NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 16 SUMMER 2020 NUMBER 3

DUAL-CLASS SHARE STRUCTURE—A VIABLE APPROACH TO SHAREHOLDER VALUE CREATION

JOANNA XU*

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* J.D./M.B.A., 2018, New York University School of Law and Stern School of Business. This note began as a paper for the late Professor William Allen's seminar on Corporate Litigation in the Delaware Court of Chancery. I would like to thank Professor Allen for his thoughtful insight and the members of the NYU Journal of Law and Business for their helpful feedback.

INTRODUCTION

The controversy over the dual-class share structure has reached its peak in recent years. The dual-class share structure is a type of share division wherein a company issues shares that have different voting rights but bear the same economic interest in a company. With the rising popularity of the dual-class structure among many emerging companies, debates have arisen over the fairness of decoupling voting rights from economic interest. Much of the literature has been critical of the dual-class structure due to the related agency costs and the appearance of inequality. However, with the success of technology, companies that have embraced the dual-class structure, such as Google and Facebook, proponents of the dual-class structure started to defend this share structure not only as ethical, but also as in the best interest of all shareholders. Nonetheless, the success of technology giants cannot serve as the sole justification for separating voting rights from economic interest, since no evidence has been provided to show that these technology companies with the dual-class share structure would not have sustained their growth or have performed better financially with a single-class structure.

This paper aims to examine whether the dual-class share structure presents a viable approach to shareholder value creation, which is one of the most important functional purposes of corporations and measurements of corporate success. Part I of this paper examines the evolution of the dual-class share structure since its inception. Part II considers the functional purpose of corporations and proposes to use this purpose as a metric against which the benefits and drawbacks of the dual-class share structure can be measured. Part III revisits the "One Share, One Vote" doctrine and evaluates its applicability in the evolving landscape of corporate governance. Part IV discusses the current literature surrounding the pros and cons of the dual-class share structure. Then, Part V analyzes the agency costs involved in this share structure and the principal costs it can mitigate. Part V investigates various corporations' experiences with the dual-class share structure from an empirical perspective. This part reviews the impact of the adoption of the dual-class share structure on companies' stock returns, various accounting metrics of corporate success and how share unifications have impacted companies' stock and operating

performance. Part VI examines the current Delaware legal regime and its effectiveness in protecting minority or non-controlling shareholder interest in a change of control and a recapitalization. Part VII covers the market mechanisms that have been adopted to regulate the dual-class share structure. Finally, this paper evaluates whether the dual-class share structure serves as a viable approach to shareholder value creation based on evidence presented in the previous parts of this paper.

I.
THE EVOLUTION OF THE DUAL-CLASS SHARE STRUCTURE

In the 1900s, a majority of U.S. corporations adopted the "one share, one vote" principle, which most state corporation statutes established as a default rule.[1] The dual-class share structure first emerged in the early 1900s.[2] Since then, s growing number of corporations started to issue two classes of common stock, with only one class carrying voting rights.[3] In 1940, the New York Stock Exchange (the "NYSE") announced a rule banning the listing of nonvoting common stock.[4] However, the NYSE made several exceptions later on, including the 1956 listing of Ford Motor Company.[5]

In the 1980s, companies started to adopt the dual-class share structure to protect themselves against hostile takeovers.[6] The dual-class share structure served as a strong defense against a takeover because high-voting shares were usually not publicly traded. Consequently, no matter how many shares activists acquired, they would not obtain enough voting rights to wield any meaningful power over the boards of

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1. Stephen M. Bainbridge, *The Short Life and Resurrection of SEC Rule 19c-4*, 69 WASH. UNIV. L. REV. 565, 569 (1991).

2. *Id.*

3. *Id.*

4. *Id.* at 569; Jimmy Nicholls, *Snap Snub Prompts Debate on Dual-Class Shares,* GOVERNANCE INST. (Aug. 09, 2017), https://www.icsa.org.uk/knowledge/governance-and-compliance/analysis/snap-snub-prompts-debate-on-dual-class-shares.

5. Michael A. Hiltzik, *NYSE Decides to End Its One-Share, One-Vote Standard,* L.A. TIMES (July 4, 1986), http://articles.latimes.com/1986-07-04/business/fi-648_1_voting-rights.

6. Katie Bentel & Gabriel Walter, Dual Class Shares 18 (2016) (seminar paper), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1000&context=fisch_2016.

targeted companies. Another approach companies took at that time was using time-phased voting rights. Some companies amended their charters to give their common stock multiple votes per share.[7] However, subsequent shareholders were only entitled to one vote per share unless they held the shares for a substantial time.[8] Time-phased voting plans effectively raised the number of shares required for a corporate raider to gain control. These different forms of the dual-class share structures aided corporations in fending off hostile takeovers in the 1980s. In the meantime, since the NASDAQ still permitted the listing of dual-class companies, the NYSE was forced to abandon its ban on the dual-class structure to remain competitive.[9]

In 1988, the SEC proposed Rule 19c-4, which prohibited dual-class recapitalizations but permitted dual-class Initial Public Offerings ("IPOs"). Rule 19c-4 has the effect of "nullifying, restricting, or disparately reducing the per share voting rights of existing common stock shareholders of the company."[10] The proposed rule prohibited transactions including time-phased voting rights plans, capped voting plans and issuances of shares with per-share voting rights greater than those of existing common shares.[11] The theoretical basis of this proposed rule encompassed three components. First, the SEC was concerned with the collective action issue.[12] It was argued that shareholders would generally assign low values to careful consideration of proxies. Therefore, shareholders would tend to approve a dual-class transaction without thinking through the benefits and perils attached to such a decision.[13] Second, the SEC noted that management could exert substantial influence over large individual shareholders to support a dual-class recapitalization.[14] Third, the SEC viewed the higher dividends

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7. Bainbridge, *supra* note 1, at 573.
8. *Id.*
9. Stephen I. Glover & Aarthy S. Thamodaran, *Debating the Pros and Cons of Dual Class Share Structures*, 27 INSIGHTS: CORP. & SEC. L. ADVISOR 10, 11 (2013).
10. Bainbridge, *supra* note 1, at 578.
11. *Id.* at 579.
12. *See id.* at 580.
13. *See id.*
14. *Id.*

paid to low-vote shares as a bribe, which should not be allowed.[15]

Nonetheless, Professor Stephen M. Bainbridge noted that none of the reasons given by the SEC could justify an across-the-board prohibition of dual-class recapitalizations. Collective action problems could be spotted in various corporate settings.[16] The SEC's power would be substantially expanded should collective-action problems be used as a theoretical basis for a prohibition on dual-class recapitalizations. Furthermore, the concern surrounding coercion imposed by management should be addressed through the enforcement of fiduciary duties of the board of directors instead of a total prohibition of dual-class recapitalizations.[17] Thirdly, if a dual-class recapitalization is negotiated at arm's length with higher dividends as a "bribe," then the SEC should not step in to question shareholders' voluntary decisions.[18]

In 1990, the D.C. Circuit Court invalidated Rule 19c-4 because the rule was beyond the scope of the SEC's delegated authority.[19] After this decision, the SEC urged the U.S. stock exchanges to adopt a uniform policy for dual-class share structures.[20] In response, multiple exchanges agreed to prohibit listed companies from engaging in dual-class recapitalizations while still allowing companies to maintain dual-class structures, if they adopted a dual-class share structure prior to being listed.[21]

Currently, the use of dual-class share structures has steadily risen. There were only 6 dual-class IPOs in 2006, but, in 2015, that number more than quadrupled to 27.[22] Heated debates have raged regarding the legitimacy of the dual-class share structure, particularly among founders and institutional investors, which are examined in more detail below.

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15. *Id.* at 581.
16. *See id.*
17. *Id.*
18. *See id.*
19. Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).
20. Glover & Thamodaran, *supra* note 9, at 2.
21. *Id.*
22. Brandon Marsh, *The Rising Tide of Dual-Class Shares: Recipe for Executive Entrenchment, Underperformance and Erosion of Shareholder Rights*, 31 THE NAPPA REP. 1, 2 (2017), https://www.blbglaw.com/news/publications/data/00206/_res/id=file1/Rising%20Tide%20of%20Dual-Class%20Shares.pdf.

II.
The Purpose of Corporations

To evaluate the effectiveness of the dual-class structure, one must address whether the structure will fulfill the purpose of corporations, which has long been subject to contentious discussion. Currently, there are two forms of corporate governance, shareholder-centric and stakeholder-centric.

Under the classic shareholder-centric model, the sole purpose of corporations is to increase shareholder value.[23] The stakeholder approach, on the other hand, proposes that the purpose of corporations is to maximize the welfare of each stakeholder affected by corporate decisions. The benefits and drawbacks of the dual-class structures may be different when analyzed under the two forms.

The purpose of this paper is not to get into the details of which corporate governance form is superior. However, it is necessary to choose a framework under which the dual-class share structure can be evaluated. Despite the criticisms, the shareholder-centric approach has prevailed as the functional corporate governance form in the United States. Indeed, under Delaware law, the board of directors has a duty to seek the best value reasonably available to the shareholders in the context of a merger, which demonstrates the importance of the maximization of shareholder value.[24]

Therefore, as a practical matter, this paper proposes the dual-class share structure should be evaluated in terms of its effectiveness in maximizing shareholder value. In other words, even if low-voting shareholders are denied voting rights under a dual-class share structure, as long as the shareholder value, which is also the residual interest in a company, can be maximized by having voting rights held by a controlling share-

23. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, *in* Corporate Ethics and Corporate Governance 173, 173 (Walter C. Zimmerli et al. eds., 2007); *see also* Aswath Damodaran, Applied Corporate Finance 48 (5th ed. 2014) ("Although the objective in corporate finance is to maximize the firm value, in practice we often adopt the narrower objective of maximizing a firm's stock price. As a measurable and unambiguous measure of a firm's success, stock price offers a clear target for managers in the course of their decision making.").

24. *See generally* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); *see also* Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994).

holder or bloc, the share structure is effective in advancing all shareholders' interests. However, if shareholder value is jeopardized by instituting a dual-class share structure, the legitimacy or necessity of adopting the structure should be brought into question.

III.
"One Share, One Vote" Theory Revisited

Intuitively, one would analogize the ideal of "one share, one vote" to justifications for democracy in the political arena. Just like how citizenship should bear the same social and political rights for every citizen, the same amount of economic interest in a corporation should grant an equal level of voting rights in the same entity. However, as examined in Part II, the purpose of a corporation is vastly different from the ideals embodied in democratic governance. Although pursuing the welfare of the public is an important goal that each polity should bear in mind, equal protection and human rights are the fundamental notions embedded in the democratic decision-making process. Full democratic participation is only possible if each person is afforded the same amount of voting power. Nonetheless, in the context of corporate governance, shareholder-voting rights are not afforded such significance.

As a matter of fact, the "one share, one vote" regime is not the historical norm. The development of the "one share, one vote" regime was a natural extension of the shareholder-primacy theory. This theory states that corporate law shall ensure that "corporations generally operate in the interest of shareholders."[25] The common wisdom has been that "one share, one vote" would be able to advance such an objective. As the owners of a corporation, shareholders shall be afforded the voting rights to exercise their rights of possession. However, if one views the interests shareholders have acquired from buying shares as a bundle of rights, then it is not necessary that such a bundle of rights include the right to vote. Issuers and buyers of shares should be afforded the right to negotiate the rights to be included in the transference of shares through arm's-length negotiations.

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25. D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. Corp. L. 277, 277 (1998).

Scholars have argued that unequal voting rights would provide skewed incentives for high-voting shareholders to pursue their own interest without prioritizing maximization of the residual interest in a corporation. As Easterbrook and Fischel pointed out: "Those with disproportionate voting power will not receive shares of the residual gains or losses from new endeavors and arrangements commensurate with their control; as a result, they will not make optimal decisions."[26] In other words, without "one share, one vote," shareholders would lose the ability to place any check on bad management. This theory holds true under many circumstances, such as when a corporation is controlled by minority family shareholders. However, this theory cannot be applied universally, as its assumption that every shareholder shares the same interest of maximizing shareholder value is complicated by the introduction of large institutional shareholders.[27]

The "one share, one vote" regime assumes that each shareholder in a corporation shares the same goal of maximizing the residual interest in a corporation. It is widely recognized that shareholders can have different perspectives on the time spans that should be used to measure such interest. But even if one assumes that every shareholder in a corporation would agree on the length of time that should be used to measure returns, shareholders' interests are not as homogenous as supposed by scholars. When corporations were still mostly held by individual shareholders, their interests in holding the shares might not go beyond extracting the economic interests from the operation of the company. Currently, however, most corporations are controlled by a group of institutional investors who may also advance agendas other than maximizing the residual interest when casting their votes on major corporate decisions. Two kinds of institutional investors are often the targets of such criticisms—pension funds and sovereign wealth funds (SWFs).

Pension funds have attracted increasing amounts of attention due to their activism in the board rooms. For example,

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26. FRANK EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 73 (1991).

27. *See generally,* Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity,* 30 CARDOZO L. REV. 445, 446 (2008).

62% of the New York City funds' shareholder activism over the past decade covered social or policy concerns which shared only attenuated relationships with share value.[28] Proposals sponsored most frequently by the New York City Pension Funds involved employment matters.[29] Although further studies on the impact of such proposals on stock performance are still needed, pension funds have been expressing self-interested objectives through proxy access proposals. Another pension fund that has been under various criticisms is CalPERS. In its efforts to unseat Steve Burd as the Chairman of Safeway in 2004, CalPERS has been criticized as "ostensibly" upset about underperformance, "but the real problem seems to be the tough stance the grocery chain took against labor during a recent strike."[30] CalPERS's then-president, Sean Harrigan, was an international vice president of the United Food and Commercial Workers Union (UFCW). Moreover, eleven of thirteen CalPERS board members were either union members, officials or politicians who received union contributions.[31] The motives behind CalPERS's activism against Safeway were thus brought into question. It is likely that CalPERS's interest in advancing employees' benefits was not equally valued by other shareholders.

It is beyond the scope of this paper to discuss whether CalPERS was justified in advancing union interest through shareholder activism. However, some interests advocated by certain shareholders are not necessarily aligned with maximization of shareholder value. In summary, the heterogeneity of shareholder interests has undermined the presumption that "one share, one vote" necessarily maximizes shareholder value.

Another type of institutional shareholder that may have other interests in mind, other than shareholder value maximization, is the SWFs. SWFs are investment funds that receive national funding and return their profits back to a state government. SWFs have adopted a wide range of investment strategies. Notably, they invest in both private and public corporations. The U.S. government has always been concerned with

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28. James R. Copland, *Special Report: Public Pension Funds' Shareholder-Proposal Activism*, PROXY MONITOR, http://www.proxymonitor.org/Forms/2015Finding3.aspx.

29. *Id.*

30. Editorial, *Conflicted in California*, WALL ST. J., May 11, 2004, at A18.

31. *Id.*

foreign governments intruding on national security by buying stakes of corporations in key industries. In response, the U.S. established the Committee on Foreign Investment in the United States (CFIUS), which would automatically review a transaction where "a foreign government seeks controlling interest in a U.S. corporation."[32] However, even if a foreign government's interest in a U.S. corporation does give rise to any national security concern, questions still remain as to whether SWFs would seek benefits other than shareholder value maximization when it comes to issues pertaining intellectual property. SWFs may vote for decisions that would benefit the domestic industries in the SWFs' nations of origin. As a result, SWFs' interests may not be perfectly aligned with the rest of the shareholder body. One would question whether "one share, one vote" in this case would necessarily lead to the goal of shareholder value creation.

In conclusion, "one share, one vote" is not an indefeasible ideal. Instead, "one share, one vote" has given rise to multiple corporate governance issues such as conflicts of interest due to the more and more complex interests behind institutional shareholders. It is debatable whether corporations should become a forum where shareholders can advance their agendas, but it is a certain that these agendas do not necessarily lead towards the end goal of shareholder value maximization. Therefore, "one share, one vote" should not become the doctrinal bedrock of corporate governance.

IV.
THE DEBATE OVER THE PROS AND CONS OF THE DUAL-CLASS STRUCTURE

A. *Protection of Founders and Visionaries*

One reason given by many who support the dual-class structure is the protection of innovation and visionaries. It is argued that the dual-class structure is necessary to fend off activists and other institutional shareholders whose major concerns are short-term profits. Indeed, empirical evidence has shown that many executives would place heavier weight on

32. Hayden & Bodie, *supra* note 27, at 489.

short-term earnings.[33] It is contended that entrepreneurs who successfully launched revolutionary companies like Google or Facebook can only continue to maintain the culture and growth of the companies by staying in control. This idea was expressed in the statement issued by Google amid its recapitalization settlement: "We've always believed our founder-led approach gives us the freedom to make long-term bets, like Android, Chrome and YouTube, that benefit consumers and shareholders alike."[34] However, there is no statistical evidence showing that companies will not continue to thrive without the founders. Although Steve Jobs' ejection from Apple in the 1980s may serve as a good example where the founder's departure significantly impacted the company in a negative way, there are numerous other examples where companies have managed to maintain stable growth with successive CEOs, such as Microsoft, PayPal and Apple under Tim Cook.[35] Therefore, protection of founders and visionaries may serve as a factor when considering the adoption of the dual-class share structure, but it is nonetheless an insufficient independent justification.

B. *Agency Costs*

The primary concerns associated with the dual-class share structure are the lack of monitoring and the subsequent agency costs that result from the separation of voting control from cash-flow rights. Professors Michael C. Jensen and William H. Meckling famously define agency costs as the sum of monitoring costs by the principals, bonding expenditures by

33. John R. Graham, Campbell R. Harvey & Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3, 47 (2005) (finding that 78% of executives surveyed "admit that they would sacrifice . . . [long-term] value to achieve a smoother earnings path").

34. Tom Hals, *Google Settlement Clears Way for New Class C Stock*, REUTERS (June 17, 2013), https://www.reuters.com/article/us-google-stockplan-settlement/google-settlement-clears-way-for-new-class-c-stock-idUSBRE95G0MU20130617.

35. Anita Balakrishnan, *Tim Cook's Record-crushing Tenure as Apple CEO Is the Most Under-appreciated Story in Business*, CNBC (Nov. 6, 2017), https://www.cnbc.com/2017/11/06/tim-cooks-performance-as-apple-ceo-profits-sales-and-innovation.html.

the agent, and residual loss.[36] In the context of dual-class shares, it is argued that controlling shareholders tend to entrench their interest in the company because any efficiency gained through relinquishing their control would go to the other shareholders, and the shareholders would "internalize the loss of private benefits."[37] It is also contended that shareholders with the same cash-flow rights shall bear the same costs of decisions-making. Yet, with a smaller equity stake in a company, high-voting shareholders, who are often responsible for management decisions, may be willing to undertake riskier projects. Low-voting shareholders would internalize the negative effects of controlling shareholders' actions; however, high-voting shareholders would only bear a small fraction of the risks while enjoying all the upsides.[38]

Moreover, high-voting shareholders may sacrifice short-term profitability for the sake of long-term returns, the time span of which is not well-defined. This interest misalignment may not be an issue when a company's stock is performing well, but it can become contentious among different shareholder classes when the stock performs poorly. Another concern is executive compensation. When a company has controlling minority shareholders, the executives, who in many cases happen to be shareholders themselves, can decide how much they themselves are paid. Indeed, empirical evidence has shown that CEOs at dual-class firms tend to be paid more than their peers at single-class firms.[39] Other potential agency issues associated with dual-class structures include, but are not limited to, questionable use of cash reserves and poor acquisition decisions.

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36. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON 305, 308 (1976).

37. Henrik Cronqvist & Mattias Nilsson, *Agency Costs of Controlling Minority Shareholders*, 38 J. FIN. & QUANTITATIVE ANALYSIS 695, 699 (2003).

38. Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 602 (2017).

39. Ronald W. Masulis, Cong Wang & Fei Xie, *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697, 1722 (2009) (finding that CEOs at dual-class firms are paid more).

C. *Principal Costs*

A major critique of the agency costs model was offered by Professors Zohar Goshen and Richard Squire. They proposed the principal-cost theory, which states that "a firm that seeks to maximize total returns will weigh principal costs against costs when deciding how to divide control between managers and investors."[40] Under this model, there are two major elements of principal costs—competence and conflict.[41]

Principal competence costs include lack of experience, inadequate information, and lack of intelligence.[42] In the case of many technology companies that adopted the dual-class share structure, it can be argued that the founders or visionaries are the ones with the highest competence to lead the companies' future growth. Therefore, by giving more power to the management or controlling shareholders, investors reduce the costs accrued from fending off the threats of outside investors who may want to transfer the hidden value in the companies to themselves. In other words, investors can make their own judgment call when it comes to weighing principal costs against agency costs.

Principal conflict costs include collective-action, holdouts, and empty voting problems.[43] Principal conflict costs mainly result from "investor self-seeking conduct attributable to the separation of ownership and control."[44] Such costs can be manifested in the conflict of interest issues experienced by pension funds and SWFs as discussed above. Principal conflict costs may also arise when an activist investor seeks to extract short-term profits at the expense of investment in research and development.

In summary, the crux of the principal-agency theory holds that the allocation of control rights should be firm-specific by weighing agency costs against principal costs. As a result, the dual-class share structure is neutral under this framework. Under circumstances where the adoption of this structure can minimize a company's combination of principal and agency

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40. Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 771 (2017).
41. *Id.* at 784.
42. *Id.* at 795.
43. *Id.*
44. *Id.* at 791.

costs, the company should adopt this structure because the efficiency created by this structure would help create shareholder value. However, in other situations where the dual-class share structure would worsen the costs a company must bear, avoiding dual shares would be in the best interest of the shareholders.

The principal-agency costs approach presents a more rational basis for analyzing the dual-class share structure, because it gives credit to capable incumbent management, who can often be controlling shareholders, while at the same time, recognizing the risks associates with forfeiting too much control to management. Next, this paper examines empirical evidence to evaluate whether the dual-class share structure can serve the purpose of minimizing total principal and agency costs by comparing the financial performance of companies with the dual-class share structure with that of their single-class peers and reviewing the impact dual-class recapitalizations had on companies in practice. Though such empirical studies would not be able to fully prove the effect of dual-class shares on principal and agency costs, they could provide a peek into how the dual-class companies performed compared to their single-class peers in terms of maximizing shareholder value, which in turn can inform us of the relative levels of principal and agency costs incurred by different groups of companies.

V.
Empirical Evidence on Stock and Financial Performance of Dual-Class Share Companies

A wide range of empirical studies has been conducted to unearth how the dual-class share structure has impacted corporate governance and corporations' performance. The methodologies adopted by the existing studies can generally be divided into four categories: (1) comparing the stock performance of dual-class companies against those of their single-class peers; (2) comparing other accounting performance measures of dual-class and single-class class companies; (3) measuring the impact of dual-class share unifications on a corporation's financial performance; and (4) comparing the financial performance of dual-class corporations with family ownership against both their dual-class and single-class peers.

A. *Stock Returns and Performance*

Intuitively, the dual-class share structure can be harmful to low-voting shares because of the structure's inherent agency costs.

However, if utilizing stock performance as a measurement of the success of the dual-class structure, the evidence shows that companies that have adopted this structure have outperformed their peers overall. A study by Professors Ekkehart Boehmer, Gary C. Sanger, and Sanjay B. Varshney in 1995 shows that for a sample of 98 dual class IPOs, the dual-class firms outperformed their single-class counterparts in terms of stock-market returns after controlling for exchange, offer date, industry, and size.[45] The initial returns used by this study were "the first closing price listed with the aftermarket returns covering months 1 through 36 following the IPO (excluding the initial period)."[46] Though the authors did not attribute better returns to the adoption of the dual-class structure, they concluded that "closely-held voting control lessens the constraints on managerial decision making, [and] benefits appear to outweigh the costs for those firms that chose to go public with two classes of stock."[47] In other words, Boehmer, Sanger and Varshney's study found that the benefits of the dual-class structure can outweigh the agency costs and that the structure may present a viable approach to maximizing shareholder value. Notably, Boehmer, Sanger and Varshney's study was conducted in the mid-1990s, before the emergence of immensely successful dual-class tech giants such as Google and Facebook. The study helped shed light on the effectiveness of the dual-class structure in the context of non-disruptive companies, which are more representative of public corporations.

Professors Valentin Dimitrov and Prem C. Jain found that a group of 178 firms that recapitalized from a single-class into

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45. Ekkehart Boehmer, Gary C. Sanger & Sanjay B. Varshney, *The Effect of Share Structure and Consolidated Control on Firm Performance: The Case of Dual-Class IPOs*, EMPIRICAL ISSUES IN RAISING EQUITY CAPITAL (Mario Levis ed., 1996), https://www.researchgate.net/profile/Gary_Sanger/publication/256066074_The_Effect_of_Capital_Structure_and_Consolidated_Control_on_Firm_Performance_The_Case_of_Dual-Class_IPOs/links/5710f34f08aeff315b9f6e7e/The-Effect-of-Capital-Structure-and-Consolidated-Control-on-Firm-Performance-The-Case-of-Dual-Class-IPOs.pdf.

46. *Id* at 11.

47. *Id.* at 20.

a dual-class structure between 1979 and 1998 experienced, on average, significant positive abnormal returns outperforming the matching portfolios of single-class firms by 23.11% in a period of 4 years following the announcement of the recapitalization, with even higher abnormal returns accruing when additional equity is issued to grow the firm.[48]

In a study conducted by Professor M. Megan Partch, positive abnormal returns were found for a sample of 44 U.S. dual-class recapitalizations during the period from 1962 to 1984 upon the announcement of the plans and significant positive abnormal returns in nine recapitalizations where managers owned votes sufficient to approve the recapitalization.[49]

In a similar vein, Professors Marcia Millon Cornett and Michael R. Vetsuypens studied the average-excess returns of 70 companies in the two days following the first public announcement of the proposed issuance of restricted-voting common stock over the period from 1962–1986 and found that the creation of dual classes of common stock, on average, led to abnormal stock price increases even though only 50% of the sample experienced positive returns.[50] Additionally, a study done by Professors James S. Ang and William L. Megginson found that there was a positive price effect for dual-class recapitalizations at British firms.[51]

However, despite the consistent positive return findings in the above studies, a study by Professors Gregg A. Jarrell and Annette B. Poulsen found significant negative price effects for narrow windows centered on the public announcement of the recapitalization plans for 94 firms that adopted dual-class common stock from 1976 to May 1987.[52]

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48. Valentin Dimitrov & Prem C. Jain, *Recapitalization of One Class of Common Stock into Dual-Class: Growth and Long-Run Stock Returns*, 12 J. CORP. FIN. 342, 342 (2006).

49. M. Megan Partch, *The Creation of a Class of Limited Voting Common Stock and Shareholder Wealth*, 18 J. FIN. ECON. 313, 326, 329 (1987).

50. Marcia Millon Cornett & Michael R. Vetsuypens, *Voting Rights and Shareholder Wealth: The Issuance of Limited Voting Common Stock*, 10 MANAGERIAL & DECISION ECON. 175, 186 (1989).

51. James S. Ang & William L. Megginson, *Restricted Voting Shares, Ownership Structure, and the Market Value of Dual-Class Firms*, 12 J. FIN. RES. 301, 302 (1989).

52. Gregg A. Jarrell & Annette B. Poulsen, *Dual-Class Recapitalizations as Antitakeover Mechanisms: The Recent Evidence*, 20 J. FIN. ECON 129, 149 (1988).

The consistent findings of positive abnormal returns over both the short and long term across a substantial number of studies, albeit the existence of a minority of studies saying otherwise, demonstrates that the dual-class share structure could be employed under many circumstances to boost shareholder value.

B. *Financial Performance*

Studies have consistently found that companies with a dual-class share structure outperform their single-class share counterparts in many instances. In a study that samples a comprehensive list of all single-class and dual-class firms in the United States from 1995–2002 through the S&P's Compustat, scholars found that "that 6% of U.S. public companies have the dual-class share structures, but their combined market capitalization constituted 8% of U.S. public companies' total market capitalization."[53] Boehmer, Sanger, and Varshney found that "[o]ne year after the IPO, dual-class firms have about twice the assets of control firms, twice the sales, and three times the net operating income (NOI) and preserve these relations through year +3."[54] Professors Scott W. Bauguess, Myron B. Slovin, and Marie E. Sushka found that the majority of firms that recapitalized to dual-class structures had superior industry-adjusted operating performance and fewer bankruptcy filings.[55] Further, dual-class firms garnered larger premiums takeovers.[56] By contrast, Professors Wayne H. Mikkelson and M. Megan Partch found that dual-class recapitalizations were associated with subsequent negative operating performance.[57]

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53. Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUD. 1051, 1057 tbl.2 (2010).

54. Ekkehart Boehmer, Gary C. Sanger & Sanjay Varshney, *The Effect of Capital Structure and Consolidated Control on Firm Performance: The Case of Dual-Class IPOs*, *in* EMPIRICAL ISSUES IN RAISING EQUITY CAPITAL 18 (Mario Levis ed., 1995).

55. Scott W. Bauguess, Myron B. Slovin & Marie E. Sushka, *Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights*, 36 J. BANKING & FIN. 1244, 1247 (2012).

56. *Id.* at 1249.

57. Wayne H. Mikkelson & M. Megan Partch, *The Consequences of Unbundling Managers' Voting Rights and Equity Claims*, 1 J. CORP. FIN. 175, 177 (1994).

Additionally, studies have also found that the market often perceives companies with a dual-class share structure as having both higher risk and potential for future gains. A study conducted by Professors Scott B. Smart, Ramabhadran S. Thirumalai and Chad J. Zutter found that dual-class firms traded at a lower price, relative to earnings and earnings before interest, taxes, depreciation, and amortization (EBITDA), than single-class firms, both at the time of IPO and five years later.[58] Furthermore, Smart, Thirumalai, and Zutter found that dual-class firms had lower price-to-earnings and price-to-sales ratios two years after IPO, which means that the market attached higher risks to those dual-class firms.[59] Professors Kenneth Lehn, Jeffry Netter and Annette Poulsen found that firms that conducted dual-class recapitalizations were more likely to have high market-to-book ratios, which means that firms that were recapitalized to adopt a dual-class structure are more likely to be perceived to have greater future gains and thus more likely to be a takeover target.[60]

In conclusion, while the overall operating performance of companies with a dual-class share structure have been found in various empirical studies, the financial measurements, such as price-to-earnings and market-to-book ratios, point to the market's higher degree of caution about the prospects of companies with the dual-class share structure. These results seem to contradict the findings provided by scholars on dual-class firms' stock performance. However, all the findings are consistent in the sense that, horizontally speaking, dual-class companies might outperform their single-class peers in terms of stock performance and operating measurements in many instances, but vertically speaking, these dual-class companies might have greater room for growth and thus were riskier, which resulted in lower price relative to earnings and EBITDA as pointed out by Smart, Thirumalai, and Zutter. Indeed, in the study done by Dimitrov and Jain, it was found that compared to competitors, firms that were recapitalized into the dual-class structure

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58. 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, 97 (2008).

59. *Id.*

60. Kenneth Lehn, Jeffry Netter & Annette Poulsen, *Consolidating Corporate Control: Dual-Class Recapitalizations Versus Leveraged Buyouts*, 27 J. FIN. ECON. 557, 559 (1990).

were high-growth firms in the year preceding the recapitalization as measured by book-to-market value.[61]

C. *The Impact of Dual-Class Share Unifications*

Despite the benefits that the dual-class structure can provide to controlling shareholders, some dual-class firms have voluntarily unified their shares. Based on public record, the three most common reasons given by Canadian companies for share unifications are to (1) restructure debt, (2) facilitate sales of control blocks, and (3) increase investor appeal prior to seasoned offering.[62] Further, Professor Jason W. Howell found that 70% of 54 companies who identified specific reasons for eliminating the dual-class structure in shareholder proposals, listed "increase liquidity" as one of the reasons for unification.[63]

Howell found a positive and significant market reaction to the elimination of the dual-class structure after examining 61 American dual-class share unifications.[64] Ang and Megginson also found a positive price effect for dual-class unifications at British firms.[65] Smart, Thirumalai, and Zutter found that dual-class IPO firms that unified their shares later experienced average value gains of 6% or more.[66]

The empirical evidence demonstrates that companies would voluntarily unify the different classes of shares if the dual-class structure was no longer optimal for company growth or was regarded as limiting the liquidity of the existing shares. Therefore, even without a sunset provision in place, various market pressures may well push companies to adjust their share structures.

The findings on the positive impact of dual-class share unifications on dual-class companies seem to contradict the results on positive stock performance witnessed by companies that went through dual-class recapitalizations. However, the seemingly paradoxical result can be explained by the fact that

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61. Dimitrov & Jain, *supra* note 48, at 342.
62. Jason W. Howell, No More Share Classes: A Study of U.S. Dual Class Stock Unifications, 56 (Sept. 24, 2008) (unpublished manuscript), https://getd.libs.uga.edu/pdfs/howell_jason_w_201005_phd.pdf.
63. *Id.* at 71.
64. *Id.* at 15–16.
65. Ang & Megginson, *supra* note 51, at 302.
66. Smart, Thirumalai, & Zutter, *supra* note 58, at 28.

the dual-class share structure may not be a good choice for every company. Some companies may benefit from the adoption of the dual-class structure, whereas others may find it burdensome in advancing shareholder interest. If studies show both dual-class recapitalizations and unifications can bring beneficial results across a wide range of samples, this may demonstrate that managers and shareholders can have relatively good understandings regarding what share structure would work best for their companies. In other words, the flexibility managers and shareholders have to choose a share structure has been shown to serve many companies' interests.

Further, it is difficult for every study to single out the share structure as the only variable factor. Often, companies' performance can be affected by multiple factors. It is probable that corporations may have experienced below-average operating performance before either a recapitalization or unification announcement. In summary, it is difficult to draw a definite conclusion based on these studies regarding the pros and cons of dual-class recapitalizations or unifications. Nonetheless, evidence does suggest that the business judgment of managers has led to prudent and tailored decisions regarding which share structure best fits a company's interest in a broad range of cases.

D. *Family Ownership*

Regarding the financial performance of dual-class companies with family ownership, results have been consistent across various studies, which is that a high percental of family ownership generally has a negative impact on a company's value. Professors Ben Amoako-Adu, Vishaal Baulkaran and Brian F. Smith found that family members in executive positions in dual-class companies traded on the Toronto Stock Exchange were paid significantly more than executives in single-class firms with concentrated control.[67] Professors Belen Villalonga and Raphael Amit found that family control in excess of ownership, which can be manifested in multiple share classes,

67. Ben Amoako-Adu, Vishaal Baulkaran & Brian F. Smith, *Executive Compensation in Firms with Concentrated Control: The Impact of Dual Class Structure and Family Management*, 17 J. CORP. FIN. 1580, 1592 (2011).

reduces shareholder value and such reduction is proportional to the excess of voting over cash flow rights.[68]

VI.
The Delaware Legal Regime Governing the Dual-Class Structure

The effectiveness of the dual-class share structure for shareholder value creation also depends on the mechanisms available to protect non-controlling shareholders' interest. With unequal voting power given to different classes of shares, it is possible that shareholders that own higher voting shares would engage in conflicted transactions and leverage their voting power to acquire an unfair allotment of economic interest at the expense of the minority shareholders.

Under Delaware law, there are two types of such conflicted transactions: (i) self-dealing transactions where controlling shareholders stand on both sides; and (ii) controlling shareholders leveraging their position to acquire premiums or other benefits not shared by other shareholders.[69] Under the second category, the *In re Crimson Expl. Inc. Stockholder Litig.* court identified three applicable situations: (i) the controlling shareholders receive greater monetary consideration than the minority shareholders; (ii) the controlling shareholders take a different form of consideration than the minority shareholders; and (iii) the controlling shareholders get a "unique benefit" by acquiring "something uniquely valuable to the controller, even if the controller nominally receives the same consideration as all other [share]holders."[70] There are two types of controlling shareholders: (i) shareholders who own more than

68. Belen Villalonga & Raphael Amit, *How Do Family Ownership, Control and Management Affect Firm Value?*, 80 J. Fin. Econ. 385, 414 (2006).

69. *See In re* Martha Stewart Living Ominimedia, Inc. Stockholder Litig., C.A. No. 11202-VCS, 2017 WL 3568089, at *11 (Del. Ch. Aug. 18, 2017); *see also* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (defining self-dealing as where "the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary."); *see also In re* Crimson Expl. Inc. Stockholder Litig., No. 8541-VCP, 2014 Del. Ch. LEXIS 213, at *39–40 (Oct. 24, 2014) (finding two categories of conflicted transactions involving controlling stockholders that can trigger entire fairness review: "transactions where the controller stands on both sides" and "transactions where the controller competes with the common stockholders for consideration").

70. *Id.* at *41–45.

50% of the company's votes and are *de jure* controlling shareholders[71]; and (ii) shareholders who own less than 50% of the votes but can exert such a level of influence over the board that they have actual control over the course of the transaction.[72] In a transaction involving a dual-class company, either of a change of control or a recapitalization transaction that involves dual-class shares, shareholders who hold high-voting shares would likely fall under the category of controlling-minority shareholders.

A. *Change of Control*

Transactions involving acquisitions of dual-class companies will likely result in a situation where controlling-minority shareholders receive disparate considerations compared to nonvoting or low-voting shareholders. The Delaware Courts ruled that controlling shareholders can receive controlling premiums when an unaffiliated third-party acquires the company and that a premium by itself is not a sufficient cause of action.[73]

In *In re John Q. Hammons Hotels Inc. S'holder Litig.,* the Delaware Court of Chancery ruled that controlling shareholders of dual-class companies will face the entire fairness review in a change-of-control transaction if they receive different considerations in a merger transaction unless the transaction is (i) approved by an independent special committee of the board or (ii) approved by a majority of the disinterested and fully informed shareholders absent threats or coercion.[74]

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71. *See* Weinstein Enters., Inc. v. Orloff, 870 A.2d 499, 507 (Del. 2005) ("[C]ontrol exists when a stockholder owns, directly or indirectly, more than half of a corporation's voting power.").

72. *See In re* Western Nat'l Corp. S'holders Litig., C.A. No. 15927-CC, 2000 WL 710192, at *20 (Del. Ch. May 22, 2000) ("[A] significant stockholder that does not, as a general matter, exercise actual control over the investee's business and affairs or over the investee's board of directors but does, in fact, exercise actual control over the board of directors during the course of a particular transaction, can assume fiduciary duties for purposes of that transaction.").

73. *See* Abraham v. Emerson Radio Corp., 901 A.2d 751, 761–62 (Del. Ch. 2006) ("[P]ure control premium envy is not a cognizable claim for a minority stockholder under Delaware law.").

74. *See In re* John Q. Hammons Hotels Inc. S'holder Litig., C.A. No. 758-CC, 2009 Del. Ch. LEXIS 174 (Oct. 2, 2009).

Hammons involves the merger of John Q. Hammons Hotels, Inc. ("JQH") with an acquisition vehicle controlled by Jonathan Eilian. JQH had two classes of stock: Class A common stock, which was publicly traded and entitled the owner to one vote per share, and Class B common stock, which was not publicly traded and entitled the owner to fifty votes per share.[75] John Q. Hammons owned approximately 5% of the Class A common stock and all the Class B stock, which gave him over 75% of JQH's voting power.[76] Additionally, Mr. Hammons was JQH's CEO and the Chairman of JQH's eight-member board of directors.[77]

In early 2004, Mr. Hammons began discussions with Mr. Eilian regarding a potential sale of Mr. Hammon's interest in JQH, and later, the board of directors of JQH formed a special committee to negotiate the proposed transaction on behalf of the unaffiliated shareholders.[78] Eventually, the special committee recommended an offer where holders of Class A common stock would be paid $24 per share in cash, which represented a substantial premium to the $4 to $7 range at which the stock was trading. Additionally, Mr. Hammons and Mr. Eilian entered into multiple side agreements through which Mr. Hammons would still retain an economic interest in JQH's future operation.[79]

The *Hammons* Court noted that "[a]lthough I have determined that Hammons did not stand 'on both sides' of this transaction, it is nonetheless true that Hammons and the minority shareholders were in a sense 'competing' for portions of the consideration Eilian was willing to pay to acquire JQH and that Hammons, as a result of his controlling position, could effectively veto any transaction."[80] The court subsequently noted that robust procedural protections were needed to en-

75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. Hammons agreed to exchange his controlling interest in a limited partnership through which JQH conducted its operations for (i) a 2% interest in the cash flow distributions and preferred equity of the surviving LP, (ii) a $25 million short-term line of credit, (iii) a $275 million long-term line of credit, (iv) an agreement that Hammons would continue to manage the hotels with a $200,000 annual salary plus benefits. *Id.*
80. *Id.* at *40.

sure that the minority shareholders have "sufficient bargaining power."[81]

Defendants' failure to satisfy the second prong of the test discussed above precluded business judgment review. To provide sufficient protection, a majority-of-the-minority vote must be both nonwaivable and conditioned upon a majority of all minority shareholders—not just those who voted. The rationale behind this requirement is that a nonwaivable vote would make the minority shareholders aware of their ability to block a transaction that they do not think is fair.

In 2017, the Delaware Court of Chancery further addressed the standard to be applied in a conflicted transaction where a controlling shareholder receives disparate consideration for its shares in *In re Martha Stewart Living Ominimedia, Inc. S'holder Litig.* In this decision, the Delaware Court of Chancery confirmed that the business judgment standard of review will apply if the transaction is afforded protections provided in *Kahn v. M&F Worldwide Corp.*, which previously only applied to controlling shareholder squeeze-out mergers.[82]

Furthermore, if minority shareholders contracted a right to equal treatment in the charter, the Delaware courts would honor such right. In *In re Delphi Financial Group*, the Delaware Court found that the controlling shareholder breached his fiduciary duty to minority shareholders by obtaining a control premium for his shares because the certificate of incorporation required that all classes of shares be treated equally in a merger.[83]

In a nutshell, Delaware did not afford nonvoting shareholders protection in a change of control transaction, should controlling shareholders acquire premiums or benefits not shared by shareholders of other classes.

B. *Recapitalizations and Reclassifications*

In 2012, Google announced a recapitalization plan where it proposed to issue nonvoting stock to all current shareholders in the form of a 2-for-1 stock split. In other words, the origi-

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81. *Id.*

82. *In re* Martha Stewart Living Ominimedia, Inc., 2017 WL 3568089 at *36–38.

83. *See generally In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG, 2012 Del. Ch. LEXIS 45 (Mar. 6, 2012).

nal Class A voting shareholders would split the shares they owned into Class A voting and Class C nonvoting shares. The Plaintiffs in this case contended the recapitalization was a conflicted transaction where the founders and controlling bloc, Larry Page and Sergey Brin—who had combined voting power of 56.1%[84]— extracted a unique benefit, which was the perpetuation of their controlling position.[85] Two cases are particularly relevant to the Google recapitalization—*William v. Geier* and *IRA Trust FBO Bobbie Ahmed v. Crane*.

In *William v. Geier*, the Geier family, a controlling bloc of the corporation Milacron, proposed a recapitalization plan that would create "tenure voting" where holders of common stock would be granted ten votes per share. Upon a sale or other transfer, each share would revert to one-vote-per-share status until that share was held by its owner for three years.[86] The *Geier* Court refused to apply the entire fairness review, and one of the reasons given by the Court was that "no non-pro rata or disproportionate benefit . . . accrued to the Family Group on the face of the Recapitalization, although the dynamics of how the Plan would work in practice had the effect of strengthening the Family Group's control."[87] The *Geier* Court also found that directors' approval of recapitalization was motivated by good-faith judgment for the company's future growth.[88]

Recently, the Delaware Court of Chancery again clarified the standard that should be applied in a recapitalization or a reclassification transaction in *IRA Trust FBO Bobbie Ahmed v. Crane*. NRG Yield, Inc. ("Yield") had two classes of shares, each with one vote per share.[89] Class A was held by public shareholders while Class B was held by NRG Energy, Inc. ("NRG"),

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84. Plaintiffs' Opening Pre-Trial Brief at 7–8, In re Google Inc. Class C S'holder Litig., No. 7469-CS, 2013 WL 2728583 (Del. Ch. June 10, 2013) [hereinafter Plaintiff's Opening Pre-Trial Brief].

85. Opening Pretrial Brief of Google Inc. and Independent Director Defendants at 14, 16, *In re Google Inc. Class C S'holder Litig.*, No. 7469-CS, 2013 WL 2728591 (Del. Ch. June 10, 2013); *see also In re* Crimson Expl. Inc., 2014 Del. Ch. LEXIS 213.

86. Williams v. Geier, 671 A.2d 1368, 1370 (Del. 1996).

87. *Id.* at 1378.

88. *Id.* at 1376.

89. IRA Tr. FBO Bobbie Ahmed v. Crane, No. 12742-CB, 2017 WL 7053964, at *1 (Del. Ch. Dec. 11, 2017).

which constituted about 65% of Yield's voting power.[90] After its IPO, Yield issued additional equity to raise capital which diluted NRG's voting power from 65% to 55%.[91] To prevent further dilution, NRG proposed a reclassification plan in which Class C and Class D shares would be distributed to Class A and Class B shareholders *pro rata*.[92] Each Class C and Class D share would have 1/100 of a vote, and Class C shares would be traded publicly to finance future asset acquisitions.[93] This reclassification plan was conditioned upon the approval of a majority of the Class A shareholders unaffiliated with NRG and subject to approval by the a conflicts committee.[94]

In this case, the *IRA Trust* Court found that although the Class C and Class D shares were distributed *pro rata*, NRG received a unique benefit, which was the perpetuation of its control over Yield.[95] As a result, the reclassification fell under the second category of conflicted transaction discussed earlier in this paper where controlling shareholders leverage their position to acquire premiums or other benefits not shared by other shareholders.[96] Such transactions are presumptively subject to entire fairness review. Then the *IRA Trust* Court proceeded to apply the *MFW* framework and noted that this framework should be applicable beyond the context of a squeeze-out merger.[97] After finding that the reclassification transaction adopted all the protections required by the *MFW*

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90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.* at *9.
96. *In re* Martha Stewart Living Ominimedia Inc, 2017 WL 3568089 at *11.
97. IRA Tr. FBO Bobby Ahmed, 2017 WL 7053964 at *12. *See* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 645 (Del. 2014) (laying out the six elements that need to be fulfilled before the application of the business judgment standard of review: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority).

framework, the Court applied the business judgment standard of review.[98]

Notably, plaintiffs in *IRA Trust* challenged the adequacy of Yield's proxy disclosure, stating that it failed to clarify that "in the absence of the Recapitalization, NRG's ownership could have been reduced below 50.1% as early as 2015 without additional Yield equity issued to NRG . . . and that to maintain voting control (at least 50.1% ownership) in Yield, NRG would have had to take back ~$118mm in Yield stock for scheduled dropdowns through 2019."[99] However, the court found it sufficient that the proxy indicated "how close NRG was to losing majority control, and stated the specific amount of additional equity issuances that would cause NRG to close control."[100] No speculative timeline regarding when the controlling shareholder would lose control without new share issuance was required in the proxy disclosure.[101] Moreover, the Court found the proxy disclosure was not materially misleading when it stated "NRG's expressed intention to maintain a controlling interest in the Company," and that "[t]he Recapitalization Could Prolong the Period of Time During Which NRG Can Exercise a Controlling Influence on Most Corporate Matters."[102] In summary, one of the *MFW* elements, which is that the vote of the minority is informed, was met in this case when the proxy provided enough information for shareholders to calculate how many Class C shares Yield would have to issue for NRG not to lose control and gave the expressed intention behind the recapitalization plan.

The most distinguishable difference between *Geier* and *IRA Trust* is that the *Geier* Court didn't find the controlling shareholder acquired a unique benefit through the adoption of the time-phased voting plan, though recognizing that "the dynamics of how the Plan would work in practice had the effect of strengthening the Family Group's control,"[103] whereas the *IRA Trust* Court found the opposite for NRG in Yield's recapitalization. Though of different designs, the *de facto* effects of both plans are essentially the same, which is to perpetuate

98. IRA Tr. FBO Bobby Ahmed, 2017 WL 7053964 at *20.
99. *Id.* at *17.
100. *Id.* at *18.
101. *Id.* at *18.
102. *Id.* at *19.
103. Williams v. Geier, 671 A.2d at 1370.

the voting power of the controlling shareholders. Would courts in the future fail to find a unique benefit embedded in a time-phased voting plan, like in *Geier*, yet at the same time, find such a unique benefit in a recapitalization plan with the issuance of a new class of shares, like in *IRA Trust*? The answer to this question remains to be seen. The *Geier* Court concluded that any dilutive effect resulting from the time-phased voting plan was incidental as the controlling shareholder did not have control over whether any minority shareholders would seek to rebut presumption that "all shares held in street name were to be short-term." In the dissenting opinion of *Geirer*, Justices Hartnett and Horsey said "notwithstanding the self-serving denials of the proponents of the Plan, its effect on shareholders' voting rights was clearly substantial rather than incidental. The Court of Chancery, in our view, should have held an evidentiary hearing to determine if the Recapitalization Plan has a negative effect on the minority shares and to determine whether the primary purpose of the Plan was to assure the continual control of the corporation by the Geier Family members while permitting them to sell some of their shares." Justices Hartnett and Horsey's recommendation to probe the primary purpose behind the time-phased voting plan is more in line with the *IRA Trust* Court's stance and should be recommended for Delaware courts' future reference; otherwise, the protection afforded to low-voting shareholders in *IRA Trust* would be rendered meaningless given that companies could always switch to time-phased plans to achieve the same end that was blocked on another route.

Another case pertaining to recapitalizations is *Levco Alternative Fund v. Reader's Digest*, where Class A nonvoting shareholders of Reader's Digest Association, Inc. ("RDA") sought to prevent the implementation of a recapitalization of RDA where RDA would purchase Class B voting shares owned by a group of funds for an aggregate purchase price of approximately $100 million.[104] The Delaware Supreme Court enjoined the recapitalization because the special committee breached its fiduciary duties by not evaluating the fairness of the $100 million payment to Class B voting shareholders.[105]

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104. *See* Levco Alternative Fund Ltd. v. Reader's Digest Ass'n, Inc., 803 A.2d 428, 428 (Del. 2002).

105. *Id.* at 429.

Reader's Digest suggests that, should premiums paid in a recapitalization result in the decrease of a certain class of shareholders' post-recapitalization equity interest, the special committee shall acquire an independent opinion that evaluates the fairness of the recapitalization to this class of shareholders.

In the Google recapitalization, which, as analyzed above, was a conflicted transaction – if the two founders were viewed as a controlling bloc – where the controlling bloc obtained a unique benefit, which was the perpetuation of their controlling position.[106] The recapitalization was eventually settled through a negotiation between a special committee of independent directors and the founders on the condition that two protection provisions would be included in the agreement: (1) a Transfer Restriction Agreement (the "TRA"), which required the founders to sell an equal number of Class B shares when selling Class C shares, and (2) an Equal Treatment Amendment (the "ETA") to be included in the charter requiring all classes of stock to receive the same amount of consideration in a change of control transaction.[107] Judge Strine approved the settlement, adding three further restrictions to the TRA clause—the TRA could be waived or modified only if it was (1) recommended by a committee of independent directors, (2) approved unanimously by the board of directors of Google, and (3) made public with a delay of thirty days to allow a judicial challenge, where the entire fairness standard of review would apply.[108] Further, should Google decide to issue more than ten million Class C shares, its independent directors would be required to consider the effect of the issuance on its Class A shareholders.[109] The parties also reached a "true-up" agreement where Google agreed to pay Class C shareholders an amount based on the discount of their shares relative to Class A shares one year after Class C shares started trading.[110] However, the highest discount based on which the Class C shareholders were entitled to receive payments was 5%.[111]

106. Plaintiffs' Opening Pre-Trial Brief, *supra* note 84, at 6

107. Plaintiffs' Opening Pre-Trial Brief, *supra* note 84, at 4, 6.

108. Google Inc., Current Report (Form 8-K), Ex. 99.1 Memorandum of Understanding, (June 17, 2013) [hereinafter Google Inc. 8(k)].

109. *Id.*

110. Google Inc., Current Report (Form 8-K), Ex. 99.1 Stipulation of Compromise and Settlement, 3.1(a) (Oct. 30, 2013).

111. *Id.*

Should a recapitalization plan similar to Google's where a controlling shareholder or bloc would extract a unique benefit be litigated in Delaware in the future, the Delaware courts would apply the *MFW* standard. As a result, the presumptions of the business judgment rule are available if and only if "(1) the controller from the outset conditions the transaction on the approval of both a special committee and a majority of the minority shareholders; (2) the special committee is independent; (3) the special committee is broadly empowered, including to freely select its own advisors and to say no definitively; (4) the special committee meets its duty of care; (5) the minority vote is informed; and (6) the minority is not coerced. Failure to satisfy any one of these conditions would subject the defendants to entire fairness review."[112] If the plan were approved by a majority of the outstanding minority shareholders and a special committee, which obtained an independent report evaluating the plan's fairness to the minority shareholders, as required by *Reader's Digest*, the first contentious issue would come down to the independence of the special committee. As noted by Judge Strine in the Google settlement: "During the negotiations, were they arranging a fishing trip to Alaska? That stuff can actually be substantively relevant."[113] Thus, the determination of the independence of the special committee would be based on fact intensive findings. Second, the courts would adjudicate whether the special committee is empowered to freely select its own advisors, say no definitively, and meet its duty of care in negotiating a fair price.[114] Next, the courts would look at whether the vote of the minority is informed. In *IRA Trust*, the Court deemed the minority shareholders informed because Yield fully disclosed the intention behind its recapitalization and the information necessary for the minority shareholders to calculate the number of shares Yield needed to issue for NGR to maintain its majority status. Granted, whether the votes of minority shareholders are informed should be determined on a case by case basis. However, *IRA Trust* shows that companies do not need to walk minority shareholders through the detailed calculations behind a recapitalization, as long as the intention behind the transac-

112. Kahn v. M & F Worldwide Corp., 88 A.3d at 645.
113. Hals, *supra* note 34.
114. Kahn v. M & F Worldwide Corp., 88 A.3d at 645.

tion is disclosed, and adequate information is provided for the minority shareholders to make informed decisions and calculations. Lastly, the courts would look into whether there is coercion of the minority shareholders.[115] In *Sciabacucchi v. Liberty Broadband Corporation*, Vice Chancellor Glasscock found that minority shareholders' approval of stock issuances by Charter Communications, Inc. ("Charter") to Liberty Broadband Corporation ("Liberty") and the grant of a voting proxy to Liberty did not represent a free choice by the disinterested shareholders because the consummation of the merger with Time Warner Cable and the acquisition of Bright House, which were mutually agreed by all parties as value-enhancing, were contingent on the approval of the proxy agreement with the stock issuance to Liberty.[116] Though *Sciabacucchi* did not involve a controlling shareholder, the Delaware Court of Chancery addressed the issue of structural coercion, which shed light on how the Delaware courts would view the adequacy of the last cleansing act required by *MFW*. The Court ruled that the Board failed to show that the approval of the proxy agreement with the stock issuance to Liberty was necessary to the transactions with Time Warner Cable or Bright House.[117] As a result, the court ruled that the vote approving the proxy agreement with and stock issuance to Liberty was "structurally coerced" and thus business judgment review did not apply.[118] Therefore, it is worth noting that, in order for the last cleansing act to be satisfactory, the approval of the minority shareholders shall not be structurally coerced. In the Google settlement case, structural coercion was not evident in the facts provided. However, again, the determination of whether the last cleansing act is satisfactory depends on specific facts presented.

The fairness of the Google settlement terms can be questioned in terms of the value of compensation offered to Class A shareholders versus the market capitalization loss they suffered or would suffer over the long term. However, if a reclas-

115. *Id.*

116. Sciabacucchi v. Liberty Broadband Corp., CV 11418-VCG, 2017 WL 2352152, at *23 (Del. Ch. May 31, 2017).

117. *Id.*

118. *Id.* at *2 (finding structural coercion exists when "the directors [create] a situation where a vote may be said to be in avoidance of a detriment created by the structure of the transaction the fiduciaries have created, rather than a free choice to accept or reject the proposition voted on").

sification transaction, like the one carried out by Google, were consummated after an arm's-length negotiation where all the procedural protections afforded by *MFW* were met, the dissenting shareholders then would not have a post-recapitalization right to demand the payment of a fair value for their shares. Dissenting shareholders in a reclassification transaction who view themselves as being undercompensated might feel oppressed if a majority of the disinterested shareholders approve a recapitalization like the one adopted by Google. As discussed above, the parties in the Google settlement reached a "true-up" agreement where Google agreed to pay Class C shareholders an amount based on the discount of their shares relative to Class A shares.[119] However, in recapitalization or reclassification transactions where such true-up agreements are absent and where the *MFW* procedural protections are satisfactorily taken, there's no other legal right the dissenting minority shareholders can resort to in order to protect their interest. Even with the presence of a true-up agreement, it's still possible that dissenting shareholders in a recapitalization or a reclassification transaction would view their values as being unfairly expropriated if the value difference between two classes of shares grew significantly wider after the true-up period has elapsed. In such a situation, appraisal rights could provide a remedy. The Delaware law does not currently grant appraisal rights in the case of a reclassification or a recapitalization.[120] Given the rising concerns of expropriation of economic value by controlling shareholders from other shareholders through recapitalization or reclassification arrangements and the lack of post-recapitalization protections for dissenting shareholders, it is time for the Delaware Court of Chancery to consider providing appraisal rights in recapitalization and reclassification transactions. Granted, even in mergers and consolidation, appraisal rights are not available to dissenting shareholders who receive publicly traded stock as consideration.[121] However, Delaware may want to rethink this approach because whether in mergers or recapitalizations, inadequate considera-

119. Google Inc. 8(k), *supra* note 108.

120. Arthur Fleischer, Jr., Alexander R. Sussman & Gail Weinstein, *Recapitalization and Restructuring*, *in* TAKEOVER DEFENSE: MERGERS AND ACQUISITIONS § 13.02 n.10 (8th ed. 2018).

121. 8 Del. C. § 262(b).

tion is inadequate regardless of the form of payment. The application of the *MFW* standard by the *IRA Trust* Court was a step forward by Delaware to protect minority shareholders in reclassification transactions, and the increasing popularity of the dual-class share structure requires Delaware's jurisprudence to be more thoughtful in addressing dissenting shareholders' rights.

VII.
Market Constraints on the Dual-Class Structure

The embrace of dual-class structures does not come without resistance; however, the pressure to attract more technology companies has led regulators to rethink their approaches to the dual-class share structure. Alibaba was rejected by the Hong Kong Exchange because of its dual-class shares.[122] On April 24, 2018, the Stock Exchange of Hong Kong Limited published new rules permitting "listings of high-growth and innovative companies with dual-class shares or 'weighted voting rights' (WVR) structure[.]"[123] Singapore's stock exchange, despite not allowing companies with dual-class structures to do IPOs, allows them to seek secondary listings if the companies already have primary listings in developed countries.[124]

Contrary to the trend in the rest of the world to change rules to accommodate dual-class shares, the S&P Dow Jones Indices announced that it would exclude companies with a multiple-class share structure on July 31, 2017 and FTSE Russell announced they would exclude companies with low- or non-voting rights on July 26, 2017. However, existing dual-class

122. Paul J. Davies, *Alibaba Abandons $60bn Hong Kong Listing*, FIN. TIMES (Sep. 25, 2013), https://www.ft.com/content/525f4bc2-25ae-11e3-aee8-00144feab7de.

123. Christopher W. Betts, Z. Julie Gao & Haiping Li, *Hong Kong Publishes Groundbreaking New Rules for Dual-Class Shares, Emerging and Innovative Sectors*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Apr. 25, 2018), https://www.skadden.com/insights/publications/2018/04/quarterly-insights/hong-kong-publishes-groundbreaking-new-rules.

124. Douglas Appell, *Singapore's Stock Exchange Gives Dual-Class Shares a Secondary Listing Toehold*, PENSIONS & INVESTMENTS (July 31, 2017), http://www.pionline.com/article/20170731/ONLINE/170739996/singapores-stock-exchange-gives-dual-class-shares-a-secondary-listing-toehold.

companies in the S&P indices were grandfathered in.[125] On the surface, dual-class companies are not substantially affected by these two decisions. However, given the intense flow of funds into passive strategies, "listing standards for index providers have become an increasingly important battleground for investors concerned with corporate governance."[126] Should this trend continue to expand among index providers, dual-class public companies may experience economic pressure because companies in indices like the S&P 500 can expect higher trading volumes.[127]

The Snap IPO has stirred investors' concerns. After Snap announced its plan to issue non-voting stock, the Council for Institutional Investors (the "CII") sent a letter to Snap's executives, co-signed by 18 institutional investors, urging them to abandon the plan which would "[deny] outside shareholders any voice in the company."[128] How much influence the CII has exerted over major indices' decision to exclude companies with multi-class structures is unknown. Yet it is undeniable that acting collectively, institutional investors could leverage their influence substantially to cause headaches to companies considering the dual-class share structure. In a letter to the CEOs of S&P 500 Companies, Larry Fink, the CEO of BlackRock commented, "[a]s a fiduciary acting on behalf of these clients, BlackRock takes corporate governance particularly seriously and engages with our voice, and our vote, on matters than can influence the long-term value of firms."[129] Should funds like BlackRock and Vanguard take a hard stance on the dual-class

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125. John Divine, *Karma for SNAP Stock: S&P 500 Bans Dual-Class Shares*, U.S. NEWS (Aug. 1, 2017), https://wtop.com/news/2017/07/karma-for-snap-stock-sp-500-bans-dual-class-shares/.

126. Abe M. Friedman et al., *S&P and FTSE Russell on Exclusion of Companies with Multi-Class Shares*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 5, 2017), https://corpgov.law.harvard.edu/2017/08/05/sp-and-ftse-russell-on-exclusion-of-companies-with-multi-class-shares/.

127. Divine, *supra* note 125.

128. Ronald Orol, *Insurgents Irate That Snapchat IPO Will Only Sell Non-Voting Shares*, THE STREET (Feb. 8, 2017), https://www.thestreet.com/story/13993167/1/insurgents-irate-that-snapchat-ipo-will-only-sell-non-voting-shares.html.

129. *Blackrock Investor Stewardship: Corporate governance and proxy voting guidelines for European, Middle Eastern, and African securities*, BLACKROCK (Jan. 2020), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-emea.pdf.

share structure, founders may rethink their choices of share structures when their companies plan to go public.

Sunset provisions, such as fixed-time and triggering-event sunsets, provide a possible market solution to management entrenchment. A fixed-time sunset is a provision that puts a time limit on how long the high-voting shares can carry the superior voting rights.[130] A triggering-event sunset provision requires "a conversion to a single-class structure upon the occurrence of a specified event, such as the founder's disability, death, or reaching or retirement age."[131] Bankers and lawyers can negotiate such limitations on high-voting shares. However, sunset provisions, particularly trigger-event ones, have limited influence on incumbent high-voting shareholders because their influence will be here-to-stay until they retire.

Overall, the U.S. market is cautious of the increasing popularity of dual-class share structures, and institutional investors are collectively placing pressures on companies that plan to go public with such share structures, which would serve as a constraint.

Conclusion

The rise of the dual-class share structure is not a new phenomenon. History has witnessed the popularity of dual-class shares multiple times, including during the heyday of hostile takeovers. Though empirical evidence on the performance of dual-class companies is not consistently in favor of the dual-class share structure, there are numerous studies finding positive abnormal returns after dual-class recapitalization, both over the short and long terms, and that dual-class companies outperform their counterparts in terms of financial and operating metrics. Studies have also shown that companies that have adopted the dual-class share structure voluntarily unified their shares for multiple reasons, including increasing the liquidity of common stock, and such unifications had a positive impact on the companies' enterprise value. The seemingly paradoxical observation of positive effects of both dual-class recapitalizations and unifications shows that the adoption of the dual-class share structure should be a company-specific decision. The dual-class share structure is not the right choice for

130. Bebchuk & Kastiel, *supra* note 38, at 619.
131. *Id.* at 620.

everyone, but it works under certain circumstances. The positive abnormal returns witnessed by companies that were recapitalized into the dual-class share structure by those that unified their shares demonstrate that managerial decisions could be responsive to company-specific needs, and investors are capable of weighing principal against agency costs and minimizing the combination of both costs. This result should inform the regulatory agencies' future policy making since it has been proved that a substantial number of managers and investors were able to choose the right share structure for their firms to benefit shareholder wealth.

The current Delaware corporate legal regime affords relatively detailed procedural protections for minority shareholders in both change-of-control and recapitalization/reclassification transactions. The application of the *MFW* standard to change of control and recapitalization transactions involving conflicted transactions would help shareholders negotiate at an arm's length and say no to transactions that they do not think are fair. However, the Delaware Court of Chancery has yet to solve the dissenting shareholder oppression issue in recapitalizations. A good solution would be to introduce appraisal rights to evaluate the fairness of compensation to dissenting minority shareholders. However, due to the difficulties involved in determining the loss suffered by minority shareholders in recapitalizations, more robust studies still need to be done to explore the practicability of this option.

The current global trend has been to accommodate dual-class share structures as more and more companies have started to favor this option. However, there is tension between institutional investors and companies that favor the dual-class share structure, which can serve as a healthy balance of power to place checks on the use of dual shares.

Overall, empirical evidence demonstrated that managers could be capable of adjusting share structure choices according to needs, and the market could pressure a dual-class company to unify its shares when the dual-class share structure no longer serves the company's interest. A major drawback of the protections afforded to dissenting minority shareholders in recapitalization/reclassification transactions is the absence of appraisal rights, the practicability of which is still left for future studies to determine. However, given the success of dual-class share structures shown by various empirical evidence and the

relatively detailed procedural protections made available by the Delaware Court of Chancery, the dual-class share structure has proved to be a viable approach for shareholder value creation.