Will Loyalty Shares Do Much for Corporate Short-Termism?

By Mark J. Roe and Federico Cenzi Venezze*

Stock-market short-termism—stemming from rapid trading and activists looking for quick cash—is, a widespread view has it, hurting the American economy. Because stock markets will not support corporate long-term planning, the thinking goes, companies fail to invest enough, do not do enough research and development, and buy back so much of their stock that their coffers are depleted of cash for their future.

This widespread view has induced proposals for remedy. One major proposal is for corporate “loyalty shares,” whereby stockholders who own their stock for longer periods would get more voting power than those who trade their stock quickly. That voting boost would support stability and sound long-term planning, its proponents hope. Venture capitalists have already obtained the go-ahead from the Securities and Exchange Commission to found the “Long-Term Stock Exchange,” as it is called—whose centerpiece has been loyalty shares and their concomitant voting boost for companies on the new exchange.

There is a strong intuitive appeal to the idea that more votes for long-term shareholders would promote more long-term corporations. But, in this article, we show why loyalty shares promoters’ thinking is overly optimistic. Facilitating insider control will be loyalty shares’ dominant motive and effect. Long-term thinking, planning, and investing will be weaker motivations and effects. Indeed, loyalty shares will at times undermine long-term planning at companies that use them.

Loyalty-share voting boosts would shift voting power in those U.S. public companies that adopt them, but they will not shift voting power toward shareholders most likely to promote the long term. Instead, we should expect loyalty shares to empower conflicted corporate players who seek not more corporate focus on the long term but better protection for themselves and their corporate positions. Controller-insider self-interest will dominate their motivation, not fighting short-termism, because insiders have self-interested reasons to lock in control and shut down outsiders, even if doing so fails to improve corporate time horizons. Policymakers with a bona fide long-term vision will be frustrated by the outcome.

Existing data from Europe, where loyalty shares are more extensively used thus far than in the United States, supports this structural analysis. Control motivations dominate; long-term motivations are few or absent from on-the-ground practice.

Other reasons—as yet undiscussed as far as we can tell—may well justify opening corporate law to loyalty-share programs. We introduce to the loyalty-share analysis the ex

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* Professor, Harvard Law School, and Associate, Cleary Gottlieb Steen & Hamilton LLP (Milan). (Mr. Cenzi Venezze’s views expressed in this article are his own and do not necessarily reflect those of his firm.) Thanks for comments go to David Berger, Vincent Buccola, Lynne Dallas, Anete Pajuste, Nancy Rapoport, and Holger Spamann.
ante value to the entrepreneur of retaining control—i.e., loyalty shares can help motivate founders and thereby induce new entry, new start-ups, and new, original entrepreneurial activity. Weighing the value of continued control in fostering start-ups and original entrepreneurial activity against its later costs is not easy and it is not obvious which weighs more. But if there is economy-wide value to loyalty shares, that value in motivating entrepreneurial start-up action is where it is likely to reside. For short-termism, policymakers should be skeptical that promoting sound corporate long-termism will be a major result of facilitating loyalty shares in the American corporation.

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INTRODUCTION

Loyalty shares—which reward long-term shareholders with extra voting power—are increasingly touted to combat stock-market-driven short-termism, which is widely viewed as a deep corporate and economic cost. The corporate short-term problem is that the stock market’s rapid trading and excessive activism, in the view of the critics, induce America’s public companies to reduce their investment in capital and their workforce’s skills and morale, cut back research and development from what it should be, and return so much cash to shareholders that the firms cannot operate well. The shortened time horizon for American business, in this view, reduces the health of the American economy. The present and the next financial quarter are valued highly; the future, not so much.

Policy leaders criticize corporations for too much short-term thinking.1 Political leaders and the business media criticize corporate America for overly focusing on the next quarter’s financial reports—leading to the epithet of “quarterly capitalism.” The Securities and Exchange Commission worries about how its policies and regulations could foster short-termism and quarterly capitalism, leading to a recent July 2019 roundtable focused on how the SEC could bolster long-term actions and reduce short-term influences.2

The SEC has been considering major proposals to permit new stock exchanges that would foster wide use of loyalty shares, particularly in Silicon Valley and for newer, innovative firms.3 The primary proposal—to the Securities and Exchange Commission to approve a long-term stock exchange, the LTSE, which would specialize in loyalty shares—is controversial, drawing sharp institutional investor opposition, because differential voting rights have generally been disfavored in the United States, with one-share, one-vote being the usual (but not unanimous) norm.4

The proffered rationale for the loyalty-share stock exchange comes from the expectation that more votes for shareholders that own their shares for longer periods will lead companies to be more long-term oriented. Proponents see the American public firm as too short-term oriented, primarily due to stockholders’ short attention span. Stockholders trade their stock rapidly, inducing American firms to shun long-term investments. Stock traders and activists push firms for short-term action and sell their stock quickly thereafter, the thinking runs. Too many firms overly focus on their immediate performance, too many

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1. See infra Part II.B.
4. Letter from Jeffrey P. Mahoney, Gen. Counsel, Council of Inst. Inv’rs, to the U.S. Sec. & Exch. Comm’n (Jan. 22, 2019) (“we do not support the LTSE Application”). LTSE is the acronym for the so-called Long-Term Stock Exchange.
seek immediate cash, and too many fail to invest for the long run. They thereby allow their firms’ productive capacities to decline.

In the proponents’ vision, executives would appeal to loyal, longer-term stockholders for votes against activists and traders and, by investing for the long run, would obtain the loyalty-share votes. The longer-run stockholders, with extra votes, would elect like-minded boards and support longer-term corporate business policies. The affected companies would profit more and the American economy would prosper.

Although this intuition is appealing, we consider here reasons for skepticism. We analyze (1) what loyalty shares are and how their governing structure would arise in the United States—who would make loyalty shares “happen” and what their interests are—which do not inevitably lead to less short-termism, (2) which shareholders would obtain the loyalty-share boost in the United States and whether they could reliably be counted on to reduce short-termism, (3) how loyalty shares would affect the most prominently discussed ways that stock markets are thought to propel corporate short-termism, and (4) the loyalty-share experience thus far around the world and what that experience tells about its likely impact in the United States.

Each of these four analytic streams points to no more than a limited impact for loyalty shares on making the corporation more long-term focused. And surprisingly, given the glowing rhetoric, sometimes they could even be detrimental for the long term. An alternative to the loyalty-share-reduces-short-termism approach is that distant, smaller shareholders, even if they hold their stock for longer, will still be free riders in corporate governance and, hence, passive. Trading may decline, but the stock will still have a current price that adjusts to new information—and to the extent directors and managers pay attention to changing stock prices, they will continue to see a stock price to pay attention to.

This analytic does not ineluctably mean that loyalty shares should be disfavored—facilitating longer corporate horizons and more investment is not the only margin for evaluating them. The voting bonus could support entrepreneurship and start-ups5—particularly because entrepreneurs are thought to highly value continued control—in a “biodegradable” format that allows the entrepreneur to retain control in a way that is less rigid than dual class stock.

But loyalty shares’ ongoing primary public-regarding propellant of fostering the long term should be treated skeptically, or rejected outright.

* * *

First off, loyalty shares will redistribute the voting power inside a public corporation through its impact on two main ownership structures. The first one is the public company with widely held shares; these are typically mature companies. The second one is the public company with a controlling shareholder/ founder running the company, which is usually seen in the United States when the company initially goes public and for several years thereafter.

5. See infra Part V.C.
Insiders and controlling shareholders will disproportionately affect the design structure for loyalty shares and will favor mechanisms that, in turn, favor their own interests. They and their legal advisors will have a pivotal role in designing and adopting the loyalty-share structures and their governing rules. CEOs and controllers will retain the power to stop their corporation from adopting loyalty shares if the insiders do not see the structure as fitting their interests. Insiders will be less enthusiastic about loyalty-share voting boosts in firms with a large stable base of outsiders (who would get the boost) than in firms whose outside shareholders would not get the voting boost. These insiders will typically have the incentive to favor a loyalty-voting boost only if they are the primary beneficiary of the boost.

Second, the experience in nations that have used loyalty shares is consistent with this analysis. Dominant, controlling shareholders have been the primary users of loyalty shares. Although the loyalty-voting boost is formally available to all shareholders, the real-world implementation mechanisms impede outsiders, such as most institutional investors—even long-term institutional investors—from acquiring the loyalty-voting boost and the real-world structures facilitate insider-controllers getting the voting boost. We show how this experience is likely to be replicated if the United States widely uses loyalty shares.

Third, the types of shareholders that would gain and lose voting power in the United States do not inexorably induce better long-term outcomes. Insider-managers would get more votes, as would the increasingly important index funds, which hold stock for the long term weighted by a standard stock market index, like the Standard & Poor’s 500. The three major index funds (BlackRock, Vanguard, and State Street) already own about one-quarter of the stock in a wide array of large public companies in the United States. In any evenhanded setup, the index funds would be big winners of extra votes. Traders, shareholder activists, and newly formed blockholders with long-term intentions would all lose voting power. We show how the likely voting shift, if evenhandedly implemented, would not assuredly promote the long term; the dominant variable is the extent to which shifting voting power from activists to indexers promotes or degrades the long run. The impact of this shift on corporate time horizons is, we show, uncertain.

Even worse, though, we should not expect that lawmakers will evenhandedly set up the rules for loyalty shares, nor should we expect that the adopting companies’ loyalty-share structures will be evenhanded. On-the-ground rules and company-by-company implementation will favor those with an interest in getting more votes for themselves and fewer votes for outsiders; they would usually not have the long term foremost in mind as their primary motivation (although long-termism may be foremost in their headline rhetoric).

Fourth, the most prominent means touted for why the stock market promotes short-term behavior is that excessively rapid trading pulls executives’ time horizons to match the traders’ short horizons. Often the channel for alignment is thought to be executive compensation. Executive pay is tightly tied to share price, and, if share price is decided by rapid trading, the thinking runs, executives will focus on short-term results that keep stock prices up and, hence, their
bonuses and other compensation up. Loyalty shares will, the thinking runs, slow down this trading.

But loyalty shares will not stop stock prices from rising and falling. If quarterly results overly influence stock price now, they will overly influence stock price of companies with loyalty shares. The stock will still trade and have a price. Trading volume may decrease, yes, but loyalty shares alone will not stop share price from affecting stock-based executive compensation. If stock price overly affects executive compensation now, it will overly affect it even when companies use loyalty shares. Indeed, loyalty shares could contribute to worsening the perceived problem, because loyalty-share proponents expect that the voting bonus will motivate longer-term shareholders to trade even less. Hence, if the loyalty-share theory is correct, longer-term shareholders will contribute less to the stock’s current price. In contrast, the purportedly erratic remaining short-termers will continue to trade and could well contribute more to the stock’s price and thereby influence management. Loyalty shares will not outlaw the trading of the stock; it will only affect who trades it.

This result is important: loyalty shares could reduce trading (as its proponents expect, although the evidence from Europe is inconsistent with the expectation) but, because loyalty shares will neither eliminate trading nor affect how traders price their shares, nearly all of the stock-market trading channel’s purported detrimental short-termism will persist.

Hence, there is little reason to expect much long-term benefit from facilitating loyalty shares in the United States. It will likely primarily cement insider control and only secondarily and derivatively, if at all, improve the long term.

There are other reasons to facilitate loyalty shares that we briefly explore—the prospect that founders value control and, if there are more means such as loyalty shares for them to retain control, more new firms are likely to be founded. This rationale appears not to be prominent in the current public analysis, but we see it as the most important justification. Moreover, there are good reasons to defer to investors’ and founders’ decisions and deals at the time of the initial public offering. But one should not strongly hope that wide use of loyalty shares will lengthen the time horizon of the U.S. public firm.6

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The roadmap for this article is as follows: In Part I, we describe loyalty shares in theory and in practice. Then we look at who wants them: policy analysts who

6. We build on several insightful papers on loyalty shares, including Marco Becht, Yuliya Kami-sarenka & Anete Pajuste, Loyalty Shares with Tenure Voting—Does the Default Rule Matter? Evidence from the Lafi Florange Experiment, 63 J.L. & ECON. 473 (2020); David J. Berger, Steven Davidoff Solomon & Aaron J. Benjamins, Tenure Voting and the U.S. Public Company, 63 BUS. LAW. 295 (2017); Lynne L. Dallas & Jordan M. Barry, Long-Term Shareholders and Time-Phased Voting, 40 DEL. J. CORP. L. 541 (2016); Paul H. Edelman, Wei Jiang & Randall S. Thomas, Will Tenure Voting Give Corporate Managers Lifetime Tenure?, 97 TEX. L. REV. 991 (2019). We refer to these papers in this article’s text. Dual-class stock has features analogous to those of loyalty shares; we do not set out the extensive dual-class work here, but refer to specific works where relevant. We also draw on the European experience with loyalty shares, which is much more extensive than the American; we refer to the specific works where relevant.
ascribe long-term benefits to loyalty shares and private controllers who see loyalty shares as a means to cement their control for the long term.

In Part II, we analyze the loyalty shares’ incentive structure to show that more votes for long-term owners does not translate into more long-term corporate behavior. Insiders would have more power, but their long-term orientation cannot be assured. Small, stable shareholders may get more votes than they have now. Indexed and quasi-indexed funds would have more voting power in the United States in any evenhanded implementation. Losers would be active shareholders and activist funds, which would be saddled with low-vote shares for several years.

In Part III, we show that the purported impact on corporate time horizons is uncertain and weak, and could readily shorten horizons. Small, stable shareholders would get more votes than they have now, but their incentives to be uninvolved in corporate governance would persist. The longstanding, well-understood free-rider problem of having many shareholders who are passive would persist unameliorated, even if the smaller shareholders had more votes. The new power centers in American corporate governance—the indexers—are generally passive. There is little reason to think that more votes would make them more active. The case for improving time horizons then rests with loyalty shares’ potential to weaken presumably short-term active shareholders and activist funds and the shares’ potential to strengthen the presumably long-term-focused insiders and controlling shareholders.

In Part IV, we look at how loyalty shares have played out around the world. They have locked in controllers—including the state—and locked out foreign investors, serving a national goal of keeping domestic control of large firms. They have not led outside owners—even the long-term ones—to get more votes. Loyalty shares lock in insider, founder, domestic, and governmental control, with long-termism the rhetorical justification.

In Part V, we set out the current governing structure for loyalty shares in the United States and the current proposals for change.

In Part VI, we analyze the choice mechanisms (1) for how loyalty shares would be authorized in the law and (2) for how they would be adopted firm-by-firm. The choice mechanisms for adoption will favor loyalty shares when they protect insiders, not when they facilitate long-term thinking. In Part VI we also bring forward—we believe for the first time—a vital rationale for loyalty shares that does not involve promoting the long term. Loyalty shares could help to bring forward more new start-ups that help to propel competition, change, and the economy. These are benefits, although they are not time-horizon benefits.

We then conclude. Loyalty shares would enhance the voting power of some shareholders—most notably insider-controllers and, in any broad implementation, index funds—and diminish the voting power of others, most notably new blockholder-activists. That configuration does not offer comfort that they would promote the long term.

The core justification for loyalty shares—in halting or substantially reducing stock-market-driven corporate short-termism in firms that use loyalty shares—is thus at least exaggerated and quite possibly false.
I. WHAT ARE LOYALTY SHARES AND WHO WANTS THEM?

A. WHAT THEY ARE

Shareholders who have held their stock for a specified period get enhanced voting power—in the most usual loyalty-share formulation, two votes per share if held for two years or more, instead of one vote. A long-term benefit seems intuitive: shareholders with a longer time horizon will have more voting power, trade less often, and want their corporation to have a longer time horizon as well, thereby reducing corporate short-termism.

Departure from one-share, one-vote has long been considered dangerous for minority investors and the corporation. The U.S. governing rules treat loyalty shares and dual-class stock (by which one class of shares has a fixed, higher voting power) similarly and cautiously, effectively barring both structures unless adopted when a firm first sold shares to the public. If the differential voting structure is in place at the time of the firm’s initial public offering, buyers can “price” the terms of the votes into what they pay for the stock. Midstream changes, in contrast, are harder to price effectively.

Loyalty shares resemble dual-class stock. The latter gives more votes to owners (usually controllers) of specified stock, but that stock can trade and, when it trades, the buyers acquire the extra votes from the sellers. The controller can typically sell control by selling the voting rich shares, with the extra votes available to the buyer. With loyalty shares, in contrast, the buying shareholder loses the extra votes. And any loyal shareholder can obtain the voting bonus if it holds the stock for long enough. High-voting loyalty shares become low-vote shares when the long-term owner sells the shares; the buyer of high-vote dual-class shares buys the high votes along with the stock.

Loyalty-share voting has until recently mainly been a matter for theoretical discussion in the United States. But it has now become real. Lawyers are discussing and promoting the idea. Promoters have organized a new loyalty-share-focused stock exchange in Silicon Valley, obtained regulatory approval for its basic operation, and announced their intention to seek regulatory approval to use loyalty shares that would enhance the voting power of longer-term investors by as much as a factor of ten. The organizers of the exchange emphasize its

7. Loyalty shares are also called “tenure-share voting stock” or “time-phased voting stock.”

8. N.Y. STOCK EXCH., LISTED COMPANY MANUAL § 313.00(A) (2020) (“Voting rights of existing shareholders of publicly traded common stock registered under Section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issuance. Examples of such corporate action or issuance include, but are not limited to, the adoption of time phased voting plans . . . .”), see also NASDAQ STOCK MARKET, NASDAQ LISTING RULES § 5640 (2019) (similar restrictions).

9. See, e.g., Berger, Solomon & Benjamin, supra note 6, at 323.

long-term ambitions—indeed, its name, LTSE, is the acronym for “long-term stock exchange”—and they seek to specialize in loyalty shares. Institutional investors have opposed this initiative.\(^{11}\) In this article, we analyze whether loyalty shares’ purported big benefit—longer-term corporate behavior—is plausible. We conclude that much skepticism is warranted.

**B. WHO WANTS LOYALTY SHARES?**

1. **Academics and Lawmakers: Viewing Loyalty Shares as Designed to Facilitate the Long Term**

A major criticism of the U.S. public firm is that rapid stock trading makes it too short-term oriented. If stockholders own shares for only a short time, the thinking runs, management cannot run the company for the long term.\(^{12}\) Stock turns over so fast that shareholders do not sometimes even know basics about the underlying business of the corporation whose stocks the trader just bought and sold. Executives and boards, it is said, cater to traders and activists who want a quick profit, strong quarterly financial results, and a strong stock price right now, which affects much of their compensation. If the stockholding base is made of traders who overly focus on quarterly results, the thinking runs, then the executives and board of that company will do the same.

The case for loyalty shares—which is supported by several academics\(^ {13}\) and several political players\(^ {14}\) —rests on the expectation that firms using them would attract and retain more long-term investors and diminish the influence of short-term traders.

2. **Real World Controllers: Loyalty Shares to Lock in Control**

In the United States thus far, Silicon Valley entrepreneurs and their lawyers have promoted loyalty shares\(^ {15}\) by seeking regulatory approval for a stock exchange to

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\(^{11}\) See Mahoney, supra note 4.

\(^{12}\) Tamara Belifanti, *Shareholder Cultivation and New Governance*, 38 Del. J. Corp. L. 789, 834 (2013) (“[T]ime-weighted voting allows companies to distinguish among shareholders based on the shareholders’ level of commitment in owning the firm’s stock. . . . It rewards stewardship capital on one hand, and potentially discourages the . . . short-term gamblers.”); Berger, Solomon & Benjamin, supra note 6, at 323 (concluding that “tenure-voting plans could help shareholders, companies, the marketplace, and society return to a disciplined, long-term approach to investment and growth”); Dallas & Barry, supra note 6, at 542, 551; Edward B. Rock, *Shareholder Eugenics in the Public Corporation*, 97 Cornell L. Rev. 849, 901 (2012) (time-phased voting “provides greater incentives to longer-term shareholders to invest in making those decisions and greater incentive to remaining shareholders to enjoy the increased voting rights”).

\(^{13}\) Belifanti, supra note 12, at 834; Berger, Solomon & Benjamin, supra note 6, at 323; Dallas & Barry, supra note 6, at 542, 551.

\(^{14}\) See infra note 123.

trade these shares and by touting their benefit in promoting the long term. Some executives are said to have similar views: “The way to reimagine capitalism, [American business leaders] suggest, is to get investors off their backs. They propose . . . ways in which this might be done—from changes in law . . . to only allowing investors to vote their shares if they have held them for a sufficiently long period of time” so that “investors would have less power.”16 In Europe, several nations’ governments seek to slow down corporate change and industrial displacement by promoting loyalty shares,17 as have controlling shareholders. We shall see parallels between the U.S. and European developments.

II. WINNERS AND LOSERS FROM LOYALTY SHARES

A. THE BIG WINNER: CONTROLLING SHAREHOLDERS

Concentrated ownership is less common among mature U.S. public companies than it is in continental Europe.18 Concentrated ownership is, however, frequent in the United States for the years after a founder takes the company public in an IPO. And it persists for a few public companies—e.g., Oracle, Tesla, and Amazon—and on occasion for generations thereafter, such as for Walmart.19

Controlling shareholders and other insiders with significant stakes will gain voting power from loyalty shares. But the impact on their corporation’s time horizon is uncertain. It could motivate them to favor the long term, to foster the short term, or to entrench their control with no systematic long- or short-term impact.

If controlling shareholders are naturally and usually long-term visionaries, then enhancing their voting power will strengthen their authority to foster long-term investments. But if their enhanced votes allow them to retain control with a lower dollar investment in their firm, the impact on the corporation’s short- versus long-term behavior becomes uncertain. One cannot know in advance what the controllers’ time horizons are. In this section we explain the uncertainty.

16. REBECCA HENDERSON, REIMAGINING CAPITALISM IN A WORLD ON FIRE 123 (2020).
19. According to Institutional Shareholder Services Inc. data, only 3.6 percent of S&P 500 and 8.4 percent of Russell 3000 have a controlling shareholder. However, CEOs have significant stakes in several U.S. public companies, especially smaller ones, with more than 20 percent of the smaller 1500 companies of the Russell 3000 having a CEO holding at least 5 percent of the stock. Kosmas Papadopoulos, ISS DISCUSSES CEO Ownership, Corporate Governance, and Company Performance, CLS BLUE SKY BLOG (May 13, 2019), https://clsbluesky.law.columbia.edu/2019/05/13/iss-discusses-ceo-ownership-corporate-governance-and-company-performance/
1. Mixed Incentives from Diversification While Retaining Power

The optimistic view posits that founder-controllers will seek the long term, if outside shareholders do not stop the controllers from doing so. Some controllers fear that outside investors would oust the dominant shareholder of control, if the insider-controller slips in any one quarter. So, a controller owning half of a company’s 200 shares would fear raising new capital for the long term by having the company issue, say, 100 new shares. After the sale, the previously dominant shareholder would have only one-third of the vote (because it would own 100 of the firm’s now 300 shares) and, hence, could lose control and be outvoted by finicky, nervous outsiders. But if the controller instead turned his or her stock into loyalty shares with two votes for each share that has been owned for more than two years, and if the original controller’s ownership was stable, then the controller would have 200 votes, despite owning only 100 shares, while the outside shareholders owning 200 shares would, after the new stock issuance, have 200 votes. The owner could raise new capital from outside stockholders and still keep half of the votes and control. That new capital could not readily impede the insider-controller from operating as the insider-controller saw fit, because the controller would have half of the votes (but only one-third of the shares). If the insider-controller is long-term focused, the corporation would be long-term focused as well.

Founders and CEOs with significant but noncontrolling stakes would also take advantage of loyalty shares (especially if, as has been proposed, more than two votes per share—the EU norm—are granted to loyal U.S. company shareholders). If the 5 percent CEO could get ten votes per share through loyalty shares, he or she could outvote transient investors that lacked the loyalty-voting boost and thereby preserve his or her long-term strategy.

The skeptical view is that loyalty shares could just as well empower the controller/CEO to settle in for the last few years of his or her tenure, cementing control with extra loyalty-share votes. Horizons would be left unchanged—or even shortened to the controller’s expected tenure. Worse, since controlling shareholders are often under-diversified, with much of their wealth in their single firm, the loyalty-share voting bonus could free controllers to sell some stock to diversify while the extra votes would assure them of continued control. With less of their wealth inside the corporation, the controllers’ commitment to their firms would


21. Fifty percent of a public company’s votes is enough for control, but if the formality of uncontestable control is needed for the example, the controller could buy one more share, to have just over 50 percent of the votes.
ordinarily decrease. The controller could well then refocus on obtaining quick value (through salary and other payments) rather than promoting long-term value. Which of these two effects would dominate is hard to assess and this conflict is missing in the existing optimistic analyses of loyalty shares’ impact on corporate time horizons.

2. Lower Value on Sale

Because the high-voting shares become low-voting shares upon those shares’ sale, the controller cannot readily monetize the value of loyalty-share voting power. This locks the controller into the firm and means that the controller cannot readily sell the firm to an outsider who has a long-term vision for that firm. That is, the inside-blockholder with half of the votes (but only one-third of the stock) may wish to sell; a new investor with a long-term plan may be ready to buy. But under the loyalty-share rules, the new buyer would obtain only one-third of the votes, not half; the transaction would destroy half of the controller’s votes. The potential buyer’s weakened voting rights could deter the sale to the longer-run player from the locked-in but short-horizon senior controller.

Loyalty shares could induce more firms to fail to adapt to the best longer-term strategy when incumbents lack the adaptive skills but cannot sell to those who have those skills. Long-term degradation could, hence, be a consequence of widespread adoption of loyalty shares. Loyalty shares can thus create a mismatch between the controller’s skills and the firm’s best long-term strategic adaptation. This problem appears to be unrecognized in the existing literature: a priori, loyalty shares do not enhance and protect a controller’s long-term motivations but can harm the long term.

3. Take the Private Benefits Now

Worse yet, under plausible and common circumstances, loyalty shares can induce greater short-termism.

Assume that a new technology would boost the firm’s long-term value. The founder lacks the skill to implement that technology but prefers to keep running the company. The CEO prefers to be paid the excess salary (“excess” because the

22. Cf. Onur Arugaslan, Douglas O. Cook & Robert Kieschnick, On the Decision to Go Public with Dual Class Stock, 16 J. CORP. FIN. 170, 180–81 (2010) (data on initial public offerings show that “dual class IPO firms do not invest more than single class IPO firms in general or in R&D over either a one- or three-year horizon after their IPOs” and “deviations from a one share–one vote regime are done to permit insiders to diversify their portfolios while retaining control”).


24. The calculation: a one-share, one-vote structure with the controller owning one-third of the stock gets the controller 100 votes out of the 300 cast. In a loyalty share structure with the controller being the only shareholder with two votes for loyalty, the controller gets 200 votes of the 400. The controller gets one-half of the total votes, with one-third of the economic investment.

25. Loyalty shares would deter the sale for one of two reasons. Either the potential buyer would have to pay a “control premium” to the seller (because the seller is giving up control), but the buyer would not receive control in return, or the current controller would be reluctant to sell control without being paid a control premium (because the buyer would not obtain control).
controlling CEO is not up to the job of bringing the company up to speed with the new technology) from continuance and the pleasure of running the company for the next five years (the short term in this example), even if that is costly to the firm’s longer-term value. Without a loyalty-share voting boost, the CEO cannot control the board sufficiently to get that result. But with the loyalty-share voting boost to the CEO’s shares, he or she has the voting power to implement the CEO’s preference for continuance without the new technology for the next five years—i.e., the CEO’s short-term plan.

Now, with numbers: Posit that the CEO controls a firm with one-third (plus one) of the shares. The other two-thirds of the stock get a single vote per share; the CEO-controller gets double votes. The controller therefore has just over 50 percent of the shareholder votes to elect the board.²⁶ He or she controls the firm. Assume now that, with control, he or she can and does take $60 in special benefits for himself or herself (via excessive salary, but also in the value to the controller from the prestige, satisfaction, power, and respect that comes with the position). This $60 comes at the expense of outside stockholders such that the firm, initially worth $300 operationally, is worth $240 operationally. From that $240, the controller gets $80 (from 1/3 x $240), with a total “take” of $60 + $80, or $140.

Posit that a better, longer-term strategy is available to the company; it requires though that the controlling CEO cede control because the long-term strategy requires technological changes that the incumbent CEO is ill-equipped to implement. That strategy will make the company worth $390, but with one-third of the stock, the CEO would obtain only $130 in value, $10 less than the CEO-controller gets from the short-term strategy. Hence, the incentives from the loyalty-share structure are for the controlling CEO to adopt the short-term strategy. The incumbent stays on as CEO for another five years and blocks the firm from implementing the new technology that the CEO cannot understand and that would require the CEO to step aside if implemented.

Without loyalty shares, however, the CEO would have had strong reason to go long term because if the CEO did not, then the other shareholders would have the votes to replace him or her. Loyalty shares in plausible and common circumstances diminish long-term investing.

To better see the details why: Posit that the new technology will make the firm worth $390 overall, $90 more than the short-term strategy. Without loyalty shares, the controller would have had only one-third of the votes, not enough to entrench his or her control and not enough to get the extra private $60 benefit.²⁷ The controller would get only $100 from the short-term strategy (from 1/3 x $300) but could boost his or her direct take to $130 (from 1/3 x $390) from adopting the new long-term technology. The outside stockholders, with two-thirds of the

²⁶. See supra note 24.
²⁷. Sometimes one-third of the votes is enough to entrench, sometimes it is not; in this hypothetical we have one-third as insufficient for control and one-half as sufficient.
votes in the one-share, one-vote firm would incentivize the company’s board to adopt the new technology, replacing the CEO-stockholder if necessary.  

Table 1 summarizes the scenario: loyalty shares, in realistic circumstances, lock in the short term and deter the long run, the contrary of what loyalty shares were intended to achieve. It is not a necessary result, but it is a logically plausible result for some, perhaps many, loyalty-share companies.

28. Again, a more realistic example would be phrased in terms of probabilities: the firm without a loyalty-share controller would be more likely to go long term than a firm with a one-third shareholder/CEO with loyalty-share control worth $140 to the controller.
shares’ supporters aim to accomplish. Rows A and B summarize the incentives with loyalty shares: the controller-CEO goes short term because the controller thereby obtains $140 overall from the company in delaying the best long-term strategy (that short-term $140 is more than the $130 that he or she would get from going long term—a strategy that would lead the CEO to, in effect, resign). If the firm had a one-share, one-vote structure, the controller would go with the strategy shown in row C, the long-term strategy. The controller might prefer the short-term strategy with extracted benefits but lacks the voting power to obtain those benefits.

If the CEO lacks loyalty-share control, he or she (1) cannot extract the same level of short-term private benefits and (2) can less effectively sidetrack the outside shareholders, because they have two-thirds of the votes.

While controllers could prefer a long-term, profitable strategy that other stockholders reject, loyalty shares could in principle also—as Table 1 shows—undermine the long term, contrary to the conventional wisdom.

B. THE POTENTIAL BIG VOTE WINNER: INDEX FUNDS

Shareholding in the United States is dispersed, with most public firms lacking a controlling shareholder. The big new American corporate governance player is the index fund: investment funds that own a balanced portfolio of the entire stock market for the long term. At the end of 2018, indexed, passive investment funds owned about 20 percent of the stock market—a portion that has been rising and is expected to continue rising further.

The largest indexed portfolios are run by BlackRock, Vanguard, and State Street; on average, the three together own about 20 percent of the stock of each listed company, making the three collectively the largest owner in nearly all of the 500 largest public companies.

These indexed investors buy and sell stock infrequently—only when they need to balance their holdings to the index. Hence, they would automatically qualify for the loyalty-share voting boost in an evenhanded set-up for loyalty-vote bonuses. But since they are generally passive in corporate governance and primarily focused on keeping their fees and expenses ultra-low, it is

30. Fichtner, Heemskerk & Garcia-Bernardo, supra note 29, at 302, 313. The $4 trillion passively managed stock in mutual funds exceeds the size of the hedge fund industry. Id. at 303.
31. Id. at 313. The Standard & Poor’s 500 (or S&P 500) is a common index of the 500 largest U.S. public firms.
unclear what impact their enhanced votes will have on the corporate time horizon. They might have no impact. Below in Part IV we examine this issue further.

C. THE FIRST BIG LOSER: LONGER-TERM OUTSIDE BLOCKHOLDERS

Much academic analysis puts information asymmetries as the biggest real reason for short-termism: small shareholders will not invest in understanding their company’s complex long-term technological characteristics. Active long-term blockholders ameliorate the problem, because they can spread the cost of acquiring and evaluating information about the company over a large investment. Would loyalty shares induce more such blockholding by dedicated owners?

Loyalty shares would reduce the number of dedicated outside blockholders, thereby degrading information flow on complex, proprietary, and subtle aspects of the company’s future business, and thereby damaging public company long-termism. The next paragraphs explain how.

Loyalty shares would make an outside investor who was considering buying a large percentage of the company’s stock hesitate from buying. That investor would not get loyalty-share extra votes when it invests, making its own vote underweighted and diluted for two or more years. That would mean, first, that the investor would be less influential than its financial investment would warrant and, second, that it would have to sit for two or more years with prior investors who would have more weight in electing the board and running the company. The new investor would not acquire voting parity with the existing loyalty voters until the loyalty-share waiting period passed—two years in the typical formulation and as much as ten years under the LTSE original proposal. Loyalty shares thereby discourage outsider blockholder investments.

33. The text assumes that index funds, because they own their shares semi-permanently, will obtain the extra votes. However, the designers of the loyalty system could impede that result. If, say, the shares need to be registered with the issuer, but the index funds do not wish to register the shares because they prefer to use the shares for financial operations—such as lending the shares for a fee to investors that need the shares temporarily for other purposes (which is a common and profitable practice for funds), then they would not be big vote winners. See Jesse Blocher & Robert E. Whaley, Two-Sided Markets in Asset Management: Exchange-Traded Funds and Securities Lending 1 (Vanderbilt Owen Graduate Sch. of Mgmt. Res. Paper No. 2474904, Sept. 28, 2016), https://ssrn.com/abstract=2474904; Dawn Lim, How Investing Giants Gave Away Voting Power Ahead of a Shareholder Fight, WALL ST. J. (June 10, 2020), https://www.wsj.com/articles/how-investing-giants-gave-away-voting-power-ahead-of-a-shareholder-fight-11591793863 (reporting that, a few weeks before a proxy fight at GameStop, the three largest asset managers of the target company held 40 percent of the stock, but “when it was time to commit to voting, they controlled roughly 5 percent of ballots [as they] chose to loan out substantial GameStop shares for the rich stream of fees their investors stood to gain”). The European experience, discussed in Part IV, shows organizers impeding institutional investors from obtaining loyalty share bonus votes.


35. See Investors Exchange LLC, Proposed LTSE Listings Rule 14A.413(b) (Form 19b-4(e)) (Mar. 19, 2018).

Bottom-line: the loyalty-share structure would discourage the type of longer-term blockholders most likely to mitigate or reverse any stock-market driven short-termism due to poor transmission of complex information from inside the firm to its shareholders. Loyalty shares will lock in old, existing blockholding, and will deter new adaptive blocks.

D. THE SECOND BIG LOSER: SHAREHOLDER ACTIVISTS

Activist investing is controversial, with proponents bringing forward evidence that it enhances long-term performance. Loyalty shares will lower activists’ direct voting power and thereby reduce activism. If one dislikes activists’ time horizons, then diminishing their voting power is good. If the activists are valuable for corporate change, then loyalty shares will harm the corporation and its long-term prospects.

First, the activists’ direct voting power will be weakened (as compared to a one-share, one-vote regime), because existing insiders and longer-term holders will have more voting power from their loyalty-share voting boost. Second, the new activist blockholders will need to wait, typically two years, before they can match the incumbent controllers in voting strength.

Activists’ power to influence also comes from building alliances with existing shareholders. For example, in a company with no blockholders but with many index funds with double votes and a management that has drifted away from the corporate long term, the potential activist’s calculations would be more complex. The activist would need votes from indexed investment funds and other long-term holders who are generally, but not always, passive in corporate governance or who often support management. In an even-handed set-up, loyalty shares will increase the indexers’ direct voting power and decrease the activists’ power, weakening the latter’s relative voting weight. Loyalty shares would thereby increase the activists’ need for index and passive investors’ support.

To the extent that the activists depended on their own votes, they would become

voting “may scare off investors, such as Warren Buffett, who want to buy a large position but won’t accept worse voting rights”).

37. E.g., Lucian A. Bebchuk, Alon Brav & Wei Jiang, The Long-Term Effects of Hedge Funds Activism, 115 COLUM. L. REV. 1085, 1090 (2015); Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, Hedge Fund Activism, Corporate Governance and Firm Performance, 63 J. FIN. 1729, 1730 (2008) (hedge fund activism is valuable to shareholders).


40. See Jill E. Fisch, The Uncertain Stewardship Potential of Index Funds, in GLOBAL SHAREHOLDER STEWARDSHIP (Dionysia Katelouzou & Dan W. Puchniak eds., forthcoming).
less active than before, because their own vote would be diluted (for two years) relative to those with the voting bonus.\textsuperscript{41}

If loyalty-share promoters primarily seek to weaken activists, they are likely to succeed in doing so. If activists are usually short-term-oriented, a disputed proposition,\textsuperscript{42} then loyalty shares would indeed reduce short-termism by reducing the activists’ influence and their incentives to act. If weakening activists is not loyalty shares’ primary purpose, then other loyalty-share designs would now be part of the discussion. For example, the voting bonus could come if the buyer assures that it will not sell the stock during the loyalty period. Such assurance could come via lock-ups, which are common corporate mechanisms, or via governing rules that levy a stinging fine (say, 10 percent of the value of the stock), if the assurer did not retain the stock for the loyalty vesting period. The fact that such ideas are not on the table, when the anti-activist impact of loyalty shares is apparent, could be suggestive of their having an anti-activist purpose.

Thus, whether this loyalty-share shift in power would overall increase, decrease, or leave activist efforts unchanged is in the abstract indeterminate.

### III. Loyalty Shares’ Limited Capacity to Lengthen the Corporate Investment Horizon

As just discussed, the incentives of outside activists and blockholders to acquire blocks would diminish in a company using loyalty shares. But there is yet more uncertainty as to loyalty shares’ impact on the corporate time horizon. Loyalty shares may get more votes for longer-term shareholdings, but if these longer-term shareholders are passive and inactive—and persist as passive and inactive when they have more votes—the result would not encourage corporate longer-term behavior. For example, to the extent that the problem to combat is how short-term stock price affects executive compensation, which in turn affects executives’ time horizons, the intuition that loyalty shares will encourage a longer horizon is questionable and likely incorrect. To the extent that it is wide, rapid trading that in and of itself encourages short-termism, the passive, inactive (in corporate governance) shareholder is unlikely to give up trading in return for extra votes that it does not value. That purported propellant of short-term behavior would persist. We explicate further in the sections that follow.

#### A. Time Displacement: More Uncertainty

What counts for motivating a shareholder to think long term is not how long it has already held the stock, but how long it plans to hold the stock after the vote
that determines the company’s board, its management, and its direction. It is the forward time period that determines the stockholder’s time horizon, yet it is the backward-looking holding period that determines whether the voting power gets pumped up. Loyalty-share voting boosts may not, as a matter of logic, go to longer-term shareholders.

The loyalty-share program could thus backfire. If the two-year shareholder gets extra votes but plans to sell tomorrow, after the corporate vote today, then the loyalty bonus gives more votes to a short-term shareholder. And if a shareholder is settling in with plans to hold onto its own new stock for at least two years, then it still gets only one vote today; the new investor intends to be a long-term shareholder but its vote is diluted for two years, until it gets its voting bonus. Although many of those who have owned for two years are likely to own for another two years, not all will; and, in contrast, those who bought yesterday include those who expect to hold for two years. Loyalty-share programs therefore do not accurately categorize long-term and short-term investor horizons at the time when the investors vote. They set up an imprecise tendency, not a hard certainty.

B. THEIR IMPACT ON RAPID TRADING AND EXECUTIVE COMPENSATION

Some corporate critics worry that volatile stock prices induce volatile corporate decision-making. Excessively rapid trading pulls executives’ time horizons toward the traders’ short horizons, often via executives’ compensation. If compensation is tied to immediate stock price, then executives will seek short-term business results, it is said, to keep prices high and thereby keep their compensation high.

But the stock will still trade and its price will fluctuate. The traders who forsake the loyalty-voting bonus will still make for a fluctuating price for the stock, as will loyal shareholders who buy more or who give up their loyalty-voting bonus when they sell. Executive compensation tied to stock price will still give executives the motivation to pay attention to their stock’s price.

True, loyalty shares may induce the volume of trading to decrease (if some shareholders want to keep or get their extra votes and hence trade less often), but with or without loyalty shares, the corporation’s stock price will rise, fall, and affect stock-based executive compensation. Moreover, longer-term shareholders do sometimes trade their stock. Loyalty shares, if they have their promoters’ intended effect, will incentivize those long-term shareholders to trade even less frequently; hence, they will contribute less to the stock’s current price. In contrast, the purportedly erratic short-termers will trade and contribute relatively more to the stock’s price and influence management.

C. THE PERSISTENCE OF SHAREHOLDER FREE-RIDING AS REDUCING LOYALTY SHARES’ IMPACT

Loyalty-share proponents expect that the loyalty-share voting bonus will induce more shareholders to hold for the longer term and that these longer-term shareholders’ corporate governance engagement will be beneficial. There are good reasons to doubt that either of these two channels will be powerful.

1. More Long-term Shareholding?

Ordinary shareholders have little reason to hold stock longer to get more votes. With or without the voting boost, their stake is small and their corporate governance power weak. Many institutional shareholders consider corporate voting a burden, not a benefit. Hence, loyalty shares incentivize longer-term holding less than its proponents posit.

2. More Long-term Corporate Orientation?

The overall concept is that executives’ horizons will match shareholders’ horizons. If more shareholders, with more votes, hold for the longer term, the thinking runs, then executives’ time horizons will catch up.

There is something to be said for that intuition if these long-term shareholders are powerfully involved in their firms’ corporate governance. But most shareholders have too small a holding to be actively involved with the firms in which they invest. This free-rider problem is central to the public corporation’s incentive structure, sharply weakens the incentives of typical shareholders to have ongoing input into corporate governance, and loyalty shares will not alter these basic free-riding incentives.

As a consequence, the basic logic of the loyalty-share program—longer-term owners will be better longer-term stewards—is faulty. Those with a small percentage of stock will typically be passive, regardless of how many votes they have, and extra votes will not induce smaller holdings to be held longer. Why not? Because the extra votes are valuable to those involved in corporate governance; but most shareholders free ride and are not involved in corporate governance. Hence, they will not find the voting bonus an attraction that will make them trade less.

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Thus, loyalty shares could increase long-termism or decrease it. Or make no difference at all.

We have limited experience with loyalty shares in the United States. Thus, we look next at how loyalty shares have played out in Europe. The European experience is not dispositive for what would happen in the United States, but it

provides material evidence to examine whether results there parallel the foregoing incentive-based analysis for the United States.

IV. WHO WINS AND WHO LOSES IN EUROPE?

Controlling families and the government are the immediate beneficiaries of loyalty-share plans in Europe. These two beneficiaries sought loyalty shares to solidify their control of enterprises, and foreign investors found their shareholding diluted. Strong evidence for greater long-term orientation is absent, with some evidence even to the contrary.

A. THE FRENCH FLORANGE LAW

More than half of the 104 most frequently traded French companies adopted loyalty shares by 2014. Of the half that adopted them, nearly half of those had a controlling shareholder. Family-controlled companies were the heaviest users of loyalty shares, with twenty-eight out of thirty-five family-controlled firms (80 percent) using them.

Loyalty shares were somewhat less common in widely held companies, with eleven out of nineteen companies with dispersed ownership (57 percent, as compared to 80 percent) adopting them. However, in seven of the eleven adopting companies that are classified as dispersed, employees held significant stakes. The loyalty-voting boost enhanced the insider-employees’ votes beyond their investment, making them the first shareholder by number of votes. Hence, for seven of the eleven, the loyalty shares boosted the votes of insiders—here, employee-insiders—and not those of financial investors.

Other research found that among the French dispersed ownership firms using loyalty shares only 9.5 percent of the overall shares received the additional vote, while those companies with controlling shareholders had the loyalty-share vote boosting about four times as many shareholder votes, or 36 percent. France readily allows loyalty shares, but the voting bonus can only double the vote.

45. Becht, Kamisarenka & Pajuste, supra note 6, at 477 (59 of 104).
46. Id. at 490 tbl. 8 (28).
47. Id. Other researchers, with differing samples, find a similar disjunction: controlled firms use loyalty shares more frequently than diffusely owned firms. See Belot, Ginglinger & Starks, supra note 44, at 14 (using a sample of 455 pre-Florange French firms, the authors found that “the majority of the firms granting double voting rights (62 percent) are family firms, i.e. closely held firms. In contrast, 37 percent of the firms with the one share–one vote structure are family firms”).
48. Id. And for French IPOs between 2010 and 2018, 70 percent of the family-owned firms used loyalty shares while fewer, 42 percent, of the venture-capital-controlled firms used loyalty shares. Id. at 479–80. The other ownership categories are companies controlled by other corporations (9 out of 23, or 39 percent used loyalty shares), financial firms (8 out of 15, or 53 percent), and firms controlled by the French state (3 out of 12, or 25 percent). Id.
in firms with dispersed ownership than they are used in firms with a controlling shareholder.

The 2014 Florange law made loyalty shares the default voting structure for French public companies. If a company’s shareholders did nothing, the company was thereafter ruled by loyalty-share voting. Shareholders could change this default rule by a two-thirds vote. When the law was being considered, outside investors generally opposed making loyalty shares the default provision, for fear that it would enhance the voting power of the French government, of unions with share ownership, and of other controlling shareholders—all at the outside investors’ expense. But outside investors lost and the law was enacted. It is plausible to hypothesize that the law’s proponents were not primarily concerned with short-termism, other than to delegitimize the prevailing ownership arrangements, but were rather most interested in promoting state and union authority inside large French companies.

Index funds, which would regularly hold shares for the requisite two-year loyalty period and thereby get the bonus votes, found the requisite registration mechanisms cumbersome and compliance sometimes impossible. A major international investor complained that “[i]n most cases, only domestic shareholders can effectively be granted [the loyalty-share bonus] because the law requires that the shares be registered with the company in the investor’s name in order to get the double votes. But foreign investors typically own their stock through intermediaries and cannot structurally register their stock directly with the company. This impediment to outside investors was not an oversight; it was intended. Quite plausibly, part of the law’s goal was to reduce the power in

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51. Id. (reporting that “LGIM, which holds just under 1 per cent of the French market through its index funds, was unable to register for double voting rights”).
52. BLACKROCK, KEY CONSIDERATIONS IN THE DEBATE ON DIFFERENTIATED VOTING RIGHTS 2 (2015), www.blackrock.com/corporate/en-in/literature/whitepaper/blackrock-the-debate-on-differentiated-voting-rights.pdf (emphasis added); see also GEORGESON’S 2015 PROXY SEASON REVIEW UK, FRANCE, NETHERLANDS, SWITZERLAND 41 (2015), http://www.georgeson.com/uk/Documents/Georgeson%202015%20Proxy%20Season%20Review.pdf (“double voting rights . . . disadvantage many international and institutional investors, as they usually do not hold shares in registered form in the French market, and therefore will not receive double voting rights even if they have held the shares for two years”).
53. In France, securities are held: (i) in “bearer” form by a financial intermediary, or (ii) in registered form recorded directly on the issuer’s books or in the issuing company’s accounts with an intermediary. Only shareholders holding their shares in registered form receive the additional loyalty share votes. See CODE DE COMMERCE [C. COM.] [FRENCH COMMERCIAL CODE] arts. L.228-1 & L.229-123.
55. de Guerre, supra note 54 (“le gouvernement et les entreprises qui ont poussé à cette mesure avaient connaissance de ces points techniques, beaucoup d’investisseurs ou des chefs d’entreprises le leur ayant rappelé” [“the government and companies that pushed for the measure were aware of these technical points as many investors and heads of companies reminded them”]).
French firms of foreign investors, with anti-short-termist rhetoric simply part of the justification.

1. The Florange Law of 2014: Loyalty Shares as the Default Voting Structure

“Florange” is the name of the town in France with key operations of ArcelorMittal—the world’s largest steel producer. In 2012, ArcelorMittal closed two steel blast furnaces and dismissed workers, attracting viral French media attention and a negative government reaction. The blast furnaces’ closing became a presidential campaign issue in 2012 and the winning candidate, François Hollande, promised to act against such factories’ closings. The Florange law, enacted after his election, was the result.

The law’s default rule required all firms to use loyalty shares; firms that disliked the rule would have to opt out. Was the Florange law and its loyalty-share rule primarily motivated to induce longer-term thinking in the French firm or to protect incumbents, including controllers and favored labor sectors? To assess the likelihood that incumbent-protection was primary, consider the rest of the Florange statute, which had substantial anti-takeover, protect-the-incumbent qualities. That should open us to the hypothesis that its loyalty-share support was also motivated by anti-takeover, protect-the-incumbent considerations.

2. The Rest of the Florange Law

The Florange law was first and foremost an anti-takeover law. First, it ended the board neutrality principle that had governed French takeovers. Before the Florange law, French boards could not oppose takeovers, but after it, they could. Second, it required that the offeror consult with the relevant unions before making any takeover offer, and specified when a qualified expert had to evaluate the bidder’s industrial, financial, and employment plans and their consequences prior to the offer.


Third, the law required 1000-employee firms seeking to close a fifty-employee factory to market that factory as a going concern under the strict supervision of the firm’s works council. The works council was primarily composed of representatives of the employees and the unions. Under the Florange law, the works council would have three months to seek buyers. France’s commercial courts could scrutinize the overall sale process and, if a court concluded that the selling firm’s effort to find a buyer was insufficient, then the court could fine the company up to twenty times the minimum wage level for each employee laid off.

Fourth, the loyalty-share advocating Gallois Report to the French Prime Minister sought to mandate that there be four employees on the board of every French enterprise having 5,000 or more employees—further suggesting labor protection as a prime motivation. Finally, and fifth, early versions of the Florange bill restricted double votes to French-based, or EU-based shareholders. Foreign investors in one version, and non-EU investors in another, could never get loyalty votes under the original core default rule.

When the Florange law was passed, the French government opposed General Electric’s proposed acquisition of the electricity generation assets of Alstrom, the huge French electrical company. The government extended its veto power over foreign investments in energy, water supply, transportation, communication, and public health. Protectionism was in the air and on the ground.

60. Profit-oriented managers would willingly sell the factory as a going concern if the price exceeded the value from shutting the factory down. To have an impact, the law would have had to induce firms to sell or continue operating poorly performing plants even if shut down was more valuable. This provision was declared unconstitutional in early 2014. See Conseil Constitutionnel [CC] [Constitutional Court] decision No. 2014-692 DC art. 1, Mar. 27, 2014, JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Apr. 1, 2014, p. 6232.
61. See CODE DU TRAVAIL [C. TRAV.] [FRENCH LABOR CODE] arts. L.2324-1, -2 (2014) (Fr.).
BlackRock, the huge investment firm, which manages some of the largest index funds, has sharply criticized short-termism in the United States. Yet it opposed the Florange law’s loyalty-share efforts. It concluded that the entrenchment channel would be too strong, allowing controllers to extract value more easily for themselves at the expense of outside shareholders.

Thus, the motivations behind the law were to protect firms against takeovers, to protect French firms from foreign finance, and to protect the voting power inside the firm of politically favored incumbents, such as controlling shareholders, the state, and favored labor sectors. These were all means of protecting people with jobs from employment disruption.

3. Who Benefited On-the-ground?

In the big state-based firms, the French state’s voting power was immediately and greatly boosted.

The French state owned big blocks in seventy or more large firms, and increasing the state’s voting power was a major goal. The boost facilitated the state’s capacity to raise cash without raising taxes. (Here’s how: If the government owned 20 percent of Air France, then the Florange law doubled the state’s votes, allowing it to sell half of its stock without losing any of its original voting power.)

The law allowed stockholders to stop the boost before it took effect, however. For a few major firms, such as Renault and Air France, the government feared that other investors would vote against loyalty shares, so it bought more stock to block outside investors from stripping out the double vote. With its double vote protected, the state could then later sell some of its stock.
The Florange law thus allowed the state “to increase its voting power . . . while permitting [it] both to sell stock and to maintain its influence.” The government justified its action as promoting the long term, although management of both Renault and Air France opposed the government’s actions. Ironically enough, a few months after the law passed, the French government demanded cash from those companies—a request that a French government watchdog concluded worked to the “long-term detriment of the [underlying] businesses.”

In late 2014, Air France management sought to expand its low-cost unit. It planned to invest $1.3 billion over five years to buy fifty new aircraft and hire 250 new pilots to face increasing competition by low-cost carriers. The airline’s existing pilots opposed and went on strike. “However, [Air France] management finally cracked after coming under pressure from . . . the French government, its largest shareholder.” The loyalty-share voting bonus did not here bring short-termism under control. It was used to protect a favored labor sector, arguably to protect for a short while arrangements that have limited long-term staying power. It is plausible that the law aimed not so much to lengthen time horizons (other than in its rhetoric) but to empower the French state and to protect favored labor sectors. For these aspects, the law may well have been successful in the eyes of its supporters, even if it did not lengthen management’s or stockholders’ time horizons.

4. Impact

Loyalty shares bolster the large French stockholder’s control, not the voting power of outside long-term investors. During the 2015 to 2017 proxy seasons, nearly 100 controller-backed shareholder resolutions would have failed without the French controller’s loyalty-share voting boost.

The analytic data available from Marco Becht, Yuliya Kamisarenka, and Anete Pajuste shows that pre-Florange, higher quality firms adopted loyalty shares, but the researchers could not eliminate the possibility that the better firms
self-selected into loyalty shares (rather than that it was the loyalty shares that boosted quality). After the Florange law made loyalty shares the default, however, one-share, one-vote firms that rejected the law’s default transition to loyalty shares were higher quality businesses than those that proceeded with the law’s switch to loyalty shares. The majority of the latter were state-controlled firms. And foreign investors in firms that acquiesced in the law’s double voting (mostly for insiders) exited and the firms’ cost of capital rose. The stock price of firms rejecting the double vote rose. In IPOs, firms using loyalty shares raised less money and were more likely to be family controlled than one-share, one-vote firms.

Critics who seek to combat American short-termism hope that loyalty shares with reduced trading of shares will induce more long-term thinking and that this long-termism will lead to more future-focused research and development. But these sought-for consequences have not yet been found in the French firms adopting loyalty shares. Annual share turnover did not differ much for the adopting companies before and after the Florange reform—and the stockholders' average holding period actually shortened in state-controlled loyalty-share firms. Similarly, French firms with loyalty shares did not differ in their R&D spending from one-share, one-vote firms.

Thus, the overall impact: French loyalty shares facilitated insider and government control. Long-term benefits have yet to be seen.

B. THE ITALIAN EXPERIENCE

Loyalty shares became permissible in Italy in December 2014. By July 2020, 60 of the 254 companies listed on Italy’s main stock exchange had adopted loyalty-share bylaws. But the distribution of adopting firms suggests no major boost to the long term. Why? The best candidates for loyalty shares to combat short-termism are not the ones that chose them. 

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83. The authors used Tobin’s Q to measure quality. Tobin’s Q is a standard but rough and disputed measure of firm quality, calculated from the ratio of stock value to underlying asset value. Firms whose stock is priced much higher than their underlying assets are thought to be better managed than firms whose ratio is lower.
84. Becht, Kamisarenka & Pajuste, supra note 6, at 491.
86. Becht, Kamisarenka & Pajuste, supra note 6, at 480.
87. Id. at 489.
88. Belot, Ginglinger & Starks, supra note 44, at 13. Leverage, another potential short-term problem, was not more pronounced in loyalty-share firms as well. Id.
short-termism are widely held companies because they are most susceptible to short-termism, in the conventional critics’ story of excessive short-term trading and activism. But widely held companies were not the ones that jumped in Italy to use loyalty shares. Controlled companies were.

1. Concentrated Owners, Not Widely Held Companies, Use Loyalty Shares

Ownership in Italian listed companies is typically concentrated. At year-end 2018, more than half were controlled by a single, majority shareholder, about one-quarter had a controlling shareholder with a minority stake, and another 10 percent were controlled by a shareholders’ agreement.91 Larger firms tended to be widely held or weakly controlled.92

By May 2020, about one-quarter had loyalty share structures.93 Nearly all of those had either a controlling shareholder or a coalition of investors bound by a shareholders’ agreement. Most companies adopted loyalty shares when they were controlled by a single shareholder with 40 percent or more of the shares or when dominated similarly by an investor or a coalition of investors. Firms using loyalty shares were “family-controlled, small-sized industrial companies,”94 not widely held firms with no controller. But, again, widely held firms are thought to be most susceptible to short-termism. Controlling shareholders obtain loyalty shares and can then sell some of their shares while increasing their voting power, rather than to raise money for further investment.95 Loyalty shares thus cemented insider control in Italy—not longer-term thinking in diffusely held public companies.96

It is not easy in Italy, just as it has not been easy in France, for institutional investors to register their shares to obtain the voting bonus.97 The Italian

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92. Id.
93. Id.
97. Shareholders wishing to receive loyalty shares in Italian companies need to register their shares in a special company-held ledger. Those shares cannot be traded or loaned out without notifying the issuer and losing the loyalty-voting bonus. See Article 127-quinquies, Decreto Legislativo n. 58, 24 febbraio 1998 [Legislative Decree No. 58, Feb. 24, 1998] (as amended by the Competitiveness Decree); Article 143-quater, Consob Resolution no. 11971 of May 14, 1999 (as amended), Article 43, Banca d’Italia/Consob Ruling, Feb. 22, 2008 (as amended).
management company association concluded that the mechanics for registration *de facto* made loyalty shares unavailable in Italy to institutional investors, further suggesting that the motivation for facilitating loyalty shares was to bolster insiders, by using the excuse of combatting short-termism.

Institutional investors who excoriate short-termism in the United States opposed loyalty shares in Italy. For example, when large shareholders of the huge, widely held Italian insurer, Assicurazioni Generali S.p.A., proposed loyalty shares for the company, BlackRock, a major American-based, worldwide investor, opposed using them.100

2. Background to the Double Voting Law

Cross-border competitive pressure on Italy to retain companies incorporated in Italy drove its loyalty-share reform of 2014.101 Early that year the automaker Fiat, a major Italian listed company, reincorporated to the Netherlands and adopted a Dutch loyalty-share program,102 which Italy did not then permit. The Italian parliament felt the competitive pressure and amended its corporate law to allow loyalty shares just a few months later.103

The spirit of the reform was competitiveness, with other provisions of the reform opening borrowing channels and granting tax credits for new investments. But critics saw the law as allowing the Italian state to sell stock without losing control and as helping insiders to lock in control.104 The law triggered strong media and lobbying backlash against what the media and lobbyists said was an excessively insider-focused law.105

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104. See Ventoruzzo, supra note 101 (loyalty shares “allow the Italian Treasury to sell [a] large amount of shares, cashing in the value of these corporations, without losing control”). Luigi Zingales, Quel Voto Plurimo Così Opaco [Multiple Vote Is Opaque], IL SOLE 24 ORE (Aug. 1, 2015) (the state introduced loyalty shares which would allow it to “sell more shares without the risk of losing control”).

105. Alberto Alesina et al., Il Voto Doppio e il Quorum Qualificato [Double Voting and the Qualified Quorum], IL SOLE 24 ORE (Jan. 15, 2015).
C. OVERALL: ENTRENCHMENT AND NATIONALISM, LOCKING CONTROLLERS IN AND FOREIGN INVESTORS OUT

The Italian and French evidence demonstrates loyalty shares being used to support incumbent controllers and reduce foreign investors' voting power.\textsuperscript{106} The two concepts can be collapsed into a single, incumbent-protection metric. The rhetoric of supporting local, national champions against foreign competitors and investors bolsters the political rhetoric for loyalty shares and other foreign exclusion.\textsuperscript{107} Whether insulating incumbents leads primarily to greater long-term corporate operations is not evident. Reducing short-termism seems to be neither the primary motivation nor clearly an effect.

V. THE STATE OF LOYALTY SHARES IN THE UNITED STATES

Loyalty shares are permitted under Delaware law, are barred in midstream recapitalizations under the stock exchange rules (as are dual-class recapitalizations), and were sought to be facilitated under recent applications to the SEC.

A. THE EXISTING RULES

1. The Delaware Law

The Delaware courts have validated corporate charters providing for loyalty-shares structures. In \textit{Williams v. Geier},\textsuperscript{108} the Delaware Supreme Court upheld a listed company's 1986 loyalty-shares recapitalization, seeing it as "promot[ing] long-term planning and values by enhance[ing] the voting rights of long-term shareholders."

More recently, the Delaware Chancery Court \textit{de facto} impeded that result,\textsuperscript{109} when concluding that a board authorizing low-voting and non-voting shares—presumably including loyalty shares—that support insider control would obtain business judgement deference only if independent directors and a majority of the outside shareholders approved. Public companies, even those with a controlling or influential shareholder, often have a significant portion of the minority owned by the large institutions (BlackRock, Vanguard, and State Street) that oppose departures from one-share, one-vote.\textsuperscript{110} Their presence makes approval from

\textsuperscript{106}. See also Alessio Pacces, \textit{Exit, Voice and Loyalty from the Perspective of Hedge Funds Activism in Corporate Governance}, 9 \textit{Erasmus L. Rev.} 199, 213 (2016).

\textsuperscript{107}. On nationalism and corporate law, see generally Mariana Pargendler, \textit{The Grip of Nationalism on Corporate Law}, 95 \textit{Ind. L.J.} 533 (2020).

\textsuperscript{108}. 671 A.2d 1368, 1377–78 (Del. 1996).


a majority of the outside shareholders difficult to obtain. Hence, midstream re-
structurings to loyalty-share use are difficult.

2. The Existing Stock Exchange Listing Rules

Until 1988, U.S. listed companies were entitled to adopt loyalty-shares plans or dual-class structures “midstream,” well after their initial public offerings. In 1988, however, the SEC adopted Rule 19c-4, which required stock exchanges to adopt listing standards prohibiting the issuance of securities or other corporate actions “with the effect of nullifying, restricting, or disparately reducing the per share voting rights of holders of an outstanding class or classes of common stock.”

Rule 19c-4 was challenged and, in 1990, the U.S. Court of Appeals for the D.C. Circuit found that the SEC had exceeded its regulatory powers. Although Rule 19c-4 was struck down, the major stock exchanges voluntarily implemented its substance, following an informal SEC campaign. The New York Stock Exchange rules on voting rights illustrate:

Voting rights of existing shareholders of publicly traded common stock registered under Section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issuance. Examples of such corporate action or issuance include, but are not limited to, the adoption of time phased voting plans [i.e., loyalty shares].

Bottom-line: loyalty-share plans can be adopted before the initial public offering and can persist thereafter, but cannot be adopted midstream, when the shares are already traded on regulated markets.

B. The Existing Use

Loyalty shares are now uncommon in the United States, with stock exchange proposals seeking to make them more widely available.

In the most comprehensive retrospective on loyalty shares in the United States, only a dozen American companies were found to have loyalty shares. Ten of them (all family controlled) adopted loyalty shares shortly before 1987, through a shareholders’ vote, when stock exchange listing rules still allowed such midstream recapitalizations, while the remaining two went public in the early 1990s with this structure already in place. Of the twelve companies that adopted them in the 1980s and early 1990s, six rescinded them afterward.

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113. See Bainbridge, supra note 111, at 627.
114. N.Y. STOCK EXCH., LISTED COMPANY MANUAL § 313.00(A) (2020); see also NASDAQ STOCK MARKET, NASDAQ LISTING RULES § 5640 (2019) (similar restrictions).
115. Dallas & Barry, supra note 6, at 593–97.
116. Id. at 599, 620.
Thus, with usage so limited in the United States, it is hard to assess whether they are promoting long-run behavior, insider control, or both. But what little evidence is available seems to be largely consistent with the European protectionist results: Lynne Dallas and Jordan Barry comprehensively examine the loyalty-share results in the United States, showing that, where used, they primarily protect controllers. They “found no evidence that [loyalty-share voting] was associated with increased ownership by dedicated shareholders or decreased ownership by transient shareholders.”

The few firms that adopted loyalty shares generally outperformed the market. However, their relative performance was better before they adopted loyalty shares. This result does not support loyalty shares as promoting better corporate results. And companies that terminated loyalty shares were just as likely to see performance improve as to see it decline, providing mixed evidence. But with the sample of loyalty-share firms in the United States so small, little that is definitive can be concluded.

C. THE REFORMS PROPOSED

1. The Proposed Format for “Tenure-voting Plans”

Loyalty shares have been promoted via the Long-Term Stock Exchange proposals to the SEC and well-placed writing on the benefits of “tenure-voting plans”—loyalty shares—to address the perceived short-termism affecting U.S. companies. The proposals seek to facilitate midstream recapitalizations. A major think tank—the Roosevelt Institute—endorsed authorizing loyalty shares and suggested that Congress “pass legislation modeled on the . . . Florange Act.”

2. Alternative Formats: Economic Rewards to Loyal Shareholders

While the voting boost is the lure for long-term loyalty ownership in the public proposals, academics have designed other lures that could be more effective. Patrick Bolton and Frederic Samama have proposed that longer-term shareholders

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117. Id. at 542, 551, 627–28. Similar results for dual-class stock are described in Arugaslan, Cook & Keschnick, supra note 22, at 180–81.

118. Dallas & Barry, supra note 6, at 542, 552.

119. Id. at 552.

120. Berger, Davidoff & Solomon, supra note 6, at 323 (concluding that “[i]f adopted, tenure-voting plans could help shareholders, companies, the marketplace, and society return to a disciplined, long-term approach to investment and growth”).

121. Id.; see also Belifanti, supra note 12, at 834 (“with more attention being focused on the negative impacts caused by shareholder short-termism and some shareholder activists, the NYSE’s ban on time-weighted voting may be ripe for reconsideration”).

be compensated with a boost to the cash dividend or with warrants to purchase the firm’s stock at a favorable price. Yet, this proposal has had, as far as we can tell, no traction in real-world proposals in the United States: the real-world initiatives seek to use extra votes, not extra cash. In Europe, there are some companies with loyalty-share dividends, but these are few in comparison to the voting-boost loyalty shares.

While it is possible that the finance economists designed a mechanism that would not work, the alternative hypothesis, which we see as more likely, is that the real-world promoters of loyalty shares are for the most part interested in preserving control, with long-termism a justification. Extra votes for loyalty shares help to preserve control, extra cash does not.

**VI. THE CHOICE MECHANISM**

**A. LOCAL CHOICE AND PRIVATE ORDERING: ONE SIZE DOES NOT FIT ALL**

Above, we concluded that it is unclear whether loyalty shares would foster long-term behavior if adopted. Another feature of American corporate lawmaking furthers this uncertainty and strengthens the likelihood that it would not. The usual thinking in American corporate lawmaking is that different companies with differing businesses should be allowed to “tailor” their structures. Each company (meaning each company’s management, board, and shareholders) could choose what voting structure to use. One size does not fit all.

This “private ordering” preference would, we believe, lead to loyalty-share adoptions being more control-oriented than long-term focused. In this part we explain why.

Consider firm-by-firm choice for loyalty shares. A board could propose that the firm reconfigure to use loyalty shares by amending the corporate charter. Then the

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124. As an example, among companies in the CAC40, the main French stock index, in December 2020 only three companies (7.5 percent) awarded monetary benefits (dividende majoré) to loyal shareholders (usually a 10 percent dividend increase if the shares are held for more than twenty-four months in registered form), while twenty-seven companies (67.5 percent) granted additional votes through traditional loyalty shares.


126. For differential voting, the usual thinking is that this freedom of choice should be confined to when the private firm first sells its stock to the public.
shareholders could approve or reject the change. In an ideal business world, firms would sort themselves into those that would benefit strongly from loyalty shares (and adopt them) and those firms that would be damaged or not helped (and not adopt them). But analysts and regulators should not expect this result, because the board can effectively block the change. If the board—or its controller—benefits from loyalty shares, one should expect the proposal to be forwarded to shareholders for approval; if the board and the controller do not benefit, then the proposal will go nowhere. Controllers who value control highly (irrespective of whether that control would bolster the company’s long-term prospects) would seek loyalty shares. But controllers who would not benefit from a loyalty-share structure—because, say, they plan to divest their shares rapidly or fear that outside investors like index funds will obtain the bulk of the loyalty-vote bonus—would not.

This sorting difficulty is an under-recognized problem in corporate governance. The rhetorical power of investor choice is so strong that it often dominates careful analysis of the choice mechanism. Michal Barzuza showed recently that private ordering often will not assuredly lead firms to adopt the right corporate governance rule for themselves.127 In particular, “[f]irms that benefited most from independent directors . . . did not add them voluntarily.”128 If the incumbents would lose authority, they disfavored the rule even if the firm would be improved.

We expect that loyalty-share adoptions in the United States would sort themselves on similar lines, without necessarily benefiting long-term firm value.

B. INDEX FUNDS, AGAIN

Loyalty shares’ impact in the United States depends considerably on their impact on index funds, which now own one-fifth of the stock market. Index funds are core American long-term holders; they typically buy a balanced portfolio of the entire stock market.

The long-termist task is to match the long-term horizon of these index investors with their portfolio companies’ decision-making. But the matchup, despite its intuitive appeal, is not strong. Indexed investors own stock across the economy, disincentivizing them from carefully examining each investment for the long run. They are passive investors who compete on the basis of the low fees they charge investors rather than on their portfolio’s performance. They spend little on stewardship.129

127. Michal Barzuza, Inefficient Tailoring: Private Ordering Paradox in Corporate Law, 8 HARV. BUS. L. REV. 131, 136–37 (2018). For loyalty-share adoptions at the time the firm goes public, the controlling founders internalize the costs and benefits; the problem primarily pertains to post-IPO adoptions.

128. Id. at 136 (emphasis added); cf. Lucian A. Bebchuk, Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments, 102 HARV. L. REV. 1820, 1824 (1989) (“Although an amendment requires approval by a shareholder vote . . . the amendment must first be proposed by the board.”).

Hence, doubling indexers' votes would bolster long-term investors who have only weak incentives to use those votes well. Index funds tend to support corporate managers so as to attract and retain business deriving from pension-related services.

As Ronald Gilson and Jeffrey Gordon explain, though institutional investors have the votes, activist investors have the skills “to identify strategic and governance shortfall with governance-related underperformance.” Because the activists typically lack control of the targeted firm, they need support from institutional investors, such as the index funds. As we saw in Part II.D, loyalty shares will reduce the activists' relative voting power (because the activists will be owning “fresh” shares that would not be entitled to the loyalty-share two-year voting boost) and would increase the indexers' voting power. Which effect is larger from loyalty voting changes—magnifying long-term indexers or decreasing activists' incentives—is difficult to assess.

Here, the design problem—and the capacity of controllers to control the design—becomes relevant once more. Paul Edelman, Wei Jiang, and Randall Thomas show that American inside-managers could not lock in control with conventional loyalty shares without buying a quarter of the company—more than management typically owns. But management would have noticeably more voting power with the conventional boost and it could even assure itself of control if it obtained more than the conventional voting boost (i.e., management could seek more than the conventional doubling of the vote). It could seek and obtain ten votes per share. That result could get management control with a modest investment.

Management (and controllers) could do even better in garnering a larger percentage of the votes if they sought a voting structure that impeded outsiders, such as the indexers, from getting the extra votes, a result that is common in...
Europe. The reigning U.S. proposal—to establish the so-called Long-Term Stock Exchange for Silicon Valley—as originally drafted would have done so.

The LTSE planned that shares that would get the voting boost had to be registered with the company. But institutional investors prefer not to register their shares. They need to balance their portfolios intermittently, which would become cumbersome if the shares are registered; hence, the mechanics discourage institutional investors' ability to get the loyalty-share boost. (The indexers and other institutional investors do not value their votes highly but do value low cost when they rebalance their portfolios.) They also make a business of lending their shares to investors who seek to sell “short” (and thereby bet on the firm's stock price declining). Hence, their loyalty-share plan would make it easy for insider-controllers to get the voting boost, make it hard for outside institutional investors to get it, and deny the voting boost to activists.

This registration structure and the indexers' aversion to it would weaken outside investor voting power and bolster insider-controller-management voting power. The activist-index fund alliance works now in American corporate governance (although there are disagreements on this point, as some opponents believe that this alliance is too focused on shareholder value, neglecting the interests of other stakeholders). However, this alliance will weaken or disappear if insiders design and implement a loyalty-share system that disrupts that alliance by weakening the activists' and the institutions' voting power relative to the insiders.

C. AND THEREFORE?: LOYALTY SHARES TO PROPEL ENTREPRENEURIAL START-UPS?

Although we are skeptical that loyalty shares benefit the long term in any direct and major way, and although promoting the long term has been loyalty shares' major rationale, that does not mean they must be barred. Our analysis is partial and skeptical—focused on the widely held, intuitively attractive, but erroneous view that loyalty shares would assuredly and powerfully ameliorate short-termism.

But loyalty shares have other benefits. Entrepreneurs who start firms often value keeping control even after their firm succeeds, goes public, and raises

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136. Investors Exchange LLC, supra note 35. These plans are being updated.
137. See supra note 33.
138. See supra Part IV. An important recent work on loyalty shares outlines how the holding-period tracing could be done with new blockchain technology, without depending on traditional registration. Berger, Solomon & Benjamin, supra note 6.
139. There's reason to facilitate loyalty shares that are put in place when the firm first went public, but not thereafter. Consumer sovereignty (not anti-short-termism) is the usual justification—the buyers know what they are buying and price their low-voting potential accordingly. We sympathize with that justification. In the next Section C, we introduce a more compelling justification for a “going-public” exception—also not based on anti-short-termism.
outside capital.\textsuperscript{140} There is considerable evidence that entrepreneurs value the benefit of being the boss—and of not being someone else’s employee.\textsuperscript{141}

Autonomy is a value and goal in and of itself.\textsuperscript{142} Though much corporate analysis focuses on control’s monetary value, there is more that is not regularly attended to. Pride of ownership, power, prestige, and self-satisfaction from controlling the enterprise are major motivations for business leaders.\textsuperscript{143} According to the great Alfred Marshall: the entrepreneur “often [puts up with] considerable disadvantages [because] the freedom and dignity of his position are very attractive[.]”\textsuperscript{144} Stated more vigorously by Joseph Schumpeter, for the entrepreneur:

There is a dream and the will to found a private kingdom. . . . The sensation of power and independence [is vital]. . . . Then there is the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself . . . .\textsuperscript{145}

Modern managerial analysis confirms Alfred Marshall’s and Joseph Schumpeter's conjectures. Noam Wasserman, calling the problem the “founder’s dilemma” in 2012, shows that founders’ decisions are pervasively influenced by whether to be “rich” (actually, to be “richer”) or to preserve the founder’s control. He shows that for his set of investigated firms—10,000 initial founders of firms over a decade—when faced with value versus control choices, founders regularly choose control over maximizing value.\textsuperscript{146}

\textsuperscript{140.} See Ronald J. Gilson & Bernard S. Black, \textit{Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets}, 47 J. FIN. ECON. 243, 258–59 (1998) (indicating how an owner-founder loses control to venture capital but reacquires control if he or she is sufficiently successful that the firm can go public, whereupon the VC firm sells its shares, leaving the owner-founder in effective control). (And, see supra note 139, as there is less reason to be concerned about loyalty-share adoptions when the founders take the firm public than with later adoptions.) But cf Brian Broughman & Jesse M. Fried, \textit{Do Founders Control Start-Up Firms that Go Public?}, 10 HARV. BUS. L. REV. 49 (2020) (founders are often no longer the CEO of start-ups that go public).


\textsuperscript{144.} Benz, supra note 142, at 23.


\textsuperscript{146.} NOAM WASSERMAN, T HE FOUNDER’S DILEMMA 284–88, 291–96, 331–71 (2012); Noam Wasserman, \textit{The Throne vs. the Kingdom: Founder Control and Value Creation} in Startups, 38 STRATEGIC MGMT. J. 255, 262, 271 (2017); see also Raphael Amit et al., \textit{Does Money Matter?: Wealth Attainment as the Motive for Initiating Growth-Oriented Technology Ventures}, 16 J. BUS. VENTURING 119, 135–36 (2000) (interviews comparing entrepreneurs’ motivation to that of similarly placed executives show “independence[seeking] . . . and ego affect the decision to found a new high-technology venture” and that “money is [not] . . . the most important[] motive for entrepreneurs[]”). Founders may start out with this dream, but later abandon it. See Broughman & Fried, supra note 140.
Thus, loyalty shares’ systemic justification could come from the plausible conjecture that they would encourage entry and competition. Entrepreneurs value control and autonomy. If entrepreneurs know upfront that they can lock in their control with loyalty shares, that should entice more of them to start businesses. Start-ups and more competition are valuable to the economy, even if there is no long-term benefit for loyalty shares in ongoing enterprises. This channel would justify loyalty shares for start-ups and for entrepreneurs when they take their firm public. For this channel, a long-term sunset is embedded in the loyalty share, because loyalty shares’ autonomy-promoting quality would fade as the enterprise and the entrepreneur aged, terminating when the founder finally sells his or her stock.147

And that start-up channel also yields a speculative path toward long-termism. Posit (again) that start-up entrepreneurs highly value the continued control that loyalty shares facilitate. If that prospect of retained control facilitates more start-ups, and if more start-ups contribute to long-term progress, then loyalty shares could indeed foster the long term.

This positive aspect of loyalty shares locking in control in ways that entice entrepreneurship resembles the foundational problem for patenting. If innovators get no patent protection and if copying is costless, then few businesses will innovate; the innovator will incur the costs of discovery, but others will copy the innovation. But patent protection can be “too much,” because it stifles the economy from getting the full value of free access to the patented technology—the patentor is, after all, awarded a monopoly that allows it to charge a high price.

Patent protection that is too strong will mean higher prices and less production.148 How long and how sharply the protection should be to best maximize national well-being is not answered by theory but by empirical reality as to where the tradeoff line (innovation inducement versus monopoly protection) should be drawn.149 In the absence of good evidence, the most plausible policy result would be to let investors and founders decide among themselves when the firm goes public.

This start-up channel that we raise—encouraging entrepreneurial activity in the first place—is abstractly important. But because it has not been brought forward before, as far as we can tell, it has not been measured nor is it the channel

148. Full costs include probabilistic costs. If innovation in, say, drugs has ten companies chasing the innovation and only one can succeed, then the successful company should recover ten times its costs plus an appropriate profit.
to long-term economic results for the American economy that loyalty-share advocates have brought forward. Its value is difficult to assess.

But if loyalty shares are to be justified, it is here—in encouraging startups—that the justification will come.\textsuperscript{150}

**CONCLUSION**

Financial market short-termism is widely thought to induce large firms around the world to forgo socially beneficial research and development and to reduce the long-term investments that power the economy. Loyalty shares are widely thought in corporate governance circles to powerfully reverse this financial short-termism. By giving longer-term shareholders more votes, the firm and its executives will more readily invest and manage for the long term.

Major proposals have emerged for instituting loyalty shares in the United States. The Securities and Exchange Commission has approved the LTSE promoters’ plan to establish the so-called Long-Term Stock Exchange. And the LTSE’s core goal has been to use loyalty shares in a sustained way. The Exchange announced plans to seek such authorization.

We have shown here that the impact of loyalty shares in bolstering the long term is far from assured. Insider-controllers will often capture the adoption machinery and will adopt loyalty shares when it favors the insiders, regardless of whether it favors the long term. Insider-controllers will seek or veto loyalty shares based on their self-interest, and combating short-termism is a lesser element of their self-interest. Such players typically obtain private benefits from maintaining control and will seek that their firms use loyalty shares when doing so perpetuates their own control (even if that is not in the long-term interest of the organization) or allows them to diversify their stock and maintain their prior voting strength.

The results in nations where loyalty shares are more developed than in the United States are consistent. Insiders in Europe seem thus far to capture the extra votes to facilitate their goals in ways that are neither value-maximizing nor necessarily long term. The players obtaining the extra “loyalty” votes are not institutional investors who hold onto their stock for the long term. Widely held firms—the most susceptible to quarterly capitalism—do not adopt loyalty-share programs in Europe as widely or as intensely as do firms with controlling shareholders who seem to be seeking to enhance and preserve their control. Loyalty shares lock in insider control and that structure is justified, without supporting evidence, as bolstering the long term. These results make us wary of

\textsuperscript{150} This power, independence, and autonomy channel does not depend on the entrepreneurs having an idiosyncratic vision deserving of protection. See Goshen & Hamdani, supra note 20. No particular level of imagination or vision need be attributed to the entrepreneur. It need only be that we value entry and competition, even if done without any vision, panache, or forward-looking insight.
how loyalty shares would be implemented in the United States, because the incentives in the United States are similar.

For the broad mass of public firms, loyalty shares will enhance the voting power of insiders and management, typically when they go public, while diminishing the eventual voting power of dedicated blockholders and of shareholder activists. Yet the former is central to academic analysis of what will enhance the long term and the latter is widely (but disputedly) thought important for sound long-term corporate decision-making.

A fundamental corporate governance quality may be in play: A problem is identified (here: short-termism). Academics and practitioners design a mechanism to mitigate the problem, but implementation (both in the legislature and in the corporate decision-making process) is captured by incumbents with authority in the corporation or the polity. That capture diminishes the reformers’ desired impact and can even reverse it.

The value of loyalty shares is unlikely to lie in their reducing corporate short-termism. That analytic channel and justification should be dropped. The managerial and entrepreneurial literature shows, however, that many entrepreneurs value control, and trim their own wealth maximization to maintain that control. This channel could be loyalty shares’ true value: having the loyalty-share option available motivates the founder to push ahead, because he or she is assured of being able to maintain control of the new business, even after it goes public with outside shareholders, for as long as the founder remains as a substantial owner. We should then expect to have more start-ups than otherwise.

Moreover, this loyalty-share structure has a “biodegradable” quality to it. The buyers in an initial public offering can price a structure that enables the current controllers to keep control over the long haul, by evaluating its advantages and its potential long-run disadvantages to the company’s operating agility. With loyalty shares as the mechanism for continuing control (unlike with dual-class shares), the controller cannot readily sell control to an outsider, because upon the sale the loyalty shares’ voting power shrinks, while the dual-class shares’ voting power does not shrink. Those buying stock in the loyalty-share-IPO can more readily put a price on the current insiders having persistent control. The insiders can keep it but they cannot sell it.

The value here is not in fostering an idiosyncratic vision, especially if that vision comes midstream, after the firm goes public. When the firm is well along, there are trade-offs from fostering an inside vision versus suffering from sclerotic persistence—and the overall trade-off is hard to evaluate. The value here for loyalty shares is rather in bolstering the entrepreneurial ex ante motivation to start up a new firm—and depends on whether founders and their immediate successors value control for its own sake. Loyalty shares are well attuned to bolster this value, while minimizing later costs. The insider’s control degrades over time, roughly corresponding to the controller’s diminishing interest in the firm. The controller can maintain control for himself or herself but cannot sell it to an outsider. The difficulty in assessing policy here comes not in this feature weighing in as a positive—as it must—but in measuring its strength and importance, and
in comparing it to the likelihood of later corporate rigidities before the controller leaves the scene. That weighing is the next task for this literature.

But the bottom line here is that there are strong reasons to be skeptical of loyalty shares having an important capacity to foster the corporate long term and diminish stock-market short-termism.