Dual Class Stock in Comparative Context

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Marc T. Moore, *Designing Dual Class Sunsets: The Case for a Transfer-Centered Approach*, University College London Faculty of Laws Working Paper No. 9/2019, available at SSRN.

The optimal balance of power between shareholders and boards of directors in public companies remains one of the most consequential and contested issues in corporate governance, and the debate has only intensified as share ownership has become more concentrated in the United States and U.S.-style shareholder activism has arisen in other capital markets around the world. Against this backdrop, as Marc Moore explores in the paper cited above, dual class stock (DCS) structures "have spread exponentially in recent years across much of America's public company community," and "certain jurisdictions that have traditionally been averse to permitting DCSs have come to recognize the potential benefits of taking a more permissive stance" – including Singapore and Hong Kong, two of the world's most prominent financial centers. In his paper, Moore maps this complex terrain, providing a comparative analysis of various approaches to regulating DCS structures and calibrating associated incentives. Specifically, he focuses on "whether DCSs should be perpetual or rather should terminate (or 'sunset') at some point in time," and "the most appropriate means of determining when and how time-limited DCSs should sunset."

Moore observes that U.S. tolerance for DCS structures and associated deviation from the one share/one vote approach "would appear to be more international outlier rather than norm," even relative to the United Kingdom where "London's traditional capital market norms have proved considerably less tolerant in this regard." Through a detailed discussion of extant literature, he contrasts proponents' aim to give management "a degree of strategic breathing space … from the intense pressure exerted by quarterly financial reporting hurdles" with opponents' concerns regarding various forms of controller agency costs borne by holders of low-voting stock.

Singapore and Hong Kong, however, have pursued intermediate approaches that point toward a spectrum of possibilities in DCS design. Both have recently liberalized their listing rules to permit DCS structures under certain circumstances as a means of attracting innovative high-tech companies, but only within specific regulatory parameters, which include sunsets. Notably, in both jurisdictions, multiple-vote shares generally convert to single-vote shares upon transfer. Meanwhile, alternative sunset models have been advocated, including ownership-based sunsets, under which conversion is generally triggered by multi-vote shareholders' cash-flow interest in the company falling below a specified level (say, 10 percent), and time-based sunsets, under which conversion is generally triggered by passage of a specified period of time (say, 10 years). As Moore describes, the latter have increasingly been adopted, on a firm-by-firm basis, in the United States.

Acknowledging that "there are in practice a variety of general sunset models for investors, managers and (where relevant) regulators to choose from" along the foregoing lines, and "a wide range of specific potential triggers within each of those models" that might be adopted, Moore concludes that transfer-based models generally ought to be favored. Notably, Moore argues that "regulatory requirements for fixed-term sunsets calibrated on anything wider than a firm-specific basis are inherently arbitrary," and that even firm-specific sunsets of this sort may prove undesirable because, "by their very nature, they are designed proactively a number of years ahead of their intended activation." Ownership-based thresholds, requiring that a certain level of economic interest be maintained, may prove "less problematic" in this regard, yet are still "susceptible to the same charge of eliciting crude and factually insensitive outcomes" in so far as a founder or other controller may have "legitimate prudential motivations for wishing to liquidate part of her multi-vote holding." Having to forego such flexibility might "increase the relevant firm's cost of raising fresh equity capital from prospective future controllers."

The transfer-based approach adopted by Singapore and Hong Kong, on the other hand, generally "will only be triggered by the death or retirement (as a director) of the multi-vote holder(s), or the sale of her equity stake," which "insures against the risk of disturbance to the firm's pre-existing business trajectory." By the same token, Moore observes that since a transfer of control "entails a sudden change of trajectory for the firm's business (whether strategically or at least culturally) *in any event*, it follows that conversion of the firm's capital structure at this point in time will not *in itself* be a likely cause of organizational destabilization." Based on these and other considerations, Moore suggests that U.S. regulatory authorities "give serious consideration to adopting the transfer-centered model of sunset regulation that has recently been implemented by the Hong Kong and Singaporean exchanges, as a more moderate alternative" to the time-based approach that institutional investors have advocated.

Moore's comparative framework brings analytic clarity to a rapidly evolving set of corporate governance issues, while raising important normative and empirical questions for future research. For example, given the general arguments against DCS structures, perhaps there is a reasonable normative case to make for U.S. adoption of a moderate brake on their use, as Moore's analysis suggests. Conversely, however, given the general arguments in favor of DCS structures, perhaps there is likewise a reasonable normative case to make for moderate liberalization of the U.K. approach, departing from London's historically "less tolerant" position in the other direction. By the same token, the intermediate approaches recently adopted by Singapore and Hong Kong may or may not, as an empirical matter, strike the stable balance desired. Should they prove unworkable, or otherwise be disfavored by an increasingly globalized marketplace, this might re-focus attention on the more extreme approaches, in one direction or the other, or some new approach entirely – time will tell. Regardless, Moore's framework provides a nuanced and insightful guide to the issues, and a clear lens through which to assess future developments in this dynamic area of corporate governance.

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