THE YALE LAW JOURNAL FORUM
DECEMBER 4, 2017

The Agency Costs of Equal Treatment Clauses

Kirby Smith

ABSTRACT. Founders want to maintain control over their companies. One way to do that is to use multiclass share structures. These structures allow founders to maintain control over business decisions despite decreasing their economic ownership in their companies. An overlooked feature of these new multiclass share offerings is the equal treatment clause—a clause that requires all share classes to receive equal consideration in the event of an acquisition. This Essay explores the agency costs associated with these clauses. Despite these clauses' benign appearance, this Essay shows that they can influence a controller's decision to sell. In effect, these clauses create another hurdle to the sale of a controlled company to the potential detriment of minority shareholders. After documenting this phenomenon, this Essay discusses the strengths and weaknesses of two potential solutions: complete removal or embedding a control premium in the articles of incorporation of founder-controlled companies.

INTRODUCTION

In 2017, Snapchat went public.[1] The long-anticipated IPO of this technology "unicorn" was met with mixed fanfare. Although the company rose by over 44%

1. Michael J. de la Merced, *Snap Prices I.P.O. at $17 a Share, Valuing Company at $24 Billion*, N.Y. TIMES (Mar. 1, 2017), http://www.nytimes.com/2017/03/01/business/dealbook/snap-ipo-snapchat.html [http://perma.cc/W7D7-BH6M].

in its debut on the New York Stock Exchange,[2] S&P excluded it from its ubiquitous S&P 500 Index.[3] Its exclusion from the index was due, in part, to Snapchat's unusual stock structure: its public stock has no voting rights. Instead, the founders of Snapchat retain control of the company through a separate class of stock with complete voting power. Snapchat's tripartite class structure is not unique.

Several companies that have recently gone public have done so with similar governance structures whereby the founders retain control through the use of multiple classes of stock.[4] To allay shareholder concerns, most of these companies' articles of incorporation contain a provision that requires any merger consideration to be distributed pro rata. On first glance, these equal treatment clauses provide some protection to minority shareholders, who purchase the stock knowing that, in the event of a change of control, they will be compensated at the same rate as the founders. However, there has been limited analysis on the agency costs of such a structure. For instance, does this structure discourage founders from voting for a sale when it would be optimal for minority shareholders? This Essay attempts to fill the gap. It finds that, all else equal, controllers generally have an incentive to maintain control, and equal treatment clauses further encourage controllers to maintain control, to the detriment of minority shareholders. To make the case, this Essay proceeds in three Parts. Part I begins by establishing the value of control and how founders can structure stock offerings to retain control. It also briefly documents the structure and increasing prevalence of equal treatment clauses in multiclass share structures, a typical vehicle for the maintenance of control. Part II sketches the agency costs that arise when control is concentrated before discussing the agency costs embedded in equal treatment clauses based on various theories of the value of shareholder control. Part III outlines potential solutions through either judicial review or changes to the articles of incorporation.

I. MULTICLASS SHARES AND EQUAL TREATMENT CLAUSES

Control is valuable. It allows the controller to direct the corporation free from interference by others, permitting the controller to pursue her long-term

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2. Edmund Lee, *Snap's IPO Was a Success. Now It Has To Prove It's Not Twitter.*, RECODE (Mar. 2, 2017), http://www.recode.net/2017/3/2/14795366/snaps-ipo-was-a-success [http://perma.cc/X9AH-MJMP].

3. *See* Trevor Hunnicutt, *S&P 500 To Exclude Snap After Voting Rights Debate*, REUTERS (July 31, 2017, 1:44 AM), http://www.reuters.com/article/us-snap-s-p/sp-500-to-exclude-snap-after-voting-rights-debate-idUSKBN1AH2RV [http://perma.cc/T5TK-9EE4].

4. Blue Apron, Zillow, and FitBit have all gone public in the last two years with multiple class structures. For details, see *infra* Appendix.

idiosyncratic strategy[5] or extract private benefits.[6] Perhaps most importantly, "[a]mong the rights associated with control is the ability to seek a control premium should [the company] be sold."[7] And Delaware law recognizes that the controller should be able to negotiate for this control premium in a sale—the minority is not entitled to the premium.[8]

Because control is valuable, entrepreneurs seek to maintain it. One way of maintaining control is through the use of multiple classes of shares. Instead of issuing a single class of shares, each with an equal vote, a controller can issue high-voting shares to herself and sell the low-voting shares to the public. For instance, if a controller needs to sell 70% of her company to the public in order to continue operations, she can maintain control by selling the public shares with only one vote per share while retaining shares with ten votes per share. At the close of the transaction, our controller will own only 30% of the company but will have over 81% voting control of the company.

Founders of technology startups typically have a unique vision for their firms that they do not want interrupted by the prospect of public shareholders, so, unsurprisingly, this structure has become increasingly popular among technology startups that raise capital on the public markets. Blue Apron, Facebook, Google, and others have all gone public with this structure.[9] However, this structure presents a problem for controllers. As the company grows and needs to issue additional shares, the controller will start to lose control. When the above controller's share of ownership drops below 9.1%, she will no longer have voting

5. *See generally* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560 (2016) (arguing that control is valuable because it allows controllers to pursue their visions).

6. Private benefits can be obtained either because the controller is engaging in private dealing to extract these benefits at the expense of the minority or because the controller is being rewarded for monitoring the corporation to the benefit of the minority. *See* Michael J. Barclay and Clifford G. Holderness, *Private Benefits from Control of Public Corporations*, 25 J. FIN. ECON. 371, 374 (suggesting that one of the benefits of control is pecuniary, such as "higher salaries for individual blockholders or below-market transfer prices for corporate blockholders"); Ronald J. Gilson & Jeffery N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003) (explaining the tradeoffs between different facets of the agency problem in corporate law).

7. *In re* Delphi Fin. Grp. S'holder Litig., No. 7144-VCG, 2012 WL 729232, at *1 (Del. Ch. 2012).

8. Abraham v. Emerson Radio Corp., 901 A.2d 751, 753 (Del. Ch. 2006) ("Under Delaware law, a controller remains free to sell its stock for a premium not shared with the other stockholders except in very narrow circumstances.").

9. See *infra* Appendix for details on recent initial public offerings (IPOs) with a multiclass structure. *See also* Anna S. Han, *The Facebook IPO's Face-Off with Dual Class Stock Structure*, 2012 MICH. J. L. REFORM *ONLINE* 50, 51, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1011&context=mjlr_caveat [http://perma.cc/W45F-BMEY] (documenting investor concerns over Facebook's dual-class stock structure).

control of the company. To prevent this potential inevitability, Snapchat and Google have both created a third class of stock: one with no voting rights.[10] This structure allows these companies to continue to issue equity to finance the company, pay employees, or acquire other companies, without the risk that the founders will lose control.

Theoretically, the sale of a minority investment in a company with a controller should yield less than the pro rata true value of the company. This occurs for two reasons. First, the controller can sell the control premium without sharing the premium with the minority. Second, the controller may engage in behaviors that are detrimental to the company's value, and the minority has limited recourse to correct or stop these actions besides exiting the investment.[11] Controllers try to allay the second concern by providing minority shareholders with information about the controller's strategy, but ultimately, the minority is, in part, investing in the controller's ability to run and monitor the company. This investment in a controller's ability to successfully operate the company is more pronounced as of late, as recent multiclass shares are structured such that the high-voting shares automatically become low-voting shares when alienated by the original holders.[12] Thus, in essence, a future controller is forced to purchase the entire company if she wishes to retain control—she cannot purchase control

10. *See infra* Appendix.

11. *See* Henrik Cronqvist & Mattias Nilsson, *Agency Costs of Controlling Minority Shareholders*, 38 J. FIN. & QUANTITATIVE ANALYSIS 695, 696 (2003) ("CMSs [Controlling Minority Shareholders] have the power to expropriate non-controlling shareholders, and this power is limited only by legal restrictions and by CMSs' financial incentives not to engage in expropriation.").

12. *See infra* Appendix.

from the initial controller.[13] And that control does not come cheaply. For instance, Amazon paid roughly 27% more for Whole Foods than it was worth the day before they announced their acquisition of the company.[14]

The controller's right to receive a control premium, however, can be negotiated away, to the supposed benefit of the minority. This is done through a charter provision that provides for equal treatment of all classes of stock when the company is acquired or merged with another company. Delaware courts have recognized such a possibility and its potential to increase the sale price of the minority stake ex ante.[15]

Bargaining away the right to disparate treatment has become more common in recent public offerings with multiclass share structures. Blue Apron, Zillow, Square, GoPro, Snapchat, and others have all recently gone public with multiclass structures and have included an equal treatment clause in their articles of incorporation.[16] An equal treatment clause, found in the articles of incorporation, mandates that, in the event of a liquidation, merger, or acquisition, minority shareholders receive the same consideration controlling shareholders receive. Once cemented in the articles of incorporation, a majority vote of each class of stock is required to change it.[17]

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13. Lucian Bebchuk and Marcel Kahan have investigated the optimal rule of sale when a controller can freely alienate her controlling block. *See* Lucian Arye Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q. J. ECON. 957, 968-73 (1994) (identifying conditions in which potential controllers do not have to purchase all shares to gain control); Marcel Kahan, *Sales of Corporate Control*, 9 J.L. ECON. & ORG. 368, 372-78 (1993). More recently, Bebchuk, Reinier Kraakman, and George Triantis have investigated the agency costs of "controlling-minority structure[s]" whereby a controller does not own a majority of the cash flow rights in a firm. Lucian Arye Bebchuk et al., *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP 295, 295 (Randall K. Morck ed., 2000). In all of these analyses, they assume that a controller can freely alienate control; however, that assumption fails in recent multiclass structures due to the automatic conversion of high-voting shares into low-voting shares when sold. *See infra* Appendix. As such, this Essay proceeds under the assumption that a sale of control requires a sale of the entire firm.

14. Nick Turner, Selina Wang & Spencer Soper, *Amazon To Acquire Whole Foods for $13.7 Billion*, BLOOMBERG (June 16, 2017), http://www.bloomberg.com/news/articles/2017-06-16/amazon-to-acquire-whole-foods-in-13-7-billion-bet-on-groceries [http://perma.cc/SW7T-XY3N].

15. *See In re* Delphi Fin. Grp. S'holder Litig., No. 7144-VCG, 2012 WL 729232, at *1-2 (Del. Ch. 2012) (noting that the controller "could retain or bargain away th[e] right" to "seek a control premium," and that by providing for equal consideration in a charter provision, the controller bargained away his right, which "resulted, presumably, in a higher purchase price for [minority] stock than would have been the case without the [charter] provision").

16. *See infra* Appendix.

17. DEL. CODE ANN. tit. 8, § 242(b)(2) (2011) ("The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to

However, these ever-prevalent equal treatment clauses are often not without an "out" for the controller. Snapchat's equal treatment clause is an adequate representation of most equal treatment clauses, stating that

> In the event of a Liquidation Event [including asset transfers or acquisitions], . . . the remaining assets of the Company legally available for distribution to stockholders shall be distributed on an equal priority, pro rata basis to the holders of Common Stock, unless different treatment of the shares of each such class is approved by the affirmative vote of the holders of a majority of the outstanding shares of Class A Common Stock, Class B Common Stock and Class C Common Stock, each voting separately as a class . . . .[18]

The Appendix canvasses recent initial public offerings where equal treatment clauses have become ubiquitous among companies with multiclass share structures.[19] The "out" may theoretically neuter the force of equal treatment clauses, but in practice, the "out" may not be effective because minority shareholders rarely vote, and such a vote provides an opportunity for hedge funds to "hold up" the founders.[20] As of 2015, "about 14 percent of all companies that went public have done so with a dual class structure."[21] As this structure becomes more common, the details of the arrangements between controlling and minority shareholders will become increasingly important. As such, this Essay next turns to investigating the agency costs of these equal treatment clauses.

II. THEORIES OF CONTROL AND EQUAL TREATMENT CLAUSES

Control is valuable because it allows the controller to extract value from the company. Scholars have posited three explanations for the value of control: the

vote thereon by the certificate of incorporation, if the amendment would . . . alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely.").

18. Snap, Inc. Amended and Restated Certificate of Incorporation (Jan. 2017), art. IV.F.4, http://www.sec.gov/Archives/edgar/data/1564408/000119312517029199/d270216dex31.htm [http://perma.cc/9KJ9-59A5].

19. *See infra* Appendix.

20. *See infra* text accompanying notes 57-67.

21. Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 7 HARV. BUS. L. REV. *3 (forthcoming 2017) http://papers.ssrn.com/abstract_id=2619462 [http://perma.cc/QQ6C-PLVJ] (footnote omitted).

"minority-expropriation view," the "optimal-reward view," and the "idiosyncratic vision view."[22] The adoption of an equal treatment clause does not necessarily prevent the controller from extracting value under any of these theories; however, the clause does, under all theories of control, decrease the controller's incentive to sell the company. This Part starts by briefly outlining the various theories of corporate control before discussing how, under each theory, a controller bound by an equal treatment clause is disinclined, or at least less likely, to seek a sale of the company, depriving minority shareholders from maximizing the value of their interests.

A. Theories of Control

The classic and most prevalent theory of control is the private benefits theory, whereby a controller extracts value from the company at the expense of the minority.[23] A controller does this through self-dealing. The ability to self-deal is somewhat self-explanatory: a controller can, for example, cause the company she controls to contract with company B, which she has an interest in, at an off-market rate that favors company B.[24] Although this type of outright self-dealing is a breach of a controller's duty of loyalty under Delaware law,[25] it is a model for subtler forms of self-dealing that allow the controller to extract benefits to the detriment of the minority shareholders. These could be in the form of business decisions that the controller pursues that she would not be able to without control or merely the ability to direct innocuous benefits to parties the controller prefers—for example, having the corporation donate to the controller's preferred charities.[26]

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22. The naming conventions for these theories of control are taken from Goshen & Hamdani, *supra* note 5.

23. *See* Ronald J. Gilson & Alan Schwartz, *Corporate Control and Credible Commitment*, 43 INT'L REV. L. & ECON. 119, 125 (2015) (reviewing the literature).

24. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 723 (Del. 1971) (finding self-dealing where a controller prevented the controlled company from enforcing contract rights against the controller).

25. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (1987) ("[The duty of loyalty] embodies not only an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage. In short, directors must eschew any conflict between duty and self-interest.").

26. *See* Gilson & Gordon, *supra* note 6, at 792-93 (2003). *See also* Kishore Eechambadi, *The Dual Class Voting Structure, Associated Agency Issues, and a Path Forward*, 13 N.Y.U. J.L & BUS. 503, 521-22 (2017) (discussing agency costs and the extraction of private benefits).

The optimal-reward view of control posits that a controller receives "rewards" from the minority in exchange for monitoring management.[27] Under this hypothesis, a controller provides a benefit to the minority shareholders and should be rewarded for the benefit conferred. Minority shareholders' incentives to monitor are weak—the costs of monitoring may be high relative to their stake in the venture, and any monitoring costs incurred may benefit the rest of the shareholders at the minority shareholders' expense. Controllers, on the other hand, have a substantial stake in the venture. In that sense, their interests are aligned with the minority in that their monitoring is profitable both to the controller and the minority shareholders. However, because control comes with associated costs (for example, illiquidity), the theory suggests that minority shareholders compensate the controllers for their valuable monitoring services by allowing them to extract some private benefits from the corporation.[28] Warren Buffet's control of Berkshire Hathaway epitomizes this type of arrangement. An individual would find it nearly impossible to understand the myriad businesses Berkshire is engaged in, but Buffet has every incentive to monitor each investment, as most of his wealth is tied up in Berkshire stock.[29]

Lastly, the idiosyncratic vision view suggests that controllers maintain control not to extract private benefits but rather to pursue a strategy that the market would otherwise not let them pursue. The theory suggests that entrepreneurs have a long-term vision that the market, if it had control of the enterprise, may not let come to fruition. As a result, the entrepreneur sacrifices equity to maintain control, thereby ensuring that her idiosyncratic vision will be realized.[30] The founders' maintenance of control at companies such as Google, Facebook, and Snapchat may be examples of this type of idiosyncratic vision. Google, for instance, invests in moonshot projects[31] that a company controlled by a diverse group of investors likely would not allow the company to engage in.

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27. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006) (observing that an owner-manager may police the company more effectively than dispersed shareholders).

28. *See id.* at 1652 (observing that "[b]ecause controlling shareholders must bear the direct costs of monitoring, liquidity, and nondiversification from holding a concentrated position, some private benefits of control likely are necessary to induce a party to play that role").

29. Berkshire Hathaway, Inc. Schedule 14A Information (May 2017), http://www.sec.gov/Archives/edgar/data/1067983/000119312517087493/d305499ddef14a.htm [http://perma.cc/6983-BXNF].

30. *See* Goshen & Hamdani, *supra* note 5.

31. *See, e.g.*, Seth Fiegerman, *Google's Moonshots Lost $1 Billion Last Quarter*, CNN (Jan. 26, 2017, 4:59 PM EST), http://money.cnn.com/2017/01/26/technology/google-earnings-q4/index.html [http://perma.cc/VEX2-QERE] (noting that Alphabet's "other bets" division lost over $3.6 billion in 2016); Danielle Muoio, *Google and Alphabet's 20 Most Ambitious Moonshot Projects*, BUS. INSIDER (Feb. 13, 2016, 7:08 PM), http://www.businessinsider.com

B. Equal Treatment Clauses and Controllers

Under any theory, control creates agency costs.[32] In the minority-expropriation view and the optimal-reward view, agency costs exist because the controller extracts private benefits.[33] And while the controller may bestow monitoring efficiencies on the minority in the optimal-reward view, the risk for the minority is that the private benefits extracted may be greater than the benefits conferred. Idiosyncratic vision has agency costs too, but they are represented not by private benefits but by the controller's overvaluation of her strategy or execution of the strategy. The controller may invest in projects that have a negative expected value because of the controller's idiosyncratic visions, to the detriment of minority shareholders when the projects go belly up.[34]

In addition, under any theory of control, the controller should be disinclined to sell the company. As others have noted, "sizable private benefits of control can also lead to an inefficient lock-in, where a more efficient buyer (who can generate a higher stream of cash-flows) is unable to purchase the control block from the controlling shareholder."[35] This is true under the first two theories because a more efficient buyer may undervalue the controlling shares because she is not be able to extract the private benefits of control. Let us assume that a controller's firm is worth $1,000 and the controller owns 30% of the firm but has control via a dual-class share structure. Traditionally, the controller's stake in the venture would be worth $300; however, the controller may be able to extract $200 of value from the firm at the expense of $200 of value to the firm's shareholders. As such, the controller's stake in the venture, to her, is worth $440.[36] If a buyer can increase the value of the firm by 20%, the controller may still not choose to alienate control. Even if the controller can get paid differential consideration, once the buyer pays the controller $440, the buyer only has $520 to pay the rest of the shareholders, which is less than the current value of their shares.[37] In such cases,

/20-moonshot-projects-by-google-turned-alphabet-2016-2/#google-fiber-1 [http://perma.cc/E9RC-2GBH].

32. Jensen and Meckling observed that agency costs "arise in any situation involving cooperative effort," including "the relationship between the stockholders and manager of a corporation." Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976).

33. Gilson & Schwartz, *supra* note 23 (developing an agency cost model to explain the incentive problem with controllers).

34. *See* Goshen & Hamdani, *supra* note 5, at 577–80.

35. Choi, *supra* note 21, at *21.

36. The controller owns 30% of the value (0.3 x $800) plus an additional $200 of private benefits.

37. The current value of their shares is worth $560 or (0.7 x $800).

the valued accrued to the controller from private benefits extracted by the controller can prevent efficient transactions from occurring.[38]

The same is true under the idiosyncratic vision theory. However, instead of extracting benefits, the controller values her shares differently than the market because she has internalized the potential success of her venture. Again, assume the firm is worth $1,000 and the controller owns 30% of the firm. While the market views the controller's stake as only worth $300, the controller believes that her vision will be successful and values her stake at $450.[39] As a result, unless a buyer can increase the value of the firm by more than 15%, the controller will not alienate her control.

Equal treatment clauses exacerbate this lock-in effect. By requiring a potential buyer to compensate all shareholders equally, the controller is, ex ante, ensuring that a sale can only take place if a buyer's value of the company is higher than the controller's value of the company. Because of a controller's idiosyncratic value associated with the firm or the private benefits they receive, it is unlikely ever to be the case that the buyer values the firm more than the controller, to the potential detriment of the shareholders. The controller has, essentially, a veto right over any proposed transaction.[40] As such, to approve a transaction, the controller will need to receive more than her current value of the firm, which includes value based on private benefits or an idiosyncratic vision.

However, efficient transactions can take place when differential consideration is possible. Take the hypothetical firm controlled by our idiosyncratic controller with a value of $1,000. If differential consideration can be offered, the buyer needs only to value the firm at more than 15% of its current value to purchase it—the buyer pays the controller $450, the minority shareholders $700, for a total purchase price of $1,150. This is not completely unrealistic, as the average

38. Although a controller could unilaterally agree to sell the company and obligate minority shareholders to accept less than the current value of their shares, such an agreement would likely run afoul of the entire fairness standard and could be subject to potential appraisal litigation, thus mitigating the minority shareholders' losses. *See infra* notes 59 and Part III. Moreover, such risk would likely deter a buyer from agreeing to such a transaction.

39. If the controller did not value her stake at more than the market price, then she would not have raised the capital in the first place in an inefficient way (by maintaining control). *See* Goshen & Hamdani, *supra* note 5, at 585-86.

40. Delaware law requires "a majority of the outstanding stock of the corporation entitled to vote" for a merger. Del. Code Ann. Tit. 8, § 251(c) (2011). Because a controller, through the use of multiclass shares, possesses more than 50% of the voting power, the controller effectively controls the merger vote. Once the controller agrees to sell the company, the vote, then, is a legal necessity but a practical certainty.

premium in a change-of-control transaction can fluctuate between 25% to 35%.[41] However, once an equal treatment clause is introduced, the buyer must now value the firm at more than 50% of its current value[42] – an increase that will drive most if not all potential suitors away.

The same result is true when the hypothetical controller extracts private benefits. In that scenario, if a buyer could offer differential consideration, the buyer need only value the company at more than 25% of its current value to purchase it. Under such a scheme, the buyer would be able to pay the controller $440 while paying the minority shareholders $560 for a total purchase price of $1000 on a current firm value of $800 because the controller is extracting $200 of firm value. However, once an equal treatment clause is introduced, the prospective buyer now needs to value the firm at more than 83.3% of its current value in order to purchase it.[43]

These numbers are only illustrative, and assume that the controller is rational – that is, once she receives an offer to purchase the firm in slight excess to her existing value, she will sell the firm. Missing from this analysis is any irrational behavior that may drive the selling price up, such as the endowment effect.[44] The endowment effect suggests that individuals place a higher value on items simply because they own them.[45] This principal may hold true of controllers, and she may ascribe value to her control merely because she controls the firm, increasing the premium she will need before alienating her ownership. Of course, this problem is exacerbated when an equal treatment clause is present. But, as the hypothetical above illustrates, equal treatment clauses are one-way ratchets that significantly increase the requisite sale price.

This lock-in risk is not just theoretical. In 2013, for instance, Snapchat's founders turned down an offer from Facebook to purchase the company for $3

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41. *See, e.g.*, *Flashwire US Monthly*, FACTSET RES. SYS. INC. 2 (Oct. 2017), http://www.factset.com/mergerstat_em/monthly/US_Flashwire_Monthly.pdf [http://perma.cc/V2UP-KEEL].

42. The controller values the company at $1,500 ($450/30%). Because the controller can stymie any deal, the buyer needs to pay her $450 for 30% of the company. But the equal treatment clause forces the buyer to also pay the minority the same value, for a total purchase price of $1,500.

43. The controller values the firm at $1,466 ($440/30%). The equal treatment clause forces the buyer to pay the controller's value.

44. *See generally* Thomas M. Zellweger & Joseph H. Astrachan, *On the Emotional Value of Owning a Firm*, 21 FAM. BUS. REV. 347, 347 (2008) (describing the endowment effect as the emotional value assigned to an ownership stake that leads people to assign a higher sell price to assets that they own than the price at which they would be willing to acquire the asset").

45. *Id.*

billion.[46] What seemed illogical at the time may have turned out to be prophetic—as of this Essay's publication, Snapchat's current market valuation is upwards of $15 billion.[47] Of course, Snapchat was not yet a public company when it turned down Facebook's offer, and its concentrated minority shareholders were likely supportive of waiting for a higher valuation. Similarly, Yelp's CEO, Jeremy Stoppelman, turned down offers as a public company because a sale would "conflict with his long-term goals."[48] In 2015, Google made overtures to Yelp while it had a dual-class stock structure and an equal treatment clause.[49] The merger discussions eventually ceased, likely in part because of Stoppelman's idiosyncratic vision. In contrast to Snapchat, Stoppelman's gamble did not pay off for Yelp shareholders. Since the discussions with Google started, its market value has declined by about 20%.[50]

Equal treatment clauses exacerbate the inclination of controllers to reject efficient acquisition transactions. Of course, as noted in Part I, most of these clauses contain an "out"—they allow differential consideration if a majority of each class of shares approves of the differential consideration.[51] Theoretically, this "out" should render equal treatment clauses toothless. If the market efficiently prices the value of the minority's shares, then they should agree to any proposed acquisition so long as their consideration is higher than the current

46. Robert Cyran, *A Sign of Desperation in Facebook's Snapchat Offer*, N.Y. TIMES: DEALB%K (Nov. 14, 2013, 12:00 PM), http://dealbook.nytimes.com/2013/11/14/a-sign-of-desperation-in-facebooks-snapchat-offer [http://perma.cc/BJ69-GGZ9] (noting that Facebook was "dangling as much as $3 billion to lure" Snapchat into a deal).

47. *See Snap Inc*, GOOGLE FINANCE (Dec. 4, 2017, 12:50 PM), http://finance.google.com/finance?q=NYSE%3ASNAP&sq=SNAP&sp=2&ei=QnXlWaGQBZTvjAGiipXoBQ [http://perma.cc/R9RT-4DD3] (listing the NYSE opening price on December 4, 2017 as $13.95, with 863.06 million shares outstanding).

48. Daniel Roberts, *Can Yelp's CEO Keep Turning Down Acquisition Offers?*, FORTUNE (May 15, 2015), http://fortune.com/2015/05/15/yelp-ceo-stoppelman-sell-yelp [http://perma.cc/YU5B-LNAC].

49. *See infra* Appendix.

50. Although this decline is likely attributable to a variety of factors, Yelp's share price declined by over 10% after it was reported that Stoppelman halted Yelp's sale process. Benjamin Snyder, *Yelp Shares Are Tanking Because of This Decision by the CEO*, FORTUNE (July 2, 2015), http://fortune.com/2015/07/02/yelp-shares-stoppelman [http://perma.cc/VP5Z-YE8L]. The refusal to sell was, in part, connected to Stoppelman's control and unwillingness to sell. Daniel Roberts, *Here's Why Yelp's Stock Is Tanking*, FORTUNE (July 29, 2015), http://fortune.com/2015/07/29/yelp-stock-tanked-tuesday [http://perma.cc/749E-7GMW] (noting that Stoppelman "is likely to avoid selling as long as he can").

51. *See supra* Part I; *see also infra* Appendix.

market price, irrespective of the controller's consideration.[52] In fact, anecdotal evidence bears this out. Delphi Financial Group had a dual-class structure with an equal protection clause that did *not* contain an out. However, Delphi's controller insisted on obtaining a control premium to allow the company's sale to Tokio Marine Holdings to go forward.[53] Because the charter contained an equal protection clause without an "out," the minority shareholders had to approve both a charter amendment and the merger. Despite a rock-solid equal treatment clause, the shareholders overwhelmingly approved both the charter provision and the merger.[54]

In other cases, these equal protection clauses can be accretive to minority shareholders. For instance, LinkedIn had a dual-class structure with an equal treatment clause.[55] In 2016, LinkedIn agreed to be purchased by Microsoft for $196 per share, and equal treatment was given to both classes of shares.[56] The merger valued LinkedIn's shares at a 49.5% premium over the closing price on the day before it was announced. At the time of the merger, Reid Hoffman, LinkedIn's cofounder and chairman, possessed over 50% of the voting power in the company. Despite his heavy involvement in the merger negotiations, the issue of dual consideration never emerged even though LinkedIn's equal treatment clause had an "out." Yet, there was good evidence that Hoffman's controlling stock necessitated a high premium. Hoffman was significantly involved in the deal negotiations, which ultimately increased Microsoft's initial proposal of $165 per share to over $185. Throughout the negotiations, Hoffman, as a controlling shareholder, could have squashed what may have been an efficient deal at $165 per share (a roughly 25% premium over LinkedIn's share price at the time), if Microsoft did not increase the price to meet Hoffman's valuation.[57]

52. This, of course, is not completely accurate. The fact that existing minority shareholders own the stock at the current market price is evidence that they must value the stock at or *above* the current price. As such, some additional consideration is necessary to achieve a sale.

53. *In re* Delphi Fin. Grp. S'holder Litig., No. 7144-VCG, 2012 WL 729232, at *5-9 (Del. Ch. Mar. 6, 2012).

54. Zacks Equity Research, *DFG Shareholders Approve Sale*, YAHOO! FINANCE (Mar. 14, 2012), http://finance.yahoo.com/news/dfg-shareholders-approve-sale-210845654.html [http://perma.cc/G7VY-34GZ].

55. *See infra* Appendix.

56. *See* LinkedIn Corp., Current Report (Form 8-K) 2 (June 13, 2016), http://www.sec.gov/Archives/edgar/data/1271024/000110465916126712/a16-13234_18k.htm [http://perma.cc/C9GB-JHVB] (noting that both Class A and Class B stock "will be cancelled and automatically converted into the right to receive cash in an amount equal to $196.00").

57. *See* LinkedIn Corp., Proxy Statement (Schedule 14A) 40 (July 22, 2016), http://www.sec.gov/Archives/edgar/data/1271024/000104746916014430/a2229104zdefm14a.htm [http://perma.cc/95Z3-X3JY] (noting that Reid Hoffman called Microsoft's CEO to "indicate that he would personally support a transaction with Microsoft at $185 per share or greater").

The Delphi and LinkedIn transactions represent only anecdotal evidence of how controllers will respond to equal treatment clauses. It is impossible to measure the number of transactions not begun because of these clauses. In addition, we may see such provisions influence how buyers structure their acquisition bids. Buyers may choose to approach the controller privately rather than take their proposal to a full shareholder vote because once the controller approves of an equal consideration transaction, the vote is legally necessary but superfluous.[58]

Moreover, differential consideration may expose the buyer to the potential for appraisal arbitrage. Delaware General Corporate Law § 262 allows shareholders, after a merger, to petition the court to appraise their shares. This mechanism effectively provides shareholders with an alternative to the price offered if they believe it is too low. Section 262 is meant to protect minority shareholders from "rampant majority rule,"[59] by allowing shareholders to ask for "an appraisal by the Court of Chancery of the fair value of the stockholder's shares."[60] This threat is not hypothetical; for example, the Delaware Chancery Court recently determined that the "fair value" of Dell's shares was 28% higher than the merger consideration.[61] The appraisal remedy has been growing in popularity as hedge funds seek to gain the spread between the merger price and the "fair value" assessed by the Chancery Court.[62] And presently, the Chancery Court's mixed decisions on the issue create risks that the court may find the consideration paid to the controller the proper appraisal price.[63] When conducting appraisals, the Chancery Court determines the going concern value of the firm, which is not necessarily the price paid by a third party and results in a decision, like the Dell case, where the price paid by the third party is found inadequate. In cases with different consideration paid to different shareholders, the Chancery Court could look to the higher consideration as potential evidence of fair value. So, to avoid this risk, buyers may insist on equal consideration.

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58. *See supra* note 40.

59. Barry M. Wertheimer, *The Shareholder Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L. J. 613, 613 (1998).

60. DEL. CODE ANN. tit 8, § 262(a) (2017).

61. *In re* Appraisal of Dell Inc., No. 9322-VCL (Del. Ch. May 31, 2016).

62. *See, e.g.*, Theodore N. Mirvis, *Delaware Appraisal At a Crossroads?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 20, 2017), http://corpgov.law.harvard.edu/2017/06/20/delaware-appraisal-at-a-crossroads [http://perma.cc/S5FP-PEWV].

63. *Compare In re* Appraisal of PetSmart, Inc, No. 10782-VCS (Del. Ch. May 26, 2017) (appraising the company at the price purchased during the sale process), *with In re* Appraisal of Dell Inc., No. 9322-VCL (Del. Ch. May 31, 2016) (holding that the price arrived at through the sale process was not an adequate price for appraisal proceedings).

Similarly, in the case that the equal treatment clause is waived, controllers may be leery of entertaining a vote of each class of shareholders. There is the psychic cost of convincing shareholders to support the merger while facing questions about the differential consideration. Additionally, obtaining a majority-of-the-minority vote is no small feat, especially for widely held companies. A significant portion of retail holders do not vote, and their votes are effectively counted as "no" votes.[64] "Hot" technology stocks are a key destination for retail investors.[65] And because any differential consideration *requires* their votes, failure to convince a majority of these shareholders to vote, and vote for the merger, could lead the controller to forgo an attempt to achieve differential consideration.[66]

Moreover, seeking a majority-of-the-minority vote may expose the merger to activist involvement in the other classes of stock. While minority shareholders may have limited rights in most transactions, equal protection clauses with an "out" provide an opportunity for activists to attempt to block the merger unless additional consideration (or equal consideration, as suggested by the charter) is provided. The risk of activist entrance to block mergers is not just theoretical; it has been extensively documented and is quite successful.[67] One example is the Dolan family's attempt to take Cablevision private in 2007. An activist was able to prevent the transaction because it required a majority of the minority vote.[68] Such activist engagements create perils for minority shareholders: either the threat of an activist means the controller will be asked to consent to a merger that contains equal treatment, exposing the shareholders to the agency costs dis-

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64. The acquisition of Dell Inc. by Michael Dell and a consortium of other investors provides a recent example. Michael Dell failed to achieve a majority-of-the-minority vote, a condition of the merger, at the first shareholders meeting in part because of these "no" votes from retail investors. *See* Leonard Chazen, *Did the Dell Majority-of-the-Minority Clause Go Too Far?*, LAW360 (July 22, 2013), http://www.law360.com/articles/459110 [http://perma.cc/B79E-AWJC].

65. *See, e.g.*, Angela Moon, *Millennial Love for Snapchat Extends to the Stock*, REUTERS (Mar. 12, 2017), http://www.reuters.com/article/us-snap-stock-millennials-idUSKBN16J0GA [http://perma.cc/KK9M-EC22].

66. For example, at GoPro's 2016 annual meeting, only 23% of minority voters voted. *See* GoPro, Inc., Current Report (Form 8-K) (June 6, 2016), http://www.sec.gov/Archives/edgar/data/1500435/000150043516000100/form8-k2016annualstockhold.htm [http://perma.cc/G59K-7UET]. The percentage is calculated by taking the number of Class A votes present for quorum purposes, subtracting the number of broker nonvotes and dividing that number by the number of outstanding Class A shares.

67. *See* Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 60, 99-102, 123.

68. *See id.* at 101 n.136.

cussed above, or the shareholder will engage in an efficient differential-consideration transaction that has the potential to be blown up by activists. Either way, minority shareholders may suffer.

III. POTENTIAL ALTERNATIVES TO EQUAL TREATMENT CLAUSES

As Part II documented, equal treatment clauses have the potential to expose minority shareholders to agency costs that reduce the likelihood of an efficient change-of-control transaction. In this Part, this Essay turns to outlining potential alternatives that can benefit minority shareholders. This Part starts by documenting the current standard of review under which Delaware courts assess differential consideration change-of-control transaction.[69] The Essay then suggests that the standard may adequately protect minority shareholders, but, given that it is a standard, it may discourage certain efficient transactions. As a result, this Part concludes by suggesting that a fixed control premium be built into the equal treatment clauses to provide appropriate incentives to controllers while avoiding the agency problems that emerge from true equal protection clauses.

A. Delaware's Existing Standard

When a controlling shareholder receives differential consideration in a change-of-control transaction, the Delaware courts evaluate the transaction using the entire fairness standard, "Delaware's most onerous standard."[70] The Delaware Supreme Court has defined entire fairness as having "two basic aspects: fair dealing and fair price."[71] And while Delaware separates the process and the price components of the transaction for the purpose of analysis, the courts "determine[] entire fairness based on all aspects of the entire transaction."[72] Heightened scrutiny of these transactions strives to ensure that the premium received by the controller represents only the control premium and does not extract any greater value from the minority.

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69. This Essay focuses on Delaware law because "more than fifty percent of U.S. public companies and more than sixty percent of the Fortune 500" incorporate in Delaware. Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 L. CONTEMP. PROBS. 135, 135 (2004).

70. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 44 (Del. Ch. 2013). *See also In re* Crimson Exploration Inc. S'holder Litig., 2014 WL 5449419, *12–14 (Del. Ch. 2014) (documenting that Delaware courts apply the entire fairness standard in "transactions where the controller competes with the common stockholders for consideration").

71. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

72. Valeant Pharm. Int'l v. Jerney, 921 A.2d 732, 746 (Del. Ch. 2007).

In terms of fair dealing, the Delaware courts look to process. The "gold standard" for process in these cases is negotiation and approval of the transaction "by a disinterested and independent special committee" of the board, which, in effect, represents the minority shareholders of a controlled corporation.[73] The authority and independence of the committee is instrumental to ensuring fair dealing because the process in these negotiations is complex. This leads to a three-way negotiation between the potential acquirer, the controller, and representatives of the minority shareholders. The controller and minority shareholders are aligned in extracting as much consideration as possible from the potential acquirer, but then become opposing parties when attempting to divvy up the spoils.

To ensure minority shareholders are adequately represented during the negotiation process, the court looks to a few key considerations. First and foremost, the independent committee needs authority and a clear mandate.[74] Moreover, to properly protect the interest of minority shareholders, the committee needs access to sophisticated financial and legal advisors who can ensure that the committee is "fully informed" with "complete information."[75] Lastly, the committee's negotiation with the controller needs to be at arm's length and independent.[76] These factors indicate that fair dealing existed, but because the standard is flexible, the absence of any single factor is not dispositive.[77]

But fair dealing is only half of the puzzle, and determining a fair price proves to be more difficult. Delaware precedent indicates that the price needs to be fair on both an absolute and a relative basis.[78] Effectively, the court considers two premiums: (i) the absolute premium over the trading price of the stock; and (ii) the relative premium between the two classes of stock, or the control premium. "[C]omparable precedent high-vote stock premiums" may be used to evaluate the relative fairness of the price received by the two classes of stock,[79] but the court's ability to precisely determine the fair amount is more art than science.

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73. *In re* John Q. Hammons Hotels Inc. S'holder Litig., No. 758-CC, 2009 WL 3165613, at *12 (Del. Ch. 2009).

74. *See In re* Telecomms., Inc. S'holder Derivative Litig., No. Civ.A. 16470, 2005 WL 3642727, at *9 (Del. Ch. 2006) (noting the deficiencies in a special committee's mandate as a flaw that cuts against a view that the fair dealing existed).

75. *Id.* at *10-12.

76. *Id.* at *8, 12.

77. *Id.* (taking into account various factors that help to establish fair dealing but not holding any one dispositive).

78. *Id.* at *13 (noting that the committee recognized that the price of the shares, on their own, was fair, but that the committee failed to evaluate whether "the relative impact of a preference to one class [was] fair to the other class").

79. *Id.* at *14.

Any differentiation in consideration received by the controller will be evaluated by courts under the entire fairness standard, which may adequately protect minority shareholders. If the merger can pass judicial review, it may go ahead without obtaining a majority-of-the-minority vote, skirting activist involvement in the stock post-merger.[80] But, if a buyer or controller is worried about the ambiguity of the entire fairness standard, a majority-of-the-minority vote will cleanse the transaction and subject it to highly deferential business judgment rule. Therefore, minority shareholders may feel adequately protected by judicial review, and willing to give up the protection of equal treatment clauses in order to improve the chance that an efficient change-of-control transaction goes forward. Without the equal treatment clause, controllers have flexibility to pursue efficient change-of-control transactions rather than being hamstrung by a clause that may work to the detriment of minority shareholders.

Subjecting process and price to the crucible of judicial scrutiny, rather than relying on covenants, has both ex ante and ex post benefits. Ex ante, the courts' judgments should guide boards and controllers, ensuring that negotiations are conducted in a manner that properly allocates the control premium.[81] Ex post, dissatisfied investors may seek review of the board's efforts to protect them—ensuring shareholders receive adequate consideration. The process of determining a fair differential price, however, is not well canvassed by the Delaware courts and, therefore runs into the issue inherent in all standards—ambiguity yields uncertainty that can stymie efficient transactions. Unexpectedly, this may be beneficial for minority shareholders as the controller may err on the side of caution and accept equal consideration, even without such a clause, that will be evaluated under the favorable business judgment standard in Delaware.[82]

Ultimately, the Delaware courts' less than clear pronouncements about absolute and relative price fairness may lead controllers to shy away from embracing the standard.[83] In the case that controllers attempt to avoid entire fairness

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80. According to DEL. CODE ANN. tit 8, § 251(c) (2017) a majority vote of the shareholders will be necessary to accomplish the merger; however, because the controller likely has enough votes, the vote itself is a fait accompli.

81. *See generally* Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone*, 70 BUS. LAWYER 679 (2015) (describing how legal and financial advisors can use existing legal doctrine to reduce potential liability and ensure compliance with fiduciary duties).

82. *See In re Synthes*, 50 A.3d at 1035-37.

83. Few Delaware cases address this question. For example, a recent article only cites three cases as relevant to the discussion of differential consideration. *See* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 614 n.86 (2017).

review completely,[84] they must receive approval from a special independent committee of the board *and* subject the merger to approval by a majority-of-the-minority vote of all minority shareholders.[85] Of course, such a process runs into the same issues that may prevent differential consideration, and thus efficient transactions, from occurring with an equal treatment clause in the first place, as discussed above.[86] As such, fully embracing Delaware's entire fairness standard for differential consideration transactions may be a theoretically appealing but practically flawed approach to the agency costs of equal treatment clauses.

B. Embedding a Control Premium in the Articles of Incorporation

An alternative solution to fully embracing the entire fairness standard may be embedding a control premium in the charter. Delaware respects the articles of incorporation as a contract between shareholders and the company.[87] As then-Vice Chancellor Strine noted, Delaware law is "largely enabling and provides a wide realm for private ordering."[88] Unless "forbidden by settled rules of public policy," Delaware courts are hesitant to accept challenges to the validity of private ordering found in the articles of incorporation.[89] Delaware allows controllers to

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84. Because the Delaware courts take a holistic approach when applying entire fairness, it is not always clear what level of process is required to overcome the standard. *See, e.g.*, *In re* Trados Inc. S'holder Litig, 73 A.3d 17 (Del. Ch. 2013) (finding that a transaction was entirely fair despite not satisfying the process prong); *In re* Southern Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761, 813 (Del. Ch. 2011) (finding that a transaction did not meet the burden of entire fairness despite a nominally independent special committee approving the transaction).

85. *See In re John Q. Hammons*, 2009 WL 3165613 at *12-13 (noting that the business judgment standard when the transaction is "(1) recommended by a disinterested and independent special committee, *and* (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders").

86. *See supra* Section II.B (explaining how equal treatment clauses may lock in inefficiencies in a controller's valuation of a company).

87. *See* Airgas, Inc. v. Air Products and Chemicals, Inc., 8 A.3d 1182, 1188 (Del. 2010) ("Corporate charters and bylaws are contracts among a corporation's shareholders.").

88. Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's* Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1260 (2001).

89. Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 118 (Del. 1952); *id.* ("[T]he stockholders of a Delaware corporation may by contract embody in the charter a provision departing from the rules of the common law, provided that it does not transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation Law itself.").

obtain a premium,[90] so shareholders should be able to embed a control premium in the charter ex ante.

Embedding a control premium in the charter does not entail fancy footwork; it merely requires structuring the premium appropriately. This can be done explicitly in an equal treatment clause by stating that high-voting classes of stock are allowed to receive *X* percent more than low-voting classes of stock in a merger or acquisition.[91] Alternatively, the charter could grant high-voting shares an option to purchase a predetermined amount of low-voting shares at $0.01 per share directly prior to an acquisition or merger. A merger would trigger this option and allow the controller to obtain a predefined quantity of stock for free, or in essence, an embedded control premium.

There are varying reasons to embed the control premium in the articles of incorporation rather than include an option to purchase low-voting shares exercisable when acquired. A fixed control premium is more flexible. For example, if a holder of high-voting stock ceases to control the corporation, embedding the premium in the charter makes the premium optional. And if control is eliminated, there may be little reason to provide additional compensation to the former controller. For example, if a controller issued enough low-vote stock that her high-vote stock no longer allowed her to exercise control, she could still receive a premium because the option granted to her when she did control allows her to obtain free shares—a substitute for a control premium—in the event of a merger.[92] Providing high-voting shares an essentially free option to purchase low-voting shares creates a declining but nonflexible premium. The amount of the premium declines as more shares are issued, so, all else equal, as more shares are issued, the value of a single share should decrease. Unlike the fixed control premium, the option is not flexible.

One advantage to using an option structure is that it may diminish a controller's willingness to use low-voting shares to fund inefficient acquisitions. For example, some speculated that Facebook's 2014 acquisition of WhatsApp was an example of a company with a controller using low-voting stock to purchase an

90. *Abraham v. Emerson Radio Corp.*, 901 A.2d at 753 ("Under Delaware law, a controller remains free to sell its stock for a premium not shared with the other stockholders except in very narrow circumstances.").

91. This Essay does not take up the task of suggesting a particular percentage. Empirical evidence suggests that a range of 1% to 4% is appropriate in the United States. *See, e.g.*, Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 J. FIN. ECON. 325, 340 (2003) (finding that the value of control-block votes goes up to 4% more than other votes in the United States).

92. Of course, there may be ways to structure the option such that it is conditional on the controller still maintaining control.

overpriced asset that would not provide much value to shareholders.[93] This fear can be tamed if these inefficient transactions lower the potential future control premium—affected via the option structure—because the value of low-vote shares is diluted.

Ultimately, the structure of the premium is subject to negotiation by underwriters, institutional investors, and the controller. The market will determine what is appropriate, and may determine that certain companies are better fits for either the option or fixed premium structure. For instance, minority investors in a smaller, riskier firm may prefer the option-based structure because it provides the controller with a large premium initially, which decreases if the controller continues to invest in the risky venture after initial investments reveal it is a dud—at that point, the minority prefers a sale to another capital raise, and the option-based structure incentivizes the controller to sell rather than raise capital. Conversely, for companies as large as Google and Facebook, investors may feel comfortable with the fallback of the entire fairness standard. Any sale of these behemoths would be scrutinized and founders, knowing this ex ante, would internalize all of the potential costs of their sales strategy as a result. Any structure is likely to still have flaws. Regardless of the structure chosen, either should address some of the potential inefficiencies introduced by the current structure of equal treatment clauses.

CONCLUSION

As the bargaining power of founders has risen, so too has the issuance of multiclass shares, which has led to the increasing prevalence of equal treatment clauses. So far, however, commentary or analysis of these clauses has been limited. This Essay introduces the presence of equal treatment clauses to the legal literature and begins to explore the potential implications of these clauses. By looking at these clauses through an agency-cost framework, this Essay shows that equal treatment clauses can exacerbate a controller's incentives to maintain control, effectively locking-in control. This lock-in can prevent efficient change-of-control transactions from occurring, harming minority shareholders.

To avoid this scenario, this Essay proposes two alternative solutions. The first is removing these clauses altogether and allowing Delaware's existing entire fairness framework, which seeks to protect minority shareholders when receiving differential consideration, to govern these transactions. However, allowing these transactions to be governed by a legal standard can also create ambiguity,

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93. *See* John Cassidy, *Facebook and WhatsApp: A Deal Too Far?*, NEW YORKER (Feb. 19, 2014), http://www.newyorker.com/news/john-cassidy/facebook-and-whatsapp-a-deal-too-far [http://perma.cc/7KST-MCYX].

which may prevent efficient transactions from moving forward. As such, this Essay also proposes embedding a control premium in the articles of incorporation. Embedding this premium in the articles ex ante is subject to being over- or under-inclusive, but provides the basis for a controller to engage in efficient change-of-control transactions that can be thwarted by the existing equal treatment clauses. These recommendations are not definitive and more research is certainly necessary, but this Essay serves as an opening salvo in the debate regarding the details of control arrangements that require scrutiny to ensure efficiency.

Kirby Smith is a 2017 J.D. graduate of The University of Chicago Law School. *For helpful comments and conversations, I owe a debt to Richard Deulofeut-Manzur, Eric Lewin, Matt Ladew, and Dorothy Shapiro Lund. As always, thanks to Christina Bell for her patience and support. Finally, thanks to the* Yale Law Journal *editors for their thoughtful comments.*

Preferred Citation: Kirby Smith, *The Agency Costs of Equal Treatment Clauses*, 127 YALE L.J. F. 543 (2017), http://www.yalelawjournal.org/forum/the-agency-costs-of-equal-treatment-clauses.

APPENDIX. RECENT IPOS WITH EQUAL TREATMENT CLAUSES[94]

Company	IPO Date	Class Structure	Equal Treatment Amendment	Persistent Control
Blue Apron Holdings, Inc (NYSE: APRN)	June 28, 2017[95]	Tripartite class structure. Class A shares are entitled to 1 vote per share. Class B shares are entitled to 10 votes per share. Class C shares are not entitled to a vote.[96]	Equal pro rata treatment *required* upon the consolidation or merger of the corporation.[97]	Class B shares are converted to Class A shares upon transfer.[98]
Snap Inc. (NYSE: SNAP)	March 2, 2017[99]	Tripartite class structure. Class A shares are not entitled to a vote. Class B shares are entitled to 1 vote per share. Class C shares are entitled to 10 votes per share.[100]	Equal pro rata treatment unless a majority of the adversely affected class of shares approve disparate consideration.[101]	Class B and C shares are converted to Class A and B shares upon a transfer, respectively.[102]
Square, Inc. (NYSE: SQ)	November 19, 2015[103]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[104]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[105]	Class B shares automatically convert to Class A shares upon transfer.[106]
Fitbit, Inc (NYSE: FIT)	June 19, 2015[107]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[108]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[109]	Class B shares convert into Class A shares upon transfer.[110]

Box, Inc. (NYSE: BOX)	January 23, 2015[111]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[112]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[113]	Class B shares automatically convert into Class A shares upon transfer.[114]
GoPro, Inc. (NASDAQ: GPRO)	June 26, 2014[115]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[116]	Equal pro rata treatment in the event of a merger and are generally treated equally.[117]	Class B shares automatically convert to Class A shares upon transfer.[118]
Facebook (NASDAQ: FB)[119]	May 18, 2012[120]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[121]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[122]	Class B shares automatically convert to Class A shares upon transfer.[123]
Yelp Inc. (NYSE: YELP)[124]	March 2, 2012[125]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[126]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[127]	Class B shares are converted to Class A shares upon transfer.[128]
Zillow (NASDAQ: Z)	July 20, 2011[129]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[130]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[131]	Class B shares automatically convert to Class A shares upon transfer.[132]
LinkedIn Corp. (NYSE: LNKD)[133]	May 19, 2011[134]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[135]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[136]	Class B shares automatically convert into Class A shares upon transfer.[137]

Zynga Inc. (NASDAQ: ZNGA)	December 16, 2011[138]	Tripartite class structure. Class A shares are entitled to 1 vote per share. Class B shares are entitled to 7 votes per share. Class C shares are entitled to 70 votes per share.[139]	Equal pro rata treatment unless a majority of each class of shares approve disparate consideration.[140]	Class B and C shares automatically convert to class A shares upon transfer.[141]
Under Armour, Inc. (NYSE: UAA)[142]	November 18, 2005[143]	Dual class structure. Class A shares are entitled to 1 vote per share, and Class B shares are entitled to 10 votes per share.[144]	Equal pro rata treatment exempting amounts paid to Kevin Plank (founder) as "compensation for services."[145]	Class B shares automatically convert into Class A shares upon transfer.[146]
Alphabet Inc. (NASDAQ: GOOG)[147]	August 19, 2004[148]	Tripartite class structure. Class A shares are entitled to 1 vote per share. Class B shares are entitled to 10 votes per share. Class C shares are not entitled to a vote.[149]	Equal pro rata treatment in the event of a merger and are generally treated equally.[150]	Class B shares automatically convert into Class A shares upon transfer.[151]

94. These recent IPOs are not selected systematically; however, they represent high-profile recent IPOs that contain equal treatment clauses.

95. Anita Balakrishnan, Snap Closes Up 44% After Rollicking IPO, CNBC (Mar. 2, 2017, 11:19 AM), http://www.cnbc.com/2017/03/02/snapchat-snap-open-trading-price-stock-ipo-first-day.html [http://perma.cc/QH3S-XGB4].

96. Blue Apron Holdings, Inc., Restated Certificate of Incorporation, art. IV.A.2 (Dec. 22, 2016), http://www.sec.gov/Archives/edgar/data/1701114/000104746917004085/a2232430zex-3_3.htm [http://perma.cc/SGL4-HMTC].

97. *Id.* art. IV.A.6.1 (providing that "different or disproportionate consideration in connection with such consolidation, merger or other transaction if the only difference in the per share consideration to the holders of the Class A Common Stock, Class B Common Stock and Class C Capital Stock is that any securities distributed to the holder of a share of Class B Common Stock have ten (10) times the voting power of any securities distributed to the holder of a share of Class A Common Stock and that any securities distributed to the holder of a share of Class C Capital Stock have no voting rights or power").

98. *Id.* art. IV.A.7.2(a).

99. Balakrishnan, *supra* note 95.

100. Snap Inc., Amended and Restated Certificate of Incorporation, art. IV.F.3, (May 24, 2012), http://www.sec.gov/Archives/edgar/data/1564408/000119312517029199/d270216dex31.htm [http://perma.cc/G4Q7-48YF].

101. *Id.* art. IV.F.2.A.

102. *Id.* arts. IV.F.5.b.ii & IV.F.6.a.i.

103. Ryan Mac, *The Winners and Losers of the Square IPO*, FORBES (Nov. 19, 2015, 6:42 PM), http://www.forbes.com/sites/ryanmac/2015/11/19/the-winners-and-losers-of-the-square-ipo [http://perma.cc/KZ8R-B6XT].

104. Square, Inc., Amended and Restated Certificate of Incorporation, art. IV.C.2.B (Nov. 24, 2015), http://www.sec.gov/Archives/edgar/data/1512673/000119312515387010/d38020dex31.htm [http://perma.cc/DP7F-WECD].

105. *Id.* art. IV.C.4.

106. *Id.* art. V.B.

107. *Fitbit Shares Surge 47 Percent in Market Debut*, N.Y. TIMES DEALB%K (June 18, 2015), http://www.nytimes.com/2015/06/19/business/dealbook/fitbit-shares-surge-52-percent-in-market-debut.html [http://perma.cc/9BP5-WY6B].

108. Fitbit, Inc., Restated Certificate of Incorporation (June 23, 2015), art. IV.3.2, http://www.sec.gov/Archives/edgar/data/1447599/000144759915000006/exhibit31.htm [http://perma.cc/G7XM-XNDR].

109. *Id.* art. IV.3.6.

110. *Id.* art. V.3.

111. Shawn Tully, *Box IPO: The $120 Million That Got Away*, FORTUNE (Jan. 23, 2015), http://fortune.com/2015/01/23/box-ipo [http://perma.cc/E2XD-76RF].

112. Box, Inc., Amended and Restated Certificate of Incorporation (Jan. 28, 2015), art. IV.D.1, http://www.sec.gov/Archives/edgar/data/1372612/000119312515112029/d893446dex31.htm [http://perma.cc/K969-RSEF].

113. *Id.* art. IV.D.2.c.

114. *Id.* art IV.D.3.b.

115. William Rosenthal, *GoPro Soars 31% in IPO Debut*, N.Y. POST (June 26, 2014), http://nypost.com/2014/06/26/gopro-soars-26-in-ipo-debut [http://perma.cc/ZQ9M-DDEF].

116. GoPro, Inc., Restated Certificate of Incorporation (May 2014), art. IV.B.3, http://www.sec.gov/Archives/edgar/data/1500435/000119312514232583/d552193dex301.htm [http://perma.cc/M4ZQ-S4S].

117. *Id.* arts. IV.B.2, IV.B.7.

118. *Id.* art. IV.B.9.3.

119. In June 2016, Facebook's existing shareholders approved a new Articles of Incorporation that included Class C shares with no voting rights. However, the new Articles are not yet effective.

120. Seth Fiegerman, *5 Years After Rocky IPO, Facebook Is Stronger Than Ever*, CNN (May 18, 2017), http://money.cnn.com/2017/05/18/technology/facebook-ipo-anniversary/index.html [http://perma.cc/29BA-KYPC].

121. Facebook, Inc., Restated Certificate of Incorporation (May 22, 2012), art. IV.3.2, http://www.sec.gov/Archives/edgar/data/1326801/000119312512325997/d371464dex31.htm [http://perma.cc/HT7N-HLH3].

122. *Id.* art. IV.3.6.

123. *Id.* art. IV.3.8.

124. Yelp Inc.'s Articles of Incorporation were amended on September 23, 2016, and no longer include a dual-class share structure. *See* Yelp Inc., Current Report (Form 8-k) (Sep. 22, 2016), http://www.sec.gov/Archives/edgar/data/1345016/000120677416007234/yelp3063374-8k.htm [http://perma.cc/2WFC-USHL]. The items in the table represent the terms of the charter when a dual-class structure existed.

125. Pepitone, *supra* note 107. *Yelp Shares Soar More Than 60% in IPO*, CNN (Mar. 2, 2012), http://money.cnn.com/2012/03/02/technology/yelp_ipo/index.htm [http://perma.cc/49BF-S7V7].

126. Yelp Inc., Eighth Amended and Restated Certificate of Incorporation, art. Fourth D.1(b), http://www.sec.gov/Archives/edgar/data/1345016/000119312512106811/d312269dex31.htm [http://perma.cc/F9GA-862B].

127. *Id.* art. Fourth D.2(c).

128. *Id.* art. Fourth D.4(b).

129. Julianne Pepitone, *Zillow Shares Pop in IPO*, CNN (July 20, 2011, 4:27 PM), http://money.cnn.com/2011/07/20/technology/zillow_IPO/index.htm [http://perma.cc/L8W7-8EAB].

130. Zillow Group, Inc., Amended and Restated Articles of Incorporation, art. 2.3(a), (Feb. 11, 2015), http://www.sec.gov/Archives/edgar/data/1617640/000119312515050790/d874339dex31.htm [http://perma.cc/8MWA-Z79].

131. *Id.* art. 2.3(d).

132. *Id.* art. 2.3(e)(ii).

133. LinkedIn announced in June 2016 that Microsoft was acquiring it. *See supra* text accompanying note 56.

134. Julianne Pepitone, *LinkedIn Stock More Than Doubles in IPO*, CNN (May 19, 2011), http://money.cnn.com/2011/05/19/technology/linkedin_IPO/index.htm [http://perma.cc/6SHR-FDEC].

135. LinkedIn Corp., Sixth Amended and Restated Certificate of Incorporation (2011), art. IV.D.1, http://www.sec.gov/Archives/edgar/data/1271024/000119312511064249/dex32.htm [http://perma.cc/H3AA-WRDH].

136. *Id.* art. IV.D.2.c.

137. *Id.* art. IV.D.4.

138. Julianne Pepitone, *Zynga Shares Close Below IPO Price*, CNN (Dec. 16, 2011), http://money.cnn.com/2011/12/16/technology/zynga_ipo/index.htm [http://perma.cc/6B7C-HV2T].

139. Zynga Inc., Seventeenth Amended and Restated Certificate of Incorporation (June 11, 2014), art. V.4.1, http://www.sec.gov/Archives/edgar/data/1439404/000119312514236407/d742303dex31.htm [http://perma.cc/W4HU-FS9M].

140. *Id.* art. V.7.2.

141. *Id.* arts. V.5.2, V.5.3.

142. Under Armour is incorporated in Maryland. *See* Under Armour, Inc., Amended and Restated Articles of Incorporation, http://www.sec.gov/Archives/edgar/data/1336917/000133691716000077/ua-3312016xex301.htm [http://perma.cc/4Y7T-UNLP].

143. Julianne Pepitone, *LinkedIn Stock More Than Doubles in IPO*, CNN (May 19, 2011), http://money.cnn.com/2011/05/19/technology/linkedin_IPO/index.htm [http://perma.cc/6SHR-FDEC].

144. *Id.* art. Sixth(a)(ii).

145. *Id.* art. Sixth(a)(vii).

146. *Id.* art. Sixth(a)(ix)(B).

147. For a more detailed review of Google's implementation of its tripartite stock structure, see generally Paul Lee, *Protecting Public Shareholders: The Case of Google's Recapitalization*, 5 HARV. BUS. L. REV. 281 (2015).

148. Paul R. La Monica, *Google Jumps 18% in Debut*, CNN (Aug. 19, 2014), http://money.cnn.com/2004/08/19/technology/goog [http://perma.cc/KY3S-LPR8].

149. Alphabet Inc., Amended and Restated Certificate of Incorporation (Oct. 2, 2015), art. IV, §§ 2(a), 5, http://www.sec.gov/Archives/edgar/data/1652044/000119312515336577/d82837dex31.htm [http://perma.cc/WAU6-VRVH].

150. *Id.* art. IV, §§ 2(e), 5(e).

151. *Id.* art. IV, § 2(f).