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Abstract

Founder-CEOs may hold power in a corporation in myriad ways: through managerial control, by designating seats on the board, or by holding significant voting power, which can be amplified by dual-class structures with superior voting rights. The debate on control mechanisms such as dual- and multi-class stock structures, as well as concomitant concerns about the cult of founder-CEOs and their grip on managerial power, have been a central theme of corporate law and governance in an era of "founder-friendly" startup governance and tech company dominance of markets. Amid the twists and turns of this debate, we observe that a small but important point is missing: a substantial number of founder-CEOs have been ousted—forced or pushed to step down from the CEO role despite maintaining important indicia of control that, according to prevailing theory, empowers them to withstand such pressures. We argue that a variety of countervailing forces and factors can work to limit the durability of a founder-CEO's power and may ultimately lead to their resignation under pressure even though they may hold significant or even controlling voting power. Among these forces are performance problems or poor financial position of the company or its stock value, legal concerns, employee and public pressure, as well as personal motivations and struggles. A founder-CEO who faces strong opposition and adverse effects on the company's performance is often better off stepping down than attempting to maintain managerial control. Further, we explore the limits of these forces on powerful founder-CEOs—they can only do so much to serve as guardrails against voting control and they exist in a particular moment. Ousting can be temporary, and founder-CEOs can find their way back to the throne or see a rebirth in new ventures. Finally, we examine how an appreciation of these forces and their limits can shed new light on why public investors might be willing to accept multi-class structures in venture-backed startup IPOs.

Keywords: Founders, CEOs, controlling shareholder, dual-class stock, multi-class stock, high-voting, sunset, CEO turnover, ouster, startups, venture capital, corporate governance, capital structure, IPOs, agency costs, margin loans, technology industry, shareholder activism, ownership, control

JEL Classification: G24, G34, G32, K20, K22, K42, L26, M13, J63

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We argue that a variety of countervailing forces and factors can work to limit the durability of a founder-CEO's power and may ultimately lead to their resignation under pressure even though they may hold significant or even controlling voting power. Among these forces are performance problems or poor financial position of the company or its stock value, legal concerns, employee and public pressure, as well as personal motivations and struggles. A founder-CEO who faces strong opposition and adverse effects on the company's performance is often better off stepping down than attempting to maintain managerial control. Further, we explore the limits of these forces on powerful founder-CEOs—they can only do so much to serve as guardrails against voting control and they exist in a particular moment. Ousting can be temporary, and founder-CEOs can find their way back to the throne or see a rebirth in new ventures. Finally, we examine how an appreciation of these forces and their limits can shed new light on why public investors might be willing to accept multi-class structures in venture-backed startup IPOs.

Introduction

Founder-CEOs have been the focal point of both great admiration as visionaries and significant concern as the source of potential governance problems.[1] It is the rare individual who can start a company and stay on the throne as a top executive

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1 While other positions in the company may hold considerable power, this Article specifically focuses on founder-CEOs because of the managerial control held by the highest level executive and their potential

throughout the company's lifecycle.[2] In recent decades, founders who have been grinding to achieve rocket-ship-level growth while also aiming to hold onto power have heard the cautionary tale of Apple cofounder Steve Jobs, who was ousted "from his own company." Motivated by this, many have pursued negotiations for dual-class stock or enhanced control measures to fortify their influence within their companies.[3]

Dual-class structures, common in venture-backed IPOs, have their roots in control negotiations during a company's private phase. Venture financing typically progresses through defined phases or "stages." With staged financing, venture capitalists can exert non-voting control by determining the allocation of further resources to the company.[4] Venture capitalists also frequently invest in convertible preferred stock—a type of equity that provides conversion rights into common stock in the event of a successful exit and contractual preferences with protections for downside scenarios. These cash flow-based control mechanisms are complemented by shareholder agreements and protective provisions in the company's certificate of incorporation, which collectively delineate and distribute decision-making power in startups.[5] In the past, venture capitalists often held control of the board after a few rounds of financing, and founder-CEOs were often replaced when the company was perceived to have outgrown them or was readying for the public market.[6] Although a number of founder-CEOs nonetheless managed to take their company public as the top executive, this occurred relatively rarely and companies typically went public without bolstering the founder-CEO's voting power or retaining private-style governance.[7]

Recent years, however, have witnessed a shift in power dynamics and corporate structures. Founders of venture-backed startups that have generated competitive, over-subscribed rounds of financing at high valuations have in some instances managed to avoid getting substantially diluted.[8] A subset of these founders also secured provisions such as super-voting rights and additional board seats, safeguarding their positions in executive roles even after transitioning to the public markets.[9]

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for individual vision and leadership to shape corporate activity, which in turn has influenced the debate about control-enhancing mechanisms such as dual-class stock.

2 Brian Broughman & Jesse M. Fried, *Do Founders Control Start-up Firms That Go Public?*, 10 Harv. Bus. L. Rev. 49 (2020).

3 Steve Blank, *When Founders Go Too Far*, Harv. Bus. Rev., Nov.-Dec. 2017, at 94.

4 Paul A. Gompers, *Optimal Investment, Monitoring, and the Staging of Venture Capital*, 50 J. Fin. 1461 (1995).

5 *See infra* Part I.

6 Blank, *supra* note 3; Noam Wasserman, The Founder's Dilemmas: Anticipating and Avoiding the Pitfalls That Can Sink a Startup (2012).

7 Blank, *supra* note 3; Broughman & Fried, *supra* note 2.

8 *See* Suresh Kotha, Seowon Joseph Shin & Greg Fisher, *Time to Unicorn Status: An Exploratory Examination of New Ventures with Extreme Valuations*, 16 Strat. Entrepreneurship J. 460 (2022); *The Terms Behind Unicorn Valuations*, Fenwick (Feb. 10, 2016), https://www.fenwick.com/insights/publications/the-terms-behind-unicorn-valuations [https://perma.cc/XYL4-8TX3].

9 Broughman & Fried, *supra* note 2 (studying the number of companies with founder-CEOs at time of IPO); Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 Colum. Bus. L. Rev. 852 (2018) (studying the number of companies that IPO with dual-class stock structures).

A number of companies use shareholder agreements, voting agreements, investor rights agreements, and the like to create structures other than dual-class stock that grant insider shareholders disproportionate control.[10] Thus, some founder-CEOs of public companies, especially in the tech industry, enjoy a degree of control over their company that was previously considered possible only at private firms.

In turn, these salient examples of founder-friendly governance and a spike in companies going public with multi-class structures have spurred a renaissance in the debate about these structures. To some, these are important options in a menu of ownership structures for preserving founders' ability to pursue their idiosyncratic vision or coaxing them into public markets.[11] But a key concern has arisen that some founders will have "lifetime control" over the companies they started, despite the potentially changing needs of companies in a highly dynamic tech environment and the public markets' norm of so-called shareholder democracy.[12]

Concerns about multi-class structures date back more than a century.[13] Insiders with disproportionate control bear only a fraction of the consequences of their

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10 *See generally* Gladriel Shobe & Jarrod Shobe, *The Dual-Class Spectrum*, 39 Yale J. on Reg. 1343 (2022); *see also* Moran Ofir, *Controlling Non-Controlling Shareholders: The Case of Effective Control*, 25 Theoretical Inquiries L. 187 (2024)(reviewing the case law regarding minority activist shareholders and the potential gap between voting rights and effective control).

11 Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 Yale L.J. 560, 579, 584 (2016) (arguing that "entrepreneurs value corporate control because it allows them to pursue their vision" and identifying dual-class structures as an ownership structure they might bargain for to carry out this goal); David J. Berger, *Dual-Class Stock and Private Ordering: A System That Works*, Harv. L. Sch. Forum on Corp. Gov. (Mar. 24, 2017), https://corpgov.law.harvard.edu/2017/05/24/dual-class-stock-and-private-ordering-a-system-that-works/ [https://perma.cc/5B9E-2Z5K] (arguing that dual-class stock is best left to private ordering and it is "necessary and appropriate to respond to the corporate governance misalignment that exists in our capital markets"); Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. Chi. L. Rev. 119, 136–40 (1987) (discussing why it may be efficient for insiders to retain control and use dual-class voting as a mechanism for preserving insider control); Bernard S. Sharfman, *A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs*, 63 Vill. L. Rev. 1, 7 (2018) (arguing that "the use of the dual class share structure in IPOs is a value-enhancing result of the bargaining that takes place in the private ordering of corporate governance arrangements").

12 *See* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 Va. L. Rev. 585, 589 (2017); Ronald W. Masulis, Cong Wang & Fei Xie, *Agency Problems at Dual-Class Companies*, 64 J. Fin. 1697 (2009); Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 Rev. Fin. Stud. 1051 (2010). Some have also noted the potential for "public" agency costs of "unaccountable power in the socio-political realm." *See* Jeffrey N. Gordon, *Dual Class Common Stock: An Issue of Public and Private Law*, CLS Blue Sky Blog (Jan. 2, 2019), https://clsbluesky.law.columbia.edu/2019/01/02/dual-class-common-stock-an-issue-of-public-and-private-law/ [https://perma.cc/2L64-F78V]; Gregory H. Shill, *The Social Costs (and Benefits) of Dual Class Stock*, 75 Ala. L. Rev. 221 (2023); *see also* Vittoria Battocletti, Luca Enriques & Alessandro Romano, *Dual Class Shares in the Age of Common Ownership*, 48 J. Corp. L. 541 (2023) (arguing "that there should be limits placed on the use of dual class shares by systemically relevant firms" based on "a firm's specific ability to impose systemic externalities"); Rimona Palas, Dov Solomon, Dalit Gafni & Ido Baum, *Does Wedge Size Matter? Financial Reporting Quality and Effective Regulation of Dual-Class Firms*, 54 Fin. Res. Letters 103774 (2023).

13 On the history of the dual-class stock debate, see Jeffrey Kerbel, *An Examination of Nonvoting and Limited Voting Common Shares-Their History, Legality, and Validity*, 15 Sec. Reg. L.J. 37, 47–50 (1987); Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 St. John's L. Rev. 863, 890–905 (1994); Stephen M. Bainbridge, *The Short Life and Resurrection of SEC Rule 19C-4*, 69 Wash. U. L.Q. 565, 568 (1991).

decisions because of their comparatively lower economic interest in the company. This potential for founders to maintain unbridled control has prompted scholars and corporate governance participants to recommend sunset provisions and equal treatment agreements.[14] The debate about sunset provisions has focused on the merits of time-based provisions versus other triggers such as the dilution of high-vote shares,[15] the departure, death, or incapacity of the founder-CEO,[16] and the transfer of high-vote shares.[17] Equal treatment agreements, often found in dual-class charters, mandate uniform treatment for stockholders, such as guaranteeing the same per-share consideration during a company sale, thereby helping to reduce agency costs associated with high-vote shares.[18] The notion has taken hold that these provisions and agreements serve as the primary check on the hazards of dual-class stock.

Yet one only has to read the headlines to notice that the "uncontestable," "perpetual," and "locked-in" control of founder-CEOs with dual-class stock, even without sunset provisions, does not seem as permanent as sometimes imagined. A steady stream of tech founder-CEOs are stepping down, and entrenched executives are becoming the exception rather than the rule.[19] The ousting of founder-CEOs from their companies in the era of control-enhancing mechanisms has not yet been fully recognized in the literature. We use the term "ousted" in a broad sense, referring to scenarios where founder-CEOs, despite having carefully fortified their control, choose to resign amid pressure. Although the exact frequency is difficult to quantify, ousting is a regular occurrence in the business world.

In this Article, we argue that a variety of countervailing forces or factors can work to limit the durability of founder-CEOs' managerial control in both private and public companies. Although scholarly literature and policy debates tend to link the founder-CEO's position as a controlling shareholder to their ability to remain in office, we show that it is not uncommon for founder-CEOs to be dethroned despite being controlling shareholders or having substantial indicia of control. A host of financial, legal, and personal factors, as well as public and employee pressure, can push founder-CEOs with control out of office. This can occur without resorting

14 Bebchuk & Kastiel, *supra* note 12, at 589-90; Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. Rev. 1229, 1232 (2019); *The Rise of Dual Class Shares: Regulation and Implications*, Comm. On Cap. Mkts. Regul. 16 (Apr. 2020), https://www.capmktsreg.org/wp-content/uploads/2020/04/The-Rise-of-Dual-Class-Shares-04.08.20-1.pdf [https://perma.cc/N9CX-3TJ4]. On equal treatment agreements, *see* Caley Petrucci, *Equal Treatment Agreements: Theory, Evidence & Policy*, 40 Yale J. on Reg. 620, 621 (2023).

15 Winden, *supra* note 9, at 872.

16 *Id.* at 875.

17 *Id.* at 880; Bebchuk & Kastiel, *supra* note 12; Jill E. Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. Rev. 1057 (2019).

18 *See* Petrucci, *supra* note 14.

19 *See, e.g.*, Erin Griffith, *The Boy Bosses of Silicon Valley Are on Their Way Out*, N.Y. Times (Aug. 10, 2022), https://www.nytimes.com/2022/08/10/business/silicon-valley-boy-boss.html [https://perma.cc/PBY5-MDPL]; *see also* Assaf Hamdani & Kobi Kastiel, *Superstar CEOs and Corporate Law*, 100 Wash. U. L. Rev. 1353, 1353, 1376 (2023) (noting that some but not all superstar CEOs are founders, and observing that "superstar CEOs' power is limited in both duration and scope: it is likely to vanish when markets lose faith in their star qualities").

to formal channels of activism frequently explored in related literature,[20] and in contrast to the board-driven turnover of non-controller CEOs.[21] We observe that this phenomenon exists in both public and private companies and explore the varying dynamics in these different contexts.

Notably, there are limits to what countervailing forces or factors can achieve as informal guardrails in the face of powerful founder-CEOs with control. In some instances, a founder-CEO may continue to hold the reins despite significant pressures to step down. We therefore also explore the contours of countervailing forces on founder-CEO power and observe that a tipping point or personal calculus might need to be reached that will vary by individual and surrounding circumstances. Further, ousting can be temporary, and even controversial founder-CEOs can find their way back to the throne or see a rebirth in new ventures.

Finally, we examine how an appreciation of these forces and their limits can shed new light on why public investors might be willing to accept multi-class structures in venture-backed IPOs. Investors in such companies face a tradeoff between the risk of heightened agency costs and the potential rewards of investing in a rapidly growing business. In light of the factors that can limit the durability of a founder's managerial power when the company performs poorly, we observe that investors might reasonably accept the risks of multi-class structures to invest in companies with visionary founders. The potential for growth is high, founder-CEOs with control are not entirely immune to countervailing forces, and investors can diversify their portfolios. In short, the gains from investing early in a company like Google with extraordinary cofounder-CEOs might counterbalance losses from other companies plagued by agency costs, and even the latter might experience CEO turnovers that allow for experienced managers to take the helm.

The Article proceeds as follows. Part I sets out the basics of founder-CEOs and control arrangements across private and public markets. Part II observes that a substantial number of founder-CEOs have been ousted from, or resigned, their CEO positions while maintaining important indicia of control. It specifically argues that a variety of countervailing forces or factors can work to limit the durability of founder-CEOs' managerial control, including poor financial position or performance, legal concerns, employee and public pressure, as well as personal issues. Part III explores the limits to these counterforces and implications for the dual-class stock debate.

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20 *See, e.g.*, Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 Colum. Bus. L. Rev. 60, 67 (2016) (discussing activists' ability to elect minority directors in certain dual-class firms, to veto conflicted transactions, and to conduct activism in the shadow of litigation); *see also* Dionysia Katelouzou, *Worldwide Hedge Fund Activism: Dimensions and Legal Determinants*, 17 U. Pa. J. Bus. L. 789, 818–826 (2015) (discussing shareholder rights as a foundation of hedge fund activism).

21 *See, e.g.*, Lucian A. Taylor, *Why are CEOs Rarely Fired? Evidence from Structural Estimation*, 65 J. Fin. 2051, 2054 (2010) (modelling the forced CEO turnover rate and effects on shareholder value); Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed?*, 12 Int'l Rev. Fin. 57, 58 (2012) (studying board-driven CEO turnover); Dirk Jenter & Fadi Kanaan, *CEO Turnover and Relative Performance Evaluation*, 70 J. Fin. 2155, 2156 (2015) (examining the likelihood of board-driven CEO turnover after bad industry or market performance).

I. Founder-CEOs and Control Arrangements

As a startup progresses through the various stages of the business lifecycle, the balance of control between founder-CEOs and investors can shift significantly. In the world of venture-backed startups, this dynamic can be complex. In this Part, we explore the mechanisms that impact founder-CEO control at different stages of the startup journey, from private to public, concluding with a focus on the rise of dual-class structures and related debate.

A. Control Arrangements in Private Startups

Founder-CEOs have a distinctive trajectory. Their story typically starts as an entrepreneur with a business idea. If the entrepreneur funds the entire business, she will remain the sole owner, and thus ownership and control will be fully aligned in the founder.[22] However, rather than bootstrap a company on their own, it is more common for founders of innovative ventures to raise money from venture capital investors. By doing so, they can raise potentially large amounts of capital for development and growth, gain access to investors' knowledge and networks, and establish credibility. Venture capital firms' willingness to invest can provide confidence in the prospects of a company, which can be valuable for attracting other investors, customers, and employees.[23]

By giving up equity in their company in exchange for funding, founders opt into relinquishing some level of control over the company.[24] Despite the broadly shared goal of maximizing the company's value, differences in opinion and preferences, asymmetric information, and agency costs can make control valuable to each party for different reasons.[25] Founders typically value control not only for financial private benefits but also for nonpecuniary private benefits or for protecting their idiosyncratic

22 Elizabeth Pollman, *Startup Governance*, 168 U. Pa. L. Rev. 155, 196–97 (2019) (noting that with a single owner, "[g]overnance is not an issue because there are no relationships or conflicts to manage within the corporation").

23 *See id.* at 197–98.

24 *See, e.g.*, William A. Sahlman, *The Structure and Governance of Venture-Capital Organizations*, 27 J. Fin. Econ. 473, 506–07 (1990) (exploring the relationship between investors and venture capitalists, and between venture-capital firms and startup entrepreneurs, and control mechanisms in venture investing and startup governance); Gompers, *supra* note 4, at 1461–62 (examining staged financing as a control mechanism of venture capital); Josh Lerner, *Venture Capitalists and the Oversight of Private Firms*, 50 J. Fin. 301 (1995) (examining the representation of venture capitalists on startup boards); Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 Rev. Econ. Stud. 281 (2003) (examining contingent control allocation in VC contracting). However, in an era of capital abundance in the private markets, some venture capitalists are not interested in control rights. *See generally* Brian Broughman & Matt Wansley, *Risk-Seeking Governance*, 76 Vand. L. Rev. 1299 (2023); Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 88 Tenn. L. Rev. 985 (2020).

25 Goshen & Hamdani, *supra* note 11, at 584 (explaining the "interplay between control and cash-flow rights in allowing entrepreneurs to pursue their idiosyncratic vision while protecting investors against agency costs").

vision.[26] Meanwhile, venture capitalists may not invest without substantial control rights, including board seats and the ability to block certain transactions, in order to mitigate the risk of information asymmetry and agency costs.[27] As a result, the allocation of control rights becomes a matter of bargaining between the parties. The key levers of control that get negotiated include board composition, financing and cash flow rights, shareholder voting, and protective provisions.[28] Each of these levers of control is important in determining the balance of power between founders and venture capitalists, and the resulting corporate governance structure.[29]

Board composition. Typically, in venture-backed startups, a small but significant group of investors holds a nontrivial stake in the company and often has representation on the board. For the most part, venture capitalists are active investors who play an important role in corporate governance.[30] Board composition is the subject of heavy negotiation, with investors frequently bargaining for the right to elect one or more directors. Control of the board can either be shared between the entrepreneurs and the investors or allocated to one of these parties.[31]

Despite the intense negotiations surrounding board structure, most startup boards rarely engage in contentious formal votes. Instead, decisions are often made unanimously, with deliberations occurring in the shadow of the formal control mechanisms.[32] As discussed below, venture capitalists often exert more influence by leveraging their ability to withhold subsequent capital than through their voting rights. Their choice to abstain from endorsing the startup or its founders when speaking to other potential investors also provides significant leverage, especially given the substantial financial needs of startups. Therefore, venture capitalists' influence can be significant even when they leave formal board control to the founders.

Financing and cash flow rights. For cash-hungry startups, the ability to control the company's financing can be a determinative factor in its success or failure.[33]

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26 Broughman & Fried, *supra* note 2, at 55 ("While control can always provide financial private benefits, non-pecuniary private benefits (for example, the satisfaction of bringing new products to market) are likely to be just as—or even more—valuable to the founders of a startup"); Goshen & Hamdani, *supra* note 11.

27 Broughman & Fried, *supra* note 2, at 55.

28 Will Gornall & Ilya A. Strebulaev, *The Contracting and Valuation of Venture Capital-Backed Companies*, *in* Handbook of the Economics of Corporate Finance, Vol. 1: Private Equity and Entrepreneurial Finance 33–60 (B. Espen Eckbo, Gordon M. Phillips & Morten Sorensen eds., 2023).

29 *See* Sahlman, *supra* note 24, at 503–10; *see also* Goshen & Hamdani, *supra* note 11, at 585–86 (noting that "competition and relative bargaining power can result not just in different pricing, but also in variations in a contract's quality of terms (from the investors/or the entrepreneur's perspective)").

30 *Cf.* Broughman & Wansley, *supra* note 24; Alon-Beck, *supra* note 24.

31 Gornall & Strebulaev, *supra* note 28, at 48. Investors who do not get to designate a board member may negotiate for board observers or information rights. Brad Feld, Matt Blumberg & Mahendra Ramsinghani, Startup Boards: A Field Guide to Building and Leading an Effective Board of Directors 30 (2d ed., 2022).

32 *See, e.g.*, Feld et al., *supra* note 31, at 118–32 (describing startup board meeting dynamics and voting practice); Brian Broughman & Jesse M. Fried, *Carrots and Sticks: How VCs Induce Entrepreneurial Teams to Sell Startups*, 98 Cornell L. Rev. 1319, 1332–35 (2013) (noting that startup boards may be advised to reach unanimous votes on exit transactions to minimize litigation risks, which can lead to intense negotiations and bargaining in the shadow of shareholder voting rights).

A. 33 Gompers, *supra* note 4.

Convertible preferred stock provides a form of financing that is dependent on the startup's future performance and, similar to debt financing, enables a flexible governance structure for the firm, based on whether good or bad states of the world arise.[34] Staged funding reduces the amount of free cash available to the founders and sets performance-based milestones for each round of funding to keep the founders on track. Venture capitalists often bargain for pro rata rights to participate in future rounds of financing.[35] As a result, the capital-raising process becomes exceptionally challenging if incumbent venture capitalists are uncooperative, sending negative signals to the market. If further funding is not provided, the company may face failure and be liquidated or sold, with venture capitalists holding liquidation preferences.[36]

Shareholder voting rights and protective provisions. Shareholder voting is often structured differently in startups than elsewhere in the corporate world. For example, while preferred stockholders in public corporations usually do not have voting rights, venture capital investors holding convertible preferred shares generally do have such rights.[37] Further, as noted above, founders typically hold a significant portion of the common stock and negotiate with investors regarding the composition of the board; the outcomes of these negotiations shape the board's design, as documented in the charter or a voting agreement.[38] Different classes or series of stock frequently have different voting rights, such as the right to block certain actions, including liquidating the company, amending the corporate charter, declaring dividends, issuing debt, and changing the size of the stock option pool and board.[39] Some private companies have adopted super-voting share structures in which a certain class of stock has higher voting rights.[40] Meanwhile, restricted stock units and stock options granted to employees generally do not carry voting rights until they are vested and exercised or settled.[41] In some companies, late-stage employees' equity awards convert into nonvoting common stock.[42]

Thus, the combination of board composition, financing and cash flow rights, and shareholder voting rights and provisions allows for a dynamic evolution throughout the company's growth stages. Early on, founders typically hold most voting rights and board seats but are heavily reliant on investors due to staged financing and investors' preferential cash flow rights. With the growth of the company, founders usually, but not always, lose their majority position on the board and voting power in subsequent rounds of financing.

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34 Gornall & Strebulaev, *supra* note 28, at 17, 20–23.

35 Natl. Venture Cap. Ass'n, Investors' Rights Agreement, *in* Model Legal Documents, https://nvca.org/model-legal-documents/ [https://perma.cc/M3ZQ-YDXJ] (last visited Oct. 30, 2023).

36 *See* Elizabeth Pollman, *Startup Failure*, 73 Duke L.J. 327 (2023).

37 Gornall & Strebulaev, *supra* note 28, at 36.

38 *Id.* at 42–49; Feld et al., *supra* note 31, at 47–52, 57–59; Natl. Venture Cap. Ass'n, Certificate of Incorporation and Voting Agreement, *in* Model Legal Documents, https://nvca.org/model-legal-documents/ [https://perma.cc/M3ZQ-YDXJ] (last visited Oct. 30, 2023).

39 Gornall & Strebulaev, *supra* note 28, at 38–40.

40 *Id.* at 37–38.

41 *Id.* at 26–28, 36–37, 49–50.

42 *Id.* at 36.

B. Founder-CEOs and the Difficult Path to Going Public with Control

The transition to the public markets generally signifies a shift in company governance and control mechanisms.[43] Notably, the power dynamics between founder-CEOs and venture capitalists have markedly changed over the past several decades on the path to public company status.

There was a time when founder-CEOs were widely perceived to be structurally weak.[44] The venture capital playbook of the 1980s and 1990s dictated that after a few financing rounds, experienced executives from established corporations would be brought in to help the company go public.[45] A successful IPO was the preferred exit path for venture capitalists, who often controlled the board, to liquidate their financial positions.[46] Sometimes founder-CEOs managed to hold onto their CEO roles through the time of IPO, and this may have been aided by the relatively short average timeline to going public.[47] But even in that era, the founder-CEO retaining the top executive spot through IPO occurred less than half the time for those companies successful enough to go public.[48] In many instances, going public meant that the company had to convince investment bankers that its leadership team was competent and reliable. Narratives recounting this dynamic used colorful, if perhaps loaded or paternalistic, characterizations of bringing in "suits," "gray hair," "adult supervision," or other variants conveying the perceived need for more experienced executive leadership than startup founder-CEOs could typically provide.[49]

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43 Following an IPO, the company must comply with mandatory corporate governance rules, introducing additional mechanisms for transparency and oversight. For instance, U.S. public companies are required to file periodic reports with the Securities and Exchange Commission, establish and maintain internal control structures for financial reporting, have a majority of independent directors on their board, and provide shareholders with the opportunity to vote on certain matters, including executive compensation. *See* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 Colum. L. Rev. 2563, 2626–27, 2582 (2021).

44 Noam Wasserman, *Founder-CEO Succession and The Paradox of Entrepreneurial Success*, 14 Org. Sci. 149 (2003); Warren Boeker & Rushi Karichalil, *Entrepreneurial Transitions: Factors Influencing Founder Departure*, 45 Acad. Mgmt. J. 818 (2002); Blank, *supra* note 3, at 94. Black and Gilson theorized that founders might regain control in the event of an IPO, but recent empirical study has suggested that founders are unlikely to regain durable control. *See* Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets*, 47 J. Fin. Econ. 243, 243 (1998) (theorizing a call option on control via IPO); Broughman & Fried, *supra* note 2, at 51 (studying venture-backed startup IPOs from 1990-2012 and finding that "[e]ven if a startup is successful enough to reach IPO, a founder is unlikely to regain durable control").

45 Dawn R. DeTienne, *Entrepreneurial Exit as a Critical Component of the Entrepreneurial Process: Theoretical Development*, 25 J. Bus. Ventur. 203 (2010).

46 Blank, *supra* note 3.

47 *See* Broughman & Fried, *supra* note 2, at 69 (noting that "[r]esearch on IPO grandstanding suggests many VC-backed firms in the late 1990s were taken public early—after minimal financing—so VCs seeking to raise new funds could tout their achievements").

48 *Id.*

49 Blank, *supra* note 3, at 96 (discussing the "stereotypical fire-the-founder pattern" in the 1980s and 1990s in which "an IPO was the eventual goal for nearly every start-up" and "green and unskilled founders were a problem that had to be solved" by VCs who "routinely removed founding CEOs and replaced them with 'suits'—experienced executives from large companies—to scale up the sales force, build a true organization… and lead the public offering"); *see also* Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did "We" Not Work?*, 99 Tex. L. Rev. 1347, 1349 (2021) (discussing "the

Yet professional outside management failed to prevent the dotcom bust of the early 2000s, and in the aftermath, the conventional wisdom of bringing in a "responsible adult" was not uniformly followed and began to lose its sway. Contributing to this trend were companies like Microsoft and Amazon, which experienced phenomenal success after going public with their founders still in control. Steve Jobs, Apple's cofounder who was famously ousted from the CEO position and had served as a cautionary tale to ambitious entrepreneurs, was eventually brought back to reinvigorate the company.[50] In the early 2000s, Google cofounders, Sergey Brin and Larry Page, agreed to hire Eric Schmidt as CEO once the company began to take off, but they stayed highly involved as cofounders. They trailblazed a Dutch auction for their IPO and commanded a dual-class structure.[51] Their IPO prospectus featured a letter from the cofounders that boldly proclaimed their intention to continue leading the company with their vision, including "moonshots" that might fail, displease public investors, or take long periods to pay off.[52] Although dual-class stock structures had a long history, particularly in media corporations and family enterprises, they had not been regularly used at the time of the Google IPO. The move by Brin and Page became a talking point in Silicon Valley, serving as inspiration for entrepreneurs hoping to maintain control of their companies while going public.[53] Some other entrepreneurs indeed managed to be rich and king.[54] When Facebook went public in 2012, Mark Zuckerberg was able to retain his CEO position and maintain a controlling interest through a dual-class stock structure, a significant shift from the traditional model but in line with the growing trend of founder control.[55]

Although it was rare for entrepreneurs to achieve such circumstances, the fortunes had started to play more in their favor. In the internet software era, startup costs fell, new funding sources emerged, and competition for talent increased, leading many entrepreneurs to negotiate for more favorable control arrangements.[56] Keeping founders in managerial control also became more attractive as M&A exits began

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ever-lengthening period of time and the resulting temptations without sufficient grown-up supervision that high-tech start-up companies have before undergoing the so-called rites of passage to public adulthood").

50 *See* Ben Austen, *The Story of Steve Jobs: An Inspiration or a Cautionary Tale?*, Wired (July 23, 2012), https://www.wired.com/2012/07/ff_stevejobs/ [https://perma.cc/7EZ4-KVN9].

51 Steven Levy, *At Google, Eric Schmidt Wrote the Book on Adult Supervision*, Wired (Dec. 22, 2017), https://www.wired.com/story/at-google-eric-schmidt-wrote-the-book-on-adult-supervision/ [https://perma.cc/8B5T-HJGU] (noting that CEO Eric Schmidt "governed Google as part of a troika along with Page and Brin"). At the time of IPO, Google's founders controlled approximately 38% of the voting power, and by a year later their voting control had increased to 57%. Broughman & Fried, *supra* note 2, at 73 n.73.

52 Google Inc., Registration Statement (Form S-1) (Apr. 29, 2004), https://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm [https://perma.cc/9PT9-MC55]; Alphabet Investor Relations, *2004 Founders' IPO Letter: "An Owner's Manual" for Google's Shareholders*, https://abc.xyz/investor/founders-letters/2004-ipo-letter/ [https://perma.cc/442S-38R6]. Notably, after a decade in the CEO role, Eric Schmidt returned the role to Larry Page. Levy, *supra* note 51.

53 Dov Solomon, Rimona Palas & Amos Baranes, *The Quality of Information Provided by Dual-Class Firms*, 57 Am. Bus. L.J. 443, 445 (2020).

54 Wasserman, *supra* note 6, at 158.

55 Blank, *supra* note 3; *see also* Sebastian Mallaby, The Power Law: Venture Capital and the Making of the New Future (2022).

56 Pollman, *supra* note 22, at 205–08.

to far outnumber IPOs, and acquirers often valued the opportunity to add key innovators to their team.[57] Further, the JOBS Act of 2012 eased regulatory restrictions in U.S. federal securities laws, generally allowing companies to stay private longer.[58] New capital sources in the venture ecosystem, including sovereign wealth funds, corporate venture capital, and private equity, diminished the need to go public in order to raise growth-stage capital.[59] The greater availability of private capital reduced firms' needs for public financing and led to an increase in the frequency of founder control over time.[60] Many venture capital firms adopted a "founder-friendly" policy towards ambitious entrepreneurs, or at least accepted these terms.[61] With an abundance of capital flooding the private markets, before the tech downturn set in, some founder-CEOs in the past decade had the luxury of raising large rounds of private financing while wielding significant bargaining power.

Historically, founders often had to sell their stock to realize their riches.[62] However, in the founder-friendly era, companies provided loans to their founders and permitted them to pledge their shares as collateral in margin loans.[63] This allowed founders to tap into their illiquid wealth without sacrificing voting rights.

The uptick in founder control, and the use of dual- and multi-class structures at the time of IPO, has been dramatic. When Google went public in 2004 with a dual-class structure, this structure accounted for only 3% of all IPOs.[64] By 2017-2019, 19% of all IPOs were founder-controlled dual- or multi-class companies.[65] Companies have typically issued Class B shares that have ten times the voting power of Class A shares. However, some companies, like Alphabet, Under Armour, Blue Apron, and Snap, have pushed the envelope on the dual-class concept by offering common

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57 Blank, *supra* note 3, at 99 (noting that in recent years "a start-up is 30 times as likely to be acquired as to go public" and "[w]hen a larger tech company acquires a smaller one, having the smaller company's founder retain a leadership role can make a deal more attractive" and so VCs are "more inclined to leave founders in charge").

58 Abraham J.B. Cable, *Fool's Gold: Equity Compensation & the Mature Startup*, 11 Va. L. & Bus. Rev. 615 (2016); Yifat Aran, Note, *Beyond Covenants Not to Compete: Equilibrium in High-Tech Startup Labor Markets*, 70 Stan. L. Rev. 1235 (2018); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 Geo. L.J. 337 (2013); George S. Georgiev, *The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J. L. & Bus. 221 (2021).

59 Alon-Beck, *supra* note 24; Marina Temkin, *'Tourist' Investors Haven't Fled VC, But There Are Signs of a Tactical Retreat*, PitchBook (May 3, 2022), https://pitchbook.com/news/articles/hedge-fund-corporate-venture-capital-vc-deals.

60 *See* Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg & Lubomir P. Litov, *The Rise of Dual-Class Stock IPOs*, 144 J. Fin. Econ. 122 (2022).

61 Renee M. Jones, *The Unicorn Governance Trap*, 166 U. Pa. L. Rev. Online 165 (2017); Evan Epstein, *Why Governance Matters for Your Startup* (Rock Ctr. for Corp. Gov., Working Paper No. 232, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3162329 [https://perma.cc/2MCX-3ELE].

62 Wasserman, *supra* note 6.

63 *See, e.g.*, Julie Bort, *Snapchat Loaned Its Founder $15 Million Last Year and He Paid It Back in 7 Months*, Bus. Insider (Feb. 2, 2017), https://www.businessinsider.in/snapchat-loaned-its-founder-15-million-last-year-and-he-paid-it-back-in-7-months/articleshow/56945158.cms [https://perma.cc/VD9D-HL5J]; *infra* Part II.A.

64 Aggarwal et al., *supra* note 60.

65 *Id.*

shares with no voting rights.[66] Palantir went public through a direct listing and a multi-class structure that included a special class of stock, called F shares, owned by the cofounders through a trust that guarantees them at least 49.99% of the total voting power.[67]

C. The Dual-Class Debate

The proponents of dual- and multi-class structures claim they allow founders to focus on a long-term or idiosyncratic vision rather than short-term profits.[68] Furthermore, proponents argue that the availability of these structures could help convince founders to take their companies public, thereby increasing the number of public companies and allowing public market investors to share in the company's growth and associated returns.[69] Another argument in support focuses on the potential efficiency of private ordering and allowing parties to arrange governance structures in a way that accommodates a diversity of investors and their priorities.[70]

Others have criticized these structures as inefficient or unfair to public investors because they can reduce insider accountability and increase agency costs.[71] While several index providers have excluded or limited the addition of companies with multi-class structures from major indexes including the S&P 500,[72] calls for regulators and stock exchanges to adopt prohibitions banning these structures outright have been unsuccessful thus far.[73]

Given these challenges, some scholars and industry players have sought a compromise. As a way to strike a middle ground, they have advocated for sunset provisions for dual-class structures in which, under specified circumstances, the high voting shares in a dual-class structure are automatically converted to a single class with equal voting power.[74] Thus, the sunset clause is intended to protect the founder's vision for a limited period, while minimizing agency costs over the long term. Others have pointed out that time-based sunset provisions impose arbitrary

66 Vijay Govindarajan, Shivaram Rajgopal, Anup Srivastava & Luminita Enache, *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/TB8D-G3LF]; Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 Stan. L. Rev. 687, 701 (2019); Dov Solomon, *The Importance of Inferior Voting Rights in Dual-Class Firms,* 2019 BYU L. Rev. 533, 535 (2019).

67 Richard Waters, *Palantir Goes Public But Founders Will Have Control for Life*, Fin. Times (Sept. 29, 2020), https://www.ft.com/content/27eddb59-1770-4ad8-a07f-6a940e20e00c [https://perma.cc/N8QF-6Y5B].

68 *See* Goshen & Hamdani, *supra* note 11.

69 Aggarwal et al., *supra* note 60; *see also* Matt Levine, *Public Markets Don't Matter Like They Used To*, Bloomberg (Aug. 5, 2020), https://www.bloomberg.com/opinion/articles/2020-08-05/public-markets-don-t-matter-like-they-used-to [https://perma.cc/9T74-T2VZ].

70 Lund, *supra* note 66.

71 Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 Rev. Fin. Stud. 1051, 1051–54 (2010); Bebchuk & Kastiel, *supra* note 11.

72 Hirst & Kastiel, *supra* note 14, at 1232.

73 Andrew Winden & Andrew C. Baker, *Dual-Class Index Exclusion*, 13 Va. L. & Bus. Rev. 101, 113–14 (2019).

74 Fisch & Solomon, *supra* note 17; David J. Berger, *Why "Sunset" Provisions for Dual Class Stock Are Not the Answer*, CLS Blue Sky Blog (Mar. 29, 2019), https://clsbluesky.law.columbia.edu/2019/03/29/why-sunset-provisions-for-dual-class-stock-are-not-the-answer/ [https://perma.cc/36XX-UMZM].

cutoffs and have suggested different triggers, focusing on the transfer or dilution of the founder's interest or the death, incapacitation, or departure of the founder.[75] As we highlight in Part II, however, founder-CEOs often face pressures to resign and relinquish control well before any sunset provision would require them to do so. This underscores the disproportionate focus on these legal mechanisms despite the complex dynamics of founder-led companies.

And, as no conclusive evidence links dual-class structures with negative economic outcomes, the debate has remained unsettled, and dual- and multi-class stock structures continue to be perceived as a contentious issue of corporate governance.[76] The rise of venture-backed IPOs using dual-class stock notably suggests that investors are less concerned about this issue than academics. The following Part may shed some light on one possible explanation for investors' acceptance—namely, that even firmly entrenched founder-CEOs may be forced out through countervailing forces—and the subsequent discussion explores limits to these forces and a broader market perspective.

II. Factors Limiting the Durability of a Founder-CEO's Control

We have explored various mechanisms that allow founder-CEOs to retain control in corporations before and after going public, including the right to nominate the majority of board seats pre-IPO and the use of dual-class structures to maintain dominant voting power post-IPO. Despite the prevalence of these mechanisms, a significant debate surrounds their use. Concerns arise that sustained concentration of control and managerial power in the hands of founder-CEOs can lead to reduced accountability and resistance to both board monitoring and market pressures. Often overlooked in this debate, however, is that many founder-CEOs have been removed from their executive roles, even as they continue to hold significant control levers.

In this Part, we describe how a variety of countervailing forces or factors can work to limit the durability of founder-CEOs' power and may ultimately lead to their ouster even when they hold a majority of the voting power or other means of control.[77] Among these forces are performance problems, legal concerns, employee and public pressure, as well as personal struggles and motivations. These factors can

75 Fisch & Solomon, *supra* note 17, at 1086–91. Further, Hamdani and Kastiel point out that founder-CEOs might seek a dual-class structure without a time-based sunset clause precisely to protect themselves when "the market no longer considers them essential to their company's success." Hamdani & Kastiel, *supra* note 19, at 1393.

76 Govindarajan et al., *supra* note 66.

77 Our argument is consistent with empirical evidence such as Broughman and Fried's finding that "founder control declines in the three years after IPO, as firms delist, founders quit or are removed from the CEO position, or founder voting power is diluted by founder stock sales or firm equity issuances." Broughman & Fried, *supra* note 2, at 73. Broughman and Fried note that their findings suggest that "many founder-CEO/blockholders cannot, or do not wish, to maintain strong control." *Id.* at 74. Our account aims to explore the mechanisms and reasons for this pattern.

interact in complex ways, exacerbating the problems and making it more difficult for the founder-CEO to stay in their role. Ultimately, a founder who faces strong opposition is often better off stepping down from a leadership role than attempting to maintain managerial control. Through a series of private and public company examples, we explore how control structures and mechanisms may not shield severely underperforming founder-CEOs from being ousted.

A. Poor Financial Position or Performance of the Company

In a strong economy, with skyrocketing valuations and soaring stock prices, a founder-CEO's missteps seem to have little to no consequence. A decline in the stock price and dissatisfaction with the company's performance, however, may build pressure to resign. When the tide shifts, even the most powerful founder-CEOs can find themselves in a precarious situation, particularly because their net worth is often intricately linked to the value of a single company. This section first delves into the dynamics observed in private companies and subsequently in public companies.

1. In Private Firms: Illiquidity Shield and Diminishing Runway

In private markets, the illiquidity of shares offers a buffer, insulating firms from the rapid stock value fluctuations common in public markets. This inherent characteristic can provide relative stability. However, this stability only lasts for so long. When a company burns through cash at a fast pace and reaches the end of its runway, founders' options are limited regardless of their voting rights or board positions. Traditional debt financiers and venture capitalists have long leveraged this insight by advancing funds in stages in order to discipline entrepreneurs.[78] As discussed in Part I, staged financing restricts the amount of free cash available to founders and establishes milestones to keep them on course. A lack of further funding may lead to failure, resulting in liquidation or sale.

In similar fashion, banks offer working capital through lines of credit and lending commitments, and they often retain the power to review new information and reject credit requests at their discretion. Contract designs like these can lead to cash crunches that threaten founder control, especially when combined with growth strategies that reinvest profits.

A frequently overlooked aspect is that governance by leverage is not just confined to the firm's finances, but also deeply intersects with the founder's personal financial situation. In the past, founders faced the dilemma of either becoming wealthy or maintaining control. For founders to become wealthy, they had to sell equity, which weakened their control; to keep control, they needed to hold on to undiversified positions, which exposed them to losses if the value of the business declined.[79] More recently, however, many founders have been able to enhance their buying power and diversify their holdings without having to sell their shares. Founders may take

78 Gompers, *supra* note 4.

79 Noam Wasserman, *The Founder's Dilemma*, Harv. Bus. Rev., Feb. 2008, https://hbr.org/2008/02/the-founders-dilemma [https://perma.cc/S9DR-Q4BX].

an interest-bearing margin loan, which allows them to borrow against the value of their shares.[80] Ownership and voting rights remain with the founder, and the shares are collateralized. These loans are attractive to equity-rich but cash-poor founders: using shares as collateral for a loan can allow them to afford a luxurious lifestyle at a lower cost than selling their shares, which would result in capital gains tax and eliminate future market gains. But there is a downside to this arrangement—there is a minimum maintenance requirement for margin accounts, and the founder risks a margin call if this requirement is not met.[81] A margin call can lead to forced stock sales, accelerating a downward spiral in the company's stock price.

Take a key example that underscores both the risks of relying heavily on external capital and the pressure of potential margin calls: the widely publicized departure of Adam Neumann from WeWork in 2019. Before his departure as CEO, Neumann was a highly visible founder-CEO with a dual-class structure that gave him super-voting rights and majority voting power.[82] However, as WeWork explored plans to go public, its proposed valuation, business model, organizational culture, and corporate governance were heavily criticized.[83] Consequently, the company shelved its plans to raise capital with a public offering and was forced to find an alternative source of funding, while subject to debt restrictions that limited its options.[84]

Furthermore, as WeWork's valuation came under scrutiny and began to decline, Neumann's erratic leadership provoked controversy and his personal financial standing grew increasingly tenuous.[85] Major banks, including JPMorgan, UBS, and Credit Suisse, had granted him hundreds of millions of dollars in credit, using his WeWork stock as the primary collateral.[86] If the value of Neumann's equity stake had

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80 Joe Koontz, *Exploring Founder Liquidity Options*, Silicon Valley Bank (Sept. 12, 2017), https://www.svb.com/blogs/joe-koontz/exploring-founder-liquidity-options [https://perma.cc/7BBJ-8H8P].

81 *See* Matt Levine, *Elon Called Off His Margin Loan*, Bloomberg (May 26, 2022), https://www.bloomberg.com/opinion/articles/2022-05-26/elon-called-off-his-margin-loan (discussing how Elon Musk ultimately decided against his original plans to partially finance the purchase of Twitter with a $12.5 billion margin loan secured by his Tesla stock at a 20% loan-to-value ratio, after Tesla's share value declined during the spring of 2022); United States Securities and Exchange Commission (SEC), *Amendment No. 3 to Schedule 13D Twitter, Inc.* (Apr. 20, 2022), https://www.sec.gov/Archives/edgar/data/1418091/000110465922048128/tm2213229d1_sc13da.htm [https://perma.cc/S8KL-6D9B].

82 Neumann's shares at one point granted him 20 votes per share; that figure dropped to 10 votes per share following scrutiny from Wall Street investors. Annie Palmer, *WeWork's Valuation Could Fall to Below $15 Billion in IPO, Down from $47 Billion Private Valuation*, CNBC (Sept. 13 2019), https://www.cnbc.com/2019/09/13/wework-makes-sweeping-corporate-governance-changes-ahead-of-ipo.html [https://perma.cc/HV6D-LXWK].

83 *See*, *e.g.*, Amy Chozick, *Adam Neumann and the Art of Failing Up*, N.Y. Times (Nov. 2, 2019), https://www.nytimes.com/2019/11/02/business/adam-neumann-wework-exit-package.html [https://perma.cc/C4EJ-6E7E].

84 Stephan Gandel, *WeWork CEO Adam Neumann Ousted As Company Runs Low on Cash*, CBS News (Sept. 24, 2019), https://www.cbsnews.com/news/adam-neumann-wework-ceo-ousted-as-company-runs-low-on-cash/ [https://perma.cc/9Q57-6WEA].

85 Chozick, *supra* note 83; Eric Platt, James Fontanella-Khan & Andrew Edgecliffe-Johnson, *SoftBank and JPMorgan at Odds Over WeWork Rescue*, Fin. Times (Oct. 18, 2019), https://www.ft.com/content/a9254a70-f1a8-11e9-bfa4-b25f11f42901 [https://perma.cc/AF8U-7GXK].

86 Lina Saigol & Paul Clarke, *JPMorgan's Credit Line to WeWork Co-Founder Adam Neumann: Almost $100m*, Fin. News (Aug. 14, 2019), https://www.fnlondon.com/articles/jpmorgan-lent-wework-co-founder-adam-neumann-almost-100m-ipo-filings-show-20190814 [https://perma.cc/R5QC-XDJL].

experienced a marked devaluation, he would have been pressured to satisfy lenders by offering additional shares, cash, or even relinquishing substantial real estate assets he had accumulated over the years.[87] Neumann's urgent need for repayment of his credit line likely contributed to his decision to ultimately accept a lifeline extended by WeWork's largest investor, SoftBank, which tried to salvage its own investment.

As part of the rescue financing, SoftBank agreed to buy out most of Neumann's shares and pay him consulting fees over several years.[88] SoftBank also granted Neumann a $500 million loan to repay his credit line. The arrangement ended up in litigation and a settlement.[89] The upshot of the turmoil was clear, however—Neumann walked away with riches and agreed to "ousting himself."[90]

While we revisit and delve deeper into the myriad factors leading to Neumann's ouster in subsequent sections, we emphasize at this point that we are not overlooking the importance of Neumann's control rights. Indeed, the immense value he managed to extract is a testament to his considerable bargaining power. Yet, WeWork's story draws attention to the delicate equilibrium that founder-CEOs must maintain. Even though Neumann secured astonishingly favorable terms from SoftBank upon his departure, our discussion brings to the fore the often-overlooked reality: the intersection of the company's and the founder-CEO's financial challenges. Despite his significant voting control, Neumann found himself in an increasingly constrained position, until he was forced or coaxed under pressure to relinquish managerial control.

2. *In Public Firms: Leverage and the Downward Spiral*

Shifting gears to the public company context, research on CEO turnover has shown that industry performance and, to a lesser extent, market returns influence forced turnovers—that is, factors beyond CEOs' control can contribute to their removal. The influence of CEOs' power—whether as founders, large equity shareholders, or through boards dominated by insiders—affects CEO removals similarly, regardless of whether the removal is due to industry and market performance or company-specific performance issues.[91]

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87 *Id.*

88 Jena McGregor, *Adam Neumann's Billion-Dollar Exit Package from WeWork is a Lesson in Giving Founders Too Much Control*, Wash. Post (Oct. 24, 2019), https://www.washingtonpost.com/business/2019/10/24/adam-neumanns-billion-dollar-exit-package-wework-is-lesson-giving-founders-too-much-control/ [https://perma.cc/KLR5-PJG5].

89 Peter Eavis, *Adam Neumann, WeWork's Former Chief, Sues SoftBank*, N.Y. Times (May 5, 2020), https://www.nytimes.com/2020/05/05/business/adam-neumann-softbank-lawsuit.html [https://perma.cc/8Y67-K7DY]; Peter Eavis, *WeWork's Path to Markets Is Cleared as Co-Founder and SoftBank Settle Suit*, N.Y. Times (Feb. 26, 2021), https://www.nytimes.com/2021/02/26/business/wework-SoftBank-settlement.html [https://perma.cc/5L8L-A7U3].

90 Shannon Carlin, *The True Story Behind WeCrashed*, Time (Mar. 18, 2022), https://time.com/6158804/wecrashed-true-story/ [https://perma.cc/9HQJ-FYPU] ("In a stunning move, Neumann cast a vote against himself, giving up his CEO position, as well as a majority control of the company he co-founded. Neumann cited 'investor concerns' as his reason for ousting himself.").

91 Jenter & Kanaan, *supra* note 21, at 2180–81 (finding no consistent impact of CEO power on using relative performance evaluation in CEO turnover decisions, and that where CEO power influences the connection between performance and CEO turnover, its effect is the same for both peer and idiosyncratic

Scholars have theorized that founder-CEOs, with most of their wealth tied to one company, will be largely aligned with shareholder interests and generally incentivized to maximize company value.[92] The literature on dual-class structures, particularly in cases involving nonvoting shares, cautions that these structures can introduce a potential risk to this accountability framework. The larger the wedge between executives' control and their economic share in the company, the greater the agency costs.[93] This phenomenon can lead to scenarios where founder-CEOs, holding substantial control without a commensurate economic stake, may face reduced incentives for accountability.

An often-underestimated factor in this dynamic, however, is the tendency for founders to collateralize their shares for loans, as touched upon above. Furthermore, while private firms can manage the visibility of their share price given the illiquidity of their stock and can sometimes avoid a down round financing by increasing contractual protections for investors,[94] public firms do not have this ability. The consistent public scrutiny of their stock prices can lead to highly visible price fluctuations, making executives with margin loans particularly vulnerable as a drop in stock price not only reduces founders' net worth but also brings the risk of bank margin calls into play. Given the complex interplay of factors, stock prices may have a substantial impact on the governance of public companies, even those with dual-class stock.

A case in point is John Foley, the former founder-CEO of Peloton, a popular technology-enabled fitness company known for its stationary bicycle and interactive fitness platform, which gained significant popularity during the Covid-19 pandemic. Foley stepped down from the CEO role in February 2022 and ultimately gave up his position as board chairperson in September of that year. Foley could have been a shining example of a visionary founder-CEO empowered by super-voting rights. He founded the company in 2012 with a small Kickstarter campaign, and led the company for over a decade, taking it public and reaching a market capitalization of $50 billion at its peak.[95] Peloton went public with dual-class shares granting 20 votes per share to founders and other insiders. This structure allowed Foley to hold

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performance-driven removals); *see also* Kaplan & Minton, *supra* note 21, at 58; Dirk Jenter & Katharina Lewellen, *Performance-Induced CEO Turnover*, 34 Rev. Fin. Stud. 569 (2021) (introducing the concept of "performance-induced turnover" and estimating that it drives 38%–55% of CEO turnovers); Scott B. Smart, Ramabhadran S. Thirumalai & Chad J. Zutter, *What's in a Vote? The Short- and Long-Run Impact of Dual-Class Equity on IPO Firm Values*, 45 J. Acct. & Econ. 94, 108 (2008) (finding that within 5 years post-IPO, 58% of dual-class firms and 62% of single-class firms experience CEO turnover, with the difference being statistically insignificant).

92 Goshen & Hamdani, *supra* note 11.

93 *See, e.g.*, Aggarwal et al., *supra* note 60.

94 Gornall & Strebulaev, *supra* note 28, at 66–67; Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 Wash. U. L. Rev. 913, 948 (2021); Yifat Aran, *Making Disclosure Work for Start-Up Employees*, 2019 Colum. Bus. L. Rev. 867, 911 (2019).

95 Avery Hartmans, Ben Tobin & Grace Mayer, *Peloton Wants to Expand Beyond At-Home Fitness with a Push into Gyms, Businesses, and Hotels. Here's How It Went from a Pandemic-Era Success Story to Losing Money*, Business Insider (Aug. 18, 2023), https://www.businessinsider.com/peloton-company-history-rise-fall-2022-2 [https://perma.cc/U9TQ-TA5T].

nearly 40% of the company's voting power, while cofounders Thomas Cortese and Hisao Kushi held another 18%, collectively giving them hard control.[96]

In theory, this dual-class structure should have discouraged activist hedge funds from targeting the company, since these funds often seek to modify a company's market strategy and leadership quickly.[97] Effecting change would seemingly be infeasible if the board sought to remove a founder-CEO with considerable shareholder voting power, either independently or with the support of allies. In such circumstances, the founder-CEO and his or her allies could leverage their dominant shareholder position to overhaul the board with members more likely to reinstate the founder. Yet despite Foley's voting power and Peloton's governance structure, which did not provide for majority voting, proxy access, or the ability to call special meetings or act by written consent,[98] Foley was nonetheless pressured to step down by an activist hedge fund.

Following a plunging stock price and sluggish growth, the activist fund Blackwells Capital launched a campaign to remove Foley.[99] But instead of trying to convince Foley's cofounders or the venture capitalists on the board to vote against him, Blackwells focused on persuading Foley himself to resign. In a slide deck presented to shareholders, Blackwells quoted Foley describing his indifference to the financial and technological aspects of running the business, and his overall view of himself as an inadequate manager.[100]

At the same time, as highlighted later by *Wall Street Journal* reporting, Foley was grappling with personal financial turmoil.[101] As Peloton's stock price suffered a severe decline, Goldman Sachs reached out to him on multiple occasions for additional collateral linked to personal loans it had extended.[102] These loans carried significant weight because Foley had used about 20% of his Peloton stake, initially valued at over $300 million a year earlier, as collateral.[103] The shares plummeted to just a tenth of that value in a short span.[104] These commitments were further complicated by his board membership, which posed certain restrictions on the quantity of shares he

96 Matt Levine, *Peloton's CEO Has Had Enough*, Bloomberg (Feb. 8, 2022), https://www.bloomberg.com/opinion/articles/2022-02-08/peloton-s-ceo-has-had-enough [https://perma.cc/EG5Z-PL9C].

97 *See, e.g.*, Kastiel, *supra* note 20, at 74 ("In theory, however, the existence of a controller should have a chilling effect on shareholder activism as a disciplinary mechanism, and should reduce activists' ex ante incentives to launch a campaign against a company.").

98 *Peloton – A Call for Action*, Blackwells Capital 45 (Feb. 10, 2022), https://www.blackwellscap.com/wp-content/uploads/2022/02/BW_Peloton_Presentation_Feb072022.pdf [https://perma.cc/W3GP-3PX3].

99 Svea Herbst-Bayliss, *Peloton Stock Jumps as Blackwells Pushes for CEO Ouster, Sale*, Reuters (Jan. 25, 2022), https://www.reuters.com/business/activist-investor-blackwells-seeks-remove-peloton-ceo-2022-01-24/ [https://perma.cc/J4K8-8QSK].

100 Blackwells Capital, *Peloton*, *supra* note 98, at 25.

101 Sharon Terlep & Suzanne Vranica, *Peloton Co-Founder John Foley Faced Repeated Margin Calls From Goldman Sachs as Stock Slumped*, Wall St. J. (Oct. 11, 2022), https://www.wsj.com/articles/peloton-co-founder-john-foley-faced-repeated-margin-calls-from-goldman-sachs-as-stock-slumped-11665488908?mod=hp_lead_pos6 [https://perma.cc/738C-XCSU].

102 *Id.*

103 *Id.*

104 *Id.*

could sell and the timing of those sales. While Foley maintained that these margin calls were not the central reason for his exit,[105] the combination of Blackwells' campaign and this looming personal financial pressure likely created a dual front of vulnerabilities for him. For instance, Blackwells' presentation implied that Foley had sold shares in excess of Peloton's insider trading policy following a margin call on his pledged Peloton shares.[106] By resigning from the board, Foley had the flexibility to sell or pledge more Peloton shares.[107] Foley's resignation in the face of a confluence of pressures underscores a broader takeaway: even with substantial control and governance structures in place, declining stock values can render founder-CEOs vulnerable, enabling investors to push them toward voluntary departure.

Blue Apron, a meal-kit delivery service, is another example. Its founder and CEO, Matthew Salzberg, led the company during its public debut in June 2017. At that time, the company's class A shares carried one vote each, and the company's class B shares carried ten votes each. As a result, class B shareholders, including the founders and early investors, retained 98% of all voting power. Prior to the company's IPO, the Council of Institutional Investors sent Salzberg a letter stating that "Blue Apron's share structure amounts to a ticking time bomb due to the gross misalignment of ownership and control, with class B holders operating the clock."[108] By year's end, the bomb had exploded, but not in the way investors had anticipated. Blue Apron's IPO was the "worst-performing major IPO" of 2017, with stock price trading 70% below the offer price, resulting in a market capitalization of $600 million versus $1.89 billion in IPO.[109] Although Salzberg retained control, he stepped down as CEO and became executive chairman in November 2017.[110] Salzberg was able to use his position to secure an increase in his relatively modest compensation package.[111] However, despite being a controlling shareholder, he was unable to retain his role as CEO during the company's downward spiral. In September 2021, as part of the company's preparations to raise $78 million in equity to fund growth and boost wages for hourly employees, Salzberg resigned from his role as chairman of the board. Jennifer Carr-Smith, an independent board member,

105 *Id*.

106 Blackwells Capital, *Peloton*, *supra* note 98, at 36.

107 Terlep & Vranica, *supra* note 101.

108 Letter from Council of Institutional Investors, Letter to Blue Apron (June 20, 2017), https://www.cii.org/files/issues_and_advocacy/correspondence/2017/06_20_17_letter_to_Blue_Apron_final.pdf [https://perma.cc/K46B-AU2U].

109 Rani Molla, *Blue Apron is the Worst-Performing Major U.S. IPO this Year*, Vox (Nov. 13, 2017), https://www.vox.com/2017/11/13/16630074/blue-apron-worst-performing-ipo-2017 [https://perma.cc/3GDV-TEXP].

110 *See* Jing Cao, *Blue Apron CEO Salzberg Steps Down, to Be Replaced by CFO*, Bloomberg (Nov. 30, 2017), https://www.bloomberg.com/news/articles/2017-11-30/blue-apron-ceo-salzberg-steps-down-to-be-replaced-by-cfo [https://perma.cc/6D88-3EJE].

111 *See* Alison Griswold, *Blue Apron Gave its Former CEO a Big Raise to Stop Doing the Job*, QZ (May 1, 2018), https://qz.com/1267213/blue-apron-gave-former-ceo-matt-salzberg-a-big-raise-to-stop-doing-the-job [https://perma.cc/5ZYA-8JPP].

succeeded him.[112] Additionally, at that time, Barry Salzberg, Matthew's father and a fellow board member, also stepped down.[113]

The examples highlighted above emphasize that even founder-CEOs who are controlling shareholders may be vulnerable when stock prices plummet or the performance of a company falters. These declines do not just diminish founder-CEOs' personal wealth because of their equity stakes but also potentially generate a financial motivation for them to resign due to margin calls on personal loans collateralized by these same equity stakes. The hope is that their departure could foster stock recovery, while also granting them increased flexibility to sell shares or use them as collateral for a margin loan. The following section explores how founder-CEOs might also see their positions threatened by legal actions from regulators or shareholders.

B. Legal Enforcement and Risks

Our analysis thus far has demonstrated that even the most firmly entrenched founder-CEOs are vulnerable to losing their leadership position due to the poor financial position or performance of the company. Founder-CEOs can also lose control if regulators or shareholders pursue legal action against them.

It is not uncommon for startups to skirt regulations. In many industries, companies that circumvent the law and seek to change regulations are rewarded for their actions. In Silicon Valley, startups have been encouraged to "move fast and break things," as Mark Zuckerberg famously advised Facebook employees.[114] However, as companies grow and mature, this mentality could lead to one too many conflicts with regulators. Understanding when a brush with a regulator has gone too far can be challenging and is often only realized in retrospect. Public outrage or poor financial performance can give the regulator a tailwind, and vice versa, regulatory actions can spark public outrage against a company and its leadership. Both dynamics can ultimately lead an overconfident founder-CEO to fall from power.

One of the most notable examples is Travis Kalanick's conflict with regulators. Kalanick resigned from his position as CEO of Uber in June 2017 amid a series of scandals, including Uber's use of a program called Greyball to evade law enforcement investigations.[115] This resignation has become a defining story in the technology industry, partly because the investor group that ousted Kalanick held only 40% of the

112 *See Blue Apron Co-Founder Matthew Salzberg Resigns from Board*, Reuters (Sept. 15, 2021), https://www.reuters.com/business/blue-apron-co-founder-matthew-salzberg-resigns-board-2021-09-15/ [https://perma.cc/FE2W-JPVR].

113 *Id.*

114 *See* Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. Cal. L. Rev. 383 (2016) (exploring companies with a business model aimed at changing or shaping the law); Elizabeth Pollman, *The Rise of Regulatory Affairs in Innovative Startups*, *in* The Cambridge Handbook of Law and Entrepreneurship in the United States 27 (D. Gordon Smith, Brian Broughman & Christine Hurt eds., 2022) (describing startup culture of "permissionless innovation" and disruption).

115 Mike Isaac, *How Uber Deceives the Authorities Worldwide*, N.Y. Times (Mar. 3, 2017), https://www.nytimes.com/2017/03/03/technology/uber-greyball-program-evade-authorities.html [https://perma.cc/UB8K-B847].

voting power. Despite holding most of the voting power and the ability to nominate additional board members, Kalanick was persuaded to step down.[116]

Uber's plight mirrors that of Zenefits, a San Francisco-based company that provides a technology platform for businesses to administer and manage human resources, including employee payroll and health insurance coverage. The company's founder-CEO, Parker Conrad, resigned in February 2016 after admitting he had written software that allowed employees to circumvent state insurance broker licensing requirements.[117] Later investigations revealed that Zenefits employed unlicensed salespeople in multiple states, violating local insurance laws and regulations.[118] In addition to regulatory issues, Zenefits missed its revenue targets and showed slower than anticipated growth. In response, Fidelity marked down its investment in the company by 48%.[119] Following these regulatory issues and financial woes, reports detailed Zenefits' poor internal infrastructure and fraternity-like culture, which made it a "leading exemplar" of "Silicon Valley's cult of hypergrowth."[120]

The series of scandals led the company's primary backer, the venture capital fund Andreessen Horowitz, to push for Conrad's resignation. As with Kalanick, with three of the company's four board seats under his control, Conrad could have fought to keep his seat, but according to media reports, instead he leveraged his position to negotiate his ouster, accepting a severance payment and keeping his stock, including shares that vested within six months of his resignation.[121]

Legal pressure does not always come from outside the company. In rare circumstances, the founder-CEO may be sued by insiders rather than state authorities. In one such instance of a Silicon Valley investor suing a founder, Benchmark Ventures sued Kalanick in 2017 to remove him from Uber's board. Benchmark accused Kalanick of covering up a number of misdeeds before he was given the authority to nominate new board members.[122] The previous year, Benchmark had approved

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116 Blank, *supra* note 3.

117 Claire Suddath & Eric Newcomer, *Zenefits Was the Perfect Startup. Then It Self-Disrupted*, Bloomberg (May 9, 2016), https://www.bloomberg.com/features/2016-zenefits/#xj4y7vzkg [https://perma.cc/9DM2-EHSS].

118 Farhad Manjoo, *Zenefits Scandal Highlights Perils of Hypergrowth at Start-Ups*, N.Y. Times (Feb. 17, 2016), https://www.nytimes.com/2016/02/18/technology/zenefits-scandal-highlights-perils-of-hypergrowth-at-start-ups.html [https://perma.cc/J8H5-Z3BT].

119 Brian Solomon, *Embattled Unicorn Zenefits Admits Revenue Growth Slower Than Expected*, Forbes (Nov. 16, 2015), https://www.forbes.com/sites/briansolomon/2015/11/16/embattled-unicorn-zenefits-admits-revenue-growth-slower-than-expected/?sh=6df8cd2d1a87 [https://perma.cc/9WSQ-2MSA]

120 *Id.*; William Alden, *How Zenefits Crashed Back Down to Earth*, BuzzFeed (Feb. 18, 2016), https://www.buzzfeednews.com/article/williamalden/how-high-flying-zenefits-fell-to-earth [https://perma.cc/27D4-3K47].

A. 12 1 William Alden, *Zenefits Co-Founder Sold Stock Months Before Scandal*, BuzzFeed (May 9, 2016), https://www.buzzfeednews.com/article/williamalden/zenefits-co-founder-sold-stock-months-before-scandal [https://perma.cc/6DFY-E97L]; *see also* Suddath & Newcomer, *supra* note 117 ("[D]espite his downfall, Conrad is still a coveted name in Silicon Valley").

122 *See* Complaint at ¶ 5, Benchmark Capital Partners VII, L.P. v. Kalanick, No. 2017-0575, 2017 WL 3437765 (Del. Ch. Aug. 10, 2017); Bloomberg, *A Major Uber Investor Just Sued to Remove Travis Kalanick From the Board*, Fortune (Aug. 10, 2017), https://fortune.com/2017/08/10/benchmark-capital-travis-kalanick-

Kalanick's proposal to add three new board seats and give himself the authority to delegate directors for the seats. The lawsuit alleged that Kalanick failed to divulge information about the Greyball program that deceived law enforcement and the possibility of intellectual property litigation with Google's Waymo.[123] The lawsuit against Kalanick was settled in a grand bargain tied to an investment deal between Uber and a group of investors led by SoftBank.[124] As part of that deal, Kalanick sold close to one-third of his 10% stake in Uber to SoftBank, giving SoftBank a total of 15% in Uber, making it the company's largest shareholder. Uber expanded its board from 11 to 17 directors, including four independent directors, reducing Kalanick's control and limiting early shareholders' voting power.[125] Following the governance changes, Uber was able to go public in May 2019, and Kalanick eventually stepped down from his board seat in December 2019, after selling his remaining Uber shares.[126]

The examples of Zenefits and Uber illustrate how regulatory pressure or a combination of pressure by regulators and investors can further erode the control of a founder-CEO, making resignation more appealing than battling in court and potentially imperiling the company. In the following section, we examine how a public outcry and employee protest may further exert pressure.

C. Public Outrage and Stakeholder Pressure

As the saying goes, when it rains, it pours. When a founder-CEO struggles, whether due to declining firm performance or regulatory pressure, reputational loss and employee pressure usually exacerbate the problem. In technology startups, where talent is unique and at times irreplaceable, the power of a founder-CEO is intrinsically tied to his or her ability to lead the team effectively, and founders may lose their position if the team loses faith in their leadership. This dynamic, while pronounced in startups, also occurs in public firms where leadership accountability is heightened by public scrutiny and shareholder expectations. When a company's reputation is

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uber/ [https://perma.cc/N3NP-3G68]; Klint Finley, *One of Uber's First Investors Sued Travis Kalanick for Fraud*, Wired (Aug. 10, 2017), https://www.wired.com/story/benchmark-capital-just-sued-former-uber-ceo-travis-kalanick-for-fraud/ [https://perma.cc/GTS8-MCGP].

123 Heather Somerville & Melissa Wen, *Uber Investor Sues to Force Former CEO Kalanick Off Board*, Reuters (Aug. 10, 2017), https://www.reuters.com/article/us-uber-lawsuit-idUSKBN1AQ2DF [https://perma.cc/JE9U-D7EJ].

124 *Benchmark Capital Drops Lawsuit Against Ex-Uber CEO Kalanick*, Reuters (Jan. 25, 2018), https://www.reuters.com/article/us-uber-benchmark-lawsuit/benchmark-capital-drops-lawsuit-against-ex-uber-ceo-kalanick-idUSKBN1FE2Z5 [https://perma.cc/WXL3-S46E]; Greg Bensinger, *Uber Board Settles Feud, Clearing Way for SoftBank Deal*, Wall St. J. (Nov. 13, 2017), https://www.wsj.com/articles/uber-set-to-announce-softbank-deal-after-kalanick-benchmark-reach-terms-1510516418 [https://perma.cc/47SQ-CB8L]; *see also* Fisch & Solomon, *supra* note 17, at 1094 n.190 (noting a "loophole" in Uber's dual-class structure that gave investors leverage to obtain Kalanick's agreement to the deal).

125 Heather Somerville, *SoftBank is Now Uber's Largest Shareholder as Deal Closes*, Reuters (Jan. 18, 2018), https://www.reuters.com/article/us-uber-SoftBank-tender-idUSKBN1F72WL [https://perma.cc/U6PH-G42Z].

126 Kate Conger, *Uber Founder Travis Kalanick Leaves Board, Severing Last Tie*, N.Y. Times (Dec. 24, 2019), https://www.nytimes.com/2019/12/24/technology/uber-travis-kalanick.html [https://perma.cc/2535-JER2].

tarnished by scandals and missteps, it may have to pay a larger compensation package to retain and hire employees.[127] Furthermore, it is not uncommon for employees to leak information to reporters or regulators, walk out, or resign in large numbers if they feel the company has strayed from ethical standards.[128]

One example is Pinterest's founder-CEO, Ben Silbermann, who resigned in June 2022 following complaints about racism and sexism at the company. In contrast to WeWork and Uber, the media hailed Pinterest as a well-disciplined unicorn that rejected Silicon Valley's "bro" culture and relentless growth mentality.[129] The company branded itself as the "anti-unicorn," one that valued equity and inclusion and wanted to provide "a safe and happy place for inspiration."[130] Nevertheless, the company's IPO in April 2019 put it under new scrutiny.

The company went public using a dual-class structure, which gave Class B shareholders, including the founding team and venture capital investors, 20 votes per share, in contrast to the Class A shares with one vote each. Immediately after the IPO, Class B shares held approximately 99.2% of the company's voting power. Pinterest also adopted a divestment-based sunset provision under which Class B shareholders stand to lose their super-voting rights in 2026 if they sell more than half of their shares. Concerned about Pinterest's unusual voting arrangements, the Council of Institutional Investors attempted unsuccessfully to get Pinterest's board to adopt a simple time-based sunset provision that would eliminate all special voting rights for the firm's Class B shares within seven years of the IPO.[131] In the immediate aftermath of the IPO, the cofounders Silbermann and Evan Sharp held 13.4% of the voting power and 11.5% of the equity of the company.[132] The third cofounder, Paul Sciarra, who had left the company earlier on, held an additional 9.3% of the voting power.[133] Over time, however, as other Class B shareholders sold their shares at a faster rate than the founders in the post-IPO market, Silbermann's voting power grew to 37% and cofounder Paul Sciarra's to 33%, effectively giving the pair hard control over the company (Sharp's voting power, in contrast, diminished to just below 4%).[134]

In an analysis of Pinterest's governance structure ahead of its IPO, prominent scholars warned:

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127 Kali Hays, *Facebook Is Paying a "Brand Tax" to Hire Tech Workers Who Fear a Black Mark on Their Careers If They Work At the Company*, Bus. Insider (Jan. 4, 2022), https://www.businessinsider.com/facebook-pays-brand-tax-hire-talent-fears-career-black-mark-2021-12 [https://perma.cc/U9WN-QN74].

128 *See generally* Jennifer S. Fan, *Employees as Regulators: The New Private Ordering in High Technology Companies*, 2019 Utah L. Rev. 973; Anat Alon-Beck, *Times They Are a-Changin': When Tech Employees Revolt!*, 120 Md. L. Rev. 80 (2020).

129 Erin Griffith, *Pinterest Is a Unicorn. It Just Doesn't Act Like One.*, N.Y. Times (Sept. 9, 2018), https://www.nytimes.com/2018/09/09/technology/pinterest-growth.html [https://perma.cc/FBW6-84R7].

130 *Id.*

131 *See* Lucian Bebchuk & Kobi Kastiel, *The Perils of Pinterest's Dual-Class Structure*, Harv. L. Sch. Forum on Corp. Gov. (Apr. 10, 2019), https://corpgov.law.harvard.edu/2019/04/10/the-perils-of-pinterests-dual-class-structure/ [https://perma.cc/8D4U-BYK7].

132 *Id.*

133 *Id.*

134 Matthew Frankel, *Pinterest Just Got a Big Vote of Confidence—Time to Buy?*, Motley Fool (July 15, 2022), https://www.fool.com/investing/2022/07/15/pinterest-just-got-a-big-vote-of-confidence-time-t/ [https://perma.cc/QU56-RAF9].

> Pinterest's IPO structure will secure extremely long-lasting lock on control for Pinterest's co-founders. If Pinterest were to go public with a standard one-share-one-vote structure, the 13.4% aggregate ownership stake of Pinterest's co-founders would not enable them to be insulated from removal in the event of under-performance. In such a case, if Pinterest's co-founders eventually became value-reducing leaders, public investors would be able to facilitate a leadership change. However, with the dual-class structure now in place, Pinterest's co-founders can be expected to obtain over time a lock on control that subsequently would enable them to remain in power even if they became value-reducing leaders.[135]

Given the disparity in voting power, Pinterest's dual-class structure was evidently a risk. In reality, however, Silbermann resigned under public scrutiny rather than remain in power as predicted.

Several reasons likely precipitated Silbermann's resignation. The site was very popular during the pandemic, but its user base declined as demand cooled, resulting in a 76% drop in share price. In addition, the company was repeatedly accused of fostering a toxic work environment and discriminating against minorities and women.[136] Lawsuits over these claims led to a "digital walkout" by employees and to lawsuits accusing the company's executives and directors of tarnishing the reputation of the company among its overwhelmingly female user base.[137] Upon stepping down as CEO in June 2022, Silbermann became executive chairman and stayed on the board.[138] Silbermann vacated the CEO position to Bill Ready who was previously in charge of Google's commerce division, declaring Ready the "right leader" for the company's e-commerce transition, causing shares to rise 5% in after-hours trading.[139]

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135 Bebchuk & Kastiel, *supra* note 12, at 111.

136 Mike Leonard, *Pinterest Board Blamed in Suit for Toxic Workplace Culture*, Bloomberg Law (Mar. 30, 2021), https://news.bloomberglaw.com/esg/pinterest-board-fostered-toxic-culture-toward-women-suit-says [https://perma.cc/DAH9-XY3Z]; Erin Griffith, *Pinterest Settles Gender Discrimination Suit for $22.5 Million*, N.Y. Times (Dec. 14, 2020), https://www.nytimes.com/2020/12/14/technology/pinterest-gender-discrimination-lawsuit.html [https://perma.cc/NWW2-22CB]; Nitasha Tiku, *Black Women Say Pinterest Created a Den of Discrimination—Despite Its Image As the Nicest Company in Tech*, Wash. Post (July 4, 2020), https://www.washingtonpost.com/technology/2020/07/03/pinterest-race-bias-black-employees/ [https://perma.cc/PW3C-NNKK]; Erin Griffith, *Pinterest Accused of Not Paying Female 'Co-Creator'*, N.Y. Times (Sept. 13, 2021), https://www.nytimes.com/2021/09/13/technology/pinterest-lawsuit.html [https://perma.cc/22KF-ZH3F]. On the #MeToo movement and departures of high-profile executives generally, *see* Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 Colum. L. Rev. 1583 (2018); Amelia Miazad, *Sex, Power, and Corporate Governance*, 54 U.C. Davis L. Rev. 1913 (2021).

137 Erin Griffith, *Pinterest's Ben Silbermann Steps Down as Chief Executive*, N.Y. Times (June 28, 2022), https://www.nytimes.com/2022/06/28/business/pinterest-ben-silbermann.html [https://perma.cc/4MVC-98WS]; Peter Hayes, *Pinterest Shareholder Suit Alleges Discrimination*, Bloomberg Law (Dec. 1, 2020), https://news.bloomberglaw.com/securities-law/pinterest-shareholders-allege-race-gender-discrimination [https://perma.cc/QU4N-3CN2]; Leonard, *supra* note 136.

138 Kurt Wagner, *Pinterest CEO Silbermann Steps Down; Google's Executive to Take Job*, Bloomberg (June 28, 2022), https://www.bloomberg.com/news/articles/2022-06-28/pinterest-ceo-silbermann-steps-down-google-s-ready-to-take-job.

139 Jessica Bursztynsky & Jennifer Elias, *Pinterest CEO Ben Silbermann Is Stepping Down and the Stock Is Up*, CNBC (June 28, 2022), https://www.cnbc.com/2022/06/28/pinterest-shares-pop-on-report-ceo-ben-silbermann-is-stepping-down.html [https://perma.cc/9RDD-N689].

Interestingly, as with Peloton, the corporate governance of Pinterest, including the fact that its cofounders retained a majority of voting rights after Silbermann's departure, did not deter an activist hedge fund from targeting the company. In July 2022, Elliott Management bought a large stake in Pinterest. With 9% of the shares, Elliott Management's voting power was negligible in terms of hard control, suggesting that Elliott Management believed it could drive change by persuasion.[140] Subsequently, in December of that year, the company announced that it had reached an agreement in which an Elliott Management portfolio manager would join its board.[141]

Pinterest's example is by no means unique. Kalanick's resignation as Uber CEO in June 2017 came amid backlash from the public as well as employee protests over a hostile work environment.[142] Kris Duggan, founder-CEO of BetterWorks, another Silicon Valley HR startup, resigned in July 2017 following allegations of assault and sexual harassment.[143] Mike Cagney, the founder-CEO of online lender SoFi, resigned in September 2017, stating that "a combination of HR-related litigation and negative press have become a distraction from the company's core mission," shifting focus "more toward litigation and me personally."[144] Dan Price, founder-CEO of Gravity Payments, who had grabbed the media's attention by cutting his own pay so employees would each earn at least $70,000, resigned amid allegations of sexual misconduct.[145] These and other examples demonstrate that focusing solely on governance control mechanisms underestimates the potential impact of public opinion and employee actions in the current workplace climate.

In our discussion so far, we have explored how poor financial performance, legal battles, and stakeholder outrage and pressure may undermine founder-CEOs' ability to remain in executive positions. Lastly, we examine founders' psychology and personal struggles and motivations, which may impact their desire to keep their position when adversity surrounds them.

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140 Kenneth Squire, *How Activist Investor Elliott May Plan to Support Value Creation at Pinterest*, CNBC (July 16, 2022), https://www.cnbc.com/2022/07/16/how-activist-investor-elliott-may-plan-to-support-value-creation-at-pinterest.html [https://perma.cc/9YK2-PWQP].

141 *Pinterest Reaches Deal with Activist Elliott; Steinberg to Join Board,* Reuters (Dec. 6, 2022), https://www.reuters.com/technology/pinterest-reaches-deal-with-activist-elliott-steinberg-join-board-2022-12-06/ [https://perma.cc/EJ7F-33MU].

142 Todd Haselton, *Uber's CEO is Out: Here's Everything that Went Wrong with Uber this Year*, CNBC (June 21, 2017), https://www.cnbc.com/2017/06/21/uber-timeline-why-did-ceo-travis-kalanick-leave.html [https://perma.cc/KN5G-ZVDE].

143 Becky Peterson, *BetterWorks CEO to Step Down Following Accusations of Assault, Sexual Harassment*, Bus. Insider (July 26, 2017), https://www.businessinsider.com/betterworks-ceo-steps-down-following-allegations-assault-sexual-harassment-2017-7 [https://perma.cc/KMR8-ZZ58].

144 *SoFi CEO Cagney to Step Down Immediately*, Reuters (Sept. 15, 2017), https://www.reuters.com/article/us-sofi-ceo-idUSKCN1BQ2B8 [https://perma.cc/4DC8-EBFX].

145 Hamza Shaban, *Dan Price, CEO Who Cut His Pay So Workers Made at least $70,000, Resigns*, Wash. Post (Aug. 18, 2022), https://www.washingtonpost.com/business/2022/08/18/dan-price-resigns/ [https://perma.cc/VQ9T-2K96].

D. Personal Reasons and Motivations

The psychological value of being in control of the companies they created is a significant factor for founder-CEOs,[146] and it sets them apart from other professional CEOs. For some founders, their company is often not just a job or a career, but rather an extension of their identity and purpose.[147] This emotional attachment and sense of ownership can motivate them to go above and beyond in leading and growing their company.[148]

The flip side of the founder-CEO's emotional investment in their company, however, is that they bear a significant mental and emotional load when their company is underperforming or under attack. The scrutiny and criticism that come with being a public company CEO can exacerbate these feelings, leading some founder-CEOs to consider resigning voluntarily if they no longer enjoy being at the helm or believe they are no longer the best person to lead the company through a challenging period. The prestige of being a founder-CEO declines when the company or their performance falters.

More generally, many founder-CEOs would rather take an honorable exit from the top executive role and maintain their reputation than stay in managerial control of a company navigating the choppy waters of public markets. For example, Google founders Larry Page and Sergey Brin stepped down from their executive roles at Alphabet in December 2019, saying they did not believe in holding onto positions when they thought there was a better alternative for the company.[149]

In a public company, the pressure to deliver strong financial results, meet investor expectations, and maintain a positive public image can be immense. The skills relevant to the startup context, such as generating traction, aggressive growth, and fundraising, are distinct from managing investor expectations in public markets and hitting quarterly earnings targets. Thus, as companies grow and change, founders often lose interest, and stepping down can provide a sense of liberation, allowing the founder to refocus on their strengths or pursue other interests or hobbies. For example, Jeff Bezos stepped down as Amazon's CEO in July 2021 to focus on

146 *See* Jonathan D. Arthurs & Lowell W. Busenitz, *The Boundaries and Limitations of Agency Theory and Stewardship Theory in the Venture Capitalist/Entrepreneur Relationship*, 28 Entrepreneurship Theory & Prac. 145, 157 (2003) (discussing the psychological attachment of founders to their firms, as well as the complementary nature of the founder's human capital, suggesting that founder-controlled firms should be valued higher for their entrepreneurial assets); Javier Gimeno et al., *Survival of the Fittest? Entrepreneurial Human Capital and the Persistence of Underperforming Firms*, 42 Admin. Sci. Q. 750, 758 (1997) (suggesting that founders derive personal satisfaction and intrinsic motivation from self-employment which leads to a negative effect on the likelihood of their exit even if the financial return to the founder is lower than outside opportunities); *see also* Thomas M. Zellweger & Joseph H. Astrachan, *On the Emotional Value of Owning a Firm*, 21 Fam. Bus. Rev. 347, 347 (2008) (discussing the emotional value in firm ownership).

147 Arthurs & Busenitz, *supra* note 146.

148 Gimeno et al., *supra* note 146.

149 Kaya Yurieff, *Google Co-Founders Larry Page and Sergey Brin Stepping Down as Alphabet Executives*, CNN (Dec. 4, 2019), https://edition.cnn.com/2019/12/03/tech/alphabet-google-co-founder-larry-page-step-down/index.html [https://perma.cc/8Q32-MTTZ].

"new products and early initiatives" such as his Blue Origin space company.[150] Jack Dorsey left Twitter in 2021 to focus on Block (Square) and develop his passion for cryptocurrencies.[151]

Moreover, even though founder-CEOs may brand themselves as larger-than-life characters, they are just human and have their own vulnerabilities. For instance, the timing of Travis Kalanick's ouster from Uber came after taking a leave of absence to grieve over the tragic death of his mother in a boating accident.[152]

In a similar vein, it goes without saying that a CEO may decide to step down if they are facing major health issues. For example, Steve Jobs retired in 2011 after battling pancreatic cancer for several years.[153] He died only six weeks after his resignation. Likewise, a CEO may decide to step down to focus on their family and personal relationships, or may at least highlight this as their key motivation.

Overall, many personal reasons may incline a CEO to voluntarily step down, and each individual's decision is likely to be influenced by a combination of factors. Founder-CEOs may have attained a level of wealth that frees them from the need to keep working. It should not be underestimated or overlooked that managing a company's daily operations is challenging, and if the company is struggling, the experience may not be enjoyable. Even after taking extensive measures to maintain their control, founder-CEOs may realize they no longer want managerial power.

III. Limits and Implications

Our analysis thus far has highlighted that founder-CEOs with various forms of control might be more constrained than predicted by current theory once we take into account market and reputational forces and other practical realities, such as bad financial circumstances or legal problems. In this final Part, we explore limits to the countervailing forces and broader implications or market perspectives on founder-CEOs seeking control through dual-class structures or related protections.

A. Limits of Counterforces on Powerful Founder-CEOs

Several important limits to the above analysis arise and ultimately temper the effects of counterforces on powerful founder-CEOs. First, although poor financial performance, legal exposure or scandals, and stakeholder pressure or personal

150 Theodore Schleifer & Jason Del Rey, *Jeff Bezos is Stepping Down as Amazon's CEO*, Vox (Feb. 2, 2021), https://www.vox.com/recode/2021/2/2/22263090/jeff-bezos-amazon-ceo-stepping-down-andy-jassy [https://perma.cc/UT4U-98W6].

151 MacKenzie Sigalos, *Jack Dorsey's Departure from Twitter Gives Him More Time to Focus on His Passion for Bitcoin*, CNBC (Nov. 29, 2021), https://www.cnbc.com/2021/11/29/jack-dorseys-twitter-departure-means-more-time-for-bitcoin-passion.html [https://perma.cc/Z2UQ-3Q3S].

152 Eric Newcomer & Brad Stone, *The Fall of Travis Kalanick Was a Lot Weirder and Darker Than You Thought*, Bloomberg (Jan. 18, 2018), https://www.bloomberg.com/news/features/2018-01-18/the-fall-of-travis-kalanick-was-a-lot-weirder-and-darker-than-you-thought [https://perma.cc/M2Q7-G2PN].

153 John Markoff, *Apple's Visionary Redefined Digital Age*, N.Y. Times (Oct. 5, 2011), https://www.nytimes.com/2011/10/06/business/steve-jobs-of-apple-dies-at-56.html [https://perma.cc/2KR7-HJYW].

struggles can put a founder-CEO in a tenuous position, such circumstances do not always dethrone them. There might be a tipping point or individual calculus that must be reached in circumstances where the founder-CEO has control and does not want to step down. While certain patterns emerge between the types of circumstances that lead a founder-CEO to ouster or resignation under pressure, it is not entirely predictable. Personal characteristics and preferences likely play a role, and counterforces are a matter of degree.

For instance, Mark Zuckerberg, one of the most prominent examples of a founder-CEO becoming "rich and king," famously had a business card in the company's early startup days that said, "I'm CEO, Bitch."[154] And, while the freewheeling culture of a young Facebook and its leadership has evolved from that time to today's Meta, Zuckerberg has notably not stepped down despite Meta's stock experiencing a downturn of more than 50% at one point.[155] The company faced bruising market scrutiny of its strategic focus on the metaverse and was entangled in a high-profile consumer privacy scandal.[156] Zuckerberg also encountered pushback against a plan to issue a new class of non-voting shares to the public that would have allowed him to retain control while selling his shares to fund philanthropic endeavors.[157] The company withdrew its plan in the face of a shareholder lawsuit arguing that the recapitalization plan amounted to unfair self-dealing.[158] Through all of these challenges and potential off-ramps, Zuckerberg has persisted in leading the company.[159]

Second, in some instances, the founder-CEO is ousted but the circumstances are so dire that the company also fails—Elizabeth Holmes of Theranos and Sam Bankman-Fried of FTX are prime examples. In the case of Holmes, her shares held 100 votes each, giving her complete control over company decisions.[160] Bankman-

154 MG Siegler, *Card Designer: The Inspiration For Zuckerberg's "I'm CEO, Bitch"? Steve Jobs.*, TechCrunch (June 25, 2011), https://techcrunch.com/2011/06/25/im-ceo-bitch/ [https://perma.cc/T8GP-VF4L].

155 Michael Hiltzik, *Meta and Twitter Show the Drawbacks of Giving Self-Satisfied Billionaires Too Much Power*, L.A. Times (Nov. 3, 2022), https://www.latimes.com/business/story/2022-11-03/meta-and-twitter-show-the-drawbacks-of-giving-self-satisfied-billionaires-too-much-power [https://perma.cc/9ECM-SQDE].

156 *See* Jacob Carpenter, *Mark Zuckerberg Is Spending Billions on the Metaverse. Wall Street Wants Him to Fix Facebook and Instagram First*, Fortune (Apr. 28, 2022), https://fortune.com/2022/04/28/meta-earnings-metaverse-facebook-instagram-zuckerberg/ [https://perma.cc/NR32-8FQ3]; Chavi Mehta & Katie Paul, *Investors Punish Zuckerberg as Costly Metaverse Pitch Falls Flat*, Reuters (Oct. 26, 2022), https://www.reuters.com/technology/investors-punish-zuckerberg-costly-metaverse-pitch-falls-flat-2022-10-27/ [https://perma.cc/PZ9K-538K]; Joel Rosenblatt, *Meta Agrees to Pay $725 Million Over Cambridge Analytica Scandal*, Bloomberg (Dec. 22, 2022), https://www.bloomberg.com/news/articles/2022-12-23/meta-agrees-to-pay-725-million-to-settle-privacy-lawsuit [https://perma.cc/6GWL-NRJZ].

157 Kurt Wagner, *Six Key Questions for Mark Zuckerberg After He Gave Up on Trying to Split Facebook Stock*, Vox (Sept. 23, 2017), https://www.vox.com/2017/9/23/16354302/why-mark-zuckerberg-facebook-stock-split [https://perma.cc/KW3T-W9TA].

158 Zohar Goshen & Assaf Hamdani, *Corporate Control, Dual Class, and the Limits of Judicial Review*, 120 Colum. L. Rev. 941, 944 (2020).

159 Zuckerberg has stated that he believes he would have been fired "at several points" if he had not had voting control of the company. Catherine Clifford, *Mark Zuckerberg: If I Didn't Have Complete Control of Facebook, I Would Have Been Fired*, CNBC (Oct. 3, 2019), https://www.cnbc.com/2019/10/03/zuckerberg-if-i-didnt-have-control-of-facebook-i-wouldve-been-fired.html [https://perma.cc/T8GP-VF4L].

160 Peter Cohan, *SEC Charges Theranos With Fraud, CEO Holmes Gives Up Voting Control*, Forbes (Mar. 14, 2018), https://www.forbes.com/sites/petercohan/2018/03/14/sec-charges-theranos-with-fraud-ceo-holmes-gives-up-voting-control/?sh=6c4efed320d1 [https://perma.cc/ZZN9-H92S].

Fried led a company for an extended period without a traditional startup board, instead concentrating managerial control in a small group of individuals with little experience or oversight.[161] These examples serve to highlight that market forces, legal pressures, and personal accountability may not be sufficient to save a company in the face of fraud allegations or extreme governance failures—ousting a founder-CEO is sometimes little comfort.

Third, it is important to note that even when a founder-CEO is ousted, they may still retain significant control over the company. This is exemplified in cases such as Uber's Travis Kalanick, Peloton's John Foley, Blue Apron's Matt Salzberg, and Pinterest's Ben Silbermann where the process of dislodging the founder-CEO from managerial power may occur in stages, starting with the CEO position and subsequently from the board of directors. Moreover, the founder may still hold a significant percentage of the voting stock, which can allow them to exert influence over the company's decision-making processes post-resignation. For this reason, researchers who have studied founder control have created an assortment of measures, such as characterizing a founder as having "weak" control if he is CEO and "strong" control if he has a voting interest of at least a certain percentage, such as 30%.[162] Scholars have also raised concerns about small minority controllers regardless of whether these controllers remain as CEOs.[163]

Finally, an ousting may be temporary—it exists at a particular moment and the founder may go on to have another act. Steve Jobs staged a "boardroom coup" to return to Apple as CEO, and it was in this second phase of his leadership that the company reached record success.[164] Ironically, the Apple board abruptly ousted its then-chair and CEO, Gilbert Amelio, during a period of poor financial performance and stock decline, to reinstall Steve Jobs.[165] And, while it is relatively rare for a founder to step down or be ousted and then brought back to lead the same company, it is relatively commonplace for the founder to have a rebirth with a new venture.[166]

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161 Hannah Lang & Doina Chiacu, *Poor Management, Inexperienced Leaders, Led to FTX Collapse, New CEO Says*, Reuters (Dec. 13, 2022), https://www.reuters.com/legal/poor-management-inexperienced-leaders-led-ftx-collapse-new-ceo-tells-lawmakers-2022-12-13/ [https://perma.cc/8PQA-PF6R]; Joshua Chaffin, *'Fraud in Shorts and T-shirts': the Case Against the FTX Founder*, Fin. Times (Dec. 14, 2022), www.ft.com/content/3f2ae696-0cba-403d-bcof-17433b547e27 [https://perma.cc/93GC-6TDZ].

162 Broughman & Fried, *supra* note 2, at 51.

163 *See generally* Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 Geo. L.J. 1453 (2019).

164 Matt Weinberger & Avery Hartmans, *Steve Jobs Would Have Been 65 on Monday. Here's How the Late Apple CEO Saved the Company from Disaster and Set it on the Path to a $1 Trillion Valuation*., Bus. Insider (Feb. 24, 2020), https://www.businessinsider.com/steve-jobs-apple-photos-2017-1 [https://perma.cc/FF2F-MX68].

165 Steve Lohr, *Apple Computer Ousts Chief In Response to Poor Results*, N.Y. Times (July 10, 1997), https://www.nytimes.com/1997/07/10/business/apple-computer-ousts-chief-in-response-to-poor-results.html [https://perma.cc/SMW5-VE7T]. *See also* Nico Grant, *Google Calls In Help From Larry Page and Sergey Brin for A.I. Fight*, N.Y. Times (Jan. 20, 2023), https://www.nytimes.com/2023/01/20/technology/google-chatgpt-artificial-intelligence.html [https://perma.cc/9LKQ-4XWS]; Miles Kruppa & Deepa Seetharaman, *Sergey Brin Is Back in the Trenches at Google*, Wall St. J. (July 21, 2023), https://www.wsj.com/articles/sergey-brin-google-ai-gemini-1b5aa41e%20 [https://perma.cc/Z9LA-JL3E].

166 Pollman, *supra* note 36 (describing the law and culture that facilitates serial entrepreneurship for founders and employees in failed startups).

Over time, the startup ecosystem has evolved to be more founder-friendly, reflecting the interdependent relationship between founder-CEOs and investors, often repeat players in the space. Maintaining a founder-friendly reputation is crucial for investors, but at the same time, founders are dependent on venture capital investors as they aspire to launch new ventures. This interdependency encourages both parties to work together and maintain, at least superficially, the appearance of an amicable decision. Examples of this dynamic abound. Travis Kalanick, for example, started a new company of "ghost kitchens" after his ouster from Uber.[167] After taking WeWork to the brink of collapse, Adam Neumann walked away with a personal fortune and started a new venture in residential real estate, backed by brand-name venture capitalists.[168] After losing 87% of his wealth on paper by the end of his tenure at Peloton, John Foley started a new company that makes custom rugs.[169] And the stories of rebirth go on. Indeed, the potential for starting anew, and maintaining one's reputation to do so, likely is a consideration when a founder steps down under pressure.

B. Implications for the Dual-Class Debate

In this final section of our discussion, we conclude with the implications of our analysis for the dual-class debate. Corporate governance literature notes that many dual-class stock offerings have originated from technology companies, which are often financed by venture capital firms.[170] Theory suggests that companies are motivated to create optimal governance systems upon going public. Consequently, the literature acknowledges a puzzle: why do dual-class structures persist in IPOs of venture-backed companies, even when they are perceived to have high agency costs?[171]

According to the literature, dual-class shares have both benefits and costs for shareholders: They are getting shares in a young, fast-growing company led by a visionary founder, but the downside is that if the founder decides to take the company

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167 Dave Lee & Michael Pooler, *Travis Kalanick Expands "Dark Kitchens" Venture Across Latin America*, Fin. Times (Sept. 5, 2022), https://www.ft.com/content/162460f3-5707-4857-9676-70aa1d9df203 [https://perma.cc/97RW-5SP2]; Polina Marinova, *Ex-Uber CEO Travis Kalanick Is Betting on the Rise of 'Ghost Kitchens'*, Fortune (Nov. 8, 2019), https://fortune.com/2019/11/08/uber-travis-kalanick-cloud-kitchens/ [https://perma.cc/3HQ9-6CDW].

168 Andrew Edgecliffe-Johnson, *WeWork's Adam Neumann on Investing, Startups, Surfing and Masayoshi Son*, Fin. Times (Mar. 10, 2022), https://www.ft.com/content/42c8644e-240e-45a8-954d-31d58e036dec [https://perma.cc/2224-WFBA]; Andrew Ross Sorkin et al., *Adam Neumann Gets a New Backer*, N.Y. Times (Sept. 29, 2022), https://www.nytimes.com/2022/08/15/business/dealbook/adam-neumann-flow-new-company-wework-real-estate.html [https://perma.cc/MF8N-HYUR].

169 Prarthana Prakash, *The Former CEO of Fitness Bike Maker Peloton Will Now Be Selling Rugs*, Fortune (Nov. 9, 2022), https://fortune.com/2022/11/09/former-peloton-ceo-to-sell-rugs-ernesta/ [https://perma.cc/6XEK-RBRC].

170 Aggarwal et al., *supra* note 60.

171 *Id.* ("[F]rom a governance perspective, the increase in dual-class stock IPOs is puzzling . . . VC firms have incentives to design optimal governance systems for their portfolio firms when those firms go public in order to preserve the value of their investment . . . . Thus, one might expect VC firms to insist on a one-vote one-share system for their portfolio companies at the IPO. In light of these concerns about agency costs, it is natural to ask why IPO firms appear to increasingly be adopting dual-class structures").

down a path that investors consider destructive, there is not much they can do. Our analysis of the forces and factors that may lead to a founder-CEO's resignation provides new insight into why structures can be offered by venture-backed startups to public market investors at no cost or at a slight discount.[172]

A first point to keep in mind is that venture-backed startups often go public before turning a profit, which can lead to cash shortages that force founders to return to the capital markets or lenders for further funding. While financial constraints in public companies may not be as immediate as in private companies, they still impact a founder-CEO's ability to wield control. For example, the founder-CEO of cash-strapped Peloton, John Foley, was readily ousted despite possessing several means of control.[173] Similarly, in the case of Blue Apron's Matt Salzberg, he opted to relinquish his board seat ahead of an equity issuance to generate much-needed capital. In stark contrast, Mark Zuckerberg has remained impervious to comparable pressures thanks to Meta's vast reserves of cash.[174]

A second point is that control arrangements may be renegotiated. In the private company context, in which ownership and governance arrangements are regularly bargained for among a relatively small number of participants, there is the possibility of pushing out a leader with the hopes of giving the company a chance at a fresh start. One way that investors can remove an underperforming founder-CEO in the private company context is by buying them out, as seen in the case of Adam Neumann's deal, which allowed SoftBank to gain control of WeWork.[175]

Similarly, as we have seen, Travis Kalanick, the cofounder of Uber, was ousted from his position as CEO in 2017 after a series of scandals and controversies.[176] However, Kalanick remained on the board of directors and maintained significant voting power, which allowed him to influence the company's direction.[177] To resolve this issue, Uber's board negotiated a deal to buy out Kalanick's shares and reduce his voting power. The deal allowed Kalanick to step down voluntarily, so the company could move forward without his influence.[178] In both cases, buying out the CEO

172 *See* Martijn Cremers, Beni Lauterbach & Anete Pajuste, *The Life-Cycle of Dual Class Firm Valuation*, at 16 (European Corp. Gov. Inst. (ECGI)-Fin., Working Paper 550 (July 14, 2018)), https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=3062895 [https://perma.cc/V9EZ-3UCW] ("It appears that dual class firms enjoy a statistically significant valuation (Tobin's Q) premium of about 0.20 over single class firms in the first 5 years after the IPO. On year 6 after the IPO the valuation premium drops to about 0.10 and in year 7 it turns negative, i.e., dual class firms start trading at a discount relative to single class firms. In later years this Tobin's Q discount stabilizes at about 0.15.").

173 Jordan Valinsky, *Peloton is Burning Through Cash and Borrowing from Wall Street to Stay Afloat*, CNN (May 10, 2022), https://edition.cnn.com/2022/05/10/investing/peloton-third-quarter-earnings/index.html [https://perma.cc/WH6F-AT5S].

174 Meta, Meta Reports Third Quarter 2022 Results, (Oct. 26, 2022), https://s21.q4cdn.com/399680738/files/doc_news/Meta-Reports-Third-Quarter-2022-Results-2022.pdf [https://perma.cc/NK69-YJSR].

175 *Id.*

176 *See supra* Part II.B.

177 Annie Palmer, *Travis Kalanick Severs All Ties with Uber, Departing Board and Selling All His Shares*, CNBC (Dec. 24, 2019), https://www.cnbc.com/2019/12/24/travis-kalanick-to-depart-uber-board-of-directors.html [https://perma.cc/376X-V6CY].

178 *Id.*

was a strategic move to prevent the company from sinking further and protect the investors' interests.

In the public company context, founder-CEOs with control are not as likely to be bought out, but the experiences of former Blue Apron founder-CEO Matt Salzberg and Pinterest's Ben Silbermann demonstrate that in such cases relocating a founder from the CEO position to the executive chairperson role, potentially coupled with a compensation adjustment, can be a mutually agreeable and relatively seamless way to encourage the founder to step down as CEO and facilitate their eventual departure from the company. This approach functions as an intermediate stage until the founder is willing to relinquish their position on the board entirely.

The third point to consider is that if the founder-CEO chooses a highly destructive path (illegal or unethical), other forces will intervene to help discipline the founder-CEO, including from regulators, courts, employees, and the public. As a result, the founder-CEO's entrenched control holds more sway in a company that is profitable and does not break the law or otherwise engage in extremely unethical behavior, and less sway in an unprofitable company where there are grave legal and cultural issues.

Lastly, in high-stakes bets on rapidly growing companies, the removal of the founder-CEO may not always address the root causes of a company's failure. While agency costs can be a factor, there are often more profound problems at play, such as a flawed business model or a lack of sustainable growth. In such cases, the founder-CEO may have been the driving force behind the company's initial success, and it may not be easy for another leader to replicate their vision or expertise. The issues that led to the company's failure may be inherent in its business model or market conditions, making it difficult for anyone, including a new CEO, to turn the company around.

Taking all of the above into consideration clarifies the puzzle significantly. Investors in high-growth companies often face a potential tradeoff between the risk of agency costs and the potential rewards of investing in a rapidly growing business. While there is uncertainty about whether the company's founder will be a visionary or a bad actor, the potential rewards of investing in a company led by visionary founders who can execute their visions without interference from market forces may outweigh the potential risks. In the case of high-growth companies, investors may be more willing to tolerate agency costs in exchange for the potential rewards of investing in a company with significant growth potential. For example, investors in Amazon, Facebook, or Google have seen extremely high returns over the long term, despite entrenched control of the founders. Additionally, investors may be more willing to tolerate agency costs in high-growth companies due to the increased level of competition in the market. In rapidly growing industries, companies must move quickly to establish a dominant position, and investors may be more willing to overlook agency costs if it means getting a stake in a company that is well-positioned to take advantage of growth opportunities.

In the event that founder-CEOs are bad actors and exploit their super-voting rights to extract private benefits, investors may lose a maximum of one time (1x) their investment. Still, if the company is unprofitable, breaks the law, or acts extremely

unethically, other forces may intervene to counteract the founder-CEO's actions. Meanwhile, if the founder is indeed a truly visionary leader, by protecting them from market forces and allowing them to execute their vision, investors could yield a return many times greater than the amount invested.[179] Therefore, a public market investor who invests in a portfolio of venture-backed companies going public can rationally place a relatively small discount or even a premium on dual-class structures.

Conclusion

Founder-CEOs who hold substantial voting power or other means of control have attracted significant debate about the promise and perils of their involvement in the company. Dual-class structures in particular have been a source of controversy in both the private and public realms. For companies that have gone public with dual-class stock, sunset provisions have been seen as the primary means of saving public shareholders from the potential dangers of a founder-CEO who has led the company astray.

In this Article, we have explored a range of other countervailing forces and factors that can work to limit the durability of a founder-CEO's power and may ultimately lead to their ouster, or resignation under pressure, even though they may hold substantial voting power or other means of control. Founders are human and subject to pressure in the face of financial performance problems, legal concerns, and employee and public backlash or activism, and they also experience personal struggles and other motivations that can ultimately push them out of the top executive role. We further highlight limits to the effectiveness of these forces as guardrails—they may not always be enough to dethrone a powerful founder-CEO, they do not obviate other measures of control, and they may be temporary, as the founder may rise again or start a new venture. Finally, our analysis helps to shed light on broader market trends of dual-class stock in private and public markets.

179 *See* Broughman & Wansley, *supra* note 24 (noting that power-law-based strategies might explain the acceptance of dual-class stocks by investors). While Broughman and Wansley argue that investors accept dual-class structures to incentivize founders to take more risks, our argument explores the downside scenarios and proposes that investors benefit from countervailing forces and factors that reduce agency costs and limit founder control.

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