ecgi

Extending Dual Class Stock: A Proposal

Finance Working Paper N° 707/2023
May 2023

David J. Berger
Wilson Sonsini Goodrich & Rosati

Jill E. Fisch
University of Pennsylvania and ECGI

Steven Davidoff Solomon
University of California, Berkeley and ECGI

ECGI Working Paper Series in Finance

Extending Dual Class Stock: A Proposal

Working Paper N° 707/2023

May 2023

David J. Berger
Jill E. Fisch
Steven Davidoff Solomon

Abstract

The increasing use of dual class voting structures in public companies, and the frequency with which such structures contain sunset provisions, raises the issue of when and how such sunset provisions should be modified, extending the company's use of the dual class structure. Recent decisions have applied the entire fairness legal standard to dual class extensions, but, in the recent Trade Desk case, the Delaware Chancery court concluded that the extension complied with the MFW standard and should therefore receive the protection of the business judgment rule. We question the practicality of applying either entire fairness or MFW to dual class extensions. Instead, we argue for a contractual approach in which the initial charter specifies the conditions under which a dual class structure can be extended. The contractual approach increases the information available to shareholders at the IPO stage, thereby improving market efficiency. We argue that extensions that comply with such charter provisions should be insulated from entire fairness review.

Keywords: Dual class voting, capital markets, entire fairness, MFW standard, institutional investors, controlling shareholders, shareholder voting, term-based sunsets, shareholders, IPO market, Trade Desk, corporate charters, Delaware Chancery Court

JEL Classifications: G32, K22

David J. Berger
Partner
Wilson Sonsini Goodrich & Rosati
650 Page Mill Rd
Palo Alto, CA 94304-1050, United States
e-mail: dberger@wsgr.com

Jill E. Fisch*
Saul A. Fox Distinguished Professor of Business Law
University of Pennsylvania, School of Law
3501 Sansom Street
Philadelphia, PA 19104, United States
phone: +1 215 746 3454, fax: +1 215 573 2025
e-mail: jfisch@law.upenn.edu

Steven Davidoff Solomon
Alexander F. and May T. Morrison Professor of Law
University of California, Berkeley
693 Simon Hall
Berkeley, CA 94720, United States
phone: +1 510 642 1769
e-mail: steven.solomon@law.berkeley.edu

*Corresponding Author

University of Pennsylvania Carey Law School

ILE

INSTITUTE FOR LAW AND ECONOMICS

A Joint Research Center of the Law School, the Wharton School,
and the Department of Economics in the School of Arts and Sciences
at the University of Pennsylvania

RESEARCH PAPER NO. 23-13

Extending Dual Class Stock: A Proposal

David J. Berger
WILSON SONSINI GOODRICH & ROSATI

Jill E. Fisch
UNIVERSITY OF PENNSYLVANIA CAREY LAW SCHOOL

Steven Davidoff Solomon
UC BERKELEY LAW

Extending Dual Class Stock: A Proposal

David J. Berger[*]
Jill Fisch[**]
Steven Davidoff Solomon[***]

Forthcoming in Theoretical Inquiries in Law

Draft dated March 20, 2023

Abstract

The increasing use of dual class voting structures in public companies, and the frequency with which such structures contain sunset provisions, raises the issue of when and how such sunset provisions should be modified, extending the company's use of the dual class structure. Recent decisions have applied the entire fairness legal standard to dual class extensions, but, in the recent Trade Desk case, the Delaware Chancery court concluded that the extension complied with the MFW standard and should therefore receive the protection of the business judgment rule.

We question the practicality of applying either entire fairness or MFW to dual class extensions. Instead, we argue for a contractual approach in which the initial charter specifies the conditions under which a dual class structure can be extended. The contractual approach increases the information available to shareholders at the IPO stage, thereby improving market efficiency. We argue that extensions that comply with such charter provisions should be insulated from entire fairness review.

Introduction

Dual class stock has become common and ubiquitous in U.S. capital markets. Amidst its evolution over the last decade, dual class structures now often include a variety of sunset mechanisms.[1] These come in various flavors, including term-based sunsets, dilution thresholds, and life cycle events.[2] And with early-adopter IPOs aging, some sunset mechanisms, particularly

---

[*] Partner, Wilson Sonsini Goodrich & Rosati. Wilson Sonsini represented The Trade Desk's founder, Jeff Green, in negotiating the charter amendment extending the sunset of the company's dual-class stock structure and the subsequent litigation over this extension.

[**] Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania Law School. We are grateful to Tasneem Warwani, Penn Law Class of 2024 for excellent research assistance.

[***] Alexander F. and May T. Morrison Professor of Law, U.C. Berkeley School of Law.

[1] *See* Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. LAW REV. 1057, 1064-1070 (2019) (tracing the development of dual class stock and sunsets).

[2] *See generally* Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 COLUM. BUS. L. REV. 852, 870 (describing the various forms of sunset clauses and empirically analyzing their usage). The Council for Institutional Investors ("CII") has stated that "in the Russell 3000 excluding the S&P 1500, the proportion [of corporations with dual class structures] more than doubled between 2015 and

term-based sunsets, are beginning to take effect.[3] As early-adopters consider whether to follow their initial sunset mechanisms, this article assesses when and how dual class stock should be extended.

In some cases, companies have allowed sunsets to take effect resulting in the collapse of the company's dual class structure.[4] In other cases, companies have attempted to extend or revise the length of existing dual class structures. Alphabet, for example, succeeded in such an extension by issuing nonvoting Class C shares, but Facebook withdrew a similar proposal in order to settle litigation challenging its proposed adoption.[5] Despite Facebook's failure, such extensions can be upheld even if litigated to a judgment. In the recent case of *City Pension Fund for Firefighters and Police Officers in Miami v. The Trade Desk, Inc.*,[6] the Delaware Chancery Court, applying the *MFW* standard, found that an arrangement to extend the life of dual class stock was appropriate. [7]

While *MFW* has been put forth as the appropriate procedure to reduce judicial scrutiny of dual class extensions, we believe that it leaves a practical void for two reasons.[8] First, *MFW* requires approval of the disinterested shareholders.[9] However, given the structure of our capital markets, in most cases it is unlikely that institutional shareholders will approve an extension of a term-based sunset or other sunsets which they perceive as disenfranchising them. As we discuss, we believe this institutional bias is so strong that even when there is an economic case for such an extension, approval is likely to be difficult. This is particularly true when the issue involves the extension of a term-based sunset, since sunsets are a feature that institutional shareholders and SEC officials have consistently supported.[10] Second, if a company

---

2022, from 30.9% to 68.1%." Subodh Mishra, *Dual Class Share Structures: Is the Sun Setting Too Slowly?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 19, 2022), https://corpgov.law.harvard.edu/2022/12/19/dual-class-share-structures-is-the-sun-setting-too-slowly/#more-153402.

[3] *See Dual-Class Stock*, COUNCIL INSTITUTIONAL INVS. https://www.cii.org/dualclass_stock (last visited Dec. 22, 2022) (detailing a number of sunset provisions which have taken effect, including Yelp and Evo Payments).

[4] *Id.*

[5] *See* Tom Hales, *Google Settlement Clears Way for New Class C Stock*, REUTERS (June 17, 2013), https://www.reuters.com/article/us-google-stockplan-settlement/google-settlement-clears-way-for-new-class-c-stock-idUSBRE95G0MU20130617; *see also Facebook Drops Class Plan—Shareholder Attorney*, REUTERS (Sept. 22, 2017), https://www.reuters.com/article/facebook-stock-zuckerberg-idCNL2N1M31SF. Wilson Sonsini represented Alphabet in the negotiations and litigation arising out of the decision to issue its Class C shares.

[6] No. CV 2021-0560-PAF, 2022 WL 3009959 (Del. Ch. July 29, 2022).

[7] The case in the Delaware Supreme Court which set forth this standard was Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014), *overruled in part by* Flood v Syntura Int'l, Inc., 195 A.3d 754 (Del. 2018).

[8] *MFW* required that the following conditions must be met for the business judgment rule to apply: "(i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority." *Id.* at 645.

[9] *Id.*

[10] *See, e.g.*, Robert Jackson, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. SEC. & EXCH. COMM'N (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty#.

fails to meet the *MFW* standard in connection with its decision to extend its dual class structure, judicial review is likely to involve an entire fairness analysis.[11] However, dual class extensions present a novel issue for the application of the entire fairness standard. Unlike the cases for which entire fairness was created and is typically employed—i.e., those involving the valuation of a company in a squeeze-out merger, a transaction, or a business opportunity—here, entire fairness would involve an assessment of the terms of any extension and weighing of the extension terms against the potential effect on the company of continuing the dual class structure.[12] Whether or not such an exchange is "fair" under Delaware law, it is a non-quantifiable event. In other words, the value of such a trade is not quantitatively measurable. It is also bespoke; the value of a dual class structure is firm-specific, and each negotiated extension will contain different terms and procedures. Thus a comparative analysis on a qualitative basis by a court will be difficult, if not impossible.

The legal and practical uncertainty of how Delaware law will treat sunset extensions has two adverse effects at the initial public offering (IPO) stage. The first is a classic lemons problem.[13] Because shareholders do not know *ex ante* whether there will be an attempt at an extension or how the extension will be treated under Delaware law, they are likely to address this uncertainty by discounting all dual class companies. Second, because insiders cannot predict the difficulty of extending a sunset, they are likely *ex ante* to implement longer term sunsets than they otherwise would, leading dual class structures to persist in companies for which the structure is no longer appropriate or necessary.

We propose a solution to address these issues as well as the controversy inherent in dual class stock. We argue that companies should identify in their charter the terms and conditions of any potential dual class extension at the time of their IPO. Such terms could designate permissible procedures by which a corporation may extend its dual class structure, including the timing of such an extension, the extent to which the extension requires approval by directors and/or shareholders, and the threshold required for such approval. They could also set forth the substantive grounds on which an extension is permitted. These grounds could, for example, include the company meeting designated metrics such as stock price returns or earnings. An extension could also be conditioned on various non-economic terms such as the continuing commitment of the founder to the company, the development of certain technology, or the company's adherence to specified environmental, social and governance (ESG) criteria.

Our solution is designed to ensure that dual class stock creates the value it is intended to. More specifically, the rationale underlying dual class stock is that a company should be allowed to focus on issues other than stock price; this can include, for example, a visionary founder who steers and perpetuates that vision so long as the founder continues to provide

[11] *See Kahn*, 88 A.3d at 645.

[12] Notably, this impact can be positive or negative. Empirical evidence on the economic impact of dual class voting structures is mixed. *See* Fisch & Solomon, *supra* note 1, at 1061.

[13] *See generally* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

extraordinary value to the enterprise or an AI company that wants to develop a novel technology without putting the power of that technology for sale to the highest bidder.[14] By setting the terms of any extension at the time of the IPO, shareholders will have more concrete expectations of whether, when, and how sunset extensions will occur. Shareholders, at the time of the IPO, will be better informed about the likelihood that such extensions will be beneficial to the company, theoretically leading to more accurate IPO pricing. Setting these terms will also limit the impact of institutional shareholder forces which are inherently biased against these extensions for policy reasons (which we examine further below).[15]

Part I examines the issues behind dual class extensions. Part II examines the recent *Trade Desk* case and its attempt to provide a clear path for such extensions by endorsing the *MFW* procedure. Part III offers and defends our proposed alternative to the twin challenges of *MFW* and the entire fairness analysis (i.e., charter provisions that specify *ex ante* procedures and conditions for sunset extensions).

I. The Growth of Dual Class and the Issue of Sunset Extensions

Dual class stock is a species of capital structure that features high vote and low vote shares. Dual class stock has been in use for decades. For many years, its use was concentrated in family and/or media companies such as Ford or the New York Times. Following Google's IPO in 2004 with a dual class voting structure, dual class structures have become increasingly prominent with technology and emerging growth companies.[16] While the typical allocation is ten votes to one vote, other ratios are utilized; for example, Snap was notable for not issuing any voting shares to the public.[17] At the time of a company's IPO, the high vote shares are

---

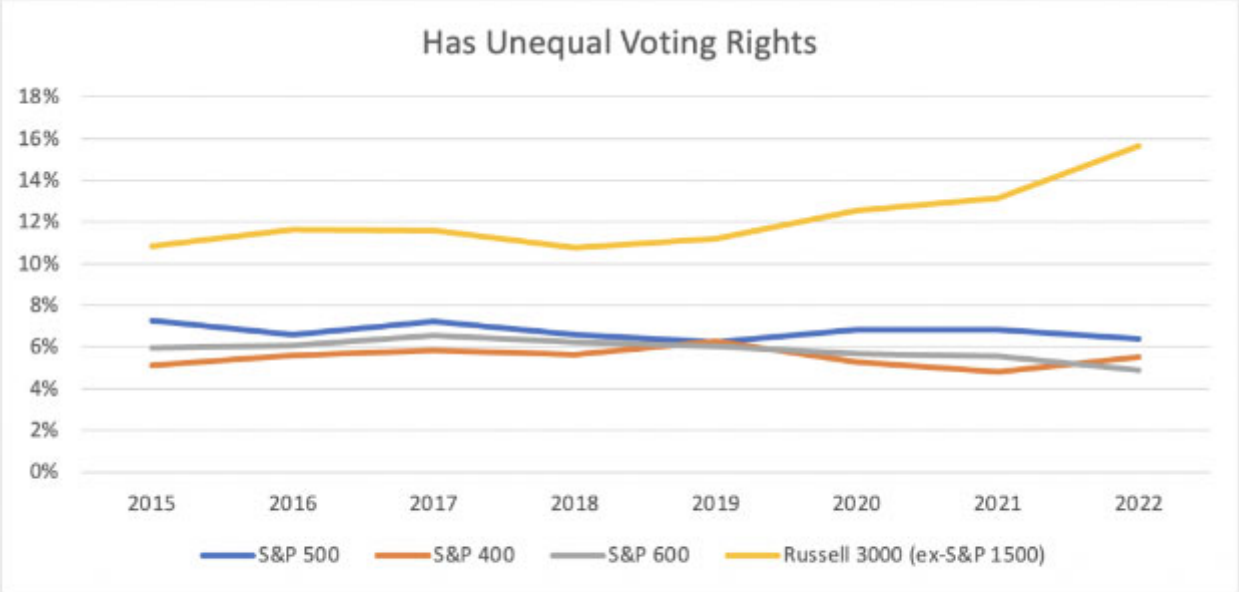
[14] *See* Adi Grinapelli, *Dual-Class Stock Structure and Firm Innovation*, 25 STAN. J.L. BUS. & FIN. 40, 46 (2020) "[T]he desire to protect founders' idiosyncratic vision also drives the decision to [adopt a dual class-structure]"; *see also* Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 ST. JOHN'S L. REV. 863, 871 n.26 (1994) ("An aversion to bidders is thought to be the reasoning behind the introduction of dual-class stock into the capital structure of a firm . . . .") .

[15] We do not take an issue with the policy reasons espoused by institutional shareholders in opposition to dual class stock. Rather, our point in this article is that there may be good reasons why an extension is appropriate, but blanket policies may nonetheless prevent an institutional shareholder from approving such an extension. Nor do we take a normative position on the use of dual class voting structures or sunset provisions. Instead, we take the position in this article that there are quantifiable economic as well as other benefits to both dual class voting structures and sunset provisions depending upon the situation and form. This is in accord with academic studies on this issue. *See, e.g.*, Bobby Reddy, *More than Meets the Eye: Reassessing the Empirical Evidence on US Dual Class Stock,* 23 U. PA. J. BUS. L. 955 (2021) (surveying empirical studies finding that dual-class firms often outperform single-class firms with respect to both stock returns and financial financial performance). We do, however, acknowledge that there are contrary studies. *See, e.g.*, Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 J. FIN. ECON. 325 (2003).

[16] *See* David J. Berger & Laurie Simon Hodrick, *Are Dual-Class Companies Harmful to Stockholders? A Preliminary Review of the Evidence*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 15, 2018), https://corpgov.law.harvard.edu/2018/04/15/are-dual-class-companies-harmful-to-stockholders-a-preliminary-review-of-the-evidence/ [https://perma.cc/R59V-8PLH] (tracing the history of dual class stock).

[17] *See* Benjamin Robertson & Andrea Tan, *Dual Class Shares: Second-Class Investors?*, BLOOMBERG (Jan. 14, 2019, 9:25 PM), https://www.bloomberg.com/quicktake/dual-class-shares (noting that Facebook, LinkedIn, and Snap, among others, have all gone public with dual class structures).

allocated to the founder or a group of founding or controlling shareholders. Through this mechanism, control of the company is preserved.[18] Figure 1 shows the growth in usage of dual class structures in IPOs from 2015 to 2022:



Source: ISS Corporate Solutions Data Analytics, November 2022

Figure 1: Growth of Dual Class Structures in IPOs from 2015 to 2022.

The rise of dual class stock has been controversial. Institutional shareholders have complained that dual class structures unduly disenfranchise public stockholders. Despite these complaints, they continue to buy shares of companies with dual class stock.[19] The Council of Institutional Investors ("CII") has also protested, and it has adopted a policy which prohibits dual class stock.[20] Institutional pressure has therefore led certain index providers to exclude companies with dual class shares; as such, those companies are not included in mutual funds that track those indexes.[21]

---

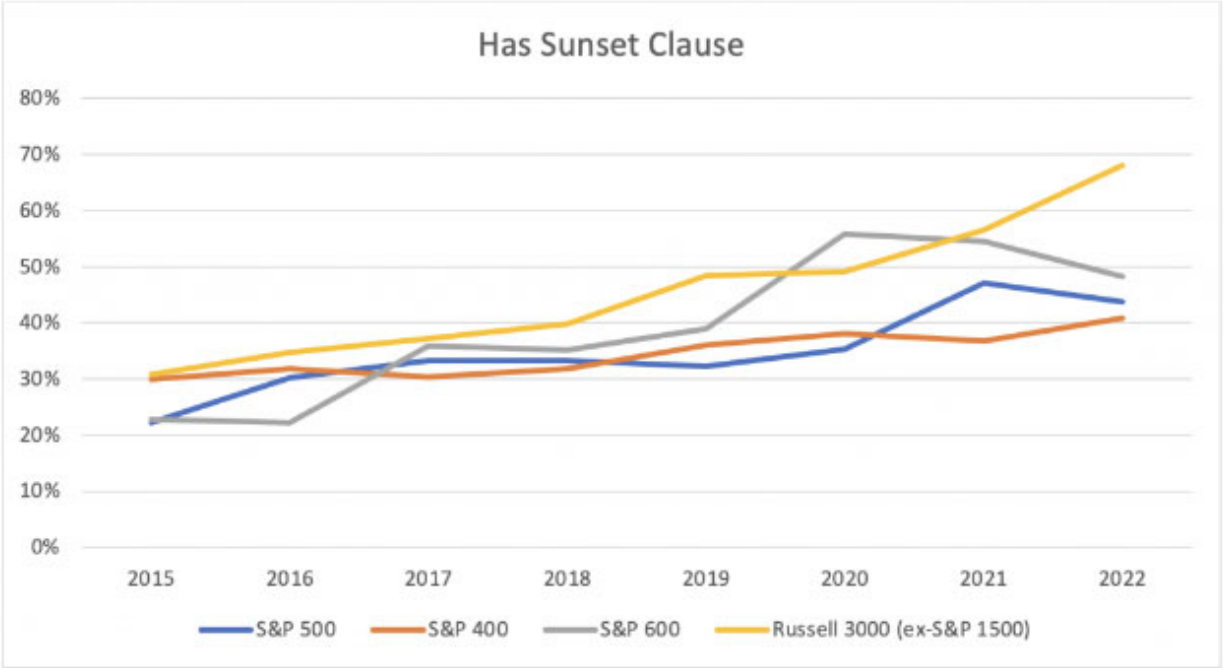
[18] *See* Fisch & Solomon, *supra* note 1, at 1065 ("Founders or other early stage investors use dual class stock to retain control of the firm.")

[19] *See* Steven Davidoff Solomon, *Shareholders Vote with Their Dollars to Have Less of a Say*, N.Y. TIMES: DEALBOOK (Nov. 4, 2015), https://www.nytimes.com/2015/11/05/business/dealbook/shareholders-vote-with-their-dollars-to-have-less-of-a-say.html ("[W]hen push comes to shove, [institutional investors] seem ready to drop the vote for a good I.P.O. deal.")

[20] *See* COUNCIL INSTITUTIONAL INVS., supra note 3 ("CII's policies endorse the principle of 'one share, one vote': every share of a public company's common stock should have equal voting rights.").

[21] *See* Press Release, S&P Dow Jones Indices, S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules (July 31, 2017), https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162_spdjimulti-classsharesandvotingrulesannouncement7.31.17.pdf [https://perma.cc/3ATA-JJZF]. *But see* Rachel Evans, *MSCI Rejects Calls to Ban Dual-Class Stocks from Its Indexes*, BLOOMBERG (Oct. 30, 2018, 5:05 PM), https://www.bloomberg.com/news/articles/2018-10-30/msci-rejects-calls-to-ban-dual-class-stocks-from-its-indexes.

In response to institutional investor demands, companies have increasingly adopted so-called sunset mechanisms. These sunsets provide that, upon the passage of a designated period of time or the occurrence of other specified events, the insider shares will lose their higher voting rights and the company will convert automatically to a one/share one/vote structure.



Source: ISS Corporate Solutions Data Analytics, November 2022

Figure 2: Growth of Sunset Provisions from 2015 to 2022.

Figure 2 highlights the growing usage of sunset provisions, particularly by smaller companies in the Russell 3000. The growth of sunset provisions has been offered as a curative to those who oppose the usage of dual class structures, decrying it as "perpetual royalty."[22] And in this regard, some studies have shown that, on average, the gains for dual class stock accrue during the early years.[23] This has provided further support for sunset provisions.

But the rise of sunset provisions itself raises another issue that companies are beginning to grapple with—when a sunset is triggered, are there circumstances in which the company should nonetheless retain the dual class structure? We term these dual class extensions because they extend the dual class structure beyond the terms initially contemplated in the charter. It is typically controlling shareholders who seek dual class extensions, and they do so in

[22] Jackson, *supra* note 10.

[23] *See, e.g.*, K.J. Martijn Cremers, Beni Lauterbach, Anete Pajuste, *The Life-Cycle of Dual-Class Firm Valuation* 1 (European Corp. Governance Inst., Working Paper No. 550/2018, 2022) ("As firms age, the valuation premium of dual class firms tends to dissipate . . . .").

an effort to perpetuate their control.[24] However, these extensions raise significant doctrinal issues. More specifically, a dual class extension presents the possibility of a classic conflict-of-interest transaction involving a self-interested controller who is obtaining a benefit not shared by minority shareholders. As a result, the extension is subject to entire fairness review.[25] Dual class extensions therefore raise two legal questions: (1) can entire fairness review be avoided through procedural mechanisms, such as those countenanced in *MFW*, and (2) to the extent the corporation does not employ an appropriate procedural mechanism to allow the extension to receive business judgment deference, how should the court analyze the fairness of the extension?

Secondarily, beyond the doctrinal issues are substantive ones. Under what circumstances is an extension appropriate? More specifically, a corporation wishing to extend a sunset provision should be able to demonstrate that such a revision is beneficial to the corporation and its shareholders. While extending the dual class structure and its ability to insulate corporate decisions from short term market pressure may be beneficial, dual class inherently reduces the power of minority shareholders to influence corporate decisions and enhances the potential for controlling shareholder agency costs. From a substantive perspective, it is unclear how to evaluate these competing factors for the purpose of applying entire fairness review.

The recent case of *Trade Desk* illustrates these issues:

In *Trade Desk*, stockholders of The Trade Desk ("TTD") challenged an amendment to the TTD's certificate of incorporation that effectively prolonged the voting control of the Company by TTD's CEO and co-founder, Jeff Green.[26] The parties did not dispute that the amendment was an interested transaction with a controlling stockholder; instead, they simply argued whether the transaction complied with the *MFW* framework, a framework that, if applicable, would have the effect of reducing the level of judicial scrutiny from entire fairness review to the deference of the business judgment rule.[27]

Green, the co-founder, CEO and chair of TTD, owned fifty-five percent of the voting stock of the Company through his ownership of both Class A shares (which had one vote per share) and Class B shares (which had ten votes per share).[28] As is typical, Class B shares were automatically converted to Class A shares once they were sold or transferred, thereby losing

[24] Notable instances include Google and Facebook.
[25] *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (explaining that when a controlling shareholder receives a benefit to the detriment of a minority shareholder, it is a self-dealing transaction); Eng. v. Narang, No. CV 2018-0221-AGB, 2019 WL 1300855, at *6 (Del. Ch. Mar. 20, 2019), *aff'd* 222 A.3d 581 (Del. 2019) (explaining that a controlling shareholder must engage in a self-dealing transaction for entire fairness review to apply).
[26] *Trade Desk*, 2022 WL 3009959, at *8. Wilson Sonsini represented The Trade Desk's founder, Jeff Green, in negotiating the charter amendment and in the subsequent litigation.
[27] *Id.* at *11.
[28] *Id.* at *2.

their higher voting rights.[29] In addition, TTD's charter contained a dilution-based sunset. Under the charter, all Class B shares would be converted to Class A shares once "the number of outstanding shares of Class B common stock represents less than ten percent (10%) of the aggregate number of shares of the then outstanding Class A common stock and Class B common stock" (the "Dilution Trigger").[30]

Green owned ninety-eight percent of the Class B shares.[31] The number of Class B shares declined after the IPO as Green sold some of his shares under a 10b5-1 trading plan.[32] In addition, as the company continued to grow it continued to issue Class A shares to new and current employees.[33] As a result, the number of outstanding Class B shares continued to decline as a percentage of the Company's total outstanding stock.[34] By March 31, 2020, the Class B common stock constituted 11.2% of the Company's total outstanding Class A and Class B common stock.[35] Because the company was continuing to grow and issue new Class A stock to new and current employees, it appeared that the Dilution Trigger would be met by the end of 2020 or early 2021 even if Green stopped all sales of his stock.[36]

To consider the potential implications of this result and having recognized that an effort to preserve the dual class structure might involve a potential conflict between Green's interests and those of the minority public shareholders, the Board formed a special committee and empowered it to evaluate a potential amendment to the Company's charter to extend the Company's dual class structure.[37] The committee retained independent legal and financial advisors to assist it in its evaluation of the various alternatives and in any negotiations.[38] Green and the Company also each had separate counsel.[39]

After negotiations between the Committee and Green, the Committee and Green reached agreement on amendments to the Class B stock that eliminated the Dilution Trigger in favor of a term and event-based sunset clause whereby the Class B stock would be eliminated after five years or if Green was removed as CEO.[40] In addition, the Committee and Green agreed to several additional governance changes that had the effect of giving more rights to the Class A shareholders.[41]

---

[29] *Id.*
[30] *Id.* (quoting TTD Certificate Art. IV(C)(3)(c))
[31] *Id.*
[32] *Id.* at *3.
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.* at *4.
[38] *Id.* at *4-5
[39] *Id.*
[40] *Id.* at *6.
[41] *Id.*

The full board ultimately approved these amendments, and on October 27, 2020, the Company sent shareholders a proxy statement seeking approval of the amendment at a special meeting to be held on December 7, 2020. [42] The December 7 meeting was adjourned to allow the Company to continue discussions with stockholders, and the amendments were ultimately approved by fifty-two percent of the unaffiliated shares on December 22, 2020.[43]

In June 2021, Plaintiff filed his complaint alleging breach of fiduciary duty against Green in his capacity as a controlling stockholder, as well as against the Company's officers and directors.[44] The parties agreed that the cleansing procedure accepted by the Delaware Supreme court in *MFW* potentially applied to this transaction.[45] To obtain business judgment rule review instead of entire fairness under *MFW*, the controller must show that (1) the controller conditioned the transaction at the outset on the approval of both a Special Committee and a "majority of the minority" vote of the stockholders (2) the Special Committee was independent (3) the Special Committee was empowered to freely select its own advisors and to say no to the transaction (4) the Special Committee met its duty of care in negotiating a fair price; (5) the vote of the minority was informed and (6) there was no coercion of the minority.[46] Plaintiff alleged that two of the requirements of *MFW* were not satisfied: (1) the Special Committee was not independent (element two) and (2) the stockholder vote was uninformed (element five).[47]

The court first examined plaintiff's claims that the Committee was not independent. Plaintiff argued that (1) the chair was not independent because of the compensation she had received from TTD as a consultant in 2016 and as a director in 2019 and 2020 and (2) the committee operated under a "controlled mindset" because "no independent fiduciaries acting in good faith would take affirmative action to perpetuate a dual class structure when the company and minority investors have an imminent opportunity to eliminate a super-voting class of stock."[48]

The court rejected both arguments. As to the chair's independence, the court determined that plaintiff failed to include any allegations showing that the compensation was material to the committee's chair.[49] Further, even if the compensation was material and the chair was not independent, the complaint failed to include any facts supporting a finding that a majority of the committee was not independent or so dominated by the chair as to undermine the integrity of the committee as a whole.[50]

---

[42] *Id.* at *7.
[43] *Id.*
[44] *Id.* at *8.
[45] *Id.* at *11.
[46] *Id.* at *10 (citing *Kahn*, 88 A.3d at 645).
[47] *Id.* at *11.
[48] *Id.* at *12, *15.
[49] *Id.* at *13.
[50] *Id.* at *14.

The court also found that plaintiff's "'controlled mindset' assertion [was] not supported by any well-pleaded allegations that the Special Committee members were beholden to Green," or that they agreed to the extension to ingratiate themselves with Green.[51] The court rejected plaintiff's argument that agreeing to extend the dual class structure demonstrated a lack of independence, finding that "a director could believe in good faith that it is generally optimal for companies to be controlled by their founders and that this governance structure is value-maximizing for the corporation and its stockholders."[52] The court concluded that

> [a]t bottom, plaintiff's challenge to the Special Committee is grounded in plaintiff's belief that maintaining the dual-class structure through the Dilution Trigger Amendment was a bad deal for TTD stockholders. Maybe it was, but the Delaware Supreme Court has clarified that this court's role in applying the *MFW* framework is limited to a process analysis, not second guessing the ultimate "give" and "get": "To lard on to the due care review a substantive review of the economic fairness of the deal approved by a special committee, as the plaintiff advocates, is to import improperly into a due care analysis the type of scrutiny used in entire fairness review and in appraisal cases."[53]

Plaintiff also claimed that the shareholder vote was uninformed because the Company's proxy statement failed to disclose six material facts.[54] The court recognized that while the question of materiality is a "context-specific inquiry," the six alleged omissions, individually and collectively, relating to such issues as Green's alleged desire to sell class B stock, the Special Committee's efforts to obtain stockholder support, and the consideration by the Board's compensation committee of a mega stock option grant to Green did not result in an uninformed vote.[55] Accordingly, the court concluded that *MFW* was satisfied, the business judgment rule applied and plaintiff did not, and could not, satisfy the pleading requirements to overcome the protections of the business judgment rule.[56]

II. Theoretical and Economic Background of Dual Class Extensions

Trade Desk provides a doctrinal road map for using the MFW procedure to implement a dual class sunset extension. However, as we detail below, *Trade Desk*, while addressing the immediate issue of the proper standard of review for such extensions, may not fully address the economic and institutional issues surrounding these extensions. In this section, we further address these issues.

---

[51] *Id.* at *15.
[52] *Id.* (quoting United Food & Commercial Workers Union & Participating Food Indus. Empls. Tri-State Pension Fund v. Zuckerberg, 250 A.3d 862, 895 (Del. Ch. 2020), *aff'd*, 2021 WL 4344361 (Del. Sept. 23, 2021)).
[53] *Id.* (quoting *Synutra*, 195 A.3d at 756).
[54] *Id.* at *20.
[55] *Id.* at *23.
[56] *Id.*

Subsection 1 discusses the potential challenges associated with applying the *MFW* procedure to sunset extensions, and, in particular, the problems with obtaining shareholder approval in light of institutional investor opposition to dual class structures. Subsection 2 addresses the challenges associated with judicial application of entire fairness review of sunset extensions in the absence of an effective *MFW* procedure. Subsection 3 sets forth our analysis of the implications of these challenges at the IPO stage for issuers with dual class structures.

1. The Problem of *MFW*

Trade Desk applied the *MFW* standard to assess the validity of a dual class extension. MFW offers a roadmap by which an issuer can comply with a variety of *ex ante* procedures to avoid entire fairness review of a conflict-of-interest transaction.[57] The Delaware Supreme Court in *MFW* adopted that roadmap in the context of a controlling shareholder freeze-out.[58] The principle underlying *MFW* is that the standard is designed to mimic arms-length bargaining. More specifically, *MFW* contemplates that the process it sets forth in the standard of review will replicate negotiations with an arms-length third party because, among other requirements, a special committee advised by independent advisors must be empowered to bargain with the controlling shareholder.[59] As part of this process, the value of the company will be determined by independent advisors using a variety of different methodologies, summaries of which are required to be provided to the minority shareholders when they consider whether or not to approve the transaction.[60] The minority shareholders will then have the ability to vote on whether or not the freeze-out will occur. Subsequently, the Delaware courts have reasoned that *MFW* procedures can be used in other transactions involving a controlling shareholder and a potential conflict of interest.[61] The *Trade Desk* decision is consistent with this approach.

The *MFW* procedure, however, has potential challenges and was never designed to cover every transaction with a controlling shareholder. In particular, *MFW* requires that the transaction be conditioned on approval by the special committee and a majority of disinterested shareholders *ab initio*. It limits the role of the controlling shareholder in the process and prohibits that shareholder's direct participation in negotiating the transaction. *MFW* further requires that the special committee be sufficiently independent as well as a detailed inquiry into the scope of its authority. For companies with a controlling shareholder, all

[57] *See Kahn*, 88 A.3d at 645.
[58] *Id.* Prior to the decision, Delaware case law required entire fairness review in all controlling shareholder mergers. Itai Fiegenbaum, *The Controlling Shareholder Enforcement Gap*, 56 AM. BUS. L.J. 583, 589 (2019).
[59] *Kahn*, 88 A.3d at 645.
[60] *Id.* at 653-54 (applying this standard to the case).
[61] See, e.g., IRA Tr. FBO Bobbie Ahmed *ex. rel.* Class A S'holders of NRG Yield, Inc. v. Crane, No. CV 12742-CB, 2017 WL 6335912, at *11 (Del. Ch. Dec. 11, 2017), *as revised* (Jan. 26, 2018), *opinion revised and superseded sub nom*. IRA Tr. FBO Bobbie Ahmed v. Crane, No. 12742-CB, 2017 WL 7053964 (Del. Ch. Dec. 11, 2017) (applying *MFW* to reclassification); *In re* Ezcorp Inc. Consulting Agreement Derivative Litig., No. CV 9962-VCL, 2016 WL 301245, at *28 (Del. Ch. Jan. 25, 2016), *reconsideration granted in part* (Feb. 23, 2016), *appeal denied sub nom*. MS Pawn Corp. v. Treppel, 133 A.3d 560 (Del. 2016), *appeal denied sub nom*. Roberts v. Treppel, 133 A.3d 560 (Del. 2016) (applying *MFW* to advisory services agreement); Tornetta v. Musk, 250 A.3d 793 (Del. Ch. 2019) (holding that *MFW* process could apply to compensation agreement between issuer and CEO/controlling shareholder).

those requirements are potentially fraught, leaving transactions subject to entire fairness review.[62]

We focus here, however, on a separate issue, the requirement of disinterested shareholder approval. *MFW* contemplates that disinterested shareholder approval will limit controlling shareholder self-dealing because minority shareholders will vote in their own economic interests. In the context of dual class extensions, however, that assumption is subject to two important limitations.

First, institutional investors, which make up the overwhelming majority of most public companies, have forcefully adopted one-vote one share policies.[63] As one commentator explains: "leading mutual funds and public pension funds, such as Fidelity, Vanguard, California Public Employees' Retirement System ("CalPERS"), and California Teachers Retirements System ("CalSTRS"), have committed to corporate governance guidelines that oppose all dual-class structures."[64] As an institutional matter, these shareholders, who collectively own a substantial portion of the shares of most publicly-traded companies, are unlikely to vote to extend a sunset provision. This is particularly true for a term-based sunset where institutional shareholder policies have, in general, supported these term limits.[65] But even for other types of extensions, such as the one in *Trade Desk*, approval is uncertain. In *Trade Desk*, a bare majority (fifty-two percent of the minority shareholders) approved the extension, and the company was only able to obtain that vote after delaying the shareholder meeting from its initially scheduled date.

The result is that while *MFW* is a road map for a dual class extension, it is a road map with inherent roadblocks. Consequently, companies will be biased against extending sunsets. While this may be a net benefit for those who are ideologically opposed to extensions of sunset provisions, it means that in the case of a beneficial extension, institutional considerations may prevent such an extension. Obstacles to dual class extensions also potentially impact the initial terms of the dual class structure, an issue to which we return in subsection 3 below.

2. Entire Fairness and Sunset Extensions

---

[62] *See, e.g.*, Christopher B. Chuff, Joanna J. Cline, and Matthew M. Greenberg, MFW *Pitfalls: Bypassing the Special Committee and Pursuing Detrimental Alternatives*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 30, 2020), https://corpgov.law.harvard.edu/2020/06/30/mfw-pitfalls-bypassing-the-special-committee-and-pursuing-detrimental-alternatives/ (describing potential pitfalls of *MFW* cleansing); *In re* Dell Techs. Inc. Class V S'holders Litig., No. CV 2018-0816-JTL, 2020 WL 3096748 (Del. Ch. June 11, 2020) (rejecting the application of *MFW* at the pleading-stage).

[63] *See, e.g.*, Danielle A. Chaim, The Corporate Governance Cartel, (manuscript at 4), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4324567 ("Over the last five years or so, a large group of institutional investors, including prominent asset management institutions, pension funds, and union-related funds, have joined forces against issuers of dual-class stock").

[64] Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. REV. 1229, 1236 (2019).

[65] *See, e.g.*, Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 COLUM. BUS. L. REV. 852, 870 (2018) ("[M]ost institutional investors and proxy advisors . . . insist that dual-class companies must adopt reasonable sunset provisions.")

As noted above, if *MFW*'s procedures are not followed, then the court applies an "entire fairness" analysis to evaluate a transaction involving a controlling shareholder.[66] Entire fairness analysis requires the court to evaluate whether there is fair price and a fair process.[67] In the deal context, price is the predominant characteristic.[68] This approach is logical—in a freeze-out transaction, there are several quantifiable financial options: the transaction with the controlling shareholder, alternative transactions, or the minority retaining its existing stake in the company. Making valuation determinations with the help of expert advisors fits well into the *MFW* framework, and financial advisors are well-versed on the task of determining whether a deal is fair from a financial perspective.[69]

In a situation like in *Trade Desk*, the benefit of extending founder control is much more difficult to value. As Zohar Goshen and Assaf Hamdani have convincingly argued in a perceptive article: "Similar economic models for valuing the reallocation of control rights simply do not exist."[70]

We agree and put forth these valuation issues in the context of three factors also discussed by Professors Goshen and Hamdani. First, despite the considerable attention paid to such issues as dual class stock and various defensive measures, commentators continue to debate, and disagree on, the question of whether dual class structures create value, limit value, or have no impact on the value of the corporation.[71] Second, a dual class extension involves both a give and a get. In *Trade Desk*, the founder traded a waiver of the dilution sunset for a term sunset.[72] Thus, fairness analysis requires both valuing and weighing the give against the get. Third, the value of a sunset extension depends on unique firm-specific features including

---

[66] *See Crane*, 2017 WL 7053964, at *9 (concluding that a reclassification under which the controlling stockholder ensured that it would retain voting control "well into the future" was presumptively subject to entire fairness review).

[67] *See Kahn*, 88 A.3d, at 645 (listing the factors that must be met for the business judgment standard of review to apply).

[68] *Id.* (identifying price as a critical point).

[69] *See, e.g.*, Zohar Goshen & Assaf Hamdani, *Corporate Control, Dual Class, and the Limits of Judicial Review*, 120 COLUM. L. REV. 941, 946 (2020) ("Economists have developed valuation models for many types of cash-flow rights, like specific assets and entire companies, that aid courts in determining fair price.").

[70] *Id.*

[71] *See, e.g.*, Michael L. Lemmon & Karl V. Lins, *Ownership Structure, Corporate Governance, and Firm Value: Evidence from the East Asian Financial Crisis*, 53 J. FIN. 1445, 1447 (2003) (finding lower stock returns in firm in which managers have "separated their control and cash flow ownership"); Karl V. Lins, *Equity Ownership and Firm Value in Emerging Markets*, 38 J. FIN. & QUANTITATIVE ANALYSIS 159, 181 (2003) (finding lower firm values "[w]hen managers have control rights that exceed their proportional ownership"). *But see* Dimitris Melas, *Putting the Spotlight on Spotify: Why Have Stocks with Unequal Voting Rights Outperformed?*, MSCI (Apr. 3, 2018), https://www.msci.com/www/blog-posts/put ting-the-spotlight-on/0898078592 (reporting research showing that "unequal voting stocks in aggregate outperformed the market over the period from November 2007 to August 2017, and that excluding them from market indexes would have reduced the indexes' total returns by approximately 30 basis points per year over our sample period"). *See generally* Reddy, *supra* note 15 (summarizing empirical research on the impact of dual class structures on a corporation).

[72] 2022 WL 3009959, at *6.

the nature of the issuer and the identity of the founder. Traditional valuation techniques such as comparable companies analysis are likely to provide limited insight.

This is of course not to say that it is impossible to evaluate a sunset extension using entire fairness. The analysis would, however, raise distinctive challenges, particularly given the firm-specific nature of each situation. We note that even within the context of the more traditional evaluation of company value, the Delaware courts have struggled to identify the most appropriate approach.[73] Accordingly, a *post hoc* entire fairness analysis introduces, at a minimum, litigation risk and uncertainty into the sunset extension process.

3. Implications at the IPO stage—Lemons and Incentive Issues

The existence of a sunset provision and possibility of an extension creates issues at the IPO stage, issues that are exacerbated by the litigation uncertainty described in the preceding subsection.

The first issue concerns shareholder analysis of a dual class structure at the time of the IPO. At the IPO stage, shareholders face two unknowns. First, shareholders do not know the impact of the dual class structure. As noted above, the results of empirical studies of dual class have been mixed. It is not clear if a dual class structure is likely to be beneficial to a company or not. The conditions necessary to impact that effect are also uncertain. Specifically, information asymmetries at the IPO stage make it difficult for shareholders to analyze the extent to which a founder's idiosyncratic vision is likely to be realized as well as the potential trade-off between insulating the company from market discipline in order to realize that vision and the potential agency costs that may arise from that insulation.

Similar uncertainties affect shareholder ability to evaluate a dual class sunset provision at the IPO stage and, in particular, the extent to which the company will economically benefit or be hurt by such a provision. More specifically, for IPO charters that contain a term-based sunset provision, shareholders would have to predict the extent to which a founder's continued maintenance of control at the time of the sunset will benefit the enterprise, whether economically or otherwise. But given the length and term of sunset provisions—which range from three to twenty years—this cannot be known at the IPO stage.

Given this, the purchaser of shares at the IPO cannot neither assign an economic benefit nor detriment to the sunset. If the purchasers of IPO shares know that the sunset will be economically beneficial, they will price in the sunset and provide a higher value to the stock.

---

[73] *Compare* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd, 177 A.3d 1, 23 (Del. 2017) (holding that a reliable valuation requires a court to consider all facts and use relevant, accepted financial principals), *and* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128, 130 (Del. 2019) (finding deal price minus synergies to be the most reliable indicator of fair value), *with In re* Appraisal of Jarden Corp., No. CV 12456-VCS, 2019 WL 3244085, at *2 (Del. Ch. July 19, 2019), *on reargument in part sub nom*. *In re* Jarden Corp., No. CV 12456-VCS, 2019 WL 4464636 (Del. Ch. Sept. 16, 2019), *aff'd sub nom*. Fir Tree Value Master Fund, LP v. Jarden Corp., 236 A.3d 313 (Del. 2020) (using the unaffected market price as the most reliable indicator of fair value).

Conversely, if the purchasers of IPO shares know the sunset will hurt the company, they will assign negative value to it. In the absence of such knowledge, a lemons effect occurs, and all companies are likely to be treated equally. In other words, shareholders, especially institutional investors who are the largest purchasers of IPO shares, are likely to discount dual class companies across the board based on their ideological view that the dual class structure will be harmful. This gives an undue benefit to underperforming companies and a unfairly penalizes overperforming companies.

The same issue arises with sunset extensions. As the company nears the expiration of its dual class structure, shareholders are typically unaware as to whether or not the company will seek an extension of its sunset provision. However, shareholders can assess the extent to which the dual class structure has succeeded or failed thus far. This is true even though the performance and engagement of the company and founder cannot be disentangled from the effect of the sunset provision. In other words, the performance of the company may or may not be due to the existence of the sunset provision, but shareholders will not be able to assess the value of the dual class structure independently.

Regardless, without knowing whether or not the sunset provision will be extended, shareholders are likely to assume that it will take effect due to the issues outlined below. The consequence, once again, is that all companies will be assigned the same value whether or not the sunset provision is beneficial for them. The net effect of this is that shareholders are unable to price the effect of a sunset provision both at the IPO and as the time of sunset nears. To be sure, it can be argued that this is a minor corporate governance feature that is likely not priced at all.[74] But we think that issues of control are typically priced in stock at the IPO level and amidst midstream changes. Indeed, research has shown that this is the case for both dual class stock and other control mechanisms.[75] In addition, we acknowledge that this is a problem faced with other corporate governance mechanisms. However, because this affects issues of control, and is likely to become a repeated issue as dual class sunsets take effect, we believe that addressing it is economically worthwhile.

---

[74] *See, e.g.,* Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783-827 (2009) (examining corporate governance provisions and finding that many do not affect firm value as measured by Tobin's Q); David J. Berger & Laurie Simon Hodrick, *Are Dual-Class Companies Harmful to Stockholders? A Preliminary Review of the Evidence*, HARV. L. SCH. F. ON CORP. GOV. (Apr. 15, 2018), https://corpgov.law.harvard.edu/2018/04/15/are-dual-class-companies-harmful-to-stockholders-a-preliminary-review-of-the-evidence/ (examining dual class stock and finding that "our analysis also raises fundamental questions about how much value shareholders perceive in having voting stock versus non-voting stock in these relatively new to market technology companies.").

[75] *See, e.g.*, Scott B. Smart, Ramabhadran S. Thirumalai, & Chad J. Zutter, *What's in a Vote? The Short- and Long-Run Impact of Dual-Class Equity on IPO Firm Values*, 45 J. ACCT. & ECON. 94, 96 ("The data show that firms choosing voting-right structures that favor management face a significant and persistent valuation discount in the market, even after controlling for the endogenous choice to go public with dual-class equity. This valuation gap persists while controlling for cross-sectional differences in industry valuation multiples as well as firm-specific attributes including growth, profitability, and leverage.").

A second IPO stage problem concerns the impact of the legal and practical uncertainty of sunset extensions on the initial terms of dual class structures. As a practical matter, company founders who wish to retain control may reasonably predict that extending an existing sunset provision will be difficult. As a result, they have an incentive to bargain for as much protection of the dual class structure as they can reasonably obtain *ex ante* rather than taking the risk that they will be unsuccessful in a midstream effort for greater protection. So, for example, a founder who reasonably believes that he can realize his idiosyncratic vision in seven years might instead seek a fifteen year term sunset because, if his prediction is overly optimistic, his chances of obtaining a sunset extension at a later date are poor.

These concerns are highlighted in an IPO market in which the extent to which dual class structures contain sunset provisions and the terms of those sunsets vary extensively. Even if the market prices dual class stock, it is difficult to imagine that the market can efficiently price this variation. At least in some cases, shareholders may be left with lesser control rights than they would have had if the founder were more confident in his ability to obtain a midstream sunset extension, should such an extension prove beneficial to the company.

III. A Proposed Solution

Other commentators have weighed in on the problem of dual class extensions. Goshen and Hamdani propose a simple solution: that such extensions be evaluated under a business judgment rule analysis rather than an entire fairness standard. Their proposal has the advantage of relieving the court of the impossible task of applying entire fairness scrutiny to the extension. Its principal weakness, however, is the scope of discretion it gives to the founder, discretion which, we argue, contributes to investor uncertainty and heavy discounting at the IPO stage. A system that provides greater certainty as to the circumstances under which a dual class structure can be extended would reduce this uncertainty.

Caley Petrucci evaluates a different component of dual class—the role of equal treatment provisions.[76] Such provisions, which are typically included in dual class charters, delineate the circumstances under which the holder of high vote shares can or cannot receive differential treatment.[77] Although commentators tend to focus on the charter requirement that all shares be treated equally, Petrucci observes that unequal treatment provisions can be beneficial both in providing predictability and giving controllers the incentive to structure transactions in ways that benefit all shareholders.[78] Structural commitments to unequal treatment also reduce controller incentives to attempt to evade the equal treatment requirement through external mechanisms such as employment-based compensation.[79]

---

[76] Caley Petrucci, *Equal Treatment Agreements: Theory, Evidence & Policy*, YALE J. REG. (forthcoming 2023), https://ssrn.com/abstract=4027138 (discussing the limits of equal treatment agreements and the increasing role of unequal treatment provisions).

[77] *Id.* at 2.

[78] *Id.* at 7-9.

[79] Unlike in the case of dual class extensions, there have been extensive practices developed in addressing the differential treatment of a controlling shareholder in a sale transaction. *See* Steven M. Davidoff (Solomon), *Finding*

Petrucci's analysis about the value of *ex ante* predictability can be extended beyond the scope of mergers. We similarly propose that the issues with dual class extensions be solved at the IPO stage. More specifically, we propose that, when a company goes public with a dual class voting structure that is subject to a sunset provision, the mechanics and standards for a sunset extension be set forth in a company's charter at the time of an IPO.

We believe this solves multiple problems and addresses the problem of controller rent-seeking that would occur if the business judgement rule applied instead. First, we envision that the extension provision would set out substantive metrics that would justify extension of the sunset. These would be metrics that presumably reflect that the company has received the anticipated economic benefits of dual class—namely that control over the long term has allowed the company to succeed.

Such metrics would presumably be performance based: has the founder achieved the idiosyncratic results expected at the time of IPO? We believe that in this regard, provisions based on market capitalization or earnings metrics such as EBITDA could be appropriate, as well as other metrics set forth by the founder in the founder's letter.[80] Metrics could also be based on sustained out-performance against a peer group (although this may be more challenging given the changing nature of peers and competitors). We also believe that in the case of single product companies, such as an automotive maker or pharmaceutical company, operational milestones might be appropriate. The key here is that the founders, working with the pre-IPO company's board and other stakeholders, would be in a position to set forth metrics, in the company's charter, to determine whether or not it is appropriate to extend the sunset provision.

We also believe that the charter, at the time of the IPO, should set out the mechanics of an extension. In some cases, the extension could be automatic; for example, the dual class structure extends for a specified period of time if the designated substantive metrics are met. Alternatively, the charter could designate procedural mechanisms for an extension decision either on the basis of substantive metrics or in the absence of substantive criteria. One option would be for the designated procedures to follow the contours of *MFW* (and supersede its application). However, we also view this as a means to simplify, relative to the procedures set out in *MFW*, the procedures for such an extension. Indeed, a developing body of LLC and LP law has developed firm-specific procedures as a substitute for applying entire fairness review to conflict-of-interest transactions.[81] We envision an approach that would enable an issuer to

---

the Real Issues in the ACS Deal, N.Y. TIMES: DEALBOOK (Oct. 2, 2009), https://archive.nytimes.com/dealbook.nytimes.com/2009/10/02/finding-the-real-issues-in-the-acs-deal/ (discussing the law and practices in treatment of differential consideration payments to a controller in an M&A transaction).

[80] Such letters are typically provided to shareholders at the time of the IPO and may include a variety of non-financial metrics.

[81] See, e.g., Dieckman v. Regency GP LP, 155 A.3d 358, 369 (Del. 2017) (holding that limited partnership agreement could substitute procedural safe harbors for duty of loyalty analysis in conflict-of-interest transactions).

identify such procedures that might include independent committee approval, shareholder approval, specific terms for an extension, and so forth, but which would not be limited to the procedures which would satisfy the *MFW* standard.

Given the unique issues of applying *MFW* to a dual class extension, we believe that this will create a natural force that incentivizes the pre-IPO company to focus on what is important to the company and how to measure those priorities at the time the company is going public. It is also a solution which is likely to be economically superior. The process of defining the terms for a sunset extension at the time of an IPO would provide shareholders with greater information about the likelihood of a sunset extension—both in terms of who would control the extension decision and the circumstances under which it would occur. Limiting the potential for a sunset extension would therefore reduce the lemons problem at the IPO stage. By setting out in the charter conditions under which an extension could occur, our proposal also reduces the incentive for founders to bargain for excessive insulation *ex ante* (including insulation that may not be value-enhancing).

Predictability would be further enhanced if the IPO charter sets out the length of any proposed sunset extension. The charter could allow for multiple extensions or maintenance of the dual class so long as certain metrics are met over a long-term period. It could also provide for differing extension lengths based on the criteria that trigger the sunset (e.g., depending on whether it is triggered by a term-based versus dilution-based provision).

Ultimately, we believe that these provisions will engender greater pricing certainty for company stock prices as well as provide a roadmap for dual class extensions when the board (and shareholders) deem such extensions to be economically beneficial. These proposals are consistent with the contractual nature of the corporation and Delaware's endorsement of *ex ante* bargaining and agreements among shareholders and corporations. Significantly, our proposal also affords issuers the opportunity to seek sunset extensions under conditions that are not laid out in the charter. But as with partnership law, because such extensions present a potential conflict of interest, extensions that fall outside the scope of the charter would require either full compliance with *MFW* or would be evaluated under entire fairness.

Conclusion

The prevalence of dual class capital structures with a variety of sunset provisions poses a lurking problem for corporate law: how should courts evaluate issuer efforts to extend dual class in light of a sunset trigger? The question is complicated by competing concerns—i.e., the substantial potential for controlling shareholder agency costs and the recognition that the factors that trigger a sunset provision are frequently arbitrary. Because courts increasingly evaluate sunset extensions under an entire fairness analysis, the transactions present a degree of legal risk and unpredictability that is potentially problematic in corporate law.

Drawing up the increasingly contractual approach to Delaware corporate law, we offer a solution to the problem of sunset extensions: identification in the corporate charter of

substantive and procedural justifications for sunset extensions. Compliance with the charter provisions would provide a safe harbor from entire fairness review. It would also allow a body of precedent and practice to build, thereby providing measurable metrics by which the courts can assess dual class extensions outside of charter provisions. Ultimately, we believe that charter provisions providing procedures for dual class extensions are likely to enhance the value and use of sunset provisions keyed more specifically to the attributes of the company which justify such provisions.

about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities.*

The ECGI will produce and disseminate high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It will draw on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

Electronic Access to the Working Paper Series

The full set of ECGI working papers can be accessed through the Institute's Web-site (www.ecgi.global/content/working-papers) or SSRN:

Finance Paper Series	http://www.ssrn.com/link/ECGI-Fin.html
Law Paper Series	http://www.ssrn.com/link/ECGI-Law.html