricably linked—*i.e.*, are "coupled"—in the typical one share-one vote company.

An accelerating, insufficiently recognized severing of that link—*"decoupling"*—and associated transformative investor changes are increasingly undermining the foundational premise. Without the company's knowledge, sophisticated investors may now hold votes independent of any financial stake—positive, negative, or zero—in the shares. For example, even an investor with a negative financial stake can nevertheless hold voting rights and be motivated to vote in ways that *destroy*, not promote, share value. Moreover, what we have termed the investor's "organizational voting dynamics" can result in voting motivations that can amplify, run directly counter to, or otherwise affect the motivations flowing from its financial stakes.

Such systematic misalignments began with transformative changes at hedge funds in the mid-2000s. Hedge funds started deploying decoupling and misalignment as a strategy, often relying on byzantine derivatives-laden financial stakes and on novel uses of longstanding organizational voting dynamics such as share borrowing. Around the mid-2010s, such misalignments started accelerating at more mainstream institutional investors—not pursuant to strategy but, instead as byproducts of transformative changes occurring for independent reasons. Here, relatively straightforward financial stakes and new forms of organizational voting dynamics are at play.

Courts have often recognized the possibility of departures from the foundational premise to a limited extent. However, the core response emerged long before such decoupling-related

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[1] Blasius Industries, Inc. v. Atlas Corporation, 564 A.2d 651, 658 (Del. Ch. 1988).

[2] *Id.* at 662 (stating that "I recognize the transcending significance of the franchise to the claims of legitimacy of our scheme of corporate governance". The Delaware Supreme Court stated that the "most fundamental principles" in corporate governance are "a function of the allocation of power within a corporation between its stockholders and its board" and that "the stockholder's power is the right to vote." MM Cos. v. Liquid Auto, Inc, 813 A.2d 1118, 1126 (Del. 2002). Similarly, Kathaleen McCormick, the current Chancellor, wrote that "categorically concluding that *all* stockholder efforts to change or influence corporate direction constitute a threat to the corporation runs directly contrary to the ideological underpinnings of Delaware law." Williams Companies Stockholder Litigation, 2021 WL 754593 [at 29] (Del. Ch. 2021).

[3] The late 1980s-early 1990s optimism about the role of institutional shareholders in dealing with the Berle-Means problem is exemplified in Dana Wechsler Linden & Nancy Rotenier, *Good-bye to Berle & Means – Nineteen ninety-three was the year when shareholders and boards of directors showed the boss who was boss*, FORBES, Jan. 3, 1994, at 100.

[4] *See* Part I.A.1 *infra* (discussing *Kurz* and *Crown EMAK* opinions).)

misalignments arose.[5] This core response—currently embodied in two well-known lines of cases, the "*MFW*" line and the "*Corwin* cleansing" line—has been through a single judicial construct.[6] The construct is that of a "disinterested shareholder"—in essence, a shareholder whose stakes incentivize them to vote or tender their shares in value-maximizing ways. In challenges to transactions otherwise subject to judicial review under enhanced scrutiny or entire fairness standards, Delaware courts have long given validating effect to uncoerced, informed stockholder votes to approve the transaction. Under this doctrine, only the votes of the "disinterested shareholders" count.

With the April 4, 2024 Delaware Supreme Court *Match Group* decision, the role of such votes will likely increase dramatically and with it, the importance of the judicial construct.[7] Under the *MFW* line of cases, it was unclear what was necessary for a controlling stockholder to obtain the benefits of business judgment review when a controlling stockholder transaction did not involve a freeze out merger. Some believed that, apart from the freeze out merger context, either approval of an independent special committee or approval by an appropriate shareholder vote would suffice. In *Match Group*, the Delaware Supreme Court held unequivocally that approvals by both are essential in all circumstances.

The standard of review can be critical to the fate of the challenged transactions, as Elon Musk recently found out in a $55.8 billion way.[8] On January 30, 2024, the Delaware Court of Chancery's rejection of his Tesla pay package flowed from a failure to comply with *Corwin* cleansing requirements and the court's application of the entire fairness standard.

Under current law, institutional investors are governed by the same "disinterested shareholder" construct that individual investors are subject to. This is despite the emergence of factors unique to institutional investors that can systematically cause them to vote in ways that depart from what their share ownership would seemingly motivate. These new systematic biases are affecting institutional investors at a time when institutional investors not only account for the vast majority of shares and hence of the voting power but, because retail investors tend not to vote, an even higher percentage of the votes actually cast.

Increasingly important systematic motivational misalignments flow from the decoupling and associated transformational changes in the financial stakes and organizational voting dynamics of institutional investors. They first started appearing in force in the mid-2000s, when hedge funds started deploying decoupling and misalignment as a strategy, relying on complex financial stakes facilitated

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[5] By 1987, for example, it was well established that "approval by … disinterested stockholders under section 144(a)(2) [of the Delaware General Corporation Law] permits invocation of the business judgment rule and limits judicial review to issues of gift or waste with the burden of proof upon the party attacking the transaction." Marciano v. Nakash, 535 A.2d 400, 405 n. 3 (Del. 1987). *See also* In re Wheelabrator Technologies S'holders Litig., 663 A.2d 1194, 1203 (Del. Ch. 1995) (a transaction between a corporation and its directors "will not be voidable if it is approved in good faith by a majority of disinterested stockholders.").

[6] In re MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013), *aff'd sub nom.* Kan v. M&F Worldwide Corp., 88 A.3d 635 (Del 2014); Corwin v. KKR Financial Holdings LLC, 125 A.3d 304 (Del. 2015). As to the significance of these lines of cases, see, e.g. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Company Law*, 56 BUS. LAW. 1287 (2001); Lawrence A. Hamermesh, Jack B. Jacobs & Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321 (2022) [hereinafter Hamermesh, Strine, & Jacobs, *Retrospective* and *Look Ahead*].

[7] In re Match Group, Inc. Derivative Litigation, C.A. No. 2020-0505 (Del. Apr. 4, 2024).

[8] Tornetta v. Musk, 2024 Del. Ch. LEXIS 27, *128 (Del. Ch. Jan. 30, 2024) (insufficiency of disclosure to shareholders prevented their favorable vote from avoiding requirement of establishing entire fairness of compensation package).

by modern derivatives and on novel uses of longstanding organizational voting dynamics such as share borrowings. In 2006, an analytical framework for decoupling that one of us co-developed showed, for instance, how a hedge fund could use financial stakes involving complex holdings of the host company shares, "coupled assets" (such as derivatives and short-selling arrangements), and "related non-host assets" (such as shares in a counterparty) to achieve "empty voting with a negative overall economic interest" in the host shares.[9] With this strategy, a hedge fund could achieve the unlikely result of having the highest number of votes at the host company while having an incentive to vote for actions destructive of the value of the host shares--*i.e.*, while having a large *negative* "overall economic interest" in the host shares.

This is precisely contrary to the early hopes for the role of the institutional investor: this institutional investor's large (*negative*) economic stakes in the host shares would incentivize it to use its voting clout not to enhance share value, but to destroy it. The analytical framework also showed how motivational misalignment could occur purely through organizational voting dynamics, instead of through byzantine financial stakes. The prime example offered involved the novel use of the longstanding share lending/borrowing market: a hedge fund can secretly acquire massive voting rights completely irrespective of—and without any impact on—the fund's overall economic interest in the host shares. This new form of vote buying, which the framework termed the "record date capture strategy," would allow the hedge fund to use the bought votes to further the fund's economic goals, whether it be to enhance share value (as with a hedge fund with a net long position in the shares) or to destroy it (as with a hedge fund with a net short position in the shares).

In our 2023 *Decoupling and Motivation* article, we suggested that a series of other transformative changes were starting to cause increasingly pronounced motivational misalignments at more mainstream institutional investors.[10] Unlike the case with hedge funds, the misalignments do not result from the deployment of decoupling and misalignment as a strategy, but instead arise as byproducts of transformative changes in financial stakes and organizational voting dynamics occurring for wholly independent reasons.

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[9] Henry T. C. Hu & Bernard Black, *The New Vote Buying, Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) [hereinafter Hu & Black, *2006 Decoupling I (Southern Cal.)*]. The framework was extended and refined in about a dozen lead- or sole-authored articles, apart from our 2023 article, cited at note 10 *infra*. *See, e.g.*, Henry T. C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011 (2006) [hereinafter Hu & Black, *2006 Decoupling I (Bus. Law.)*]; Henry T. C. Hu & Jay L. Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321 (2007) [hereinafter Hu & Westbrook, *2007 Columbia*]; Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling II: Importance and Extensions*, 156 U. PA. L. REV. 625 (2008) [hereinafter Hu & Black, *2008 Decoupling II (Penn.)*]; Henry T.C. Hu & Bernard Black, *Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 EUR. FIN. MGMT. 663 (2008) [hereinafter Hu & Black, *2008 Decoupling II (EFM)*]; Henry T. C. Hu, *Financial Innovation and Governance Mechanisms: The Evolution of Decoupling and Transparency*, 70 BUS. LAW. 347 (2015) [hereinafter Hu, *2015 Financial Innovation and Governance Mechanisms*]; Henry T. C. Hu, *Governance and the Decoupling of Debt and Equity: The SEC Moves*, 17 CAP. MKTS. L.J. 411 (2022) [hereinafter Hu, *2022 Governance and Decoupling*].

[10] Henry T. C. Hu & Lawrence A. Hamermesh, *Decoupling and Motivation: Re-Calibrating Standards of Fiduciary Review, Rethinking "Disinterested" Shareholder Decisions, and Deconstructing "De-SPACs*," 78 BUS. LAW. 999, 1024-34 (2023) [hereinafter, Hu & Hamermesh, *Decoupling and Motivation*]. In this Article, we focus on (non-controlling) shareholder motivations flowing from (a) financial stakes in or directly related to the host company and (b) "organizational voting dynamics" as hereinafter defined relating to those stakes. As detailed in note 13, *infra*, this Article does not deal either with the full range of economic incentives that may affect how an investor votes and other less other less measurable considerations, not necessarily economic in nature,

On the financial stakes side, changes include matters such as the combined impact of the now-gargantuan size of certain asset managers and the rise of indexing, derivatives positions, and market neutral and other “alternative” strategies. These financial stake changes in and of themselves have profound consequences. Mainstream asset managers, with surprising frequency, now have negative overall economic interest in host shares. Or, in the lingo of the judicial construct, these mainstream institutional investors would not be “disinterested shareholders.”

However, comprehensively determining the voting motivations of a shareholder must go beyond consideration of the effect of its overall economic interest in the host shares. It is also necessary to consider the shareholder’s organizational voting dynamics, an area in which institutional investors have also experienced transformative changes. The secular rise in the importance of non-value maximizing goals (such as from certain extreme versions of ESG-based investing) do not affect overall economic interest but can have a direct impact on the shareholder franchise’s foundational premise of a value-driven voting motivation. Similarly, a secular rise in share lending volumes, sparked by both an SEC interpretive change and the growth of indexation, has had the result of, among other things, rendering share lending, share recall, and share borrowing decisions more important to voting outcomes.

In this Article, we provide evidence to suggest that these mainstream institutional investor changes became especially important around the mid-2010s. The factors contributing to misalignment --such as the increase in size and market share of large asset managers, the increase in indexing as an investment strategy, and the increase in non-shareholder value enhancing-motivated voting behavior and in share lending--cannot be safely ignored any longer.

Fundamental conceptual and practical problems flow from the failure to reconsider the robustness and impact of the longstanding disinterestedness doctrine in the face of such increasing systematic voting misalignments.

From a conceptual standpoint, as shown in our 2023 article, a basic dilemma arises. On the one hand, a straightforward application of the judicial doctrine to institutional investors would disqualify the votes of major institutional investors from being considered disinterested with alarming, and we believe highly undesirable, frequency. One consequence of such disqualification is that there would be a disruptive and unintended shift in voting power to, among others, individual investors—ironically, the very voters whose rational apathy and informational deficiencies Berle-Means and others have been concerned about. In addition, as we show in this Article, this would have the consequence of shifting power to activist hedge funds, a disruptive and unintended shift in allocation of power at corporations with profound impact. On the other hand, given the overwhelming dominance of institutional investor share ownership today, failing to apply the disinterestedness doctrine to institutional investors would be to effectively insulate the vast majority of votes from the core method for checking their legitimacy.

In 2023, we noted several possible responses to this problem, including “reduc[ing] the importance accorded to shareholder votes and tendering as guides to shareholder preferences,” on one hand, and alternatively, “continu[ing] to adhere to the disinterested shareholder voting fiction and

ignor[ing] the many issues noted above, on the theory that somehow the overall results are good enough … ."[11]

We offered some interim steps that could address some of these issues. More importantly, we reluctantly concluded that, on balance, there was a compelling need for a limited and temporary strategic pause in the straightforward application of this key judicial doctrine until there was a wholesale rethinking of deference to shareholder decisions."[12]

This Article undertakes the rethinking of this disinteredness doctrine, but also offers a far broader perspective: the actual role of the foundational premise with respect to the shareholder franchise as a whole. We show that, notwithstanding the power of the vision for the role of the stockholder franchise and its ostensible foundational premise, in reality, the law insists only erratically on alignment of voting power and economic interest. We offer a taxonomy showing contexts reflecting varying degrees of such insistence.

We find that the courts' rhetorical insistence on that premise has direct enforcement traction only in two major contexts. The first context is the "disinterested shareholder" context in which the votes are used by courts as a measure of the merit of the challenged transaction. This context is the primary focus of this Article, which proposes a solution to the problems associated with the core judicial response to decoupling-related motivational misalignments.

The second context—one which could potentially apply to the entirety of the shareholder franchise—is when voting rights are transferred without the accompanying economic rights. Here, the cases reflect a concern not only about the possibility of motivational misalignments in the *direction* of the incentives (the sole concern of the "disinterested" shareholder construct) but also in the *magnitude* of the incentives. We believe that current precedents in this area could be construed to preclude misalignments when the magnitude of the decoupled voting rights transferred affects the voting outcome. Such constraints would potentially affect all contexts in which shareholder voting occurs, even extending to the exercise of statutory voting rights (e.g., voting as to election of directors and fundamental transactions such as mergers).

With respect to the "disinterestedness" response, we show that the situation is worse than we had feared. The overwhelming informational challenges associated with accurately assessing the disinterestedness of institutional shareholders would preclude any careful application of the associated judicial doctrine. The gaps between the information available publicly or through the host company and the information needed are surprisingly large, and voluntary and subpoenaed information cannot fill the gaps.

As to information on financial stakes, the analytical framework for decoupling showed the need for highly granular information as of the voting date as to each shareholder's holdings of: (a) the host

[11] *Id.* More broadly, one of us has written on disclosure, substantive, and other strategies that courts, legislators, regulators, the share-lending market, corporate private ordering, and those responsible for the voting architecture can implement to improve the legitimacy of the stockholder franchise. *See, e.g.,* Hu & Black, *2006 Decoupling I (Southern Cal.)*, *supra* note9, at 864-906; Hu & Black, *2008 Decoupling II (Penn.)*, *supra* note 9, at 682-721; Hu, *2022 Governance and Decoupling*, *supra* note8, at 430-66. As to three families of strategies and the possibility of private ordering, see, *e.g.*, Hu & Black, *2008 Decoupling II (Penn.)*, *supra* note 9, at at 694-721.

[12] Hu & Hamermesh, *Decoupling and Motivation*, *supra* note 10, at 1039.

shares; (b) "coupled assets" (e.g., derivatives positions and short-selling arrangements); and (c) "related non-host assets" (e.g., common ownership in counterparty companies). If the relevant person is an institutional investor, detailed information as to the institution's "organizational voting dynamics" is also needed. Large asset managers vary markedly on matters such as the purpose of their voting (e.g., is it to maximize the value of the host shares or is it to maximize the value of a fund's overall portfolio or something else), the allocation of voting authority between individual portfolio managers and the institution as a whole, the extent and nature of "pass through" voting, and the extent, if any, of value-destructive versions of ESG-motivated voting. Information on the share lending and share recall decisions of institutional investors would also be essential in determining disinterestedness of their votes.

Under the judicial doctrine, defendants bear the burden of demonstrating the "disinterestedness" of the requisite majority of shareholders. In a public company, that demonstration would necessitate an affirmative, shareholder-specific finding for as many as hundreds or thousands of shareholders, both institutional and individual. This is an impossible task. We show systematically and in detail the massive gaps between the information on financial stakes and organizational voting dynamics needed and the information that is readily available, even as to the most highly-regulated and transparent of institutional investors. Apart from the nature of the information required, the need for synchronicity of the information has surprising quirks. Overall, as a practical matter, it is impossible for a court to assess the disinterestedness of a typical large institutional investor accurately and comprehensively based on information available publicly or through the host company and, short of a subpoena, investors will not provide the missing information voluntarily. Indeed, we show that such a court inquiry would operate like a poll tax, and would have the perverse effect of discouraging voting.

This Article proposes a focused, scaled, and cost-effective solution to the problems with the core response, one that seeks to protect the integrity of the shareholder franchise when the lack of disinterestedness genuinely matters. The proposal seeks to do so notwithstanding the overwhelming informational challenges.

As a preliminary matter, the judicial construct of "disinterestedness" needs to be re-conceptualized. Currently, the "disinterested shareholder" construct only considers motivational alignments flowing from an investor's financial stakes—and then, only misalignments in the *direction* of the alignment, not with respect to its *magnitude*. However, since the shareholder's organizational voting dynamics have independent effects on alignment, we suggest a modest re-conceptualization of the "disinterestedness" construct: the construct must comprehend the combined effect of financial stakes and organizational voting dynamics.[13]

Our solution begins with the adoption of an evidentiary presumption that shareholders are disinterested (in the reconceptualized sense). We acknowledge that this presumption is superficially contrary to existing doctrine that gives validating effect to shareholder approval of a transaction only if defendants satisfy the burden of proving that such approval is informed, uncoerced, and disinterested. We show, however, that this inconsistency is only superficial.

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[13] As will be discussed in Part I.C, a yet broader concept of disinterestedness would involve also considering: (1) economic motivations other than those flowing from an investor's financial stakes and organizational voting dynamics; and (2) non-economic motivations. This Article's focus is on the typically more quantifiable, and perhaps more important, misalignment that flows from financial stakes and organizational voting dynamics.

Failing to adopt such a presumption – in effect, requiring affirmative proof of disinterestedness – would have consequences for the stockholder franchise that are radical and unintended. Conditioning deference on the informationally impossible is tantamount to a blanket rejection of decades of precedent giving validating effect to shareholder approval in important contexts. Such a striking diminution of the role of shareholder voting and correspondingly enhancing the role of judges and boards should occur, if at all, only after careful debate. It should not occur by accident.

There are also other, non-informational, reasons for this presumption. Most important, such a radical and inadvertent diminution of the stockholder franchise would be inconsistent with the incremental and thoughtful approach Delaware courts have undertaken elsewhere to respond to the voting challenges presented by decoupling. Specifically, Delaware precedents relating to the transfer of voting rights without accompanying economic rights reflect careful consideration of, for instance, the analytical framework for decoupling's concerns over how such transfers may affect the *magnitude* of motivational alignment—a matter more subtle than the *direction* of alignment at the core of the disinterestedness construct. Similarly, apart from this vote transfer context, in full awareness of the foundational premise, Delaware has generally refused to use decoupling as a basis for constraining the ubiquitous exercise of statutory voting rights.

In addition, in effect, an unspoken, ill-defined version of the presumption we propose is already practiced by the courts. So, a move from the current *de facto* presumption to an openly-adopted *de jure* presumption is incremental in nature. This move, while incremental, is highly consequential. Keeping a presumption in the shadows not only results in legal uncertainty as to its contours—most notably, when and how the presumption should be rebutted--but also precludes a disciplined analysis and possible refinement.

Finally, we believe that, as an empirical matter, several important categories of shareholders are generally likely to be motivationally aligned or at least to vote or tender as if they were aligned.

To shore up the legitimacy of judicial reliance on shareholder voting, the Article further outlines a workable, focused process that can overcome daunting informational challenges and help identify instances where the disinterestedness of a shareholder vote is meaningfully compromised.

Plaintiffs can rebut the presumption with respect to an institutional investor based on easily available public information but must also overcome a materiality filter with probability and magnitude components. Only then may an accurate and comprehensive assessment of an institutional investor's disinterestedness be called for. In all but the most exceptional and outcome determinative circumstances, this approach will avoid the need to gather and process the massive amounts of information on financial stakes and organizational voting dynamics such an assessment would require. This proposed process would provide a meaningful degree of validation to reliance on shareholder voting, thereby shoring up and enabling the continuation of established governance practice and corporate law doctrine.

The *Match* opinion that effectively mandates far more votes of "disinterested" shareholders and the 2024 *Tornetta* decision invalidating Elon Musk's $55.8 billion pay are among the most

consequential governance cases in years. The role of informed voting of disinterested shareholders is becoming markedly more important.

This Article is organized as follows.

Part I offers a baseline and terminology for the systematic analysis of the direction and magnitude of decoupling-related motivational misalignments. It begins with an overview of the decoupling phenomenon, the analytical framework for decoupling, the relationship of the phenomenon and framework to the foundational premise, and Delaware law's general approach to decoupling. It proceeds to the transformative institutional investor changes and the judicial "disinterestedness" construct. For those familiar with our 2023 article and earlier articles relating to the decoupling analytical framework, Part I departs in four ways. First, this Article introduces a term--"motivational alignment" -- to capture a concept latent in the prior articles. One aspect of this concept is that both financial stakes and organizational voting dynamics must be considered to understand the voting incentives of an investor. Another aspect is that misalignment could flow from problems not only in the direction of incentives but also from their magnitude. Second, we suggest a reconceptualization of the judicial construct of "disinterestedness" to comprehend not only certain distortions flowing from financial stakes but also those flowing from organizational voting dynamics. Third, we provide evidence to suggest that the pertinent transformative changes for mainstream institutional investors accelerated around the mid-2010s. Fourth, beyond briefly referring to the reasons set out in our 2023 article for a limited and temporary strategic pause in the application of the disinterestedness doctrine, we show an additional reason: the unintended shift of power to activist hedge funds.

Part II reviews the contexts in which courts have or have not tolerated departures from the foundational premise. We discuss, among other things, judicial response to the decoupling arising from the transfer of voting rights without accompanying economic rights. We show how the apparent general rule as to the transfer of decoupled voting rights can offer modest improvements to the legitimacy of all contexts in which shareholder voting occurs.

Part III begins setting the core of our solution to the "disinterested" shareholder response. We propose and justify a rebuttable presumption that all shareholders are disinterested.

Part IV offers a scaled, focused approach for rebutting the presumption, intended to detect and respond to meaningful misalignments in a practical way.

I. Motivational Alignment, the Foundational Premise, and the Rise of Decoupling

A. Motivational Alignment and the Foundational Premise

1. Overview

As stated by Vice Chancellor Laster in *Kurz v. Holbrook*, in language endorsed by the Delaware Supreme Court in *Crown EMAK Partners*, "[w]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their

collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization."[14]

This concept, consistent with longstanding business practices and economic theories, assumes that ownership of equity conveys a bundle of economic, voting, and other rights (and, sometimes, disclosure and other obligations) that cannot be unbundled from each other.

Beginning around the mid-2000s, however, sophisticated, lightly regulated hedge funds began using derivatives, the share borrowing/lending market, short-selling, and other means to break up the basic equity building block.

2006 Decoupling I (Southern Cal.) introduced the concept of "decoupling" to refer to this unbundling phenomenon as part of an analytical framework to show how it can arise and how it posed unprecedented complexities for classic law-based and market-based mechanisms of corporate governance. For instance, an investor can, without the consent or knowledge of the company, unilaterally create materially greater voting power than its economic interest. The investor can effectively depart from the voting structure established by statute and charter. The standard "one share/one vote" pattern involves proportionality between economic rights and voting rights, and existing and potential shareholders normally presume it is applicable to everyone. Decoupling allows a shareholder to decide on its own how much voting power it will have.

If, for instance, a person has a 100,000-share long position in the company but has sold short 30,000 shares (or instead bought an equivalent negative economic exposure via buying put options or other similar derivatives), that person has a positive net economic interest in the company's shares—i.e., 70,000 shares. But that person is what the article termed an **"empty voter:"** that person's votes have been "emptied" of a corresponding economic interest. The *magnitude* of his incentives to vote in favor of value-enhancing actions is substantially less than that of a person who simply holds a 100,000-share long position. Unilaterally, this person has been able to depart from the proportionality between economic rights and voting rights seemingly mandated by the company's one share-one vote regime.

If this person has instead sold short 150,000 shares, even the very *direction* of this person's voting incentives changes. That is, this person would have incentives to vote in value-destructive ways. Because he is net short, the gains from his short position of 150,000 shares would outweigh the losses from his long position of 100,000 shares.

By "**motivational misalignment**," we refer to decoupling-related distortions in *both* the magnitude and the direction of voting incentives.

In *Crown EMAK*, the Delaware Supreme Court has adopted this concept of decoupling-based motivational misalignments.[15] The court stated that:

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[14] *Kurz v. Holbrook*, 989 A.2d 140, 178 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom. Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 388 (Del. 2010).

[15] Consistent with our interpretation of *Crown EMAK*, Theodore Mirvis of Wachtell Lipton Rosen & Katz has written that *Crown EMAK* "endorsed recent scholarship by Professors Henry Hu and Bernard Black on what they have called 'empty voting,' and the danger to corporate policy presented by the [decoupling] of voting interests and economic interests." Theodore Mirvis, *Delaware Addresses Vote Buying and Synthetic Ownership*, HARV. L. SCH. F. ON CORP. GOVERNANCE &

> For many years, Delaware decisions have expressed consistent concerns about transactions that create a misalignment between the voting interest and economic interest of shares."[16]

Quoting from *2006 Decoupling-I (Bus. Law.),* the court described the decoupling framework's concept of "economic ownership" as referring to economic returns associated with shares, and how "[e]conomic ownership can be either be positive . . . the same direction as the return on shares . . . or negative . . . the opposite direction from the return on shares."[17] Similarly, then-Vice Chancellor Leo Strine, Jr. in discussing the relationship between empty voting and irrevocable proxies in *TR Investors,*[18] expressed skepticisim on voting by persons with a "relatively small economic interest," as well as voting by investors with an economic interest adverse to the firm who could vote in ways that reduce the company's share price.[19] Other Delaware courts have also referred to this decoupling framework and terminology in considering the logic of the shareholder franchise.[20]

This analytical framework also showed how decoupling-related motivational misalignments can arise in two basic ways.

One way involves the impact on investor incentives flowing from its **financial stakes** in or directly related to the host company. Thus, by reason of an investor's financial stakes, its "overall economic interest" in the host shares may be loosely characterized as positive, negative, or zero.

Another way involves the impact of investor incentives flowing from its "organizational voting dynamics." As we will be shortly illustrated with the example of the "record date capture" strategy, an investor's organizational voting dynamics can affect voting incentives independent of the investor's overall economic interest in the host shares.

To understand the overall motivation of an investor's votes—its "**motivational alignment**" — consideration must be given to the combined effect of an investor's financial stakes and its organizational voting dynamics.

We now briefly discuss the impact of financial stakes and organizational voting dynamics at a conceptual level and, in Part I.B.1, will illustrate how hedge funds have used decoupling and motivational misalignment as a strategy.

2. Financial Stakes: Decoupling Framework's "Overall Economic Interest in Host Shares"

FIN. REG. (May 3, 2010), https://corpgov.law.harvard.edu/2010/05/03/delaware-addresses-vote-buying-and-synthetic-ownership/.

[16] Crown EMAK, 992 A.2d at 391

[17] *Id*.

[18] 2010 WL 2901704, (Del. Ch. July 23, 2010), *aff'd*, 26 A.3d 180 (Del. 2011).

[19] *Id*. at *21.

[20] For a discussion of these Delaware cases, see, e.g., Hu, *2022 Governance and Decoupling*, supra note9, at 455-58.

Normally, an investor's financial stakes in the host company will incentivize the investor to vote in ways that would enhance the value of the shares of the host company (the **"host shares"** or **"host company shares"**). In fact, this is not necessarily the case: the overall impact of the investor's stakes on the investor's incentives can not only blunt the impact of the investor's holdings of host shares, but can alter the very direction of the incentives associated with those shares. Specifically, the framework offers a methodology that analyzes the person's **"overall economic interest"** in the host shares flowing from the net effect of that person's holdings of **(a) "host shares;" (b) "coupled assets;"** and **(c) "related non-host assets."** That is:

> **A person's overall economic interest in the host shares flows from the combined effect of its holdings of:**
>
> > **(a) host shares;**
> >
> > **(b) coupled assets –rights that directly relate to the host shares and directly increase or decrease economic exposure to the shares; and**
> > > **- e.g., derivatives positions and short-selling arrangements**
> >
> > **(c) related non-host assets – securities of another company, whose value is directly related to the value of the host shares.**
> > > **- e.g., if the host company is planning to acquire a target in a share-for-share merger with a fixed exchange rate, the target's shares are a related non-host asset)**[21]

If the person has a **(material)** ***positive*** **overall economic interest** in the host shares, the combined effect of that person's financial stakes would incentivize it to vote in ways that ***promote*** the value of the host shares while a person with a **(material)** ***negative*** **overall economic interest** in the host shares would be incentivized to vote in ways that ***destroy*** the value of the host shares. A person who has a ***zero*** **(or immaterially different from zero) overall economic interest** would be indifferent to the share price of the host shares.

In many situations, no related non-host assets are at issue: the financial stakes consist of only host shares and coupled assets. In this circumstance, the decoupling framework would characterize a person's financial stakes as resulting in that person having a positive, negative, or zero "**net economic ownership.**" The person we referred to earlier who held 100,000 shares and sold short 30,000 shares is an "**empty voter**:" its voting rights have been emptied of the corresponding economic ownership. This empty voter continues to have motivations to vote in value-enhancing ways, but the motivations are less in *magnitude* than a shareholder who simply held 100,000 shares. If, on the other hand, this shareholder sold short not 30,000 shares but 150,000 shares (or held a very large put option position), then that person is not merely an "empty voter," but the extreme kind of an empty voter the analytical framework referred to as an **"empty voter with negative economic ownership."** This extreme empty voter has incentives to vote in value-destructive ways: the very *direction* of its motivations is contrary to those of a shareholder who simply held 100,000 shares.

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[21] Naturally, a holding in the shares of a company whose price movements have a high correlation to the shares of the target—often, the share prices of companies in the same industry are highly correlated—would have a similar effect. For reasons of tractability, the "related non-host asset" concept would only relate to shares in the target.

3. Organizational Voting Dynamics: Decoupling's Framework's "Record Date Capture" as Example

2006 Decoupling I (Southern Cal) showed a person could become an empty voter independent of its overall economic interest in the host shares. It set out a new strategy (the "record date capture strategy") for buying votes that took advantage of the share lending arrangements that had historically merely serviced the needs of short sellers.

The strategy is to borrow host shares in the share lending market just before the record date and returning the host shares shortly afterward.[22] Since the borrower is the record owner, the borrower can vote the shares—even though the borrower may literally have no economic interest in the shares whatsoever. In a typical share lending arrangement, the borrower contracts with the share lender to (a) return the shares to the lender at any time at the election of either side; and (2) pay to the lender an amount equal to any dividend or other distributions the borrower receives on the shares. The borrower holds votes without economic ownership in the host shares while the lender has economic ownership in the host shares without votes.

Notice that the borrower's overall economic interest in the host shares is not affected in any way by the share borrowing. Yet, it has as much voting power as it desires through the simple expedient of paying borrowing fees for the few days around the record date. With respect to the borrowed shares, it is an empty voter with exactly zero economic interest in the host shares. *2006 Decoupling I (So. Cal.)* characterized this as a form of "new vote buying."

Such bought votes could be helpful to the borrower. If the borrower has an overall economic interest in the host shares that is negative, it can use its bought votes in ways that it believes would destroy share value. If, on the other hand, the borrower has an overall economic interest in host shares that is positive, it would be motivated to use its bought votes in ways it believes would enhance share value. The borrowed shares can give effect to the borrower's motivations that flow from its financial stakes in the host shares.

As for the lender, there is a subtle impact on the "emptiness"—or, more accurately, the opposite of "emptiness"—of the votes it casts with respect to the shares it has not lent. During the pendency of the loan, the lender has given away the voting rights of the shares it has lent but still retains full economic interest in those shares. Thus, when the lender votes the shares it has not lent, the lender has an economic interest that is in in excess of its votes: it's the opposite of an "empty voter." This imbalance should offset in full or in part, for instance, the impact on disinterestedness flowing from the lender having financial stakes such as put options on the host shares.

In other words, determining the borrower's or lender's motivational alignment depends not only on the overall economic interest flowing from its financial stakes but also from the impact of other factors, such as its share borrowing/lending decisions. In our 2023 article, we characterized certain non-financial stake-based considerations that must be considered in evaluating the "emptiness" of an

[22] Hu & Black, *2006 Decoupling I (Southern Cal.)*, *supra* note 9, at 832-34; Hu & Black, *2008 Decoupling II (Penn.)*, *supra* note 9, at 707-15.

institution's shares as the institution's "organizational voting dynamics."[23] Even though share lending/borrowing decisions do not fit neatly within the definition of "organizational voting dynamics" as set out in the 2023 article, in this Article, we will include such borrowing and lending in that term.

In sum, the decoupling framework showed that determining the overall motivational alignment of institutional investors will be driven not only by the impact of their financial stakes (*i.e.*, their overall economic interest in the host shares) but also their organizational voting dynamics. And motivational misalignments can arise in both the direction of incentives and in their magnitude. As will be discussed in Part I.C, this analysis of motivations does not consider either (1) economic motivaitons not relating to an investor's financial stakes in or related to the host company or (2) an investor's non-economic motivations.

B. Transformative Institutional Investor Changes and Decoupling

This Article focuses on institutional investors and discusses retail investors largely as an incidental matter. First, institutional investors now hold a large majority of shares. As of 2022, institutional investors held 59% of shares, even when the direct holdings of households are combined with holdings of non-profit organizations.[24] Second, with the possible exception of certain meme stocks, few retail investors vote—and those who do vote may not necessarily be representative.[25] In the 2022 proxy season, retail investors voted 29 percent of the shares they owned while institutional investors voted 82 percent of their shares.[26] Third, individual investors are unlikely to have the coupled asset, related non-host asset, and organizational voting dynamics complexities that are at the core of this Article.[27]

1. Transformative Changes: Hedge Funds – Decoupling and Motivational Misalignment as Strategy

Beginning in the mid-2000s, sophisticated, lightly regulated hedge funds began to deploy decoupling as a strategy to further their economic interests.

Sometimes they did so using techniques on the organizational voting dynamics side. Laxey Partners, a hedge fund, used the record date capture strategy to obtain 42,000,000 votes that would augment the votes derived from its shareholdings in British Land, a property company. Laxey had sought a breakup of British Land and opposed the reelection of British Land's chairman. Tapping the share lending market this way helped Laxey overcome the usual advantages that incumbent management enjoys.[28]

Sometimes, hedge funds used decoupling techniques on the financial stakes side and, sometimes in decidedly troubling ways. Perry Corp., a hedge fund, owned 7 million shares of King

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[23] Hu & Hamermesh, *Decoupling and Motivation*, *supra* note10, at 1031-34.
[24] SIFMA, 2023 CAPITAL MARKETS FACT BOOK 75 (July 2023).
[25] As to meme stocks, see, e.g., Dhruv Aggarwal, Albert H. Choi, & Yoon-Ho Alex Lee, Meme Corporate Governance (draft of Sept. 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4347885#
[26] BROADRIDGE FIN. SOLS., 2023 PROXY SEASON PREVIEW AND 2022 PROXY SEASON HIGHLIGHTS 4 (2022), *https://www.broadridge.com/_assets/pdf/broadridge-2023-proxypulse-report.pdf*.
[27] Hu & Hamermesh, *Decoupling and Motivation*, *supra* note 10, at 24-25, 1030-31.
[28] Hu & Black, *2006 Decoupling I (Southern Cal.)*, *supra* note 9, at 816-17, 832-34.

Pharmaceuticals. In late 2004, Mylan Laboratories agreed to buy King in a stock-for-stock merger at a substantial premium, but Mylan's shares dropped sharply when the deal was announced. To help Mylan obtain shareholder approval, Perry bought 9.9 percent of Mylan shares (Mylan was thus the "host company"). By holding derivatives positions directly related to Mylan shares—coupled assets—Perry fully hedged the market risk associated with Mylan shares. Under the analytical framework's methodology for assessing an investor's "overall economic interest" from its financial stakes, Perry's overall economic interest flowed from the net effect of:

> (a) **host shares** (9.9 percent of Mylan shares)
>
> (b) **coupled assets** (enough derivatives-based hedges to eliminate its exposure to the market risks of Mylan shares); and
>
> (c) **related non-host assets** (7 million King shares)

The net effect of Perry's financial stakes –*i.e.*, (a), (b), and (c)—is that the more Mylan (over-)paid for King, the more Perry would profit. Because of Perry's coupled assets (i.e., the hedges on Mylan shares) it was indifferent to the price of Mylan shares, but because of Perry's related non-host assets (i.e., the King shares), it would benefit from Mylan overpaying for King. Thus, Perry had a negative overall economic interest in Mylan shares: the impact of a transaction *harmful* to the economic returns on Mylan shares would be *beneficial* to Perry.

Such intentional financial stake-rooted misalignment on the part of hedge funds still occurs, as in the TELUS/Mason Capital proxy fight to be discussed at Part II.C.

2. Transformative Changes: Mainstream Institutional Investors – Decoupling and Motivational Misalignment as By-Products of Changing Financial Stakes and Organizational Voting Dynamics

Our 2023 article showed that the impact of decoupling on voting incentives has now spread in a serious way from aggressive hedge funds with sophisticated clients to mainstream institutional investors that service the needs ranging from the smallest of retail investors to the largest sovereign wealth funds. With hedge funds, the transformative changes began in the mid-2000s and were centered in their strategic use of decoupling and misalignment as a strategy to further their economic interests. Complex, often derivatives-laden, financial stakes and novel uses of longstanding organizational voting dynamics (e.g., share borrowing) were employed. In contrast, with mainstream institutional investors, the impact of decoupling was the byproduct of transformative changes in financial stakes and organizational voting dynamics occurring for independent reasons.

We do not seek to repeat the analysis and supporting evidence here and, instead, briefly refer in conclusory terms to the most important of the changes in financial stakes and organizational voting dynamics identified in our 2023 analysis. What we do add to that analysis is evidence suggesting that

while the changes have been occurring for some time, the overall impact of such changes seems to have accelerated around the mid-2010s.[29]

a. Financial Stakes

As for changes in financial stake patterns involving mainstream institutional investors, we paid most attention to what we perceived as the increasing conflicts associated with "related non-host assets." These conflicts arise from the combination of: (a) the increased and absolute size of large institutional investors; (b) the rise of passive management (i.e., indexed funds, direct indexers, and closet indexers); and (c) an overarching belief in diversification. Institutional investors in public companies (especially companies included in popular indexes) will often hold both host shares and related non-host assets in the form of shares of companies with interests contrary to those of the host company. Indeed, in the event of concurrent ownership, it will frequently turn out that in merger vote and tender decisions, institutional investors will thereby have either a zero or negative overall economic interest in host shares.

Vice Chancellor Laster's thoughtful opinion in *CNX* illustrates this related non-host asset problem. A key issue was whether T. Rowe Price, which held about 37 percent of the minority shares in CNX and "roughly equivalent equity interests" (in percentage terms) in the controller/offeror (CONSOL) and the host/target (CNX) (6.5 percent and 6.3 percent, respectively), was "disinterested" for purposes of whether the controller's tender offer satisfied a "majority-of-the-minority" tender condition. The court reasoned that this near-equivalence in percentage holdings in the two companies meant that it had "materially different incentives" than a shareholder invested in only one company, "thereby calling into question the effectiveness of the majority-of-the-minority condition."[30]

In our 2023 article, we showed that the court's determination that T. Rowe Price was not "disinterested" could also apply to BlackRock, Vanguard, and State Street—the "Big Three" asset managers. T. Rowe Price's ownership percentage ratio in CNX and CONSOL was 1.00:1.03, meaning that it had a near-zero overall economic interest in CNX. In contrast, a review of 13F filings by the "Big Three" showed that, roughly contemporaneously, their pertinent ownership stakes were far more

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[29] There are two important lines of related research that also offer insights as to the voting incentives of mainstream institutional investors, both of which largely developed subsequent to the initial decoupling articles. The first relates to the controversy over whether index funds have sufficient incentives to engage in corporate stewardship (including through the exercise of voting rights) while the second relates to the impact of what is variously referred to as "common ownership," "concurrent ownership," and "cross ownership." The decoupling framework's approach differs in a number of respects. As to the effects of index funds, see, e.g., Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theories, Evidence, and Policy*, 119 COLUM. L. REV. 2029 (2019). As to antitrust aspects of common ownership, see, e.g., Einer Elhauge, *Horizontal Shareholdings*, 129 HARV. L. REV. 1267 (2016). First, both of the other lines of research generally do not consider certain matters that have been key to the framework's approach since its inception, such as the impact of financial stakes in the form of "coupled assets" (e.g., derivatives positions or short selling as to the host shares) and organizational voting dynamics such as share lending/borrowing. Second, the framework offers a methodology for assessing a shareholder's (positive, negative, or zero) "overall economic interest" in host shares. This methodology is a starting point for analyzing not only the magnitude of a shareholder's incentives relative to those of a plain vanilla shareholder but also the less-recognized issues involving the very direction of the incentives. Third, more broadly, the framework identifies and systematically analyzes the decoupling phenomenon that is a root cause of motivational misalignments and other challenges for corporate and debt governance and for securities law and offers terminology that can facilitate consideration of not only equity decoupling (the focus of both of the other lines of research and of this Article) but also debt and hybrid decoupling.

[30] In re CNX Gas Corp. S'holders Litig., 4 A.3d 397, 401, 416 (Del. Ch. 2010).

lopsided in favor of CONSOL. BlackRock, for instance, had a stake of 0.03% of CNX and 0.795% of CONSOL. None of BlackRock (ratio of 1:27.6), State Street (ratio of 1.0:29.0) and Vanguard (1.0:10.2) were "disinterested" and, in contrast to T. Rowe Price, their overall economic interest in host (CNX) shares was decidedly negative.

Perhaps the best, albeit indirect, statistical evidence related to the extent and growth of the related non-host problem comes from the Backus, Conlon, Silkinson study of common ownership of S&P 500 constituent stocks for the period 1980-2017.[31] Relying on three different measures of overlapping ownership that they termed "profit weights," the authors identified a relatively steady rise from 1980 to 1999, relatively static overlap from 1999 to 2009, and then a resumption of a steady rise from 2009 to 2017.[32] They attributed the increase to the rise of indexing and diversification and the increased concentration of assets in the largest asset managers, notably the "Big Three."

Additionally, they tried to track a measure that correlates more closely with the related non-host asset incentive problems identified in the analytical framework for decoupling. This measure, which they call "tunnelling," showed a "striking increase" in frequency between 1993 and 2002, and again in the period from 2015-2017.[33] Indeed, the tunnelling frequency reached in 2017 was so high that the authors thought it was "implausibly strong."[34]

Statistical measures of the root causes of the related non-host asset problems suggest an inflection point in the early to mid-2000s, and that they are more pervasive now than even in 2017.

(i) Increase in Passive Investment, with Inflection in Mid-2010s

The close of 2023 marked the first time in which assets in passively managed mutual funds and ETFs exceeded their actively managed counterparts.[35] However, passively managed assets' market share has not been growing incrementally. Rather, between 2011 and 2016, the percentage of the U.S. stock market owned by passive investors fluctuated between a high of 19.52% and a low of 16.23% with no discernable pattern.[36] However, in 2017 the percentage jumped 9.22 percentage points to 28.58%.[37] For the next three years, the percentage of the market owned by passive investors grew each year until it reached 37.77% in 2020. [38]

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[31] Matthew Backus, Christopher Conlon, & Michael Sinkinson, *Common Ownership in America: 1980-2017*, 13 AM. ECON. J.: MICRO. 273 (2021).
[32] Id. at 276 (Figure 1).
[33] Id. at 292.
[34] Id. at 293.
[35] Adam Sabban, *Its Official: Passive Funds Overtake Active Funds*, MORNINGSTAR, (Jan. 17, 2024) https://www.morningstar.com/funds/recovery-us-fund-flows-was-weak-2023
[36] Alex Chinco & Marco Sammon, *The Passive-Ownership Share is Double What You Think it Is* 26 (July 19, 2022) (unpublished manuscript) During those years, the percent of the U.S. stock market owned by passive investors was as follows: 19.52% in 2011; 17.67% in 2012; 16.99% in 2013; 18.81% in 2014; 16.23% in 2015; and 19.36% in 2016.
[37] *Id*.
[38] *Id*.

What explains the growth in passive investors' ownership of the U.S. stock market? First, the 2008 financial crisis caused investors to shift their interest from active to passive strategies.[39] In fact, 2005 and 2006 were the last two years in which actively managed U.S. equity funds had back-to-back inflows.[40] Actively managed funds suffered huge losses during the financial crisis which scared off new investors.[41] U.S. stock index funds, however, saw inflows in 2008 [42] Second, active managers are now facing competition from the growing ETF market.[43] About 200 U.S. stock ETFs have been introduced since 2015.[44] Third, the shift from active-to-passive has occurred alongside a shift in asset allocation.[45] Specifically, flows to passively managed funds have been increasing in tandem with flows to what the Morningstar style box refers to as large-blend funds, a category that includes S&P 500 products. The main force behind this side-by-side growth is the increasing flows to large-blend index funds.[46]

(ii) Increase in Absolute Size and Market Share of Largest Asset Managers: Inflection in Mid-2010s

In the mid-2010s, the largest asset managers began to substantially increase their absolute size and market share. Beginning with absolute size, the "Big Three" asset managers each experienced unprecedented growth in their assets under management (AUM). From 2009 to 2015, BlackRock's AUM rose modestly from $3.35 trillion to $4.65 trillion.[47] In the latter half of the 2010s, BlackRock experienced more marked growth. From 2016 to the second quarter of 2023, BlackRock's AUM rose from $5.15 trillion to $9.43 trillion.[48] Between 2010 and 2015, State Street's AUM rose from its low of $1.84 trillion in 2010 to its high of $2.45 trillion in 2014.[49] From 2016 to 2023, State Street nearly doubled its 2014 high, increasing AUM from $2.47 trillion to $4.13 trillion.[50] Vanguard's AUM sat at $991.9 billion in 2005.[51] By 2021, that number rose to $7.3 trillion, then to $8.1 trillion in 2021, and finally to $8.6 trillion in 2024.[52]

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[39] Tom Lauricella & Gabrielle DiBenedetto, *A Look at the Road to Asset Parity Between Passive and Active U.S. Funds*, MORNINGSTAR, 2024. https://www.morningstar.com/views/blog/funds/active-vs-passive-investing (last visited Mar. 9, 2024).
[40] *Id*.
[41] *Id*.
[42] *Id*.
[43] *Id*.
[44] *Id*.
[45] *Id*.
[46] *Id*. In 1998 passive large-blend funds accounted for 10.1% of the Assets in U.S. Equity Funds. By 2019, they accounted for 33%.
[47] STATISTA, COMPANIES & PRODUCTS BLACKROCK, 34, (2024) https://www.statista.com/study/102446/blackrock/.
[48] *Id*. (BlackRock's AUM peaked in 2021 at $10.1 trillion.)
[49] STATISTA, TOTAL ASSETS UNDER MANAGEMENT (AUM) OF STATE STREET CORPORATION FROM 4TH QUARTER 2010 TO 4TH QUARTER 2022, (2023) https://www.statista.com/statistics/1255849/assets-under-management-state-street/
[50] *Id*. (State Street's AUM peaked in 2021 at $4.14 trillion).
[51] STATISTA, COMPANIES & PRODUCTS THE VANGUARD GROUP, 5, (2024) https://www.statista.com/study/135289/the-vanguard-group/
[52] *Id*.

The largest asset managers have also increased their market share of mutual fund and ETF assets.[53] Specifically, the "share of assets managed by the five largest firms rose from 35 percent at year-end 2005 to 55 percent at year end 2022."[54] The most significant jump in the largest five firms' market share was a 9% increase between 2015 and 2020.[55]

B. Organizational Voting Dynamics

A wide variety of organizational voting dynamics can affect the extent to which an institutional investor's shares should be considered disinterested. We discuss two examples here. Other examples, including the increasingly pervasive practice of pass-through voting, are discussed in Part III.B.4.

(i) Shift Away from Share-Value Enhancing Motivated Voting

As for changes in the organizational voting dynamics of mainstream institutional investors, our 2023 article paid most attention to what appears to be a secular rise in institutional investor consideration of non-shareholder-centric investing and voting behavior. While there has been a distinct change in enthusiasm in the past year or two, the debate over the wisdom of shareholder primacy has been intensifying, often under the broad, ambiguous rubric of "ESG."[56] Some of the debate participants view ESG considerations as being conducive to maximizing shareholder wealth as classically construed. At the other extreme, some call for the subordination of the interests of shareholders. Notwithstanding constraints such as those flowing from trust fiduciary law's "sole interest rule," there is concern that some institutional investors—or certain of the portfolios managed by these investors—will be incentivized to vote in ways contrary to the interest in maximizing share value.[57]

As the U.S. market for "sustainable investing" has grown, so too has the presence of shareholders who are eager use their voting rights to push ESG considerations. U.S. sustainable investment strategies grew from accounting for $11.995 trillion in 2018 to $17.081 trillion in 2020.[58] Global ESG ETF assets have also grown considerably in recent years. Between 2009 and 2015, global ESG ETFs assets fluctuated between $11 and $16 billion.[59] However, in 2016 they jumped to $23

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[53] INVESTMENT COMPANY INSTITUTE, INVESTMENT COMPANY FACT BOOK 27 (2023) https://www.ici.org/system/files/2023-05/2023-factbook.pdf

[54] *Id*.

[55] *Id*. (From 2005 to 2022, the percentage of total net assets of mutual funds and ETFs held be the five largest firms is as follows: 35% in 2005; 42% in 2010; 45% in 2015; 53% in 2020: 54% in 2021; and 55% in 2022.)

[56] *See, e.g.*, Elizabeth Pollman, *The Making and Meaning of ESG* (Univ. of Pa. Inst. for L. & Econ. Research Paper No. 22-23, 2022), https://ssrn.com/abstract=4219857.

[57] As to such fiduciary constraints, see 78 BUS. LAW. at 1031-32. As to incentives and pressures on public pension funds to depart from fiduciary principles on ESG-related grounds and some purported examples, see, e.g., Larry Pollack, Other People's Money: Can Investing Public Employee Pension Assets to Further Nonfinancial Goals Ever Be Consistent with Fiduciary Principles, at Part V (Reason Foundation, May 2023). For a broader view of the relationship between shareholder primacy and public pension funds and labor union funds, see, e.g. David H. Webber, Should Labor Abandon Its Capital? A Reply to Critics, 12 HARV. BUS. L REV. 215, 242-48 (2015).

[58] GLOBAL SUSTAINABLE INVESTMENT ALLIANCE, GLOBAL SUSTAINABLE INVESTMENT REVIEW 2022, 45, (2023) https://www.gsi-alliance.org/members-resources/gsir2022/ [hereinafter GLOBAL SUSTAINABLE INVESTMENT REVIEW]

[59] STATISTA, GLOBAL ESG ETF ASSETS FROM 2006 TO NOVEMBER 2023, (2024) https://www.statista.com/statistics/1297487/assets-of-esg-etfs-worldwide/.

billion and have increased every year since.[60] At first, growth was gradual, but beginning in 2019 growth accelerated rapidly leading to global ESG ETF assets reaching $480 billion in November 2023.[61] The substantial assets in the "sustainable investing" market appear to create an environment in which some institutional investors are incentivized to subordinate the interests in maximizing share value to ESG considerations.

It must be noted, however, that the data in the ESG market ought to be viewed with a degree of skepticism. For one, greenwashing remains a prevalent concern in the ESG context. Apart from steps to curb greenwashing, changes in research methods may affect how data on sustainable investing assets is calculated.[62] For instance, the significant drop in the proportion of sustainable investing assets relative to total managed assets in for 2020 to 2022 "reflects significant changes in the research methodology in [the U.S.], making comparisons with previous reports particularly difficult."[63]

Furthermore, institutional investors have recently signaled a wariness towards ESG.[64] For instance, BlackRock "is no longer pushing for changes in corporate behavior, talking about hard-to-quantify social issues or actively promising ESG investing criteria."[65] Rather, BlackRock and other investors such as Brookfield Asset Management are directing funds toward "infrastructure projects that will help speed the transition from fossil fuels."[66] Such investments "differ from many bets on publicly traded companies or ESG strategies that avoid fossil-fuel projects."[67] BlackRock's actions may be indicative of an industry trend as according to Morningstar, investors pulled about $13 billion, or roughly 4% of assets, from publicly traded ESG funds in 2023.[68]

(ii) Increasing Awareness of Effect of Share Lending on Voting Rights and Supply of Shares Available to be Borrowed

While the Laxey hedge fund's use of the share market to acquire 8 million votes without an accompanying economic interest was a surprise and received wide attention, the social learning among institutional investors as to the impact of share lending on voting was surprisingly slow. In a 2016 report, the International Corporate Governance Network's *Guide on Securities Lending* felt compelled to remind its members that:

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[60] *Id*.
[61] *Id*.
[62] GLOBAL SUSTAINABLE INVESTMENT REVIEW, *supra* note 58, at 11.
[63] *Id*.
[64] *See, e.g.,* Jon Sindreu, *ESG Investing Loses Its Steam*, WALL ST. J., Mar. 24, 2024, at B9
[65] Jack Pitcher & Amrith Ramkumar, *Step Aside, ESG. Black Rock is Doing 'Transition Investing' Now*, Wall Street Journal, (Mar. 3, 2024), https://www.wsj.com/finance/investing/step-aside-esg-blackrock-is-doing-transition-investing-now-59df3908#:~:text=BlackRock%20has%20since%20made%20a,something%20different%20to%20every%20person. Larry Fink, the head of BlackRock has been increasingly targeted by those opposed to the firm's use of ESG factors, so much so that BlackRock has more than tripled its spending on his home security in 2023. Louis Ashworth and Brooke Masters, *BlackRock steps up security for Larry Fink after 'anti-woke' backlash*, FIN. TIMES, Apr. 20, 2024, https://www.ft.com/content/c1296bc4-978b-45c3-83db-c798d2439062.
[66] *Id*.
[67] *Id*.
[68] *Id*.

> Institutional investors should recognize that if shares are lent out, they temporarily lose their rights for the duration of loan ... . [69]

Institutional investor awareness that their share lending and share recall decisions could prove decisive to voting outcomes has increased considerably, as exemplified by the carefully calibrated decisions discussed at Part III.B.3.a.

Two supply side factors are also making more shares available for lending and, as a result, presumably making it cheaper and easier for activist funds both on the short side and long side to buy votes. First, a 2019 change in SEC guidance made it clearer that the fees from share lending were an approved basis for investment advisers declining to vote. Edwin Hu and his co-authors found that that after this clarification, institutions supplied 58% more shares for lending immediately prior to meetings.[70]

Second, the rise of indexation has also contributed to an increase in supply. The study also found that, when it came to proxy fights, stocks with high index ownership saw a marked increase in shares available for lending prior to the meeting. One academic has even hypothesized that a passive investor may be able to generate revenue from a decline in the value of their investment portfolios from lending shares to short-sellers.[71]

C. The Judicial "Disinterested Shareholder" Response

As we pointed out in the 2023 Article and will be discussing in more detail in Parts II.C and II.D.3, Delaware courts have long given validating effect to uncoerced, informed stockholder votes to approve transactions.[72] For instance, in what has been known as "*Corwin* cleansing," approval by informed disinterested shareholders may restore deference under the business judgment rule to a sale of the company that would otherwise be subject to enhanced scrutiny in cases like *Revlon*[73] and *QVC*.[74] Inquiry into the effectiveness of such validation played a prominent role in the January 2024 decision by Chancellor Kathaleen McCormick to reject Elon Musk's $55.8 billion pay package voted on by Twitter shareholders.

A consistent premise of such judicial deference to shareholder voting, however, has been that the voting approval comes from "disinterested" shareholders and constitutes "the determination of impartial decision-makers with … an actual economic stake in the outcome."[75] Our 2023 Article concluded that to warrant validating effect, the current judicial construct of a "disinterested" shareholder refers to shareholders having a positive overall economic interest in host shares—*i.e.* its motivations based on its financial stakes are aligned in *direction* with the incentives of shareholders

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[69] International Corporate Governance Network, ICGN Guide on Securities Lending 8 (2016)
[70] Edwin Hu, Joshua Mitts, & Haley Sylvester, *The Index-Fund Dilemma: An Empirical Study of the Lending-Voting Tradeoff* (draft of Dec. 2020), http://ssrn.com/abstract=3673531.
[71] Joshua Mitts, *Passive Exit*, 28 STAN. J L. BU. & FIN., 157, 158 (2023).
[72] Hu & Hamermesh, *Decoupling and Motivation*, *supra* note 10, at 1020 (citing Gottlieb v. Heyden Chemical Corp., 91 A.2d 47, 59 (Del. 1952)).
[73] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).
[74] Paramount Commc'ns Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994).
[75] Hu & Hamermesh, *Decoupling and Motivation, supra* note 10, at 1021 (citing *Corwin*, 125 A.3d at 313-314).

who simply held host shares.[76] We did not conclude that the construct cared about voting misalignments in terms of the magnitude of the incentives or voting misalignments flowing from an investor's organizational voting dynamics.

On April 4, 2024, determining which shareholders should be considered "disinterested" took on even more significance with the rendering of the Delaware Supreme Court's *Match Group* opinion, perhaps the most closely-watched corporate governance case in recent years.[77] The key issue was whether the procedure set forth in its *MFW* opinion[78] (independent special committee approval *and* approval by "disinterested" shareholders) must be followed to obtain business judgment review of a*ny and all* transactions between the corporation and the controller, not just transactions involving a freeze out merger. The Supreme Court held that approval by both the special committee and disinterested shareholders was necessary.

The current judicial construct of disinterestedness focuses on a specific type of motivational misalignment—in the *direction* of incentives—flowing from financial stakes. Courts have not reached the matter of organizational voting dynamics. But as we discussed in Part I.A.1, an investor's motivational misalignment could result not only from its financial stakes, but also from its organizational voting dynamics. We urge a modest reconceptualization of "disinterestedness" to comprehend the overall impact of both an investor's financial stakes and organizational voting dynamics. In the interest of incrementalism, we do not propose that the "disinterestedness" construct include misalignments in the magnitude of incentives. In this Article, unless the context otherwise requires, we will generally use the term "disinterestedness" in the modestly more comprehensive sense.

The judicial construct of disinterestedness is largely concerned with misalignments flowing from financial stakes and, under our re-conceptualization, from the associated organizational voting dynamics. Other kinds of economic incentives, such as the desire to retain or obtain rewarding asset management business, may affect how an institutonal investor votes. Non-economic motivations, such as "soft" considerations flowing from friendships, familial ties, social status, and ego satisfaction may also matter. A more comprehensive approach to disinterestedness would entail considering all economic incentives as well as non-economic ones. We welcome judicial efforts to consider such other matters, in the disinterestedness context and elsewhere, and they may sometimes prove independently dispositive.[79] Our Article's focus, however, is on the typically more quantifiable, and perhaps more important, misalignments that flow from financial stakes anf organizational voting dynamics.

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[76] *Id.* at 1022.

[77] In re Match Group, Inc. Derivative Litig. C.A. No. 2020-0505 (Del. Apr. 4, 2024)

[78] Kahn v. M&F Worldwide Corp, 88 A.3d 1110 (Del. 2014).

[79] *2006 Decoupling I (Southern Cal.)* noted, *supra* note 9, at 862-63 (citing Hewlett v. Hewlett-Packard Co., No. Civ. A. 19513-NC, 2002 WL 818091, at *12 (Del. Ch. Apr. 30, 2002)) (discussing plaintiff 's allegation, rejected by the court, that Deutsche Bank's vote in the Hewlett Packard-Compaq battle was coerced by threats from Carly Fiorina that the bank's future business relationship with HP would suffer if the bank voted against the merger). One case that demonstrates the importance of non-economic factors is a case involving a question of a director's independence and impartiality in relation to a fellow director defendant in a derivative suit. Sandys v. Pincus, 152 A.3d 124 (Del. 2016), Chief Justice Leo Strine, Jr. focused on the two directors' sharing ownership of a private jet," which is suggestive of an extremely close friendship between their families." Courts routinely evaluate whether directors "are beholden to an interested party or 'so under [that party's] influence that their discretion would be sterilized.'" *See, e.g.,* Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 719-20 (Del. Ch. 2023).

As discussed in Part I.B.2, in 2023, we showed that "the doctrinal insistence in Delaware case law that 'disinterestedness' requires having an 'actual economic stake in the outcome of the vote,' will, among other things, often disqualify institutional investor voting in public companies from being considered sufficiently 'disinterested' to validate fiduciary decision-making."[80]

In 2023, we also showed that, in contrast, individual investors were unlikely to have the coupled assets and related non-host assets that would result in them having a negative or zero overall economic interest that would disqualifying them from being considered "disinterested."[81] The contrast between the individual investor's highly likely status as disinterested with the institutional investor's apparent frequent disqualification from such status led to our conclusion that the judicial doctrine would lead to an inadvertent, likely undesirable shift in power to individual investors.

Here, we suggest that there would be another inadvertent shift in power, one to activist investors. Activist investors are a category of institutional investors whose holdings of host shares are unlikely to be offset by the effects of coupled assets and related non-host assets. The 13F filings reflecting positions as of September 30, 2023 showed that Paul Singer's Elliott Investment Management held only 13 stocks while Nelson Peltz's Trian Fund Management held only 10 stocks.[82] Because of their largely undiversified portfolios,[83] it is reasonable to presume that activist investors have positive overall economic interests in the host company.

There is enormous controversy over whether hedge fund activism is privately or socially optimal.[84] The straightforward application of the disinterestedness doctrine would have the effect of shifting power to activist investors without any consideration of the benefits and costs of merits of doing so.

Determining the proper roles of individual investors, activist funds, incumbent management, mainstream institutional investors, and courts, and structuring corporate law and market incentives poses deep challenges. Re-allocating power through sheer fluke or rush to judgment would be irrational.

II. DECOUPLING VOTING RIGHTS FROM ECONOMIC RIGHTS: A SUBSTANTIVE LAW TAXONOMY

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[80] *Id.* at 1036.

[81] Hu & Hamermesh, *Decoupling and Motivation*, supra note10, at 1024-25, 1030-31.

[82] See https://whalewisdom.com/filer/elliott-management-corp; https://whalewisdom.com/filer/trian-fund-management-l-p

[83] Alon Brav, *et al.*, *Governance by Persuasion: Hedge Fund Activism and Market-Based Shareholder Influence* (Dec. 2021), at 18-19, available at https://www.ecgi.global/sites/default/files/working_papers/documents/bravjianglifinal_0.pdf ("unlike traditional investors who are subject to diversification requirements … hedge funds often manage concentrated portfolios"); Charles Nathan, *Debunking Myths About Activist Investors* (Mar. 15, 2013), available at https://corpgov.law.harvard.edu/2013/03/15/debunking-myths-about-activist-investors/ ("Rather than managing large and diverse stock portfolios, activist investors concentrate on one company or a relatively small number of companies at a time.").

[84] For contrasting views, see, e.g., Zohar Goshen & Reilly S. Steel, Barbarians Inside the Gates: Raiders, *Activists, and Risk of Mistargeting*, 132 YALE L. J. 326 (202); Lucian A. Bebchuk, Alon Brav, and Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085 (2015).

As previewed above, the principle that shareholder voting rights should be exercised by persons having a positive overall economic interest in the shares and to an extent commensurate with the amount of share ownership is expressed in substantive corporate law in a variety of contexts. Those contexts vary widely, however, in the care devoted to applying that principle. This Part presents a taxonomy placing these contexts on a spectrum ranging from contexts in which little or no care is generally devoted to scrutinizing whether voting rights are decoupled from economic interest in shares of stock, to contexts in which such scrutiny is intensive. This taxonomy reveals important insights about the manner in which substantive corporate law treats such decoupling, and why that variation occurs.

As developed more fully below, the exercise of statutory voting rights (specifically the right to vote in the election of directors and the right to vote on fundamental transactions such as mergers) stands at one end of the spectrum: with rare exceptions resulting from statutory insistence, courts reviewing the outcome of such votes do not examine the extent to which voting shareholders have a positive overall economic interest in their shares. Indeed, they recognize that empty voting is pervasive but tolerate it nevertheless. At the other end of the spectrum are situations – vote buying, irrevocable proxies, voting trusts, and voting agreements – in which the voting power of shares is effectively transferred to persons who may have no economic interest in the voted shares. In those situations, and absent compliance with statutory strictures, courts have intervened to reject the votes of such shares (especially when the votes associated with those shares are outcome-determinative), expressing the concern that decoupling undermines the legitimacy of shareholder voting. Importantly, these constraints on such transfers of voting rights would apply in all shareholder voting settings, and could serve to limit outcome-determinative transfer-based decoupling even in votes involving the exercise of statutory voting rights.

Situated between the foregoing endpoints are situations in which courts rely on the results of shareholder voting to guide their choice of a standard of judicial review of fiduciary conduct in approving a transaction. The intensity of judicial scrutiny varies depending on how shareholders have voted on the transaction. Such reliance on shareholder voting takes into consideration the extent to which the outcome of the vote is the result of voting by "disinterested" shareholders. How that consideration can be implemented in practice is a subject addressed in Part III.

A. Statutory Voting Rights

Corporate statutes typically confer upon shareholders the right to vote in the election of directors and on fundamental transactions such as mergers, sales of all or substantially all assets, dissolution, and amendments to the corporation's certificate or articles of incorporation.[85] With rare exceptions discussed below, the voting rights conferred by these statutes are unencumbered by any explicit requirement that the rights be exercised only by persons having a positive overall economic interest in the shares, let alone a requirement that holders' organizational voting dynamics be demonstrably supportive of share value maximization. Consistent with that statutory framework, and putting aside cases involving transfers of voting rights not accompanied by transfers of the voting

[85] *E.g.*, Del. Code Ann. tit. 8, §§ 211(b), 212(a), 242, 251, 271, 275; Model Bus. Corp. Act §§ 7.01, 7.21(a), 10.03, 11.04, 12.02, 14.02.

shares,[86] we have not been able to identify a single case in which a court has declined to give effect to a shareholder's vote for purposes of compliance with statutory requirements for electing directors or approving a merger, dissolution, or charter amendment.[87]

That vacuum is certainly not due to a lack of well understood and pervasive instances of voting by persons with no economic interest in voted shares. Indeed, courts have recognized that shares are frequently voted by persons having no economic interest in the shares at all. Shareholders of record who are nominees of beneficial owners are entitled to vote shares held in their names, and the corporation may give effect to their vote regardless of whether the person beneficially owning the shares concurs with or even has been consulted with respect to the vote.[88] In *Blasius*, the opinion in which Chancellor Allen announced that "the shareholder franchise is the ideological underpinning" of director authority, the court also ruled that despite evidence that shareholders of record do not invariably give effect to the voting intentions of beneficial owners of stock, "the law does not inquire into the subjective intent of either the record owner or the beneficial owner" in evaluating shareholder votes."[89]

Similarly, the statutory framework establishing record dates for voting guarantees that shares can be voted by persons who hold shares as of the record date but who sell them before the meeting date on which the shares are voted and thus have no economic interest in the shares at the time they are voted.[90] Thus, the record date/voting date disparity and the practice of holding shares in nominee name both make empty voting inevitable, at least to some degree.

In addition to the foregoing instances of empty voting, corporate law expressly validates allocations of voting rights that result in wide disparities between economic interest and voting power.

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[86] *See* Part II.B below.

[87] In the case of a controlling shareholder who controls less than all of the corporation's stock, however, the exercise of voting control can be constrained by equitable considerations, particularly the fiduciary duty of loyalty. *E.g.*, In re *Sears Hometown and Outlet Stores, Inc. S'holder Litig*., Cons. C.A. No. 2019-0798-JTL (Del. Ch. Jan. 24, 2024), slip op. at 60 ("when exercising voting power affirmatively to change the status quo, a controlling stockholder owes a fiduciary duty of loyalty, which requires that the controller not intentionally harm the corporation or its minority stockholders … ."). This principle animates the case law that subjects controlling shareholders to strict judicial review of transactions in which their overall economic interest in host shares is negative, as in the case where they (or a wholly-owned affiliate, for example) seek to acquire assets from the host corporation or shares held by minority shareholders. Hu & Hamermesh, *Decoupling and Motivation*, supra note 10, at 1013 n. 40, quoting In re *Synthes, Inc. S'holder Litig.*, 50 A.2d 1022, 1039 n. 81 (Del. Ch. 2012). In such situations, the controller's vote is ordinarily effective as a formal matter of compliance with statutory voting requirements, but the transaction is subject to being enjoined or rescinded, or may provide the basis for an award of rescissory or compensatory damages from the controller. *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983).

[88] *American Hardware Corp. v. Savage Arms Corp*., 136 A.2d 690, 692 (Del. 1957) ("If an owner of stock chooses to register his shares in the name of a nominee, he takes the risks attendant upon such an arrangement, including the risk that he may not receive notice of corporate proceedings, or be able to obtain a proxy from his nominee. The corporation, except in special cases, is entitled to recognize the exclusive right of the registered owner to vote."); *accord*, *Preston v. Allison*, 650 A.2d 646, 649 (Del. 1994) ("If a beneficial stockholder is disenfranchised because of the record stockholder's failure to follow instructions, no relief is afforded in the usual case.").

[89] *Blasius Indus., Inc. v. Atlas Corp.,* 564 A.2d 651, 659, 668 (Del. Ch. 1988).

[90] *See, e.g.,* Del. Code Ann., tit. 8, 213(a) (record date for determining entitlement to vote can be as much as 60 days before the date of the meeting at which votes are cast). *Cf. Kurz v. Holbrook*, 989 A.2d 140, 179 (Del. Ch. 2010), *aff'd in part and rev'd in part sub nom. Crown EMAK Partners LLC v. Kurz*, 992 A.2d 377 (Del. 2010) ("A Delaware public policy of guarding against the decoupling of economic ownership from voting power can be seen in the 2009 amendment to Section 213(a), which now authorizes a board to set one record date for purposes of giving notice of a meeting of stockholders and a second, later record date for determining which stockholders can vote at the meeting.").

Certainly there is nothing mandatory about a "one share/one vote" rule that maintains voting power in strict proportion to positive economic interest in shares: charter provisions can depart from the default one share/one vote rule in multiple ways. Most commonly and controversially, corporate charters may provide that shares of one class hold substantially greater voting power than shares of another class with equivalent economic rights.[91] Such provisions have faced continual criticism because of the inherent mismatch of economic interest and voting power,[92] and they have been a frequent subject of debate about the extent to which stock exchanges should allow for listing dual class shares.[93] Nevertheless, such dual class voting arrangements are neither new[94] nor uncommon: many of the largest publicly traded companies employ dual class voting structures.[95]

Less common but similarly reflecting departures from the ostensible "one share/one vote" principle are charter provisions that allocate voting power based on duration of share holding (so-called tenure voting),[96] levels of share ownership (graduated voting),[97] shareholder identity,[98] and even per capita voting.[99] Governance control that is disproportionately large in relation to share ownership can also be achieved by means of agreements that confer upon one or more shareholders the power to direct the corporation to take, or refrain from taking, specified actions.[100] An April 2024 Court of Chancery decision acknowledged that such agreements could be implemented through provisions in the

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[91] *E.g.*, *Freedman v. Redstone*, 753 F.3d 416, 429 (3d Cir. 2014) (under Section 151(a) of the Delaware General Corporation Law, corporations may issue shares of nonvoting as well as voting stock).

[92] *E.g.*, Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017).

[93] Congressional Research Service, *Dual Class Stock: Background and Policy Debate* (Dec. 8, 2021), available at https://crsreports.congress.gov/product/pdf/IF/IF11992/2 (reviewing the New York Stock Exchange's previously long-standing prohibition against listing dual class shares, and describing the adoption in 1994 by the NYSE, NASDAQ, and the Amex of their current "policies that permit[] their listed firms initially to issue multi-class shares but does not allow them to subsequently reduce the stock's voting rights during recapitalizations.").

[94] *Id.* (The first American publicly traded firm to issue multi-class shares was reportedly the International Silver Company in 1898."); Landon Thomas, Jr., *Morgan Stanley Criticizes Stock Structure of Times Co.* (Nov. 4, 2006) ("The dual structure of The New York Times Company has been in place since before the company went public in 1969 and was intended to protect the newsroom from interfering outside pressures.").

[95] Thomas, *supra* note 89 ("Somewhat similar arrangements exist at other newspaper companies, assuring that the Washington Post Company remains in the control of the Graham family, and Dow Jones in the control of the Bancroft family, … "); Marcus Lu, *More U.S. Tech Companies Are Adopting Unequal Dual-Class Voting Structures* (Apr. 15, 2023), available at https://www.visualcapitalist.com/us-tech-companies-adopting-dual-class-voting-structures/ (reporting numbers of initial public offerings of low vote or non-voting classes of shares, including Google (Alphabet), Facebook (Meta), Snap, Inc., Dropbox, Pinterest, Palantir, Coinbase, and Doordash).

[96] *Williams v. Geier,* 671 A.2d 1368, 1370 (1996) (provision that each share would have 10 votes, but "would revert to one-vote-per-share status until that share is held by its owner for three years.").

[97] *Providence & Worcester Co. v. Baker*, 378 A.2d 121 (Del. 1977) (upholding provision that "each stockholder shall be entitled to one vote for every share of the common stock of said company owned by him not exceeding fifty shares, and one vote for every twenty shares more than fifty, owned by him; provided, that no stockholder shall be entitled to vote upon more than one fourth part of the whole number of shares issued and outstanding of the common stock of said company, unless as proxy for other members.").

[98] *Colon v. Bumble,* 2023 Del. Ch. LEXIS 367, *1-2 (Sep. 12, 2023) (upholding charter provision allocating enhanced voting power to identified "Principal Stockholders").

[99] *Sagusa, Inc. v. Magellan Petroleum Corp*., 1993 Del. Ch. LEXIS 268, *8 (Dec. 1, 1993), *aff'd*, 650 A.2d 1306 (Del. 1994) ("Nowhere in the Delaware General Corporation Law is there a provision prohibiting per capita voting, directly or indirectly. Thus, it cannot be said that per capita voting violates public policy.").

[100] *See* Gabriel V. Rautenberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. REG. 1124, 1170 n. 158 (2021) ("One other major governance concern is raised by voting agreements— why exactly are they not a form of unlawful vote buying?"). *See also* Part II.B.3 below on shareholder voting agreements.

certificate of incorporation,[101] and although that decision invalidated such agreements because they were not included in the charter, an amendment to Section 122 of the Delaware General Corporation Law was promptly proposed that would broadly validate them[102] and thereby result in even greater tolerance for agreements with stockholders that decouple voting rights from economic rights.

To be sure, as one of us has argued in the decoupling context, provisions that are adopted midstream following the initial public offering pose special concerns: the usual arguments for IPO charters do not apply to midstream charter amendments.[103] Such midstream adoption can be evaluated under standard principles of fiduciary duty and can be invalidated if inequitably adopted.[104] But where they are included in charters when shares are first offered for sale to the public, they are supported by settled law and have been routinely sustained.

Substantive corporate law thus extensively tolerates voting by persons having a negative or zero overall economic interest in host shares, and departures from a putative one share/one vote principle are rampant. Certain state antitakeover statutes, however, establish explicit exceptions to that general tolerance. Delaware's antitakeover statute is a prominent example: Section 203(a)(3) of the Delaware General Corporation Law provides that an "interested stockholder" may consummate a "business combination" with the corporation if the board approves it *and* it is then approved at a meeting by a 2/3 vote of the shares "not owned by the interested stockholder."[105] In somewhat oversimplified essence, then, an "interested stockholder" – generally a person owning 15% of more of the corporation's voting stock – cannot exercise the voting power of its own shares in voting on a merger or similar transaction between itself and the corporation – a situation in which the "interested stockholder's" overall economic interest in host shares is negative. Outside of Delaware, control share acquisition statutes take a similar approach, effectively disenfranchising a takeover bidder's shares in excess of a specified level unless and until shareholders not affiliated with the bidder vote to restore voting rights to such shares.[106]

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[101] W. Palm Beach Firefighters' Pension Fund v. Moelis & Co., 2024 Del. Ch. LEXIS 52 (Feb. 23, 2024).

[102] Council of the Corporation Law Section of the Delaware State Bar Association draft, https://f.datasrvr.com/fr1/624/18856/2024_DGCL_Amendments_Bill_Form.pdf. *See also* Richards, Layton & Finger, The Proposed 2024 Amendments to the Delaware General Corporation Law (Apr. 3, 2024), https://clsbluesky.law.columbia.edu/2024/04/03/the-proposed-2024-amendments-to-the-delaware-general-corporation-law/#:~:text=The%202024%20amendments%20also%20add,to%20representations%2C%20warranties%2C%20covenants%20or. The proposed amendment to Section 122 would establish the ability of the board of directors, subject to the appropriate exercise of its fiduciary responsibilities, to approve an agreement between the corporation and one or more current or prospective stockholders that would, among other things, require approval by one or more stockholders for corporate actions specified in the agreement, or require the corporation to take specified actions in the future.

[103] *See* Hu & Black, *2006 Decoupling I (Southern Cal.)*, *supra* note9, at 821-22, 859-60, 893-95; Hu & Black, *2008 Decoupling II (Penn.)*, *supra* note 9, at 698.

[104] In 2023, the enforceability of a charter provision for differential voting rights within the same class of shares was effectively established by Vice Chancellor Laster's characteristically thoughtful Colon v. Bumble, Inc. decision. The opinion firmly established that from a *legal* standpoint, the contractarian approach embodied under Delaware statutory provisions and cases like Williams v. Geier was followed. However, Vice Chancellor Laster explicitly reserved the right to reject such a provision from an *equitable* standpoint, a matter that he stated he did not address in his decision. *Colon v. Bumble*, 2023 Del. Ch. LEXIS 367 at *45 ("This decision provides no opportunity to express any view on situations in which a governance structure that used identity-based voting could be inequitable.").

[105] Del. Code Ann., tit. 8, § 203(a)(3).

[106] Matteo Gatti, *Interested Voting*, 48 B.Y. U. L. REV. 1619, 1660-61 (2023).

These statutory voting disqualifications, however, stand as rare exceptions. Although it has been said that Delaware has a "public policy of guarding against the decoupling of economic ownership from voting power,"[107] courts simply do not enforce any such policy in determining whether statutory voting requirements have been satisfied; to the contrary, courts as a general matter make no effort to reject the votes of shareholders with a zero or negative overall economic interest in their shares. As will be discussed in Part II.B, the primary exception would be when votes that have been acquired without an accompanying economic interest are outcome-determinative.

B. Transfers of Voting Rights Decoupled from Economic Rights

Where the "public policy of guarding against the decoupling of economic ownership from voting power" has had at least some force, on the other hand, is when shareholders attempt to transfer the voting rights of their shares without at the same time transferring economic ownership associated with the shares. Although decisions invalidating such transfers have become increasingly uncommon, there are several forms of such transfers that the courts and corporate statutes have continued to review closely and occasionally invalidate, as discussed below.

1. Vote Buying

Vote buying, in the context of corporate law, has been defined as "any transaction by which a party [the vote buyer] directs a shareholder's vote for consideration personal to that shareholder."[108] Put another way, vote buying occurs when a shareholder, in exchange for consideration, cedes voting discretion and authority to another person without at the same time transferring any economic interest in the voted shares. Rather than routinely giving effect to such transfers of voting rights, courts recite that the arrangement warrants close scrutiny to avoid impairment of the shareholder franchise generally. As stated in the leading case on the subject, "[b]ecause vote-buying is so easily susceptible of abuse it must be viewed as a voidable transaction subject to a test for intrinsic fairness."[109] Absent proof of fairness, a vote procured through vote buying will be disregarded if the arrangement's "object or purpose is to defraud or in some way disenfranchise the other stockholders."[110] The explicit rationale for this approach is the concern that the shareholder vote will fail to be based on the motivations of persons with a positive overall economic interest in the corporation's shares.[111] Judicial scrutiny of vote buying may also be animated by concern that shareholders may not be adequately informed when they agree to sell their vote.[112]

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[107] *Kurz,* 989 A.2d at 179.

[108] In re *IXC Communs. S'holders Litig. v. Cincinnati Bell*, 1999 Del. Ch. LEXIS 210, *21 (Oct. 27, 1999).

[109] *Schreiber v. Carney*, 447 A.2d 17, 26 (Del. Ch. 1982).

[110] *Id.* at 25-26.

[111] *IXC*, 1999 Del. Ch. LEXIS 210 at *21 ("courts closely scrutinize vote-buying because a shareholder who divorces property interest from voting interest, fails to serve the 'community of interest' among all shareholders, since the 'bought' shareholder votes may not reflect rational, economic self-interest arguably common to all shareholders.").

[112] *Kurz,* 989 A.2d at 178 ("our law should be particularly sensitive to informational disparities and the importance of disclosure where votes are concerned. For example, disaggregated shareholders rationally de-value their votes when it appears they do not have control implications. A party seeking to aggregate votes into a meaningful block could take advantage of the rational pricing expectations of disaggregated stockholders who did not know such an effort was underway.")

To be sure, judicial scrutiny of vote buying is not as stringent as it apparently once was. Delaware courts have abandoned any presumption that "bought" votes are inherently void,[113] and hold that such votes "should not be considered to be illegal *per se*.[114] And vote buying will be deemed to be "disenfranchising" only "when it delivers the swing votes"[115] – *i.e.,* when it is outcome determinative. When holders of the shares not subject to vote buying retain the power to determine the outcome of the vote (*e.g.*, where they hold the majority of voting shares), vote buying has been disregarded.[116]

Such relaxation of judicial constraints against vote buying may have encouraged the creation of a recently established online vehicle for buying and selling voting rights of corporate shares.[117] Those who would consider using that vehicle or other arrangements to buy votes, however, should be sensitive to the prospect that in a vote in which the bought votes affect the outcome, a court might invalidate and disregard the bought votes. There is little doubt, for example, that management use of corporate funds to buy votes in a contested election could result in invalidation of such votes.[118] Invalidation of votes can also be an appropriate remedy even where votes are purchased by a shareholder using its own funds, rather than corporate assets. As stated by the Court of Chancery, when "third party vote buying [*i.e.*, purchase of votes by a shareholder not using corporate assets] prove[s] deleterious to stockholder voting, this Court can and should provide a remedy."[119] And finally, in light of the stated rationale for judicial policing of vote buying (adverse effects of decoupling), vote buying by persons who own no shares at all should be subject to particularly close scrutiny.[120]

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[113] *Schreiber v. Carney*, 447 A.2d at 25.
[114] *Id.*
[115] *Crown EMAK,* 992 A.2d at 387.
[116] *IXC*, 1999 Del. Ch. LEXIS 210 at *24 ("The fact that a numerical majority of IXC shareholders are still in a position independently to void the allegedly onerous effect of this vote-buying transaction by voting against the merger leads me to conclude that this agreement does not, in fact, have the purpose or effect of disenfranchising this remaining majority of shareholders.").
[117] The Shareholder Vote Exchange describes itself as "the world's first marketplace for shareholder voting rights," and establishes a platform for buying and selling share voting rights. https://www.svegroup.com. *See* Alexander Osipovich, *Votes for Sale! A Startup Is Letting Shareholders Sell Their Proxies*, WALL. ST. J., Jan. 21, 2024, https://www.wsj.com/finance/stocks/buy-my-vote-a-startup-is-letting-shareholders-sell-their-proxies-122f0eb9.
[118] *Portnoy v. Cryo-Cell Int'l, Inc*., 940 A.2d 43,74 (Del. Ch. 2008) (concluding that in connection with a proxy contest the corporation's CEO "breached her fiduciary duties by intentionally using corporate assets to coerce [a significant shareholder] in the exercise of its voting rights."). Delaware General Corporation Law Section 160(c) could supply an independent basis for invalidating such votes, if use of corporate funds to buy voting rights were deemed to result in indirect ownership of the shares by the corporation. Del. Code Ann. § 160(c) ("Shares of a corporation's capital stock shall neither be entitled to vote nor be counted for quorum purposes if such shares belong to … [t]he corporation … ."). A corporation's purchase of share voting rights, even unaccompanied by acquisition of any economic interest in the shares, would implicate the policy concern of Section 160(c). *See Speiser v. Baker*, 525 A.2d 1001, 1017 (Del. Ch. 1987) ("Almost from the earliest stirrings of a distinctive body of law dealing with corporations, courts have been alert to the dangers posed by structures that permit directors of a corporation, by reason of their office, to control votes appurtenant to shares of the company's stock owned by the corporation itself or a nominee or agent of the corporation.").
[119] *Kurz*, 989 A.2d at 177; *see also Hewlett v. Hewlett-Packard Co*., 2002 Del. Ch. LEXIS 44, *10 n.5 (Apr. 8, 2002) ("the principle that vote-buying is illegal *per se* if entered into for deleterious purposes survives.").
[120] The Shareholder Vote Exchange reportedly does have safeguards such as requiring vote buyers to attest that they have a net long position in a company's stock. *See* SVE Group – Rules & Regulations, at Section 3, https://www.svegroup.com/exchange-rules. But, for instance, a person who has a long position in the shares themselves might nevertheless have a negative "overall economic interest" in the shares because the impact of that person's "related non-host assets" would need to be taken into account. *See* Osipovich, *supra* note 116 (Hu's comment on one limitation to Shareholder Voter Exchange's net long requirement).

In any event, and even though the precise scope of the prohibition against buying votes is decidedly unclear,[121] vote buying doctrine contemplates that bought votes can be disregarded altogether.[122] We believe that there is substantial doubt that a court would give formal effect to outcome-determinative votes that arose from the transfer of voting rights without the accompanying economic rights. In Part II.B.4., we offer a hypothetical situation to illustrate how existing vote buying law could be interpreted to limit the validity of transferred voting rights in this context when the associated votes would be outcome determinative, even if the acquiror had a positive overall economic interest in the shares.

2. Irrevocable Proxies

Perhaps nowhere is the "public policy of guarding against the decoupling of economic ownership from voting power" more forcefully expressed and applied than in challenges to the effectiveness of irrevocable proxies. A shareholder who grants an irrevocable proxy entirely cedes discretion and authority over voting the shares to a person who may have no economic interest in the shares.[123] The resulting "concerns raised by decoupling voting power from ownership" underlie the courts' insistence that the terms of a proxy make irrevocability "clear and unambiguous."[124]

Even apart from that strict construction approach, courts and statutes have addressed more directly the decoupling concerns inherent in irrevocable proxies. Specifically, they have insisted that a proxy can be irrevocable only if it is "coupled with an interest."[125] Although that critical phrase lacks nothing in ambiguity, examples of it provided in case law and in the statutes themselves suggest that it refers to an interest in the economic well-being of the corporation.[126] Thus understood, the "coupled

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[121] 2 DAVID A. DREXLER, ET AL., DELAWARE CORPORATION LAW AND PRACTICE § 26.08 (2023) ("to date, there has not been established a 'bright-line' test between lawful and unlawful 'vote buying.'").

[122] *E.g.*, *Chew v. Inverness Management Corp.*, 352 A.2d 426 (Del. Ch. 1976); *Macht v. Merchants Mortg. & Credit Co*., 194 A. 19 (Del. Ch. 1937).

[123] *Hawkins v. Daniel*, 273 A.3d 792, 795 (Del. Ch. 2022), *aff'd sub nom. Daniel v. Hawkins*, 289 A.3d 691 (Del. 2023) ("The creation of an irrevocable proxy exacerbates the risk of a divergence of interests between principal and proxyholder, precisely because the principal abjures the oversight authority inherent in the ability to terminate the proxy arrangement."); *see also Haft v. Haft*, 671 A.2d 413, 421 (Del. Ch. 1995) (the requirement that an irrevocable proxy be "coupled with an interest" arises because "the exercise of voting control over corporations by persons whose interest in them is not chiefly or solely as a residual owner will create circumstances in which the corporation will be less than optimally efficient in the selection of risky investment projects.").

[124] *Id.* at 809. *See also TR Investors, LLC v. Genger*, 2010 Del. Ch. LEXIS 153, *71 (July 23, 2010) ("the decoupling of shareholder voting rights and economic interest, which is increasingly common and only loosely regulated by the securities laws, is of concern because empty voting can theoretically allow investors with voting power but with an economic interest adverse to the firm to vote in ways that reduce the company's share price.").

[125] *E.g.,* Del. Code Ann., tit. 8, § 212(e); Model Bus. Corp. Act § 7.22(d); *Zohar II 2005-1, Ltd. v. FSAR Holdings, Inc.*, 2017 Del. Ch. LEXIS 826, *43 (Nov. 13, 2017) ("The Proxies at issue here cannot be deemed irrevocable because they are not "coupled" with a sufficient interest of the Proxy holder as required by Section 212(e)."); *AV Auto., L.L.C. v. Bavely*, 110 Va. Cir. 374, 376 (Va. Cir. 2022), *citing* Va. Code Ann. § 13.1-663(D) ("The revocability of proxies in corporations is clear: a proxy is irrevocable only if coupled with an interest or given as security.").

[126] *E.g.*, Del. Code Ann., tit. 8, § 212(e) ("A proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally."); Model Bus. Corp. Act § 7.22(d) (providing examples of interests sufficient to support irrevocability); *Bamford v. Bamford*, 777 N.W.2d 573, 583 (Neb. 2010) ("The necessary interest of the proxyholder is a proprietary incentive, or comparable security need, to maximize the overall welfare of the corporation so that abuse of the power is rendered highly unlikely."); *Haft v. Haft*, 671 A.2d at 423

with an interest" requirement mitigates the decoupling problem by assuring that the proxy holder has a positive economic interest either in the shares in question or in the issuer of the shares.

In any event, when courts conclude that an allegedly irrevocable proxy is *not* "coupled with an interest," or is ambiguous, they do not hesitate to refuse to give effect to the proxy in assessing the vote of the shares purportedly subject to the proxy.[127]

3. Voting Trusts and Voting Agreements

Like vote buying and irrevocable proxies, arrangements known as voting trusts and voting agreements contemplate that shareholders cede their voting authority to a third person. In the case of a voting trust, shareholders transfer their shares to a trustee who determines how the shares will be voted.[128] In the case of a voting agreement, two or more shareholders agree to vote their shares in a manner specified by the agreement.[129] In either case, shareholders forgo the discretion and control over voting their shares that they otherwise would have had, and voting power may thereby become decoupled from economic interests in the shares.

In some cases now over a century old, courts viewed such decoupling as contrary to public policy, and therefore invalidated voting trusts.[130] A premise of that view was a sense that shareholders owed each other a duty "to so use such power and means as the law and his ownership of stock give him, that the general interest of stockholders shall be protected, and the general welfare of the corporation sustained … ."[131] Therefore, it was reasoned, "the law will not allow him to strip himself of the power to perform [t]his duty" by transferring voting authority to a trustee. Such cases

(Del. Ch. 1995) (ruling (somewhat grudgingly) that holding an executive position in the corporation was an "interest" sufficient to support irrevocability, and that the requirement stated in dictum in In re *Chilson*, 168 A. 32, (Del. Ch. 1933), "that in order to support irrevocability of a proxy, the holder had to have an interest in the stock itself" had been relaxed by the adoption of Section 212(e) and subsequent case law, including *Deibler v. Charles H. Elliott Co.,* 81 A.2d 557 (Pa. 1951)); *Zollar v. Smith*, 710 S.W.2d 155, 158 (Tex. App. 1986) *quoting* Comment, *Irrevocable Proxies*, 43 TEX. L. REV. 733, at 743 (1965) ("The interest required to enforce an irrevocable proxy . . . should constitute a substantial commitment to the corporation."); *Calumet Industries, Inc. v. MacClure*, 464 F. Supp. 19, 26 (N.D. Ill. 1978) ("The 'interest' necessary in order to support irrevocability may be, for example, security for a loan, title to the stock itself, or, in more recent cases, an employee's interest in the corporation.").

[127] *Zohar II 2005-1, Ltd. v. FSAR Holdings, Inc.*, 2017 Del. Ch. LEXIS 826 at *46 (rejecting irrevocability of proxy); *Hawkins v. Daniel*, 273 A.3d at 833 (rejecting application of irrevocable proxy to a transferee); *TR Investors, LLC v. Genger*, 2010 Del. Ch. LEXIS 153 at *73 (rejecting application of irrevocable proxy to a transferee); *Bamford v. Bamford*, 777 N.W.2d at 272-73 (rejecting irrevocability of proxy).

[128] *E.g., In re Morse*, 247 N.Y. 290, 297 (N.Y. 1928) ("A voting trust agreement confers on voting trustees the right to vote on stock transferred to them for such purpose, irrevocably for a definite period. Stock transferred under such an agreement is canceled and trust certificates are issued by the trustees to the stockholders. The right to vote is thereby separated from the beneficial ownership of the stock. The courts below have upheld the validity of the agreement in question.").

[129] *See, e.g.*, Del. Code Ann. tit. 8, § 218(c) ("An agreement between 2 or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as provided by the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed upon by them.").

[130] *E.g.*, *Shepaug Voting Trust Cases*, 24 A. 32, 41 (Conn. Super.1890) ("It is the policy of our law that ownership of stock shall control the property and the management of the corporation, and this cannot be accomplished, and this good policy is defeated, if stockholders are permitted to surrender all their discretion and will, in the important matter of voting, and suffer themselves to be mere passive instruments in the hands of some agent who has no interest in the stock, equitable or legal, and no interest in the general prosperity of the corporation.").

[131] *Id.*

undoubtedly gave rise to the judicial perception that voting trusts had been viewed by courts with "disfavor" or "indulgence."[132]

With the advent of widely traded shares, however, courts came to reject the idea that shareholders owed each other a duty to avoid decoupling their voting rights and economic interests in shares.[133] Legislatures also adopted statutes that came to supplant decoupling concerns as the source of public policy regarding the validity of voting trusts. Thus, a voting trust would be invalidated only if it failed to conform to limits (notably durational limits) specified by statute.[134] And the statutes themselves grew increasingly less prescriptive, particularly in abandoning previously strict limits on the duration of voting trusts.[135]

Voting agreements have seen a similar evolution from judicial distrust to statutory validation. In a landmark Delaware opinion, the Court of Chancery addressed a challenge to the validity of an agreement between two shareholders that conferred upon an "arbitrator" authority to vote their shares in case of a deadlock.[136] Characterizing it as a "serious question," the court acknowledged the challenger's "contention that the arbitration provision has the effect of providing for an irrevocable separation of voting power from stock ownership and that such a provision is contrary to the public policy of this state."[137] The court therefore recognized that because "the arbitrator has voting control of the shares in the instances when he directs the parties as to how they shall vote, …it is perhaps at variance with many, but not all of the precedents in other jurisdictions dealing with agreements of this general nature.[138] The court also acknowledged the existence of "cases which strike down agreements on the ground that some public policy prohibits the severance of ownership and voting control [on the grounds] that there is something very wrong about a person 'who has no beneficial interest or title in or to the stock' directing how it shall be voted, …[because s]uch a person, according to these cases, has 'no interest in the general prosperity of the corporation.'"[139]

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[132] *Perry v. Missouri-Kansas Pipe Line Co*., 191 A. 823, 827 (Del. Ch. 1937).

[133] *Mackin v. Nicollet Hotel, Inc*., 25 F.2d 783, 786 (8th Cir. 1928), *cert. den.* 278 U.S. 618 ("The old theory … that every stockholder in a corporation is entitled to have the benefit of the judgment of every other stockholder in the selection of a board of directors, has necessarily been rendered obsolete because of our modern business being conducted by large corporations with thousands of stockholders located in all parts of the country.").

[134] *In re Morse,* 247 N.Y. at 298 ("voting trusts do not stand or fall on common-law theories of public policy. They are recognized and regulated by statute. Whether they would be valid at common law in the absence of a statute defining and regulating them is immaterial. Public policy in regard thereto is defined by the Legislature.").

[135] For example, both the Delaware statute and the Model Business Corporation Act deleted a 10-year limit on the duration of a voting trust. Del. Laws. ch. 263, § 2 (1994) (amending Section 218(a) of the Delaware General Corporation Law to delete the 10-year durational limit on voting trusts); Model Bus. Corp. Act Ann. § 7.30 (5th ed. 2020) ("In 2013, the 10-year term limit was eliminated in favor of a rule leaving the duration of the voting trust to be determined in the voting trust itself."). *See also Oceanic Exploration Co. v. Grynberg*, 428 A.2d 1, 7 (Del. 1981) ("there has been a significant change from the days of our original 1925 statute. Voting trusts were viewed with "disfavor" or "looked upon . . . with indulgence" by the courts. … Other contractual arrangements interfering with stock ownership, such as irrevocable proxies, were viewed with suspicion. The desire for flexibility in modern society has altered such restrictive thinking. E. Folk, The Delaware General Corporation Law, Section 218 at 240-42 (1972). The trend of liberalization was markedly apparent in the 1967 changes to our own § 218. Voting or other agreements and irrevocable proxies were given favorable treatment and restrictive judicial interpretations as to the absolute voiding of voting trusts for terms beyond the statutory limit were changed by statute.").

[136] *Ringling v. Ringling Bros.-Barnum & Bailey Combined Shows*, 49 A.2d 603 (Del. Ch. 1946), *modified on other grounds, Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling*, 53 A.2d 441 (Del. 1947).

[137] *Id.* at 609.

[138] *Id.*, *citing Alderman v. Alderman,* 181 S.E. 897 (S.C. 1935)*,* and *Creed v. Copps,* 152 A. 369 (Vt. 1930).

[139] *Id.* 49 A.2d at 610, *citing Shepaug Voting Trust Cases.*

Nevertheless, the court upheld the voting agreement, explaining that concerns about decoupling failed to recognize that placing confidence (and voting authority) in the arbitrator's hands was the act of the owner of economic rights as well as voting rights, and that the shareholders "would not want to place such power over their investment in the hands of one whom they felt would not be concerned with the welfare of the corporation."[140] In any event, and recognizing some continued uncertainty about the validity of voting agreements, the drafters of the 1967 revision of the Delaware General Corporation Law added what is now Section 218(c), which validates an agreement among shareholders that prescribes how their shares are to be voted.[141]

To be sure, however, a voting agreement that is used as a vehicle to accomplish otherwise invalid "vote buying" would probably not be spared invalidation simply because it complied with the formal requirements of the voting agreement statute.[142] Likewise, a formally valid voting agreement will not be enforced where it is a product of fraud or illegal purpose.[143] Thus, "the principle that vote-buying is illegal *per se* if entered into for deleterious purposes survives."[144] Indeed, the leading Delaware case on vote buying (*Schreiber v. Carney*) long postdated the adoption of the Delaware statute validating voting agreements.

4. Judicial Constraints on Misalignments in Magnitude and Direction Flowing from Transfers of Decoupled Voting Rights

As discussed at Part II.B.1, the transfer of voting rights without accompanying economic rights is especially suspect when the votes are outcome-determinative. The record date capture strategy, in effect, is such a transfer[145] and if treated as such, the borrowed shares should not be counted if they are outcome determinative.

Suppose that Investor's sole economic interest in or related to XYZ Corp. is 500,000 shares of XYZ Corp., out of 10 million shares in the public float. (Mogul owns 30 million shares and is the controller.) In a vote on a proposal by Mogul to buy an XYZ division, 9 million publicly traded shares are voted, including Investor's 500,000 shares and 2 million shares that Investor borrowed per the

[140] *Id.*

[141] Report of Professor Ernest Folk to the General Corporation Law Committee of the Delaware State Bar Association at 163-64, available at https://delawarelaw.widener.edu/files/resources/folkreport.pdf.

[142] *See Schnell v. Chris-Craft Industries, Inc*., 285 A.2d 437, 439 (Del. 1971) ("inequitable action does not become permissible simply because it is legally possible.").

[143] *Ringling*, 49 A.2d at 610 ("objection to [voting agreement's] legality must be based not on some abstract public policy but on fraud or illegality of purpose.").

[144] *Hewlett v. Hewlett-Packard Co*., 2002 Del. Ch. LEXIS 44 at *10 n. 5.

[145] To our knowledge, *Schreiber* and related corporate have not been used to invalidate the "new vote buying" strategy of borrowing shares just before the record date. As explained above, that case law presumes a direct transfer of voting rights from a vote seller to a vote buyer; it then assesses the business justification for the seller's transfer of voting rights. *Schreiber* defines vote buying as "a voting agreement supported by consideration personal to the stockholder, whereby the stockholder . . . votes as directed by the offeror." In contrast, the record date capture strategy involves neither an identifiable "seller" nor an identifiable "transfer" of voting rights. For record date capture, the sale of votes occurs through share lending—as a legal matter, an actual sale of the economic and voting rights of ownership to the borrower --- an ordinary activity with legitimate uses unrelated to vote buying. *See Hu & Black 2006 Decoupling I (Southern Cal.)*, *supra* note 9, at 818.

record date capture strategy. Investor's overall economic interest in XYZ is materially positive, but if the sale is approved by 5,250,000 publicly held shares - a majority of the minority shares - should that vote have a validating effect under *MFW*, when 2 million of the votes are "empty?"

Put differently, would courts tolerate outcome-determinative vote buying (without the transfer of accompanying economic rights) just because it is accomplished by someone with a positive overall economic interest? We think probably not. This hypothetical involves voting as a measure of the merit of a challenged transaction. There is no reason to believe that the result should be any different in a situation involving statutory voting rights, such as voting for directors.

If we are correct, framed in motivational alignment terms, the vote buying limitations serve to constrain misalignments flowing from the *magnitude* of misalignments when the decoupled votes are outcome determinative as well as those flowing from their *direction*.

C. Voting as Measure of Merit of Challenged Transaction

Having mapped the endpoints of an increasingly short spectrum, we turn to a third category: situations in which shareholder votes (and sometimes tenders of shares) are evaluated not to determine whether a statutory voting requirement has been satisfied, but to assess whether some proposed transaction or policy is deemed to be beneficial to the corporation and to disinterested shareholders. This occurs in two doctrinally distinct settings. First, in the case of transactions in which directors or controlling shareholders have conflicting interests and the transaction is initially subject to strict judicial scrutiny to determine "entire fairness," courts may choose to apply a less demanding standard – either shifting to plaintiffs the burden of proof on the question of fairness, or applying the deferential business judgment rule – if the transaction is approved by a majority of fully informed, uncoerced disinterested shareholders.[146] In this first litigation setting, it is the corporation's directors and controlling stockholders who are the defendants who seek to establish and rely on such approval. Second, where a merger involving a sale of the company is initially subject to enhanced judicial scrutiny under *Revlon*,[147] similar approval by disinterested shareholders shifts the standard of judicial review to the deferential business judgment rule.[148] In this second litigation setting, it is the selling company and its directors who are the defendants who seek to establish and rely on such approval (although the acquirer, as the new owner of the selling corporation, also has a significant interest in validating the transaction, even if it is not a named defendant).

In both these situations, as noted in *Corwin*, reliance on shareholder voting (or tendering shares) explicitly rests on the premise that a favorable vote (or tender offer response) is the result of decisions

[146] *E.g., Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (together with qualified approval by a special committee of independent directors, fully informed uncoerced approval by disinterested shareholders restores business judgment rule deference and avoids scrutiny for entire fairness in freezeout mergers); *Kahn v. Lynch Comm. Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994) (informed approval by disinterested shareholders shifts to plaintiff the burden of proof on the question of fairness of a freezeout merger effected by a controlling).

[147] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

[148] *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312-13 (Del. 2015) (fully informed uncoerced approval by disinterested shareholders restores business judgment rule deference and avoids enhanced scrutiny under *Revlon* and *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1994)).

by shareholders with a positive overall economic interest in their shares.[149] Therefore, in these situations courts pay more attention to shareholder disinterestedness than they do in determining whether shareholder voting satisfies statutory voting requirements.[150]

In Delaware, this reliance on the evaluative role of the shareholder vote and the critical matter of shareholder disinterestedness can be seen in a pair of recent de-SPAC cases. In the 2023 *Delman* opinion, Vice Chancellor Lori Will rejected the defendants' contention that the 98% favorable shareholder vote in favor of a merger should result in business judgment deference as being inconsistent with the principles animating *Corwin*. She noted that:

> Stockholders' voting interest were decoupled from their economic interests. . . .
>
> Public stockholders had no reason to vote against a bad deal because they could redeem. Moreover, redeeming stockholders remained incentivize to vote in favor of a deal—regardless of its merits—to preserve the value of the warrants included in SPAC IPO units.

Similarly, in a 2024 order in another de-SPAC case, Chancellor Kathaleen McCormick dismissed the relevance of a 67% shareholder vote, reasoning that "[s]tockholders. . . are 'decoupled' by virtue of having the chance to redeem their initial investment (plus interest)."[151]

The two contrasting approaches to statutory effectiveness of shareholder votes and the use of shareholder votes to measure the merits of a transaction were both followed by the British Columbia Supreme Court in the TELUS litigation, one the highest profile and most contested proxy fights in Canadian history.[152] That controversy involved a hedge fund that Justice Fitzgerald, relying in part on the affidavit one of us provided, found "in all likelihood" was "the extreme type of 'empty voter' identified by Hu & Black as an 'empty voter' with 'negative economic ownership.'"[153] The fund had voted against a proposed plan of reorganization, but in considering the fund's objections, the court recognized and took into account that the fund's negative economic ownership would incentivize it to "act in a manner detrimental to the interests of . . . other Common Stockholders."[154] The court approved the plan.

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[149] *E.g., Corwin*, 125 A.3d at 313-14 (judicial deference to "the determination of impartial decision-makers with ... an actual economic stake in the outcome (in the case of informed, disinterested stockholders.)").

[150] *See Marciano v. Nakash*, 535 A.2d 400, 404 (Del. 1987) ("The ratification process contemplated by [Delaware General Corporation Law] section 144 presupposes the functioning of corporate constituencies capable of providing assents.").

[151] Electric Last Mile Solutions, Inc. Stockholder Litigation, Order Resolving Motion to Dismiss, C.A. No. 2022-0630-KSJM (Del Ch. 2024)

[152] TELUS Corporation (re), 2012 BCSC 1919 (2012). One of us prepared an affidavit to assist the court and not as an advocate for any party pursuant to the strict requirements of Rule 11-2(2) of the British Columbia Supreme Court. See Affidavit of Henry T. C. Hu, TELUS Corporation (re), 2012 BCSC 1919 (8 Oct. 2013). The legal counsel for TELUS were Norton Rose Canada and Farris Vaughan Willis & Murphy. For earlier discussions of this litigation, see Hu, *2022 Governance and Decoupling*, *supra* note 9, at 457; Hu, *2015 Financial Innovation and Governance Mechanisms*, *supra* note 9, at 375-81.

[153] TELUS Corporation (re), 2012 BCSC 1919 (2012), paragraphs 342 and 365.

[154] TELUS Corporation (re), 2012 BCSC 1919 (2012) , paragraphs 361 to 367.

On the other hand, the court expressly affirmed that the hedge fund was entitled to have its shares counted for purposes of determining whether a formal voting requirement had been satisfied.[155] Neither TELUS nor the affidavit suggested a contrary position.

D. The Policy and Logic of the Taxonomy

The variation in judicial attention to decoupling across the spectrum described above can be explained by policy considerations associated with the three points on the spectrum.

1. Statutory Voting Rights

Turning first to the endpoint involving statutory voting rights, a judicial refusal to give formal effect to shareholder votes would be a radical act, given the clarity and prominence of those rights. The statutory right to vote has been recognized as the first in the list of "the most familiar default rights of shares."[156] That voting right shares a fundamental characteristic with other private property rights: namely, "the exclusive authority to determine how [the] resource is used."[157] Accordingly, as observed by the Delaware Court of Chancery, "[s]hareholders are free to do whatever they want with their votes, including selling them to the highest bidder."[158] A shareholder's motivations for voting "may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders."[159]

Indeed, "[t]he ownership of voting stock imposes no legal duty to vote at all."[160] Thus, there is no realistic expectation on the part of investors that their fellow investors' votes in director elections or

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[155] *Id*. at ¶ 353 ("I do not consider that TELUS is arguing that Mason [the fund] should be disenfranchised as a voting shareholder.")].

[156] *Colon v. Bumble,* 2023 Del. Ch. LEXIS 367 at *11 ("The most familiar default rights are the rights to vote, sell, and sue."); *see also Stokes v. Cont'l Trust Co*., 78 N.E. 1090, 1093 (N.Y. 1906) (the right to vote is the shareholder's "supreme right and main protection."); *In re Diamond State Brewery, Inc*., 2 A.2d 254, 256-57 (Del. Ch. 1938) ("the right to vote [is] a right so essential to the enjoyment of property in stock that, it has been suggested, it is a part of the property itself.").

[157] Armen A. Alchian, *Property Rights*, available at https://www.econlib.org/library/Enc/PropertyRights.html.

[158] *Hewlett v. Hewlett-Packard Co*., 2002 Del. Ch. LEXIS 44 at *11; *accord, Flaa v. Montano*, 2014 Del. Ch. LEXIS 87, *24 (May 29, 2014); *Williams v. Ji*, 2017 Del. Ch. LEXIS 115, *17 (June 28, 2017); *but see Kurz*, 989 A.2d at 177 ("Although *dictum* in *Hewlett-Packard* could be read to suggest that there are no restrictions on the buying or selling of votes when corporate resources are not involved, I do not believe that was what Chancellor Chandler intended").

[159] *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling*, 53 A.2d 441, 447 (Del. 1947); c*f. Hudson v. Prime Retail, Inc*., 2004 Md. Cir. Ct. LEXIS 26 (Md. Cir. Apr. 1, 2004), citing Hanks, *Maryland Corporation Law* § 7.15, at 253 (Supp. 2003) ("stockholders have the right "to cast [their] votes, or to grant a proxy or otherwise transfer [their] right to vote, in any way [they] decide[] and for any reason or no reason."). Of course, an important caveat to this proposition is the case of controlling shareholders, whose fiduciary duties can give rise to judicial remedies against them if they exercise their voting power to serve their personal interest at the expense of the corporation or its other shareholders. *Supra* note [ ] As Vice Chancellor noted in *Sears Hometown and Outlet Stores, Inc. S'holder Litig.. supra* note-:

In 1977, the high court summarized the history of Delaware law on majority voting as follows:

> In sum, for more than fifty years our Courts have held, consistent with the general law on the subject, that a stockholder in a Delaware corporation has a right to vote his shares in his own interest, including the expectation of personal profit, *limited, of course, by any duty he owes to other stockholders.*

Tanzer v. Int'l Gen. Indus., Inc., 379 A.2d 1121, 1124 (Del. 1977) (emphasis added), *overruled on other grounds by Weinberger v. UOP, Inc*. 457 A.2d 701, 704 (Del. 1983) (overruling business purpose test).

[160] *Id.*

on fundamental transactions are motivated by a materially positive overall economic interest. To the contrary, governing law allows and contemplates that shareholders may vote for entirely idiosyncratic reasons.[161] Accordingly, and given the importance attached to the control flowing from share voting rights, a regime in which courts make *ad hoc* decisions declining to give statutory effect to a shareholder's vote due to concerns that the vote might be decoupled from a positive economic interest in the corporation would impair the value of voting shares by rendering associated voting rights less predictable.[162]

The law also tolerates, for compelling practical reasons, the exercise of voting rights by persons lacking a positive overall economic interest in shares. In a publicly held company, or any corporation with a large number of shareholders, it is clearly impractical, and ordinarily impossible, to gather, present, and evaluate evidence regarding the economic interests of each and every one of hundreds or thousands of voting shareholders. Ascertaining and evaluating the competing economic interests of even just one shareholder can be a complex, time-consuming exercise, and non-economic/qualitative considerations only further complicate the inquiry.[163] In short, insisting on proof that all voting occurs at the instance of persons with a positive overall economic interest in the shares as a condition to entitlement to vote such shares would make exercise of statutory voting rights essentially impossible.

Judicial opinions support this justification for tolerating voting by persons with no (or perhaps even negative) economic interest in shares. As explained by Chancellor Allen in *Blasius*, "[a] legal test that made inquiry into the subjective wishes of ultimate owners relevant would, of course, threaten to convert every close proxy fight into protracted and costly litigation."[164] Paraphrasing that assessment to apply to shareholder voting motivation more generally, a legal test that required or even allowed inquiry into the overall economic interest, let alone the overall motivation, of holders of voting shares would "threaten to convert every close [vote] into protracted and costly litigation." Allowing such an inquiry would thus defeat the value of the shareholder franchise by depriving corporations and their shareholders of the "certainty and expedience in the decision-making process [they need] in order to operate effectively."[165]

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[161] *Heil v. Standard Gas & Electric Co*., 17 Del. Ch. 214, 216 (Del. Ch. 1930) ("stockholders have the right to exercise wide liberality of judgment in the matter of voting and may admit personal profit or even whims and caprice into the motives which determine their choice, so long as no advantage is obtained at the expense of their fellow stockholders."); *see also Schreiber v. Carney*, 447 A.2d 17, 25 (Del. Ch. 1982), *quoting* 5 Fletcher *Cyclopedia Corporation* (Perm. Ed.) § 2066 ("The theory that each stockholder is entitled to the personal judgment of each other stockholder expressed in his vote, and that any agreement among stockholders frustrating it was invalid, is obsolete because it is both impracticable and impossible of application to modern corporations with many widely scattered stockholders, and the courts have gradually abandoned it.").

[162] As noted, of course, an exercise of voting rights must not contravene a controlling shareholder's fiduciary obligations. *Supra* note []. Thus, where a controller uses its voting power to effectuate a merger in which it acquires the shares of the minority holders, the merger may be effective for purposes of statutory voting requirements, but will be enjoined, set aside, or provide a basis for recovery of damages if it breaches the controller's fiduciary duty of loyalty. This situation is simply an extreme example in which a controller's duty of loyalty may be implicated by its exercise of voting rights where it has a negative overall economic interest in host shares. Moreover, one recent opinion holds that a controlling shareholder that exercises its voting power to alter the status quo may breach a fiduciary duty of care if it does so with gross negligence, apparently even if its overall economic interest in host shares is positive. In re *Sears Hometown and Outlet Stores, Inc. S'holder Litig*., *supra* note [], slip op. at 60.

[163] *See* Part III.B *infra* for a detailed review of the informational challenges associated with inquiry into shareholder disinterestedness.

[164] *Blasius,* 564 A.2d at 668.

[165] *Preston v. Allison*, 650 A.2d at 649.

In the case of the annual election of directors – undoubtedly the most prevalent occasion for shareholder voting[166] - there are additional reasons why judicial evaluation of shareholder economic interests in host shares and related assets in order to assess shareholder voting motivation is unwarranted:[167]

- Elections of directors are typically uncontested, so there is little prospect that evaluation of shareholder motivation would affect the outcome.[168]
- Director elections may appropriately involve multi-dimensional considerations of a non-economic nature, to which economic factors affecting shareholder voting motivation may be irrelevant.
- The tendency of large asset managers to refrain from recalling share loans in order to vote the shares[169] corroborates the view that voting in uncontested director elections and in other routine matters is not economically significant. That view is mirrored in provisions like New York Stock Exchange Rule 452, which enables brokers to direct the voting of shares beneficially owned by their customers on routine matters such as uncontested elections of directors.[170]
- Judicial intervention is available to address situations in which directors take improper action, making active review of director elections less useful. Fiduciary duties and norms of fiduciary conduct provide ongoing influence over the conduct of directors once they are elected, thereby rendering shareholder voting incentives less important as a mechanism to promote desirable director behavior.

2. Transferring Voting Rights Decoupled from Economic Rights

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[166] About 3,700 companies are listed on U.S. stock exchanges, and each one conducts an annual meeting of shareholders to elect directors. Nicole Goodkind, *America has lost half its public companies since the 1990s. Here's why* (June 9, 2023), available at https://www.cnn.com/2023/06/09/investing/premarket-stocks-trading/index.html.

[167] Professor Matteo Gatti has noted reasons similar to those in the text for rejecting an active judicial role in monitoring "interested" voting by shareholders in the election of directors. Gatti, 48 B.Y. U. L. REV. at 1663-64.

[168] A theoretical exception would be an uncontested election subject to a majority vote rule, under which candidates must receive more votes in favor than against their election. *See* Council of Institutional Investors, *FAQ: Majority Voting for Directors,* (Jan. 2017), available at https://www.cii.org/files/issues_and_advocacy/board_accountability/majority_voting_directors/CII%20Majority%20Voting%20FAQ%201-4-17.pdf. In that situation, disqualifying shares as interested could move a candidate from majority approval to mere plurality approval, thereby resulting in a failed election bid.

[169] Blackrock, *Policy Spotlight: Securities Lending Viewed through the Sustainability Lens*, at 5 (2021), available at https://www.blackrock.com/corporate/literature/publication/securities-lending-viewed-through-the-sustainability-lens.pdf ("In most cases, BlackRock anticipates that the potential long-term financial benefit to the Fund of voting shares would be less than the potential revenue the loan may provide the Fund."); Fidelity Investments, *Proxy Voting Guidelines*, at 12, available at https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Full-Proxy-Voting-Guidelines-for-Fidelity-Funds-Advised-by-FMRCo-or-FDS.pdf (Jan. 2024) ("generally … securities out on loan remain on loan and are not voted because, for example, the income a fund derives from the loan outweighs the benefit the fund receives from voting the security"); JPMorgan Asset Management, *Global proxy voting guidelines*, at 25, (Mar. 2023), available at https://am.jpmorgan.com/content/dam/jpm-am-aem/global/en/institutional/communications/lux-communication/corporate-governance-principles-and-voting-guidelines.pdf ("For routine voting, JPMAM views the revenue from lending activities to be of more value to the client than the ability to vote.").

[170] NYSE Rule 452 (a broker may direct the vote of a client's shares if it " … has no knowledge of any contest as to the action to be taken at the meeting and provided such action is adequately disclosed to stockholders and does not include authorization for a merger, consolidation or any other matter which may affect substantially the rights or privileges of such stock.").

The foregoing explanations for judicial reluctance to invalidate votes for purposes of applying statutory voting requirements, however, do not explain why courts have been more willing to invalidate votes cast pursuant to vote buying arrangements or purportedly irrevocable proxies. Indeed, such instances of invalidation are somewhat surprising from the perspective of viewing voting rights as property. Property rights are ordinarily freely transferable,[171] and disqualifying votes of shares due to a transfer of the voting right unaccompanied by a transfer of the underlying shares is a significant limitation on the shareholder's dominion over a core right attaching to the shares.

Several aspects of irrevocable proxies and vote buying may account for the courts' willingness to invalidate votes. First, in both situations there are compelling substantive reasons for courts to act. In the case of an irrevocable proxy, courts obviously cannot decline to overlook the statutory requirements that the proxy be expressed in writing and coupled with an interest. In the case of vote buying, in which invalidation of votes is purely a judge-made result, it is inconceivable that a court would decline to invalidate a vote once it determines that a vote buying arrangement was either fraudulent or unfair, and resulted in disenfranchisement of other shareholders.[172]

Another distinctive aspect of vote buying and irrevocable proxies that may explain the more aggressive policing of decoupling in those contexts is the fact that these two situations, unlike voting trusts and voting agreements, can involve transfers of voting rights to persons who own no shares at all, and who therefore have no apparent incentive to vote in the interests of the corporation and its shareholders generally. That is the circumstance that most clearly implicates the expressed concern about separation of voting rights from economic rights of shares. It is a circumstance, moreover, that is absent from voting agreements, which by statutory definition are entered into only by shareholders.

Finally, judicial review of cases of vote buying and irrevocable proxies may be relatively more intensive for purely practical reasons. Compared to the situation involving votes of thousands of dispersed shareholders each of whose motivational misalignments might require deep, expensive factual exploration, cases involving vote buying or irrevocable proxies focus on one or at most a few discrete voting blocs, and the question of whether voting and economic rights have been decoupled is relatively uncomplicated. Vote buying cases tend to involve fairly obvious economic inducements,[173] and the only potentially complex questions are the factual ones of whether the bought votes are outcome determinative and whether the inducement was fair or manipulative. Similarly, the existence of an

[171] *E.g., Hawkins v. Daniel*, 273 A.3d at 823 and n. 32 ("By default under the common law, contract rights and other property rights are freely alienable."), *citing Tracey v. Franklin,* 31 Del. Ch. 477, 67 A.2d 56, 58 (Del. 1949) ("An important incident of the ownership of property is its transferability and the proposition is frequently stated in the texts that a general restraint upon alienation is invalid because contrary to public policy."); *P.C. Connection, Inc. v. Synygy Ltd*., 2021 Del. Ch. LEXIS 2, 2021 WL 57016, at *13 (Del. Ch. Jan. 7, 2021) ("In general, contractual rights are freely assignable."); Restatement (First) of Property § 406 cmt. a (Am. Law Inst. 1944), Westlaw (database updated Mar. 2022) ("The established policy of the law is in favor of freedom of alienation."); Restatement (Second) of Property: Donative Transfers div. I., part II., intro. note (Am. Law Inst. 1983), Westlaw (database updated Mar. 2022) ("The rule against direct restraints on alienation is older than the rule against perpetuities.").

[172] *E.g.*, *Schreiber v. Carney,* 447 A.2d at 25-26.

[173] *E.g.*, *id.* at 20 (to overcome a stockholder's opposition to a plan of reorganization, the corporation made a loan of over $3.3 million to fund an exercise of warrants); *Chew v. Inverness Mgmt. Corp.*, 352 A.2d at 429-30 (purportedly irrevocable proxy procured through purchase, for $0.10 each, of options to acquire proxy grantors' shares at $20 or more per share for stock "having a negative value"); *Macht v. Merchants Mortg. & Credit Co*., 194 A. at 22 (voting rights "secured by paying out money to the depositing stockholders as an inducement to them to do so. … In so far as the voting power of these shares is concerned, I think there can be no doubt that it was purchased.").

irrevocable proxy is a simple matter of fact: the only remotely difficult question is one of law, namely whether the proxy is coupled with a sufficient interest within the meaning of the applicable statute.[174] Thus, these are discrete, relatively uncomplicated matters of fact and law, and the courts are able to police decoupling in these contexts, at least where the votes in question are outcome determinative.

3. Voting as Measure of Merit of Challenged Transactions

In the third category of our taxonomy – *i.e.* situations in which courts rely on shareholder voting to determine the appropriate standard of judicial review of fiduciary conduct – the justification for some degree of judicial attention to decoupling is self-evident. Those cases rest explicitly on the premise that voting is by shareholders with an "actual economic stake in the outcome."[175] It would be irrational for courts to set out that premise but fail to exercise some oversight to determine that voting is done by disinterested shareholders. What we examine next, then, is how the policies and practicalities discussed above play out in determining when and how courts do and should engage in the exercise of evaluating shareholder disinterestedness when they determine whether a transaction has been approved by a majority of disinterested shareholders.

III. THE INFORMATIONAL IMPOSSIBILITY OF REQUIRING AFFIRMATIVE PROOF OF SHAREHOLDER DISINTRESTEDNESS

A. Overview

In our 2023 article, we showed that if institutional investors' disinterestedness were rigorously scrutinized, one undesirable and ironic consequence would be to shift voting power primarily to, among others, individual investors—precisely the group at the core of Berle-Means concerns.

In this Article, we show that the situation is even worse. First and foremost, requiring a shareholder vote to be accepted as disinterested only upon affirmative proof that the requisite majority of voted shares is held by disinterested shareholders is an informational impossibility. Obtaining, presenting, and accurately evaluating the sufficiency of disinterested votes would entail, as an initial step, granular and synchronous data on each of the financial stakes (i.e., host shares, coupled assets, and related non-host assets) held by each shareholder as well as on each shareholder's organizational voting dynamics (*e.g.*, shares lent/borrowed, non-share value-driven voting, pass-through voting arrangements, and house view versus portfolio manager view policies). **(Part III.B.1)** We contrast such data needs with the information that is publicly available (or available to the host company). We start with individual investors. **(Part III.B.2)** Then we turn to public data on institutional investor financial stakes and on organizational voting dynamics. **(Parts III.B.3 and III.B.4)** Even with highly transparent institutional investors such as mutual funds, the data is incomplete. With foreign institutional investors, collective investment trusts, and pension funds, the situation is far worse.

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[174] *See* Part II.B.2.
[175] *Corwin*, 125 A.3d at 313-14.

In theory, the missing information may be provided voluntarily or through subpoenas. This would not be promising. Among other things, the cost of doing so would, in effect, impose an unacceptable “poll tax” on shareholders called upon to provide that data. This would have the perverse effect of discouraging them from voting. **(Part III.C)**

B. The Information Needed and the Information Available

1. Nature and Synchronicity of Information Needed

A shareholder’s disinterestedness lows from the combined effects of its financial stakes (*i.e.*, its “overall economic interest in the host shares”) and organizational voting dynamics. Information is needed on each shareholder’s:

> (a) financial stakes: *i.e.*, its “overall economic interest in the host shares” flowing from the net effect of its holdings of host shares, coupled assets (e.g., derivative positions and short-sale arrangements), and related non-host assets (i.e., common ownership, whether through derivatives or direct equity holdings); and
>
> (b) organizational voting dynamics: *e.g.*, its share lending/borrowing, its non-host share-value-enhancing voting motivations (whether on ESG- or non-ESG-related grounds), its pass-through voting arrangements, and its house view versus individual portfolio manager view policies.

The organizational voting dynamics can matter in assessing disinterestedness. If, for instance, some of the shares held by an institution are subject to a completely pure “pass-through” voting arrangement, the effect of the pass-through would be to reduce the institution’s motivations flowing from its overall economic interest in the host shares.

This information must be synchronous – that is, it must coincide in time with the date of the vote or the tendering of shares (“Decision Date”).[176] Such synchronicity can sometimes prove challenging. It would be mere coincidence if public information such as disclosed in an SEC filing would be available for that precise date. That is, the SEC “as of” date will almost invariably be asynchronous with the Decision Date. Assume, for instance, that the Decision Date is the close of business on February 15. SEC requirements for the “as of” dates for the reporting of financial stakes are generally calendar-based—typically as of month-end or quarter-end.

The longer the period between SEC “as of” dates, the more likely it is the SEC data would undermine the quality of the disinterestedness evaluation. Thus, if the pertinent SEC filing has “as of” dates for every month end, SEC data with an “as of” date of January 31 and SEC data with an “as of” date of February 28 may give a good sense as to what the true stake was on February 15. However, if the pertinent SEC filing has “as of” dates of every quarter-end, neither the SEC data as of December

[176] This assumes, for simplicity, that the investor is able to countermand any voting or tendering instructions he had made prior to the Decision Date.

31 nor SEC data as of March 31 would provide a reliable guide to the stake as of the February 15 Decision Date.

This asynchronous information problem will almost always occur, but it varies in degree. Asynchronicity is obviously more of a problem when the value of a financial stake is highly volatile. Less obvious, but perhaps more important is that asynchronicity is a particularly troubling problem with respect to the share lending activities of institutional investors. As will be discussed in Part III.B.4.a, decisions of large institutional investors to recall their shares expressly rest in part on a belief that doing so may affect voting outcomes. The sudden and binary nature of such recall decisions can render useless data on share lending the day prior to the recall decision.

2. Individual Investors

Individual investors who are not company insiders subject to Section 16 of the Securities Exchange ct of 1934 are not required to make any public disclosures of their financial stakes. However, as to financial stakes in the form of host shares, the host company will have the requisite information as to the substantial majority of the shares beneficially owned by individual investors. The vast majority of shares issued by U.S. companies are not held in the name of the beneficial owner but instead in "street name," i.e., in book-entry form through a securities intermediary such as broker-dealer or bank.[177] However, by reason of SEC rules adopted in 1983, broker-dealers and banks are required to provide issuers, at their request, with lists of the names of beneficial owners who did not object to having such information provided to issuers.[178] As of 2021, an industry working group estimated that 76% of individual investors were "NOBOs," i.e., non-objecting beneficial owners.[179]

However, it is entirely a different matter with respect to individual investor financial stakes in the form of either coupled assets—such as the derivatives they hold or their short-selling—or related non-host assets (such as their stock or derivative positions in a counterparty company). Information on these stakes is not required to be publicly disclosed and the host company will not have access to such information. Individual investors, like institutional investors, do lend shares.[180] As we discuss in Part III.B.4.a, information on the identities of share borrowers/lenders and the amounts they have borrowed/lent is not generally publicly available.

3. Institutional Investors: Financial Stakes

The SEC mandate for ownership disclosure has long been bewildering in its complexity. *2006 Decoupling I (Southern Cal.)* provided a matrix that set out the broad outlines of five discrete SEC

[177] Concept Release on the U.S. Proxy System, Exchange Act Rel. No. 62495, at 13 (July 24, 2010). In the interests of disclosure, both authors were involved in preparing the Concept Release: Hu was the Director of Economic and Risk Analysis (then called the "Division of Risk, Strategy, and Financial Innovation") and Hamermesh was Senior Special Counsel at the Division of Corporation Finance.
[178] Id at 67.
[179] OBO/NOBO Working Group, Report of the OBO/NOBO Working Group to the Staff of the U.S. Securities and Exchange Commission 15 (Aug. 31, 2021) [hereinafter, *Working Group*].
[180] See, e.g. Robinhood, Introducing Stock Lending at Robinhood (May 4, 2022), https//newsroom.aboutrobinhood.com/introducing-stock-lending-at-robinhood; SEC, Investor Bulletin: Understanding Margin Accounts (June 10, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_marginaccount

ownership disclosure systems.[181] That matrix consisted of 14 columns and approximately 100 cells. Different rules often apply in determining what triggers the disclosure requirements and what must be disclosed if disclosure is required. Economically identical holdings are often disclosed in different ways. Positions involving OTC derivatives often escape disclosure, when a substantively identical position involving exchange-traded derivatives would be disclosed.

The SEC mandates have become yet more complex. The explosive growth of ETFs subsequent to that 2006 article introduces yet an additional unique ownership system that itself would require a matrix to capture.[182] In addition, in 2023, the SEC adopted rules modifying the Schedule 13D and 13G requirements for the reporting by 5% and over beneficial owners[183] and adopted certain transparency rules relating to share lending and short selling.[184]

For the purposes of this Article, it is not necessary to try to provide an overview of the current ownership disclosure system for institutional investors. Instead, in this Part III.B.3 we focus in summary fashion on **gaps** in publicly available information with respect to data on financial stakes – i.e., host shares, coupled assets, and related non-host assets. Here, our goal is to be roughly correct. In Part III.B.4 we deal with public data on organizational voting dynamics.

(a) Host Shares

Unlike the case with individual shareholders, companies can glean little information from their own records as to the identities of the beneficial ownership of their shares by institutions. As of 2021, 72 percent of institutional investors were **objecting** beneficial owners ("OBOs").[185] This is because, to the extent they can do so, institutional investors generally seek to keep their holdings and proprietary trading strategies confidential and to prevent front-running of their trades.[186]

Instead, easily accessible information on institutional beneficial ownership of host shares must primarily come from SEC mandates. The nature, asynchronicity, and granularity of such information varies with factors such as the size of the holdings (i.e., whether the holdings meet the 5% trigger of Schedules 13D or 13G), the size of the investor (i.e., whether it meets the Form 13F $100 million assets under management trigger), the type of investor (e.g., is it a registered investment company or a pension fund), and citizenship of the investor (e.g., is it a U.S.-based mutual fund or a non-U.S. based one).

The best data comes from the requirement that all persons who "directly or indirectly" acquire "beneficial ownership" of more than 5% of a public company's shares, must, within 10 calendar days (and, effective February 5, 2024, 5 business days) of crossing the 5 percent threshold, file a Schedule 13D with the SEC.[187] Should certain institutional investors invest in the ordinary course of business

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[181] *See* Hu & Black, *2006 Decoupling I (Southern Cal), supra* note 9*,* at 864-875

[182] See Henry T. C. Hu and John D. Morley, *The SEC and Regulation of Exchange-Traded Funds: A Commendable Start and a Welcome Invitation*, 92 SO. CAL. L. REV. 1155 (2019); Henry T. C. Hu and John D. Morley, *A Regulatory Framework for Exchange-Traded Funds*, 91 SO. CAL, L. REV. 839 (2018)

[183]Modernization of Beneficial Ownership Reporting, Rel. 33-11253, 88 Fed. Reg. 76896 (Nov. 7, 2022).]

[184] Reporting of Securities Loans, Rel. 34-98737, 88 Fed. Reg. 75644 (Nov. 3, 2023).

[185] Working Group, *supra* note 179, at 15.

[186] Working Group, *supra* note 179, at 12.

[187] *See* Exchange Act Rule 13d-1, Filing of Schedules 13D and 13G, 17 C.F.R. § 240.13d-1(a); Modernization of Beneficial Ownership Reporting, Exchange Act Release No. 98704, 88 Fed. Reg. 76896, 76906 (Nov. 7, 2023).

without the intent to influence control of the host company, they can file the more abbreviated Schedule 13G but are subject to the same filing deadline.[188] Both schedules require disclosure of "beneficial ownership" including the number and percentage of shares beneficially owned. However, outside of these Schedule 13D/13G filers, the public data can often be quite asynchronous.

Form 13F requires institutional money managers to disclose their holdings at the end of each quarter.[189] Within forty-five days after the end of each quarter, every "institutional investor manager" who holds $100 million or more of "section 13(f) securities" (such as publicly traded shares) is required to disclose their holdings by filing Form 13F with the SEC. [190] An "institutional investment manager" is defined broadly and includes, among others, "an entity that either invests in, or buys and sells, securities for its own account."[191] The SEC publishes an "Official List of Section 13(f) Securities," which is limited to common shares and exchange-traded options of U.S. public companies.[192]

The usefulness of Form 13F information for disinterestedness calculation purposes is limited in two basic ways. First, the information is highly asynchronous because the filing is only due within 45 days after the end of the calendar quarter.[193] Second, the information provided is with respect to the institutional investor in the aggregate, not with respect to the holdings, for instance, of particular mutual funds that are in its family.[194] Understanding whether or how much an institution's financial stake-based calculation of that person's motivation should be adjusted by that person's organizational voting dynamics can depend on the particular holdings of specific funds.

Certain types of institutional investors provide more information than that provided in Schedule 13D/13G and Form 13F filings. If the shares are owned by registered investment companies such as mutual funds, additional requirements apply. Registered investment companies are required to file with the SEC Form N-Port, which requires detailed information about their portfolio holdings no later than 30 days after the end of each month.[195] However, public access to such information is limited and available only on a delayed basis. Only the quarter-end Form N-Port information as to specified kinds of holdings is available to the public—and some 60 days after the end of the quarter.[196]

While most ETFs are registered investment companies, as a practical matter, the disclosures these ETFs generally offer are far more synchronous. Because of the arbitrage mechanism central to ETF share prices moving in tandem with net asset values, the vast majority of ETFs provide of their holdings on a daily basis.[197]

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[188] *See* Exchange Act Rule 13d-1(b), 17 C.F.R. § 240.13d-1(b)
[189] SEC Form 13F, Information Required of Institutional Investment Managers Pursuant to Section 13(f) of the Securities Act of 1934 and Rules Thereunder, 17 C.F.R. § 249.325 (2005) [hereinafter Form 13F].
[190] *See* Exchange Act § 13(f)(1), (f)(5)(A) (2010); 15 U.S.C. § 78m(f)(1), (f)(5)(A) (2010); Exchange Act Rule 13f-1, 17 C.F.R. § 240.13f-1 (2022). (The filings are usually publicly available.)
[191] SEC Division of Investment Management: FAQ About Form 13F, Question 3 (May 2023), https://www.sec.gov/divisions/investment/13ffaq [hereinafter SEC 13F FAQ].
[192] *See* Exchange Act Rule 13f-1(c), 17 C.F.R. § 240.13f-1(c) (2005); SEC 13F FAQ, Question 7.
[193] Rule 13f-1(a)(1) and Form 13F – General Instruction 3
[194] *Id.*, at General Instructions 1.
[195] Investment Company Act Rule 30b-19, 17 C.F.R. 270.30b1-9; U.S. Securities and Exchange Commission, Form N-Port – Monthly Portfolio Investments Report – General Instructions (OMB Number: 3235-0730) (expires: January 31, 2025)
[196] U.S. Securities and Exchange Commission, Form N-Port – Monthly Portfolio Investments Report – General Instructions, at F (OMB Number: 3235-0730) (expires: January 31, 2025).
[197] *See* the articles cited at *supra* note 182.

In contrast, easily available public information on the holdings of certain other important institutional investors shareholdings is largely limited to Schedules 13D/13G and Form 13F. Perhaps the three most important of these less transparent entities are foreign institutional investors, collective investment trusts, hedge funds, and pension funds:

Foreign institutional investors. As of 2022, foreign institutional investors held $11.9 trillion of US equities (16.7 percent), nearly the same as that held by U.S. mutual funds ($11.9 trillion) (18.4%).[198] The public disclosures required by foreign regulators of these institutional investors will vary widely.

Collective investment trusts. Increasingly, employer defined contribution plans offer "collective investment trusts" (CITs) instead of traditional open-end mutual funds to their participants. By 2022, CITs have grown from 13% of assets in 2022, representing 28% ($2.25 trillion) of defined contribution assets.[199] In the important subcategory of target-date strategy assets, Morningstar expects that CITs will be the most popular target date vehicle by the end of 2024.[200] The biggest reason for this shift from mutual funds to CITs is cost: CITs are typically structured to avoid being subject to SEC prospectus requirements or SEC requirements as to registered investment companies. Thus, CITs are not required to issue prospectuses, make periodic reports on performance and holdings or make account statements to investors.[201] CITs that are regulated by the Office of the Comptroller of the Currency are only required to issue financial reports on an annual basis.

Hedge funds. Hedge funds currently manage over $5 trillion in assets.[202] Of the ten largest, nine were headquartered in the U.S.[203] Neither U.S.-based nor foreign hedge funds invested in U.S. stocks are subject to SEC disclosure requirements applicable to registered investment companies.

Private pension funds and state and local government retirement funds. Private pension funds and state and local government retirement funds held $3.1 trillion and $2.9 trillion in U.S equities in 2022, respectively.[204] The pertinent disclosure laws vary.[205]

(b) Coupled Assets: Derivatives and Short-Selling

As a general matter, public information on an institution's holdings of coupled assets--such as derivative positions, short selling, and share lending arrangements—is more limited than on holdings of host shares. Because of the extent and the vote-centric nature of share recall decisions, coupled assets in the form of share lending are especially significant both to disinterestedness calculations and to

[198] SIFMA, 2023 Capital Markets Factbook 80-81 (July 2023).
[199] Lia Mitchell, 2023 Retirement Plan Landscape Report – An In-Depth Look at the Trends and Forces Reshaping U.S. Retirement Plans 24 (April 2023)
[200] Morningstar, Target-Date Strategy Landscape: 2023 1 (2023)
[201] Natalaya Schnitzer, Overtaking Mutual Funds: The Hidden Rise and Risk of Collective Investment Trusts (draft of March 15, 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4573199
[202] Value of assets managed by hedge funds worldwide from 1997 to 2023, https://www.statista.com/statistics/271771/assets-of-the-hedge-funds-worldwide/ (Jan. 2024).
[203] https://hedgelists.com/top-250-largest-hedge-funds-2023/
[204] SIFMA, 2023 CAPITAL MARKETS FACTBOOK. 80 (July 2023)
[205] Working Group, *supra* note 179, at 12.

actual voting outcomes. Thus, after quickly discussing short-selling and derivatives, we will focus on share lending, especially as to its opacity and its unique asynchronicity issues.

Derivatives. As for equity derivatives, Form 13F only requires disclosure of positions in exchange-traded options, but not substantively identical positions in OTC options. Moreover, money managers need not report options they have *written* rather than *bought*. Even in the vital area of 13D blockholders, notwithstanding the potential for gaming through "hidden (morphable) ownership" techniques, the SEC has recently decided against a general requirement that cash-settled equity swap positions be disclosed.

Highly non-transparent OTC positions can affect the disinterestedness of institutional investors in material ways. As of mid-2023, the notional amount of U.S. OTC equity-linked derivatives was approximately $4 trillion.[206] U.S. based mutual funds and ETFs engage in engage in a limited amount of highly non-transparent derivatives. An SEC analysis in 2015 suggested that equity swaps and written equity options—neither of which would be covered by 13F—were used by around 5% of U.S.-based regulated investment companies.[207]

BlackRock's Global Equity Market Neutral Fund is an example of an "alternative" fund that uses derivatives in a large way.[208] This $1.1 billion fund uses a long/short strategy to seek returns with little dependence on overall market movements. While the fund is permitted to take long and short positions in shares themselves, it maintains long and short positions primarily through swaps and other derivatives.

Short-Selling.

It has long been the case that no SEC rules directed at short-selling require a person engaging in this practice to disclose its short positions.[209] This did not change with the SEC's October 2023 adoption of rules to improve transparency in the short-selling market.[210] Thus, under new Rule 13f-2, the SEC requires that institutional investment managers with gross short positions meeting certain thresholds file Form SHO with the SEC. However, the SEC will only make this data publicly available on an anonymized basis.[211]

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[206] Bank for International Settlements, OTC derivatives statistics at end-June 2023 6 (Nov 16, 2023), https://www.bis.org/publ/otc_hy2311.pdf

[207] Daniel Dell, Paul Hannouna, Christof W. Stahel, Yue Tang, and William Yost, Use of Derivatives by Registered Investment Investment Companies 2 (Dec. 2015), https://www.sec.gov/files/derivatives12-2015.pdf

[208] *See* BlackRock, PROSPECTUS – BLACKROCK GLOBAL EQUITY MARKET NEUTRAL FUND (Aug. 28, 2023), at 3-8; at BlackRock, GLOBAL EQUITY MARKET NEUTRAL FUND (factsheet as of 12/31/2023 – OEF-BDMIX-F1223;

[209] Division of Economic and Risk Analysis, Short Sale Position and Transaction Reporting (June 5, 2014).

[210] Short Position and Short Activity Reporting by Institutional Investment Managers, Rel. No. 34-98738, https://www.sec.gov/files/rules/final/2023/34-98738.pdf.

[211] It should be noted that there is a nuance to this continued opacity that short sellers are becoming concerned about. Specifically, short-sellers are concerned about the possible impact of artificial intelligence, predictive data analytics, and similar technologies in combination with the aggregated information that would flow from this SEC 2023 short-selling rule and from a 2023 SEC rule relating to share lending. See, e.g., Marc E. Elovitz et al., SEC Securities Lending Rule: Increased Transparency and the Risk of Information Leakage, Schulte Roth & Zabel (Nov. 7, 2023), at 6. ; Alternative Investment Management Association, Comment on Securities Loans (File No. S7-18-21) (Aug. 11, 2023); Managed Funds Association, Comment on Securities Loans: File NO. S7-18-21 (Aug. 4, 2023) The concern is that, thanks to the wonders of AI, the

Short-selling is not limited to hedge funds. Mainstream institutional investors short-sell as well. Vanguard's Market Neutral Fund reports holding short positions with a market value of $460,479,000.[212]

(c) Related Non-Host Assets

The gaps just discussed with respect to host company-associated positions in shares, OTC and exchange-traded derivatives, short-selling arrangements, and share lending also apply to related non-host assets.

However, interesting informational gaps in this related non-host assets can arise in ways pertinent to this Article. Consider a shareholder who holds shares in both the host company and a company it may merge with. If that shareholder holds a 5% stake in one company and is involved in the control contest, it must promptly (within two business days) file a 13D with respect to that company. However, it would not have to make a prompt filing with respect to its holdings of the other company so long as the stake is below 5%; instead, the public would not be aware of its holdings in the other company until a Form 13F filing ultimately comes along.

4. Institutional Investors: Organizational Voting Dynamics

The organizational voting dynamics of an institutional investor present informational demands which would make it nearly impossible for a judge to determine whether such investors are disinterested voters in every case. We begin with the informational challenges related to share lending and then turn to a variety of other organizational voting dynamics.

(a) Share Borrowing, Share Lending, and Share Recalls

As discussed in Parts I.A.3 and I.B.1, hedge funds began borrowing shares for the purpose of obtaining the associated voting rights in the mid-2000s. The use of the record date capture strategy is continuing. In 2022, Martin Lipton warned that one of the devices hedge fund activities use is stock loans to increase voting power beyond the activist's economic investment."[213]

A hedge fund's overall economic interest in the host shares does not change by reason of the borrowing—the entire economic ownership of the shares remains with the stock lender—but those bought votes could affect voting results. If the hedge fund has an overall economic interest in the host shares that is positive (as with Laxey), the bought votes would be used in ways that the fund believes

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aggregated data could be dissected in a way that would allow outsiders to determine the securities positions and trading strategies of individual participants.

[212] Vanguard Market Neutral Fund, *Form N-CSR Certified Shareholder Report of Registered Investment Management Companies*, 1, 8 (2023) https://www.sec.gov/Archives/edgar/data/1409957/000110465923095375/tm2319809d6_ncsrs.htm

[213] Matin Lipton et al. Wachtell Lipton on Dealing with Activist Hedge Funds and Other Activist Investors, CLS Blue Sky Blog Sept. 7, 2022, https://clsbluesky.law.columbia.edu/2022/09/07/wachtell-lipton-on-dealing-with-activist-hedge-funds-and-other-activist-investors-3/

to be value-enhancing. If the fund has a negative overall economic interest, the fund would be motivated to use the bought votes to destroy share value.

In contrast, a mainstream institutional investor is more likely to be a share lender, not a share borrower. As explained in Part I.A.3, the shares it lends have a subtle impact on the "emptiness" of the votes it casts with respect to the shares it has not lent. During the pendency of the loan, the lender has given away the voting rights of the shares it has lent but still retains full economic interest in the shares. Thus, when the lender votes the shares it has not lent, the lender has economic incentives that are in excess of its votes: it is the opposite of an "empty voter." This imbalance should offset in full or in part, for instance, the impact on disinterestedness flowing from the lender having financial stakes such as put options on the host shares. Thus, especially as many institutions engage in material amounts of lending and their share recall decisions are highly vote-centric in nature and can be determinative of voting outcomes, knowing the precise extent of the shares lent as of the record date is essential to helping determine an institution's motivational alignment.

Surprisingly, share lending can have an impact on voting outcomes even if the share borrower does not exercise the voting rights associated with the borrowed shares. This may be for legal or mechanical reasons or because the share borrowing was undertaken simply for traditional short selling purposes rather than to acquire the associated voting rights. This is because the shares lent (but whose voting rights are not exercised) removes the voting rights associated with the loan from the pool of possible votes. This reduction in the "denominator" can sometimes make a difference in voting results.[214]

There are two basic informational challenges here. First, in general, share lending positions of institutions are not publicly available. Second, more interestingly, even when they are available—such as is the case with mutual funds and ETFs—the asynchronicity problem is especially pronounced in the share lending context. We briefly turn to these basic claims before looking at the particulars of share lending at several large mainstream asset managers.

A lender's decision as to whether to recall the shares before the record date is highly vote-centric in nature and can be determinative of voting outcomes. The lender is paid a fee by the borrower. In deciding whether to recall, the lender must balance its loss of potential revenue against the benefits of being able to vote. As part of this balancing, an economically rational lender must consider the likelihood that its votes will affect the voting outcome. Recalling the shares even if the associated votes would not have such an effect would simply be foregoing fees for no good reason.

Thus, asset managers conduct a cost benefit analysis when deciding whether to recall lent shares. Considerations which may lead to an asset manager recalling shares include whether the vote is material to corporate governance, and whether the vote involves a situation "with the highest potential financial implications."[215] Additionally, asset managers will evaluate whether a vote is likely to be close.

[214] We thank a highly experienced practitioner for this point.

[215] Vanguard, *Investment Stewardship About our Program*, 1, 20 (2023) https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/about_our_program_2023.pdf; State Street Global Advisors, *Global Proxy Voting and Engagement Principles*, 1, 9 (2023) https://www.ssga.com/library-content/pdfs/asr-library/global-proxy-voting-and-engagement-principles.pdf (Situations with the highest potential financial implications include "proxy contests and strategic transactions including mergers and acquisitions, goring dark transactions, change or corporate form, bankruptcy, and liquidation.)

BlackRock states that it will recall lent shares when it determines that a proposal up for a vote is "contentious," meaning that it received between 40 and 60 percent shareholder support.[216] BlackRock will also consider the impact its votes will have the outcome of a vote. When faced with a contest for board control of the Italian telecommunications company Telecom Italia, BlackRock recalled its lent shares so that it could vote.[217] Its decision to do so was based not only on its view that "the vote was financially material," but also on its belief that "the vote could be close."[218] Given the tightness of the vote, BlackRock felt that it could impact the outcome by voting its "full holding."[219]

The decision is all or nothing in nature: recall or not recall. And, unlike the case with an institution's buying and selling of host shares, where an institution may need to spread out its purchases or sales in order to avoid disrupting the market, the recall decision can be implemented immediately. Assume the record date is January 31. In order to vote, an institution decides to recall all of its loaned shares on January 28.[220] Data as to that institution's share lending position as recent as January 27—four days before the record date—would be useless in determining disinterestedness. The asynchronicity problem is acute in this context.

The law has long been that, generally speaking, a share lender need not publicly disclose the shares it has lent. This did not change with the SEC's 2023 adoption of Rule 10c-1a to improve transparency in the securities lending markets.[221] Under the new rule, a broad range of participants in the securities lending market must provide detailed information on their securities lending on a daily basis to the Financial Industry Regulatory Authority (FINRA), which information will be made available to the SEC.[222] However, FINRA will publicly disclose transactions only on an aggregated basis.

There are certain circumstances where some information is available. If the lender is a registered investment company, such as mutual funds and most ETFs, the securities lent need to be reported on Form N-PORT.[223] However, as noted earlier, public access is on a substantially delayed basis. The special asynchronicity problem associated with share recall decisions could well make such information useless.

(b) To What End? Host Share Value versus Portfolio Value

A vote that is value enhancing to a host company's shares could sometimes be detrimental to the value of an institutional investor's portfolio. In this scenario, adherence to a judicial concept of

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[216] Blackrock, *Policy Spotlight: Securities Lending Viewed Through the Sustainability Lens*, 1, 6 (2021) https://www.blackrock.com/corporate/literature/publication/securities-lending-viewed-through-the-sustainability-lens.pdf ("In the 2021 proxy year – July 1, 2020 through June 30, 2021 – less than 1% of the proposals BlackRock voted on behalf of clients were considered contentious.")

[217] Blackrock, *Policy Spotlight: Securities Lending Viewed Through the Sustainability Lens*, 6, (2021) https://www.blackrock.com/corporate/literature/publication/securities-lending-viewed-through-the-sustainability-lens.pdf

[218] *Id.*

[219] *Id.*

[220] Hu & Black, 2008 Decoupling II (Penn.), supra note 9, at 708.

[221] Reporting of Securities Loans, SEC Release No. 34-98737 (Oct. 13, 2023).

[222] Technically, the rule provides that the information needs to be provided to a "registered national securities association" (RNSA). However, the only current RNSA is FINRA. See Sullivan & Crowell, SEC Adopts Rule Mandating Reporting of Securities Loans 7 (Nov. 3, 2023).

[223] Form N-Port, Item C.12.c.

disinterestedness would dictate no deference to the votes of an institutional investor's voting motivated by the goal of portfolio value maximization. Further complications also ensue from the fact that an asset manager will run many funds with different objectives: what may be good from the standpoint of a speculative equity fund may differ from what may be good from the standpoint of a conservative equity fund in the same family.

Vanguard is clearest, indicating that it votes "in the best interests of each Vanguard advised fund."[224] Blackrock has said that it seeks to do what is best for "each individual company" it holds when making voting decisions.[225] But in the Statement of Additional Information that BlackRock provides to its S&P 500 index fund clients, it has also said that it uses voting to "help maximize long-term shareholder value for our clients."[226] Fidelity's voting guidelines are not clear as well. When faced with a vote that presents a somewhat novel set of circumstances, Fidelity's voting guidelines are noncommittal about whether it will vote based on what is best for the host company or what is best for its portfolio's shareholders.[227] However, in communications with the SEC, Fidelity is unambiguous in its deference to its portfolio's shareholders stating that its responsibility is to "advance the best interests of *its shareholders*, and in so doing place those interests *ahead of any other interests*."[228]

SEC disclosure mandates relating to proxy voting are largely related to registered investment companies.[229] CITs, notably, are not subject to such mandates.[230] But even when disclosure mandates apply, the information that has been provided is limited in resolving lingering uncertainties.

Per Item 17(f) of Form N-1A, a fund's proxy voting policies and procedures must be set out in the fund's Statement of Additional Information (SAI).[231] The rule is fairly general about what institutional investor funds need to disclose. It does, however, emphasize that funds need to disclose how they handle potential conflicts of interest and include a discussion of any policies and procedures

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[224] Vanguard, *Investment Stewardship About Our Program*, 1, 15, (2023) https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/about_our_program_2023.pdf; *Id.*, at 15 "our voting guidelines require case-by case analysis of each proposal to determine whether support is in the best interest of each fund."

[225] BlackRock, *Viewpoint: The Investment Stewardship Ecosystem*, 1, 6 (2018) https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf; *see also*, BlackRock: *BlackRock Investment Stewardship's Approach to Engagement on Climate Risk*, 3, (2020) https://www.wlrk.com/docs/blk-commentary-engaging-on-climate-risk.pdf (emphasis added) ("As an asset manager and a fiduciary on behalf of our clients, our decisions are determined by our assessment of how best to support long-term sustainable financial performance in the context of each company's specific circumstances.")

[226] BlackRock, *BlackRock Funds III iShares S&P 500 Index Fund Statement of Additional Information*, 1, B-4 (2023) https://www.blackrock.com/us/individual/literature/sai/sai-sandp500fund-us.pdf

[227] Fidelity Investments, *Proxy Voting Guidelines*, 1, (2024) https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Full-Proxy-Voting-Guidelines-for-Fidelity-Funds-Advised-by-FMRCo-or-FDS.pdf ("Fidelity will vote on proposals not specifically addressed by these guidelines based on an evaluation of a proposal's likelihood to enhance the long-term economic returns or profitability of the company *or* to maximize shareholder value.")

[228] Fidelity Management & Research Company, Re: Proposed Rules: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies (Release Nos. 33-8131, 34-46518, IC- 25739; File No. S7-36-02), (Dec. 6, 2002) https://www.sec.gov/rules/proposed/s73602/edroiter1.htm.

[229] [investment advisers]

[230] *See* Schnitzer, *supra* note 201.

[231] Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies**,** Investment Company Act Release No. 33, 8188 68 Fed. Reg. 6564, 6566 (Feb. 7., 2003) https://www.govinfo.gov/content/pkg/FR-2003-02-07/pdf/03-2951.pdf

of the fund's investment adviser or any other third party that are used to determine how the fund will vote its portfolio securities' proxies.[232] The SEC has emphasized that if multiple funds covered by the same SAI "have different voting policies and procedures, these should be reflected in the SAI."[233]

Large asset managers have responded to the rule's generality with generalized descriptions of their own. For instance, while Vanguard notes that funds may vote differently than one another if "doing so is in the best interest of the individual fund," it does not specify the extent to which such vote splitting is permitted, how it determines what is in the best interest of a specific fund, or the extent to which an individual fund manager may dictate how his fund votes.[234] Despite mentioning that multiple funds may vote in different ways, the SAI for Vanguard Index Funds (VIF) does not specifically mention how it handles conflicts of interest between funds.[235] Fidelity and BlackRock are similarly vague in describing the precise steps they take when a vote presents a conflict between the interests of two or more of their funds.[236]

Institutional investors' descriptions of their voting policies and procedures provide little assistance in assessing their "disinterestedness" in a particular vote. While insisting that proxy voting decisions are made based on what is best for each fund, institutional investors' SAIs do not provide the level of granularity required for a judge to determine whether a particular fund's interests aligned with the interests of a host company's shareholders in a particular vote.[237] This area may require more

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[232] Item 17(f) Form N-1A (The full rule reads as follows ""Unless the Fund invests exclusively in non-voting securities, describe the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities, including the procedures that the Fund uses when a vote presents a conflict between the interests of Fund shareholders, on the one hand, and those of the Fund's investment adviser; principal underwriter; or any affiliated person of the Fund, its investment adviser, or its principal underwriter, on the other. Include any policies and procedures of the Fund's investment adviser, or any other third party, that the Fund uses, or that are used on the Fund's behalf, to determine how to vote proxies relating to portfolio securities."

[233] Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisors, Exchange Act Release No. 86,721, Investment Company Act Release No. 33,605, 84 Fed. Reg. 47,423 (Sept. 10, 2019) https://www.govinfo.gov/content/pkg/FR-2019-09-10/pdf/2019-18342.pdf

[234] Vanguard, *Vanguard Index Funds Statement of Additional Information*, B-1, B-65 (2023) https://personal.vanguard.com/us/faces/JSP/Funds/ProspRep/FundProspectusReportsWinJSP.jsp?fundId=0540&isReqFromProducts=true

[235] *Id.*, at B-64; B-65. (Vanguard merely states that its proxy voting ""procedures require that voting personnel act as fiduciaries and must conduct their activities at all times in accordance with the following standards: (i) fund shareholders' interests come first; (ii) conflicts of interest must be avoided; (iii) and compromising situations must be avoided.")

[236] Fidelity, *Funds of Fidelity Concord Street Trust Statement of Additional Information* 1, 39 (2023) https://www.actionsxchangerepository.fidelity.com/ShowDocument/documentPDF.htm (Geode Capital Management, the fund manager, states that should a conflict arise it "will consider the matter and may (1) determine that there is no conflict of interest (or that reasonable measures have been taken to remedy or avoid any conflict of interest) that would prevent Geode from voting the applicable proxy, (2) abstain, (3) cause authority to be delegated to the Agent or a similar special fiduciary to vote the applicable proxy or (4) recommend other methodology for mitigating the conflict of interest."); BlackRock, *BlackRock Advantage Large Cap Growth Fund Statement of Additional Information*, I-1, II-130 (2023) https://www.blackrock.com/us/individual/literature/sai/sai-advlcg-us.pdf ("The Manager maintains policies and procedures that are designed to prevent undue influence on the Manager's proxy voting activity that might stem from any relationship between the issuer of a proxy (or any other dissident shareholder) and the Manager, the Manager's affiliates, a Fund or a Fund's affiliates.")

[237] *See* Vanguard, *Vanguard Index Funds Statement of Additional Information*, B-1, B-65 (2023) https://personal.vanguard.com/us/faces/JSP/Funds/ProspRep/FundProspectusReportsWinJSP.jsp?fundId=0540&isReqFromProducts=true (procedures "seek to ensure that proxy voting decisions are suitable for individual funds.); BlackRock, *BlackRock Funds III iShares S&P 500 Index Fund Statement of Additional Information*, 1, B-4 (2023)

vigorous interpretation of current SEC rules. Specifically, the Commission could consider demanding that institutional investors give specific descriptions of how they will handle situations in which a fund votes with interests which diverge from those of a host company's shareholders generally.

Under Investment Company Act Rule 30b1-4, registered management investment companies are required to file their proxy voting record on an annual basis via Form N-PX.[238] Funds must disclose information on Form N-PX for each matter relating to a portfolio security considered at any shareholder meeting held during the period covered by the report and with respect to which the fund was entitled to vote.[239] Such information includes: the name of the issuer or the portfolio security; the security's exchange ticker symbol; the Council on Uniform Securities Identification Procedures (CUSIP) number for the security; the date of the shareholder meeting; the matter voted on; who proposed the matter; whether the institutional investor voted; how the institutional investor voted; and whether its vote was for or against management.[240]

As currently constructed, the Form N-PX requirements are of little help in assessing an asset manager's "disinterestedness" in a particular vote. A review of large institutional investors' N-PX filings reveals that they are extremely cursory in their responses, providing the bare amount of information necessary to be compliant.[241] However, the SEC has recently amended Rule 30b-1-4 to expand the information asset managers need to report regarding their proxy votes on their annual reports on Form N-PX.[242] Three of those expanded requirements are particularly noteworthy.

First, the amendments require that institutional investors disclose not only how shares were voted, but also the number of shares voted in each matter if they were voted in multiple matters.[243] In adopting this requirement, the SEC was focused on funds with multiple subadvisors, stating that disclosing the number of shares voted in each matter would "provide investors with some indication of

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https://www.blackrock.com/us/individual/literature/sai/sai-sandp500fund-us.pdf (BlackRock uses voting to "help maximize long-term shareholder value for our clients.")

[238]17 U.S.C. § 270.30b1-4 (2003)

[239] Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies**,** Investment Company Act Release No. 33, 8188 68 Fed. Reg. 6564, 6569 (Feb. 7., 2003) https://www.govinfo.gov/content/pkg/FR-2003-02-07/pdf/03-2951.pdf

[240] United States Securities and Exchange Commission, Form N-PX, Item 1 Proxy Voting Record https://www.sec.gov/files/formn-px.pdf

[241] *See* Vanguard Chester Funds, Form N-PX (Aug. 28, 2023) https://www.sec.gov/Archives/edgar/data/752177/000110465923095583/tm2322097d1_npx.txt; Fidelity Concord Street Trust, Form N-PX (Aug. 10, 2023) https://www.sec.gov/Archives/edgar/data/819118/000081911823000144/filing6739.htm

[242] Enhanced Reporting of Proxy Votes by Registered Management Investment Companies Reporting of Executive Compensation Votes by Institutional Investment Managers, Release No. 33,11131 87 Fed. Reg. 78770 78817-18 (Dec. 22, 2022) https://www.govinfo.gov/content/pkg/FR-2022-12-22/pdf/2022-24292.pdf (Such information includes "(1) the name of the issuer of the security; (2) the CUSIP, International Securities Identification Number ("ISIN"), and (optionally) the global share class Financial Instrument Global Identifier ("FIGI") for the security; (3) the shareholder meeting date; (4) an identification of the matter voted on and its relevant category (director elections, say-on-pay, audit-related, investment company matters, shareholder rights & defenses, extraordinary transactions, capital structure, compensation, corporate governance, ESG, human rights, DEI, other social issues, or another category altogether); (5) whether management or a shareholder proposed the matter; (6) the number of shares that were voted; (7) the number of shares loaned and not recalled; (8) how the shares were voted, including the number of shares voted in each manner if they were voted in multiple manners; (9) whether the vote was for or against management's recommendations; (10) the name of each Institutional Manager that exercised voting power over the security; (11) and any other information the fund would like to provide.")

[243] *Id*. at 78818.

how subadvisors may have influence the fund's votes."[244] Such an obligation would at least signal to a reviewing court that there are some interests particular to a fund which influenced how some shares were voted.

Second, the amendments require that institutional investors reveal the identity of the institutional manager exercising voting power.[245] In conjunction with identifying split votes, this requirement could further assist a reviewing court in identifying where potential "disinterestedness" may lie. The SEC noted that the combination of identifying which managers had voting power, the identification of split votes, and disclosure of proxy voting policies and procedures, would serve to enhance shareholder's understanding of how their shares were voted.[246] Presumably, such disclosures would assist a reviewing court in the same manner.

Third, the updated N-PX requirements call for disclosure of "the number of shares that the reporting person loaned and did not recall."[247] It appears evident that this requirement will be of some utility to reviewing courts trying to evaluate how share lending should affect an institutional investor's disinterestedness in a particular vote.

However, these amendments do not become effective until July 1, 2024.[248] Even when they do become effective, Form N-PX still will only provide retrospective information. The required disclosures are made on an annual basis, so any shareholder challenges to a vote before, or at the time it occurs, would be forced to rely on dated information.[249] At best, information disclosed on Form N-PX would be useful in assessing an institutional investor's disinterestedness in a vote from a prior year.

(c) To What End? Value-Destroying ESG-Related Voting

The basic motivational premise for the shareholder franchise and its disinterested shareholder construct are that such shareholders will vote with a view to maximizing the value of their shares. The increasing debate over the wisdom of shareholder primacy—much of it under the broad and ambiguous rubric of "ESG"—poses a dilemma. In the views of some participants in this debate, corporations and investors in their voting and other behavior should be allowed to further ESG goals even when doing so would detract from share value.

Institutional investors are quite constrained in their ability to undertake actions that depart from the interests of their clients. For example, under the "sole interest rule" of trust fiduciary law, trustees

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[244] *Id*. at 78779.
[245] *Id*.
[246] *Id*. at 78779 ("a fund may have multiple subadvisors exercising the power to vote over a portion of securities held by the fund. To the extent one of these subadvisors voted a reporting fund's shares differently than the other subadvisors to the fund, the fund's quantitative disclosures will reflect this split vote by showing the fund had a number of shares voted both for and against. Further, investors will continue to have access to descriptions of funds' proxy voting policies and procedures through required disclosures, which would include applicable descriptions of the policies and procedures of investment advisers or other third parties that are used to determine how to vote fund proxies."
[247] *Id*. at 78818
[248] *Id*. at 78788
[249] *Id*. at 78771-72

of pensions must consider only the interests of the beneficiary.[250] Thus, if a trustee's use of ESG or other considerations is motivated not by a desire for better risk-adjusted returns but by the trustee's ethics or to benefit others, the duty is violated. Thus, the 2022 Department of Labor mandate that an ERISA fiduciary may consider ESG matters to improve risk-adjusted returns but not to obtain collateral benefits.[251]

So, at least in theory, there should be little by way of institutional investor non-value enhancing ESG-related behavior. And certainly asset managers have been forthright in pledging fealty to the pecuniary interests of their clients, even BlackRock, which had long been at the forefront of concern for ESG matters.[252] Nevertheless, there has been at least a widespread perception that such non-value-enhancing investor ESG-related behavior has occurred and some limited empirical evidence it does occur.[253]

We believe it does and has grown with a general rise in ESG-related investing. However, for legal reasons, few institutional investors would easily admit doing so, much less offer a reliable estimate of its magnitude. While the paucity of public information on this important source of institutional investor motivational misalignment is understandable from the standpoint of investor legal and perhaps reputational risk, it creates enormous difficulties from the standpoint of voting legitimacy.

(d) House View versus Individual Portfolio View

Institutional investors vary as to whether they give individual portfolio managers discretion when making voting decisions or insist on a unitary "house" view when voting. Vanguard, T. Rowe Price, and BlackRock give individual portfolio managers discretion to make their own voting decisions.[254] State Street, on the other hand, employs a "house" view for voting its proxies.[255] When

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[250] Max M. Schanzenbach & Robert H. Sitkoff, Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee, 72 STAN. L. REV. 381 (2020).

[251] Max M. Schanzenbach & Robert H. Sitkoff, ESG Investing After the DOL Rule on "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (Feb. 2, 2023).

[252] BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: GLOBAL PRINCIPLES 3 (2023), *https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global.pdf* (stating how BlackRock uses its "voice as an investor to promote sound corporate and business practices to help maximize long-term shareholder value for our clients").

[253] Pollack, *supra* note --,--; Hu & Hamermesh, Decoupling and Motivation, *supra* note 10,at 1032.

[254] *See* Vanguard, *Proxy Voting Policy For U.S. Portfolio* Companies, 1, 4 (2023), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/us_proxy_voting_2023.pdf ("Proposals are voted case by case, under the supervision of the Investment Stewardship Oversight Committee and at the direction of the relevant Fund's Board. In all cases, proposals are voted as determined in the best interests of each fund consistent with its investment objective."); T. Rowe Price, *Proxy Voting Guidelines*, 1, 18 (2023), https://www.troweprice.com/content/ dam/trowecorp/Pdfs/proxy-voting-guidelines-TRPA.pdf ("Ultimately, the portfolio managers decide how to vote on the proxy proposals of companies in their portfolios. Because portfolio managers may have differences of opinion on portfolio companies and their unique governance issues, the T. Rowe Price Funds may cast different votes at the same shareholder meeting."); BlackRock, *BlackRock Funds III iShares S&P 500 Index Fund Statement of Additional Information*, 1, B-14 (2023), https://www.blackrock.com/us/individual/literature/sai/sai-sandp500fund-us.pdf ("Portfolio managers have full discretion to vote the shares in the Funds they manage based on their analysis of the economic impact of a particular ballot item on their investors."

[255] State Street Global Advisors, *Global Proxy Voting and Engagement Principles*, 1, 2 (2023), https://www.ssga.com/library-content/pdfs/asr-library/global-proxy-voting-and-engagement-principles.pdf ("Despite the vast array of investment strategies and objectives across State Street Global Advisors, the fiduciary responsibilities of share

determining whether an asset manager was disinterested in a particular vote, the reviewing court would first need to determine whose views are reflected in the vote: the firm's or the portfolio manager's?

Once a court makes this determination, it will realize that the "house" versus "individual discretion" distinction is not as firm as it appears on first glance. Fidelity and Vanguard each state that they treat votes that raise "corporate governance concerns" differently than those that do not.[256] When a vote involves corporate governance concerns, both firms will cast their votes in a uniform manner.[257] However, should the vote not raise corporate governance concerns, but instead present more common-place economic issues, each firm gives its portfolio managers freedom to vote on their individual funds' behalf.[258] Thus, a reviewing court will need to determine whether a particular vote in question raised corporate governance concerns or not. Furthermore, it will need to determine what those corporate governance concerns are. Such a review requires highly particularized and likely ambiguous data about an institution which a court is unlikely to be able to acquire and review promptly and reliably.

(e) Index Funds versus Active Funds

Distinctions between how active funds and index funds vote add a further layer of complexity to the task facing a reviewing judge. BlackRock, the world's largest asset manager, has stated that differing motivations sometimes lead to "active portfolio managers voting differently than other BlackRock portfolios (i.e., index funds)."[259] Specifically, index fund managers tend to focus "on the long-term value of the company" while active fund managers see their votes as a way to encourage "a

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ownership and voting for which State Street Global Advisors has voting discretion are carried out with a single voice and objective.")

[256] *See* Vanguard, *Vanguard Chester Funds Proxy Guidelines Supplement,* 1, 2 (2019) https://www.sec.gov/Archives/edgar/data/752177/000093247119007326/sai059012019.htm; Fidelity Management & Research Company, *Re: Proposed Rules: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies (Release Nos. 33-8131, 34-46518, IC- 25739; File No. S7-36-02),* (Dec. 6, 2002) https://www.sec.gov/rules/proposed/s73602/edroiter1.htm (such "corporate governance concerns" include "proposals relating to equity-based compensation plans; anti-takeover devices such as poison pill plans, staggered boards, or golden parachutes; or other proposals that would curtail or erode shareholders' rights, such as the issuance of classes of common stock with differential voting rights or elimination of the right of shareholders to call a special meeting").

[257] *See* Fidelity Management & Research Company, *Re: Proposed Rules: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies (Release Nos. 33-8131, 34-46518, IC- 25739; File No. S7-36-02),* (Dec. 6, 2002) https://www.sec.gov/rules/proposed/s73602/edroiter1.htm (Fidelity will cast its votes "in accordance with a detailed set of proxy voting guidelines."); Vanguard, *Vanguard Chester Funds Proxy Guidelines Supplement,* 1, 2 (2019) https://www.sec.gov/Archives/edgar/data/752177/000093247119007326/sai059012019.htm (In Vanguard's words, "For most proxy proposals, particularly those involving corporate governance, the evaluation will result in the same position being taken across all of the funds and the funds voting as a block.")

[258] *See* Fidelity Management & Research Company, *Re: Proposed Rules: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies (Release Nos. 33-8131, 34-46518, IC- 25739; File No. S7-36-02),* (Dec. 6, 2002) https://www.sec.gov/rules/proposed/s73602/edroiter1.htm (In this context Fidelity states that "portfolio managers are free to decide for their respective funds how proxy votes should be cast on these types of proposals, since the decisions are part and parcel of the investment decision-making process entrusted to them."); Vanguard, *Vanguard Chester Funds Proxy Guidelines Supplement,* 1, 2 (2019) https://www.sec.gov/Archives/edgar/data/752177/000093247119007326/sai059012019.htm (Vanguard notes that under these conditions "a fund may vote differently, depending upon the nature and objective of the fund, the composition of its portfolio, and other factors.")

[259] BlackRock, *Viewpoint: The Investment Stewardship Ecosystem*, 1, 12 (2018) https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf

particular outcome at a company that is aligned with their investment views."[260] In comments before the FTC, BlackRock's Vice Chairman Barbara Novick noted that BlackRock may split votes "when an active portfolio manager may have a different view from that of the stewardship team."[261] An active manager's view may be completely unique to its portfolio and unshared by its parent firm.[262]

(f) Externally-Managed Funds versus Internally Managed Funds

Institutional investors may give externally managed funds different treatment than they give to those they internally manage. For instance, "Vanguard's Investment Stewardship team" votes on behalf of "each internally managed Vanguard fund."[263] However, in 2019, Vanguard's board "delegated full proxy voting responsibility for Vanguard's externally managed funds to the external managers of those funds."[264] This means that externally managed funds are free to set their own voting policies.[265] A judge reviewing disinterestedness would need to assess not only which of an institutional investor's votes represent the views of outside portfolio managers, but also whether the external manager sets its own voting policy, and if so, what that policy entails.

C. Limits to Relying on Voluntarily Supplied Information and Subpoenaed Information

In light of the foregoing review of limits on the availability and clarity of information pertinent to evaluating shareholder motivation, requiring individual proof of shareholder disinterestedness would run into two sets of insurmountable problems.

The first set of problems relates to the fact that, as we have shown, there is not enough information available publicly or to the host company to make accurate alignment determinations as to individual investors or even as to the most transparent of institutional investors like mutual funds. And assets under management held by less transparent foreign investors, collective investment trusts, hedge funds, and pension funds far exceed the size of these investment companies.

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[260] *Id.*

[261] Barbara Novick, Vice Chairman, BlackRock, Revised and Extended Remarks at FTC Hearing #8: Competition and Consumer Protection in the 21st Century, Panel Discussion on Institutional Investors, Diversification, and Corporate Governance (Dec. 6, 2018) at 10, *available at* https://www.blackrock.com/corporate/literature/publication/remarks-barbara-novick-ftc-hearing-8-competition-consumer-protection-21st-century-120618.pdf.

[262] Federal Trade Commission, *Hearing on Competition and Consumer Protection in the 21st Century*, 1, 133, (Dec. 6, 2018) https://www.ftc.gov/system/files/documents/public_events/1422929/ftc_hearings_session_8_transcript_12-6-18.pdf (Novick gave an example of such a unique view: "Let's say an active portfolio manager just established a position at a company. It would seem that they're confident, they're coming in at a good price, they're confident in that management going forward. But let's say the stewardship team has engaged over time and feels that some things haven't been done that they want to see done. So the stewardship team may say, you know, it's time. You know, we have patience, but patience is up, it's time for us to vote against some specific director, call it the audit committee, the compensation -- whatever. Whereas the active manager who just bought that company, just entered, might say, well, I entered on the premise that I understand what's going on and I think there's going to be change over time, and I'm okay being patient now. So you see those kinds of splits, and there can be splits on other things.")

[263] Vanguard, Investment Stewardship About Our Program, 6, 2021.

[264] *Id.* at 4.

[265] *Id.*, ("Each manager has their own policies and guidelines that govern their voting decisions. The external managers are carefully selected to ensure their investment principles and processes align with the interests of the fund they manage.)

It would be the rare retail or institutional institution who would voluntarily provide such information. Consider first the individual investor. In its latest Survey of Consumer Finances, released in October 2023, the Federal Reserve Board estimated that the median holding of stocks directly held by all families in 2022 was only $15,000.[266] Rational apathy may explain why the vast majority of retail investors do not even vote. In the 2022 proxy season, retail investors only voted 29 percent of the shares they owned.[267]

Even a higher majority can be expected to ignore any questionnaires about their financial holdings. Here, not only rational apathy but concerns over loss of privacy and suspicions that a questionnaire is part of a financial scam would be involved. The brokerage community has noted that the privacy interests of retail investors in their names, addresses, and trading histories has been increasing amidst an increase in the general societal interest in cybersecurity and identity theft.[268]

Institutional investors are even less likely to volunteer information. As noted above, the substantial majority of institutional investors are OBOs while the substantial majority of individual investors are NOBOs. The decision to elect OBO status is to keep their holdings and proprietary trading strategies confidential and to prevent front-running of their trades.[269] The same considerations apply here.

In theory, defendants could conceivably obtain information about motivation by means by subpoenas to shareholders, including individual investors.[270] A shareholder served with a subpoena would need to either comply, negotiate a narrower production of information, or move to quash the subpoena. Wide-scale subpoenas would not be practical, however, even leaving aside all the attendant transaction costs. As of its latest Form 10-K, Apple had 23,763 shareholders, many of whom are individuals, including many non-U.S. individuals. As of 2022, "households" as defined by SIFMA accounted for 40.8% of all U.S. holdings of equities.[271] It is inconceivable that a subpoena could be served on all such individual investors.

A second set of problems arises from the public perception of widespread attempts, by subpoena or otherwise, to gather information bearing on motivational alignment. Requiring affirmative proof of disinterestedness would impose on voting shareholders the cost of gathering and producing the complex data necessary to evaluate disinterestedness. That cost would effectively amount to a poll tax on voting, and would have the perverse effect of discouraging shareholders from voting.

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[266] Data from "Survey of Consumer Finances, 1989-2022" --- (Oct. 2023), at https://www.federalreserve.gov/econres/scf/dataviz/scf/table/#series:Directly_Held_Stocks;demographic:all;population:1;units:median

[267] Broadridge Fin. Sols., 2023 Proxy Season Preview and 2022 Proxy Season Highlights 4 (2022), https://www.broadridge.com/_assets/pdf/broadridge-2023-proxypulse-report.pdf.

[268] Working Group, *supra* note 179 at 14.

[269] Working Group, *supra* note 179 at 12.

[270] See, e.g. Federal Rules of Civil Procedure Rule 45 and Delaware Court of Chancery Rule 45.

[271] SIFMA, 2023 CAPITAL MARKETS FACT BOOK 75 (July 2023) This figure includes the holdings of non-profit organizations. The balance (59.2%) is held by institutions.

IV. PROPOSAL: A MEASURED SOLUTION FOR IMPLEMENTING THE DISINTERESTED SHAREHOLDER DOCTRINE

A. Overview

As the foregoing review of informational problems demonstrates, it is impossible as a practical matter to gather, present, and evaluate affirmative proof that even a few, let alone a majority, of public company shareholders are disinterested. That impossibility has enormously significant legal consequences.

The most immediate consequence would be to render irrelevant decades of precedent giving validating effect to shareholder approval of mergers and acquisitions involving director or controlling stockholder conflicts of interest. Proving that such approval was disinterested and appropriately motivated would be informationally impossible, and defendants would therefore be unable to establish the shareholder disinterestedness required for such validation.

We are faced with two unacceptable extremes: either ignore the compelling evidence that many investors, especially large institutional investors, may not vote in a way that is motivated by advancing the goal of share value maximization, or effectively do away with judicial reliance on disinterested shareholder voting because of its insistence on disinterestedness as a response to violation of the foundational premise of the shareholder franchise.[272]

What is called for is a workable, if imperfect, resolution. In this Part, we propose a measured way of resolving the tension between the interest in limiting the shareholder franchise to disinterested shareholders and the informational impossibility of comprehensively and accurately ascertaining their motivational alignment.

We begin by advocating judicial adoption of an evidentiary presumption that a holder of host company shares is disinterested for purposes such as *Corwin* cleansing and *MFW*. **(Part IV.B)** The primary justification for this presumption is that failing to adopt such a presumption—in effect, requiring affirmative proof of alignment—would have consequences for the shareholder that are not only radical and highly undesirable but completely inadvertent. This would violate any semblance of means-end rationality and be inconsistent with the thoughtful ways Delaware has elsewhere responded to decoupling. Second, there is a basis in incrementalism. The presumption is an explicit and more refined version of what has been a long-accepted but unstated proposition of legal doctrine, albeit one with uncertain contours. Third, there are plausible reasons to believe that many shareholders are disinterested in some way or vote or tender shares as if they were.

But to shore up the legitimacy of judicial reliance on the vote, we further outline a workable, focused process that can overcome the daunting informational challenges and would help identify material instances of institutional investor departures from disinterestedness. **(Part IV.C)** The proposed presumption would be rebuttable through the use of readily available public information about

[272] *E.g.*, Del. Code Ann., tit. 8, § 251(b).

institutional investor holdings, and would allow for a full evidentiary review of motivational alignment where such an investor's holdings or motivational alignment are not clearly too insignificant to affect its vote or to influence the overall outcome of the shareholder vote.

B. Rebuttable Presumption of Disnterestedness as Starting Point and Justifications

We advocate judicial adoption of an evidentiary presumption that a holder of host company shares is disinterested for purposes such as *Corwin* cleansing and *MFW*.

1. Means-End Rationality and Delaware's Approach Elsewhere to Decoupling

Conditioning the possibility of giving validating effect to a shareholder vote on affirmative proof that is informationally impossible would be to entirely eliminate a key context for the exercise of the shareholder franchise. This radical re-allocation of power from shareholders to courts and incumbent management would not occur as a result of some thoughtful assessment of the benefits and costs of such a re-allocation.

To the contrary, there would be no thought at all. The re-allocation would flow entirely from the sheer fluke of informational impossibility because of shareholder realities that emerged well after the development of the judicial construct of "disinterestedness." It would defy the entire concept of ends-means rationality: there would be no "end," much less any attempt to fashion the best means to an end. It would be nothing short of irrational.

A thoughtful assessment may be concerned, for instance, that the blanket repudiation of this exercise of the shareholder franchise might lead to greater judicial scrutiny of the substantive fairness of conflict transactions. Such scrutiny might remedy or deter rent-seeking or value destructive transactions, but it might also deter value creating transactions as well as impose additional litigation costs. Without reasonable certainty about how those competing considerations would balance out, it cannot be confidently asserted that a rigid application of the disinterestedness requirement would be beneficial.

What would be an unthinking and radical abandonment of the shareholder franchise in the core judicial response to decoupling would stand in direct contrast to the thoughtful and circumspect approach that Delaware has taken in other voting contexts involving decoupling.

First, as discussed in Part II.B, Delaware case law relating to the transfer of voting rights without accompanying economic interests reflects careful consideration of decoupling issues. Most notably, the case law reflects the analytical framework's concerns over how such transfers may cause motivational misalignments in the magnitude of incentives, yet intervenes to set aside bought votes only when they are outcome determinative.

Second, as discussed in Part II.A, Delaware has been very circumspect in using decoupling as a basis for constraining the exercise of statutory voting rights. This is despite the full awareness of the challenges decoupling poses to the foundational premise of aligned economic interest and voting power.

Third, culminating in the April 2024 *Match Group* opinion, the Delaware Supreme Court has devoted enormous effort to evaluating the effects of shareholder voting and tendering on the standard of review and burden of proof in litigation challenging sales of the corporation or transactions involving conflicts of interest on the part of directors or controlling stockholders. Although the *Match Group* decision defines those effects as less extensive than what one of us has argued,[273] the Delaware courts explicitly view shareholder approval as an important consideration in determining the appropriate judicial role in shareholder litigation. An approach that would decline to presume shareholder disinterestedness and instead insist on affirmative proof that shareholder voting is disinterested would be demanding the impossible, and would thereby render irrelevant the courts' dedicated efforts to define the role of shareholder voting.

2. Incrementalism

The proposed presumption of disinterestedness has the virtue of being part of an incremental, rather than radical, approach to confronting changing market realities. Incrementalism has real advantages in addressing novel, complicated issues flowing from capital market dynamism. Less information is required, the results are more predictable, and if the changes prove misguided they are easier to reverse.[274]

For one thing, the presumption accords with a long-accepted if tacit proposition of legal doctrine. If nothing else, courts have justified giving validating effect to shareholder approval of mergers or tender offers based on the proposition that the shareholders have an "actual economic stake" in the host company.[275] Indeed, faith that share ownership creates meaningful incentives to act in the best interests of the corporation undergirds several other aspects of Delaware corporate law: the requirement of continuous share ownership for representing the corporation in derivative litigation rests on the belief that such ownership helps "ensure that the plaintiff prosecuting a derivative action has an economic interest aligned with that of the corporation and an incentive to maximize the corporation's value,"[276] and "[i]t is a guiding principle of Delaware law that material amounts of stock ownership can serve to align the interests of fiduciaries with the interests of other stockholders."[277]

Courts thus plainly accept the proposition that shareholders will presumptively vote, tender shares, and otherwise act in the interest of company shareholders generally. And as discussed above,[278] courts do not systematically require affirmative proof that votes are not the result of vote buying or based on invalid purported irrevocable proxies. In effect, then, courts have already established a tacit

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[273] Hamermesh, Jacobs, & Strine,*Retrospective and Look Ahead*, *supra* note 6.
[274] Henry T. C. Hu, *Misunderstood Derivatives: The Causes of Informational Failure and the Promise of Regulatory Incrementalism*, 102 YALE L.J. 1457 (1993).
[275] *E.g.,* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 313-14 (Del. 2015) (advocating judicial deference to the votes of shareholders having "an actual economic stake in the outcome").
[276] Parfi Holding AB v. Mirror Image Internet, Inc., 954 A.2d 911, 939 (Del. Ch. 2008).
[277] In re Mindbody, Inc., 2020 Del. Ch. LEXIS 307, *35 (Oct. 2, 2020).
[278] *Supra* Part II.B.

presumption that share ownership results in a positive overall economic interest in the shares. Rejecting that presumption would therefore require jettisoning long-standing corporate law precedent.

3. The Empirical Basis

A presumption is appropriate as a substitute for specific proof if what is presumed – here, motivational alignment – typically follows from the observable fact – here, ownership of host company shares – that gives rise to the presumption.[279] While we cannot confidently say that the more empirically plausible presumption is that institutional shareholders are motivationally aligned, we believe many are, or vote or tender as if they are, while the overwhelming majority of individual shareholders are.

(a) Individual Investors

When individual investors are sufficiently motivated to vote, their relatively small number of stock holdings—the only systematic analysis found an average investor to hold a four-stock portfolio—indicates that it is highly unlikely that their economic interest in host shares would be offset by related non-host assets, such as shares of a merger counterparty.[280] It also seems unlikely that individual investors would normally trade in derivatives or other coupled assets that would offset the positive economic interest associated with their host share ownership. The effect of organizational voting dynamics like share lending seems unlikely to offset the effect of their financial stakes.

(b) Institutional investors

In the various ways discussed below, it is realistic to presume that institutional investors' shares are voted with a motivation that aligns with the interests of shareholders generally in maximizing share value.

Activist Funds. As discussed in Part I.C. activist investors tend to have largely undiversified portfolios, and it is reasonable to presume that activist investors have positive overall economic interests in the host company.

Proxy Advisors. Proxy advisory firms such as ISS provide proxy research and vote recommendations to institutional investor clients.[281] In 2022, ISS helped more than 1,600 clients make

[279] *See, e.g., Tot v. U.S.,* 319 U.S. 463, 467-68 (1943) ("a statutory presumption cannot be sustained if there be no rational connection between the fact proved and the ultimate fact presumed, if the inference of the one from proof of the other is arbitrary because of lack of connection between the two in common experience."); *Edmanson v. Wilmington & Philadelphia Traction Co*., 120 A. 923, 924 (Del. Super. 1923) ("Presumptions arise from the doctrine of probabilities. The future is measured and weighed by the past, and presumptions are created from the experience of the past. What has happened in the past, under the same conditions, will probably happen in the future and ordinary and probable results will be presumed to take place until the contrary is shown."). [tons of cases from other states quoting this language]

[280] Hu & Hamermesh, *Decoupling and Motivation*, supra note 10, at 1024-25.

[281] See, e.g., Andrey Malenko & Nadya Malenko, Proxy Advisory Firm: The Economics of Selling Information to Voters, 74 J. Fin. 2441 (2019); Stephen Friedman, Testimony at the Committee on Financial Services hearing: "Oversight of the Proxy Advisory Industry," Harv. L. Sch. Forum on Corporate Governance, July 29, 2023,

and execute proxy voting decisions for approximately 50,000 shareholder meetings in over 100 markets worldwide.[282] There is strong empirical evidence that proxy advisors' recommendations have a large impact on voting outcomes.[283] Chang Shu's 2024 study found that when a proxy advisor issues a recommendation opposing management, its mutual fund customers are approximately 20 percentage points more likely to oppose management relative to other investors.[284]

Moreover, an increasing proportion of customers votes in lockstep with proxy advisor recommendations, a practice known as "robo-voting." In 2021, 23% of ISS clients in the study were robo-voters (using a dual over-99.9% standard) , more than triple the percentage in 2007.[285] Some of the robo-voting was outcome-determinative: in 66 of the director elections in the 2007-2021 sample years, the election outcomes would have been reversed if the votes of ISS robo-voters were excluded. The robo-voters tend to be smaller mutual fund families and families which had a larger proportion in index products and a lower propensity to offer ESG funds.

While the impact of proxy advisors on firm value is currently a topic of debate,[286] in general, proxy advisors claim to formulate their recommendations on an issuer-specific basis.[287] This presumably means a general focus on promoting shareholder returns and if their clients follow the recommendations, their clients would be acting consistent with disinterestedness.

To be sure, the relationship between such a focus and the impact of custom voting policies is not clear. In 2022, 86% of the total voted shares ISS processed were linked to their client's custom voting policies reflecting their individual mandates and specific proxy voting considerations. ISS's long-time general counsel construed this as meaning that for the vast majority of shares, it is those custom voting policies that set the basis for and direct ISS's vote recommendations. Nevertheless, it is not unreasonable to conclude that the influence of ISS's issuer-specific focus tends to result in significant institutional investor voting that is meaningfully oriented toward share value maximization.

Moreover, even assuming that a particular institutional investor could not be considered entirely motivationally aligned, a number of circumstances suggest that at least some of its shares should be viewed that way. Our 2023 Article briefly touched on two such circumstances—pass-through voting and individual portfolio manager voting authority.[288]

Pass-Through Voting. If we are prepared to accept a presumption that individual investors and perhaps some smaller institutional investors are disinterested, we should likewise accept a

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https://corpgov.law.harvard.edu/2023/07/19/testimony-at-the-committee-on-financial-servicess-hearing-oversight-of-the-proxy-advisory-industry/.

[282] Friedman, *supra* note 281.

[283] Malenkov & Malenkov, supra note 281, at 2441.

[284] Chong Shu, *The proxy advisory industry: Influencing and being influenced*, 154 J. FIN. ECON. 103810 (2024) (study looking at data from 2007 to 2021).

[285] Shu's study considered a mutual fund family to be a robo-voter if it met two criteria: (1) over 99.9% of its votes align with the advisor's recommendations, and (2) over 99.9% of its votes on proposals where the advisor opposes management also align with the advisor's recommendations. Shu, *supra* note 284, at 11-13.

[286] *See, e.g.,* Aiyesa Dey, et al., *Proxy Advisory Firms and Corporate Shareholder Engagement* 1 (Jan 24, 2023).

[287] Stephen J. Choi, *et al.*, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 658 (2009) ("all the major proxy advisors provide general guidelines that … describe their processes as employing substantial issuer-specific judgment").

[288] Hu & Hamermesh, *Decoupling and Motivation*, supra note 10, at 1033-34.

presumption that votes cast by large asset managers in accordance with instructions from individual and perhaps some smaller institutional clients should generally be considered to be motivationally aligned with the interest in maximizing host company share value. Continued growth of pass-through voting may make that presumption more generally applicable.[289]

We acknowledge that the precise nature of the choices asset managers give to their clients and the choices their clients make would make a difference in whether the votes that are passed through should be considered disinterested. We illustrate by focusing on BlackRock's institutional and individual investor pass-through arrrangments.

In 2022, BlackRock established its "Voting Choice" program. Under this program, certain institutional pooled vehicles have the ability to apply their preferred voting policy to shares in the pooled fund reflecting the client's relative ownership of that fund.[290] To develop their preferred policy, they could rely on in-house teams or contract directly with third-party proxy advisors. Clients in separately managed accounts (SMAs) have an option that clients in institutional pooled vehicles do not have: they can make specific voting decisions on the topics or at the companies that matters most to them. Both types of institutional clients have the ability to select a set of voting plices from third-party proxy advisers—and also to simply rely on BlackRock's Investment Stewardship voting policy.

In February 2024, BlackRock extended its Voting Choice program on a pilot basis to the three million individual investors in its primary S&P 500 index fund. [291] They would have the opportunity to select one of six third-party proxy voting policies, as well as having the option to continue relying on BlackRock's Investment Stewardship voting policy.

In theory, to the extent that BlackRock's passed-through voting rights could be voted in the sole discretion of its clients such shares should generally be considered disinterested. This assumes that the clients are themselves disinterested. BlackRock's SMA clients unquestionably have this sole discretion: hey have the right to make specific voting decisions. (It is unclear, however, how many SMA clients would themselves actually be disinterested or at least should be presumed to be disinterested.)

In practice, the complexities of the Voting Choice program can make this disinterestedness issue yet more complex. For example, one of the choices available to clients participating in the program is to rely entirely on BlackRock's "Investment Stewardship" voting policy.[292] In that case, should the pertinent shares still be considered disinterested?

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[289] *See* Broadridge Financial Solutions, *Pass-through Voting* (2023) at 6, available at https://www.shareholderforum.com/access/Library/20230400_Broadridge-Firebrand.pdf ("The increased appetite for pass-through voting processes that better enable investor engagement and the fact that several of the largest asset managers in the market such as BlackRock, Charles Schwab and Vanguard have adopted such a model indicates that other firms are likely to move in this direction.").

[290] BlackRock, Empowering Investors through BlackRock Voting Choice, https://www.blackrock.com/corporate/about-us/investment-stewardship/blackrock-voting-choice#:~:text=We%20launched%20BlackRock%20Voting%20Choice,more%20accessible%20for%20eligible%20client [hereinafter BlackRock, *Empowering Investors*]; BlackRock, Voting Choice FAQs (NM1223U-3268600-8/8).

[291] BlackRock, U.S. Pilot Program FAQs 3 (nm0224u-3387596)

[292] Blackrock, *Empowering Investors*, supra note 290.

Another example posing complexities is that these clients can also select from a set of voting policies from third-party proxy advisers. BlackRock's menu in its pilot program for individual investors included, for instance, the "Socially Responsible Investment policy," the "Catholic Faith-Based Policy," and "Climate Policy." It is not clear whether votes according to one or more of these policies will be solely influenced by value enhancement.

Individual Portfolio Manager Voting Authority. Even where a large asset manager's aggregate holdings result in a zero or negative overall economic interest in host shares, the holdings of some individual portfolios within those aggregate holdings may have a positive overall interest. Where that is the case, and where the asset manager's policies delegate unfettered and full voting authority and discretion to individual portfolio managers, a presumption of disinterestedness as to the shares held in such portfolios is factually supported.[293]

C. Process for Identifying and Resolving Issues of Departures from Disinterestedness

Disinterestedness cannot be presumed based on mere share ownership without establishing a procedure for determining the circumstances in which significant and consequential departures exist, particularly where institutional investors are involved. We propose a sequence of three elements.

First, a plaintiff can rebut the presumption of alignment using publicly available data on a person's financial stakes and, at the option of the plaintiff, supplemented by other information, including information on the person's organizational voting dynamics. **(Part IV.C.1)** The limitations of such financial stake information and the absence of information on organizational voting dynamics would not stand in the way. The plaintiff would merely have to show that, based on such publicly available financial stake data, there is a reasonable inference that the shareholder is not disinterested. The plaintiff could, but would not be required to, provide additional information beyond what is available through SEC filings.

Second, if the presumption is rebutted, the court should still consider whether the shareholder's holdings and lack of disinterestedness are material in terms of both probability and magnitude. **(Part IV.C.2)** With regard to probability, a court could reasonably decline to further engage in an assessment of a particular shareholder's alignment if, for instance, the court were confident, on a summary judgement basis,[294] that the size of that person's holdings, together with holdings of other shareholders whose presumptive disinterestedness has been rebutted, would be or have been unlikely to affect the outcome of the vote or tender offer. With regard to magnitude, if, for example, the overall economic interest is trivial in amount compared to the shareholder's overall portfolio, a court could conclude that

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[293] *See* Hu & Hamermesh, *Decoupling and Motivation*, supra note 10, at 1033-34 (comparing asset managers with a "house" view of voting with managers that delegate voting discretion to individual portfolio managers). As we pointed out there, in the *CNX* case nearly half of T. Rowe Price's block of 37% of the publicly held shares of CNX (target) stock were held by a separately managed fund that owned no shares of the tender offeror, and thus had an undiluted incentive to maximize the value of the CNX (host) shares. *Id.*

[294] *See* Court of Chancery Rule 56(c) (summary judgment appropriate where "there is no genuine issue as to any material fact and [] the moving party is entitled to judgment as a matter of law.")

it is unlikely that the overall economic interest would impair the shareholder's motivation in voting or tendering shares.

Third, and only if a shareholder's presumptive disinterestedness has been rebutted, and application of the materiality standards does not filter out further inquiry, would the court and the parties engage in the difficult task of gathering shareholder-specific data (produced by the shareholder voluntarily or in response to a subpoena). **(Part IV.C.3)** The defendants would be permitted to offer the necessary information on the shareholders' financial stakes and organizational voting dynamics for two independent reasons. First, the defendants could show that the shareholder's holdings and overall economic interest do not meet the probability or magnitude components of the materiality requirement. Second, the defendants could show that all or part of the shareholder's votes should be considered disinterested. In either case, the burden of proof would rest on the defendants who invoke disinterested shareholder approval in order to obtain a more relaxed standard of judicial review.

1. Rebutting the Presumption of Disinterestedness

The presumption of motivational alignment that we advocate would of course be rebuttable, and one can expect that considerations of litigation economics would make it likely that the presumption would be challenged only for institutional investors, especially larger institutional investors. While retail investors in certain contexts such as de-SPACs and meme stocks can present class-wide disinterestedness issues as well, this proposal is targeted at institutional investors.[295]

To rebut the presumption of disinterestedness, the plaintiff would be required to show, based solely on reasonably contemporaneous publicly available information on a shareholder's financial stakes at the Decision Date (the time of the relevant vote or tender), as supplemented by other information, if the plaintiff chooses, that the shareholder had or would have a near-zero-, zero, or negative economic interest in the host shares. In addition, the plaintiff would have the option of presenting public or non-public information about the shareholder suggesting that, when considered together with the its financial stakes, the shareholder has incentives to vote all or part of its voting rights in ways contrary to the goal of maximizing share value.[296] Thus, it could rely on the sources of public data identified in Part III.B.1(1) with respect to host shares, coupled assets (coupled assets such as share lending, derivative positions, and short-selling), and related non-host assets. This is easily done by the plaintiff at a computer terminal, and without the need for any discovery. There would be no requirement that the plaintiff try to obtain and adjust for the organizational voting dynamics of a shareholder, something that would require costly discovery and factual determinations.

CNX, a case we previously examined,[297] illustrates how easy this would be. In that situation, based on publicly available 13F filings, we showed that the proportionate interests of Vanguard, BlackRock, and State Street in a controlling shareholder/tender offeror (CONSOL) exceeded their

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[295] *See* Hu & Hamermesh, *Decoupling and Motivation*, *supra* note 10, at 1022 n. 75.

[296] The reason for this option is that a person who has a *positive* overall economic interest in host shares may have organizational voting dynamics that can trump its incentive to vote in favor of share-value enhancing way. For instance, if the person is voting all or part of its shares based on a value-destructive form of ESG investing, then the voting rights associated with the pertinent shares should not be considered as disinterested.

[297] Hu & Hamermesh, *Decoupling and Motivation*, supra note 10, at 1026-27, discussing In re *CNX Gas Corp. S'holders Litig*., 4 A.3d 397 (Del. Ch. 2010).

proportionate interests in CNX (target/host) shares by factors of 10, 26, and 29, respectively.[298] That information alone would suffice to rebut the presumption of motivational alignment.

The point here is to use a low-cost way to identify a plausible, though likely over-inclusive, group of institutional shareholders whose disinterestedness can no longer be presumed.

2. Applying a Materiality (Probability and Magnitude) Filter

If the presumption of motivational alignment is rebutted for any given shareholder, it would still be appropriate to deploy a materiality filter to determine if the investor's holdings are sufficiently consequential to warrant a complex and costly factual inquiry. Under the classic *TSC Industries* concept of materiality under federal securities law[299] and adopted in corporate fiduciary duty law by the Delaware Supreme Court:

> *An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.* [This standard] does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. *What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder*.[300]

And, with respect to contingent or speculative events, the U.S. Supreme Court in *Basic* held that materiality "will depend at any given time upon a balancing of both the indicated probability that the events will occur and the anticipated magnitude of the event in light of the totality of the company activity."[301]

In an analysis that we will not repeat here, *Decoupling and Motivation* suggested that when *TSC* and *Basic* are considered together in the general context of disinterestedness, materiality should be evaluated from two perspectives:[302]

(1) probability – the potential for affecting the overall result of a vote
(2) magnitude – the extent of economic influence on the shareholder's voting decision

We believe that this approach to materiality should be applied in the general context of disinterestedness where the presumption proposed above has been rebutted.

a. Probability

More specifically, in terms of the "probability" half of the materiality filter, we should consider the perspective of the overall outcome of a vote or tender offer: that is, the potential that the investor's

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[298] Hu & Hamermesh, *Decoupling and Motivation*, supra note 9, at 1026 n. 92.
[299] TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).
[300] Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985) (emphasis added).
[301] Basic, Inc. v. Levinson, 485 U.S. 224, 238 (quoting SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).
[302] *Id.* at 1034-36.

shares, together with other similarly situated investors, might affect or have affected the overall outcome. Where a vote has been or is clearly going to be lopsidedly favorable, the overall economic interest of any one shareholder is almost inherently unlikely to affect or have affected the outcome, and is therefore immaterial and can be ignored. On the other hand, where the overall vote (or tender response) is barely enough to support a challenged transaction, or where the outcome of an anticipated vote (or tender offer) cannot be reliably predicted, an institutional investor with even a modest percentage interest cannot be dismissed as immaterial. Focusing only on outcome determinative holdings would mirror the Delaware courts' treatment of vote buying issues: as explained above,[303] Delaware courts reject "bought" votes only when they are outcome determinative.

Under that approach, the court need not apply the "probability" component of the materiality filter based merely on the interest of a single shareholder. Even where a single investor's overall percentage interest might alone be deemed unlikely to affect the outcome of a vote, it may nevertheless satisfy the "probability" component if its interest, together with the interest of other investors with similar overall economic interest, would be deemed likely to have affected the outcome.[304]

In post-transaction litigation, it is easy to tell how close a vote or tender response was and whether the votes or tenders of a single shareholder or group of shareholders were outcome-determinative. And certainly Delaware courts have relied on such after-the-fact information. In *Tesla Motors v. SolarCity*, despite acknowledging the possibility that institutional co-ownership of Tesla and SolarCity City shares might detract from deference, the court nonetheless relied on the strongly favorable (85 percent) vote in ruling that the deal was substantively fair.[305]

In a challenge to a transaction on which the shareholders have not yet acted, however, as would be the case where a plaintiff seeks a preliminary injunction against completion of the transaction, the probability component of the materiality filter cannot be applied without a reasonably reliable forecast of the likely outcome of the vote or tender offer response. Like any prediction, such a forecast will not be perfectly accurate; but there are reasons to believe that in many cases a court will be able to make an informed judgment about the likelihood that a vote or tender response will be lopsided or close.

First, there is good reason to believe that management has access to reasonably reliable information about how shares are likely to be voted.[306]

Second, the relatively few large proxy solicitation firms all advertise the ability to predict voting outcomes.[307] For reputational reasons, those firms would be disinclined to proffer voting predictions

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[303] See Part II.B.1.
[304] Hu & Hamermesh, *Decoupling and Motivation*, supra note 9, at 1035-36.
[305] *In re* Tesla Motors, Inc. Stockholder Litig., Cons. C.A. No. 12711-VCS, 2022 Del. Ch. LEXIS 94, at *65 n.430 (Apr. 27, 2022), *aff'd*, No. 181, 2023 Del. LEXIS 178 (June 6, 2023).
[306] Yair Listokin, *Management Always Wins the Close Ones*, 159 AM. L. & ECON. REV. 159, 178 (2008) ("Management enjoys access to real-time voting information.").
[307] *E.g.*, Innisfree M&A Inc., *What We Do*, available at https://www.innisfreema.com/situations ("We project likely voting outcomes."); Georgeson, *Proxy management for shareholder meetings*, available at https://www.georgeson.com/us/business/proxy-solicitation/prepare-for-shareholder-meetings ("Annual meeting certainty means knowing your investors and the vote results ahead of time."); D.F. King, *Contested proxy solicitation*, available at https://equiniti.com/us/public/governance-proxy-ownership-services/corporate-proxy-services/contested-proxy-solicitation/ ("Avoid surprises with high-level institutional research and critical vote projection analysis."); Mackenzie Partners, *Proxy Services*, available at http://www.mackenziepartners.com/proxy-services.php ("MacKenzie Partners is

that later prove to be wildly incorrect, so it is unlikely that even competing predictions would fail to agree that an imminent vote would be either lopsided or reasonably close. In many cases, therefore, courts will be able to apply the probability component of the materiality filter in real time.

Third, large institutional shareholders that lend their shares will likely have probative market information about the prospect of a close vote. As detailed in Part III.B.[ ], BlackRock has explicitly stated that its decisions as to whether recall lent shares in order to vote depend on how close they think a vote will be and whether their shares could have an effect on the outcome.

Finally, the costs for borrowing shares around the time of the record date should increase in connection with close votes on important matters. That information is publicly available and would shed further light on the prospects that the vote of one of more shareholders might determine the outcome.

b. Magnitude

The magnitude element of the materiality test could also support a preliminary determination, again in the nature of summary judgement, that detailed inquiry into a particular investor's disinterestedness would be unwarranted. Even if public information indicated that an investor's overall interest in host company shares is or was negative at the relevant time, that interest could be so small that it would not be reasonably plausible that the overall interest, although negative, is or would have been substantial enough to have assumed actual significance in a voting or tendering decision.[308] To illustrate, return once more to the CNX example: although State Street's proportionate interest in CONSOL exceeded its proportionate interest in CNX by a factor of 29, if the actual dollar amounts of the investments were, say, $116,000 and $4,000, respectively, a court could be confident that the size of the stakes could not have affected the tender decision of a firm with billions of dollars of assets under management. To be sure, evidence of lack of significance would have to be clear and convincing to avoid a more thorough exploration of an investor's disinterestedness, but as the example suggests, it may not be uncommon that an investor's stakes are clearly too small to have influenced its voting or tender decision, even where the presumption of disinterestedness is rebutted. Of course, in that situation it is likely that the small size of the stakes involved would result in application of the probability element of the materiality filter (too small to affect the outcome), and the magnitude element of the filter may therefore have a relatively small independent role to play in identifying which investors warrant deeper inquiry into disinterestedness.

3. Examining a Limited Number of Shareholders on Full Information About Financial Stakes and Organizational Voting Dynamics

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often asked for an analysis and recommendation regarding the probability of passing specific proposals,"); Alliance Advisors, *Shareholder Meeting Advisory & Shareholder Engagement*, available at https://allianceadvisors.com/what-we-do/?gclid=Cj0KCQiAh8OtBhCQARIsAIkWb6_2Rp-3ymekw8nUoH7TXVKsZ1mFixixZsJ2BNp6ksvL-PrAMDYA1T0aAsdoEALw_wcB#shareholder-engagement-solicitation ("Our retail voting analytics unlock insights on shareholder's behaviours and provide voting projections to better manage the solicitation strategy.").

[308] *See* Hu & Hamermesh, *Decoupling and Motivation*, *supra* note10, at 1035.

If a shareholder's presumptive disinterestedness has been rebutted and its holdings of host shares cannot be considered immaterial, definitive assessment of the shareholder's disinterestedness would require gathering and evaluating the likely extensive and complex information about its financial stakes and organizational voting dynamics. Taking all of that information into account, this definitive assessment would determine whether to consider the shareholder's vote to be motivationally appropriate, and whether the defendants establish by a preponderance of the evidence that the magnitude of the shareholder's overall economic interest should not be considered material. We do not underestimate the difficulty of this step: our inventory of relevant information and of the gaps in publicly available data[309] amply demonstrates that difficulty. We offer two observations, however, suggesting that including this step in the analytical sequence will be viable as a practical matter.

The first observation rests on the premise that where defendants seek to invoke a shareholder vote or tender response, it is the defendants' burden to prove that the voting or tendering shareholders were disinterested.[310] That allocation of the burden of proof applies to other aspects – adequacy of disclosure, for example[311] – of transaction validation by disinterested directors or shareholders. Defendants may ordinarily satisfy that burden by relying on the presumption of disinterestedness that we advocate, but it would remain defendants' burden to prove disinterestedness in a case where that presumption is rebutted.[312] Allocating to defendants the burden of proving disinterestedness in such a case would compel them to engage in a cost-benefit analysis weighing the formidable costs of gathering and presenting the relevant information against the likelihood of an ultimate finding of disinterestedness. In cases in which the presumption-rebutting evidence of negative overall economic interest is compelling, defendants would rarely resort to expending substantial resources in a likely unsuccessful effort to prove disinterestedness. Even in closer cases, the cost-benefit analysis could counsel defendants against even attempting to prove disinterestedness. Our first observation, then, is that the universe of shareholders whose disinterestedness will actually involve a searching factual inquiry is likely to be even smaller than the already likely small set of shareholders whose presumptive

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[309] *Supra* Part III.B.

[310] Reliance on a vote of disinterested shareholders is an affirmative defense. *See, e.g.*, In re *Inv'rs Bancorp, Inc. Stockholder Litig*., 177 A.3d 1208, 1211 (Del. 2017) ("when the stockholders have approved an equity incentive plan, the affirmative defense of stockholder ratification comes into play. Stated generally, stockholder ratification means a majority of fully informed, uncoerced, and disinterested stockholders approved board action, which, if challenged, typically leads to a deferential business judgment standard of review."). And as a general rule, the burden of establishing an affirmative defense rests on defendants. *See, e.g*., *Tafeen v. Homestore, Inc*., 2004 Del. Ch. LEXIS 50, *2 (Del. Ch. Apr. 27, 2004) ("Since an unclean hands defense is an affirmative defense, defendant would have the burden of proof as to this defense at trial.").

[311] In re *Solera Holdings, Inc. Stockholder Litig*., 2017 Del. Ch. LEXIS 1, *19 (Del. Ch. Jan. 5, 2017), quoting *Harbor Finance P'rs v. Huizenga*, 751 A.2d 879, 899 (Del. Ch. 1999) ("when a board seeks "to obtain 'ratification effect' from a stockholder vote, 'the 'burden to prove that the vote was fair, uncoerced, and fully informed falls squarely on the board.'").

[312] *See* F.R.E. Rule 301 ("In a civil case, unless a federal statute or these rules provide otherwise, the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption. But this rule does not shift the burden of persuasion, which remains on the party who had it originally."). Delaware's general rule on this subject may be different. *Cf. Oberly v. Howard Hughes Medical Inst.,* 472 A.2d 366*,* 388 (Del. Ch. 1984) ("under Delaware law, a presumption does not merely shift to the other party the burden of going forward with evidence to counter the effect of the presumption. Our Rule 301 does not embrace the 'bursting bubble' theory under which the evidentiary weight of the presumption vanishes once the opposing party comes forward with evidence to rebut it. … Rather, as it states, our Rule 301 imposes upon the party against whom the presumption is directed 'the burden of proving' that the nonexistence of the presumed fact is more probable than its existence."). In the context of judicial review of conflict transactions, however, in which defendants generally bear the burden proving approval by disinterested directors or shareholders, we expect that the presumption we advocate would not relieve defendants of the burden of proving disinterestedness of a shareholder as to whom the presumption of disinterestedness has been rebutted.

disinterestedness is rebutted and whose holdings pass through the preliminary materiality filter that we advocate. In any event, the prediction that deep dives into the minutiae of shareholder disinterestedness will be rare is corroborated by the paucity of cases in which the disinterestedness of specific shareholders not affiliated with the corporation has actually been closely scrutinized.[313]

Our second observation about the final phase of our sequenced approach acknowledges the burdens of gathering full information bearing on disinterestedness, but asserts that the exercise is at least possible. That information will be primarily or exclusively in the hands of the shareholders (typically institutional investors) whose holdings are significant enough to pass through the materiality filter. Obtaining that information from those third parties would likely present many practical difficulties: information about share lending, derivatives holdings, and voting policies may be proprietary, and institutional investors will presumably be loath to disclose that information, because of concerns including the prospect of other investors front-running their positions on the basis of the disclosed information, and other investors free-riding off of their research efforts. There are mechanisms, however, that could elicit voluntary or at least compelled (by subpoena) disclosure of the information. Standard confidentiality stipulations and orders would enjoin the parties to the litigation to assure, on pain of sanctions for contempt, that information designated by third party shareholders as confidential would not become publicly available, would be presented to the court under seal, and would be used solely for purposes of the litigation.[314] Such orders routinely protect production in discovery of even sensitive proprietary information about intellectual property,[315] and there is no reason to believe that information about an institutional investor's coupled assets and related non-host assets would not likewise be available through discovery by the parties to litigation.

CONCLUSION

The early, *Blasius*-era vision of the modern stockholder franchise rests on a foundational premise of stockholder motivation that is increasingly in conflict with today's institutional investor realities. The nature and extent of systematic motivational misalignments flowing from transformative investor changes and associated decoupling of voting rights from economic rights have not been sufficiently recognized by judges or academics. The misalignments pose profound challenges to the logic and the law of the shareholder franchise. Some of the challenges need immediate and workable remediation while others necessitate re-conceptualizations of longstanding principles.

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[313] The *CNX* case is a rare example of such scrutiny.

[314] *See Murphy Marine Servs. of Del. v. GT USA Wilmington, LLC*, 2022 Del. Ch. LEXIS 236, *54-55 (Del. Ch. Sep. 19, 2022) (finding party in contempt for violating confidentiality order, and imposing sanction of attorneys' fees and expenses incurred in litigating the motion for contempt).

[315] *See, e.g., Lola Cars Int'l, Ltd. v. Krohn Racing, LLC*, 2011 Del. Ch. LEXIS 18, *5 (Del. Ch. Feb. 8, 2011) (ordering plaintiff to produce proprietary computer aided design (CAD) files subject to a confidentiality order, finding that "the Court has no reason to believe that [defendant's representative] would not comply with any order that it might enter to protect the confidentiality of the CAD files."); *Beam Sys. v. Checkpoint Sys*., 1997 U.S. Dist. LEXIS 8812, *7 (C.D.Cal. Feb. 5, 1997) (disqualifying an expert witness and requiring payment of attorneys' fees and expenses in litigating the motion for sanctions for violating a confidentiality order, and stating that "violations of protective orders issued to safeguard the confidentiality of trade secrets and other confidential information cannot and must not be tolerated … [and] the sanctions that can be imposed for violating a protective order may be severe.").

Such institutional investor voting misalignments are becoming increasingly pervasive. They are no longer limited to aggressive hedge funds affirmatively deploying motivational misalignments as a strategy, based on decoupling through byzantine, often derivatives-laden, financial stakes and novel uses of longstanding organizational voting dynamics such as share borrowing. Our 2023 Article showed that decoupling-related motivational misalignments were now also occurring with surprising frequency at mainstream institutional investors. With such institutional investors, the decoupling-related misalignments are not matters of strategy, but instead are byproducts of transformative changes in financial stake patterns (e.g., the size of certain asset managers and the rise of indexation) and in a variety of organizational voting dynamics occurring for independent reasons.

This Article adds to the existing literature on decoupling-related motivational misalignments in four major ways.

First, this Article offers a baseline and terminology for the systematic analysis of the direction and magnitude of such motivational misalignments. We show that to ascertain the incentives of an institutional investor in this context, it is necessary to determine the combined effect of: (a) its positive, negative, or zero "overall economic interest" in the host shares (flowing from the investor's "host shares," "coupled assets, and "related non-host-assets"), and (b) the investors's organizational voting dynamics. This baseline and terminology build on ideas in the analytical framework for decoupling and in our 2023 Article. We relate the foregoing to the Delaware judiciary's general approach to decoupling. The existing academic literature—one centered on the effects of indexing and common ownership—has largely ignored the impact of changes in organizational voting dynamics. In addition, among other thing, while the existing literature has considered certain changes in financial stake patterns, it has focused on "related non-host assets" to the exclusion of "coupled assets" such as short-selling, and derivatives positions.[316]

Second, this Article refines our 2023 article's analysis of the failure of judicial doctrine of ratification to come to grips with the recent and sweeping changes to institutional investor changes. Our 2023 Article was the first to show that application of a judicial doctrine of ratification now creates surprising problems because of its reliance on the concept of "disinterested shareholder," in decoupling terminology, a shareholder with a *positive* overall economic interest in the host shares.

The 2023 Article showed that a straightforward application of the doctrine would, with alarming and surprising frequency, disqualify mainstream institutional investors' votes from being considered disinterested. That would result in an abrupt, unanticipated, and profoundly consequential shift in voting power from institutional investors to retail investors and to activist hedge funds. Moreover, the doctrine only considers motivational misalignments flowing from certain of an institution's financial stakes and does not consider at all the misalignments flowing from the institution's organizational voting dynamics.

Beyond urging a reconceptualization of "disinterestedness" to comprehend both sources of misalignment, this Article shows that there is another basic problem with this judicial doctrine. In fact, it is close to impossible to accurately and comprehensively assess the disinterestedness of most large institutional investors. We show the massive amounts of highly granular nformation needed to identify the net effects of each of the constituent elements of that shareholders financial stakes and

[316] *See supra* note 29 (discussing the indexing and common ownership lines of reearch).

organizational voting dynamics. Even with the most transparent of institutional investors, the gap between the data that is available to the public or to the host company and what is needed is stunning.

The judicial construct of disinterestedness is largely concerned with misalignments flowing from financial stakes and, under our re-conceptualization, from the associated organizational voting dynamics. Other kinds of economic motivations, such as the desire to obtain lucrative asset management business, may also cause misalignments. Non-economic motivations, such as those flowing from friendships can also be important. A more comprehensive approach to disinterestedness would entail considering stake- and non-stake-related economic incentives as well as non-economic ones. We applaud judicial efforts to consider such other matters, and they may sometimes prove independently dispositive. Our Article's focus is on the typically more quantifiable, and perhaps more important, misalignments that flow from financial stakes and organizational voting dymanics.

Third, this Article shows that, notwithstanding the power of the vision for the role of the stockholder franchise and its ostensible foundational premise, in reality, the law insists only erratically on alignment of voting power and economic interest. We offer a taxonomy showing contexts reflecting varying degrees of such insistence, and the policies underlying the willingness to tolerate pervasive instances of decoupling of voting power and economic interest.

This taxonomy helps unveil new insights as to the entirety of the shareholder franchise, not just as to the disinterested shareholder context. We find that the taxonomy does not consist of mutually exclusive contexts. We show, for instance, how the relatively stringent judicial constraints on transfers of voting rights without an accompanying economic interest could serve to limit decoupling from affecting outcomes not only in the "disinterested" shareholder context but also in the context of the exercise of statutory voting rights in director elections and fundamental transactions such as mergers.

Fourth, and most important, this Article offers a focused, scaled, and cost-effective solution that overcomes the informational challenges posed by insistence on shareholder disinterestedness. That approach begins with a presumption of disinteresetness that already tacitly underlies settled doctrine. We point out that given the impossibility of producing affirmative proof of disinterestedness on the part of all or even a majority of voting shareholders, a refusal to presume disinterestedness would effectively undo decades of settled precedent giving validating effect to shareholder approval of conflict transactions. It may even call into question the utility and legitimacy of universal statutory requirements of shareholder voting on director elections and on fundamental transactions such as mergers. Such a striking diminution of the role of shareholder voting and a corresponding enhancement of the role of judges and boards should occur, if at all, only based on careful debate and persuasive empirical analysis of costs and benefits. It should not happen without any analysis whatsoever and by the fluke of informational impossibility.

Moreover, such a diminution of the role of the stockholder franchise would be inconsistent with the incremental and thoughtful approach Delaware courts have taken in addressing cases of transfer of voting rights without accompanying economic rights. In those cases, the courts have long used the decoupling analytical framework and given careful consideration of, for instance, the framework's concerns over how the transfers may affect the *magnitude* of motivational alignment. Nevertheless, and in full awareness of the foundational premise, Delaware courts have intervened to set aside empty

voting only where it is outcome determinative, and they have not used decoupling generally as a basis for constraining the ubiquitous exercise of statutory voting rights.

Coupled with a thoughtful method of identifying the (likely rare) cases where deep factual inquiry into motivational alignment is warranted, the approach we propose would help promote the legitimacy of the shareholder vote and shareholder tendering. It would be foolish to maintain that the sequenced process we outline will be entirely free of difficulty. We believe, however, that it would provide some meaningful assurance that outcome dispositive cases of voting or tendering by shareholders with zero or negative overall economic interest or other significant motivational misalignment can be exposed and excluded from consideration.

The gap between the vision and reality of the stockholder franchise is increasing in undesirable ways due to transformational institutional investor changes. This Article shows that vision and the reality should not and need not always be binary opposites.