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Distributed Ledgers, Traceable Shares, and the Division of Power in Corporate Law

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George S. Geis, *Traceable Shares and Corporate Law*, 113 *Nw. U. L. Rev.* __ (forthcoming 2018), available at [SSRN](#).

Theories of corporate governance, and associated normative claims about the optimal balance of power between shareholders and boards of directors, often gloss over—or ignore entirely—the recessed plumbing of back-end clearing processes.” To be sure, growing empirical literatures inform such debates by illuminating various strategies of exit and voice deployed by important categories of investors, yet the accuracy, efficiency, and integrity of securities trading and voting mechanisms often go unexplored. In the article *Traceable Shares and Corporate Law*, [George Geis](#) provides a fascinating window onto the complex mechanics of clearing and voting in publicly traded companies—and particularly how “distributed ledgers and blockchain technology” may revolutionize these processes, with potentially profound implications for corporate law and governance.

As Geis recounts, by the 1960s, transfer of physical stock certificates had become unworkable due to substantial growth in trading volume. The solution to this problem was “unidentified fungible bulk” shareholding. Shares now typically reside at the Depository Trust & Clearing Corporation (DTCC), with legal title held by a subsidiary called Cede & Company, which appears as the record holder of the stock in corporate stockholder lists. Accordingly, when the stock is sold from one investor to another, DTCC simply “transfers beneficial ownership electronically from seller to buyer via bookkeeping adjustments”—obviating the need for slow, cumbersome, and expensive transfers of physical stock certificates.

While an elegant solution in the abstract, however, the mechanics remain what Geis aptly terms “a kludge.” This results largely from the array of intermediaries—notably banks, brokerages, and third-party service providers—involved in the complex process of transmitting trading and voting information up and down the chain between DTCC, at one end, and “beneficial” shareholders, at the other. For example, the process of voting shares in a publicly traded company involves execution of a “global proxy” by Cede, the record holder, permitting votes for shares held at DTCC to be cast by custodian banks and brokerages. These in turn either execute further proxies to beneficial shareholders or (more likely) request voting instructions from them—an approach that firms may, in turn, “outsource...to a third-party provider.”

Given the complexity and the number of parties involved, it is hardly surprising that such processes could impact legal rights that hinge on identification of particular shares with particular investors. For example, § 11 of the Securities Act of 1933 provides a potent cause of action for investors who acquire shares issued pursuant to a materially misleading registration statement—but courts have tended to interpret this provision to require that the shares in question be directly traceable, with mathematical certainty, to the defective registration statement. This requirement is easily met when IPO shares represent the only publicly traded stock, yet may prove impossible to meet if multiple vintages of stock were available in the secondary market at the time of purchase—due to fungible bulk clearing. Likewise, establishing appraisal rights following a merger under § 262 of the Delaware General Corporation Law (DGCL) requires that the shares in question were not voted in favor of the merger—which could prove problematic if the complex multi-step voting mechanics described above go awry.

Against this backdrop, however, Geis argues that we find ourselves in “an important moment for corporate law...because new technology is approaching a state where clearing and settlement systems may soon support traceable shares.” Building on the detailed yet accessible technical introduction that he provides, Geis observes that “it has become possible to envision how distributed ledger technology might be adopted to permit direct and rapid settlement of stock trades.” This, he suggests, could permit development of “a ‘golden ledger’ of stockholders, reflecting the most current ownership data and substantially reducing (or perhaps even eliminating) the need for the custodial arrangements” described above.

While Geis acknowledges that any effort to develop and implement such a system would face formidable legal and technological hurdles, he concludes that “the odds of a transformation cannot be ignored” and provides a survey of the significant changes we might witness if each share of publicly traded stock could literally be traced to a particular shareholder. Straightforwardly, the action for materially misleading registration statements under § 11 of the Securities Act would become more widely available in secondary markets, as multiple vintages of stock would no longer preclude direct tracing. Identifying who should be entitled to pursue an appraisal action under DGCL § 262 would likewise become a simpler matter, as the voting record for the shares in question would be more readily determinable. More generally, we might expect “a reduction of unintentional errors,” as multiple checks on accuracy are a hallmark of blockchain technology. At the same time, such a system might curb so-called “empty voting”—that is, voting shares “without economic exposure to the consequences of a decision”—by obviating the practical need to key voting power to a “record date” falling weeks in advance of the actual vote (thereby limiting potential for voting rights to be severed from economic rights by a sale between those dates). By the same token, traceable shares might facilitate new forms of remedies—for example, permitting plaintiffs in securities class actions to “claw back” gains from investors who benefited from corporate misrepresentations (say, by selling their stock at an inflated price).

Perhaps most intriguing of all, however, are the implications for long-standing debates regarding corporate governance theory. Minimally, traceable shares could raise thorny questions “about the circumstances under which an outside shareholder (or other party) should be able to access” newly available “real time data about the identification and ownership stake of all shareholders”—access to which could readily fuel shareholder activism. At the same time, “a more accurate system for tabulating votes and parsing out other legal rights might cause some scholars to reconsider their positions” on the optimal balance of power between shareholders and boards in publicly traded companies. Where this might lead necessarily

remains uncertain, given the nascent state of the technology and the fact that (by hypothesis) we cannot know what such granular data might reveal about the interests and incentives of various categories of investors. Regardless, Geis compellingly argues that traceable shares could impact corporate law and governance in fundamental ways, and the article provides a nuanced and insightful guide to this complex and dynamic landscape.

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