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Misalignment Under the Radar: Stealth Dual-Class Stock

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Executive Summary

Traditional dual-class or multi-class stock structures have received significant attention from market participants because of the disconnect they create between voting rights and economic ownership, thereby insulating company insiders from accountability to the company's owners. However, it is important for investors to understand that companies can deliver substantially similar entrenchment mechanisms without creating multiple classes of common stock or adopting widely understood anti-takeover devices such as poison pills. In fact, there may be an incentive for insiders to achieve the same control enhancing outcomes without adopting a traditional dual-class structure. By doing so, they may receive the private benefits of outsized decision-making power without receiving the negative attention and stock price discount accompanying dual-class stock. This paper reviews nine examples of arrangements that could constitute "stealth dual class": identity-based voting power, side agreements with favored shareholders, stock pyramiding/cross-ownership, umbrella partnerships and C corporations (Up-Cs), employees granting irrevocable proxy voting rights transferred from employees to insiders, golden shares, situational super-class issuances, non-equity votes and vote caps.

Introduction

Dual-class stock structures raise concerns for many investors because of the misalignment they cause between equity ownership and corporate control, and the associated long-term underperformance compared to companies without these structures.[1] In a 2023 paper, we analyzed total stock market returns for companies with both a dual-class structure and a classified board, finding that total returns for these companies underperformed benchmark stock indices.[2]

The essential feature of dual-class structures is disproportionate voting rights compared to economic ownership, violating the "one share, one vote" principle. "Dual-class stock" has traditionally referred to companies with two classes of common shares, a high-vote class and a low-vote class, with the high-vote class being owned by primarily or exclusively by insiders such as founders. However, any corporate governance structure that results in disproportionate voting rights compared to economic ownership raises similar concerns as traditional dual-class structures, regardless of the exact mechanism or design that gives rise to the disproportionate control. Empirical evidence suggests that institutional investors consider voting rights in their investment decisions and invest less money in companies with dual-class structures, controlling for other determinants, and that institutional investors increase their investment in the same companies when they collapse the dual-class structure into one share class.[3]

With attention on dual-class structures from investors, index providers and proxy advisors, there may be an incentive for company insiders to accomplish the same disproportionate influence without adopting a traditional dual-class structure. By taking this approach, they may receive the private benefits of outsized decision-making power without receiving the negative attention and stock price discount accompanying dual-class stock. For example, one company's prospectus includes among its risk factors that "the dual class structure of our common stock may prevent the inclusion of our Class A common stock in such indices [such as the S&P 500], may cause stockholder advisory firms to publish negative commentary about our corporate governance

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[1] As noted in the 2023 publication in note 2, for a broader review of dual-class structures, see Lucian Bebchuk and Kobi Kastiel's The Untenable Case for Perpetual Dual-Class Stock, Virginia Law Review (2017), CII Summaries of Key Academic Literature on Multi-Class Structures and Firm Value, and The Life-Cycle of Dual Class Firm Valuation, European Corporate Governance Institute (2022) by Martijn Cremers, Beni Lauterbach, and Anete Pajuste.

[2] Dual-Class Structures & Classified Boards: Evidence from 2018-2023 by the Council of Institutional Investors Research and Education Fund.

[3] Do Voting Rights Affect Institutional Investment Decisions? Evidence from Dual-Class Firms, Financial Management (2008) by Kai Li, Hernán Ortiz-Molina, and Xinlei Zhao and Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights, Journal of Banking & Finance (2012) by Scott Bauguess, Myron Slovin, and Marie Sushka.

practices or otherwise seek to cause us to change our capital structure and may result in large institutional investors not purchasing shares of our Class A common stock."[4]

In 2019, after a prominent index provider's since-reversed decision to exclude dual-class entrants going forward from certain core indices, the Carlyle Group announced that it was converting from a dual-class company to a single-class company. While the announcement touts that the "[n]ew one-share/one-vote structure will deliver industry-leading governance rights to all shareholders," it also highlights how changing its stock structure would increase its attractiveness "to a broader group of passive and active investors through potential inclusion into indices and benchmarks utilized by more than $7 trillion of industry assets."[5]

In addition to cases where public companies may choose alternative arrangements to adopt dual-class stock to avoid the discounting and exclusion that might accompany a traditional dual-class structure, private equity investors may seek alternatives to dual-class because they have different strategies and incentives than founders. Empirical evidence suggests that private equity investors would prefer contractual rights through shareholder agreements rather than owning dual-class stock.[6] This is likely because of private equity investors' typical plan to exit their investment to redeploy capital elsewhere rather than holding on to the stock in the long-term. One paper concludes that at least 35% of companies that are dual-class in function do not have the traditional design of at least two classes of shares, one with disproportionate voting rights compared to economic ownership, but instead accomplish dual-class outcomes through other approaches.[7]

An alternative view of "stealth dual class" structures is that they represent the legally valid and legitimate exercise of private ordering, allowing companies and investors to tailor their corporate governance structures to the context and needs of a particular company. In this view, customization may foster innovation, and any potential dangers are constrained by market discipline.[8] Others have responded to this view by arguing that stealth dual-class structures

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[4] See this filing: SEC Filing | StepStone Group Inc. (2019). This example, among the others listed in this section, were identified in by Gladriel Shobe & Jarrod Shobe in The Dual-Class Spectrum, Yale Journal on Regulation (2022) and reproduced here from that paper except where otherwise noted.
[5] See The Carlyle Group Announces Conversion to Full C-Corporation Reports Second Quarter 2019 Financial Results.
[6] Ria Sen, Private Equity, Private Ordering, and the Stealth Dual Class, unpublished manuscript.
[7] Gladriel Shobe & Jarrod Shobe in The Dual-Class Spectrum, Yale Journal on Regulation (2022). That paper concludes that stealth dual-class companies make up approximately 35% of all dual-class companies, a figure which includes Up-C structures and the granting of disproportionate control of the board to insiders.
[8] Barry Baysinger & Henry Butler, The Role of Corporate Law in the Theory of the Firm, Journal of Law and Economics (1985).

violate corporate governance norms of standardization, transparency and accountability and are inappropriate for corporations.[9]

This paper reviews nine potential categories of "stealth" dual-class structures.[10]

Stealth Dual-Class Categories

Identity-based Voting

Instead of creating multiple share classes with different voting rights, companies can assign different voting rights based on the identity of the owner of those shares. This was reaffirmed for companies incorporated in Delaware in *Colon v. Bumble, Inc.*,[11] where the Delaware Court of Chancery found that a company's charter can modify the standard requirements for voting rights provided by Delaware law. In the case of Bumble, shares have one vote each, unless they are held by a "principal stockholder"—in that case, the shares have ten votes each. The "principal stockholders" are anyone who was a party to another specific publicly disclosed stockholder agreement, other than the company itself. This approach also allows insiders to freely buy and sell their shares on the public market rather than needing to hold on to a separate class of stock with superior voting rights.

A more well-known application of identify-based voting is tenure-based voting rights, also known as time-phased voting. Shares with such rights entitle the holder to superior voting rights after they are continuously held for a certain period of time. On its face, this may seem to support longer-term investment, but empirical evidence does not support that conclusion. For example, France adopted a tenure-voting system as the default, requiring a supermajority of shareholders to override the default. The average holding period among tenure-voting firms and one-share-one-vote firms is not significantly different before and after the system was implemented.[12,13]

[9] Jill Fisch, Stealth Governance: Shareholder Agreements and Private Ordering, Washington University Law Review (2022).
[10] Lucian Bebchuk, Reinier Kraakman, and George Triantis termed these "controlling-minority structures" in Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights, published in Concentrated Corporate Ownership (Randall K. Morck, editor), University of Chicago Press (2000).
[11] Colon v. Bumble, Inc., Delaware Court of Chancery (2023).
[12] Loyalty Shares with Tenure Voting: Does the Default Rule Matter? Evidence from the *Loi Florange* Experiment, Journal of Law and Economics (2020) by Marco Becht, Yuliya Kamisarenka, and Anete Pajuste.
[13] The Capital Market Consequences of Tenure-Based Voting Rights: Evidence from the Florange Act, Management Science (2022) by Thomas Bourveau, Francois Brochet, and Alexandre Garel. Compare to Encouraging long-term shareholders: The effects of loyalty shares with double voting rights, Finance (2024) by François Belot, Edith Ginglinger, and Laura Starks.

Tenure-based voting rights tend to grant outsized rights to insiders, especially for companies with significant family ownership. In addition to the French companies mentioned above, below are some examples from U.S. companies.

Examples. A 2017 review of U.S. companies found only five current examples of tenure-based voting in the U.S. public markets: Aflac, Carlisle Companies, J.M. Smucker Company, Quaker Chemical Corporation and Synovus Financial Corporation.[14] Of these companies, our review of 2024 proxy statements identified only Aflac as still having tenure-based voting.

Side Agreements

Side agreements between companies and particular shareholders, such as founders or early investors, are generally adopted while a company is private, before its initial public offering. They are not subject to the same disclosure requirements as documents like the company's charter or bylaws, but shape important features of the company's governance and include such documents as voting agreements, stock purchase agreements and investors' rights agreements.[15]

While state law sets certain defaults, most of these default provisions of governance may be modified by companies. As noted by Bainbridge (2006), "Under the Delaware Code […] shareholder voting rights are essentially limited to the election of directors and approval of charter or bylaw amendments, mergers, sales of substantially all of the corporation's assets, and voluntary dissolution."[16]

Rauterberg (2021) notes that corporate law justifies the board of directors' authority over corporate affairs by virtue of the fact that the board is elected by shareholders, but then permits that default to be modified by contract, which is pervasive in private companies.[17] In some ways, these board-nomination rights give certain insider shareholders even greater control than they would have in traditional dual-class companies because they have the right to designate certain members of the board. A company insider who owns high-vote shares but holds no more than 50% of the voting power would not alone have enough power to control any seats on the board.

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[14] David Berger, Steven Solomon, and Aaron Benjamin, Tenure Voting and the U.S. Public Company, Business Lawyer (2017) reacting to Lynne Dallas and Jordan Barry, Long-Term Shareholders and Time-Phased Voting, Delaware Journal of Corporate Law (2015).
[15] Barry Baysinger & Henry Butler, *supra* note 8. Companies may be required to disclose shareholder agreements under different provisions of the federal securities laws or state securities laws.
[16] Stephen Bainbridge, The Case for Limited Shareholder Voting Rights, UCLA Law Review (2006).
[17] Gabriel Rauterberg, The Separation of Voting and Control: The Role of Contract in Corporate Governance, University of Michigan Law and Economics Research Paper No. 20-031 (2021), p. 4. ("Statutory corporate law confers authority over corporate affairs on the board of directors and justifies that authority through the board's election by shareholders. That statutory system makes the election of the board a function of shareholder voting power […] Shareholders, however, can alter these defaults by contract, and in private firms, do so widely.").

Contractual rights to nominate or appoint members of the board effectively guarantee insiders seats on the board, even if they own just a minority stake.

To be sure, not all shareholder agreements deliver control to the contracting shareholder, and in many cases shareholder agreements can facilitate long-term shareholder value. A shareholder agreement that secures one or two board seats for representatives of early investors with "skin in the game" and special skills to offer at a pivotal time in the company's growth is a very different arrangement from a shareholder agreement like the arrangement at issue in *Moelis*, which became the subject of intense litigation and legislation in 2024. The contracting party, founder Ken Moelis, used the agreement to assert veto power over a broad range of board powers, to the extent that the board's oversight function had become pro forma. Investors are charged with determining for themselves which shareholder agreements cross the threshold into "stealth dual class."

In a review of schedule 13D filings from 1996 to 2018, Schoenfeld (2020) found than 24% of these companies with a 5% or greater ownership block had shareholder agreements.[18] A separate sample of 2,100 initial public offerings (IPOs) between 2000 and 2020 also found that 24% of firms went public with shareholder agreements that contained either the right to appoint members of the board of directors or with veto rights overt certain decisions,[19] a much higher prevalence than the number of companies that went public with a traditional dual-class stock structure.[20]

In comparison to dual-class stock structures, which usually seek to grant outsized voting power to founders, shareholder agreements may grant outsized power to others such as private equity investors. In Schoenfeld's sample, board control is granted for an average of 33% ownership of the company, and for less than 10% ownership of the company in almost 25% of these agreements. Sen's analysis of this sample suggests that the market is pricing not just whether a company has dual-class stock structures or shareholder agreements but is differentiating between whether those structures or agreements are for the benefit of private equity companies or for the benefit of founders. It finds that the market reacts negatively to the control by private equity firms. Interestingly, the analysis does not find that this discounting results from worse operating

[18] Jordan Shoenfeld, Contracts Between Firms and Shareholders, Journal of Accounting Research (2020).

[19] Examples include veto rights over acquiring or disposing of assets or entering into joint ventures with a value in excess of $5 million; incurring capital expenditures in any fiscal year in excess of 10% over the amount of capital expenditures provided for in the annual budget; incurring indebtedness for borrowed money; initiating any liquidation, dissolution, bankruptcy or other insolvency proceeding involving any of our subsidiaries; making any material change in the nature of the business conducted by the company or subsidiaries; terminating the employment of the Chief Executive Officer or Chief Financial Officer or hiring a new Chief Executive Officer or Chief Financial Officer; and changing the size or composition of the board of directors.

[20] Sen, *supra* note 6.

performance by companies because firms backed by private equity in this sample had better operating performance than those that did not.

Below are several examples of how the selection and organization of the board of directors may be modified by these agreements.

Example 1. Through shareholder agreements and a combination of partnerships and privately held groups, Jack Ma controls Alibaba despite owning less than 5% of the company.[21]

Example 2. "The Investment Agreements require us to elect or appoint a representative of the Gapstow fund, the Montlake funds and Mr. Hovde to the board of directors […]" Coastal Finance Corp.

Example 3. "[F]or so long as Thoma Bravo beneficially owns in the aggregate at least (i) 30% of our outstanding shares of common stock, Thoma Bravo will have the right to designate the chairman of our board of directors and of each committee of our board of directors as well as nominate a majority of our board of directors." Dynatrace, Inc.

While traditional dual-class stock includes concerns about the entrenchment of insiders such as the CEO, shareholder agreements can accomplish the same outcome on a more direct basis by limiting the removal of board members, the CEO and other key executives.

Example 4. Sotera Health Company has a provision requiring a supermajority board vote for "any termination of the chief executive officer or designation of a new chief executive officer" if certain insider shareholders hold a certain percentage of common stock.

Example 5. Rackspace Tech., Inc. has an agreement requiring the consent of certain insider shareholders who own at least 33% for "hiring or terminating our Chief Executive Officer or our Chief Financial Officer."

Example 6. PlayAGS, Inc. has an agreement requiring approval of an insider shareholder for "a termination of the chief executive officer or designation of a new chief executive officer."

Such agreements may also provide specific veto rights over other shareholders, even at lower levels of ownership.

[21] For a full description of how Jack Ma controls Alibaba, see Jesse M. Fried and Ehud Kamar, Alibaba: A Case Study of Synthetic Control, Harvard Business Law Review (2021).

Example 7. Gatos Silver, Inc. provides veto rights regarding mergers, consolidation or sale of all or substantially all of their assets, or incurrence of more than $100 million of indebtedness and the issuance of more than $100 million of equity securities to certain insiders as long as they own at least 35% of outstanding shares.

Example 8. Livent Corporation's 2018 prospectus provides an insider with veto rights over disposing of assets, issuing equity, acquiring another company, incurring debt, and settling litigation.

Example 9. AXA Equitable Holdings, Inc.'s 2018 prospectus provides an insider veto rights, including over acquisitions, any issuance of stock or debt, forming a new committee of the board, and amending the certificate of incorporation or bylaws.

Example 10. Noodles & Company's 2013 prospectus provides that "[t]he rights of holders of Class A common stock and Class B common stock are identical, except that our Class B common stock does not vote on the election or removal of directors […]"

Creative shareholder agreements used in connection with non-voting stock may also not be subject to reporting obligations that would otherwise apply:

Example 11. Atreca, Inc's 2019 prospectus notes that "[b]ecause our Class B common stock is generally non-voting, stockholders who own more than 10% of our common stock overall but 10% or less of our Class A common stock will not be required to report changes in their ownership from transactions in our Class B common stock pursuant to Section 16(a) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and would not be subject to the short-swing profit provisions of Section 16(b) of the Exchange Act. In addition, acquisitions of Class B common stock would not be subject to notification pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended."

Side agreements can be all-encompassing and not limited to just one or two board seats. One day before the company's shares started trading publicly, Ken Moelis, Moelis & Co. and affiliates of Moelis & Co. entered into a stockholder agreement that required prior written consent from Ken Moelis for 18 categories of actions that the board might take. As noted by the Delaware Court of Chancery in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, "[t]he pre-approval requirements encompass virtually everything the Board can do."[22] In addition, Ken Moelis retained control over the composition of the board.

[22] See West Palm Beach Firefighters' Pension Fund v. Moelis & Co.

Amendments to the Delaware Code specifically allowing such stockholder agreements were passed by the legislature and signed into law by the Delaware Governor[23] in July of 2024 in response to the Chancery Court's decision. With these amendments, shareholder agreements may become more common and may encourage even more creative structures that could mimic dual-class structures and make it difficult for investors to easily ascertain how much of the company is controlled by minority owners wielding significantly more influence than their economic ownership would otherwise provide.

Stock Pyramiding/Cross-Ownership

In a stock pyramid, ownership is vertically separated from economic interests. More common in Asia and in Europe than the United States, control is maintained through nested ownership of companies that ultimately own the operating company.

An example of this arrangement is a three-company design where one party owns 50% of a parent company owning 50% of a subsidiary that owns 50% of the operating company. While the parent company has majority control over the operating company (as the determinative vote at each level), the party with these holdings only owns 12.5% of the total cashflow rights.[24]

Crossholdings are mathematically more complex but accomplish disproportionate control by horizontal holdings, usually by more than one shareholder acting together, such as a family.[25] Crossholdings obfuscate the concentrated control that these parties have over these companies.

Examples

Two examples include the Hong Kong Li Ka-shing group and Sweden's ABB. [26] The Li Ka-shing family operates through the Cheung Kong public company, the fifth largest company in Hong Kong. The Li-Ka-shing family holds a 35% interest in this company. Cheung Kong, in turn, has a 44% interest in its main operating company, Hutcheson Wampoa. Hutcheson Wampoa owns Cavendish International, which is the holding company for Hong Kong Electric. Hutchison Whampoa and Cheung Kong Holdings are among the largest companies in Hong Kong.

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[23] See An Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law.
[24] As discussed by Lucian Bebchuk, Reinier Kraakman, and George Triantis, *supra* note 10, this is $50\% \times 50\% \times 50\% = (50\%)^3 = 0.50^3 = 0.125 = 12.5\%$.
[25] For a mathematical derivation of how cross-ownership structures lead to disproportionate cashflows rights and economic ownership, see pages 299-300 of Lucian Bebchuk, Reinier Kraakman, and George Triantis, *supra* note 9.
[26] These examples are from Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, Corporate Ownership Around the World, the Journal of Finance (1999).

ABB, the fourth most valuable company in Sweden, is controlled by the Wallenberg family through a pyramid of companies. Incentive, the 17th most valuable company in Sweden, owns 24.3% of capital and has 32.8% of the votes in ABB. The Wallenberg Group owns 32.8% of the capital but has 43.1% of the votes in Incentive. Corporate Ownership Around the World, published in the Journal of Finance (1999) reported that the family can buy 20% of the voting power in ABB at a cost of only 4.46% of the total capital due to cross-ownership.

Umbrella partnerships and C corporations (Up-Cs)

An "Umbrella partnership and C corporation" or "Up-C" structure is a partnership owned by a C corporation, in which the corporation is the parent entity and thus an "umbrella" over the partnership it owns. Insiders own units of the partnership, which are often convertible to publicly traded shares. However, because of the partnership structure, members of the partnership have significant cash flow advantages over those holding shares of the corporation. While Up-C structures have been touted primarily for their tax benefits, disclosure of how the insiders' partnership is more economically valuable has been less transparent.[27,28,29] The prevalence of Up-C structures has increased in recent years, representing 1% of initial public offerings (IPOs) prior to 2004, but 8% of IPOs in recent years.

Three of these advantages to insiders over other shareholders are in cash distributions, payment of expenses and tax receivable agreements. When the partnership makes a cash distribution, the partners automatically receive cash, but other shareholders receive cash distributions only when a dividend is declared by the publicly traded corporation. If the corporation does not declare a dividend, company insiders also disproportionately benefit. This is because the insiders effectively own of a portion of the accumulated cash at the corporation level even after receiving the initial cash distribution as an owner of the partnership., since their partnership units are often convertible to shares of the corporation.

Similarly, operating expenses are frequently reimbursed by the corporation to the partnership, meaning that insiders received disproportionate value because operating expenses, which would otherwise reduce their total returns, are transferred from the insiders to the public shareholders.

[27] This information in this section generally derived from The Dual-Class Spectrum, Yale Journal on Regulation, (2022) by Gladriel Shobe & Jarrod Shobe and The Substance over Form Doctrine and the Up-C, Virginia Tax Review (2018) by Gladriel Shobe.

[28] There are other risks that may be underestimated by investors. The Internal Revenue Service (IRS) has not opined on the tax treatment of Up-C structures, so Up-C owners currently get the best of both worlds: the Securities and Exchange Commission applies a form over substance approach, while the IRS applies a substance over form approach. However, if the IRS were to make an unfavorable determination on the tax treatment, this could materially impact after-tax performance.

[29] While the exact description of the tax advantage is beyond the scope of this paper, there is a tax step-up because of a pre-IPO § 754 election under the Internal Revenue Code, which reduces tax liability for the corporation.

Finally, while Up-C structures confer tax advantages, companies frequently redirect the value of these tax advantages from public shareholders to company insiders through tax receivable agreements. Under these agreements, the corporation pays the partnership for the value of the tax advantages created by the Up-C structure, reallocating the economic value of the tax benefits from public shareholders to company insiders. Because the tax receivables agreement are separate contractual agreements and not a right inherent in ownership of partnership units, insiders can assert that the partnership units and the publicly traded shares are economically equivalent because the disproportionate value is driven by the contractual agreement and not a feature of the partnership units themselves.

Examples of disclosure of these features can be found below:

Example 1. "Our organizational structure, including the [tax receivable agreement], confers certain benefits upon the Continuing LLC Owners that will not benefit the holders of our Class A common stock to the same extent that it will benefit the Continuing LLC Owners."[30]

Example 2. "We intend, as its managing member, to cause SSE Holdings to make cash distributions to the owners of LLC Interests in an amount sufficient to (i) fund all or part of their tax obligations in respect of taxable income allocated to them and (ii) cover our operating expenses, including payments under the Tax Receivable Agreement."[31]

Empirical evidence suggests that while Up-C deals increase IPO valuations, they harm public shareholders and underperform relative to traditional IPOs.[32]

Irrevocable proxy voting rights transferred from employees to insiders

Shareholders generally have a right to vote and to assign this right to others. In the context of employees, this is concerning because employers could require assignment of rights to the employer as a condition of employees receiving certain stock awards or being hired. This takes away the employees' rights as shareholders, and using company funds to grant compensation that may be motivated by a desire to exercise disproportionate control rather than to recruit and retain employees.

[30] Evo Payments, Inc. 2018 Prospectus 424B4 (sec.gov)
[31] Shake Shack Inc. 2015 prospectus Shake Shack Inc. (Form: S-1/A).
[32] Innovations in IPO Deal Structure: Do Up-C IPOs Harm Post-IPO Shareholders?, Management Science (2022) by Mary Billings, Kevin Hsueh, Gladriel Shobe & Melissa Western.

As an example, the Carlyle Group notes in a presentation explaining its 2019 move away from dual-class stock that "[s]enior employees, representing approximately 60% of current total outstanding units, will generally assign their voting rights for up to five years to our existing General Partner and that entity will exercise those votes as a block."[33]

Golden shares

Issued by a company or a government, golden shares are shares that come with certain veto rights and that are frequently associated with government control of a company, but which may be tradeable. Golden shares might come with the right to block mergers or as a veto over any action that shareholders collectively can make. Golden shares may be used to prevent outcomes that might otherwise be in the best interest of shareholders for goals other than long-term shareholder value. Golden shares often grant broad discretion to the holder to exercise their veto rights for any reason or no reason.

In addition to the risk that countries' leaders may veto strategically in ways that are not in the best interest of shareholders, golden shares may also discourage merger offers because of the additional uncertainty. The European Court of Justice has ruled that golden shares are unlawful when they "impede the free flow of capital" but not that they are unlawful in and of themselves.[34]

Examples of situations in which golden shares played a part include the proposed merger between Boeing and Brazilian company Embraer,[35] and the acquisition of Britoil by British Petroleum in 1987.[36] As a result of the Brazilian government's golden share in Embraer, Boeing and Embraer entered into a complex joint venture including the transfer of intellectual property from Embraer to a separate entity in order to avoid the downsides of Brazilian government's golden share, potentially at a higher cost. In the case of Britoil, the golden share may have discouraged acquisition offers due to the additional uncertainty that the government's veto power provided, especially given the risk that the veto power might be used for political purposes rather than in the best interest of shareholders broadly.

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[33] See Conversion to a C-Corporation by the Carlyle Group (2019).
[34]See Portugal Telecom 'golden shares' ruled illegal, Financial Times.
[35] See Fool's Gold? Constitution, Sovereignty and the Golden Share in Embraer-Boeing Case, The Journal of Applied Business and Economics (2021) by Rodrigo Oliveira Salgado, Fábio Sampaio Mascarenhas, and Marcus Vinícius Silva de Oliveira.
[36] British Government to Yield Its 'Golden Share' of Britoil - The New York Times (nytimes.com)

China has also worked since 2015 to acquire golden shares with "special management rights" in companies like Alibaba and Tencent.[37] A 2017 paper even advocated for the introduction of the "golden shares" in bank regulation.[38]

Situational super-class issuances

Boards may also be empowered to issue extra stock in certain situations, often provided for in their charter. While small- and mid-cap companies may be using these to achieve a quorum, such issuances raise concern about diluting shareholder voting rights.[39] While technical uses that are intended to meet quorum without diluting voting rights may be an understandable solution in some cases, further research should explore cause of the quorum nonattainment and potential solutions that do not involve the issuance of new stock solely to solve quorum issues.

Non-equity votes

The board may be empowered to issue stock or non-stock certificates and may use this power to accomplish purposes far beyond meeting quorum. For example, Spotify's articles of incorporation allow the board of directors to issue up to one billion, four-hundred million "beneficiary certificates [...] in its absolute discretion."[40] Although these certificates are not shares and are not entitled to cash flow rights, they do carry one vote each—the same as a share of common stock. This has allowed Spotify to recreate the unequal voting structure of a dual-class company but with only one class of stock.

Vote caps

In addition to seeking to increase the voting rights of insiders, the same outcome can be accomplished by reducing or capping the voting rights of non-insiders. These vote caps may also be intended as anti-takeover devices.

Example 1. McCormick & Company limits the amount of influence one common stock shareholder can have to 10% of all outstanding stock. The charter also provides that McCormick has the right to redeem any or all shares of Common Stock owned by a person owning more than

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[37] China moves to take 'golden shares' in Alibaba and Tencent units (ft.com)
[38] Bank Governance and Systemic Stability: The 'Golden Share' Approach, Alabama Law Review, (2017) by Saule Omarova.
[39] Companies Implementing 'Super-Voting Preferred Stock' as Stockholder Meeting Solution, Cooley Law Firm (2023).
[40] See Spotify's articles of incorporation: Articles of Incorporation.

10% off all outstanding stock unless such person acquires more than 90% of the outstanding shares of each class of their common stock.[41]

Example 2. The United Parcel Service, Inc. certificate of incorporation limits voting such that, with certain exceptions, if a shareholder has more than 25% of the total voting power, each vote beyond that threshold is valued at 1/100th of a regular vote.[42]

Example 3. Magellan Petroleum Corporation provided one vote per shareholder no matter how many shares they held. This approach did not survive Magellan's merger with Tellurian Inc.[43]

Conclusion

Mechanisms used to create a wedge between voting rights and economic ownership have expanded far beyond traditional dual-class stock structures and encompass at least eight different approaches that may be of interest to investors, regulators, and market participants. These approaches raise concerns that are similar to those raised by traditional dual-class stock, such as blocking mergers or replacement of the CEO when the majority of shareholders on a one-share-one-vote basis desire that outcome. Both accomplish similar outcomes in different ways, but stealth dual-class stock is less transparent and understandable to investors.

Recent legal developments also raise the possibility that stealth dual-class stock could become more common, which underscores the importance of understanding the prevalence, design, and impact of these structures. Depending on how they are designed, these mechanisms can result in severe misalignments between ownership and control.

[41] See McCormick & Co 2023 Annual Report.
[42] See UPS Certificate of Incorporation..
[43] Delaware Court of Chancery, *supra* note 11, page 16.