

Founder friendly stock alternatives I: keeping control and super-voting common stock

By Jonathan Axelrad

Many founders worry about keeping control of their startups as their companies grow. As a company takes on new investment, the founders will typically lose control of the company's board of directors and voting control of the overall company. Because the board can fire a founder and is the gatekeeper to other major milestones in the life cycle of a company, founders are often concerned about their ongoing ability to maintain their vision and control. This article explores some of the ways founders may address this concern.

Control

We often find ourselves reminding founders that owning a smaller piece of a bigger pie with sophisticated investors on the board who can help a company rapidly scale is usually in the founders' best interests. In rare cases though, a founder can have her cake and eat it too, enjoying a rapidly growing company while keeping control. This is typically achieved by adopting dual class common stock, which is ideally done at formation. Sometimes this class of stock is called Class F Common Stock, but, whatever the name, the purpose of the stock is to provide founders with more than one vote for each share they own (typically 10 votes for every one share).

Super-voting stock sounds pretty good, doesn't it? The trouble is that it runs counter to most investor expectation, and arguably sets up a governance structure that could be abused. Many leading venture capitalists will reject it out of hand, but, for seasoned founders, especially with a rocket-ship idea, it may be easier to make the case for it, especially if the decision to include the Class F stock is made at formation. However, including super-voting stock will narrow the field of potential investors, may lead to lower valuations and may possibly increase performance expectations. That said, this type of stock also is usually convertible to standard common stock upon certain events, so it's not irreversible (though the message it sends to investors might be).

The chart below summarizes various considerations in adopting super-voting stock as well as some other approaches to trying to secure and/or buttress a founder's control in the company.

Term	Comments
Voting Multipliers	This will provide the founder's stock a powerful control mechanism over any votes that require stockholder approval (any amendment of the charter, which is required for most financings and a merger or sale of substantially all assets). Typically set at 10:1 votes, but higher ratios might be considered, based on facts and circumstances.
Founder Protective Provisions	This would require a percentage of the super-majority voting stock to approve certain key decisions, mirroring in concept, if not in scope, typical preferred protective provisions. A possible list might include (i) creating a new class of senior or <i>pari passu</i> securities to the super-voting stock; (ii) amending the charter or bylaws in a manner that adversely impacts the super-voting stock, (iii) increasing the size of the board; and (iv) approving a liquidation event (merger or sale of substantially all the assets of the company).

Conversion of Super-Voting Common	A key provision to consider when adopting super-voting stock is how it converts to common. Since so much control of the company is associated with this stock structure, the charter typically includes provisions that convert the super-voting stock to standard common stock: (i) in a case where a majority of holders of the super-voting class agree and (ii) if it is transferred by the original holder to third parties. In addition, companies should consider adding a conversion trigger should a founder be terminated for cause or voluntarily resign.
Director Super-Votes	A little used provision of Delaware law allows companies to give individual directors more than one vote. If a founder is trying to implement control provisions after the company has already issued stock, this might be a better manner of implementing founder control provisions.
Vesting, Triggers and Severance	A founder should consider if some of the concerns over maintaining control of the company stem from fear of being terminated and losing unvested stock. This is more easily addressed via vesting triggers, severance and an employment agreement than by the adoption of super-voting stock. See our article on founder stock vesting.
Severance	A founder could use cash severance payments as further protection from downside risk on termination of employment. This would be a guaranteed cash payment of an agreed amount in case of a termination for something other than cause or resignation for good reason.

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