Contractual Control in Dual-Class Corporations

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Founders and other corporate insiders often seek to control the companies they take public. For over a century, they have used high-vote stock to obtain disproportionate control rights, which has resulted in seemingly endless debate among scholars, investors, and regulators. More recently, insider shareholders have used a different mechanism to obtain outsized corporate control rights: control by contract. In 2024, contractual control rights took center stage in the Delaware courts and legislature due to the seminal Moelis case and subsequent Delaware legislation. Despite the intense focus on both dual-class companies and contractual control rights, existing research has treated high-vote stock and contractual control rights as alternative tools for insider control.

This Article is the first to consider that insider shareholders in dual-class companies often obtain significant contractual control rights in addition to high-vote stock. Based on an empirical analysis of dual-class IPOs from 2000 to 2021, this Article provides a novel dataset showing that over one-quarter of dual-class companies grant insiders significant contractual control rights in addition to high-vote stock. For example, Moelis & Company, the corporation that was the subject of the controversial Moelis case, granted its founder both high-vote stock and substantial contractual control rights. The combination of these two forms of corporate control rights substantially extends and expands insiders' control over a wide range of corporate decisions, including decisions that are generally not subject to a shareholder vote because they are the exclusive purview of the board of directors. These findings create a more complete account of the myriad ways in which insider shareholders retain outsized corporate control, which allows courts and policymakers to consider important implications for companies that grant insiders control through high-vote stock, contractual control rights, or both.

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Introduction

Founders and other corporate insiders go to great lengths to control the companies they take public, and the mechanisms they use to maintain control have been a central theme of corporate law. Dual-class structures, which give insider shareholders voting rights that exceed their economic rights,[1] are a common way for insiders to maintain post-IPO control. Scholars and policymakers have endlessly debated the costs and benefits of these structures,[2] which have surged in popularity over the past 20 years.[3] As one prominent scholar put it, dual-class structures are "[t]he most important issue in corporate governance today."[4]

Although high-vote, dual-class structures remain controversial, over the past few years a new form of insider control has taken center stage in the legal literature and in the Delaware courts and legislature: control by contract.[5] Recent literature, including by the authors, has shown that insider shareholders frequently use contracts to engage in private ordering and to maintain control over corporate governance, much like they do

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." (citation omitted)).

2. For scholarly analyses of the costs of dual-class structures, see, for example, Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1465-66 (2019) [hereinafter Bebchuk & Kastiel, *The Perils*]; Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 604 (2017) [hereinafter Bebchuk & Kastiel, *The 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*, at 693 ("Critics of dual-class structures argue that issuing nonvoting or low-voting shares increases agency costs and results in suboptimal decisionmaking."). For scholarly support of dual-class structures, see Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 560, 565-67 (2016) ("[W]hen 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, 136-40 (1987) (arguing that dual-class structures allow for long-term planning because founders can avoid the threat of takeovers).

3. *See infra* note 28 and accompanying text.

4. John C. Coffee, Jr., *Dual Class Stock: The Shades of Sunset,* COLUM. BLUESKY BLOG (Nov. 19, 2018), https://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset [https://perma.cc/4NSR-PL3Y].

5. Recent scholarship has examined the expansive ways that insider shareholders have used corporate contracts to alter the governance features, but never in the dual-class context. *See generally* Megan Wischmeier Shaner, *Corporate Resiliency and Relevance in the Private Ordering Era*, 2 COLUM. BUS. L. REV. 804 (2022) (exploring the consequences of private ordering through shareholder agreements and other contracts); Gladriel Shobe & Jarrod Shobe, *The Dual-Class Spectrum*, 39 YALE J. ON REGUL. 1286 (2022) (empirically studying insider shareholders' contractual control rights in publicly-traded companies at single-class companies); Jill Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913 (2022) (analyzing and critiquing the use of shareholder agreements to alter corporate governance); Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REGUL. 1124 (2021) (empirically studying shareholder agreements in publicly traded companies).

through dual-class structures.[6] Shareholder litigation has challenged the use of contracts to grant insider shareholders special control and governance rights as a violation of the Delaware corporate law statute. In early 2024, the Delaware Chancery court issued the first ruling in connection with these challenges, *West Palm Beach Firefighters' Pension Fund v. Moelis & Company* ("*Moelis*").[7] This seminal case invalidated some of the contractual control rights analyzed in this Article, at least in their present form, and subsequent cases have similarly held that certain type of contractual control rights violate Delaware corporate law.[8] These prominent cases have triggered extensive and fierce debate about insiders' use of contracts to usurp board control over fundamental corporate decisions and prompted the Delaware legislature to adopt new laws that override *Moelis* and expand insider's ability to enter into such contracts.[9]

Despite the intense focus on both dual-class companies and contractual control rights, an important piece of the corporate-control story is missing. Existing research has treated high-vote stock and contractual control rights as alternative tools for insider control. However, no one has documented or considered what it means for insiders to have outsized control through both high-vote stock *and* contractual control rights. This Article uses a novel, hand-collected dataset to show that over one-quarter of dual-class companies grant insider shareholders significant contractual control rights *in addition to* high-vote stock.[10] This Article is the first to document and explore the relationship between contractual control rights and high-vote stock in dual-class companies, and it shows that the allocation of control rights often goes deeper, and is more complex, than the binary dual-class and single-class distinction that drives the ongoing dual-class debate.

For example, Moelis & Company uses a typical dual-class structure that grants its founder, Ken Moelis, Class B stock with ten votes per share, while Class A stockholders hold shares with one vote each.[11] With these shares, Ken Moelis held over 90% of the company's voting rights at IPO

6. Insider shareholders include founders and pre-initial-public-offering (pre-IPO) investors, including venture capitalists and private-equity companies.

7. West Palm Beach Firefighters' Pension Fund v. Moelis & Co., 311 A.3d 809, 820 (Del. Ch. 2024) (holding that the combination of veto rights held by the company's controller was invalid, but leaving open the possibility that other, weaker veto rights could possibly be valid).

8. *Id.* at 1-10; Wagner v. BRP Group, Inc., 316 A.3d 826, 883 (Del. Ch. 2024) (invalidating control provisions in a shareholder agreement, including holding facially invalid an officer pre-approval requirement and a charter pre-approval requirement).

9. *See infra* Section III.C.

10. They grant these contractual control rights directly in their founding contractual documents or in separate contracts between the insiders and the company. For a discussion of the dataset, see *infra* Part II.

11. Moelis & Company, Prospectus (Form 424B4), at 11 (April 15, 2014).

and would continue to hold a majority of the company's voting rights as long as he held a relatively small equity position in the company.[12] Nevertheless, at IPO the company also entered into a stockholder agreement with Ken Moelis that granted him substantial rights over the board and its decision making—rights that his high vote shares could not give him. In addition to his high vote stock, Ken Moelis had the contractual right to veto a variety of board decisions and to have significant direct control over the composition of the board and its committees.[13]

This Article's findings show that companies allocate control in ways that challenge foundational principles of corporate law. Delaware courts have stated that the "separation of control and ownership" is "[o]ne of the fundamental tenets of Delaware corporate law."[14] Under this separation of control and ownership, shareholders own economic rights but only have the right to vote on a few significant corporate actions, while the board of directors controls all other aspects of the corporation, including selecting corporate officers and overseeing the day-to-day operations of the corporation. A traditional dual-class structure gives insider shareholders outsized voting control over matters that are subject to a shareholder vote, but no direct say over board-level decisions, and therefore does not alter the separation of control that exists between shareholders and the board.

Our findings show that insider shareholders in these dual-class corporations can effectively eliminate the separation of control and ownership for themselves (and widen the gap for public shareholders) by supplementing their super-voting rights with contractual control rights over matters they could not control with high-vote stock alone. By using contracts to obtain control rights, insiders can turn what on the surface looks like any other dual-class corporation into something more.

Our data shows that dual-class companies often grant insider shareholders contractual control over the board's composition. One of the most important shareholder rights is voting on the board of directors, who then act as agents of the shareholders to oversee the operations of the corporation.[15] Our findings show that dual-class corporations often grant insider

12. *Id.* at 26-27. Ken Moelis had to continue to hold one-third of his ownership as of the IPO and at least 5% of Moelis & Company's equity interest in order to maintain his supervoting stock. *Id.* at 40.

13. *Id.* at 39.

14. Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998). The famous discussion that coined the phrase "separation of control and ownership" and can be 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.").

15. *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 a combination of high-vote stock, which gives them the ability to control board elections, and contractual rights to nominate the directors they will vote on. These rights allow insiders to control a board of directors in unique ways unavailable to public shareholders.[16] Insiders' board-related contractual control powers can also extend to controlling the size of the board, choosing the chair of the board, and choosing which directors sit on each committee of the board—rights that public shareholders never have.[17] The *Moelis* opinion addressed board composition rights and held that some of the rights are valid, others are facially invalid, while other rights may be invalid on an as-applied basis.[18] Our data shows that the most prevalent contractual control rights in dual-class companies are valid under the *Moelis* opinion, but that some companies grant company insiders aggressive board composition rights that would be invalid under *Moelis*.

Our data also shows that dual-class corporations sometimes grant insider shareholders veto rights that give them contractual control over the board's decision-making process. These contractual provisions can require insider sign-off over a number corporate decisions that would otherwise be the exclusive right and responsibility of the board, including decisions to incur debt, hire a CEO or other officers, purchase or sell assets, issue new stock, pay a dividend, adopt a poison pill, or implement stock compensation plans.[19] In *Moelis*, Vice Chancellor Laster addressed contractual veto rights and held that pre-approval/veto rights are invalid under Delaware law when the rights effectively eliminate a board's ability to run the company.[20]

We posit that there are two primary reasons why insider shareholders choose to use contracts to obtain control rights rather than relying on high-

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").

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

17. *See, e.g.*, Elanco Animal Health, Inc., Prospectus (Form 424B4), at 171 (Sept. 19, 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 86-90 and accompanying text (discussing different sorts of board designation structures).

18. West Palm Beach Firefighters' Pension Fund v. Moelis & Co., 311 A.3d 809, 820 (Del. Ch. 2024).

19. *See infra* Section II.C, D.

20. Moelis & Co., 311 A.3d at 820.

vote stock alone. First, insiders use contracts to extend their disproportionate control beyond the life of the dual-class structure, which is commonly subject to sunset under predetermined conditions. Second, insiders use contracts to supplement their super-voting rights. Insiders can, by contract, obtain control rights over matters that are not subject to shareholder vote and that therefore cannot be directly controlled by shareholders, even with high-vote stock.

Our data and analysis add color to the ongoing debate about the agency costs and benefits of dual-class structures. Critics of dual-class structures argue that they are problematic because they create agency costs by giving insider shareholders voting rights that far exceed their economic rights, which results in a misalignment of interests with public shareholders.[21] The core of the concern is that insiders' disproportionate control allows them to use the corporation for their personal benefit while only suffering "a small fraction of the negative effects of their actions on the company value."[22] Our findings demonstrate that this concern should be heightened when dual-class corporations grant insiders enhanced control rights through contract. Other scholars are less critical of dual-class structures, arguing that they can create agency benefits by minimizing shareholder meddling and short termism, thereby allowing experienced founders to carry out their vision to create greater corporate value, which benefits everyone.[23] If that is true, then empowering insiders to an even greater degree may be for the best, since it will allow the insiders more leeway to execute their value-enhancing vision.

This Article's findings do not resolve this longstanding and ongoing debate over agency costs in dual-class structures. Instead, we show that key control arrangements in dual-class corporations are missing from the discussion. Our findings have relevance for proposed remedies to address the downsides of dual-class structures, including proposals that would require

21. Gregory H. Shill, *The Social Costs (and Benefits) of Dual-Class Stock*, 75 ALA. L. REV. 221, 237 (2023).

22. *See* Bebchuk & Kastiel, *The Untenable Case*, *supra* note 2, at 602-03; Bebchuk & Kastiel, *The Perils*, *supra* note 2, at 1460; Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651; Goshen & Hamdani, *supra* note 2, at 582.

23. Adi Grinapell, *Dual-Class Stock Structure and Firm Innovation*, 25 STAN. J. L. BUS. & FIN. 40, 40 (2020) (arguing that "placing limitations on dual-class stock structure can prevent such firms from implementing the optimal stock structure needed for the execution of their founders' vision"); Goshen & Hamdani, *supra* note 2, at 579-80; Gilson, *supra* note 22, at 1651; Lund, *supra* note 1, at 694-97 ("[W]eakly motivated voters should rarely vote in shareholder elections. And when they do vote, their lack of information, coupled with pro-management biases and other conflicts of interest, make it unlikely that their votes will be value enhancing for the company."); Fischel, note 2, at 134-37 ("Many shareholders are passive investors who hold many different investments. They have little interest in managing the firm and insufficient incentive to learn the details of management."); Bernard S. Sharfman, *The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuk and Kasiel*, 93 S. CALIF. L. REV. POSTSCRIPT 1, 9 (2019) ("Shareholders suffer from the problems of asymmetric information and the simple inability to make the proper evaluation of a leader's idiosyncratic vision.").

public companies to issue voting stock[24] or require sunsets on high-vote stock.[25] This Article's findings show that these solutions would be at best incomplete. It would not be enough to require that the public receive a certain amount of voting control or to require high-vote stock to sunset if insider shareholders can use contractual control rights to override shareholder votes or to extend their disproportionate control well beyond the sunset of the high-vote stock.

Our findings also have implications for the heated debate surrounding *Moelis* and recent Delaware legislation expanding the breath and scope of shareholder agreements. In particular, it shows that most dual-class companies that use shareholder agreements *do not* include veto rights or other types of contractual control rights that were found to be invalid under *Moelis*. These findings indicate that while certain types of contractual control rights have become common market practice, the types of rights that were held to be invalid under *Moelis* mostly have not, even among shareholders who are the most interested in controlling corporate actions (i.e., those who choose to control companies through a combination of high-vote, dual-class stock and contractual control rights).

This Article proceeds in four Parts. Part I provides a brief history of the use of dual-class structures and the debate surrounding the propriety of their use. It then discusses recent literature on contractual control provisions. Part II describes the types of contractual control rights we found in our sample along with examples of each type. Part III analyzes the policy implications of contractual control in dual-class corporations. Part IV concludes.

I. The Dual-Class Debate

How and whether to regulate dual-class companies is a constant topic of debate among academics, investor groups, and regulators. This debate has ebbed and flowed over the last century but has gained renewed vigor in recent decades as many of the largest and most prominent IPOs have

24. Lund, *supra* note 1, at 739-40. Bebchuk & Kastiel, *The Perils*, *supra* note 2, at 1506-07.

25. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 2, at 590; *Dual-Class Stock*, COUNCIL OF INST. INVS., https://www.cii.org/dualclass_stock [https://perma.cc/7LGA-7ANC] ("In the fall of 2021, CII submitted draft federal legislation that would prohibit the U.S. listing of companies with multi-class stock with unequal voting rights absent a sunset provision that takes effect within seven years of IPO . . . ."); Robert J. Jackson, Jr., Comm'r, Sec. & Exch. Comm'n, Perpetual Dual-Class Stock: The Case Against Corporate Royalty (Feb. 15, 2018) ("Seven or more years out from their IPOs, firms with perpetual dual-class stock trade at a significant discount to those with sunset provisions." (citations omitted)), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty [https://perma.cc/2QCZ-YPPL].

chosen to use dual-class structures. This debate has mostly taken a negative view of dual-class corporations because they privilege insider shareholders over public shareholders. A few recent articles, including by the authors, have shown that insiders in single-class companies frequently use another controversial tool to control publicly traded companies: control by contract.[26] This research has shown that corporations often grant their founders and other corporate insiders special contractual control rights over a wide range of corporate actions, sometimes in ways that supplant Delaware's board-centric model of corporate control. This Part provides a brief overview of the ongoing dual-class debate and the recent literature on contractual control.

A. High-Vote Dual-Class Control

High-vote dual-class companies play a significant role in the public markets and have become increasingly popular in recent years.[27] While less than 5% of IPOs in the 1980s featured a dual-class structure, over the past decade, approximately 22% of IPOs utilized the structure, including 25.9% of all IPOs in 2023.[28] The sharp rise in companies going public with a dual-class structure has drawn renewed interest and scrutiny from policymakers and academics.

The policy debate over dual-class structures is longstanding.[29] In 1926, the New York Stock Exchange adopted a policy of excluding companies with unequal voting rights due to their "long-standing commitment to encourage high standards of corporate democracy . . . and accountability to

26. *See* infra note 5 and accompanying text.

27. Dual-class structures have existed in various forms for over 100 years, though the structure was not commonly used for most of the 20th century. *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). Non-U.S. companies also utilize dual-class structures. *See The Rise of Dual Class Shares: Regulation and Implications*, COMM. ON CAP. MKT. REGUL. 6-11 (Apr. 2020), https://www.capmktsreg.org/wp-content/uploads/2020/04/The-Rise-of-Dual-Class-Shares-04.08.20-1.pdf [https://perma.cc/W453-WN4F].

28. *See* Jay R. Ritter, *Initial Public Offerings: Dual Class Structure of IPOs Through 2023* (Apr. 11, 2023), https://site.warrington.ufl.edu/ritter/files/IPOs-Dual-Class.pdf [https://perma.cc/5JLJ-YG67]. Likewise, our data shows that from 2000 to 2021, 12.0% of companies went public with a high-vote dual-class structure, with the highest percentage of such companies going public in 2019 (20.2%) and 2021 (22.5%) and the lowest in 2006 (4.2%). *See infra* Part II.

29. *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."); Ashton, *supra* note 27, at 892-93 (describing historical 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); *see also* Seligman, *supra*, at 699-700, 700 n.78 (noting that while the New York Stock Exchange (NYSE) delisted Cannon Mills in 1962 after the company distributed shares of nonvoting common stock to its common shareholders, that the NYSE often enforced its one-share, one-vote policy simply by the threat of delistment). 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 27, at 569.

shareholders."[30] While dual-class stock continued to be disfavored throughout most of the 20th century, late in the century more companies began to test the market for dual-class companies.[31] As a result, the NYSE was forced to reexamine its rules to stay competitive with other exchanges that began to allow these structures.[32] This appears to have provided confidence to founders of other companies that they could also go public using a dual-class structure without causing undue harm to their companies' stock prices.[33] The SEC created rules that attempted to stop the tide, but the D.C. Circuit ultimately struck down those rules.[34] Dual-class structures have become a staple of the IPO market,[35] albeit a controversial one, and many of the largest and most successful companies now go public using a dual-class structure.[36]

Dual-class corporations generally offer two classes of stock that share the same economic entitlements but differ with respect to their voting

30. Seligman, *supra* note 29, at 699 (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)). Other exchanges used the NYSE's restriction on dual-class companies as a competitive advantage by allowing these companies to list on their exchanges. *See* Ashton, *supra* note 27, 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").

31. *See* Jill E. Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1057, 1065 (2019) ("The modern use of dual class stock dates back to 1976. In that year, Wang Laboratories listed using dual class on the American Stock Exchange ('AMEX'). The listing was controversial, and at the time barred by the New York Stock Exchange . . . ." (citation omitted)); Shobe & Shobe, *supra* note 5, at 1294 ("Beginning in the 1980s, companies, starting with General Motors, increasingly began to challenge the NYSE by issuing stock with disparate voting rights.").

32. *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 27, at 895-96.

33. *See* Bebchuk & Kastiel, *The 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 . . . .").

34. *See* 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)); Bus. Roundtable v. SEC, 905 F.2d 406, 407 (D.C. Cir. 1990). *See also* Bainbridge, *supra* note 27, at 589-625 (detailing the rationale and general implications of D.C. Circuit's decision to strike down SEC regulations regarding dual-class stock); Gordon, *supra* note 2, at 69-75.

35. *See* Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg & Lubomir P. Litov, *The Rise of Dual-Class Stock IPOs*, 144 J. FIN. ECON. 122,122 (2022) ("[M]any of the firms that have recently elected to go public are tightly controlled by their founders or other entities via a dual-class stock structure.").

36. Google, Facebook, Linkedin, Snap, Lyft, Pinterest, and Zoom are just a few examples.

rights. These dual-class companies offer low-vote common stock (usually called "Class A stock") to the public and high-vote stock (usually called "Class B stock") to pre-IPO insiders.[37] Typically, Class A stock will have one vote per share while Class B stock will be entitled to 10 votes per share,[38] though these formulations vary and some companies create dual-class structures with a far greater wedge between their Class A and Class B share voting rights, and some give public shareholders no voting rights at all.[39]

By obtaining voting rights that far exceed their economic ownership, pre-IPO insiders in dual-class structures have an outsized say in all matters that are subject to a shareholder vote.[40] Shareholders have the right to vote on fundamental corporate matters, including who is elected to the board of directors, a sale of the company, a sale of substantially all of the company's assets, and the adoption of amendments to the certificate of incorporation. Therefore, company insiders who hold high-vote stock can often dictate the outcome of a dual-class company's most important corporate decisions.

The wedge between economic ownership and voting rights created by dual-class structures generates substantial debate about the use of these structures. Many institutional investors and shareholder advisory groups have publicly lobbied for restrictions on or elimination of dual-class

37. The high-vote stock is almost always available to only the company insiders, and we are unaware of any company that has offered high-votes shares to the public in an IPO. In fact, if a company insider sells their Class B stock, the stock generally 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. 8, 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 . . . .").

38. *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, 1053 (2010) ("The most common structure is for superior shares to have ten votes per share, while inferior shares have one vote per share."). For example, 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. 18, 2004). 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 17, 2012).

39. *See, e.g.*, Groupon, Inc., Prospectus (Form 424B4), at 1 (Nov. 6, 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 . . . .").

40. *See* Aggarwal, Eldar, Hochberg & Litov, *supra* note 35, at 122. According to Google cofounder Larry Page, as a result of Google's dual-class structure, "[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." *See* Larry Page & Sergey Brin, *Founders' IPO Letter*, ALPHABET: INV. RELATIONS (2004), https://abc.xyz/investor/founders-letters/2004-ipo-letter [https://perma.cc/2T7J-HY66]; *see also* Facebook, Inc., Prospectus (Form 424B4), at 33 (May 17, 2012) (warning public investors that the company insider's "concentrated control will limit or preclude your ability to influence corporate matters for the foreseeable future").

structures.[41] For example, Institutional Shareholder Services, a proxy advisory firm, recommends that shareholders withhold or vote against directors in companies with high-vote stock.[42] Politicians and the SEC have also weighed in on the debate,[43] with one SEC commissioner arguing that dual-class structures create a kind of "corporate royalty"[44] and another commissioner arguing that these structures are "inherently undemocratic, disconnecting the interests of a company's controlling shareholders from its other shareholders."[45] The S&P has vacillated on how to address these concerns. In 2017, S&P Global responded to the dual-class debate, which was

41. *See, e.g.*, Letter from Kenneth A. Bertsch, Exec. Dir., Council of Inst. Invs., to MSCI Equity Index Cmty. 2-3 (Aug. 3, 2017), https://www.cii.org/files/issues_and_advocacy/correspondence/8-3-17%20CII%20response%20to%20MSCI%20Consutation.pdf [https://perma.cc/Q5WW-PEUQ]; Ross Kerber & Jessical Toonkel, *Exclusive: T. Rowe Price to Oppose Key Directors at Super-Voting Share Companies*, REUTERS (Mar. 7, 2016, 4:52 AM), 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/J2DE-4SQP]; Ross Kerber, *U.S. Investor Group Urges Halt to Dual-Class Structures in IPOs*, REUTERS (Mar. 23, 2016, 1:23 PM), 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/E6VU-JEZP]; *Vanguard's Proxy Voting Guidelines*, pt. IV.G., VANGUARD (Sept. 2016), https://pcg.law.harvard.edu/wp-content/uploads/2016/09/5-Vanguards-proxy-voting-guidelines-_-Vanguard.pdf [https://perma.cc/8TZ2-JEBT]; Letter from Jeff Mahoney, Gen. Couns., Council of Inst. Invs., to Edward S. Knight, Exec. Vice President & Gen. Couns., NASDAQ OMX Grp. (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/A6QK-5PEW]; *The Tragedy of the Dual Class Commons*, INST. S'HOLDER SERVS. 1, 3 (Feb. 13, 2012), http://online.wsj.com/public/resources/documents/facebook0214.pdf [https://perma.cc/F7NA-KSZX]; Shanny Basar, *Calpers Sets Sights on Dual-Class Stock Structures*, WALL ST. J. (Aug. 20, 2012, 12:16 PM), https://www.wsj.com/articles/SB10000872396390443855804577601271252759472 [https://perma.cc/ECC9-WW33] (describing how the California Public Employees' Retirement System, the largest U.S. pension fund, and other large institutional investors threatened to stop investing in dual-class companies).

42. United States Proxy Voting Guidelines Benchmark Policy Recommendations, INST. S'HOLDER SERVS., (Dec. 13, 2022), https://www.issgovernance.com/file/policy/latest/americas/US-Voting-Guidelines.pdf [https://perma.cc/92C6-QS7G].

43. *See* Letter from Elizabeth Warren, U.S. Senator, to John Carey, Vice President-Legal, NYSE Regul., 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/Z8WM-TRYM]; Jackson, Jr., *supra* note 25 (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/C9FM-FT2N] (recommending additional disclosure requirements for dual-class companies); Ronald Orol, *SEC's Clayton "Watching" Insider-Controlled IPOs*, THESTREET (Oct. 12, 2017, 2:51 PM), https://www.thestreet.com/markets/mergers-and-acquisitions/sec-chief-eyes-dual-class-ipo-structure-14341287 [https://perma.cc/UK23-DY5B].

44. Jackson, Jr., *supra* note 25.

45. Kara M. Stein, Comm'r, Sec. & Exch. Comm'n, Remarks at Stanford University: Mutualism: Reimagining the Role of Shareholders in Modern Corporate Governance (Feb. 13, 2018).

particularly heated due to Snap's IPO with zero-vote common stock earlier that year, by adopting a rule excluding all new dual-class companies from the S&P 500.[46] However, in 2023 they reversed that policy and now have no restrictions on dual-class companies. Investors have sharply criticized that decision.[47]

Scholars have argued that dual-class structures exacerbate agency problems in corporations by creating misalignment between insiders' economic rights and control, thereby allowing insiders to use the corporation to create private benefits for themselves at the expense of public shareholders.[48] Insiders with super-voting rights can use their control over the board and over fundamental corporate transactions to engage in self-dealing, appropriate corporate opportunities for themselves, or to pressure the board to hire them or their associates into lucrative positions at the corporation.[49] They can also block takeover attempts, meaning they are effectively insulated from outside influence.[50] While insider control might reduce the value of the corporation, the insiders bear only a portion of the

46. *See* Trevor Hunnicutt, *S&P 500 to Exclude Snap After Voting Rights Debate*, REUTERS (Aug. 1, 2017, 5:06 AM), https://www.reuters.com/article/technology/sp-500-to-exclude-snap-after-voting-rights-debate-idUSKBN1AH2RV [https://perma.cc/6Y74-USRQ]. In 2017, Snap issued 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 [https://perma.cc/K2SB-SE87]. Other companies have followed suit by also authorizing the issuance of non-voting stock. *See* Tom Zanki, *More Cos. Authorizing No-Vote Shares Despite Resistance*, LAW360 (July 12, 2017, 8:37 PM), https://www.law360.com/articles/943458/more-cos-authorizing-no-vote-shares-despite-resistance [https://perma.cc/T238-F6GK] (discussing no-vote stock authorized in the Altice and Blue Apron IPOs); *see, e.g.*, Dropbox, Inc., Registration Statement (Form S-1), at 7-8 (Feb. 23, 2018).

47. *See, e.g.*, Patrick Temple-West & Antoine Gara, *S&P Criticised by Pension Funds Over Dual-Class Shares Decision*, FIN. TIMES (May 1, 2023), https://www.ft.com/content/0a09f926-86a2-4f6d-9b37-86ed98cc8a7a [https://perma.cc/SE2R-Z2WV].

48. *See, e.g.*, 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 CORP. OWNERSHIP 295, 301-05 (Randall K. Morck ed., 2000) (discussing how a dual-class structure can create conflicts of interest).

49. *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). 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, 1722 (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).

50. *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/68T6-J9BH] (describing preferred stockholders blocking a management buyout using their supervoting power); COUNCIL INST. INVS., *supra* note 25.

cost and can shift the rest of the cost on public shareholders,[51] and there is some evidence that controllers use their control in ways that harm company value.[52]

Scholars have also explored the potential upsides of high-vote dual-class structures. Some have argued that granting insiders disproportionate voting control provides stability and insulation from activist investors, which allows companies to focus on long-term plans that may ultimately generate greater value than a focus on short-term results.[53] Others observe that a dual-class structure may allow a visionary founder with great expertise to guide the company without being subject to the short-term whims of capital markets or bearing excessive economic risk that might make them unduly cautious.[54] Others lament the decline of public listings and note that the availability of dual-class structures may increase the number of companies that go public in the first place because it provides a

51. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, 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.").

52. *See, e.g.*, Gompers, Ishii & Metrick, *supra* note 38, at 1084-85 (concluding that the larger the gap between insiders' voting rights and their equity ownership, the more that the company underperforms); *see also* 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/T74M-CCCM] (providing examples that "demonstrate the dangers to investors that result when voting power does not align with economic interest—a risk indicator GMI Ratings has identified at over 200 publicly traded companies in the Russell 3000").

53. *See* Fischel, *supra* note 2, 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 dual-class structures allow 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); 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/PNF7-N55K] (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").

54. *See, e.g.*, Goshen & Hamdani, *supra* note 2, at 567 (noting that retaining control of Ford Motor Company allowed Henry Ford to transform "his innovative ideas . . . into one of the greatest corporate success stories of all time"); Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transaction Review*, 169 J. INST. & THEORETICAL ECON. 160, 168-69 (2013) (noting that "[c]ontrolling shareholders do not suffer from the limited vision outsiders have into the corporation's actual workings"); Bebchuk & Kastiel, *The 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." (citations omitted)); 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."); Letter from Warren E. Buffett, Chairman of the Bd., Berkshire Hathaway Inc., to the Shareholders of Berkshire Hathaway Inc. (Feb. 28, 1997), https://www.berkshirehathaway.com/letters/1997.html [https://perma.cc/YU8B-9Z32].

mechanism for otherwise skeptical founders to take their companies public while maintaining control.[55] These arguments in support of dual-class structures have been received with significant skepticism. Regardless, the debate in legal and empirical journals continues as vigorously as ever, with arguments and empirics pointing in both directions.[56]

B. Control by Contract

Contracts also play a significant, but less salient, role in the allocation of corporate control rights between insider shareholders, public shareholders, and the board of directors.[57] Recent scholarship has examined the expansive ways insider shareholders use corporate contracts to their advantage to alter the governance features within public corporations, with a focus on single-class corporations.[58] This literature has shown that founders and other insider shareholders often grant themselves special control rights through a company's foundational contracts, including the certificate of incorporation and bylaws, and through separate contracts between the insiders and the company, such as shareholder agreements, nomination agreements, director-designation agreements, and voting agreements.[59]

55. *See* Fisch & Solomon, *supra* note 31, at 1061 ("[D]ual class structures may increase the willingness of founders to take their companies public, potentially mitigating the decline in the number of public companies . . . ."); Emily Stewart, *SEC Chair Highlights Need for More Public Companies in First Public Speech*, TheStreet (July 13, 2017, 12:20 AM), https://www.thestreet.com/politics/sec-chair-highlights-need-for-more-public-companies-in-first-public-speech-14224963 [https://perma.cc/7KGT-CJR8] (quoting SEC Chair Jay Clayton as arguing that the recent decline in public listings is a "serious issue for our markets and the country more general[ly]"). Professor Jack Coffee claims that "practitioners point to recent examples of dual class IPOs, which in 2018 included Dropbox, Inc., GreenSky, Inc., Pivotal Software, Inc., Pluralsight, Inc., and SmartSheet, Inc., to argue that these issuers would have remained outside the public markets if they could not have used a dual class capitalization." Coffee, Jr., *supra* note 4.

56. *See, e.g.*, 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); 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, 108 (2008) ("[D]uals exhibit neither better nor worse operating performance relative to singles."); Gompers, Ishii & Metrick, *supra* note 38, at 1053.

57. *See* EASTERBROOK & FISCHEL, *supra* note 51, at 163; Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1430-33 (1989). For a historical account of this evolution, see John C. Coffee, Jr., *No Exit?: Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919, 939 (1988) ("Historically, American corporate law has never regarded the corporation as simply a private contract."); Shaner, *supra* note 5, at 810-14 (noting that under the nexus-of-contracts theory, "the relationship between directors, officers, and shareholders can be characterized as contractual in nature . . .").

58. *See supra* note 5-6 and accompanying text. Prior to and outside of the use of these corporate contracts, shareholders' primary power over the board of directors was through litigation. Reinier Kraakman, Hyun Park & Steven Shavell, *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1733 (1994) ("Shareholder suits are the primary mechanism for enforcing the fiduciary duties of corporate managers.").

59. *See* Shobe & Shobe, *supra* note 5, at 1286 (showing that over the past two decades, companies have granted corporate insiders special control rights through contracts more often than through high-vote, dual-class structures); *see also* Rauterberg, *supra* note 5, at 1124

For example, insider shareholders often use contracts to obtain the right to nominate certain members of the board[60] or obtain the right to control or veto certain actions of the directors,[61] thereby allowing insider shareholders the right to directly participate in board-level corporate governance.[62]As Professor Shaner has noted, "Aggressive contracting efforts in this space have, however, moved beyond traditional matters, such as voting and board composition, to alter bedrock governance rights."[63]

Current shareholder litigation has raised similar concerns about the use of contracts to grant insider shareholders special control and governance rights.[64] It is widely accepted in U.S. corporate law that certain foundational principles in corporate law cannot be changed by contract, including certain fiduciary duties, specific processes for shareholder approval of mergers and acquisitions, dissolution of the corporation, and approving amendments to the charter.[65] Recent Delaware Chancery shareholder

("[F]ifteen percent of corporations that went public in recent years did so subject to a shareholder agreement.").

60. *See* Shobe & Shobe, *supra* note 5, at 1305; Rauterberg, *supra* note 5, at 1130 ("[I]n a majority of agreements, the corporation commits to supporting specific shareholders' board nominees by including the nominees in the corporate proxy slate and using its best efforts to ensure the nominees' election."); Fisch, *supra* note 5, at 913 ("Corporate law has embraced private ordering—tailoring a firm's corporate governance to meet its individual needs.").

61. *See* Shobe & Shobe, *supra* note 5, at 1366; Rauterberg, *supra* note 5, at 1130 ("In a substantial minority of agreements, the corporation grants specific shareholders veto rights over major corporate decisions, such as mergers, terminating the CEO, or changing lines of business . . . ."); *see also* Shaner, *supra* note 5, at 819-20 ("As shareholders have flexed their muscles to increase participation in the governance of public firms, it has led to a push and pull with management over the balance of power in the corporation.").

62. The authors have argued elsewhere that control by contract is similar to control by super-voting shares in that both are used by insider shareholders to obtain control rights that exceed their economic rights. Shobe & Shobe, *supra* note 5, *passim*.

63. Shaner, *supra* note 5, 858*; id*. at 804 ("[T]he current trajectory of corporate doctrine appears to privilege freedom of contract and the contractarian theory above other theories of the firm.").

64. In critiquing the use of contracts to create "private ordering" within public corporations, Professor Fisch stated: "Corporate law, unlike contract law, is not susceptible to near-infinite customization." *See* Fisch, *supra* note 5, at 943; *id.* ("Although many features of the relationship among a corporation's participants can be modified by contract, some cannot."); *see also* James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 282-83 (2015) ("The juxtaposition of LLC statutes with general corporation statutes not only invites but also confirms the conclusion that a clear distinction exists between the two with respect to the embrace of private ordering. Whereas the LLC enjoys few private–ordering restrictions, corporate law provides a body of predictable mandatory rules and no open–ended invitation for their alteration. While less freedom for private ordering exists within the corporate statute, corporate statutes' greater rigidity through more standardized terms has social significance by reducing information costs for market participants as well as reducing legal uncertainty." (footnotes omitted)).

65. *See* Shaner, *supra* note 5, at 815-16 ("Corporate law maintains certain mandatory, immutable features. These include structural aspects, like requiring a charter and bylaws and identifying the key participants in the corporation, as well as specifying their respective powers within

complaints claim that foundational principles of corporate law are "under siege" where certain insider private equity shareholders have entered into "an array of contractual rights that were plainly designed to allow the [private equity shareholders] to control the business and affairs of the Company irrespective of whether they actually maintain majority voting power or the support of the Company's board of directors. . . ."[66] These shareholder suits argue that these contractual control rights deprive boards of their key role under Section 141(a) of the Delaware General Corporation Law, which famously states that "the business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."[67]

The first ruling on these cases challenging contractual control rights was recently released. In *Moelis*, Vice Chancellor Laster sided with the plaintiffs in invalidating some of the types of control rights we discuss here.[68] Moelis & Company is a global investment bank that granted its eponymous founder, Ken Moelis, a variety of significant contractual control rights.[69] The contractual control rights allowed Ken Moelis to effectively control the company despite lacking shareholder voting control. In invalidating Moelis's contractual control rights, Vice Chancellor Laster stated, "Internal corporate governance arrangements that do not appear in the charter and deprive boards of a significant portion of their authority contravene Section 141(a)."[70] As discussed in detail below, *Moelis* generated significant controversy, and the Delaware legislature responded by adopting laws that overturn *Moelis* and expand the breath and power of shareholder contractual control rights.[71]

Although many companies, including Moelis and Company, grant their insider shareholders super-voting stock *and* contractual control rights, the scholarly literature and shareholder litigation have focused solely on how insider shareholders obtain outsized control rights *either*

the enterprise. In addition, other rights and responsibilities within the corporation are mandatory, including fiduciary duties, holding annual shareholders' meetings, shareholder voting rights, and specific processes for approving charter amendments, mergers and acquisitions, and dissolution."); *see* DEL. CODE ANN. tit. 8, §§ 102, 109, 141, 151, 211, 242, 251, 271 (2022).

66. Opening Brief in Support of Plaintiff's Motion for Summary Judgment at 2, Seavitt v. N-Able, Inc., 321 A.3d 516 (Del. Ch. 2024) (No. 2023-0326-JTL); *see also* West Palm Beach Firefighters' Pension Fund v. Moelis & Company, 311 A.3d 809, 816-19 (Del. Ch. Feb. 23, 2024) (challenging insider contractual controls).

67. *See* DEL. CODE ANN. tit. 8, § 141(a).

68. 311 A.3d 809, 881; *see also* Wagner v. BRP Group, Inc., 316 A.3d 826, 883 (Del. Ch. 2024) (addressing similar issues as *Moelis* and holding that if the company did not enter a "consent agreement" in response to the litigation, "all of the Challenged Provisions would be facially invalid under Section 141(a)").

69. Moelis & Company is a single-class corporation, and Ken Moelis held a minority voting position in the company. *See Moelis*, 311 A.3d at 817-25.

70. *Id.* at 822.

71. *See infra* Section III.C.

through super-voting stock or through special contractual control rights.[72] No one has considered what it means for insiders to have both. The following part shows that dual-class companies often grant insiders both types of control, which has important implications for how control is allocated between insiders and public shareholders.

II. Empirical Findings of Contractual Control Rights in Dual-Class Corporations

Dual-class companies have been the subject of much debate over the past century, and contractual control rights have recently become a hot topic, especially due to recent Delaware cases. However, there is a gap in the literature, which has only considered companies that either use dual-class structures or grant contractual control rights but has never analyzed how or why companies do both.

This Part provides the first empirical account of dual-class companies that give insider shareholders super-voting shares *and* special contractual control rights. It shows that over the past two decades, more than one-quarter of dual-class companies, including Moelis & Company, granted contractual control rights to their insider shareholders at the time of an IPO, in addition to super-voting shares. It describes these contractual control rights, which allow insider shareholders to maintain contractual control of the most fundamental corporate governance rights and corporate actions, often long after their supervoting rights have gone away. This original dataset reveals that the long-standing and ongoing dual-class debate, and the more recent shareholder-control-by-contract debate, each fail to account for the full variety of ways in which dual-class structures allocate power away from public shareholders and to insiders.

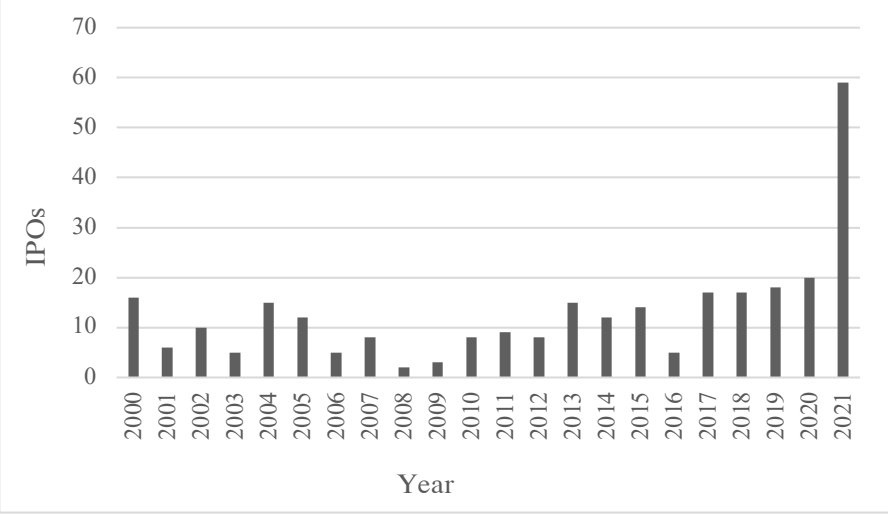
A. Methodology

To create a dataset of companies that grant insider shareholders significant contractual control rights in addition to high-vote stock, we started by deriving a sample of all IPOs from the Thompson Securities Data

72. For example, our prior research in this space was limited to single-class companies with contractual rights, specifically excluding companies with super-voting rights. *See* Shobe & Shobe, *supra* note 5, at 1301; *see also* Rauterberg, *supra* note 5, at 1162 n.125 (comparing control by shareholder agreement to control by dual-class stock); Shaner, *supra* note 5, at 827-32 (comparing contractual control rights to dual-class control rights); Opening Brief in Support of Plaintiff's Motion for Summary Judgment at 1, Seavitt v. N-Able, C.A. No. 2023-0326-JTL (Jun. 20, 2023) ("Apparently dissatisfied with the generous flexibility provided by Delaware's approach to the insulation of corporate control through super-voting shares, founders and other insiders have increasingly seized upon a simpler strategy: control by contract.").

Company Platinum database of global IPOs for a 22-year period, from 2000 through 2021.[73] We then separated out corporations listed as dual-class and hand-checked whether the corporation was a high-vote dual-class corporation, since some corporations use a dual-class structure for regulatory or tax reasons rather than control reasons.[74] This yielded a sample of 284 high-vote dual-class corporations, or an average of around 13 per year. As shown in Figure 1, the number of high-vote dual-class IPOs in a year of our sample ranged from only 2 in 2008, in the middle of the financial crisis, to 59 in 2021, a year in which there was a boom of IPOs.[75]

Figure 1. High-Vote Dual-Class IPOs Per Year



Using this sample of 284 high-vote dual-class corporations, we then examined their IPO prospectuses, which contain detailed disclosures about

73. We limited our search to corporations incorporated in the United States with a market capitalization exceeding $100 million at IPO and that are traded on a major stock exchange in the United States. We chose 2000 as a starting point because public filings before that time can be difficult to reliably locate in electronic form. 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, Ishii & Metrick, *supra* note 38, at 1056; Smart, Thirumalai & Zutter, *supra* note 56, at 99 ("Types of firms excluded from our data set include closed-end funds, unit offers, investment companies, real-estate investment trusts, and limited partnerships.").

74. Shobe & Shobe, *supra* note 5, at 1321 ("We found that approximately two-thirds of all non-high-vote dual-class companies do so in order to create an 'Up-C' [tax] structure."); *id.* at 1326 ("[A] handful of companies use dual-class structures to facilitate compliance with certain banking regulations, and a few companies use dual-class structures to issue special dividends to their company insiders.").

75. For data about IPOs in 2021, see Phil Mackintosh, *A Record Year for IPOs in 2021*, NASDAQ (Jan. 13, 2022), https://www.nasdaq.com/articles/a-record-year-for-ipos-in-2021 [https://perma.cc/LV7N-9XVK].

economic and control arrangements, to hand-collect and code for contractual control rights granted to insider shareholders at the time of IPO.[76] This uncovered several types of significant contractual control rights that companies may grant to their pre-IPO owners at the time of IPO, including board nomination rights, committee designation rights, and veto rights.[77]

We found that insider shareholders obtained these rights in a variety of ways. First, many companies grant their insider shareholders special control rights through the corporation's foundational documents, including the certificate of incorporation and bylaws.[78] For those companies, the insider shareholders are specifically named in the companies' foundational documents. Second, insider shareholders often enter into separate, side agreements directly with the company immediately prior to the IPO. The contracts between the insider shareholders and corporations have a variety of titles. They are most commonly called a shareholder agreement but often have other names like nomination agreement,[79] director-designation

76. We found the special rights discussed in this Article 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." Board and committee designation 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.

77. We coded board designation and nomination rights, vacancy rights, board size rights, committee designation rights, and veto rights as "significant" contractual control rights. If insiders were granted less significant rights like written consent, special meeting rights, phased-in supermajority rights, or information rights we did not code those companies as having significant contractual control rights even though those were among the contractual control rights we observed and for which we coded.

78. *See, e.g.*, Ping Identity Holding Corp., Prospectus (Form 424B4), at 49 (Sept. 18, 2019) (stating that "[o]ur 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%" of the company's outstanding stock); Certara, Inc., Prospectus (Form 424B4), at 125 (Dec. 10, 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. 19, 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. 30, 2020) (same).

79. *See, e.g.*, Applovin Corp., Prospectus (Form 424B4), at 136 (Apr. 14, 2021) ("Pursuant to the Director Nominations Agreement, KKR Denali will have the right to designate a nominee to our board of directors subject to the maintenance of certain ownership requirements in us."); Evo Payments, Inc., Prospectus (Form 424B4), at 140 (May 22, 2018) ("We will enter into a director nomination agreement with MDP effective upon completion of this offering that will provide MDP with the right to designate. . . .").

agreement,[80] voting agreement,[81] master separation agreement,[82] investors agreement,[83] or investor-rights agreement.[84] In addition, it is common for corporations to grant insider shareholders special control rights through a combination of these tools. For example, many of the corporations in our sample grant insiders separate rights in both a shareholder agreement and in the certificate of incorporation or bylaws.

In total, we found that 73 dual-class corporations in our sample granted their insider shareholders significant contractual control rights, or just over one-quarter of the 284 dual-class corporations from 2000 to 2021.[85] As Figure 2 illustrates, the number ranged from a high of 16 in 2021 to a low of 0 from 2008 through 2010, a period of very low IPO activity because of the 2008 financial crisis.[86]

80. *See, e.g.*, JGWPT Holdings Inc., Prospectus (Form 424B1), at 16 (Nov. 8, 2013) ("Upon completion of this offering, we will enter into a Director Designation Agreement with the JLL Holders and PGHI Corp.").

81. *See, e.g.*, Sprout Social, Inc., Prospectus (Form 424B4), at 133 (Dec. 12, 2019) ("The Voting Agreement provides that the Company shall nominate the designee of the Goldman Entities. . . ."); Entravision Communications Corp, Prospectus (Form 424B4), at 96 (Aug. 2, 2000) ("On the closing of this offering, we will enter into a voting agreement with Walter F. Ulloa. . . .").

82. *See, e.g.*, TODCO, Prospectus (Form 424B4), at 75 (Feb. 4, 2004) ("The master separation agreement provides Transocean with continuing rights to nominate board and committee members."); Freescale Semiconductor, Inc., Prospectus (Form 424B1), at F-41 (July 16, 2004) ("Additionally, the master separation and distribution agreement contains covenants, which limit the Company's ability to undertake certain actions without the prior consent of Motorola for as long as Motorola beneficially owns at least 50% of the total voting power of the outstanding capital stock of the Company.").

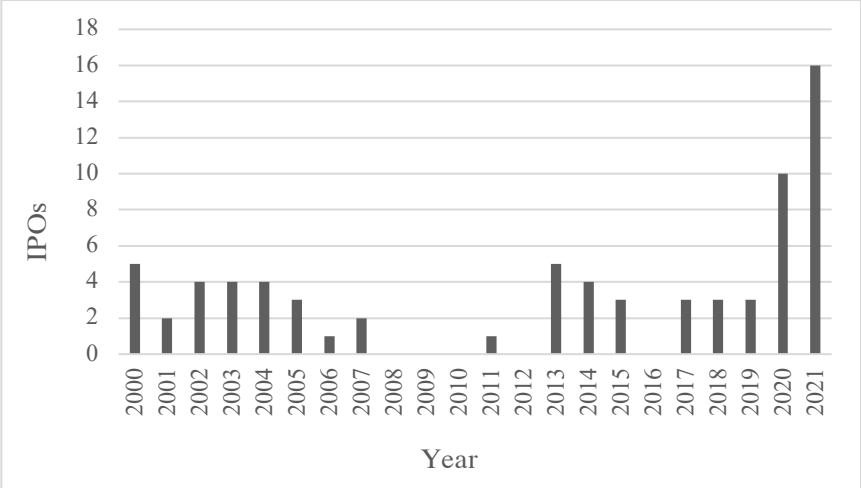
83. *See, e.g.*, Dobson Communications Corp., Prospectus (Form 424B1), at 78 (Feb. 3, 2000) ("The holders of our Class B common stock have entered into an investors agreement that enables them to appoint all of our directors . . . .").

84. *See, e.g.*, Arhouse, Inc., Prospectus (Form 424B4), at 49 (Nov. 3, 2021) ("Further, the investor rights agreement that will be in effect after the completion of this offering will contain agreements among the Freeman Spogli Funds, the Founder and the Class B Trusts with respect to the voting on the election of directors and board committee membership."); BellRing Brands, Inc., Prospectus (Form 424B4), at 125 (Oct. 16, 2019) ("Under the investor rights agreement, Post has the right to designate the members of each committee until the votes that may be cast by Post under our amended and restated certificate of incorporation are less than 25% of the total voting power of all of our shares of common stock.").

85. *See supra* note 77 (explaining which rights constitute "significant" contractual control rights).

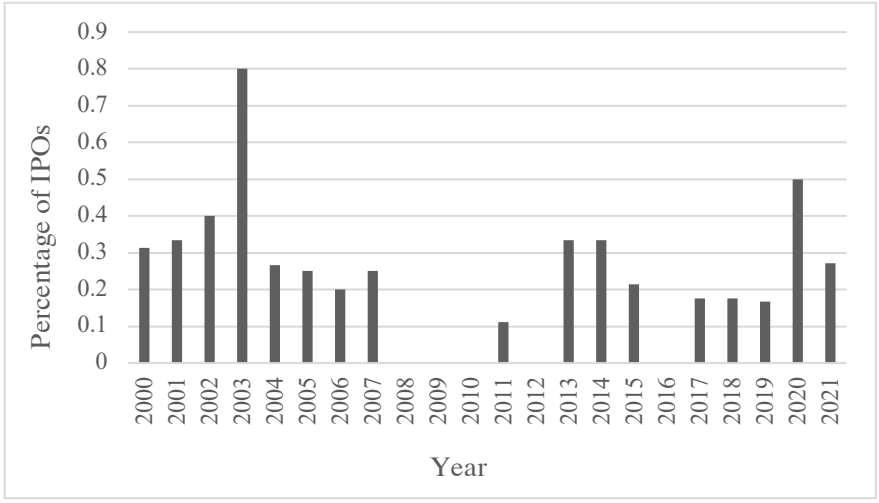
86. Our sample included only 2 dual-class IPOs in 2008, 3 in 2009, and 8 in 2010.

Figure 2: IPOs with High-Vote Stock and Significant Contractual Control Rights Per Year



While the total number of corporations that grant insider shareholders high-vote dual-class stock and significant contractual control rights has increased in recent years, the percentage of these corporations to all dual-class corporations has stayed more stable in recent years, as shown in Figure 3.

Figure 3: Percentage of IPOs with High-Vote Dual-Class Stock and Significant Contractual Control Rights



B. Board Composition Rights

1. Designation and Nomination Rights

Our findings show that the right to designate or nominate members of the board is the most common form of contractual control rights granted to insider shareholders in dual-class companies.[87] We found sixty dual-class companies, or over 21% of all dual-class companies in our sample, that grant board designation or nomination rights to founders and other company insiders.[88] For example, Airbnb, Inc. entered into a nominating agreement that granted the company's three founders the right to be nominated to the board for 20 years or until they sell 90% of their shares.[89] The contractual rights often include a provision requiring the company and other insider shareholders to use their reasonable best efforts to ensure that these nominees are elected to the board.[90] These rights are commonly structured on a sliding scale that gives insiders the ability to nominate a

87. For a discussion of director nomination rights in single-class companies, see Shobe & Shobe, *supra* note 5, at 1306 ("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."); *see also* Rauterberg, *supra* note 5, 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."). Only 3 companies in our sample granted nomination rights through their certificate of incorporation, with the rest in separate contractual agreements.

88. A designation right enables insider shareholders to specify potential candidates for election but does not require the board to nominate any such candidate. In contrast, a nomination right requires the company to include an insider shareholder's designees in the company's slate of nominees. Although there are distinctions between these rights, we are unaware of any company that has not nominated an insider shareholder's designee. Because designation and nomination rights appear to be functionally equivalent in practice, we report and discuss designation rights and nomination rights together.

89. *See* Airbnb, Inc., Prospectus (Form 424B4), at 269, 317 (Dec. 9, 2020). And Rent the Runway, Inc., which had an 11-member board of directors at IPO, granted its founder/CEO and two venture capital sponsors nomination rights to all 11 seats on the board. *See* Rent the Runway, Inc., Prospectus (Form 424B4), at 184, 224 (Oct. 26, 2021) ("The Bain Capital Ventures Entities will have the right to designate one of our directors, or the Bain Capital Ventures director, for so long as the Bain Capital Ventures Entities directly or indirectly, beneficially own, in the aggregate, 5% or more of all issued and outstanding shares of Class A common stock; Highland Capital Partners will have the right to designate one of our directors, or the Highland director, for so long as Highland Capital Partners directly or indirectly, beneficially owns, in the aggregate, 5% or more of all issued and outstanding shares of Class A common stock and Ms. Hyman will have the right to designate (i) nine of our directors, for so long as she directly or indirectly, beneficially owns, in the aggregate, 15% or more of the total voting power of all issued and outstanding shares of Class A common stock and Class B common stock. . . .").

90. Fifteen of the companies in our sample included this type of provision. *See, e.g.*, BellRing Brands, Inc., *supra* note 84, at 160 ("For any person designated by Post as provided above, BellRing Brands, Inc. will ensure that such person so designated will be nominated for election and will use reasonable best efforts to cause such person to be elected as a director.").

majority of the board at the time of the IPO and then a progressively lower number of board nominees as their ownership interests decrease.[91]

Our data shows that insider shareholders can use director nomination rights to extend their control over board composition even after they lose voting control. Many companies in our sample granted insiders the ability to nominate members of the board both when they have voting control and long after their voting control has dropped below 50%, with the corporation agreeing to use its best efforts to ensure that those nominees are elected.

For example, Moelis & Company went public in 2014 with a high-vote dual-class structure, with Class A shareholders receiving one vote per share and Class B shareholders receiving 10 votes per share.[92] Ken Moelis, the company's founder, owned all 36.2 million Class B shares at the IPO, which gave him 96.8% of the company's voting rights, with the remaining 3.2% held by Class A stockholders.[93] The company also entered into a stockholders agreement at the IPO that granted Mr. Moelis, among many other rights, the right to nominate a majority of the company's board so long as he continued to hold 4.46 million shares of the Company. Following the IPO, Mr. Moelis began a steep sell down of his equity in the company. Mr. Moelis held 33.3 million shares in 2016, 16.5 million in 2018, and 11.2 million in 2020.[94] His voting control dropped from 94.5% in 2016 to 79.8% in 2018 to 66.6% in 2020.[95] In 2021, he had sold his equity interest down to 4.9 million shares, which dropped his voting control to below a majority, 44.8%; at that point, he stopped his sell down just above the 4.45 million shares he was required to hold in order to maintain the right to nominate a majority of the board under the stockholders agreement.[96] As of 2024, Mr. Moelis holds 4.5 million shares, which represent only 5.9% of the

91. For example, BellRing Brands, Inc. entered into an investor rights agreement that granted insiders the right to designate (i) a majority of the board for as long as they hold a majority of the voting power, (ii) one less than a majority when they control between 25%-50% of the vote, and (iii) 1/3 of the directors if they hold between 10%-25% of the company's total voting power. *See* BellRing Brands, Inc., *supra* note 84, at 160. The nomination rights often sunset at a specific time or upon the occurrence of certain events, like the departure of a founder. For a discussion of sunsets of supervoting rights, see generally Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 COLOM. BUS. L. REV. 852 (describing and analyzing companies that have used time-based sunsets); Fisch & Solomon, *supra* note 31 (same).

92. *See* Moelis & Co., Prospectus (Form 424B4), at 11 (Apr. 15, 2014).

93. *Id.* at 98.

94. Moelis & Co., 2016 Proxy Statementm at 22 (Apr. 28, 2016); Moelis & Co., 2018 Proxy Statement, at 33 (Apr. 25, 2018); Moelis & Co., 2020 Proxy Statement, at 33 (Apr. 22, 2020).

95. Moelis & Co., 2016 Proxy Statement, at 22 (Apr. 28, 2016); Moelis & Co., 2018 Proxy Statement, at 33 (Apr. 25, 2018); Moelis & Co., 2024 Proxy Statement, at 33 (Apr. 22, 2020).

96. Moelis & Co., 2021 Proxy Statement, at 26 (Apr. 20, 2021).

economic rights of the company and 38.7% of its voting control.[97] Yet despite controlling less than a majority of the company's voting control and a small fraction of its economic rights, under the stockholders agreement Mr. Moelis retained the right to nominate a majority of the board by virtue of holding just over the 4.46 million shares required to maintain the contractual control right. The stockholders agreement has therefore served to allow Mr. Moelis to retain firm control of the company's board years after he no longer had majority voting control.

Dual-class companies also commonly have time-based sunsets on their dual-class structures, often five to seven years after IPO.[98] Stockholders agreements rarely have a similar time-based sunset. Stockholders agreements therefore can extend the insiders' control by allowing them to maintain outsized control through the stockholders agreement long after the dual-class structure goes away. For example, loanDepot, Inc., a residential mortgage originator, went public with a dual-class structure that gave insiders stock with five votes per share compared to one vote per share for public shareholders.[99] Under this high-vote dual-class structure, the founder had voting control at the time of the IPO, though the high-vote dual-class structure was designed to sunset five years after the IPO.[100] The founder and the company also entered into a shareholders agreement that allowed the founder to nominate two members of the board as long as he held at least 5% of the company's total voting power.[101]

While it is clear that director nomination rights extend shareholders' control rights, nomination rights also serve a second important purpose. A shareholder with the contractual right to nominate members of the board holds a powerful combination of rights—their contractual rights allow them to choose who is nominated to the board and their voting rights allow them to vote on their proposed nominees. In other words, when shareholders hold voting control through super-voting shares and a contractual right to nominate board members, this combination of rights guarantees that their chosen nominees will become board members. For example, Airbnb went public in 2020 with a dual-class structure that granted insiders 20

97. Moelis & Co., 2024 Proxy Statement, at 70 (Apr. 24, 2024).

98. *See* Winden, *supra* note 91, at 950-51.

99. *See* loanDepot, Inc. Prospectus (Form 424B4), at 1 (Feb. 11, 2021).

100. *Id.* at 22-23 ("Five years from the date of this offering, all shares of Class C and D Common Stock will be converted into shares of Class B and Class A Common Stock, respectively. As such, five years from the date of this offering all shares of our common stock will have one vote per share.").

101. *Id.* at 213. Many other companies provide similar contractual control rights to insiders that can last long after they no longer have voting control of the company. For example, GoodRx Holdings, Inc. has a seven-year sunset on its high-vote dual-class structure and grants similar rights to its controlling insiders that allow them to designate directors as long as they own a relatively small percentage. *See* GoodRx Holdings, Inc., Prospectus (Form 424B4), at 11 (Sept. 22, 2020). Fluence Energy, Inc. similarly has a seven-year sunset on its high-vote dual-class structure and grants insiders contractual control rights that can last long after the dual-class structure is gone. *See* Fluence Energy, Inc., Prospectus (Form 424B4), at 160-61, 169 (Oct. 27, 2021).

votes per share.[102] The dual-class structure had a sunset that would trigger 20 years following the IPO.[103] The three founders of Airbnb also entered into a Nominating Agreement that required Airbnb to "include our founders in the slate of nominees nominated by our board of directors . . . for election by our stockholders."[104] The Nominating Agreement would sunset no later than sunset of the dual-class structure,[105] meaning the founders were guaranteed to be nominated to the board during the period in which they had high-vote stock that they could use to approve their nominations.

In contrast, shareholders who hold only voting control *or* board nomination rights have significant, but incomplete, control over the board nomination process. A controlling stockholder has significant influence over a board's composition and decision making but cannot be certain that the board's directors, especially the independent directors, will always vote as the controller wishes. Contractual control rights can serve to complement voting control rights to ensure a controlling stockholder maintains control over the board. In addition, shareholders without board nomination rights generally only have the option of voting "yes" or "no" on proposed director nominees,[106] who are typically chosen by the board's nominating committee.[107] To be sure, a shareholder with voting control but no nomination right can *almost* be sure that they will have a say on the composition of the board—they can vote against proposed nominees and force the company

102. *See* Airbnb, Inc., Prospectus (Form 424B4), at 317 (Dec. 9, 2020).

103. *Id*.

104. *Id*. at 306. The company was also required to "use reasonable efforts to . . . recommend in favor of each founder's election as a director, and to solicit proxies or consents in favor of their election." *Id.*

105. *Id*. at 306-07 ("The Nominating Agreement will remain in effect until . . . the time at which all outstanding shares of Class B common stock automatically convert to Class A common stock . . . .").

106. Lucian Ayre Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAWYER 43, 45 (2003) ("Although shareholder power to replace directors is supposed to be an important element of our corporate governance system, it is largely a myth. . . . By and large, directors nominated by the company run unopposed and their election is thus guaranteed. The key for a director's re-election is remaining on the firm's slate.").

107. *See* Lawrence A. Hamermesh, *Director Nominations*, 39 DEL. J. CORP. L. 117, 134 (2014) ("[T]here is a long-standing, widespread system by which the board of directors or its nominating committee, as such, nominates candidates for election at the annual meeting."); LISTED COMPANY MANUAL § 303A.04(a), (b)(i), N.Y. STOCK EXCH. ("Listed companies must have a nominating/corporate government committee . . . [and the committee must] select, or . . . recommend that the board select, the director nominees for the next annual meeting of shareholders . . ."); STOCK MARKET LISTING RULES, Rule 5605-6(e), NASDAQ (requiring that nominees for election to the board of directors be selected either by a nomination committee of the board or, alternatively, independent directors constituting a majority of the board); *see also* Regulation S-K Item 407(c), 17 C.F.R. § 229.407(c)(2)(vii) (2024) (requiring public disclosure about companies' nominating committees of the board).

to engage in an expensive proxy contest,[108] and therefore a nominating committee will almost certainly take the controlling shareholder's preferences into consideration. However, absent a contractual right to nominate members to the board, even a "controlling" stockholder does directly control who gets nominated, and a nominating committee may choose to nominate members that the controlling stockholder would not oppose, but who may not be the controlling stockholder's first choice. Likewise, a shareholder who holds nomination rights but not voting control can be almost certain that their proposed nominee(s) will be elected to the board. [109] However, a shareholder without voting control runs the low but potentially high-stakes risk that their proposed nominee may not receive the requisite votes.[110]

In sum, shareholders who hold either nominating rights or voting control have significant influence over the composition of the board, but do not exercise complete control over the nomination and election process. In contrast, shareholders who hold both voting control and contractual control effectively control the entire board nomination process: they can choose who is nominated to the board and then vote to approve their nominees. The prevalence of these contractual control rights in dual-class companies suggests that insider shareholders value this belt-and-suspenders approach to board composition control.[111]

108. David Yermack, *Shareholder Voting and Corporate Governance*, 2 ANN. REV. FIN. ECON. 103, 108 (2010) ("Although shareholder voting rights are potentially powerful, they are seldom used directly to unseat members of a board. Only a few dozen contested proxy contests are held each year in which rival candidates compete head-to-head."); Bebchuk, *supra* note 106, at 45 ("To be sure, shareholders who are displeased with their board can nominate director candidates and then solicit proxies for them. The costs and difficulties involved in running such a proxy contest, however, make such contests quite rare."); Jie Cai, Jacqueline L. Garner & Ralph A. Walking, *Electing Directors*, 64 J. FIN. 2389, 2396 (2009) (finding that the average director nominee runs unopposed and receives approximately 94% of the "for" votes); *see also* Lucian Bebchuk, *The Myth of Shareholder Franchise*, 93 VA. L. REV. 675, 711 (2007) (arguing that the power of shareholders to replace the board "is largely a myth"). For a discussion of proxy access and proxy contests, see generally Scott Hirst, *Universal Proxies*, 35 YALE J. ON REGUL. 437 (2018); and Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 64 BUS. LAW 329 (2010).

109. Nomination rights alone are generally sufficient because most nominees run unopposed, and the vast majority of nominees are elected. *See* Hirst, *supra* note 108, at 439.

110. Although proxy contests are uncommon, when they do occur, they are high-stakes and require significant company resources. *See, e.g.*, Derek Saul, *Disney Wins Proxy Fight with Peltz—But Here's Why It Still Has to Worry*, FORBES (Apr. 3, 2024, 1:41 PM EDT), https://www.forbes.com/sites/dereksaul/2024/04/03/disney-wins-proxy-fight-with-peltz-but-heres-why-it-still-has-to-worry [https://perma.cc/93NH-7KMM].

111. Notably, the recent *Moelis* opinion held that nomination rights and board effort requirements were not facially invalid under the facts of that case because those rights do not necessarily infringe on the board's authority. West Palm Beach Firefighters' Pension Fund v. Moelis & Company, 311 A.3d 809, 870-78 (Del. Ch. 2024).

2. Vacancy and Board Size Requirements

Our findings show that companies also grant board members contractual control rights that *Moelis* held are facially invalid under Delaware law. For example, in our sample of dual-class companies, we found that 18 companies, or around 6% of our sample, are contractually obligated to replace or use "commercially reasonable actions to cause" the board to replace the insider's nominees who depart the board with another director hand-chosen by the insider. These "vacancy requirements" are different from nomination rights in that they require a board to place the insiders' chosen person on the board, not merely recommend them for a shareholder vote. It is unsurprising that insiders want this right, since if their nominee departs the board and the spot is filled with someone not of their choosing, they will have to wait until the next shareholder meeting to try to replace the new director with another director that they nominate. However, the court in *Moelis* found that this type of provision violates Delaware corporate law because it removes "from the directors in a very substantial way their duty to use their own best judgment on a management matter, viz., who should serve as a director."[112]

Relatedly, some insiders with nomination rights also want a guarantee that the company will not increase its board size—because increasing the board size would dilute the control exerted by the insider's nominees. For example, if an insider has the right to nominate four directors on a seven-person board, they will not want the board to be able to increase its size, which would make them no longer in control of a majority of the board. Fourteen companies, or around 5% of our sample, included a contractual right against increasing the board beyond a certain size. The *Moelis* opinion held that even though the right had never been invoked in that case, and indeed could not be invoked absent an amendment to the company's charter and bylaws because they also limited the size of the board, it was still facially invalid because, again, it would remove from the directors the ability to exercise their best judgment about the size of the board.[113] These examples of contractual control rights highlight that shareholders in dual-class companies are dissatisfied with the limitations of their voting control over shareholder-level matters and have sought to obtain contractual control over board-level decisions, in ways that may exceed the power a shareholder is allowed under Delaware law.

112. West Palm Beach Firefighters' Pension Fund v. Moelis & Company, 311 A.3d 809, 869 (Del. Ch. 2024).

113. *Id.* at 118.

C. Committee Designation Rights

In addition to the right to nominate members of the board, insiders are also sometimes granted the right to choose which members of the board serve on each committee of the board and who serves as chair of the board. We found nineteen corporations that grant these types of rights, or approximately 7% of our sample. These rights come in different forms. To illustrate, BellRing Brands, Inc. allows insiders to appoint the members of all committees of its board so long as those insiders hold at least 25% of the company's voting control.[114] Ryan Specialty Group Holdings allows insiders to appoint one of their nominees to each of the committees of the board.[115] Kayak Software Corp. allows insiders to designate two members of the compensation committee, which determines executive pay and therefore has significant sway over top management.[116] And Dreamworks Animation Inc.'s certificate of incorporation required that only insiders be included on its board nominating and corporate governance committee.[117]

Like director nomination rights, committee designation rights reallocate control away from the board to named insider shareholders. Despite this similarity, the recent *Moelis* decision held that committee designation rights violate Delaware law, but director nomination rights are facially valid. The court reasoned that "[d]etermining the composition of committees falls within the Board's authority," and therefore cannot be contractually transferred to shareholders.[118] However, the director nomination rights do not violate Delaware law because shareholders, at least in theory, can nominate their designees at stockholders' meetings, and therefore directors nomination rights are not held exclusively by the board of

114. *See, e.g.*, BellRing Brands, Inc., *supra* note 84, at 160 ("For so long as the votes that may be cast by Post under our amended and restated certificate of incorporation are 25% or more of the outstanding BellRing Brands, Inc. common stock, Post will have the right, subject to applicable corporate governance rules of the SEC and the NYSE, to designate the members of the committees of our Board of Directors.").

115. *See, e.g.*, Ryan Specialty Group Holdings, Inc., Prospectus (Form 424B4), at 175 (July 21, 2021) ("In addition, at any time when the Ryan Parties have the right to designate at least one nominee for election to our Board, the Ryan Parties will also have the right to have one of their nominated directors hold one seat on each Board committee.").

116. *See* Kayak Software Corp., Prospectus (Form 424B4), at 81 (July 19, 2012) ("Additionally, the Series A designator has the right to designate two members of the compensation committee pursuant to our Sixth Amended and Restated Investor Rights Agreement, as amended."); *see also* Osca, Inc., Prospectus (form 424B4), at 65 (June 8, 2000) ("[S]o long as Great Lakes owns shares representing 10% or more of the votes entitled to be cast by the voting stock, the compensation committee shall include at least one director designated by Great Lakes.").

117. *See, e.g.*, Dreamworks Animation Inc., Prospectus (Form 424B4), at 88 (Oct. 27, 2004) ("Our restated certificate of incorporation provides that . . . the nominating and corporate governance committee will be composed solely of the Class C director (if any shares of Class C common stock are then issued and outstanding), Jeffrey Katzenberg (or, if he is not our chief executive officer, then his designee) and David Geffen (or his designee).").

118. West Palm Beach Firefighters' Pension Fund v. Moelis & Company, 311 A.3d 809, 821 (Del. Ch. 2024).

directors.[119] Notably, Dreamworks Animation Inc. was the only company to include its committee right in its certificate of incorporation, with the rest granting this right through a separate contractual agreement; that is significant because the *Moelis* decision held that these types of control rights are invalid unless they are located in the certificate of incorporation.[120]

D. Veto Rights

Our dataset shows that approximately 6% of dual-class companies grant insider shareholders "veto" rights over certain board-level decisions, with some companies in our sample granting expansive veto rights over day-to-day corporate actions and other companies granting only narrow veto rights over corporate actions that would adversely affect the insider shareholder.[121] Shareholders normally have no say in whether the company takes on debt, engages in joint ventures, hires or fires company officers, declares dividends, or takes any other action that is the exclusive purview of the board. However, our findings show that insider shareholders who already control shareholder-level decisions through their super-voting stock also use contracts to gain control over these and other board-level decisions.

The *Moelis* decision held that the veto/pre-approval rights held by Mr. Moelis violate Delaware law because they caused "the business and affairs of the company [to be] managed under the direction of Moelis, not the Board."[122] The court further held that, like committee designation rights, veto rights may be valid if they are granted through a company's certificate of incorporation. However, only three of the companies in our sample granted veto rights through their certificates of incorporation or bylaws, and therefore, the remaining companies' contractual rights could be invalid under the *Moelis* decision.

For an illustrative example, consider Spansion, Inc. Spansion's bylaws require the prior consent of two named insider shareholders before

119. *Id.* at 821-22 ("The Nomination Requirement is also not facially invalid. Moelis could nominate his designees at a stockholder meeting.").

120. *See supra* Section I.B.

121. We found veto rights both in corporations' foundational documents, like bylaws and certificates of incorporation, and in separate contractual arrangements with names like "investor rights agreement" or "stockholders agreement." In some companies we found them in both places. In total, we found 16 dual-class companies that granted veto rights to insiders, or around 6% of all dual-class companies in our sample. It is worth noting that for purposes of this Article, we defined "veto rights" to include only pre-approval rights, not supermajority rights, in accordance with the *Moelis* definition of veto rights.

122. *Moelis*, 311 A.3d at 821.

engaging in a host of common business decisions, including (i) entering into certain joint ventures, (ii) conducting certain lines of business, (iii) closing facilities, or (iv) laying off employees.[123] Similarly, Pivotal Software Inc. entered into a master transaction agreement requiring certain pre-IPO shareholders' approval prior to, among other things, (i) adopting a poison pill, (ii) selling assets worth more than $100 million, (iii) acquiring assets worth more than $250 million, (iv) issuing new stock, (v) making equity grants, or (vi) declaring dividends.[124] And Deltek Inc. entered into an investor rights agreement requiring the consent of a certain pre-IPO shareholder before, among other things, (i) increasing the size of the board of directors, (ii) incurring debt greater than $10 million, (iii) selling, leasing, or transferring assets worth $10 million or more, (iv) purchasing assets worth more than $5 million, (v) paying a dividend, or (vi) issuing stock.[125] These rights effectively ensure that boards must consult with, and receive approval from, insider shareholders before they can engage in a wide range of corporate actions.[126]

Likewise, Warner Music Group went public in 2020 with a dual-class structure that granted its Class A shares 1 vote per share and Class B shares, which were held exclusively by insiders, 20 votes per share.[127] The insider shareholders held 99% of the company's voting rights at IPO. The insiders also entered into an extensive shareholder agreement that terminated when their ownership of the overall outstanding shares went below

123. *See* Spansion Inc., Prospectus (Form 424B4), at 32 (Dec. 15, 2005) ("[O]ur bylaws will provide that for so long as AMD and Fujitsu maintain specified ownership levels in our common stock, we will not take certain actions specified in our bylaws without the prior consent of AMD and Fujitsu. These consent rights will include, among other things . . . . Joint Ventures and Strategic Alliances . . . Conduct New Unrelated Business . . . Facility Closings . . . Headcount Reductions . . . .").

124. *See* Pivotal Software, Inc., Prospectus (Form 424B4), at 142-43 (Apr. 19, 2018).

125. *See* Deltek, Inc., Prospectus (Form 424B4), at 114 (Nov. 1, 2007) ("We cannot, without the prior written consent of the New Mountain Funds, take certain actions including, among other things, actions to . . . incur indebtedness of more than $10 million . . . sell, lease, transfer or otherwise dispose of any asset or group of assets with a book value or fair market value of $10 million or more . . . purchase, acquire or obtain any business or assets of another person having a value in excess of $5 million . . . pay or declare a dividend or distribution on any shares of our capital stock. . . .").

126. *See* The AZEK Company Inc., Prospectus (Form 424B4), at 162-63 (June 11, 2020) (explaining that "as the Sponsors collectively own at least 30% of the outstanding shares of our common stock, the following actions will require the prior written consent of each of the Sponsors," "merging or consolidating with or into any other entity," "acquiring or disposing of assets, in a single transaction or a series of related transactions, or entering into joint ventures, in each case with a value in excess of $75.0 million," "incurring indebtedness . . . in excess of $100.0 million," "terminating the employment of our chief executive officer or hiring or designating a new chief executive officer," "amending, modifying or waiving any provision of our organizational documents in a manner that adversely affects the Sponsors," "commencing any liquidation, dissolution or voluntary bankruptcy, administration, recapitalization or reorganization," or "increasing or decreasing the size of our board of directors").

127. *See* Warner Music Group Corp., Prospectus (Form 424B4), at 40 (June 3, 2020). For additional examples of companies that grant insider shareholders similar rights, see *supra* Section II.C.

10%, which was the same as the sunset for the dual-class structure.[128] This shareholder agreement granted the insiders wide-ranging control rights including the ability to veto any merger, acquisition of assets greater than $25 million, change in the company's capital stock, issuance of debt exceeding $25 million, listing on a securities exchange, action to increase or decrease the size of the board or create any new committee of the board, amendments to the certificate of incorporation or bylaws, hiring of a CEO, CFO, or general counsel, change in auditor, stock compensation plan, or settlement of litigation exceeding $15 million.[129] These rights effectively guaranteed that the insiders would not only control all shareholder votes, but that they could also determine the day-to-day actions of the board, including choosing the company's most important executives.

Our data shows that insiders use veto rights to extend and expand their control rights beyond the control they receive through their high-vote stock. The contractual control rights extend insiders' control rights beyond the existence of the dual-class structure, which is often subject to sunset under predetermined conditions by granting insiders an veto rights over corporate matters long after the insiders have ceased to have voting control.[130] This allows them to retain disproportionate control even after they lose voting control, thereby making the disproportionate control rights last longer than they might appear on the surface of the dual-class structure.[131] In addition, the fact that many companies grant insiders contractual control rights that are in effect at the same time as the insiders' voting control rights shows that controlling shareholders are often dissatisfied with voting

128. Warner Music Group Corp., supra note 127, at 40. Our data shows that many companies grant insiders contractual control rights that sunset at the same time or before the dual-class structure sunsets, as opposed to contractual control rights that start when or extend into the time an insider loses majority voting control, which are addressed in the following Section. *See, e.g.*, Newmark Group, Inc., Prospectus (Form 424B4), at 185 (Dec. 14, 2017) (describing the supplemental contractual control rights of its controlling shareholder will hold "[f]or so long as BGC Partners beneficially owns at least 50% of the total voting power of our outstanding capital stock . . . .").

129. Warner Music Group Corp., supra note 127, at 40.

130. *See, e.g.*, Noodles & Company, Prospectus (Form 424B4), at 92-93 (June 27, 2013) ("[F]or so long as Catterton and Argentia hold at least 35% of the voting power of our outstanding common stock, certain actions may not be taken without the approval of Catterton and Argentia, including any merger . . .; any sale of all or substantially all the assets of the Company . . .; or any amendment of our certificate of incorporation, bylaws or equivalent organization documents. . . ."); Todco, Prospectus (Form 424B4), at 92-93 (Feb. 4, 2004) ("[F]or so long as Transocean beneficially owns shares representing at least 15% of the voting power of our outstanding voting stock, we will not, without the prior consent of Transocean, adopt any amendments to our amended and restated certificate of incorporation or bylaws. . . .").

131. Although insider shareholders with super-voting rights will generally keep voting control far longer than they would if they did not hold high-vote stock, dual-class companies often adopt sunset provisions that convert high-vote stock into "one vote" common stock after a set number of years or upon a certain event.

control alone, since if voting control were enough then they would have no reason to obtain contractual control rights over decisions that are typically left to the board.

E. Summary

At first glance, contractual control rights appear to be an alternative to super-voting rights: each give insider shareholders outsized control over the corporation and may be viewed as two ways of accomplishing the same purpose. Accordingly, to the limited extent practitioners, academics, and the judiciary have compared dual-class voting control to contractual control rights, they have described these two forms of control as substitutes.[132] In fact, the plaintiffs in *Seavitt v. N-Able*, a Delaware shareholder suit challenging insiders' contractual control rights, expressed that view when they posed the question: "Why even worry about maintaining majority voting power when you can simply provide yourself with a perpetual contractual right to control the most important decisions and functions of your company and its board of directors?"[133] This rhetorical question captures the issues that this Article grapples with.

Although shareholder agreements can be used in lieu of a dual-class structure, this Article's findings show that contractual control rights and high-vote stock are often used together. Our data shows that over one-quarter of dual-class companies grant insiders super-voting rights *and* contractual control rights at the time of IPO, which indicates that many insider shareholders do not view these two types of control rights as redundant. Our findings indicate that contractual control rights, including board nomination rights, committee designation rights, and veto rights, serve distinct purposes from super-voting rights. These contractual rights extend and expand insider shareholders' control rights beyond those typically held by a shareholder, including shareholders with majority voting control. By holding super-voting shares and contractual control rights, insider shareholders control matters that are subject to a shareholder vote through their super-voting shares and control certain board actions and corporate governance decisions through their contractual control rights.

III. Implications for the Dual-Class and Contractual Control Rights

132. *See* Travis Laster, *The Unintended Beneficiaries of Section 122(18)*, LINKEDIN, https://www.linkedin.com/pulse/unintended-beneficiaries-section-12218-travis-laster-oruze [https://perma.cc/3Z53-VCKY] (stating that the biggest beneficiaries of the legislation "are the repeat players who want the ability to take companies public, avoid the valuation penalty of a dual-class structure, and sell down without giving up control"); Shobe & Shobe, *supra* note 5, at 1315-19 (providing theories why shareholders would choose to use shareholder agreements instead of high-vote, dual-class stock).

133. *See* Opening Brief in Support of Plaintiff's Motion for Summary Judgment at 2, Seavitt v. N-Able, C.A. No. 2023-0326-JTL (Jun. 20, 2023)

Debates

Our findings have several implications for current scholarly and policy debates. Fundamentally, our findings show that contracts are often used to allow insider shareholders to obtain and retain greater control than they could with only high-vote stock. Existing scholarly literature and policy proposals have spent over a century considering the costs and benefits of super-voting rights and have recently begun to consider what it means for a corporation to grant contractual control rights. Yet, no one has considered what it means for insiders to have outsized control through high-vote stock *and* contractual control rights. This Part argues that the scholarly debate and policy proposals surrounding dual-class structures should account for the ways contractual control rights dramatically extend and expand insiders' control. It then discusses the implications of the findings for the controversy surrounding the *Moelis* decision and recent Delaware legislation intended to override *Moelis*.

A. Agency Costs and Benefits

Critics of dual-class structures argue that they are problematic because they create a disconnect between economic and voting rights, which results in agency costs that can harm public shareholders. Dual-class structures create a misalignment of interests between low-vote shareholders, whose economic rights exceed their voting control, and insiders holding high-vote stock, whose voting rights exceed their economic rights.[134] Since economic incentives are not aligned, insiders with voting control have an incentive, and often the ability, to use the corporation for their benefit. Insiders receive the full benefit of transactions that create personal benefits but suffer "only a small fraction of the negative effects of their actions on the company value."[135] Insiders may prefer something other than just the highest stock price possible, especially if they can benefit from their control more directly in other ways, such as engaging in conflicted transactions with family members or with another entity affiliated with the insider. Scholars have explored tools that insiders in dual-class companies can use to extract disproportionate economic benefits,[136] and empirical evidence

134. Shill, *supra* note 21, at 237.

135. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 2, at 602.

136. Gilson, *supra* note 22, at 1651; Goshen & Hamdani, *supra* note 2, at 582; Bebchuk & Kastiel, *The Untenable Case*, *supra* note 2, at 602-03; Bebchuk & Kastiel, *The Perils*, *supra* note 2, at 1460.

supports that insiders have used these tools to extract personal benefits.[137] This misalignment with public shareholders, who are generally concerned primarily, and often exclusively, with the corporation's share price, is at the core of the principal-agent problem.

This Article's findings add another dimension to the standard agency-costs account by showing that control rights are often deeper and more complex than the much-discussed high vote/low vote divide. By granting rights that go far beyond simple voting rights, like the ability to veto critical board and management-level decisions, the divergence between ownership and control becomes larger, and takes a different shape, than in a simple high-vote structure. The combination of high-vote stock and contractual rights allows insiders to have significantly more control than they could just as shareholders in traditional dual-class companies because they can effectively control shareholder votes and matters that are reserved for officers and directors.

Because contractual control rights expand insider shareholders' opportunities to control corporate decisions in ways that can maximize their private benefits, we would expect agency costs to be higher for public shareholders in companies that grant insider shareholders high-vote dual-class stock and significant contractual control rights than traditional dual-class companies. Insiders can use contractual rights to control the composition of the board and its committees, to veto changes to the certificate of incorporation and bylaws, and to block potential acquisition offers, debt issuances, stock issuances, asset purchases, or other important corporate actions that might have been advantageous from a financial standpoint for a corporation as a whole but do not align with their strategic or financial interests.[138] Therefore, it seems that concerns commonly raised about dual-class companies apply even more strongly when companies couple high-vote dual-class stock with contractual control rights.

The agency costs created by the combination of contractual control rights and high-vote stock are not only likely higher, but they are also more amorphous and uncertain than the agency costs in a typical dual-class corporation, making them harder to quantify. Various legal and finance scholars have calculated the "wedge between voting power and cash-flow rights" in an attempt to quantify the agency costs in dual-class structures.[139]

137. Masulis, Cong Wang & Fei Xie, *supra* note 49, at 1703-06 (finding that a larger disconnect between insider control and economic interests increases the likelihood of insiders diverting corporate benefits to themselves); Jackson, Jr., *supra* note 25 ("Seven or more years out from their IPOs, firms with perpetual dual-class stock trade at a significant discount to those with sunset provisions.").

138. *See supra* Section II.D.

139. *See* Bebchuk & Kastiel, *The Perils*, *supra* note 2, at 1473; Bebchuk & Kastiel, *The Untenable* Case, *supra* note 2, at 591 ("When the wedge between the interests of the controller and those of the public investors grows over time, the agency costs of a dual-class structure can also be expected to increase."); Rimona Palas, Dov Solomon, Dalit Gafni & Ido Baum, *Does*

Although the purpose of measuring a "wedge" is to determine whether and how disproportionate control rights affect company performance and shareholder value, existing scholarship uses high-vote stock as the exclusive input for control rights.[140] In other words, scholars calculate the control wedge at dual-class companies by simply comparing a shareholder's voting control percentage to their percentage of economic rights. This Article's data render this existing literature on dual-class wedges at best incomplete, since the true wedge between control and economic rights is significantly higher, and more difficult to determine, for a sizable portion of dual-class corporations. Empirical research that calculates the wedge between control rights and economic rights should also account for insider's significant contractual control rights, which, as described above, are present in approximately one-quarter of dual-class corporations.

Supporters of dual-class structures claim that granting disproportionate voting rights to insider shareholders can increase company value. They claim that dual-class structures can allow visionary founders to use their expertise to maximize the value of the corporation.[141] This purported insider expertise is acquired over many years and can be used to develop and implement long-term strategies that can generate outsized corporate benefits, which can increase a company's share price to the benefit of its public shareholders.[142] In contrast, single-class companies are more susceptible to proposals and campaigns by activist investors, who sometimes focus on narrow or short-term company issues at the expense of long-term growth. Furthermore, even if a company is not the target of activist investors, supporters of the use of dual-class claim it may be better than allowing the company to be controlled by passive public investors, who are "weakly

Wedge Size Matter? Financial Reporting Quality and Effective Regulation of Dual-Class Firms, 54 FIN. RES. LETTERS 103774, 1 (2023).

140. Scholars use this method of calculating wedges to show that a larger wedge contributes to lower firm valuation. *See, e.g.*, Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg, Lubomir P. Litov, *The Rise of Dual Class Stock IPOs*, 144 J. FIN. ECON. 122, 128-29 (2022) ("A primary measure of interest for a dual-class firm is the 'wedge' between voting and economic rights for key economic actors within the firm."); Gompers, Ishii & Metrick, *supra* note 38, at 1084; Masulis, Cong Wang & Fei Xie, *supra* note 49, at 1705 (defining the wedge as "excess control rights measured by the ratio of insider voting rights to cash flow rights"); Michael L. Lemmon & Karl V. Lins, *Ownership Structure, Corporate Governance, and Firm Value: Evidence from the East Asian Financial Crisis*, 53 J. FIN. 1445, 1447 (2003); *Karl V. Lins, Equity Ownership and Firm Value in Emerging Markets*, 38 J. FIN. & QUANT. ANALYSIS 159, 181 (2003).

141. Adi Grinapell, *Dual-Class Stock Structure and Firm Innovation*, 25 STAN. J. L. BUS. & FIN. 40, 40 (2020) (arguing that "placing limitations on dual-class stock structure can prevent such firms from implementing the optimal stock structure needed for the execution of their founders' vision"); Goshen & Hamdani, *supra* note 2, at 579-80.

142. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006).

motivated" and poorly situated to dictate the company's direction.[143] Dual-class structures that grant insiders contractual control rights increase insiders' ability to guide the direction of the company by providing them more tools to control the company and greater insulation from shareholder pressure for longer. If it is true that dual-class structures create agency benefits, then it may be that providing insiders even greater control over the composition of the board and the decisions of the board through contractual arrangements is for the best.

Other scholars are more agnostic about dual-class structures and argue that public shareholders can simply price in their loss of control by paying less for shares of dual-class companies, thereby effectively making the controllers bear the economic cost of their disproportionate control.[144] Some scholars similarly argue that private ordering is preferable to regulation and so it is best to leave it to the free market to decide how to deal with dual-class structures.[145] While these arguments in favor of allowing private ordering could also hold true for the type of contractual control rights we describe here, it may be more difficult for public shareholders to know how to discount for these less salient and less predictable contractual rights than it would be for more common and better understood high-vote dual-class structures.[146] The types of contractual rights we highlight here make the calculus for public shareholders more complicated since it is hard to predict at the time of the IPO how those contractual rights could hurt, or help, shareholder value. As Professor Jill Fisch has put it, "shareholder agreements undermine the uniformity and predictability associated with the corporate form" and "the transparency of corporate ownership and the operation of shareholders' governance rights."[147]

143. *See* Lund, *supra* note 1, at 694-97 ("[W]eakly motivated voters should rarely vote in shareholder elections. And when they do vote, their lack of information, coupled with pro-management biases and other conflicts of interest, make it unlikely that their votes will be value enhancing for the company."); Fischel, *supra* note 2, at 134-37 ("Many shareholders are passive investors who hold many different investments. They have little interest in managing the firm and insufficient incentive to learn the details of management."); Sharfman, *supra* note 23, at 9 (2019) ("Shareholders suffer from the problems of asymmetric information and the simple inability to make the proper evaluation of a leader's idiosyncratic vision.").

144. *See* WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 205 (2003) (noting that "public investors who discount accordingly will always get what they pay for").

145. 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, 7 (2018).

146. The literature suggests that the IPO market does not always accurately price in governance terms and the types of contractual rights we found in our sample seem to be the types of governance terms that the market would struggle to price accurately. *See, e.g.*, Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protections in IPOs*, 17 J.L. ECON. & ORG. 83, 86-113 (2001).

147. *See* Jill E. Fisch, *Private Ordering and the Role of Shareholder Agreements* 39, 45 (Eur. Corp. Gov. Inst., Working Paper 538/2020), https://www.ecgi.global/sites/default/files/working_papers/documents/fischfinal.pdf [https://perma.cc/B3B6-S368].

B. Proposals to Address Agency Costs

Recent proposals by investor groups and scholars have conceded that dual-class structures will continue to exist and, rather than proposing to do away with them, have focused on how the agency costs created by these structures can be curbed. This Section discusses how proposed solutions to address agency costs in dual-class structures can consider the role of contractual control rights in dual-class companies.

1. Sunsets

To address agency costs in dual-class structures, many have proposed that high-vote stock be required to sunset automatically after a certain amount of time, often around seven years. Supporters of time-based sunsets argue that this would provide the best of both worlds: a visionary founder would have a reasonable amount of time to implement her unique vision, after which the company would convert to a single class of stock.[148] For example, Professors Lucian Bebchuk and Kobi Kastiel argue that the purported benefits of the dual-class structure decrease over time and that sunsets are therefore an appropriate policy response.[149] Investor groups similarly argue that sunset provisions allow for a realignment of interests if applied over a "reasonable" period of time.[150]

Not everyone agrees that mandatory sunsets are a panacea. Professors Fisch and Solomon have been critical of proposals for mandatory sunsets, arguing that this "one-size-fits-all approach is overly simplistic."[151] They advocate for more tailored and nuanced sunset provisions that are designed to fit the realities of each company.[152] Another concern raised with time-based sunsets is that because they provide a defined period in which insiders have control, the insiders have an incentive to quickly use that control to maximize their own personal benefits before their control is gone. This incentive becomes even stronger as the sunset draws near. As Professors Fisch and Solomon put it, "the knowledge that the founder's control is drawing to an end can cause the founder to engage in short-termist

148. The SEC has generated data showing that dual-class companies with sunset provisions have higher valuations than those without sunset provisions seven years after IPO. *See* Jackson, Jr., *supra* note 25 ("Seven or more years out from their IPOs, firms with perpetual dual-class stock trade at a significant discount to those with sunset provisions.").

149. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 2, at 590.

150. *See Dual-Class Stock*, COUNCIL OF INST. INVS, https://www.cii.org/dualclass_stock [https://perma.cc/S6JA-7P3X] ("CII has pressed dual-class IPO companies to include reasonable time-based "sunset" provisions in their charters.").

151. Fisch & Solomon, *supra* note 31, at 1063.

152. *See id.*

behavior such as excessive risk-taking or conservatism, self-dealing, or opportunistic behavior with other ventures."[153] Professor John Coffee says that sunsets create "a sharp cliff" and that this "may have perverse effects."[154]

Our findings show that these proposals and conclusions are incomplete. First, time-based sunsets are only a partial solution since, as demonstrated in the previous Part, contractual control rights often persist long after the high-vote stock goes away. For corporations with a sunset on super-voting rights, the contractual rights can effectively extend the sunset period, thereby allowing insiders to keep disproportionate control for much longer than the dual-class structure exists.[155] If sunsets are necessary to ensure that insiders retain disproportionate control only for a set time, then they would need to apply to contractual rights too. Second, while it is true that time-based sunsets create a cliff, contractual control rights can mitigate that cliff by allowing for extended but reduced control rights that typically do not fully go away until the insiders' economic interests drop below a relatively low level. Contractual control rights may dull the incentive to engage in self-dealing or short-termist behavior and therefore be a useful way of smoothing the transition from a dual-class corporation to a single-class one.

2. Indexes and Institutional Investors

Because the SEC lacks the statutory authority to curb issues raised by dual-class structures, some large index funds and institutional investors have taken it upon themselves to address agency costs in dual-class structures. An index fund is a portfolio of publicly traded companies that many of the largest investors, including mutual funds, use for investing in the public market. If a publicly traded company is included in an index, then investors in that index effectively have no choice but to invest in that

153. Fisch & Solomon, *supra* note 31, at 1083.

154. Coffee, Jr., *supra* note 4.

155. For example, loanDepot granted board nomination rights not only to its founder/controller, but also to an investment fund that was a large pre-IPO investor. The founder and the investment fund each had the right to appoint two members of the Board of the company's seven-member board. Combined, the founder and investment fund had the ability to control a majority (4/7) of the board's seats as long as they held a combined 20% of the company's stock. *See* loanDepot, Inc., *supra* note 92, at 213 ("Pursuant to the stockholders agreement, the Parthenon Stockholders will have (i) the right to designate two nominees for election to our board of directors so long as such group owns at least 15% of the total voting power of our common stock, and (ii) otherwise one nominee for election to our board of directors so long as such group owns at least 5% of the total voting power of our common stock. Additionally, the Hsieh Stockholders, will have (i) the right to designate two nominees for election to our board of directors so long as such group owns at least 5% of the total voting power of our common stock, and (ii) upon the Parthenon Stockholders' ceasing to own more than 15% of the total voting power of our common stock, the Hsieh Stockholders shall have the right to designate an additional nominee to the our board of directors . . . ."). Even after the five-year sunset of the high-vote dual-class structure, they could continue to control a majority of the seats of the board, thereby effectively continuing the dual-class structure in a different form.

company.[156] Indexes have tried to discourage the use of dual-class structures by limiting, underweighting, or excluding companies with dual-class structures from their indexes.[157] For example, in 2017, the S&P Global responded to investor concerns about dual-class companies by adopting a rule excluding all new dual-class companies from the S&P 500.[158] This had the effect of decreasing the capital available to invest in those companies, which in turn may have a negative effect on their share prices, although the data is mixed.[159] Yet, in 2023, the S&P reversed that policy and now have no restrictions on dual-class companies. Investors have sharply criticized this decision.[160]

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

157. *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[,] 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."). Indexes 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.capmktsreg.org/wp-content/uploads/2020/04/The-Rise-of-Dual-Class-Shares-04.08.20-1.pdf [https://perma.cc/WV2Z-NAXN] ("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.").

158. 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/ZJX9-PPS2].

159. *See*, *e.g.*, StepStone Grp., Inc., Prospectus (Form 424B4), at 61 (Sept. 15, 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 Techs. Inc., Prospectus (Form 424B4), at 69 (Dec. 1, 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."). Empirical studies are at best inconclusive on this effect, with some finding that exclusion can actually improve returns. *See* Nimesh Patel & Ivo Welch, *Extended Stock Returns in Response to S&P 500 Index Changes*, 7 REV. ASSET PRICING STUD. 172, 196 (2017); Andrew Winden & Andrew Baker, *Dual-Class Index Exclusion*, 13 VA. L. & BUS. REV. 101 (2019).

160. *See Index Providers and Dual-Class Stock*, COUNCIL OF INST. INVS., https://www.cii.org/index-providers-dual-class-stock [https://perma.cc/4UPZ-JJAJ] ("Further reducing the likelihood of exchange-based reform, multiple non-U.S. exchanges with long-standing 'one share, one vote' requirements recently have yielded to 'race to the bottom' pressure to attract new listings, permitting dual-class structures in certain circumstances.").

The Council of Institutional Investors, a trade group comprised of mostly state and local pension funds, has argued that dual-class structures create a "founder-knows-best approach" that "can entrench management" with "little interference from boards they effectively control."[161] Many large institutional investors have similarly advocated against dual-class structures.[162] Likewise, Institutional Shareholder Services, the largest proxy advisory firm, recommends that shareholders vote against directors of public companies with high-vote dual-class structures.[163]

If institutional investors and indexes are concerned about traditional dual-class structures, then they should be even more concerned about dual-class companies that layer on insider control through contractual control rights, thereby diverting greater power away from public investors. This Article's findings should cause them to consider more broadly how insiders maintain disproportionate control in corporations.

3. Dual-Class Stock Restrictions

A few scholars have argued that to address agency costs in dual-class structures, regulators could restrict the use of the most extreme versions of dual-class structures. For example, Professor Dorothy Lund has urged that dual-class companies be required to issue at least a "non-negligible amount of voting stock to the public."[164] She defines "non-negligible" as a number "sufficiently large that it would give outside investors leverage over management and a path toward unseating management in the future."[165] Professors Bebchuk and Kastiel, on the other hand, argue that regulators and institutional investors should discourage the use of non-voting stock at all because it creates "an extreme separation between cash-flow rights and voting rights."[166]

If regulators are to consider the agency effects created by dual-class stock, then they should also consider the effects contractual rights have on insiders' control. For example, public shareholders of a company that grants insider shareholders extensive contractual control rights face similar agency costs as shareholders of a dual-class company that grants only zero vote stock to its public shareholders—both sets of shareholders are beholden to the decisions of the insider shareholders over critical corporate actions. In addition, a dual-class company with a 10 to 1 voting differential between insiders and the public that also grants strong contractual control

161. *Dual-Class Stock*, *supra* note 150.

162. *See supra* notes 41-42 and accompanying text.

163. Cydney Posner, *ISS Issues Benchmark Policy Updates for 2023*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Dec. 23, 2022), https://corpgov.law.harvard.edu/2022/12/23/iss-issues-benchmark-policy-updates-for-2023 [https://perma.cc/K8K6-AC7L].

164. Lund, *supra* note 1, at 739.

165. *Id*. at 739-40.

166. Bebchuk & Kastiel, *The Perils*, *supra* note 2, at 1506-07.

rights to insiders raises similar, and perhaps greater, agency concerns as a dual-class company that grants zero vote stock to the public but no contractual control rights to insiders. Given the important effects of contractual rights on the allocation of control between public shareholders, insider shareholders, and the board regulators' focus should be on the substance of the control rights insiders have, not just the form their rights take.

C. Delaware and Contractual Control Rights

1. Delaware Courts and *Moelis*

The legal status of contractual control rights became one of the central debates in Delaware during 2024. As this Article's findings show, these rights have existed for decades, and corporations consistently use them to shift control over corporate actions to insider shareholders. For many decades these rights went unchallenged. Recent Delaware shareholder derivative complaints challenged the use of many of the contractual control rights described here, including board nomination rights and a variety of veto rights, as invalid under Section 141(a) of the Delaware General Corporate Law, which says that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."[167] This statute has been interpreted by Delaware courts to mean that the board may not, by contract or otherwise, delegate the responsibility to manage the corporation to a shareholder or anyone else.[168] The recent shareholder complaints challenged the company insiders' contractual control rights on these grounds, arguing that the contractual control rights constitute "a contractual power to control the most important

167. *See* DEL. CODE ANN. tit. 8, § 141(a) (2006); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation.").

168. As one Delaware Supreme Court decision put it, "[t]o the extent that a contract . . . purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable." Quickturn Design Systems, Inc. v. Shapiro, 721 A.2d 1281, 1292 (Del. 1998). A Delaware Chancery decision from 1956 ruled that governance restrictions violate Section 141(a) when they "have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters" or "tend[] to limit in a substantial way the freedom of directors decisions on matters of management policy. Abercrombie v. Davies, 123 A.2d 893, 899 (Del. Ch. 1956), rev'd on other grounds, 130 A.2d 338 (Del. 1957). This has been cited many times by both the Delaware Supreme Court and the Delaware Court of Chancery. *See, e.g.*, Quickturn Design Sys., Inc. v. Shapiro (Quickturn II), 721 A.2d 1281, 1292 (Del. 1998); Mayer v. Adams, 141 A.2d 458, 461 (Del. 1958) (citing Abercrombie with approval); Adams v. Clearance Corp., 121 A.2d 302, 305 (Del. 1956) (endorsing Abercrombie's analysis).

decisions and functions properly entrusted to the Company's Board under our corporate system,"[169] and that "there are certain fundamental powers provided to Boards (and stockholders) under the DGCL that are so core to our system of corporate governance that they should never be permitted to be curtailed. . . ."[170]

In the first opinion addressing these stockholder complaints, *West Palm Beach Firefighters' Pension Fund v. Moelis & Company*, Vice Chancellor Laster ruled in favor of the plaintiffs, invalidating veto rights, committee composition rights, and certain other significant contractual control arrangements described here as violating Section 141(a). Vice Chancellor Las ter held that the veto rights at issue, which required "prior written consent before taking virtually any meaningful action," were invalid.[171] The opinion explained that the insider's contractual veto rights over board-level matters made it so that "the Board is not really a board."[172]

Vice Chancellor Laster's opinion also addressed board composition provisions and held that three of the company's six board composition provisions were invalid. For example, the right to nominate directors, which is among the most commonly granted contractual control rights, survived challenge because Vice Chancellor Laster ruled that right is within the type of power that shareholders are normally allowed to exercise.[173] Therefore, Vice Chancellor Laster ruled that such rights are valid whether they are granted in the charter or through a separate contractual agreement.[174] The right to determine the composition of committees of the board, however, was invalidated as outside the scope of traditional shareholder power.[175]

Notably, Vice Chancellor Laster's opinion focused on the form of these rights. As quoted above, Section 141(a) states that the board

169. Verified Stockholder Class Action Complaint for Declaratory Relief ¶ 2, Seavitt v. N-Able, Inc., 321 A.3d 516 (Del. Ch. 2024) (No. 2023-0326), at 29-30.

170. Opening Brief in Support of Plaintiff's Motion for Summary Judgment, *supra* note 66, at 2; *see* West Palm Beach Firefighters' Pension Fund v. Moelis & Company, 311 A.3d 809, 821 (Del. Ch. 2024).

171. *Moelis*, 311 A.3d at 820. Vice Chancellor Laster did not rule on each veto right individually but instead ruled that, taken together, were invalid. A plaintiff challenged similar contractual control provisions in a recent, post-*Moelis* case. Unlike *Moelis*, the plaintiff challenged these provisions individually, as opposed to collectively. *See* Wagner v. BRP Group, Inc., 316 A.3d 826, 853 (Del. Ch. 2024). In the opinion, Vice Chancellor Laster held that all of the challenged provisions were, or would have been, invalid. *Wagner*, 316 A.3d at 852 ("Here, the plaintiff might have challenged the Pre-Approval Requirements collectively, as in the *Moelis Merits* decision. That likely would have been an easier sell, because the plaintiff could have contended, as in *Moelis Merits,* that the Pre-Approval Requirements violated Section 141(a) in their totality. Instead, the plaintiff opted to target the three Challenged Provisions individually."); *Wagner*, 316 A.3d at 883 ("The Officer Pre-Approval Requirement is facially invalid under Section 142. The Charter Amendment Pre-Approval Requirement is facially invalid under Section 242. Without the Consent Agreement, all of the Challenged Provisions would be facially invalid under Section 141(a). With the Consent Agreement, the Challenged Provisions survive review under Section 141(a).").

172. *Moelis*, 311 A.3d at 820.

173. *Id.* at 875.

174. *Id.*

175. *Id.* at 876-78.

oversees the business and affairs of a corporation "except as may be otherwise provided in . . . its certificate of incorporation."[176] Vice Chancellor Laster noted that Moelis "could have accomplished the vast majority of his control objectives through the Company's certificate of incorporation," which would not have violated Section 141(a). [177] Moelis could have done so by granting the invalid rights, including the committee composition and veto rights, directly in the certificate of incorporation or in a separate class of preferred stock, which "would become part of the Charter as a matter of law."[178] This effectively provided a blueprint for companies looking to provide insiders with these rights in a valid manner.

Vice Chancellor Laster noted that "some might find it bizarre that the DGCL would prohibit one means of accomplishing a goal while allowing another . . . ."[179] Although on its face it might appear strange to allow control rights in a certificate of incorporation yet hold that the same rights are invalid if they appear in a stockholders agreement, we believe there is an important distinction between the two forms. Requiring board control rights to be memorialized in preferred shares or directly in a company's certificate of incorporation has the benefit of making them more salient to stockholders and makes them subject to change by stockholder vote after the IPO. Stockholder agreements may be less accessible to public stockholders and are often only briefly summarized deep in an IPO prospectus, whereas discussions of the certificate of incorporation and preferred stock are often featured prominently early in a prospectus. A company's foundational document would appear to be the most salient place to include critical details about restrictions on a board's ability to act. The relative salience of provisions has been shown to affect IPO pricing,[180] so there is reason to believe that by making these rights more salient, public stockholders will be able to price them more accurately.

Although *Moelis* provided a blueprint for companies that were contemplating entering into a shareholder agreement prior to an IPO, it created uncertainty for public companies with existing, invalidated

176. DEL. CODE ANN. tit. 8, § 141(a) (2006); DEL. CODE ANN. tit. 8, § 104.

177. *Moelis*, 311 A.3d at 822.

178. *Id.*

179. *Id.*

180. *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 A. Gompers, Joy L. 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).

shareholder agreements. Any attempt to "restore" rights to insiders by moving the rights to the certificate of incorporation or preferred shares would be subject to shareholder vote and implicate important fiduciary duty questions.[181] However, post-*Moelis* case law has highlighted an alternative, court-approved solution for companies with existing but invalid contractual control rights. In *Wagner v. BRP Group, Inc.*, the company responded to litigation challenging the founder's contractual control rights over fundamental company decisions by entering into a "consent agreement" that gave the board the ability to override the founder's veto.[182] The court held because the company entered into the consent agreement in response to the litigation, the "Challenged Provisions no longer violate Section 141(a)."[183] Notably, the consent agreement only gave the board power to bind the founder and the company to certain actions if the independent board members unanimously "determined that the action was in the best interests of the corporation," which the court described as a "major restriction" on the board's power; because the restrictions were procedural, not substantive, the court held that the consent agreement "sufficiently frees the Board to make substantive decisions on matters otherwise governed by the Pre-Approval Requirements."[184]

This Article's findings also raise the fundamental and unanswered question of when and to what extent controlling shareholders can wield their contractual control rights under Delaware law. Delaware law is clear that controlling shareholders have fiduciary duties to minority shareholders, but it is unclear how those duties extend to a controlling shareholder who exerts its contractual control, even if that control is memorialized in preferred shares that by law are part of a certificate of incorporation. In theory, a controlling shareholder with voting control and contractual rights can use its contractual control in any way it desires to achieve its own ends, whether or not it believes it is in the best interests of the corporation.[185] As

181. Although the *Moelis* decision could be viewed as transferring control away from insiders to the board of directors, which would create a windfall for the public, the court's decision makes clear that several of the contractual control rights were facially invalid and therefore were never rights that insiders could hold in that form. It does not seem that a board of directors could believe it is in the best interests of a company to propose that shareholders vote to give these rights to insiders when they are not otherwise compelled to. And it seems unlikely that shareholders would vote to approve a grant of additional control rights to insiders without a compelling reason or without receiving something of equivalent value in return.

182. Wagner v. BRP Group, Inc., 316 A.3d 826, 838 (Del. Ch. 2024) ("Under that additional agreement, the founder bound himself to consent to any action that required his pre-approval if the members of a board committee determined that the action was in the best interests of the corporation.").

183. *Id.* at 883.

184. *Id.* at 3, 93 ("The Committee Provision sufficiently frees the Board to make substantive decisions on matters otherwise governed by the Pre-Approval Requirements. After the execution of the Consent Agreement, the Challenged Provisions no longer violate Section 141(a).").

185. Delaware law tends to offer strong protection for contractual rights. *See* Megan Wischmeier Shaner, *Corporate Resiliency and Relevance in the Private Ordering Era*, 2022 COLUM.

the Chancery court put it, 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."[186] No case that we can find directly addresses the question of whether a shareholder that is unquestionably a controlling shareholder by virtue of high-vote stock can exercise its separate contractual rights in its own interests without being subject to fiduciary duties. The cases that come closest seem to waffle on this question and often avoid it altogether by ruling on a different basis.[187] At the very least, when controllers obtain rights to control board-level decisions by contract, it creates a gray area where it is unclear whether and to what extent fiduciary duties apply to a controller's use of those contractual rights for their benefit.[188]

BUS. L. REV. 804, 809 (2023) ("Delaware courts have given a full-throated endorsement of the contractarian view of the corporation."); Lynn M. LoPucki, *Corporate Charter Competition*, 102 MINN. L. REV. 2101, 2157 (2019); Mohsen Manesh, *The Corporate Contract and the Internal Affairs Doctrine*, 71 AM. U. L. REV. 501, 501-09 (2021).

186. Thermopylae Cap. Partners, L.P. v. Simbol, Inc., No. CV 10619-VCG, 2016 WL 368170, at *13 (Del. Ch. Jan. 29, 2016); *see id.* at 12 ("It is, of course, conceivable that MDV was a fiduciary controller at the time of the re-pricing transaction, assuming it had achieved control or influence over a majority of directors *through non-contractual means* . . . ." (emphasis added)); *see also* Ivanhoe Partners v. Newmont Min. Corp., 535 A.2d 1334, 1344 (Del. 1987) ("Moreover, it is well established law that nothing precludes Gold Fields, or for that matter Ivanhoe, as a stockholder from acting in its own self-interest.").

187. *See, e.g.*, Williamson v. Cox Commc'ns, Inc., No. CIV.A. 1663-N, 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006) ("There is no case law in Delaware, nor in any other jurisdiction that this Court is aware of, holding that board veto power *in and of itself* gives rise to a shareholder's controlling status."); Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co., No. CIV.A. 1668-N, 2006 WL 2521426, at *4 (Del. Ch. Aug. 25, 2006) ("In substance, SVS asks the Court to engraft upon ReliaStar's specific and fairly negotiated contractual rights a limitation that ReliaStar cannot just consider its interests whenever it decides whether to waive (or not) any provision which it obtained during the process of negotiating the Agreement. Here, ReliaStar is alleged to have taken advantage of its contractual rights for its own purposes. Without more, that is not sufficient to allege that ReliaStar is a 'controlling shareholder' bound by fiduciary obligations."); *Superior Vision*, 2006 WL 2521426, at *12-13 ("In sum, a significant shareholder, who exercises a duly-obtained contractual right that somehow limits or restricts the actions that a corporation otherwise would take, does not become, without more, a 'controlling shareholder' for that particular purpose. There may be circumstances where the holding of contractual rights, coupled with a significant equity position and other factors, will support the finding that a particular shareholder is, indeed, a 'controlling shareholder,' especially if those contractual rights are used to induce or to coerce the board of directors to approve (or refrain from approving) certain actions.").

188. In a recent decision, Vice Chancellor Laster held that a controller has fiduciary duties when exercising shareholder-level voting power, but that those fiduciary duties are subject to a lower standard than those of directors. This indicates that a controller exercising contractual rights would at most be subject to less stringent fiduciary duties. In re Sears Hometown & Outlet Stores, Inc. S'holder Litig., 309 A.3d 474, 483-84 (Del. Ch. Jan. 24, 2024) ("This decision holds that

2. The Delaware Legislature and the Contractual Control Debate

In response to concerns that *Moelis* would undermine Delaware's attractiveness as the state-of-choice for major corporations, the Delaware legislature recently passed a bill, S.B. 313, which added a new subsection 18 to DGCL § 122. The purported purpose of this bill was to override *Moelis*.[189] This new legislation significantly expands insider shareholders' ability to obtain contractual control over board-level decisions by allowing a corporation to "restrict or prohibit itself from taking actions specified by contract," "require . . . approval or consent . . . before the corporation may take actions specified in the contract," and "take, or refrain from taking, actions specified in the contract . . . ." The broadly worded legislation conceivably allows a corporation to enter into any contract to modify its governance and appears to apply much more broadly than just to the facts of the *Moelis* case.[190] As described by Chancellor McCormick, S.B. 313 "reflects the broadest set of substantive amendments since the 1960s."[191]

S.B. 313 has been heavily criticized by academics, members of the Delaware judiciary, and other policymakers. More than 50 law professors signed a letter stating that "the legislation would give free rein to influential shareholders in ways that could hurt other investors."[192] Chancellor

when exercising stockholder-level voting power, a controller owes a duty of good faith that demands the controller not harm the corporation or its minority stockholders intentionally. The controller also owes a duty of care that demands the controller not harm the corporation or its minority stockholders through grossly negligent action. Directors, by contrast, must act affirmatively to promote the best interests of the corporation, and they must subjectively believe that the actions they take serve that end. A controller need not meet that higher standard when exercising stockholder-level voting rights.").

189. *See* S.B. 313 § 122.

190. Although some law firms have tried to claim that the proposed amendments are not broad, the fact that firms have to argue that the "plain language" differs from the amendments' real-world application strongly indicates that the amendments are vaguely drafted and difficult to interpret. *See, e.g.*, Richards, Layton & Finger, *The Proposed 2024 Amendments to the Delaware General Corporation Law*, CLS BLUESKY BLOG, (Apr. 3, 2024) ("While the plain language of the new subsection would appear to give the board the power to bind the corporation to take fundamental action, such as approving a merger, at the direction of a stockholder, the real-world operation of any provision included in a stockholders' agreement will be much more limited.").

191. Letter from Kathleen St. Jude McCormick, Chancellor, to The Delaware State Bar Ass'n Exec. Comm. (Apr. 12, 2024), https://s3.documentcloud.org/documents/24692528/mccormick-ltr-to-dsba.pdf [https://perma.cc/4Y87-SNBM].

192. Erin Mulvaney & Theo Francis, *Battle Over Shareholder Pacts Strains Delaware's Business Courts*, WALL ST. J., (July 14, 2024, 11:00 PM), https://www.wsj.com/business/shareholder-agreements-delaware-corporate-law-b083e768 [https://perma.cc/3MVA-HEGS]. In addition, during testimony at the Senate Judiciary Committee of the Delaware General Assembly, several prominent law professors and other policymakers voiced their opposition to S.B. 313. *See The Long Form*, CHANCERY DAILY (June 13, 2024) (on file with authors); *see also* Sarath Sanga & Gabriel Rauterberg, *Proposed Amendments to DGCL on Stockholder Contracting Would Create More Problems Than They Purportedly Solve*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Apr. 5, 2024), https://corpgov.law.harvard.edu/2024/04/05/proposed-amendments-to-dgcl-on-stockholder-contracting-would-create-more-problems-than-they-purportedly-solve [https://perma.cc/VPW3-8B5T] ("The Amendments may be well-intentioned, but regardless of one's view of *Moelis*, they are not well-suited to their purpose. They would not resolve the deep

McCormick criticized the bill, calling it a "rushed reaction."[193] Vice Chancelor Laster called the legislation a fundamental change to Delaware law and pointed to the fact that the legal academy came "out in force" to oppose the legislation as evidence of its many flaws.[194]

Our data and analysis offer valuable insights into the heated debate surrounding *Moelis* and new DGCL §122(18). The driving force behind DGCL § 122(18) was the Delaware legislature's belief that *Moelis* "clashed with common market practices."[195] Although proponents of the legislation claimed that it was necessary to validate common market practice,[196] many who opposed the legislation argued that the shareholder agreement in *Moelis* was unusually far reaching and did not represent market practice.[197] Each side essentially made empirical claims about Delaware market practice regarding stockholders agreements without citing to conclusive data regarding existing market practice.[198] While prior research has shown that shareholder agreements are commonly used by corporations, because that research pre-dated *Moelis*, it was not targeted toward showing whether the

legal uncertainties inherent in stockholder agreements such as the one at issue in *Moelis*. Instead, they would replace a century of nuanced if imperfect Delaware jurisprudence with an open-ended statement that enables too much to be taken at face value.").

193. *See* McCormick, *supra* note 191, at 5 ("The Proposal was not the product of a cautious and deliberative process. The Proposal is not targeted in scope or uncontroversial. The Proposal does not address Delaware Supreme Court decisions. Quite the opposite. The Proposal was the product of a rushed reaction, prepared mere weeks after *Moelis* and *Activision* were issued.").

194. *See* Travis Laster, LINKEDIN https://www.linkedin.com/posts/travis-laster-397079216_some-thoughts-on-the-senate-testimony-in-activity-7207829805189189635-CjQg [https://perma.cc/NKB2-VMKT]; *see also* Laster, *supra* note 132 (discussing how proposed amendments will impact Delaware law).

195. Mulvaney & Francis, *supra* note 192; *see also* McCormick, *supra* note 191, at 5 ("I have heard two explanations [for the legislation]. The first is that the decisions at issue run contrary to market practice.").

196. At the Senate debate and final vote, Srinivas Raju, Chair of the Corporation Law Council, spoke extensively regarding the market practice of shareholder agreements. For example, he stated "[C]ertainly the prevailing view in the marketplace and among corporate practitioners was: [I]t was not necessary to put these rights in the charter or in a preferred stock. It was permissible, based on the existing interpretation of the law, and based on existing case law. It was the prevalent belief in the marketplace that this could be done, also, through stockholders agreements. . . ." *See The Long Form*, CHANCERY DAILY (July 18, 2024).

197. Sarath Sanga, Gabriel Rauterberg & Eric Talley, *Letter in Opposition to the Proposed Amendment to the DGCL*, HARV. L. SCH. FORUM (June 7, 2024), https://corpgov.law.harvard.edu/2024/06/07/letter-in-opposition-to-the-proposed-amendment-to-the-dgcl [https://perma.cc/L55M-PEX3] ("Proponents of the Proposal argue that the *Moelis* decision struck down a common practice of Delaware corporations and that the Proposal merely restores the status quo ante. Not so. The contract in *Moelis* was far from typical, especially for public corporations. . . .").

198. The legislation was proposed mere weeks after *Moelis*, and prior research did not specifically address the prevalence of the majority of the types of contractual control rights that were found invalid under *Moelis*. *See generally* Rauterberg, *supra* note 5 (not focusing on the types of control rights invalidated by *Moelis*); Shobe & Shobe, *supra* note 5 (same).

types of contractual control provisions invalidated by *Moelis* are standard market practice.[199]

While this Article's data is limited to dual-class companies that use shareholder agreements, the data was deliberately coded to match the categories in *Moelis*, and therefore provides some insight into market practice surrounding shareholder agreements. This Article shows that, at least among dual-class companies, the contractual control rights that were invalidated under *Moelis* are *not* commonly used among public companies. For example, in our sample, we found that committee designation rights, vacancy requirements, and board size requirements—rights that *Moelis* held were invalid—were only present in approximately 7%, 6%, and 5% of the companies in our sample, respectively.[200] Notably, the types of strong veto rights that were the focus of much of the controversy surrounding *Moelis* are only present in seven dual-class corporations, or 2.5% of our sample.[201] In contrast, approximately 21% of companies in our sample granted board nomination or designation rights, which *Moelis* held are generally valid. Professor Rauterberg similarly found that shareholder agreements grant board nomination rights more frequently than any other contractual control right.[202] These findings indicate that while certain types of contractual

199. For example, *The Dual-Class Spectrum,* a pre-*Moelis* empirical study by the Authors about all single-class companies that went public between 2000-2020, excluded certain categories of contractual control rights that were central to the *Moelis* holding, defined other categories differently than in the opinion, and focused much of the study on rights that were not even addressed in the case. Shobe & Shobe, *supra* note 5, passim. In addition, Professor Rauterberg's foundational empirical study on shareholder agreements, *The Separation of Voting and Control*, included many of the categories that were at issue in *Moelis*; but because the study was limited to shareholder agreements, and the contractual control rights analyzed in *Moelis* are often granted through other forms of corporate contracts, that study does not show broader market practice of contractual control rights. Rauterberg, *supra* note 5, passim.

200. *See supra* Section II.B.

201. Although 16 companies in our sample granted some form of veto right to insider shareholders, several of the veto rights were very different from, and served a different purpose than, the veto rights in *Moelis*. For example, some of the veto rights took the form of pre-approval rights over actions that could threaten a company's tax-free spin-off, while other veto rights took the form of narrow veto rights over actions that would disproportionately and negatively affect the insider shareholder. *See, e.g.*, TODCO, Prospectus (Form 424B4), at 92 (Feb. 4, 2004) ("The master separation agreement specified the form of our amended and restated certificate of incorporation and bylaws to be in effect at the time of this offering. It also provides that for so long as Transocean beneficially owns shares representing at least 15% of the voting power of our outstanding voting stock, we will not, without the prior consent of Transocean, adopt any amendments to our amended and restated certificate of incorporation or bylaws or take any action to recommend to our stockholders certain actions which would, among other things, limit the legal rights of Transocean, or deny any benefit to Transocean or any of its subsidiaries as our stockholders in a manner not applicable to our stockholders generally.").

202. *See* Rauterberg, *supra* note 5, at 1177-78. It is worth noting that Gabriel Rauterberg's empirical study of shareholder agreements found that only around 13% of public companies granted director nomination rights. However, we believe that this lower finding is because companies often grant board nomination rights and other contractual control rights through other corporate contracts. *See, e.g.*, Ryan Specialty Group Holdings, Inc., Prospectus (Form 424B4), at 195-96 (July 21, 2021) (granting director nomination rights through a contract called the "Director Nomination Agreement); P10, Inc, Prospectus (Form 424B4), at 65 (Oct. 20, 2021) (granting director nomination rights through a contract called the "Controlled Company Agreement").

control rights have become common market practice, the types of rights that were held to be invalid under *Moelis* are relatively rare. Furthermore, because contractual control rights almost always phase out as the insiders' ownership decreases,[203] and the majority of the contractual control rights are held by private equity firms that typically sell down their interests within a few years of the IPO, most of the rights in our sample had already phased out prior to the *Moelis* holding.[204] For example, although 7 of the companies in our sample granted strong veto rights like those discussed in *Moelis* to their insider shareholders, the veto rights at 5 of those companies had phased out before the *Moelis* opinion was issued, leaving only one other company in our 22-year sample whose veto rights were invalidated by *Moelis*.

Although this Article's data is limited to dual-class companies, similarities between these findings and prior empirical research indicate that insider shareholders at dual-class companies use shareholder agreements in similar ways to shareholders at single-class companies. For example, the Authors' prior empirical study of contractual control rights in single-class companies found similar results.[205] Ultimately, further empirical work needs to be done in order to fully understand Delaware market practice and the scope of *Moelis*, including how many companies were actually affected by the *Moelis* decision, and therefore whether the new § 122(18) protected market practice or whether it served more to open the door for new forms of shareholder contractual control. However, our findings indicate that *Moelis* likely would have invalidated only a handful of the most

203. *See supra* note 91 and accompanying text.

204. *See, e.g.*, Rauterberg, *supra* note 5, at 1154 ("Private equity firms are by far the most common institutional signatory to the agreements, while other common institutional signatories are public and private companies, venture capital firms, and hedge funds . . . . [I]t is probable that most of these parties unwind their ownership positions over time, limiting the duration of the shareholder agreements.").

205. That study reported that approximately 19% of single-class companies granted insider shareholders board-nomination rights, which is similar to this Article's finding that approximately 21% of dual-class companies granted their insider shareholders board-nomination rights. *See supra* Section II.B.i; Shobe & Shobe, *supra* note 5, at 1301-06 (finding that 364 of 1870 single-class companies granted their insider shareholders board nomination rights). Similarly, the earlier study found that approximately 5% of all single-class companies granted their insider shareholders committee designation rights, while this Article showed that approximately 7% of all dual-class companies granted their insider shareholders committee designation rights. *See supra* Section II.C; Shobe & Shobe, *supra* note 5, 1301-06 (finding that 87 of 1870 single-class companies granted their insider shareholders committee designation rights). We are unaware of other empirical studies that have reported findings on committee designation rights. *See, e.g.*, Rauterberg, *supra* note 5, at 1152 ("There are also provisions that are often included but were not coded. Two are especially worth noting. First, the corporation often commits to include shareholders' board nominees on specific committees, such as audit, governance, and executive committees, or on all committees.").

aggressive shareholder agreements. If that is the case, new § 122(18) may be an extreme and far-reaching response to a relatively minor problem.

Conclusion

In the ongoing dual-class debate academics, investor groups, the SEC, and index funds focus on and measure insiders' disproportionate control rights solely through the lens of their disproportionate voting rights. This Article shows that the dual-class debate is incomplete and therefore undertheorized because it does not reflect the fact that insider shareholders in dual-class companies often obtain extensive contractual control rights that significantly extend and expand their control. Contractual control rights can create a tangled web of conflicts between public shareholders, insider shareholders with high-vote stock and contractual control rights, and boards of directors. These rights should be an integral part of any discussion of dual-class companies, which would allow for the development of well-targeted policies that address the policy issues raised by the powerful combination of control by high-vote stock and contract. This Article provides a framework that scholars, courts, investor groups, and policymakers should use to take a more complete approach to the debates surrounding dual-class companies and the use of contractual control rights.