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THE UNTENABLE CASE FOR PERPETUAL DUAL-CLASS STOCK

Lucian A. Bebchuk and Kobi Kastiel***

The desirability of a dual-class structure, which enables founders of public companies to retain a lock on control while holding a minority of the company's equity capital, has long been the subject of a heated debate. This debate has focused on whether dual-class stock is an efficient capital structure that should be permitted at the time of initial public offering ("IPO"). By contrast, we focus on how the passage of time since the IPO can be expected to affect the efficiency of such a structure.

Our analysis demonstrates that the potential advantages of dual-class structures (such as those resulting from founders' superior leadership skills) tend to recede, and the potential costs tend to rise, as time passes from the IPO. Furthermore, we show that controllers have perverse incentives to retain dual-class structures even when those structures become inefficient over time. Accordingly, even those who believe that dual-class structures are in many cases efficient at the time

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of the IPO should recognize the substantial risk that their efficiency may decline and disappear over time. Going forward, the debate should focus on the permissibility of finite-term dual-class structures—that is, structures that sunset after a fixed period of time (such as ten or fifteen years) unless their extension is approved by shareholders unaffiliated with the controller.

We provide a framework for designing dual-class sunsets and address potential objections to their use. We also discuss the significant implications of our analysis for public officials, institutional investors, and researchers.

Keywords: corporations, dual-class, controlling shareholders, corporate governance, agency costs, sunset.
JEL Classification: G32, G34, K22

INTRODUCTION

IN 1990, Viacom Inc., a prominent media company, adopted a dual-class capital structure, consisting of two classes of shares with differential voting rights. This structure enabled Viacom's controlling shareholder, Sumner Redstone, to maintain full control over the company while holding only a small fraction of its equity capital.[1] At the time, Redstone was already one of the most powerful and successful figures in Hollywood.[2] Indeed, three years earlier, he had purchased Viacom in a hostile takeover, exhibiting the array of savvy and daring business maneuvers that subsequently helped him transform Viacom into a $40 billion entertainment empire that encompasses the Paramount movie studio and the CBS, MTV, and Showtime television networks.[3] Investors during the 1990s could have reasonably been expected to be content with having Redstone safely at the helm.

[1] Sumner Redstone indirectly controls Viacom through National Amusements, Inc. ("NAI"), while holding only 8% of Viacom's equity capital. See Viacom Inc., Proxy Statement (Form DEF 14A) 22 (Dec. 16, 2016) (explaining that NAI owns approximately 79.8% of the voting interest and 10% of the equity interest in Viacom, and that NAI is controlled by Redstone through the Sumner M. Redstone National Amusements Trust, which owns shares in NAI representing 80% of the voting interest of NAI).

[2] Michael J. de la Merced, How Sumner Redstone Went from Army Cryptographer to Media Mogul, N.Y. Times (May 5, 2016), https://www.nytimes.com/2016/02/07/business/media/how-sumner-redstone-went-from-army-cryptographer-to-media-mogul.html.

[3] Id.; Sydney Ember, "He Can't Speak," Lawyer Says as Redstone Word War Rages, N.Y. Times, July 1, 2016, at B3.

Fast-forward twenty-six years to 2016: Ninety-three-year-old Redstone faced a lawsuit, brought by Viacom's former CEO and a long-time company director, alleging that Redstone suffered from "profound physical and mental illness"; "has not been seen publicly for nearly a year[;] can no longer stand, walk, read, write or speak coherently[;] . . . cannot swallow[;] and requires a feeding tube to eat and drink."[4] Indeed, in a deposition, Redstone did not respond when asked his original family birth name.[5] Some observers expressed concerns that "the company has been operating in limbo since the controversy erupted."[6] However, public investors, who own approximately 90% of Viacom's equity capital, remained powerless and without influence over the company or the battle for its control.

Eventually, in August 2016, the parties reached a settlement agreement that ended their messy legal battles, providing Viacom's former CEO with significant private benefits and leaving control in the hands of Redstone.[7] Notably, despite the allegation and the evidence that surfaced, the settlement prevented a court ruling on whether Redstone was legally competent.[8] Note that even a finding of legal competency would have hardly reassured public investors: Legal competence does not by itself qualify a person to make key decisions for a major company.[9] Moreover, once Redstone passes away or is declared to be legally in-

[4] Emily Steel, Viacom Chiefs Take Trust Battle to Court, N.Y. Times, May 24, 2016, at B1; see also Ember, supra note 3, at B3 (noting that lawyers for Viacom's CEO stated that Redstone "was mentally incapacitated and had been unduly influenced by Shari Redstone").

[5] Peter Elkind, Did Sumner Redstone's Testimony Help Him?, Fortune (May 6, 2016, 4:09 PM), http://fortune.com/2016/05/06/did-sumner-redstones-testimony-help-him/ [https://perma.cc/GM38-KGQV] ("Midway through the short deposition, the interpreter shifted to asking Redstone to spell out his answers by pointing to individual letters shown to him. He seemed unable to do this.").

[6] Emily Steel, Redstone's Busy October: 3 Cases in 3 Courts in 3 States, N.Y. Times, July 30, 2016, at B2; see also James B. Stewart, How Dauman Lost the Battle for Viacom, N.Y. Times, Aug. 26, 2016, at B1 ("Given the uncertainty, companies didn't want to make deals with Viacom, and key employees threatened to leave. Viacom shares have been battered, dropping 46 percent over the last two years.").

[7] See Viacom Inc., Current Report (Form 8-K) 2–5 (Aug. 18, 2016).

[8] The issue of Redstone's competency was the subject of court battles in both Massachusetts and California. See Ember, supra note 3, at B3; Emily Steel, Redstone Removes Viacom Chief from Trust and Parent Board, N.Y. Times, May 21, 2016, at B1.

[9] Steven Davidoff Solomon, Hearing Shows Little Is Known on Who Controls Viacom, N.Y. Times: DealBook (June 24, 2016), http://www.nytimes.com/2016/06/25/business/dealbook/hearing-shows-little-is-known-on-who-controls-viacom.html ("Even if he is 'competent,' it does not appear that Mr. Redstone is in good shape.").

competent, legal arrangements in place would require the control stake to remain for decades in an irrevocable trust that would be managed by a group of trustees, most of whom have no proven business experience in leading large public companies.[10] Thus, even assuming that Viacom's governance structure was fully acceptable to public investors two decades ago, this structure has clearly become highly problematic for them.

Let us now turn from Viacom to Snap Inc. The company responsible for the popular disappearing-message application has recently gone public with a multiple-class structure that would enable the company's co-founders, Evan Spiegel and Robert Murphy, to have lifetime control over Snap.[11] Given that they are now only twenty-six and twenty-eight years old, respectively, the co-founders can be expected to remain in control for a period that may last fifty or more years.[12]

Public investors may be content with having Spiegel and Murphy securely at the helm in the years following Snap's initial public offering ("IPO"). After all, Spiegel and Murphy might be viewed by investors as responsible for the creation and success of a company that went public at a valuation of nearly $24 billion.[13] However, even if the Snap co-founders have unique talents and vision that make them by far the best individuals to lead the company in 2017 and the subsequent several years, it is hardly certain that they would continue to be fitting leaders down the road. The tech environment is highly dynamic, with disruptive innovations and a quick pace of change, and once-successful founders could well lose their golden touch after many years of leading their companies. Thus, an individual who is an excellent leader in 2017 might become an ill-fitting or even disastrous choice for making key decisions in 2037, 2047, or 2057. Accordingly, as the time since Snap's IPO grows, so does the risk that Snap's capital structure, and the co-founders' resulting lock on control, will generate costly governance problems.

[10] See Steel, supra note 8, at B1.

[11] Steven Davidoff Solomon, Snap's Plan Is Most Unfriendly to Outsiders, N.Y. Times: DealBook (Feb. 3, 2017), https://www.nytimes.com/2017/02/03/business/dealbook/snap-ipo-plan-evan-spiegel.html?_r=0 ("[[T]he founders' control goes away only if they die.").

[12] Snap Inc., Amendment No. 2 to Form S-1 Registration Statement 130 (Feb. 16, 2017) [hereinafter Snap Registration Statement].

[13] Michael J. de la Merced, Snap Prices I.P.O. at $17 per Share, Valuing Company at $24 Billion, N.Y. Times, Mar. 2, 2017, at B1.

The examples of Viacom and Snap highlight an important dimension that has thus far received insufficient attention—the passage of time since a company's IPO. This Article seeks to provide a comprehensive, systematic analysis of how the potential costs and benefits of a dual-class structure—and thus the overall efficiency of such a structure—change over time.

Our analysis demonstrates that, as time passes, the potential costs of a dual-class structure tend to increase while the potential benefits tend to erode. As a result, even if the structure were efficient at the time of the IPO, there would be a substantial risk that it would not remain so many years later, and this risk would keep increasing as time passes. Furthermore, we show that controllers have strong incentives to retain a dual-class structure even when that structure becomes inefficient over time. Thus, even those who believe that a dual-class structure is often efficient at the time of the IPO should recognize the perils of providing founders with perpetual or even lifetime control.

In the debate over dual-class structures, which has focused on whether and when it is desirable for companies to go public with a dual-class structure, we side with those opposed to dual-class IPOs.[14] Our analysis of the midstream perils of dual-class structures highlights a significant cost of such structures. This cost weighs against dual-class IPOs and should be taken into account in any assessment of their value.[15]

The key contribution of this Article, however, is to demonstrate that even supporters of dual-class IPOs should agree to take one option—that of a perpetual dual-class structure—off the table. Going forward, the debate should be limited to the choice between (1) precluding dual-class structures altogether and (2) permitting dual-class structures that sunset after a fixed period of time (such as ten or fifteen years) unless their ex-

[14] For a recent article by one of us that expresses concerns about the use of a dual-class structure at the IPO of a prominent company, see Lucian Bebchuk, Alibaba's Governance Leaves Investors at a Disadvantage, N.Y. Times: DealBook (Sept. 16, 2014, 2:00 PM), http://dealbook.nytimes.com/2014/09/16/alibabas-governance-leaves-investors-at-a-disadvantage/ [https://perma.cc/BFN9-8CNP].

[15] The costs and benefits of dual-class structures have long been the subject of academic study. See, e.g., the well-known surveys of theoretical and empirical work by Mike Burkart & Samuel Lee, One Share - One Vote: The Theory, 12. Rev. Fin. 1 (2008), and Renée Adams & Daniel Ferreira, One Share-One Vote: The Empirical Evidence, 12 Rev. Fin. 51 (2008). However, the large literature on the subject has not focused on the time dimension, which is the central focus of this Article.

tension is approved by shareholders unaffiliated with the controller. The case for a perpetual dual-class structure, we show, is untenable.[16]

Our analysis is organized as follows. Part I explains the substantial stakes in the policy debate that we seek to reframe. We begin by discussing the importance of dual-class companies in the United States and around the world. A significant number of U.S. public companies—including such well-known companies as CBS, Comcast, Facebook, Ford, Google, News Corp., and Nike—have dual-class structures.[17] Furthermore, since Google decided to use a dual-class structure for its 2004 IPO, a significant number of "hot" tech companies have followed its lead.[18]

Part I also discusses the long-standing debate over the desirability of dual-class structures. The New York Stock Exchange ("NYSE") prohibited dual-class structures for approximately sixty years, until the mid-1980s, and they are still prohibited or rare in some jurisdictions, such as the United Kingdom and Hong Kong.[19] However, the rules now prevailing in the United States, as well as in some other jurisdictions around the world, permit the use of dual-class stock.[20] Moreover, the debate on the

[16] Although some investors have expressed support for sunset provisions in dual-class companies, see, e.g., Canadian Coal. for Good Governance, Dual Class Share Policy 10–12 (Sept. 2013) [hereinafter The CCGG Policy], http://www.ccgg.ca/site/ccgg/assets/pdf/dual_class_share_policy.pdf [https://perma.cc/9AZE-3PCS], our work provides the first comprehensive analysis of sunset provisions and the untenable case for dual-class structures that do not use them. For earlier work that expresses support for sunsets in other corporate-law contexts, see Lucian Arye Bebchuk, Why Firms Adopt Antitakeover Arrangements, 152 U. Pa. L. Rev. 713, 751–52 (2003), and John C. Coates IV, Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?, *in* Reforming Company and Takeover Law in Europe 677, 704 (Guido Ferrarini et al. eds., 2004).

[17] See Edward Kamonjoh, Investor Responsibility Research Ctr. Inst., Controlled Companies in the Standard & Poor's 1500: A Follow-up Review of Performance & Risk 84–87 (Mar. 2016), https://irrcinstitute.org/wp-content/uploads/2016/03/Controlled-Companies-IRRCI-2015-FINAL-3-16-16.pdf [https://perma.cc/M5LU-Y64M]. In 2015, Google announced a corporate reorganization that created a holding company, Alphabet Inc., with Google as a subsidiary. Julia D'Onfro, Google is Now Alphabet, Bus. Insider: Tech Insider (Oct. 2, 2015, 10:56 AM), http://www.businessinsider.com/google-officially-becomes-alphabet-today-2015-10 [https://perma.cc/NB2J-DU6Y]. Because the enterprise is largely still known as Google, however, that name will be used in this paper.

[18] See infra notes 23–24.

[19] For a discussion on the past prohibition of dual-class stock in the United States, see infra notes 28–35 and accompanying text. For a review of the restrictions on dual-class stock in other jurisdictions, see infra notes 46–55 and accompanying text.

[20] See infra notes 26–27, 35 and accompanying text.

subject is still ongoing—both in jurisdictions that prohibit dual-class structures and those that permit them.

Part II analyzes how the potential costs of dual-class structures change over time. These costs tend to increase for two major reasons. To begin, in a dynamic business environment, even a founder who was the fittest leader at the time of the IPO might eventually become an inferior leader due to aging or changes in the business environment, and this risk increases the expected costs of providing the founder with a lifetime lock on control. Indeed, the expected costs of a lifetime lock on control are likely to be especially large when the founder is young or even middle-aged at the time of the IPO.

Concerns about the emergence of inferior leadership over time are further aggravated when the dual-class structure enables a transfer of the founder's lock on control to an heir who might be unfit to lead the company. Furthermore, many dual-class structures enable controllers to substantially reduce their fraction of equity capital over time without relinquishing control, and controllers often do so to diversify their holdings or finance other investments or assets. When the wedge between the interests of the controller and those of the public investors grows over time, the agency costs of a dual-class structure can also be expected to increase.

Part III then analyzes how the potential benefits of a dual-class structure can be expected to change over time. Dual-class structures are often justified on the grounds that the founder of a company going public has skills, abilities, or vision that makes her uniquely fit to be at the helm. Many years later, however, the founder's superiority as the company's leader, and with it the expected value of having the founder retain a lock on control, could erode or disappear altogether. Another potential benefit often ascribed to dual-class structures is that they insulate management from short-term market pressures. However, the expected benefit from such insulation is likely to be larger when the controller is a fitting leader for the company and likely to decline when the passage of time makes the controller ill fitting for the leadership role. Finally, it might be suggested that insulation from market forces might be beneficial to companies that are new to the public market, but any such potential benefit is again expected to decline and eventually disappear as time passes from the IPO.

Part IV explains why public officials and investors cannot rely on private ordering to eliminate dual-class structures that become inefficient with time. We show that controlling shareholders, especially those who hold a small fraction of equity capital, have significant perverse incentives to retain a dual-class structure that has become inefficient, even when dismantling it—via a conversion to a one-share, one-vote structure or a sale of the company—would produce substantial efficiency gains. The reason is that the controller would capture only a fraction of the efficiency gains, which would be shared by all shareholders, but would fully bear the cost of forgoing the private benefits of control associated with the dual-class structure.[21]

To address the distorted incentives of controllers to retain dual-class structures even when those structures become substantially inefficient, an IPO dual-class structure can include a sunset provision stipulating the structure's expiration after a fixed period of time, such as ten or fifteen years. Part V discusses the merits and design of such sunset provisions. To enable the retention of structures that remain efficient, we explain that the initially specified duration of the dual-class structure could be extended if such extension is approved by a majority of the shareholders unaffiliated with the controller. We also address potential objections to arrangements that preclude or discourage perpetual dual-class structures. In particular, we respond to objections that (1) perpetual dual-class structures should be presumed efficient if they are chosen by market participants and (2) allowing perpetual structures is necessary to induce founders to go public.

Finally, Part VI discusses the implications of our analysis for policymaking, investors, and corporate-governance research. Public officials and institutional investors should consider precluding or discouraging IPOs that set a perpetual dual-class structure. They should also be attentive to the aggravated agency problems that are posed by companies that went public with perpetual dual-class structures a long time ago. Researchers should take the time dimension into account in their analyses of dual-class structure and should test several empirical predictions that

[21] For earlier work by one of us that analyzes how controllers' private interests may lead them to make inefficient decisions midstream, see Lucian Arye Bebchuk, Efficient and Inefficient Sales of Corporate Control, 109 Q.J. Econ. 957, 964–68, 974–80 (1994), and Lucian Arye Bebchuk & Mark J. Roe, A Theory of Path Dependence in Corporate Ownership and Governance, 52 Stan. L. Rev. 127, 142–49 (1999).

Part VI puts forward. We hope that future assessments of dual-class structures will be informed by the problems that we identify in this Article and the framework of analysis that we put forth.

I. THE STAKES

This Part lays out the institutional and policy background to our discussion. Section A explains the importance of dual-class companies in the United States and around the world. Section B describes the longstanding and ongoing debate over whether issuers should be permitted to go public with dual-class structures. Finally, Section C explains how this debate could be advanced by recognizing the significance of a key dimension to the assessment of dual-class structures—the time that has passed since the IPO.

A. The Importance of Dual-Class Companies

Dual-class companies play an important role in the U.S. economy. As indicated in Table 1, these companies are significantly represented in the leading stock indices and have an aggregate market capitalization exceeding $3 trillion as of July 2016.[22]

Table 1: Dual-Class Companies in Major Indices (2016)

	S&P 100	**S&P 500**	**Russell 1000**	**Russell 3000**
Number	9	32	83	245
Percentage of Index	9%	6.4%	8.4%	8.2%
Total Market Cap (in Trillions)	$2.26	$2.79	$3.18	$3.35

Furthermore, there has been an upward trend in the adoption of dual-class stock since Google went public with a dual-class structure in 2004

[22] The data was collected from the Bloomberg database and is current as of July 11, 2016. Consistent with previous studies, we excluded REITs from the list of dual-class companies.

and was followed by well-known tech companies, such as Facebook, Groupon, LinkedIn, Snap, Trip Advisor, and Zynga.[23] Indeed, according to data-provider Dealogic, "[m]ore than 13.5 percent of the 133 companies listing shares on United States exchanges in 2015 have set up a dual-class structure . . . compare[d] with . . . just 1 percent in 2005."[24]

The use of dual-class stock is not limited to the tech industry. Major companies with dual-class structures operating in other sectors include AMC, Berkshire Hathaway, Cablevision, CBS, Comcast, Estée Lauder, Ford, Hershey, News Corp., Nike, Ralph Lauren, Tyson Foods, and Viacom.[25]

Dual-class companies are also quite common in many other jurisdictions around the world.[26] A well-known survey of 464 companies in sixteen European countries conducted by Institutional Shareholder Services ("ISS") in 2007 revealed that 24% of sampled companies had dual-class shares.[27] Prominent examples of large foreign companies with dual-class stock include Alibaba, the Chinese e-commerce giant, and Ericsson, the Swedish telecommunications company. The global prevalence of this

[23] Maureen Farrell, In Snap IPO, New Investors to Get Zero Votes, While Founders Keep Control, Wall St. J. (Jan. 16, 2017, 8:24 PM), http://www.wsj.com/articles/in-snap-ipo-new-investors-to-get-zero-votes-while-founders-keep-control-1484568034 (presenting evidence that "[b]etween 2012 and 2016, roughly 19% of U.S. tech firms that went public did so with dual-class structures—more than double the share over the prior five-year period"). Our research using Compustat to identify dual-class IPOs in recent years indicates that Facebook, Groupon, LinkedIn, Trip Advisor, and Zynga adopted this structure when they went public. For information on Snap's dual-class structure, see supra notes 11–13.

[24] See Steven Davidoff Solomon, Shareholders Vote with Their Dollars to Have Less of a Say, N.Y. Times: DealBook (Nov. 4, 2015), http://www.nytimes.com/2015/11/05/business/dealbook/shareholders-vote-with-their-dollars-to-have-less-of-a-say.html [https://perma.cc/T86Z-CHAY].

[25] See Kamonjoh, supra note 17, at 84–90.

[26] For data on the global use of dual-class structures, see Hong Kong Exchs. & Clearing Ltd., Concept Paper, Weighted Voting Rights, at III-1 to III-17 (Aug. 2014) [hereinafter HKEX Report] and Shearman & Sterling LLP, Institutional S'holder Servs. & European Corp. Governance Inst., Report on the Proportionality Principle in the European Union 15, 26–27 (May 18, 2007) [hereinafter Report on the Proportionality Principle], http://www.ecgi.org/osov/documents/final_report_en.pdf [https://perma.cc/4HDK-AFPU].

[27] See Report on the Proportionality Principle, supra note 26, at 23, 25. Bennedsen and Nielsen report similar results using a much larger sample of more than 4,000 companies in fourteen Western European countries. See Morten Bennedsen & Kasper Meisner Nielsen, Incentive and Entrenchment Effects in European Ownership, 34 J. Banking & Fin. 2212, 2214 (2010).

structure, therefore, makes the topic and findings of this Article important to policymakers both in the United States and around the world.

B. The Policy Debate

This Section describes the heated policy debate that has been waged, both in the United States and in other jurisdictions, between supporters and opponents of limitations on the use of dual-class structures by companies going public. This debate is ongoing and quite alive, both in jurisdictions that currently place such limitations and those that do not.

1. In the United States

The era of prohibition. In 1926, the NYSE decided not to list the stocks of companies with either nonvoting common stock or unequal voting rights.[28] This decision came in response to a public outcry, initially inspired by Harvard economist William Ripley, against the issuance of nonvoting common stock by several prominent companies, including Dodge Brothers.[29] The NYSE explained that its "one share, one vote" policy was grounded in the NYSE's "long-standing commitment to encourage high standards of corporate democracy . . . and accountability to shareholders."[30] For six decades, the NYSE insisted on preserving its one-share, one-vote rule.

The move to permissibility. In 1985, facing increasing competition from other U.S. exchanges that offered to list companies with dual-class share structures, and after General Motors threatened to leave for NASDAQ, the NYSE proposed amendments to its listing requirements that would permit listed companies to use dual-class structures.[31] In re-

[28] For detailed accounts of the history of dual-class structures in the United States, see NYSE's Proposed Rule Changes on Disparate Voting Rights, 18 Sec. Reg. & L. Rep. (BNA) No. 37, at 1389 (Sept. 19, 1986) [hereinafter NYSE's Proposed Rule Changes]; Louis Lowenstein, Shareholder Voting Rights: A Response to SEC Rule 19c-4 and to Professor Gilson, 89 Colum. L. Rev. 979, 979–85 (1989); and Joel Seligman, Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy, 54 Geo. Wash. L. Rev. 687, 693–707 (1986).

[29] Seligman, supra note 28, at 694.

[30] Id. at 699.

[31] See NYSE's Proposed Rule Changes, supra note 28, at 1389–92. The proposed amendment permitted both new issuances of dual-class stock and recapitalizations midstream but required that the latter be approved by a majority of independent directors and public shareholders unaffiliated with the controller. Id. at 1392; see also Ronald J. Gilson, Evaluating

sponse, the Securities and Exchange Commission ("SEC") adopted Rule 19c-4 in 1988 to limit the ability of existing companies with one-share, one-vote structures to move to dual-class structures.[32] Although the District of Columbia Court of Appeals invalidated this Rule on grounds that the SEC lacked authority to adopt it,[33] the SEC persuaded the main stock exchanges to prohibit dual-class recapitalizations under their listing standards.[34] As such, while U.S. companies still face constraints on introducing a dual-class structure midstream, they have been largely free to go public with a dual-class structure for about three decades.[35]

The continuing opposition. The decision of U.S. regulators and stock exchanges to permit the use of dual-class structures by IPO companies did not end the battle over the desirability of the practice. A wave of dual-class IPOs, intensifying after Google employed the structure when it went public in 2004, rekindled the public and academic discourse about it. Institutional investors, their advisors, and prominent governance thought leaders have all expressed strong opposition to the use of dual-class structures.

The Council of Institutional Investors ("CII")—an organization of more than 140 public, union, and corporate pension funds—petitioned the stock exchanges to adopt a one-share, one-vote policy.[36] In June

Dual Class Common Stock: The Relevance of Substitutes, 73 Va. L. Rev. 807, 807 n.1 (1987) (discussing the pressures that prompted the NYSE to alter its policy); Alison Smith et al., Exchanges Divided by Dual-Class Shares, Fin. Times (Oct. 3, 2013), https://www.ft.com/content/e18a6138-2b49-11e3-a1b7-00144feab7de.

[32] Voting Rights Listing Standards; Disenfranchisement Rule, 53 Fed. Reg. 26,376 (July 12, 1988) (codified as amended at 17 C.F.R. § 240.19c-4 (2009)), invalidated by Bus. Roundtable v. SEC, 905 F.2d 406, 417 (D.C. Cir. 1990).

[33] *Bus. Roundtable*, 905 F.2d at 417.

[34] Order Granting Approval to Rule Changes Relating to the Exchanges' and Association's Rules Regarding Shareholder Voting Rights, 59 Fed. Reg. 66,570 (Dec. 27, 1994).

[35] See, for example, NYSE Listed Company Manual § 313.00 (1992), which prohibits dual-class recapitalizations for listed companies but provides several exceptions for the listing of multiple classes of shares, including the issuance of multiple classes prior to the IPO that are maintained after the company has gone public. See also NASDAQ Stock Market Rules, at r. 5640 (restricting the reduction of voting rights of common-stock shareholders but permitting companies to issue additional shares of already "existing super voting stock"), http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F4%5F3&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2Dequityrules%2F [https://perma.cc/Y5V3-LMCT].

[36] Letter from the Council of Institutional Investors to Edward S. Knight, Executive Vice President and General Counsel, NASDAQ OMX Group (Mar. 27, 2014), http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_27_14_CII_letter_to_nasdaq_one_share

2013, Senator Elizabeth Warren joined CII in urging U.S. exchanges to limit the use of dual-class stock.[37] Leading mutual funds, such as Vanguard, Fidelity, and T. Rowe Price, have expressed general opposition to dual-class structures.[38] Prominent pension funds, including the California State Teachers' Retirement System ("CalSTRS"), the California Public Employees' Retirement System ("CalPERS"), and the Florida State Board of Administration ("Florida SBA"), have expressed similar opposition.[39] A recent survey indicates that this view is shared among many institutional investors.[40]

Leading shareholder advisory groups have also expressed strong opposition to dual-class structures. For example, ISS denounced them as

_one_vote.pdf [https://perma.cc/KG32-DGL8]; Letter from the Council of Institutional Investors to John Carey, Vice President–Legal, NYSE Regulation, Inc. and NYSE Euronext (Mar. 27, 2014), http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_27_14_CII_letter_to_NYSE_one_share_one_vote.pdf [https://perma.cc/J59F-2QKM].

[37] Letter from Elizabeth Warren, U.S. Senator, to John Carey, Vice President–Legal, NYSE Regulation, Inc. and NYSE Euronext & Edward Knight, Executive Vice President and General Counsel, NASDAQ OMX (June 5, 2013), http://www.warren.senate.gov/files/documents/Senator%20Warren%20letter%20to%20NYSE,%20Nasdaq%20-%206-5-2013.pdf [https://perma.cc/SH7H-56MM].

[38] For statements reflecting the opposition of these mutual funds to dual-class structures, see Fid. Invs., Corporate Governance and Proxy Guidelines § VI.C, https://www.fidelity.com/about-fidelity/fidelity-by-numbers/fmr/proxy-guidelines [https://perma.cc/C9JE-39M2]; T. Rowe Price, Proxy Voting Policies, https://www3.troweprice.com/usis/content/trowecorp/en/utility/policies/_jcr_content/maincontent/polices_row_1/para-mid/thiscontent/pdf_link/pdffile [https://perma.cc/24TQ-V2NL]; and Vanguard, Vanguard's Proxy Voting Guidelines, at pt. IV.G https://about.vanguard.com/vanguard-proxy-voting/voting-guidelines [https://perma.cc/93TH-XNVW].

[39] For statements in opposition to dual-class structures in the proxy voting guidelines or annual reports of these public pension funds, see Cal. Pub. Emps.' Ret. Sys., Statement of Investment Policy for Global Governance 12 (Mar. 16, 2015), https://www.calpers.ca.gov/docs/policy-global-governance.pdf [https://perma.cc/48GZ-8K64]; Cal. State Teachers' Ret. Sys., Corporate Government Principles 15 (July 14, 2016), http://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf [https://perma.cc/W3QV-74GA]; and Fla. State Bd. of Admin., Corporate Governance Principles: Proxy Voting Guidelines 37–38 (2016), https://www.sbafla.com/fsb/Portals/FSB/Content/CorporateGovernance/ProxyVoting/2016_SBACorpGovPrinciplesProxyVotingGuidelines.pdf?ver=2016-08-08-144634-157 [https://perma.cc/58ZS-WPHL].

[40] The ISS survey included 120 responses from institutional investors. Fifty-seven percent supported negative recommendations against directors at companies that go public with dual-class stock. Marc Goldstein, 2016–2017 Annual Benchmark Voting Policy Survey, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (Oct. 5, 2016), https://corpgov.law.harvard.edu/2016/10/05/2016-2017-annual-benchmark-voting-policy-survey/ [https://perma.cc/3SEC-YCZ3].

"an autocratic model of governance."[41] Similarly, GMI Ratings warned that using a dual-class share structure "can pose a serious risk to a company's public shareholders."[42]

The opposition to dual-class structures has become so widely accepted that it was incorporated in recent documents attempting to identify minimum and consensus standards of acceptable corporate-governance practices. Such opposition was included in a set of corporate-governance principles that were put forward by a group of leading executives that included not only CEOs of asset managers but also those of major public companies.[43] Such opposition was also subsequently incorporated in the set of consensus governance principles adopted by a coalition of institutional investors managing in the aggregate more than $17 trillion.[44]

2. Around the World

Variation in regulation. Dual-class companies are permitted and common in many jurisdictions around the world. Such jurisdictions include Canada, Denmark, Finland, the Netherlands, Sweden, and Switzerland.[45] At the same time, the rules or conventions of other important jurisdictions prohibit or discourage companies from going public with dual-class structures. The Hong Kong Stock Exchange ("HKSE") has prohibited this practice since 1987.[46] In the United Kingdom, the general

[41] Institutional S'holder Servs., The Tragedy of the Dual Class Commons 1, 3 (Feb. 13, 2012), http://online.wsj.com/public/resources/documents/facebook0214.pdf [https://perma.cc/RUG8-RN23] (also noting that "[t]he adverse implications of Balkanized ownership interests can linger for years, producing unintended consequences").

[42] Kimberly Gladman, The Dangers of Dual Share Classes, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (May 21, 2012), https://corpgov.law.harvard.edu/2012/05/21/the-dangers-of-dual-share-classes/ [https://perma.cc/6USD-A9ZV].

[43] Margaret Popper et al., Commonsense Principles of Corporate Governance, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (July 22, 2016), https://corpgov.law.harvard.edu/2016/07/22/commonsense-principles-of-corporate-governance/ [https://perma.cc/P7J3-824V].

[44] Inv'r Stewardship Grp., Corporate Governance and Stewardship Principles, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (Feb. 7, 2017), https://corpgov.law.harvard.edu/2017/02/07/corporate-governance-and-stewardship-principles/ [https://perma.cc/GHV4-5WRN].

[45] See supra notes 26–27.

[46] The HKSE listing rules do not permit the listing of companies with shares that have a voting power that does not bear a reasonable relationship to the equity interest of those shares. Such listing is permitted only in "exceptional circumstances," but the HKSE has thus far not listed a company using this exception. See HKEX Report, supra note 26, at 25–28.

hostility of institutional investors has practically precluded the use of dual-class structures.[47] In 2012, Manchester United, the well-known English soccer club, went public on the NYSE rather than the London stock exchanges in order to use a dual-class structure.[48] In Brazil, the Novo Mercado (New Market), an important segment within the Sao Paulo Stock Exchange, imposes a mandatory one-share, one-vote requirement.[49] In addition, some other countries in Continental Europe, including Belgium, Germany, Luxembourg, Poland, and Spain, currently limit the use of dual-class structures.[50]

The continuing debate. The heated debate over the use of dual-class stock still continues. In some jurisdictions that limit the dual-class structure, there has been a push to relax them. For instance, in Hong Kong, the securities exchange faced tremendous pressure to deviate from its one-share, one-vote principle to prevent Alibaba from listing else-

[47] Id. at III-12 to III-13 (noting that institutional shareholders are generally hostile to these structures); Fabio Braggion & Mariassunta Giannetti, At the Origins of the Non-Voting Shares' Discount: Investor Preferences vs. Fundamentals 1 (Dec. 2012) (unpublished manuscript) http://cn.ckgsb.com/Userfiles/doc/bg%20At%20the%20Origins%20of%20the%20Non-Voting%20Shares%E2%80%99%20Discount%20december%2019%202012.pdf [https://perma.cc/N3U7-KP37] (describing the history of dual-class in the UK); see also Smith et al., supra note 31 (quoting Julian Franks, a professor of finance at London Business School, stating that "[t]he UK market believes in the principle of 'one share, one vote' even if that trumps efficiency").

[48] Steven Davidoff Solomon, In Manchester United's I.P.O., a Preference for American Rules, N.Y. Times: DealBook (July 10, 2012, 2:32 PM), http://dealbook.nytimes.com/2012/07/10/in-manchester-uniteds-i-p-o-a-preference-for-u-s-rules [https://perma.cc/FK2A-72TW].

[49] Ronald J. Gilson et al., Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union, 63 Stan. L. Rev. 475, 488–91 (2011).

[50] OECD Steering Grp. on Corp. Governance, Lack of Proportionality Between Ownership and Control: Overview and Issues for Discussion 14–17 (2007), http://www.oecd.org/daf/ca/corporategovernanceprinciples/40038351.pdf [https://perma.cc/P5ZX-2GY7] (listing the countries that prohibit this practice). Note, however, that in some of those countries, such as Germany, the issuance of nonvoting shares with preferential rights to dividends (to compensate for the absence of voting rights) is permitted and is sometimes even prevalent. Report on the Proportionality Principle, supra note 26, at 7. The European Union also attempted to curb the unilateral use of high-voting shares to block takeovers, enacting a breakthrough rule in 2004. Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, Official J. Eur. Union L142/12 (Apr. 30, 2004). In practice, however, this directive has had little effect because it only sets the breakthrough rule as a default and member countries are allowed to opt out of it. See Guido Ferrarini, "One Share–One Vote: A European Rule?," 3 Eur. Company Fin. L. Rev. 147, 166–68 (2006).

where.[51] In response, the exchange conducted comprehensive research and a public consultation on potential changes to listing rules that would permit dual-class stock.[52] The city's market regulators and large institutional investors objected to such changes and, as this Article went to print, the exchange still preserved its policy.[53] In the United Kingdom, the Financial Conduct Authority recently issued a discussion paper seeking feedback on possible changes to enhance the attractiveness of U.K. capital markets, including making it easier for companies to list with dual-class share structures.[54]

At the same time, in some jurisdictions that permit dual-class structures, institutional investors have advocated for limits on such structures. For example, in Canada, a broad coalition of large institutional shareholders called for placing limits on the use of dual-class structures.[55]

C. Reframing the Debate

The preceding Sections have described the long-standing and ongoing debate, both in the United States and around the world, over the use of

[51] See Neil Gough, Hong Kong I.P.O. Structure Is Fine as Is, Investor Survey Finds, N.Y. Times: DealBook (Apr. 15, 2014, 4:51 AM), http://dealbook.nytimes.com/2014/04/15/hong-kong-i-p-o-structure-is-fine-as-is-investor-survey-finds/ [https://perma.cc/9CFT-2S77] (citing Alibaba's executives and regulators who expressed concerns that "Hong Kong could lose a huge franchise for good" and that "the rest of the world [will] pass[] it by"). For articles examining the desirability of pressures produced by regulatory competition, see, for example, William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale L.J. 663 (1974); Lucian Arye Bebchuk, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, 105 Harv. L. Rev. 1435 (1992); Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 Yale L.J. 2359 (1998); Oren Bar-Gill et al., The Market for Corporate Law, 162 J. Institutional & Theoretical Econ. 134 (2006).

[52] See HKEX Report, supra note 26, at 5; see also Gough, supra note 51 (noting that HKEX was "widely expected to introduce a public consultation on potential changes to the city's listing rules . . . to get formal feedback on allowing nontraditional shareholding structures").

[53] See Jacky Wong, Hong Kong Stock Exchange Kills Dual-Class Share Plan, Wall St. J. (Oct. 5, 2015, 6:52 AM), http://www.wsj.com/articles/hong-kong-stock-exchange-kills-dual-class-share-plan-1444042360 (noting that "Hong Kong's stock exchange said it has terminated a plan to allow dual-class shares" and describing regulators' opposition to that plan). Also, a survey conducted in 2014 among seventy institutional investors in Hong Kong shows that "nearly all respondents were opposed to dual-class shareholding." Gough, supra note 51.

[54] Fin. Conduct Auth., Discussion Paper, Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape 7–8, 20–23 (Feb. 2017).

[55] See The CCGG Policy, supra note 16, at 5–6.

dual-class stock. This debate has focused on whether public companies should be permitted to adopt dual-class structures when they go public. Accordingly, participants in this debate have focused on whether a dual-class structure is likely to be efficient at the time of the company's IPO.

In this Article, however, we seek to reorient the debate by highlighting a key dimension for the assessment of dual-class structures: the time that has passed since the IPO. We focus on the ways in which the efficiency of a dual-class structure is likely to change as time passes from the IPO. Our analysis shows that, even if a dual-class structure were to be efficient at the time of the IPO, it would likely become inefficient many years down the road. Accordingly, we wish to reframe the debate by taking one option—a perpetual dual-class structure—off the table. Going forward, the debate should be only over whether companies would be allowed to go public with finite-life dual-class structures—that is, structures that sunset after a fixed period of time (such as ten or fifteen years) unless their extension is approved by shareholders unaffiliated with the controller.

II. POTENTIAL COSTS AND THE TIME DIMENSION

This Part analyzes how the potential costs of using a dual-class capital structure can be expected to change over time. Section A discusses the potential costs of dual-class structures, and Section B introduces the time dimension and considers its effect on these costs.

A. Costs

Two fundamental problems arise from the use of dual-class stock: entrenchment and low equity holdings. Entrenchment insulates controllers from the disciplinary force of the market for corporate control that otherwise might limit the ability of a poorly performing controller to continue leading the company. At the same time, controllers with low equity holdings bear only a small fraction of the negative effects of their actions on the company value while capturing the full private benefits. Thus, controllers' incentives regarding certain issues may become distorted and misaligned with the preferences of public investors.[56]

[56] See Lucian Arye Bebchuk et al., Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights, *in*

The combination of entrenchment and limited equity holdings produces serious problems. For a widely held company with low equity holdings but no entrenchment, the market for corporate control imposes certain limits on managers' ability to underperform or act in ways contrary to the interests of public investors. Conversely, while the market for corporate control could not replace and thus discipline a majority owner of a controlled company, her large equity stake in the controlled company provides powerful financial incentives to maximize the company's value. She bears most of the costs of her actions and captures most of their benefits. Without both market discipline and strong financial incentives, a controller with a minority equity stake may favor choices that increase the private benefits of control even if those choices substantially diverge from those of other public shareholders, and no threat of removal exists to prevent her from pursuing those interests. This distortion of incentives becomes more severe when the controller of a dual-class company holds a smaller percentage of the company's equity capital.[57]

A wide range of distorted choices may result from entrenchment and low incentives. Such distorted choices may include the appointment or retention of the controller or a family member as an executive rather than a better outside candidate, engagement in inefficient self-dealing transactions with an entity that is affiliated with the controller, the usurpation of an opportunity that would be more valuable in the hands of the company rather than the controller, or other choices aimed at increasing private benefits of control at the expense of the value received by other shareholders.

More generally, the empirical evidence indicates that the combination of entrenchment and low equity holdings reduces company value, distorts controller incentives, and increases extraction of private benefits of control. Paul Gompers, Joy Ishii, and Andrew Metrick, studying U.S. dual-class companies over 1995–2002, found evidence that these companies exhibited increased agency costs and reduced value.[58] The study also showed that the larger the "wedge"—the gap between the control-

Concentrated Corporate Ownership 295, 298–301 (Randall K. Morck ed., 2000) (presenting a detailed description of the dual-class mechanism and the distortions it creates).

[57] For an analysis demonstrating this point, see id.

[58] See Paul A. Gompers et al., Extreme Governance: An Analysis of Dual-Class Firms in the United States, 23 Rev. Fin. Stud. 1051, 1051–54 (2010).

ler's fraction of voting rights and her fraction of equity capital—the more severe the resulting reductions in the company's value.[59]

Using the same sample as Gompers et al., Ronald Masulis, Cong Wang, and Fei Xie examined how the divergence between insider voting rights and equity capital at dual-class companies affects the extraction of private benefits of control. They reported that, as that divergence widens, corporate cash reserves are worth less to outside shareholders, CEOs receive higher levels of compensation, managers are more likely to make value-destroying acquisitions, and capital expenditures contribute less to shareholder value.[60]

B. The Time Dimension

The costs of a dual-class structure are likely to increase over time for two main reasons: the likely erosion of any superior skills that the controller might have had at the time of the IPO and the likely decrease in the controller's fraction of equity capital.

1. Erosion of the Controller's Superiority

At any given time, the costs of providing a founder with a lock on control depend on the likelihood that the controller is no longer the most suitable person for this role. At the time of the IPO, the founder of a company may have the special skills and deep knowledge of a specific industry and business to make her uniquely fit to be at the helm.[61] There-

[59] Id. at 1084–85.

[60] Ronald W. Masulis et al., Agency Problems at Dual-Class Companies, 64 J. Fin. 1697, 1722 (2009). For a survey of the empirical evidence, see Adams & Ferreira, supra note 15. We note that, although there is significant empirical evidence on the negative effects of dual-class structures, some empirical studies suggest that such structures might also have positive effects. See, e.g., Scott W. Bauguess et al., Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights, 36 J. Banking & Fin. 1244, 1244–46 (2012); Valentin Dimitrov & Prem C. Jain, Recapitalization of One Class of Common Stock into Dual-Class: Growth and Long-Run Stock Returns, 12 J. Corp. Fin. 342, 346–47 (2006). We have questions about the findings of these papers. However, even assuming that these findings are accepted, they would not be inconsistent with the key points we develop below: that whatever the costs of a dual-class structure at the time of adoption, these costs can be expected to increase over time; and that whatever the benefits of such a structure at the time of adoption, these benefits are expected to decline over time.

[61] See, e.g., Ronald J. Gilson & Alan Schwartz, Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transaction Review, 169 J. Institutional &

fore, supporters of dual class often argue that it is preferable to let such a talented controller remain in control long after the IPO.[62]

However, this superior-controller argument does not provide a good basis for the use of a *perpetual* dual-class structure. While such an argument might justify the use of dual-class stock at the IPO stage, it loses most of its power with the passage of time. Consider, for instance, talented and successful entrepreneurs such as the co-founders of Snap. Even if they can currently lead their company better than anyone else, will they still be the best fit for their company, say, thirty years down the road?

Rather, many years after the IPO, there is a real possibility that the founder's superiority as the company leader will erode or even disappear. Over time, a once-successful founder may face natural limitations in a fast-evolving technological or business environment. She could also simply lose her golden touch.[63] If the founder stops being the most fitting (or even a fitting) leader, the expected costs from her lock on control could become significant. These expected costs are especially high in the case of a young founder: The longer her lock on control, the greater the risk that she would become an ill-fitting leader.

Theoretical Econ. 160, 168–69 (2013) (suggesting that founders can serve as a "high-powered performance monitor").

[62] When Google went public in 2004, the founders expressed their confidence that "everyone associated with Google—including new investors—will benefit from this structure." James Kristie, Dual-Class Stock: Governance at the Edge, 36 Directors & Boards 37, 37 (Sept. 2012), http://sites.udel.edu/wccg/files/2012/10/Dual-Shares-Q3-20121.pdf [https://perma.cc/J2AK-NLNZ]; see also Scott Kupor, Sorry CalPERS, Dual Class Shares Are a Founder's Best Friend, Forbes (May 14, 2013, 10:01 AM), http://www.forbes.com/sites/ciocentral/2013/05/14/sorry-calpers-dual-class-shares-are-a-founders-best-friend/#48931b3d7016 [https://perma.cc/E5R2-T94Q] ("Now imagine that, instead of Steve Jobs, Larry Page and Mark Zuckerberg at the helms of their respective companies innovating through these product cycles, the California Public Employees' Retirement System (CalPERS) was calling the shots. . . . In this brave new world, founder-led technology companies . . . will fail to reach their full potential.").

[63] See Steven M. Davidoff, Thorny Side Effects in Silicon Valley Tactic to Keep Control, N.Y. Times, Sept. 4, 2013, at B8 ("Even when the founders stay, there hasn't always been a happy outcome."); Jeffrey Goldfarb, Monster Truck, Bus. Standard: The Smart Investor (May 9, 2015, 1:22 AM), http://smartinvestor.business-standard.com/market/Marketnews-310863-Marketnewsdet-Monster_truck.htm#.V5td3vkrLIU ("Some young leaders . . . may deserve to operate unrestrained for a while. Inevitably, however, their choices increasingly tend to be at odds with the greater good."); see also supra notes 1–9 and accompanying text (discussing Viacom example).

Furthermore, dual-stock structures may enable the transfer of a lock on control to an heir of the founder, who might not be as able, talented, skilled, or driven as her predecessor. This problem is known in the economic literature as the problem of the "idiot heir."[64] Indeed, there is evidence that companies run by descendants often underperform other family companies that are managed by their founders or by hired external managers.[65] A structure that provides the founder's family with a perpetual lock on control forgoes the benefits of optimal succession of leadership upon the founder's departure.

Relatedly, the standard design of private equity partnerships reflects an implicit understanding that the advantages of superior leadership skills tend to fade over time. In such funds, the general partner has full control over the management of the fund's assets—but only for a *finite* period, commonly on the order of ten years.[66] This structure sets a default that counteracts the natural tendency towards inertia: If the track record of the general partner (or other information) suggests that she no longer remains the best choice to manage the fund, the fund's investors are not stuck with her.[67] Certainly, the general partner often persuades

[64] See, e.g., Antoin E. Murphy, Corporate Ownership in France: The Importance of History, *in* A History of Corporate Governance Around the World: Family Business Groups to Professional Managers 185, 187 (Randall K. Morck ed., 2005).

[65] For empirical studies supporting this view, see Ronald C. Anderson & David M. Reeb, Founding-Family Ownership and Firm Performance: Evidence from the S&P 500, 58 J. Fin. 1301, 1316–17, 1321 (2003); Morten Bennedsen et al., Inside the Family Firm: The Role of Families in Succession Decisions and Performance, 122 Q.J. Econ. 647, 669–70 (2007); Nicholas Bloom & John Van Reenen, Why Do Management Practices Differ Across Firms and Countries?, 24 J. Econ. Persp. 203, 205, 217–18 (2010); Francisco Pérez-González, Inherited Control and Firm Performance, 96 Am. Econ. Rev. 1559, 1574–78 (2006); and Belen Villalonga & Raphael Amit, How Do Family Ownership, Control and Management Affect Firm Value?, 80 J. Fin. Econ. 385, 402–03 (2006).

[66] See Andrew Metrick & Ayako Yasuda, The Economics of Private Equity Funds, 23 Rev. Fin. Stud. 2303, 2309 (2010) ("The typical fund has a lifetime of ten years."); Jennifer Bollen, Average Private Equity Fund Life Span Exceeds 13 Years, Wall St. J. (Mar. 31, 2015, 6:45 AM), http://blogs.wsj.com/privateequity/2015/03/31/average-private-equity-fund-life-span-exceeds-13-years/ (quoting an industry expert saying that "[PE] funds have common 10-year life spans and up to a three-year extension").

[67] Addison D. Braendel & Seth Chertok, Closed-End Private Equity Funds: A Detailed Overview of Fund Business Terms, Part II, 13 J. Priv. Equity 57, 68 (2010) (discussing the dissolution of a private equity fund). Certain evergreen funds have started to emerge in recent years, but they are still "a niche part of the private equity eco-system." See Sonja Cheung, Should Asian Private Equity Think About Evergreen Funds?, Wall St. J. (Jan. 30, 2014, 1:45 PM), http://blogs.wsj.com/privateequity/2014/01/30/should-asian-private-equity-

investors to keep their assets under her management by simply rolling them into a new fund. But requiring investor consent as an intermediate step for the continued management of assets addresses the risk that the comparative advantages of a particular general partner may erode over time.

In sum, in assessing a dual-class structure, it is important to focus not only on the merits of the founder's leadership at the time of the IPO. Regulators and investors should also consider the risk that, many years hence, the founder (or her heirs) might not have superior leadership skills and might even have inferior leadership skills. As a result, the costs of a perpetual dual-class structure can be expected to increase over time.

2. Decrease in the Controller's Equity Capital

In addition to the concern that a controller's superiority might eventually erode or even disappear, a decrease in the controller's equity capital also increases over time the agency costs generated by the controller's power. Many dual-class structures enable controllers to unload their holdings without losing control, and controllers often do so to diversify their portfolios and reduce their idiosyncratic risk.[68] At (or shortly after) the IPO stage, controllers often maintain more than a majority of the votes, either by allocating extensive voting power to the shares they hold or by holding an initial large stake in the controlled company. If, for instance, a controller initially holds 80% of the voting rights, she can sell a significant percentage of her shares without going below the 50% threshold and losing her lock on control.

In addition, some dual-class companies go public with structures that enhance the ability of controllers to unload holdings without relinquishing control. For instance, the governance documents of a dual-class

think-about-evergreen-funds/. Also, while evergreen funds formally have indefinite lives, "[e]very couple of years—typically four—[their investors] have the ability to exit or to change their investment[s]." Billy Fink, What Is an Evergreen Fund Structure?, Axial F. (Feb. 25, 2014), http://www.axial.net/forum/evergreen-fund-structure/ [https://perma.cc/L4J7-NB7T] (internal quotation marks omitted).

[68] See the data provided in Table 2. For discussions of the role of dual-class stock in reducing controllers' lack of diversification risk, see George W. Dent, Jr., Dual Class Capitalization: A Reply to Professor Seligman, 54 Geo. Wash. L. Rev. 725, 749 (1986), and Gilson, supra note 31, at 812.

company may include a provision that allocates a fixed percentage of voting rights to the controlling shareholder, without regard to the controller's equity stake.[69] Such a hardwiring provision enables a controlling shareholder to sell as many shares as she wishes and still retain control over the dual-class company.

To illustrate the tendency of controllers to reduce their holdings over the years, we examined the changes in ownership interests in the ten largest dual-class companies (based on market capitalization) as of 2015. Table 2 below documents changes in controllers' equity capital since each company's IPO (or, if the figures at the IPO are not publicly available, since the company's first public filing on the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR")).[70] As we expected, the controller's equity holdings in each of these ten dual-class companies declined substantially during the examined period, averaging 11.6% as of 2015 compared to 30% initially.

This data is consistent with our claim that controllers of dual-class companies tend to reduce their fraction of equity capital over time without losing control. As a result, the gap between their interests and those of the companies' public investors grows, as do the agency costs of the dual-class structure.

Table 2: Controller's Equity Interest in Ten Largest Dual-Class Companies

Company Name	**Date of First Available Filing**	**Initial Holdings**	**Holdings as of 2015**
Berkshire Hathaway Inc.	1999	32%	20%
Facebook, Inc.	2012	28%	15%
Google Inc.	2004	28%	12%
Comcast Corporation	1978	42%	0.4%

[69] Ford has a hardwiring provision that provides the controlling family with 40% of the company's voting power, without regards to the family's equity holding. Ford Motor Co., Proxy Statement for the 2016 Annual Meeting (Schedule 14A) 72, 76 (Apr. 1, 2016).

[70] The data was hand collected from Forms S-1 and Proxy Statements of the relevant companies, filed on the SEC's EDGAR.

NIKE, Inc.	1984	68%	31%
Ford Motor Company	1969	7.1%	1.8%
Regeneron Pharmaceuticals, Inc.	1991	7%	5%
Twenty-First Century Fox, Inc.	2005	16%	15%
CBS Corporation	1995	26%	8%
Broadcom Corporation	1999	45%	8%
Average:		**30%**	**11.6%**

Indeed, as one of us analyzes in greater detail elsewhere, the decline in the controller's equity capital usually results in a disproportionate increase in associated agency costs.[71] For instance, when one compares two dual-class companies that are identical except that one controller owns 20% of her company's equity capital and the other controller owns only 15%, the agency costs in the latter company are expected to be more than twice those in the former.[72]

This concern is significant. As Section II.A discussed, the empirical evidence indicates that the combination of entrenchment and low equity holdings reduces firm value and generates significant agency costs. Furthermore, the analysis presented in Part IV below shows that when the stake of a controlling shareholder declines over time, making the dual-class structure especially inefficient, the controller's incentives to maintain a lock on control are strengthened.

III. POTENTIAL BENEFITS AND THE TIME DIMENSION

This Part analyzes the potential benefits of a dual-class structure and how they can be expected to change over time. In particular, a dual-class structure is often justified by the superior leadership skills of the founder

[71] See Bebchuk et al., supra note 56, at 301–05.
[72] See id. at 298–301.

at the time of the IPO or by the need to insulate management from short-term market pressures. However, as this Part shows, none of these arguments can support the use of dual-class stock with infinite life.

A. Superior Leadership Skills

As noted earlier, supporters of dual-class stock often argue that it could be value enhancing to provide a talented founder with a lock on control because of her superior business skills.[73] According to this view, a lock on control enables a talented founder to freely implement her strategy and "utilize" her skills to produce superior returns. These superior returns could in turn benefit not just the founder but also all other investors.[74]

This potential benefit, however, greatly depends on the controller being a superior, or at least a fitting, leader of the company. Even assuming this to be the case at the IPO stage, changes in the superior skills of a controller may occur over time due to the factors discussed in Section II.B. First, in a dynamic business environment, as time passes, even a founder who was a superior leader at the time of the IPO might become ill fitting due to aging or changes in circumstances.[75] Second, over time, a founder who had superior leadership skills might transfer the control to her heirs who lack such skills. Third, over time, the controller might reduce the fraction of equity capital she holds, and this reduction might in turn worsen the controller's incentives. When the controller turns out to be an ill-fitting leader for the company due to one or more of these factors, the "superior controller" argument for maintaining a lock on control weakens and might even reverse. Letting an ill-fitting controller determine business decisions and outcomes might be counterproductive.

Whereas private equity funds are sometimes praised as structures that enable long-term focus, they generally provide their general partners with control only for a fixed period of time, usually on the order of ten years, rather than permanently.[76] This structure might well reflect recognition that, many years down the road, a general partner's skills might

[73] See supra Subsection II.B.1.

[74] See, e.g., Zohar Goshen & Assaf Hamdani, Corporate Control and Idiosyncratic Vision, 125 Yale L.J. 560, 567 (2016).

[75] See supra note 63.

[76] See supra notes 66–67.

no longer be superior or even adequate. Similarly, any "superior controller" benefits that a dual-class structure might offer at the time of the IPO are likely, on an expected-value basis, to decline or even disappear many years after the IPO.

B. Long Termism

Another benefit that supporters ascribe to dual-class structures is that they insulate corporate decision makers from short-term market pressures and enable them to focus on the long term.[77] For instance, Snap's IPO documents state that the company's structure is intended to "permit us to continue to prioritize our long-term goals rather than short-term results."[78] According to this view, without a lock on control, founders might be concerned that they might be ousted if their short-term performance is poor and might, therefore, seek to enhance short-term prices at the expense of long-term value. With a long-term lock on control that a dual-class structure provides, so the argument goes, founders can focus on the long term and make decisions that enhance long-term value free from short-term pressures and the constant risk of being ousted.[79]

We note that this "long-termism" argument for dual-class structures lacks substantial empirical support. For example, a recent academic study finds that, compared with single-class companies, dual-class companies do not invest more either in general or in research and development.[80] Regardless, even if a dual-class structure were to offer some long-term benefits at the time of the IPO, these benefits can be expected to recede or even reverse over time.

[77] For early work raising the claim that dual-class stock facilitates long-term planning and reduces the distraction caused by the threat of takeovers, see Dent, supra note 68, at 748, and Daniel R. Fischel, Organized Exchanges and the Regulation of Dual Class Common Stock, 54 U. Chi. L. Rev. 119, 137–38 (1987). See also Solomon, supra note 24 ("Many defend dual-class stock because it may insulate a company from pressure to take short-term actions at the behest of shareholders."); The CCGG Policy, supra note 16, at 3 (presenting the long-term advantages of dual-class stock).

[78] See Snap Registration Statement, supra note 12, at 167.

[79] Id. (noting that the company's triple-class structure also intends to discourage transactions that may involve an actual or threatened acquisition of Snap). For a review and examination of the literature on long termism, see Lucian A. Bebchuk, The Myth that Insulating Boards Serves Long-Term Value, 113 Colum. L. Rev. 1637 (2013).

[80] Onur Arugaslan et al., On the Decision to Go Public with Dual Class Stock, 16 J. Corp. Fin. 170, 171, 174 (2010).

The expected benefits from long-term insulation are likely to be large or even positive only when the controller is a fitting leader for the company. The long-termism argument loses its force when the controller is ill fitting. An ill-fitting controller might make poor decisions not just for the short term but also for the long term.[81] When the controller becomes ill fitting, insulating her from market discipline could be counterproductive. Since the passage of time makes the controller less likely to be the fittest leader of the company, as discussed in the preceding Section, the expected benefit from long-term insulation is also likely to decline over time.

Finally, it might be argued that insulation from market forces is especially valuable for young companies with volatile value in the years following their IPOs. Whereas this view supports permitting companies to go public with a dual-class structure, it does not provide a basis for having such a structure indefinitely.[82] This view can support having a dual-class structure for only the years following the IPO and is fully consistent with sunsetting the dual-class structure when the company matures.

C. Oversight Benefits

Another potential benefit often ascribed to having a controlling shareholder is oversight benefits.[83] A controlling-shareholder structure moves power from professional managers to a controller, who has both the ability and incentives to police managers and limit their agency problems. By doing so, controllers "may better help the controlled company to re-

[81] Thomas J. Chemmanur & Yawen Jiao, Dual Class IPOs: A Theoretical Analysis, 36 J. Banking & Fin. 305, 305–06 (2012) (developing a model suggesting that dual-class stock may increase value in the hands of high-ability managers but may increase agency costs and reduce value in the hands of low-ability managers).

[82] See, e.g., Bebchuk, supra note 16, at 751–52 (noting that "the optimal arrangements for a publicly traded company that just went public . . . might well be different from those optimal for a large, mature publicly traded company"); William C. Johnson et al., The Lifecycle of Firm Takeover Defenses 1, 6 (Mar. 3, 2017) (unpublished manuscript) https://ssrn.com/abstract=2808208 [https://perma.cc/76GT-GCBW] (reporting that "the relation between firm value and the use of takeover defenses is positive for firms at their IPOs, and declines steadily as the firm matures, becoming negative approximately five years after the IPO").

[83] Gilson & Schwartz, supra note 61, at 168 (arguing that monitoring by controlling shareholders, including those relying on dual-class common stock, can be superior to market discipline).

alize the gains from professional management at lower agency costs than do markets."[84] When holding a majority of the equity capital would not be feasible or impose large risk-bearing costs on the controller, a dual-class structure would facilitate retaining a controlling-shareholder structure and thereby enable the controller to oversee and limit the power of the managers.

The size of any oversight benefits, however, likely depends on the extent to which the controller is a fitting leader for the company and has appropriate incentives. When this is no longer the case, the benefits of shifting power from managers to controllers might decline or even reverse. As discussed in Section II.B, the quality of both the controller's leadership skills and incentives can be expected to decline as time passes from the IPO due to the likely erosion of the controller's superior skills and the likely decrease in the controller's fraction of equity capital. As a result, there is a risk, growing over time, that the controller's ability and incentives to provide oversight will also diminish.[85] At the same time, monitoring by activist investors that focus on widely held firms might be discouraged by the presence of a controlling shareholder. Overall, any oversight benefits that a dual-class structure might provide at the time of the IPO can be expected to decline or even reverse over time.

IV. THE PERSISTENCE OF INEFFICIENT STRUCTURES

We have demonstrated that dual-class structures tend to become less efficient over time and that this reduced efficiency favors the choice of a dual-class structure with finite duration at the IPO stage. One can argue, however, that if a dual-class structure becomes inefficient over time, it can be expected to be eliminated by an ex-post private action. This Part analyzes the merits of this argument and explains why public officials and investors cannot rely on private ordering to eliminate dual-class structures that become inefficient with time.

Below we describe two main routes that can lead to the elimination of a dual-class structure: (1) a sale of the entire dual-class firm to an outside buyer and (2) a voluntary unification of the dual-class structure by

[84] Id.

[85] Recall the example of Sumner Redstone, see supra notes 4–5, who, at the age of ninety-three and with a deteriorating health condition, seems unlikely to be an effective monitor of managerial performance.

the existing controller. As we show, in both scenarios, the controller would forgo the private benefits of control associated with the dual-class structure while capturing only a fraction of the efficiency benefits generated by its elimination. As a result, controllers' structural incentives may lead them to retain a dual-class structure that becomes inefficient.

A. Resistance to a Sale

A dual-class structure could be eliminated through the sale of the entire company or all of its assets to a third party. When a dual-class company is managed inefficiently, the company's stock price is likely to be below its full potential value. In this case, it might be argued, an outside buyer could emerge and offer to purchase the whole company for a price that is at a significant premium to its market capitalization. On this view, a sale would be expected to end the inefficient dual-class structure that depressed the market value of the company.

As we explain below, however, the controlling shareholder might be unwilling to accept such a value-enhancing sale. Controlling shareholders, especially those who hold a small fraction of equity capital, have significant perverse incentives to retain a dual-class structure even when eliminating it through a sale of the company would produce significant efficiency gains for the company's shareholders. Whereas the sale would eliminate the controller's private benefits of control, the controller would capture only a minority (or even a small minority) of the produced efficiency gains, which would be shared pro rata by all shareholders.

To illustrate this distortion in controllers' incentives, consider the following simple example. Suppose that a dual-class structure enables a controller who holds 10% of the equity capital to have a lock on control. Suppose that the market value of the company is $1 billion, that the company is now managed inefficiently due to the dual-class structure, and that an outside buyer, say a given widely held company, would be willing to offer for the company a price *P* substantially exceeding $1 billion. Would such a sale take place?

Not necessarily. The controller would take into account not only the premium offered but also that the sale would bring to an end her control and the private benefits associated with it. Suppose that the controller derives private benefits worth 5% of the company's current value ($50 million). In this case, the controller currently holds 10% of the $1 billion market capitalization and private benefits of \$50 million, or a total value of \$150 million. In the event of a sale, the controller would receive 10% of the sale price P but would lose all of her private benefits of control.[86]

Therefore, as long as 10% of P does not exceed \$150 million—that is, as long as P does not exceed \$1.5 billion—a sale would not be in the private interest of the controller. If the outside buyer would be willing to offer less than \$1.5 billion (because it estimates the potential value gains by up to \$500 million), then a value-enhancing sale will not occur. Thus, there is a wide range of situations in which a sale that would produce gains from eliminating an inefficient dual-class structure would not take place.[87]

Let us now consider the problem in a more general formulation. Suppose that a controller owns α of the company's equity capital and derives B as private benefits of control and that the market capitalization of the controlled company is V. Suppose also that the current structure is inefficient, that an outside buyer would therefore be able to increase the value by a large amount of ΔV, and that the sale would eliminate the controller's private benefits of B.[88] Since the highest price the outside buyer would be willing to pay (P) is $V + \Delta V$, the transaction would not be in the private interest of the controller and could not be expected to take place as long as:

[86] Our analysis assumes that the acquisition price will be distributed pro rata. Of course, the controller might be willing to sell the whole company if she could get a much larger per-share price than other public investors. But, the Delaware court has placed limits on the ability of a controller to sell the controlled company to a third party in exchange for a benefit not shared by other shareholders by subjecting the transaction to the entire fairness review. See, e.g., In re John Q. Hammons Hotels Inc. S'holder Litig., No. CIV. A. 758-CC, 2009 WL 3165613, at *12 (Del. Ch. Oct. 2, 2009); In re Tele-Commc'ns, Inc. S'holders Litig., No. CIV. A. 16470, 2005 WL 3642727, at *7 (Del. Ch. Dec. 21, 2005); In re LNR Prop. Corp. S'holders Litig., 896 A.2d 169, 178 (Del. Ch. Nov. 4, 2005). Differential consideration in the event that there is a change of control is also prohibited by certain exchanges, such as the Toronto Stock Exchange. See The CCGG Policy, supra note 16, at 9–10. While such limits might well be justified, their unintended consequence is that the controller might often prefer to retain the dual-class structure even if it becomes inefficient.

[87] When considering the case of unification, we assume that existing rules against self-dealing protect public shareholders of a dual-class company from having the controller appropriate to herself a bigger fraction of the company value by, for instance, freezing out minority shareholders at a depressed price.

[88] We assume that ΔV exceeds B and that the sale would thus clearly be efficient.

$$\alpha V + B > \alpha[(V + \Delta V)]$$

which would be the case as long as

$$\Delta V < B/\alpha.$$

Thus, when the controller enjoys significant private benefits of control, the controller has a structural incentive to retain a dual-class structure in a range of situations in which a sale would be efficient. Note that this range expands, and the controller's perverse incentives strengthen, when the controller's fraction of equity capital (α) is smaller. Therefore, when α declines over time, the decline tends to increase the inefficiencies of a dual-class structure and strengthens the controller's incentive to retain the dual-class structure.

We should emphasize that the above distortion does not imply that such a sale would never take place. As the analysis shows, the sale would take place if the expected gain (ΔV) is sufficiently large. The key point, however, is that a sale ending an inefficient dual-class structure would not be expected to take place for a substantial range of inefficient situations.

B. Resistance to a Unification

Another route for eliminating an inefficient dual-class structure is a voluntary conversion to a single-class structure by the controller. Yet, a controller has structural incentives to avoid such unification even if it would produce substantial efficiency gains. The distortion afflicting the controller's choice whether to have a value-enhancing unification is similar to the distortion afflicting her choice regarding a value-enhancing sale: In both cases, the controller would capture only a fraction of the efficiency gains that the transaction would produce while fully bearing the loss of the private benefits of control.

Let us again consider a controller who owns a fraction α of the company's equity capital and derives B as private benefits of control, and suppose that the market capitalization of the controlled company is V. Further suppose that the current structure is inefficient and that the unification would increase the market capitalization by a large amount of

ΔV and would eliminate the controller's private benefits of B.[89] If the conversion takes place, the controller will have her fraction α of the enhanced value $V + \Delta V$. Still, the transaction would not serve the controller's private interest under the same condition identified in the preceding section—that is, as long as $\alpha V + B > \alpha[(V + \Delta V)]$. Thus, as long as $\Delta V < B/\alpha$, the controller would retain the dual-class structure. As before, the smaller the fraction of equity capital (α) and the larger the private benefits of control (B), then the wider the range of efficient unifications that the controller would have an incentive not to effect.[90]

Here, again, our analysis does not suggest that efficient voluntary dual-class unifications will never occur. Despite the structural incentives that the controller has to retain the dual-class structure, the controller would have an incentive to unify the dual-class structure when ΔV is large enough. Our point is only that a unification that could bring an inefficient dual-class structure to an end also might not take place for a substantial range of inefficient situations.

This theoretical analysis is supported by evidence presented in a recent empirical study on dual-class unifications in Europe.[91] This study shows that controllers with low equity interest and high levels of private-benefit extraction possibilities are less likely to effect a dual-class unification. Likewise, evidence on precatory shareholder proposals to dismantle the dual-class stock of U.S. companies show that controllers tend to disregard the results even when the overwhelming majority of

[89] We assume that ΔV exceeds B and that the sale would thus clearly be efficient.

[90] Controllers might agree to unify the dual-class shares if they get a substantially large side payment from public investors to compensate them for the loss of their private benefits of control. The Delaware court, however, has placed limits on the ability of a controller to engage in dual-class restructuring with side payments by subjecting this type of transaction to an entire fairness review. See, e.g., Levco Alt. Fund Ltd. v. Reader's Digest Ass'n, 803 A.2d 428 (Table), 2002 WL 1859064, at *2 (Del. Aug. 13, 2002). Indeed, we were unable to identify any significant number of voluntary unifications in exchange for significant side payments either in the United States or Europe. See also Benjamin Maury & Anete Pajuste, Private Benefits of Control and Dual-Class Share Unifications, 32 Managerial & Decision Econ. 355, 365 (2011) (researching dual-class unifications in seven Western European countries and finding that only nine companies (out of 493 companies) compensate the controller for the loss of voting rights with additional stock or cash).

[91] See, e.g., Maury & Pajuste, supra note 90, at 356 (finding that "firms with lower levels of private benefit extraction possibilities, that is, the ones with a lower wedge between the voting rights and equity rights held by the controlling shareholders, the ones with a financial investor, and the ones cross-listed in the USA, are more likely to unify their share classes").

shareholders unaffiliated with the controllers vote in favor of these proposals.[92]

In sum, the theory presented in this Part suggests that controlling shareholders have substantial private incentives to retain a dual-class structure even if it becomes inefficient. This analysis of the persistence of inefficient dual-class structures is consistent with patterns documented in a recent study by ISS. The study found that dual-class companies have longer life spans than companies without such a structure.[93] The average age of these dual-class companies (31 years) was "more than double the [average] age (15 years) of firms with a single class of shares and a controlling party."[94]

V. SUNSETTING DUAL-CLASS STRUCTURES

Part III showed that as time elapses following the IPO, the costs of a dual-class structure can be expected to increase while the benefits decline. Over time, therefore, there is a growing risk that a dual-class structure will stop being an efficient capital structure, even if it were so at the outset. Furthermore, as demonstrated in Part IV, controllers have considerable private incentives to retain a dual-class structure regardless of its efficiency from the standpoint of shareholder wealth.

As noted in the Introduction, we disfavor the use of dual-class structures altogether. However, to the extent that companies are permitted to go public with a dual-class structure, our analysis calls for including an adequate sunset provision. Absent a sunset provision, the lifecycle of a dual-class structure is perpetual, and this infinite duration is likely to create growing risks and costs over time. Section A of this Part discusses the optimal design of a sunset clause. Section B addresses potential objections to such a clause.

[92] We examined data from SharkRepellent on fifty-three shareholder proposals to dismantle dual-class structures submitted to twenty-five Russell 3000 companies between 2005 and 2014. When a proposal to eliminate dual-class structures was submitted to the same company more than once, we used the proposal that received the highest support rate. On average, these proposals obtained a support rate of 71% among shareholders unaffiliated with the controllers. Nonetheless, in all these cases, the controller chose not to implement the proposal.

[93] See Kamonjoh, supra note 17, at 22.

[94] Id.

A. Designing Sunset Clauses

Below we discuss several possible designs of a sunset clause and, in particular, the trigger for sunsetting the dual-class structure: (1) a fixed-time sunset, (2) a triggering-event sunset, and (3) an ownership-percentage sunset. We explain why we favor the use of fixed-time sunsets, address situations in which it is efficient to extend the duration of the dual-class structure, and conclude with an additional design issue—addressing attempts at circumventing the sunset clause.

1. Fixed-Time Sunset

A sunset provision with a time limitation is triggered at a predetermined date—say, ten years after the IPO. When the clause is activated, the shares with the superior voting rights automatically convert into ordinary shares, and the company's second class is eliminated. To enable the retention of structures that remain efficient, the provision may stipulate that the conversion could be delayed by additional periods of not more than ten years each, provided that the majority of shareholders unaffiliated with the controller approve such extensions. This type of sunset clause ensures that controlling shareholders would be able to retain only efficient dual-class structures. With unaffiliated shareholders determining the structure's future, the controlling shareholder is unlikely to prolong an inefficient structure that serves her private benefits at the expense of enterprise value.

We have identified several companies—including Fitbit, Groupon, Kayak, and Yelp—that recently adopted a fixed-time sunset clause at the IPO stage.[95] The duration of the dual-class structures in these cases ranged from five years to twenty years. Groupon, for example, adopted a five-year sunset clause at its IPO in 2011, and, as a result, it converted to a single-class company in 2016.[96] However, the companies adopting this type of provision still constitute a minority of dual-class IPOs.[97]

[95] We reviewed the Forms S-1 of the fifty largest dual-class companies that went public between 2009 and 2015. Of these companies, we identified twelve that went public with a fixed-time sunset.

[96] Groupon, Inc., Amendment No. 7 to Registration Statement (Form S-1) 6, 98 (Nov. 1, 2011); Groupon, Inc., Current Report (Form 8-K) (Oct. 31, 2016).

[97] See supra note 95. Also, a review of the organizational documents of all controlled dual-class companies in the S&P 1500 shows that none of them has a sunset provision with a fixed-time limitation.

2. Triggering-Event Sunset

A second type of sunset, adopted by some dual-class companies, is a triggering-event sunset requiring a conversion to a single-class structure upon the occurrence of a specified event, such as the founder's disability, death, or reaching of retirement age.[98] This type of a sunset arrangement prevents the founder from retaining control when reaching old age or disability and from transferring control to heirs. However, such a sunset provides the founder with control for the remainder of her working life.[99]

For a founder who is young or middle-aged, such a sunset allows a lock on control that has an excessively long duration. Consider a founder who is forty years old and goes public with a sunset providing for expiration of the dual-class structure upon her reaching the age of seventy. This triggering-event sunset would likely keep the founder in power for thirty years. Considering the analysis in Parts II and III regarding the eroding efficiencies of dual-class structures over time, a three-decade duration creates substantial risks and expected costs. A founder who has decades of working life ahead of her poses substantial risks that she would not remain a fitting leader of the company throughout her entire working life. Thus, a standard triggering-event sunset that provides the founder with power over the company for the remainder of her working life is substantially inferior to a ten- or fifteen-year time limitation.

[98] Google, Groupon, LinkedIn, and Zynga adopted such a triggering-event sunset when they went public. See HKEX Report, supra note 26, at 47.

[99] See the example of Couche-Tard, a Canadian company that operates a large chain of convenience stores. Couche-Tard had a sunset provision that was to be triggered when the youngest of the founders turned sixty-five or passed away. Although the controllers were interested in prolonging the dual-class structure, shareholders rejected a management proposal to that end in 2015, and the company had to unify its dual-class structure. See Press Release, Alimentation Couche-Tard Inc., Alimentation Couche-Tard Inc. Files Management Proxy Circular (July 24, 2015), http://www.prnewswire.com/news-releases/alimentation-couche-tard-inc-files-management-proxy-circular-518408281.html [https://perma.cc/4CGA-FKBN]; Nicolas Van Praet & Bertrand Marotte, Couche-Tard Chairman Says Bay Street Investors Blocking Founders' Control, Globe & Mail (Apr. 20, 2016), http://www.theglobeandmail.com/report-on-business/couche-tard-chairman-says-bay-street-investors-blocking-founders-control/article29699072/.

3. Ownership-Percentage Sunset

Some companies, including LinkedIn and Zynga, have recently adopted a sunset clause triggered by crossing a certain ownership percentage.[100] An ownership-percentage sunset converts the high-vote shares held by the founders into common stock when they represent less than a certain predetermined percentage of the total number of all common shares outstanding. The rationale for such a trigger is that a large equity stake provides an alignment of interest between the controller and public investors and might thus mitigate concerns associated with allowing the founder to retain control. However, although such a sunset provision may induce the controller to retain at least the specified stake during the period of control, it is unlikely to effectively address the problem of control lasting for an excessively long period.

We note that the ownership-percentage sunsets recently adopted in dual-class IPOs tend to feature low ownership thresholds. Indeed, the data that we hand-collected on U.S. dual-class companies suggest that most of them use an ownership threshold that does not exceed 10%, meaning that the controller can retain a lock on control despite a significant wedge between her voting rights and cash-flow rights.[101] When the controller owns one-tenth (or less) of the company's equity capital, the wedge between voting power and economic stake is large and the risks and potential costs of distortions are substantial.

Most importantly, sunsets with ownership-percentage triggers are unlikely to lead to an expiration of the dual-class structure. The controller can and is likely to avoid such expiration by keeping her fraction of equity ownership above the specified floor. When the private benefits associated with control are significant, the controller can be expected to stay above the ownership trigger to retain these private benefits.

[100] See HKEX Report, supra note 26, at 46, 48. We reviewed the organizational documents of all seventy-eight controlled dual-class companies in the S&P 1500 as of 2015. Twenty-five of them adopted a sunset provision with a beneficial ownership threshold. We also reviewed the fifty largest dual-class IPOs during the period 2009–2015; 54% of these adopted a sunset with ownership threshold.

[101] Eighty percent of the dual-class companies in the S&P 1500 that adopted a sunset provision with a beneficial ownership threshold have an ownership threshold that does not exceed 10%. Similarly, 63% of the recent largest dual-class IPOs that adopted this type of sunset set a minimum ownership threshold of 10% or less.

To be clear, compared with a perpetual dual-class structure that has no restrictions on reducing the controller's equity stake, an ownership-threshold sunset introducing such restrictions may provide *some* benefits. Such a provision may induce the controller to retain a larger fraction of the equity capital than she otherwise would, and thereby limit the wedge between her voting rights and cash rights as well as the potential distortions resulting from this wedge.[102] Such a sunset provision, however, inadequately addresses the problem of indefinite retention of power even when the dual-class structure becomes inefficient. By contrast, a fixed-time sunset addresses this concern directly and effectively.

4. Addressing Circumvention

Of course, as with every regulatory arrangement, policymakers who consider requiring dual-class IPOs to include a sunset should examine whether founders would be able to circumvent such a requirement. For example, founders might try to bypass such a requirement by going public with nonvoting preferred shares rather than common shares with inferior voting rights.

Such circumvention issues arise in the case of any rule that limits the use of dual-class structures. Indeed, a number of jurisdictions that prohibit dual-class IPOs, including Belgium, Estonia, Germany, Greece, Luxembourg, and Spain, have already dealt with such issues. In these jurisdictions, nonvoting-preference shares may not represent more than a certain percentage (usually up to 50%) of the company's outstanding shares.[103] Moreover, these jurisdictions usually require preferred shares to have preferential rights for dividends, which discourages their use as a circumvention device around a dual-class prohibition.[104] Finally, more generally, controllers' incentives to circumvent mandated sunset provisions are considerably weaker than their incentives to circumvent outright prohibitions on dual-class structures.

[102] See supra Subsection II.B.2.

[103] The size of the cap varies from jurisdiction to jurisdiction. It is 33% of the company equity capital in Belgium and Estonia; 40% in Greece; and 50% in Germany, Luxembourg, and Spain. See Report on the Proportionality Principle, supra note 26, at 19.

[104] Id.

B. Objections

This Section considers and responds to several possible objections to requiring sunsets. In particular, we examine the Panglossian objection, the "one-size-does-not-fit-all" objection, the concern that such a requirement would discourage IPOs, and the end-period problem. We conclude that these objections do not, either individually or collectively, provide a good basis for opposing sunset provisions.

1. The Panglossian Objection

We begin with an objection that we refer to as the Panglossian objection.[105] According to this objection, market forces ensure that the best governance arrangements are always adopted. Because founders taking their companies public have strong incentives to adopt a value-maximizing set of arrangements, Panglossians argue that these founders can be expected to adopt sunset clauses whenever they are value enhancing.[106] Thus, on this view, whenever controllers go public without a sunset provision, the provision is bound to be value reducing.

There are several reasons for questioning this objection. To begin, to accept the Panglossian argument, one must believe not only (1) that the market accurately prices the difference between a dual-class structure and a single-class structure, but also (2) that the market prices accurately the difference between a dual-class structure with and without a sunset clause. Belief (2) assumes a very high degree of market efficiency. Whereas IPO buyers might pay attention to and price a salient feature like a dual-class structure, they might not similarly price more subtle features, such as the presence and specifics of a sunset provision.[107]

Second, to accept the Panglossian argument, one must accept that it is commonly value maximizing for dual-class structures to have a perpetu-

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[105] We use this term in the sense that it was used in Lucian Arye Bebchuk, The Case for Increasing Shareholder Power, 118 Harv. L. Rev. 833, 888 (2005), and Lucian A. Bebchuk, Reply, Letting Shareholders Set the Rules, 119 Harv. L. Rev. 1784, 1805–06 (2006). The term is named after Voltaire's protagonist, Dr. Pangloss, who believed that our world is "the best of all possible worlds." See Voltaire, Candide, or Optimism 17 (Burton Raffel trans., Yale Univ. Press 2005) (1759).

[106] For a general formulation of the argument that IPO pricing reflects the quality of offered governance, see Fischel, supra note 77, at 123–25, and Romano, supra note 51, at 2361–64.

[107] Bebchuk, supra note 16, at 740–42 (discussing the pricing of governance terms).

al duration. Because founders going public with a dual-class structure have commonly not included any sunset provision, Panglossians must believe that in all these cases any time limitation whatsoever would have been value decreasing on the whole.[108] As our analysis has shown, however, the potential benefits of a dual-class structure tend to decline over time, its potential costs tend to increase over time, and controllers have private incentives that might lead them to retain a dual-class structure even if it becomes inefficient. Therefore, while there might be room for reasonable disagreement about the optimal *duration* of dual-class structures, it is in our opinion implausible to believe that perpetual duration is commonly optimal.

Of course, some Panglossians might take the view that, as a matter of principle, they oppose any mandatory limitation on the terms that controllers may choose to offer when going public. The main audience of our analysis, however, are readers who are interested in identifying which arrangements are likely to be value reducing because they are open to restricting or discouraging terms likely to be value reducing. Such readers should find of interest our demonstration that perpetual dual-class structures are unlikely to be value enhancing.

2. One Size Does Not Fit All

A related objection is the "one-size-does-not-fit-all" objection. A governance arrangement that might be optimal for some companies might not be optimal for others. Therefore, it might be argued, some dual-class structures might remain desirable several or even many decades after the IPO.

A sunset provision, however, would not necessarily result in the removal of an optimal dual-class structure after a certain period of time. Rather, such a provision merely prevents the controller from unilaterally prolonging the use of a dual-class structure that investors oppose as value reducing. If a controlling shareholder performs well and extending her control seems to be value enhancing, shareholders would be able to vote to prolong the controller's power for an additional period.

Consider the example of Fairfax, a major Canadian company that has a dual-class structure. In the summer of 2015, the controller of Fairfax brought to a shareholder vote governance changes extending his out-

[108] See supra notes 95 & 97 and accompanying text.

sized voting power, and these changes were approved by 68.4% of the votes cast by shareholders unaffiliated with the controller.[109] This example illustrates that investors whose money is on the line—including, critically, institutional investors—can be persuaded to extend a dual-class structure if they view such extension to be value enhancing.

3. Discouraging IPOs

Another possible objection to any proposed limitation on the use of dual-class structures is that the limitation would discourage founders from taking their company public. As a result, it might be argued, such a restriction would deprive public investors of beneficial investment opportunities. In our view, however, this concern does not justify support for perpetual dual-class structures.

Several developed-market jurisdictions, including Hong Kong and the United Kingdom, prohibit or strongly discourage the use of dual-class stock but still have well-developed capital markets with a large number of publicly traded companies.[110] The experience of these jurisdictions, as well as the history of the United States capital markets during the decades in which the leading American stock exchange prohibited dual-class structures, suggests that founder willingness to go public is robust even when dual-class structures are completely prohibited.[111] And requiring such structures to include a sunset can be expected to have less of an effect on the willingness to go public than their outright prohibition. For founders with limited personal wealth, accessing the public market at some point is commonly critical to scaling up their companies and creating liquidity for themselves and early investors.

[109] Press Release, Fairfax Fin. Holdings Ltd., Fairfax Calls Special Shareholders' Meeting to Consider Amendment to Terms of Multiple Voting Shares (June 12, 2015, 6:16 PM), http://www.marketwired.com/press-release/fairfax-calls-special-shareholders-meeting-consider-amendment-terms-multiple-voting-tsx-ffh-2029345.htm [https://perma.cc/G5N4-C43F]; Press Release, Fairfax Fin. Holdings Ltd., Fairfax Announces Approval of Amendments to Multiple Voting Share Terms (Aug. 24, 2015, 10:05 AM), http://www.marketwired.com/press-release/fairfax-announces-approval-of-amendments-to-multiple-voting-share-terms-tsx-ffh-2049809.htm [https://perma.cc/6E29-TP7J].

[110] See supra notes 46–50 and accompanying text.

[111] See supra notes 28–35 and accompanying text. True, founders can still choose to list their companies outside the United States, but there are heavy regulatory costs associated with foreign listings. Also, as noted earlier, the major competitors of the United States as international financial centers do not permit the use of dual-class stock, and, therefore, U.S. founders are unlikely to take their companies public elsewhere.

Some may argue that, in the current environment, founders can obtain outside equity capital from venture capital funds and other investors and thereby avoid going public. However, such outside equity investors often provide financing based on their expectation that the company will eventually provide them with an "exit" through an IPO or sale. Such investors are unlikely to be willing to become investors in a company that will permanently remain private and under the founder's control.[112]

4. The End-Period Problem

Another possible concern is that the adoption of a sunset clause would lead a controlling shareholder to act opportunistically in the period just before the dual-class structure is set to expire. According to this view, a controller on the precipice of losing her outsized influence might choose to act aggressively in the end period to take advantage of her power over the company while it lasts. This concern, however, does not justify perpetual dual-class structures.

First, existing corporate-law rules governing controlling shareholders would place some limits on the extent to which a controller can divert value during the end period.[113] Furthermore, to the extent that controllers are able to engage in significant value diversion in the end period, allowing perpetual control is a counterproductive response to it. Shareholders would likely be worse off having to bear the costs of such diversion indefinitely than to bear the costs of a somewhat increased diversion in the end period.

Finally, enabling shareholders unaffiliated with the controller to extend the duration of a dual-class structure that is scheduled to sunset would discourage end-period opportunism. As long as there is a chance of obtaining such an extension, its prospect would provide the controller

[112] Even if a founder could hypothetically find alternative private funding sources, going public would still have certain advantages. In particular, going public would tap the resources of a vast number of potential investors, enable trading in very liquid markets, and provide a convenient currency for compensating employees and making acquisitions.

[113] Delaware law, for example, places limits on the extent to which a controlling shareholder can obtain private benefits of control through related-party transactions by subjecting these transactions to judicial scrutiny. See, e.g., In re Ezcorp Inc. Consulting Agreement Derivative Litig., No. CV 9962-VCL, 2016 WL 301245, at *29–30 (Del. Ch. Jan. 25, 2016) (reviewing Delaware cases that have subjected such transactions to judicial scrutiny).

an incentive to perform well and to avoid opportunism that could discourage shareholders from voting against an extension.[114]

VI. GOING FORWARD

This Part discusses the significant implications of our analysis. In particular, we review the implications that this analysis has for public officials (Section A), institutional investors and their advisors (Section B), and researchers (Section C).

A. Public Officials

Our analysis has considerable implications for public officials in jurisdictions that permit the use of dual-class stock. In discussing these implications, it is useful to distinguish and consider separately (1) future dual-class IPOs and (2) existing companies that have already gone public with a perpetual dual-class structure.

Future Dual-class IPOs. Public officials should consider requiring companies that go public with a dual-class structure to include a sunset provision. In particular, we recommend a ten- or fifteen-year sunset with an option to extend that period by an affirmative vote of shareholders unaffiliated with the controller. As explained in Part IV, there are reasons to expect that the private interests of controllers might lead them to retain a dual-class structure even if it becomes inefficient and other public shareholders oppose its continued use.[115] These reasons, in turn, make it desirable to have a sunset with an extension option built into the dual-class structure.

Requiring sunsets would still enable controllers to go public with a dual-class structure and have secure control for a substantial period of time after the IPO. Furthermore, the extension option embedded into sunsets would enable a dual-class structure to remain in place if it continues to be efficient when the time for its expiration arrives. If a controlling shareholder performs well during the first ten- or fifteen-year pe-

[114] To the extent that one is concerned about having a sharp endpoint, one could consider using a "gradual" sunset. Under such a gradual sunset, after a period of, say, ten or fifteen years, the high-vote shares will convert to low-vote shares gradually over a period of several years. Certain issuers may prefer a gradual conversion along these lines to a one-time drop-off in voting power.

[115] See supra Section IV.A.

riod and retaining the dual-class structure appears to serve shareholder value, other shareholders can be expected to vote in favor of an extension.

Existing Dual-class Companies. The policy implications for companies that have already gone public without a sunset provision raise additional issues deserving attention that we would like to flag briefly. Our analysis indicates that leaving perpetual dual-class structures in place indefinitely can be expected to produce governance problems and efficiency losses. This analysis also indicates that, without government intervention, such companies might get "stuck" in an inefficient dual-class structure for a long time.

On the other hand, requiring companies that already went public with a dual-class structure to add ex post a sunset provision could be viewed as transferring value from controllers to public investors. To the extent that public officials are reluctant to act in a way that raises a distributive concern, they might consider coupling the introduction of sunset provisions with compensation to controllers for the loss of their superior voting rights. During the 1990s, Israeli public officials adopted rules that encouraged controllers to accept dual-class stock unifications while enabling controllers to receive compensation in the form of additional common shares for giving up their superior voting status.[116] Joining sunset provisions with compensation to the controller can benefit both public investors and controllers, especially where companies remain stuck for a long time in an inefficient dual-class structure.

Finally, to the extent that public officials enable some existing companies to retain dual-class structures without a sunset provision, they should recognize that such companies are especially prone to governance problems and agency costs. Thus, such companies would be appropriate candidates for stricter scrutiny of controller choices or other enhanced protections of public investors.[117] For example, a recent article co-authored by Assaf Hamdani and one of us puts forward the possibility of strengthening the protection of public investors in controlled com-

[116] Shmuel Hauser & Beni Lauterbach, The Value of Voting Rights to Majority Shareholders: Evidence from Dual-Class Stock Unifications, 17 Rev. Fin. Stud. 1167, 1169 (2004).

[117] For a review and analysis of the types of arrangements that are and are not effective for protecting public investors from controller opportunism, see Lucian A. Bebchuk & Assaf Hamdani, The Elusive Quest For Global Governance Standards, 157 U. Pa. L. Rev. 1263 (2009).

panies by enabling these shareholders to influence the choices of independent directors.[118] Indeed, such enhanced protections could be especially valuable and appropriate for controlled companies with an enhanced risk of governance problems.

B. Investors and Advisors

Leading institutional investors have expressed their opposition to the use of dual-class stock and have sought to end its use.[119] Both of us are skeptical of dual-class structures and would welcome a general return to single-class structures. However, in jurisdictions where institutional investors conclude that ending the use of dual-class structures is not feasible, they should at least consider pressing for the use of appropriate sunset provisions in all dual-class companies. General adoption of such sunsets would address a major concern posed by dual-class structures: the problem of long-standing structures that become increasingly costly and inefficient over time.

The leading proxy advisor, ISS, recently moved in the direction we advocate, amending its voting policies to indicate its intention to issue negative recommendations for director nominees at companies with a dual-class structure that does not include a "reasonable sunset provision."[120] We are pleased by this change and believe that our analysis provides a useful framework for any future assessment of the reasonableness of a sunset provision. This analysis suggests (1) that acceptable sunset provisions should have a fixed-time trigger rather than only a triggering-event or ownership-percentage trigger; (2) that a fixed-time duration of ten or fifteen years is reasonable; and (3) that reasonable sunset provisions should include an option to extend the dual-class structure upon the affirmative majority approval of shareholders unaffiliated with the controller.

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[118] Lucian A. Bebchuk & Assaf Hamdani, Making Independent Directors Work, 165 U. Pa. L. Rev. (forthcoming May 2017).

[119] See supra notes 36–43 and accompanying text.

[120] See Institutional S'holder Servs., Americas: U.S., Canada, and Latin America Proxy Voting Guidelines Updates: 2017 Benchmark Policy Recommendations 4–5 (Nov. 21, 2016), https://www.issgovernance.com/file/policy/2017-americas-iss-policy-updates.pdf [https://perma.cc/QE4W-YGTH]; Institutional S'holder Servs., US Policy - Unilateral Board Actions – Multi Class Capital Structure at IPO (2016), https://www.issgovernance.com/file/policy/unilateral-board-actions-multi-class-capital-structure-at-ipo.pdf [https://perma.cc/SH9F-JX5F].

Finally, we note that "withhold" campaigns—investors withholding support from directors of companies that went public with a perpetual dual-class structure—are by themselves unlikely to be effective in discouraging such structures. As we explained, once a company goes public with a perpetual dual-class structure, the controller will be reluctant to give up her control. Because the controller has the power to elect directors, a symbolic withholding of support by institutional investors would be unlikely to apply sufficient pressure to induce controllers of existing dual-class companies to adopt sunset provisions. Institutional investors can most effectively discourage the use of perpetual dual-class structures by abstaining from participation in dual-class IPOs that do not contain appropriate sunset provisions. Whether institutional investors are capable of acting in such a way is a question that is beyond the scope of this Article. For our purposes, what is important is that such actions by institutional investors could not be expected without widespread recognition among such investors that the case for perpetual dual-class stock is untenable. We hope that this Article will contribute to such widespread recognition.

C. Researchers

Our analysis has identified and analyzed problems that would be worthwhile examining further in future research. Among other things, our analysis yields predictions that would be valuable to test empirically.

To begin, our analysis indicates that the agency costs associated with the use of dual-class stock can be expected to increase over time. Thus, the analysis implies that, controlling for relevant characteristics, the performance and valuation of dual-class companies will decline and agency costs will become more severe as the time from the IPO passes. These are empirical predictions that future research can and should examine.

In addition, our analysis suggests that dual-class structures can be expected to persist over time. We have shown that controllers have substantial private incentives to avoid a sale of a company with a dual-class structure even if such a sale would be value enhancing. Thus, our analysis implies that, controlling for relevant characteristics, companies with a dual-class structure are likely to have substantial persistence power.

More generally, future research should take the time dimension into account in any empirical or policy analysis of dual-class structures. Our work shows that the time dimension is critical. Future work should recognize that the valuation and agency consequences of a dual-class structure are expected to evolve over time in ways that have substantial implications for company performance and shareholder wealth.

CONCLUSION

This Article has aimed to contribute to the long-standing debate regarding the desirability of dual-class structures. We have sought to highlight the significance of a key dimension—the time that has passed since the IPO of a dual-class company—for the assessment of dual-class structures.

Our analysis has demonstrated that, over time, the potential benefits of dual-class structures can be expected to decline and the potential costs to increase. We have also shown that controllers have perverse incentives to retain dual-class structures even when those structures become substantially inefficient. Thus, as time passes from the IPO, there is a growing risk that a dual-class structure will become value decreasing and that public investors will find themselves subject to an inefficient structure with significant governance risks and costs.

Our analysis identifies a significant midstream cost of dual-class structures that should be taken into account in any overall assessment of such structures. Our key contribution, however, is to demonstrate that even those who believe that dual-class structures are often efficient at the time of the IPO, and the period following it, should have substantial concerns about dual-class structures that provide perpetual or lifetime control. All participants in the debate should accept taking such structures off the table.

Going forward, the debate should focus on the choice between (1) precluding dual-class IPOs altogether, and (2) permitting IPOs with a dual-class structure that sunsets after a fixed period of time (such as ten or fifteen years) unless its extension is approved by shareholders unaffiliated with the controller. The case for indefinite dual-class structures is untenable. Our analysis has significant implications for public officials, institutional investors, and researchers. We hope that it will prove useful and inform the future examination of dual-class structures.