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Deal Commentary

"Empty Voting" and Other Fault Lines Undermining Shareholder Democracy: The New Hunting Ground for Hedge Funds

Highlights

Empty voting is a generic term embracing a variety of factual circumstances that result in a partial and often total separation of the right to vote at a shareholders' meeting from beneficial ownership of the shares on the meeting date. Empty voting occurs principally as the result of several different circumstances.

- Shares are bought and sold between the record date and the meeting date, and it is impossible to trace beneficial ownership back to beneficial owners on the record date who are accorded the right to vote by practice and law. The more shares that trade in the interval, the larger the number of shares subject to empty voting at a shareholders' meeting.

- There is a large market in borrowing and lending shares for a variety of purposes, including for short sales and for hedging transactions. Under the standard documentation, the borrowed shares are entitled to the vote. Most beneficial owners have no idea whether their shares have been lent to third parties by their custodians and as a result believe, wrongly, that they have the right to vote the lent shares held in their accounts. The borrowers likewise believe they have acquired the right to vote the borrowed shares. This often leads to "over voting", in which more votes are cast with respect to a block of shares held by a custodian than the number of shares held.

- Moreover, borrowing shares immediately prior to a record date and repaying the shares immediately after the record date can readily be used by hedge funds or other activist investors to assemble a large voting position at a very small cost with virtually no market exposure.

- Finally, modern hedging techniques readily permit investors to separate ownership of the economic risks of stock from ownership of the right and ability to vote those shares. As a result, activist investors sometimes create large hedge positions solely to gain the vote, while avoiding economic exposure to the market. These empty voting positions are used solely to affect the outcome a shareholder vote.

Introduction

The last 20 years have ushered in a new age of corporate governance that is grounded in the very powerful concept of shareholder democracy. Activist institutional investors, hedge funds and other event driven investors and academics have united to promote a model of corporate governance that rests squarely on the fundamental right of shareholders to use their voting franchise to shape the governance of the modern corporation and to insist on heightened accountability by management and the board of directors to the company's shareholders.

Structural impediments to the unfettered utilization of the shareholder voting franchise have come under attack over this period of time. Witness the increasingly successful investor campaigns against:

- Shareholder rights plans
- Staggered boards
- Plurality rather than majority voting
- Supermajority voting requirements
- Impediments to shareholders' ability to call special meetings

By the same token, shareholders have also begun promoting greater affirmative rights to exercise their voting power, including most recently:

- Direct shareholder access to company proxy materials for director nominations
- Expansion of shareholders' ability to utilize SEC Rule 14a-8 to promote corporate governance and shareholder democracy positions

The SEC and the SROs have also participated in this movement toward enhanced shareholder voting rights by actions such as:

- Discouraging high and low vote common stocks
- Reforming the Proxy Rules to permit internet dissemination of proxy materials by managements and shareholders
- Eliminating broker discretionary voting for directors

While a number of these initiatives are in progress or as yet largely untested, there is no doubt that structural impediments to shareholder exercise of the voting franchise are being eliminated at an increasingly rapid pace. Moreover, few would doubt that investors will continue to prevail in their quest for increased power through an expanded utility of their voting power and increased accountability of managements and boards to shareholders.

There are, however, a number of theoretical and practical problems with this rosy model of shareholder democracy that are becoming increasingly evident as hedge funds and other like minded, event driven investors become more active in voting contests.

Background

Our existing corporate governance model is imbedded in the relatively simple but fundamental concept that the "owners" of the residual economic value in the corporate enterprise—the equity—are best suited collectively to govern the enterprise because they bear the full brunt of the entrepreneurial risk inherent in the corporate entity. The drafters of our corporate laws translated this simple principle into a series of statutory provisions that focus on shareholders' meeting, annual or special, and set default principles for the holding of a shareholders' meeting intended to give the equity owners their fundamental governance rights through voting on the basis of "economic," not "political" equality. That is to say, recognizing that the modern corporation is an economic (not a political) entity, votes are distributed by number of shares owned, not by the number of owners. Instead of our political model of democracy embodied in the precept of "one person, one vote," our corporate statutes uniformly have adopted an economic model of democracy embodied in the precept of "one share, one vote."

At the formative stages of our corporate law, share ownership and trading were very different from today. While somewhat of an over-simplification, our corporate statutes and accompanying judicial decisions are premised on a paradigm of:

- relatively low volatility in share ownership,
- the purchase and sale of shares in face-to-face (or near face-to-face) transactions,
- physical embodiment of shares in the form of share certificates,
- transfer of shares through the manual assignment of negotiable share certificates and their reissuance to new owners through physical delivery to and by transfer agents and registrars,
- a coincidence of record and beneficial ownership, or at most a relatively simple (one tier) system of "street name" holdings, and
- perhaps most fundamentally, the ability to link beneficial ownership to specific share certificates.

In a world of low ownership volatility and physical share certificates, the statutory construct of setting a record date well in advance of a meeting to determine rights to vote at a shareholders' meeting was not only meaningful, but necessary to allow for identification of, and written communications with, owners entitled to vote at a meeting. An implicit assumption of the advance record date structure for shareholder meetings was that relatively few shares would change ownership between the record date and the meeting date, and that purchasers of shares after a record date would have the practical means to obtain a proxy from the seller if they wanted to exercise their franchise at the meeting. This paradigm, moreover, implicitly underpinned the SEC's proxy rules, particularly the requirements for physical distribution of proxy statements and accompanying proxy cards to shareholders.

For better or worse, today's reality of share ownership and trading is vastly different from the relatively simplistic physically certificated paradigm underlying our corporate statutes and the SEC's proxy rules.

- Trading on modern stock exchanges, because of their auction or inter-dealer structures and net clearing and settlement policies, makes it impossible in all but a few rare cases for a buyer to identify its seller.
- The anonymity of the modern trading markets has been increased by the necessary development of central share depositaries (such as DTC) and more frequent use of nominee holders, frequently on several levels, as an improvised but effective system for book entry transfers and net clearing trade settlement procedures.
- Trading volumes have expanded exponentially over the last 50 years. Beneficial ownership can no longer be viewed as a relatively static, long-term phenomenon for vast portions of the equity markets. This trend has been exacerbated in the last few years by the growth of hedge funds whose direct and indirect (through the purchase and sale of related derivative products) trading today dominates the equity markets in terms of volume and volatility.
- The growth in exchange and over-the-counter derivatives has further complicated the picture, both in terms of classic concepts of beneficial ownership and in terms of "virtual" ownership.

While all of these trends have long been evident, their importance to the corporate governance model of our statutory and judicial law could be (and by and large were) ignored until the advent of event driven hedge funds and similar activist investors. These market players have increasingly recognized the disconnects between the theoretical model of shareholder democracy and the actuality of our equity trading markets. They have used the resulting fault lines to advance their economic interests, often at the cost of the goals and theory of shareholder democracy.

Fault Lines Between the Theory of Shareholder Democracy and Reality

Record Date vs. Meeting Date. By edict of our corporate statutes and Wall Street custom, the right to vote at a shareholders' meeting is determined by ownership on the record date. Whatever may have been the case in the simpler world of the early 20th Century, in today's world of central depositaries and nominee holdings, it is beyond dispute that there is a vast gulf between record ownership and beneficial ownership. Accordingly, law and practice accept the principle that it is the beneficial holder on the record date which is entitled to vote, either by direction to the record holder or by obtaining an effective proxy from the record holder.

The task of bridging the gulf between record holders and beneficial holders is simpler in theory than in practice because of the layers of ownership between the ultimate beneficial owner and the top-tier depositary, most frequently the DTC. In practice, the process is mediated through a combination of NYSE and NASD member firm rules and custom and is implemented by the various depositories which delegate voting authority through "master proxies" to underlying depositories and nominees, as well as by private providers, principally ADP, which deliver proxy materials and voting instruction forms to ultimate beneficial holders and receive, tally and report voting instructions by ultimate beneficial holders to holders of "master proxies."

Barring mistake and mischief, the process, while cumbersome, usually will produce a reasonably accurate tally of proxy votes attributable to the beneficial owners on the record date. If no beneficial owner sold shares between the record date and the meeting date, the practical inability to match beneficial ownership of specific shares that have been transferred would not matter.

Of course, in the real world many beneficial owners do sell their shares between the record date and the meeting date, making their exercise of the franchise suspect since they lack the financial stake in the company that underpins the very concept of shareholder democracy. This is the classic instance of what two current academic observers have labeled "empty voting"—the exercise of the voting franchise divorced from the ownership of the residual equity interest in the company. On the other side of the coin are the buyers of the residual equity interest between the record date and the meeting date who in practice lack the voting rights normally associated with beneficial ownership.

There is a body of case law dealing with this divorce of the vote from the other attributes of beneficial ownership; it provides the succeeding beneficial owner with the right to require its predecessor beneficial owner to provide a proxy with the shares being sold. In practice, however, it is impossible in ordinary market trading to match sellers and buyers. As a result, the theoretical legal rights of succeeding beneficial owners to obtain proxies from preceding beneficial owners are of no practical consequence. The only exception is for true face-to-face trades in which the buyer is in contractual privity with its seller and can bargain for and obtain an effective proxy, assuming of course that the seller held the shares beneficially on the record date and itself has a proxy vote that would be recognized by the current corporate voting system.

Where there is no controversy about the outcome of a shareholders' meeting, the failure of our current system to match votes and beneficial ownership as of the meeting date is of little practical significance. For many years that has been the case with the result that, with the exception of an occasional proxy contest, the conceptual and practical weaknesses of the time gap between the record date and the voting date did not matter and went largely unnoticed.

The advent of event-driven equity investing and the growing assertiveness of activist investors in opposing the election of certain directors or proposing by-law amendments and other binding actions has changed the world of shareholder meetings by multiplying the number of at which there is a significant controversy. The controversy may take the form of opposing a target company's plan to merge or be acquired (as in the proposed WorldCom acquisition by Verizon on the grounds WorldCom was selling too cheap), or opposing an acquirer's plan to buy a company (as in Mylan's proposed acquisition of King Pharmaceuticals on the grounds Mylan was buying too dear), or opposing the election of certain directors (as in a proxy contest or withhold or against vote campaigns) or acting on any other shareholder proposal, particularly of a binding nature. Whatever the nature of the controversy, it seems clear that allowing former beneficial owners to vote shares where the vote may be outcome determinative is a real-life problem.

Appraisal Rights. Appraisal rights in most jurisdictions, notably including Delaware, also hinge on the exercise of the franchise. In almost all jurisdictions, a dissenter's right to appraisal requires some form of dissension at the shareholder meeting considering the corporate transaction for which appraisal rights are granted—in the form of a vote against the action or at least not voting in favor of the action. This construct, like the other corporation law constructs involving voting, seems based on the assumption of an ability to match ownership of shares with votes cast on a share by share basis, or as a minimum that such a match can be made on the record date and that there is no further ownership changes for the shares in question.

The fault line between the assumptions underlying the appraisal process and the reality of the current equity market is well illustrated by the pending Delaware appraisal action involving Transkaryotics Therapies, Inc. In *Transkaryotics*, appraisal is being sought for well over 8 million shares acquired by hedge funds after the record date for the shareholders' meeting. The Delaware appraisal statute requires that to be eligible for appraisal shares must not have been voted in favor of the transaction. The question in the case is how to interpret the statutory requirement when it is impossible to match votes cast or not cast by record holders as of the record date with shares acquired by hedge funds after the record date. In *Transkaryotics* it is undisputed that more shares were not voted at the meeting than the number for which appraisal is being sought, and it is apparently undisputed that the subsequent hedge fund buyers did not attempt to vote or direct the vote of the over 8 million shares acquired after the record date. Neither the company nor the hedge funds, however, can trace the subsequently acquired shares to actual votes (or actual failures to vote), so it is possible that record owners of the 8 million some-odd shares on the record date may have voted some or all of the shares in question in favor of the merger, thereby arguably eliminating dissenters' rights with respect to those shares.

Whatever the outcome of the *Transkaryotics* appraisal proceedings, its lesson is simple. The typical appraisal statute does not deal in a meaningful way with the realities of today's equity markets. A decision in favor of the hedge funds will in effect create a post record date trading market in appraisal rights, divorced from the actuality of votes cast and abstentions at the shareholder meeting. A decision in favor of the company will effectively limit the exercise of appraisal rights to beneficial holders as of the record date who can establish that they instructed their record holder to vote no or not to vote. Neither result will deal with the divorce between voting rights and beneficial ownership inherent in the time gap between record and meeting dates.

Borrowed Shares and Over-Voting. A frequently occurring phenomenon is where the same share is voted twice. This is commonly the result of the vast increase in share lending that now permeates the equity markets. Developed in the context of short sales, the practice of share lending has mushroomed in recent years and frequently represents a significant source of income for investors and for brokers and other custodians. By custom and contract, the shares being lent are accompanied by full voting rights, so that the party borrowing the stock or its transferee can vote the shares which it holds on a record date. If, however, as frequently happens the lending party is a custodian which does not allocate the lent shares to and notify specific beneficial account holders, it is possible that both the lending beneficial owner and the borrower will vote the shares and over-voting will occur. Nor will over-voting be readily noticed if the total number of proxies cast by the custodian does not exceed its book position at the record date.

Historically, where over-voting has resulted in a custodian voting more proxies than its record position on the record date, the vote has been "corrected" by the inspector of elections to reduce the obvious over-vote. More recently, the NYSE has embarked on a compliance campaign with its member firms to insure more accurate record keeping of share lending and borrowing, including attribution to underlying beneficial holders, to eliminate over-voting. Whether the enforcement campaign will succeed and whether it will affect the practices of the many custodians that are not NYSE member firms remains to be seen.

Even if over-voting is eliminated, the ability of market participants to "buy" votes by borrowing shares will not be affected. This, like so many of the problems surrounding shareholder democracy today, has not been invented by hedge funds. But it is increasingly being used by hedge funds to further their economic interests. Record date "capture" of the vote is relatively inexpensive because stock lending fees are modest and because once the record date has passed the borrower can return the shares to its lender. As a consequence, this source of "empty voting," unless regulated, is likely to grow.

Use of Derivatives to Separate Voting and Economic Ownership. The last and most significant fault line confronting the theory and practice of shareholder democracy is the growing use by hedge and other investors of a variety of equity derivative instruments to separate the voting rights and the economics of share ownership.

A growing body of academic literature is appearing cataloging the incidents and mechanics used to achieve this result. They range from the fairly simple use of puts and calls or other derivative instruments to narrow or eliminate the economic risks of a long position in shares, without affecting voting rights inherent in the long position, to more exotic (and sometimes questionable) use of derivative contracts and trading relationships to give hedge fund or other like-minded investors practical control over voting rights associated with record ownership positions held by trading counter-parties. The choice of trading strategy and execution can be economic (picking the economically most efficient method of separating votes and economics), regulatory (exploiting gaps in the regulatory structure to acquire the practical ability to vote shares without economic ownership) or tactical (relying on a lack of transparency to hide the voting power being exercised).

Moreover, depending on the situation, the hedge fund might not fully insulate itself from the economics of share ownership but protect only against upside or downside price movements or only price movements outside or inside specified price bands. In other words, hedge funds seeking to influence or determine the outcome of a shareholder vote are not restricted to choosing between traditional 100% ownership of voting and economic rights or wholly "empty voting" rights. Rather, they can modulate their ownership rights on both the voting and economic sides to achieve a more nuanced and complicated partially "empty voting" position.

Is "Empty Voting" a Problem? For our purposes the methods by and degree to which the divorce of vote and value is achieved is less important than the fact that it can be achieved and, given the growing efficiencies of the derivatives and stock lending markets, more easily and cheaply than in the past. In short, the partial or complete divorce of vote and value is now a simple fact of our equity markets and any legal system governing shareholder voting should take into account that its original rationale, based on an identity of voting and economic interests, is simply no longer the case. Voting rights in today's equity world just do not equate to ownership of the residual economic interests in the corporation. Put another way, "empty voting" is no longer a theoretical, but an intensely practical issue.

While the divorce between voting and some or all of the economic incidents of share ownership may not accord with the traditional rationale for shareholder democracy, does it matter?

This question is not simple. After all, a believer in free markets and market efficiency would presumably view the residual equity position in a corporation as consisting of a bundle of rights, with the right to vote being merely one stick in that bundle. In the context of an efficient market analysis, if an investor chooses to sell or otherwise dispose of its right to vote (as it does when it lends the stock for a fee), why is that bad? Why is it different from selling some of the economic up-side or buying protection against the economic down-side through selling call options or buying put options? And if it is permissible for the owner of the vote to dispose of the voting right, how can it be wrong for another investor to buy the voting right? After all, the investor is acquiring voting rights in an open market and at a cost which in theory reflects the value of the rights. If there is no proxy vote or contest then pending or in sight, presumably the vote has little value. If the transaction is in the midst of a proxy contest or other controversial vote, presumably the vote has greater value and the acquirer will have to pay that much more.

Moreover, the foregoing analysis, dealing with what one might characterize as the naked buying and selling of voting rights, is just one aspect of a much larger pattern of conduct on the part of hedge funds and other market participants. In many cases the right to vote is not the article of commerce, rather it is the traditional share which is purchased or sold and a related derivative transaction or series of transactions is used to separate voting and economic rights, sometimes in whole and sometimes in part. These transactions, while accomplishing the creation of "empty" or partially "empty voting," don't involve the purchase or sale of the vote, but rather classic hedging transactions. As such, it is hard to construct a policy-based rationale that these types of transactions are improper "vote buying" or that the hedging techniques are being improperly used.

On the other hand, there is a countervailing point of view premised on the economic argument that the right to vote should be directly associated with the other economic incidents of equity ownership in order to produce governance decisions that benefit the entire class of equity holders.

The proposed acquisition by Mylan of King Pharmaceuticals illustrates this viewpoint. Perry Corporation, an event driven hedge fund, had established a large arbitrage position in the stock of King, the target company, in which it was long King shares and short a corresponding number of Mylan shares at the fixed exchange ratio for the proposed merger. As a result, Perry had a large economic stake in the transaction being completed and a significant economic exposure if the transaction failed on both sides of its arbitrage position. When Icahn entered the picture on the Mylan side by acquiring about 10% of Mylan's stock and publicly opposed the merger as being too costly to Mylan, Perry sought to protect its investment in consummation of the merger by establishing a countervailing 10% "empty voting" position in Mylan through the acquisition of Mylan shares coupled with hedging transactions that insulated Perry from the economic risks of its ownership of Mylan stock. While Perry undoubtedly incurred costs to establish its "empty voting" position in Mylan, it would have benefited economically only through a Mylan shareholder vote in favor of the merger. Moreover, because Perry had no residual economic stake in Mylan, it didn't have any economic exposure if Mylan was, in fact, over-paying for King. In sum, Perry acquired its 10% "empty voting" position in Mylan to protect its economic stake in completion of the merger, with total indifference to whether the transaction was value creating or value diminishing for Mylan's shareholders.

Possible Regulatory Approaches to "Empty Voting"

Judge Made Law. There is a body of relatively ill-defined law that tries to deal with "vote buying," utilizing traditional equitable considerations. Case law, however, has proven ill-adapted to identify the issues, let alone resolve them. First, most of the cases have arisen in the context of corporate actions that involved influencing voting decisions of the issuer's shareholders or acquiring proxies from shareholders of counter-parties. The factual situations and judicial definitions in these cases are not apposite to the variety of "empty voting" techniques that are currently being utilized in the equity markets. As a result, the analytical bases and conclusions of the case law on buying votes do not fit the current pattern of "empty voting," and seem largely beside the point.

Disclosure. A classic U.S. approach to difficult economic problems is to focus on disclosure, rather than pick economic sides in the underlying dispute. This course of action has been advocated by some observers of "empty voting," but is not without its difficulties. First, of course, is developing adequate and simple definitions for the conduct or economic situation that requires disclosure. There are at least four different SEC disclosure systems dealing with ownership of equity interests in a corporation which do not share uniform definitions and reporting triggers. Creating a new system to deal with derivative positions and "empty voting" rights and/or reforming some or all of the existing systems to achieve these goals would not be easy or lacking in controversy.

Moreover, disclosure pre-supposes an agreed minimum level of ownership of rights that would trigger the disclosure obligation. Currently, the lowest such level under Federal law is 5% of the outstanding securities of a class. But, as has been so often noted, 5% is a relatively high threshold for hedge fund ownership of a single company, particularly a mid-to-large cap company. Rather, hedge fund effectiveness and tactics frequently depend on parallel action by a number of independent hedge funds sharing common objectives. If we could develop an adequate disclosure system, use of a 5% threshold might only reinforce existing hedge fund proclivities to stay under the threshold and thus operate below the proverbial "radar screen."

A third difficult issue inherent in a disclosure based regulatory system is the timing of the required filing in relation to the event that triggers the filing. Current SEC reporting systems vary from annual filings for passive 5% shareholders on Schedule 13G to what in practice amount to same day disclosure obligations for active shareholders' amendments to Schedule 13D, with a variety of other filing deadlines for an initial Schedule 13D and initial and subsequent Section 16 filings. The utility to the market of the disclosures is a function of timeliness, as well as detail. Learning as much as a year later that an institutional investor had amassed a large "empty voting" position will have little importance to anyone but a historian. Many market participants, and certainly the issuer of the equity, will want to know much sooner and will press for "real time" reporting. Other market participants will, of course, argue against any disclosure and certainly against disclosure so timely that it will interfere with the creation or change of economic or voting positions. Moving away from our current patchwork of reporting dates will be as complicated and controversial as moving away from our current patchwork of reportable positions and events.

Finally, of course, is the overriding issue of the purpose and utility of disclosure. While it might better illuminate the incidences and types of partial and total "empty voting," it will not directly affect its prevalence, utility or appropriateness in a regime premised on "shareholder democracy." Indeed, one may fairly question the point of what inevitably will be a painful and difficult revision of our already overly-complicated stock ownership disclosure scheme.

Elimination of the Record Date-Meeting Date Time Gap. As we have seen, a cause of some, but hardly all, "empty voting" opportunities is the relatively long time gap between record and voting dates that is universal in our shareholder meeting paradigm. Elimination of that gap would eliminate "accidental" instances of "empty voting," as well as perhaps ease the difficulties of keeping track of borrowed and lent shares in order to reduce or eliminate over-voting.

The long gap between record date and meeting date is anachronistic and a vestige a long-gone era of physical stock certificates trotted around lower Manhattan for manual clearing, transfer and registration. With modern technology, there is no apparent need to retain an advance record date concept to manage shareholder voting. Rather, the record date could be as late as the close of business on the night preceding the meeting, with a voting period (i.e., the time for which the polls remain open) at or in conjunction with the meeting lasting several hours or perhaps a full working day. Assuming the various book entry systems supporting the equity markets could be made to "talk to each other" electronically, voting could likewise be electronic, and a "real time" voting system should be feasible.

Such a real time voting system would need accommodations from the SEC. Physical proxy statement delivery in advance of the meeting to all voters could no longer be mandated by the proxy rules. The reality, of course, is that this concept is outmoded. Physical delivery of proxy material to record holders is only the beginning of a complicated and costly system that, in theory, results in beneficial owners on the record date receiving the proxy material. No allowance is made in the system for physical delivery to subsequent transferees who acquire voting rights, let alone for acquirers of "empty voting" rights. Moreover, physical dissemination of supplemental proxy material in a proxy fight or other controversial shareholder vote is necessarily spotty, particularly as the meeting date approaches.

The SEC has taken a number of steps toward the open recognition that physical delivery of proxy material is not a prerequisite for exercise of the shareholder franchise. Its "free writing" rules for mergers and tender offers go in that direction, as does its long-standing flexibility with regard to dissemination of supplemental proxy material. More important, the SEC has now made a major foray into electronic proxy statement and proxy dissemination through the internet. While it might not be easy, there is no apparent reason in principle why the SEC could not adapt its proxy disclosure system to a real time voting structure.

A New Voting Paradigm. As with a revised disclosure system focusing on voting rights, however, a real time voting system would not solve the central problem of "empty voting"—the use of stock borrowing, derivatives and other hedges to separate voting rights from the economic incidences of equity ownership. If this phenomenon is to be curtailed, it will have to be through a new relationship between economic ownership of the residual equity and voting rights.

One such re-arrangement of voting rights would be to authorize a time-phased voting system. Under such a system, voting could be keyed to duration of ownership. Because the economic structures utilized by hedge funds to segregate the vote are not free and often entail some exposure to market dynamics (that is, the positions are open or only partially hedged) either on the up or down side, time-phased voting would change the economics of most, if not all, "empty voting" structures by making them more expensive. A variant on the idea would be to impose time-phased voting only on "empty voting" positions, but not on traditional full-fledged beneficial ownership positions, or perhaps set up a three-tiered system where, for example, "empty voting" positions had to be held at least 6 months to be entitled to a vote, traditional full-fledged beneficial ownership would have no holding period for exercise of the vote and long-term (say a minimum of one or two years), full-fledged beneficial holders would receive a multiple vote in recognition of their far different time horizons.

At present, time-phased voting for U.S. equity securities is effectively barred by NYSE and NASDQ listing standards, adopted under pressure from the SEC after the SEC's Rule 19c-4 was struck down in the Business Roundtable decision in the early '90s. Adoption of time-phased voting would thus require a major about-face on this subject by all three regulatory bodies. It would, of course, also require implementation through amendments to certificates of incorporation, in turn requiring shareholder approval. While interesting in theory as a possible antidote to "empty voting," time phase voting is not on today's horizon.

Conclusion

While much is known about “empty voting,” much is not. We know it happens some of the time by happenstance and some of the time by intent. We know it seems to be proliferating as hedge funds discover its uses in furthering their objectives and as techniques to create “empty voting” become better understood, more varied and less expensive. We know it undermines the economic premise that most observers believe validates shareholder democracy. We know that it runs counter to our political model, which jealously insists on uniting voters and votes and abhors any method by which votes become an item of commerce.

On the other hand, we don’t know how often “empty voting” occurs, either by accident or by design, nor do we have a very good idea of how often it is the measure of difference in a shareholder vote. We don’t have a theoretical basis for distinguishing between partial and total hedges and resultant partial and total “empty votes, nor between “innocent” and “pernicious” hedges that result in “innocent” and “pernicious” “empty votes.” We don’t yet have a regulatory model that would lead to the “right amount” of disclosure, nor any agreement on what the “right amount” would be. Nor do we have a regulatory model that would permit substantive control of “abusive” forms of “empty voting.” Indeed, it is not at all clear that we can agree on a definition of “abusive empty voting” or that we know whether and why “empty voting” is a problem that needs to be solved.

Absent a better understanding of the “empty voting” phenomenon and a widely shared analytical and policy basis for measuring and limiting the use of the practice, solutions are bound to be arbitrary in nature and quite possibly counter-productive to the efficient wealth creation that is the goal of our equity markets.

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