

# THE SOCIAL COSTS (AND BENEFITS) OF DUAL-CLASS STOCK

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## THE SOCIAL COSTS (AND BENEFITS) OF DUAL-CLASS STOCK

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*Dual-class stock creates a two-tiered ownership structure that allows new investors to buy a piece of a fast-growing company, with just one catch: they become second-class shareholders who have little or no voting power in the corporation. A rich literature debates whether this arrangement, which cements founder control, is truly optimal for investors. This Article is the first to identify an entirely different type of problem: the structure's social costs.*

*This Article makes three contributions. First, it adds an essential yet missing dimension to the understanding of dual-class stock: the structure's social costs (or negative externalities). Second, it connects the concept of social cost to two developments this century that have supercharged corporate influence on American life: the rise of dual-class technology companies like Google and Facebook and the widened scope of corporate constitutional rights under U.S. Supreme Court caselaw. The interaction of these changes gives two men (at Google) or even just one (at Facebook) a constitutional beachhead from which they can deploy vast corporate resources for personal as well as business ends. The Article then develops a policy playbook that is responsive to these problems yet grounded in a fair assessment of the structure's benefits. These solutions can inform approaches to other externalities of the corporation as well.*

*These contributions are both theoretical and practical in nature. They aim to curb the social costs of dual-class stock (and, optimistically, to nurture its social benefits) while preserving its private appeal to founders and investors.*

## INTRODUCTION

The philosopher Edmund Burke once described the British East India Company as “a state in disguise of a merchant.”<sup>1</sup> In our own time, technology platforms like Google and Facebook<sup>2</sup> are human beings in the guise of corporations—entities whose enormity, ubiquity, and identity as public companies belie the reality that they are legally controlled by just two men, in

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1. ANDREW PHILLIPS & J.C. SHARMAN, *OUTSOURCING EMPIRE: HOW COMPANY-STATES MADE THE MODERN WORLD* 144 (2020).

2. After name changes, Google is officially known as Alphabet Inc. and Facebook as Meta Platforms, Inc. Tracking common usage, however, this Article refers to the companies as Google and Facebook.

the case of Google (Sergey Brin and Larry Page),<sup>3</sup> or a single man, Mark Zuckerberg, at Facebook.<sup>4</sup>

What gives these founders such a tight grip is not mere ownership of a large economic stake (no man owns more than 13% of his company),<sup>5</sup> but the use of a device known as dual-class stock that multiplies their voting power. In the typical such structure, a company issues one class of common stock to founders<sup>6</sup> that gives them extra voting rights, and another to the public that comes with fewer votes or (in the case of Snapchat)<sup>7</sup> none at all.<sup>8</sup> The standard account holds that these structures are a problem for shareholders.<sup>9</sup> This Article argues that they are a problem for us all.

To understand why, it is instructive to consider the controversy that surrounded Henry Ford's decision to build the Ford Motor Company River Rouge factory. The colossus, begun in 1917, was perhaps the most innovative and sophisticated such facility in the world, as well as the largest.<sup>10</sup> Citing its great cost, dissenting shareholders sued to block construction.<sup>11</sup> The litigation confirmed Ford's right to build the factory, but the judicial opinion in the case<sup>12</sup>—which is famous for its statement of corporate purpose<sup>13</sup>—also reveals a basic fact of corporate democracy: Ford the man owned most of the stock in Ford the company and could simply outvote any faction that disagreed with his

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3. Alphabet Inc., Definitive Proxy Statement (Schedule 14A) at 39 (Apr. 21, 2023) (reporting combined total voting power of founders Larry Page and Sergey Brin of 51.3%, with 26.3% for Page and 25% for Brin).

4. Meta Platforms, Inc., Definitive Proxy Statement (Schedule 14A) at 67 (Apr. 14, 2023) (reporting total voting power of founder Mark Zuckerberg as 61.1%).

5. Alphabet Inc., *supra* note 3, at 107 (text of stockholder proposal noting that Google founders Larry Page and Sergey Brin together own less than 12% of the company's equity); Meta Platforms, Inc., *supra* note 4, at 72 (text of stockholder proposal noting that Facebook founder Mark Zuckerberg owns 13% of the company's equity).

6. Sometimes other insiders, such as venture capital firms, are also given access to supervoting shares. Will Gornall & Ilya A. Strebulaev, *Squaring Venture Capital Valuations with Reality*, 135 J. FIN. ECON. 120, 121 (2020). The Article emphasizes founders but its logic is not limited to them.

7. Snapchat is owned by Snap Inc. As with Alphabet and Meta, this Article uses the company's more common name, Snapchat.

8. Snap Inc., Annual Report (Form 10-K) at 44 (Feb. 1, 2023).

9. Rick Fleming, Investor Advocate, Dual-Class Shares: A Recipe for Disaster, Speech at the ICGN Miami Conference (Oct. 15, 2019), in U.S. SEC. & EXCH. COMM'N, SPEECHES AND STATEMENTS (Oct. 15, 2019), <https://www.sec.gov/news/speech/fleming-dual-class-shares-recipe-disaster> [<https://perma.cc/5EL7-9FKQ>].

10. See ALLAN NEVINS & FRANK ERNEST HILL, FORD: EXPANSION AND CHALLENGE 279–99 (1957). See also *Ford Rouge Timeline*, THE HENRY FORD.ORG, <https://www.thehenryford.org/visit/ford-rouge-factory-tour/history-and-timeline/timeline/> [<https://perma.cc/Z8LQ-VU3Y>] (recounting key dates of the factory's construction).

11. See *Dodge v. Ford Motor Co.*, 204 Mich. 459, 474 (1919); see also STEPHEN M. BAINBRIDGE, THE PROFIT MOTIVE: DEFENDING SHAREHOLDER VALUE MAXIMIZATION 27–36 (2023) (recounting the background of the plant and litigation).

12. *Dodge*, 204 Mich. at 507–10 (rejecting effort by minority shareholders to enjoin construction of the River Rouge factory but ordering the payment of certain dividends).

13. See BAINBRIDGE, *supra* note 11; Mark J. Roe, *Dodge v. Ford: What Happened and Why?*, 74 VAND. L. REV. 1755, 1756 (2021).

vision.<sup>14</sup> His ownership of a majority equity stake obviated the need for persuasion.

Today, Henry Ford would not need to own most of the equity in the company he founded in order to implement his vision. Instead, he could dispense with the “one share, one vote” shareholding model in favor of a dual-class structure.<sup>15</sup> In fact, the founder’s descendants use this device to exercise control today: the Ford family owns only about 2% of the automaker’s equity but controls 40% of its voting power.<sup>16</sup> The gap between voting and economic interests at Ford is not extreme among dual-class companies—at Snapchat, the founders control 99% of the votes<sup>17</sup> while owning 9% of its equity<sup>18</sup>—and its implications extend beyond the paradigmatic shareholder–manager relationship of corporate governance, including to constitutional law and individual rights.<sup>19</sup>

By any measure, the importance of dual-class stock is surging. The proportion of initial public offerings (IPOs) that are of founder-controlled companies has increased by over 500% in recent years.<sup>20</sup> Dual-class stock is increasingly common at fast-growing technology firms, including both unicorns (large private companies) and publicly traded giants.<sup>21</sup> When going public, most unicorns—51%—now “have a dual class share structure that allows founders to retain control even after their firms become public.”<sup>22</sup> While only 15% of

14. *Dodge*, 204 Mich. at 504. Controlling shareholders like Henry Ford are “[t]he most common class of controllers.” Dhruv Aggarwal et al., *The Rise of Dual-Class Stock IPOs*, 144 J. FIN. ECON. 122, 127 (2022). Though they enjoy considerable freedom of action, controlling shareholders are subject to certain fiduciary restrictions. See *infra* Parts II & III.B.3.

15. One vote per share was both the norm and the statutory default in the early twentieth century, though corporations did have authority to modify it. Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 ST. JOHN’S L. REV. 863, 891 (1994); Stephen Bainbridge, *Understanding Dual Class Stock Part I: An Historical Perspective*, PROFESSORBAINBRIDGE.COM (Sept. 9, 2017), <https://www.professorbainbridge.com/professorbainbridge.com/2017/09/understanding-dual-class-stock-part-i-an-historical-perspective.html> [<https://perma.cc/9LTY-8XTX>] [hereinafter Bainbridge, *Understanding Dual Class Stock*].

16. Ford Motor Company, Definitive Proxy Statement (Schedule 14A) at 92 (Apr. 1, 2022); Michael Wayland, *Bill Ford Is Doubling Down on Ford Shares, and Quietly Amassing More Control of His Great-Grandfather’s Company in the Process*, CNBC (Jan. 14, 2022), <https://www.cnbc.com/2022/01/14/bill-ford-is-doubling-down-on-ford-shares-and-amassing-more-control-of-the-company.html> [<https://perma.cc/36EB-8NSF>] (also observing that the company’s dual-class structure has been in place since its 1956 IPO).

17. Snap Inc., *supra* note 8, at 44.

18. *Id.* at 139 (reporting 3% and 5.9% figures for Spiegel and Murphy, respectively).

19. Recent caselaw has expanded the scope of corporate constitutional rights, which intersect with the dual-class structure in potentially important ways. See *infra* Part III.B.

20. Aggarwal et al., *supra* note 14, at 124 (reporting that “in 2017-2019, 19 percent of all IPOs were founder-controlled dual-class firms, a significant increase from 3 percent of all IPOs in 1994-2006”).

21. See Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 182 & nn.147, 149 (2019) (discussing industry sources). Unicorns are private companies that have a valuation of one billion dollars or more. *Id.* at 157. Among private companies, dual-class models are rare outside “the highest echelon of unicorns,” where they are “relatively commonplace.” *Id.* at 182.

22. Daria Davydova et al., *The Unicorn Puzzle* 5, (Nat’l Bureau of Econ. Rsch., Working Paper No. 30604, 2022), <https://www.nber.org/papers/w30604> [<https://perma.cc/BNV4-4XWK>].

IPOs in 2020 were of dual-class firms,<sup>23</sup> they accounted for 60% of the value of all companies that went public.<sup>24</sup>

Dual-class stock simultaneously prevents meddling by shareholders and disenfranchises them. One school of thought argues that this turns founders into unaccountable “corporate royalty.”<sup>25</sup> Another argues that it is an efficient mechanism for allocating capital, with the particulars best left to private ordering.<sup>26</sup> A substantial literature has sprung up to debate how to measure and optimize dual-class tradeoffs for investors;<sup>27</sup> one scholar has deemed that challenge “[t]he most important issue in corporate governance today.”<sup>28</sup>

But this body of work, while sophisticated, assumes that the challenges posed by dual-class stock are reducible to a single dimension: the principal–agent problem. That problem has been the central preoccupation of corporate governance scholars for a century.<sup>29</sup> Google’s 2004 IPO and the rise of passive investing around the same time have recently prompted increased interest in dual-class stock—but primarily for its agency costs and benefits.<sup>30</sup>

This Article argues that the most important social challenges of dual-class stock are not contained within the firm but instead overflow its boundaries. It is the first to identify and build an account of the problem of dual-class social costs.

23. COUNCIL OF INST. INVS., DUAL-CLASS IPO SNAPSHOT: 2017-2020 STATISTICS 1, <https://www.cii.org/files/2020%20IPO%20Update%20Graphs%20.pdf> [<https://perma.cc/7UK9-MZVK>] [hereinafter CII, DUAL-CLASS IPO SNAPSHOT: 2017-2020]. These figures are restricted to what the Council of Institutional Investors describes as “traditional IPOs,” i.e., they exclude offerings by foreign private issuers (FPIs), special purpose acquisition companies (SPACs), and real estate investment trusts (REITs). *Id.*

24. *Id.* at 3. During 2021, the share of IPOs with dual-class structures increased by one half (to 22.7%). See COUNCIL OF INST. INVS., NEWLY PUBLIC OPERATING COMPANIES SNAPSHOT: 2021, at 2, [https://www.cii.org/Files/issues\\_and\\_advocacy/Dual%20Class%20post%206-25-19/2022\\_1\\_19%20Dual-Class%20IPO%20Snapshot%202021\\_.pdf](https://www.cii.org/Files/issues_and_advocacy/Dual%20Class%20post%206-25-19/2022_1_19%20Dual-Class%20IPO%20Snapshot%202021_.pdf) [<https://perma.cc/YY5K-SRDY>] [hereinafter CII, NEWLY PUBLIC SNAPSHOT: 2021]. This figure, like its counterparts for 2020, excludes FPIs, SPACs, and REITs. See CII, DUAL-CLASS IPO SNAPSHOT: 2017-2020, *supra* note 23.

25. Robert J. Jackson, Jr., SEC Commissioner, Perpetual Dual-Class Stock: The Case Against Corporate Royalty, Speech to University of California Berkley Law School, in U.S. SEC. & EXCH. COMM’N, SPEECHES AND STATEMENTS (Feb. 15, 2018), <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty> [<https://perma.cc/L389-ZVVA>]; see *infra* Part II.B.

26. See *infra* Part II.B.

27. See *infra* Part II.

28. John C. Coffee, Jr., *Dual Class Stock: The Shades of Sunset*, COLUM. L. SCH. BLUE SKY BLOG (Nov. 19, 2018), <https://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset/> [<https://perma.cc/V64B-PBC8>]; see *infra* Part II.

29. See, e.g., Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811, 1823 (2020); Stephen M. Bainbridge, *Independent Directors and the ALJ Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034, 1034 (1993) [hereinafter Bainbridge, *Independent Directors*]. The classic statement of the problem, known in the corporate context as agency costs, observes that “important decision agents”—such as managers—“do not bear a substantial share of the wealth effects of their decisions.” See Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301 (1983).

30. See *infra* Part II. Mutual funds and other pooled investments with a passive mandate are limited in their capacity to influence management behavior because they cannot exit investments strategically and companies know this.

While dual-class structures can be found in several types of businesses,<sup>31</sup> their prevalence in some of the most influential corporations in modern times suggests a need to account for external consequences. These technology companies, including Google, Facebook, Palantir, Airbnb, Lyft, Snapchat, Zoom, and Slack, have recently been faulted by regulators<sup>32</sup> and scholars<sup>33</sup> for a wide range of concerns, from antitrust and privacy to defamation, misinformation, the housing shortage,<sup>34</sup> and greenhouse gas emissions.<sup>35</sup> That control of these companies is dominated by a tiny number of individuals should heighten concerns around each of these issues. To this extent, the agency costs critique—which seeks to empower dual-class investors to challenge founders<sup>36</sup>—is still relevant. In the dual-class firm, mechanisms that would otherwise give investors influence are moot. But addressing the externalities of dual-class firms requires more than simply amplifying investor voice.

To understand the external or social welfare<sup>37</sup> dimension of dual-class stock, it is useful to first consider its internal rationale, i.e., why the structure exists to begin with. Early in the lifecycle of a company, founders face a dilemma: they need capital to grow but don't want to give up control.<sup>38</sup> Dual-class stock offers a solution: by decoupling voting power from cash-flow rights, it gives investors the economics of ownership while keeping founders in control. This structure would be appealing to most founders, but precisely because of the agency costs it creates, it is unlikely to be available to all founders as a practical matter.<sup>39</sup> The key determinant of availability appears to be the founders' bargaining power at IPO<sup>40</sup>—and in particular, their perceived ability

31. See *infra* Part I.

32. David McCabe & Nico Grant, *U.S. Accuses Google of Abusing Monopoly in Ad Technology*, N.Y. Times (Jan. 24, 2023), <https://www.nytimes.com/2023/01/24/technology/google-ads-lawsuit.html>; Steve Lohr, *To Rein in Big Tech, Europe Looked Beyond Lawsuits. Will the U.S. Follow?* N.Y. Times (Dec. 10, 2022), <https://www.nytimes.com/2022/12/10/business/big-tech-antitrust-rules.html>.

33. See, e.g., Danielle Keats Citron, *Privacy Injunctions*, 71 EMORY L.J. 955 (2022); Lina M. Khan, *The Separation of Platforms and Commerce*, 119 COLUM. L. REV. 973 (2019); MORGAN RICKS ET AL., NETWORKS, PLATFORMS, AND UTILITIES: LAW AND POLICY (2022).

34. See generally LILY M. HOFFMAN & BARBARA SCHMITTER HEISLER, AIRBNB, SHORT-TERM RENTALS AND THE FUTURE OF HOUSING (2020).

35. See, e.g., Jacob W. Ward et al., *Air Pollution, Greenhouse Gas, and Traffic Externality Benefits and Costs of Shifting Private Vehicle Travel to Ridesourcing Services*, 55 ENV. SCI. & TECH. 13174, 13174 (2021) (concluding that “shifting private travel to [ridehailing platforms like Lyft and Uber] increases external costs by 30–35%”).

36. See *infra* Part II.

37. Social welfare “is assumed to be a function of individuals’ well-being, that is, of their utilities.” STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 2 (2004). The social welfare function is also sometimes referred to by economists as a preference aggregation function. See, e.g., MARTIN J. OSBORNE & ARIEL RUBINSTEIN, MODELS IN MICROECONOMIC THEORY 312 (‘She’ ed. 2020) (observing that a preference aggregation function “maps the preferences of the individuals in a society into a single ‘social’ preference relation . . . usually called a social welfare function”).

38. See Pollman, *supra* note 21, at 180.

39. See Aggarwal et al., *supra* note 14, at 123.

40. See *id.* at 124 (“When founders have greater bargaining power . . . they are more likely to be able to negotiate for greater control rights at the time of IPO, and thus, the firm is more likely to adopt a dual-class structure.”); Laura Field & Michelle Lowry, *Bucking the Trend: Why Do IPOs Choose Controversial Governance*

to deliver on an idiosyncratic vision if given the protections of dual-class stock.<sup>41</sup>

The main ingredient venture capital investors say they look for in portfolio companies is the potential for founders to deliver on a vision that has vast economies of scale, achieved by increasing revenue at a far higher rate than costs.<sup>42</sup> This possibility, investors believe, makes it rational to allow certain teams a longer leash to transform a game-changing idea into reality.<sup>43</sup> There is no better example of scale than technology platform companies. Each additional Facebook user costs the company fractions of a penny to service,<sup>44</sup> but the company can harvest data and sell advertisements against the user for far more.<sup>45</sup> In securities disclosures, tech companies tend to confirm a connection between vision and stock structure, proclaiming their founders to be “visionaries”<sup>46</sup> who need dual-class protections to accomplish their vision (i.e., to prevent investor meddling).<sup>47</sup>

This Article makes three contributions. First, it introduces the concept of dual-class social costs, i.e., externalities that spring from a corporation’s stock structure. It supports this new concept by adding conditions for when dual-class companies should be treated differently under corporate and securities law. It splits the externalities of dual-class stock into two categories. First are actions that deprive investors of voice in ways that are *not closely related* to the core purpose of dual-class stock (dual-class “frolics”).<sup>48</sup> These diversions from the founder’s scale-enhancing vision would include the exemption of the corporation from generally applicable regulation, for example, the

*Structures and Why Do Investors Let Them?*, 146 J. FIN. ECON. 27, 51–52 (2022); Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 COLUM. BUS. L. REV. 852, 902 (2018); Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 585 (2016).

41. See Winden, *supra* note 40, at 856 (explaining that dual-class stock “allows [founders] to pursue their vision for creating corporate value” free of investor meddling) (alteration in original); Goshen & Hamdani, *supra* note 40; see also Aggarwal et al., *supra* note 14, at 124.

42. See Pollman, *supra* note 21, at 168.

43. *Id.*

44. Meta, *Meta Reports Fourth Quarter and Full Year 2022 Results*, CISION PR NEWSWIRE (Feb. 1, 2023, 16:05), <https://www.prnewswire.com/news-releases/meta-reports-fourth-quarter-and-full-year-2022-results-301736645.html> [https://perma.cc/9ENA-Q97T].

45. *Id.*

46. For example, Lyft’s prospectus proclaims the firm to be a “Visionary, Founder-Led Company.” See Lyft, Inc., Registration Statement 3 (Form S-1) (Mar. 1, 2019) (“Visionary, Founder-Led Company. Our Co-Founders have always led our company with a focused and consistent mission to improve people’s lives with the world’s best transportation.”). Lyft’s co-founders owned less than 5% of the company’s stock after its initial public offering, but they retained a near majority of the voting power. Lucian Bebchuk & Kobi Kastiel, *The Perils of Lyft’s Dual-Class Structure*, HARV. L. SCH. F. ON CORP. GOVERNANCE, (Apr. 3, 2019), <https://corpgov.law.harvard.edu/2019/04/03/the-perils-of-lyfts-dual-class-structure/> [https://perma.cc/6EKC-6BK5].

47. The Article is agnostic on the merits of the question of for which companies and at which stages dual-class structures foster innovation, and indeed on the merits of a structure–innovation nexus altogether. It identifies that assumption and seeks to curb its external consequences.

48. See *infra* Part III.B.1.



contraceptive mandate. Second are ways in which the structure is *not appropriately related* to that vision (dual-class “exploits”)—for example, engaging in corporate political spending with the aim of thwarting antitrust regulation.<sup>49</sup> Conduct in this latter category arguably serves shareholders, so it would entirely escape existing reform proposals that are designed to curb agency costs.

This builds the foundation for the Article’s second contribution: connecting the rise of dual-class technology companies like Google and Facebook with the widened scope of corporate constitutional rights under U.S. Supreme Court caselaw.<sup>50</sup> The interaction of these changes may give individuals who control dual-class giants a constitutional beachhead from which they can deploy vast corporate resources for personal as well as business ends.

Third, the Article develops the beginnings of a securities regulation agenda that is responsive to these problems yet grounded in a fair assessment of the structure’s benefits. The Article’s conception of dual-class externalities and choice of solutions leaves many other externalities of the corporation unaddressed, but by focusing on the distinctive social costs of dual-class stock, the Article is able to propose solutions that are tailored to that problem without undermining the structure’s private appeal.<sup>51</sup>

Part I overviews the mechanics of dual-class stock. It explains how the structure allows founders to keep voting control of a company despite having a tiny economic stake. Part II presents the existing agency costs critiques of the structure as well as leading solutions. While its analysis makes clear the limitations of the agency analysis for understanding the structure’s external effects, it also suggests the potential of some agency-track reforms to address them.

Part III gets into dual-class stock’s externalities in earnest. To connect the logic of dual-class stock to its social possibility—namely, the potential to harness the beneficial idiosyncrasies of the founder—it also sets forth the potential social benefits generated by the structure, especially in technology firms—including platforms.<sup>52</sup> The agency perspective is essential to understanding these dynamics, which stem from either too little or too much

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49. See *infra* Part III.B.2.

50. See *infra* Part III.B.2.

51. Undermining the private appeal of dual-class stock in public companies could be counterproductive if it reduced the incentive to go public in the first place. See Alexander I. Platt, *Unicornphobia*, 13 HARV. BUS. L. REV. 115, 188 (2023) (arguing that changing the current securities regulation regime would jeopardize the social benefits that flow from startup companies’ freedom of action in private ordering).

52. The Article does not claim that dual-class structures are either necessary or sufficient for generating particular types of outcomes, nor that they are used only at technology firms (they are not; see Part I.C., *infra*). Their advantages at such firms may be their most salient use, however. See Aggarwal et al., *supra* note 14, at 132 (calling “the classic example of the founder-controlled software firm” a “salient one,” while emphasizing it is not the only such example); *id.* (observing that “[t]he most common controllers of dual-class IPO firms are founders”).

of a connection to the idiosyncratic vision of the founder—the very vision that the structure was designed to protect.

Part IV develops a package of securities regulations that is designed to meet these social costs and benefits for both “frolics” and “exploits.” To deal with “frolics,” it advocates a change to Securities and Exchange Commission (SEC) Rule 14a-8 to make it easier for shareholders to bring proposals at dual-class companies. This reform would leverage a key agency channel—the mediating influence of shareholders—to allow socially minded investors to formally propose change at the firm’s annual meeting. Second, it argues for using the government contracts channel to bar dual-class firms from receiving such contracts for two years following a political contribution. This proposal, which would also be adopted by the SEC, would be challenged under *Citizens United v. FEC*,<sup>53</sup> but a similar SEC rule (which applies to certain investment advisers) has survived constitutional challenge.<sup>54</sup> The Article then concludes with some reflections on these reforms, which may offer insights for addressing social costs of the corporation in general.

### I. DUAL-CLASS STOCK

Equal-voting structures—especially among holders of common stock—are more common than alternatives like dual-class stock.<sup>55</sup> However, shareholders do not have a legal entitlement to one vote per share.<sup>56</sup> The logic of unequal voting rights in common stock is clearest and perhaps the most common<sup>57</sup> as a solution to the founder’s dilemma, i.e., how to raise capital without giving up control. In particular, these structures are available where early investors can be persuaded that a founder’s idiosyncratic vision<sup>58</sup> requires protection from meddling by subsequent investors.

Under a dual-class share structure, a company issues two classes of common stock. Typically, one class is restricted to favored investors and another is offered to the public. The first class enjoys extra voting rights (ten

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53. *Citizens United v. FEC*, 558 U.S. 310 (2010).

54. See *infra* Part IV.

55. See Field & Lowry, *supra* note 40, at 28.

56. See Aggarwal et al., *supra* note 14, at 123.

57. See Alice Gomstyn, *Supervoters, Stocks, and Silicon Valley: What Investors Should Know About Dual-Class Voting Structures*, THE MOTLEY FOOL (Dec. 5, 2015, 9:10 PM), <https://www.fool.com/investing/general/2015/12/05/supervoters-stocks-and-silicon-valley-what-investo.aspx> [<https://perma.cc/B3VC-DWFS>].

58. This Article uses terms like “idiosyncratic vision” descriptively to capture the dominant market view of founders it deems worthy. However, the gendered nature of this image and the attendant impacts on capital raising is receiving growing recognition. See Benjamin P. Edwards & Ann C. McGinley, *Venture Bearding*, 52 U.C. DAVIS L. REV. 1873, 1873 (2019) (identifying the practice of “venture bearding,” or “behaviors that persons with contextually stigmatized identities adopt to access social status and capital”); Bonnie Chiu, *Female Founders Struggle To Break the Bias Despite Record Exits*, FORBES (Mar. 5, 2022, 12:20 PM), <https://www.forbes.com/sites/bonniechiu/2022/03/05/female-founders-struggle-to-break-the-bias-despite-record-exits/>.

votes per share is typical) while the class available to the public typically enjoys only one.<sup>59</sup> Some dual-class models, including that of Snapchat's parent company Snap, offer only nonvoting shares to the public;<sup>60</sup> others are technically multi-class in that they provide more tiers (in Google's case, three) of voting rights.<sup>61</sup> As discussed *supra* in the Introduction, a growing share of technology companies have gone public with dual-class stock structures in recent decades,<sup>62</sup> including Google in 2004<sup>63</sup> and Facebook in 2012,<sup>64</sup> and the choice of a dual-class structure has become increasingly common among such firms in the past few years.<sup>65</sup> Most scholars identify Google's IPO as patient zero for the trend among technology firms.<sup>66</sup>

While dual-class stock has existed in some form since at least 1898,<sup>67</sup> it is possible that "the unique needs of technology firms—including their emphasis on idiosyncratic vision—might incline them towards a dual-class structure."<sup>68</sup> Technology platform companies have widely adopted dual-class structures,<sup>69</sup> and concern around the structures has grown<sup>70</sup> at the same time as concern about the power of the companies, but these developments have largely not been connected.

59. *Dual-Class Stock*, COUNCIL INST. INVS., [https://www.cii.org/dualclass\\_stock](https://www.cii.org/dualclass_stock) [<https://perma.cc/9SCV-B5FN>].

60. Vijay Govindarajan et al., *Should Dual-Class Shares Be Banned?*, HARV. BUS. REV. (Dec. 3, 2018), <https://hbr.org/2018/12/should-dual-class-shares-be-banned> [<https://perma.cc/FXX7-U7AS>]. Other companies, including Google, Under Armour, and Blue Apron, have also offered nonvoting shares. *Id.*

61. Sometimes emerging companies issue three or more classes of stock over the course of their pre-IPO lifecycle, but they often use the IPO as an opportunity to simplify their share structures, including by whittling them down to two classes. Pollman, *supra* note 21, at 209–10. Unequal voting structures sometimes contain multiple (not just two) classes of common stock. *See, e.g.*, Gornall & Strebulaev, *supra* note 6 (finding an average of eight share classes in a sample of large privately held companies). Nevertheless, the general term for such structures is dual-class, and this Article follows that usage.

62. *See generally* Jay R. Ritter, *Initial Public Offerings: Updated Statistics*, WARRINGTON COLL. BUS. (May 19, 2022), <https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf> [<https://perma.cc/7PB8-H8NV>] [hereinafter Ritter, *IPOs: Updated Statistics*] (providing statistics on the number of dual-class IPOs from 1980 to 2021); CII, NEWLY PUBLIC SNAPSHOT: 2021, *supra* note 24, at 1–3; RECOMMENDATION OF THE INVESTOR ADVISORY COMMITTEE: DUAL CLASS AND OTHER ENTRENCHING GOVERNANCE STRUCTURES IN PUBLIC COMPANIES, SEC. & EXCH. COMM'N 1, <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-on-dual-class-shares.pdf> [<https://perma.cc/8LZG-QTAY>].

63. *See* Google Inc., Registration Statement (Form S-1), (Apr. 29, 2004).

64. *See* Facebook, Inc., Registration Statement (Form S-1), (Feb. 1, 2012).

65. *See* RECOMMENDATION OF THE INVESTOR ADVISORY COMMITTEE, *supra* note 62.

66. *See* Lizzie Meager, *Shareholders' Class Problem*, 2019 INT'L FIN. L. REV. 10, 10 (2019); Jonathan J. Burson & Marlin R.H. Jensen, *Institutional Ownership of Dual-Class Companies*, 13 J. FIN. ECON. POL'Y 206, 206 (2021).

67. W. H. S. Stevens, *Stockholders' Voting Rights and the Centralization of Voting Control*, 40 Q.J. ECON. 353, 355 (1926).

68. Adi Grinapell, *What Drives the Use of Dual-Class Structures in Technology IPOs*, 17 J.L. ECON., POL'Y 28, 30 (2021).

69. Some have likened markets and prices to a kind of economic technology, *see, e.g.*, John B. Braden, *Economic Technology and Resource Management*, 2 SOC'Y & NAT. RES. 1 (1989), and in that analogy, dual-class shares are an important subsidiary "technology."

70. *See* Govindarajan et al., *supra* note 60.

Dual-class founders enjoy unique freedom of action and insulation from the markets for corporate control<sup>71</sup> and influence. They are not checkable via director elections (as they would be at uncontrolled firms).<sup>72</sup> They need not place much of their own money at risk (unlike controllers of single-class firms).<sup>73</sup> They are substantially insulated from takeover threats from outside the corporation.<sup>74</sup> In single-class firms, these checks offer a way (albeit an imperfect one) for the market to discipline antisocial corporate behavior, and their absence in dual-class firms raises social as well as private concerns.

### A. *The Dual-Class Wedge*

Dual-class share structures create the potential to aggravate the principal-agent problem, which has been the central preoccupation of scholars of public company corporate governance for nearly a century.<sup>75</sup> In their foundational 1932 book, Professors Adolf Berle and Gardiner Means expressed concerns about the ability of shareholders to discipline managers given the separation of the firm's ownership from its control.<sup>76</sup> The diffuse, uninformed nature of the shareholder base made it hard for them to oversee a centralized and highly informed management, which was also optimally positioned to use the levers of corporate power to divert profits for personal gain (e.g., in the form of higher salaries).<sup>77</sup> By separating control from equity, dual-class stock creates a variation on this agency problem where founders—because their stock makes them controlling shareholders without requiring them to own a majority of the company's stock—have the ability to take advantage of public shareholders.<sup>78</sup> This “wedge” gives founders leverage to control companies whose equity they might only own a small piece of.<sup>79</sup>

### B. *The Case of Google*

Google provides a representative example of dual-class stock structures. It creates three types of shares:

71. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 109–45 (1991) (discussing the property-law-like status and high value of control); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965).

72. See generally EASTERBROOK & FISCHEL, *supra* note 71.

73. *Id.*

74. See generally Manne, *supra* note 71.

75. See *infra* Part II.

76. See generally ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

77. *Id.*

78. Further drawbacks of dual-class from an investor standpoint are discussed in Part II, *infra*.

79. See Aggarwal et al., *supra* note 14, at 124 (describing the wedge as a measurement of “how much outsider shareholders’ voting rights lag behind their economic rights.”).

[W]e will have two classes of authorized common stock, Class A common stock and Class B common stock. The rights of the holders of Class A common stock and Class B common stock are identical, except with respect to voting and conversion. Each share of Class A common stock is entitled to one vote per share. Each share of Class B common stock is entitled to ten votes per share and is convertible at any time into one share of Class A common stock.<sup>80</sup>

The Class B shares of Google, with the right to ten votes per share, are not sold in the public stock market but instead are offered only to insiders.<sup>81</sup>

Google's registration statement discloses the agency issues inherent in dual-class stock,<sup>82</sup> noting it as a risk factor to holders of the Class A common stock:

[B]ecause of this dual class structure, our founders, directors, executives and employees will continue to be able to control all matters submitted to our stockholders for approval *even if they come to own less than 50% of the outstanding shares of our common stock*. This concentrated control will limit your ability to influence corporate matters and, as a result, we may take actions that our stockholders do not view as beneficial.<sup>83</sup>

Google also offers a third class—the Class C common stock, with no voting rights<sup>84</sup>—and has warned investors of its risks: the company's founders own “approximately 85.8% of our outstanding Class B stock, [which enjoys 10 votes per share and] which represent[s] approximately 51.2% of the voting power of our outstanding common stock. . . . *This concentrated control limits or severely restricts other stockholders' ability to influence corporate matters. . . .*”<sup>85</sup>

### C. *History and Current Practice*

Dual-class stock has arisen in two different eras as an alternative to the more mainstream one share, one vote standard of corporate democracy. The first history begins in the first half of the nineteenth century when, Professor Stephen Bainbridge observes, “a trend towards a one share—one vote standard emerged” in corporate law.<sup>86</sup> Though this standard was both the general norm

80. Google Inc., *supra* note 63.

81. Floyd Norris, *The Many Classes of Google Stock*, N.Y. TIMES (Apr. 2, 2014, 6:03 PM), <https://economix.blogs.nytimes.com/2014/04/02/the-many-classes-of-google-stock>.

82. That the risks of these arrangements are disclosed to prospective investors prior to the issuance of the stock complicates agency critiques but is orthogonal to dual-class structures' social-costs dimension.

83. Google Inc., *supra* note 63, at 21 (emphasis added).

84. Alphabet Inc., Annual Report (Form 10-K) (Feb. 3, 2023); Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 705–06 (2019) (noting the shareholder litigation that followed Google's stock split that created the Class C nonvoting shares).

85. Alphabet Inc., *supra* note 84, at 20 (emphasis added).

86. Bainbridge, *Understanding Dual Class Stock*, *supra* note 15; Stevens, *supra* note 67, at 353–355; *see also* Ashton, *supra* note 15, at 890–92. Professor Bainbridge emphasized its default-rule status, however, and observed that restrictions on shareholder voting rights, of which dual-class structures are merely one example, “are as old as the corporate form itself.” Bainbridge, *Understanding Dual Class Stock*, *supra* note 15.

and statutory default by the early twentieth century, corporations were able to modify it.<sup>87</sup> It was at this stage, in the early 1900s, that dual-class stock structures became more common.<sup>88</sup> A backlash followed<sup>89</sup> for largely the same reasons that make the structure controversial today—namely, agency costs.<sup>90</sup> In the 1920s, the New York Stock Exchange (NYSE) began to change its practices to limit dual-class listings, and in 1940, it banned them outright,<sup>91</sup> a posture that lasted (with some exceptions) until competition from other exchanges and pressure from issuers drove the NYSE to amend its policy in the 1980s.<sup>92</sup>

Prior to the early twenty-first century, dual-class stock structures were primarily adopted by closely held family businesses, eager to keep control within the family, and media companies, eager to protect an idiosyncratic editorial vision as well as journalistic integrity.<sup>93</sup> The most prominent early media companies were newspapers, and the largest newspapers all eventually adopted a dual-class structure.<sup>94</sup> Some commentators have argued that the “two-class” shareholding structure that undergirds America’s three best newspapers (the New York Times, the Washington Post, and the Wall Street Journal) was explicitly designed to permit decisions to be made for non-economic reasons.”<sup>95</sup>

87. Lund, *supra* note 84, at 702; Bainbridge, *Understanding Dual Class Stock*, *supra* note 15.

88. Bainbridge, *Understanding Dual Class Stock*, *supra* note 15.

89. Lund, *supra* note 84, at 702; Bainbridge, *Understanding Dual Class Stock*, *supra* note 15.

90. See *infra* Part II.

91. Lund, *supra* note 84, at 687 (noting an ad hoc disfavoring of dual-class structures by the NYSE followed by the adoption of a listing rule in 1940 that “in effect excluded dual-class companies”); Bainbridge, *Understanding Dual Class Stock*, *supra* note 15; Ivy Wong, *The Revival of Dual Class Shares*, INT’L FIN. L. REV. (Mar. 10, 2020), <https://www.iflr.com/article/b1lmx6clj4l38j/the-revival-of-dual-class-shares> [<https://perma.cc/PGE7-PNLV>]; *Dual Class Stocks*, CORP. FIN. INST. 1, 1, <https://corporatefinanceinstitute.com/resources/knowledge/finance/dual-class-stocks> [<https://perma.cc/Y9UK-F2ZC>].

92. Lund, *supra* note 84, at 702–03; Wong, *supra* note 91; *Dual Class Stocks*, *supra* note 91. Prior to repealing it, the NYSE did make exceptions to this policy, including when the Ford Motor Company went public in 1956. Bainbridge, *Understanding Dual Class Stock*, *supra* note 15; Eve Tahmincioglu et al., *The Pros & Cons of the Dual-Class Stock Structure: Two Corporate Governance Experts Battle it Out*, DIRECTORS & BOARDS (Aug. 30, 2018), <https://www.directorsandboards.com/news/pros-cons-dual-class-stock-structure-two-corporate-governance-experts-battle-it-out> [<https://web.archive.org/web/20230507171946/https://www.directorsandboards.com/news/pros-cons-dual-class-stock-structure-two-corporate-governance-experts-battle-it-out>].

93. Lund, *supra* note 84, at 704; Tahmincioglu et al., *supra* note 92; Navanwita Sachdev, *Why the Dual-Class Stock Structure is Popular with Tech Companies*, SOCIABLE (Mar. 6, 2019), <https://sociable.co/business/why-dual-class-stock-structure-popular-tech-companies> [<https://perma.cc/M2GA-ZMZX>]; James Fallows, “Two-class” Corporate Ownership Structure: Not Just for Media Dinosaurs Any More!, THE ATLANTIC (July 31, 2007), <https://www.theatlantic.com/technology/archive/2007/07/-quot-two-class-quot-corporate-ownership-structure-not-just-for-media-dinosaurs-any-more/7682/>.

94. NYT: *Dual-Class Stock Structure Not Unique to Company*, MARKETWATCH (Apr. 24, 2007, 8:27 AM), <https://www.marketwatch.com/story/nyt-dual-class-stock-structure-not-unique-to-company> [<https://perma.cc/BV2X-HX4Z>].

95. James Fallows, *Moving the Bancroft/Murdoch Choice to the Moral Level*, THE ATLANTIC (July 30, 2007), <https://www.theatlantic.com/technology/archive/2007/07/moving-the-bancroft-murdoch-choice-to-the-moral-level/7680/>. The 2013 sale of The Washington Post to someone—Jeff Bezos, Amazon founder and onetime richest man in the world—who likely was not inspired to purchase the paper for its profit potential

In 2004, Google went public with a dual-class structure “for the explicit purpose of keeping control of the company in the hands of the founding group.”<sup>96</sup> The “‘Owner’s Manual’ for Google’s Shareholders” released by the company as part of its registration statement explained the tradeoffs of this choice in terms that are now familiar, but were groundbreaking at the time:

In the transition to public ownership, we have set up a [dual-class] corporate structure that will make it harder for outside parties to take over or influence Google. This structure will also make it easier for our management team to follow the long term, innovative approach emphasized earlier. . . .

The main effect of this structure is likely to leave our team, especially Sergey and me, with increasingly significant control over the company’s decisions and fate . . . .

*While this structure is unusual for technology companies*, similar structures are common in the media business. . . .

Some academic studies have shown that from a purely economic point of view, dual class structures have not harmed the share price of companies. Other studies have concluded that dual class structures have negatively affected share prices, and we cannot assure you that this will not be the case with Google.<sup>97</sup>

In the time since Google’s IPO, the significance of the dual-class technology company has come into focus. Dual-class structures have become increasingly common in tech firms,<sup>98</sup> and a large share of post-Google dual-class IPOs—about 44% between 2005 and 2021—have been of tech companies.<sup>99</sup> In 2020, only 15% of IPOs were of dual-class firms,<sup>100</sup> but they accounted for 60% of IPO market value,<sup>101</sup> much of it in dual-class tech firms. Both those figures represent a far higher prevalence among tech companies

allows this possibility to continue without a need for a dual-class structure. *See* Washington Post Staff, *Washington Post Company History*, WASH. POST (Jan. 1, 2021, 12:00 PM), <https://www.washingtonpost.com/company-history/>.

96. Lund, *supra* note 84, at 704.

97. Larry Page & Sergey Brin, *Founders’ IPO Letter: “An Owner’s Manual” for Google Shareholders*, ALPHABET INV. RELS. (Aug. 18, 2004) (emphasis added), <https://abc.xyz/investor/founders-letters/2004-ipo-letter/> [<https://perma.cc/61G9-VQU5>].

98. Kosmas Papadopoulos, *Dual-Class Shares: Governance Risks and Company Performance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 28, 2019), <https://corpgov.law.harvard.edu/2019/06/28/dual-class-shares-governance-risks-and-company-performance> [<https://perma.cc/5tF7-WDXJ>] (“The media and entertainment industry group shows by far the highest prevalence of dual-class share structures, including tech giants like Facebook and Alphabet, as well as more traditional media names, such as CBS Corp., Viacom Inc., and News Corp. Food and beverage companies, household and personal products, and software and services also have relatively high concentration of dual-class share structures.”); Tahmincioglu et al., *supra* note 92 (“Since Google, a number of other tech companies wanted to focus on building great products, on expanding businesses, on trying to figure out some way to grow and not have to worry so much about what stockholders are concerned but think about the other constituencies.”).

99. Ritter, *IPOs: Updated Statistics*, *supra* note 62 (depicting in Table 23 the number of IPOs each year with dual-class stock structures in tech and non-tech companies).

100. *See* CII, DUAL-CLASS IPO SNAPSHOT: 2017-2020, *supra* note 23, at 1. In 2021, this figure grew by half to 22.7%. *See* CII, NEWLY PUBLIC SNAPSHOT: 2021, *supra* note 24, at 2.

101. CII, DUAL-CLASS IPO SNAPSHOT: 2017-2020, *supra* note 24, at 3.

than in the stock market writ large, where around 5%–7% of companies use the structure.<sup>102</sup>

This century, there has been a dramatic increase in the use of dual-class stock structures in tech companies specifically. In 2004, when Google went public, only 4.9% of tech IPOs adopted a dual-class structure;<sup>103</sup> in 2021, by contrast, 46% of tech IPOs used a dual-class structure<sup>104</sup>—which was double the figure for non-tech IPOs that year.<sup>105</sup>

Founders value the control that a dual-class structure affords,<sup>106</sup> which enables them to pursue their idiosyncratic vision free from shareholder intervention.<sup>107</sup> A recent study by Professor Ofer Eldar and coauthors suggests that Google’s model caught on at technology firms after the introduction of cloud computing.<sup>108</sup> They find that, since 2006, firms in cloud industries, such as software platforms, “were 11.9% more likely . . . to be dual-class than other IPOs.”<sup>109</sup> They explain that these changes in technology permitted companies, particularly startups, to “reduc[e] . . . costs of experimentation, business formation and scaling for software and web-based ventures.”<sup>110</sup> This gives founders an upper hand in negotiation, making it possible for them to negotiate for a dual-class stock structure.<sup>111</sup> From this the authors conclude “that the popularity of dual-class structures is at least in part the result of stronger

102. Subodh Mishra, *Dual Class Share Structures: Is the Sun Setting Too Slowly?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 19, 2022), <https://corpgov.law.harvard.edu/2022/12/19/dual-class-share-structures-is-the-sun-setting-too-slowly/> [<https://perma.cc/QV2J-U8XJ>] (in the 2015–2022 window, reporting the proportion of large-cap (S&P 500), mid-cap (S&P 400), and small-cap (S&P 600) firms with a dual-class structure at between 4.8% and 7.3%).

103. *Id.* In 2004, 8% of non-tech companies adopted a dual-class structure at their IPO. *Id.*

104. Ritter, *IPOs: Updated Statistics*, *supra* note 62, at 67 (Table 23 lists the number of dual-class IPOs each year since 1980, distinguishing between tech and non-tech companies).

105. *Id.*

106. Vittoria Battocletti et al., *Dual Class Shares in the Age of Common Ownership*, 48 J. CORP. L. 541, 555 (2023); Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1057, 1061 (2019).

107. *See generally* Goshen & Hamdani, *supra* note 40 (arguing that founders value corporate control to pursue their long-term idiosyncratic vision, and not merely to extract private benefits).

108. Aggarwal et al., *supra* note 14, at 132–34 (analyzing the decrease in dual-class IPOs in the communications industry and the increase in dual-class IPOs in tech industries).

109. *Id.* at 143.

110. *Id.* at 125.

111. *See generally id.* (finding that firms in cloud industries are more likely to have dual-class structures because they give greater control to founders). *See also* William Alden, *Venture Capitalists Coddle Entrepreneurs as Royalty*, N.Y. TIMES: DEALBOOK (Aug. 5, 2014, 7:52 PM), [https://archive.nytimes.com/2014/08/05/venture-capitalists-coddle-entrepreneurs-as-royalty/](https://archive.nytimes.com/dealbook.nytimes.com/2014/08/05/venture-capitalists-coddle-entrepreneurs-as-royalty/) (explaining that Silicon Valley has undergone a shift in which “investors increasingly came to believe that visionary entrepreneurs were better equipped than investors to guide a young company to success”). Alden identifies Mark Zuckerberg as an example of a visionary founder better equipped to lead his company than potential investors, for example Yahoo, whose \$1 billion offer Zuckerberg rejected. *Id.*



founders' bargaining position vis-a-vis investors following technological changes that reduced entrepreneurs' need for external financing."<sup>112</sup>

The dual-class stock structure "is . . . particularly well suited for founder-led technology companies where the ability to innovate across product cycles yields success . . . and where economic interests between external shareholders and internal management are aligned."<sup>113</sup> This has proven true with visionary founders such as Google's Larry Page and Sergey Brin and Facebook's Mark Zuckerberg, who led their companies to success while retaining control and likely had an easier time doing so because of their firms' dual-class stock structures.<sup>114</sup>

## II. AGENCY COSTS (AND BENEFITS) OF DUAL-CLASS STOCK

The unusual powers that dual-class structures give founders create stark tradeoffs, especially when paired with the historically expansive interpretation of corporate powers enjoyed by the twenty-first-century corporation. By concentrating the entirety of corporate power in just one or two people, dual-class firms allow founders to leverage the social influence of their companies even if they own only a tiny fraction of their stock. Further, these byproducts of dual-class stock are poorly addressed by existing checks imposed on controllers, executives, and corporations by corporate law and securities regulation.

To understand this gap, this Part details the predominant existing critique of dual-class stock, that of agency costs.

Professors William Allen and Reinier Kraakman summarize the traditional law and economics view of the efficient markets response to dual-class share structures: if emerging firms issue low-voting stock, "public investors who discount accordingly will always get what they pay for."<sup>115</sup> Early work on dual-

112. In fact, the option a dual-class structure provides of raising money in the public capital markets without requiring founders to forgo control may help encourage more firms to go public. Aggarwal et al., *supra* note 14, at 146.

113. Scott Kapor, *Sorry CalPERS, Dual Class Shares Are a Founder's Best Friend*, FORBES (May 14, 2013, 10:01 AM), <https://www.forbes.com/sites/ciocentral/2013/05/14/sorry-calpers-dual-class-shares-are-a-founders-best-friend/?sh=1985651312d9>.

114. To be clear, there are other ways for founders and other insiders to exercise substantial control of a company without either owning a controlling economic stake or adopting a dual-class structure. Elon Musk provides one such example at Tesla. *See, e.g.*, Tim Higgins, *Tesla Board Fails to Pass Supermajority Measure It Proposed Amid Call for More Oversight*, WALL ST. J., <https://www.wsj.com/articles/tesla-shareholders-rejectmeasure-to-eliminate-super-majority-vote-requirement-11560290775> (June 12, 2019, 2:27 PM) (discussing supermajority voting requirement at Tesla to make major corporate changes, complicated by Musk's large ownership stake).

115. WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 205 (2003). Allen also served as a judge. *In Memory of William T. Allen*, WACHTELL, LIPTON, ROSEN & KATZ, <https://www.wlrk.com/william-t-allen/> [<https://perma.cc/S7A5-J8WD>].

class stock sought to evaluate versions of this claim.<sup>116</sup> More recently, concerns about the dual-class stock structure have grown among scholars, policymakers, and market participants such as institutional investors<sup>117</sup> for its effect on agency costs.

Agency costs scholarship, which dominates corporate law, debates the extent to which wedges or gaps “between the [founder’s] fraction of voting rights and fraction of equity capital” are harmful or desirable.<sup>118</sup> The wedge insulates entrepreneurs from investor pressure even where they own only a small minority of the company’s stock, either (depending on one’s view) empowering entrepreneurs or stifling investors.<sup>119</sup>

Dual-class stock also has its defenders. They argue that private ordering is more efficient than regulation at allocating investor capital and favor a hands-off approach to dual-class stock for this reason.<sup>120</sup> A discussion of this debate reveals its limitations as a framework for addressing externalities.

Framing this debate is the conception of exit, voice, and loyalty classically articulated by Professor Albert Hirschman.<sup>121</sup> Professor Hirschman theorized that constituents such as shareholders generally possess three options in response to decline of their organization: exit (selling the stock);<sup>122</sup> voice (a “recuperation mechanism” that is an alternative to exit, e.g., when shareholders vote against management recommendations but do not sell the stock);<sup>123</sup> and loyalty (a mechanism that “holds exit at bay and activates voice”<sup>124</sup>). Though it lacks an account of externalities, this provides a useful framework for understanding the interaction of shareholder rights and founder decision-making.

116. See Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119, 121 (1987) (weighing “whether exchange rules permitting the trading of dual class common stock are economically beneficial to investors and whether federal regulation is necessary to protect investors from such exchange rules”).

117. See, e.g., Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 529 n.180 (2018) (noting that the Big Three institutional asset managers—Blackrock, Vanguard, and State Street—“have vocally opposed the rising incidence of dual class structures” and “have also participated in lobbying efforts to ban dual class companies from stock exchanges and stock indices, arguing that they are forced to buy nonvoting and low-voting shares because of their indexing strategy, even when they oppose it”).

118. See Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1461 (2019) [hereinafter Bebchuk & Kastiel, *The Perils*]; see also Michal Barzuza & Eric L. Talley, *Long-Term Bias*, 2020 COLUM. BUS. L. REV. 104, 181–85 (2020); Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. REV. 1229 (2019); Bernard S. Sharfman, *A Private Ordering Defense of a Company’s Right to Use Dual Class Share Structures in IPOs*, 63 VILL. L. REV. 1 (2018); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 805–07 (2017); Goshen & Hamdani, *supra* note 40; Fischel, *supra* note 116, at 136–138.

119. Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1466.

120. See Sharfman, *supra* note 118.

121. ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY (1970).

122. *Id.* at 21–29.

123. See *id.* at 30 (defining “voice” as “any attempt at all to change, rather than to escape from, an objectionable state of affairs”); see generally *id.* at 30–43.

124. See *id.* at 78; see generally *id.* at 76–105.

### A. Agency Benefits

Scholars writing within the agency framework argue that dual-class stock has several benefits. These are overviewed briefly in this Subpart.

#### 1. *Dual-Class Stock Prevents Investor Meddling*

Corporations benefit from issuing dual-class stock by minimizing several inefficiencies associated with investor voting and meddling.<sup>125</sup> Professor Dorothy Lund has identified the risks that attach to issuing voting stock to “weakly motivated” and uninformed shareholders.<sup>126</sup> These problems include the potential for uninformed shareholders to “dilute the voice of informed voters because it is more costly and difficult for the informed voters to discipline management.”<sup>127</sup> Additionally, the corporation must organize and manage voting for a much larger group of shareholders.<sup>128</sup> Finally, if uninformed shareholders exercise their voting power, “the risk increases that they will move the company in the wrong direction.”<sup>129</sup> Professor Lund identifies this third risk—that an uninformed subset of shareholders, who possess incentives that are only weakly aligned with the corporation, could misdirect the corporation with their voting power—as the most consequential risk of voting stock.<sup>130</sup> Thus, corporations issuing dual-class stock can sidestep the potentially ruinous influence of uninformed investors.

These risks may be especially pronounced at technology firms for reasons that are core to the purposes—scale and innovation—for which founders elect a dual-class structure to begin with. Professor Adi Grinapell argues:

[S]ince technological innovation requires constant investment in new ideas with returns that may only exist in the long term, technology-based firms are at greater risk for quarter-to-quarter volatility, disrupting market’s ability to evaluate long-term investments and potentially reducing the value of technology-based firms.<sup>131</sup>

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125. Lund, *supra* note 84, at 694–97, 716–29; *see also* Fischel, *supra* note 116, at 134–37.

126. Lund, *supra* note 84, at 697.

127. *Id.*

128. *Id.*

129. *Id.* “[W]eakly motivated voters should rarely vote in shareholder elections. And when they do vote, their lack of information, coupled with pro-management biases and other conflicts of interest, make it unlikely that their votes will be value enhancing for the company.” *Id.* at 696.

130. *Id.* at 697. Though identified by Lund, the risk of shareholders voting to send the corporation in the wrong direction is low. If shareholders exercise their vote, they “routinely vote for incumbent managers and approve management-sponsored initiatives in all but the rarest of cases.” Fischel, *supra* note 116, at 134. Lund even notes that retail shareholders, when holding shares with voting rights, do not often value their ability to vote and thus are not likely to exercise the right. Lund, *supra* note 84, at 695.

131. Grinapell, *supra* note 68.

Accordingly, “placing limitations on dual-class stock structure can prevent such firms from implementing the optimal stock structure needed for the execution of their founders’ vision.”<sup>132</sup> By contrast, dual-class stock allows founders to pursue that vision without having to constantly convince others of its validity.<sup>133</sup>

## 2. *Managers Are Best Positioned to Make Decisions for the Firm*

Professors Zohar Goshen and Assaf Hamdani identify the ability for managers to pursue their idiosyncratic vision free from investor meddling as a core benefit of separating control rights and equity rights through dual-class stock.<sup>134</sup> For managers, control over decision-making is a valuable asset because it allows them “to direct the corporation free from interference by others, . . . to pursue a long-term idiosyncratic strategy,”<sup>135</sup> and to “extract private benefits.”<sup>136</sup> This control over management decisions “allows [managers] to ensure that the firm will pursue [their] idiosyncratic vision even against the investors’ objections.”<sup>137</sup>

Proponents of the dual-class stock structure argue that managers are in the best position to implement business decisions, and that if the manager’s idiosyncratic vision is successful, the shareholders and the corporation both benefit.<sup>138</sup> The manager’s vision represents business strategy and expertise that investors neither possess<sup>139</sup> nor have the incentives to acquire.<sup>140</sup> Additionally, the manager’s vision will reflect the manager’s access to non-public information

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132. Adi Grinapell, *Dual-Class Stock Structure and Firm Innovation*, 25 STAN. J. L. BUS. & FIN. 40, 40 (2020).

133. Goshen & Hamdani, *supra* note 40, at 579–80.

134. *Id.*

135. Kirby Smith, *How Dual-Class Share Structures Create Agency Costs*, COLUM. L. SCH. BLUE SKY BLOG (Jan. 5, 2018), <https://clsbluesky.law.columbia.edu/2018/01/05/how-dual-class-share-structures-create-agency-costs> [https://perma.cc/9HQF-NXVT].

136. *Id.*

137. Goshen & Hamdani, *supra* note 40, at 576.

138. *See id.* at 567; Bernard S. Sharfman, *The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuk and Kastiel*, 93 S. CAL. L. REV. POSTSCRIPT 1, 9 (2019) (“Shareholders suffer from the problems of asymmetric information and the simple inability to make the proper evaluation of a leader’s idiosyncratic vision.”).

139. Goshen & Hamdani, *supra* note 40, at 579 (“The entrepreneur’s idiosyncratic vision will often include elements that outsiders, including the firm’s minority shareholders, cannot observe or verify.”); Winden, *supra* note 40, at 856 (“Entrepreneurs are often creative visionaries who continue to develop new ideas and products as their companies grow. The dual-class structure allows them to pursue their vision for creating corporate value without the threat of their ideas being overruled or dismissed by investors who may have less patience for brilliance to manifest than profit.”).

140. Fischel, *supra* note 116, at 134 (“Many shareholders are passive investors who hold many different investments. They have little interest in managing the firm and insufficient incentive to learn the details of management.”).

due to the nature of her position and control within the corporation.<sup>141</sup> Finally, business decisions require long spans of time to develop and implement, and control rights permit managers to pursue their long term visions for the company instead of focusing on short-term decisions aimed at appeasing investors.<sup>142</sup> Thus, shareholders who hold stock with diminished or no voting rights benefit from the business ideas of those in control.<sup>143</sup> If the manager's idiosyncratic vision is successful, the shareholder's equity will reflect this change without the shareholder having to expend the effort to take part in decision-making.<sup>144</sup> This model assumes that managers will use their outsize control over the corporation in ways that benefit shareholders, and in certain contexts, there is evidence to support this.<sup>145</sup>

### B. Agency Costs

Professor (then SEC Commissioner) Robert Jackson memorably expressed the agency costs objection to dual-class stock when he said it turned founders into "corporate royalty."<sup>146</sup> When he did so, he was arguing that the downsides of dual-class stock were a particular case of a general problem—the general problem—in corporate law.<sup>147</sup> Since its inception a century ago, the dominant focus of corporate scholarship has been on agency costs, or the problem of imperfectly aligned incentives between principals (e.g., firms) and agents (e.g., managers).<sup>148</sup>

The standard account of dual-class stock's benefits and costs applies this same agency framework. In that body of work, scholars debate the propensity

141. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006) (explaining that managers benefit from proximity and lower costs to gain information).

142. Goshen & Hamdani, *supra* note 40, at 565.

143. *Id.* ("Business ideas take time to implement. This ongoing process requires many decisions, ranging from day-to-day management issues to major strategic choices.")

144. *Id.* at 567 ("The entrepreneur's idiosyncratic vision . . . reflects the above-market pecuniary return expected by the entrepreneur, which, if the business succeeds, will be shared . . . between the entrepreneur and investors.")

145. See, e.g., Dov Solomon et al., *The Quality of Information Provided by Dual-Class Firms*, 57 AM. BUS. L.J. 443, 443 (2020) (concluding that "the quality of financial reports . . . is higher for dual-class companies than for their single-class counterparts."). Some of the same researchers have found that quality of reporting remains high in dual-class firms and, counterintuitively, may even be positively associated with wedge size. Rimona Palas et al., *Does Wedge Size Matter? Financial Reporting Quality and Effective Regulation of Dual-Class Firms*, 54 FIN. RES. LETTERS 103774 (2023); Rimona Palas & Dov Solomon, *The Quality of Earnings Information in Dual-Class Firms: Persistence and Predictability*, 7 J. L. FIN. & ACCT. 127 (2022). Finally, the observation that the market is more willing to tolerate dual-class structures in certain firms is consistent with work arguing that idiosyncratic demand for specific stocks may result in higher valuations. See Caleb Griffin, *Extrinsic Value*, 75 ALA. L. REV. (forthcoming 2023) (manuscript at 5) (SSRN) (contending that the price of some stocks is elevated due to "demand-induced price effects" among investors).

146. Jackson, *supra* note 25.

147. *Id.*

148. See, e.g., Shill, *supra* note 29, at 1823; Bainbridge, *Independent Directors*, *supra* note 29, at 1034.

for dual-class stock structures to exacerbate agency costs or, alternatively, to facilitate efficient private ordering that maximizes shareholder wealth.<sup>149</sup> This Subpart provides a brief overview of the key points of the literature, which is helpful for understanding the social costs of dual-class stock and why existing agency-focused reforms would not address them.

### 1. *Controlling Shareholders May Divert Resources for Private Gain*

Dual-class controllers have both more capability and potentially more reason to divert corporate resources for private gain. The wedge permits founders to retain control despite owning less equity; equity is what aligns the incentives of founders with those of shareholders, so absent those incentives, founders may be tempted to use their power to extract private benefits. They have a number of tools at their disposal to do so,<sup>150</sup> including “excessive pay and perks,”<sup>151</sup> advantageous related-party transactions,<sup>152</sup> appointments of family members into key positions to further entrench their control,<sup>153</sup> and engaging “in inefficient self-dealing transactions with an entity that is affiliated with the controller,”<sup>154</sup> among other private benefits.<sup>155</sup> There is empirical evidence to support these theoretical possibilities,<sup>156</sup> the upshot of which is “that managers facing a larger separation of ownership and control [i.e., a bigger wedge] enjoy more benefits in the form of higher compensation.”<sup>157</sup>

Controlling shareholders with small equity stakes also operate with reduced incentives to manage effectively<sup>158</sup> because they “bear only a small fraction of

149. See, e.g., Hirst & Kastiel, *supra* note 118; Lund, *supra* note 84; Fisch & Solomon, *supra* note 106; Bebchuk & Kastiel, *The Perils*, *supra* note 118; Andrew Winden & Andrew Baker, *Dual-Class Index Exclusion*, 13 VA. L. & BUS. REV. 101 (2019); Sharfman, *supra* note 118; Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VIRG. L. REV. 585 (2017) [hereinafter Bebchuk & Kastiel, *The Untenable Case*]; Goshen & Hamdani, *supra* note 40; Paul Gompers et al., *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUD. 1051 (2010); Ronald W. Masulis et al., *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697 (2009); Fischel, *supra* note 116, at 54; Harry DeAngelo & Linda DeAngelo, *Managerial Ownership of Voting Rights: A Study of Public Corporations with Dual Classes of Common Stock*, 14 J. FIN. ECON. 33 (1985).

150. Gilson, *supra* note 141, at 1651.

151. Goshen & Hamdani, *supra* note 40, at 582.

152. *Id.*

153. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 602–03.

154. *Id.* at 603; see also Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1460.

155. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 602–03.

156. Masulis et al., *supra* note 149, at 1703–06 (finding a positive association between larger wedges—companies in which insiders have more control relative to equity—and the likelihood of diversion of corporate funds to private insider benefits). The study also found that higher levels of control rights within a corporation “ha[ve] a positive and statistically significant effect on CEO compensation.” *Id.* at 1706.

157. *Id.*

158. Gilson, *supra* note 141, at 1651; Masulis et al., *supra* note 149, at 1715 (“[A]s insider voting rights rise relative to cash flow rights, dual-class firms tend to make less profitable capital investments, consistent with the firms making investment decisions in pursuit of private benefits rather than shareholder wealth maximization.”); Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 602 (arguing that separation

the negative effects of their actions on the company value while capturing the full private benefits.”<sup>159</sup> By contrast, a shareholder with a large equity stake “is more likely to have the incentive either to monitor managers effectively or to manage the company itself.”<sup>160</sup> When shareholders exercise control by operation of unequal voting rights and a small equity position rather than equal voting rights and a large equity position, they may still “increase productivity by effectively managing the company or by effectively monitoring managers, but also may take more than [their] share of the gain.”<sup>161</sup> These misaligned incentives between managers and shareholders may also present themselves in managers attempting to block sales of the corporation in order to maintain their control, even if shareholders would benefit from a sale.<sup>162</sup> Shareholders bear the brunt of this expense in the form of lower share prices and foregone acquisition consideration.

## 2. *Public Shareholders in Dual-Class Firms Have Limited Voice*

When investors have voting rights on par with the voting rights of the founders, the “knowledge that [managers] can be ousted by the exercise of these votes provides them an incentive to maximize the value of the firm.”<sup>163</sup> This knowledge also factors into managers’ decision-making process, “act[ing] as a constraint on the ability of managers to take actions that harm investors.”<sup>164</sup> By the same token, when this form of leverage is absent, managers face fewer repercussions for failing to maximize shareholder value.

When controller–founders of dual-class firms choose to award themselves private benefits at the expense of outside public shareholders, the latter group has limited recourse.<sup>165</sup> Additionally, when managers perform negatively, their controlling position insulates them from shareholder reaction.<sup>166</sup> This idea is known as entrenchment—managers are not subject to the “disciplinary force of the market . . . that otherwise might limit the ability of a poorly performing controller to continue leading the company.”<sup>167</sup>

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between control and equity rights leads to managers with incentives that are “distorted and misaligned with the preferences of public investors”).

159. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 602.

160. Gilson, *supra* note 141, at 1651.

161. *Id.*

162. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 614–16; Smith, *supra* note 135 (explaining that a controller is likely to block a sale because they will not receive the same benefits as shareholders with equity shares).

163. Fischel, *supra* note 116, at 136.

164. *Id.* at 133–34.

165. See Lund, *supra* note 84, at 693–94 (identifying and dispelling a common critique of dual-class stock—that shareholders have “limited recourse when problems emerge”).

166. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 602 (identifying entrenchment as one of the two fundamental agency costs of dual-class stock).

167. *Id.*

Even if it serves to protect a visionary founder in positive ways initially, entrenchment may not age well—for example, if the founder’s competitive advantage decays with time<sup>168</sup>—and it need not end at the founder. Dual-class structures are frequently not encumbered by transfer restrictions, making control freely alienable by the founder without regard to the transferee’s qualifications,<sup>169</sup> business record, or even fit with the founder’s own idiosyncratic vision.<sup>170</sup> Even if a founder really does have the magic sauce, the person they select as a successor may not—and they may not see that due to personal biases, for example, if the successor is a close relative. A new dual-class controller could even be selected out of spite.

### 3. *The Structure of the Market Inhibits Its Response*

Another critique of dual-class stock holds that the market is not adequately equipped to respond to the agency costs of dual-class structures.<sup>171</sup> Specifically, the rise of passive index funds presents challenges to the private ordering case for dual-class stock.

The challenge begins with the indexes themselves, such as the S&P 500 (created by S&P Global Inc., formerly Standard & Poor’s) and the Dow Jones Industrial Average (by Dow Jones & Company, Inc.), which serve as benchmarks.<sup>172</sup> Vanguard, BlackRock, State Street, and other asset managers offer passively managed funds whose sole purpose is to mimic the performance of these benchmarks, which makes it nearly impossible for them to deviate from the index providers’ inclusion criteria.

Yet the index providers are not all powerful in the face of the spread of dual-class structures or other controversial market trends.<sup>173</sup> While retail investors can choose not to buy a particular stock based on the issuer’s chosen share structure, index providers do not exercise discretion on that level.<sup>174</sup> In order to assemble a bundle of companies into an index that is marketable to

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168. *Id.* at 606–07.

169. *Id.* at 606 (terming the unqualified dual-class transferee problem the “idiot heir”).

170. *Id.*

171. Dov Solomon, *The Importance of Inferior Voting Rights in Dual-Class Firms*, 2019 BYU L. Rev. 533, 537 (2019) (noting that index providers cannot completely avoid investing in nonvoting shares in favor of investor protection); Blair Nicholas & Brandon Marsh, *Dual-Class: The Consequences of Depriving Institutional Investors of Corporate Voting Rights*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 17, 2017), <https://corpgov.law.harvard.edu/2017/05/17/dual-class-the-consequences-of-depriving-institutional-investors-of-corporate-voting-rights> [<https://perma.cc/N2NQ-HDFM>] (“[P]assively managed funds may not be able to simply sell individual companies’ stock at will. . . . If the only solution is for investors to abandon certain investments after dual-class systems have done their damage, owners lose out financially and discussions in corporate boardrooms and C-suites across the country will suffer from a lack of diversity, perspective, and accountability.”).

172. *See generally* Winden & Baker, *supra* note 149.

173. Hirst & Kastiel, *supra* note 118, at 1243–48.

174. *Id.*



investors, index providers must “be as expansive and diverse as the underlying industries and economies whose performance they seek to capture.”<sup>175</sup> If index providers were to exclude all dual-class stock, “the indexes they produce would no longer reflect the investable marketplace.”<sup>176</sup> Thus, index providers cannot be expected to effectively police the use of dual-stock stock.<sup>177</sup>

Given how passive index investing works—the goal is to mirror the indexes—the institutional asset managers that develop their fund menus based on popular indexes cannot be expected to exercise effective discipline either.<sup>178</sup> Shareholder activism, which supplies a partial solution to the agency problem created by passive indexing,<sup>179</sup> would have great difficulty serving that function in the dual-class context given the dominance of controlling shareholders.<sup>180</sup> At bottom, the agency costs posed by dual-class structures do not appear to be sufficiently salient to the market or its intermediaries to curb their rise.

### C. *Managing Agency Costs*

This Subpart presents prominent proposed solutions to the agency costs of dual-class stock.

#### 1. *Sunset Clauses*

To reduce agency costs, Professors Lucian Bebchuk and Kobi Kastiel propose sunset provisions in dual-class firms.<sup>181</sup> Such clauses are intended to work by chipping away at the wedge.<sup>182</sup> They also build in a solution to expected

175. *Id.* at 1243.

176. *Id.* (arguing that instead of expecting index providers to regulate share structure, index exclusion should be reserved as “a nuclear option”).

177. *See id.* at 1248–52, 1243 (arguing against the view that index providers are capable of acting as “the new sheriffs of the U.S. capital markets”).

178. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 889–90 (2013).

179. Gregory H. Shill, *The Golden Leash and the Fiduciary Duty of Loyalty*, 64 UCLA L. REV. 1246, 1256–59 (2017) (describing hedge fund activist strategies as a response to agency costs); Lucian A. Bebchuk et al., *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPS. 89, 89, 104–07 (2017); Gilson & Gordon, *supra* note 178, at 866–67.

180. *See* Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 60, 90 (2016).

181. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 618–27; Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1504–05; Dhruv Aggarwal et al., *supra* note 14; COLUM. L. SCH. BLUE SKY BLOG (Apr. 21, 2021), <https://clsbluesky.law.columbia.edu/2021/04/21/the-rise-of-dual-class-stock-ipos> [<https://perma.cc/K77E-ERQU>] (“Sunset provisions substantially limit founders’ control over the firm and therefore the agency costs associated with dual-class structures.”).

182. Aggarwal et al., *supra* note 14, at 146 (explaining that sunsets target agency costs by “address[ing] the risk that controllers will have too little a stake in the outcome of their decisions”); Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1504 (arguing that “a controller with a sizable equity holding is likely to better internalize and act in furtherance of the interests of the company’s public shareholders”).

decay in the value of the controlling shareholder's idiosyncratic vision and business expertise over time.<sup>183</sup>

A growing share of dual-class companies have adopted sunset clauses. Among smaller public companies, the proportion with sunsets “more than doubled between 2015 and 2022, from 30.9% to 68.1%.”<sup>184</sup> About 40% of dual-class S&P 500 firms have them.<sup>185</sup> However, many leading firms, including Google and Facebook, do not have sunset provisions.<sup>186</sup>

Sunsets can take several forms.<sup>187</sup> A fixed-time sunset provision triggers on a set date, at which time the two classes of shares convert into a single class.<sup>188</sup> A triggering-event sunset provision triggers “upon the occurrence of a specified event, such as the founder's disability, death, or reaching of retirement age.”<sup>189</sup> An ownership-percentage sunset provision sets a minimum equity threshold for controlling shareholders.<sup>190</sup> Below it, the sunset provision converts the high-voting shares into single voting shares, thereby shrinking the potential size and risks of the wedge.<sup>191</sup>

Sunsets could, in principle, be adopted either by private ordering in company organizational documents<sup>192</sup> or by mandatory regulation. Some scholars strongly favor the former as the exclusive mechanism.<sup>193</sup> They believe that the market is best positioned to determine when sunsets are value-enhancing and its determination on the subject should be deemed conclusive from a regulatory perspective.<sup>194</sup> As an in-between, regulators could provide

183. Aggarwal et al., *supra* note 14, at 146; Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 618–27.

184. Mishra, *supra* note 102.

185. *Id.*

186. Sharfman, *supra* note 138, at 8 (pointing to top market performers that do not have sunset provisions, including Alphabet and Facebook).

187. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 618.

188. *Id.* at 618–19. This fixed time period is most commonly ten years from the date of the IPO. Winden, *supra* note 40, at 870–71.

189. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 620; Winden, *supra* note 40, at 875–80.

190. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 621; Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1504.

191. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 149, at 621; Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1504.

192. Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1504–05.

193. See, e.g., Fisch & Solomon, *supra* note 106 (opposing time-based sunset provisions and imposition of such provisions through government regulation); Sharfman, *supra* note 138 (arguing against mandatory sunset provisions); see also Lund, *supra* note 84, at 739 (“The recent wave of advocacy for mandatory sunset provisions for dual-class structures is similarly wrongheaded. . . . Requiring them, however, is a crude solution, as it is unclear ex ante at what point in the future the dual-class structure will become inefficient.”).

194. See Sharfman, *supra* note 138, at 3; see also David F. Larcker et al., *The Market Reaction to Corporate Governance Regulation*, 101 J. FIN. ECON. 431, 432 (2011) (“Because governance choices are endogenous decisions made by managers and shareholders, the value-maximizing governance choices for one firm could be very different from the value-maximizing governance choices of another firm.”); Adena Friedman, *The Promise of Market Reform: Reigniting America's Economic Engine*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 18, 2017), <https://corpgov.law.harvard.edu/2017/05/18/the-promise-of-market-reform-reigniting-americas-economic-engine> [https://perma.cc/8HA5-ZMPD] (“[A]s the U.S. has continued to add layer after

incentives to nudge companies to adopt sunsets.<sup>195</sup> This debate recapitulates the agency debates in the dual-class literature and corporate governance more broadly.

## 2. *Index Exclusion*

As discussed *supra* at Part II.B.3, index providers select stocks to be part of a basket that represents a segment of the stock market, such as the S&P 500. Standard & Poors applies a variety of criteria to select companies for inclusion in this all-important index, which is tracked by many passive index funds.<sup>196</sup> Index providers can, in principle, exercise influence over corporate governance by excluding companies with certain characteristics, for example dual-class structures, from their eligibility criteria and thus their indexes.<sup>197</sup>

Professors Scott Hirst and Kobi Kastiel note that index providers are limited in their ability to exclude dual-class stock companies from mainstream indexes because those indexes are intended to mirror the market in whole or in part, not corporate governance terms.<sup>198</sup> Index providers are also wary of stepping into a quasi-regulatory position<sup>199</sup> and generally face barriers in influencing governance structures.<sup>200</sup> Some of the available empirical evidence suggests they would not be effective if they tried.<sup>201</sup> Despite its theoretical power—a company’s potential to be excluded from the S&P 500 intuitively seems like it would be a major motivator—index exclusion may be too blunt an instrument to influence governance structures.<sup>202</sup>

## 3. *Requiring the Issuance of (Some) Voting Stock*

Professor Dorothy Lund has urged a middle-ground approach whereby companies that choose dual-class structures must issue some nontrivial amount

layer of obligation, we have reached a point where companies increasingly question whether the benefits of public ownership are worth the burdens.”).

195. See Friedman, *supra* note 194.

196. See generally Winden & Baker, *supra* note 149.

197. See *id.*; Hirst & Kastiel, *supra* note 118, at 1234.

198. Hirst & Kastiel, *supra* note 118, at 1248.

199. *Id.* at 1244–45 (discussing desire to avoid embroilment with federal regulation); *id.* at 1247 (discussing constraints imposed by portfolio rebalancing); *id.* at 1248–50 (discussing competitive pressures).

200. *Id.* at 1252–53; Paul Brest et al., *How Investors Can (and Can’t) Create Social Value*, 44 J. CORP. L. 205, 225 (2018); Winden & Baker, *supra* note 149 (describing effect of index inclusion and exclusion as “diminishing to the vanishing point”); Nimesh Patel & Ivo Welch, *Extended Stock Returns in Response to S&P 500 Index Changes*, 7 REV. ASSET PRICING STUD. 172, 179 (2017).

201. Some studies have found an association between exclusion from the S&P 500 and abnormally positive returns, following an initial dip. See Patel & Welch, *supra* note 200, at 196; Winden & Baker, *supra* note 149, at 136.

202. Winden & Baker, *supra* note 149; Hirst & Kastiel, *supra* note 118, at 1234.

of voting stock to the public in addition to the nonvoting stock.<sup>203</sup> While these voting shares will not give investors control over management, they provide a tool for investors to wield to capture the attention of insiders.<sup>204</sup> Voting shares provide shareholders with the means to influence insider decisions and can contribute to founders loosening their grip on the company over time.<sup>205</sup>

Professors Bebchuk and Kastiel approach the question of regulating the mix of voting and nonvoting stock from the opposite end of the telescope. Rather than advocating a minimum proportion of voting shares, they suggest that regulators and exchanges restrict the number of *non*voting shares corporations can issue.<sup>206</sup> Under their proposal, regulators would target the wedge by limiting not only the number of nonvoting shares that can be issued but also the number of authorized-but-unissued nonvoting shares.<sup>207</sup>

These proposals, while helpful for addressing the agency problems inherent in dual-class structures, are not intended to (and would not) adequately address their externalities. The next Part explains those externalities, and the Part that follows proposes a way to maximize their expected social value.

### III. SOCIAL COSTS (AND BENEFITS) OF DUAL-CLASS STOCK

This Part introduces the social costs of dual-class stock. It also proposes a simple taxonomy to understand them and to aid in the design of regulation. Conceiving of dual-class stock's social costs is novel in itself, considering the literature's current fixation on agency costs. However, making fuller sense of social costs requires an appreciation of the social benefits created by the same structure. This Part thus begins by detailing the social benefits of dual-class stock, which any response (such as the Article's proposal in Part IV) must be mindful of lest they be inadvertently extinguished by regulation.

#### A. *Social Benefits*

Dual-class structures enhance social welfare when they harness a founder's vision for social gain. This Subpart explains that mechanism. In doing so, it presents the optimistic case for dual-class social benefits.<sup>208</sup> This is not to suggest that such benefits are typical; they may or may not be present and, either way, should be contemplated in conjunction with applicable social costs

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203. Lund, *supra* note 84, at 739.

204. *Id.* at 741–43.

205. *Id.* at 744.

206. Bebchuk & Kastiel, *The Perils*, *supra* note 118, at 1506–07.

207. *Id.*

208. For another perspective on social benefits of dual-class stock, see Emilie Aguirre, *The Social Benefits of Control* (2023) (unpublished manuscript) (on file with author).

(presented in the next Subpart).<sup>209</sup> Similarly, the Article is agnostic on the question whether the social benefits of dual-class stock (in general or in a given company) outweigh their social costs.

The aspect of the founder's vision that early investors may wish to shelter is her *beneficial idiosyncrasies*—her knowledge, experience, drive, and skill. As discussed in Part II, *supra*, these may not be universally observable to or accepted by subsequent investors.<sup>210</sup> Even in dual-class firms, founder and company remain subject to forms of market discipline other than voting, such as exit.<sup>211</sup> But insulation in the form of control allows the founder to avoid having to repeatedly convince the market.<sup>212</sup> Control reduces investors' choice to staying or leaving.

At its best, dual-class stock harnesses the founder's beneficial idiosyncrasies by nurturing her visionary experimentation and giving her runway to create a business grounded in favorable economies of scale. These benefits are a natural fit for the ambitious technology platform.<sup>213</sup>

Though the existing literature on dual-class stock<sup>214</sup> is expansive, the agency function around which it revolves—optimizing the value of the structure for firms' investors, founders, and managers<sup>215</sup>—is self-consciously focused on private rather than social welfare.<sup>216</sup> As Parts I and II show, this literature, while deep and sophisticated, lacks a compelling account of social value. The simplest way to approximate positive social returns is to aggregate private returns to investors. But this leaves out benefits that do not accrue to the owners of dual-class firms, i.e., benefits enjoyed by society at large, such as the increased fiscal capacity of a government that presides over increases in income and wealth or the opportunity of consumers to access products made by dual-class firms. Especially since the IPO market and some of the world's largest and most influential corporations are intermediated by the structure, its many unique features warrant closer examination. This examination counsels for a

209. It would be surprising if a given company did not produce notable negative externalities, whether as a consequence of its operations or internal aspects of the firm like stock structure.

210. See Goshen & Hamdani, *supra* note 40, at 579–80.

211. See *supra* Part II.

212. See Goshen & Hamdani, *supra* note 40, at 579–80.

213. This same autonomy, in the context of expansive corporate rights and a deferential business judgment rule, makes such firms ripe for abuse of their share structure. See *infra* Part III.B.

214. See *supra* Part II.

215. See, e.g., Lund, *supra* note 84, at 738 (“[N]onvoting stock can play an important role in improving firm efficiency by reducing agency costs and the transaction costs associated with voting.”); Sharfman, *supra* note 118, at 7 (defending dual-class structures in IPOs as “a value-enhancing result of the bargaining that takes place in the private ordering of corporate governance arrangements”); Fischel, *supra* note 116, at 140 (“The cost of dual class common stock is that the effectiveness of the market for corporate control as a monitoring device is reduced.”).

216. The standard understanding of social welfare is that it represents personal well-being in the aggregate. See SHAVELL, *supra* note 37, at 2; *supra* Introduction. Importantly, it is not equal to *investor* well-being; it would include the well-being of individuals in general, not only *qua* investors, and of society at large.

conception of social benefits that is distinct from the sum of private benefits to dual-class investors.

These social benefits can be defined in terms of inputs and outputs that might plausibly be increased by the use of dual-class share structures.<sup>217</sup> Here, a note of caution is appropriate regarding the explanatory power of inferences in this space. As with claimed agency benefits of dual-class stock, it is probably not feasible to show that the dual-class structure makes social benefits more likely.<sup>218</sup> Selection effects in the choice of share structure make the question a poor fit for a causal inquiry.<sup>219</sup> But this problem characterizes all work on dual-class structures. Accordingly, in terms of explanatory power, this Subpart's case for the existence of dual-class social benefits should be taken to parallel previous work on its agency benefits. But importantly, while optimistic, the conceptualization of those benefits offered here requires no change in assumptions regarding corporate purpose (e.g., dual-class firms are presumed to prioritize the profits of the firm or firm agents over any public purpose).

### 1. *Inputs*

The number and size of investable firms is an important input in the size and depth of capital markets and plays a role in macroeconomic outcomes.<sup>220</sup> It is plausible that the United States has more technology firms—and in particular, more *publicly traded* technology firms—because of the existence of dual-class stock structures. Many founders aspire for their companies to be acquired or go public; dual-class allows them to do that without surrendering control.

There is a symbiosis between many technology firms and dual-class structures. Tech firms often require large amounts of capital, have low marginal costs of production, or both.<sup>221</sup> Though many classic and modern-day technology firms have not used a dual-class structure, these characteristics make such firms well-suited to the structure—and the potential of these firms to

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217. See *infra* Part III.A.1–2.

218. See Renée Adams & Daniel Ferreira, *One Share-One Vote: The Empirical Evidence*, 12 REV. FIN. 51, 53 (2008) (“Because ownership structures are *endogenous* (i.e. they are not randomly assigned to different firms in a given country or industry), many difficulties arise in estimating the impact of disproportional ownership on firm and market outcomes.”).

219. See JOSHUA D. ANGRIST & JÖRN-STEFFEN PISCHKE, *MOSTLY HARMLESS ECONOMETRICS: AN EMPIRICIST’S COMPANION* 4 (2009) (identifying “experiment[s] that could ideally be used to capture the causal effect of interest” as ones with random assignment of variables) (emphasis omitted). Corporate governance scholarship in general could benefit from more modesty in causal inference and the use of data. See generally Andrew C. Baker et al., *How Much Should We Trust Staggered Difference-in-Differences Estimates?*, 144 J. FIN. ECON. 370 (2022) (showing bias in a common method of estimating causal relationships); Jens Frankenreiter et al., *Cleaning Corporate Governance*, 170 U. PA. L. REV. 1 (2021) (calling into question the accuracy of a set of data commonly used in corporate governance scholarship).

220. See Goshen & Hamdani, *supra* note 40, at 579–80.

221. See Imanol Ramírez, *Merger Thresholds in the Digital Economy*, 45 DEL. J. CORP. L. 433, 440–41 (2021).

generate outside returns helps explain the concentration of dual-class stock in the industry. Not all dual-class firms are technology firms, and not all technology firms have a dual-class structure, but dual-class technology firms now account for a majority of the IPO market by value.<sup>222</sup>

The category of “technology” firms is notoriously slippery,<sup>223</sup> but a sensible working definition would include pharmaceutical companies, software firms, and other businesses that make money by applying or selling specialized scientific knowledge. Pharmaceutical companies offer a prominent example of the relationship of technology to scale: the bulk of their costs are in the area of research and development; when they have a successful product, such as a vaccine, they can increase production of that product at a far lower marginal cost than could, say, a company that operates chain restaurants or owns medical practice groups. The role of intellectual property law compounds this basic law of economics: pharmaceutical companies enjoy legal monopolies on many of their products.<sup>224</sup> Software exemplifies these concepts perhaps best of all. The invention, development, and marketing of a new phone app is costly; the marginal cost of pushing it out to one additional customer is trivial.<sup>225</sup> Technology firms as a group offer investors a value proposition different from other types of firms. The election of dual-class structures by technology entrepreneurs—and the toleration or embrace of those constraints by investors—reflects something distinctive about the dynamics of founding and funding technology firms.<sup>226</sup>

## 2. *Outputs*

Corporate law may be intended to facilitate optimal private ordering, but an underlying assumption of that project—and by extension, of capitalism—is that it will on the whole tend to promote social welfare. Endogeneity in share structure selection makes this an unfalsifiable claim.<sup>227</sup> But in weak form, it seems plausible that dual-class structures are symbiotic with tech firms because of the superior economies of scale they theoretically enable, and that those scale economies benefit society as well as the firms’ investors. These scale economies are believed to result from technology companies’ leadership being able to

222. See CII, DUAL-CLASS IPO SNAPSHOT: 2017-2020, *supra* note 23, at 3; Aggarwal et al., *supra* note 14, at 2.

223. See, e.g., Marli Guzzetta, *Why Even a Salad Chain Wants to Call Itself a Tech Company*, INC. MAGAZINE, May 2016, <https://www.inc.com/magazine/201605/marli-guzzetta/tech-company-definition.html> [<https://perma.cc/FS49-JRC9>].

224. Amy C. Waltz, *Closing the Deal: Making the Right Congressional Decision About Patent Settlement Agreements*, 5 IND. HEALTH L. REV. 155, 180 (2008).

225. See Ramírez, *supra* note 221, at 440–41.

226. For a comprehensive discussion of these dynamics beyond dual-class structures, see Pollman, *supra* note 21, at 182.

227. See Adams & Ferreira, *supra* note 218, at 53.

pursue their vision without interference.<sup>228</sup> The promise of rapid returns to scale helps explain why many such firms have been able to persuade investors to accept a diminution or elimination of voice to begin with.

Optimistically, dual-class technology firms in the aggregate have a positive macroeconomic impact. The rationale for unequal voting rights is that they nurture a founder's vision and protect her execution capacity. This can in principle benefit not only investors in the dual-class stock but society as a whole. The mechanism is straightforward: the same creative potential that makes growing technology firms attractive to investors also suggests their ability to increase innovation and macroeconomic output. Firms that sell or rely heavily on technology offer this "triple win" potential—for founders, investors, and society.<sup>229</sup> The existence of this potential does not suggest it is always present, even for highly profitable or otherwise successful businesses. It is merely a case where the purposes of dual-class stock theoretically accomplish both investor and social welfare maximization. Other scholars have suggested consequences that, when aggregated, mimic this conception of benefits, at least at the level of capital markets.<sup>230</sup>

To go one step further, maximizing the value of firms accomplishes many important social goals. The additional wealth created means not only higher living standards for beneficiaries, but deeper fiscal capacity. It also, in the case of some technology firms, can mean more vaccines, more treatments, and more lives saved directly. Whether it actually does so is speculative, just like the question whether it actually maximizes shareholder wealth.<sup>231</sup> But to the extent one accepts the thesis of dual-class stock—that it helps founders establish scale—it should generate social benefits. The full benefit of a groundbreaking invention, be it a new medication or new software, cannot be internalized by any one firm; some of it spills over into society in the form of consumer surplus, knowledge, or wealth.

### B. *Social Costs*

The dual-class firm is a human being in the guise of a corporation—or at least it has the potential to be. This Subpart explains why, and how such humans have come to gain access to ironclad legal protections designed to protect corporations. This protection is not only powerful but diversified. It comes from two distinct spheres of law: constitutional law and corporate law.

The negative externalities of corporate operations invest this legal oddity with great consequence. Such costs are a byproduct of many corporate

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228. See Goshen & Hamdani, *supra* note 40, at 557–79.

229. See *id.* at 579–83.

230. See, e.g., Lund, *supra* note 84, at 738 (arguing that “detering companies from issuing nonvoting stock,” as several stock indices have done, “impede[s] beneficial experimentation in capital structuring”).

231. See Adams & Ferreira, *supra* note 218.



activities; this Subpart emphasizes those that could be exacerbated by a dual-class stock structure.<sup>232</sup>

Constitutional law scholarship has explored how business entities can use the corporate form to present themselves as individuals, taking advantage of constitutional rights recently extended to businesses as a function of their owners' rights.<sup>233</sup> This Subpart discusses the possibility of the reverse: individuals leveraging corporate power—conferred by two entirely separate reservoirs of authority, constitutional law and corporate law—via dual-class stock structures for personal benefits as well as for anticompetitive or otherwise inappropriate firm benefits.

### 1. *Social Costs Defined*

The classic statement of the problem of social costs, by Professor Ronald Coase, describes them as “those actions of business firms which have harmful effects on others.”<sup>234</sup> As an example, Professor Coase cites “a factory the smoke from which has harmful effects on those occupying neighbouring properties.”<sup>235</sup> In the decades since, social costs have been given a broader understanding as negative externalities, which need not be limited to physical invasions.<sup>236</sup> They have also been understood to lend themselves not only to Professor Coase's preferred solution—stronger property rights—but to external regulation.<sup>237</sup> To maximize social welfare, policy strives to structure private tradeoffs so they produce socially optimal results (however defined). Rational actors are presumed to maximize their own utility already; the reason to address social costs separately is that “[i]n deciding whether to open a factory or increase production, a firm will compare its private benefits and costs but may ignore the social costs of pollution” because those costs are not

232. By the same token, the Article does not consider social costs that might simply be *more common* in a dual-class structure. For example, dual-class firms as a group might plausibly be more intent on maximizing profits at all social costs, and therefore might be less likely to embrace environmental, social, and governance (ESG) strategies. This suggests possibilities for future empirical and theoretical work on other social costs of different stock structures.

233. See *infra* Part III.B.2.i.

234. Ronald Coase, *The Problem of Social Cost*, 3 J.L. ECON. 1, 1 (1960).

235. *Id.*

236. See, e.g., Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713, 716 n.2 (1996) (defining “harmful externalities” as “adverse outcomes that occur as a byproduct of an injurer's activity”).

237. External regulation may consist of any of a number of interventions, including taxation of socially costly activities (“Pigouvian taxes”) or legal restrictions thereon. See, e.g., Matthew Kotchen, *Taxing Externalities: Revenue vs. Welfare Gains with an Application to U.S. Carbon Taxes* 1, (Nat'l Bureau of Econ. Resch., Working Paper No. 30321, 2022), <https://www.nber.org/papers/w30321> (“[b]y internalizing marginal external costs, Pigouvian taxes calibrate private incentives to implement the socially efficient level of market activity”); Steven A. Morrison et al., *Fundamental Flaws of Social Regulation: The Case of Airplane Noise*, 42 J.L. & ECON. 723, 723 (1999) (conducting an economic assessment of the 1990 Airport Noise and Capacity Act, which “mandated the elimination of certain aircraft, such as the Boeing 727 and DC-9, from all U.S. airports by the end of 1999 to meet quieter noise requirements”).

internalized by the firm but rather borne by neighbors, foreigners, or future generations.<sup>238</sup>

Corporate law scholarship has begun to address social costs at the level of the firm<sup>239</sup> and capital markets,<sup>240</sup> but has not yet examined it in the context of share structure. This requires distinguishing the costs that are distinctive of dual-class stock from those that attend corporate activity in general.

Dual-class stock structures create two distinctive categories of social cost. The first is acts that have an *insufficient nexus* to the core purpose of dual-class shares (dual-class “frolics”), i.e., acts that depart from the founder’s scale-enhancing vision detailed *supra* at Part II. This category would include efforts to exempt the firm from generally applicable regulations in a way that earns it no competitive advantage in the market and may even disadvantage it (but probably not enough to motivate an investor response). The second is acts that have an *inappropriate nexus* to that vision (dual class “exploits”)—for example, engaging in corporate political spending with the aim of thwarting regulation.

The motivation for this taxonomy is that existing law offers no practical feedback mechanism for investors to address acts in either category—and investors aren’t even the right group to be doing so, especially for dual-class exploits.

#### *a. Dual-Class “Frolics”*

Frolics<sup>241</sup> from the purpose of dual-class stock structures are likely to create social costs. These are acts taken by dual-class founders that lack a connection to the scale-enhancing function of the structure and to the spirit of entrepreneurialism that motivated investors to agree to concessions of voice to begin with.

Consider actions by dual-class founders using their control of the corporation to avoid offering contraceptive coverage to employees, despite a legal mandate to do so, or to make large donations to charitable causes (for example, to the founder’s prep school alma mater) that are of personal interest to the founder but unrelated to the business.

238. Daniel B. Kelly, *Strategic Spillovers*, 111 COLUM. L. REV. 1641, 1650 (2011).

239. See, e.g., Gregory H. Shill & Matthew L. Strand, *Diversity, ESG, and Latent Board Power*, 46 DEL. J. CORP. L. 255 (2022); Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401 (2020).

240. See, e.g., Zohar Goshen & Doron Levit, *Agents of Inequality: Common Ownership and the Decline of the American Worker*, 72 DUKE L.J. 1 (2022); Madison Condon, *Market Myopia’s Climate Bubble*, 2022 UTAH L. REV. 63 (2022).

241. The term “frolic” comes from agency law; an agent who is on a frolic, or who has gone out of her way on a private errand, has severed the link to her principal to such a degree that her acts while on the frolic cannot create tort liability for the principal. See *Frolic of His Own*, RESTATEMENT (SECOND) OF AGENCY INDEX 546 (AM. L. INST. 1958). As used in this Article, the term draws on this concept, but without implications for tort liability.

Currently, these acts are not conceptualized as “costs” for corporate law purposes at all. That may be because the dollar amounts are trivial from a shareholder perspective—and if not, the expenditures in question may constitute waste, which would be a breach of fiduciary duty (though an exceedingly difficult claim to prevail on).<sup>242</sup> In the case of reducing employees’ insurance coverage, that may slightly *increase* shareholder profits. Accordingly, reforms designed to increase shareholder power, such as those described in Part II, *supra*, are mismatched to these problems. The concerns they raise fundamentally operate at the social rather than investor level.

The best way to regulate social policy is directly, not by enlisting shareholders to do it. But increasing shareholder voice, as advocated at Part IV, *infra*, may increase consideration of frolics at dual-class firms.

*b. Dual-Class “Exploits”*

In dual-class exploits, the founder exploits the wedge to gain outside scale, then turns around and uses that scale in a way that creates outside externalities. The term borrows from computer security, where an exploit is “a program, or piece of code, designed to find and take advantage of a security flaw or vulnerability in an application or computer system . . . .”<sup>243</sup> While in the first type of dual-class social cost—a frolic—a given corporate act is not closely related enough to the founder’s scale-enhancing vision, in an exploit the act in question is *too close* to that vision.

The category of exploits illustrates the limitations of defining the risks of dual-class stock in agency terms. After all, applying the shareholder wealth maximization norm that is standard in the agency literature and compelled by Delaware law, it is impossible for a founder to use her control of the corporation to maximize shareholder welfare *too much*. So, for example, a founder who directs the corporation to spend large sums on political campaigns to elect candidates who oppose tighter regulation of the corporation’s own activities would be deemed appropriately aligned with his shareholders, not misaligned.

However, the social costs of large, scaled-up, innovative firms with dual-class structures engaging in such activities are potentially quite large. They cannot (and should not) be precluded from participating in the political process. But neither—and here, this Article takes a normative position—should they be allowed to leverage the outside agency advantages that motivated them to adopt dual-class stock to begin with for the purpose of exercising outside political power.

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242. Ronald J. Colombo, *Corporate Waste*, in LAW OF CORPORATE OFFICERS & DIRECTORS: RIGHTS, DUTIES, & LIABILITIES § 2:17 (2022–2023 ed.).

243. See *What Is an Exploit?*, CISCO <https://www.cisco.com/c/en/us/products/security/advanced-malware-protection/what-is-exploit.html> [<https://perma.cc/3VBE-8E2R>].

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Both dual-class frolics and exploits—actions by founders that, on one hand, have an insufficient nexus to the firm’s scale-enhancing purpose and, on the other, exploit that purpose inappropriately—enjoy strong protection under constitutional and corporate law alike.

2. *Corporate Constitutional Rights in Dual-Class Firms: The “Snap Lobby” and “SocialMediaCo” Problems*

The potential social costs of the dual-class firm have grown in recent decades due to the growth of corporate rights.<sup>244</sup> In particular, the constitutional character of those rights as recognized under U.S. Supreme Court caselaw makes them difficult to regulate. The holdings and logic of those cases do not appear to hinge on stock structure. Since the key cases, including *Citizens United v. FEC*<sup>245</sup> and *Burwell v. Hobby Lobby*,<sup>246</sup> were decided, the Court has only grown more friendly to corporate constitutional rights. A similar trend has unfolded in lower federal as well as state courts.

These developments signal that the full panoply of rights available to corporations in general may be available to certain publicly traded technology firms as well. Founders of dual-class tech firms—in some cases, a single natural person—can direct corporate acts, both frolics and exploits, that have important social consequences but that are insulated from important levers of regulation.

a. *Corporate Constitutional Rights in General*

Frolics and exploits by dual-class founders benefit from strong legal protection under modern constitutional law jurisprudence. The Constitution has been expansively applied to corporations in such a manner as to provide corporations with many of the same rights as individuals. The evolution and scope of these rights, which embrace both property and liberty protections, is detailed painstakingly in Professor Adam Winkler’s master work on the subject.<sup>247</sup> These constitutional matters will be reviewed only briefly here—enough to show that the Supreme Court’s view of corporate constitutional

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244. These developments are in flux and, although it explores them, this Article makes no attempt to capture them all. Future work by scholars of constitutional law exploring the eligibility of dual-class firms for constitutional protections is needed. Cf. ADAM WINKLER, *WE THE CORPORATIONS: HOW AMERICAN BUSINESSES WON THEIR CIVIL RIGHTS* (2018) (exploring the growth of those protections in general, without regard to the role of share structure).

245. *Citizens United v. FEC*, 558 U.S. 310 (2010).

246. *Burwell v. Hobby Lobby*, 573 U.S. 682 (2014).

247. WINKLER, *supra* note 244, at 369.

rights is not expressly contingent on stock structure and thus might be available to dual-class firms.

For many purposes, corporations are treated as “persons” under the Fourteenth Amendment. Through that amendment, they receive entitlements to equal protection, due process, and most protections in the Bill of Rights.<sup>248</sup> Corporations also enjoy Fifth Amendment criminal procedure protections<sup>249</sup> generally.<sup>250</sup> Finally, as determined in cases like *Citizens United*, corporations have rights under the First Amendment.<sup>251</sup>

In identifying which constitutional rights are available to corporations, courts look to the amendment’s purpose, particularly whether it protects a “‘purely personal’ guarantee[],”<sup>252</sup> with the inquiry focused on whether a fictional person (e.g., a corporation) is entitled to protections extended to natural persons. Courts evaluating that question focus “on the nature, history, and purpose of the particular constitutional provision.”<sup>253</sup> Some rights deemed “purely personal” and thus inapplicable to corporations include “the right to marry, to parent a child, or to vote.”<sup>254</sup> But others do apply to corporations as an extension of their owners’ rights.

It is now settled law that corporations are entitled to First Amendment protection,<sup>255</sup> including protection of speech.<sup>256</sup> Questions around the

248. John D. Moore, *The First Amendment Case for Corporate Religious Rights*, 16 NEV. L.J. 1, 20 (2015) (quoting Darrell A.H. Miller, *Guns, Inc.: Citizens United, McDonald, and the Future of Corporate Constitutional Rights*, 86 N.Y.U. L. REV. 887, 910–11 (2011)); WINKLER, *supra* note 244, at 369.

249. WINKLER, *supra* note 244, at 369; Moore, *supra* note 248, at 20 (quoting Miller, *supra* note 248, at 910–11); *see also* Kent Greenfield, *Corporations are People Too (and They Should Act Like It)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 30, 2019), <https://corpgov.law.harvard.edu/2019/01/30/corporations-are-people-too-and-they-should-act-like-it> [<https://perma.cc/TMW5-EGCD>] (arguing in favor of applying constitutional rights to corporations when they are necessary to incorporate functioning such as “the right to be free of uncompensated takings, the right of access to courts, and the right to be free of unreasonable searches”).

250. An exception is the right against self-incrimination. Moore, *supra* note 248, at 20 (explaining that the right of self-incrimination does not extend to corporations because it is “purely personal” and has historically been limited to individuals).

251. WINKLER, *supra* note 244, at 324–26; *Citizens United v. FEC*, 558 U.S. 310, 342 (2010). *See generally* Kent Greenfield, *In Defense of Corporate Persons*, 30 CONST. COMMENT. 309 (2015) (analyzing corporate personhood and responding to arguments against it).

252. Moore, *supra* note 248, at 20 (quoting *First Nat’l Bank of Bos. v. Bellotti*, 435 U.S. 765, 778 n.14 (1978)).

253. *Id.*

254. Ciara Torres-Spelliscy, *The History of Corporate Personhood*, BRENNAN CTR. JUST. (Apr. 8, 2014), <https://www.brennancenter.org/our-work/analysis-opinion/history-corporate-personhood> [<https://perma.cc/299R-4XWA>].

255. WINKLER, *supra* note 244, at 324–26; *Citizens United*, 558 U.S. at 342 (“The Court has recognized that First Amendment protection extends to corporations.”); *Bellotti*, 435 U.S. at 784 (“We thus find no support in the First or Fourteenth Amendment, or in the decisions of this Court, for the proposition that speech that otherwise would be within the protection of the First Amendment loses that protection simply because its source is a corporation that cannot prove, to the satisfaction of a court, a material effect on its business or property.”). *See generally* Greenfield, *supra* note 251, at 309 (analyzing corporate personhood and responding to arguments against it).

256. U.S. CONST., amend. I.

constitutionality of limitations on corporate speech in the context of political campaign contributions culminated in the Supreme Court's opinion in *Citizens United* in 2010.<sup>257</sup> By a 5–4 vote, the majority held “that the Government may not suppress political speech on the basis of the speaker’s corporate identity.”<sup>258</sup> Regulation of independent corporate expenditures is subject to strict scrutiny, which was fatal in fact<sup>259</sup> at least in this case: the Court found “[n]o sufficient governmental interest” existing to place “limits on the political speech of nonprofit or for-profit corporations.”<sup>260</sup> In the aftermath of *Citizens United*, Congress cannot restrict independent corporate expenditures, but it may regulate corporate contributions to political campaigns in a regime that parallels the regulation of individual contributions.<sup>261</sup>

*Citizens United*, like the rest of the Court’s corporate constitutional jurisprudence, is share-structure agnostic.<sup>262</sup> There is little guidance in its caselaw on how it would interpret the application of constitutional protections asserted by controllers of dual-class firms. There is no indication in, for example, *Citizens United* or the Court’s other major corporate constitutional cases that voting structure would cause a dual-class owner to lose the constitutional rights she exercises through the company. The question may turn on how the Court values the beliefs of a dual-class controller as compared with those of minority shareholders, especially those with little to no say in the corporation’s affairs due to its dual-class structure. Do the latter group’s opinions matter for constitutional purposes? The question remains open.

Corporations also enjoy some religious protections, on both statutory and constitutional grounds. The Court in *Hobby Lobby* addressed whether the Religious Freedom Restoration Act (RFRA), which prohibits the federal government from substantially burdening “a *person’s* exercise of religion,”<sup>263</sup> extends to corporate persons.<sup>264</sup> At issue was the desire of Hobby Lobby, a

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257. See generally *Citizens United*, 558 U.S. 310 (holding that the government may not suppress corporate political speech and invalidating a statute restricting corporate expenditures).

258. *Id.* at 365.

259. See *Adarand Constructors v. Peña*, 515 U.S. 200, 237 (1995) (majority opinion by Justice Sandra Day O’Connor noting the Court’s “wish to dispel the notion that strict scrutiny is ‘strict in theory, but fatal in fact’”).

260. *Citizens United*, 558 U.S. at 365.

261. 52 U.S.C. § 30116(a). Some gaps remain in the Court’s jurisprudence on some aspects of corporations’ political speech rights in this area; though direct contributions to political campaigns are restricted, corporations are permitted to contribute to super PACs without limit. Contributions to super PACs are not limited because super PACs do not contribute to political campaigns but instead use contributions from donors for independent expenditures only.

262. The likeliest reason for this is that corporate law is state, not federal, substantive law. See, e.g., *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 98 (1991). Thus the Court would rarely have cause to decide questions turning on the nuances of share structure.

263. 42 U.S.C. § 2000bb-1 (emphasis added).

264. *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682 (2014). Once it decided that question, it also decided other important questions beyond the scope of this Article.

closely held corporation<sup>265</sup> whose owners had a “sincere religious belief that life begins at conception,”<sup>266</sup> to avoid complying with a generally applicable law that required covered corporations to provide contraception coverage to employees. By a 5–4 vote, the Court held that RFRA’s protection of “persons” did extend to corporations, and that Hobby Lobby was entitled to a faith-based exemption.<sup>267</sup> The Court mentioned the company’s status as a closely held corporation but did not expressly condition its holding on this fact.<sup>268</sup> And elsewhere, the Court suggested few grounds for limiting its holding to such companies. At a minimum, a structure like Snapchat’s, which contains no public investor voting rights, raises the possibility that such a decision might be deemed a protected personal belief at some public companies. After all, the founders of Snapchat could legitimately claim that any given action they take reflects their personal views, and therefore those of the corporation’s voting shareholders; there are no minority shareholder voting rights to consider.

In subsequent cases, the Court further extended constitutional protections to the owners of business entities. In *Masterpiece Cakeshop v. Colorado Civil Rights Commission*, for example, it considered a state agency’s decision to enforce anti-discrimination law against a business that refused to bake a wedding cake for a same-sex couple.<sup>269</sup> The majority concluded that the business’s conduct was protected under the First Amendment’s Free Exercise Clause.<sup>270</sup> Notably, the conduct in question came not (just) from an individual but from a profit-seeking business entity<sup>271</sup>—one that had other employees<sup>272</sup> who in principle could have baked the cake.<sup>273</sup> In *303 Creative LLC v. Elenis*, the Court considered the refusal by a single-member limited liability company (LLC) to design a wedding website for a same-sex couple, holding that the owner’s conduct constituted free expression that enjoyed constitutional protection and trumped public

265. *Burwell*, 573 U.S. at 717.

266. *Id.* at 720.

267. *Id.* at 707–08 (observing that the Court’s own jurisprudence and Congress both treat corporations as “persons” as pertinent to facts of the case (first citing 1 U.S.C. § 1 (defining “person” as used in any Act of Congress to include corporations); and then citing *FCC v. AT & T Inc.*, 562 U.S. 397, 404–05 (2011))).

268. *Id.* at 719.

269. *Masterpiece Cakeshop, Ltd. v. Colo. C.R. Comm’n*, 138 S. Ct. 1719 (2018).

270. *Id.* at 1723–24. Specifically, it held that the state government agency’s decision to enforce state anti-discrimination law against the petitioner “violated the State’s duty under the First Amendment not to base laws or regulations on hostility to a religion or religious viewpoint.” *Id.* at 1731. Justice Kagan wrote separately to argue that “Colorado can treat a baker who discriminates based on sexual orientation differently from a baker who does not discriminate on that or any other prohibited ground. But only, as the Court rightly says, if the State’s decisions are not infected by religious hostility or bias.” *Id.* at 1734 (Kagan, J., concurring).

271. *Id.* at 1723–24.

272. *See id.* at 1745 (Thomas, J., concurring) (observing that the owner had employees).

273. The business is now seeking to expand its constitutional protections further after refusing to bake a cake for a transgender woman that was both pink and blue, which, the woman explained, “represented her gender identity.” Clara Geoghegan, *Colorado Court of Appeals Hears Newest Masterpiece Cakeshop CADA Case*, L.W.K. COLO. (Oct. 7, 2022), <https://www.lawweekcolorado.com/article/colorado-court-of-appeals-hears-newest-masterpiece-cakeshop-cada-case> [https://perma.cc/KTU6-RFUJ].

accommodations laws.<sup>274</sup> The Court noted that the owner “offers her speech for pay and does so through 303 Creative LLC, a company in which she is ‘the sole member-owner.’”<sup>275</sup> Of the commercial nature of the activity, the Court said, “none of that makes a difference.”<sup>276</sup> Neither the majority nor the dissent analyzes the conduct at issue at the entity level, perhaps because the LLC has only one owner. But the discussion is also consistent with a holding that the beliefs of those members or shareholders who control the entity are the only relevant ones for purposes of the constitutional analysis.

Decisions in the lower federal and state courts confirm an ongoing expansion in corporate constitutional rights,<sup>277</sup> including to invalidate laws regulating certain aspects of corporations’ internal affairs. A California law requiring diversity on corporate boards of directors was held to violate the equal protection clause of the state constitution,<sup>278</sup> for example, and other constitutional challenges to corporate governance rules are ongoing.<sup>279</sup> The implications for dual-class firms of the expanding reach of corporate constitutional law merits further consideration.

*b. “Snap Lobby”: Applying Constitutional Protections to Dual-Class Frolics*

Both dual-class frolics and exploits enjoy strong protection under constitutional law.<sup>280</sup> They also raise unique concerns for the simple reason that they substitute the corporation for the individual, allowing one person—a founder of a dual-class firm—to marshal the full force of constitutional and corporate law in promotion of her personal vision. Whether or not that is useful for shareholders, it creates grave risks for society.

274. 303 Creative LLC v. Elenis, 143 S. Ct. 2298 (2023).

275. *Id.* at 2316.

276. *Id.*

277. *See, e.g.*, Nat’l Ass’n of Mfrs. v. SEC, 800 F.3d 518, 530 (D.C. Cir. 2015) (concluding that portions of the SEC’s conflict minerals rule violated corporations’ free speech rights under the First Amendment).

278. Crest v. Padilla, No. 19STCV27561 (Cal. App. Dep’t Super. Ct. May 13, 2022); Sarah Fortt et al., *California Gender Board Diversity Law is Held Unconstitutional*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jun. 12, 2022), <https://corpgov.law.harvard.edu/2022/06/12/california-gender-board-diversity-law-is-held-unconstitutional> [<https://perma.cc/P3AC-VTE6>]. Laws requiring diversity disclosures have fared better. *See* Maeve Allsup, *Diversity Disclosure Rules Thrive as Mandates Die in Court*, BLOOMBERG L. (Jun. 15, 2022, 3:01 PM), <https://news.bloomberglaw.com/esg/board-diversity-disclosure-rules-thrive-as-mandates-die-in-court>.

279. *See* Jody Godoy, *Showdown over Nasdaq Board Diversity Rule Heads to 5th Circuit*, REUTERS (Aug. 29, 2022, 9:05 AM), <https://www.reuters.com/legal/government/showdown-over-nasdaq-board-diversity-rule-heads-5th-circuit-2022-08-29> [<https://perma.cc/D8Y3-P429>] (describing lawsuit bringing First Amendment challenge to Nasdaq rule requiring disclosure of board diversity for listed companies); Jonathan D. Brightbill, *Evaluating Challenges to SEC’s ESG Disclosure Proposal*, WINSTON & STRAWN LLP (Aug. 25, 2021), <https://www.winston.com/en/winston-and-the-legal-environment/evaluating-challenges-to-secs-esg-disclosure-proposal.html> [<https://perma.cc/CB62-YPTJ>] (reviewing challenges to an SEC rule requiring ESG disclosures); Andrew Ramonas & Amanda Iacone, *SEC Climate Rules Pushed Back Amid Bureaucratic, Legal Woes*, BLOOMBERG L. (Oct. 19, 2022, 4:00 AM) (same), <https://news.bloomberglaw.com/securities-law/sec-climate-rules-pushed-back-amid-bureaucratic-legal-woes>.

280. They also enjoy protection under the business judgment rule of corporate law. *See infra* Part III.B.3.



Using Snapchat's structure as an example, with some tweaks to the company's mission, helps shine a light on dual-class "frolics." These are actions by company founders that are insufficiently connected to the firm's scale-enhancing purpose.

Although it is a public company, the only stock Snapchat has issued that trades publicly has no voting power; founders Evan Spiegel and Bobby Murphy control over 99% of its voting power between them<sup>281</sup> despite owning less than 10% of its equity combined.<sup>282</sup> Consider a company that has the share structure and all other features of Snapchat's parent company except its corporate mission, which it takes from Hobby Lobby. This company is called "Snap Lobby."

Suppose that Spiegel and Murphy were the founders and controllers not of Snapchat but of "Snap Lobby." Snap Lobby decides to cease providing contraception coverage to its 5,288 employees,<sup>283</sup> claiming a religious exemption.<sup>284</sup> Suppose further that the two of them had and could document a "sincere religious belief that life begins at conception,"<sup>285</sup> but that their employees by and large held a different view.<sup>286</sup> Under the above framework, this would be characterized as a frolic: a personal excursion departing from the scale-enhancing function of dual-class stock that is of primary interest to the founders themselves. Yet given *Hobby Lobby*, on what basis could Spiegel and Murphy (or Snap Lobby) face negative legal consequences for violating an obligation to provide contraception coverage?

By some measures, Hobby Lobby is a bigger firm than Snap Lobby. Around 13,000 people worked at Hobby Lobby at the time of the litigation and it operates hundreds of retail locations.<sup>287</sup> The company was (and remains) owned by its founder, along with members of his family.<sup>288</sup> Snap Lobby, unlike Hobby Lobby, has public shareholders, but their shares implicitly recognize that only the founders' voice matters. Corporate law generally does not interfere with such private-ordering decisions.<sup>289</sup> Further, Snap Lobby will observe, past

281. Snap Inc., *supra* note 8, at 44.

282. *Id.* at 139 (reporting 3% and 5.9% figures for Spiegel and Murphy, respectively).

283. *Id.* at 9 (estimating number of full-time employees).

284. The contours of the religious exemption to the contraception mandate in the Affordable Care Act have evolved over time, *see, e.g.*, Neil S. Siegel & Reva B. Siegel, *Compelling Interests and Contraception*, 47 CONN. L. REV. 1025, 1028–29 (2015), and this Article does not attempt to define them.

285. *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682, 720 (2014).

286. The contrary situation—employees holding conservative political views—would be unusual at a large technology company. *See* Rani Molla, *Tech Employees Are Much More Liberal than Their Employers—at Least as Far as the Candidates They Support*, VOX (Oct. 31, 2018, 12:16 PM), <https://www.vox.com/2018/10/31/18039528/tech-employees-politics-liberal-employers-candidates> [<https://perma.cc/PV3H-23U3>].

287. *Hobby Lobby Stores, Inc. v. Sebelius*, 723 F.3d 1114, 1122 (10th Cir. 2013), *aff'd sub nom. Burwell*, 573 U.S. 682.

288. *Burwell*, 573 U.S. at 702–03.

289. As discussed *infra* Part III.B.3, a choice by the founders to cause the corporation to repudiate contraceptive coverage would also likely be protected by the business judgment rule.

precedent recognizing a fundamental individual right to contraception<sup>290</sup> does not create an affirmative obligation in employers to pay for it.

The strongest constitutional objection would be an attack by public shareholders on the legitimacy of an assertion of constitutional rights by the founders on behalf of the publicly traded corporation. This would be a case of first impression, but given the expansion of corporate constitutional rights in the past two decades—as well as changes to the composition of the Supreme Court since they decided *Citizens United* (2010), *Hobby Lobby* (2014), and *Masterpiece Cakeshop* (2018)—there is reason to believe courts would seriously consider deferring to Snap Lobby’s arguments.

Some scholars have argued that the Court should extend the logic of *Hobby Lobby* to other for-profit corporations,<sup>291</sup> for example those that are publicly traded. The Court’s existing jurisprudence provides a vehicle to do so. While the Court in *Hobby Lobby* repeatedly noted the corporation’s closely held status, it did not expressly rule out the application of the holding to more diffusely held or even publicly traded corporations (regardless of share structure). It did indicate a few reasons why it believed such corporations would be *unlikely* to frequently bring similar claims in the first place.<sup>292</sup> But it would be a stretch to read such a prediction as a binding constraint or even an indication of the Court’s own sentiment. Moreover, the Court itself emphasized the universality of its interpretation of RFRA’s operative language. Of the word at the heart of that case—person—it stated: “*no conceivable definition of the term* includes natural persons and nonprofit corporations, but not for-profit corporations.”<sup>293</sup> As a type of for-profit corporation, dual-class firms would presumably be “persons” on the Court’s reading.

After all, upon buying the stock, public owners of Snap Lobby consented to be fully ruled in all corporate matters by Spiegel and Murphy,<sup>294</sup> giving up their voice in exchange for what they believed was economic upside. Assuming the firm’s religious purpose was properly disclosed at the time it sold stock to the public, could Snap Lobby argue that its controllers, in rejecting contraceptive coverage, were merely exercising their religious beliefs, and not trespassing against other shareholders in doing so? It is not possible to predict with confidence how the Court would answer this question.

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290. See *Griswold v. Connecticut*, 381 U.S. 479 (1965).

291. See, e.g., Moore, *supra* note 248, at 18–36 (arguing that courts should extend First Amendment religious protections to for-profit corporations that are not closely held if they can demonstrate a sincere corporate religious belief).

292. *Burwell*, 573 U.S. at 717 (“[I]t seems unlikely that . . . corporate giants . . . will often assert RFRA claims” due to the improbability “that unrelated shareholders—including institutional investors with their own set of stakeholders—would agree to run a corporation under the same religious beliefs.”).

293. *Id.* at 708 (emphasis added).

294. For a discussion of the complication that many shareholders in large corporations own stock through retirement funds that passively own an index of stocks, see *supra* Part II.

c. “SocialMediaCo”: *Applying Constitutional Protections to Dual-Class Exploits*

If the stylized example of a Snap Lobby seems unlikely, perhaps one can more readily imagine a dual-class founder exploiting the scale enabled by her company’s stock structure to leverage its corporate rights, including in ways that generate negative externalities. For example, suppose that a founder–CEO controls a social media company, “SocialMediaCo,” via a dual-class structure. SocialMediaCo is larger and more successful, its securities filings declare, because its dual-class structure shelters its “visionary” chief. That controller, through the directors he alone elects, causes the corporation to make political donations for the purpose of forestalling regulation of the firm and increasing its likelihood of receiving government contracts. The corporation may have more resources to devote to this than single-class peer firms; after all, increased scale and profitability is the thesis of the dual-class form. But the controller is doing so in a way that stands to increase shareholder wealth, so agency responses are of limited utility. This should raise questions about the limits of private ordering in providing a socially valuable check on dual-class controllers.

The case of Google demonstrates that the SocialMediaCo hypothetical is far from fanciful. Google increased its lobbying expenditures by 27% in 2021 over 2020 amid rising political pressures on large technology firms regarding privacy and allegedly anticompetitive practices, among others.<sup>295</sup> One of Google’s strategic goals is to resist certain forms of regulation, including by the Department of Justice, which has since filed suit against it,<sup>296</sup> alleging that the company monopolizes aspects of the search engine market.<sup>297</sup>

Of course, engagement in the political process by corporations is not limited to those with a dual-class structure. Single-class counterparts of Google,

295. *Google U.S. Lobbying Jumps 27% as Lawmakers Aim to Rein in Big Tech*, REUTERS (Jan. 20, 2022, 5:19 PM), <https://www.reuters.com/technology/google-us-lobbying-jumps-27-lawmakers-aim-rein-big-tech-2022-01-20/> [https://perma.cc/6F67-MJBD].

296. David McCabe & Nico Grant, *U.S. Accuses Google of Abusing Monopoly in Ad Technology*, N.Y. TIMES (Jan. 24, 2023), <https://www.nytimes.com/2023/01/24/technology/google-ads-lawsuit.html>.

297. Tiago Bianchi, *Market Share of Leading Desktop Search Engines Worldwide from January 2015 to July 2023*, STATISTA (Sep. 20, 2023), <https://www.statista.com/statistics/216573/worldwide-market-share-of-search-engines/> [https://perma.cc/43W2-TEUD] (reporting Google’s share of the global search market in December 2022 at 84.08%, relatively stable throughout the period studied, from January 2015 to July 2023).

such as Apple,<sup>298</sup> Exxon Mobil,<sup>299</sup> and General Motors,<sup>300</sup> engage in political advocacy, spending, or both—and their decisions to do so are protected by both constitutional law (e.g., *Citizens United*) and corporate law (i.e., the business judgment rule<sup>301</sup>).

However, recall that the purpose of dual-class stock in a modern technology firm like SocialMediaCo is to promote scale. Taking that purpose at face value, dual-class firms that intervene in politics are leveraging *superior* scale relative to a counterfactual version of the same firm that has a single-class structure. They can capture a larger share of government contracts for the same reason. The question, then, is whether a dual-class founder who is capable of harnessing both superior scale and the strong protections the business judgment rule provides to corporate strategy might marry the two to engage in conduct that raises social concerns.

Such a founder is, to borrow Edmund Burke’s formulation, operating as a corporation in the guise of a human being.<sup>302</sup> It is probably not an accident that many dual-class firms are platform companies, including Google, Facebook, Snapchat, Slack, Doordash, Lyft, and Airbnb, that rely on market power and network effects to fuel their businesses.<sup>303</sup> Perhaps in part for this reason, a vast literature debates whether these companies ought to have unchecked ability to use a “wedge” stock structure that dilutes their investors’ voice<sup>304</sup> to the point that their founders enjoy the status of “corporate royalty.”<sup>305</sup> But that analysis stops short of considering costs that fall primarily outside the walls of the firm.

298. *Public Policy Advocacy*, APPLE, <https://www.apple.com/public-policy-advocacy/> [<https://perma.cc/J4QU-N6VG>] (stating that Apple “does not make political contributions to individual candidates or parties” and does not have a political action committee, but does “occasionally” donate to ballot measures and engage in “direct advocacy” at the federal, state, and local levels).

299. *Political Contributions*, EXXONMOBIL, <https://corporate.exxonmobil.com/about-us/policy/political-contributions> [<https://perma.cc/MW9J-GPRY>] (“The Board of Directors has authorized ExxonMobil to make political contributions to candidate committees and other political organizations as permitted by applicable laws in the United States and Canada.”).

300. *U.S. Political Engagement Overview*, GEN. MOTORS, <https://investor.gm.com/static-files/2c15b126-d9b1-450d-9170-2a98be77bb0d> (“GM makes political contributions to candidates and entities that support our industry, reflect our values and principles, and advance our vision for the future of mobility.”).

301. See *infra* Part III.B.3.

302. See PHILLIPS & SHARMAN, *supra* note 1, at 144.

303. See Caio Mario S. Pereira Neto & Filippo Lancieri, *Towards a Layered Approach to Relevant Markets in Multi-Sided Transaction Platforms*, 83 ANTITRUST L.J. 429, 429, 431–32 (2020); Kenneth A. Bamberger & Orly Lobel, *Platform Market Power*, 32 BERKELEY TECH. L.J. 1051, 1087 (2017); see also Jerry Davis, *The Simple Reason Tech CEOs Have So Much Power*, FAST COMPANY (Apr. 3, 2021), <https://www.fastcompany.com/90620747/dual-class-voting-tech-ceo-power> [<https://perma.cc/55TB-6MFA>] (discussing the use of dual-class stock at leading tech firms).

304. See *supra* Part II.

305. Jackson, *supra* note 25.

### 3. *Applying the Business Judgment Rule to Dual-Class Frolics and Exploits*

In addition to their protections under constitutional law, frolics and exploits by dual-class founders receive strong protection in corporate law under the business judgment rule (BJR). The BJR has special force in dual-class firms, as a practical if not a doctrinal matter. The rule “mandates that courts defer to the board of directors’ judgment absent highly unusual exceptions.”<sup>306</sup> It insulates directors and officers from lawsuits alleging breaches of both the duty of care and the duty of loyalty—that is to say, suits claiming, respectively, that the agent egregiously violated her professional responsibilities or that she inappropriately put her own interests ahead of the corporation’s.<sup>307</sup> In so doing, the BJR places corporate policy decisions “all but beyond the review of courts.”<sup>308</sup>

The BJR implies a statutory<sup>309</sup> choice that “businesspeople and the market are better able to decide” corporate policy than judges and shareholders and that their decisions have more legitimacy as well.<sup>310</sup> However, its protections are not limited to situations where businesspeople arguably enjoy a comparative advantage. Delaware law makes the BJR available not only for actions implicating the duty of care but also for those implicating the duty of loyalty, so long as an independent board approves it.<sup>311</sup> Recent Delaware caselaw provides a path for dual-class and other types of controlled firms to take advantage of the same protections.<sup>312</sup>

306. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87–88 (2004).

307. For a fuller discussion of these duties, see Shill, *supra* note 29, at 1866–72. For a discussion of internal inconsistencies in the theory of the duty of loyalty, see Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 939 (2019).

308. Shill, *supra* note 29, at 1813 (citing Bainbridge, *supra* note 306, at 87–88).

309. See *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (“[T]he business judgment rule is the offspring of the fundamental principle, codified in [Delaware General Corporation Law] § 141(a), that the business and affairs of a Delaware corporation are managed by or under its board of directors. . . . The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors.”) (footnote omitted) (citations omitted), *overruled on other grounds*, *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

310. Shill, *supra* note 29, at 1813. The assignment of corporate decision-making authority to the board of directors supplies an additional rationale for deferring to them in the first instance.

311. *Id.* at 1864–66 (discussing the effects of approval of a decision by a board or board committee composed of a majority of outside, or independent, directors).

312. See, e.g., Andrew G. Gordon et al., *Delaware M&A Updates*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 2, 2023), <https://corpgov.law.harvard.edu/2023/02/02/delaware-ma-updates/> [<https://perma.cc/P3J3-5AXJ>] (canvassing recent Delaware cases adjudicating fiduciary duty challenges). The most that would be required in order to enable a controlled corporation (regardless of share structure) to take advantage of BJR protection is the process spelled out in *Kahn v. M & F Worldwide Corp.* and its progeny, which require (among other things) approvals from a majority of the minority shareholders. Shill, *supra* note 29, at 1885–88 (discussing *Kahn v. M & F Worldwide Corp.*, 88 A.3d. 635 (Del. 2014), *overruled on other grounds*, *Flood v. Synutra Int’l, Inc.*, 195 A.3d 754 (Del. 2018)). That case involved a management buyout, and the procedure it set forth would be overkill for most transactions by controlled firms. *Id.*

Which decisions are eligible for immunization from suit by the BJR? Nearly any corporate policy decision.<sup>313</sup> This would include, for example, the decision to donate corporate money to a particular charity<sup>314</sup> or to engage in political spending.<sup>315</sup> The availability of BJR immunity for corporate charitable donations reflects the presumption that these gifts contribute to the corporation's goodwill and are thus sound business decisions. But the definition of a charity under the Internal Revenue Code is expansive, many dubious charities operate with impunity,<sup>316</sup> and no particularized showing of a connection to the corporate interest need be made.

On the other hand, even gifts to charities that have a close *personal* connection to top brass at the corporation can benefit from BJR immunity. In *Kahn v. Sullivan*, for example, shareholders challenged the corporation's contribution to the building of a museum to house an art collection owned in part by the man who was serving as CEO and chairman of the board.<sup>317</sup> Even in light of the close personal connection of the CEO and chairman to the charity, which irked some shareholders, the trial court concluded and the state supreme court agreed "that the business judgment rule would likely have protected the board's decision to make the charitable gift."<sup>318</sup>

Theoretically, the appropriate vehicle for questioning BJR treatment of charitable contributions is a waste claim.<sup>319</sup> However, in evaluating allegations that a gift wastes corporate assets, courts consider the reasonableness of the gift, applying a very deferential standard.<sup>320</sup> This makes waste claims difficult for the shareholder to win.<sup>321</sup>

313. Some corporate policy decisions, for example selling the corporation or substantially all its assets, require a shareholder vote as a matter of statute. *See, e.g.*, DEL. CODE ANN. tit. 8, § 271 (2023). Others require that the board follow special procedures to avoid the application of entire fairness review. *See* Shill, *supra* note 29, at 1872–79, 1885–90.

314. The classic case on the subject is *A.P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581 (N.J. 1953). BAINBRIDGE, *supra* note 11, at 37–45.

315. *See supra* Part III.B.2.

316. *See, e.g.*, Barry Meier & Rebecca R. Ruiz, *Patchwork Oversight Allows Dubious Charities to Operate*, N.Y. TIMES (May 21, 2015), <https://www.nytimes.com/2015/05/22/business/patchwork-oversight-allows-dubious-charities-to-operate.html>.

317. *Kahn v. Sullivan*, 594 A.2d 48, 51 (Del. 1991).

318. R. Franklin Balotti & James J. Hanks, Jr., *Giving at the Office: A Reappraisal of Charitable Contributions by Corporations*, 54 BUS. LAW. 965, 977 (1999). *See generally Kahn*, 594 A.2d at 61 (noting that the trial court had determined that the business judgment rule applied to the Special Committee's actions, including the decision to build the museum).

319. *See generally* Steven C. Caywood, *Wasting the Corporate Waste Doctrine: How the Doctrine Can Provide a Viable Solution in Controlling Excessive Executive Compensation*, 109 MICH. L. REV. 111 (2010) (outlining court treatment of corporate waste claims).

320. For example, in *A.P. Smith Mfg. Co. v. Barlow*, the Court deemed a fire hydrant manufacturer's donations to Princeton University reasonable and permissible, citing for support a statement by a corporate titan that private universities supported the system of "[c]apitalism and free enterprise." 98 A.2d at 583.

321. *See* Caywood, *supra* note 319. *But see* Harwell Wells, *The Life (and Death?) of Corporate Waste*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 2, 2017), <https://corp.gov.law.harvard.edu/2017/01/02/the-life-and-death-of-corporate-waste> [<https://perma.cc/TL6E-4C8N>] ("The conventional wisdom is that waste

Beyond the BJR but in a similar vein, corporations can also give to charities with which they share directors—that is, charities some of whose board members are also independent directors of the donating corporation—without those directors losing their “independent” status at the corporation.<sup>322</sup>

The rich, nuanced caselaw here lays procedural traps that would cause the poorly advised corporation to lose BJR protection for potentially conflicted charitable donations and other transactions.<sup>323</sup> These traps apply to both corporations in general and controlled corporations in particular, including dual-class firms.<sup>324</sup> However, so long as certain procedural minima are satisfied, the BJR is available to controlled firms, including those with dual-class founders in control.<sup>325</sup>

\* \* \*

A corporation’s reservoir of authority under the BJR and twenty-first century constitutional law is deep. Those doctrines can enable frolics and exploits by dual-class founders that generate significant social costs.

Snap Lobby-style frolics by dual-class founders might not prompt a response even from alert shareholders for two reasons: they are outvoted and the conduct at issue probably does not waste a lot of corporate capital. Exploits, on the other hand, are *especially* unlikely to invite an effective response from shareholders. The underlying theory of a dual-class founder exploiting their company’s scale for corporate gain is that they demonstrate *too close* a nexus to the structure. For these reasons, these social costs escape existing reform proposals that operate purely on the agency channel.

#### IV. A POLICY PLAYBOOK FOR DUAL-CLASS SOCIAL COSTS

This Part details prescriptions that address dual-class social costs identified in Part III. These could complement other proposals designed to address the structure’s agency costs, for example sunsets,<sup>326</sup> but they can also stand on their own.

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claims never succeed; but empirical studies show that’s wrong, and some of the most significant corporate law cases of the last two decades have dealt with waste.”)

322. Ye Cai et al., *Paying by Donating: Corporate Donations Affiliated with Independent Directors*, 34 REV. FIN. STUD. 618, 619 (2021) (“[S]tock-exchange rules do not bar directors from being classified as independent based on corporate charitable contributions to director-affiliated charities, regardless of their amount.”).

323. See Shill & Strand, *supra* note 239, at 267–70 (reviewing BJR evolution); Shill, *supra* note 29, at 1862–90 (reviewing the mechanisms by which boards can ensure BJR application).

324. See Shill & Strand, *supra* note 239, at 267–70; Shill, *supra* note 29, at 1862–90.

325. Shill, *supra* note 29, at 1862–90. And, notably, the decision of whether to issue dual-class stock in the first place is itself protected by the BJR. Shill & Strand, *supra* note 239, at 276–79.

326. See Winden, *supra* note 40; *supra* Part II.C.1.

These prescriptions are narrowly tailored to balance two competing policy priorities. On one hand, they seek to allow early investors to select entrepreneurs whom they deem worthy of being sheltered from later generations of investors—i.e., to realize the potential of the dual-class structure expressed by Google in its Owner’s Manual. Relatedly, they seek to avoid introducing a disincentive to going public, a perennial worry among securities regulation scholars. On the other hand, they strive to prevent founders from abusing the expansive constitutional and corporate powers of the modern firm for purposes that lack a nexus to the motivating theory of dual-class stock—or that unduly exploit such a nexus.

*A. Addressing Dual-Class “Frolics” Like a Hypothetical “Snap Lobby” via the Shareholder Proposal Channel*

Founders of dual-class firms should use their outsize control rights to advance their scale-enhancing vision. That normative argument tracks the underlying business logic motivating the existence of the dual-class structure in general and its success in modern technology firms specifically. But it is not, currently, the basis of a legal argument, nor is it well suited to enforcement in litigation.

Frolics by founders that depart from the purpose of dual-class stock—acts like a hypothetical Snap Lobby refusing to provide birth control to employees<sup>327</sup>—are unlikely to be cured by voice or loyalty, because dual-class firms structurally disempower their shareholders. The effect of this disempowerment should be understood as two-faceted. First, the dual-class structure raises the level of agency cost required in order to provoke investor reaction, because it makes it harder for investors to achieve change. Second, because frolics probably trigger more social than agency costs, they are unlikely to clear this higher bar for investor reaction. The Snap Lobby hypothetical illustrates the interaction of these two dynamics. Denying contraception coverage might actually lower the corporation’s insurance premiums slightly—probably not enough to lead investors to agitate in favor, but by the same token, narrow profit maximization may not provide much reason to oppose it.

To address dual-class frolics, the SEC should amend its shareholder proposal rule to make it easier to bring proposals at dual-class firms. This change to Rule 14a-8<sup>328</sup> could make it easier to bring such proposals (also known as resolutions). For starters, it could relax the procedural requirements for making them.<sup>329</sup> But given the broader muffling of shareholder voice at

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327. See *supra* Part III.B.2.ii.

328. 17 C.F.R. § 240.14a-8 (2023).

329. For example, the SEC could lower the bar for shareholder proposals at dual-class issuers by reinstating the lesser minimum holding period and investment amount (twelve months for a \$2,000 investment) required of investors prior to 2020. *SEC Adopts Amendments to Modernize Shareholder Proposal Rule*,



dual-class firms and its potential to create social costs, the SEC should consider simply making it easier to bring meritorious proposals at dual-class firms to begin with.

The most straightforward way to encourage shareholder proposals that seek to reduce dual-class firms' social costs is to amend the substantive bases for exclusion available to issuers when they use dual-class stock. Firms with unequal voting rights should have a harder time excluding shareholder proposals.

For dual-class companies only, the SEC should abolish the "economic relevance" basis for exclusion provided by Rule 14a-8(i)(5).<sup>330</sup> This basis allows companies to exclude a shareholder proposal that has minimal economic relevance to their finances and "is not otherwise significantly related to the company's business."<sup>331</sup> This is an appropriate basis for most companies, as it minimizes undue meddling. But in a dual-class company, the most significant potential source of "meddling"—shareholder participation in corporate governance—has already been sharply reduced or eliminated up front, via unequal or nonexistent voting rights. Adopting this change would give oxygen to proposals that relate to a dual-class company's social costs, allowing discussion and consideration of them at the annual meeting. It would also invite more participation from shareholder advocates.

Though it goes further than past changes, this reform is directionally in sync with other changes to Rule 14a-8 that have recently been implemented<sup>332</sup> or proposed<sup>333</sup> by the SEC. The implemented changes include a declaration by the SEC that it is essentially returning to the standard of *Lovenheim v. Iroquois Brands, Ltd.*,<sup>334</sup> under which "proposals that raise issues of broad social or ethical concern related to the company's business may not be excluded, even if the relevant business falls below the economic thresholds of Rule 14a-8(i)(5)."<sup>335</sup> However, at dual-class firms, the outright abolition of this basis of

SEC. & EXCH. COMM'N (Sept. 23, 2020), <https://www.sec.gov/news/press-release/2020-220> [<https://perma.cc/E5H5-FVW4>] (describing change in minimum holding period for an investor who owns \$2,000 in company stock).

330. 17 C.F.R. § 240.14a-8(i)(5) (2023).

331. Specifically, the exception allows the exclusion of a proposal when it "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business." *Id.*

332. The most significant example of a recent fully implemented change to the SEC's shareholder proposal rules is Staff Legal Bulletin 14L, which rescinded three prior staff legal bulletins. *See Shareholder Proposals: Staff Legal Bulletin No. 14L (CF)*, SEC. & EXCH. COMM'N (Nov. 3, 2021), <https://www.sec.gov/corpfin/staff-legal-bulletin-14l-shareholder-proposals> [<https://perma.cc/7QBL-J9EY>]. This had the effect of narrowing the substantive bases under which companies could exclude shareholder proposals. *Id.*

333. Richard Alsop et al., *SEC Proposes Narrowing Grounds for Excluding Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 7, 2022), <https://corpgov.law.harvard.edu/2022/08/07/sec-proposes-narrowing-grounds-for-excluding-shareholder-proposals/> [<https://perma.cc/MV6U-JEGA>].

334. *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554 (D.D.C. 1985).

335. *See Shareholder Proposals: Staff Legal Bulletin No. 14L (CF)*, *supra* note 332.

exclusion would be preferable because it would deny founders the ability to stonewall minority shareholders.<sup>336</sup> And as it does not seek to regulate (much less bar) the issuance of dual-class stock, it should not run aground on the shoals of existing caselaw—for example, a case rejecting an effort by the SEC to bar dual-class stock from public exchanges.<sup>337</sup>

Bolstering shareholder voice by making Rule 14a-8 proposals easier to bring at dual-class companies would help restore the power of shareholders to act as a proxy for social interests. That said, while the Rule 14a-8 process gives advocates of change a venue (the shareholder meeting) and a vehicle (the shareholder proposal), skeptics may rightly note that it provides no assurance that dual-class frolics will be curbed.

Enhancements to Rule 14a-8 target process rather than outcomes as such. A robust debate exists on that process.<sup>338</sup> Many scholars and market commentators question its utility; shareholder proposals ordinarily fail to win majority support, and remain precatory even when they succeed (but can distract managers).<sup>339</sup> Shareholder advocates subscribe to a theory of change that treats campaigns as opportunities for awareness-raising and mobilization that do not require electoral victory.<sup>340</sup> But at least as to dual-class firms and their social costs, this debate is only of limited relevance. In dual-class companies, unlike their single-class counterparts, proposals frequently *do* attract

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336. For example, companies could force shareholders to make a case to the SEC that their proposal is truly of “broad social or ethical concern.” See *Shareholder Proposals: Staff Legal Bulletin No. 14L (CF)*, *supra* note 332 (emphasis added). A law firm client note reviewing recent no-action letters suggested that the SEC staff may currently be applying a stricter standard to the evaluation of issuer requests for exclusion, at least under two other substantive grounds. Eric T. Juergens et al., *Shareholder Proposals under Rule 14a-8: Practical Guidance for Proxy Season*, DEBEVOISE & PLIMPTON: DEBEVOISE IN DEPTH (Dec. 14, 2022), <https://www.debevoise.com/insights/publications/2022/12/shareholder-proposals-under-rule-14a8> [<https://perma.cc/84NX-A7FN>] (click “View Debevoise In Depth” icon) (reviewing SEC staff comments on no-action requests in 2022). It is easy to imagine this changing with the political winds, however.

337. See *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (holding that the SEC lacks authority under § 19 of the Securities Exchange Act of 1934 to bar stock exchanges from listing common stock with unequal voting rights); Stephen M. Bainbridge, *The Short Life and Resurrection of SEC Rule 19c-4*, 69 WASH. U. L.Q. 565 (1991).

338. See, e.g., Virginia J. Harnish, *Rule 14a-8 After Reagan: Does It Protect Social Responsibility Shareholder Proposals?*, 6 J.L. & POL. 415 (1990); see also Laughlin Silvestri, *The Climate Crisis, Impact Investing, and Corporate Accountability: Amplifying Shareholder Concerns About Corporate Sustainability Measures and Tackling Transparency Surrounding Corporate Contributions to the Climate Crisis*, 14 GOLDEN GATE U. ENV'T L.J. 83, 92–95 (2022) (discussing the effects of recent changes to Rule 14a-8).

339. See Merritt B. Fox & Menesh S. Patel, *Common Ownership: Do Managers Really Compete Less?*, 39 YALE J. ON REG. 136, 174 n.85 (2022).

340. For example, a leading shareholder advocate has written: “Voting on shareholder resolutions is different than a standard political vote. If you were running for mayor and got only 29 percent of the vote, you’d likely consider it a failure,” whereas if 29% of a corporation’s ownership base is agitated about an issue the firm is likely to feel some obligation to consider it. ANDREW BEHAR, *THE SHAREHOLDER ACTION GUIDE: UNLEASH YOUR HIDDEN POWERS TO HOLD CORPORATIONS ACCOUNTABLE* 10 (2016).

high levels of support from public shareholders.<sup>341</sup> This may be because the more important voice mechanisms are absent in dual-class firms.

If enhanced at dual-class companies for the explicit purpose of curbing social costs, it is not fanciful to imagine that shareholder proposals might take on a different character. Dual-class shareholders have little hope of influencing other corporate actions (for example, via director elections); in these companies, the proposal process might be a productive place for those energies to go.

*B. Addressing Dual-Class “Exploits” Like a Hypothetical “SocialMediaCo” via the Government Contracts Channel*

Regardless of any changes to Rule 14a-8 at dual-class firms, the overwhelming majority of shareholders would likely continue to be only weakly motivated to advocate for anything other than their own financial interests. In fact, this agency gap is a key reason why it is important to consider the social costs of dual-class stock to begin with—and in particular, those of the technology platform giants that use it. For this reason, a solution that works outside the agency channel is needed to address exploits, acts that seek to *inappropriately* cement the founder’s scale-enhancing vision. This category of conduct arguably serves shareholders but frustrates the public interest—for example, by facilitating large corporate campaign contributions with the aim of forestalling platform regulation or by lobbying for government contracts. Google and Palantir have substantial government contracting businesses.

Dual-class firms that engage in political spending should be barred from government contracts for a period of two years afterwards. Under *Citizens United*, stricter limitations on political spending by such firms might face a dubious constitutional future; this rule, however, occupies firmer ground. The social costs created by exploits of this type are in the nature of inappropriately influencing public officials (or giving the appearance of doing so).

Notably, in 2012, the SEC adopted the same restriction advocated here for investment advisers and for this same reason: covered persons are prohibited from providing advisory services to government entities if they have made campaign contributions within the previous two years.<sup>342</sup> That restriction has survived challenge under both the Administrative Procedure Act and the First

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341. Papadopoulos, *supra* note 98 (reporting that after “excluding the voting power of directors and officers from the vote tally, we estimate median support rates for these proposals at approximately 60 percent of votes cast,” and observing that “actual support levels among minority investors are likely higher, since, in many instances, the super-voting stock is also held by [groups that were included in the denominator, like] non-directors and non-executives”).

342. See 17 C.F.R. § 275.206(4)–5(a) (2023).

Amendment, most recently in *New York Republican State Committee v. SEC*.<sup>343</sup> The standard applied by that court in assessing the First Amendment claim was whether the rule “is closely drawn to serve a ‘sufficiently important’ governmental interest.”<sup>344</sup> It held that the rule’s rationale—preventing corruption—cleared that bar, and strongly suggested it would even survive strict scrutiny if that were the standard.<sup>345</sup> The same would, hopefully, apply to a rule for dual-class firms. At a minimum, dual-class firms should be pressured to engage in more robust disclosure of their political spending.<sup>346</sup>

An SEC that regulates dual-class firms more stringently than single-class firms would draw ire simply for that reason, i.e., for interfering in private ordering.<sup>347</sup> However, there is precedent for treating controlled companies—including those with dual-class structures—differently in some aspects of securities regulation.<sup>348</sup>

Finally, the limited scope of this proposal bears noting. Edmund Burke’s critique hints at the social risks inherent in concentrating unaccountable power even in private hands—and no corporate law device achieves such a concentration more effectively than dual-class stock. In addition to the examples noted above, a dual-class company could make operational decisions that do not seek to influence the U.S. political or government contracting process but are immensely consequential anyway. Social media content moderation provides a prominent example. In 2017, “the Myanmar security forces undertook a brutal campaign of ethnic cleansing against Rohingya Muslims,” per Amnesty International.<sup>349</sup> The human rights organization accused Meta, the dual-class parent of Facebook, of using “dangerous algorithms” and a “business model” that “substantially contributed to the

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343. N.Y. Republican State Comm. v. SEC, 927 F.3d 499, 509–10 (D.C. Cir. 2019). The court indicated this result was compelled by an earlier holding in an “indistinguishable case” involving a rule “identical in every constitutionally relevant way” but applied to a different set of investment professionals. *Id.* at 510.

344. *Id.*

345. *Id.* Preventing corruption and the appearance thereof are “the only legitimate and compelling government interests thus far identified for restricting campaign finances.” *FEC v. Nat’l Conservative Pol. Action Comm.*, 470 U.S. 480, 496–97 (1985).

346. See, e.g., Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923 (2013). But see Michael D. Guttentag, *On Requiring Public Companies to Disclose Political Spending*, 2014 COLUM. BUS. L. REV. 593 (2014).

347. See, e.g., Bebchuk & Jackson, *supra* note 346, at 953–66.

348. For example, stock exchange listing rules exempt controlled companies from the requirement of ensuring that a majority of their boards are composed of independent outside directors. See § 303A.00 Introduction, in *Listed Company Manual*, N.Y. STOCK EXCH., <https://nyseguide.srorules.com/listed-company-manual/09013e2c8503fca9> [<https://perma.cc/PT36-E4VR>]; § 5615(c), in *Rulebook—The Nasdaq Stock Market*, NASDAQ, <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/Nasdaq%205600%20Series> [<https://perma.cc/7LAW-RXUT>].

349. AMNESTY INTERNATIONAL, THE SOCIAL ATROCITY: META AND THE RIGHT TO REMEDY FOR THE ROHINGYA 6 (2022), <https://www.amnesty.org/en/documents/ASA16/5933/2022/en/> [<https://perma.cc/76YX-VCSU>].

serious human rights violations perpetrated against the Rohingya.”<sup>350</sup> As with political contributions and government contracts, it would be unwise to expect shareholders to curb practices that stand to increase their wealth by exploiting the scale of the dual-class firm. But operational decision-making is harder to regulate from a corporate law perspective because it implicates core business judgments. To the extent such judgments are influenced by the controller’s lock on the firm—and are in fact as dangerous as Amnesty alleges—they may not be susceptible to regulation via the government contracts channel.

## CONCLUSION

For well-founded reasons, the dual-class stock structure is favored by leading platform companies and other technology giants. It governs many of the firms synonymous with innovation, including Google, Facebook, Snapchat, and Lyft. Each of these publicly traded companies is fully controlled by two men or even just one.

The standard account of dual-class stock considers only the tradeoffs of the structure for founders and investors. That perspective has severe conceptual limitations when it comes to understanding the social costs of the corporation, including its stock structure.

As large corporations, dual-class technology firms are hardly unique in generating outsize impacts on society. But they *are* unique in two things. First is their power to insulate founders from the market so that they can amass scale. This was the thesis of the dual-class structure set forth by Google in its Owner’s Manual manifesto,<sup>351</sup> and it swept technology firms following the company’s IPO in 2004. Second, dual-class stock is unique at empowering one or two founders at each scaled-up company to fully dictate corporate policy, and by implication many external effects thereof. Problems with dual-class stock are widely known, but existing reform proposals—which try to create substitutes for ordinary shareholder protections that exist at single-class firms—are a poor match for these social costs. This Article expands the literature’s domain from agency to externality, a framework that contributes to evergreen but urgent debates over the side effects of business activity and concentrated corporate power.<sup>352</sup>

The policy playbook developed in this Article would help mitigate the distinctive externalities of dual-class stock while at the same time preserving its

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350. *Id.* at 7 (alleging that Meta’s “business model, based on invasive profiling and targeted advertising, fuels the spread of harmful content, including incitement to violence”).

351. Page & Brin, *supra* note 97.

352. See, e.g., Roy Shapira & Asaf Eckstein, *Compliance Gatekeepers*, 41 YALE J. REG. (forthcoming June 2024) (manuscript at 49) (SSRN) (noting the social purposes animating some corporate compliance requirements); Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. 499 (2020); Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1 (2020).

special potential for powering innovation and economies of scale. That balance of priorities, and the mechanisms it harnesses, can inform approaches to externalities of the firm more broadly.