

Locke Lord QuickStudy: Delaware Court of Chancery Approves ?Differential Voting Within Same Class

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Two recent decisions of the Delaware Court of Chancery offer increased flexibility for Delaware corporations to adopt differential voting by stockholders. Differential voting has typically been used to give key stockholders greater voting power than other stockholders, so that those stockholders are in a position to exercise control even without having a sufficient economic interest to do so. Use of differential voting power in this way has been justified as affording stability to corporations and increased flexibility to raise equity capital, for example, through an initial public offering, without causing a change-in-control. On the other hand, this differential voting has been controversial from a corporate governance perspective, especially in the absence of a time limit on the super-voting power.^[1]

Historically, differential voting has been accomplished through the use of two classes (or series) of stock, one of which, held by identified stockholders, has super-voting rights (e.g., 10 votes per share instead of one). If a holder ceases to be eligible or transfers the shares to an ineligible holder, the shares in the super-voting class automatically convert to the normal voting class. This approach has been used because there was uncertainty as to whether differential voting within the same class was permissible since shares within the same class had to have the same rights. The recent Delaware decisions now give companies alternative and potentially simpler ways to create super-voting rights for identified stockholders.

In *Colon v. Bumble, Inc.*, 2023 WL 5920100 (Del. Ch. Sept. 12, 2023), Vice Chancellor Laster, in granting the defendants' motion for summary judgment, ruled that differential voting rights in the same class of stock based upon a formula referencing "facts outside of the certificate of incorporation" was valid under the Delaware General Corporation Law (DGCL). In this case, Bumble had a single class of stock with one vote per share except that shares owned by a "Principal Stockholder," defined as "the parties to a publicly disclosed stockholders agreement," had ten votes. The court noted that the formula applied to all shares in the class and that nothing in sections 102(a)(4), 151(a) or 212(a) prevented the identity-based voting under the formula. In so ruling, the court referred to several prior Delaware decisions upholding voting rights provisions that used formulas dependent on facts outside of the certificate of incorporation in different contexts, as well as the Delaware courts approval of shareholder rights plans that provided different rights to certain stockholders of the same class.^[2]

After ruling that the differential voting provision in Bumble's certificate of incorporation complied with Delaware law, the court noted that corporate action under Delaware law is always twice tested, once for legality and again in equity. However, because the plaintiff only challenged the provision's legality, the decision was not addressing

when use of this differential voting could be inequitable.

Shortly after the *Bumble* decision, in a comment to a one–page order in *Vestal v. Carvana Co.*, C.A. No. 2022–0609– KSJM (Del. Ch. Sept. 27, 2023), Chancellor McCormick, based on the reasoning in *Bumble*, upheld a two-class structure where the shares of one of the classes carried ten votes rather than one vote as long as they were held by an identified founder of the company.

Takeaway

The Delaware Court of Chancery has now addressed the concern of practitioners over use of differential voting within the same class or series of stock, at least when the differential voting is based upon a formula applicable to all shares in the class or series, which may be based upon facts ascertainable outside of the certificate of incorporation in accordance with section 151(a) of the DGCL. The recent decisions now give practitioners additional flexibility and simpler alternatives for providing for differential voting, including identity–based voting, when that is desirable and justified. For example, use of a single class with differential voting can avoid issues surrounding separate class voting when there are multiple classes. It is important to remember, however, that differential voting and its use in particular circumstances can still be challenged on equitable grounds.

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[1] See NYSE American Company Guide Section 122 and Nasdaq Rule 5640.

[2] *Providence & Worcester Co. v. Baker*, 378 A.2d 121 (Del. 1977) (scaled voting based on number of shares held upheld); *Williams v. Geier*, 1987 WL 11285 (Del. Ch. May 20, 1987) (tenured voting upheld); and *Sagusa v. Magellan Petroleum Corp.*, 1993 WL 512487 (Del. Ch. Dec. 1, 1993), *aff'd*, 650 A.2d 1306 (Del. 1994) (per capita voting upheld).

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