The Founder's Primer on Multi-Class Voting Structures

Since its founding in New York in 1819, Cravath has advised founders, innovators and enterprises on the capital, governance and control decisions that support long-term growth. In 1848, the Firm secured a patent for Samuel Morse to protect his invention of the electromagnetic telegraph. In the 1850s, Charles Goodyear engaged the Firm in rubber patent matters, and the Firm handled the granting of American licenses of Henry Bessemer's steel-process patents. In 1971, just days before The Washington Post began publishing the Pentagon Papers, the Firm took The Washington Post Company public with an innovative share structure designed to protect editorial freedom. Across emerging technologies and established industries, companies poised for their next phase of growth face a similar challenge: how to raise capital from investors without surrendering the independence of the visionaries who created and remain instrumental to the business.

Today's founders confront that same challenge whenever they consider an initial public offering ("IPO"), and multi-class share structures have become the principal means of addressing it. By giving the shares held by founders (and, in some cases, other pre-IPO investors) greater voting power than the shares sold to the public, these structures allow founders to retain voting control with a non-controlling equity position and to pursue their long-term strategy without undue exposure to short-term market pressures and activist threats. Multi-class structures have historically been most prevalent among U.S.-listed technology companies, but are becoming more common in other industries when the founder plays a critical role in the business. Institutional investors have also grown increasingly receptive to thoughtfully designed structures, including those that pair founder voting control with features such as an empowered board of directors and a time-based or event-based "sunset" provision. These considerations have particular resonance for founders building capital-intensive businesses, including in artificial intelligence. This primer introduces the core concepts founders should understand, describes the principal structures in use today and outlines the design decisions founders should consider before an IPO.

MULTI-CLASS VOTING STRUCTURES: AN OVERVIEW

Dual-Class Structures

This is the most common approach. The company sells to the public a class of shares carrying one vote per share, while the founder keeps a separate class of "high-vote" shares that carry extra votes. Technology IPOs have largely coalesced around two ratios: 10 votes per high-vote share and 20 votes per high-vote share. The 10-vote ratio is the most familiar to investors, but it requires the founder to hold a larger slice of the company's equity, often 10% or more, to stay above 50% of the vote. The 20-vote ratio allows a founder to maintain a lower economic stake and obtain some liquidity post-IPO without losing control. Recent IPOs have also used other, less common, ratios.

Triple-Class Structures

Triple-class structures add a third class with full economic rights but no voting rights. In a common form, the public holds shares of a low-vote class, the founder holds shares of a high-vote class and the company has authorization to issue shares of a third, nonvoting class. A nonvoting class gives the company flexibility to issue shares for future financings, acquisitions or employee compensation without diluting the founder's voting power. Investors and index providers may be sensitive to nonvoting shares, particularly because those shares carry economic rights without corresponding voting rights.

Variable-Vote Structures

A variable-vote (sometimes called "hardwired") structure fixes the result rather than the ratio: instead of giving each high-vote share a set number of votes, the charter creates a special class whose votes are automatically adjusted up or down so that the class, sometimes together with the founder's other shares, always carries a set percentage of the total vote. That percentage may be set slightly below or slightly above 50% (for example, 49.9% or 50.1%). The practical benefit for a founder is that voting control does not erode as the company issues new shares in financings, acquisitions or employee grants, or as the founder sells down. If the company has multiple founders, the special class is often held through a vehicle so that the founders vote as a bloc, and it typically falls away on events such as the death of the last founder. Because the structure is less familiar to investors, it generally requires more explanation during the IPO marketing process. Some structures instead pair a fixed ratio high-vote class with a cap set at a percentage of the vote, and others give the high-vote class a separate right to elect a majority of the board.

Sunsets and Conversion Triggers

A "sunset" is an agreed expiration date for the structure: at a specified point, high-vote shares automatically become ordinary one-vote shares and the founder's voting control ends. Time-based sunsets run for a fixed period after the IPO, commonly 7, 10, 15 or 20 years. Event-based sunsets are tied to the founder: the death or disability of the founder, the founder ceasing to provide services to the company, or the founder's holdings falling below a threshold (often based on a stated percentage of the shares he or she held at the IPO). Nearly all structures also convert high-vote shares upon transfer to a third party, which means that a founder who sells shares gives up voting power faster than economic ownership. Exceptions to these conversion triggers should therefore be drafted to permit estate planning transfers and voting trusts without causing the founder to lose control.

Accompanying Governance Features

A multi-class structure is rarely adopted in isolation. For example, co-founders may enter into voting agreements to vote together on director elections, and certain non-founder pre-IPO investors may grant a founder a proxy. High-vote shares often carry separate class approval rights over changes to their terms and certain major transactions. Companies also commonly adopt a staggered board, limits on stockholder-called special meetings and supermajority requirements for charter amendments, with these elements often designed to take effect only once the high-vote class loses voting control. Because investors will evaluate the governance structure in its entirety, each feature should be designed as part of a single, cohesive framework.

PRACTICAL CONSIDERATIONS FOR FOUNDERS

Timing and Approvals

For founders considering entering the public markets, it is desirable to implement a multi-class structure before or in connection with the IPO. The process often begins with a draft of key terms, followed by discussions with the board and key investors. Implementing the structure requires a charter amendment approved by holders of a majority of the voting power, and preferred stockholder approval is generally also required. Founders should therefore secure buy-in from investors whose consent will be needed and consider seeking approvals that preserve some flexibility on final terms.

Voting Ratio and Scope

Founders should consider how much equity the company is likely to issue in the future (for primary capital raises, as acquisition currency and to employees) and how much of their equity they may wish to sell over time while retaining control, which informs the choice between a 10-vote and a 20-vote ratio or an alternative structure such as a variable-vote structure. They should also decide whether

high-vote shares will be issued only to the founders or to some or all pre-IPO holders. Extending high-vote shares to early investors can ease approvals, but those holders may not always be aligned with the founders; a voting agreement or proxy in favor of the founders can mitigate that risk.

Sunset Design

Proxy advisory firms and the Council of Institutional Investors generally favor time-based sunsets of 7 years or less. Nonetheless, recent large technology IPOs have commonly adopted time-based sunsets of up to 20 years, or none at all, relying instead on event-based sunsets. Founders should calibrate the sunset to the strength of their position and the expected investor reaction.

Exchange Listing Requirements

Both the New York Stock Exchange ("NYSE") and Nasdaq permit companies with multi-class structures to list, so the choice of structure will not keep a company off either exchange. If more than 50% of the voting power for the election of directors is held by a single person or a group, the company is a "controlled company" and may opt out of the NYSE and Nasdaq requirements for a majority-independent board and fully independent compensation and nominating committees. The audit committee independence requirements apply regardless. Founders should also note that certain index providers exclude multi-class companies from some indices, although the S&P Dow Jones Indices exclusion that previously applied is no longer in effect.

Investor Relations

There is no strong evidence that technology IPOs have suffered negative post-IPO trading effects from multi-class structures that are suitably tailored and include appropriate guardrails, although investors may apply a discount if they perceive material governance risk. Direct advocacy by founders is typically the most effective approach: investors and directors are often more receptive when founders explain how the structure supports their vision, and many investors do not wish to be seen as unfriendly to visionary founders. Founders should emphasize their alignment with public investors through significant equity at risk and lock-up commitments, highlight safeguards such as a strong board and be prepared to adjust the ratio, sunset or protections prior to the IPO if needed.

Controlling Stockholder Considerations

A structure that places significant voting power in a founder may cause the founder to be treated as a "controlling stockholder" under the law of the company's state of domicile. In Delaware, transactions involving a controlling stockholder have historically attracted heightened judicial scrutiny, although recent changes to Delaware law have introduced safe harbors for approval. Other states, including Nevada and Texas, take narrower approaches. Founders should therefore consider approval processes for conflicted transactions and determine the voting structure, board composition and state of domicile in tandem.

CONCLUSION

In short, multi-class structures allow founders to bring a company to the public markets while preserving the long-term vision that created its value. Governance concerns are real, but they are increasingly addressed through thoughtful sunsets, conversion triggers or board safeguards rather than through a rigid insistence on "one share, one vote" for everyone. Founders considering a multi-class structure should begin planning before the IPO kickoff, leaving time to engage with advisors to design the governance package as a coherent whole.

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