

## Empty Voting

The general principle of one-share-one-vote relies on the view that shareholders with the largest economic interest in the company's success should have the largest say in any decision. But in recent years there have been an increasing number of instances where the votes controlled by hedge funds or other activist investors have been proportionately much larger than their economic interest in the company.

There are several ways that this divergence between control rights and cash-flow rights can occur. For example, if one investor borrows stock from another, the borrower generally acquires the voting rights but has no economic interest in the company. If the borrower then shorts the stock, he has an incentive to vote for policies that reduce company value.

A split between voting power and economic interest can also result from derivatives activity. For example, if a shareholder hedges her position by buying put options, she retains her voting rights even though she no longer has an interest in the prosperity of the firm.

This decoupling of voting power and economic interest has been termed "empty voting"; the shareholders' votes have been "emptied" of any economic interest. The problems that can result from empty voting are illustrated by the case of Perry Corporation, a hedge fund. In 2004 Perry owned seven million shares of King Pharmaceuticals. Then Mylan Labs agreed to buy King in exchange for shares, at which point Mylan's shares fell sharply. Perry's response was to buy 9.9% of Mylan stock but to fully hedge this shareholding. This gave Perry considerable influence on Mylan without any economic exposure. As a result, Perry's interests diverged from those of other Mylan's shareholders. The more that Mylan paid for King Pharmaceuticals, the more that Perry profited.<sup>1</sup>

In 2010 the SEC reacted to concerns about the possible dangers of empty voting by seeking public comment.

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<sup>1</sup> The Perry example is taken from H.T.C. Hu and B. Black, "The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership," *Southern California Law Review* 79 (May 2006), pp. 811-908.