

## THE PROS AND CONS OF DUAL CLASS STOCK STRUCTURES

A so-called “dual class stock” structure is a tried and true method of ensuring that a group of shareholders (usually insiders, such as all or some of the founders, senior management or early investors in the company) maintain voting power that is disproportionate to their economic interest in the company. Dual stock structures vary and can range from simple to complex, but basically the company authorizes two classes of common stock, which are identical in all respects except for their voting rights. Typically, one class of voting common stock has one vote per share and the other class has a substantially higher number of votes per share.



For purposes of illustration, assume that Smith, Jones and Davis decide to form a new company. Smith is an experienced business person and will put up most of the capital required to launch the new company. Jones and Davis are younger and very tech-savvy in the area most relevant to the new company's business, but they have limited business experience and very little capital. All of the founders agree that Smith should remain in control of management decisions, including the board of directors. Nevertheless, the three founders want to share their economic interest in the company equally.

One way to accomplish these inconsistent goals is to set up the Company with a dual stock structure. Smith would receive one-third of the common stock, all of which would be Class A common stock. Jones and Davis also would each receive one-third of the common stock, but all of their stock would be Class B common stock. The new company's incorporation papers would state that Class A common and Class B common were identical in all respects, except that Class A would have ten votes per share and Class B would have one vote per share. As additional stock is issued to key employees or early stage investors, they would generally receive Class B shares. This issuance of additional stock going forward would dilute all of the founders on a pro-rata basis, but a huge amount of Class B common stock would have to be issued before Smith would lose voting control of the Company.

Another situation where dual stock structures are common is a family company where the founder wants to benefit his family equally from an economic perspective, but not all family members are capable of or interested in taking over the business when the founder retires or passes away.

Dual stock structures have become increasingly unpopular among many investors in public companies because they make it more difficult to replace management and approve unsolicited acquisition offers. However, you do not have to be a public company in order to encounter some pushback if you have adopted a dual stock structure. They are usually not a problem for early stage “friends and family” investors because they know the founders and usually understand the underlying reasons for the structure. However, many venture capital funds and other private equity investors may view them more negatively. Nevertheless, there are ways to temper these concerns. The voting rights can convert to the one vote per share class of stock after the passage of time or the occurrence of a specified future event. The super voting rights may also be limited to the election of a stated number of board members.

There is no question that a dual stock structure can be an effective means of addressing various sets of issues that impact many private companies. However, like many other aspects of starting and running a business, choosing and implementing a dual stock structure requires careful thought and experienced legal counsel.

If we can provide any further information, please contact your regular PLDO attorney or William F. Miller at [wmler@pldolaw.com](mailto:wmler@pldolaw.com).



## William F. Miller

Partner

William F. Miller is a Partner with Pannone Lopes Devereaux & O’Gara LLC and a member of the Corporate & Business Law Team. He is a highly skilled attorney with more than 30 years of experience who focuses his practice on corporate and business law matters, including mergers and acquisitions, angel, venture capital and private equity financing, commercial contract matters, intellectual property protection and licensing, and entity and investment fund formation. Mr. Miller frequently advises early stage technology companies, manufacturers, service and distribution companies as well as investors in such companies.

PANNONE LOPES  
DEVEREAUX & O’GARA LLC  
*c o u n s e l o r s   a t   l a w*

*Pannone Lopes Devereaux & O’Gara LLC is a full service law firm that provides legal services in multiple practice areas including administrative law, business and corporate law, health care law, municipal law, nonprofit law, employment law, estate planning, probate and trust litigation, criminal defense, civil litigation, government relations and strategies, real estate development and commercial lending and special masterhips. Our attorneys are cross-trained in several disciplines and work in collaborative teams to quickly identify the core issues in any legal matter and prescribe the right strategy from concept through resolution in the most responsive and cost-effective manner. For more information about our firm and our attorneys, please visit [www.pldolaw.com](http://www.pldolaw.com) or contact our firm.*