

DUAL CLASS CONTRACTING

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Preliminary Draft – Comments Welcome

ABSTRACT

Dual class companies—in which insiders have more votes per share than public shareholders—have become widespread in the tech sector. But while the choice between single class and dual class structures has long been studied and debated, customization and innovation within dual class structures remain poorly understood. Voting inequality is a spectrum, not a binary choice; yet we know little about how different dual class companies choose a level of voting inequality along this spectrum.

In this Article, I seek to shed some light on this phenomenon by presenting and discussing quantitative and qualitative data on dual-class IPOs, including the analysis of a comprehensive sample of dual class charters adopted at IPO by U.S. nonfinancial companies as well as a survey of capital markets lawyers with expertise on dual class IPOs. The corporate charters analyzed for this Article span 27 years, from 1996 to 2022, and the respondents to the survey include more than three dozen law firm partners, working at elite law firms that have assisted more than two thirds of the U.S. dual class companies that went public in the past decade.

The Article has three main goals. The first is to map the dual class landscape and to document standardization and customization of voting inequality and dual class charters across almost 300 companies and three decades. It finds that most dual companies choose similar or identical levels of voting inequality, but that dual class “norms” occasionally

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break and unravel. The second goal is to reconstruct the “contracting process” that shapes dual class charters, as experienced by expert IPO lawyers, and the role of key market actors in this process. The third goal is to try to reconcile this picture with the basic tenets of the “classic contractarian theory,” the richer and more nuanced insights of “modern contractarian theory,” and the work of sociologists and social economists on the evolution of social norms.

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INTRODUCTION

The default voting rule in corporate law is one share, one vote.¹ At Amazon, for example, founder and CEO Jeff Bezos owns 13% of the shares and may cast 13% of the votes.² At Walmart, the Walton family owns 47% of the shares and may cast 47% of the votes.³ The voting power of controlling or influential shareholders is thus proportionate to the size of their investment.

A growing number of large and innovative companies, however, especially in the technology sector and in the platform economy—such as Alphabet, Meta, Airbnb, Lyft, and Zoom—go public with a dual class structure, in which founders and insiders have greater voting power than public investors.⁴ In these companies, some shareholders can cast a majority of votes with only a minority of shares. This is the case, for example, at Meta Platforms (formerly Facebook), where founder and CEO Mark Zuckerberg has 13% of the shares and 57% of the votes;⁵ at Alphabet (formerly Google), where founders Sergey Brin and Larry Page have 6% of the shares and 51% of the votes;⁶ and at Ralph Lauren Corp., where the eponymous founder has 36% of the shares and 85% of the votes.⁷

Dual class structures are one of the most controversial topics in corporate governance. Many find them objectionable, on the grounds that they violate fundamental principles of shareholder democracy, reduce accountability of managers, and distort the controller's incentives to create value for all shareholders. Others, in contrast, believe that dual class structures protect the founders' entrepreneurial vision from myopic market pressures, improve the controller's incentives with respect to risk-taking, and strengthen the managers'

¹ Del. Code Ann. tit. 8, § 212 (“Unless otherwise provided in the certificate of incorporation..., each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder”); Mod. Bus. Corp. Act § 7.21(a) (2021 rev.) (“[U]nless the articles of incorporation provide otherwise, each outstanding share, regardless of class or series, is entitled to one vote on each matter voted on at a shareholders’ meeting”).

² Amazon.com, Inc., 2022 Proxy Statement (Form 14A) 87 (Apr. 14, 2022). More precisely, Bezos owns 49,932,682 shares and has sole voting power on additional 14,655,736 shares, likely due to an irrevocable proxy or a shareholder agreement. *Id.*

³ Walmart, Inc., 2022 Proxy Statement (Form 14A) 101 (Apr. 21, 2022).

⁴ See Jill E. Fisch & Steven Davidoff Solomon, *Dual Class Stock*, U. OF PENN. INST. FOR L. & ECON. RES. PAPER NO. 23-21 (Apr. 27, 2023), at 2 (“The incidence of corporations with disparate voting structures... continues to increase”).

⁵ Facebook, Inc., 2022 Proxy Statement (Form 14A) 61 (Apr. 8, 2022).

⁶ Alphabet, Inc., 2022 Proxy Statement (Form 14A) 38, 108 (Apr. 22, 2022).

⁷ Ralph Lauren Corp., 2022 Proxy Statement (Form 14A) 52, 111 (Jun. 24, 2022).

bargaining power vis-à-vis buyers of the company.⁸ The debate remains unresolved.⁹

The choice between dual class and single class structures has been the subject of academic and policy debates for many years. But voting inequality is a spectrum, not a binary choice. A dual class structure that allows the controller to have a majority of votes with only 4.8% of the shares (such as the one chosen by Pinterest, for example) is much more unequal than a dual class structure that requires the majority shareholder to have at least 35% of the shares (such as the one adopted by Cognizant). In fact, by this measure, Cognizant's dual class structure is closer to a single class structure such as Amazon's (where a majority shareholder must own 50% plus one shares) than to Pinterest's dual class structure. If the choice between a single class structure like Amazon's and a dual class structure like Cognizant's is significant and worthy of careful analysis, so must be the choice between a dual class structure like Cognizant's and a dual class structure like Pinterest's.

Similarly, a dual class structure that can last for the entire life of the founders (such as the one chosen by Google, for example) or in perpetuity (such as the one chosen by Facebook) is much more unequal than a dual class structure that expires after five years (such as the one chosen by Groupon).¹⁰ Once again, if voting inequality matters, then the choice between temporary inequality or lifelong or perpetual inequality must be taken seriously.

Unlike the "categorical" choice between dual class and single class structures, the "continuous" choice of specific levels of voting inequality remains understudied. How much variation and customization are there within dual class structures? What is the contribution of the various market actors to the final shape of these structures? Do real-world dual class arrangements adapt to different characteristics of companies and controllers? How do dual class structures evolve over time and what might explain the patterns of change or persistence?

This Article seeks to shed some light on these questions by examining both quantitative and qualitative evidence on initial public offerings (IPOs) of U.S. dual class companies. I analyze and discuss a hand-collected sample of dual class charters adopted at IPOs by U.S. nonfinancial companies, as well as the findings from a survey of more than three dozen law firm partners with expertise on dual

⁸ See *infra*, Part I.A.

⁹ See Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1057, 1061 (2019) ("The debate over whether dual class structures increase or decrease corporate value is, to date, unresolved").

¹⁰ See Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017).

class IPOs. The charters included in this study represent a comprehensive sample of all dual-class IPOs by U.S. nonfinancial companies from 1996 to 2022, for a total of 293 corporate charters. Respondents to the survey and follow-up interviews are experienced IPO lawyers, working at elite law firms that have assisted more than two thirds of dual class issuers in the past decade.

The Article has three goals. The first goal is to map the dual class landscape and to document variation and customization of voting inequality and dual class charters across almost 300 companies and three decades. Unlike the previous literature on dual class charters, I try to map a comprehensive sample of dual class structures and focus on the levels of voting inequality contracted for at IPO, rather than measured at one specific time; I also collect and analyze substantive qualitative evidence from practitioners.¹¹

I measure voting inequality in two dimensions: *degree* and *duration*. I measure the *degree* of voting inequality by calculating, for each dual class charter, the smallest percentage of common stock that a high-vote shareholder must own in order to have 50% of the votes.¹² I call this metric the “control lock.”¹³ I measure the *duration* of voting inequality by calculating the combined effect of charter provisions that allow high-vote shareholders to keep a dual class structure in place over time.

One important finding is that, despite a broad spectrum of possible tailor-

¹¹ Previous research, by Professors Andrew Winden, Professors Lucian Bebchuk and Kobi Kastiel, and Professors Dhruv Aggarwal, Ofer Eldar, Yael Hochberg, and Lubomir Litov, has tackled the specific question of variation across dual class charters. Professor Winden analyzed the IPO charters of 139 dual-class companies and identified a variety of charter provisions. Professors Bebchuk and Kastiel examined 170 dual-class charters (adopted at IPO or at a later stage) and found that many dual-class controllers were potentially able to maintain control with small or very small fraction of common stock. Professors Aggarwal et al. examines the effect of outside funding options on the degree of voting inequality in dual class companies (measured by the “wedge” of the controller at IPO). See Andrew W. Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 COL. BUS. L. REV. 852 (2018); Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L. J. 1453 (2019); Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg, & Lubomir P. Litov, *The Rise of Dual-Class Stock IPOs*, 144 J. FIN ECON. 122 (2022).

¹² This methodology was first proposed by Professors Lucian Bebchuk and Kobi Kastiel. See Bebchuk & Kastiel, *Perils*, *supra* note 11, at 1493-1495.

¹³ This way to measure voting inequality is different from the one typically found in the finance literature, which is the so called “wedge” (that is, difference) between cash flow rights and voting rights. The wedge is typically measured at IPO (or at another reference date) and therefore is only a snapshot of voting inequality at a given point in time. As I will show, the wedge almost always varies significantly across time, with many companies with a smaller wedge ending up having a larger one, or vice versa. By contrast, the control lock measures the maximum degree of voting inequality that investors have agreed to and therefore is a more accurate measure of the degree of voting inequality “bargained for” between insiders and public investors.

made options, most dual companies choose similar or identical levels of voting inequality. Over the entire 27-year period, 62% of companies chose a control lock in the very narrow range between 9% and 10%, and less than 7% chose a control lock greater than 20%. Furthermore, between 1996 and 2010, 96% of dual class structures had a potentially lifelong (27%) or perpetual (69%) duration; then the landscape changed dramatically and in the period between 2011 and 2022 only 58% of dual class companies chose lifelong or perpetual structures. In particular, perpetual structures become quite infrequent (21% in the 2011-2022 period, 13% 2021-2022).

Interestingly, *degree* and *duration* of voting inequality are not statistically associated with characteristics that, according to the previous literature, predict the choice between dual class and single class structures. In other words, factors that seem to be related to the categorical choice between dual class and single class structure do not seem to be related to the continuous choice of a given level of voting inequality.

The second goal is to reconstruct the “contracting process” that shapes dual class charters, as experienced by expert IPO lawyers directly involved in the process. In a 2006 article, Professor Michael Klausner observed that the fact that “corporate contracts... reflect a high degree of uniformity” rather than “fulfilling their contractarian role as the locus of innovative and customized corporate contracting” warrants “at least some rethinking of the contractarian theory.”¹⁴ Even Klausner, however, considered dual class structures as one of the very few instances of “deliberate contracting... in the drafting of corporate charters.”¹⁵

But what counts as “deliberate contracting”? The picture emerging from the experience of the top IPO lawyers shows that “norms” and “precedents” play an important role in the shaping of dual class structures. The textbook story is that corporate insiders “bargain” with the investment banker, as a representative of the public investors, and the governance features ultimately chosen by the company tend to maximize the joint surplus of insiders and public investors, given the individual characteristics of the company. But the widespread perception of expert lawyers is that the pricing of dual class features is surrounded by high uncertainty, and companies tend to comply with “market norms” rather than tailoring the levels of voting inequality to their specific circumstances.

¹⁴ Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 782.

¹⁵ *Id.*, at 790-791. See also Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913, 919 (2021) (using “dual or multiclass voting structures” as an example of private ordering “tailoring a corporation’s structure and governance mechanism to meet firm-specific needs”).

Interestingly, neither investment bankers nor investors are perceived to play an important role in shaping dual class features, whereas founders, venture capitalists (VCs) and—surprisingly—issuer lawyers are believed to play a significant role. Both issuer lawyers and investment bank lawyers, in particular, perceive the role of issuer lawyers as crucial in reshaping founders’ preferences based on the existing “market practice.” Suggestive evidence on the similarity and evolution of charter texts and on the correlation between major law firms and dual class features is consistent with this narrative.

The third goal is to try to reconcile this picture with the existing theories of the corporate contract. Dual class “market practice” resembles some characteristics of social norms as studied by sociologists and social economists: compression (lower variation than otherwise expected), stickiness (persistence over time), and punctuated equilibrium (long periods of stasis followed by rapid change). But why do market actors follow dual class norms? And is there any money left on the table?

The “classic contractarian theory” of the corporation argues that pre-IPO owners internalize the effects of charter provisions on firm value, and therefore corporate charters will tend to include value maximizing provisions.¹⁶ Under this view, the level of voting inequality should be a function of company

¹⁶ For classic defenses of the contractarian theory of the corporation, see William A. Klein, *The Modern Business Organization: Bargaining under Constraints*, 91 YALE L.J. 1521 (1982); Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON U. L. REV. 99 (1989); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989); Jonathan R. Macey, *Corporate Law and Corporate Governance a Contractual Perspective*, 18 J. CORP. L. 185 (1993); Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1996-1997).

For early critiques of the contractarian theory, see Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); John Coffee, *No Exit?: Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOKLYN L. REV. 919 (1988); Lucian Ayre Bebchuk *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989); Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703 (1989); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549 (1989); David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, in PROGRESSIVE CORPORATE LAW 1-33 (Lawrence E. Mitchell ed. 1995).

For more recent studies on contractarian theory, see Lucian Ayre Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779 (2006); Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325 (2013); Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373 (2018); Robert IV Anderson, *A Property Theory of Corporate Law*, 2020 COLUM. BUS. L. REV. 1 (2020); Grant M. Hayden & Matthew T. Bodie, *Codetermination in Theory and Practice*, 73 FLA. L. REV. 321 (2021); Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 13 J.L. ANALYSIS 672 (2021).

characteristics and founder characteristics. Plausibly, company and founder characteristics vary significantly across firms; therefore, the low variation among voting inequality is puzzling. It is possible, in theory, that the 9%-10% control lock and a lifelong-perpetual duration (before 2011) or a mix of lifelong and 7-10-year duration (from 2011) are optimal for most dual class companies. However, the fact that companies with different characteristics do not choose tailor-made solutions more frequently is suspicious.

More recent work has provided richer and more nuanced versions of the contractarian theory. I call them “modern contractarian theories.”¹⁷ The main insights of modern contractarian theories concern the role of learning and network externalities, signaling, and agency problems. These phenomena try to explain conformity and standardization in market behavior. But do they persuasively explain dual class norms?

I will argue that learning and network externalities, as well as signaling models, are of little help in this specific setting, whereas a theory of agency problems informed by some insights from social psychology provides a more promising framework for further research on dual class contracting. Dual class features are harder to price, and therefore agents prefer a structure that is easier to justify within their “reputational community,” even if such structure is suboptimal, rather than attempting a potentially value-enhancing but risky customization. This strategy can be driven by psychological biases, but it likely to be an economically rational choice. Indeed, in a dual class IPO, it is plausible that agents capture a relatively small fraction of the benefits of a marginally more efficient charter, but they capture a much larger fraction of the costs of a public IPO failure, especially when the failure follows the choice of a non-standard governance structure. It is similarly plausible that agents are more risk averse than their principals. Both facts are consistent with the agents’ incentives to push for a more standard and safer structure, even if its expected value is significantly lower.

An open question remains: why do principals sign off on this strategy? One possibility is that the inefficiency is relatively small; in this case, we should reconsider the importance of corporate voting and of the dual class debate. Another possibility is that the inefficiency is indeed large, but its burden is mostly borne by uninformed and unsophisticated principals, namely the beneficial owners whose savings are in the hands of asset managers. In this case, the policy debate on dual class companies becomes would be even more urgent and important.

The Article proceeds in four parts. Part I identifies the problem and

¹⁷ I thank Marcel Kahan for suggesting this label.

illustrates the methodology employed to study it. Part II maps the dual class landscape by presenting evidence on the degree and duration of voting inequality across the 293 dual class companies in the sample and across the 27 years of the sample period. Part III reconstructs the “contracting process” in dual class IPOs as perceived by expert lawyers involved in the process. Part IV tries to reconcile the findings with the insights of the classic contractarian theory, the modern contractarian theory, and social norm theories. The conclusion suggests that the policy debate on dual class structures should focus less on the merits of dual class structures, or even specific dual class features, and more on the institutional processes that can, more effectively, correct mistakes, increase customization, and facilitate positive innovation.

I. PROBLEM, DATA, AND METHODOLOGY

A. The “Categorical” Problem of Dual Class Structures

Dual class structures are one of the most controversial topics in corporate governance. Critics believe that they are “inherently undemocratic,”¹⁸ and aimed at perpetuating “corporate royalty.”¹⁹ Supporters, in contrast, argue that giving insiders superior voting power protects companies from market short-termism or otherwise encourage managers to focus on creating long-term value.²⁰

The controversy over dual class companies is not novel.²¹ However, whereas

¹⁸ 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), <https://www.sec.gov/news/speech/speech-stein-021318>.

¹⁹ Robert J. Jackson, Jr., Comm'r, U.S. Sec. & Exch. Comm'n, Address at Univ. Cal. Berkeley Sch. of Law: Perpetual Dual-Class Stock: The Case Against Corporate Royalty (Feb. 15, 2018), <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-againstcorporate-royalty>.

²⁰ See, e.g., Google, Inc., IPO Prospectus, *supra* note 24 at 29 (“This [dual-class] structure will also make it easier for our management team to follow the long term, innovative approach emphasized earlier”); Opening Pretrial Brief of Defendants Larry Page and Sergey Brin at 2, In re Google, Inc. Class C Shareholder Litigation., 2013 WL 2728581 (Del.Ch. Jun. 3, 2013) (arguing that “[Google’s dual-class] capital structure had the effect of concentrating voting power in [...] longest-term stockholders, particularly the Founders” and that the company “guided by the Founders’ vision [...] made big long-term bets on revolutionary products and services, and pursued its ambitious mission”); Facebook, Inc., Preliminary Proxy Statement (Form PRE 14-A) 55 (Apr. 27, 2016) (arguing that a proposal of reclassification (later abandoned) to create a class of nonvoting stock would have “allow[ed] the company to maintain focus on Mr. Zuckerberg’s long-term vision for the company”).

²¹ For a brief overview of past controversies on dual-class structures, see Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687 (1985). See also Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1 (1988) (documenting the wave of dual class recapitalizations in

in the past dual class structures were used quite rarely,²² in the last two decades they have become a very familiar way to allocate voting rights in the technology sector, one of the fastest-growing sectors of the U.S. economy.²³

In 2004, Google (now Alphabet) made the decision, then unusual for tech companies, to adopt a dual class structure.²⁴ Since then, many large and visible tech IPOs have followed Google's example, including Facebook (now Meta Platforms), LinkedIn, First Data, Snap, Lyft, Airbnb, DoorDash, Zoom, and many others. Today, there is the widespread perception that dual class IPOs have become the norm in Silicon Valley.²⁵

As happened in the past, commentators disagree on the advantages and disadvantages of dual class structures. On the one hand, tech founders and their advisers argue that dual class structures allow entrepreneurs to focus on innovation and long-term value creation, thanks to the insulation from the pernicious short-term pressure of the stock market.²⁶ On the other hand, many commentators believe that dual class structures violate the fundamental shareholder right of "one share, one vote," reduce managerial accountability, and

the 1980s); Stephen M. Bainbridge, *The Short Life and Resurrection of SEC Rule 19C-4*, 69 WASH. U. L. Q. 565 (1991).

²² Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 J. L. ECON. & ORG. 83, 96 (2001) (finding that only 6.4 percent of companies that went public between January 1, 1994, and July 1, 1997, chose a dual-class structure).

For decades, dual-class structures were most often associated with media companies—including The New York Times Co., The Washington Post Co., and Dow Jones & Co. (publisher of The Wall Street Journal). See Johnnie L. Roberts & Linda Sandler, *Washington Post Seeks to Strengthen Graham Family's Control of Company*, WALL. ST. J., Apr. 14, 1988, at 36 (reporting that "many media concerns [use dual-class structures] to ensure continued control by founding family members"). Corporate leaders of dual-class media companies argued that, by insulating the insiders' control of the company from shareholder interference, dual-class stock ensured editorial independence against the whims of the stock market. See, e.g., Johnnie L. Roberts, *Media General Case Likely to Spotlight Any Cracks in the Dual Stock Defense*, WALL ST. J., Apr. 1, 1988, at 16 (quoting Ray Shaw, President of Dow Jones, arguing that dual-class structures are aimed to "insure journalistic independence").

²³ Andrew DePietro, *U.S. Industries with The Biggest Growth In GDP From 2000 To 2020*, FORBES, Aug. 23, 2021, <https://www.forbes.com/sites/andrewdepietro/2021/08/23/us-industries-with-the-biggest-growth-in-gdp-from-2000-to-2020>

²⁴ Google, Inc., IPO Prospectus (Form 424B4) 30 (Aug. 18, 2004) (reporting the founders' observation that "[w]hile [a dual-class] structure is unusual for technology companies, similar structures are common in the media business and has had a profound importance there").

²⁵ See, e.g., Eliot Brown, *IPO Demands Tilts Power to Tech Founders*, WALL. ST. J., Dec. 23, 2020, at B1 (reporting that "[dual-class] share structures... [once] reserved for a tiny number of startups... ha[ve] effectively become the norm" and presenting data from Professor Jay Ritter showing that more than 40 percent of tech IPOs in 2020 had a dual-class structure).

²⁶ See sources cited *supra* note 20.

undermine the trust of investors in the market.²⁷

Legal and finance scholars are similarly divided on the virtues and vices of dual class structures. As some studies have made clear, by creating a wedge between insiders' cash-flow rights and control rights, dual class structures increase managerial agency costs.²⁸ Consistent with this hypothesis, empirical studies have found that the valuation of dual class companies is lower relative to the valuation of comparable single class companies.²⁹ More recently, some scholars have hypothesized,³⁰ and others have documented empirically,³¹ that dual class companies underperform relative to single class companies in the long run.

Other scholars, in contrast, have proposed arguments as to why dual class structures might be good for shareholders. One traditional argument is that takeover defenses (including dual class structures) give managers more bargaining power vis-à-vis buyers in case of sale of the company, and therefore managers, using such enhanced bargaining power, can obtain a higher premium for shareholders.³²

Another argument is that dual class structures allow CEO-controllers to diversify their investment portfolio without losing control of the company, thus

²⁷ See, e.g., Letter from Elizabeth Warren, U.S. Senator, to John Carey, Vice President, NYSE Euronext, and Edward Knight, Executive Vice President and General Counsel, NASDAQ OMX (Jun. 5, 2013) ("If a company goes to the public market to raise money, long-term ordinary common stock investors – a category that includes directly or indirectly millions of retirees and workers – should be entitled to certain basic rights. One of the most basic of those rights is one-share-one-vote"). Letter from the Council of Institutional Investors to Evan Thomas Spiegel, CEO, Snap, Inc., Robert Murphy, Chief Technology Officer, Snap, Inc., and Michael Lynton, Chairman-Designate, Snap, Inc., on the Proposed Multi-Class Structure for Post-IPO Snap, Inc. (Feb. 3, 2017), at http://www.cii.org/files/issues_and_advocacy/correspondence/2017/02_03_17_SNAP_IPO.pdf ("[W]e believe a decision by Snap to go public with the reported dual class structure will undermine the quality and confidence of public shareholders in the market").

²⁸ For a discussion of how the misalignment between cash-flow rights and voting rights increase agency costs, see generally Bebchuk & Kastiel, *Perils*, *supra* note 11. See also Lucian A. Bebchuk, Reinier Kraakman, & George Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in CONCENTRATED CORPORATE OWNERSHIP 295-318 (Randall K. Morck 2000).

²⁹ See, e.g., Paul A. Gompers, Joy Ishii, and Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUD. 1051 (2010); Ronald W. Masulis, Cong Wang, and Fei Xie, *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697 (2009); 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. OF ACCOUNT. & ECON. 94 (2008).

³⁰ Bebchuk & Kastiel, *The Untenable Case*, *supra* note 10.

³¹ K. J. Martijn Cremers, Beni Lauterbach, & Anete Pajuste, *The Life-Cycle of Dual Class Firm Valuation*, REV. CORP. FIN. STUD. (forthcoming 2023).

³² See, e.g., Rene M. Stulz, *Managerial Control of Voting Rights: Financing Policies and the Market for Corporate Control*, 20 J. FIN. ECON. 25 (1988).

making them less risk-averse when making business decisions.³³ According to this view, a CEO-controller with a very large fraction of her wealth invested in the company would take much fewer risks than optimal.

A further argument is that entrepreneurs may have peculiar perspectives that are difficult to convey to shareholders, either because they are based on private information that cannot be disclosed to the public or because they are part of an idiosyncratic vision with which uninformed or short-term oriented shareholders might disagree. Therefore, dual class structures protect the entrepreneur's vision from such disruptive market pressure and allow the company to innovate and produce long-term value for shareholders.³⁴

Theoretical and empirical studies on the effects of dual class structures on shareholder value leave us with limited evidence³⁵ and conflicting conclusions. The debate remains unresolved.³⁶

In this Article, I will take an agnostic view on the costs and benefits of dual class structures. It is possible that dual class structures are bad for shareholders in some companies but good for shareholders in other companies. For example, for some companies, dual class structures may exacerbate agency costs, while for other companies, dual class structures may protect the entrepreneur's vision from the negative effects of short-termism.

Furthermore, it is possible that some of these positive and negative effects coexist in the same company, but to different degrees. Therefore, dual class structures may produce *both* increased agency costs *and* increased shareholder value, but for some companies the net effect will be positive and for other companies the net effect will be negative.³⁷ Hence, the voting structure that is

³³ See, e.g., Scott W. Bauguess et al., *Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights*, 36 J. BANKING & FIN. 1244 (2012).

³⁴ See Jeremy C. Stein, *Takeover Threats and Managerial Myopia*, 96 J. POL. ECON. 61 (1988) (proposing a model in which uninformed shareholders pressure managers into sacrificing long-term value for short-term gains); Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L. J. 560, 579-581, 590-591 (2016) (arguing that asymmetric information between public shareholders and insiders, as well as differences of opinion, can disrupt the entrepreneur's idiosyncratic vision, whereas insulating mechanisms such as dual-class structure can correct this effect). See also Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687 (2019) (arguing that dual-class structures can be used to separate informed and non-informed shareholders in an efficient way).

³⁵ For a discussion of the limits of dual-class empirical studies, see e.g., Fisch & Davidoff Solomon, *supra* note 9, at 1073-1075.

³⁶ *Id.* at 1061.

³⁷ For example, a highly innovative company is likely to be more vulnerable to information asymmetry and short-termism and in this company the value-increasing effects of a dual-class structure might outweigh its value-decreasing effects. See, e.g., Bronwyn H. Hall & Josh Lerner, *The Financing of R&D and Innovation*, in 1 HANDBOOK OF THE ECONOMICS OF INNOVATION (Bronwyn H.

good for one company is not necessarily good for another company.³⁸ Importantly, even a value-decreasing voting structure does not necessarily result in the exploitation of shareholders, as long as shareholders are able to price the effect of the structure and therefore pay a correspondingly lower price for the company's stock.

B. The "Continuous" Problem of Voting Inequality

1. The Voting Inequality Spectrum

The choice between dual class and single class structures has been the subject of academic and policy debates for years. But voting inequality is a spectrum, not a binary choice. Corporate charters can choose different levels of voting inequality, and in some cases the difference in voting inequality between a dual class company and a single class company can be smaller than the difference between two dual class companies.

Consider the following example. Amazon went public as a single class company. If its founder and CEO Jeff Bezos wants to exercise a majority of votes, he must own a majority of shares. By contrast, Pinterest and Cognizant went public as dual class companies. Based on their IPO voting structures, high-vote shareholders in Pinterest and Cognizant can have a majority of votes with less than 50% of shares. At Pinterest, owners of Class B shares can reduce their equity holding down to 4.8% and still have a majority of votes; at Cognizant, founder Kumar Mahadeva can potentially reduce his equity stake down to 35% and keep a majority of the votes. If he goes below 35% of common stock, he loses the voting majority.

Whatever effects voting inequality has on public companies, good or bad, it is clear that Pinterest has greater voting inequality than Cognizant. In fact, if we measure voting inequality by this metric—the minimum percentage of common

Hall & Nathan Rosenberg eds. 2010) at 614 ("In the innovation setting, the asymmetric information problem refers to the fact that an inventor frequently has better information about the likelihood of success and the nature of the contemplated innovation project than potential investors"). By contrast, in a company with significant amounts of free cash flow, there are more opportunities for insiders to waste resources on pet projects and other private goals and therefore the value-decreasing effects of a dual-class structure might outweigh its value-increasing effects. *See, e.g.,* Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986).

³⁸ For a defense of this view, see Goshen & Hamdani, *supra* note 34, at 586-587 ("any contract between entrepreneurs and investors... represents a different balance between idiosyncratic vision and agency costs"). *See also* Zohar Goshen & Assaf Hamdani, *Corporate Control, Dual Class, and the Limits of Judicial Review*, 120 COLUM. L. REV. 941, 962 (2020) ("Through the negotiation [between insiders and investors at IPO], the parties are able to reach an acceptable balance between idiosyncratic vision and agency costs that fits their preferences and the nature of the business activity").

stock needed to have a majority of votes—Cognizant’s dual class structure is closer to Amazon’s single class structure than to Pinterest’s dual class structure. Therefore, the division of voting structures into single class and dual class gives us a very partial picture. We should pay attention to the different levels of voting inequality within dual class structures, not just to binary division between single class and dual class structures.

The problem of customization and innovation within dual class structures is important in and of itself because, as explained above, voting inequality is, from a logical, legal, and economic standpoint, a continuous phenomenon, not a categorical one. However, this problem is also relevant for its implications on the traditional “categorical” debate.

The “classical contractarian theory” of the corporate charter argues that pre-IPO owners internalize the effects of charter provisions on firm value, and therefore corporate charters will tend to include value maximizing provisions³⁹. Critics, by contrast, argue that low variation across corporate charters warrants some rethinking of the contractarian theory.⁴⁰

Dual class structures, however, have been usually considered, even by critics of contractarianism, as an example of “deliberate contracting.”⁴¹ But little attention has been paid to how deliberate this contracting process exactly is: How much variation and customization are there within dual class structures? What is the contribution of the various market actors to the final shape of these structures? Do real-world dual class arrangements adapt to different characteristics of companies and controllers? How do dual class structures evolve over time and what might explain the patterns of change or persistence?

2. Degree of Voting Inequality

To take account of the differences among dual class structures, I will consider two dimensions of voting inequality. The first is the *degree* of voting inequality. A dual class structure that enables the founder to control the company with only 4.8% of shares has a greater degree of voting inequality than a dual class structure that enables the Founder to control the company with 35% of shares.

In the corporate governance literature, this aspect is often measured by the difference between cash-flow rights and voting rights (the so-called *wedge*). A larger wedge means a higher degree of voting inequality. However, the wedge may and does vary over time, and companies with different wedges at IPO may

³⁹ See sources cited *supra* note 16.

⁴⁰ See Klausner, *The Contractarian Theory*, *supra* note 14, at 789.

⁴¹ *Id.*, at 790-791. See also Fisch, *Stealth Governance*, *supra* note 14, at 19.

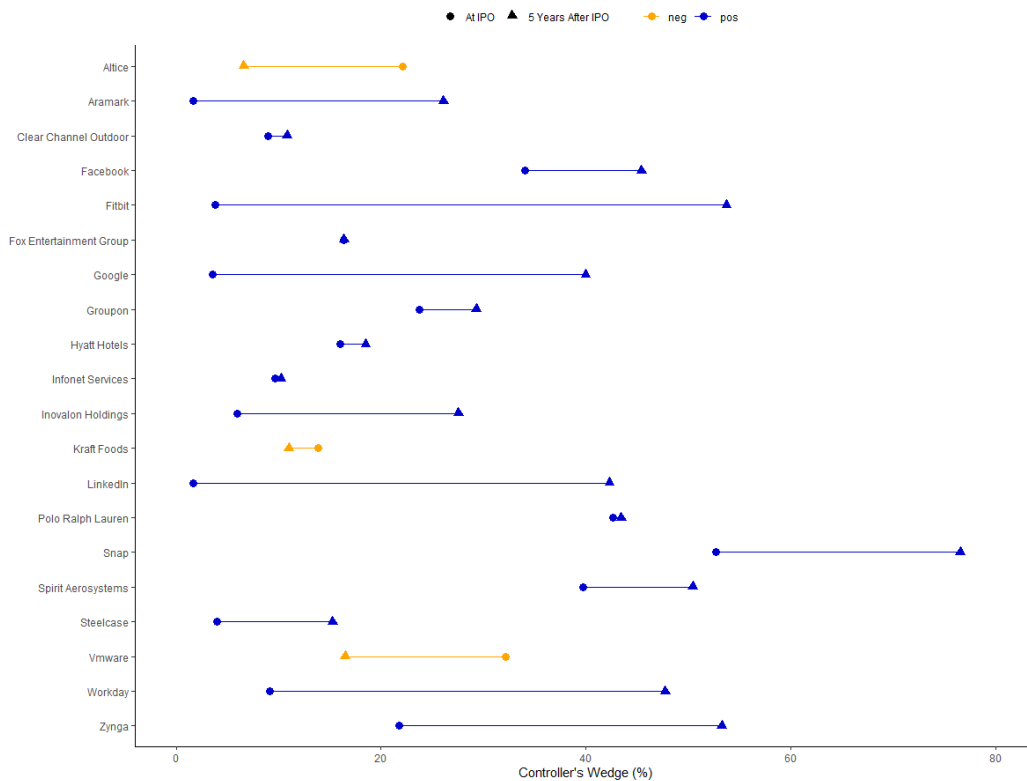
end up having very similar wedges after a few years, whereas companies with similar wedges at IPO may end up having very different wedges after a few years. To illustrate this point, I will draw a subsample of dual class structures from the dataset of dual class IPOs that I will analyze in detail in Part II.

Figure 1 reports, for the twenty largest dual class IPOs in my dataset,⁴² the controller wedge at IPO and five years after IPO. As the Figure shows, with only a few exceptions, the controller wedge five years after IPO is significantly different from what it was at IPO—in most cases, it is much larger. At Facebook, for example, Zuckerberg had 24% of shares and 58% of voting rights at IPO (34% wedge) and 14% of shares and 60% of voting rights five years after IPO (45% wedge). At Google, Brin and Page had 28% of shares and 32% of voting rights at IPO (4% wedge) and 18% of shares and 58% of voting rights five years after IPO (40% wedge).

Furthermore, companies with similar wedges at IPO had very different wedges five years after IPO, and vice versa. For example, at Aramark and Fitbit, the controller wedges at IPO were quite close (2% and 4%, respectively), but they were very different five years later (26% and 54%, respectively). By contrast, at Zynga and DreamWorks, the wedges at IPO were very different (22% and 45%, respectively) whereas five years after IPO they were very close (53% and 55%, respectively).

⁴² I excluded companies that, after five years from the IPO, had been acquired or had become single class companies.

Figure 1. Controller Wedge at IPO and 5 Years After IPO



Therefore, measuring the controller wedge at IPO (or at any other specific point in time) reveals the degree of voting inequality only at that specific time, but it tells us nothing about the potential degree of inequality that public investors accepted when adhering to the “corporate contract.” By accepting a certain dual class structure, public shareholders accept that voting inequality can increase over time, by unilateral decision of the controller, and therefore the instantaneous measure of such inequality at a given point in time does not capture the substance of the arrangement agreed upon by insiders and public investors.

Therefore, to measure the degree of voting inequality in dual class structures I will measure the *maximum* degree of voting inequality that investors have accepted in the charter. Building on a methodology introduced by Professors Bebchuk and Kastiel,⁴³ I calculate, for each dual class company in my sample, the minimum percentage of shares with which high-vote shareholders could keep a majority of votes, if they unilaterally used all the potential tools built in the IPO charter to their fullest extent. I will refer to this metric as the “control lock.”

⁴³ See *supra* note 12.

3. *Duration of Voting Inequality*

The second dimension of voting inequality is its *duration* over time. At Google, for example, the dual class structure can potentially last for the entire life of the founders, whereas at FitBit the dual class structure will convert into a single class structure ten years after the IPO. Other things being equal, a dual class structure that lasts for ten years will have different effects, both on shareholder value and private benefits, than a dual class structure that lasts for a lifetime. Whatever the costs and benefits of a dual class arrangement, they accrue year after year, and therefore the present value of these effects, when estimated at the time of the IPO, heavily depends on how long these structures will last.

As I will show in Part II, different contractual mechanisms affect the duration of voting inequality over time. Longer-lasting structures create larger private benefits for the founder and may create larger benefits or larger costs for public investors, depending on the specific circumstances.

C. Data and Methodology

1. *The Charter Dataset*

To study the problem of dual class customization and innovation, I constructed a novel dataset of dual-class charters. The dataset consists of all dual class IPOs by U.S. nonfinancial companies completed between 1996 and 2022. To build the dataset, I started from the database of multi-class IPOs compiled by Professor Jay Ritter,⁴⁴ and then I excluded non-U.S. companies, companies in the financial, insurance, real estate, and utility sectors, and legal entities other than corporations. For each of the remaining companies, I manually reviewed the final IPO prospectus, filed pursuant to Rule 424 at the completion of the IPO, and the proposed charter as enclosed with the company's registration statement (Form S-1). All these documents were collected from the Securities and Exchange Commission (SEC)'s Electronic Data Gathering, Analysis, and Retrieval system (EDGAR). Based on this review, I excluded companies for which the prospectus or the charter was not available on EDGAR, as well as the companies that were mistakenly coded as dual class in the Ritter's database but were in fact single class companies.

Finally, I excluded all the companies that adopted a multi-class structure for other purposes than enhancing insiders' control. The focus of this Article—and of the scholarly and policy debate on dual class companies—is on legal structures

⁴⁴ Jay Ritter, A List of IPOs from 1975-2020 With Multiple Share Classes Outstanding (2020), available at <https://site.warrington.ufl.edu/ritter/ipo-data/>. The list used for constructing the sample was downloaded on in October 2021.

aimed at preserving the insiders' control (or influence) on the company. However, multi-class structures are also used for other purposes, including tax and regulatory reasons, sometimes only for a short transitory period.

To this end, I excluded: (a) multi-class structures with equal voting rights; (b) multi-class structures in which low-vote shares had privileged dividend rights; (c) so-called "Up-C" structures in which the unequal voting rights at the level of the publicly-traded issuer are part of a more complex, multi-company structure designed for tax reasons;⁴⁵ (d) multi-class structures in which public investors receive high-vote shares (often because some pre-IPO shareholders may not exercise voting rights, or more than a certain number of voting rights, for regulatory reasons); (e) multi-class structures in which high-vote stock has superior voting rights only on specific matters (typically, a charter amendment) but not on the election of directors; (f) dual class structures mentioning the possibility of a subsequent spin-off or split-off, if the spin-off or split-off occurred within three years of the IPO.⁴⁶

⁴⁵ In an "Up-C" structure, a holding company goes public with an unequal voting structure, but the voting inequality often disappears when one considers the combination of cash flow rights and voting rights in the holding company and in the subsidiary partnership or limited liability company. *See, e.g.,* Joshua Ford Bonnie & John C. Hart, *The "Up-C" Structure: A Primer on Employing the Umbrella Partnership-C-Corporation Structure in an IPO* (Jan. 19, 2016), available at <https://www.stblaw.com/docs/default-source/related-link-pdfs/up-c-slides.pdf?sfvrsn=6>. In some Up-C IPOs examined for the construction of the dataset, there is also some voting asymmetry even after taking into account the combined equity interest in the holding and the operating subsidiary. However, given the peculiarity of these structures, I decided to exclude them from the final dataset. In any event, they would constitute a very small fraction of the total and they do not show major differences compared to the most common dual-class structure found among regular IPOs.

⁴⁶ Some charters mention the possibility of a spin-off or split-off, that is, the distribution of the company stock owned by its parent corporation to the shareholders of the latter. The parent company (controller) chooses a dual-class structure, but in many of these cases it plans to relinquish control shortly after the IPO, upon completion of the aforesaid spin-off. In these cases, the dual-class structure does not seem aimed at strengthening the control of the parent company on strategic and managerial issues, but only to facilitate the execution of the spin-off or split-off.

The reason for this type of structure seems to be a statutory requirement that the "distributing" company must own at least 80% of the total voting power of the controlled company, for the spin-off to be tax-free. *See* 26 U.S.C.A. §§ 355 and 358 (West) (requiring, for a tax-free spin-off, that the parent company distributes to its stockholders "an amount of stock in the controlled corporation constituting control" and defining control as "the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation"). Therefore, high-vote shares are issued to the parent company to artificially keep the voting power of the latter above the threshold of 80% until the completion of the spin-off. This goal is occasionally acknowledged by the issuer. In other instances, by contrast, a future spin-off is mentioned only as one of the potential scenarios that the controller envisages for the future. In

The final dataset, so constructed, contains 293 dual class IPOs. For each charter and prospectus, I manually reviewed and coded the provisions affecting voting inequality and information regarding certain company characteristics, pre-IPO shareholders, CEO, and legal advisers. I also collected additional information from CRISP-Compustat, SDC New Issues, and news sources.

2. *Survey and Interviews*

To supplement the quantitative data discussed above, in order to study the real-world dynamics of dual class contracting, I conducted a survey of elite law firm partners and senior lawyers with expertise on dual class IPOs. The survey consisted of multiple-choice questions, open questions, and matrix questions with multiple sub-questions. In the aggregate, survey recipients were asked to answer 137 questions.

The survey was sent to law firm partners, of counsel, senior counsel (and similar senior titles) in the capital markets group of the 9 law firms most represented in my charter dataset as counsel to dual class issuers. The survey was specifically directed at the relatively small number of senior lawyers with expertise on dual class IPOs and therefore screened out those without this expertise.

Of the 502 lawyers initially contacted, 110 responded, and 46 of them said that they had “some” or “significant” expertise on dual class IPOs. The final survey dataset includes the responses of the 37 respondents who completed at least 50% of the survey: 28 respondents answered all 137 questions, 6 respondents answered between 60% and 94% of the questions, and 3 respondents answered between 51% and 57% of the questions.

The final respondents (hereinafter, the survey respondents or just the respondents) are partners, counsel, or senior counsel at 8 different law firms that have worked as issuer law firm in more than two thirds of the dual class IPOs in my dataset over the past decade (2013-2022). The respondents have between 8 and 50 years of experience as IPO lawyers, with an average (and median) of 23 years of experience. The average (median) respondent worked on 13 (7) dual class IPOs, of which 7 (5) IPOs as counsel to the issuer and 5 (2) IPOs as counsel to the underwriters. Given the significant variation in terms of expertise, all

these cases, the dual-class structure might be motivated by the intention to insulate the controller, not to facilitate the spin-off.

In our case, however, we have the benefit of hindsight. We know which parent companies have actually completed a spin-off and canceled the dual-class structure shortly after the IPO and which did not. Thus, I exclude from the analysis those charters that explicitly mention the tax-free distribution of the parent company’s holding to the extent that this distribution has actually occurred within three years of the IPO. Although highly imperfect, this criterion seems better than a qualitative inquiry into the undisclosed intentions of the corporate planners.

responses will be weighted by the total number of dual class IPOs on which the respondent has worked. Hence, when I say that “most” or “the vast majority of” or a certain percentage of the survey respondents gave a certain answer, I will refer to an experience-weighted percentage of respondents.

Finally, to collect more qualitative evidence regarding the process through which market actors make certain choices in dual class charters, I conducted follow-up interviews with 10 survey respondents from 6 different law firms. Each interview was conducted on Zoom and lasted approximately 30-40 minutes. In a few cases, the interview was followed by some follow-up questions and answers by email.

All interview respondents have expertise on dual class IPOs. However, to give more context to their comments, I will refer to respondents with above-median experience as “experienced,” and respondents with experience above the top quartile as “very experienced.” All the participants in the survey and the interviews, as well as their law firms, will remain anonymous.

II. VOTING INEQUALITY IN DUAL CLASS STRUCTURES

In this Part, I will examine the variation in voting inequality across my sample of 293 dual class charters and across time. Section A explains how dual class charters regulate voting inequality. Sections B and C examine degree and duration of voting inequality, in the sample and across time.

A. Dual Class Features

Many provisions of dual class charters deal with the voting rights of shareholders. In particular, I have identified nine contractual mechanisms (consisting of one or more charter provisions) that affect voting inequality.⁴⁷ They all contribute to the particular design of each company’s dual class structure.

Each of these mechanisms can be set up in different ways. For example, one mechanism is the authorization and issuance of multiple classes of shares with different voting rights. Most companies issue two classes of shares, but others issue three or more. Another example is the right of high-vote shareholders to transfer their high-vote power to third parties (which affects the duration of voting inequality). Most charters authorize high-vote shareholders to transfer their high-vote power only to affiliated entities or family members, but some charters authorize the transfer to unrelated buyers, and others prohibit the

⁴⁷ The dual-class mechanisms discussed here are largely consistent with what Professor Winden and Professors Bebchuk & Kastiel found in smaller samples. See Winden, *supra* note 11, at 863-886; Bebchuk & Kastiel, *supra* note 11, at 1474-1487.

transfer even when it is in favor of family members. For economy of exposition, I will refer to the specific way each mechanism is set up as a “feature” of that particular dual class structure.

(a) *Classes of common stock.* As explained above, dual class structures can have two or more classes of common stock. While most charters authorize two different classes of stock with different voting rights, some charters authorize three or more classes of stock.⁴⁸ In particular, the degree of voting inequality is affected by the presence of authorized but unissued no-vote shares, which if issued would dilute high-vote shareholders’ ownership rights but not their voting rights, thus increasing the size of the control lock. Warby Parker, for example, has a voting ratio of 10 (corresponding to a 9.09% control lock), but also 150 million authorized no-vote shares. This means that Warby Parker controllers can issue no-vote shares and keep a 50% voting power with less than 9.09% of common stock. (More precisely, they can reduce their participation down to 3.87%).

(b) *Voting ratio.* It is the ratio between the number of votes per share attached to high-vote shares and the number of votes per share attached to low-vote shares.⁴⁹ CarGurus, for example, has a voting ratio of 10 (high-vote shares have 10 votes per share, whereas low-vote shares have 1 vote per share). AirBnB, by contrast, has a voting ratio of 20 (high-vote shares have 20 votes per share, whereas low-vote shares have 1 vote per share). Other things being equal, a voting ratio of 10 corresponds to a control lock of 9.1% (high-vote shareholders can have 50% of the votes with 9.09% of common stock), whereas a voting ratio of 20 corresponds to a control lock of 4.76%. When the low-vote shares have no voting rights, the voting power differential is virtually infinite. In some cases, voting inequality does not derive from different voting rights per share but from

⁴⁸ In some cases, the classes of common stock are formally more than two, but the various high-vote classes are effectively sub-classes with identical rights. SAIC, Inc., for example, has two classes of common stock—Common Stock and Class A Preferred Stock (which, despite the name, has the same economic rights as the Common Stock class and therefore I consider common stock)—but the Class A Preferred Stock is in turn divided into four different “series”: Series A-1 Preferred Stock, Series A-2 Preferred Stock, Series A-3 Preferred Stock, and Series A-4 Preferred Stock. All four series of high-vote stock have the same voting power, namely ten votes per share; therefore, I consider them (and other structures of similar kind) as two-class structures.

⁴⁹ When there are three or more classes of shares, I measure the voting ratio of the highest-vote class to the lowest-vote class. There are some exceptions, where the third or fourth class of stock is clearly meant for a very limited and special use and therefore I exclude them from the calculation of the voting ratio. In the IPO of Nexstar Broadcasting Group, for example, one-vote shares are issued to public investors, ten-vote shares are kept by pre-IPO owners, and nonvoting shares are given to a banking investor (Banc of America Capital Investors) for regulatory reasons. In this type of cases, I calculate the voting ratio between the ten-vote shares and the one-vote shares, ignoring the special-purpose class.

special voting rights attributed to a class of stock as a whole. In these cases, the voting ratio cannot be computed.

(c) *Ownership-based sunset.* Some charters contain an automatic conversion mechanism whereby all high-vote shares convert into low-vote shares if and when the equity interest of high-vote shareholders falls below a certain threshold. provides for the automatic conversion of all high-vote shares into low-vote shares if and when high-vote shareholders (or specific high-vote shareholders, such as the founders or other key decision makers) cease to hold a minimum fraction of shares or of votes. Such threshold is calculated in different ways. Sometimes it is a fraction of total common stock, other times it is a fraction of total voting rights, or a fraction of the original number of high-vote shares outstanding immediately after the IPO.

Sometimes the ownership-based sunset does not affect the control lock, because the threshold is set at a lower level than the one sufficient to keep 50% voting power. Many times, however, ownership-based sunsets increase the size of the control lock, thus making the structure less unequal. At Internet Brands, for example, a voting ratio of 20 (and no authorized no-vote shares) would normally correspond to a 4.76% control lock, but an ownership-based sunset provides the conversion of the shares into single-class shares if high-vote shares cease to represent at least 20% of common stock. Hence, the control lock is 20%.

(d) *Time-based sunset.* Some charters provide for the winding down of the dual class structure after a certain number of years after the IPO. In these cases, the company will become a single class company after the expiration of the time-based sunset.

(e) *Event-based sunset.* Some dual class structures have a sunset provision linked not to a fixed period of time but to specific events that may happen at an unspecified time in the future, such as the spin-off of the high-vote participation by the parent company or the sale by a private equity controller.

(f) *Death, disability or departure.* Two different types of charter provisions deal with the death, disability, or departure of the founders or key executives from the company. In one type, the whole dual class structure falls apart if the key person dies, becomes unable to do their job, or leaves the company. In the other type, only the high-vote shares owned by the key person convert into low-vote shares in case of death, disability or departure. When applied to founders or controllers, both mechanisms result in a specific kind of event-based sunset.

(g) *Transfer.* Dual class charters usually regulate what happens to the high-vote power when shares are sold or donated to someone else. Some structures allow high-vote shareholders to transfer their superior voting rights to buyers, while other structures limit this possibility only to specific categories of transferees, such as affiliated entities or family members. In some cases, transfer of high-vote power is outright prohibited.

(h) *Voluntary conversion*. Most dual class charters allow high-vote shareholders to convert their own shares into low-vote shares voluntarily.

(i) *Special control rights*. Some dual class charters give high-vote shareholders the power to appoint the majority of directors regardless of their actual voting power. In these cases, voting inequality does not arise from multiple voting rights per share, but from built-in special rights that do not depend on the number of high-vote shares owned.

The control lock (the metric I use in this Article to measure the degree of voting inequality) is affected by four of the dual class mechanisms described above: the *voting ratio*, the presence of authorized but unissued *no-vote shares*, *ownership-based sunsets*, and the *voluntary conversion* of high-vote shares into low-vote shares.⁵⁰ The duration of voting inequality is determined by the combination of *transfer provisions*, *death, disability, and departure provisions*, *event-based sunsets*, and *time-based sunsets*.

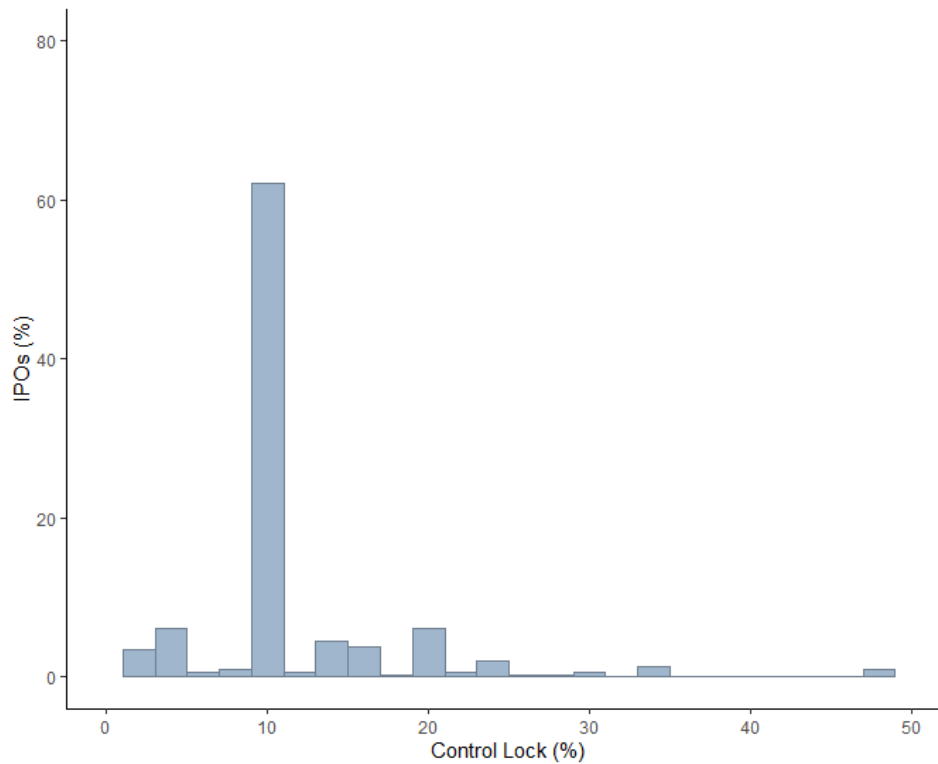
B. Degree of Voting Inequality

1. Across Companies

To examine the variation of voting inequality in the sample, I measured the control lock and duration of voting inequality for each of the 293 dual class structures. Figure 2 reports the distribution of the size of control lock for the entire sample.

⁵⁰ When high-vote shareholders sell shares to third parties, the dilution of their voting power is heavily affected by whether the transferred shares keep or lose their high-vote rights. Voluntary conversion allows a seller, in the absence of a transfer conversion provision, to convert their high-vote shares into low-vote shares right before transferring them, thus reducing the vote dilution effect.

Figure 2. Degree of Voting Inequality



Distribution of the size of the control lock in the sample. The control lock is the smallest percentage of common stock that high-vote shareholders must own in order to have 50% of votes, assuming that high-vote shareholders use all the tools available to them under the charter adopted at IPO.

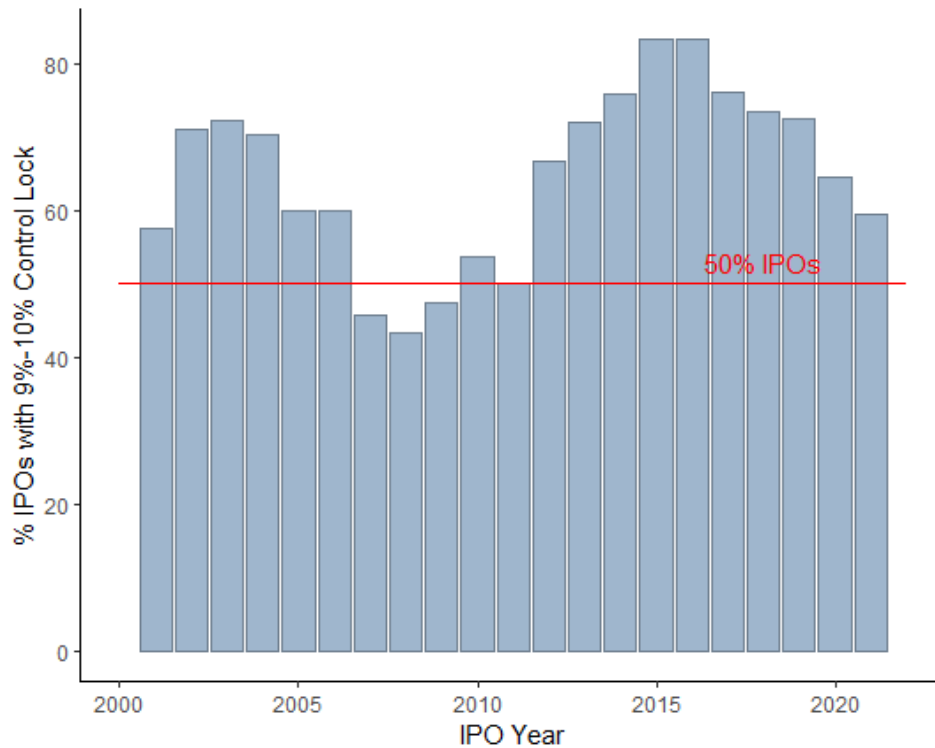
Strikingly, of all possible degrees of voting inequality that insiders and public investors can agree upon, from a control lock of slightly more than 0% up to a control lock of slightly less than 50%, most companies (62%) choose structures with a control lock in the very narrow range between 9% and 10%. Only 15% of companies choose structures with a control lock between 10% and 20%, and less than 7% of companies choose structures with a control lock greater than 20%. There is therefore an unmistakable concentration of contractual choices in a very small segment of the potential spectrum of voting inequality. A very high degree of homogeneity dominates the choice of voting inequality in dual class contracting.

2. Across Time

The 9%-10% control lock dominates dual class charters across the entire sample period. Figure 3 shows that, throughout the 27-year period, a substantial majority of dual-class structures have a 9%-10% control lock, with the only

exception being the period of the 2008-2010 financial crisis, characterized by very few IPOs.

Figure 3. 9%-10% Control Lock across Time



Percentage of dual class IPOs with a control lock between 9%-10% in each year and the four preceding years (5-year moving period). The red line indicates the 50% level on the y axis.

Historical evidence suggests that the 9%-10% control lock has been the “norm” for decades. One empirical study of dual-class recapitalizations between 1976 and 1987 mentions in passing that the dual-class structures in the study sample assigned high-vote shares “one vote per share and/or [the right] to elect a minority of the board of directors” and high-vote shares “ten votes per shares and/or [the right] to elect a majority of the board.”⁵¹ Other articles of the 1980s refers to a voting ratio of 10:1, as the “typical scheme” of dual-class companies.⁵²

⁵¹ Gregg A. Jarrell & Annette B. Poulsen, *Dual-Class Recapitalizations as Antitakeover Mechanisms: The Recent Evidence*, 20 J. FIN. ECON. 129, 136 (1988).

⁵² See, e.g., Louis Lowenstein, *Shareholder Voting Rights: A Response to SEC Rule 19c-4 and to Professor Gilson*, 89 COLUM. L. REV. 979, 989 (1989) (“In a typical scheme... her, the public

As explained in Section A, in the absence of no-vote shares and ownership-based sunsets, a 10:1 voting ratio corresponds to a 9.09% control lock.

3. Individual Characteristics

Interestingly, the size of the control lock does not seem related to some factors that are believed to be connected to the categorical choice between dual class and single class structures. The empirical literature on dual class companies has found that companies with an active founder, family-firms, and larger companies are more likely to choose a dual class structure; and that companies backed by venture capitalists (VCs) and companies with an independent chair are less likely to choose a dual class structure.⁵³ A reasonable explanation for these statistical associations is that founders and family members receive more psychological benefits if the company they founded or the company that belongs to their family remains under their control. Similarly, larger companies and companies with poorer corporate governance (e.g., overlapping roles of CEO and chair) allow controllers to extract more pecuniary private benefits. By contrast, companies with stronger investor oversight (VC backing) tend to limit extraction of private benefits.

However, these characteristics do not seem to be connected to the choice of a specific size of the control lock in my sample. The top panel of Figure 4 reports the coefficients of a linear regression model in which the aforementioned characteristics (active founder, market capitalization, independent chair, and VC backing) are used to predict the size of the control lock. The model includes control variables for IPO year and whether the company is in the tech sector. As the Figure shows, none of the coefficients for the predictor variables is significant at the 5% levels. Furthermore, the sign of the coefficient is not always consistent with the theory. For example, contrary to the expectation that VCs should push, on average, against voting inequality, VC-backed companies seem to have more voting inequality than other companies, even after controlling for the presence of an active founder or tech industry.

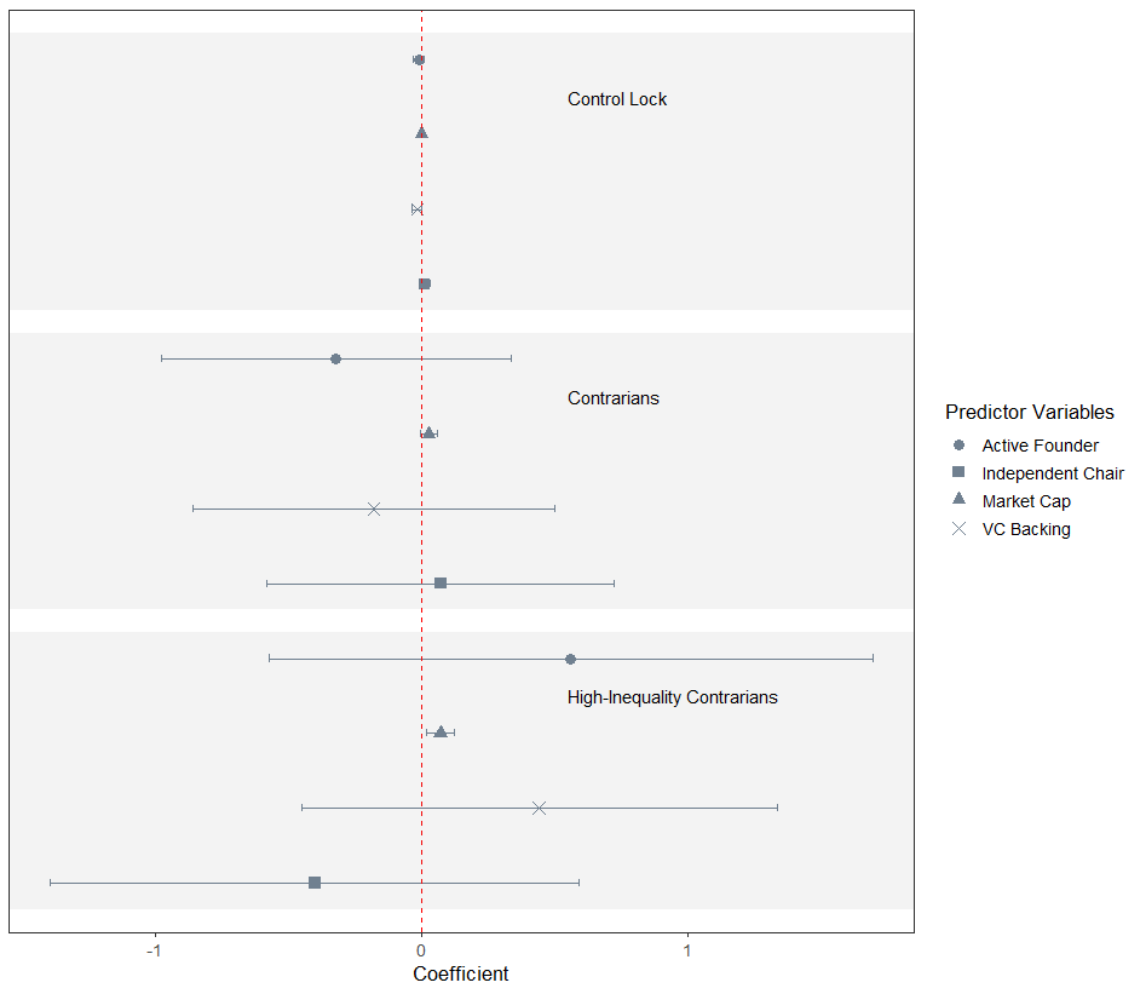
More generally, dual class companies that deviate from the 9%-10% norm (dual class contrarians) do not seem different from dual class companies that stick to the norm (dual class conformists). The middle panel of Figure 4 reports

shareholders wind up with Class A shares, the insiders get Class B shares, and each Class B share has as much as ten times as many votes as a Class A share.”)

⁵³ For the correlation between dual-class structures and family firms and firms with an active founder, see Gompers, Ishii, & Metrick, *supra* note 29. For the correlation between dual-class structures and independent chair, see Laura Casares Field & Jonathan M. Karpoff, *Takeover Defenses of IPO Firms*, 57 J. FIN. 1857 (2002). For the correlation between dual-class structures and size of the firm and venture capital backing, see Scott B. Smart & Chad J. Zutter, *Control as Motivation for Underpricing: A Comparison of Dual and Single class IPOs*, 69 J. FIN. ECON. 85 (2003).

the coefficients of a logistic regression model in which the same predictor variables are used to predict whether a company is a dual class contrarian. Once again, none of the coefficients is statistically significant. One difference emerges if we focus only on the contrarians that choose a lower (i.e., more unequal) control lock. In this case, the size of the company is statistically associated with deviation from the 9%-10% norm. Indeed, these high-inequality contrarians tend to be much larger than the conformists. The bottom panel of Figure 4 reports the relevant coefficients.

Figure 4. Control Lock and Firm Characteristics



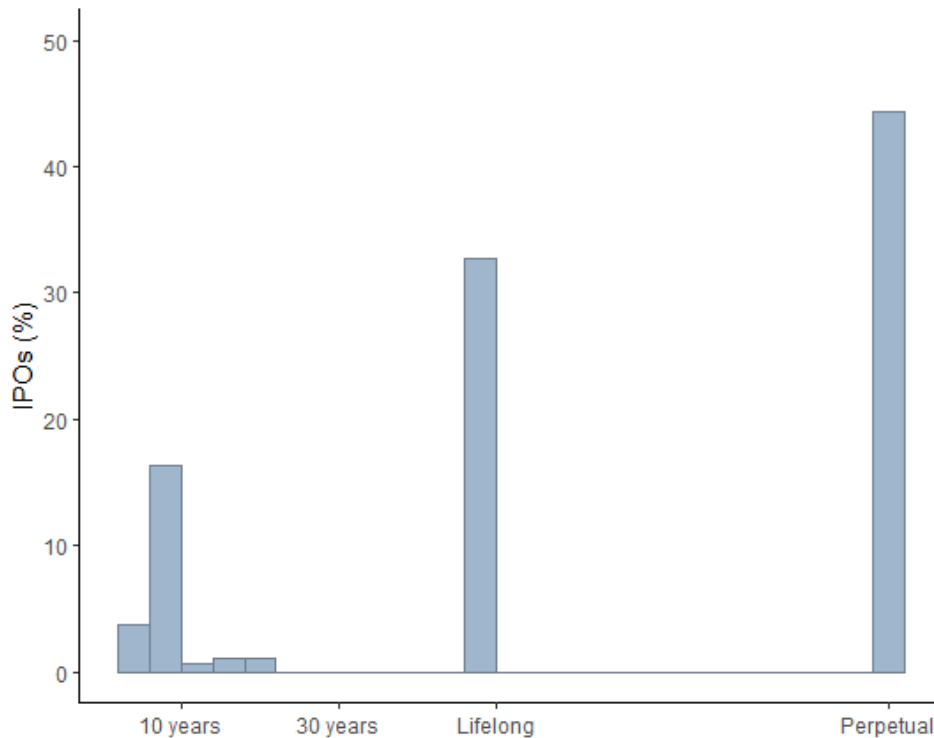
C. Duration of Voting Inequality

1. Across Companies

A similar pattern of convergence on a “norm” can be observed with respect

to the duration of voting inequality. Despite the potentially broad spectrum of customization, the vast majority of dual class structures in the sample (77%) can potentially last for the entire life of the founder or key controller (lifelong duration), or even in perpetuity. Figure 5 reports the relative frequency of different durations of voting inequality.

Figure 5. Duration of Voting Inequality



Distribution of duration of voting inequality in dual class IPOs. Perpetual dual class structures are structures with no time-based sunsets, no conversion upon death, disability or departure, and either (a) the right to transfer high-vote power to family members or third-party buyers; or (b) a corporate controller (excluding private equity firms). Lifelong dual class structures are structures with no time-based sunsets, and either (a) conversion upon death, disability or departure or (b) conversion upon transfer to family members. Time-based structures are structures with a time-based sunset or a private equity controller with an explicit change-of-control conversion clause.

2. Across Time

In this case, however, market practice has changed dramatically over time. Before 2011, more than 96% dual class structures have lifelong (27%) or perpetual (69%) durations. From 2011 onwards, by contrast, the percentage of lifelong or perpetual structures goes down to 58%, and in particular perpetual structures become quite infrequent (21% in the 2011-2022 period, 13% 2021-2022). Figure 6

shows the relevant trends.

Figure 6. Duration of Voting Inequality Across Time



Percentage of dual class IPOs with a lifelong or perpetual duration in each year and the four preceding years (5-year moving period). Perpetual dual class structures are structures with no time-based sunsets, no conversion upon death, disability or departure, and either (a) the right to transfer high-vote power to family members or third-party buyers; or (b) a corporate controller (excluding private equity firms). Lifelong dual class structures are structures with no time-based sunsets, and either (a) conversion upon death, disability or departure or (b) conversion upon transfer to family members.

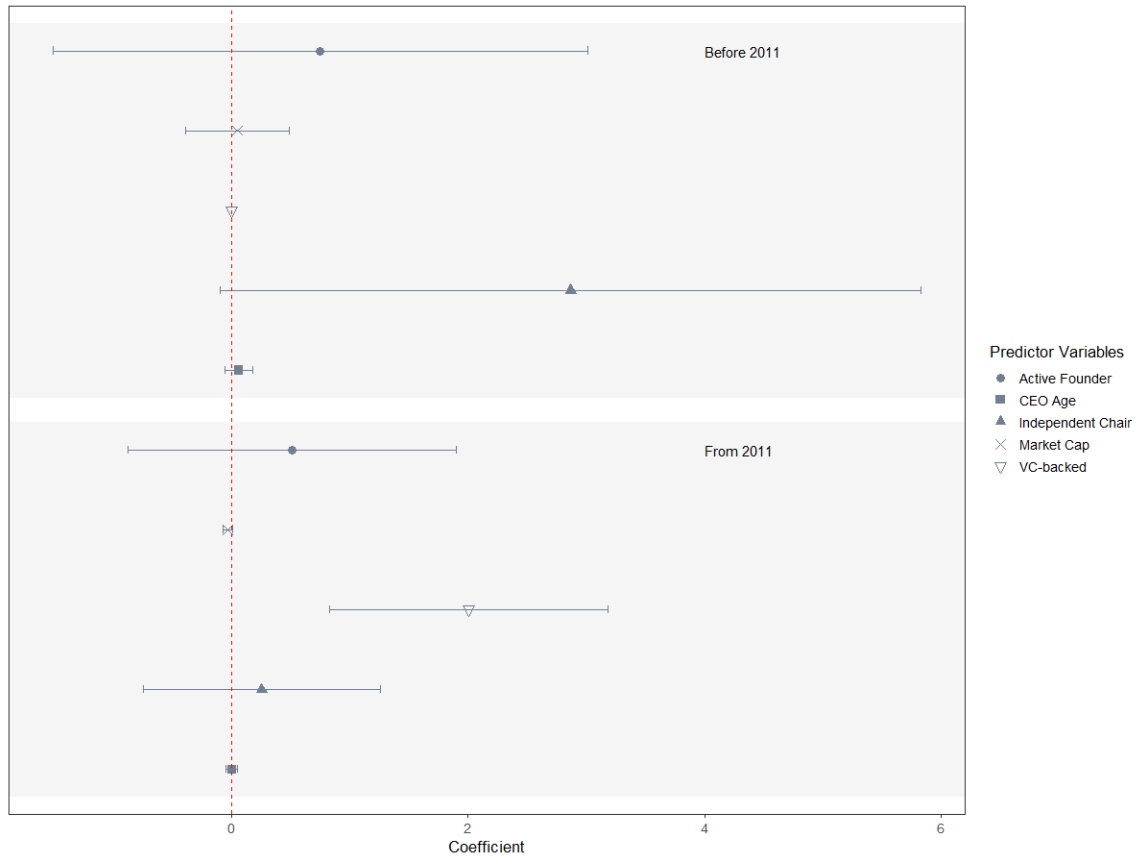
3. Individual Characteristics

Curiously, the decision to adopt a time-limited duration does not seem to be associated with the age of the CEO, even when the CEO is also the founder and the controller of the company. Similarly, the decision does not seem to be associated with the other characteristics that are believed to predict the categorical choice between dual class and single class structures, except for the presence of VCs in the capital.

Before 2011, when lifelong or perpetual structures were the norm, none of the potentially relevant predictors are associated with the (infrequent) choice of a

time-limited structure. After 2011, VC-backed companies are much more likely to choose a time-limited structure.⁵⁴ Figure 7 reports the relevant coefficients.

Figure 7. Duration of Voting Inequality and Firm Characteristics



III. DUAL CLASS CONTRACTING AS SEEN BY IPO LAWYERS

In Part II, we saw that most dual class companies choose similar or identical degrees of voting inequality, that virtually all dual class companies chose lifelong or perpetual structures before 2011 and starting from 2011 such a norm unraveled and perpetual structures have become rare. But what is the process through which these design choices are made? In this Part, I will examine how senior lawyers with expertise in dual class IPOs perceive the process of dual class contracting.

⁵⁴ This finding is consistent with Aggarwal et al., *supra* note 11, at 147.

A. The Players

The IPO pricing process is an intricate exercise where different players, with different information and incentives, interact with each other in an effort to discover the correct price for the stock. According to the standard story, the crucial role is played by the underwriters. The lead underwriter (or investment banker: I will use the latter term, for simplicity) acts as representative of the public investors.⁵⁵ Although insiders and public investors do not negotiate directly, insiders and investment banker do, to some extent. It is the investment banker who is supposed to warn the company against any charter provisions that might negatively affect the IPO price.

Investment bankers plays a triple role—adviser to the issuer, buyer of the new shares, and re-seller to the public.⁵⁶ They have an incentive to set a high price (because its fees are calculated as a fraction of the offer price) but not so high that investors might decide not to buy the stock (because they bear the risk of not being able to re-sell it). They organize the “roadshow,” where corporate managers present their company to the investor community, allocate the offer among interested investors, and price the offer based on the manifestations of interests received.

Other players, however, play a role in the process. Corporate insiders are not a monolith: founders typically have different preferences and goals than VCs; and independent directors, where present, are supposed to have a different set of goals. Lawyers are supposed to perform a merely technical function, by explaining the legal implications of possible options and translating the final choices into legal language; yet we will see that they do not perceive their role in such a narrow way. Finally, investors may provide feedback to the investment banker, thus influencing the design of the dual class charter. In the following Sections, I will examine how senior lawyers perceive and interpret the process leading to the choice of a given dual class structure, and they perceive the role that each of the above actors play in this process.

B. The Process

What does the process leading to a dual class charter look like? According to the respondents, lawyers are the first, most important, and most trusted advisers

⁵⁵ See, e.g. Easterbrook & Fischel, *The Corporate Contract*, *supra* note 16, at 1429 (“[Corporate] contracts are usually negotiated by representatives... investment banks [negotiate] on behalf of equity investors”).

⁵⁶ Richard A. Brealey, Stewart C. Myers, & Franklyn Allen, *PRINCIPLES OF CORPORATE FINANCE* 371 (10th ed. 2011)

to corporate managers during the IPO process. This kind of self-perception may well be biased, of course, but it largely reflects a widespread view of the industry.⁵⁷

Company's managers and the founder (or other key decision makers)⁵⁸ meet with lawyers to understand what the IPO process entails, and which decisions need to be made to make progress. The choice between dual class and single class structure is one such decision; the specific dual class features are other decisions that lawyers discuss first with founder and management, and then with the entire board.

According to the respondents, the decision to go public with a dual class structure, and the levels of voting inequality, rarely change during the process. More precisely, whereas a significant minority of respondents have experienced the decision to abandon an IPO altogether "often" or "sometimes", much fewer have seen companies converting the voting structure from dual class to single class with similar frequency. Furthermore, for the vast majority of respondents dual class charter provisions typically do not change at all or change only "a little" from the first to the final draft of the charter. Figure 9 and Figure 10 report the relevant responses.

Once the company has decided to go public, the investment bankers normally begin conversations with the investor community to assess the interest in the company. During this phase, called in jargon "testing the waters," bankers use materials prepared together with the management and other advisers to present the company and the structure of the IPOs. According to the respondents, these materials might mention that the company will choose a dual class structure but do not typically include information on specific dual class features.

The next stage, the "roadshow," happens after the filing of the preliminary prospectus. According to the respondents, dual class features are not typically presented or discussed in the roadshow. The dual class structure is mentioned, and some key features such as voting ratio and time-based sunsets might be mentioned in some cases, but as long as these key features are "standard," investors would not typically ask questions about dual class features. Similarly, research analysts do not typically ask questions about dual class features.

A draft of the charter adopted at IPO is included in the registration statement as an exhibit. In some cases, it is filed together with the preliminary prospectus; in other cases, it is filed only with an amendment to the preliminary prospectus.

⁵⁷ See, e.g., PWC, ROADMAP FOR AN IPO: A GUIDE TO GOING PUBLIC 70 ("A company's attorney will become the quarterback of the [IPO] process");

⁵⁸ I will generally refer to the "founder" as many dual class companies are founder-led, but the same considerations apply to other key decision makers and controllers.

Some but not all features of the dual class structure are also summarized in the body of the prospectus.

Figure 8. Changes to Dual Class Features During the IPO Process

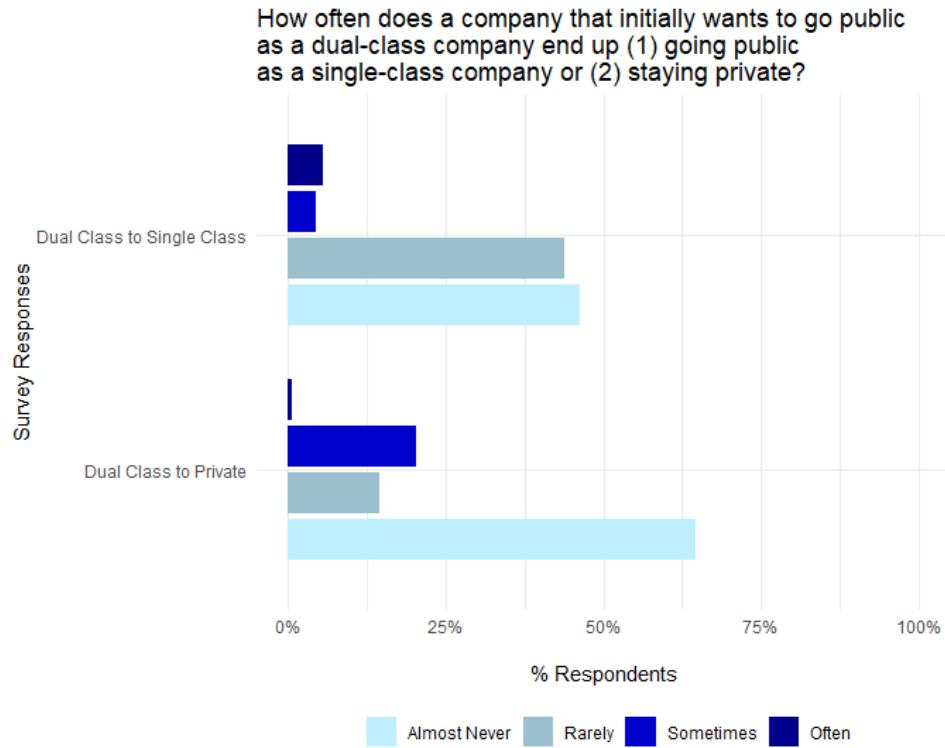
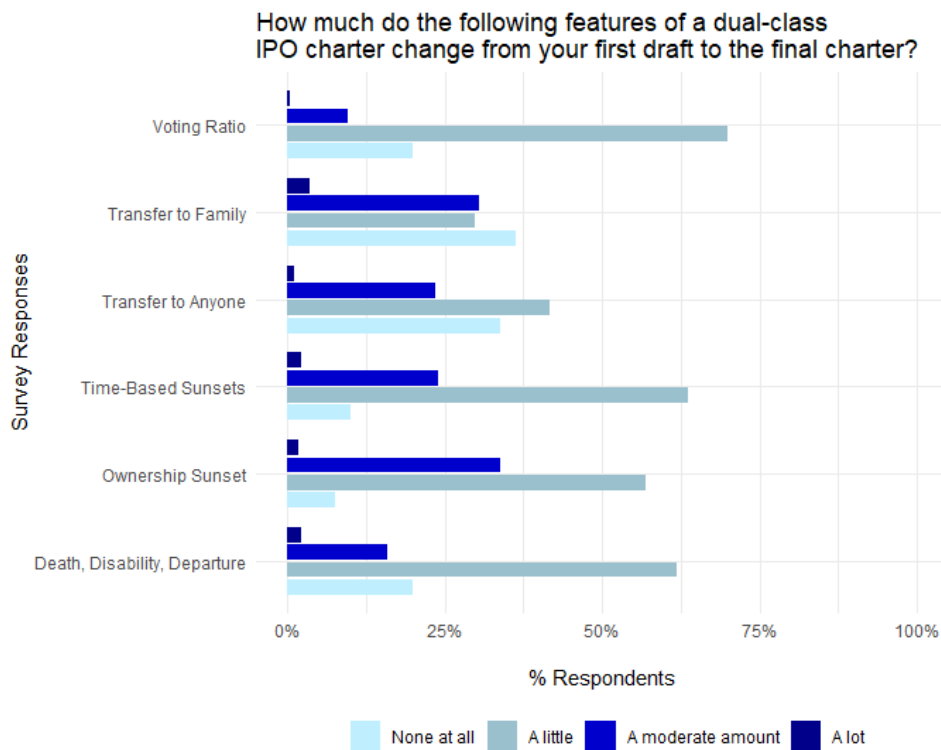


Figure 9. Abandoning a Dual Class Structure

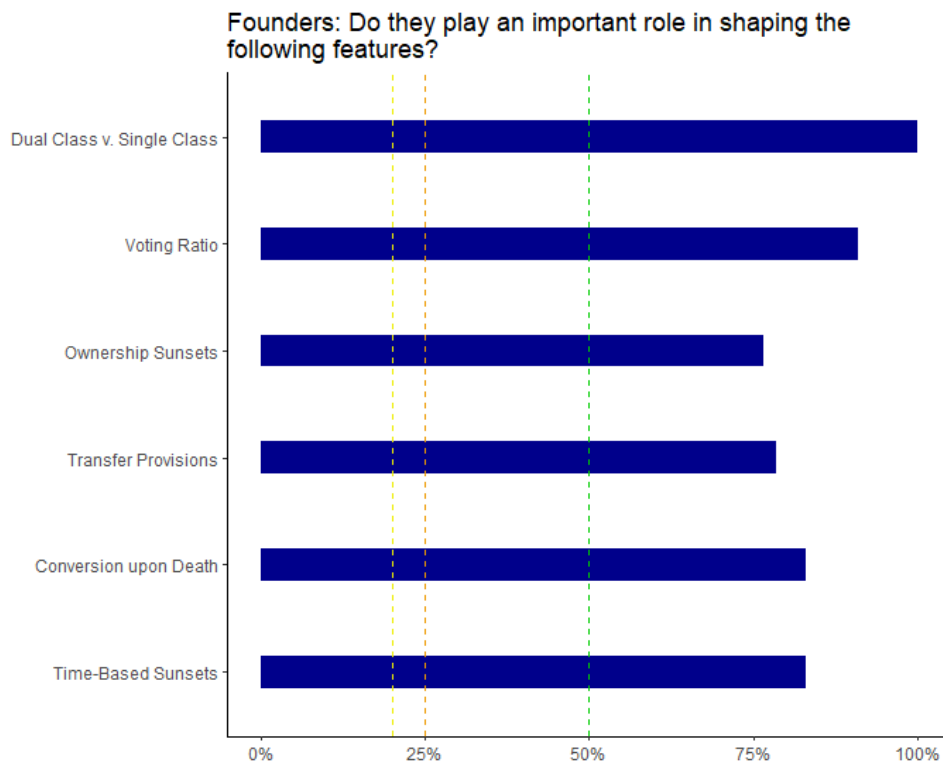


C. The Role of Market Actors

1. Founder

Unsurprisingly, there is universal agreement among respondents that the founder has an important role in shaping the features of the dual class charter. Figure 10 reports the relevant responses. According to interviewees, most founders start with very superficial notions on dual class structures, and they are educated primarily by the lawyers. In some cases, however, founders have learned that other founders have successfully used certain features and want to emulate them.

Figure 10. Role of Founder in Dual Class Design



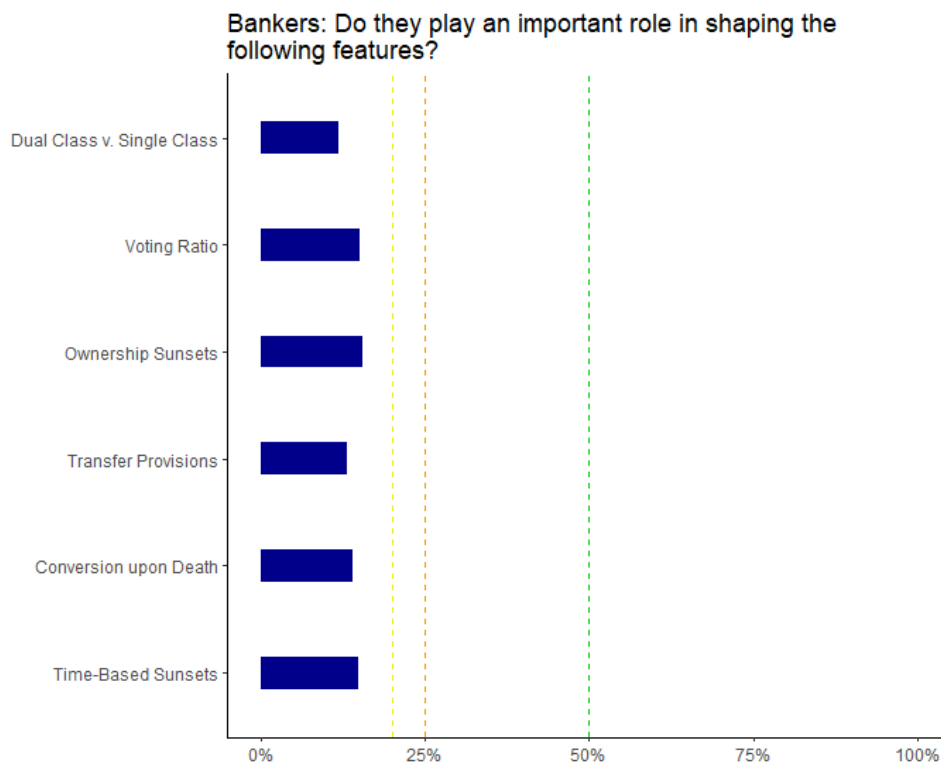
This happens not only with respect to dual class IPOs, but with governance features in general. One experienced lawyer reported, for example, that after the unusually large compensation package that Tesla approved for Elon Musk, many founders inquired about the possibility of replicating similar packages for themselves.

With respect to dual class structures, founders often exchange information with other founders and start-up contacts in their social circle and develop preferences or make final decisions based on this information. In an interesting episode reported by an interviewee, a founder was initially inclined to accept the advice of the lawyers and include a time-based sunset in the charter; then he asked a fellow founder, who led a dual company with a time-based sunset, about the rationale for choosing the specific number of years in his company's sunset. Since the other founder told him that the number of years "was completely random," with no economic rationale, the client of the interviewee decided to exclude a time-based sunset from the charter. As an experienced lawyer put it, the founder community "is a village."

2. Investment Bankers

Contrary to the conventional narrative, respondents believe that the investment banker does not play an important role in the design of the dual class structure. Only 13% of respondents believe that the investment banker has an “important role” in the categorical decision between dual class and single class structure. Similarly, few respondents believe that the investment banker has an important role in determining the voting ratio (17%), ownership-based sunsets (17%), transfer mechanisms (14%), or time-based sunsets (15%). Figure 11 reports the relevant responses.

Figure 11. Role of Bankers in Dual Class Design



According to some interviewees, investment bankers do not have effective tools to push back against the founder’s preferences. As one very experienced lawyer puts it, “the problem with bankers is that they can’t really point to something investors don’t like.” Another very experienced lawyer said that “nobody can ever say whether a dual class feature hurts [the price] or not. Bankers cannot really draw a line.”

One respondent mentioned a case in which the company management asked the banker to “run the price” based on different assumptions, or to model a

“dual class discount,” but the banker could not. The respondent commented that bankers cannot model the price discount of dual class as compared to single class structures, let alone the effect of specific dual class features. Another respondent reported that, in their experience, bankers believe that, as long as the dual class is “normal,” investors are indifferent between dual class and single class.

When it comes to dual class contracting, the banker’s role seems to be, just like the lawyers’ role discussed below, to advise the company to “stick to what’s standard.” But since this “conformization” role has been previously and, according to the lawyers, more effectively performed by the issuer lawyers, the residual role of the banker is relatively modest.

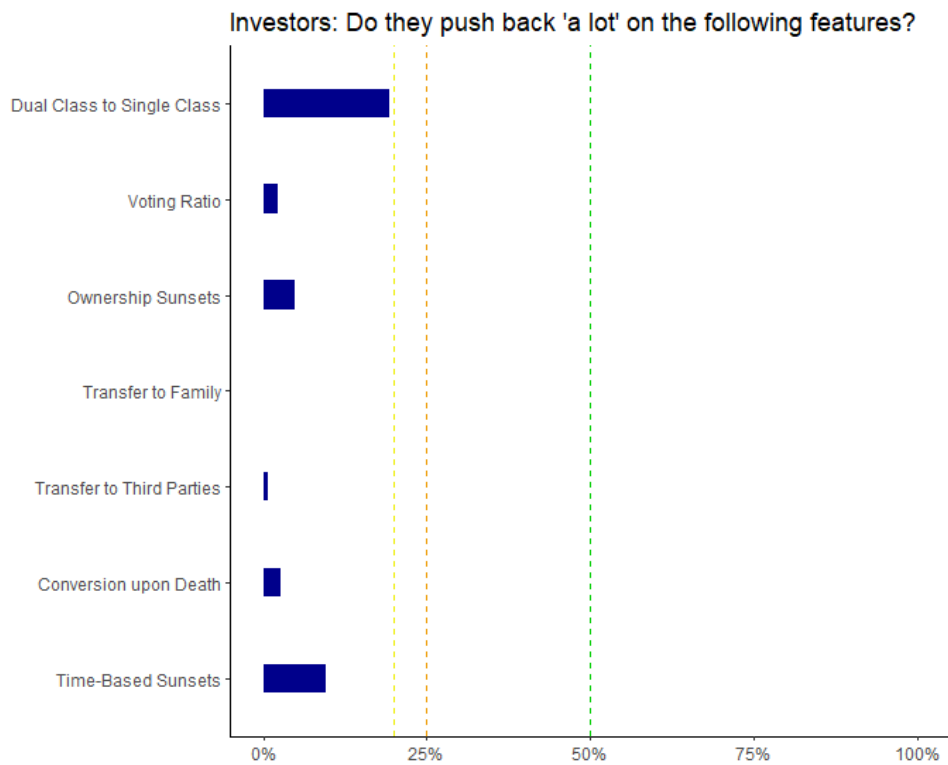
3. *Public investors*

It is not clear whether public investors play any significant role in dual class contracting. According to most survey respondents, they do not. Public investors are believed to play a very modest role in the (infrequent) cases in which the company abandons its plans to go public with a dual class structure and decides instead to go public with a single class structure or to stay private. Furthermore, in the experience of most respondents, the pushback from public investors on dual class features is only “a little” or “a moderate amount,” and for about a third of respondents it is often nonexistent. Less than 13% of respondents report that investor pushback is “a lot.” Figure 12 reports the relevant responses.

Consistent with the hypothesis that some features (such as the voting ratio) are shaped by very strong norms, while other features (those pertaining to duration) are in flux or more sensitive to contracting, only 2% of respondents report significant investor pushback on the voting ratio, whereas 12% report significant investor pushback on time-based sunsets. In any case, however, investor feedback is not perceived to be a major driver of dual class contracting.

The interviews confirm this picture. Respondents have never heard of large investors threatening to pass on an IPO (let alone actually passing on it) because of an aggressive structure. Several experienced lawyers said that they have never heard of dual class features being changed because of investor pushback. One lawyer mentioned one case in which a company was “hammered” during the roadshow and decided to change from dual class to single class structure, but even categorical changes seem to be quite rare.

Figure 12. Role of Public Investors in Dual Class Design



There is an exception, however. One very experienced lawyer reported that some large institutional investors have strong views on standard dual class structures and may pass on one that does not conform to the standard. He reported, however, that all his IPOs have been “middle of the fairway,” and that he has no experience with companies proposing aggressive non-standard structures on the roadshow. Another interviewee drew a distinction between crossover investors, which invest at the private company stage and have repeated interaction with the company during the IPO process and therefore affect structuring choices, and pure public investors, which do not play a significant role.

Consistent with the data showing that perpetual structures have become rare, a respondent reported that “investors push back on transferability to family forever.” According to another respondent, the failed IPO of WeWork attracted a lot of attention to perpetual structures and put a stigma on them. In reality, although in 2019 the press paid unusual attention to the issue of perpetual structures in connection with a speech given by We, Inc.’s founder and CEO Adam Neumann, by that time perpetual structures had already declined significantly. In my sample, perpetual structures represent 69% of the IPOs

between 1996 and 2010, and only 27% between 2011 and 2018 (before the We's IPO failure). It is possible, however, that the WeWork case, as well as the public campaigns by investor groups and experts, have reinforced and supported this trend, thus contributing to the further decline of perpetual structures (which were only 16% of dual class structures between 2020 and 2022).

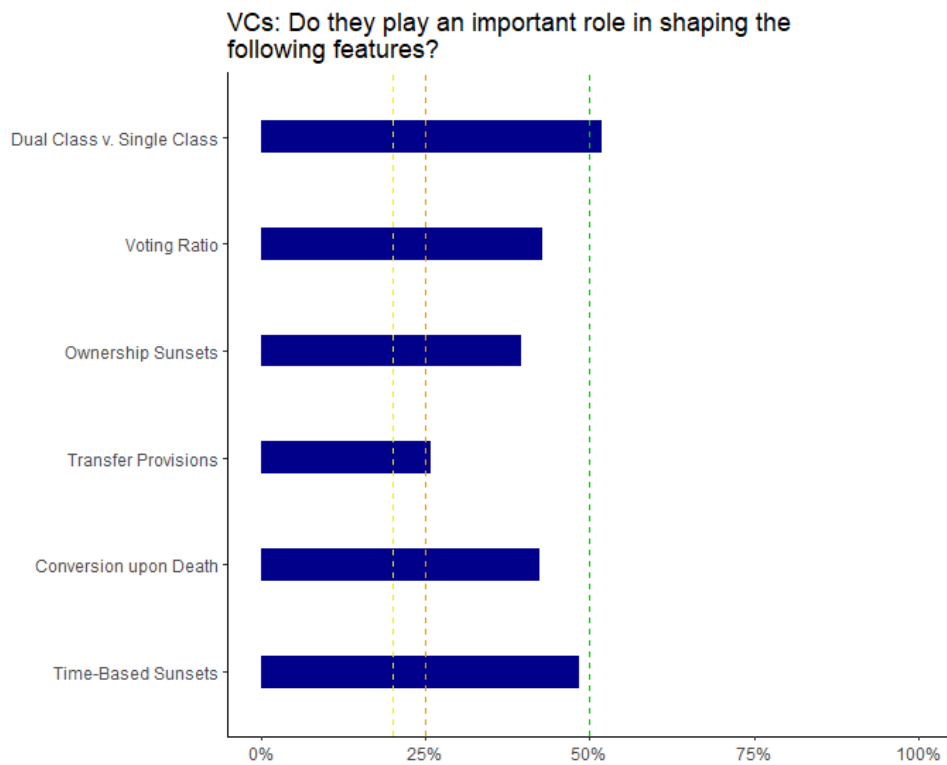
Two very experienced lawyers specifically mentioned that whereas stewardship and governance teams of institutional investors have strong views on dual class structures, portfolio managers do not seem to pay much attention to them. And portfolio managers are those participating in roadshows and interacting with the company and the investment banker. Some dual class features become problematic for portfolio managers only if and when they perceive that they are aggressively non-standard.

4. VCs

Consistent with the conventional narrative, many respondents believe that VCs play an important role in dual class contracting. This perception is stronger, however, with respect to the categorical choice between dual class and single class structures than with respect to the specific features of the dual class structure. Indeed, as shown in Part II, there is no statistical association between VC backing and the size of the control lock, or even the decision to conform or deviate from the norm; there is however, starting from 2011, a statistical association between VC backing and the presence of a time-based sunset.

In the interviews, respondents added that usually VCs and founders do not have pre-existing agreements in place on whether the future IPO will be dual class or single class, let alone on the specific features of a dual class IPO. One very experienced lawyer observed that the business model of VCs is very founder-friendly, and many interview respondents said that they have never experienced significant pushback from VCs on the dual class structure designed by the company and its lawyers, unless it presented non-standard features.

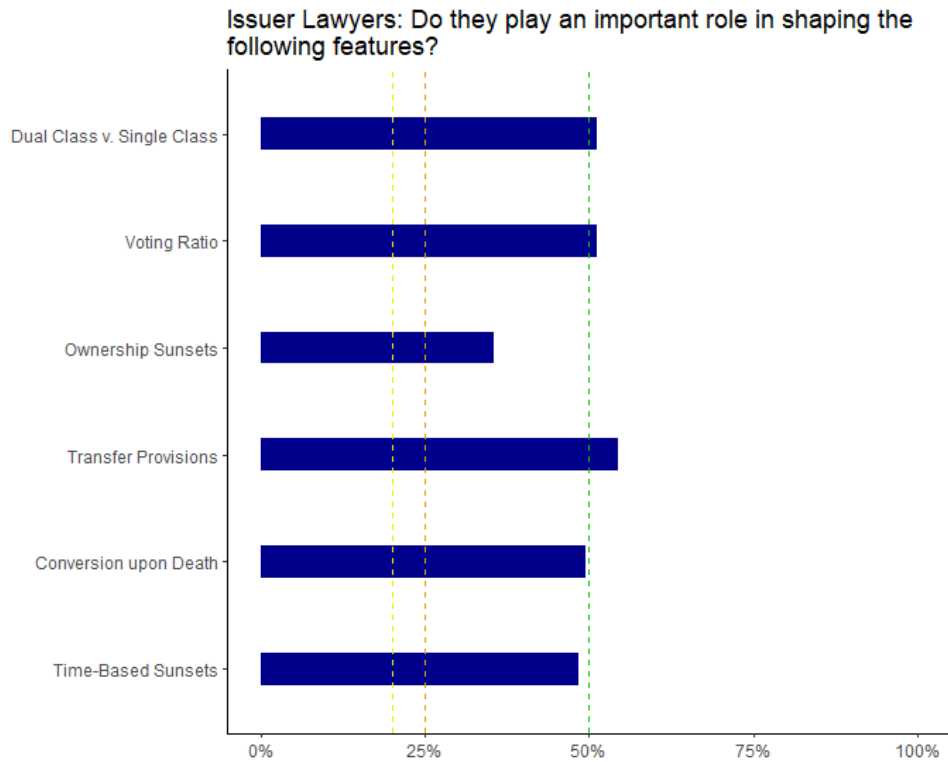
Figure 13. Role of VCs in Dual Class Design



5. Issuer Lawyers

According to the respondents, the most important actors in dual class design after the founder are—surprisingly—the company lawyers. The importance of the issuer lawyers is perceived more strongly than that of VCs. Figure 14 reports the relevant answers. Both respondent working primarily as issuer counsel and respondent working also as, or primarily as, underwriter counsel share this view. Issuer lawyers are perceived as the first and most important filter that pushes against the founder’s idiosyncratic preferences.

Figure 14. Role of Issuer Lawyers in Dual Class Design



Such a widespread belief might seem puzzling, giving that lawyers are commonly thought as merely technical advisers, not negotiators on the substance of corporate arrangements. However, this perception becomes sensible, and in fact quite obvious, when one considers the respondents' narrative, according to which, market norms play a significant role in the shaping of the dual class contract. Lawyers are not only technical advisers, who explain the legal implications of rules and agreements, but also mentors and shepherds, who educate and guide founders and directors through the IPO process, its various stages, the written rules, and the unwritten norms.

Some respondents characterized standard dual class structures using the same golf metaphor ("middle of the fairway") and explained their role as company lawyers as conveying to the company what is standard and what is not and trying to reshape the founder's non-standard preferences into a standard-complying structure. As one very experienced lawyer put it: "If you can't point to a precedent, it's problematic."

The interaction of the lawyers with the founders is perceived by the same lawyers as the main driver of norm-conformity. As one respondent put it, "founders trust [lawyers]... [and] usually the conversation with the lawyers is decisive," with respect to the shape of the dual class structure. One experienced

respondent observed that in many cases the lawyer has advised the founder since the company's formation and is one of the founder's most trusted advisors, who advises the founder also on estate planning matters and other personal issues (with the help of specialists). Another very experienced respondent observed that the responsibility of making the proposed structure consistent with standard practice is shared between issuer lawyers and bankers, "but it's more of a lawyer's job."

A puzzling aspect of the respondents' narrative is that virtually all of them consider norms extremely important, but at the same time most of them believe that the market is unable to price the terms of a dual class charter and deviations from the norm are rarely met with hostility or actual price discount. This attitude raises the question of why market actors care about norms. If investors rarely push back and investment bankers are unable to model the price effect of dual class features, what are advisers (and lawyers in particular) worried about?

Respondents do not have a clear answer. Two respondents, one of them very experienced, mentioned the publication of negative articles by the financial press. As one respondent put it, you do not want to read "on the Wall Street Journal that [your client] is a control freak." Another responded mentioned "downstream market reaction." Another very experienced respondent mentioned the risk of "get[ting] burned." Publicly salient episodes might rapidly evolve into a reputational disaster. As one respondent put it, "investors are like lemmings."

Some respondents also believe that publicly salient episodes create and change market norms.

A plausible interpretation of these and other responses is that the risk lawyers (and bankers) are worried about is not sub-optimal pricing, but that the IPO becomes publicly perceived as a failure and the failure is connected, at least in part, to governance issues and, in particular, to unusual dual class features. In other words, the main preoccupation of lawyers and bankers is not strictly about value-maximization per se, but about a major visible failure. Another way to put it is that deviation from the norm increases the variance of expected outcomes, and lawyers are more risk averse than their clients with respect to IPO outcomes. This explanation is consistent with an agency costs hypothesis and I will discuss it again in Part IV.

Publicly salient episodes are also, according to some respondents, how these norms emerge and evolve. As mentioned above, one very experienced respondent believes (more or less accurately) that perpetual structures have become taboo after the spectacular failure of We's IPO. Another experienced respondent conjectured that the use of conversion mechanisms in case of death of the founder might have been influenced by some salient fact, such as the death of

a superstar founder like Steve Jobs.⁵⁹ Whether or not these beliefs accurately describe reality, it is an interesting fact that dual class norms are considered very important but at the same time are believed to be driven by emotionally salient episodes rather than by careful economic analysis.

IV. WHAT THEORY OF DUAL CLASS CONTRACTING?

The picture emerging from the data analyzed in Part II and from the experience of IPO lawyers reported in Part III is quite clear. Dual class companies may potentially choose a variety of features leading to different levels of voting inequality, yet most of them consistently choose similar or identical degrees of voting inequality, virtually all of them before 2011 chose lifelong or perpetual duration, and starting from 2011 the vast majority of them choose either lifelong structures or time-limited structures with a sunset set after 7-10 years from the IPO. The process leading to these choices leaves little room for customization: issuer lawyers (and to some extent bankers) vigorously and effectively persuade companies to “stick to the norm”; investors do not push back against dual class features, at least so far as they are “standard”; a handful of founders, from time to time, rebel against the “norm” and impose their idiosyncratic preferences.

But how should we reconcile this picture with the theory of the corporate contract? In this Part, I will address this question. First, I will examine the characteristics of dual class contracting through the lens of social norms, as studied by sociologists and social economists; then I will examine in turn a “classic” contractarian model of dual class contracting, and some variants based on the insights of the “modern” contractarian theory.

A. Market Norms in Dual Class Contracting

The decision of most dual class companies to follow some widespread, standard practices rather than choosing tailor-made structures clearly resembles conformity to social norms. In the sense used here, social norms are standard or customary forms of behavior to which individuals in a given group conform.⁶⁰

⁵⁹ Death conversion provisions did indeed become more and more frequent starting from 2011, the year Jobs died. Such an explanation, however, seems highly speculative.

⁶⁰ See, e.g., Mary A. Burke & H. Peyton Young, *Social Norms*, in 1A HANDBOOK OF SOCIAL ECONOMICS 313 (Alberto Bisin et al. eds 2011). There are many different definitions of social norms in the legal and economic literatures. For a discussion of some of this definitional disagreement, see Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338, 350-352 (1997). In particular, many authors distinguish between norms and mere conventions, with only the former being “obligations” (whether because of social sanctions or internalized sense of

Many social norms are backed by social sanctions, such as the norm concerning politeness with co-workers and neighbors.⁶¹ Other norms are accompanied by internalized normative beliefs,⁶² and therefore are often followed even when social sanctions are unlikely, such as the norm against littering in public spaces.⁶³ Some social norms are conventions that solve a coordination problem in an arbitrary way, such as extending the right hand when greeting someone.

Other social norms, however, are mere patterns of behaviors that occur regularly and are therefore expected to occur again. Conformity to these norms is considered “normal” by members of a community, but deviation from the norm is not sanctioned, externally or internally. Cristina Bicchieri, a prominent scholar of the emergence and evolution of norms, call this type of norms “descriptive norms.” She defines them as “a pattern of behavior such that individuals prefer to conform to it on condition that they believe that most people in their reference network conform to it.”⁶⁴

Dual class norms might fit into this category. Conformity to these norms occurs regularly, although deviations are not infrequent. Conformity is considered normal, non-conformity raises questions and attracts attention. Companies feel some significant pressure to conform, although the reasons for doing so are not easily explained.

Indeed, dual class norms seem to possess some characteristics commonly associated with social norms. Drawing from the work of H. Peyton Young on the evolution of social norms, I will focus on three typical characteristics: (1) compression, (2) stickiness, and (3) punctuated equilibrium.⁶⁵

1. Compression

Most dual class companies choose the same level of voting inequality, plausibly despite significant variation in the underlying circumstances. Such a high level of conformity is perhaps the most defining feature of social norms: in the presence of a norm, “individual choices tend to exhibit less variation than

duty). Here, I follow H. Peyton Young in using the term “social norm” in the broadest sense, including social and moral obligations as well as customs and conventions.

⁶¹ See Cristina Bicchieri, Ryan Muldoon & Alessandro Sontuoso, *Social Norms*, in STAN. ENCYC. OF PHIL. (Edward N. Zalta ed. 2018), <https://plato.stanford.edu/archives/win2018/entries/social-norms/>.

⁶² For a discussion of “internalization of norms through habituation,” see for example Richard A. Posner, *Social Norms and the Law: An Economic Approach*, 87 AM. ECON. REV. 365, 366-367 (1997).

⁶³ See Burke & Young, *supra* note 60, at 313.

⁶⁴ Cristina Bicchieri, *Diagnosing Norms*, in NORMS IN THE WILD: HOW TO DIAGNOSE, MEASURE, AND CHANGE SOCIAL NORMS 19 (2017).

⁶⁵ See generally H. Peyton Young, *The Evolution of Social Norms*, 7 ANN. REV. ECON. 359 (2015); Burke & Young, *supra* note 60; H. Peyton Young, *Social Norms*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS 469 (Steven N. Durlauf & Lawrence E. Blume, eds. 2008).

would otherwise be expected.”⁶⁶ In other words, whereas each actor’s cost-benefit analysis would suggest a broader variety of optimal individual choices, conformity to a norm compresses such variety into a much narrower range.

To be sure, we do not know what the baseline level of variation is. It is possible, in theory, that the observed level of variation in dual class contracting is not “compressed” at all. However, the fact that almost two thirds of dual class companies choose the same very narrow range of control lock out of a wide range of possibilities is quite suspicious.

Adding weight to this hypothesis, the 10:1 voting ratio (which is the main determinant of the 9%-10% control lock) is probably the result of an historical accident. From 1926 to the 1980s, the New York Stock Exchange (NYSE) refused to list companies with nonvoting stock and accepted the listing of companies with low-vote shares only on a case-by-case basis.⁶⁷ The principle, as stated in the NYSE listed standards in 1983, was that under normal circumstances shareholder should voting power should be commensurate to their equity stake.⁶⁸ Consequently, dual class listings on the NYSE were an exception.

Starting in the late 1970s, however, other exchanges tried to attract dual class listings. In 1976, the American Exchange (Amex) changed its listing standards to allow the listing of Wang Laboratories, Inc. which had been rejected by the NYSE precisely because of its unequal voting rights. To accommodate the listing of Wang Laboratories, the new Amex policy allowed dual class listings but imposed some restrictions on them, including the requirement that the voting ratio could not be greater than 10:1 (corresponding, in the absence of other relevant charter provisions, to a control lock of 9.09%). Since then, the 10:1 voting ratio has become the standard in dual class companies. Despite no exchange imposes any limits to the degree of voting inequality at IPO anymore, most companies still converge on this focal point.

2. *Stickiness*

Social norms are sticky. They persist over time despite changes in circumstances. This seems true with respect to corporate voting inequality. As discussed in Part II, the market practice of choosing a 9%-10% control lock has been the prevailing one over the entire 27-year period examined, and we have evidence that it might have been the dominant degree of voting inequality for

⁶⁶ Young, *The Evolution of Social Norms*, *supra* note 65, at 364.

⁶⁷ See Seligman, *supra* note 21, at 689-690.

⁶⁸ See NYSE Listing Company Manual § 313.00, as reported in Seligman, *supra* note 21, at 700, fn. 79 (“the Exchange is of the view that any allocation of voting power under normal conditions to classes of stock other than common stock should be in reasonable relationship to the equity interests of such classes”).

decades. Even with respect to the duration of voting inequality, which has changed dramatically over time, we can easily identify a pre-2011 period, during which virtually all dual class structures were lifelong or perpetual structures, and a 2011-2022 period during which perpetual structures have progressively disappeared and sunsets have become more and more common.

To be sure, these changes might be driven by specific characteristics of the companies, and to some extent, they probably are. But the magnitude of both persistence and transformation is puzzling and the widespread perception among experienced lawyers is that dual class norms apply generally to all dual class companies.

3. *Punctuated Equilibrium*

The literature on social norms has observed that when change happens, it typically does so with a rapid rather than an incremental transition. In his seminal work on focal points and convergent expectations, Thomas Schelling observed that players' expectations sometimes shift from one focal point to another, suddenly, as a result of an incident, mutually perceived signals, or "tipping," that is, the crossing of some threshold that ignites "explosively convergent expectations."⁶⁹ When this happens, the evolution of norms presents long periods of stasis followed by periods of rapid change. Some authors, borrowing from evolutionary biology, call this phenomenon a "punctuated equilibrium."⁷⁰

By contrast, there is no reason to expect a punctuated equilibrium in individualized contracting. When parties make tailor-made contracts, they adapt the terms of the contract to their circumstances and preferences, not to some external focal points; consequently, the main driver of change is the specific characteristics of the deal and of the parties, not what other players are doing or expect others to do.

In dual class contracting, we observe two phenomena that closely resemble punctuated equilibria. Figure 15 shows the explosion of dual class IPOs in the tech sector, starting in the 2010s. From the late 1990s to the mid-2000s, dual class IPOs were not very common in the tech sector; in fact, non-tech companies were

⁶⁹ THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* 90-91 (1960).

⁷⁰ See Young, *The Evolution of Social Norms*, *supra* note 60, at 363-364. For the original use in biology, see STEPHEN JAY GOULD, *PUNCTUATED EQUILIBRIUM* (2007). The concept has been widely used in social theory. See Kathleen Thelen, *Institutional Change in Advanced Political Economies*, 47 *BRITISH J. IND. REL.* 471, 474 (2009) ("In the historical institutionalist literature, one sees this in the language of 'critical junctures' (or choice points) that occur in the past, and the historical trajectories that flow from the legacies they produce. Much of this work emphasizes long stretches of institutional stability, periodically interrupted by episodes of relatively rapid innovation.").

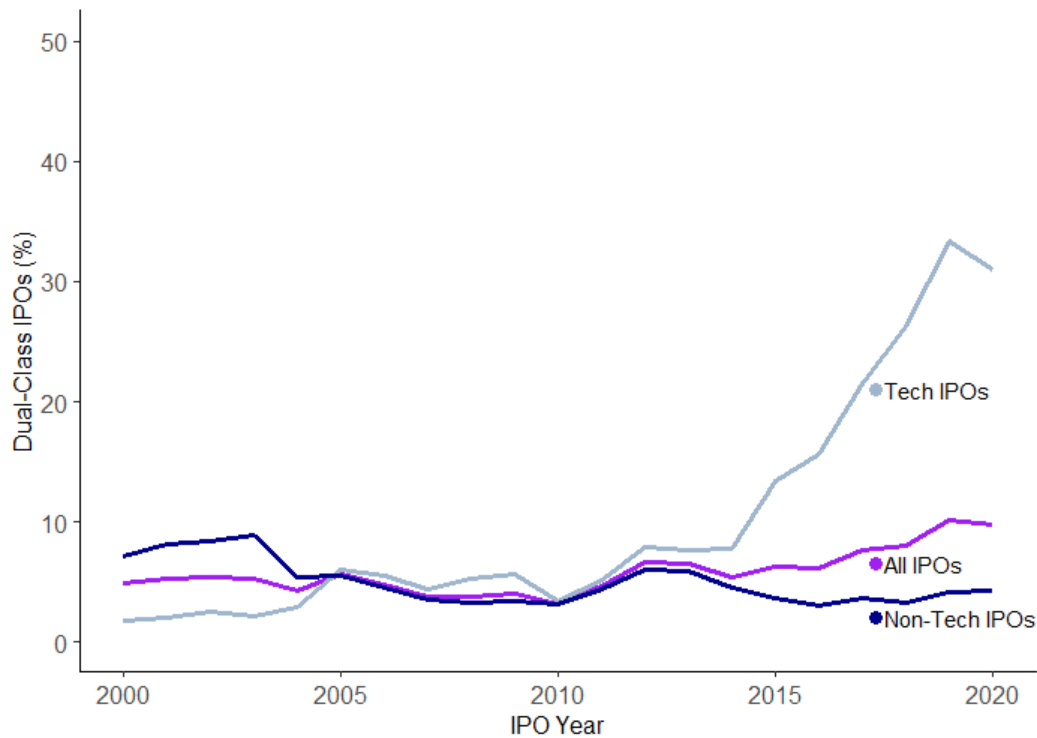
more likely to choose a dual class structure than tech companies. When Google chose a dual class structure in its 2004 IPO, its founders felt the need to explain to the market such an unusual choice:

While this structure is unusual for technology companies, it is common in the media business and has had a profound importance there. The New York Times Company, the Washington Post Company and Dow Jones, the publisher of The Wall Street Journal, all have similar dual class ownership structures... We understand some investors do not favor dual class structures. We have considered this point of view carefully, and we have not made our decision lightly. We are convinced that everyone associated with Google—including new investors—will benefit from this structure.⁷¹

After Google's IPO and until 2010, however, the trend of tech dual class IPOs continues to be flat: now tech companies are roughly as likely as non-tech companies to choose a dual class structure, but dual class structure are still uncommon. Things change abruptly in the 2010s. An increasing number of tech companies choose dual class structures to go public, whereas non-tech companies stick to the previous pattern. At the end of the sample period, one third of tech IPOs are dual class.

⁷¹ Google, Inc., IPO Prospectus 30 (Aug. 18, 2004).

Figure 15. Dual class IPOs in the Tech Sector and in Other Sectors



Percentage of IPOs that have a dual-class structure rather than a single-class structure (5-year moving period) for tech companies (gray line), non-tech companies (blue line), and all companies (purple line).

The other phenomenon resembling a punctuated equilibrium is the decline of perpetual structures after a long equilibrium in which perpetual structures were widespread. Figure 6 and Section II.C.2 discuss this phenomenon. Here too there is a long stasis and then a dramatic change, which is exactly what a punctuated equilibrium looks like.

We can only speculate on what prompted such significant innovations. With respect to the rise of dual class IPOs in the tech sector, Google and Facebook are plausible candidates as “norm innovators.”⁷² However, the possibility that in those years tech companies changed and this change caused them to choose dual class structures more frequently cannot be ruled out.

With respect to the decline of perpetual structures, it is possible that some innovators successfully changed the existing market practice. A plausible “norm innovation” story must include the role of the Council of Institutional Investors

⁷² See, e.g., Fisch & Solomon, *The Problem of Sunsets*, *supra* note 9, at 1067 (“Google opened the floodgates, and thereafter, dual class stock has become a norm for technology companies.”).

(CII), a prominent association of pension funds and other institutional investors, which started a policy campaign against dual class structures and in favor of the “one share, one vote” principle.

Among other things, in 2012, the CII petitioned NYSE and NASDAQ for a rule prohibiting the listing of dual class companies;⁷³ in 2014, it supported several shareholder proposals in favor of voting inequality, including proposals submitted to Cablevision Group, Donegal Group, Facebook, and other companies;⁷⁴ and in 2017, it strongly opposed Snap’s IPO, which adopted an extreme structure by issuing nonvoting shares to public investors.⁷⁵ Around 2017, the CII started focusing its attention on time-based sunsets. In particular, it compiled a list of dual class companies, noting those that adopted time-based sunsets, and it started writing letters to many companies preparing their dual class IPO, in which the CII criticized the choice of a dual class structure, suggested that they included at least a “time-based sunset that eliminates the super-voting shares within five years or less,”⁷⁶ and commended companies that had already included a time-based sunset in their proposed charter.⁷⁷ In 2019, the

⁷³ Letter of Jeff Mahoney, General Counsel, Council of Institutional Investors, to Edward S. Knight, Executive Vice President, NASDAQ OMX Group, Oct. 2, 2012, https://www.cii.org/files/issues_and_advocacy/correspondence/2012/10_02_12_cii_letter_to_nasdaq_dual_class_stock.pdf; Letter of Jeff Mahoney, General Counsel, Council of Institutional Investors, to Claudia Crowley, CEO, NYSE Regulation, Oct. 2, 2012.

⁷⁴ Letter of Ann Yerger, Executive Director, Council of Institutional Investors, to John R. Ryan, Chair, Audit Committee, Cablevision System Corp., Aug. 14, 2014, https://www.cii.org/files/issues_and_advocacy/correspondence/2014/08_20_14_Cablevision_System_s.pdf; Letter of Ann Yerger, Executive Director, Council of Institutional Investors, to Donald H. Nikolaus, Chairman and Chief Executive Officer, Donegal Group, Inc., Aug. 12, 2014, https://www.cii.org/files/issues_and_advocacy/correspondence/2014/08_20_14_Donegal_Group.pdf; Letter of Ann Yerger, Executive Director, Council of Institutional Investors, to Donald E. Graham, Lead Independent Director, Facebook, Inc., Aug. 12, 2014, https://www.cii.org/files/issues_and_advocacy/correspondence/2014/08_20_14_Facebook.pdf.

⁷⁵ Letter of Kenneth A. Bertsch, Executive Director, Council of Institutional Investors, to Evan Thomas Spiegel, CEO, Snap, Inc., et al., Feb. 7, 2017, https://www.cii.org/files/issues_and_advocacy/correspondence/2017/02_03_17_SNAP_IPO.pdf; Remarks of Ken Bertsch, Executive Director, Council of Institutional Investors, to the SEC Investor Advisory Committee, “Unequal Voting Rights in Common Stock,” Mar. 9, 2017, https://www.cii.org/files/issues_and_advocacy/correspondence/2017/03_09_17_IAC_testimony.pdf.

⁷⁶ See, e.g., Letter of Kenneth A. Bertsch, Executive Director, Council of Institutional Investors, to Ravi Ahuja, Chair, Nominating and Corporate Governance Committee, Roku, Inc., et al., Sept. 12, 2017, https://cii.membershipsoftware.org/files/issues_and_advocacy/correspondence/2017/09_12_17_Letter%20to%20Roku.pdf.

⁷⁷ See, e.g., Letter of Kenneth A. Bertsch, Executive Director, Council of Institutional Investors, to Kevin Hartz, Executive Chairman and Director, Eventbrite, Inc., et al., Aug. 24, 2018, <https://cii.membershipsoftware.org/files/August%202018%20CII%20Letter%20to%20Eventbrite%20on>

CII proposed an amendment of the Delaware General Corporation Law, which would provide that “no multi-class voting structure would be valid for more than seven years after an initial public offering (IPO), a shareholder adoption, or an extension approved by the vote of a majority of outstanding shares of each share class, voting separately, on a one-share, one-vote basis.”⁷⁸

The timing of this campaign tracks quite closely the rise of time-limited structures. Between 2012 and 2015, time-based structures represented about 11% of the total market capitalization of new dual class companies (in 2020 U.S. dollars). Between 2017 and 2020, they represented 49% of the total market capitalization of new dual class companies.⁷⁹

Norm innovation is sometimes spurred by the deliberate action of individual actors. In a 1996 article, Professor Cass Sunstein called these innovators “norm entrepreneurs” and defined them as individuals interested in changing existing norms, who sometimes succeed in creating “norm bandwagons” or “norm cascades”: the phenomenon in which “small shifts lead to large ones.”⁸⁰ Sunstein referred to fundamental norms in social and political structures, but a similar phenomenon can occur in the much narrower and less consequential field of corporate governance. The plausible norm cascades discussed here may well have been initiated or at least accelerated by market norm entrepreneurs, such as Google and Facebook (in the first case) and the CII (in the second case). Other publicly salient episodes, such as the failure of We’s IPO in 2019 (its founder Neumann was caught on camera saying that his grand-grandchildren would control the company) might have contributed to discrediting perpetual structures.

[%20Sunset.pdf](#) (“We therefore applaud Eventbrite for including provisions in its IPO prospectus that provide for a time-based sunset to its dual-class unequal voting structure”).

⁷⁸ Letter of Kenneth A. Bertsch, Executive Director, and Jeff Mahoney, General Counsel, Council of Institutional Investors, to Henry E. Gallagher, Jr, Council Chair, Corporation Law Section of the Delaware State Bar Association, Sept. 13, 2019, https://www.cii.org/files/issues_and_advocacy/correspondence/2019/September%2013%202019%20Final%20DGCL%20letter.pdf.

⁷⁹ Groupon was the first IPO of the “new era,” at the end of 2011. Groupon was the largest U.S. internet IPO since Google, and one of the most anticipated IPO of 2011. See Alistair Barr & Claire Baldwin, *Groupon’s IPO Biggest by U.S. Web Company since Google*, REUTERS.COM, Nov. 4, 2011, <https://www.reuters.com/article/us-groupon/groupons-ipo-biggest-by-u-s-web-company-since-google-idUSTRE7A352020111104>; Shira Ovide, *Five Tech Deals We Want to See in 2011 (and One We Don’t)*, WALL ST. J. ONLINE, Jan. 4, 2011, 3:28 pm ET, <https://www.wsj.com/articles/BL-DLB-30520>.

However, most of the subsequent largest IPOs until 2018, including Facebook (2012), Zoetis (2013), Coty (2013), First Data (2015), Altice (2017), and Switch (2017), still had a lifetime or perpetual duration. In this period, time-based sunsets seem to be chosen mostly by smaller companies. Over time, however, time-based sunsets were increasingly adopted by larger companies.

⁸⁰ Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 909 (1996).

Although the “norm innovation” story is suggestive, we cannot rule out the alternative hypothesis, according to which the dual class companies of the post-2011 period were just different, and time-based sunsets were a better fit for them. Indeed, the unraveling of the “perpetuity” norm largely overlaps with the explosion of dual class structures in the tech sector. Tech companies came to represent an increasingly larger percentage of dual class companies. These are companies that, as just discussed, used to choose single class structures; it is quite possible, therefore, that after Google and Facebook legitimized the use of dual class structures in the tech sector, a larger number of founders who wanted a dual class structure could obtain it more easily, but many of them had to settle for a time-limited one.

B. Classic Contractarian Theory

Even if we accept the diagnosis that what drives uniformity in dual class contract is a phenomenon similar to “social norms,” we still do not know what explains this phenomenon. Descriptive norms are just that: a description of regular patterns. But why would companies and investors choose conformity to norms rather than customization? Is this conformity inefficient? And what is the magnitude of such inefficiency?

If we believe that corporate voting rules are important, these questions deserve careful study. A research agenda for dual class companies should pay them attention. While this Article cannot answer these questions, it can try to situate the “dual class norms” picture emerging from Part II and Part III within the theory of the corporate contract.

Contractarianism is the dominant theory of the corporation.⁸¹ In this view, corporate charters are “contracts” between insiders and investors.⁸² In a competitive capital market, charter provisions are priced based on their effect on shareholder value. Hence, insiders internalize this effect and will propose charter provisions that maximize value for all parties involved (public investors and themselves).⁸³

Voting inequality is one important dimension of IPO charters. Whatever the effect of voting inequality on shareholder value, positive or negative, it will be eventually reflected into the IPO price. This mechanism, contractarians argue,

⁸¹ See, e.g., Anderson, *A Property Theory of Corporate Law*, *supra* note 16, at 1 (“The dominant view of the corporation in legal scholarship is contractarian, one that sees the corporation as a ‘nexus of contracts’ among factors of production”).

⁸² Easterbrook & Fischel, *THE ECONOMIC STRUCTURE OF CORPORATE LAW*, *supra* note 16, at 12.

⁸³ Klausner, *Fact and Fiction*, *supra* note 16, at 1327 (“market forces would lead the parties to create governance arrangements... that would... maximize firm value”).

creates strong incentives for insiders to choose value-maximizing charters.

A plausible corollary of this view is that what is value-maximizing depends on the specific characteristics of the individual company and its managers. Hence, each company will choose the features with the highest inherent value given the specific characteristics of the firm and the controller. As a favorite motto of contractarians puts it, one size does not fit all.⁸⁴

This is a quite accurate summary of what I will call “classic contractarian theory.” To illustrate, suppose that Alpha Inc. must decide whether to go public with a single class structure or with a dual class structure, and the specific circumstances are such that the dual class structure has a net negative effect on the value of the firm. In particular, suppose that Alpha stock is worth \$100 million (or \$100 per share) with a single class structure and \$90 million (or \$90 per share) with a dual class structure. If Alpha proposes a dual class structure and the public investors can price its net negative effect, they will pay only \$90 per share at the IPO. In this scenario, the pre-IPO shareholders (i.e., the insiders) bear the full cost of the dual class structure in terms of stock value, and the public shareholders are not exploited or abused.

But why would Alpha’s insiders choose a dual class structure and bear the corresponding cost of \$10 million? The most plausible reason is that the dual class structure provides insiders with private benefits that they value at least \$10 million. Perhaps insiders enjoy being in charge of the firm they created; they value the social recognition that comes with being the head of a visible company; or they do not like the uncertainty associated with the risk of losing their job. All these benefits associated with control are of a psychological nature. But control may also entail pecuniary private benefits. For example, the insiders might choose to have a compensation higher than optimal; they can make the company buy services from another firm that they own, at a price higher than market price; and so forth. The law addresses all these concerns and often deters the

⁸⁴ See, e.g., John C. Coffee Jr., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, 2021 COLUM. BUS. L. REV. 602, 615 (2021) (“It is traditional to begin any discussion that relies on ‘law and economics’ with the mandatory observation that ‘one size does not fit all.’”); Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 334 (2010) (reporting that opponents of a regulatory proposal on shareholder rights relied on the argument that “one size does not fit all”); Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, 26 REGULATION 26, 29 (2003) (criticizing the director independence standard introduced by the NYSE and the Sarbanes-Oxley Act on the grounds that, in corporate governance, one size does not fit all”); Troy A. Paredes, Comm’r, U.S. Sec. & Exch. Comm’n, Statement at Open Meeting to Propose Amendments Regarding Facilitating Shareholder Director Nominations (May 20, 2009), <https://www.sec.gov/news/speech/2009/spch052009tap.htm> (arguing that “one-size-fits-all mandates are inappropriate for many enterprises,” and the appropriate approach is to allow “the internal affairs of each corporation to be tailored to its own attributes and qualities.”).

most egregious behaviors. Nonetheless, the law cannot realistically reduce these pecuniary benefits down to zero, and a rational self-interested controller would take them into account to some extent.

In the above example, the dual class structure decreases the value of the company by \$10 million, the insiders obtain private benefits that they value at least \$10 million, and the public investors get a “price discount” of \$10 million. All involved parties are getting a fair deal and there is no need for regulatory interference.

As discussed in Part I, however, the allocation of voting rights between insiders and public investors is not a binary choice between single class and dual class structures. Voting inequality is a spectrum and different levels of voting inequality should be expected to produce different effects whatever effects on shareholder value and private benefits.⁸⁵ Thus, the contractarian choice of the optimal voting structure must include the choice of the optimal level of voting inequality.⁸⁶

To examine how companies choose the optimal voting structure in the contractarian model, let us consider the following stylized scenario. An entrepreneur (Founder) owns 100% of the company she founded and now wants to take the company public to fund its further growth, while keeping her job as CEO. After the IPO, the Founder will own 51% of the company and public investors (Investors) will own the remaining 49%. In the following years, the Founder may or may not sell a substantial part of her stock, based on her needs for diversification and other personal considerations.

At the time of the IPO the Founder needs to decide the voting structure for her company. She can choose a traditional, single class structure with voting equality, or she can choose one of many potential levels of voting inequality under a dual class structure. Each of these structures will have different effects on shareholder value and on the Founder’s private benefits. Since the Investors are able to price the positive or negative effects of voting inequality on shareholder value, the Founder will choose the level of voting inequality that maximizes the sum of shareholder value (V) and her own private benefits (B).

To illustrate, suppose that the Founder is considering the dual class structure S_i , in which she can keep a majority of votes with 20% of the shares for her entire life. If there is an alternative voting structure S_k that increases the aggregate value ($V + B$) the Founder has an incentive to choose such alternative structure S_k .

⁸⁵ For an illustration of this aspect, see Bebchuk & Kastiel, *Perils*, *supra* note 11 at 1466-1468.

⁸⁶ See Winden, *supra* note 11, at 909 (“[t]he optimal dual-class capital structure will be driven by the characteristics of a given situation and should be negotiated among the parties prior to an initial public offering.”).

Indeed, if S_k increases shareholder value, the Founder will choose S_k because she will be able to sell shares at IPO at a higher price and her own stock will have a higher value too. If S_k increases her private benefits without harming shareholder value, she will choose S_k because she will be able to increase her own benefits without decreasing the price of the shares. Finally, if S_k decreases shareholder value but increases her private benefits, she will choose S_k if the increase in private benefits is larger than the decrease in shareholder value.

In short, the Founder will choose whichever combination of degree and duration of voting inequality maximizes the aggregate value ($V + B$). Therefore, Founders with different preferences and companies with different characteristics will end up with different voting structures. This is, in more detailed and accurate terms, what the contractarian motto “one size does not fit all” means: that freedom of contract will lead to significant variation of voting structures across companies.

C. *The Problems with the Classic Model*

The evidence discussed in this Article raise some difficult questions for the classic contractarian model. If dual class companies are supposed to choose value-maximizing charter features based on their individual characteristics, why do most companies make similar choices? We do not know, of course, if the “standard” 9%-10% control lock happens to be value-maximizing for a majority of dual class companies, or if lifelong or perpetual structures used to be value-maximizing for virtually all dual class companies until 2011. It would be, however, a curious coincidence. Such striking pattern of conformism, coupled with the fact that variables predicting the categorical choice between dual class and single class do not predict the levels of voting inequality, is highly suspicious.

The previous literature has discussed at length why standardization and low variation in corporate charters are at odds with the classic contractarian model. As observed by Professor Klausner, this phenomenon warrants “at least some rethinking of the contractarian theory.”⁸⁷ Even Klausner, however, considered dual class structures as one of the very few instances of “deliberate contracting... in the drafting of corporate charters.”⁸⁸ This Article has shown that this perception of tailor-made contracting in dual class companies is vastly overstated. When it comes to dual class contracting, one size seems to fit most.

⁸⁷ Klausner, *The Contractarian Theory*, *supra* note 14.

⁸⁸ *Id.*, at 790-791. See also Jill E. Fisch, *Stealth Governance*, *supra* note 15.

D. Modern Contractarian Theories

Since the 1980s, when the classic contractarian theory was proposed by the first generation of law & economics scholars, corporate law scholars have directed their efforts to explaining the apparent anomalies of corporate contracting, including the high level of uniformity among corporate charters. Three richer and more nuanced theories, in particular, are plausible candidates to explain contractual uniformity in general and therefore uniformity in dual class contracting: learning and network externalities, signaling, and agency costs.

1. Learning and Network Externalities

One possible explanation for the high level of uniformity in corporate charters is that the learning and network benefits of choosing a “standard” structure outweigh the benefits of choosing an optimal but non-standard structure. This theory was proposed by Professors Michael Klausner and Marcel Kahan in two influential articles in 1996.⁸⁹

Following their work, we can summarize the main benefits of contractual standardization as follows: (i) *Drafting efficiency*. Drafting complex corporate documents is a difficult and expensive task. Copying an existing formulation is easier than formulating a customized new one. Furthermore, using an existing formulation reduces the risk of errors. (ii) *Judicial precedent*. Standard terms have usually been litigated and tested in court. This might limit uncertainty on their validity and interpretation and provide guidance to their users. (iii) *Familiarity to market actors*. An IPO term commonly used in the past is known to lawyers, investments bankers, accountants, and investors. This reduces advisory expenses (for example, a lawyer can give her advice on a charter provision more rapidly if it is well-known) and facilitates the assessment by investors and security analysts, thus reducing the issuer’s cost of capital. (iv) *Network externalities*. The benefit of standard terms may also derive from the contemporaneous use of those terms by other firms. The more firms use a given term, the more “learning benefits” (in terms of drafting efficiency, judicial precedents, and familiarity to market actors) will accrue in the future.

Do learning and network externalities convincingly explain dual class contracting? The dual class version of this theory would argue that a dual class company may find it rational to use a dual class arrangement with lower inherent value than the optimal “tailor-made” arrangement, if its adoption by

⁸⁹ See Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting. Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L. Q. 347 (1996); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713 (1997).

many firms in the past or the present produce enough compensating benefits in terms of drafting efficiency, legal certainty, familiarity to market actors, and network externalities.

In the case of dual class structures, however, this theory seems much less compelling than in other cases. Dual class companies can very easily alter the degree or duration of voting inequality with very little cost and virtually no risk of ambiguity or legal uncertainty, but in most cases they choose not to do so. For example, ownership-based sunsets are well-known charter provisions, found in almost half of the companies in my sample. A threshold of 25% or 35% is not more expensive to write or to understand or interpret than a threshold of 10%, which most ownership-based sunsets adopt. Yet only three companies in my sample choose a 25% or 35% threshold.

Similarly, almost all dual class charters assign high-vote shareholders multiple voting rights per share. A voting power of five votes per shares is not more expensive to write or to understand or to interpret than a voting power of ten votes per share. There is hardly any risk of misinterpretation: it is just a different number. Yet, 75% of dual class companies choose ten votes per share, and only 4% choose five votes per share.

To be sure, the most common features of dual class structures are indeed more familiar to investors and advisers; therefore, modern contractarians might argue that these more familiar features are more easily priced than unfamiliar features, and that is why adopting them is beneficial. At a closer look, however, this hypothesis assumes that these familiar features produce largely similar effects on different companies. Consider the following example. Companies Alpha and Beta have very different characteristics and they have announced they plan to go public with a single class structure. Potential investors have then examined their characteristics and all the available information and have made their own estimate of the value of the companies. At some point, however, both companies change their mind and announce they will go public with a dual class structure, not a single class structure; therefore, potential investors must now revise their valuation.

If dual class structures have different effects on companies with different characteristics, the fact that the two companies choose the same dual class structure or different dual class structures should not affect the complexity of the new valuation that potential investors must produce. In both cases, investors must estimate the effect of a certain level of voting inequality on a company with certain characteristics. By contrast, if dual class structures have substantially similar effects on most companies, knowing how one particular dual class structure affects most companies will be very helpful to investors, if the companies choose that particular structure. Therefore, if the reason of dual class uniformity is the “familiarity” of market actors with the most common structure,

the underlying explanation is not simply that there are learning and network externalities but also, and more importantly, that one size of voting inequality does fit most companies. The key assumption of contractarianism, as we saw, is the opposite: we should expect that the optimal features for different companies will be different. Therefore, we are back to square one.

2. Signaling

Another plausible candidate to explain uniform behavior is signaling. In signaling models, conformity is a way to convey information that is otherwise difficult to convey. The first important and most famous treatment of signaling in economics is Michael Spence's 1973 paper on job market signaling.⁹⁰ In Spence's model, people acquire education not because education increases their human capital and therefore productivity, but because going through various education cycles and managing to graduate is a costly way to inform potential employers about certain characteristics that they possess (and that they have possessed all along, even before education).

Suppose, for example, that employers value diligent, hard-working, and disciplined employees. These characteristics are easy to mimic during a job interview or even a few weeks or months of actual employment. The employer cannot easily distinguish candidates who possess these characteristics from candidates who do not. However, diligent, hard-working and disciplined candidates can prove that they truly possess these characteristics by going through many years of education and getting the relevant degrees. This is something that they can accomplish, with some substantial but not prohibitive costs, whereas candidates who do not possess those characteristics cannot afford such behavior. By observing the costly signal, employers can now tell who's who with fewer risks.

In corporate finance, signaling models have been used to explain certain managerial decisions, such as issuing dividends, taking on low levels of debt, or issuing new stock.⁹¹ In these models, managers have information that investors

⁹⁰ Michael Spence, *Job Market Signaling*, 87 Q. J. ECON. 355 (1973). Spence's paper is plausibly the first or one of the first signaling models. Interestingly, he feels the need to explain what signaling is, whereas today signaling is a standard topic in any intermediate microeconomics courses. See *id.* at 355 ("The term 'market signaling' is not exactly a part of the well-defined, technical vocabulary of the economist. As a part of the preamble, therefore, I feel I owe the reader a word of explanation about the title").

⁹¹ See Sudipto Bhattacharya, *Imperfect Information, Dividend Policy, and "The Bird in the Hand" Fallacy*, 10 BELL J. ECON. 259 (1979); Stephen A. Ross, *The Determination of Financial Structure: The Incentive-Signalling Approach*, 8 BELL J. ECON. 23 (1977); Stewart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have*, 13 J. FIN. ECON. 187 (1984).

do not have; to credibly “signal” this information to investor, managers engage in some costly behavior that would be much more costly in the absence of the specific characteristics that managers want to convey to investors.

Modern contractarians have used signaling hypotheses to explain the adoption of certain corporate governance features.⁹² With respect to dual class contracting, however, a signaling model should explain what information the founders asymmetrically possess and want to convey to the investors, what is the costly signal used to convey this information, and what is the resulting equilibrium. [To be completed]

3. Agency Problem

A third plausible candidate theory is an agency problem theory, in which contractual uniformity is mostly driven by agents (lawyers, investment bankers, portfolio managers) due to their risk aversion or their asymmetric payoff. A possible version of this theory is that dual class features are harder to price, and therefore agents prefer a structure that is easier to justify within their “reputational community,” even if such structure is suboptimal,⁹³ rather than attempting a potentially value-enhancing but risky customization.

In the social psychology literature, this decision-making strategy is known as “accountability heuristic.”⁹⁴ When making decisions, people often choose the option that is likely to be viewed more favorably by others rather than trying to figure out the truly optimal option and facing disapproval. This strategy can be driven by psychological or sociological mechanisms,⁹⁵ but it may well be an economically rational choice. Indeed, in a dual class IPO, it is plausible that agents capture a relatively small fraction of the benefits of a marginally more efficient charter, but they capture a much larger fraction of the costs of a public IPO failure, especially when the failure follows the choice of a non-standard

⁹² See Michal Barzuza, *Noise Adopters in Corporate Governance*, 2013 COLUM. BUS. L. REV. 627 (2013);

⁹³ See Claire Hill, *Justification Norms Under Uncertainty: A Preliminary Inquiry*, 17 CONN. INS. L. J. 27, 28-29 (2010).

⁹⁴ See Philip E. Tetlock, *Accountability: The Neglected Context of Judgment and Choice*, 7 RES. IN ORG. BEHAVIOR 297, 311-314 (1985) (“The simplest way of coping with accountability is by making decisions that one is reasonably confident will be acceptable to others”). See also Jennifer S. Lerner & Philip E. Tetlock, *Accountability and Social Cognition*, in 1 ENCYC. OF HUM. BEHAV. 3 (Vilayanur Ramachandran ed. 1994) (“the acceptability heuristic [is a] low-effort solution to accountability predicaments...[that occurs when] people simply adopt positions likely to gain the favor of those to whom they feel accountable”).

⁹⁵ See, e.g., Hans L. Zetterberg, *Compliant Actions*, 2 Acta Sociologica 179, 188 (1957) (“The maximization of favorable attitudes from others [is] the counterpart in sociological theory to the maximization of profit in economic theory”).

governance structure. It is similarly plausible that agents are more risk averse than their principals. Both facts are consistent with the agents' incentives to push for a more standard and safer structure, even if its expected value is significantly lower.

An open question remains: why do principals sign off on this strategy? One possibility is that the inefficiency is relatively small; in this case, we should reconsider the importance of corporate voting and of the dual class debate. Another possibility is that the inefficiency is indeed large, but its burden is mostly borne by uninformed and unsophisticated principals, namely the beneficial owners whose savings are in the hands of asset managers. In this case, the policy debate on dual class companies becomes would be even more urgent and important.

CONCLUSION: FROM MERITS TO PROCESS

This Article has presented quantitative and qualitative evidence regarding the variation of voting inequality in dual class companies and has discussed some possible implications for the contractarian theory of dual class companies and the role of "market norms" in dual class contracting. But do these findings have any relevance for the policy debate on dual class companies?

Some observers might be tempted to conclude that since companies and investors do not seem to design dual class structures in a customized way, but mechanically follow arbitrary market norms, the policymaker should step in and regulate corporate voting rights in a way that best protects investors and companies, for example by mandating a "one share, one vote" standard. This might seem consistent with the view that regulation is economically justified when the market fails to produce optimal outcomes on its own.

However, there is no reason to believe that the policymaker is better positioned than market actors to design the optimal voting structure for public companies. Even if it were true that most dual class companies choose sub-optimal voting structures, it does not follow that the policymaker would be able to choose optimal structures in their stead.

In fact, the analysis presented here suggests that the traditional question in the policy debate on dual class companies might be misleading. The key policy question should not be whether and how the policymaker should prohibit or regulate dual class structures, but rather how the policymaker can facilitate tailor-made contracting and innovation. The data suggest that there might be a deficit of customization in voting arrangements; therefore, the main policy goal should be to increase, not decrease the customization of voting arrangements. In

other words, the dual class debate should focus less on the merits of dual class structures and features and more on the process that leads to choice of certain features.

BONUS TRACK: DO ISSUER LAWYERS ACTUALLY AFFECT DUAL CLASS CHARTERS?

As discussed in Section III.C.5, most respondents believe that issuer lawyers play an important role in determining the final charter features. They educate and guide founders and companies through the IPO process and try to reshape their preferences according to standard market practice. Unlike founders and managers, who with few exceptions have little or no previous experience with IPO structures, lawyers are specialized actors who routinely interact with other specialized actors. In my sample, about 35% of all dual class companies were assisted by six law firms, Wilson Sonsini Goodrich & Rosati (WSGR) (8%), Cooley (7%), Latham & Watkins (7%), Fenwick & West (5%), Skadden (4%), and WilmerHale (3%). More recently, the market share of the top three firms have grown dramatically. From 2012 onwards, about 45% of dual class companies were assisted by Cooley, WSGR or Fenwick & West.

One way in which law firms could influence IPO market norms is through repeated interactions. Firms with the most experience are repositories of past market practice, and to the extent that voting inequality structures are influenced by justification norms of the kind analyzed in the previous Sections, law firms are plausibly instrumental in the development and perpetuation of some of these norms.

One way to study this aspect is to examine whether there is any correlation between the most experienced law firms and dual class structures.⁹⁶ Indeed, companies assisted by law firms with no experience in dual class contracting (i.e., appearing only once in my dataset) are more likely to deviate from the standard 9%-10% control lock than other companies, and the difference is statistically significant after controlling for industry, size, and IPO year (p-value = 0.021). Companies assisted by the top six firms are also more likely to follow the recent new trend of time-based sunsets, even after controlling for industry, size, and IPO year, and the difference is statistically significant (p-value=0.001).

Another way in which law firms can create or perpetuate contractual norms is through their practice of drafting new documents on the basis of a contractual precedent or template. Lawyers do not build an IPO charter (or any other document) from scratch. They choose a precedent with which they are familiar, or which they consider of good quality, and they adapt it to the specific case. Compared to conformity to the justification norms discussed so far, conformity to a contractual template is an even more mechanical and unreflective way of tailoring a contractual design to a specific situation.

⁹⁶ An earlier study finding a correlation between law firms and adoption of takeover defenses (including dual-class structures) is Coates, *Explaining Variation*, *supra* note **Error! Bookmark not defined.**

To examine this aspect, I applied standard techniques in computational text analysis to transform each of the 293 charters in my sample into a vector of 3-word strings (3-grams) and then compare all these vectors according to a metric of text similarity called “cosine similarity.”⁹⁷ The analysis identifies six “charter families,” which include dual class charters plausibly descending from the same precedent. Consistent with this hypothesis, Family 1 charters are mostly used by WSGR, Family 2 charters are mostly used by Skadden and Latham, Family 3 are exclusively used by Cooley, Family 4 charters are mostly used by Goodwin, Family 5 charters by Fenwick, and Family 6 charters by WSGR and Cooley.

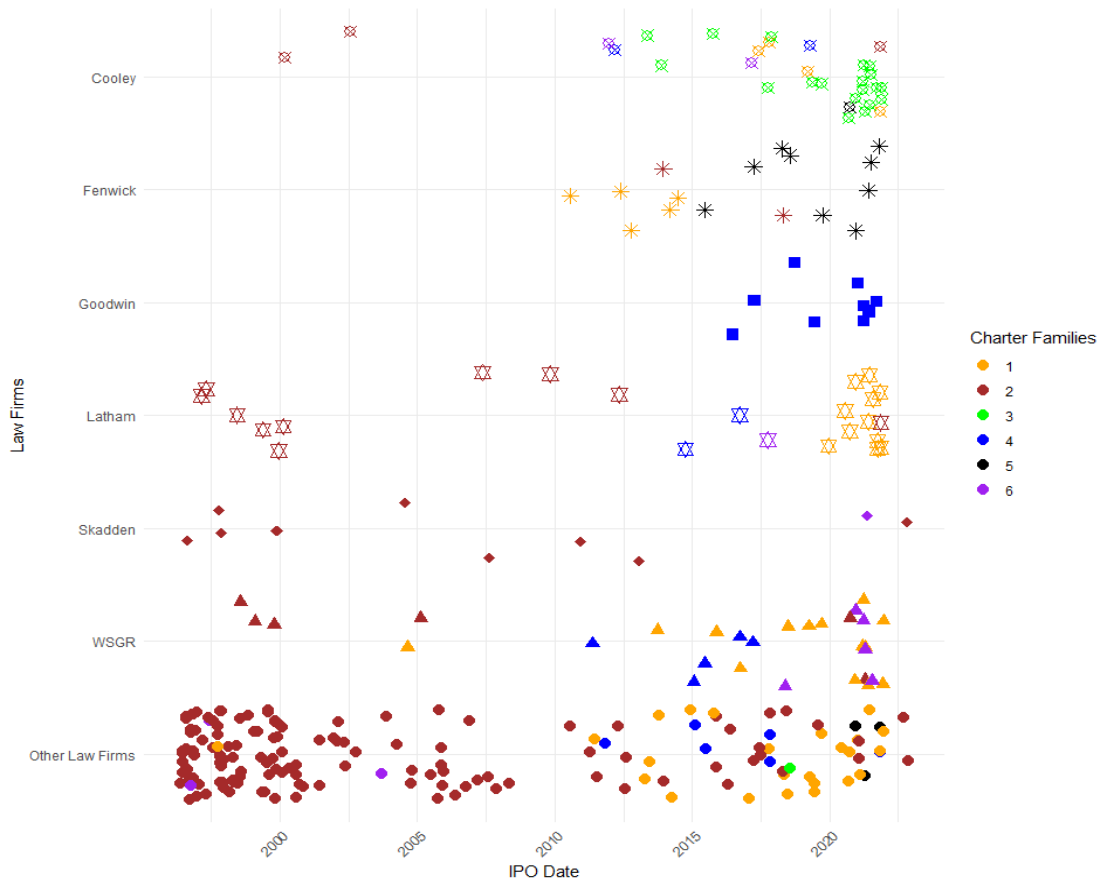
Figure 16 plots the use of charter families by these major law firms across time. As the Figure shows, before 2011, almost all dual-class companies used a Family 2 charter, and most companies were assisted by law firms other than the major six law firms that came to dominate the dual class IPO market in the second half of the sample period. Around 2011, things change. Goodwin, Fenwick, and Cooley emerge as three major players in this area; WSGR and Latham consolidate and expand their influence, whereas Skadden and other law firms lose market share.

As already observed, law firms tend to recycle their own precedents. Survey respondents acknowledge this phenomenon. New precedents, however, tend to travel from one law firm to others. After Google goes public with a Family 1 charter drafted by WSGR, Family 1 charters are adopted by companies assisted by other law firms (First Fenwick, then Cooley and Latham). After LinkedIn goes public with a Family 4 charter drafted by WSGR, Family 4 charters are adopted by other law firms. These two “templates” were very uncommon when these visible and large companies adopted them; afterwards, they spread rapidly.

In other cases, the contagion is limited or nonexistent. Family 5 appears in 2015 with FitBit’s IPO, but the use of this template remains mostly confined to Fenwick. Family 3 appears in 2013 with Tableau Software’s IPO, but Cooley will remain the only user of this template.

⁹⁷ [Explain step by step the methodology to pre-process texts, build tokenized vectors, TF-IDF, dendrogram, clusters etc.]

Figure 16. Law Firms and Charter Families



There is some suggestive evidence that law firms may have influenced not only the “form” (text) but also some substantive features of dual class charters. If true, this would confirm the importance of issuer lawyers in dual class contracting. Figure 17 plots the results of a logistic regression estimating the effect of the issuer law firm on certain important dual class terms.

As the Figure shows, it seems that law firms do have an effect on some dual class features. For example, charters drafted by some law firms (Goodwin, Fenwick) are more likely to have an ownership-based sunset than charters drafted by minor firms; whereas charters drafted by other firms (Cooley) are less likely to have an ownership based sunset than charters drafted by minor firms. Similar effects are found with respect to conversion mechanism in case of death or disability, time-based sunsets, and family transfer provisions. These results are statistically significant even after controlling for size, active founder, VC-backing,

IPO year, and whether the company is in the tech industry.

These results must be interpreted very cautiously. The subsamples analyzed here are very small and idiosyncratic decisions by only a handful of companies can dramatically change these results. The analysis is, however, suggestively consistent with the respondent's narrative that issuer play a significant role in dual class design.

Figure 17. Effect of Law Firms on some Dual class Terms

