HOW DEREGULATION AND "I" CORPORATIONS COULD SAVE SHAREHOLDERS FROM THEMSELVES: GOING PRIVATE-LITE

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Overregulation and fiscal concerns often handicap innovative public technology companies in their nascent stages. Moreover, company boards—beholden to shareholders—often face a stark choice: continue innovating or continue making money. The two choices are often at odds. This Note examines whether taking a public technology company into a quasi-private status (private-lite) would be a growth incubator, spurning innovation, or an overall detractor, acting as a magnet for bad actors and shareholder abuse. This Note's primary assertion is that removing existing financial regulations and allowing public companies with sufficient private funding to go private (or for private companies to remain private while taking on shareholders) would drive innovation by technology companies, thereby benefiting the market and consumers as a whole. This would need to be done outside of existing corporation structures by creating an "I" corporation—an "Innovation corporation."[1] Elon Musk's recent (and failed) attempt to take Tesla "private-lite" serves as both a model for what could work, and a cautionary tale of how not to proceed.

Technology startups are often products of radical thinkers. Well-known examples include Steve Jobs, Elon Musk, Mark Zuckerberg, and James Dyson. Their astute innovation led to their stratospheric status, but it has often made their shareholders uneasy. Freeing companies of shareholder oversight could potentially allow for risky financial and material decisions, that in some instances

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1. While this Note advocates primarily for technology "I" corporations, "I" corporation benefits could likely apply across the spectrum of industry. Technology companies were chosen for this Note due to the inherent risk and funding requirements for new and successful technologies.

could end in failure, but might also change and enhance how we interact with the world.

Additionally, this Note also examines modifications to current business structures—staggered boards, quinquennial elections, benefit corporations, and disproportionate votes—that promote greater mobility and flexibility for a CEO, and whether these modifications could serve as possible starting points for an "I" corporation. Furthermore, this Note looks at companies where going public has been a success; companies that have thrived with the different views that come with a diverse board, shareholder responsibilities, and ethical responsibilities.

Ultimately, if 30 "I" corporations form and only one succeeds, this is a victory. Risk takers, CEOs, and shareholders alike, deserve an opportunity to innovate without the constrictions of forced financial transparency.

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BACKGROUND AND INTRODUCTION

On August 7, 2018, Tesla CEO Elon Musk published a tweet that sent media and regulators scrambling: "Am considering taking Tesla private at $420. Funding Secured."[2] Musk, an investor and entrepreneur, has had success because of innovation.[3] Much of that innovation involved risk.[4] As CEO of SpaceX, a private space transportation company, he has taken risks that have produced innovations that are aimed at lowering cost barriers to space travel, such as: unprecedented time schedules, material innovation, production modernization (of an entirely new product), a realistic vision for humans on Mars, and launching rockets and then landing them safely back on Earth.[5] Does any of that sound risky? Imagine if SpaceX had been public, and every time rockets blow up on the launch pad (they have), or when a reusable rocket crash-landed instead of flaring gently on a floating barge (they did), stock prices fell dramatically. Shareholders and board members would be screaming for Musk to resign, a new path for the company, or a return to safer and more stable launch platforms. No more reusable rockets. No more vision for a private-venture human Mars exploration mission. Innovation loses to quarterly earnings.

Of course, in light of Musk's tweet and announcement about going private,[6] it is clear now that funding was not secure, and the public never got to see what Musk's version of going private looked like.[7] But in his explanation to his employees, Musk highlighted the reasons why he felt Tesla's trajectory as a public entity had become untenable:

> [1] Wild swings in stock price can be a major distraction for everyone working at Tesla, all of whom are shareholders. [2] Being public also subjects [Tesla] to the quarterly earnings cycle that puts enormous pressure

2. Elon Musk (@elonmusk), TWITTER (Aug. 7, 2018, 10:48 AM), https://twitter.com/elonmusk/status/1026872652290379776?lang=en [https://perma.cc/3PSE-75NK].

3. *See* IT Communications Writer, *Innovate by Taking Risks: Elon Musk*, BYU IDAHO INFO. TECH. BLOG (July 11, 2018), http://www.byui.edu/information-technology/blog/innovate-by-taking-risks-elon-musk [https://perma.cc/5CAR-A6W7].

4. *See id.*

5. Sam Blum, *SpaceX Completes First Ever Falcon 9 Launch and Landing on the West Coast*, POPULAR MECHS. (Oct. 8, 2018), https://www.popularmechanics.com/science/a23640822/space-x-west-coast-falcon-9-landing/ [https://perma.cc/8U84-GKXX].

6. *See* Dave Mosher, *Elon Musk Says SpaceX is on Track to Launch People to Mars Within 6 Years – Here's the Full Timeline of His Plans to Populate the Red Planet*, BUS. INSIDER (Nov. 2, 2018, 3:54 PM), https://www.businessinsider.com/elon-musk-spacex-mars-plan-timeline-2018-10 [https://perma.cc/X8W8-DZLW].

7. Neal E. Boudette, *Tesla Will Not Go Private, Elon Musk Says, Capping Month of Turmoil*, N.Y. TIMES (Aug. 24, 2018), https://www.nytimes.com/2018/08/24/business/elon-musk-tesla-public.html [https://perma.cc/3BJ2-CYRJ].

> on Tesla to make decisions that may be right for a given quarter, but not necessarily right for the long-term. [3] Finally. . .being public means that there are large numbers of people who have the incentive to attack [Tesla].[8]

However, on top of his failed bid to take Tesla private, Musk has also faced legal and financial repercussions for his announcement.[9]

Risk is not just about whether the technology works or not, or whether any new technology is created at all; it can also be about the innovator themselves. Yes, there is a risk involved with new technology; it works or it does not; maybe people do not actually need it; or maybe it's so expensive that no one in their right mind would actually pay to manufacture it. But the innovator behind the technology can be just as much of a risk as the technology itself. The media sees Musk as erratic and understandably so—at one point, he referred to cave divers, who were rescuing children trapped in flooded caves, as pedophiles.[10] Following Musk's pedophile comment, Tesla stock prices dipped once again.[11] While Musk's comments are regrettable, they have little bearing on his ability to meet production numbers or troubleshoot an innovative battery system. Yes, Musk is eccentric, but those who bet against him lose—and lose big.[12]

When public life starts, innovation often suffers.[13] Public company life has many pitfalls, and many technology firms have chosen to either stay private or prolong a public offering to retain innovative discretion.[14] Some companies that have chosen not to go public have been able to retain focus on innovation (CEOs spend more

8. *Elon Musk Explained His Going-Private Tweet to Tesla Employees with This Email*, MARKETWATCH (Aug. 8, 2018, 8:20 AM), https://www.marketwatch.com/story/elon-musk-explained-his-going-private-tweet-to-tesla-employees-with-this-email-2018-08-07 [https://perma.cc/49EG-KKS5].

9. *See* Press Release, Sec. & Exchange Comm'n, Elon Musk Charged with Securities Fraud for Misleading Tweets (Sept. 27, 2018), https://www.sec.gov/news/press-release/2018-219 [https://perma.cc/CM9Q-ME6K].

10. Micah Maidenberg, *Thai Cave Diver Sues Elon Musk for Defamation*, WALL ST. J. (Sept. 17, 2018), https://www.wsj.com/articles/thai-cave-diver-sues-elon-musk-for-defamation-1537212892 [https://perma.cc/Q9XS-AN48].

11. Kevin Kelleher, *After Elon Musk's 'Pedo' Tweet, Tesla Shares Fall 4% as Some Investors Worry About His Erratic Behavior*, FORTUNE (July 16, 2018), http://fortune.com/2018/07/16/elon-musk-pedo-tweet-tesla-stock/ [https://perma.cc/D6A9-JWGR].

12. Dion Rabouin, *Tesla Short Sellers Wish Elon Musk had Funding Secured at $420*, AXIOS (Jan. 14, 2020), https://www.axios.com/tesla-elon-musk-short-sellers-funding-420-552cb2a4-5fc7-403e-ad97-17aa6018573e.html [https://perma.cc/9DEG-PMA3] ("Short sellers who have bet against Tesla's stock price surrendered a total of $2.89 billion in net-of-financing mark-to-market losses in 2019" and are on track to lose even more in 2020).

13. Gabriel Horwitz, *Does Innovation Die When a Firm Goes Public?*, FORBES (Aug. 22, 2017), https://www.forbes.com/sites/washingtonbytes/2017/08/22/does-innovation-die-when-a-firm-goes-public/#7c0eb2d61edf [https://perma.cc/BLH3-K8W7].

14. *See id.*

time in the lab instead of responding to boards and shareholders). Using Dyson (which remains a private company) as an example, the company had innovative ideas, a rough start up, and funding troubles, but was still able to innovate outside the box.[15] Banks laughed at James Dyson when he said he wanted to build a fan with no blades, or a vacuum positioned on top of what looked like a basketball. But instead of focusing on quarterly statements, he put his efforts into what got him to the point of making bladeless fans in the first place: innovation.[16] Conversely, Facebook stock dropped roughly 20 percent following a mention of slight slowing in profits,[17] precipitating a rush to please investors in the short-term to stop the hemorrhaging.[18] However, there are exceptions to this rule, though, Amazon being the most notable.[19] In short, public life and shareholder demands of a company are often incompatible with the innovative culture that got the company to its successful pre-IPO state.

The current structure of public technology companies inhibits the natural ability of technology first-movers to decisively innovate and therefore continue to thrive according to their initial values. The demands of a fickle stock market and cash-focused shareholders distract from leadership's ability to think long-term, to take risks that will seem unnecessary and possibly hurt the company's bottom line in the near term.[20] An "I" corporation could provide an alternative. Shareholders who are willing to take more risk may pair with risk-taking innovators. Shareholders may choose to play the odds: maybe just one out of 30 "I" corporations succeed, but the payoff is big.

As Musk noted in his announcement to employees, "[the idea that shareholders distract from innovation] is especially true for a company like Tesla that has a long-term, forward-looking

15. *How I Built This with Guy Raz: Dyson: James Dyson*, NPR (Feb. 12, 2018), https://www.npr.org/2018/03/26/584331881/dyson-james-dyson [https://perma.cc/ZL68-TDBL].

16. *Id.*

17. Max A. Cherney, *Facebook Stock Drops Roughly 20%, Loses $120 Billion in Value After Warning that Revenue Growth Will Take a Hit*, MARKETWATCH (July 26, 2018), https://www.marketwatch.com/story/facebook-stock-crushed-after-revenue-user-growth-miss-2018-07-25 [https://perma.cc/4RUT-9T3X].

18. Timothy Seymour & Ryan Dodd, *Facebook Shares are Down 20 Percent, but Investors aren't Focused on the Key Issue*, CNBC (July 31, 2018, 3:50 PM), https://www.cnbc.com/2018/07/31/facebook-is-down-20percent-but-investors-arent-focused-on-the-key-issue.html [https://perma.cc/ST47-MZ4C] (noting that Facebook quickly began to focus on privacy issues following very public governance scandals).

19. *See* Lina M. Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710, 712 (2017) (noting that Amazon managed to report losses quarter after quarter but continued to secure investment and keep share prices stable, if not rising).

20. Alana Semuels, *How to Stop Short-Term Thinking at America's Companies*, THE ATLANTIC (Dec. 30, 2016), https://www.theatlantic.com/business/archive/2016/12/short-term-thinking/511874/ [https://perma.cc/C665-MMDP].

mission."[21] Privately held, innovative technology companies, by and large, have a much greater chance of maintaining their innovative streak by remaining private. Though going public may bring initial financial windfalls, a quasi-private corporation could combine the benefit of undistracted innovation and shareholder cash infusion.

Part one of this Note will look at the rationales and legal dilemmas in going from private to public companies. The second part will examine the current legal structures in place that either actively or theoretically attempt to create an alternate environment for unconventional CEOs to operate. Those include staggered boards, quinquennial elections, benefit corporations, and disproportionate votes. The third part will examine how aspects of these legal structures could benefit an "I" corporation, and how those aspects would most likely fall short. Lastly, this Note will discuss possible outer boundaries of an "I" corporation and possible associated legal concerns.

I. MAKING THE MOVE: PRIVATE TO PUBLIC:

Why do it? In one word: money. Going public allows a growing technology company to increase its net value, lower its debt-to-equity ratio, obtain qualified evaluations from investors, and it creates the possibility of prestige that will further entice investment.[22] But some technology companies have decided to forego the allure of a public offering, instead staying private (at least for a little while longer) to maintain innovative momentum.

Levon Ghonyan reviewed empirical research showing the benefits and drawbacks of going public.[23] His study explains that after an IPO, financial indicators for a new public firm tend to deteriorate. Notably, profitability decreases, expenditures rise, and there is a smaller return on sales.[24] Firms see less dilution in their bottom lines, gaining the ability to set a higher price for their securities through IPO than through private placement.[25] Advantages for a firm to go public are well known.[26] For example, an IPO often lowers a firm's debt-to-equity ratio, which makes a firm appear more attractive and reliable to lenders and enhances its ability to borrow.[27] For tech companies, this could mean more chances at

21. *Taking Tesla Private*, TESLA (Aug. 7, 2018), https://www.tesla.com/blog/taking-tesla-private.

22. Levon Ghonyan, Advantages and disadvantages of Going Public and Becoming a Listed Company 1–2 (June 29, 2017) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2995271).

23. *See id.*

24. *See id.* at 3–4.

25. *Id.* at 1.

26. *See id.*

27. *Id.* at 2.

financing innovation, procuring new tech, or expanding the firm's hiring pool. Similarly, if a firm performs well after going public, the stock may sell on more favorable terms, increasing the net worth of the company.[28] Shareholders are notoriously risk averse and more concerned with seeing returns in the short run instead of new technology and possible returns in the long run. Finally, and what might be the main driver for firms wanting to go public, prestige plays a major part in the decision. A public offering garners "more interest in the firm from customers, suppliers and prospective investors."[29]

Conversely, the disadvantages of going public are less well-known. First, the cost of even getting to the doorstep of a public offering can be onerous. Underwriters take their cut of the deal, sometimes totaling up to four percent of the total offering,[30] in addition to audit and legal fees shouldered by the firm.[31] But more importantly, companies going public face the gauntlet of investor relations, public disclosure of financial information, loss of control, and an unrelenting pressure from shareholders to maintain an upward trajectory of earnings.[32] These are in addition to "declines in operating performance, sales growth, and overall factor productivity post-IPO."[33] Though these factors can significantly affect a budding technology company, they do not even account for the legal and accounting costs.[34] Ghonyan succinctly points out the disadvantages in turn:[35] concerning investor relations, "[t]he company will have to hold formal board and stockholders' meetings and devote substantial time to regulatory reporting."[36] On concerns over information disclosure, Ghonyan notes that "sensitive information will be available to competitors, customers, employees and others."[37] This disclosure happens "not only when the company initially goes public but also on a continuing basis."[38]

28. *Id.*

29. *Id.*

30. Jay Ritter, *Why Is Going Public So Costly?*, FORBES (June 19, 2014), https://www.forbes.com/sites/jayritter/2014/06/19/why-is-going-public-so-costly/#1036fdb14ff0 [https://perma.cc/JN2S-WJ9Z].

31. Ghonyan, *supra* note 22, at 2.

32. *Id.*

33. Simone Wies & Christine Moorman, *Going Public: How Stock Market Listing Changes Firm Innovation Behavior*, 52 J. MARKETING RES. 694, 696 (2015).

34. Caleb Christensen, *The Costs of Going Public*, IPOHUB (Mar. 27, 2018), https://www.ipohub.org/costs-going-public/ [https://perma.cc/GQX4-NQ82] ("The fees required for your company's outside counsel and the underwriter's counsel are generally affected by the same factors listed above in the section on costs associated with underwriters, but you should expect to pay somewhere between $0.7 – $1.5 million. Included in these legal fees are the preparation of the offering document as well as the review of and advice regarding contracts directly related to the offering.").

35. Ghonyan, *supra* note 22, at 2.

36. *Id.*

37. *Id.*

38. *Id.*

There is also a pressure, both internal and external, to maintain growth.[39] "If earnings decrease from the established trend, stockholders may sell their stock,"[40] resulting in a possible breakup or new, unwanted, direction for the company. Finally, offerings are not final until the ink is dry, so a private company might end up covering expenses if the deal does not see full maturation.[41]

But success in business is often about taking risk where others would rather play it safe. So why are tech startups waiting longer to take the dive into public life?

A. Access to Private Money Means Technology Companies are Waiting Longer

An increased interest in maintaining control of the company, and instability in the IPO process, has fostered a growing trend of technology companies remaining private for longer, while still retaining access to outside funding.[42] The current trend is that tech startups are waiting longer to go public so they have more control over the company for a longer period of time.[43] Ten years ago, this would not have been a possibility.[44] Faced with financial obstacles to continued growth, many companies went public—they were unable to continue financing themselves or secure adequate private funding to remain private.[45] However, now there is an increasing amount of capital aimed at the late-stage sector that allows private companies to stay private for longer.[46] More money later in the game means firms are able to hold off going public as long as the money keeps flowing in.

Another issue affecting why tech companies are staying private longer is instability. The July 2016 podcast from McKinsey & Co. references the case of GoPro.[47] Unlike Google, whose product

39. *Id.*
40. *Id.*
41. *Id.*
42. Connie Loizos, *The IPO Market Is Heating Up Again, but It Won't Change How Fast Companies Go Public*, TECHCRUNCH (Apr. 23, 2019), https://techcrunch.com/2019/04/23/the-ipo-market-is-heating-up-again-but-it-wont-change-how-fast-companies-go-public/ [https://perma.cc/8HRP-TG5Q].
43. *Staying Private Longer: Why Go Public?*, AM. BAR ASS'N (Sept. 13, 2019), https://www.americanbar.org/groups/business_law/resources/materials/2019/annual_materials/staying_private [https://perma.cc/XZP6-2NSQ].
44. *Anatomy of a Unicorn: Why Tech Start-Ups Are Staying Private*, MCKINSEY & CO. (July 2016), https://www.mckinsey.com/industries/technology-media-and-telecommunications/our-insights/anatomy-of-a-unicorn-why-tech-start-ups-are-staying-private [https://perma.cc/TN6K-MC9S].
45. *Id.*
46. *Id.* "Late-stage" in this context means when a company is nearing the end of its lifecycle under its current funding regime, also meaning an end to the current stage of innovation. Whatever innovation has been achieved, nothing more will be achieved unless additional funding is secured.
47. *Id.*

(the "search") does not have a logical end, lasts a long time, and has a large market, a GoPro is a piece of technology aimed at a narrow market and is rather limited in scope.[48] Because of this, the logical question in an IPO would be, what is the company's next move? Accordingly, going public before a company has narrowed down their next move can create instability.[49] Companies do not want to go public when they are still trying to figure out what that next scalable model is, leading many companies to wait longer and longer to go public.[50]

As technology companies wait longer to go public, there is a growing expectation for a delayed public offering. Traditionally, employees would expect the typical life cycle of a company to culminate in a public offering, with the financial benefits that would follow. However, that does not mean that the idea has gained popularity with investors. A company saying it is *never* going public is very different than saying "not yet."[51] "The reason that [late-stage tech companies] are able to get a lot of pre-IPO investors for a very long time is because the pre-IPO investors eventually expect an IPO."[52] Using Facebook as an example, it is hard to imagine a scenario in which they could have raised so much pre-IPO money if Facebook had reneged on its announcement of going public, changing "the proposition of the company to its employees and to all of its stakeholders and partners" in the process.[53] But Facebook is an example of a large company with high expectation, both from investors and from the public. Many smaller tech companies would not feel that public pressure and have little incentive to leave a situation where they are receiving late-stage funding and high valuation for a life in the public world and the uncertainty that brings.

Essentially, the message is that if money is what you were going after by becoming public, why go through the hassle of shareholders when you have private capital? Additionally, there is very often not a consensus among employees regarding the decision to stay private, especially if they own shares of the company and are looking to have the liquidity that comes with going public. Therefore, CEOs are playing the game: they want to go public, but do not want to come straight out and say that. So, where does this leave the shareholder?

48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*

B. Where do Shareholders' Rights Fit In?

Legal protections exist for shareholders, and for good reason. These protections include the right to vote and sell shares, giving shareholders a voice in the company and an exit ramp if there are signs of trouble.[54] However, many scholars see the benefit of leaving the maintenance of a company to those actually running the company: "The business and affairs of every corporation . . . [should] be managed by or under the direction of the board of directors;[55] shareholder rights can and should be limited accordingly."[56] Even though the law often does a poor job of securing these narrow rights, shareholder rights "remain an important component of corporate governance."[57] But these narrow shareholder rights should not prevent companies from realizing their full potential.

First and foremost, a corporation's main goals are to make and sell things, provide services to customers, and in the process, employ people. All these goals to meet the ends of wealth creation, economic growth, and social welfare.[58] This applies to both private and public corporations.[59] Professor Lawrence Mitchell noted that the idea that share prices should drive the thought process of industry mutates the purpose of the industry it really serves.[60] Accordingly, shareholders should not have any rights beyond "receiving information about the corporations in which they invest and selling their shares."[61] However, the public shareholder often has a robust quiver of rights: voting to elect directors, approving certain fundamental decisions (*e.g.* amending the corporate charter), conducting mergers and corporate asset sales of a large portion of a corporation's assets, adopting and amending by-laws, removing directors for cause, and obtaining access.[62] To this end, Mitchell points out that "both finance theory and the law presume that shareholders will diversify so as significantly to mitigate, if not eliminate, any such losses."[63] In other words, the shareholder must assume risk—the system demands it.

54. Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 607–09 (2007).

55. *Id.* at 608.

56. *Id.* at 608.

57. *Id.*

58. *See* LAWRENCE E. MITCHELL, THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY 8–9 (2008).

59. *Id.*

60. *See* Lawrence E. Mitchell, *The Legitimate Rights of Public Shareholders*, 66 WASH. & LEE L. REV. 1635, 1639–40 (2009).

61. *Id.*

62. *See* STEPHEN BAINBRIDGE, CORPORATION LAW AND ECONOMICS 442–44 (2002) (discussing a general overview of shareholder rights, though not state-specific).

63. Mitchell, *supra* note 60, at 1676; *see also* Joy v. North, 692 F.2d 880, 880–82 (2d Cir. 1982) ("[I]ndeed one famous justification for the director-protective business

While courts have recognized the importance of shareholder participation and their contribution to the long-term planning of the corporation's leadership,[64] shareholders must at some point bear most of the risk for their choice of investment. Shareholders have the right to information that would allow them to make a knowledgeable and informed decision, although quarterly financial information is not necessarily included. Though boards do not have free rein to discard their fiduciary duties,[65] the responsibility of the corporation ends with providing information. Additionally, legislatures have acknowledged a board's need to effectively guide a company, as seen in the "widespread adoption of what have come to be known as constituency statutes," which "generally authorize directors to take into consideration not only the interests of shareholders, but also the interests of other stakeholders."[66] Ultimately, even shareholders' drastic actions (replacing a board member) may not give them what they want—courts allowing board members to run a company as they see fit.[67]

Although there is a recognized need for shareholder rights and the associated benefits, there are also business structures in place that recognize the need for a more flexible shareholder construct.

II. CURRENT CORPORATION ALTERNATIVES: TECHNOLOGY NOW DEMANDS MORE

Most public corporations have "a one-share, one-vote structure, in which voting power is proportional to economic ownership."[68] This structure has the two-fold advantage of empowering individual shareholders to take an economic interest in the company, as well as promoting transparent leadership.[69] However, unique corporate structures are not a new idea. Industry has formulated different structures to meet changing corporate needs. Below is a brief examination of different structures currently in place, their pros

judgment rule is that shareholders do, or ought to, diversify and that if they fail to do so, they should receive no legal protection from even significant business mistakes.").

64. Trinity Wall St. v. Wal-Mart Stores, Inc., 792 F.3d 323, 355 (3d Cir. 2015) ("The rationale for excluding a shareholder proposal in a corporation's proxy materials for shareholder consideration that is 'vague and ambiguous' is twofold: (1) shareholders are entitled to know the breadth of the proposal on which they are asked to vote; and (2) the company must be able to comprehend what actions or measures the proposal requires of it.").

65. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985) (finding board attempts to block tender offers are subject to review for breach of fiduciary duty).

66. Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 462 (2006).

67. Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1291 (Del. 1998).

68. Henry T. C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011, 1011 (2006).

69. *Id.*

and cons, and ultimately how these do not reach the goal of fully unleashing a tech CEO to innovate.

A. *Staggered Boards*

The mainstream structure of a company's board is either unitary (or annually elected) or staggered. Directors of unitary boards all stand for election at each annual shareholder meeting; members of staggered boards, by contrast, belong to separate classes whose terms are staggered.[70] Accordingly, "shareholders vote on only one class of directors (one-third of the board) each year, a change in control requires an insurgent group to win a majority of shareholder votes in at least two consecutive annual meetings."[71] This structure allows for board members to make unpopular decisions, such as investing in risky innovation or continuing down an innovative path that is yet to yield sizable returns, without the fear of shareholders revolting and demanding a change in new board membership.[72]

A staggered board protects directors and managers from control contests, or hostile takeovers that would distract from a focus on creating long-run shareholder value.[73] It also helps avoid inefficient short-termism.[74] Said best by a board member at Massachusetts-based transmission supplier Altra Holdings Inc., which elects its directors annually,

> If you have a gun to your head with annual elections, it's hard to do your job, which is to act in the best long-term interests of the company … [i]f you're a qualified independent director, you can enhance corporate governance if you're not forced to face re-election" annually.[75]

However, while this structure insulates a board from the short tempers of shareholders, it also presents the drawback of shielding

70. Robert Daines et al., *How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment* 6 (Harv. Bus. School, Working Paper No. 16-105, 2018), https://www.hbs.edu/faculty/Publication%20Files/13-068_f53b491e-9847-4ccb-8cb5-8e75808bc39f.pdf [https://perma.cc/M67L-EFL5]; *see also* Ryan Derousseau, *Why 'Staggered' Boards Are Paying Off for Stock Investors*, FORTUNE (April 30, 2019), https://fortune.com/2019/04/30/staggered-boards-stock-investors/ [https://perma.cc/62VH-XAMV].

71. Ryan Derousseau, *Why 'Staggered' Boards Are Paying Off for Stock Investors*, FORTUNE (April 30, 2019), https://fortune.com/2019/04/30/staggered-boards-stock-investors/ [https://perma.cc/62VH-XAMV].

72. *Id.* (speculating that staggered boards "make it easier for good managers to innovate, free of outside pressure . . . businesses that spend heavily on R&D tend to perform better under alternating-election boards.").

73. *Id.*

74. *Id.*

75. Becky Yerak, *Staggered Boards: Public Companies' Directors the Centerpiece of a Tug of War*, CHICAGO TRIBUNE (Apr. 4, 2012), https://www.chicagotribune.com/business/ct-xpm-2012-04-04-ct-biz-0401-bf-staggered-boards-20120401-story.html [https://perma.cc/E9WE-5W23].

the board members from "the beneficial disciplinary forces of shareholder control—leading to such agency problems as shirking and empire building."[76] Looking at the numbers, the number of companies with staggered boards is declining. According to the 2018 Board Practices Study published by Institutional Shareholder Services, approximately 65 percent of S&P 1500 companies and 87 percent of S&P 500 companies now hold annual elections for all directors.[77] The corporate malfeasance and subsequent demise of companies like Enron and Worldcom have propelled the trend.[78] However, while highly publicized cases (such as Enron and Worldcom) degrade trust in irregular corporate structures, shareholders may benefit from a staggered board.

Air Prod. & Chemicals, Inc. v. Airgas, Inc. is an example of how a staggered board can not only protect board members, but also benefit shareholders.[79] Air Products and Chemicals, Inc. (Air Products) attempted a hostile takeover of Airgas, Inc. (Air Gas). Air Gas had both a poison pill—which is a corporate strategy to defend against hostile takeovers—and a staggered board of nine directors. Three directors were up for reelection each year.[80] Approached with a takeover bid, Air Gas directors agreed that the offer from Air Products was inadequate.[81] Rebuffed on their initial bid, Air Products made subsequent bids of increased value.[82] Finally, Air Products brought suit in the Delaware Court of Chancery, arguing that Air Gas's defensive mechanisms—specifically the staggered board's refusal to redeem the poison pill—were illegal.[83] Focusing here on the court's analysis of a staggered board's ability to protect itself, "cognizable threats" were recognized as reasons for a board to enact a poison pill.[84] The board relied on good-faith advice from independent evaluators, and there was sufficient evidence that a majority of Air Gas's shareholders might be willing to tender their shares regardless of whether price was adequate or not, thereby ceding

76. *Id.*

77. *Boardroom Refreshment: A Review of Trends at U.S. Firms U.S. Board Study*, ISS (2018), https://www.issgovernance.com/library/boardroom-refreshment-review-trends-u-s-firms/ [https://perma.cc/547M-FADX].

78. Ryan Derousseau, *Why 'Staggered' Boards Are Paying Off for Stock Investors*, FORTUNE (April 30, 2019), https://fortune.com/2019/04/30/staggered-boards-stock-investors/ [https://perma.cc/62VH-XAMV].

79. *See generally* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 129 (Del. Ch. 2011) (while acknowledging shareholder concerns, the court recognized the "long-understood respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties").

80. *Id.* ("Poison pill" specifically meant the market would have been flooded with cheap additional shares).

81. *Id.*, at 64–65.

82. *Id.*, at 66, 73, 76, and 86.

83. *Id.* at 55–57.

84. *Id.* at 47.

control of target to the offeror corporation.[85] In essence, the board's actions potentially saved the company from its shareholders making hasty and financially unsound decisions.

While the court's decision seems to be a referendum on the support of staggered boards, the benefits passed on to the shareholders are also clear. Even if shareholders had wanted to agree to the initial takeover offer from Air Products, they ultimately would have benefitted from the increasing offers. What was seen by Air Products as intransigence by Air Gas's board (and it might have been), ultimately could have produced an increased financial windfall for shareholders. The construct of the staggered board also allowed for increased dissemination of information to the shareholders. By saying "no," Air Gas investors saw doubled share prices in the four years following the decision.[86]

Staggered boards have the potential to be resting places for ineffective directors, more worried about their job security than long term goals, but they can also benefit the shareholder. The experience a long serving board member may provide can hardly be replaced (e.g. knowing when a bid undervalues the company). However, staggered boards are not alone in corporate structures meant to protect board members.

B. *Quinquennial Elections*

In quinquennial election structures, board elections are held every five years with no shareholder transparency in the meantime. This system aims at getting firm management and shareholders to communicate on a more beneficial level than the purely adversarial one that the current system favors.[87] Even here, it is a mistake to assume that the corporate structure should be limited to only execute shareholder wishes.

Shareholders are predominately seen as property owners, ultimately owning the corporation they own stock in, and able to do as they please with their property.[88] Property law has governed how courts see the rights of shareholders, but this idea is flawed.[89] In a widely circulated article from Martin Lipton and Steven Rosenblum, they note that ownership of shares in a company are not the same as owning a plot of land or other real property, rather it is a

85. *Id.* at 37–40.
86. Antoine Gara, *Up in the Air: How Airgas More Than Doubled by Fighting a Takeover*, FORBES (Nov. 27, 2015), https://www.forbes.com/sites/antoinegara/2015/11/17/up-in-the-air-how-airgas-more-than-doubled-by-fighting-a-takeover/#5d962ece5114 [https://perma.cc/2PKN-VFM4].
87. Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 236–37 (1991).
88. *Id.* at 191–92.
89. *Id.*

functioning piece of the US economy.[90] Therefore, courts should not place so much emphasis on the rights of the shareholder when the corporation is doing the heavy lifting (i.e. innovation, expansion, talent, etc.).[91] Essentially, the managerial-discipline model of corporate governance (a standard board) is set up to place stockholder wishes and profits above the overall innovative success of a company.[92] This model encourages "short term obsessions" by shareholders that tend to derail a company's ability to effectively compete and innovate in a competitive market.[93]

As mentioned above, quinquennial elections systems ideally elicit more productive relationships between shareholders and board members, though this is also a main detractor. For this system to work, there must be a substantial amount of trust between the parties—something that is theoretical in nature, at best. The notion that shareholders and corporate management will get along simply for the sake of advancing the good-natured principles of the corporation seems unrealistic. Shareholders often invest in a corporation because they expect to see a reasonable return on investment; it's a plus if the corporation is good-natured and altruistic. This is a system that really favors no one, forcing all sides make concessions. The quinquennial system, as described by Lipton and Rosenblum, would allow control of a "corporation to its managers for sufficiently long periods of time to allow them to make the decisions necessary for the long-term health of their corporation."[94] Simultaneously, it would also "force managers to develop and justify their long-term plans for the corporation."[95] A theoretical win-win scenario for corporations and shareholders.

Most damaging, Lipton and Rosenblum note, is that when corporations focus on short-term goals in response to the fickle nature of the market, it comes at "the expense of the long-term planning, investment and business development of the corporation. When managers seek to boost the short-term earnings and stock price, the easiest expenditures to forego are investments in the future."[96] While quinquennial elections may serve as a defense against short-termism, "[t]o the extent these defenses are removed without taking steps to reorient the stockholders' perspective to the long term, the ill effects of the current short-term bias will be exacerbated."[97] In short, even if the threat of hostile takeovers is removed, it will

90. *Id.*
91. *Id.*
92. *Id.* at 191–92.
93. *Id.* at 253.
94. *Id.* at 224. (referencing Warren Buffet's model for investment as "patient capital," investment with the long-term goals at the forefront).
95. *Id.*
96. *Id.* at 210.
97. *Id.* at 213.

still take serious effort to break corporations of their fears that lead to short-term thinking.

The quinquennial elections system could serve as a defense against short-termism, but it does not solve the problem of uninformed and risk-adverse shareholders. If given full access to a corporation's financial records, even though board members are not up for re-election annually, this information could still stir up panic amongst current and potential shareholders. This would likely defeat the intended long-term thinking of a quinquennial elections system. But not all shareholders are exclusively profit-focused, allowing some corporate models to succeed based on substantive impact versus profit return.

C. *Benefit Corporations*

The Delaware General Corporation Law (DGCL) was amended on August 1, 2013 to create a new form of entity known as the public benefit corporation (PBC) by adding a new subchapter XV (the PBC statutes) (DGCL §§ 361 to 368). A PBC (benefit corporation "B Corp") is similar to a traditional corporation but has more requirements.[98] B corps "provide a significant new opportunity for investors" … with the possibility to "make more profits than any other types of companies," says Robert Shiller, Sterling Professor of Economics at Yale University.[99]

Certified B corps and benefit corporations are often confused. Companies that pursue either denomination make a commitment to consider the impact of their actions on stakeholders in addition to shareholders, and they must publicly disclose social and environmental metrics. The difference lies in the legally binding nature of their commitment. Over 200 companies are both certified as B corporations and incorporated as benefit corporations, but there are many companies with just one status. Ideally, benefit corporations aim to "liberate businesses from the market demands of Wall Street and the legal demands of shareholder plaintiffs seeking to hold management accountable for decisions that fail to put shareholder interests first."[100]

An example of a technology benefit corporation is Rightmesh, a Canadian firm dedicated to bringing internet connectivity to remote corners of the world.[101] Rightmesh uses existing technologies,

98. *See* Frederick H. Alexander et al., *Public Benefit Corporations (DE)*, THOMSON REUTERS PRAC. L., https://tmsnrt.rs/324TDRE [https://perma.cc/VK58-A7E2].

99. ALEX BUERKLE, KYLEE CHANG & MAX SORTO, THE YALE CENTER FOR BUS. AND THE ENV'T, JUST GOOD BUSINESS: AN INVESTOR'S GUIDE TO B CORPS 7 (2018).

100. Kent Greenfield, *A Skeptic's View of Benefit Corporations*, 1 EMORY CORP. GOVERNANCE AND ACCOUNTABILITY REV. 1, 18 (2014).

101. *See* *Mission*, RIGHTMESH, https://www.rightmesh.io/about/mission [https://perma.cc/F9WX-DBLJ].

including blockchain, to increase connectivity in remote areas. Their solutions are software based and largely humanitarian in nature. For Rightmesh, a benefit corporation structure works. Investors are looking for humanitarian benefits, not financial ones. There will be no angry shareholders if Rightmesh fails to meet profit goals; they have the luxury of failing and still completing their mission of making the effort. Additionally, there is a "benefit report" requirement with benefit corporations that would tend to dismay investors if they did not see the expected level of environmental or socially conscious behavior that they would like to see, affecting the bottom line. So, if a benefit corporation is looking to go farther afield for funding, it is limited to those investors willing to take losses to achieve humanitarian goals.

Essentially, tech companies need more flexibility than a benefit corporation structure provides. Kent Greenfield, a professor at Boston College Law School, notes that a major disadvantage to benefit corporations is that the designation does little to protect the corporation from market pressures (*e.g.*, short-termism).[102] Companies that choose to become benefit corporations will likely see lower returns compared to those corporations who retain traditional status, making them a higher risk for potential investors.[103] While it would be ideal for benefit corporations to pair themselves with investors that understand and support their objectives, it is inevitable that more lucrative, and traditional, corporations would steal the show. While Greenfield suggests that an alternative would be to "level the playing field" and "mandate [benefit corporation obligations to] all corporations,"[104] this would be akin to going after a fly with a sledgehammer.

Innovative and first-mover technology companies need flexibility for funding in large part because of their nature. Nascent or untested technology cannot always afford to wait for an altruistic investor, and must seek capital where it can (at least in the beginning stages of corporate life). For these reasons, benefit corporations will likely see little future with mainstream technology corporations.[105] Instead, CEOs seeking capital may look to woo investors by guaranteeing increased voting rights despite minority holdings.

102. *See* Greenfield, *supra* note 100, at 19.

103. *Id.*

104. *Id.*

105. A 2019 report from Edelman, a public relations firm focused on investor metrics, however, does note that a substantial amount of investors think that "maximizing shareholder returns can no longer be the primary goal of the corporation," and that environmental, social and governance "initiatives lead to a favorable impact on company growth." *An Overwhelming Majority of Investors Expect Companies to Implement Effective Environmental, Social-Impact and Governance (ESG) Practices*, EDELMAN (Dec. 3, 2019), https://www.edelman.com/news-awards/2019-institutional-investor-trust.

D. Disproportionate Votes.

Built-in defenses that appear to protect board members, absent substantial returns for shareholders, are likely not a viable solution for technology companies looking to maintain innovation in the face of shareholder demands. Disproportionate votes, or multi-class voting structure, is where CEOs, or even a minority shareholder, can retain more voting power than other shareholders, ensuring control of the company.[106] The number of public companies employing multi-class voting structures has increased since 1980.[107] "Between 2005 and 2015, the number of companies with multi-class stock structures increased by 44%."[108] The list of public companies with dual-class structures with disparate voting rights includes Google, Facebook, Snap, LinkedIn, and many others.[109]

In a working paper, the SEC effectively analyzes disproportionate voting structures, especially when describing the risks to shareholders.[110] Unique to disproportionate voting structures are the different classes of shareholders.[111] This uniqueness carries unique risks, as described in the SEC report:[112]

> (1) The inability or greater difficulty of influencing management, (2) the increased risk of divergent views over strategy or business combinations, (3) increased risk of conflict or litigation caused by such divergent views, (4) risks that those who hold relatively small ownership interests can use voting control to approve further changes in governance to the detriment of non-

106. These arrangements are also known as "dual-class" shares. *See* Rick A. Fleming, *Dual-Class Shares*: *A Recipe for Disaster*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 17, 2019), https://corpgov.law.harvard.edu/2019/10/17/dual-class-shares-a-recipe-for-disaster [https://perma.cc/5WPD-FCZ5].

107. SEC. & EXCH. COMM'N, RECOMMENDATION OF THE INVESTOR ADVISORY COMMITTEE: ON DUAL CLASS AND OTHER ENTRENCHING GOVERNANCE STRUCTURES IN PUBLIC COMPANIES, 1 (2012) (available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-on-dual-class-shares.pdf) [hereinafter RECOMMENDATION OF THE INVESTOR ADVISORY COMMITTEE].

108. *Id.*

109. *Id.* Other recent examples include Spotify, Lyft, and Pinterest—where founder-CEOs have super-voting shares. *See* Lucas Shaw, *Spotify's Founders Aren't Giving Up Control Any Time Soon*, BLOOMBERG (Feb. 20, 2018, 8:22 PM), https://www.bloomberg.com/news/articles/2018-02-21/spotify-s-founders-aren-t-giving-up-control-any-time-soon [https://perma.cc/NR2U-65G9]; Lucian Bebchuk & Kobi Kastiel, *The Perils of Lyft's Dual-Class Structure*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 3, 2019), https://corpgov.law.harvard.edu/2019/04/03/the-perils-of-lyfts-dual-class-structure [https://perma.cc/4ZZS-S775]; Lucian Bebchuk & Kobi Kastiel, *The Perils of Pinterest's Dual-Class Structure*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 10, 2019), https://corpgov.law.harvard.edu/2019/04/10/the-perils-of-pinterests-dual-class-structure [https://perma.cc/Y4JU-B4MR].

110. RECOMMENDATION OF INVESTOR ADVISORY COMMITTEE, *supra* note 107, at 2–5.

111. *Id.*

112. *Id.*

> controlling investors, which can result in delistings under major stock exchange listing requirements, resulting in reduced liquidity and loss of value for investors, and (5) risks that major classes of investors will not be available to purchase shares in the secondary market, either because of policies adopted by specific investors or because shares are excluded from major indices.[113]

Surprisingly, where you would expect to see relief from CEOs enjoying a controlling share, there have been reported drawbacks. As an example, Snap, Inc. disclosed to the SEC that one result of the disproportionate voting stockholders' inability to influence major decisions often meant an adverse effect on stock prices.[114] Additionally, Snap acknowledged that lack of shareholder input could possibly result in a delay, deferment, or prevention of changes to the company that were supported by a majority of shareholders and meant to save the company from ill-advised leadership decisions from a single party.[115]

Moreover, markets seem to be fighting back against this system of corporate governance. In 2017, S&P Dow Jones Indices announced that it would "no longer add companies with multiple share class structures" to the S&P 500, an index "designed to reflect the U.S. equity market and, through the market, the U.S. economy."[116]

These concerns bring up a "fairness factor" question: is it fair for a CEO to retain a less than 51 percent share in stocks, but still retain a monopoly on decision making? When it comes to innovative tech companies, the answer just might be "yes." It is conceivable that a tech CEO needing capital sold a majority stake in the company, but the CEO remained the driving force behind the innovation. It makes sense the CEO should be able to retain control despite not being a majority shareholder. If the other shareholders invested in the company because of the prior innovation, then continued CEO autonomy should be less of an issue. However, if shareholders are investing and gaining a majority share hold for other reasons, *e.g.*, takeover or removing a potential competitor from the market, then a disproportionate voting system would seem like a reasonable defense. However, the optics of having a controlling voice in the company, but not being a majority shareholder, could

113. *Id.* at 3.
114. *Id.*
115. *Id.*
116. S&P Dow Jones Indices, *S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules*, PR NEWSWIRE (July 31, 2017, 6:46 PM), https://www.prnewswire.com/news-releases/sp-dow-jones-indices-announces-decision-on-multi-class-shares-and-voting-rules-300496954.html [https://perma.cc/Z853-PDWS].

spell trouble for the innovative CEO in media relations and prospects for future investment.

III. NOT ALL CEOS ARE CREATED EQUAL

Not all CEOs are created equal, and there is certainly a possibility of negligent corporate behavior in any instance where there is reduced shareholder oversight. Elon Musk asked to have shareholders who would only be able to trade or sell stock on a limited basis, and who would not have the financial transparency of quarterly reports. Additionally, it is unclear as to what sort of a business scheme Tesla would have had moving forward, or how Musk would have balanced his responsibilities to shareholders, or if he would have been willing to allow them any protection. However, Musk is a 'good' example of a CEO trying to be innovative, not trying to fleece shareholders. But this is not the case for many potential "I" corporation CEOs.

The prospect of easy money often invites unscrupulous corporate managers. In chasing easy money, many CEOs have neglected their role as the chief ethics officer of the corporation, which leads to failing corporate climates and bad decisions for shareholders.[117] This is especially important in technology companies where shareholders are in all likelihood not savvy enough to understand nuances about the product, and therefore more susceptible to manipulation by a CEO. As a prophylactic against manipulation, some argue having legal mechanisms in place encourages investment by minority shareholders (who you would think of as the lay shareholder) and bolsters public trust.[118]

The onus of operating ethically ultimately falls on CEOs. This ethical behavior often includes doing right by the shareholder. Senior leadership is important because it influences the scope, orientation, and integration of formal ethics and compliance programs—something that would be necessary in order for any sort of "I" corporation to succeed. However, the ethics responsibility of a CEO also focuses on behavior affecting the internal components of the company—an important component of building a company that gains the trust shareholders. This is even more important for an "I" corporation, where financial transparency would be minimal. Investors that have braced themselves for an uncertain ride with a

117. *See* Linda K. Trevino, *Out of Touch: The CEO's Role in Corporate Misbehavior*, 70 BROOK. L. REV. 1195, 1197 (2005).

118. *See* Mauro Guillen, *The Value of Protecting Minority Shareholders in the Market*, KNOWLEDGE@WHARTON (Oct. 8, 2015), https://knowledge.wharton.upenn.edu/article/the-value-of-protecting-minority-shareholders-in-the-market/ [https://perma.cc/3QKF-YZ9U].

tech innovator may be less willing to get on board if there is evidence of corporate shenanigans or malfeasance.

Departing momentarily from the view of Musk as a 'good' example of a CEO wanting to innovate and not fleece shareholders, his tactic of tweeting a potential privatization of Tesla raised eyebrows in the legal world. The SEC did not see Musk's tweet of "funding secured" as an altruistic message to employees, but rather said that it was an illegal and reckless statement about the company.[119] In a complaint filed by the SEC, it was alleged that "Musk's false and misleading public statements and omissions caused significant confusion and disruption in the market for Tesla's stock and resulting harm to investors," amongst other harms.[120] In a subsequent deal, Musk agreed to step aside as Tesla chairman for three years and pay a $20 million fine.[121]

So, it is evident the SEC saw Musk's tweet as reckless and possibly a ploy to raise stock prices. However, the fines levied on Musk do seem strictly cautionary and inconsequential when seen proportionately considering Musk's assets; an attempt by the SEC to move past the whole episode. However, the email he sent to employees has a genuine quality; he seems to legitimately want to see the employees grow along with Tesla. However, as many news sources cite, Musk's announcement of funding secured was obviously premature and reckless. Although Musk presented the SEC with a novel scenario, there have been similar circumstances.

In 2013 the SEC issued a report, involving Netflix founder Reed Hastings, noting that companies can announce important news via social media as long as they have previously told investors they might do so, and simultaneously announce that news to the broader public.[122] This was in response to perceived confusion about the application of Regulation Fair Disclosure (Regulation FD) to

119. *See* James B. Stewart, *Did Elon Musk Violate Securities Laws with Tweet About Taking Tesla Private?*, N.Y. TIMES (Aug. 8, 2018), https://www.nytimes.com/2018/08/08/business/elon-musk-tesla-sec.html [https://perma.cc/5NBG-LECK]; Mark H. Anderson & Dave Michaels, *Federal Judge Approves Elon Musk, Tesla Settlements with SEC*, WALL STREET J. (Oct. 16, 2018), https://www.wsj.com/articles/federal-judge-approves-elon-musk-tesla-settlements-with-sec-1539699262 [https://perma.cc/PXN5-J8K5].

120. Complaint at 1–2, U.S. *Sec. & Exch. Comm'n v. Musk*, No. 1:18-cv-8865 (S.D.N.Y. Sep. 27, 2018) (citing Section 10(b) of the Exchange Act, [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder, [17 C.F.R. § 240.10b-5] as relevant law).

121. Matthew Goldstein, *Elon Musk Steps Down as Chairman in Deal with S.E.C. Over Tweet About Tesla*, N.Y. TIMES (Sept. 29, 2018), https://www.nytimes.com/2018/09/29/business/tesla-musk-sec-settlement.html [https://perma.cc/T8L5-MQUS].

122. Press Release, Sec. & Exch. Comm'n, SEC Says Social Media OK for Company Announcements if Investors Are Alerted (April 2, 2013), https://www.sec.gov/news/press-release/2013-2013-51htm [https://perma.cc/KTZ3-6W33].

social media.[123] The SEC generated the report in response to a post by Netflix CEO Reed Hastings on his personal Facebook page "stating that Netflix's monthly online viewing had exceeded one billion hours for the first time."[124] This information was not disclosed to the public at large, despite its potentially substantial effect on share prices.[125] Additionally, Hastings had not previously used his social media to communicate company metrics.[126] As shown above, Musk has regularly used his social media to communicate internally within his businesses and externally to the general public.

Fundamentally, not all companies are created equal, but what if Musk can deliver better technology when freed up to make risky choices (even if appearing erratic)? Should it be legal for a CEO like Musk to make moves impacting the company without transparency, even if they are likely to be successful? And, arguably, Musk uses social media to communicate on *all* fronts, not just potential business propositions. He might be talking about a "stainless steel starship"[127] or calling a detractor a "sanctimonious idiot,"[128] but he seems transparent on social media; for better or worse. So, for savvy investors, if you know the risk of investing with someone like Musk, the next logical step is to allow him to operate in his own way.

IV. "I" CORP

An "I" corporation would integrate components of the above corporate structures (staggered, quinquennial elections, benefit corporations, and disproportionate voting), with a noted exception: acknowledged shareholder risk. Current corporate structures operate with shareholders who expect transparency, who think of the stock they own as a "property" stake in the company. An "I" corporation would not follow that paradigm. Reduced regulation would sever the requirement for financial statements to shareholders, resulting in an environment that would allow innovators the room to fail in the experimentation process without their stock prices failing as well. Inevitable bad-apple CEOs require legal backstops for shareholders. But, as mentioned in the introduction, expect to see many "I" corporations fail. The risk would be high for both shareholders and corporate management.

123. *Id.* (Regulation Fair Disclosure (Reg FD) is a rule passed by the Securities and Exchange Commission in an effort to prevent selective disclosure by public companies to market professionals and certain shareholders).
124. *Id.*
125. *Id.*
126. *Id.*
127. Elon Musk (@elonmusk), TWITTER (Dec. 23, 2018, 11:39 PM), https://twitter.com/elonmusk/status/1077106553189093376 [https://perma.cc/G4YL-RKZT].
128. Elon Musk (@elonmusk), TWITTER (Dec. 14, 2017, 10:13 PM), https://twitter.com/elonmusk/status/941551760799277056 [https://perma.cc/57RU-5PPP].

A. *Reduced Regulation is a Good Thing*

The current corporate structures contain financial disclosure policies meant to protect shareholders and keep CEOs and leadership honest. However, an "I" corporation would be left to its own devices: no financial disclosure to shareholders except for what corporate management feels is necessary to inform the shareholders about long-term goals and accomplishments. Also, "I" corporations would have no restrictions on when shareholders may sell their shares as a check the shareholders would have on the corporation. Although an "I" corporation construct may seem too relaxed (and risky) at first glance, it would be self-regulating and ultimately would benefit all parties.

As a primer on current corporate regulation, the primary federal securities laws are the Securities Act of 1933[129] and the Securities Act of 1934.[130, 131] The '33 Act is largely aimed at requiring that "investors receive financial and other significant information concerning securities being offered for public sale; and prohibit[ing] deceit, misrepresentations, and other fraud in the sale of securities."[132] The '34 Act created the Securities and Exchange Commission (SEC) and gave it "broad authority over all aspects of the securities industry," specifically corporate reporting and tender offers.[133] Although no express cause of action for private securities fraud exists, courts have interpreted the '33 and '34 acts to allow private citizens to sue for damages on the basis of an implied private cause of action.[134] Additionally, multiple states have recognized causes of action for securities fraud under state common law theories.[135]

129. Securities Act of 1933, 15 U.S.C. § 77a (2018) [hereinafter "'33 Act"].

130. Securities Act of 1934, 15 U.S.C. § 78a (2018) [hereinafter "'34 Act"].

131. State law also governs the sale or exchange of securities, but state law largely mirrors federal securities law.

132. U.S. SEC. & EXCH. COMM'N, THE LAWS THAT GOVERN THE SECURITIES INDUSTRY, https://www.sec.gov/answers/about-lawsshtml.html#secact1933 [https://perma.cc/Q5Z2-EWFM].

133. *Id.*

134. *See, e.g.*, Dura Pharm., Inc. v. Broudo*,* 544 U.S. 336, 341 (2005) (noting that "private federal securities fraud actions are based upon federal securities statutes and their implementing regulations" which include SEC rules that allow for a cause of action by shareholders against the corporation or its agents for failure to make disclosures, omissions, or material inaccuracy in a disclosure).

135. Common law theories generally fall under the category of either fraud or negligent misrepresentation. *See* Joshua D. Ratner, *Stockholders' Holding Claim Class Actions Under State Law After the Uniform Standards Act of 1998*, 68 U. CHI. L. REV. 1035, 1036 (2001). Additionally, state courts have recognized a cause of action for securities fraud under the theory of induced forbearance. *See, e.g.*, Greenfield v. Fritz Co., 98 Cal. Rptr. 2d 530, 540 (Cal. 1st Dist. Ct. App. 2000), rev'd on other grounds sub nom.: Small v. Fritz Co., 65 P.3d 1255 (Cal. 2003) (recognizing that while precedent is scant, there is a "sound basis" for state courts to use forbearance as the basis for tort liability, noting that New York, Massachusetts, New Jersey, New Hampshire, and Wisconsin follow similar doctrine).

While a CEO may take shareholders for a ride in the short term—painting a rosier than necessary picture to attract more investors—shareholders may ultimately decide how far they want to go. Financial markets have always been a haven for get-rich-quick schemes or investors lured by dreams of finding the next Apple or Microsoft. But it has also been the domain of savvy investors who do their homework, who look before they leap. These are the investors who could really benefit from an "I" corporations. An investor will need to do more than look at a balance sheet to see the future of an "I" corp. Investors might rely on gut feelings about a CEO, or on their intuition regarding the viability of the proposed technology's future. Investors are forced to ask these questions when looking to invest in an "I" corporation. The structure itself rewards diligent and informed investors and promotes responsible investing, while also providing the "I" corporation room to maneuver and innovate.

B. *Innovation Needs Breathing Room*

Innovators with freedom to innovate—instead of living from one quarter to the next, worrying about shareholder short-termism—create a fundamentally better society. Making a profit in the short-term means nothing if you become irrelevant in the long-term. By retaining the independence of a private corporation, an "I" corporation reserves the ability to innovate with long-term goals in mind.

Dyson, a privately-owned global technology firm, is an example of how attention to innovation over short-term profits can succeed. In an NPR interview, James Dyson (founder, owner, and CEO of Dyson) explained how it took him over five years to design a new type of bag-less vacuum, and how the industry laughed at him and banks refused to finance him.[136] As a technology leader, Dyson continually places innovation in front of profits, which in his case, has brought a financial windfall for the company.[137] But the success has not come free. There have been failures.[138] But unlike at publicly listed companies, where "such a failure might have cost people their jobs . . . at Dyson, where 14.5 percent of annual revenue is earmarked for research and development, engineers [take mistakes] in stride."

As noted earlier, not all CEOs are created equal, and not every "I" corporation has an Elon Musk or James Dyson at the helm.

136. *How I Built This with Guy Raz: Dyson: James Dyson*, *supra* note 15.
137. *See* Mark Scott, *Dyson is the Apple of Appliances (and Just as Secretive)*, N.Y. TIMES (Apr. 2, 2017), https://www.nytimes.com/2017/04/02/technology/dyson-british-consumer-electronics-company.html [https://perma.cc/47MK-LRLY].
138. *See How I Built This with Guy Raz: Dyson: James Dyson*, *supra* note 15.

However, with the innovation and risk-friendlier status of an "I" corporation, there just might be even more Musks or Dysons to the benefit of technology, innovation, and society.

C. Legal Backstops in Moderation to Protect Against Extremes

Civil liability in an "I" corporation would necessarily need to look different than current structures. In large part, the significant risk that shareholders would be taking in an "I" corporation would likely serve as a deterrent to any investor that would be looking to litigation to recoup lost investments. However, there would need to be some mechanism to control corrupt or criminal CEOs. A possible structure would be putting a stopwatch on any legal claims. An "I" corporation looking for shareholders could use the following timeline: the corporation exists for three years, after which time, if shareholders suspect malfeasance on the CEO's part, they would agree to a neutral party investigating their practices and suggesting possible legal action or arbitration (or no action at all). Or there is a possibility that a corporation would not want to make any sort of arrangement, and accordingly, investors would most likely adjust their attitudes. Ultimately, as mentioned above,[139] state courts are always at the disposal of an aggrieved shareholder.

The above suggestions aim to avoid lawsuits for breach of duties of loyalty, good faith, and candor, stemming from a lack of disclosure of financial metrics. Examples of these are lawsuits previously filed against Beazer, Cincinnati Bell, Citigroup, DexOne, Occidental Petroleum, and others, by shareholders who were not satisfied with the levels of disclosure and associated leadership compensation—shareholders felt the directors were getting paid too much compared to the gains passed on to shareholders.[140] While shareholder lawsuits against a company are an important mechanism in corporate governance (if there is legitimate legal wrongdoing), they can also be an unnecessary nuisance and a symptom of overregulation.[141] "The threat of lawsuit provides strict incentive to directors to fulfill their fiduciary duty . . . [but frivolous lawsuits] impose an unnecessary cost on the corporation and its shareholders because they must be defended without any corresponding improvement in governance quality."[142] And big business is fighting back. Recently, the New York Stock Exchange, Nasdaq and Cboe sued the SEC over what they perceive to be over-regulation—a move that

139. *Infra* § IV(A).
140. *See* David F. Larcker & Brian Tayan, *Shareholder Lawsuits: Where is the Line Between Legitimate and Frivolous?*, STAN. CLOSER LOOK SERIES 1 (2012), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-29-shareholder-lawsuits.pdf [https://perma.cc/4AUB-GXNC].
141. *Id.* at 2.
142. *Id.*

shows just how far big business is willing to go to fight regulations that could dent profits or curtail flexibility.[143]

In short, lawsuits stemming from uninformed and nervous shareholders often serve as hindrances to effective business management—this would certainly be so for an "I" corporation. While there should be legal backstops in play to catch and punish illegal behavior from leadership, shareholders in an "I" corporation would not have the option of disrupting business operations because of a perceived slight. Their options would be to sell their shares or continue with their investment.

D. Over-Regulation is not an Answer to Shareholder Concerns Regarding Risk

There is always going to be a risk of bad elements in a corporation—possibly the CEO—but the remedy need not be strangulation by un-needed regulation. Regulation could over-correct if bad actors get to take advantage of the "private-lite" system.[144] Reduced regulation for a proposed "I" corporation would not mean the end of federal securities regulations; just a "side door" for "I" corporations.

The main risk concerning "I" corporations is moral hazard. "I" corporation CEOs could possibly be at the controls of a company with shareholder (and private) investment, with no responsibility to them if something goes sideways.[145] As stated previously, there is incentive for CEOs to take advantage of shareholders when transparency is reduced or even discarded; is there a legal means of policing moral hazard if there are no transparency regulations?

In a working paper, Alexander William Salter, et al., at Texas Tech University examines moral hazard and a potential fix when it comes to excessive risks taken by banks with insured deposits.[146] Salter sees the current deposit insurance regime as an encouragement to banks to invest money using more risk since they know insurance will bail them out with depositors if they make unwise

143. *See* Courtenay Brown, *3 Stock Exchanges Take on the SEC*, AXIOS (Feb. 21, 2019), https://www.axios.com/stock-exchanges-take-on-sec-58a9e155-a8d0-44bd-a726-d1fef960b8dd.html [https://perma.cc/LM2J-4484].

144. *See generally* DAVID LUBAN, MAKING SENSE OF MORAL MELTDOWNS, LAWYER'S ETHICS AND THE PURSUIT OF SOCIAL JUSTICE: A CRITICAL READER 358 (Susan D. Carle, ed).

145. *See* Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV 237, 238 (1996), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1870&context=faculty_scholarship [https://perma.cc/QV3J-SDB7] (noting what moral hazard "means is that, if you cushion the consequences of bad behavior, then you encourage that bad behavior. The lesson of moral hazard is that less is more.") (citing James K. Glassman, *Drop Budget Fight, Shift to Welfare*, ST. LOUIS POST-DISPATCH at B3 (Feb. 11, 1996)).

146. *See* Alexander W. Salter et al., *Extended Shareholder Liability as a Means to Constrain Moral Hazard in Insured Banks*, Q. REV. OF ECON. & FIN. (2017).

investments.[147] His solution seeks "to reduce banks' incentives to take excessive risks by at least partially neutralizing current safety-net subsidies to risk-taking."[148] The removal of the safety nets (depositor insurance) would mean that equity holders would bear the direct risk of a bank's investments, thereby "shifting risk from guarantee agencies to depositors and giving them an incentive to monitor and reward safe banking."[149]

While Salter focuses on banking, his idea can be adapted to an "I" corporation. With reduced avenues for shareholders to litigate, this leaves shareholders with few remedies if they do not realize a profit from an "I" corp. In turn, this would mean the "I" corporation would be more aware that the risks it is taking could result in shareholder abandonment, therefore acting as an incentive for the corporation to make wise decisions. Admittedly, there will not be a silver bullet that would completely mitigate risk for an "I" corporation investor.[150] Innovation needs room to experiment, and that means sometimes failing. Investors must be willing to share in this failure.

CONCLUSION

Shareholders have a complicated relationship with innovators: innovations and their progenitors are great, so long as they are controllable and don't mess with the bottom line. Stock market fluctuations and shareholder reticence reflect this problematic relationship. The passage of the '33 and '34 acts were supposed to level the playing field of the public stock market. But as Judge Rakoff of the U.S. District Court for the Southern District of New York recently ruled, "[a]nyone who thinks that the stock market is a level playing field obviously has no contact with reality."[151] Admittedly, there are bad actors in business—there always have been and always will. And while a new "I" corporation structure would require initial formation of new regulation, the goal would be to form a vehicle for risk-taking CEOs to connect with like-minded potential shareholders that would actually roll back financial regulations which require financial transparency to shareholders. The easing of regulations would allow for tech companies like Tesla to go "private-lite,"

147. *Id.* at 2. ("Congress passed the Federal Deposit Insurance Corporation Improvement Act (FDICIA) in 1991 to try to mitigate the moral hazard problem by restricting forbearance and implicit subsidies for undercapitalized banks.").

148. *Id.* at 3.

149. *Id.*

150. Admittedly, increased risk is the point. Technology innovators being able to take more risk should result in better outcomes for society as well as shareholders.

151. Pete Brush, *Rakoff Tells Gov't to Dump 'Level Playing Field' Language*, LAW 360 (Apr. 16, 2019, 10:53 AM), https://www.law360.com/articles/1150320/rakoff-tells-gov-t-to-dump-level-playing-field-language [https://perma.cc/75VQ-ED6G].

and would help return tech companies to the fast and nimble start-ups that were so successful to begin with.

Tech innovators like Musk, doing what Musk does, at his pace and level, equals better technology and more innovative thinking—a net benefit for society. However, there would be no getting around the fact that shareholders would be taking a blind step into their investment, but one with potentially enormous payoffs. It is unclear what the regulatory structure would look like exactly, but it would need to include both civil and criminal backstops for both government and private entities. Admittedly, many questions about an "I" corporation's regulatory framework remain unanswered here; for instance, what exactly does it mean to be a "bad apple," or does no transparency for shareholders mean that the government would also have a narrower view of the "I" corporations' financials? Moving forward, "I" corporations and deregulation could work, but only if there is a way to ensure that people like Musk or Dyson are able to innovate, and people that want to hide from shareholders are not able to take advantage of a relaxed system.