

The Dual-Class Spectrum

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The debate over dual-class companies is longstanding and ongoing. However, scholars and regulators generally treat the question of whether a company is dual class as a binary one. If a company grants certain shareholders a separate class of stock with disproportionate voting rights, then the company is treated as a dual-class company. A company with only a single class of stock is never treated as dual class because it is assumed that the shareholders in a single-class company are treated equally. This Article uses an original dataset to provide a new perspective on the dual-class debate by showing that treating the distinction between dual-class and single-class as binary has caused scholars and regulators to miss the myriad ways in which insiders receive rights that are not available to public shareholders.

The dataset shows the wide spectrum of control rights that purportedly single-class corporations grant to insider shareholders by contract rather than through high-vote stock. In fact, companies grant special rights to insiders through contractual mechanisms much more commonly than they do through traditional dual-class structures. Based on these findings, this Article argues that single-class companies that grant disproportionate control rights to insider shareholders by contract are single class in form, but dual class in substance, which, problematically, allows them to avoid the scrutiny and restrictions that protect public shareholders in traditional dual-class companies.

These insights have important implications for policymakers, scholars, and investors. For example, the Securities and Exchange Commission (SEC) has engaged in various attempts to regulate high-vote dual-class structures, and many institutional investors and indices have placed trading restrictions on their shares. However, these attempts to reduce investment in companies that grant insiders disproportionate control rights apply exclusively to high-vote dual-class companies and therefore have lacked the nuance necessary to match insiders' sophistication. This Article provides a framework that will make it possible to

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account for the full complexity of ways in which insiders use dual-class structures, either explicitly or implicitly.

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Introduction

Insiders have long attempted to retain control of companies after they go public in an initial public offering (IPO). Traditionally, they have done so by creating dual-class structures that grant company insiders disproportionate voting rights, thereby giving insiders control that exceeds their economic interests.¹ These dual-class structures have always been controversial. Opponents argue that dual-class structures create agency costs by giving disproportionate power to company insiders, which allows those insiders to operate without accountability and behave in ways that benefit themselves rather than the public shareholders.² Proponents, of whom there are markedly fewer, claim that dual-class structures can provide stability and long-term planning by uniquely well-qualified founders.³ This debate has proceeded for over a century, and despite some progress in subjecting dual-class companies to greater scrutiny, dual-class IPOs are nevertheless increasingly popular and the debate about them is as robust as ever.⁴

This Article argues that the dual-class debate has too narrowly focused on voting rights in dual-class companies and has failed to account for the myriad ways insiders obtain control rights.⁵ This Article's novel dataset shows that high-vote shares are just one of many ways in which insider shareholders obtain and maintain control in a corporation that exceeds their economic interests. In fact, we find that companies are much more likely to grant insiders special rights through contract than through a dual-class structure, with nearly one-third of companies granting at least one special contractual right to insiders. The dataset

1. See Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 701 (2019) (“Dual-class companies depart from the ‘one share, one vote’ rule by issuing different classes of common shares with unequal voting rights, but equal or similar entitlements to earnings.”).

2. See, e.g., Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1460 (2019); Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 604-05 (2017) [hereinafter Bebchuk & Kastiel, *Untenable Case*] (“Therefore, supporters of dual class often argue that it is preferable to let such a talented controller remain in control long after the IPO.”); Jeffrey N. Gordon, *Ties That Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1, 10-39 (1988); Lund, *supra* note 1, at 693 (“Critics of dual-class structures argue that issuing nonvoting or low-voting shares increases agency costs and results in suboptimal decisionmaking.”).

3. See, e.g., Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 560, 565-67 (2016) (arguing that “when the entrepreneur’s idiosyncratic vision is ultimately realized, the benefits will be distributed pro rata to all investors”); Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119, 137-38 (1987) (arguing that dual-class structures allow for long-term planning because founders can avoid the threat of takeovers); Steven Davidoff Solomon, *Shareholders Vote with Their Dollars to Have Less of a Say*, N.Y. TIMES: DEALBOOK (Nov. 4, 2015), <https://www.nytimes.com/2015/11/05/business/dealbook/shareholders-vote-with-their-dollars-to-have-less-of-a-say.html> [<https://perma.cc/99U2-W2CD>] (noting that “[m]any defend dual-class stock because it may insulate the company from pressure to take short-term actions at the behest of shareholders”).

4. See Lund, *supra* note 1, at 692-93 (discussing the debate over high-vote dual-class structures over the last century).

5. Company insiders include founders and pre-initial-public-offering (pre-IPO) investors, including venture capitalists and private-equity companies.

was created by searching the IPO documents of 1,870 companies that went public from 2000 through 2020 to show how corporations commonly and increasingly grant insider shareholders disproportionate control directly in a company's founding contractual documents, like its bylaws and certificate of incorporation, or in separate contracts between the insiders and the company.⁶ These contracts have a variety of names, like shareholder agreement,⁷ nomination agreement, director-designation agreement, voting agreement, master separation agreement, investment agreement, or investor-rights agreement.⁸ Companies often grant insiders disproportionate rights through a combination of these types of agreements. This Article also shows that companies not only use dual-class structures to allocate disproportionate control to insiders, but also often grant insider shareholders disproportionate economic rights in undisclosed and obscure ways. These findings make clear that the binary distinction between dual-class and single-class misses the fact that dual class is actually a spectrum, with varying degrees of control and economic rights running to certain insider shareholders.

By using contracts to obtain certain rights that are not available to the public, insiders gain disproportionate control and can turn what appears on the surface to be a single-class corporation into a de facto dual-class corporation. The line between single-class and dual-class public companies has surreptitiously become blurred, and many companies that are formally single class yet dual class in substance avoid much of the scrutiny that comes with being a dual-class corporation. This Article aims to reorient and update the dual-class debate by providing a deeper and richer account of how modern corporations allocate rights between the public and insiders. For example, one of the most important shareholder rights is voting on the board of directors, who then act as

6. For an explanation of the dataset, see Section II.A.

7. Some scholars have very recently begun to analyze shareholder agreements and have discussed how certain provisions in those agreements can give insider shareholders disproportionate control. See Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH U. L. REV. (forthcoming 2022) (manuscript at 45) (“[A] shareholder agreement may cause shareholders with the same economic interest to have different rights.”); Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REGUL. 1124, 1129-30 (2021) (empirically showing that 15% of corporations that went public in recent years did so subject to a shareholder agreement and that those agreements typically granted certain shareholders specific contractual rights that were not available to other shareholders); see also Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 279 (2021) (“Alibaba is a case study of how corporate control can be created synthetically with little or no equity ownership via a web of employment and contractual arrangements.”); Jordan Schoenfeld, *Contracts Between Firms and Shareholders*, 58 J. ACCT. RSCH. 383 (2020) (finding that bilateral contracts between companies and “expert” shareholders are significantly positively associated with information asymmetry between managers and shareholders). While these articles have each added to the important discussion of contracts as a mechanism for enhancing insider control, this Article explores a broader set of rights retained by insiders and is the first to explore these contractual rights within the context of the dual-class debate. This Article also contributes to this emerging area by providing a novel and more extensive dataset than currently exists, showing how single-class companies and non-high-vote dual-class companies use these contractual rights to replicate or exceed the rights shareholders receive through traditional, high-vote dual-class stock.

8. See *infra* notes 62-68 and accompanying text.

agents of the shareholders to oversee the operations of the corporation.⁹ Our findings show that in single-class IPOs, insider shareholders often obtain the right to appoint a certain number of members of the board, often a majority.¹⁰ Like high-vote stock in a traditional dual-class company, these rights allow insiders to effectively control the board even when they own much less than a majority of the shares of the company.¹¹ Insiders not only have the right to choose many or all members of the board, but they also often have even greater control of the board in the form of a right to designate the chairman of the board or which directors sit on certain committees of the board—rights that public shareholders never have.¹²

Insiders receive contractual rights far beyond only controlling the board. They often have the right to approve or disapprove of many corporate decisions, including major decisions like whether to sell the company or amend foundational corporate documents, and less fundamental decisions such as whether to incur debt, purchase assets, enter into a joint venture, or issue new stock.¹³ These control rights often go beyond what shareholders traditionally vote on by allowing insiders to control the company’s day-to-day business decisions, thereby giving insiders even greater control than they could obtain through dual-class high-vote shares. Usually, they have control of these decisions long after they cease to own a majority of the company’s shares, and in many cases when they own as little as 10% of the company.¹⁴ These control rights typically exist

9. See Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 851 (2005) (“A key element of the corporate structure is the shareholder franchise—shareholders’ power to elect and replace directors. Corporate statutes provide shareholders with this power, which courts view as a fundamental element of the corporate structure.”); *id.* at 844 (“The basic and longstanding principle of U.S. corporate law is that the power to manage the corporation is conferred on the board of directors.”); Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 407 (2006) (stating that “two rights—the rights to elect directors and the right to sell shares—are more important than any others”). This is commonly referred to as the “separation of ownership and control” and is traced back to the work of Adolf A. Berle and Gardiner C. Means. See ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 6 (1932) (referring to the “separation of ownership from control”); see also Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 619 (2006) (“Berle and Means demonstrated that public corporations were characterized by a separation of ownership and control—the firm’s nominal owners, the shareholders, exercised virtually no control over either day-to-day operations or long-term policy.”).

10. See *infra* notes 72-78 and accompanying text.

11. For an analysis of the accountability of boards of directors to shareholders, see Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119 (2016).

12. See, e.g., Elanco Animal Health, Inc., Prospectus (Form 424B4), at 171 (Sept. 21, 2018) (“The master separation agreement will provide that, for so long as Lilly and its affiliates beneficially own at least 10% of our voting shares, Lilly will be entitled . . . to designate at least one director to each committee of the board of directors other than the Audit Committee.”); see also *infra* notes 83-87 and accompanying text.

13. See *infra* notes 92-102 and accompanying text.

14. See, e.g., Palomar Holdings, Inc. Prospectus (Form 424B4), at 136 (Apr. 17, 2019) (describing a stockholders agreement that grants an insider shareholder a veto right over a wide variety of corporate actions such as changing foundational documents, making dividends, buying or selling assets, changing the nature of the business, taking on debt, and many other actions, for so long as that insider “owns at least 10% of our outstanding common stock”).

in tandem with other control rights relating to the board of directors, which allows insider shareholders to have the power not only to choose who sits on the board, but also to control their decision-making process. This type of control is never available to public shareholders, who at most can elect directors and vote on only a few fundamental corporate decisions.

This Article argues that the special control rights granted to insiders create corporate-governance structures that are so similar to traditional dual-class companies that they are effectively single class in form but dual class in substance. This is not just semantics—understanding that these purportedly single-class companies are in fact dual class in nature is important to helping investor groups, scholars, and regulators understand how to treat these companies. The significance of the labels lies in the fact that the policy concerns that dual-class structures frequently raise apply to a much broader group of companies than previously thought.

Our findings also show that around one-third of dual-class companies do not grant high-vote stock to insiders at all, meaning that some dual-class structures exist for reasons other than control. Scholars and policymakers have almost entirely ignored these non-high-vote dual-class companies, presumably because they believe these companies are not problematic for public shareholders in the way high-vote dual-class companies are. We argue that these companies can be problematic in different ways from traditional high-vote dual-class companies because they often use the dual-class structure to create a superior economic class of stock for insider shareholders in complex and often undisclosed ways. These findings illustrate how agency costs arise any time company insiders hold their interests in a different form from public shareholders.

Our research has significant implications for the dual-class debate and corporate-governance debates more broadly. These debates should focus on the substance of corporate governance, not just its form. Scholars, investor groups, and regulators have endlessly debated traditional dual class; if traditional dual class has warranted so much attention, then other structures that approximate dual class in substance through a different form warrant the same kind of attention. These groups should consider the full range of insider control rights rather than just narrowly focusing on voting rights granted through a separate class of shares. Only by doing so can they develop well-targeted policies to address potential concerns raised by the myriad ways insider shareholders disproportionately control public corporations.

For example, prominent indices have recently started limiting, underweighting, or excluding companies with dual-class structures,¹⁵ which has

15. See Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. REV. 1229, 1232 (2019) (“At the end of July 2017, S&P Dow Jones, a prominent index provider, announced that the S&P Composite 1500 and its component indexes, including the S&P 500, would no longer add companies with multi-class structures. It adopted a strict flat exclusion, but grandfathered existing multi-class companies. Around the same time, another leading index provider, FTSE Russell[,]”

decreased index investing in these companies.¹⁶ Granting insiders disproportionate control through contract (rather than a separate class of stock) allows single-class companies to circumvent these restrictions, despite the fact that these contractual dual-class structures create the same agency costs that traditional dual-class structures do. If these companies are subject to less of a financial penalty than traditional dual-class structures are, then using contracts to create a de facto dual-class structure would be a win-win for company insiders, who get to keep control without paying a penalty for it.

Some companies have explicitly done just this. For example, The Carlyle Group recently changed its structure from a dual-class structure, where three controlling founders had disproportionate voting rights that ensured their control, to a single-class structure with one vote per share. Its primary reason for doing so was that “[t]here is a more than \$3 trillion addressable passive index universe and over \$4 trillion of active [assets under management] benchmarked to potential indices into which [Carlyle] shares may be added” based on a single-class structure.¹⁷ However, at the same time Carlyle changed to a single-class structure, it entered into stockholder’s agreements whereby the three founders each have rights to nominate members of the board and the chair of the board.¹⁸ Carlyle also required employees to enter into an irrevocable proxy agreement that gave the employees’ voting rights to the founders.¹⁹ The founders were therefore able to convert the company to a nominally single-class structure that in reality mimicked the dual-class structure by leaving full control in the hands of the founders. Yet the company now qualified for index inclusion even though in substance nothing had changed. This Article argues that like things should be

decided to exclude companies with extremely low, or non-voting, rights from its indexes. After the adoption of the new exclusion rules, companies seeking inclusion in FTSE Russell’s indexes will need to have at least 5% of voting rights held by unaffiliated public shareholders.”); Press Release, S&P Global, S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules (July 31, 2017), <https://press.spglobal.com/2017-07-31-S-P-Dow-Jones-Indices-Announces-Decision-on-Multi-Class-Shares-and-Voting-Rules> [<https://perma.cc/AYT4-XJ77>]. Indices in other countries have similarly excluded multi-class structures. See, e.g., *The Rise of Dual Class Shares: Regulation and Implications*, COMM. ON CAP. MKTS. REGUL. 16 (Apr. 2020), <https://www.capmksreg.org/wp-content/uploads/2020/04/The-Rise-of-Dual-Class-Shares-04.08.20-1.pdf> [<https://perma.cc/N9CX-3TJ4>] (“In the United Kingdom, only ‘premium listed’ companies are eligible for inclusion in the FTSE UK Index Series, so companies with multiple class share structures (as well as others that fail to qualify for a premium listing) are excluded.”).

16. See, e.g., StepStone Grp., Inc., Prospectus (Form 424B4), at 61 (Sept. 16, 2020) (“Certain stock index providers, such as S&P Dow Jones, exclude companies with multiple classes of shares of common stock from being added to certain stock indices. . . . As a result, the dual-class structure of our common stock may prevent the inclusion of our Class A common stock in such indices, may cause stockholder advisory firms to publish negative commentary about our corporate governance practices or otherwise seek to cause us to change our capital structure and may result in large institutional investors not purchasing shares of our Class A common stock. Any exclusion from stock indices could result in a less active trading market for our Class A common stock.”); ZoomInfo Techns. Inc., Prospectus (Form 424B4), at 69 (Aug. 21, 2020) (“Given the sustained flow of investment funds into passive strategies that seek to track certain indexes, exclusion from stock indexes would likely preclude investment by many of these funds and could make our Class A common stock less attractive to other investors.”).

17. *Conversion to a C-Corporation*, CARLYLE GRP. 7 (July 31, 2019), <https://ir.carlyle.com/static-files/d2403b0a-d770-400b-adc1-a5ea91f2d498> [<https://perma.cc/C86Y-ZFBQ>].

18. *Id.* at 3.

19. *Id.*

treated alike by indices and that the current rules provide an unjustified opportunity for arbitrage.

The SEC has also argued against the use of dual-class structures and has attempted to put restraints on their use, but companies that have granted disproportionate control rights through contract have avoided such scrutiny. These concerns may come even more to the forefront in the Biden Administration, which has shown a propensity to focus more heavily on investor rights.²⁰ The Administration's future attempts to regulate dual-class companies should be broader than past attempts by including the full spectrum of ways in which insiders retain rights that are not available to the public. For example, this Article argues that the SEC should impose clearer disclosure rules on companies that grant insiders special rights to make these rights more salient to public investors, similar to the way dual-class companies typically include details of their structure on the first page of their prospectus and throughout their disclosures.

This Article ultimately argues that in future academic work, scholars must go beyond the categorizations available through databases and other easy sources and instead dig deep into the substance of the ways companies create their governance structures. Legal scholarship, for example, should further push the distinctions we create here to analyze companies according to their true control and economic structures, because legal scholars are the best equipped to do this. The market for IPOs has moved beyond the bifurcated and narrow single-class, equal-vote and dual-class, high-vote approaches toward more customized arrangements, and the debates surrounding how to treat dual-class companies should be updated to account for the various ways in which insiders keep disproportionate control and economic value. This Article provides a framework that scholars, courts, investor groups, and policymakers should use to take a more nuanced approach to the dual-class debate.

I. History and Evolution of the Dual-Class Debate

The use of dual-class structures that allow pre-IPO owners to retain control after the IPO is not a new phenomenon.²¹ Companies have experimented with dual-class structures as far back as the early 1900s.²² Insiders' early attempts to keep control survived judicial scrutiny, but many academics and public officials

20. See, e.g., Greg Iacurci, *Biden Administration Is Keeping a Close Eye on Private Equity and Other 'Alternative' Investments*, CNBC (Feb. 16, 2022, 3:30 PM EST) <https://www.cnbc.com/2022/02/16/biden-administration-has-close-eye-on-private-equity-other-alternative-investments.html> [https://perma.cc/Y9JZ-BBE2].

21. Indeed, it is not solely a U.S. phenomenon. Dual-class companies exist around the world. See *The Rise of Dual Class Shares*, *supra* note 15, at 6-11.

22. See Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 ST. JOHN'S L. REV. 863, 890-905 (1994) (providing a historical account of the evolution of the one-vote, one-share rule and opposition to it); Stephen M. Bainbridge, *The Short Life and Resurrection of SEC Rule 19C-4*, 69 WASH. U. L.Q. 565, 568 (1991).

did not receive them well.²³ In response, the New York Stock Exchange (NYSE) adopted rules that excluded most dual-class companies from its exchange due to its “long-standing commitment to encourage high standards of corporate democracy . . . and accountability to shareholders.”²⁴ This mostly ended the use of dual class for a time.²⁵

Beginning in the 1980s, companies, starting with General Motors, increasingly began to challenge the NYSE by issuing stock with disparate voting rights. At the same time, competitor exchanges, including the National Association of Securities Dealers Automated Quotation (NASDAQ) system and the American Stock Exchange (AMEX), implemented less restrictive rules for dual-class companies.²⁶ This forced the NYSE to reexamine its practice, and it subsequently decided to allow dual-class structures to be listed on its exchange subject to several conditions, including supermajority shareholder approval and independent-director approval.²⁷ Soon after the NYSE changed its rules, the SEC got involved in the controversy surrounding dual-class companies by issuing rules that heavily regulated and restricted the use of dual-class stock.²⁸ These rules were ultimately invalidated as beyond the scope of the SEC’s authority,²⁹ but the position of the SEC and the exchanges was clear: dual-class structures were frowned upon. However, although some restraints on dual-class structures existed, nothing prohibited their use.

The arguments for and against dual-class structures are relatively straightforward and have not changed much over the last 100 years. The arguments against them focus on how dual-class structures create agency costs by giving disproportionate power to company insiders, creating a misalignment

23. See Ashton, *supra* note 22, at 892 n.120 (collecting cases where courts acquiesced to dual-class structures under a freedom-of-contract rubric); *id.* at 892-93 (describing opposition to dual-class structures); Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 694 (1986).

24. See Seligman, *supra* note 23, at 689 (quoting NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 3 (1983), reprinted in *Impact of Corporate Takeovers: Hearings Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous. & Urb. Affs.*, 99th Cong. 1134-41 (1985)).

25. See Seligman, *supra* note 23, at 699 n.78 (noting that the New York Stock Exchange (NYSE) delisted Cannon Mills in 1962, after the company distributed shares of nonvoting common stock to its common stockholders); *id.* (noting that the NYSE often enforced its one-share, one-vote policy simply by threat of delisting). One prominent exception to this rule was the 1956 listing of the Ford Motor Company despite its dual-class capital structure. See Bainbridge, *supra* note 22, at 569.

26. See Ashton, *supra* note 22, at 896 n.138 (noting that the NASDAQ and AMEX did not adhere to the one-share, one-vote rule and that because of this “each became a suitable alternative to the capital structuring limitations of the NYSE”).

27. See Proposed Rule Change by New York Stock Exchange, Inc. Relating to Amendments to the Exchange’s Voting Rights Listing Standards for Domestic Companies, Exchange Act Release No. 23,724, 51 Fed. Reg. 37,529, 37,530 (Oct. 22, 1986); NYSE’s Proposed Rule Changes on Disparate Voting Rights, 18 Sec. Regul. & L. Rep. (BNA) No. 37, at 1389-92 (Sept. 19, 1986); Ronald J. Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA.L. REV. 807, 807 n.1 (1987) (discussing pressures that compelled the NYSE to reconsider its policy); Ashton, *supra* note 22, at 895-96.

28. Voting Rights Listing Standards; Disenfranchisement Rule, 53 Fed. Reg. 26,376 (July 12, 1988) (codified as amended at 17 C.F.R. § 240.19c-4 (2021)); see also Ashton, *supra* note 22, at 898-900 (discussing the voting-rights listing standards).

29. See *Bus. Roundtable v. SEC*, 905 F.2d 406, 417 (D.C. Cir. 1990).

of interests that allows founders and other insiders to operate without accountability and behave in ways that benefit themselves rather than the public shareholders.³⁰ The insiders bear only a small portion of the consequences of their decisions because of their comparatively lower economic interest in the company, while the public shareholders bear a disproportionate share of the costs of the downside of the structure. This incentivizes insiders to draw private benefits from their control that they do not have to share with the public shareholders, and evidence shows that they appear to act according to these incentives.³¹ These private benefits can come in the form of self-dealing transactions, stealing of lucrative corporate opportunities, or hiring close associates to high-paying jobs at the corporation regardless of their qualifications, among many others.³² Because insiders in dual-class companies hold disproportionate control, the public shareholders are less able to counteract this misalignment of interests by holding management accountable for the decisions they make. When insiders have total control, it can be nearly impossible for the public shareholders to fix this misalignment of interests.³³ Furthermore, even when the founders are no longer the most fit to lead the company, there is often no way for existing shareholders or potential acquirers to remove them because insiders' voting control serves to entrench management

30. See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 73 (1991); Gordon, *supra* note 2, at 10-39; Lund, *supra* note 1, at 693 (“Critics of dual-class structures argue that issuing nonvoting or low-voting shares increases agency costs and results in suboptimal decisionmaking.”).

31. Empirical evidence indicates that these types of conflict cause actual harm to shareholders in these firms. See Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUD. 1051, 1084-85 (2010) (concluding that the larger the gap between insiders' voting rights and their equity ownership, the more that the company underperforms).

32. See Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 304 (1983) (arguing that “decision managers” who “are not the major residual claimants” are “more likely to take actions that deviate from the interests of residual claimants”); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 312-13 (1976) (arguing that owner managers are more likely to engage in self-dealing transactions as their equity ownership falls). The transfer of wealth from a company to its controlling shareholders is often referred to as “tunneling.” See generally Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. 22 (2000) (defining “tunneling” and explaining how it happens in civil-law countries).

33. See Lucian Arye Bebchuk, Reinier Kraakman & George G. Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in CONCENTRATED CORPORATE OWNERSHIP 295, 298-301 (Randall K. Morck ed., 2000) (discussing how a dual-class structure can create conflicts). It is possible, albeit rare, for minority shareholders to put public pressure on controlling shareholders to give up control. See, e.g., David Benoit, *Activist Pressures Ratner Family to Relax Control of Forest City*, WALL ST. J. (Aug. 10, 2016, 12:00 AM ET), <https://www.wsj.com/articles/activist-pressures-ratner-family-to-relax-control-of-forest-city-1470801603> [<https://perma.cc/65NQ-M3DC>] (describing pressure from an activist investor on Forest City Realty Trust to abandon its nearly 100-year-old dual-class structure). Forest City Realty Trust ultimately agreed to eliminate its dual-class structure. See Michelle Jarboe, *Forest City to Eliminate Dual-Class Stock Structure, Reduce Ratner Family's Presence on Board*, PLAIN DEALER (Dec. 6, 2016, 1:50 PM), <https://www.cleveland.com/real-estate-news/2016/12/forest-city-to-eliminate-dual.html> [<https://perma.cc/2DZF-7HTP>]; see also Matthew Rose, *Reader's Digest's Shareholders to Give Up Control of Publisher*, WALL ST. J. (Apr. 15, 2002, 12:01 AM ET), <https://www.wsj.com/articles/SB1018822198298046520> [<https://perma.cc/YCG6-U5R9>] (describing pressure from an activist investor that led to the unwinding of Reader's Digest's dual-class structure).

and insulate them from outside influence.³⁴ This means that the market for corporate control is unlikely to be as effective at policing insider shareholders' behavior, since an acquirer can only be successful if the insiders allow it to be. Someone who was well-qualified to lead the company when it was founded could very well be unfit to lead as time goes on, but there is nothing shareholders or potential acquirers can do to remove the controlling insiders.

There are some proponents of dual-class structures, albeit fewer. Those who support these structures acknowledge their potential downsides but argue that the benefits may outweigh those downsides. They claim that dual-class structures provide for stability and facilitate long-term planning by preventing activist investors from making changes to the company that focus on short-term results.³⁵ They also argue that dual-class structures allow the founders—who know the business intimately and may be uniquely well suited to maximize the value of the company given their track record—to guide the company without having to bear excessive economic risk.³⁶ And ultimately, if the market does not like the structure, the founders will be financially punished accordingly with a lower share price, and so no further regulation is needed.³⁷

34. See Blair Nicholas & Brandon Marsh, *Dual-Class: The Consequences of Depriving Institutional Investors of Corporate Voting Rights*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REGUL. (May 17, 2017), <https://corpgov.law.harvard.edu/2017/05/17/dual-class-the-consequences-of-depriving-institutional-investors-of-corporate-voting-rights/> [<https://perma.cc/L8VR-ZF4D>]; *Dual-Class Stock*, COUNCIL INSTITUTIONAL INVS., https://www.cii.org/dualclass_stock [<https://perma.cc/TX6K-WQ4X>]. For example, Snap went so far as to issue Class A shares to the public with no voting rights, thereby ensuring that the founders would retain control indefinitely. See Steven Davidoff Solomon, *Snap's Plan Is Most Unfriendly to Outsiders*, N.Y. TIMES: DEALBOOK (Feb. 3, 2017), <https://www.nytimes.com/2017/02/03/business/dealbook/snap-ipo-plan-evan-spiegel.html?searchResultPosition=1> [<https://perma.cc/82X3-U6TS>]. Other companies have authorized the issuance of non-voting stock in the future if the company chooses. See, e.g., Dropbox, Inc., Registration Statement (Form S-1), at 7-8 (Feb. 23, 2018); Tom Zanski, *More Cos. Authorizing No-Vote Shares Despite Resistance*, LAW360 (July 12, 2017, 8:37 PM EDT), <https://www.law360.com/articles/943458/more-cos-authorizing-no-vote-shares-despite-resistance> [<https://perma.cc/FC9Q-8Z5J>] (discussing no-vote stock authorized in the Altice and Blue Apron IPOs).

35. See Fischel, *supra* note 3, at 137 (arguing that dual-class structures allow for long-term planning because founders can avoid the threat of takeovers); David J. Berger, Steven Davidoff Solomon & Aaron J. Benjamin, *Tenure Voting and the U.S. Public Company*, 72 BUS. LAW. 295, 296 (2017) (summarizing proponents' claims that a dual-class structure allows companies "to plan and act in the long term"); Bernard S. Sharfman, *A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs*, 63 VILL. L. REV. 1, 11 (2018); Davidoff Solomon, *supra* note 3 (noting that "[m]any defend dual-class stock because it may insulate a company from pressure to take short-term actions at the behest of shareholders").

36. See, e.g., Goshen & Hamdani, *supra* note 3, at 567; Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transaction Review*, 169 J. INSTITUTIONAL & THEORETICAL ECON. 160, 168-69 (2013) (arguing that a controlling shareholder can be a "high-powered performance monitor"); Bebchuk & Kastiel, *Untenable Case*, *supra* note 2, at 604 ("Therefore, supporters of dual class often argue that it is preferable to let such a talented controller remain in control long after the IPO."); Lund, *supra* note 1, at 693 n.27 ("If founders could not issue nonvoting or low-voting shares, they would often be forced to hold all or most of their wealth in the company to maintain control, which would subject them to substantial risk.").

37. See Sharfman, *supra* note 35, at 26-31 (discussing why shareholders agree to dual-class structures).

The turning point for the modern use of dual-class structures is generally traced to Google's IPO in 2004,³⁸ which started an upward trend in the use of dual class in IPOs by companies looking to retain control of the company in the hands of the founders.³⁹ From 2004 to 2020, 12.6% of companies went public with a dual-class structure, with the highest percentage of such companies going public in 2019 and 2020 and the lowest in 2006.⁴⁰ Although these structures are allowed by the SEC and stock exchanges and have gained popularity in the IPO market, the debate surrounding whether they should be allowed in the first place continues. Various large institutional investors, including many well-known public pension funds and private mutual funds,⁴¹ have recently opposed these structures, and shareholder advisory groups have expressed concern over the consequences of the structures for public shareholders.⁴² Even Senator Elizabeth Warren weighed in against dual-class structures.⁴³ Investor groups have used a variety of strategies to counteract the use of dual-class structures, including

38. Google issued Class A common shares with one vote per share to the public and Class B shares with ten votes to the founders. See Google Inc., Prospectus (Form 424B4), at 2, 24-25 (Aug. 19, 2004). According to cofounder Larry Page, the result of this structure was that “[n]ew investors will fully share in Google’s long term economic future but will have little ability to influence its strategic decisions through their voting rights.” Larry Page, *Founders’ IPO Letter*, ALPHABET: INVESTOR RELATIONS (2004), <https://abc.xyz/investor/founders-letters/2004-ipo-letter/> [<https://perma.cc/3TUS-Y67W>]. Many notable companies, most prominently Facebook, subsequently adopted similar structures. Facebook issued Class A shares to the public with one vote per share and Class B shares to insiders with ten votes per share. See Facebook, Inc., Prospectus (Form 424B4), at 33 (May 18, 2012). Facebook’s disclosures warned that “[t]his concentrated control will limit or preclude your ability to influence corporate matters for the foreseeable future.” *Id.*

39. See Bebchuk & Kastiel, *Untenable Case*, *supra* note 2, at 594; Lund, *supra* note 1, at 704 (“[B]efore 2004, only certain types of companies dared to [use dual-class structures], such as media companies . . . and closely held companies . . .”).

40. These percentages were derived from the Securities Data Company Platinum database. See *infra* Part II (explaining this Article’s methodology and use of the Securities Data Company Platinum database of global IPOs).

41. See, e.g., Letter from Jeff Mahoney, Gen. Couns., Council of Institutional Invs., to Edward S. Knight, Exec. Vice President & Gen. Couns., NASDAQ OMX Group (Mar. 27, 2014), https://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_27_14_CII_letter_to_nasdaq_one_share_one_vote.pdf [<https://perma.cc/HE5B-BM47>]; *Proxy Voting Guidelines*, FID. INVS. § VIII.B (Feb. 2021), https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Full-Proxy-Voting-Guidelines-for-Fidelity-Funds-Advised-by-FMRCo-and-SelectCo.pdf [<https://perma.cc/U7S2-UBFW>]; *Vanguard’s Proxy Voting Guidelines*, VANGUARD, at pt. IV.G. (Sept. 2016), https://pcg.law.harvard.edu/wp-content/uploads/2016/09/5-Vanguards-proxy-voting-guidelines_-Vanguard.pdf [<https://perma.cc/2H3W-LNLS>]; *Corporate Government Principles*, CAL. STATE TCHRS.’ RET. SYS. 15 (July 14, 2016), <http://resources.calstrs.com/publicdocs/Page/CommonPage.aspx?PageName=DocumentDownload&Id=9a68869e-c67f-4b37-9616-1ff915b53427> [<https://perma.cc/J4SK-5U9K>]; *Corporate Governance Principles: Proxy Voting Guidelines*, FLA. STATE BD. ADMIN. 27-28 (2021), <https://www.sbafla.com/fsb/Portals/FSB/Content/CorporateGovernance/ProxyVoting/Florida%20SBA%20Corp%20Gov%20Principles%20and%20Proxy%20Voting%20Guidelines%202021.pdf?ver=2021-10-13-131926-427> [<https://perma.cc/4KUI-MXVV>].

42. See *The Tragedy of the Dual Class Commons*, INSTITUTIONAL S’HOLDER SERVS. 1, 3 (Feb. 13, 2012), <http://online.wsj.com/public/resources/documents/facebook0214.pdf> [<https://perma.cc/FZ97-Y9CE>]; Kimberly Gladman, *The Dangers of Dual Share Classes*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REGUL. (May 21, 2012), <https://corpgov.law.harvard.edu/2012/05/21/the-dangers-of-dual-share-classes/> [<https://perma.cc/HC3A-9Z9W>].

43. See Letter from Elizabeth Warren, U.S. Senator, to John Carey, Vice President-Legal, NYSE Regulation, Inc. & NYSE Euronext, and Edward Knight, Exec. Vice President & Gen. Couns., NASDAQ OMX (June 5, 2013), <https://www.warren.senate.gov/files/documents/Senator%20Warren%20letter%20to%20NYSE,%20Nasdaq%20-%206-5-2013.pdf> [<https://perma.cc/VK4B-NDMX>].

advocating for excluding them from stock indices,⁴⁴ threatening to not invest in any company with a dual-class structure,⁴⁵ and voting against the election of directors in dual-class companies.⁴⁶

Critics' pushback against the rise of dual-class stock has had some effect, although perhaps not as much as opponents might have hoped. For example, Financial Times Stock Exchange (FTSE) Russell, S&P Dow Jones Indices, and MSCI have all added restrictions on including dual-class companies in their indices.⁴⁷ This should reduce the amount of passive investment in dual-class companies, thereby imposing a financial penalty for using the structure.⁴⁸ In addition, some SEC commissioners have expressed concern with dual-class structures, and therefore it seems possible that dual-class structures may face greater regulatory scrutiny in the future.⁴⁹

The debate about dual-class structures has been going on for over a century, and despite various public and private attempts to disallow them, they appear to

44. See, e.g., Letter from Kenneth A. Bertsch, Exec. Dir., Council of Institutional Invs. to MSCI Equity Index Comm. 2-3 (Aug. 3, 2017), https://www.cii.org/files/issues_and_advocacy/correspondence/8-3-17%20CII%20response%20to%20MSCI%20Consultation.pdf [<https://perma.cc/7ZXH-RTLS>].

45. For example, the California Public Employees' Retirement System, the largest U.S. pension fund, the California State Teachers' Retirement System, and the Florida State Board of Administration have all made threats to this effect. See Shanny Basar, *Calpers Sets Sights on Dual-Class Stock Structures*, WALL ST. J. (Aug. 20, 2012, 12:16 PM ET), <https://www.wsj.com/articles/SB10000872396390443855804577601271252759472> [<https://perma.cc/AVT9-VQWL>]; Bebchuk & Kastiel, *Untenable Case*, *supra* note 2, at 597-98.

46. See Ross Kerber & Jessical Toonkel, *Exclusive: T. Rowe Price to Oppose Key Directors at Super-Voting Share Companies*, REUTERS (Mar. 6, 2016, 10:16 PM), <https://www.reuters.com/article/us-troweprice-directors/exclusive-t-rowe-price-to-oppose-key-directors-at-super-voting-share-companies-idUSKCN0W90F2> [<https://perma.cc/5EQ3-QEJU>]; Ross Kerber, *U.S. Investor Group Urges Halt to Dual-Class Structures in IPOs*, REUTERS (Mar. 23, 2016, 6:37 AM), <https://www.reuters.com/article/us-usa-ipo-votingrights/u-s-investor-group-urges-halt-to-dual-class-structures-in-ipos-idUSKCN0WP1Q0> [<https://perma.cc/BL74-X7NZ>].

47. See FTSE Russell *Voting Rights Consultations - Next Steps*, FTSE RUSSELL 3 (July 2017), https://research.ftserussell.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf [<https://perma.cc/6BHB-DLDY>] (announcing that FTSE Russell will exclude from its indices any companies where less than 5% of the voting rights are held by public shareholders); Press Release, S&P Global, *supra* note 15 (excluding new dual-class companies from certain indices, but allowing existing dual-class companies to remain); *Consultation on the Treatment of Unequal Voting Structures in the MSCI Equity Indexes*, MSCI 2 (2018), https://www.msci.com/documents/1296102/8328554/Consultation_Voting+Rights.pdf/15d99336-9346-4e42-9cd3-a4a03ecff339 [<https://perma.cc/CB8J-UC7S>] (announcing that MSCI will adjust the weight given to dual-class companies in its indices).

48. See Lund, *supra* note 1, at 692.

49. See Robert J. Jackson Jr., Comm'r, Sec. & Exch. Comm'n, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty* (Feb. 15, 2018), <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty> [<https://perma.cc/QEJ4-P2MW>] (expressing support for a rule that would require dual-class structures to phase out over time); *Recommendation of the Investor Advisory Committee: Dual Class and Other Entrenching Governance Structures in Public Companies*, SEC. & EXCH. COMM'N: INV. ADVISORY COMM. 6, <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-on-dual-class-shares.pdf> [<https://perma.cc/E74E-QM29>] (recommending additional disclosure requirements for dual-class companies); Ronald Orol, *SEC's Clayton "Watching" Insider-Controlled IPOs*, THE STREET (Oct. 12, 2017, 2:51 PM EDT), <https://www.thestreet.com/markets/mergers-and-acquisitions/sec-chief-eyes-dual-class-ipo-structure-14341287> [<https://perma.cc/A5AD-ZTWR>].

be as popular as ever—even as the debate about them is as vigorous as ever.⁵⁰ However, the debate has taken essentially the same form for over 100 years, with a narrow focus on voting rights of different classes of common stock. This Article posits that the long-standing and ongoing dual-class debate fails to account for a significant change in the relationship between insider shareholders and public shareholders. Insider shareholders do not rely solely on high-vote shares to maintain control of a corporation. Instead, insider shareholders often receive the same one-vote, one-share rights that public shareholders have, but they also contract with the corporation to receive other control rights in addition to their voting rights, control rights that often have the same effect as a traditional dual-class structure. Insider shareholders also often use dual-class structures not to retain control but instead to gain disproportionate economic rights by owning their interests in a different form from public shareholders. The remainder of this Article seeks to reorient the dual-class debate and to prompt scholars and regulators to think more broadly about how certain shareholders retain rights that public shareholders do not receive. The dual-class debate is not so much outdated as it is incomplete, because it fails to account for the full complexity of ways in which modern companies allocate rights between the public and insiders.

II. Dual Class by Contract

Scholars and regulators generally treat the question of whether a company is dual class as a binary one that is easily answered by looking at the number of classes of common stock. If a company has two or more classes of stock and at least one of those classes grants certain shareholders disproportionate voting rights, then the company is labeled as a dual-class company.⁵¹ A company with only a single class of stock is never labeled as dual class because it is assumed that the shareholders in a single-class company are treated equally. This assumption rests on the well-accepted principle that shareholders' rights run with their shares, and therefore shareholders who own the same class of shares are presumed to have equal voting and economic rights.⁵² Although shareholders in single-class companies historically enjoyed relatively equal rights, this Part empirically shows that single-class companies have increasingly granted control rights to certain insider shareholders that are not available to other shareholders.

50. See Lund, *supra* note 1, at 692-93 (“Indeed, academics and regulators have debated whether to restrict or otherwise regulate the use of dual-class structures for at least a century.”).

51. The term dual class generally includes multi-class companies with more than two classes of common stock. See, e.g., Gompers et al., *supra* note 31, at 1052 n.3 (“Some firms have more than two classes of common stock. To keep with the traditions of this literature, we refer to all multiclass firms as ‘dual class.’”).

52. See Victor Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CALIF. L. REV. 1072, 1074 (1983) (stating that equal treatment of shareholders is “part of the received learning about publicly held corporations”); Fisch, *supra* note 7, at 41 (stating that “differential rights differ markedly from the standard corporate law principle that the rights of shareholders are not personal but run with the shares, and that the rights associated with a share of stock [are] not based on the ownership of that share”).

The line between single-class and dual-class companies has surreptitiously become blurred.

This Part makes the novel argument that single-class companies that grant disproportionate control rights to insider shareholders are single class in form, but dual class in substance. Single-class public companies grant insider shareholders these additional control rights by contract, either directly in the company charter or bylaws or through a variety of separate contracts between insiders and the corporation. This allows the insider shareholders to avoid much of the scrutiny and regulation that goes along with traditional dual-class structures while getting many of, or in some cases, more than, the same benefits.

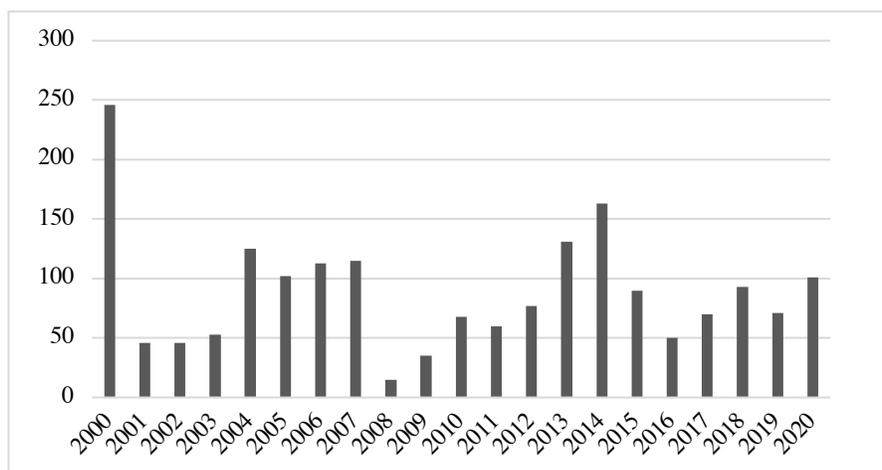
A. Methodology

To create a dataset that enables us to empirically analyze the prevalence of and trends in these contractual rights, we derived a sample of U.S. corporations by searching the Thompson Securities Data Company Platinum database of global IPOs for a 21-year period, from 2000 through 2020. We limited our search to single-class corporations incorporated in the United States with a market capitalization exceeding \$100 million at IPO that were traded on a major stock exchange in the United States.⁵³ This yielded a sample of 1,870 companies that fit our criteria, or an average of around 90 per year. As shown in Figure 1, the number of IPOs in a year of our sample ranged from only 15 in 2008, in the middle of the financial crisis, to 246 in 2000. We chose 2000 as a starting point because public filings before that time can be difficult to reliably locate in electronic form and because it provided enough separation to see possible trends.⁵⁴ We then accessed these companies' prospectuses, which is the detailed disclosure document a company must file with the SEC when it goes public in an IPO, to hand-collect discussions of special rights granted to insiders at the time of IPO.

53. We excluded special purpose acquisition corporations, limited partnerships, limited liability companies, closed-end funds, and trusts (including real estate investment trusts), because those entities do not have traditional boards of directors and other characteristics of corporations, which are the focus of this Article. Excluding these types of companies from samples is common in corporate-law literature. See, e.g., Gompers et al., *supra* note 31, at 1056; Scott B. Smart, Ramabhadran S. Thirumalai & Chad J. Zutter, *What's in a Vote? The Short- and Long-Run Impact of Dual-Class Equity on IPO Firm Values*, 45 J. ACCT. & ECON. 94, 99 (2008) ("Types of firms excluded from our data set include closed-end funds, unit offers, investment companies, real-estate investment trusts, and limited partnerships.").

54. For a discussion of the rise of traditional dual-class companies, see Lund, *supra* note 1, at 704-05; and Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg & Lubomir P. Litov, *The Rise of Dual-Class Stock IPOs*, 144 J. FIN. ECON. 122 (2022).

Figure 1: Total IPOs in Sample Per Year



The special rights discussed in this Article were found in two ways: by reading relevant sections of each prospectus that typically contain discussion of special rights and by searching the entire prospectus using relevant search terms. The relevant sections of the prospectuses where these special rights are found are typically labeled with names like “Management,” “Certain Related Party Transactions,” “Certain Transactions,” and “Description of Capital Stock.” Relevant search terms we used to find the special rights include “agreement,” “at least,” “supermajority,” “two-thirds,” “consent,” “special meeting,” “observe,” and applicable variations of such terms.⁵⁵

We sorted the special rights into different categories. These included contractual rights relating to board nomination, board-committee nomination, information rights, shareholder meetings, written-consent rights, and veto rights over certain company actions. The special rights we found were generally located in companies’ certificates of incorporation, bylaws, or through separate contractual agreements between a company and certain insiders. In compiling the data, we observed general trends in how the special rights were granted. Board-nomination, committee-nomination, and information rights are typically granted through separate contractual arrangements. Special-meeting and written-

55. Board- and committee-nomination rights are typically found either in the “Management” or “Certain Transactions” sections of a prospectus or both. Veto rights are typically found in either the “Certain Transactions” or “Description of Capital Stock” sections. Written-consent and special-meeting rights are typically found in the “Description of Capital Stock” section. Information rights are typically found in the “Certain Transactions” section. Relevant search terms we used to find board and committee nomination rights included “agreement,” “stockholder’s agreement,” “at least,” and “shareholder’s agreement.” Relevant search terms we used to find veto rights include “supermajority,” “two-thirds,” “majority,” and “consent.” Written-consent and special-meeting rights were found by searching the terms “written consent” or “special meeting,” respectively. Information rights were located using the search terms “information rights” and “observ,” since one of the most common information rights is the right to have a non-voting board observer.

consent rights are often granted through the corporation's certificate of incorporation and bylaws. Veto or supermajority rights are commonly found in either the corporation's organizational documents or in separate contractual arrangements depending on how those rights are structured, and in the case of some companies they are found in both places. Each of these categories of special rights is discussed in more detail below.

B. Single Class in Name, Dual Class in Substance

Our research shows that company insiders often create corporate-governance structures that are single class in name, but dual class in substance. The defining feature of traditional dual class is a corporate-governance structure with unequal voting rights among two or more classes of stock. Companies offer low-vote stock (usually called "Class A stock") to the public and high-vote stock (usually called "Class B stock") to the company insiders.⁵⁶ Class A stock typically has one vote per share, and Class B stock often has 10 votes per share,⁵⁷ though these numbers vary significantly among companies.⁵⁸ The purpose of granting high-vote shares to only the insider shareholders is to ensure that they have disproportionate control over the company by giving them disproportionate control of the matters that are voted on by shareholders.⁵⁹ Although shareholders generally do not control the day-to-day operations of a company, which is instead controlled by members of the board of directors and officers, shareholders retain control rights over fundamental corporate matters that affect the value of their investment.⁶⁰ Shareholders exercise this control through the right to vote on the elections of the members of the board of directors (who in turn choose the company's executives), the approval of major company transactions, including a

56. The high-vote stock is almost always available to only the company insiders. In fact, if a company insider sells their Class B stock, the stock converts from high-vote stock to regular Class A stock, thereby ensuring that the high-vote stock cannot be transferred to public shareholders. *See, e.g.*, DoorDash, Inc., Prospectus (Form 424B4), at 251-52 (Dec. 9, 2020) ("Following the completion of this offering, shares of Class B common stock will automatically convert into shares of Class A common stock upon sale or transfer . . .").

57. *See* Gompers et al., *supra* note 31, at 1053 ("The most common structure is for superior shares to have ten votes per share, while inferior shares have one vote per share.").

58. *See, e.g.*, Groupon, Inc., Prospectus (Form 424B4), at 1 (Nov. 7, 2011) ("Each share of Class A common stock will be entitled to one vote per share. Each share of Class B common stock will be entitled to 150 votes per share . . .").

59. Disproportionate control can result in pecuniary benefits for company insiders, as evidenced by the fact that Chief Executive Officers (CEOs) and other managers at dual-class companies earn higher compensation than CEOs and other managers at single-class companies. *See* Ronald W. Masulis, Cong Wang & Fei Xie, *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697 (2009); Scott B. Smart & Chad J. Zutter, *Control as a Motivation for Underpricing: A Comparison of Dual and Single-Class IPOs*, 69 J. FIN. ECON. 85, 104 (2003).

60. This is commonly referred to as the "separation of ownership and control" and is traced back to the work of Adolf Berle and Gardiner Means. *See* BERLE & MEANS, *supra* note 9; *see also* Bainbridge, *supra* note 9, at 619 ("[S]hareholders[] exercise[] virtually no control over either day-to-day operations or long-term policy.").

sale of the company, merger, or sale of substantially all of the company's assets, and the adoption of amendments to the certificate of incorporation.⁶¹

Although dual-class companies have been widely criticized for granting unequal voting rights to company insiders, thereby diluting public-shareholder control over the company, single-class companies have almost entirely escaped such scrutiny despite doing similar things, albeit in a more-tailored fashion. Single-class companies have increasingly used contracts to give company insiders disproportionate control over each of the matters that are traditionally subject to shareholder approval.⁶² This is done through a variety of mechanisms. For example, these rights are often granted through a separate contract between certain shareholders and the corporation, most commonly through a shareholder agreement but often through other contracts with titles like nomination agreement,⁶³ director-designation agreement,⁶⁴ voting agreement,⁶⁵ master separation agreement,⁶⁶ investment agreement,⁶⁷ or investor-rights agreement.⁶⁸ These rights are also often granted directly in the corporation's foundational documents like its certificate of incorporation and bylaws, with the shareholder receiving the rights specifically named in those documents.⁶⁹ And often these

61. See Bainbridge, *supra* note 9, at 616 (“Under the Delaware Code . . . shareholder voting rights are essentially limited to the election of directors and approval of charter or bylaw amendments, mergers, sales of substantially all of the corporation's assets, and voluntary dissolution.” (citing DEL. CODE ANN. tit. 8 §§ 109(a), 211(2)(b) (2001))).

62. See Fisch, *supra* note 7, at 39 (arguing that shareholder agreements are “tools of stealth governance” because they can “address governance issues or shareholder rights that would normally be addressed in the charter” or “modify the power dynamic created by a company's ownership structure and associated voting rights”).

63. See, e.g., Datto Holding Corp., Prospectus (Form 424B4), at 56 (Oct. 22, 2020) (“In connection with this offering, we will enter into a Director Nomination Agreement with Vista . . .”); Oak St. Health, Inc., Prospectus (Form 424B4), at 165 (Aug. 7, 2020) (“The Humana Director Nomination Agreement will provide Humana the right to designate [one or two Board nominees based on Humana's common-stock ownership stake] . . .”).

64. See, e.g., Leslie's, Inc., Prospectus (Form 424B4), at 124 (Oct. 30, 2020) (“In connection with this offering, we intend to enter into a Director Designation Agreement between us and Bubbles Investor Aggregator, L.P. . . .”).

65. See, e.g., BJ's Wholesale Club Holdings, Inc., Prospectus (Form 424B4), at 107 (June 28, 2018) (“Pursuant to the Voting Agreement . . . the Sponsors will be entitled to designate individuals to be included in the slate of nominees recommended by our board of directors for election to our board of directors . . .”); Ceridian HCM Holding Inc., Prospectus (Form 424B4), at 163 (Apr. 26, 2018) (“In connection with this offering, we intend to enter into a voting agreement with the Sponsors . . .”).

66. See, e.g., Elanco Animal Health, Inc., *supra* note 12, at 43 (Sept. 21, 2018) (“The master separation agreement will provide that, for so long as Lilly and its affiliates beneficially own at least 10% of our voting shares, Lilly will be entitled to designate for nomination the number of representatives on the board of directors . . .”); Arlo Techs., Inc., Prospectus (Form 424B4), at 149 (Aug. 6, 2018) (describing a “master separation agreement” that grants certain veto rights to an insider shareholder).

67. See, e.g., Coastal Fin. Corp., Prospectus (Form 424B4), at 136 (July 18, 2018) (“The Investment Agreements require us to elect or appoint a representative of the Gapstow fund, the Montlake funds and Mr. Hovde to the board of directors . . .”).

68. See, e.g., Carbon Black, Inc., Prospectus (Form 424B4), at 151 (May 4, 2018) (describing an “investor rights agreement” that provides certain rights to insider shareholders); Capella Educ. Co., Prospectus (Form 424B1), at 93 (Nov. 9, 2016) (describing an “investor rights agreement” that gives certain insiders informational rights).

69. See, e.g., Ping Identity Holding Corp., Prospectus (Form 424B4), at 49 (Sept. 20, 2019) (stating that “[o]ur bylaws will provide that Vista will have the right to designate the Chairman of the

rights will be granted through more than one of these tools in any given corporation. For example, it is common to grant insiders separate rights in both a shareholder agreement and in the certificate of incorporation and bylaws. We argue that single-class companies create de facto dual-class corporate-governance structures when they contractually grant insiders disproportionate control.⁷⁰ When these insider shareholders receive disproportionate control over the fundamental matters that are subject to shareholder approval, a company may formally have one class of common stock, but it has effectively created a dual-class structure by granting one group of shareholders disproportionate rights and control.⁷¹

Our findings show that the defining features of traditional dual-class corporate-governance structures—including disproportionate control over the composition of the board of directors, amendments to fundamental corporate documents, and major company transactions—are the same rights that certain insider shareholders receive through contractual agreements. First, because shareholders effectively delegate most of their control to the board of directors, the right to vote in elections of the board of directors is widely understood to be one of the most fundamental shareholder rights.⁷² Unsurprisingly, insider shareholders often obtain disproportionate rights that grant them the right to appoint a certain number of members of the board—a right that public shareholders do not have.⁷³ As Figure 2 below illustrates, companies regularly grant insiders the right to nominate or designate at least one member of the board. The percentage of companies in our sample doing so ranges from a low of 8% in 2007 to a high of 40% in 2016. Although there does appear to be a trend towards more companies granting special board-nomination rights to insiders, the practice is a common and longstanding one.

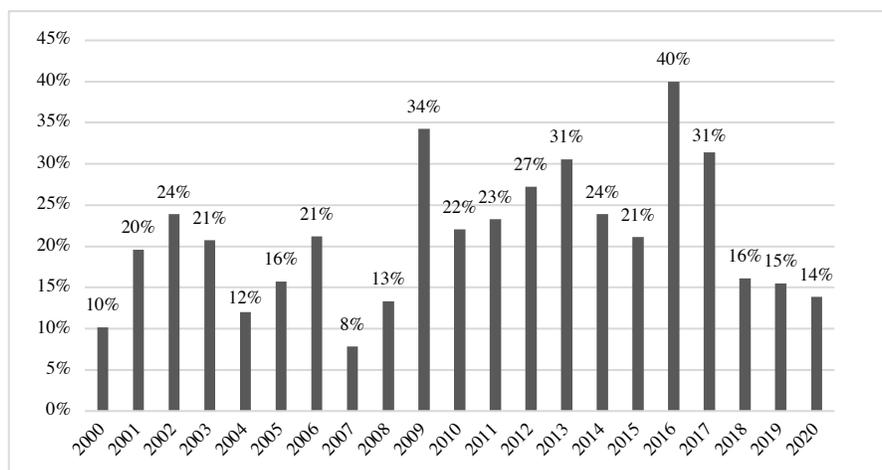
Board for so long as Vista beneficially owns at least 30%” of the company’s outstanding stock); Certara, Inc. Prospectus (Form 424B4), at 125 (Dec. 14, 2020) (describing certain special meeting rights and written-consent rights contained in the certificate of incorporation that apply only to one insider shareholder); Sotera Health Co., Prospectus (Form 424B4), at 166 (Nov. 23, 2020) (same); Jamf Holding Corp., Prospectus (Form 424B4), at 166-67 (July 23, 2020) (describing certain special meeting rights and written-consent rights contained in the certificate of incorporation and bylaws); Reynolds Consumer Prods., Inc., Prospectus (Form 424B4), at 149 (Jan. 31, 2020) (same).

70. We are aware of one other use of the term “de facto dual-class.” In its description of “what constitutes dual class,” the Council of Institutional Investors noted that Spotify granted company insiders beneficiary certificates that provided the insiders one vote per certificate, and that therefore “Spotify’s structure functions as de facto dual class.” COUNCIL INSTITUTIONAL INVS., *supra* note 34.

71. For a discussion of fundamental shareholder rights, see John Armour, *Shareholder Rights*, 36 OXFORD REV. ECON. POL’Y 314 (2020).

72. See Bebchuk, *supra* note 9, at 851 (“A key element of the corporate structure is the shareholder franchise—shareholders’ power to elect and replace directors. Corporate statutes provide shareholders with this power, which courts view as a fundamental element of the corporate structure.”); *id.* at 844 (“The basic and longstanding principle of U.S. corporate law is that the power to manage the corporation is conferred on the board of directors.”); Velasco, *supra* note 9, at 407 (stating that “two rights—the right to elect directors and the right to sell shares—are more important than any others”).

73. See Rauterberg, *supra* note 7, at 1128 (“Statutory corporate law confers authority over corporate affairs on the board of directors and justifies that authority through the board’s election by shareholders. That statutory system makes the election of the board a function of shareholder voting power. . . . Shareholders, however, can alter these defaults by contract, and in private firms, do so widely.”).

Figure 2: Percentage of Companies Granting Board-Designation Rights

Our findings show that from 2000 to 2020, 252 of the 364 companies that gave board-nomination rights to insiders, or almost 70%, gave these insiders control of a majority of the seats on the board at the time of the IPO. When insider shareholders have the right to control a majority of the board but own less than 50% of the economic interests in the company, the resulting corporate-governance structure bears particularly strong similarities to traditional dual-class structures. For example, in Dynatrace, Inc.’s recent IPO, one of its insiders (the private-equity firm Thoma Bravo), has the right to nominate a majority of the board as long as it owns at least 30% of the outstanding shares of common stock.⁷⁴ The number of members of the board Thoma Bravo can designate decreases as its ownership percentage drops below 30% of its holdings at IPO.⁷⁵ In another recent IPO, that of Datto Holding Corp., Vista Equity Partners has the right to designate all of the members of the board “for so long as Vista beneficially owns 40% or more of the total number of shares of our common stock beneficially owned by Vista upon completion of” the IPO.⁷⁶ Vista owned

74. Dynatrace, Inc., Prospectus (Form 424B4), at 119 (Aug. 1, 2019) (“[F]or so long as Thoma Bravo beneficially owns in the aggregate at least (i) 30% of our outstanding shares of common stock, Thoma Bravo will have the right to designate the chairman of our board of directors and of each committee of our board of directors as well as nominate a majority of our board of directors.”).

75. *Id.* (“[F]or so long as Thoma Bravo beneficially owns in the aggregate at least . . . 20% (but less than 30%) of our outstanding shares of common stock, Thoma Bravo will have the right to nominate a number of directors to our board of directors equal to the lowest whole number that is greater than 20% of the total number of directors (but in no event fewer than two directors); (iii) 10% (but less than 20%) of our outstanding shares of common stock, Thoma Bravo will have the right to nominate a number of directors to our board of directors equal to the lowest whole number that is greater than 5% of the total number of directors (but in no event fewer than one director); and (iv) at least 5% (but less than 10%) of our outstanding shares of common stock, Thoma Bravo will have the right to nominate one director to our board of directors.”).

76. Datto Holding Corp., Prospectus (Form 424B4), at 146 (Oct. 22, 2020).

72.2% of the company at the time of the IPO,⁷⁷ and therefore Vista will retain control of the entire board until it owns only 40% of that amount (around 29% of the company). In practice, these rights function much like insiders owning high-vote stock in a dual-class structure. Many other companies grant similar majority-control rights to insiders.⁷⁸

The other 30% of companies in our sample that grant insiders board-nomination rights do not grant insider shareholders control of a majority of the board, but they do allow them to designate a certain number of the board members, a right that public shareholders do not have. For example, in the recent IPO of PPD, Inc., one pre-IPO owner, Hellman & Friedman, has the right to designate three directors as long as they own at least 30% of all outstanding shares, two directors as long as they own less than 30% but more than 15% of the outstanding shares, and one director if they own less than 15% but more than 7.5% of the outstanding shares.⁷⁹ In the Certara, Inc. IPO, one shareholder, Arsenal, received the right to “nominate one nominee for so long as Arsenal . . . own[s] at least 5% of our outstanding common stock.”⁸⁰ Many other minority shareholders in single-class companies receive similar rights.⁸¹ In some ways, these board-nomination rights give certain insider shareholders even greater control than they would have in traditional dual-class companies because they have the right to handpick some members of the board. A company insider who owns high-vote shares but holds less than 50% of the voting power would not alone have enough power to control any seats on the board. Contractual rights to nominate or appoint members of the board effectively guarantee insiders seats on the board, even if they own a minority stake, something that is never available to minority public shareholders.

These board-nomination rights in our sample almost always sunset. Most commonly they exist along a sliding scale, with board-nomination rights decreasing as an insider’s ownership percentage decreases, even if the arrangement still gives the insider rights disproportionate to its ownership.

77. *Id.* at 143.

78. *See, e.g.*, Jamf Holding Corp., *supra* note 69, at 158 (granting the right to one shareholder to designate “all of the nominees for election to our Board for so long as [the shareholder] beneficially owns 40% or more of the total number of shares of our common stock” that they owned at the time of IPO”).

79. PPD, Inc., Prospectus (Form 424B4), at 168 (Feb. 6, 2020) (granting one shareholder “the right to nominate to our board of directors . . . (i) three members so long as it collectively owns more than 30% of our outstanding shares of common stock, (ii) two members so long as it collectively owns less than 30% but at least 15% of our outstanding shares of common stock and (iii) one member so long as it collectively owns less than 15% but at least 7.5% of our outstanding shares of common stock”).

80. Certara, Inc., *supra* note 69, at 99.

81. *See, e.g.*, Leslie’s Inc., *supra* note 64, at 124 (granting one shareholder “the right . . . to designate for nomination or appointment either one or two directors to our board of directors (with such number being determined in accordance with the agreement based on the satisfaction of certain conditions therein”); Acad. Sports & Outdoors, Inc., Prospectus (Form 424B4), at 193 (Oct. 2, 2020) (granting private-equity firm KKR & Co., Inc. the right to nominate a majority of the board when it owns more than 50% of the company, 40% of the board when it owns at least 40% of the shares, 30% of the board when it owns at least 30% of the shares, and so on).

Occasionally they will sunset at a specific time rather than as ownership decreases or at the occurrence of certain events like the departure of a founder.⁸²

Importantly, these rights to control the composition of the board are in addition to, and not in lieu of, the insiders' right as shareholders to vote in the election of the directors, meaning that insiders who receive a contractual right to appoint members of the board still vote on the remaining members of the board.⁸³ As part of their voting power, insider shareholders will also often agree to vote for each other's nominees to the board to further guarantee that their preferred directors will be on the board.⁸⁴ Ultimately, like traditional dual-class structures, these additional contractual rights grant the company insiders disproportionate control over the composition of the board of directors.

Many companies go beyond giving insider shareholders power to pick the members of the board. Some also give certain insider shareholders the right to designate the chairman of the board of directors and which directors sit on certain committees of the board. As Figure 3 illustrates, our findings show that the practice of allowing insiders to select who sits on which committees of the board has become much more common in the last decade. For example, in the Envista Holding Corp. IPO, one shareholder was granted "the right to include at least one of its designees on each committee of the board."⁸⁵ Similarly, in the BellRing Brands, Inc. IPO, one shareholder obtained the right "to designate the members of the committees of" the board as long as the shareholder owns at least 25% of the outstanding shares.⁸⁶ And Dynatrace, Inc., which went public in 2019, allows one shareholder to designate the chairman of the board for as long as the shareholder owns 30% of the outstanding shares.⁸⁷ Other companies grant certain shareholders similar rights.⁸⁸

82. See Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 COLUM. BUS. L. REV. 852, 950-51 (listing companies that have used time-based sunsets); Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1057 (2019).

83. In single-class companies, insider shareholders and public shareholders enjoy equal rights to vote as shareholders of the single class of common stock. Therefore, additional contractual rights granted to insider shareholders are in addition to, not in lieu of, their rights as shareholders.

84. See, e.g., BJ's Wholesale Club Holdings, Inc., *supra* note 65, at 106 ("The Sponsors will agree to vote their shares in favor of the directors nominated as set forth above.").

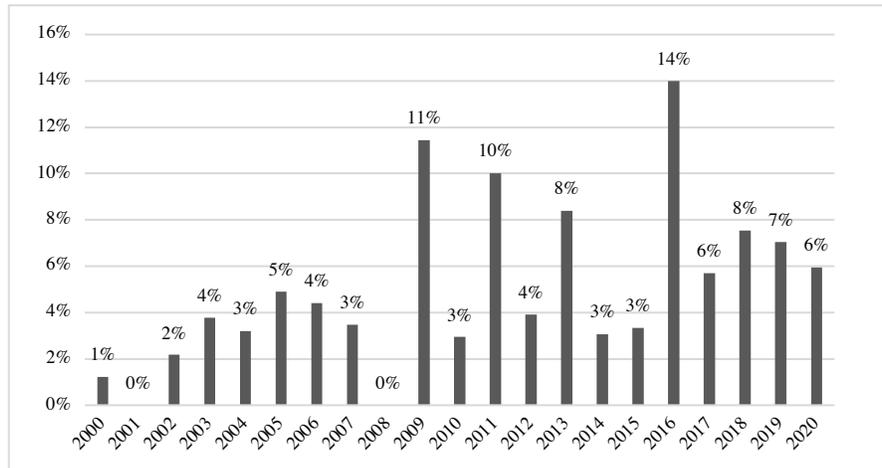
85. Envista Holdings Corp., Prospectus (Form 424B4), at 146 (Sept. 19, 2019).

86. BellRing Brands, Inc., Prospectus (Form 424B4), at 160 (Oct. 17, 2019).

87. Dynatrace, Inc., *supra* note 74, at 119-20.

88. See, e.g., Ping Identity Holding Corp., *supra* note 69, at 128 ("Our bylaws will provide that Vista will have the right to designate the Chairman of the Board for so long as Vista beneficially owns at least 30% or more of the voting power of the then outstanding shares of our capital stock then entitled to vote generally in the election of directors."); Yeti Holdings, Inc., Prospectus (Form 424B4), at 118 (Oct. 25, 2018) ("The New Stockholders Agreement also provides that so long as Cortec beneficially owns 20% or more of our then-outstanding shares of common stock, we will agree to take all necessary action to cause a Cortec Designee to serve as (i) Chairman of the Board of Directors and (ii) Chair of the nominating committee."); Elanco Animal Health, Inc., *supra* note 12, at 171 ("The master separation agreement will provide that, for so long as Lilly and its affiliates beneficially own at least 10% of our voting shares, Lilly will be entitled . . . to designate at least one director to each committee of the board of directors other than the Audit Committee.").

Figure 3: Percentage of Companies Granting Committee-Designation Rights

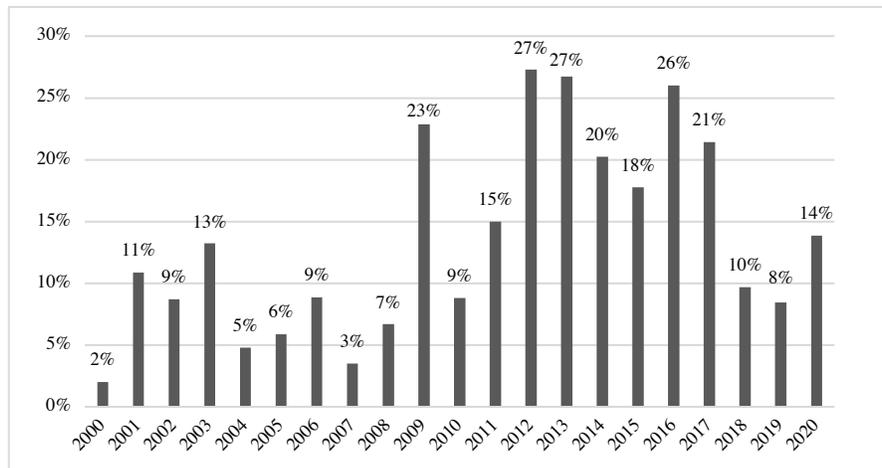


Another important right that insider shareholders often receive through contract is the right to veto certain corporate decisions. These veto rights can include both significant corporate decisions that are subject to a shareholder vote and more common decisions that are usually left to the board and officers. For example, the right to approve certain major company transactions, including a sale of the company, merger, or sale of substantially all of the company’s assets, is generally required to be put to a shareholder vote. Through their high-vote stock, company insiders in traditional dual-class companies have disproportionate approval rights over these transactions. Similarly, single-class companies grant company insiders separate and disproportionate approval rights over these exact same types of transactions by contract, generally in the form of a veto right. For example, a common provision requires certain insider shareholders to approve “change of control” transactions like a merger or sale of the company or its assets if they own a specified percentage of the outstanding shares of the company.⁸⁹ In some instances the insider shareholder may only need to hold 10% of outstanding common stock to exercise this veto right.⁹⁰

89. See, e.g., Gatos Silver, Inc., Prospectus (Form 424B4), at 145 (Oct. 27, 2020) (providing a shareholder veto rights as long as it owns at least 35% of outstanding shares).

90. See, e.g., Palomar Holdings, Inc., *supra* note 14, at 136 (“The Stockholders Agreement will terminate at such time as Genstar Capital no longer owns at least 10% of our outstanding common stock.”); see also Rackspace Tech., Inc., Prospectus (Form 424B4), at 188-89 (Aug. 5, 2020) (providing a veto right over decisions to merge or sell the company or substantially all of its assets for an insider shareholder as long as that shareholder holds at least 33% of the outstanding common stock).

Figure 4: Percentage of Companies Granting Special Veto Rights



All shareholders also traditionally have the right to vote on changes to fundamental corporate documents, including changes to the charter and bylaws.⁹¹ In traditional dual-class companies, the insiders have a disproportionate say on the approval (or veto) of these matters through their high-vote stock. Our research shows that single-class companies grant company insiders effective veto rights over these same exact matters. Common formulations require a supermajority vote for these types of changes when certain insider shareholders' ownership percentage drops below a certain threshold that would make it more difficult for insider shareholders to block these changes. For example, a common provision requires only a majority vote to make changes so long as certain insider shareholders own at least 40% or 50% of the voting power.⁹² However, once their

91. Jurisdictions vary regarding how the power to enact and amend bylaws is allocated between shareholders and directors. Under the Model Business Corporation Act, the default rule is that directors have the power to enact bylaws. MODEL BUS. CORP. ACT § 10.20 (AM. BAR ASS'N 2016). Under Delaware law, the default rule is that directors do not have this power but that the corporation can grant that power to directors under its certificate of incorporation. DEL. CODE ANN. tit. 8, § 109 (2022). It appears that this power to control the bylaws is usually granted to the directors and not shareholders. See Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 589 n.25 (2016) ("Universally, publicly traded corporations grant directors such powers from their inception; the rule is so entrenched that Delaware has construed the power of directors to enact bylaws as *more* expansive than the power of shareholders to do so, despite the Delaware General Corporation Law default rule withholding the bylaw power from directors entirely."); see also D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 150 (2011).

92. See, e.g., Acad. Sports & Outdoors, Inc., *supra* note 8181, at 202-03 ("At any time when KKR Stockholders and their affiliates beneficially own, in the aggregate, less than 40% of the voting power of all outstanding shares of stock entitled to vote generally in the election of directors, any amendment, alteration, change, addition, rescission or repeal of our amended and restated bylaws by our stockholders will require the affirmative vote of the holders of at least 66 2/3% in voting power of all the then-outstanding shares of stock entitled to vote generally in the election of directors, voting together as a single class."); Array Techs., Inc., Prospectus (Form 424B4), at 117 (Dec. 4, 2020) (providing similar rights when a certain shareholder's ownership goes below 50% of the outstanding common stock).

ownership drops below that level, a new supermajority rule applies that requires at least a two-thirds majority to approve these changes.⁹³ This has the effect of ensuring that even once the insider shareholders no longer have a majority of the voting power, they still have an effective veto right over changes to the charter or bylaws.

Single-class companies also often grant insider shareholders veto rights that go far beyond what shareholders traditionally vote on. For example, insider shareholders often have the right to veto any incurrence of debt over a certain amount,⁹⁴ the sale or purchase of any assets above a certain dollar amount,⁹⁵ the decision to enter into a joint venture,⁹⁶ a material change to the nature of the business,⁹⁷ the decision to fire the CEO or other officers,⁹⁸ the issuance of new stock,⁹⁹ and many other corporate actions that would not normally be subject to shareholder approval.¹⁰⁰ These types of veto rights are among the most common contractual rights insiders receive, and they have been increasingly popular as a tool insiders use to maintain disproportionate control, as illustrated in Figure 4

93. See, e.g., PPD, Inc., *supra* note 79, at 179-80 (requiring a two-thirds supermajority vote whenever certain insider shareholders' ownership drops below 40%).

94. See, e.g., Arlo Techs., Inc., *supra* note 66, at 149 (requiring approval from an insider shareholder to "incur any indebtedness exceeding \$100 million"); Gatos Silver, Inc., *supra* note 89, at 145 (requiring consent of an insider shareholder for "the incurrence of indebtedness in excess of \$100 million"); Rackspace Tech., Inc., *supra* note 90, at 188 (requiring the consent of certain insider shareholders who own at least 33% for "the incurrence of indebtedness . . . aggregating to more than \$100 million").

95. See, e.g., Rackspace Tech., Inc., *supra* note 90, at 188-89 (requiring the consent of certain insider shareholders who own at least 33% for the acquisition or sale of certain amounts of assets); Gatos Silver, Inc., *supra* note 89 (requiring consent of an insider shareholder for "the acquisition or sale of any asset . . . in excess of \$100 million").

96. See, e.g., Gatos Silver, Inc., *supra* note 89, at 145 (requiring consent of an insider shareholder for "any joint venture investment in excess of \$100 million").

97. See, e.g., PlayAGS, Inc., Prospectus (Form 424B4), at 136-37 (Jan. 29, 2018) (requiring approval of an insider shareholder for "fundamental changes to the nature of our business, including our entry into new and unrelated lines of business or cessation of a material portion of our business"); Rackspace Tech., Inc., *supra* note 90, at 188-89 (requiring the consent of certain insider shareholders who own at least 33% for "effecting any material change in the nature of the business of the Company and its subsidiaries, taken as a whole").

98. See, e.g., Sotera Health Co., *supra* note 69, at 167 (requiring a supermajority board vote for "any termination of the chief executive officer or designation of a new chief executive officer" if certain insider shareholders hold a certain percentage of common stock); Rackspace Tech., Inc., *supra* note 90, at 183 (requiring the consent of certain insider shareholders who own at least 33% for "hiring or terminating our Chief Executive Officer or our Chief Financial Officer"); PlayAGS, Inc., *supra* note 97, at 136 (requiring approval of an insider shareholder for "a termination of the chief executive officer or designation of a new chief executive officer").

99. See, e.g., Gatos Silver, Inc., *supra* note 89, at 145 (requiring consent of an insider shareholder for "equity issuances in excess of \$100 million"); Rackspace Tech., Inc., *supra* note 90, at 188-89 (requiring the consent of certain insider shareholders who own at least 33% for "the issuance of additional shares of any class of our capital stock or equity securities exceeding \$50 million in any single issuance or an aggregate amount of \$100 million during a calendar year").

100. See, e.g., Calyxt, Inc., Prospectus (Form 424B4), at 121-22 (July 21, 2017) (providing many veto rights to an insider shareholder); Rackspace Tech., Inc., *supra* note 90, at 188-89 (providing many veto rights to certain insider shareholders); PlayAGS, Inc., *supra* note 97, at 152 (same).

above.¹⁰¹ These veto rights are usually granted as a set, with insiders receiving a long list of veto rights that include most or all of the veto rights described above.¹⁰² In addition, the set of veto rights often exists in tandem with other control rights relating to the board of directors, so insider shareholders often have the power not only to choose who sits on the board, but also to control the board's actions on a regular basis. In most public companies, these types of decisions are clearly within the purview of the board of directors and officers, who regularly make these business decisions without shareholder input. This type of control is never available to public shareholders, who at most have the ability to elect directors and vote on a narrow group of fundamental corporate decisions. Furthermore, insider shareholders often maintain these rights long after they no longer have a majority of the voting rights of the corporation, with these rights phasing out only after they own less than 30%, or even less than 10%.¹⁰³

Insider shareholders also often get other rights that are not available to public shareholders beyond board-nomination rights and veto rights of corporate transactions, as illustrated in Figures 5 through 7 below. For example, many companies grant a right for insiders to observe all board meetings and to gain access to other inside information about the company that is not available to public shareholders, who only have access to public filings.¹⁰⁴ Almost 6% of the companies in our sample included these rights, with the number increasing significantly in the latter half of our sample. Additionally, some companies grant insider shareholders the ability to call special shareholder meetings, outside of the typical annual shareholder meetings, without requiring approval from other

101. Our data showed that from 2000-2008 these rights were relatively uncommon, with only between 2% and 13% of single-class companies granting these rights to insiders. From 2009-2020 these rights became much more common, with most years exceeding 15% of companies and half of the years exceeding 20%.

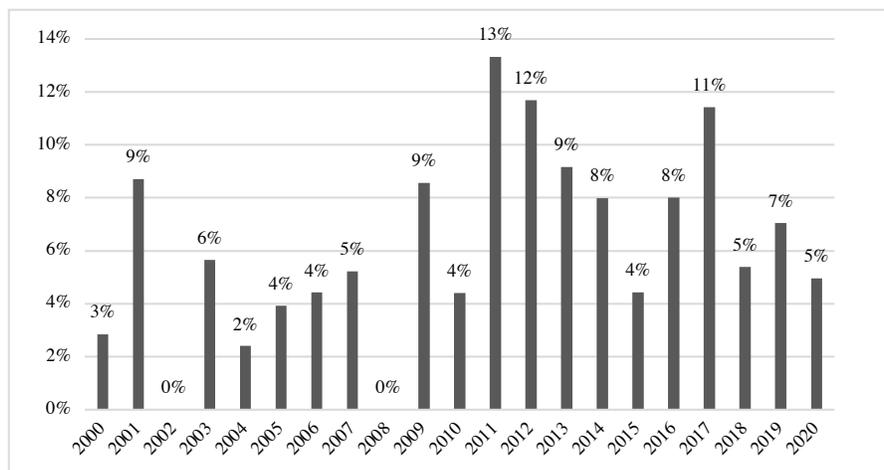
102. See, e.g., Livent Corp., Prospectus (Form 424B1), at 127 (Oct. 12, 2018) (providing a list of actions over which an insider has veto rights, including disposing of assets, issuing equity, acquiring another company, incurring debt, and settling litigation); AXA Equitable Holdings, Inc., Prospectus (Form 424B4), at 71 (May 11, 2018) (providing a list of actions over which an insider has veto rights, including acquisitions, any issuance of stock or debt, forming a new committee of the board, and amending the certificate of incorporation or bylaws).

103. See, e.g., Solarwinds Corp., Prospectus (Form 424B4), at 134 (Oct. 22, 2018) (phasing out these rights after insider shareholders collectively own less than 30% of outstanding shares); Palomar Holdings, Inc., *supra* note 14, at 136 (“The Stockholders Agreement will terminate at such time as Genstar Capital no longer owns at least 10% of our outstanding common stock.”).

104. See, e.g., Montrose Env't Grp., Inc., Prospectus (Form 424B4), at 137 (July 23, 2020) (“We also make a number of affirmative covenants to certain stockholders in the Investor Rights Agreement, including the Oaktree Holder, regarding matters including financial information and inspection rights.”); PPD, Inc., *supra* note 79, at 168 (“Blue Spectrum will have the right to designate a board observer to our board of directors so long as it collectively owns at least 5% of our outstanding shares of common stock. The GIC Holder will have the right to designate a board observer to our board of directors so long as it collectively owns at least 5% of our outstanding shares of common stock.”); Stoke Therapeutics, Inc., Prospectus (Form 424B4), at 144 (June 19, 2019) (“[F]or so long as any of Apple Tree Partners IV, L.P., RTW Master Fund or RTW Innovation Master Fund, Ltd., or any of their respective affiliates, holds any shares of our preferred stock or common stock issued upon conversion thereof, such investor or investors shall have the right to attend our board meetings in a nonvoting observer capacity.”).

shareholders, executives, or the board.¹⁰⁵ From 2000 through 2020, nearly 10% of companies in our sample granted these special-meeting rights, with companies granting these rights to insiders much more frequently in the last decade. Insiders also sometimes have the right to restrict the shareholders’ ability to act by written consent when the insiders own a minority of shares, which would allow shareholders other than insiders to act outside of shareholder meetings, and therefore without notice or input from insider shareholders.¹⁰⁶ These written-consent restrictions were present in over 12% of companies from 2000 through 2020, with a marked increase in the latter half of the sample.

Figure 5: Percentage of Companies Granting Special Information Rights



105. See, e.g., Cambium Networks Corp., Prospectus (Form 424B4), at 121 (June 26, 2019) (“[S]o long as Vector owns at least 25% of our outstanding ordinary shares, extraordinary meetings of our shareholders will also be called by the board of directors at the request of Vector.”).

106. See, e.g., AssetMark Fin. Holdings, Inc., Prospectus (Form 424B4), at 140 (July 18, 2019) (“Our amended and restated certificate of incorporation provides that holders of our common stock will not be able to act by written consent without a meeting, at any time when HTSC or any of its affiliates collectively own less than 50% in voting power of the stock of our company entitled to vote generally in the election of directors.”); Arlo Techs., Inc., *supra* note 66, at 160 (“Our amended and restated certificate of incorporation will, from and after such time as NETGEAR ceases to be the beneficial owner of shares of our capital stock representing at least a majority of the voting power of all then-outstanding shares of our voting stock, expressly prohibit the right of our stockholders to act by written consent. From and after such time, stockholder action must take place at the annual or a special meeting of Arlo stockholders.”).

Figure 6: Percentage of Companies Granting Special Meeting Rights

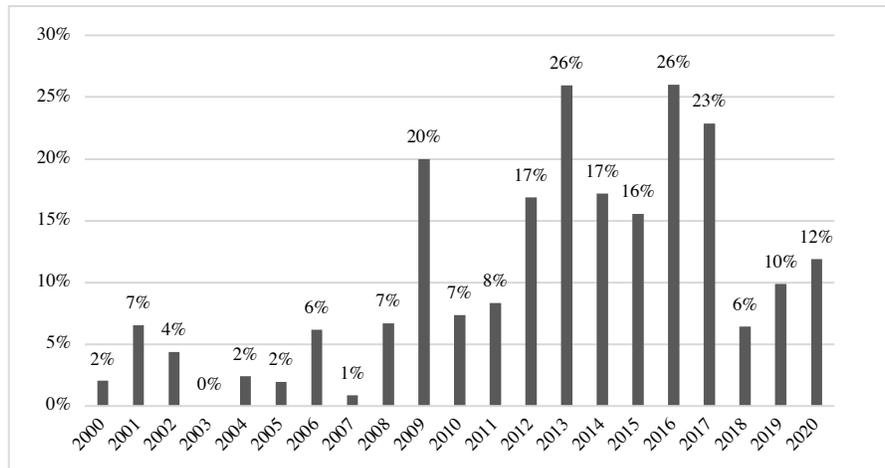
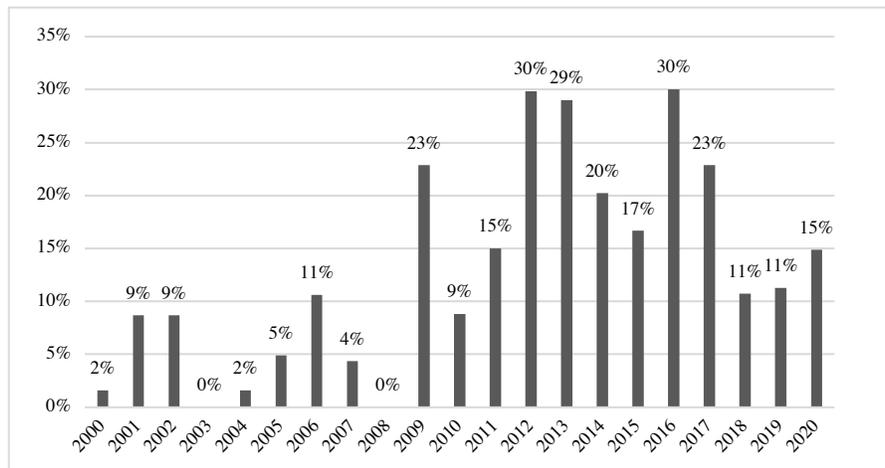


Figure 7: Percentage of Companies with Written-Consent Restrictions



The examples in this Section show that many single-class companies create corporate-governance structures that should be understood to be single class only in form and dual class in substance. Although this might just seem like semantics, recognizing that these purportedly single-class companies are in fact dual class in nature is important to helping scholars, regulators, and investors understand these companies. The policy concerns that are frequently raised by the unequal sharing of control in dual-class structures apply to a much broader group of companies than previously thought.

C. Theories of Dual Class by Contract

The disproportionate rights granted to insiders through contract raise many of the same issues raised by traditional dual-class corporations, and often create additional concerns. One consequence of granting special control rights to insiders through contract, and one plausible theory for why insiders would want these rights, is that it allows insiders to specify exactly which rights matter to them, and those rights often include more than what they would get even from a traditional dual-class structure. As discussed above, the rights that insider shareholders receive often exceed control of the board and include the right to approve even day-to-day decisions that are normally delegated to the board or executives. Therefore, in many cases, the contractual rights insiders receive can cause them to have even more control than they could receive as shareholders in a traditional dual-class structure, because the rights allow them to control matters that are generally controlled by officers and directors. It may be that these contractual rights allow insiders to control the company in ways that go beyond typical high-vote dual-class structures. Although a controlling shareholder in a traditional dual-class company arguably has these rights indirectly through their control of the board, the fact that insider shareholders often seek out these rights to directly control management and board decisions whether or not they have control of the board indicates that these additional control rights give insiders something more. These additional rights give insider shareholders additional opportunities to control corporate decisions in ways that can maximize their private benefits at the expense of the public, and therefore should perhaps be even more concerning than traditional dual-class structures.

A related, and equally problematic, theory of why insiders choose to use dual class by contract is that obtaining control rights through contract allows company insiders to gain disproportionate control while avoiding or mitigating the negative economic consequences and shareholder-protection restrictions that accompany a traditional dual-class structure. As discussed above, due to investor concern about multi-class structures, index investors have strongly advocated against dual-class companies with unequal voting rights.¹⁰⁷ In response, prominent indices have recently started limiting, underweighting, or excluding companies with dual-class structures,¹⁰⁸ which has decreased index investing in traditional dual-class companies.¹⁰⁹ An index is a portfolio of publicly traded

107. See Hirst & Kastiel, *supra* note 15, at 1278 (“[T]raditional sources of constraints on governance arrangements—state corporate law, listing exchanges, and federal securities regulation—have not been effective to constrain [dual-class] arrangements. Index exclusions represent investors’ response, pushing index providers to change their rules with the goal of limiting the disfavored arrangements.”); *Governance & Sustainability Principles*, CALPERS 6 (Sept. 2019), <https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf> [<https://perma.cc/DA64-AJA3>] (“A shareowner’s right to vote is irrevocable and cannot be reduced.”).

108. See *supra* note 47; Press Release, S&P Global, *supra* note 15.

109. See, e.g., StepStone Grp., Inc., *supra* note 16, at 61 (“Certain stock index providers, such as S&P Dow Jones, exclude companies with multiple classes of shares of common stock from being added

companies that many of the largest investors, including mutual funds, use for investing in the public market. If a publicly traded company is included on indices, index-fund investors effectively have no choice but to invest in that company.¹¹⁰ This increases the demand for the company's shares relative to traditional dual-class companies, which should have the effect of increasing its stock price. Companies therefore have a strong incentive to be included on indices. Although dual-class structures are often discounted or excluded from indices, single-class structures, including de facto dual-class structures that grant disproportionate rights to insiders (but which formally have only one class of common stock), can trade without restriction on major indices.¹¹¹ These de facto dual-class structures allow companies that are in form similar to traditional dual-class companies to get around these restrictions despite their substantive similarities to traditional dual-class structures.¹¹²

Studies of traditional dual-class stock show that single-class stock provides a pricing benefit to insider shareholders. Single-class companies generally trade at a premium compared to low-vote public shares in traditional dual-class companies.¹¹³ This is likely because institutional investors and other public

to certain stock indices. . . . As a result, the dual-class structure of our common stock may prevent the inclusion of our Class A common stock in such indices, may cause stockholder advisory firms to publish negative commentary about our corporate governance practices or otherwise seek to cause us to change our capital structure and may result in large institutional investors not purchasing shares of our Class A common stock. Any exclusion from stock indices could result in a less active trading market for our Class A common stock.”); ZoomInfo Techs. Inc., *supra* note 16, at 69 (“Given the sustained flow of investment funds into passive strategies that seek to track certain indexes, exclusion from stock indexes would likely preclude investment by many of these funds and could make our Class A common stock less attractive to other investors.”).

110. See Hirst & Kastiel, *supra* note 15, at 1232.

111. See *supra* note 47.

112. See *supra* note 17 and accompanying text.

113. Empirical studies have generally shown that dual-class stock trades at a discount relative to single-class stock. See Gompers et al., *supra* note 31, at 1084 (finding that share price is “negatively associated with insiders’ voting rights”); Smart et al., *supra* note 53, at 94 (finding that “dual-class firms trade at lower prices than do single-class firms, both at the IPO and for at least the subsequent 5 years” and that when dual-class companies “unify their share classes, statistically and economically significant value gains occur”); Smart & Zutter, *supra* note 59, at 85 (finding that dual-class companies “trade at lower prices relative to earnings and sales than single-class IPOs”); Aaron Stumpf & Andrew Cline, *Price Differentials Between Voting and Nonvoting Stock*, STOUT, <https://www.stout.com/en/insights/article/price-differentials-between-voting-and-nonvoting-stock> [<https://perma.cc/7NCD-QPT5>] (noting the factors that may contribute to lower share value in dual-class companies); see also Ben Amoako-Adu, Vishaal Baulkaran & Brian F. Smith, *Dual Class Discount, and the Channels of Extraction of Private Benefits*, 16 ADVANCES FIN. ECON. 165 (2014) (examining the relationship between the discount in the value of dual-class shares and the ways that controlling shareholders can extract private benefits); Vishaal Baulkaran, *Management Entrenchment and the Valuation Discount of Dual Class Firms*, 54 Q. REV. ECON. & FIN. 70 (2014) (examining the relationship between the dual-class discount and managerial entrenchment); Masulis et al., *supra* note 59, at 1722 (examining dual-class company performance and finding that larger insider control rights are consistent with “reduced market value to outside shareholders”). For similar findings in non-U.S. markets, see Karl V. Lins, *Equity Ownership and Firm Value in Emerging Markets*, 38 J. FIN. & QUANTITATIVE ANALYSIS 159 (2003) (examining company value in 18 emerging markets and finding that company value is lower when voting rights exceed cash-flow rights); and Stijn Claessens, Simeon Djankov, Joseph P.H. Fran & Harry H.P. Lang, *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. FIN. 2741, 2741 (2002) (examining East Asian economies and finding that “firm value falls when the control rights of the largest shareholder

shareholders, who only have the option of purchasing low-vote stock and who value voting rights, are willing to pay less for these shares than they are willing to pay for shares in a company with equal voting rights.¹¹⁴ Of course, if the public similarly discounted the amount it was willing to pay for companies that give disproportionate control rights to insiders, then the market would effectively make the insider shareholders pay for their disproportionate control.¹¹⁵

Although the public market should arguably apply a discount to companies that grant disproportionate rights to insiders, these companies' structures are significantly less evident than a traditional dual-class structure because they are not part of the company's capital structure and are instead buried deep inside a separate contractual agreement that public shareholders must parse to understand what rights they are giving up.¹¹⁶ And because regulators, scholars, and shareholder groups who regularly debate and critique traditional dual-class companies have not made the same types of public arguments against companies that grant disproportionate control to insiders by contract, shareholders are likely unaware of the problems they create. The dual-class nature of a traditional dual-class company, on the other hand, is much more readily apparent to shareholders looking to buy the company's stock, often appearing on the first page of the company's prospectus and receiving hundreds of mentions throughout their disclosures. Therefore, public shareholders are much more likely to be aware of the potential downsides of investing in traditional dual-class companies.¹¹⁷ More salient provisions have been shown to have a greater effect on IPO pricing, so

exceed its cash-flow ownership"). *But see* Byung Hyun Ahn, Jill E. Fisch, Panos N. Patatoukas & Steven Davidoff Solomon, *Synthetic Governance*, 2 COLUM. BUS. L. REV. 476, 511-13 (2021) (finding that dual-class companies outperform the market). To eliminate the possibility that dual-class companies' stock trades at lower prices simply because they are less profitable, studies generally analyze operating performance and find that dual- and single-class companies exhibit similar operating performance, strongly implying that the dual-class structure itself is the reason that public shareholders discount dual-class company stock. *See, e.g.*, Smart et al., *supra* note 53, at 108 ("[D]uals exhibit neither better nor worse operating performance relative to singles.").

114. The benefits of high-vote shares are evidenced by the fact that they command a market premium. *See* Masulis et al., *supra* note 59, at 1700 (stating that "superior-voting shares command a premium in the marketplace over inferior-voting shares"); *see also* Press Release, Council of Institutional Invs., Investors Petition NYSE, NASDAQ to Curb Listings of IPO Dual-Class Share Companies 3 (Oct. 24, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/FINAL%20Dual%20Class%20Petition%20Press%20Release%20Oct%202024,%202018.pdf [<https://perma.cc/YXP6-EKUD>]; StepStone Grp., Inc., *supra* note 16, at 61 ("[S]everal stockholder advisory firms and large institutional investors oppose the use of multiple class structures. As a result, the dual-class structure of our common stock may . . . cause stockholder advisory firms to publish negative commentary about our corporate governance practices or otherwise seek to cause us to change our capital structure and may result in large institutional investors not purchasing shares of our Class A common stock. . . . Any actions or publications by stockholder advisory firms or institutional investors critical of our corporate governance practices or capital structure could also adversely affect the value of our Class A common stock.").

115. For an argument to this effect in the dual-class context, see Sharfman, *supra* note 35, at 26-27.

116. To the extent these contractual agreements are disclosed in a company's prospectus, the description is typically in a section titled "related party transactions," which is commonly at least 100 pages into the disclosure.

117. *See* Smart et al., *supra* note 53, at 96 ("[T]he market efficiently prices dual-class companies."); Gompers et al., *supra* note 31, at 1060.

there is reason to believe that salience matters in this context too.¹¹⁸ If insiders can be subject to less of a financial penalty by receiving disproportionate rights through contract rather than through a traditional dual-class structure, then using contract would be a win-win for company insiders, who get to keep control without paying a penalty commensurate to their benefit, and a lose-lose for public shareholders, who not only receive less control on a per share basis, but also likely overpay for their low-control shares.

It is important to note that many of the rights described in this Article do not grant insiders full control of the company. However, even non-control rights that exceed rights that are available to the public should be considered as creating a type of dual class. While these rights might be viewed as minority protections of the type that are common in private closely held corporations, where scholars often characterize them as a valid way for minority shareholders to avoid oppression by majority shareholders,¹¹⁹ the publicly traded corporation context is very different.¹²⁰ In the instances we found in our sample, these control rights were generally not used to protect minority shareholders from a potential controlling oppressor. Instead, the control rights were a means for the insiders to maintain disproportionate control of the corporation as compared to the public shareholders. Whether or not contractual rights grant full control to insiders, they always give insiders something more than the public shareholders get by allowing the insiders disproportionate say over the operations of the company through, for example, disproportionate influence on the board or the ability to veto corporate decisions. These control rights can be substantial even if they are not absolute and should be considered part of the spectrum of ways insiders obtain disproportionate control rights in the context of publicly traded companies.

In sum, it is clear when comparing contractually created dual class with traditional dual class that concerns commonly raised about dual class apply in both contexts, and often even more strongly in the contractual context given the enhanced control rights insiders have over everyday decisions made by the corporation and the board of directors. As a result, the costs of granting insiders control rights through contract may be even higher to other shareholders than a traditional dual-class structure. Either way, the costs described here have been

118. See Lucian Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 783 (2009) (finding that “increases in the index level are monotonically associated with economically significant reductions in firm valuation as well as large negative abnormal returns”); K.J. Martijn Cremers & Vinay B. Nair, *Governance Mechanisms and Equity Prices*, 60 J. FIN. 2859, 2862 (2005) (finding “that internal and external governance mechanisms are complements in being associated with long-term abnormal returns”); Paul Gompers, Joy Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107 (2003) (finding that certain shareholder-rights provisions correlated with higher firm value).

119. See, e.g., D. GORDON SMITH & CYNTHIA A. WILLIAMS, BUSINESS ORGANIZATIONS: CASES, PROBLEMS, AND CASE STUDIES 283-86 (4th ed. 2019).

120. This is how shareholder agreements are commonly used in closely held corporations to protect minority shareholder rights. See *id.* at 241 (“Shareholders in closely held corporations often decide to vary the default rules contained in corporation statutes. Because the number of shareholders is, by definition, small, highly tailored arrangements allocating control are often feasible.”).

underexplored and should be accounted for by regulators, investors, and scholars. Part III provides a framework for regulators, investors, and scholars to analyze and respond to arrangements that disproportionately empower insiders.

III. Non-High-Vote Dual Class

Traditionally, the “dual class” designation denotes an equity structure with at least two outstanding classes of common stock, at least one of which grants company insiders superior voting rights.¹²¹ Accordingly, the academic literature and other commentators have focused on high-vote dual-class structures and the effects, harms, and merits of companies that grant company insiders high-vote shares.¹²² While Part II showed that this understanding of dual class is too narrow, and that insiders often get disproportionate control in formally single-class companies, this Part analyzes companies that have explicitly adopted dual-class structures but that are typically excluded from the dual-class debate because they do not grant insider shareholders superior voting rights. Our findings show that these non-high-vote dual-class companies make up approximately 35% of all dual-class companies, yet they have been almost entirely ignored by scholars and policymakers, presumably because they believe these companies are not problematic for public shareholders in the way that high-vote dual-class companies are.¹²³ This Part argues that the agency costs created by these structures should cause them to be part of the broader dual-class debate.

By disaggregating non-high-vote dual-class companies, this Part builds on Part II to further show that traditional notions of dual class are underinclusive and that the existing dual-class debate is too narrow. It shows that agency costs arise any time company insiders hold their interests in a different form from public shareholders. Although non-high-vote dual-class companies do not grant company insiders disproportionate *voting* rights, many of these companies nonetheless create a superior *economic* class of stock for the insider shareholders and an inferior class of economic stock for the public shareholders. Other dual-class companies grant company insiders superior control rights through contract despite issuing the insiders a class of stock with zero voting rights, obfuscating who truly controls those companies. The ways that these dual-class companies create disproportionate economic and control rights are complex and varied, but

121. See Lund, *supra* note 1, at 691 (“The traditional dual-class company offers low-voting stock for public investors to buy, keeping the high-voting shares (which typically have ten times as many votes as the low-voting shares) in the possession of the company’s insiders.”); Masulis et al., *supra* note 59, at 1700 (“A typical dual-class company has two classes of stock: the superior class, which has multiple votes per share and is not publicly traded, and the inferior class, which has one vote per share and is generally publicly traded.”).

122. See Lund, *supra* note 1, at 691; see also *Dual Class Companies List*, COUNCIL INSTITUTIONAL INVS. 1 n.1 (Sept. 2019), <https://www.cii.org/files/FINAL%20format%20Dual%20Class%20List%209-27-19.pdf> [<https://perma.cc/KY7F-S63X>] (“Companies that use Up-C structures with two classes of outstanding shares but have no wedge between voting and equity interests are excluded here.”); Aggarwal et al., *supra* note 54, at 127 (excluding Up-Cs from their sample).

123. See *supra* notes 53 and 55 and accompanying text for a discussion of our methodology.

in each case company insiders receive a class of stock that is not available to the public, which results in agency costs that have gone previously unnoticed.

A. *The Up-C*

In order to determine why companies adopt non-high-vote dual-class structures and whether the structures create disproportionate benefits for company insiders, we examined the companies' prospectuses and other publicly available IPO documents to analyze differences among the companies' classes of common stock. We found that approximately two-thirds of all non-high-vote dual-class companies do so in order to create an "Up-C" structure.¹²⁴ The Up-C is an important yet relatively recent form of dual-class company, and its complete absence from the dual-class literature is likely attributable at least in part to the fact that prior to 2004, less than 1% of all dual-class companies used an Up-C structure.¹²⁵ Although the Up-C is a relatively new type of dual-class company, it has risen quickly in popularity, and, according to this Article's dataset, over the past few years the Up-C has represented approximately 8% of all IPOs.¹²⁶

In order to explain the dual-class policy issues raised by the Up-C and how it allows company insiders to receive disproportionate value, it is necessary to have a basic understanding of the Up-C's organizational structure. The Up-C is a two-tiered structure with a corporation on top of a partnership.¹²⁷ The corporation is publicly traded, but all of the company's active operations are conducted through the partnership subsidiary. Importantly, the public shareholders hold their economic interests through Class A shares in the publicly traded corporation, while the company insiders hold their economic interests directly in the partnership and hold non-economic, voting Class B shares in the corporation.¹²⁸ The fact that the public shareholders and company-insider

124. Because approximately 35% of all traditional dual-class companies grant equal voting rights to their shareholders, and approximately two thirds of the non-high-vote dual-class companies are Up-Cs, approximately 23% of all traditional dual-class companies are Up-Cs.

125. See Gladriel Shobe, *The Substance Over Form Doctrine and the Up-C*, 38 VA. TAX REV. 249, 252 (2018) [hereinafter Shobe, *The Substance Over Form Doctrine and the Up-C*]; Gladriel Shobe, *Supercharged IPOs and the Up-C*, 88 U. COLO. L. REV. 913, 941-47 (2017) [hereinafter Shobe, *Supercharged IPOs*] (discussing the rise in popularity of the Up-C).

126. See also Shobe, *The Substance Over Form Doctrine and the Up-C*, *supra* note 125 (discussing the increased frequency of Up-C IPOs).

127. The corporation is generally a holding company whose primary asset is its interest in the partnership, and the partnership is an operating partnership, which holds the assets and operations of the company. The C corporation then becomes a public company by selling Class A stock to public shareholders for cash, which the newly public C corporation uses to purchase interests in the historic partnership from the pre-IPO owners or directly from the historic partnership itself. The corporation is a C corporation for U.S. federal-income-tax purposes but may be organized under state law as a corporation or a limited liability company. The operating partnership can be a partnership or any other pass-through entity that is a partnership for U.S. federal-income-tax purposes.

128. The corporation typically has two classes of common stock: Class A stock, which is held by the public shareholders, and Class B voting, non-economic stock, which is held by the pre-IPO owners (company insiders). See Shobe, *Supercharged IPOs*, *supra* note 125, at 933-34. These Class B shares can have equal voting rights with Class A shares or higher voting rights, in which case the company is a traditional dual-class company on top of being an Up-C.

shareholders hold their economic interests in different entities means that when cash flows out of the company, company insiders receive their distributions and dividends from an entirely different entity than the public shareholders do, which creates the opportunity for disparate economic treatment of the company insiders and the public shareholders, always to the benefit of the insiders.

Economic differences between public shareholders' and company insiders' interests are obscured by the Up-C's dual-class structure and by their public disclosures. Up-C companies typically claim that they adopt a dual-class structure for tax purposes¹²⁹ and that the Class A shares held by the public shareholders are economically equivalent to the partnership units held by the company insiders.¹³⁰ In other words, Up-C companies assert that although the company insiders and Class A shareholders hold their interests in different entities, each share owned by a public shareholder is economically equivalent to each unit held by the company insiders.¹³¹ The company insiders even have the right to exchange their units for Class A shares in the public corporation on a one-for-one basis whenever they choose.¹³² In addition, law firms that advise Up-C companies have represented to the SEC that the public shareholders and company insiders receive the same economic benefits on a per share/unit basis,¹³³ and the SEC has affirmatively relied on these representations.¹³⁴

129. See Gregg D. Polsky & Adam H. Rosenzweig, *The Up-C Revolution*, 71 TAX L. REV. 415 (2018); see also Victor Fleischer & Nancy Staudt, *The Supercharged IPO*, 67 VAND. L. REV. 307, 319-24 (2014) (discussing the tax benefits generated by Up-Cs and other supercharged IPOs).

130. See, e.g., GreenSky, Inc., Prospectus (Form 424B4), at 65 (May 25, 2018) (“[E]ach Holdco Unit (together with a share of Class B common stock) is economically equivalent to a share of Class A common stock on a one-for-one basis.”); BRP Grp., Inc., Prospectus (Form 424B4), at 56 (Oct. 25, 2019) (“The economic interest represented by each LLC Unit that we own will correspond to one share of our Class A stock.”); Switch, Inc., Prospectus (Form 424B4), at 60 (Oct. 10, 2017) (“We will receive the same benefits as the Members on account of our ownership of Common Units in an entity treated as a partnership . . .”).

131. See, e.g., GoDaddy Inc., Prospectus (Form 424B4), at 64 (Apr. 1, 2015) (“GoDaddy Inc. will hold a number of LLC Units that is equal to the number of shares of Class A common stock that it has issued, a relationship that we believe fosters transparency because it results in a single share of Class A common stock representing (albeit indirectly) the same percentage ownership in Desert Newco as a single LLC unit.”).

132. Pre-IPO owners have a right to exchange one Class B share and one partnership unit for one Class A share of the public company, which they can then sell on the public market. See, e.g., Planet Fitness, Inc., Prospectus (Form 424B4), at 9 (Aug. 6, 2015) (stating that the pre-IPO owners have the right “to exchange their Holdings Units, together with a corresponding number of shares of Class B common stock, for shares of our Class A common stock on a one-for-one basis”). This provides the pre-IPO owners liquidity similar to the liquidity they would have in a traditional IPO.

133. See, e.g., Letter from Joshua Ford Bonnie, Simpson Thacher & Bartlett LLP, John C. Kennedy, Paul, Weiss, Rifkind, Wharton & Garrison LLP; and Gregory P. Rodgers, Latham & Watkins LLP, to David Fredrickson, Chief Couns., Div. of Corp. Fin., Sec. & Exch. Comm’n 2 (Oct. 28, 2016), <https://www.sec.gov/divisions/corpfin/cf-noaction/2016/up-c-110116-144-incoming.pdf> [<https://perma.cc/6XEX-SGJW>] (“[E]ach OP Unit represents the same proportional interest in the Company Assets as a Corporation Share. The Corporation Shares are therefore economically equivalent to the OP Units.”).

134. See, e.g., Joshua Ford Bonnie, Simpson Thacher & Bartlett LLP, John C. Kennedy, Paul, Weiss, Rifkind, Wharton & Garrison LLP, and Gregory P. Rodgers, Latham & Watkins LLP, SEC Interpretive Letter, 2016 WL 6472833, at *1 (Nov. 1, 2016) (“In reaching this conclusion, we note in particular your representations that . . . the Up-C Governing Documents contemplate and provide the terms for the exchange of OP Units for Corporation Shares such that the OP Unitholder has the same economic risk as if it were a holder of the Corporation Shares during the entire period it holds the OP Units . . .”).

Despite the fact that companies and their advisors assert that the Up-C dual-class structure is driven by tax purposes, not substantive differences between the public shareholders and company insiders, upon closer examination of the Up-C it is clear that while the structure can create significant tax benefits,¹³⁵ it also creates the opportunity for the company insiders to receive disproportionate economic value. In fact, Up-C companies often give general disclosures that the organizational structure confers benefits to the company's insiders that are not available to the same extent for the public shareholders.¹³⁶ However, the disclosures are typically vague and do not explain the specific ways that company insiders' interests are more economically valuable than the Class A shares available to public shareholders in an Up-C.¹³⁷

One way that company insiders may receive disproportionate economic value as a result of the Up-C's dual-class structure occurs because insider shareholders receive cash directly from the partnership, so they automatically receive cash whenever the partnership makes a distribution.¹³⁸ In contrast, public shareholders own interests in the holding corporation, which in turn owns interests in the partnership, and therefore public shareholders only receive cash if the corporation chooses to make a dividend to distribute amounts that it receives from the partnership (i.e., the cash can get trapped at the corporation).¹³⁹ The reason some companies, especially companies that are controlled by insider shareholders, allow this cash to accumulate is that doing so keeps value at the company, which the insiders effectively own an economic interest in, rather than allowing that value to flow to the public shareholders. Therefore, if a company chooses not to distribute the public shareholders' pro rata portion of the cash distributions out of the Up-C partnership entity, the insider shareholders receive the economic benefit of effectively owning a portion of that accumulated cash. Several Up-Cs have disclosed the *risk* that this could result in public shareholders

135. See Shobe, *Supercharged IPOs*, *supra* note 125, at 937-38; Polsky & Rosenzweig, *supra* note 129. Because the pre-IPO owners make a § 754 election, a tax step-up occurs when pre-IPO owners exchange their partnership units for shares in the publicly traded corporation. See I.R.C. § 754. The step-up reduces a company's tax liability through amortization. For example, if a company has self-developed goodwill worth \$100 million and steps up that goodwill in the process of an Up-C IPO, since goodwill is amortizable over fifteen years, the step-up would reduce the company's tax liability by \$1.4 million per year, assuming a 21% tax rate.

136. See, e.g., EVO Payments, Inc., Prospectus (Form 424B4), at 45 (May 24, 2018) ("Our organizational structure, including the [tax receivable agreement], confers certain benefits upon the Continuing LLC Owners that will not benefit the holders of our Class A common stock to the same extent that it will benefit the Continuing LLC Owners.").

137. For empirical evidence of the general underperformance of Class A stock, see Mary Billings, Kevin Hsueh, Gladriel Shobe & Melissa Western, *Innovations in IPO Deal Structure: Do Up-C IPOs Harm Post-IPO Shareholders?*, MGMT. SCI. (forthcoming 2022) (showing that while Up-Cs demonstrate operating performance similar to that of other public companies, the Class A shares underperform compared to share value in other public companies).

138. See Gladriel Shobe, *Private Benefits in Public Offerings: Tax Receivable Agreements in IPOs*, 71 VAND. L. REV. 889, 925-34 (2018).

139. See *id.*

receiving less economic value than insider shareholders,¹⁴⁰ but no Up-C company has disclosed when the risk has become a reality and the harm to public shareholders has materialized. In other words, the issue is merely disclosed as theoretical, if it is disclosed at all. Yet it is clear that this harm does materialize in certain Up-Cs, especially profitable ones that have more income that can be unevenly distributed.¹⁴¹

Certain Up-C companies have affirmatively fixed this form of economic inequity between Class A and Class B shareholders. In *Garfield v. BlackRock Mortgage Ventures*, a recent Delaware Court of Chancery case, the court explained that the Up-C made a special distribution of \$10.1 million to the public shareholders because cash distributed to the public shareholders had become trapped at the public corporate level (whereas the company insiders received direct payments from the operating partnership).¹⁴² Similarly, Camping World made approximately \$33 million in special cash dividends¹⁴³ and Summit Materials issued approximately \$89 million in special stock dividends to their public shareholders “in order to maintain the relationship between the shares of

140. See, e.g., Planet Fitness, Inc., *supra* note 132, at 37 (“To the extent, as currently expected, we do not distribute such cash balances as dividends on our Class A common stock and instead, for example, hold such cash balances or lend them to Pla-Fit Holdings, LLC, the Continuing LLC Owners would benefit from any value attributable to such accumulated cash balances as a result of their ownership of Class A common stock following an exchange of their Holdings Units.”).

141. A closely related way that company insiders’ interests receive disproportionate economic value is that the Class A shareholders bear a disproportionate share of the company’s overhead expenses because the public corporation, not the operating partnership, generally pays these expenses. See, e.g., Shake Shack Inc., Prospectus (Form 424B3), at 142-43 (Jan. 30, 2015) (describing how the public corporation will receive distributions “to cover our operating expenses and other obligations” while the company insider pre-IPO owners will receive pro rata cash distributions). A handful of Up-Cs have chosen to have these expenses paid by the operating partnership, which results in the company insiders bearing their portion of those expenses, but it appears that most Up-Cs do not take that approach. See, e.g., Cactus Inc., Prospectus (Form 424B4), at 31 (Feb. 9, 2018) (stating that the partnership will make “non-pro rata payments to us to reimburse us for our corporate and other overhead expenses,” resulting in all owners sharing proportionally in such expenses).

142. See *Garfield v. BlackRock Mortg. Ventures, LLC*, 2019 WL 7168004, at *4 (Del. Ch. Dec. 20, 2019) (noting that a special committee considered paying a dividend of the excess tax distributions to Class A stockholders prior to the pre-IPO owners’ exchanges for Class A shares or adjusting the exchange ratio for the exchanges, and opted to pay a dividend to Class A stockholders).

143. See Camping World Holdings, Inc., Form 10-K, at 81-82 (Feb. 28, 2020) (“CWGS, LLC intends to make a regular quarterly cash distribution to its common unit holders, including us, of approximately \$0.08 per common unit, and we intend to use all of the proceeds from such distribution on our common units to pay a regular quarterly cash dividend of approximately \$0.08 per share on our Class A common stock, subject to our discretion as the sole managing member of CWGS, LLC and the discretion of our board of directors. During each of the years ended December 31, 2019, 2018 and 2017, we paid four regular quarterly cash dividends of \$0.08 per share of our Class A common stock. . . . In addition, we currently intend to pay, a special cash dividend of all or a portion of the Excess Tax Distribution (as defined under ‘Dividend Policy’ included in Part II, Item 5 of this Form 10-K) to the holders of our Class A common stock from time to time subject to the discretion of our board of directors as described under ‘Dividend Policy.’ In the years ended December 31, 2019, 2018 and 2017, we paid four special cash dividends of \$0.0732 per share of our Class A common stock, and in the quarter ended December 31, 2017, we also paid a one-time dividend of \$0.13 per share of our Class A common stock.”).

the Class A common stock and the [Limited Partnership] Units” owned directly by the company insiders.¹⁴⁴

An additional way that company insiders in an Up-C receive disproportionate economic value is through a tax receivable agreement (TRA), a contract between the company insiders and the company whereby the company is obligated to pay the company insiders for the tax benefits created by the Up-C structure.¹⁴⁵ TRAs typically obligate Up-C companies to pay hundreds of millions of dollars to insider shareholders, which results in the vast majority of tax benefits transferring to the insiders rather than benefiting the company as a whole or the public shareholders. Because (i) Up-Cs only enter into TRAs with insider shareholders, and never public shareholders, and (ii) only insider shareholders, never public shareholders, hold Class B stock and a direct interest in the underlying partnership, the TRA is a benefit that is only ever available to Class B shareholders. However, the TRA is a separate contract, not a right directly attached to insiders’ rights as shareholders. Therefore, Up-C companies can claim that the public shareholders and company insiders hold economically equivalent interests.¹⁴⁶ In that way, Up-Cs are similar to the single-class companies discussed in Part II: they each contractually allow insider shareholders to obtain rights that are not available to public shareholders, thereby making the public shareholders’ interests inferior to the insiders’ interests.¹⁴⁷

144. See Summit Materials, Inc., Prospectus (Form 424B4), at 48 (Mar. 13, 2015) (“To the extent the tax distributions Summit Materials, Inc. receives exceed the amounts it actually requires to pay taxes and make payments under the tax receivable agreement, we expect our board of directors will cause Summit Materials, Inc. to use such excess cash to acquire additional newly-issued LP Units at a per unit price determined by reference to the volume weighted average price per share of the Class A common stock during the five trading days immediately preceding the date of the relevant board action. If Summit Materials, Inc. acquires additional LP Units in this manner, we also anticipate that in order to maintain the relationship between the shares of Class A common stock and the LP Units our board of directors will at that time declare a stock dividend on the Class A common stock of an aggregate number of additional newly-issued shares that corresponds to the number of additional LP Units that Summit Materials, Inc. is acquiring.”).

145. See Shobe, *supra* note 138 (discussing tax receivable agreements).

146. See, e.g., GoDaddy, Inc., *supra* note 131, at 176 (“[W]e would be required to pay the owners of LLC Units approximately 85% of such amount, or \$1.4 billion, over the 15 year period from the date of this offering.”); GreenSky, Inc., *supra* note 130, at 53 (“[W]e would be required to pay approximately 85% of such amount, or \$928.2 million, over the 15-year period from the date of the offering.”); Artisan Partners Asset Mgmt. Inc., Prospectus (Form 424B4), at 41 (Mar. 7, 2013) (“[W]e would be required to pay the other parties to the tax receivable agreement 85% of such amount, or \$853.1 million, over the 15-year period from the date of this offering.”); Planet Fitness, Inc., *supra* note 132, at 149 (“[W]e would be required to pay the [pre-IPO owners] 85% of such amount, or \$747.6 million, over the 23-year period from the date of this offering.”).

147. Non-high-vote Up-Cs can also involve other contracts, such as those described in Part II, that create a dual-class structure by contract. See, e.g., Funko, Inc., Prospectus (Form 424B4), at 54 (Nov. 3, 2017) (stating that “pursuant to the Stockholders Agreement [between Funko, Inc., ACON, Fundamental and Brian Mariotti, our chief executive officer (the “Stockholders Agreement”)], ACON has the right to designate certain of our directors, which we refer to as the ACON Directors, which will be three ACON Directors for as long as ACON directly or indirectly, beneficially owns, in the aggregate 35% or more of our Class A common stock, two ACON Directors for so long as ACON, directly or indirectly, beneficially owns, in the aggregate, less than 35% but at least 25% or more of our Class A common stock and one ACON Director for as long as ACON, directly or indirectly, beneficially owns, in the aggregate, less than 25% but at least 15% or more of our Class A common stock (assuming in each

All of these economic differences in an Up-C benefit Class B insiders and create agency costs. Because Class B shareholders often control or maintain significant influence over the company, the fact that their economic interests differ from Class A shareholders can drive them to use the structure for their own benefit. This might involve making decisions that drive more economic value to the Class B shareholders and are not in the best interests of the company as a whole. These agency costs are often more concrete in an Up-C than in a typical high-vote dual-class company, where opportunities to extract economic value from the company are generally not as built into the structure as they are in a dual-class Up-C.

B. Other Non-High-Vote Dual-Class Companies

Our findings revealed another wrinkle in the use of dual-class structures. We found that one-third of non-supervote dual-class companies do not use an Up-C structure, but instead adopt dual-class structures for other reasons. For example, a handful of companies use dual-class structures to facilitate compliance with certain banking regulations,¹⁴⁸ and a few companies use dual-class structures to issue special dividends to their company insiders.¹⁴⁹ While these special dividends create disproportionate value for the insiders, the special dividends were clearly disclosed and generally function like preferred stock.

Our findings also show that some non-supervote dual-class companies grant disproportionate value to company insiders in opaque and arguably misleading ways. These companies granted *zero*-vote stock to their company insiders, which at first glance seems to grant full voting control to a company's public shareholders (and no voting control to the company insiders). However, each of these "zero vote" companies in our sample granted their company insiders disproportionate control much in the same way described in Part II. In other words, these companies give the insiders a class of stock with no voting power, but then grant control of the board to insiders by contract,¹⁵⁰ making their lack of voting power essentially meaningless. For example, Floor & Decor disclosed on page 1 of their IPO filing that the company had two classes of stock:

such case that all outstanding common units in FAH, LLC are redeemed for newly issued shares of our Class A common stock on a one-for-one basis).")

148. See, e.g., Cadence Bancorporation, Prospectus (Form 424B4), at 21 (Apr. 14, 2017).

149. See, e.g., Celanese Corp., Prospectus (Form 424B4), at ii (Jan. 24, 2005) ("Except for the special Series B common stock dividends . . . shares of Series A common stock and shares of Series B common stock will be identical, including with respect to voting rights.")

150. For examples of companies that used dual-class structures to grant company insiders disproportionate control over the board of directors (but did not use traditional high-vote stock), see GNC Holdings, Inc., Prospectus (Form 424B1), at 156 (Apr. 4, 2011) ("Each share of our Class A common stock entitles its holder to one vote per share on all matters to be voted upon by the stockholders. Each share of our Class B common stock entitles its holder to one vote per share on all matters to be voted upon by stockholders, except with respect to the election or removal of directors."); and Genworth Fin., Prospectus (Form 424B1), at 226 (May 25, 2004) ("So long as GE owns more than 50% of our outstanding common stock and the board of directors consists of nine members, GE, in its capacity as the holder of our Class B Common Stock, will have the right to elect five members, and holders of our Class A Common Stock will have the right to elect four members.")

Class A, which was being sold to the public in the IPO, and Class C, which was non-voting (and held only by the company insiders).¹⁵¹ Despite the fact that the Class C stock was prominently described as “non-voting,” the company also had a shareholder agreement through which company insiders, who held 100% of the Class C stock, had the right to nominate seven out of eleven of the members of the board of directors.¹⁵² Similarly, Noodles & Company disclosed that it had two classes of common stock: Class A, which was being sold in the IPO, and Class B, which “does not vote on the election or removal of directors.”¹⁵³ However, through a shareholder agreement, the company insiders, who held 100% of the Class B stock, had the right to designate four out of seven members of the board of directors.¹⁵⁴ Several other companies also grant their “zero vote” company insiders the right to nominate and appoint members to the companies’ boards of directors.¹⁵⁵

These “zero” vote dual-class companies raise similar issues as single-class companies that grant these types of rights by contract do, but they also raise a set of unique issues. In particular, granting the company insiders a zero-vote class

151. See Floor & Decor Holdings, Inc., Prospectus (Form 424B4), at 1 (Apr. 28, 2017) (“Following this offering, we will have two classes of common stock outstanding: Class A common stock and Class C common stock. The rights of the holders of our Class A common stock and our Class C common stock are generally identical, except that shares of Class C common stock are non-voting.”).

152. See *id.* at 110-11 (“Our business and affairs are managed by our board of directors, which consists of 11 directors. . . . Pursuant to the terms of the Investor Rights Agreement, each Sponsor is entitled to nominate (a) five directors for election to our board of directors for so long as it holds 40% or more of our outstanding common stock, (b) three directors for election to our board of directors for so long as it holds 30% or more of our outstanding common stock, (c) two directors for election to our board of directors for so long as it holds 15% or more of our outstanding common stock and (d) one director for election to our board of directors for so long as it holds 5% or more of our outstanding common stock. In particular, Ares has nominated Messrs. Axelrod, Kaplan and Starrett and Meses. Lee and Thornton for election to our board of directors, and Freeman Spogli has nominated Messrs. Brutocao and Roth for election to our board of directors. Pursuant to the terms of the Investor Rights Agreement, each Sponsor will agree to vote in favor of the other Sponsor’s nominees and for the election of our then-current chief executive officer to our board of directors.”).

153. See NOODLES & Co., Prospectus (Form 424B4), at 1 (June 28, 2013) (“The rights of holders of Class A common stock and Class B common stock are identical, except that our Class B common stock does not vote on the election or removal of directors . . .”).

154. See *id.* at 80 (“Our board of directors currently consists of seven members.”); *id.* at 92 (“Catterton and Argentia each will have the right to designate two members to our board of directors, and the parties to the 2013 Stockholders Agreement will agree to vote to elect such director designees.”).

155. See, e.g., INC Rsch. Holdings, Inc., Prospectus (Form 424B4), at 8, 133 (Nov. 7, 2014) (stating that the “[c]lass B common stock will not carry the right to vote on the election of directors” and “[t]he amended and restated Stockholders’ Agreement will provide that each Sponsor will have the right to elect (i) two directors to our board of directors for so long as each owns at least 15% of our outstanding shares of Class A common stock and Class B common stock; and (ii) one director each for so long as each holds at least 5% of our outstanding shares of Class A common stock and Class B common stock”); EP Energy Corp., Prospectus (Form 424B4), at 159 (Jan. 21, 2014) (“Our Board is initially comprised of not less than 11 directors, (i) five of whom are designated by Apollo, (ii) two of whom are designated by Riverstone, (iii) one of whom is designated by Access, (iv) one of whom is designated by KNOC, (v) one of whom is our chief executive officer and (vii) one of whom is an independent director designated by Apollo. Pursuant to the Stockholders Agreement, Apollo has the right to designate any director as the Chairman of the Board. Apollo has the right to and will designate one additional independent director within one year of the Effective Time and Riverstone has the right to and will designate an independent director within 90 days of the Effective Time. Upon the designation of such independent directors, our Board will comprise a total of 13 directors, of which three will be “independent” of us, the Legacy Stockholders and their affiliates under the rules of the NYSE.”).

of stock but then granting them disproportionate contractual control over the board of directors could mislead investors into believing that their voting rights grant greater control over the company than they actually do. In addition, because shareholders who hold nonvoting shares are not subject to certain reporting requirements, like short-swing-profit provisions, granting company insiders control by contract rather than through traditional voting stock could result in underreporting of those types of transactions.¹⁵⁶ These examples of non-voting dual-class companies show that in debates about dual-class structures, regulators, academics, and other commentators need to be aware of and account for the full spectrum of ways in which insiders benefit from dual-class structures beyond just disproportionate voting shares.

IV. Implications for the Dual-Class Debate

This Article has shown that the dual-class debate is underinclusive. Academics, investor groups, the SEC, and large indices all operate under the assumption that the single-class, dual-class distinction is binary, with the focus generally on whether certain pre-IPO insiders retain control of the company through traditional dual-class, high-vote shares. However, as this Article has shown, dual class exists across a spectrum due to customized contractual control arrangements between public companies and insider shareholders. Therefore, what constitutes “dual class” is not a black-and-white question, and the various ways in which insider shareholders obtain disproportionate control or economic value need to be understood according to their substance rather than their form.

This Part provides a more comprehensive framework to inform how policymakers should regulate companies that provide disproportionate rights to company insiders. Although these companies use complex corporate-governance structures and contractual arrangements in varied ways, they universally create agency costs and therefore raise the same policy concerns that apply to traditional dual-class structures. This Part concludes that regulators, stock-market indices, courts, and scholars should seek to understand the full nuance and complexity of the ways insider shareholders obtain rights that are unavailable to the public and make decisions about how to treat these companies accordingly.

156. See, e.g., Atreca, Inc., Prospectus (Form 424B4), at 57 (June 20, 2019) (“Because our Class B common stock is generally non-voting, stockholders who own more than 10% of our common stock overall but 10% or less of our Class A common stock will not be required to report changes in their ownership from transactions in our Class B common stock pursuant to Section 16(a) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and would not be subject to the short-swing profit provisions of Section 16(b) of the Exchange Act. In addition, acquisitions of Class B common stock would not be subject to notification pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.”).

A. Regulators

Our analysis has significant implications for how regulators approach dual-class companies. As discussed above, the SEC has made various efforts to put restraints on traditional dual-class companies.¹⁵⁷ Dual-class companies remain on the SEC's radar, with some commissioners recently expressing concerns about dual-class structures and an SEC advisory committee issuing recommendations for increased disclosure.¹⁵⁸ They may come even more to the forefront in the Biden Administration, which is expected to be more focused on investor rights.¹⁵⁹ Future attempts to regulate dual-class companies should do so based on their substance, not their form. The SEC should regulate companies according to the degree to which a company disproportionately allocates control rights and economic benefits to insider shareholders. For example, the SEC should treat companies that grant insider shareholders majority control of the board post-IPO through contractual arrangements the same as traditional dual-class companies that do so through multiple classes of stock. For companies that grant only minority rights to insiders through contract, the SEC could treat them more or less like dual-class companies in accordance with the level of control they grant to insiders.¹⁶⁰

Regulators should also require additional disclosure for corporations that grant control rights to insiders through contract. Currently, corporations are able to describe their voting structure as single class, with each shareholder receiving one vote (or dual class, with the insider shareholders receiving zero votes), while hiding the descriptions of the insiders' actual control rights in a variety of contracts and corporate documents. Regulators should require companies that grant insiders disproportionate contractual control rights to insiders to disclose those rights more prominently, including by requiring a description of those rights in the IPO filing's "Description of Capital Stock."¹⁶¹ This makes sense because the Description of Capital Stock is where the company describes the voting and economic rights of the shareholders in their IPO public filing. Since the contractual rights granted to insiders effectively override many of the control rights described in that section, disclosing the insiders' special contractual rights alongside the rights that they and the public shareholders receive through their ownership of the company's stock would allow public shareholders to more easily understand how control is allocated. In other words, it would allow public shareholders to get the full picture of who really controls the company in one

157. *See supra* note 28.

158. *See supra* note 49.

159. *See supra* note 20.

160. *See* Section II.A for a discussion of companies that grant insiders majority control and those that grant insiders minority rights.

161. Although minority control rights are generally agreed to be less concerning than full control rights for obvious reasons, they still allow insiders to have a wedge between their control and economic rights that they can use for their own private benefits. Therefore, corporations should be required to disclose all disproportionate control rights, regardless of whether they grant insiders complete control, whenever voting rights and classes of stock are discussed in public disclosures.

prominent place in the IPO filing rather than having to parse through separate contracts, corporate documents, and other (less prominent and seemingly unrelated) sections of the IPO filing.

Similarly, dual-class corporations that grant special economic rights to insiders, as with the Up-C, should concretely disclose the disproportionate economic benefits that accrue to insiders. It is at least apparent to shareholders in high-vote dual-class companies what they are getting when they buy low-vote shares. But where the differences can be obscured by the economics of the structure, it can be difficult for public shareholders to understand what they are giving up by buying into the dual-class structure. Currently, companies that use these dual-class structures often get away with no disclosure of the potential conflicts, or they get away with making broad and vague disclosures about possible harm in their IPO filings, making it very difficult for public shareholders to understand the potential harm when they purchase and the actual harm as it occurs.¹⁶² Because the Description of Capital Stock includes a description of the shareholders' economic rights, it is also an appropriate place for companies to include any description of the ways that insiders can receive disproportionate economic benefits. In addition to disclosing the risk of harm in an IPO filing more clearly, post-IPO, these companies should disclose the actual disproportionate economic value that accrues to the insider shareholders once that risk materializes. Therefore, the SEC should require these companies to disclose how much economic value the insiders receive in the companies' 10-Qs (quarterly reports), 10-Ks (annual reports), and other post-IPO disclosures. In sum, for the public to be able to properly price in the risks and harms of these dual-class structures, the SEC should require concrete and ongoing disclosure of ways in which these dual-class structures disproportionately benefit company insiders both at the IPO stage and subsequently as the harm materializes over time.¹⁶³

Increased disclosure may not prevent insiders from obtaining disproportionate control and economic benefits, but it will decrease the likelihood of them benefiting from a relative difference in salience. The market can only be efficient to the extent shareholders understand the full implications of their control rights and economic benefits vis-à-vis the insiders. As discussed above, there are reasons to expect that using less salient provisions might allow insiders to avoid some of the pricing downside that comes from using a dual-

162. See *supra* notes 140-141 and accompanying text.

163. A number of courts have stated that broad explanations of potential risk are not a substitute for clear disclosure of actual harm when it occurs. See *SEC v. Merch. Cap., LLC*, 483 F.3d 747, 769 (11th Cir. 2007) (“As the Fifth Circuit has recognized, ‘[t]o warn that the untoward may occur when the event is contingent is prudent, to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.’” (quoting *Rubinstein v. Collins*, 20 F.3d 160, 171 (5th Cir. 1994))); *Rubinstein*, 20 F.3d at 171 (“[T]he inclusion of general cautionary language regarding a prediction [does] not excuse the alleged failure to reveal known material, adverse facts.”); *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004) (“Cautionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired.”).

class structure.¹⁶⁴ Clear and consistent disclosure of the insiders' disproportionate control rights and economic benefits will force companies to make these obscure contractual provisions more apparent to investors, enabling them to properly account for those provisions in the price they are willing to pay for the stock.¹⁶⁵

B. Investors and Indices

Institutional investors and large investor groups have long expressed concerns about dual-class structures and have frequently sought to curb their use.¹⁶⁶ They do not, however, appear to have paid attention to other structures that have the same effect as the traditional dual-class structures they so commonly oppose. These investors and lobbying groups should voice their concerns with all types of ways in which insiders keep disproportionate control. Only once the most influential voices in the market recognize and bring attention to the issues described here will these structures receive the same type of scrutiny that traditional dual-class structures already do. Investor-advocacy groups can also consider financially punishing the structures they find most concerning by choosing not to invest in them, which will send a strong signal to the market and force insiders to suffer a financial consequence for the agency costs they create.

Indices like the FTSE Russell, S&P Dow Jones Indices, and MSCI have also taken a stand against dual-class companies with unequal voting rights by limiting, underweighting, or excluding companies with dual-class structures from their indices.¹⁶⁷ Because index investing is such a large part of the market for stock investments and is relatively passive in nature, this likely has the effect of reducing stock prices of dual-class companies relative to non-dual-class peers. Although traditional dual-class companies suffer this financial penalty, companies that grant control rights through contract but technically have only one class of common stock can trade without such limitations. Given that dual class is a spectrum, it seems appropriate for index funds to tailor the way they treat these companies according to the degree to which they disproportionately benefit insider shareholders. Since companies that grant insiders majority control generally raise the same agency concerns as traditional dual-class companies, it seems appropriate to at least subject those companies to the same index restrictions as traditional dual-class companies.

164. See Section II.B.

165. See, e.g., GoDaddy Inc., *supra* note 131, at 187 (“We have two classes of common stock: Class A and Class B, each of which has one vote per share. The Class A and Class B common stock will generally vote together as a single class on all matters submitted to a vote of stockholders, except as otherwise required by applicable law.”). The problem with this statement is that it makes it sound like all shareholders have equity voting rights and implies that public shareholders will have control commensurate with their equity holdings. However, insider shareholders of GoDaddy actually have contractual rights that allow them to maintain control of the company, and public shareholders’ votes are therefore effectively meaningless for as long as those contractual rights allow the insiders to retain control.

166. See *supra* notes 41-42.

167. See *supra* note 47; Hirst & Kastiel, *supra* note 15.

However, indices have not placed any restrictions on companies that grant rights through contract rather than a separate class of stock. For example, Carlyle recently changed its structure from a dual-class structure, where three controlling founders had disproportionate voting rights that ensured their control, to a single-class structure with one vote per share. It explicitly stated that the reason for this change was that “there is a more than \$3 trillion addressable passive index universe and over \$4 trillion of active AUM benchmarked to potential indices into which [Carlyle] shares may be added” based on a single-class structure.¹⁶⁸ In other words, Carlyle changed its structure to avoid restrictions on index trading for dual-class companies, which would presumably increase its stock price because of increased demand. However, at the same time Carlyle changed to a single-class structure it entered into stockholder’s agreements whereby the three founders each have rights to nominate members of the board and the chair of the board.¹⁶⁹ Carlyle also required employees to enter into an irrevocable proxy agreement that gave the employees’ voting rights to the founders.¹⁷⁰ The founders were therefore able to convert the company to a nominally single-class structure that in reality mimicked the dual-class structure by leaving full control in the hands of the founders. This allowed the company to qualify for index inclusion even though in substance nothing had changed. This Article argues that treating these similar situations differently is problematic.

Institutional investors, investor-advocacy groups, and indices should also think critically about insider minority control rights and non-high-vote dual-class structures, both of which benefit insiders in ways that are not available to the public. While these may pose somewhat less of a concern than situations where insiders keep majority control, there is no reason why these groups should ignore any context where insiders keep disproportionate economic and control rights. They may want to consider taking a stand against any structures that allow disproportionate rights to flow to insiders, not just situations where insiders retain majority control. However, because the agency costs in minority-controlled companies are lower, indices could, for example, treat those companies differently than they treat the companies that grant insiders majority control. For example, an index could exclude companies that give insiders full control while underweighting companies that grant minority rights. And they could underweight a company less that grants insiders one seat on the board than a company that grants insiders three seats on the board. Either way, indices and investor groups, like scholars and regulators, seem to have narrowly focused on high-vote dual-class structures and ignored the full complexity of ways in which insiders get more than public shareholders do in an IPO. This Article’s findings should cause them to think more deeply about the full spectrum of dual-class structures as they develop arguments and rules about investing in these types of companies.

168. *Conversion to a C-Corporation*, *supra* note 17, at 7.

169. *Id.* at 3.

170. *Id.*

C. Courts

This Article's findings are also relevant to courts, where questions of whether a shareholder has control can significantly change the standard of review, and therefore the outcome, of fiduciary-duty cases.¹⁷¹ Delaware law, for example, subjects controlling-shareholder transactions to much stricter judicial review than transactions involving a non-controlling shareholder.¹⁷² The threshold question for these cases is whether a shareholder has control. The test for control has two prongs: "A shareholder is a 'controlling' one if she owns more than 50% of the voting power in a corporation *or* if she 'exercises control over the business and affairs of the corporation.'"¹⁷³ While a stockholder who holds over 50% of the voting power is clearly a controlling stockholder, the analysis of whether a shareholder who holds less than 50% of a company's voting power is murky and inconsistent. And to the limited extent courts have considered insider contractual control rights, they have often ignored such rights for purposes of determining control.¹⁷⁴

As this Article has shown, contractual rights can closely mirror and even exceed the bundle of rights shareholders obtain through voting stock. Therefore, we believe the types of contractual arrangements we discuss here should be a critical part of courts' control analyses, especially for situations where shareholders hold less than 50% of the voting power. In particular, courts should give significant weight to contractual arrangements that essentially override core shareholder rights in their control analyses.¹⁷⁵ For example, because the right to vote on the board of directors is one of the most fundamental shareholder rights,

171. See Ann M. Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 1977 (2019) ("Yet even as the presence or absence of a controlling shareholder takes on heightened importance, changes in the business landscape have made controllers more difficult to identify. . . . The upshot is that courts are called upon to make early, critical judgments regarding levels of control in an increasingly complex corporate ecosystem."); Rauterberg, *supra* note 7, at 1163-64 (analyzing shareholder agreements and controlling shareholders).

172. See, e.g., *In re EzcCorp Inc., Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at *29-30 (Del. Ch. Jan. 25, 2016) (compiling Delaware cases scrutinizing controlling-shareholder transactions).

173. *Williamson v. Cox Commc'ns, Inc.*, No. Civ.A 1663-N, 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006) (quoting *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113-14 (Del. 1994)).

174. See, e.g., *Thermopylae Capital Partners v. Simbol, Inc.*, No. 10619-VCG, 2016 WL 368170, at *14 (Del. Ch. Jan. 29, 2016) ("[A] stockholder who—via majority stock ownership or through control of the board—operates the decision-making machinery of the corporation, is a classic fiduciary Conversely, an individual who owns a contractual right, and who exploits that right—even in a way that forces a reaction by a corporation—is simply exercising his own property rights, not that of others, and is no fiduciary."); Rauterberg, *supra* note 7, at 1172 ("Under Delaware law, shareholders who influence the corporation's affairs by controlling the board are controlling shareholders with fiduciary duties, while shareholders who simply wield contractual rights to influence the board are not."). *But see* *Skye Mineral Invs., LLC v. DXS Cap. (U.S.) Ltd.*, 2020 WL 8881544 (Del. Ch. Feb. 24, 2020) (finding that certain LLC members were controllers when they exercised their contractual rights to block certain company actions); *Garfield v. BlackRock Mortg. Ventures, LLC*, 2019 WL 7168004 (Del. Ch. Dec. 20, 2019) (analyzing the parties' contractual rights under the LLC agreement as part of the courts' control analysis).

175. See Lipton, *supra* note 171, at 1991 ("[T]hough control status should not be found solely because a stockholder exercises her control rights—such as rights to block a transaction or call a debt—control status may be found when contractual rights are used to coerce board action").

any contractual right that grants a shareholder control over the board, such as the right to nominate directors or control the composition of the board's committees, should be a significant factor in any court's control analysis. Similarly, rights that exceed traditional shareholder control rights, such as special veto rights, should also factor heavily into the courts' control analysis, especially because such rights grant at least some measure of "control over the business and affairs of the corporation." In contrast, contractual rights that grant less significant control rights, such as special information rights, should be given less weight.

D. Researchers

This Article's findings and analysis should cause scholars to expand and refine the debate about dual-class companies. Scholars should consider the full range of ways in which insiders maintain disproportionate rights in companies.¹⁷⁶ Our work shows that it is critical to go beyond the categorizations available through databases and other easy sources and to instead dig deep into the substance of the ways companies structure their control and economic relationships between insiders and public shareholders. Legal scholarship, for example, should further push the distinctions we create here to properly categorize companies according to their true control and economic structures because legal scholars are the best equipped to do this. This will allow for the type of widespread understanding of this phenomenon that will ultimately generate proposals that policymakers can implement to address the issues we raise here.

Our analysis also identifies areas of research that require further empirical investigation. For example, many scholars have empirically tested the performance of dual-class companies and have shown underperformance relative to their single-class peers.¹⁷⁷ However, their samples treat all single-class companies as the same regardless of whether insiders obtain control through other mechanisms. Therefore, their studies are incomplete and possibly misleading. Our analysis implies that companies that grant control rights to insiders through contract likely suffer from the same agency costs as traditional dual-class companies and may therefore suffer similar underperformance. However, as we note, these companies hide their control rights more effectively than traditional dual-class companies do. Therefore, it is possible that they suffer less of a pricing penalty than traditional dual-class companies at IPO do, which could actually cause them to suffer even worse performance as those agency costs are revealed in their subsequent performance. Future empirical research on this issue would be a valuable contribution to the literature on how the salience of provisions can affect companies' pricing and performance. Ultimately, existing studies, while helpful, are missing the nuance necessary to fully

176. Some scholars have recently begun to explore the effects of contractual rights in the context of controlling stockholder analysis. *See, e.g.*, Lipton, *supra* note 171, at 1991.

177. *See supra* note 113.

understand the underlying conflicts and performance of these companies. By disaggregating dual class, this Article provides a framework for future normative and empirical research that will help us understand these companies much better than we currently do.

Conclusion

This Article provides a new perspective on the long-standing debate about dual-class companies. It shows that this debate has missed much of the nuance in the ways company insiders obtain control beyond traditional high-vote dual-class structures. Our findings show that companies often use contractual arrangements to grant insider shareholders disproportionate control over the board of directors and other major company decisions that are generally subject to public-shareholder approval. This Article argues that these contractual arrangements create corporate-governance structures that are formally single class, but substantively dual class, and that the degree to which policymakers should be concerned about and regulate these companies depends on the degree to which these companies disproportionately allocate control and create agency costs. While the majority of companies in our sample granted insider shareholders majority control, which is at least as concerning as traditional dual class and therefore should likely be treated and regulated the same as traditional dual-class companies, other companies granted only minority protection rights to insider shareholders. While minority rights are less concerning, they still grant insiders rights that are unavailable to public shareholders and therefore also merit close scrutiny.

Our findings also show that dual-class structures are not always about maintaining control but are often used to provide disproportionate economic value to insider shareholders, often in complex and poorly disclosed ways. Our analysis demonstrates that, going forward, scholars, regulators, and other commentators should account for the full complexity of corporate arrangements that grant rights to insiders that are not available to public shareholders in order to make cogent, empirically grounded arguments about these companies.