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DESIGNING DUAL-CLASS SUNSETS: THE CASE FOR A TRANSFER-CENTERED APPROACH

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ABSTRACT

Dual-class stock (DCS) structures, and their implications for managerial accountability and corporate governance more broadly, have become prevalent concerns for corporate lawyers and policymakers. Recent academic and practitioner debates on DCS have tended to focus less on the general merits and drawbacks of DCS versus one share/one vote structures, and more on the specific common-ground concern as to whether and how such structures are subjected to contingent reversal or "sunset". This Article compares the relative advantages and disadvantages of time-, ownership- and transfer-centered models of DCS sunset provisions. It argues in favor of the transfer-centered model on the grounds that: (a) its specific event-based trigger renders it less arbitrary in application than the time-centered model, and protects against the possibility of founders being prevented prematurely from realizing their long-term strategic vision (as is a risk with the time-centered sunset model); (b) it avoids the moral hazard and other perverse controller incentives that are prone to ensue from time-centered sunsets; and (c) unlike both the time- and ownership-centered models (which are motivated primarily by agency cost concerns), the transfer-centered model is sensitive to the powerful non-financial

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incentives that controllers typically have to safeguard and promote firm value, even where their corporate control rights significantly outweigh their corresponding cash flow rights. Accordingly, it suggests that the SEC and principal U.S. exchanges should resist recent calls from influential investor-related bodies to mandate time-based sunsets. Instead, domestic policymakers should look overseas to Hong Kong and Singapore, whose respective listing authorities have recently introduced transfer-based sunset requirements for DCS issuers, in considering the most appropriate blueprint for any future regulatory initiatives in this regard.

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INTRODUCTION

Dual-class stock (DCS) structures have spread exponentially in recent years across much of America's public company community.[1] Since the turn of the present century, the annual percentage of U.S.-listed companies adopting DCS structures has increased by a factor of almost twenty in the same number of years.[2] Moreover, 26% of companies that conducted initial public offers (IPOs) on U.S. markets in 2019 had DCS structures.[3] As a consequence of these developments, dual-class listed companies account for an estimated total market capitalization of nearly $4 trillion today,[4] including 9% of the S&P 100.[5] One leading commentator has described the DCS phenomenon as "the most important issue in corporate governance today."[6]

Despite their contemporary vogue connotations, DCS structures are by no means a novelty of today's hi-tech Silicon Valley growth industries.[7] Rather, they have been a feature of corporate

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[1] *See* Robert J. Jackson, Jr., Comm'r, U.S. SEC. & EXCH. COMM'N, PERPETUAL DUAL-CLASS STOCK: THE CASE AGAINST CORPORATE ROYALTY (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty [https://perma.cc/W7Q9-MM3W].

[2] *See id.*; *see also* Navanwita Sachdev, *Why the Dual-Class Stock Structure is Popular with Tech Companies*, THE SOCIABLE (Mar. 6, 2019, 11:46 AM), https://sociable.co/business/why-dual-class-stock-structure-popular-tech-companies/ [https://perma.cc/A3L2-5F5G].

[3] COUNCIL OF INSTITUTIONAL INVS., DUAL-CLASS IPO SNAPSHOT: 2017–2019 STATISTICS, https://www.cii.org/files/2019%20Dual%20Class%20Update%2for%20Website%20FINAL(2).pdf [https://perma.cc/7JA7-SXPM] [hereinafter CII DUAL-CLASS IPO].

[4] Bernard S. Sharfman, *A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs*, 63 VILL. L. REV. 1, 3 (2018).

[5] Charles M. Elson & Craig K. Ferrere, *Unequal Voting and the Business Judgment Rule*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REGUL. (Apr. 7, 2018), https://corpgov.law.harvard.edu/2018/04/07/unequal-voting-and-the-business-judgment-rule/ [https://perma.cc/JN6N-BS8V]; *see also* David A. Bell, *Corporate Governance Survey—2018 Proxy Season Results*, FENWICK & WEST LLP (Jan. 7, 2019), https://www.fenwick.com/publications/pages/corporate-governance-survey-2018-proxy-season-results.aspx [https://perma.cc/7TZV-BR7K].

[6] John C. Coffee, Jr., *Dual Class Stock: The Shades of Sunset*, COLUM. L. SCH. BLUE SKY BLOG (Nov. 19, 2018), http://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset/ [https://perma.cc/4FP2-263R].

[7] As one leading commentator has recorded, "one share–one vote is not the historical norm" but rather, "[t]o the contrary, limitations on shareholder voting

governance, in the United States at least, since the late nineteenth century.[8] For much of this time, DCS structures have been either largely prohibited or, conversely, regarded in a fairly benign light,[9] if not ignored outright as a seemingly dull and technical aspect of corporate finance.[10] Initially, concern for controller unaccountability to investors prompted the New York Stock Exchange (NYSE) to prohibit nonvoting stock entirely in 1926 and, after 1940, to insist on one-vote-per-share as a mandatory U.S. listing condition.[11] These requirements persisted until the mid-1980s, when competitive considerations with respect to the market for listings eventually prompted the main U.S. exchanges to adopt a more permissive regulatory stance on the matter.[12]

For the remainder of the twentieth and early twenty-first centuries, dual-class and other multi-vote capital structures remained a fairly peripheral and uncontroversial element of the

rights in fact are as old as the corporate form itself" such that "[t]oday's dual class capital structures thus were almost more of a revival of the historical norm than a departure from it." Stephen M. Bainbridge, *Understanding Dual Class Stock Part I: An Historical Perspective*, PROFESSORBAINBRIDGE.COM (Sept. 9, 2017), https://www.professorbainbridge.com/professorbainbridgecom/2017/09/understanding-dual-class-stock-part-I-an-historical-perspective.html [https://perma.cc/8DMY-ADEE].

[8] *See* Sharfman, *supra* note 4, at 8. For a more thorough historical overview of the development and regulatory treatment of DCSs in the United States throughout the past century, see Samuel L. Hayes et al., *Dual Class Share Companies, Background Note 9-306-032* HARV. BUS. SCH., 1–3 (Aug. 8, 2005), https://www.hbs.edu/faculty/Pages/item.aspx?num=32631 [https://perma.cc/D4DS-4Q3P].

[9] In particular, DCS structures have traditionally been (and, to a large extent, remain) popular in certain media industries, purportedly as a means of safeguarding long-term journalistic independence and integrity in the face of potential outside-investor demands for short-term profit maximization. *See* Jill E. Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1057, 1061, 1066–67 (2019).

[10] According to one commentator, "[n]ot long ago, even simple dual-class capital structures were the anachronistic refuge of either media conglomerates or old-style industrial titans," with media companies in particular having traditionally deployed dual-class voting structures "when the requirements for journalistic integrity and independence from the market demanded a safe-harbor fortified by an impregnable curtain of voting control." Elson & Ferrere, *supra* note 5.

[11] *See* Sharfman, *supra* note 4, at 8.

[12] Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual Class Stock*, 103 VA. L. REV. 585, 596 (2017).

corporate landscape,[13] attracting limited academic and policy scrutiny during this time.[14] This began to change following Google's high profile dual-class listing in 2004, with Facebook notably following suit in this regard in 2012.[15] Today, in addition to Google (now listed under its parent company's name Alphabet)[16] and Facebook, other well-known U.S. listed companies with DCS structures[17] include Snap, Lyft, Groupon, TripAdvisor, Nike, Levi Strauss, Ford, CBS, Comcast, News Corporation, The New York Times Company, and Berkshire Hathaway.[18]

In the wake of the rapid proliferation and growing public salience of DCS in recent years, hostility towards differential vote capital structures has re-intensified with a comparable degree of

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[13] By contrast, London's indigenous institutional investor community (and, in particular, the influential Association of British Insurers) maintained a consistently hostile stance toward deviation from the conventional one-vote-per-share norm within the U.K.'s listed company sector throughout this time, a position that largely persists today. *See* REINIER R. KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 81–82 (3rd ed. 2017) [hereinafter ANATOMY OF CORPORATE LAW]; Marc T. Moore & Edward Walker-Arnott, *A Fresh Look at Stock Market Short-Termism*, 41 J.L. & SOC'Y 416, 442 (2014).

[14] In 1988, the U.S. Securities and Exchange Commission (SEC) unsuccessfully sought to introduce Rule 19c-4, which, in effect, would have mandated one-vote-per-share for all U.S.-listed companies as a universal stock exchange requirement. Sharfman, *supra* note 4, at 9. However, a federal district court subsequently enjoined this rule on the premise that the SEC significantly exceeded its statutory rule-making authority under the Securities Exchange Act of 1934 to only regulate matters pertaining to securities-market *disclosure*, as opposed to issues of substantive corporate governance, which were the appropriate domain of individual states. *See id.*

[15] *See* Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 704, 707 (2019).

[16] Although Alphabet actually now has a triple-class structure incorporating a third class of nonvoting ("C") shares. On this, see *infra* Section I.A.

[17] For a comprehensive list of current DCS issuers as promulgated and maintained by the Council of Institutional Investors (CII), see COUNCIL OF INSTITUTIONAL INVS., DUAL CLASS COMPANIES LIST (2019).

[18] *Id.*; COUNCIL OF INSTITUTIONAL INVS., COMPANIES WITH TIME-BASED SUNSETS ON DUAL-CLASS STOCK (Jun. 22, 2020), https://www.cii.org/files/6-22-20%20Time-based%20Sunsets.pdf [https://perma.cc/6Z8U-MLVF]. This is in spite of Berkshire Hathaway's chairman/CEO Warren Buffet curiously pressurizing for the removal of DCSs in Berkshire Hathaway's portfolio companies. Vijay Govindarajan et al., *Should Dual-Class Shares Be Banned?*, HARV. BUS. REV. (Dec. 3, 2018), https://hbr.org/2018/12/should-dual-class-shares-be-banned [https://perma.cc/S59Q-5CG5].

rapidity, especially within the United States' institutional investment community.[19] For instance, the Investor Stewardship Group (ISG), which represents over sixty major institutional investors with combined assets of over $31 trillion in market value, has effectively advocated for U.S.-listed companies to near-universally adhere to a one share/one vote norm in its influential Corporate Governance Principles.[20] Moreover, since 2017, S&P Dow Jones Indices have systematically excluded any new companies conducting IPOs with multiple-voting shares from its influential S&P 1500 Composite Index (including its constituent S&P 500 Index),[21] which forms the benchmark for major index-linked funds'[22] multibillion-dollar

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[19] Blair Nicholas & Brandon Marsh, *Dual-Class: The Consequences of Depriving Institutional Investors of Corporate Voting Rights*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 17, 2017), https://corpgov.law.harvard.edu/2017/05/17/dual-class-the-consequences-of-depriving-institutional-investors-of-corporate-voting-rights/ [https://perma.cc/3TGT-RBL9].

[20] In particular, Principle 2 of the ISG Corporate Governance Principles asserts the general proposition that "[s]hareholders should be entitled to voting rights in proportion to their economic interest," while Provision 2.1 recommends more specifically that "[c]ompanies should adopt a one-share, one-vote standard and avoid adopting share structures that create unequal voting rights among their shareholders." *Corporate Governance Principles for US Listed Companies*, INV. STEWARDSHIP GRP., https://isgframework.org/corporate-governance-principles/ [https://perma.cc/H36E-5YDM]. Of more immediate significance to the discussion at hand, though, is Provision 2.2 of the ISG Principles, which further stipulates that:

> Boards of companies that already have dual or multiple class share structures are expected to review these structures on a regular basis or as company circumstances change, and establish mechanisms to end or phase out controlling structures at the appropriate time [in other words, time-centered sunset provisions], while minimizing costs to shareholders.

Id.

[21] *See* Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. REV. 1229, 1232 (2019).

[22] This group includes not just passive (or "tracker") investment funds but also those active funds whose performance is benchmarked to a relevant market index. *See* Lawrence Carrell, *Passive Management Marks Decade of Beating Active U.S. Stock Funds*, FORBES (Apr. 20, 2020, 9:44 PM), https://www.forbes.com/sites/lcarrel/2020/04/20/passive-beats-active-large-cap-funds-10-years-in-a-row/#15d052d947b0 [https://perma.cc/DK2W-DAKR]; *see also* James Chen, *Active Management*, INVESTOPEDIA, https://www.investopedia.com/terms/a/activemanagement.asp [https://perma.cc/S2K6-ZEAN].

investment portfolios.[23] This controversial decision appears to have been taken largely in response to concerted lobbying from institutional investors and their representative bodies.[24] In a similar vein, the influential proxy advisory firm Institutional Shareholder Services (ISS) has a general policy of recommending that its clients vote against reelecting the incumbent directors of any companies that offer differential voting shares as part of an initial or midstream public offering.[25]

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[23] One commentator has reported that "some $8.7 trillion in assets are benchmarked or indexed to the S&P 500," including a significant proportion of the asset portfolios managed by the so-called "mega-mutual fund advisors" Blackrock, Fidelity, Vanguard, and State Street. Sharfman, *supra* note 4, at 4, 13.

[24] *See* Press Release, S&P Dow Jones Indices, S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules (Jul. 31, 2017), https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162_spdjimulti-classsharesandvotingrulesannouncement7.31.17.pdf?force_download=true [https://perma.cc/8C5C-HCP5]; Andrew Winden & Andrew C. Baker, *Dual-Class Index Exclusion* 4, 10–11 (Rock Ctr. For Corp. Governance, Working Paper Series No. 233, Aug. 6, 2018). For similar recent initiatives to this effect implemented by other major index providers, *see id.* at 3, 23–31; FTSE RUSSELL, FTSE RUSSELL VOTING RIGHTS CONSULTATION—NEXT STEPS 3 (Jul. 2017), https://research.ftserussell.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf [https://perma.cc/YY3U-LBKW]; MSCI, CONSULTATION ON THE TREATMENT OF UNEQUAL VOTING STRUCTURES IN THE MSCI EQUITY INDEXES 4 (Jan. 2018), https://www.msci.com/documents/1296102/8328554/Consultation_Voting+Rights.pdf/15d99336-9346-4e42-9cd3-a4a03ecff339 [https://perma.cc/9ARN-LHGN].

[25] Specifically, ISS's current proxy-voting policy recommends that shareholders of public issuers generally vote against, or withhold support for, re-election of the latter's incumbent directors "if, prior to or in connection with the company's public offering, the company or its board [has] implemented a multi-class capital structure in which the classes have unequal voting rights without subjecting the multi-class capital structure to a reasonable time-based sunset." INSTITUTIONAL SHAREHOLDER SERVICES (ISS), UNITED STATES PUBLIC FUND PROXY VOTING GUIDELINES UPDATES FOR 2020: 2020 POLICY RECOMMENDATIONS 6 (Dec. 31, 2019), https://www.issgovernance.com/file/policy/active/specialty/Public-Fund-US-Policy-Updates.pdf [https://perma.cc/RQ9D-NA4Q] [hereinafter ISS 2019(1)]; *see also* INSTITUTIONAL SHAREHOLDER SERVICES (ISS), UNITED STATES PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS 14 (Nov. 18, 2019), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf [https://perma.cc/VU4Y-PDKY]. This is buttressed by an additional general default recommendation that shareholders "vote against proposals to create a new class of common stock" in any investee company. *See* INSTITUTIONAL SHAREHOLDER SERVICES (ISS), UNITED STATES PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS 32 (Dec. 6, 2018), https://www.iss

On the other hand, in recent years, certain jurisdictions that have traditionally been averse to permitting DCSs have come to recognize the potential benefits of taking a more permissive stance on the matter.[26] One of the most intriguing examples in this regard is Singapore.[27] In June 2018, following an extensive consultation process, the Singapore Exchange (SGX) took the landmark step of liberalizing its formerly preclusive listing requirements, with respect to differential vote capital structures, to permit issuers to deviate from the one share/one vote norm subject to specific regulatory restrictions.[28] In taking this step, the SGX expressly sought to appeal to "companies led by founder entrepreneurs who require funding for a rapid ramp-up of the business while retaining the ability to execute on a long-term strategy."[29] This action was consistent with the country's[30] broader strategic ambition to position itself as "a tech and biomedical hub for start-ups,"[31] in

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governance.com/file/policy/2019/americas/US-Voting-Guidelines.pdf [https://perma.cc/5DLG-QC5U]; *see also* INSTITUTIONAL SHAREHOLDER SERVICES (ISS), M&A EDGE NOTE: THE TRAGEDY OF THE DUAL CLASS COMMONS 1, 4 (Feb. 13, 2012), http://online.wsj.com/public/resources/documents/facebook0214.pdf [https://perma.cc/WW34-3HJ9].

[26] *See* Aurelio Gurrea-Martínez, *Theory, Evidence, and Policy on Dual-Class Shares: A Country-Specific Response to a Global Debate*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 15, 2019), https://corpgov.law.harvard.edu/2019/07/15/theory-evidence-and-policy-on-dual-class-shares-a-country-specific-response-to-a-global-debate/ [https://perma.cc/84ET-NS6E].

[27] *See* Ivy Wong, *The Revival of Dual Class Shares*, INT'L FIN. LAW REVIEW (Mar. 10, 2020), https://www.iflr.com/article/b1lmx6clj4l38j/the-revival-of-dual-class-shares [https://perma.cc/WQE9-MQFT].

[28] *See* SGX Mainboard Rules, Rule 210(10)(f), http://rulebook.sgx.com/node/4870/revisions/13283/view [https://perma.cc/D6LS-YGX6]; *infra* text accompanying note 271.

[29] Angela Tan, *SGX Enters New Era as It Starts Dual Class Shares for Qualifying IPOs*, BUS. TIMES (June 27, 2018, 5:50 AM), https://www.businesstimes.com.sg/stocks/sgx-enters-new-era-as-it-starts-dual-class-shares-for-qualifying-ipos [https://perma.cc/S7XE-JW32] (quoting SGX CEO Loh Boon Chye).

[30] Although Singapore Exchange Ltd. (the holding company that owns and has ultimate operational control over the SGX) is formally constituted as a private limited company, its principal shareholder (with a 23.3% proportionate equity stake) is Temasek Holdings, which is one of Singapore's largest state-owned sovereign wealth funds. *See Singapore Exchange Ltd.,* NIKKEI ASIAN REVIEW, https://asia.nikkei.com/Companies/Singapore-Exchange-Ltd [https://perma.cc/4H3Z-RYRR].

[31] SING. EXCH., CONSULTATION PAPER: POSSIBLE LISTING FRAMEWORK FOR DUAL CLASS SHARE STRUCTURES 1–2 (Feb. 16, 2017) (citing 92 Sing. Parl. Deb.

recognition of the fact that "DCS listings are increasingly being considered in industries such as information technology and life sciences."[32] The reform also appears to have been motivated at least in part by Manchester United F.C.'s widely documented decision in 2012 to opt for a NYSE listing in preference to one on the Singapore Exchange,[33] with the SGX's former prohibition on DCS having been cited as a principal reason behind this move.[34] In a similar vein, Hong Kong's recently reformed (post-2017) listings regime has made limited allowance for DCS structures in the case of certain "innovative companies" as defined in the Hong Kong Stock Exchange's Listing Rules,[35] which essentially denotes firms involved in the production of new technologies or other innovations in which significant research and development (R&D) outlays are entailed.[36] This is with an express view to encouraging emerging mainland Chinese tech companies to opt for a Hong Kong over United States listing in the future, and it is prompted in large part by the Chinese e-commerce conglomerate Alibaba's controversial decision in 2014 to list on the NYSE instead of its Hong Kong counterpart.[37]

Off. Rep. (Ong Teng Koon, Member of Parliament)), https://www.rajahtannasia.com/media/2716/sgx_dcs_consultation_paper_-sgx_20170216-final.pdf [https://perma.cc/V4QJ-KENZ].

[32] *Id.* at 2.

[33] CHARTERED FIN. ANALYST INST., DUAL-CLASS SHARES: THE GOOD, THE BAD, AND THE UGLY: A REVIEW OF THE DEBATE SURROUNDING DUAL-CLASS SHARES AND THEIR EMERGENCE IN ASIA PACIFIC 2 (Aug. 2018), https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx [https://perma.cc/D7MA-TU28] [hereinafter DUAL-CLASS SHARES IN ASIA PACIFIC].

[34] John Geddie, *Singapore Details Rules for Listing of Dual-Class Shares, Follows Hong Kong*, REUTERS (June 26, 2018, 6:24 AM), https://www.reuters.com/article/sgx-regulation/singapore-details-rules-for-offering-dual-class-shares-follows-hong-kong-idUSL4N1TS3E3 [https://perma.cc/V4X9-GW4Z].

[35] *See* Alphabet, Inc., Amended and Restated Certificate of Incorporation of Alphabet Inc., art. 4(f) ("Conversion") (Oct. 2, 2015), https://www.sec.gov/Archives/edgar/data/1652044/000119312515336577/d82837dex31.htm [https://perma.cc/A9BE-6T4M]; *infra* text accompanying note 275.

[36] *See* HKEX, CONSULTATION PAPER: A LISTING REGIME FOR COMPANIES FROM EMERGING AND INNOVATIVE SECTORS 11 (Feb. 2018), https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Consultation-Paper/cp201802.pdf [https://perma.cc/3PZR-8N5G].

[37] Alibaba's NYSE listing followed the Hong Kong Exchange's widely documented refusal to permit the company to list with a DCS structure, which

In essence, the general policy debate on DCSs hangs on the purported conflict between, on the one hand, protecting the operational freedom of founders and other trusted corporate leaders to implement their long-term entrepreneurial vision, unimpeded by the destabilizing demands of short-termist activist investors[38] versus, on the other, protecting outside minority investors from manifest managerial unaccountability and associated self-dealing risk.[39] However, in recent years, academic debate on DCSs, especially in the United States, has begun to pivot less on the general merits of permitting, as opposed to prohibiting, DCSs, and more on the specific middle-ground issues of, first, whether DCSs should be perpetual or rather should terminate (or "sunset") at some point in

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would have effectively entrenched long-term board control in the hands of its executive chairman and co-founder, Jack Ma. *See* Enoch Yiu, *Securities Commission Backs Introduction of Dual-Class Shares on Hong Kong Stock Exchange*, S. CHINA MORNING POST (Dec. 20, 2017, 7:28 AM), https://www.scmp.com/business/companies/article/2124972/securities-commission-backs-introduction-dual-class-shares-hong [https://perma.cc/5U3K-AT34]. Curiously, Alibaba recently undertook a $13 billion secondary listing on the Hong Stock Exchange in addition to its continuing NYSE primary listing. *See* Tom Mitchell, *Hong Kong is Testing Whether Finance Needs the Rule of Law*, FIN. TIMES (Nov. 22, 2019), https://www.ft.com/content/e2e3c064-0d07-11ea-bb52-34c8d9dc6d84 (last visited Oct. 30, 2020). This action has been perceived internationally as a significant endorsement of the region's newly liberalized listings framework in otherwise turbulent socio-political times. *See id.*; Hudson Lockett & George Hammond, *Alibaba's Stock Jumps on Hong Kong Trading Debut*, FIN. TIMES (Nov. 26, 2019), https://www.ft.com/content/8f7af224-0f3e-11ea-a7e6-62bf4f9e 548a (last visited Oct. 30, 2020); *see also Hong Kong's Listing Regime Enters New Era, Featuring Emerging and Innovative Firms*, HKEX (Apr. 24, 2018), https://www.hkex.com.hk/News/Regulatory-Announcements/2018/180424news?sc_lang=en [https://perma.cc/HLN4-T234].

[38] According to one influential source:

> The single most important feature of DCS structures is that they give founders, entrepreneurs, and other corporate insiders voting control of the listed entity … [which is purportedly] desirable because it allows charismatic, visionary founders and entrepreneurs to execute their vision (especially in the early years of a public company) without having to worry unduly about stock market performance.

DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 8.

[39] *See* SEC. & EXCH. COMM'N, INV. ADVISORY COMM., DUAL CLASS AND OTHER ENTRENCHING GOVERNANCE STRUCTURES IN PUBLIC COMPANIES 2–3, 8–9 (Discussion Draft 2012), https://www.sec.gov/spotlight/investor-advisory-committee-2012/discussion-draft-dual-class-recommendation-iac-120717.pdf [https://perma.cc/34KE-VR2S].

time, and, second, the most appropriate means of determining when and how time-limited DCSs should sunset.[40] While debate on these more granular questions is no less fervent, the continuing permissibility of DCSs in at least *some* conditional format is now becoming an increasingly common premise of such discussions.[41]

On the vexing question of optimal sunset design there are three broad schools of thought,[42] each of which will be critically examined below.[43] The first, and increasingly most common, view in this regard is that sunset provisions should be time-conditioned, with the effect that a DCS structure automatically sunsets after a predetermined time period (for example, seven, ten or fifteen years) unless affirmatively resolved otherwise by a majority of independent (in other words, *non*-super-voting) shareholders.[44] The second common view is that sunset provisions should ideally be ownership-based, such that multiple-vote shares automatically convert, subject to offsetting independent shareholder resolution, to single-vote shares upon their holder's proportionate holding of cash-flow rights dropping below a predetermined minimum threshold (for example, 10%, 15%, or 20%).[45] And the third common view is that sunset provisions should be transfer-based, such that DCSs automatically convert (again subject to any countervailing independent shareholder vote) upon the death, incapacitation, or retirement (from the company's board) of their original holder, or if otherwise transferred to someone other than that specified person.[46] In the discussion that follows, these three competing schools of thought on the question of optimal sunset design will be referred to, respectively,

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[40] Fisch & Solomon, *supra* note 9, at 1062–64, 1078–79, 1086.

[41] Bebchuk & Kastiel, *supra* note 12, at 601.

[42] Although it may be disputed that there are in fact *four* broad schools of thought on this issue, insofar as there remain a number of commentators wedded to one of the polar extreme views to the effect that there should be no scope for sunsetting at all, either because DCSs should be perpetual and constrained only by market forces; or, conversely, because they should be prohibited outright such that the question of sunsetting never becomes an issue in the first place. *See infra* Section I.B. However, in the discussion that follows we will present these more juxtaposed arguments separately from those focusing on the question of optimal sunset design itself. *Id.*

[43] *See infra* Part II.

[44] *See infra* Section II.A.

[45] *See infra* Section II.B.

[46] *See infra* Section II.C.

as: (a) the *"time-centered"* model, (b) the *"ownership-centered"* model, and (c) the *"transfer-centered"* model of sunset design.[47]

Against the above background, this Article compares the relative advantages and disadvantages of each of the above positions. On this basis, it seeks to determine which—if any—of those models is preferable, whether as an influence for private ordering at the individual firm level, or as a blueprint for broader-reaching regulatory policy design. Accordingly, the discussion is structured as follows. Part I briefly documents the parameters of the general academic and policy debate on dual-class and other differential vote capital structures. It begins by explaining the essential structural features of DCS as a general institutional phenomenon.[48] It looks at the highly variable ways in which they have been dealt with on a regulatory level across different jurisdictions.[49] It then examines the polar extreme positions of the ongoing academic debate on DCS—which argue, respectively, for outright facilitation versus prohibition of those structures—before assessing how this debate has increasingly come to focus on the more specific common-ground concern of optimal sunset design.[50] Part II outlines the key features and policy rationales for each of the three principal models of DCS sunset provision referred to above.

Part III presents a normative argument in favor of the transfer-centered model and highlights its main comparative advantages over the other two models from both a private ordering and public-regulatory perspective. Here it will be claimed that the transfer-centered model is not only less arbitrary in its application than the competitor models, but also less inclined to elicit moral hazard and other perverse incentives on the part of corporate controllers.[51] Finally, this Article will posit that the transfer-centered model has the additional advantage of remaining sensitive to the powerful non-financial incentives that incumbent controllers typically have to safeguard and promote firm value, even when their corporate control rights significantly outweigh their corresponding cash flow rights.[52] The Conclusion suggests that, in view of the

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[47] *See generally infra* Parts II–III.

[48] *See infra* Section I.A.

[49] *See id.*

[50] *See infra* Section I.B.

[51] *See infra* Sections III.A, III.B.

[52] *See infra* Section III.C.

complexity and context-dependency of the various factors involved, there remains a strong case for devolving the question of optimal sunset design to firm-specific private ordering.[53] Nonetheless, to the extent that such provisions are voluntarily adopted or regulatorily mandated, whether in the United States or elsewhere, then the transfer-centered model would appear the least-worst blueprint for lawyers and/or policymakers to work from.[54]

I. The Parameters of the Dual-Class Stock (DCS) Debate

A. Essential Features and Regulatory Treatment of DCS Structures

A dual-class stock (or DCS) structure, according to one authoritative source, is "a share structure that gives certain shareholders voting rights disproportionate to their shareholding" such that "[s]hares in one class carry one vote, while shares in another class carry multiple votes."[55] In this regard, DCS structures constitute one particular form of a broader corporate governance phenomenon known as a "controlling-minority structure," a category which also includes stock pyramids and cross-holdings.[56] The common feature of all such structures is that they enable the separation of control and cash flow rights, consequently permitting a dominant equity investor to enjoy effective voting control over the firm while holding only a minority of cash flow rights.[57] The standard DCS structure—in United States-listed companies at least—is for multiple-vote (so-called super-voting) shares to carry ten votes each, with ordinary shares carrying only one vote each.[58] For example, Facebook's 10:1 weighted dual-class structure enables its founder, Mark Zuckerberg, together with a small group of inside associates, to exercise majority voting control despite having

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[53] *See infra* notes 402–04 and accompanying text.

[54] *See infra* notes 393–97 and accompanying text.

[55] *Listing Framework for Dual Class Share Structures*, SGX (June 26, 2018), http://rulebook.sgx.com/sites/default/files/net_file_store/SGX_Mainboard_Rules_June_26_2018.pdf [https://perma.cc/73Z4-ZFWX].

[56] On this, see LUCIAN A. BEBCHUK ET AL., CONCENTRATED CORPORATE OWNERSHIP 295–96 (Randall K. Morck ed., 2000).

[57] *Id.* at 295.

[58] *See infra* note 273 and accompanying text.

only a 14% cash flow interest in the firm.[59] In the case of Alphabet (Google), meanwhile, Larry Page and Sergey Brin are positioned to exercise majority voting control on the basis of just an 11% cash flow interest.[60] Moreover, this has remained the case following Page and Brin's recent relinquishment of their former managerial positions as Alphabet's CEO and President, respectively.[61]

More recent events would indicate that this trend is becoming even further intensified.[62] In the high-profile 2019 IPO of the ride-hailing firm Lyft and social media giant Pinterest (and, somewhat

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[59] Shannon Bond & Nicole Bullock, *Lyft IPO Revs up Debate on Dual-Class Share Structures*, FIN. TIMES (Feb. 25, 2019), https://www.ft.com/content/c7d323ba-36b0-11e9-bd3a-8b2a211d90d5 (last visited Oct. 30, 2020). Although it is noteworthy that, in Facebook's 2019 annual shareholder meeting, over 83% of Facebook's independent (i.e., single-vote) shareholders supported a recommendation to abolish the company's DCS structure in view of its perceived mishandling of a number of recent high-profile corporate scandals. Jake Kanter, *Facebook Investors Voted in Support of Proposals to Fire Mark Zuckerberg as Chairman, but Zuckerberg Still Holds Power*, INC. (June 12, 2019), https://www.inc.com/business-insider/facebook-investors-vote-in-support-fire-mark-zuckerberg-chairman.html [https://perma.cc/A4SP-RADK]. This was accompanied by a parallel proposal, which likewise commanded majority independent shareholder support, in favor of separating the CEO and chairman positions on the company's board, both of which continue to be held by its founder Mark Zuckerberg. *Id.* However, Zuckerberg's ongoing opposition to the above reforms meant that both proposals were ultimately defeated by his weighted votes cast against the relevant motions. *Id.*

[60] Bobby V. Reddy, *Finding the British Google: Relaxing the Prohibition of Dual-Class Stock from the Premium-Tier of the London Stock Exchange* 3 (Nov. 29, 2019) (Univ. of Cambridge Fac. of L. Rsch. Paper, Paper No. 4/2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3495309 [https://perma.cc/7U97-WCUB]. *See also* Bebchuk & Kastiel, *supra* note 12, at 608. To cite an even more extreme example, the 10:1 DCS structure employed by the ride-hailing platform operator Lyft following its 2019 IPO enables its cofounders Logan Green and John Zimmer to exercise effective outright voting control despite having a less than 5% cash flow interest in the firm. *See* Lucian Bebchuk & Kobi Kastiel, *The Perils of Lyft's Dual-Class Structure*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 3, 2019), https://corpgov.law.harvard.edu/2019/04/03/the-perils-of-lyfts-dual-class-structure/ [https://perma.cc/MK7M-K5AF] [hereinafter Bebchuck & Kastiel, *Lyft*].

[61] *See* Larry Page & Sergey Brin, *A Letter from Larry and Sergey*, GOOGLE: THE KEYWORD (Dec. 3, 2019), https://www.blog.google/inside-google/alphabet/letter-from-larry-and-sergey/ [https://perma.cc/6KYF-2YTN]; Rob Copeland, *Google Co-Founders Page, Brin Give Up Management Roles*, WALL ST. J. (Dec. 3, 2019, 6:08 PM), https://www.wsj.com/articles/sundar-pichai-to-replace-larry-page-as-ceo-of-alphabet-11575409229 [https://perma.cc/Q4WD-GP3R].

[62] *See* Bond & Bullock, *supra* note 59.

ominously, in the initial filings for WeWork's recently aborted IPO attempt[63]), the super-voting shares' voting rights outweighed those attached to ordinary shares by a 20:1 ratio.[64] A small group of U.S.-listed companies including Snap, Alphabet, and Under Armour have recently gone even further than this and adopted triple class share structures, which include a third class of nonvoting ("C") shares.[65] In the case of Snap,[66] this structure has moreover existed since the company's IPO in March 2017.[67]

It is well-known that nonvoting or low-vote shares typically trade at a material discount, not only vis-à-vis multiple-vote shares but also in relation to the common stock of those firms adopting an orthodox one share/one vote capital structure.[68] This is in (negative) reflection of the so-called private benefits of control that the holders of multiple-vote shares are positioned to exploit

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[63] Attracta Mooney, *Big Investors Fight Back over Dual-Class Shares*, FIN. TIMES (Nov. 24, 2019), https://www.ft.com/content/bc220535-5055-47ce-811d-fc4a56d32937 (last visited Oct. 30, 2020).

[64] *See* Benjamin Willis, *Will Super-Voting Stock Get a Tax Lyft?*, FORBES (Feb. 6, 2020, 11:58 AM), https://www.forbes.com/sites/taxnotes/2020/02/06/will-super-voting-stock-get-a-tax-lyft/#4bd72c3152fd [https://perma.cc/PJ2A-6FEW]. However, it is noteworthy that Lyft's major competitor Uber ultimately opted against adopting a multiple-vote capital structure in its high-profile 2019 IPO on the NYSE, having earlier removed a DCS structure that had formerly protected the company's early stage investors (including its controversial cofounder Travis Kalanick) as a condition of attracting a $9 billion pre-IPO investment from SoftBank. Bond & Bullock, *supra* note 59.

[65] *See* Kaitlin Descovich et al., *Voting Rights Gone in a Snap—Unequal Voting Rights Back in the Spotlight*, GOVERNANCE & SEC. WATCH (Apr. 3, 2017), https://governance.weil.com/whats-new/voting-rights-gone-in-a-snap-unequal-shareholder-voting-rights-back-in-the-spotlight/ [https://perma.cc/PF2Z-J5T7].

[66] Facebook unsuccessfully attempted to implement a similar structure in 2018 to enable its founder Mark Zuckerberg to maintain majority voting control over the firm even after selling a significant proportion of his initial multivote shares to fund personal philanthropic ventures. *See* DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 8.

[67] *See id.* at 62. Alternatively (and much less commonly today in U.S.-listed companies at least), a DCS structure might be constituted by a so-called "hardwiring" provision whereby a controlling minority is entitled to a fixed percentage of votes in annual shareholder meetings, notwithstanding the corresponding proportion of equity that they happen to own at any particular point in time. *See* Bebchuk & Kastiel, *supra* note 12, at 608.

[68] *See* Henry Hansmann & Reinier Kraakman, Essay, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 462 (2001).

at the expense of the low- or nonvoters.[69] Insofar as investors are collectively capable of pricing the relative outside shareholder friendliness of these alternative vote distributions, then it may well be argued (as many commentators have) that the evaluation of DCS structures is ultimately best left to the invisible hand of stock market forces.[70] Indeed, such an ethos essentially characterizes the modern regulatory stance on this issue that has prevailed in the United States since the mid-1980s.[71] Accordingly, under NYSE and NASDAQ listing rules alike, both multiple-vote shares and nonvoting shares are permitted at IPO stage.[72] However, so-called "midstream" variations in capital structure that disparately reduce or restrict the voting rights of existing shareholders are prohibited.[73]

While it is customary to think of the U.S. corporate governance framework as an influential yardstick for broader global developments in the field,[74] this is one area in which—viewed from a comparative standpoint—the contemporary American position would appear to be more international outlier rather than norm.[75] Indeed,

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[69] *See* ANATOMY OF CORPORATE LAW, *supra* note 13, at 79–80.

[70] *See infra* notes 97–98 and accompanying text.

[71] *See* Bebchuck and Kastiel, *supra* note 12 and accompanying text. Other jurisdictions adopting a generally permissive regulatory stance in respect of DCSs today. *See* Bebchuk & Kastiel, *supra* note 12, at 599 (including the jurisdictions of Canada, Sweden, Switzerland, the Netherlands); *see also* Zoe Condon, Comment, *A Snapshot of Dual-Class Share Structures in the Twenty-First Century: A Solution to Reconcile Shareholder Protections with Founder Autonomy*, 68 EMORY L. J. 335, 357 (2018) (including jurisdiction of France); Koji Toshima, *Cyberdyne's Dual-Class IPO*, 40 INT'L FIN. L. REV. 43, 43 (2015) (including jurisdiction of Japan).

[72] *See* Bebchuk & Kastiel, *supra* note 12, at 597.

[73] *See* NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL, Rule 313.00 (2020), https://nyse.wolterskluwer.cloud/listed-company-manual [https://perma.cc/E6S4-76P4]; *see also* NASDAQ STOCK MARKET LISTING RULES, Rule 5640 (last amended Dec. 3, 2019), https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5000#nasdaq-rule_5600 [https://perma.cc/UEH9-QQ7F]. Although, as against the above prohibition on midstream conversion of existing common stock to dual-class status, it has recently been argued that "single-class firms should be given an option to convert to dual-class shares through a shareholder vote, in order to carry out significant transformations, instead of having to completely delist in order to achieve that goal." Govindarajan et al., *supra* note 18.

[74] *See generally* Hansmann & Kraakman, *supra* note 68.

[75] *See id.* at 456.

the general regulatory tolerance shown towards DCS structures in the U.S. listings environment puts it in stark contrast with numerous other jurisdictions across the world including Austria,[76] Belgium,[77] Brazil,[78] Germany,[79] Italy,[80] Spain,[81] and the United Kingdom.[82] A common feature of all the above countries' respective corporate and/or securities law systems is their adoption of a much more protectionist (by U.S. standards)—if not altogether prohibitive—stance concerning the regulatory treatment of multi-vote capital structures in listed companies.[83] At a supranational level, meanwhile, the so-called "breakthrough rule" embodied in the European Union Takeover Directive is designed to mitigate the risk of DCSs and other insider-friendly voting structures being used as a preclusive roadblock to cross-border corporate control bids within the EU single market environment.[84]

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[76] *See* MARCCUS PARTNERS & THE CTR. FOR EUROPEAN POL'Y STUD., THE TAKEOVER BIDS DIRECTIVE ASSESSMENT REPORT 196–97 (2012), https://op.europa.eu/en/publication-detail/-/publication/67501b75-7583-4b0d-a551-33051d8e27c1 (last visited Oct. 30, 2020) [hereinafter TAKEOVER BIDS].

[77] *See id.*

[78] In Brazil, DCSs are prohibited in the voluntary listing segment Novo Mercado, but are otherwise permitted. *See* PEDRO MATOS, CFA INST., AN ASSESSMENT OF DUAL-CLASS SHARES IN BRAZIL 1 (2018), https://www.cfainstitute.org/-/media/documents/support/advocacy/dual_class_shares_in_brazil.ashx [https://perma.cc/4QRD-DR84].

[79] Germany has an outright legal prohibition on multiple vote shares along with significant limitations on the issuance of restricted- or non-voting shares. *See* DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 29.

[80] TAKEOVER BIDS, *supra* note 76, at 196.

[81] *See id.*

[82] *See id.*

[83] *See* Jennifer Payne, *Time to Make the Board Neutrality Rule Mandatory in the EU*, OXFORD BUS. L. BLOG (June 7, 2016), https://www.law.ox.ac.uk/business-law-blog/blog/2016/06/time-make-board-neutrality-rule-mandatory-eu [https://perma.cc/9ND3-W8JS].

[84] The breakthrough rule, which is set out in Article 11 of the EU Takeover Directive, is triggered by an offeror's (that is, bidder's) acquisition of at least 75% of equity or cash flow rights in the offeree (in other words, target) company. Council Directive 2004/25/EC, art. 11, 2004 O.J. (L 142) 12, 20 (EC). Once implemented, this provision has the effect of automatically converting any multi-vote shares in the offeree company to single-vote status for the purpose of any general meeting of shareholders that is convened to decide on whether any frustrative bid defense(s)

Amongst the most interesting examples in this regard is the United Kingdom where, despite unorthodox share voting structures having been treated in a liberal manner by the English courts,[85] London's traditional capital market norms have proved considerably less tolerant.[86] Moreover, the new (post-2013) enhanced listing

should be deployed. *Id.* This consequently enables the offeror—metaphorically speaking—to permeate the wall of insulation that the weighted voting structure would otherwise have provided to the offeree company's management in the face of a hostile acquisition attempt. *See* TAKEOVER BIDS, *supra* note 76, at 195.

Notably, the breakthrough rule does not apply mandatorily across the EU, but rather only takes effect at a domestic level if, and when, a member state affirmatively "opts in" to its application. *Id.* at 188. An Assessment Report on the Takeover Directive's implementation carried out in 2012 found that, despite the breakthrough rule's initial promise in 2004 to help facilitate a free pan-European market in corporate control, only one member state (namely Estonia) had actually applied the provision in full at a domestic level. *Id.* at 195. However, as highlighted above, the fact that in numerous EU member states including Belgium, Germany, Italy, Spain and the United Kingdom, DCS structures are either difficult or impossible to implement in listed companies in any event, arguably renders the limited domestic take-up of the breakthrough rule less materially significant in practice. *See supra* notes 76–83 and accompanying text.

Curiously, despite the common association of the breakthrough rule with the EU capital markets regime, its impact has actually been much more extensive in Japan where it exists today as a general listing requirement of the Tokyo Stock Exchange. *See* Toshima, *supra* note 71, at 43. *See generally* Payne, *supra* note 83; Thomas Papadopoulos, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 6 L. & FIN. MKTS. REV. 525 (2015).

[85] See, for example, Lord Upjohn's classic dictum in the landmark House of Lords decision in Bushell v. Faith [1970] AC 1099 (HL) 1109 (appeal taken from Eng.), to the effect that "Parliament has never sought to fetter the right of the company to issue a share with such rights or restrictions as it may think fit."

[86] *See* Moore & Walker-Arnott, *supra* note 13, at 442. It has been recorded that:

> [i]n the eyes of the United Kingdom's major [domestic] shareholding institutions and their representative organizations (especially the Association of British Insurers), differential voting entitlements have traditionally been viewed as an illegitimate distortion of shareholder democracy and—more worryingly—a means by which unscrupulous corporate managers can extract benefits far in excess of their corresponding cash-flow rights in the firm.

Id. Consequently, "the [London] market has for many decades exhibited something of a quasi-religious devotion to the democratic mantra of one share/one vote" as an "unwritten but yet highly influential principle." *Id.*

regime[87] applicable to premium-listed[88] companies on the London Stock Exchange's main market requires that such higher-tier issuers conform to the dual *equality* and *proportionality* principles as set out within U.K. Listing Rules.[89] The former of those principles dictates that "[a]ll equity shares in a class that has been admitted to premium listing must carry an equal number of votes on any shareholder vote."[90] More significantly for the discussion at hand, the latter principle insists that "[w]here a listed company has more than one class of securities admitted to premium listing, the aggregate voting rights of the securities in each class should be *broadly proportionate to* the relative interests of those classes in the equity of the listed company."[91]

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[87] On this generally, see FINANCIAL CONDUCT AUTHORITY, CP13/15, FEEDBACK ON CP12/25: ENHANCING THE EFFECTIVENESS OF THE LISTING REGIME AND FURTHER CONSULTATION (2013), https://www.fca.org.uk/publication/consultation/cp13-15.pdf [https://perma.cc/89V3-HGTW]; Roger Barker & Iris H.Y. Chiu, *Protecting Minority Shareholders in Blockholder-Controlled Companies: Evaluating the UK's Enhanced Listing Regime in Comparison with Investor Protection Regimes in New York and Hong Kong*, 10 CAP. MKTS. L. J. 98 (2015).

[88] An equity issuer on the main market of the London Stock Exchange has the option of undertaking either a standard or premium listing. LONDON STOCK EXCHANGE, MAIN MARKET: A GUIDE TO LISTING ON THE LONDON STOCK EXCHANGE 8, 15 (2010), https://docs.londonstockexchange.com/sites/default/files/documents/guide-main-market-pdf.pdf [https://perma.cc/P9DQ-SRR8]. In the latter instance, the issuer essentially agrees to be subject to a more rigorous compliance burden than its standard-listed counterparts with respect to key disclosure and internal governance matters, as the payoff for (in theory at least) engendering higher trust from investors and reducing its ongoing cost of capital accordingly. *Id.* at 8. In particular, the so-called "super-equivalent" rules applicable to premium-listed companies notably go beyond the minimal requirements under EU law to which London's standard-listed segment is subject. *Id.* at 15.

[89] *See* U.K. FIN. CONDUCT AUTH., FCA HANDBOOK: LISTING RULES LR 7.2.1.A (2020), https://www.handbook.fca.org.uk/handbook/LR.pdf [https://perma.cc/7YAR-WJ32].

[90] *Id.*

[91] *Id.* (emphasis added). The equality and proportionality principles applicable to London's premium-listed market segment are reinforced today by the additional independent business requirement, whereby "[a]n applicant [for premium listing] must demonstrate that it carries on an independent business as its main activity." *Id.* at LR 6.4.1. This entails (inter alia) that the relevant issuer must have access to financing from more than one person or group and must not be subject to overarching strategic control on the part of any other person or group. *See id.* at LR 6.4.3. Relatedly, an applicant for premium listing that has a controlling shareholder must be able to show that it is capable of carrying on

Although—as highlighted above[92]—the U.K. enhanced listing regime is just one of many domestic and supranational regulatory frameworks to have adopted a broadly hostile stance in relation to DCSs,[93] it is nonetheless an example that merits special attention in the context of the discussion at hand. This is because it demonstrates that a country with a fundamentally similar capital market environment to the United States,[94] and also a broadly similar politico-economic tradition,[95] can take a starkly different

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an independent business despite that shareholder's presence, having regard (inter alia) to whether that shareholder is able directly or indirectly to influence the company's operations, and also to whether the company has access to any independent sources of finance other than that shareholder. *Id.* at LR 6.5.

Furthermore, any applicant for premium listing that has a controlling shareholder (including a DCS or other controlling minority structure) must enter into a written and legally binding agreement with that shareholder (known as a relationship agreement), under which the controlling shareholder undertakes not to circumvent the issuing company's compliance with the above requirements by seeking unduly to influence its strategy, operations, or financing. *Id.* at LR 6.5.4. Finally, any such higher-tier issuer is required to hold a dual shareholder approval vote both including *and excluding* any controlling shareholder(s) on the (re)election of any of its independent directors, albeit that a negative independent (that is, noncontrolling) shareholder vote does not in itself necessarily impede reelection of any candidate(s) that have the controller's support. *Id.* at LR 9.2.2E–F. On the above dual-vote procedure and the practical limitations thereof, see Bobby V. Reddy, *The Fat Controller: Slimming Down the Excesses of Controlling Shareholders in UK Listed Companies,* 38 OXFORD J. LEGAL STUD. 733, 742–47 (2018).

[92] *See supra* note 86 and accompanying text.

[93] *Id.*

[94] Like the United States, the United Kingdom is renowned today (at least in corporate governance terms) for its characteristic system of widely dispersed public company share ownership and, correspondingly, the substantial absence (in relation to continental European and Asian style "blockholder" governance systems at least) of dominant family, state, or other controlling shareholder influences in this context. *See* MARC MOORE & MARTIN PETRIN, CORPORATE GOVERNANCE: LAW, REGULATION AND THEORY 10–14 (2017). *See generally* BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED chs. 9–10 (2008).

[95] *See* MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT 98–103 (2003). Although, for a more nuanced transatlantic comparative analysis in this regard, see generally CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER ch. 5 (2013); Brian R. Cheffins, *Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation*

regulatory and policy position in relation to DCSs where this is deemed necessary to combat the threat to minority shareholder welfare posed by potentially overreaching corporate controllers.[96] The ensuing inference, at least insofar as U.S. corporate governance is concerned, is that the United States' permissive modern stance on DCS structures in publicly traded companies is by no means the only possible way for it to go here.

B. The Polar Extremes of the DCS Debate: Facilitation Versus Prohibition

1. The Case for Facilitation

In the eyes of DCS defenders, the recent spread of insider-oriented capital structures is evidence of a well-functioning market dynamic at work.[97] Accordingly, entrepreneurs and investors who

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in the United Kingdom, in CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY 147 (Joseph A. McCahery et al. eds., 2002); Marc T. Moore, *Shareholder Primacy, Labour and the Historic Ambivalence of UK Company Law*, *in* RESEARCH HANDBOOK ON THE HISTORY OF CORPORATE AND COMPANY LAW 142 (Harwell Wells ed., 2018).

[96] *See* BRUNER, *supra* note 95, at 143–44. However, against the above background, it is curious to note recent media reports that the U.K. government has been consulting privately with London's institutional investment community, potentially with a view to reforming the country's listings framework so as to make it more attractive to high-growth firms, including dynamic tech startups. Reddy, *supra* note 60, at 4. Whether this will result in the U.K. Listing Authority relaxing to some extent its current prohibition on DCS within London's premium listed sector remains to be seen. In the present author's opinion such an outcome is unlikely, although for a contrary view on the matter see Reddy, *supra* note 60, at 4. *See* Daniel Thomas, Philip Stafford & Patrick Jenkins, *UK Seeks Change in Listing Rules to Lure Tech Start-ups*, FIN. TIMES (Nov. 4, 2019), https://www.ft.com/content/d4d2da5a-fee8-11e9-be59-e49b2a136b8d (last visited Oct. 30, 2020); Fin. Times Ed. Bd., *Why Dual-Class Shares Deserve Consideration*, FIN. TIMES (Nov. 11, 2019), https://www.ft.com/content/6f576e60-0231-11ea-be59-e49b2a136b8d (last visited Oct. 30, 2020). *See generally* HM TREASURY, FINANCING GROWTH IN INNOVATIVE FIRMS: CONSULTATION (Aug. 2017), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642456/financing_growth_in_innovative_firms_consultation_web.pdf [https://perma.cc/A6J9-F3YH].

[97] *See* Sharfman, *supra* note 4, at 1–3; Bernard S. Sharfman, *The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuk and Kastiel*, 93 S. CAL. L. REV. POSTSCRIPT 1, 2–4 (2019) [hereinafter Sharfman, *Sunsets*].

are favorable to DCSs in their unbridled format are free to support any company's adoption of such a voting structure voluntarily, whether at the IPO stage or thereafter.[98] Vice versa, those firms whose market circumstances and organizational characteristics are more attuned to the standard one share/one vote model always have the option of adopting either the default single-class voting structure or, alternatively, some contractually bespoke sunset clause in their certificate of incorporation.[99] On this premise, the fact that so many DCS structures persist is a sign of their presumptive efficiency.[100] The essential normative claim here is that entrepreneurs' continuing widespread adoption of DCSs, and investors' corresponding widespread tolerance of such structures, is testament to the propensity of DCSs to reduce the net costs of production for many firms.[101] Otherwise, DCSs would necessarily have been precluded—or, at least, substantially eradicated—by the market-driven natural selection process.[102]

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[98] *See* NASDAQ, THE PROMISE OF MARKET REFORM: REIGNITING AMERICA'S ECONOMIC ENGINE 17 (Feb. 2018), https://www.nasdaq.com/docs/Nasdaq_Blueprint_to_Revitalize_Capital_Markets_April_2018_tcm5044-43175.pdf [https://perma.cc/5NH4-GSTN]; *see also* Sharfman, *supra* note 4, at 6.

[99] On the principal broad choices available to companies in this regard, see discussion *infra* Sections II.A–C.

[100] For a critical appraisal of the concept of presumptive (or *a priori*) efficiency as adopted within law and economics scholarship generally, see Paddy Ireland, *Defending the Rentier: Corporate Theory and the Reprivatisation of the Public Company*, THE POLITICAL ECONOMY OF THE COMPANY 162 (John Parkinson et al. eds., 2000).

[101] On the relation between corporate control rights and the firm's overall net production costs generally, see Zohar Goshen & Richard Squire, Essay, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 783 (2017).

[102] On the notion of securities market forces as a (presumptively efficient) natural selection mechanism, see generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 1 (1991). Easterbrook and Fischel posit that:

> self-interested entrepreneurs and managers, just like other investors, are driven to find the devices most likely to maximize net profits. If they do not, they pay for their mistakes because they receive lower prices for corporate paper. Any one firm may deviate from the optimal measures. Over tens of years and thousands of firms, though, tendencies emerge. The firms and

On one view, the spread of DCS structures in the U.S. stock market environment can be seen as a response to a largely U.S.-specific phenomenon: that is, the increasing concentration of the country's traditionally fragmented public company ownership base, and the corresponding centralization of corporate governance influence in the hands of a relatively small and increasingly interconnected group of institutional investor bodies.[103] Allied to this development is the significantly enhanced challenge to managerial hegemony posed by activist hedge funds, who have shown a growing willingness to use (actual or threatened) proxy contests as a means of extracting major concessions from boards and/or CEOs on key strategic or financial matters, against the backdrop of the latter's potential imminent displacement.[104] One notable consequence of this conspicuous landscape shift has been a diminution in the functional value of U.S. corporate law's characteristic principle of director primacy,[105] whereby boards of directors are perceived as exercising largely untrammeled prerogative[106] in determining the strategic direction of the business.[107] DCS structures can thus be regarded as a crucial bulwark for public company boards and managers against destabilizing pressures from activist hedge funds and other aggressive capital market

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> managers that make the choices investors prefer will prosper relative to others.

Id. at 6.

[103] *See* David J. Berger, *Why Dual Class Stock? A Response to CII's Petition to NASDAQ for Mandatory Sunset Provisions* 7–8 (2009) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3365154 [https://perma.cc/6CG9-QKAF].

[104] *See generally* Sharfman, *supra* note 4, at 12; Bernard S. Sharfman, *The Tension Between Hedge Fund Activism and Corporate Law*, 12 J. L. ECON. & POL'Y 251 (2016).

[105] Insofar as Delaware corporations are concerned, the doctrinal basis of the director primacy principle is § 141(a) of the Delaware General Corporation Law, which provides that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." DEL. CODE ANN. tit. 8, § 141(a) (West 2020).

[106] On this, see generally Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. UNIV. L. REV. 547, 547–52 (2002).

[107] *See* Sharfman, *supra* note 4, at 23–25.

actors,[108] thereby resetting U.S. corporate governance's conventional board-centric equilibrium.[109]

The propensity of DCS structures to shift the balance of corporate decision-making power away from "outside" minority shareholders, and—correspondingly—towards "inside" owner controllers aligns with a parallel shift that has occurred on an academic level in recent years.[110] This has involved a progressive withdrawal by corporate law scholars from the orthodox "agency costs" thought paradigm,[111] which for the past four decades has lent sustained conceptual support to U.S. corporate governance's prevailing shareholder value orientation.[112] In its place, a group of alternative theories of corporate governance has evolved, which in varying ways purports to provide a more balanced and insider-oriented view of corporate decision-making.[113] The intellectual precursor to this evolving countermovement was Margaret Blair and Lynn Stout's classical "team production" theory of the firm.[114] Blair and Stout's theory essentially sought to portray the board of directors, rather than shareholders, as the corporation's supreme governance authority.[115] Shareholders were correspondingly relegated to the status of a mere productive input provider, in their case,

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[108] As Goshen and Squire have highlighted, "neither activist hedge funds nor hostile raiders can force the managers of a dual-class firm to change their business strategy." *See* Goshen & Squire, *supra* note 101, at 806.

[109] On this, see Bainbridge, *supra* note 106.

[110] *See* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301–02 (1983); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 288–89 (1980); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 305–06, 309 (1976).

[111] The seminal contributions to this landmark school of thought are Fama & Jensen, *supra* note 110, at 301–02; Fama, *supra* note 110, at 288–89; Jensen & Meckling, *supra* note 110, at 305–06, 309.

[112] On this, see generally Ireland, *supra* note 100.

[113] On this developing alternative school of thought, which the present author has previously termed the post-shareholder-value (or "PSV") paradigm, see Marc T. Moore, *A Necessary Social Evil: The Indispensability of the Shareholder Value Corporation*, 40 SEATTLE U. L. REV. 427, 438–42 (2017).

[114] *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 248, 248–49 (1999).

[115] Blair and Stout claim that, "[a]s the ultimate decision-making body within the firm, [directors] are not subject to direct control or supervision by *anyone*, including the firm's shareholders." *Id.* at 290.

of equity capital, to the firm in the same vein as employees and suppliers.[116] Blair and Stout's theory thus afforded shareholders no privileged governance status over other stakeholder groups.[117] They moreover rejected the notion that corporate law was designed to provide shareholders with any such exalted status.[118]

Blair and Stout's essential mantle in this regard has since been taken up, in varying ways, by a range of other leading scholars in recent times, such that non-shareholder-centric conceptions of corporate law that contest the traditional agency costs position have increasingly become the mainstream view within the legal academy today.[119] Most well-known in this regard is Stephen Bainbridge's influential director primacy theory of corporate governance, which emphatically rejects—both descriptively and normatively—the notion of shareholders as wielding any sort of superior decision-making influence over boards.[120] Contrary to Blair and Stout, Bainbridge curiously still defends directors' ultimate

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[116] According to Blair and Stout's model, "boards exist not to protect shareholders *per se*, but to protect the enterprise-specific investments of *all* the members of the corporate 'team,' including shareholders, managers, rank and file employees, and possibly other groups, such as creditors." *Id.* at 253.

[117] For a more recent and detailed exposition of this position by the latter author, see generally LYNN A. STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012).

[118] *See* Blair & Stout, *supra* note 114, at 287–88. On this, see also Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163, 174 (2008).

[119] *See, e.g.*, Bainbridge, *supra* note 106; William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010); Marc T. Moore & Antoine Rebérioux, *Revitalizing the Institutional Roots of Anglo-American Corporate Governance*, 40 ECON. & SOC'Y 84 (2011); Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise*, 37 QUEEN'S L.J. 339 (2012); Bernard S. Sharfman, *Why Proxy Access is Harmful to Corporate Governance*, 37 J. CORP. L. 387 (2012); STOUT, *supra* note 117; COLIN MAYER, FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT (1st ed. 2013).

[120] *See generally* Bainbridge, *supra* note 106; Stephen M. Bainbridge, Response, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006); STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE (2008).

fiduciary responsibility to further shareholders' interests.[121] Significantly, though, he asserts that directors are expected by law to maximize shareholder wealth in their capacity as, lexically superior, "[p]latonic guardian[s]" of shareholders, as opposed to, lexically inferior, agents of the latter group.[122]

More recently, Zohar Goshen and Richard Squire's principal costs theory[123] has sought to dispute directly the abovementioned notion that corporate governance, and, by implication, corporate law, is, and should be, focused exclusively on mitigating agency costs imposed by recalcitrant managerial "agent[s]" on their shareholder "principal[s]".[124] Adopting a not dissimilar analytical framework to those of Blair/Stout and Bainbridge, Goshen and Squire add a significant further dimension to the orthodox agency costs landscape in the form of their novel concept of "principal costs".[125] According to Goshen and Squire, whereas agency costs are the losses incurred by the firm and, in turn, its shareholders due to suboptimal managerial decisions, principal costs conversely comprise the ultimate losses to shareholders, deriving from suboptimal decisions and control strategies on the part of *shareholders themselves*.[126]

Such self-imposed shareholder losses can arise either from incompetent, misjudged, or ill-informed interventions by investors in a company's internal business affairs, so-called "principal competence costs",[127] or else by individual investors' pursuit of certain actions, such as short-term profit focused activism, that are detrimental to long-term firm—and, ultimately, shareholder—wealth, so-called "[p]rincipal conflict costs."[128] Goshen and Squire posit that any optimal corporate governance

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[121] *See* Bainbridge, *supra* note 106, at 574; Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423–24 (1993).

[122] Bainbridge explains how his director primacy model of corporate law "treats the board of directors as a sort of Platonic guardian whose power devolves from the set of contracts comprising the corporation as a whole rather than solely from shareholders." Bainbridge, *supra* note 106, at 577.

[123] On this, see generally Goshen & Squire, *supra* note 101.

[124] *Id.* at 778–83.

[125] *See id.* at 796–805.

[126] *Id.* at 770–71.

[127] *Id.* at 786–88.

[128] *See id.* at 791–93.

structure should be designed to minimize not just agency costs, but "total *control costs*,"[129] which they define as "the sum of *principal costs* and *agent costs*."[130] In essence, this necessitates investors being willing to tolerate, in appropriate instances, firms' adoption of governance structures, including, amongst other things, DCSs,[131] which are designed to limit the involvement of shareholders in complex or contentious business affairs, with a view to forestalling potentially irresponsible or misguided actions on their part.[132]

DCS structures are also held out by their advocates as a crucial countermeasure for many listed firms against the pervasive influence of financialization over modern U.S. corporate governance practices.[133] In this regard, dual-class and other differential voting structures can be said to provide a degree of strategic breathing space for corporate controllers from the intense pressure exerted by quarterly financial reporting hurdles.[134] Of course, listed firms with DCS structures remain subject to the same periodic disclosure requirements as any other issuer of SEC-registered equity

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[129] *Id.* at 770.

[130] *Id.*

[131] *Id.* at 806–07.

[132] An alternative but related rationalization of insider-oriented corporate ownership structures has recently been advanced in the form of Goshen and Hamdani's "idiosyncratic vision" theory. Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 576 (2016). The essential suggestion here is that, where investors and entrepreneurs "hold different beliefs concerning the best way to .... maximize the firm's expected return," a DCS structure or other concentrated control structure can be an effective means of ensuring "that the firm will pursue [the entrepreneur's] idiosyncratic vision even against the investors' objections." *See id.* On this, see also Eric Van den Steen, *Disagreement and the Allocation of Control*, 26 J.L. ECON. & ORG. 385, 385 (2010).

[133] On the financialization of corporate governance norms and practices, see generally Paddy Ireland, *Financialization and Corporate Governance*, 60 N. IR. LEGAL Q. 1 (2009); JULIE FROUD ET AL., FINANCIALIZATION AND STRATEGY: NARRATIVE AND NUMBERS (2006); MICHEL AGLIETTA & ANTOINE REBÉRIOUX, CORPORATE GOVERNANCE ADRIFT: A CRITIQUE OF SHAREHOLDER VALUE (2005); William Lazonick & Mary O'Sullivan, *Maximizing Shareholder Value: A New Ideology for Corporate Governance*, 29 ECON. & SOC'Y 13 (2000).

[134] *See* Sharfman, *supra* note 4, at 14–15.

securities.[135] However, the adverse consequences of management failing to conform to consensus earnings estimates are almost certain to be less severe than in the case of one share/one vote issuers, given the effective immunity enjoyed by multiple vote holding controllers from outside challenge to their incumbency on the part of proxy contestants.[136]

The insulation from short-term stock market pressures that DCSs purportedly provide is said to be valuable not just in terms of creating a greater scope for the formation and implementation of long-term business strategies, but also insofar as it can encourage more firms to go public at a relatively early stage in their business life cycle.[137] This is because DCSs and other insider-oriented voting structures enable entrepreneurial founders to "cash out" their initial equity investment in the business at the IPO stage so as to gain a market "reward" for their start-up efforts, but—crucially—*without* being compelled to give up control of their venture to outsiders in order to achieve this.[138] It has been claimed that, in turn, permitting DCS structures may help to counteract the progressive decline in listed companies that has occurred over recent decades, by encouraging more companies that would otherwise

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[135] *See id.* at 9.

[136] On this, see *id.* at 11–12. As articulated in Google's IPO documentation from 2004:

> Because of our dual class structure, our founders, executives and employees will continue to be able to control all matters submitted to our stockholders for approval even if they come to own significantly less than 50% of the shares of our outstanding common stock. This concentrated control could discourage others from initiating any potential merger, takeover or other change of control transaction that other stockholders may view as beneficial.

Google Inc., *Registration Statement* 89 (Form S-1) (Apr. 29, 2004), https://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm#toc16167_10 [https://perma.cc/JF8X-YZGN].

[137] A recent paper by Lemley and McCreary underscores the multiple social benefits of providing enhanced incentives to founder entrepreneurs to opt for an IPO as the preferred method for "exiting" their start-up investment, instead of the increasingly more common exit strategy of subjecting the firm to private acquisition by an industry incumbent. *See* Mark A. Lemley & Andrew McCreary, *Exit Strategy* 15, 48–49 (Stan. L. & Econ. Olin, Working Paper No. 542, 2019). The authors cite DCS structures, amongst other things, as a potentially significant structural driver in this regard. *See id.* at 22–23.

[138] *Id.* at 8, 14; *see* Fisch & Solomon, *supra* note 9, at 1060–61.

remain private or submit to private equity ownership, largely to avoid the adverse repercussions of pervasive stock market scrutiny, to remain in the public market domain.[139]

It is noteworthy that those who advocate facilitating DCS structures typically do not suggest that DCS structures will become universal, or even the majoritarian norm, within the listed company community.[140] Rather, their rate of adoption is expected to depend—as at present—on their compatibility with the specific corporate governance challenges faced at the micro, in other words, individual firm, level.[141] In this regard, Goshen and Squire explain how any firm's optimal balance between the dual concerns of agency cost and principal cost mitigation will depend on a range of micro level factors including "the firm's business strategy, its industry, and the personal characteristics of its investors and managers."[142] Since "each firm has a distinct division of control rights that minimizes total control costs," it purportedly follows that "law's proper role is to allow firms to select from a wide range of governance structures, rather than to mandate some structures and ban others."[143]

On the above premise, Goshen and Squire attribute the decision by any firm to adopt, or, conversely, refrain from adopting, a differential voting structure to the relative complexity and specialism of its business affairs.[144] Accordingly, in instances where investors' informational expertise deficit vis-à-vis entrepreneurs or other corporate insiders is especially pronounced, it arguably makes sense for investors to adopt a DCS structure to mitigate the risk of principal costs, and especially principal competence costs, arising.[145] While such an arrangement inevitably risks occasioning increased agency costs in the investor-controller

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[139] *See* Fisch & Solomon, *supra* note 9, at 1061.

[140] *See* Goshen & Squire, *supra* note 101, at 807.

[141] For instance, Goshen and Squire explain how:

> [t]he use of a dual-class share structure is a good illustration of the firm-specific nature of corporate governance, as the structure may be well-suited to firms in complex industries such as information technology (e.g., Google, Facebook, and LinkedIn), or to firms whose outside shareholders recognize management's unique skills and strategic vision (e.g., Berkshire Hathaway).

Id.

[142] *Id.* at 771.

[143] *Id.*

[144] *See id.* at 771–72.

[145] *See* Goshen & Squire, *supra* note 101, at 770, 772.

relation, any ensuing losses for shareholders will be tolerated insofar as they are outweighed by the corresponding saving in principal costs that the DCS structure brings about.[146] In this instance, an overall net positive wealth effect for shareholders is therefore likely to ensue.[147]

Those who claim that shareholder voting structures should be determined in the above bespoke way tend to rely on the presumptive efficiency of micro level private ordering.[148] This position entails putting considerable faith in stock market pricing mechanisms to detect and discount effectively the relative value of restricted voting rights to a DCS firm's common, single-vote, shareholders.[149] The underlying belief is that so long as relevant firms remain subject to the traditional securities law principle of full disclosure,[150] especially at the IPO stage[151] then investors will be equipped to pass reasonably prudent judgment on the continuing suitability of their governance, including voting, arrangements.[152] The flip side to this argument is that any attempt by regulators to impose a standardized governance norm with respect to shareholder voting structures, for example, a mandatory one-share/one-vote rule, will run the risk of precluding many firms from adopting more suitable

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146 *See id.*

147 However, the authors also acknowledge that, for the same reasons, DCS structures will likely not be optimal for firms in which those characteristics are not present. *See id.* at 771–72.

148 *See* Dennis P. Sheehan, Comment, *Stock Pyramids, Cross-Ownership, and Dual Class Equity*, in CONCENTRATED CORPORATE OWNERSHIP 315, 317 (Randall K. Morck ed., 2000).

149 According to Sheehan, "the fact ... that new shareholders willingly buy into firms in which wealth consequences are not proportional to voting rights .... [suggests] that these new shareholders buy into these firms at prices that protect them from being exploited." *See id.*

150 In the words of one especially eloquent commentary on the matter, "[t]he American polity has ... carried on a vigorous romance with the idea that the free flow of information is a potent remedy for social and political ills .... perhaps, because it meshes so comfortably with the principle of individual choice that permeates our conventional social philosophy." Russell B. Stevenson, Jr., *The SEC and the New Disclosure*, 62 CORNELL L. REV. 50, 50 (1977).

151 Goshen asserts in this regard that "[w]ith many sophisticated parties, the IPO market does not suffer from negotiation failures." Zohar Goshen, *Against Mandatory Sunset for Dual Class Firms*, COLUM. L. SCH. BLUE SKY BLOG (Jan. 2, 2019), http://clsbluesky.law.columbia.edu/2019/01/02/against-mandatory-sunset-for-dual-class-firms [https://perma.cc/AUV2-E84Q].

152 *See* Stevenson, *supra* note 150.

alternative arrangements in this regard, which may well be better suited to mitigate total control costs under the unique circumstances at hand.[153]

2. The Case for Prohibition

By contrast, critics of DCS structures, and, likewise, other types of differential voting structure, typically view such arrangements as a significant source of agency costs between multi-vote-holding controllers and their common, single vote, stockholding peers.[154] Specifically, it is alleged that DCS enables multi-vote-holders to maintain effective control over the firm despite owning only a minority of cash flow rights, thereby causing a significant bifurcation between, on the one hand, their scope of managerial and/or governance power, and on the other, their corresponding incentive to exercise that power in a diligent and entrepreneurially effective manner.[155]

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[153] Goshen and Squire claim that "[b]ecause the governance structure that minimizes control costs varies by firm, lawmakers—including courts, regulators, and legislators—should avoid one-size-fits-all solutions." *See* Goshen & Squire, *supra* note 101, at 774. They argue that:

> [I]n the absence of clear market failures, lawmakers should presume the efficiency of each firm's chosen governance structure," and thus "should seek to grow rather than shrink the menu of governance-structure options .... [by] allow[ing] each firm to tailor its governance structure in the manner that strikes the firm-specific optimal balance between principal costs and agent costs.

Id. at 774, 829.

[154] *See, e.g.*, BEBCHUK ET AL., *supra* note 56, at 295–96; Bebchuk & Kastiel, *supra* note 12, at 596–99.

[155] For instance, Bebchuk, Kraakman and Triantis argue that "[t]he [controlling minority shareholder] structure lacks the principal mechanisms that limit agency costs in other ownership structures" in that "[u]nlike in [dispersed ownership] structures, where controlling management may have little equity but can be displaced, the controllers of [controlling minority shareholder] companies face neither proxy contests nor hostile takeovers." *See* BEBCHUK ET AL., *supra* note 56, at 301. The authors further assert that, "unlike in [controlling majority shareholder] structures, where controlling shareholders are entrenched but internalize most of the value effects of their decisions through their shareholdings, [controlling minority shareholders] may hold a very small fraction of the cash-flow rights in their firms." *Id.*

In turn, the ensuing disparity between control and cash flow rights arguably incentivizes the controlling minority to expropriate private benefits of control from the firm while bearing only a limited part of the negative wealth effects of their behavior.[156] Such private control benefits can potentially include shirking, nepotism,[157] receipt of exorbitant compensation and hubris-driven expansionism through, in the more egregious cases of controller self-dealing, related party transactions and appropriation of corporate opportunities.[158] The purported outcome is a classic moral hazard situation whereby controlling minorities are positioned to externalize the adverse repercussions of their self-benefitting actions, or inaction, on other investors, thereby affecting an uncompensated net wealth transfer from common stockholders to multi-vote-holding controllers.[159]

In a similar vein, Bebchuk and Kastiel claim that "[t]he combination of entrenchment and limited equity holdings [in DCS companies] produces serious problems" insofar as "a controller with a minority equity stake may favor choices that increase the private benefits of control even if those choices substantially diverge from those of other public shareholders, and no threat of removal exists to prevent her from pursuing those interests." *See* Bebchuk & Kastiel, *supra* note 12, at 602. They further posit that: "[t]his distortion of incentives becomes more severe when the controller of a dual-class company holds a smaller percentage of the company's equity capital." *Id.* at 602–03. By way of response, Goshen and Squire refer to critics such as Bebchuk as "[a]gency-cost essentialists—who [erroneously in Goshen and Squire's view] believe that the reduction of agency costs is the essential role of corporate law." *See* Goshen & Squire, *supra* note 101, at 775.

[156] *See infra* note 158 and accompanying text.

[157] That is to say, appointing family members or other associates to executive positions instead of better qualified external candidates. *See* Morten Bennedsen et al., *Inside the Family Firm: The Role of Families in Succession Decisions and Performance*, 122 Q.J. ECON. 647, 648 (2007).

[158] Ronald W. Masulis et al., *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697, 1722 (2009), referred to by Bebchuk & Kastiel, *supra* note 12, at 603.

[159] *See* BEBCHUK ET AL., *supra* note 56, at 301. By contrast, in standard majority-controlled firms where there exists no such disparity between control and cash flow rights, controllers can be expected to bear a significant share of the adverse wealth effects of any expropriative or otherwise value reducing activities that they undertake vis-à-vis the firm. *See id.* DCS critics have argued, moreover, that the agency costs of DCS structures can be expected to increase exponentially as the proportion of cash flow rights held by a controlling minority decreases in relation to the corresponding percentage of voting

DCS structures are additionally criticized from the above perspective insofar as they remove controlling minorities from the discipline of the outside market for corporate control.[160] This is because any prospective outside control-acquirer will be unable to gain majority voting control over the firm by gaining the equity or votes of the firm's independent (non-controlling) shareholders alone.[161] For this reason, DCSs (and other differential voting structures) have been criticized for arguably combining the worst features of orthodox blockholder and widely held corporate ownership systems, that is to say, providing the leeway for controller exploitation of private benefits of control that is traditionally associated with European and Asian style blockholder systems, with the absence of effective proprietary incentives on the part of controllers for which Anglo-American widely held systems are conventionally renowned for.[162]

In addition, critics of DCS have contested the abovementioned claim by their academic champions that private ordering will ultimately produce efficient corporate voting structures, whether of the multi-class or one-share/one-vote variety.[163] Those of an anti-DCS disposition have contrarily argued that private ordering is unlikely to lead to efficient governance outcomes because, even in instances where terminating a dual-class share structure (whether via an outright takeover of the firm or, alternatively, via the voluntary unification of the firm's capital structure by its existing controller) would enhance firm efficiency, any ensuing benefits for the incumbent controller are unlikely to compensate for the private benefits of control that she will consequently be required to forego.[164] For this reason, it has been posited that controlling minorities cannot be trusted to make the determinative decision on whether

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rights. *See id.* at 310; Paul A. Gompers et al., *Extreme Governance: An Analysis of Dual Class Firms in the United States*, 23 REV. FIN. STUD. 1051, 1084–85 (2010), referred to by Bebchuk & Kastiel, *supra* note 12, at 603.

[160] Kishore Eechambadi, *The Dual Class Voting Structure, Associate Agency Issues, and a Path Forward*, 13 N.Y.U. J.L. & BUS. 503, 515 (2017).

[161] *Id.* at 513.

[162] *See* BEBCHUK ET AL., *supra* note 56, at 299; Bebchuk & Kastiel, *supra* note 12, at 602.

[163] *See* Bebchuk & Kastiel, *supra* note 12, at 612–13.

[164] *See id.* at 613.

to retain or dispense with a DCS structure midstream in a truly independent and disinterested manner.[165]

DCS opponents further suggest that common stockholders are ill-equipped to make rational decisions on public companies' individual capital structures, whether on an individual or collective basis.[166] It is well known that coordination and collective action problems can constrain the capacity of investors, both of an individual and institutional nature, to take informed decisions and actions with respect to complex firm-specific matters.[167] There is consequent cause to question whether stock market pricing mechanisms are sufficiently sensitive to individual corporate voting arrangements and other nuanced micro-level concerns.[168]

In response to such claims, DCS advocates would likely point to the significant concentration of U.S. public company shareholding today,[169] especially in the hands of the dominant "mega-mutual"[170] fund providers such as Blackrock, State Street and Vanguard.[171] They might additionally highlight the pervasive and centralized corporate governance influence wielded today by professional proxy advisory firms such as Institutional Shareholder Services (ISS) and

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[165] *See id.* at 617.

[166] *See, e.g.*, *id.* at 592.

[167] On the collective action problem generally as it affects decision-making and other firms of cooperative action within large business organizations and other social institutions, see generally MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965); ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION (1990); Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (1968).

[168] On this, *see* Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 791 (2006); Marc T. Moore, *Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism*, 34 OXFORD J. LEG. STUD. 693, 710 (2013). *See generally* L.A. Bebchuk, *The Debate on Contractual Freedom in Corporate* Law, 89 COLUM. L. REV. 1395 (1989); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549 (1989).

[169] *See* Berger, *supra* note 103, at 7.

[170] This term is attributable to Professor Bernard Sharfman. *See* Sharfman, *supra* note 4.

[171] Jonathan Guthrie, *The Fallacy Behind the Rise of Passive Fund Management*, FIN. TIMES (Jan. 15, 2020), https://www.ft.com/content/1c4382c6-36cb-11ea-a6d3-9a26f8c3cba4 (last visited Oct. 30, 2020).

Glass, Lewis & Co.[172] Indeed, on first reflection at least,[173] both the above developments would appear to have rendered the traditional Berle-Means dichotomy[174] of strong managers and weak owners[175] somewhat redundant within the contemporary corporate governance and stock market environments.[176]

DCS opponents have been quick to point out, though, that—market concentration factors aside—the so-called mega-mutuals are for the most part comprised of passive index-linked funds, which either actively track a particular market index or have their performance periodically benchmarked against any such index.[177] The managers of such funds therefore have limited incentives to engage in ongoing monitoring and evaluation of investee firms' micro-level governance matters.[178] Furthermore, the inevitable resource limitations of proxy advisory firms mean that they are likewise constrained with respect to their firm-specific monitoring activities, causing them typically to focus their energies on specific blacklisted firms and personnel that pose extraordinary

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[172] On this, see Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 871 (2010); Letter from Bernard S. Sharfman, Chairman of the Main St. Invs. Advisory Counc., to Vanessa Countryman, Sec'y, SEC (Dec. 20, 2019) (File No. s7-22-19), https://www.sec.gov/comments/s7-22-19/s72219-6571096-201082.pdf [https://perma.cc/JR5E-UG3S].

[173] For an alternative argument, to the effect that the relatively passive, index-linked investment practices of the major U.S. mutual fund providers have actually *exacerbated* managerial accountability problems in publicly traded firms, see Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2030 (2019).

[174] *See generally* Adolf A. Berle & Gardner Means, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[175] On this dichotomy (and the historico-political foundations thereof), *see generally* Mark J. Roe, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994).

[176] On the gradual power shift from managers to shareholders that purportedly occurred within U.S. public companies generally throughout the early part of the present century, see generally Marcel Kahan & Edward B. Rock, *Embattled CEOs*, 88 TEX. L. REV. 987 (2010).

[177] *See* Sharfman, *supra* note 4, at 13.

[178] Winden & Baker, *supra* note 24, at 10.

governance and/or accountability concerns, arguably at the expense of tracking the many less egregiously problematic cases.[179]

Allied to the above collective action constraints is the vexing dilemma that typically confronts those outside investors who are faced with an otherwise highly attractive dual-class IPO. While a new issuer's insider-oriented voting structure might pose accountability and other governance concerns for prospective purchasers of common (single-vote) stock, such worries might conceivably be outweighed by individual investors' fear of missing out on what may well turn out to be a collectively popular (or "hot"[180]) IPO.[181] It follows that, in the absence of reliable information about how their fellow investors will react to the IPO in question, each individual investor will likely be reluctant to defect from the prevailing herd mentality irrespective of their continuing concerns about the robustness of the relevant firm's capital structure.[182]

Accordingly, from the perspective of DCS critics, the combined effect of the above factors is to constrain considerably the receptiveness of stock market pricing mechanisms to the presence or absence of DCSs (and other differential voting structures) within individual public issuers relative to orthodox one-share/one-vote arrangements.[183] This in turn purportedly limits the propensity of private ordering to operate as an effective surrogate for mandatory state or exchange driven regulation of corporate capital structures.[184] The anti-DCS school thus seeks to establish an essentially paternalistic rationale for some form(s) of public-regulatory intervention in private ordering of capital structures,[185] in the

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[179] On the limitations of proxy advisors as firm-specific monitors, *see generally* Marc T. Moore, *"Whispering Sweet Nothings": The Limitations of Informal Conformance in UK Corporate Governance*, 9 J. CORP. L. STUD. 95 (2009).

[180] This term is attributable to Bebchuk & Kastiel, *supra* note 12, at 591.

[181] *See* Reddy, *supra* note 60, at 26.

[182] *See* Winden & Baker, *supra* note 24, at 9.

[183] *See id.* at 10.

[184] *See generally* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1620 (1989).

[185] On the paternalistic nature of Anglo-American corporate law generally, see MARC T. MOORE, CORPORATE GOVERNANCE IN THE SHADOW OF THE STATE, chs. 6–7 (2013); Marc T. Moore, *The De-Privatisation of Anglo-American Corporate*

interest of protecting vulnerable or misguided outside investors from exploitation at the hands of overreaching entrepreneurial controllers.[186]

C. The Shift Towards Sunsets

Until recently, the debate on the relative merits of DCS versus one-share/one-vote structures has been largely polarized, with the pivotal normative issue being a fairly straightforward one: that is, whether DCS should freely be permitted within publicly traded firms (subject only to full disclosure and private ordering) or else prohibited by appropriate regulatory means.[187] However, the progressive maturing of this debate has seen a corresponding convergence of both sides' respective argumentative positions.[188] Consequently, advocates and critics of DCS have, for the most part, commonly come to accept (albeit with different degrees of enthusiasm from one another) that any form of outright prohibition on the use of differential voting structures in publicly traded firms is probably an unrealistic aspiration for the anti-DCS school.[189] In turn, academic and policy discussions have in large part shifted away from the general binary question of whether DCS should be permitted or prohibited, and more on the specific middle-ground concerns of: (i) whether such insider-oriented voting structures should have an indefinite or contingent life span; and (ii) in the latter instance, precisely how (or, more accurately, *when*) the eventual transformation of any multi-vote shares to common (single-vote) status should take place.[190] Hence the current pertinence of so-called "sunset" provisions.[191]

Sunsets are unquestionably a vogue notion within the U.S. corporate governance world today.[192] For instance, in October 2018, the influential Council of Institutional Investors (CII), which currently represents 140 major institutional investors with

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Law?, *in* ROUTLEDGE HANDBOOK OF CORPORATE LAW, ch. 2 (Roman Tomasic ed., 2016).

[186] *See, e.g.*, Bebchuk & Kastiel, *supra* note 12, at 627.

[187] *See id.* at 590.

[188] *See* Eechambadi, *supra* note 160, at 511.

[189] *See id.*

[190] *See id.* at 531–32.

[191] *See id.* at 531.

[192] *See id.* at 526.

a combined asset base worth approximately $4 trillion,[193] publicly (albeit, as yet, unsuccessfully) lobbied both the New York Stock Exchange and NASDAQ with a view to persuading their respective authorities to introduce a universal requirement for septennial time-based sunset provisions,[194] applicable to all new DCS issuers as a mandatory precondition of listing on each of those markets.[195] In a similar vein, ISS's current proxy voting policy with respect to multi-class capital structures states that "[n]o sunset period of more than seven years from the date of the IPO will be considered to be reasonable" from an investor

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[193] *See About CII*, COUNCIL OF INSTITUTIONAL INVS., https://www.cii.org/about [https://perma.cc/VR5G-XDXA].

[194] On this, see *infra* Section II.A. At the same time, the Chartered Financial Analyst Institute has expressly been "urging" exchanges to consider mandating time-based sunsets of up to five years' duration as an "absolute maximum." *See* DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 5.

[195] *See* Letter from Ash Williams, Chair, Council of Institutional Invs. et al., to Elizabeth King, Chief Regul. Officer, Intercontinental Exch. Inc. (Oct. 24, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NYSE%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf [https://perma.cc/6KFX-EA3J]; Letter from Ash Williams, Chair, Council of Institutional Invs. et al., to John Zecca, Senior Vice President, NASDAQ Stock Market (Oct. 24, 2018) (on file with CII.ORG), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NASDAQ%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf [https://perma.cc/CQT9-V6H4] [hereinafter NASDAQ Letter]. On this, see Govindarajan et al., *supra* note 18. The CII made an additional appeal to the Delaware State Bar Association to amend Delaware General Corporation Law so as to prohibit any Delaware corporation from adopting a multi-class common structure after an initial seven-year post-IPO period. *See* Letter from Ken Bertsch, Exec. Dir., Council of Institutional Invs. et al., to Henry E. Gallagher, Council Chair, Corp. L. Section, Del. State Bar Ass'n (Sept. 13, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/September%2013%202019%20Final%20DGCL%20letter.pdf [https://perma.cc/G2W9-LM57] [hereinafter Delaware Letter]. After giving due consideration to the CII's request, the Council of the Corporation Law Section of the Delaware State Bar Association unsurprisingly opted to refrain from implementing the CII's desired reform. *See id.*; *see also* Letter from Henry E. Gallagher, Council Chair, Corp. L. Section. Del. State Bar Ass'n, to Ken Bertsch, Exec. Dir., Council of Institutional Invs. et al. (Jan. 28, 2020), https://www.cii.org/files/1-28-2020%20Letter%20to%20CII%20(05512328xCCC1C).pdf [https://perma.cc/PB4G-ZDWN].

perspective[196] Indeed, the sunset issue has come to dominate the policy agenda in respect of DCS to such an extent lately that, in the words of current (at time of writing) SEC Commissioner Robert Jackson, the principal concern in this regard today is no longer "whether dual-class ownership is *always* good or bad."[197] According to Jackson, the energies of commentators have instead been absorbed principally in seeking to answer the more focused question of "whether dual-class structures, once adopted, should last forever" such that "corporate insiders maintain outsized control *in perpetuity*."[198] In the context of the present discussion, this is a telling observation that emphasizes the exigency of the matter at hand.

From the above facts alone, it should be clear that concern for dual-class sunsets have increased exponentially in recent times.[199] Notwithstanding these important developments, though, it is fair to say that sunset provisions are still a long way from becoming a dominant feature of DCS structures in general.[200] Indeed, it is curious that almost half of companies listing on U.S. stock markets over the past fifteen years with DCS adopted a perpetual DCS structure containing no sunset provision in any shape or form.[201] Admittedly, only 14% of dual-class IPOs carried out on U.S. markets in 2017 had perpetual DCS structures, which—at least on the face of things—suggests a notable drift from the former norm.[202] However, any such conclusion is tempered by the fact that only one-third of dual-class IPOs conducted in 2018 involved time-based sunset provisions, with the majority continuing to be non-time-contingent.[203]

The somewhat truncated spread of sunsets to date is unsurprising. After all, there still exists considerable skepticism from

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[196] ISS 2019(1), *supra* note 25, at 6; *see also* Andrew W. Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, 2018 COLUM. BUS. L. REV. 852, 857 (2018).

[197] Jackson, *supra* note 1.

[198] *Id.* (emphasis in original).

[199] *See supra* notes 187–98 and accompanying text.

[200] *See* Jackson, *supra* note 1.

[201] *See id.*

[202] *See id.*

[203] *See* Sharfman, *Sunsets*, *supra* note 97, at 7 n.29.

opponents of DCS as to whether sunset provisions will prove to be the corporate governance panacea that they are frequently held out as.[204] In theory, a suitably designed sunset provision is expected to strike an effective balance between, on the one hand, upholding long-term managerial accountability, and, on the other hand, mitigating short-term stock market pressures on management at critical points in the corporate life cycle.[205] However, striking this balance in practice is a considerably more difficult governance task than it might first appear.[206] Additionally, there is the concern that, even to the extent stock market pricing mechanisms are sensitive to firm-specific governance factors such as the presence or absence of DCS, it is at least questionable whether they are responsive to such granular and nuanced considerations as whether a given DCS structure is perpetual or sunsetting in nature.[207] This is not to mention the separate (albeit interrelated) issue of the precise nature of any sunset provision that happens to be in place, which adds even further to the valuation complexities.[208]

Insofar as there exists doubt as to whether the presence (or, conversely, absence) of a sunset provision within (or from) a given DCS structure is likely to elicit a corresponding market pricing differential, it is unsurprising that many entrepreneurs and investors embarking on a dual-class listing have been either reticent or ambivalent about adopting this particular DCS component.[209] On the other hand, the steadily growing take-up of sunset provisions within recent dual-class listings suggests that a reasonable degree of investor demand for such protections does indeed exist.[210] In any event, the complex, uncertain and fluctuating nature of this issue today suggests that a degree of caution on the part of prospective

[204] *See* Winden & Baker, *supra* note 24, at 8.

[205] Eechambadi, *supra* note 160, at 531–32.

[206] *See supra* note 195 and accompanying text.

[207] *See* Bebchuk & Kastiel, *supra* note 12, at 622–23.

[208] On the questionability of stock market pricing of firm-specific corporate governance characteristics, see generally *supra* notes 177–79 and accompanying text.

[209] *See* Sharfman, *supra* note 4, at 19.

[210] *See id.* at 2 n.6.

market regulators would be salutary here.[211] This is with a view to preserving meaningful scope for private ordering at the individual firm level. Moreover, such a deferential (or "light-touch")[212] regulatory stance would appear exigent both on the more general issue of whether DCS structures should be perpetual or sunsetting in nature, and, equally, with respect to the more specific question of how best (if at all) to calibrate a suitable market-wide regulatory requirement for sunset provision. Accordingly, it is to the latter challenge that we now turn our attention.

II. THE THREE PRINCIPAL MODELS OF SUNSET PROVISION

A. The Time-Centered Sunset Model

Of the various structural forms of DCS sunset provision that have been trialed, undoubtedly the most popular—on the investor side at least—has been the time-centered model.[213] In essence, a time-based sunset provision is a bespoke charter or bylaw provision that causes a DCS company's multi-voting shares automatically to convert (or "sunset") to single-vote shares after the passing of a predetermined period of time, unless the company's existing single-vote shareholders[214] affirmatively resolve otherwise by way of a majority class vote to this effect.[215] At the individual firm level, specific sunset time triggers can vary from a

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[211] *See supra* Section I.B.

[212] On the effectiveness of so-called "soft" or "light-touch" financial regulation generally under appropriate circumstances (as viewed from a comparative trans-Atlantic perspective), see Moore, *supra* note 179, at 101 n.28. *See also* Ferran's explanation:

> The construction of a regulatory architecture relating to companies which is modern and suitable for a competitive economy depends crucially on striking the right balance between giving business the flexibility to operate effectively in dynamic and internationally orientated markets and, at the same time, giving investors confidence that they are legally protected against exploitation and underperformance by corporate management.

Eilis Ferran, *Corporate Law, Codes and Social Norms—Finding the Right Regulatory Combination and Institutional Structure*, 1 J. CORP. L. STUD. 381, 385 (2001).

[213] Fisch & Solomon, *supra* note 9, at 1079, 1086.

[214] Or, at least, those single-vote shareholders who have no material affiliation with the DCS holder. On this, see Bebchuk & Kastiel, *supra* note 12, at 618.

[215] *Id.*

low of three years in duration (such as in the case of EVO payments) to a high of twenty years (for example Workday).[216] Amongst other notable examples, Groupon has a sunset trigger of five years from IPO (which converted in 2016) and Fitbit has a twelve-year trigger (which will convert in 2027).[217] Two leading academic champions of time-based sunsets, meanwhile, have suggested ten or fifteen years as potentially appropriate trigger points for DCS companies to adopt in this regard.[218]

Time-based sunset provisions have unquestionably increased in popularity in recent years.[219] SEC filings from 2018 show that twenty-four U.S.-listed companies adopted time-based sunset provisions within their respective charters or bylaws that year.[220] Moreover, no fewer than twenty-six percent of dual-class IPOs carried out on U.S. markets in 2017 contained time-based sunset clauses, with the mean sunset period having reportedly fallen to 9.5 years that year from 10.3 years in 2016.[221] Meanwhile, the Council of Institutional Investors has recently endorsed time-based sunsets as a "second best" option for newly listing companies, aside the purported "first best" option of adopting one-share/one-vote immediately from IPO.[222] And, as remarked on above, the Council has also petitioned the NYSE and NASDAQ to introduce mandatory listing rules requiring that any multi-vote shares automatically sunset after seven years or less.[223] NASDAQ has

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[216] *See* DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 58–59.

[217] COUNCIL OF INSTITUTIONAL INVS. (CII), TIME-BASED SUNSET APPROACHES TO DUAL CLASS STOCK (Jul. 13, 2018), https://www.cii.org/files/2-14-18%20Time-based%20Sunsets.pdf [https://perma.cc/BH3J-4EDR] [hereinafter CII TIME-BASED SUNSET].

[218] *See* Bebchuk & Kastiel, *supra* note 12, at 626.

[219] *See id.* at 618.

[220] CII TIME-BASED SUNSET, *supra* note 217.

[221] CII DUAL-CLASS IPO, *supra* note 3.

[222] *See Dual Class Stock,* COUNCIL OF INSTITUTIONAL INVS., https://www.cii.org/dualclass_stock [https://perma.cc/2KJN-KCEN].

[223] *Id.* Although, in a moderate concession to firm-specific flexibility, the Council has further proposed in its recommendation to the exchanges that any multi-class issuer's initial sunset term should be extendable by one single further seven-year term, which would be conditional on the vote of a majority of ordinary (that is non-multiple-voting) shareholders to this effect. *See* Ken Bertsch, Amy Borrus & Jeff Mahoney, *Petition to NYSE on Multiclass Sunset Provisions*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 2, 2018), https://

predictably been resistant to this proposal, presumably in the belief that it will undermine its attractiveness as a listing venue for innovative hi-tech firms.[224] However, the NYSE has shown a tentative willingness at least to consider the CII's request, although at the time of writing no changes to its rules have consequently been proposed.[225]

Advocates of time-based sunsets typically point to empirical evidence which avers that, whereas U.S.-listed companies with perpetual and sunsetting DCS structures exhibit similar IPO valuations, over the longer term those with a perpetual DCS structure tend to exhibit significantly lower equity valuations than those with some form of built-in sunset.[226] One suggested reason for this delayed disparity in valuations is the tendency of DCS structures to "lock in" founder control, in the sense of insulating founding entrepreneurs (who are typically the holders of multi-vote shares) from subsequent challenge to their incumbency emanating from the market for control.[227] This is because a corporate founder whose multi-vote shares enable her to retain majority (or even near-majority) voting control after IPO simply cannot unilaterally be displaced from her controlling position by way of hostile tender offer or proxy contest, whether at the instigation of a competitor firm, private equity fund or activist investor.[228] The outcome of this, as DCS critics would seek to portray it, is an effective corporate dictatorship whereby the continuing fortunes of outside investors (typically holding only minority single-vote shares) are left at the whim of overbearing and unpredictable controllers, to whom shareholder value creation may well have become a secondary consideration at best.[229]

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corpgov.law.harvard.edu/2018/11/02/petition-to-nyse-on-multiclass-sunset-provi sions/ [https://perma.cc/U87Y-KTBZ].

[224] Coffee, *supra* note 6.

[225] *Id.*

[226] *See, e.g.*, Jackson, *supra* note 1.

[227] *See* DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 10.

[228] *See id.* at 2.

[229] Advocates of time-based sunsets have highlighted the high-profile example of Sumner Redstone, who indirectly retains a minority controlling stake (via multiple-vote stock) in ViacomCBS Inc. despite being of limited mental capacity due to dementia and memory loss. *See, e.g.*, Bebchuk & Kastiel, *supra*

The harmful economic effects of manifest controller unaccountability in DCS companies are said to be particularly pronounced in the very high technology industries where DCS structures tend to be most commonly observed in practice.[230] The purported danger is that in such dynamic and fast-changing product market sectors, once successful ideas can very quickly become outmoded.[231] In turn, initially successful startups can rapidly stagnate in the absence of a constant flow of fresh ideas and challenges to established business strategies.[232] Relatedly, whereas a relatively young company at the typically volatile post-IPO stage might arguably benefit from the strong and insulated leadership that a DCS structure permits, this is unlikely to be the case once that company matures further down the line, at which point controller unaccountability will arguably become a more elevated concern for investors.[233]

It is noteworthy that those commentators who take a less sanguine view of the supposed general merits of time-based sunsets tend to be hostile not to the time-centered sunset model itself, but rather only to the notion that it should be enforced as a universal

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note 12, at 587–89. *See generally* Elizabeth Winkler, *Can Super-Voting Stocks Survive the CBS Challenge?*, WALL ST. J. (May 15, 2018). Although the significant legal and corporate governance ramifications of the prolonged Redstone/Viacom affair are undeniable, it must nonetheless be acknowledged that this is a truly extraordinary scenario which is unlikely to recur in future with any degree of frequency. Moreover, the relevant companies' continuing combined market capitalization of approximately $25 billion arguably puts recent events into context to some extent. *See* Claire Atkinson, *CBS and Viacom Merge to Form $30 Billion Media Company*, NBC NEWS (Aug. 13, 2019, 2:12 PM), https://www.nbcnews.com/business/business-news/cbs-viacom-merge-form-30-billion-media-company-n1041306 [https://perma.cc/5VH4-2KZ3]. Accordingly, in the present author's belief it would be overly hasty to ground a case for general regulatory restriction of DCS usage on the experience of this peculiar episode alone.

[230] *See* DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 34.

[231] Bebchuk & Kastiel, *supra* note 12, at 589.

[232] *See id.* at 589, 605.

[233] *Id.* at 612. Bebchuk and Kastiel explain that "as time passes from the IPO, there is a growing risk that a dual-class structure will become value decreasing and that public investors will find themselves subject to an inefficient structure with significant governance risks and costs." *Id.* at 630. In the authors' belief, it therefore follows that "even those who believe that dual-class structures are often efficient at the time of the IPO, and the period following it, should have substantial concerns about dual-class structures that provide perpetual or lifetime control." *Id.*

regulatory norm.[234] However, critics of mandated time-based sunsets typically have no objection, but contrarily, tend to be *favorably disposed* to the idea of such provisions being introduced on an ad hoc basis via firm-specific private ordering.[235] Their essential contention, thus, is not that time-based sunsets are inherently problematic from a corporate governance or business performance standpoint.[236] Rather, it is simply that for stock exchanges or other regulatory authorities to deny individual issuers the free choice in this regard is a paternalistic intrusion on the contractual freedom of their investors and managers, who should arguably be at liberty to determine this complex matter subjectively in accordance with their own prudential and practical judgment,[237] whether at IPO stage or thereafter.[238]

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[234] For example, Sharfman contends that while "the inclusion of a time-based sunset provision makes some sense ... to come to the conclusion that they must be mandatory in every single dual class share structure one must go farther and rebut the strong presumption that private ordering is value enhancing for shareholders." Sharfman, *Sunsets*, *supra* note 97, at 6. Sharfman claims that "[t]o rebut this presumption, strong evidence of some sort of irrationality or market failure must be found when market participants refuse to include time-based sunset provisions in IPOs ... [and] such evidence does not exist." *Id.*

[235] Sharfman asserts that "[i]n sum, private ordering creates a strong presumption that the absence of time-based sunset provisions in many dual-class share structures is value enhancing and should not be interfered with by regulatory authorities." *Id.* at 3.

[236] *See id.* at 10.

[237] As Mitts vividly puts it:

> Founders were paid by investors for the chance to bet on the next great American success story. On that view, the Council of Institutional Investors' proposal that super-voting rights on dual class stock expire within at least seven years is a misguided interference with a healthy form of private ordering.

Joshua Mitts, *Why Investors Pay So Much for Dual-Class Firms*, COLUM. L. SCH. BLUE SKY BLOG (Jan. 2, 2019), https://clsbluesky.law.columbia.edu/2019/01/02/why-investors-pay-so-much-for-dual-class-firms/ [https://perma.cc/VX7X-QTQT].

[238] As against this claim, though, Fisch and Solomon caution that "[t]o the extent that market forces are not sufficient to enable public shareholders to evaluate and price sunset provisions accurately at the IPO stage, it is unclear why their ability to do so midstream will be superior." Fisch & Solomon, *supra* note 9, at 1085. Accordingly, they conclude that "the theory that public shareholders can properly evaluate whether to retain dual class at the time of the retention vote seems inconsistent with the basic premise of the dual class structure." *Id.*

B. The Ownership-Centered Sunset Model

While the time-centered sunset model would appear to have garnered the greatest share of support lately within the academic and investor communities,[239] it is by no means the only available blueprint for DCS sunset design.[240] Rather, there are two other common structural forms of sunset provision that likewise merit analysis here, namely the ownership-centered model[241] and the transfer-centered model.[242]

The former of those alternative models is part of a broader and more general category of sunset provisions known as "event-based" sunsets.[243] As its title suggests, the essence of an event-based sunset is that it triggers on the occurrence of a particular event or development, irrespective of the specific point in time at which that event takes place.[244] While event-based sunsets tend to lack the simplicity and uniformity of time-based structures, their relative complexity and malleability mean that they are capable of providing more tailored and circumstantially sensitive triggers than their time-centered counterparts.[245]

In its more complex or nuanced forms, an event-based sunset trigger could be designed by reference to a particular financial performance outcome of the relevant firm, such that any multi-vote shares convert automatically to single-vote shares (unless independently resolved otherwise) upon that firm transgressing a pre-specified negative performance threshold. The threshold for a performance-related sunset trigger could potentially be stipulated as a given level of earnings, sales or share price performance, meaning that if the firm drops below this "floor" the multi-vote holder(s) automatically forfeits her formerly privileged governance status. Alternatively, an event-based sunset could be designed so that it is triggered by the commission (or, in practice, revelation) of some form of impropriety on the part of the firm's multi-vote-holding

[239] *Id.* at 1079, 1086.

[240] *See* Bebchuk & Kastiel, *supra* note 12, at 618.

[241] *See generally id.* at 620.

[242] *See generally* DUAL-CLASS SHARES IN ASIA PACIFIC, *supra* note 33, at 60.

[243] *See id.* at 69–71.

[244] Bebchuk & Kastiel, *supra* note 12, at 619. Although if an event-based trigger is combined with a time-based trigger as part of a more complex dual-activated sunset, then timing considerations will of course be highly relevant in that case.

[245] *See* Fisch & Solomon, *supra* note 9, at 1086.

controller, which could vary from a criminal felony to any detected incidence of fraud, self-dealing or breach of fiduciary duty generally.[246] The advantage of such event-based triggers is that they render the multi-vote holder's continuing enjoyment of her privileged governance status expressly conditional on her continuing regard (or, at least, absence of manifest disregard) for business performance and minority shareholder welfare. This can be contrasted favorably with the proverbial governance "blank check" that a perpetual DCS structure would appear to hand to unscrupulous or underperforming corporate controllers.[247]

In a broadly similar vein to the above types of provision, ownership-based sunsets take effect on a multi-vote-holder's cash flow interest in the firm dropping below a certain floor level, as specified typically in terms of a given percentage of the firm's aggregate market capitalization (for example, 10% or 15%).[248] The rationale underpinning ownership-based sunsets is that multi-vote-holding controllers should at all times have meaningful "skin in the game": that is to say, a sufficiently high level of personal exposure to the firm's ongoing economic fortunes to keep their interests broadly aligned with those of (single-vote-holding) minority shareholders.[249] Conversely, the above "skin in the game" requirement is geared to mitigating the so-called "wedge"[250] between a controller's cash flow and corresponding voting rights that a DCS structure is said to engender, along with the associated agency costs that are arguably inflicted on the firm's outside investors as a result.[251]

Ownership-based sunsets have not only proved appealing to investors at the individual firm level lately but have also been influential within the global financial-regulatory domain.[252] For instance, the Hong Kong Stock Exchange's recently liberalized listing rules now permit DCS structures subject (inter alia) to the continuing requirement that DCS holders, collectively, maintain at least a 10% underlying economic interest in the company's

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[246] Winden, *supra* note 196, at 926–27.
[247] *See* Bebchuk & Kastiel, *supra* note 12, at 604.
[248] *Id.* at 620.
[249] *Id.*
[250] This term is attributable to Sharfman, *supra* note 4, at 6.
[251] Fisch & Solomon, *supra* note 9, at 1086.
[252] *See* HKEX, *supra* note 36, at 13.

equity.[253] This is expressly with a view to ensuring "that, at the time of listing, the economic interest in the company held by all [DCS] beneficiaries, as a group, is large enough, in dollar terms, to align their interests to some extent with those of other shareholders."[254] However, this general rule is subject to potential relaxation in the case of especially large-scale issuers,[255] where the Exchange deems the DCS holder's lower percentage holding to still constitute "a very large amount in absolute dollar terms."[256]

In order to have any meaningful "bite," an ownership-based sunset threshold must be set at a sufficiently high level.[257] Otherwise, the sunset provision risks being rendered superfluous on the premise that, should the multi-vote-holders' proportionate equity interest in the firm drop below that level, their controlling interest will be negated *in any event* irrespective of the sunset's presence.[258] Unfortunately, as was demonstrated most pertinently in the case of Lyft's 2019 dual-class IPO, this is very much a live issue with ownership-based sunsets.[259] Consequently, there is cause to question the practical effectiveness of such provisions, at least pending the formation of certain generally agreed market and/or regulatory norms as to what constitutes a materially significant level of economic exposure for corporate controllers.[260]

C. The Transfer-Centered Sunset Model

The third main structural form of sunset provision, namely the transfer-centered model, is also the least restrictive one from the perspective of a DCS company's controllers.[261] This is because, unlike the time- and ownership-centered models, it does not impose any restrictions on controllers for as long as they retain

[253] *Id.*

[254] *Id.*

[255] This category includes (inter alia) any issuer with a market capitalization in excess of HK$80 billion. *Id.*

[256] *Id.*

[257] *See* Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers,* 107 GEO L. J. 1453, 1459 (2019) [hereinafter Bebchuk & Kastiel, *Perils*].

[258] *See* Bebchuk & Kastiel, *Lyft*, *supra* note 60.

[259] *See id.*

[260] *See* Bebchuk & Kastiel, *Perils*, *supra* note 257, at 1457.

[261] *See* Bebchuk & Kastiel, *supra* note 12, at 620.

ownership of their multiple-vote shares.[262] The only constraint on a controller's behavior arising from such a structure concerns her freedom to dispose of her shares either on death or retirement from the business, that is, at least on terms that guarantee the transferee the same voting entitlements previously enjoyed by the transferor.[263]

The rationale behind a transfer-based sunset is that it protects the legitimate expectations of a DCS company's (single-vote-holding) minority shareholders, who may well have assented to their subordinate governance status in the firm based on their faith and/or trust in its incumbent (multi-vote-holding) controller.[264] It follows that, where the identity of the controller changes in one or other of the above instances, minority shareholders in effect endure a fundamental rewriting of their implicit governance contract with the firm in the absence of any corresponding compensation.

Admittedly, where the transferee is an independent purchaser of the relevant shares in an arm's length commercial transaction, there is at least the *a priori* assurance for minority shareholders that—since the new controller has purchased those shares for fair market value—she at least has a rational incentive to ensure that that value is preserved (and preferably enhanced) in the future.[265] However, where the transferee has acquired the previous controller's shares unilaterally by way of familial inheritance, such a prudential motivation on the new controller's part cannot readily be inferred, not to mention the separate issue as to whether that person has the requisite entrepreneurial acumen to take the business forward successfully.[266] It is in these latter circumstances that there is a risk of the so-called "idiot heir"[267] problem arising.

The "idiot heir" phenomenon denotes situations where the offspring, spouse or other familial successor of a corporate

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[262] *See id.* at 620–21.
[263] *See id.*
[264] *See id.* at 609, 620.
[265] *See id.*
[266] *See id.* at 605
[267] This term is attributable to Bebchuk & Kastiel, *id.*

founder acquires control over the firm via inheritance, but without possessing the same degree of entrepreneurial acumen, integrity and/or motivation as their predecessor.[268] In a non-DCS company with a uniform share voting structure, there is at least the background assurance that where the relevant firm's value is consequently reduced to a sufficiently material level,[269] the new controller(s) will become vulnerable to potential ouster by means of an outside contest for control. However, where the relevant company has a DCS structure in favor of the new controller(s), that person (or group) has an effective power of veto over any attempted control acquisition, thereby locking down the firm under their command at the potential expense of its independent investors. Moreover, where the DCS structure persists beyond the lifespan of the successor-controller herself, the "idiot heir" problem could potentially even carry down through further familial generations, at least insofar as the firm stays out of bankruptcy.[270]

In acknowledgment of these potential collateral effects of allowing DCS structures, the reformed (as of 2018) Singaporean Listing Rules provide that multiple-vote shares (MVSs)—while now generally permitted for SGX-listed companies—will automatically convert into standard (single-vote) equity shares on either: (i) the MVS holder ceasing to be a director whether as a result of death, retirement or otherwise, or (ii) the original MVS holder transferring

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[268] *Id.* In this regard, Reddy reports how "numerous studies have shown that controlling shareholder firms perform worse where control is in the hands of heirs as opposed to the original founder." *See* Reddy, *supra* note 60, at 37.

[269] Indeed, in this regard, Bebchuk and Kastiel note the existence of "evidence that companies run by descendants often underperform other family companies that are managed by their founders or by hired external managers." Bebchuk & Kastiel, *supra* note 12, at 606.

[270] As SEC Commissioner Robert Jackson vividly puts it:

> [P]erpetual dual-class ownership—forever shares—don't just ask investors to trust a visionary founder. It asks them to trust that founder's kids. And their kids' kids. And their *grandkid's* kids. (Some of whom may, or may not, be visionaries.) It raises the prospect that control over our public companies, and ultimately of Main Street's retirement savings, will be forever held by a small, elite group of corporate insiders—who will pass that power down to their heirs.

Jackson, *supra* note 1 (emphasis in original).

her shares to a new holder.[271] The only exception to this rule applies where the relevant company shareholders have affirmatively provided—by majority vote—for the continuation of the MVSs in any of the above instances.[272] However, to be effective the above disapplication vote must be carried out by way of an "enhanced voting process" whereby all shares voted (whether single- or multiple-vote) are recorded strictly on a one share/one vote basis for the purpose of the resolution in question.[273]

The new (post-2017) Hong Kong listings regime likewise requires the automatic conversion of MVSs into single-vote equity shares on an MVS holder's death, incapacity, retirement or removal as a director of a DCS company, or on the transfer of the MVSs (or, at least, the economic interest therein) to another person.[274] In the U.S. listings environment, meanwhile, it is noteworthy that Alphabet/Google's "Class B" (in order words, multi-vote) stock is subject to a firm-specific sunset provision of a fundamentally equivalent character to the above provisions.[275] And, in a similar vein, Lyft's 2019 dual-class IPO on NASDAQ involved a transfer-centered sunset provision with a specific succession-based trigger, which was preferred over both a more general transfer-based trigger and a time-based sunset.[276]

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[271] SGX Mainboard Rules, *supra* note 28.

[272] *Id.* at (10)(f)(ii).

[273] *Id.* at (10)(f). In addition, under new SGX Listing Rule 210(10)(d), all MVSs in SGX-listed firms have their voting entitlement mandatorily capped at ten votes per share *at all times*, irrespective of any contractual or constitutional provision to the contrary. *Id.* at (10)(d).

[274] HK LISTING RULES, RULE 8A.17–8A.22, https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Listing-Rules-Contingency/Main-Board-Listing-Rules/Equity-Securities/chapter_8a.pdf?la=en [https://perma.cc/KWP3-9VZD]. *See also* HKEX, *supra* note 36, Appendix I, at I-6-7. In a similar vein, the current (post-2008) Japanese listings regime requires the automatic conversion of MVSs into single-vote shares on either the death of the original MVS holder or the transfer of her shares to a third party. *See* Toshima, *supra* note 71, at 44.

[275] *See* Alphabet, Inc., *supra* note 35.

[276] Sharfman, *Sunsets*, *supra* note 97, at 7. On this, see also Bebchuk & Kastiel, *Lyft*, *supra* note 60.

III. THE CASE IN FAVOR OF THE TRANSFER-CENTERED MODEL

From the preceding discussion, it should be apparent that the issue of DCS sunset design is by no means a "one-size-fits-all"[277] endeavor. On the contrary, there are in practice a variety of general sunset models for investors, managers and (where relevant) regulators which to choose.[278] Furthermore, on a lower level of granularity there are also a wide range of specific potential triggers within each of those models.[279] As mentioned above, the time-centered model is unquestionably the most popular one today (at least in the United States), not least on account of the strong support that this model has garnered from influential investor-related bodies.[280]

The intuitive appeal of the time-centered model over the principal alternative sunset paradigms is entirely understandable. As well as being relatively simple for corporate lawyers to design, it is also comparatively costless for investors, proxy advisors and regulators to implement and enforce, due to the uniform and straightforward nature of the standard time thresholds.[281] However, as will be argued below, from a broader social point of view the time-based model is—in certain respects—the most problematic of the principal sunset models available, whereas the transfer-centered model is the least problematic of the three.[282] This is for three main reasons, which shall be explained in turn below.[283] These are: (i) the lesser degree of arbitrariness of the transfer-centered sunset model compared to the time- and ownership-based models; (ii) the lesser danger of the transfer-centered model giving rise to moral hazard and other perverse controller incentives, relative to the time-centered model at least; and (iii) the unique sensitivity of the transfer-centered

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[277] The author's usage of this term in the present context is attributable to David Berger. *See* Berger, *supra* note 103, at 15.

[278] *See supra* Part II; *see also* Fisch & Solomon, *supra* note 9, at 1086–91 (discussing alternative sunset provisions).

[279] *See id.* at 1086 (describing several events that may trigger a sunset).

[280] *See supra* Section II.A.

[281] *See* Delaware Letter, *supra* note 195, at 7 n.16.

[282] *See infra* Section III.A.

[283] *See infra* Sections III.A–C.

model to the powerful non-financial motivations of multiple-vote-holding corporate founders.[284]

The third of the above considerations in particular suggests that dogmatic adherence by academic commentators to the agency cost rationale for time- and ownership-based sunsets is not only unnecessary, but also potentially harmful to the long-term business performance of DCS companies.[285] At the same time, this Article will caution against necessarily embracing a "pure" private ordering approach to DCS sunset design, which some other commentators have called for.[286]

A. Lesser Degree of Arbitrariness

It is submitted that the first key comparative advantage of the transfer-centered model of sunset design is its lesser degree of arbitrariness in comparison with the other two main models, and especially the time-centered one.[287] Indeed, it is in this regard that the time-centered model's key practical strength—namely its relative simplicity and uniformity—also becomes its main weakness by imposing a "bright-line" objective approach to what is, more often than not, a matter of nuanced and subjective business judgment.[288]

The conversion of a DCS structure to a universal single-vote arrangement can have potentially profound implications, not just for those investors who are immediately affected but also for the relevant firm as a whole.[289] In addition to effecting an automatic *de facto* wealth transfer from the controller(s) to minority shareholders, it also has the collateral impact of intensifying the outside capital market pressures acting on the controller(s) and her managerial delegates, who are suddenly subjected to the potentially destabilizing pressures of the market for corporate control.[290]

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[284] *Id.*

[285] *See infra* Section III.C.

[286] *See infra* Section III.C.

[287] *See* Fisch & Solomon, *supra* note 9, at 1081–82; *see also* Sharfman, *Sunsets*, *supra* note 97, at 10.

[288] *See* Fisch & Solomon, *supra* note 9, at 1062–63, 1080–82.

[289] *See* Sharfman, *Sunsets*, *supra* note 97, at 9–10.

[290] On the purportedly destabilizing effect of such pressures generally, see STOUT, *supra* note 117, ch. 6; MAYER, *supra* note 119, at 89–116; Andrei Shleifer

In a company whose controller—behind the notional capital market buffer of a DCS structure—had previously been pursuing a strategic course of action that was idiosyncratic[291] and/or successful in an oblique[292] or inchoate way, the sudden imperative to communicate that business model to an external capital market constituency can be a galling task.[293]

The ensuing corporate culture shock may even necessitate a consequent shift in the fundamental purpose of the business[294] towards a more overtly shareholder value-oriented objective.[295] Of course, in some instances, exposing an incumbent management and corporate culture to such external pressures can be a beneficial way of reinvigorating an ailing or stagnant business, especially where a founder's vision and ideas have become outmoded as a result of market, technological or other societal shifts.[296] However, where a DCS sunset provision is activated prematurely, such exposure can potentially be harmful for the firm (and, indirectly, its general body of shareholders) by facilitating unwarranted interference by activist and institutional investors in a controller's implementation of her long-term strategic plan or vision.[297]

& Lawrence H. Summers, *Breach of Trust in Hostile Takeovers in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33–67 (Alan J. Auerbach ed. 1988); Simon Deakin & Giles Slinger, *Hostile Takeovers, Corporate Law and the Theory of the Firm*, 24 J.L. & SOC'Y 124 (1997).

[291] On the potential economic value to the firm and its investors of idiosyncratic entrepreneurial vision, see generally Goshen & Hamdani, *supra* note 132.

[292] On the potential economic value to the firm and its investors of oblique or indirect (as opposed to instrumental or direct) methods of corporate profit-making, see generally JOHN KAY, OBLIQUITY: WHY OUR GOALS ARE BEST ACHIEVED INDIRECTLY 24–34 (2011).

[293] On the communicative imperatives of capital markets vis-à-vis corporate managers generally, see Moore & Walker-Arnott, *supra* note 13, at 432–37; FROUD ET AL., *supra* note 133, ch. 5.

[294] On the notion of corporate purpose generally as viewed from a legal perspective, see Christopher M. Bruner, *Power and Purpose in the 'Anglo-American' Corporation*, 50 VA. J. INT'L L. 579, pt. II (2010); BARNALI CHOUDHURY & MARTIN PETRIN, CORPORATE DUTIES TO THE PUBLIC ch. 3 (2019).

[295] Berger, *supra* note 103.

[296] On the propensity of corporate-managerial "insiders" to overvalue the firm's internal capital allocation plans, and the corresponding value of external stock market signals as a potential means of correcting such overvaluations, see Jeffrey N. Gordon, *The Rise of Independent Directors in the United States: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1469–70 (2007).

[297] On this, see *supra* notes 103–09 and accompanying text.

The contention here is not that DCS sunsets, or indeed DCS structures generally, are inherently "good" or "bad" in terms of their overall economic efficiency or social utility. The point, rather, is that there is no "one-size-fits-all" optimal time period for DCS sunsets.[298] On the contrary, determining an appropriate sunset period for any DCS company is an inherently contextual and firm-specific issue that eludes universal regulatory treatment.[299] Accordingly, any micro-level equilibrium in this regard is dependent on the nature of the relevant corporate controller(s), business model, organizational culture, product market, technological environment, and/or point in the relevant business life cycle.[300] Indeed, typical corporate investment time horizons can vary considerably both between and even within industrial sectors, ranging from as short as three to five years in some sectors to as high as ten to fifteen in others.[301] In respect of certain radically innovative and technologically intensive initiatives, the investment-to-return time frame can potentially even be much higher.[302]

In view of the above, it becomes apparent that regulatory requirements for fixed-term sunsets calibrated on anything wider than a firm-specific basis are inherently arbitrary in nature.[303] The CII's abovementioned proposal for universal seven-year sunsets is especially problematic in terms of arbitrariness given its intended potential application to the U.S.-listed company sector in its entirety.[304] As Goshen points out, such a bright-line

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[298] Sharfman, *Sunsets*, *supra* note 97, at 10.

[299] Fisch & Solomon, *supra* note 9, at 1063.

[300] Govindarajan et al. claim that "a sunset clause would be ideal if there exists a fixed, predetermined time after which all companies become mature enough to need no further changes in their business models." Govindarajan et al., *supra* note 18. However, they point out that a company's age-to-maturity period typically "differs based on the firm's technology and business model" such that "a one-size-fits-all policy would not work." *See id.*

[301] HM TREASURY, FINANCING GROWTH IN INNOVATIVE FIRMS: CONSULTATION 10 (Aug. 2017), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642456/financing_growth_in_innovative_firms_consultation_web.pdf [https://perma.cc/X83V-CQRD].

[302] *See id.*

[303] *See* Goshen, *supra* note 151.

[304] *See supra* note 195 and accompanying text.

rule seems predicated on the unrealistic notion that entrepreneurial vision can only be realized successfully during the first seven years of a company's post-IPO life, whereas in fact "there is nothing in the company, or in life, suggesting that" to be the case.[305]

Moreover, even firm-specific sunsets are not necessarily immune from charges of arbitrariness in that, by their very nature, they are designed proactively a number of years ahead of their intended activation.[306] As such, their formulation inevitably takes place to some extent in the abstract, without knowledge or foresight of the specific challenges facing the relevant firm's business at the (later) point in its life cycle when the relevant sunset is activated.[307] In this regard, Fisch and Solomon note that in most current instances of time-based sunsets "the length of the sunset period appears to be arbitrary and does not seem to correlate with any theory about the length of time necessary for a founder to implement his or her vision."[308] However, as the same authors highlight, "[t]he timeframe necessary for realizing a company's goals is likely to vary depending on the company, based on factors like the company's maturity at the IPO stage, the duration of its business model, and the time required to develop its products or services and bring them to market."[309] Accordingly, any sunset provision that is triggered by an ex ante time-contingent trigger—whether regulatory or firm-specific in nature—inevitably runs the risk of cutting adversely against the grain of the relevant firm's business trajectory at the time of its eventual activation.[310]

Given their more contingent and context-dependent nature, ownership-based and other event-triggered sunsets are, in general, less problematic than time-based sunsets in terms of their potential arbitrariness.[311] However, even ownership-based triggers are susceptible to the same charge of eliciting crude and

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[305] Goshen, *supra* note 151.
[306] *See* Fisch & Solomon, *supra* note 9, at 1080–81.
[307] *See id.* at 1081.
[308] Fisch & Solomon, *supra* note 9, at 1081.
[309] *Id.* at 1082.
[310] *See id.* at 1084.
[311] *See* Fisch & Solomon, *supra* note 9, at 1086.

factually insensitive outcomes.[312] This risk is especially pertinent where a corporate founder or other controlling shareholder may have legitimate prudential motivations for wishing to liquidate part of her multi-vote holding, for example to obtain enhanced personal liquidity.[313] In those instances, it is likely that the multi-vote holder will significantly reduce her proportionate cash flow interest in the firm, irrespective of her continuing faith in and/or commitment to the firm's success.[314] As such, the increased wedge consequently arising between her voting and corresponding cash flow rights in the firm should not be presumed to denote a case of the proverbial captain fleeing her sinking ship, as an agency-cost-centered interpretation of the same scenario would typically suggest.[315] For this reason, an ownership-based sunset trigger can prove a potential curb on an incumbent multi-vote holder's personal financial flexibility, which can in turn increase the relevant firm's cost of raising fresh equity capital from prospective future controllers.[316]

Compared to the time and ownership-centered sunset models, the transfer-centered model is less susceptible to allegations of harmful arbitrariness.[317] This is for two main reasons. First, since a transfer-based sunset 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, there is consequently no risk of a transfer-based trigger being activated during the period of an incumbent controller's premiership.[318] This insures against the risk of disturbance to the firm's pre-existing business trajectory.[319] And, second, since a transfer of corporate control (whether by way of succession or sale/purchase) inevitably entails a sudden change of trajectory for the firm's business (whether strategically or at

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[312] *See id.*

[313] *See* Marc Moore, *Designing Dual Class Sunsets: The Case for a Transfer-Centered Approach*, COLUM. L. SCH. BLUE SKY BLOG (Dec. 19, 2019), https://clsbluesky.law.columbia.edu/2019/12/19/designing-dual-class-sunsets-the-case-for-a-transfer-centered-approach/ [https://perma.cc/PK7Z-65HZ].

[314] *See id.*

[315] *See* Fisch & Solomon, *supra* note 9, at 1086.

[316] *See* Moore, *supra* note 313.

[317] *See id.*

[318] *Id.*

[319] *Id.*

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.[320]

Accordingly, the transfer-centered model would appear the preferable option from the above perspective.[321]

B. Avoidance of Moral Hazard and Other Perverse Controller Incentives

In addition to their alleged arbitrariness, time-based sunsets are also susceptible to criticism on account of their purportedly perverse behavioral effects.[322] This is because a time-based sunset—whether prompted by regulation or private ordering—arguably creates an artificial incentive on the part of an incumbent controller to dispose of her DCS holding at some point within the specified pre-sunset period.[323] By doing so, the controller will expectedly be able to recoup as much of her remaining control premium as possible before it dissipates on the triggering of the applicable sunset deadline.[324] As Coffee has noted, this could have the unintended consequence of engendering greater industry concentration by encouraging dynamic start-up founders to sell their multi-vote stakes to established market leaders some time before the expiry of their privileged governance status.[325] In turn, the above trend could have the long-term effect of creating what Coffee has termed a "permanent gerontocracy",[326] which presumably denotes a heavily concentrated

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[320] *See* Fisch & Solomon, *supra* note 9, at 1088.

[321] *See generally id.* at 1088–89.

[322] *See id.* at 1083.

[323] *See id.* at 1083.

[324] *See id.* Although, as Fisch and Solomon have highlighted, in principle such differential pricing of multi-vote vis-a-vis single-vote stakes could be eliminated by inserting an equal treatment provision in the relevant company's charter, which would in effect compel the controller to sell her (controlling) multi-vote stake at the same per-share price as any (non-controlling) single-vote stake(s). *Id.* at 1089. However, whether the relevant multi-vote holder would be prepared to assent to such a wealth-reducing condition in practice is questionable, at least without demanding some corresponding compensation in the form of a higher upfront cost of capital and/or offsetting side benefits (e.g., an increased executive salary). *See* Kirby Smith, *The Agency Costs of Equal Treatment Clauses*, 127 YALE L.J. FORUM 543, 561 (2017).

[325] Coffee, *supra* note 6, at 2.

[326] *Id.*

corporate sector dominated by a small group of large, mature, and clunky market leaders.[327]

Of course, insofar as conversion of the multi-vote shares to common (single vote) stock takes place automatically on the triggering of the relevant sunset provision, it follows that acquisition of the (controlling) multi-vote stake will not in itself guarantee the acquirer long-term corporate control.[328] Accordingly, the extent of the price differential attaching to the multi-vote dimension of a DCS structure will tend to reduce progressively towards zero as the pre-specified sunset date nears.[329] However, even then, there is still a significant moral hazard risk with a time-based sunset, which can consequently compel the multi-vote holder in this position—faced with the known prospect of imminent loss of control—to engage in short-term, excessively risky and/or self-serving behavior in order to maximize her own personal wealth prior to the inevitable "cliff edge"[330] of the predetermined sunset deadline arriving.[331]

In response to the above criticism of time-based sunsets, Bebchuk and Kastiel point out that, with a provision in the form recently proposed by the CII, the termination of the relevant DCS structure after the specified time period is not a necessary consequence.[332] Rather, as explained above, under the CII-backed model, minority (single-vote) shareholders can always opt to

[327] Although Coffee himself does not offer an explicit definition of this term in the present context, the Oxford/Lexio dictionary defines the word "gerontocracy" in its more generic (i.e., non-corporate-specific) sense as denoting "a state, society or group governed by old people". *Gerontocracy*, LEXIO, https://www.lexico.com/en/definition/gerontocracy [https://perma.cc/E57V-PMUD].

[328] *See* Bebchuk & Kastiel, *supra* note 12, at 611.

[329] *See id.*

[330] Fisch & Solomon, *supra* note 9, at 1083.

[331] *Id.* Admittedly, it could be queried why the other two dominant types of sunset provisions examined in this article are not prone to have the same perverse incentive effects on corporate controllers. *See generally id.* at 1086–91. However, it is submitted that in the case of ownership, transfer, and other event-based sunsets, the elements of contingency and resulting indeterminacy involved in triggering the relevant DCS conversion provision mean that such sunsets typically do not have the same cliff-edged nature as *ex ante* time-based sunsets. *See id.* at 1083, 1086. It is therefore arguable that the risk of incumbent controllers engaging in "last shot" reckless or rent-seeking behavior is, in general, a less exigent corporate governance concern in those latter instances.

[332] *See* NASDAQ Letter, *supra* note 195.

retain the DCS structure after the initial (e.g., seven-year) sunset period by means of an affirmative independent vote to this effect.[333] This theoretically caters to instances where a DCS structure continues to prove advantageous for the firm and its investors, by enabling voluntary deactivation (or, at least, suspension) of the sunset trigger by minority shareholders.[334] However, the argument that the cliff-edged nature of time-based sunsets—together with their consequent adverse behavioral influence on controllers—are effectively neutralized by the procedural stopgap of an independent shareholder vote on the matter is a highly problematic one.[335] This is for two main reasons.

First, it fails to account for the significance of the time-based sunset's default status under the CII's model and, relatedly, the fact that any independent shareholder vote on postponement of the sunset's triggering must be proposed by way of a proactive minority shareholder resolution to this effect.[336] If that significant hurdle is passed, there remains the additional challenge of securing a majority independent shareholder vote to this effect, which, in the public company environment, can be a galling corporate governance task for even the most active and committed of investors.[337] Against the background of these significant communication

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[333] *Id.*

[334] Bebchuk & Kastiel, *supra* note 12, at 624.

[335] *See* Richard H. Thaler & Cass R. Sunstein, *Libertarian Paternalism*, 93 AEA PAPERS & PROC. 175, 176 (2003).

[336] In this regard, Thaler and Sunstein have highlighted how selecting a "default option" is in practice never a value-neutral decision for policymakers, but in reality has an inevitable paternalistic or welfarist element to it. *Id.* The authors explain that "[i]n a fully rational world such design choices would have little effect (at least in high-stakes situations) because agents would simply choose the best option for them regardless of the default." *Id.* However, as against this, they observe how "numerous experiments illustrate that there is a very strong 'status quo' bias [in practice]" whereby "[t]he existing arrangement, whether set out by private institutions or by government, tends to stick." *Id.* For an extended and more generic (i.e., non-corporate-specific) argument to this effect by the same authors, see generally RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH AND HAPPINESS (2008).

[337] This factor is especially concerning given Berger's recent observation that "the most striking empirical studies these days are those showing that the traditional measures of 'good corporate governance' have little relationship to either corporate performance or ethical corporate behavior." Berger, *supra* note 103, at 15. Rather, "all that is measured by corporate governance studies is

and coordination difficulties, it becomes clear that the default status of an automatic time-based sunset is far from a trivial matter.[338] On the contrary, it matters a great deal in weighing the conversion versus postponement question firmly in favor of the former outcome, which is therefore likely to ensue in all but the most manifestly inappropriate cases.[339] Even in those instances, though, it is debatable whether the arguments in favor of postponement will be sufficiently compelling in the eyes of non-controlling investors to bring about the circumvention of a time-based sunset's automatic activation.[340]

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whether a company meets the current 'checklist' of various governance metrics, which again have little to do with performance or ethics." *Id.* On the common investor and intermediary practice of corporate governance "box-checking" generally (albeit with principal reference to the United Kingdom, rather than the United States, securities market context), see generally Moore, *supra* note 179, at 117–25; *supra* note 212 and accompanying text; Bobby V. Reddy, *Thinking Outside the Box—Eliminating the Perniciousness of Box-Ticking in the New Corporate Governance Code*, 82 MOD. L. REV. 692 (2019).

[338] On status quo bias generally, see generally William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK UNCERTAINTY 7 (1988).

[339] On one view, setting a one share/one vote default norm for former DCS companies after seven years could be regarded as an example of what Ayres and Gertner have termed a "penalty default" rule, which is deliberately set in favor of the less informed party (i.e., non-controlling shareholders) so as to give the more informed party (i.e., the founder and/or controlling shareholder) the incentive to reveal greater information to the other party (e.g., as to their future strategic plans for the company) as a precondition of securing their support for reversing the relevant default (i.e., for reintroducing a DCS structure). Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 97–100 (1989). However, it is questionable to what extent non-controlling shareholders can actually be regarded as relatively less well-informed on corporate governance issues within the contemporary U.S. capital market environment, where institutional investors, proxy advisors and other specialized professional intermediaries now customarily exert a pervasive influence over key corporate governance norm selections and adaptations at the individual firm level. Christie Hayne & Marshall D. Vance, *Information Intermediary or De Facto Standard Setter?: Field Evidence on the Indirect and Direct Influence of Proxy Advisors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 20, 2019), https://corpgov.law.harvard.edu/2019/03/20/information-intermediary-or-defacto-standard-setter-field-evidence-on-the-indirect-and-direct-influence-of-proxy-advisors/ [https://perma.cc/U45R-78RF].

[340] In view of the above factors, it would arguably be more appropriate for securities market regulators to set the retention of the DCS structure after the

A second reason for doubting the effectiveness of independent shareholder sunset postponement votes is the inherent conflict of interest that non-controlling, single-vote shareholders will be faced with in this scenario.[341] When voting on the sensitive conversion versus postponement question with respect to a given company's DCS structure, single-vote shareholders will be acting in the knowledge that they stand to gain directly from the removal of the multi-vote holder's control premium via DCS conversion.[342] Vice versa, on conversion of the DCS structure to a uniform one share/one vote platform, the single-vote shareholders' corresponding minority discount will automatically be offset.[343] The prospect of reaping this immediate personal wealth gain will make it highly difficult, if not outright impossible, for the single-vote shareholders to give genuinely impartial consideration to the question of which voting arrangement is in the long-term interest of the company and its investor body as a whole.[344] The existence of this manifest conflict on the part of single-vote shareholders arguably further strengthens the case for weighing the conversion versus postponement decision on the side of the latter outcome, by setting the retention of the existing DCS structure as the reversible-default

initial sunset period (e.g., seven years) as the default norm, while vesting independent (single-vote) shareholders with the right to propose and vote on converting the super-voting shares to single-vote shares. *See generally* Ayres & Gertner, *supra* note 339; Hayne & Vance, *supra* note 339. By inverting the abovementioned CII-backed reform in this way, regulators may well strike a more efficient balance between encouraging the take-up of time-based sunsets by listed DCS companies and preventing independent shareholders from being swayed by status quo bias into systematically favoring DCS conversion on the expiration of the initial sunset period. *See generally* Govindarajan et al., *supra* note 18. At the same time, activist and institutional investors will still have the right to propose conversion resolutions in appropriate instances, especially where those proposals attract additional support from proxy advisors and other influential pro minority-shareholder groups. *See* NASDAQ Letter, *supra* note 195. On the relevant CII proposal in its existing form, and related discussion, see generally Council of Institutional Invs., *supra* notes 193–95.

341 *See* Fisch & Solomon, *supra* note 9, at 1084.

342 *Id.*

343 *See* William J. Piercy, *For What It's Worth ... Court Rejects Minority Discount in Valuing Stock,* BERMAN FINK VAN HORN P.C. BLOGS (May 21, 2018), https://www.bfvlaw.com/for-what-its-worth-court-rejects-minority-discount-in-valuing-stock/ [https://perma.cc/9TTS-DC75].

344 Fisch & Solomon, *supra* note 9, at 1084–85.

outcome of time-based sunsets (to the extent, of course, that it is seen as prudent to mandate or even deploy such provisions for DCS companies generally).[345]

For the above reasons, it is therefore unlikely that the availability of an independent shareholder postponement vote will be effective in mitigating the moral hazard and other unintended behavioral consequences that time-based (and, to a lesser extent, ownership-based) sunsets are liable to give rise to.[346] It consequently pays to consider other less obtuse or intrusive ways of designing sunset triggers, especially if any such provision is intended as a blueprint for prospective future regulatory reforms.

C. Sensitivity to Non-Financial Controller Motivations

At the heart of the academic case for time-based (and, by implication, ownership-based) sunsets is the abovementioned "wedge"[347] issue: that is to say, the disparity that can develop between a multi-vote holder's governance and cash flow rights in a DCS company, and the ensuing agency problems that this mismatch is said to create.[348] Accordingly, purely transfer-based sunsets that are triggered only by the death or retirement of corporate founders are said to be insufficiently responsive to developing agency cost issues in founder-controlled DCS firms.[349]

For example, Bebchuk and Kastiel question the effectiveness of succession-triggered sunsets that permit DCS structures to endure throughout a multi-vote holder's life (or, at least, for the length of her ownership or directorial tenure).[350] This is on the

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[345] In this regard, Sharfman explains that since,

> [s]hareholders suffer from the problems of asymmetric information and the simple inability to make the proper evaluation of a leader's idiosyncratic vision [they are consequently left] in the position of having the knowledge that ending the dual class share structure will expose the shares to the market for corporate control and hedge fund activism, an expected positive for the company's share price, without being able to evaluate the cost.

Sharfman, *Sunsets*, *supra* note 97, at 9–10.

[346] *Id.*

[347] *Id.* at 7.

[348] *See id.* at 9–10.

[349] *See* Winden, *supra* note 196, at 894.

[350] Bebchuk & Kastiel, *supra* note 12, at 619.

purported premise that "[a] founder who has decades of working life ahead of her poses substantial risks that she would not remain a fitting leader of the company throughout her entire working life."[351] The authors consequently conclude that such arrangements are "substantially inferior" from an agency cost perspective than shorter-term time-based sunset provisions.[352]

In a similar vein, Goshen and Hamdani claim that, because multi-vote holders—as effective minority controllers—have a lesser proportion of residual cash flow rights at risk than controlling majority shareholders in single-class stock companies, it follows that independent investors are likely to face greater exposure to controller agency costs in firms with DCS structures.[353] They argue that, in contrast, "the concentrated-ownership structure allows [a controlling majority shareholder] to enjoy indefinite and uncontestable control without subjecting investors to the high management agency costs associated with the dual-class structure."[354] In forming such a favorable impression of orthodox majority control structures over their minority control (e.g., DCS) counterparts, Goshen and Hamdani proceed on the express assumption that "[t]he higher the controller's share of cash-flow rights, the lower her incentive to expropriate the minority."[355] In this regard, they refer to the perceived "lock-in" effect of orthodox controlling shareholdings, which are typically illiquid in nature due to their relatively large scale, coupled with the significant concentration of firm-specific risk that they tend to entail.[356] As such, majority control stakes in large business organizations are normally unsusceptible to ready disposal, and consequently do not permit their holder a frictionless exit from her position at any desired moment in time.[357] A notable implication of Goshen and Hamdani's analysis is that DCS and other minority control structures—correspondingly—do not have such a lock-in effect on a

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351 *Id.* at 620.
352 *Id.*
353 Goshen & Hamdani, *supra* note 132, at 590–91.
354 *Id.* at 593.
355 *Id.* at 591.
356 *Id.* at 593.
357 *Id.*

multi-vote-holder's position in the firm.[358] As such, they purportedly fail to restrict a multi-vote-holder's capacity "to quickly walk away from the business,"[359] thereby undermining the propensity of entrepreneurial controllers to commit to ensuring DCS companies' long-term development and success (in preference to expropriating private benefits of control).[360]

However, while controller alienation and/or rent extraction in DCS companies might seem likely when viewed from a purely agency cost-oriented perspective, on a broader and more nuanced analysis such concerns would appear to be significantly overstated.[361] It is submitted that the principal blind spot of orthodox agency cost analyses of DCS structures is their tendency to overlook the overall calculus of financial *and non-financial* costs of private (and especially founder) control, by regarding only the former type of cost as an effective constraint on entrepreneurial wealth extraction.[362] Thus the presumptive starting point of the agency cost view is that without some meaningful element of "skin in the game" in the form of personal financial risk exposure, controllers of DCS companies stand to lose relatively little from abandonment and/or misuse of their privileged governance position within the firm.[363]

What the above problematization of DCS fails to recognize, though, is the practical reality that multi-vote-holding controllers—and especially founder-entrepreneurs—have considerably more at stake in the firm than just their basic financial equity.[364] Of comparable personal significance for an entrepreneur are the crucial non-financial personal consequences of the failure or underperformance of a business enterprise that she

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358 *See id.*

359 *Id.*

360 *See id.* at 593–94.

361 *See* Lemley & McCreary, *supra* note 137, at 23.

362 In this regard, it has recently been highlighted that since "firms that go public are commonly controlled by founders, and going public in any case rewards founders who care about non-pecuniary factors (control, public prominence, etc.) rather than profit maximization," it follows that "[w]ithout such founder control and non-financial motivations, the go-public rate might be lower still." *Id.*

363 *See* Bebchuk & Kastiel, *supra* note 12, at 620.

364 Melissa S. Cardon et al., *The Nature and Experience of Entrepreneurial Passion*, 34 ACAD. MGMT. REV. 511, 512–14, 517, 521 (2009).

has founded and invested her time, energy, and creativity in, including the loss of valuable reputational capital amongst peers and associates.[365]

It has been observed how reputational constraints on minority controller rent-seeking can be especially compelling in family controlled firms,[366] given the status of families as effective "repositories for reputation."[367] In addition, there is the common personal interest of founder-entrepreneurs in maintaining firm growth for the benefit of subsequent familial generations, which provides a further powerful motivation to limit their exploitation of private benefits of control on an ongoing basis.[368] Reputational incentives for responsible (or, at the very least, non-exploitative) controller conduct in DCS companies are arguably further intensified in instances where a minority controller envisages issuing additional nonvoting or restricted voting stock in the future, which creates an imperative to keep the external capital market onside.[369] The above considerations together support a general presumption that family controlled firms—or, at least those family firms at the first generation (founder) stage—will be managed in a broadly diligent and responsible manner *without* the systematic exploitation of private benefits of control, notwithstanding the existence of a significant wedge between the founder-entrepreneur's voting and corresponding cash flow rights in the firm. Or, at the very least, they imply that adoption of such a default starting point is not as naïve or misguided a position as agency cost analyses of minority control structures would tend to suggest.

With respect to entrepreneurial motivation more generally,[370] meanwhile, psychological research has highlighted the centricity to entrepreneurship (based on an analogy with parenthood) of entrepreneurial passion, and a founder-entrepreneur's typically strong sense of attachment to and identification with their

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[365] *Id.* at 513, 521, 527.

[366] *See* BEBCHUK ET AL., *supra* note 56, at 305–06.

[367] *Id.* at 306. *See generally* Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999).

[368] *See* BEBCHUK ET AL., *supra* note 56, at 306.

[369] *See* Sheehan, *supra* note 148, at 318.

[370] That is to say, both within *and outside* the family firm context.

personal business venture.[371] Entrepreneurial passion is said to be experienced "as a complex pattern of psychological, brain and body responses activated and maintained by an entrepreneur's passion that, when [self-]regulated, aid in motivating coherent and coordinated goal pursuit."[372] Crucial to entrepreneurial passion in the above sense is the notion of self-identity, which is claimed to provoke "intense positive feelings experienced by engagement in entrepreneurial activities associated with roles that are meaningful and salient to the self-identity of the entrepreneur."[373]

The notion of entrepreneurial passion has recently been developed further by Lahti *et al.*, who claim that "a venture embodies the founding entrepreneur's creations, ideas, goals, unique knowledge, work, invested efforts, and life experiences, all of which are expressive of and salient to the entrepreneur's representation of the self," thereby engendering "a high degree of motivation to act on behalf of the venture."[374] It follows from this purported "sense of self"[375] embodied in the entrepreneurial firm that "the venture's failure may severely reduce the entrepreneur's self-worth, causing the entrepreneur to suffer shame and embarrassment."[376] Vice versa, it has been observed how entrepreneurial passion brings powerful "nonmonetary [and especially

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[371] Melissa S. Cardon et al., *A Tale of Passion: New Insights into Entrepreneurship From a Parenthood Metaphor*, 20 J. BUS. VENTURING 23, 23–27 (2005) [hereinafter *A Tale of Passion*]. Building (inter alia) on these insights, more recent psychological research conducted by Lahti et al. has identified a comparable phenomenon which these authors term "entrepreneurial bonding", denoting "an entrepreneur's profound connection with the venture" in a fundamentally similar vein to parent-to-child bonding. Tom Lahti et al., *Why and How do Founding Entrepreneurs Bond with their Ventures? Neural Correlates of Entrepreneurial and Parental Bonding*, 34 J. BUS. VENTURING 368, 368–69 (2019). Lahti et al. claim that, "[b]y developing strong bonds with their ventures, founding entrepreneurs become motivated to overcome environmental threats and challenges, putting themselves in a better position to improve venture creation outcomes, growth, and performance." *Id.* at 369.

[372] *See* Cardon et al., *supra* note 364, at 518.

[373] *Id.* at 517.

[374] *See* Lahti et al., *supra* note 371, at 371.

[375] *Id.*

[376] *Id.* at 372.

emotional[377]] rewards" to offset lower monetary rewards from self-conducted business, while also encouraging self-sacrifice and delayed gratification on the entrepreneur's part.[378] At the same time, an entrepreneur's identification with, or attachment to, their firm or venture can cause them to view that firm in effect as an extension of themselves, especially in instances where the firm (rather like a human offspring) inherits some of the founder's personal character traits as reflected in its distinct organizational culture and norms.[379]

From the perspective of the issue at hand, one notable purported implication of such attachment is that engagement in entrepreneurial activities that are meaningful to self-identity is principally simulated not "by the instrumental goal of wealth creation and 'maximisation,'" but rather by "intrinsic motivation stemming from the validation and affirmation of an entrepreneur's conception of true self."[380] Curiously, it has been found that in such circumstances "wealth seeking is relevant but not central to the conception of the self."[381] Moreover, entrepreneurial passion, insofar as it is linked inextricably to self-identity, is said by its nature to "endure over a longer period of time" as opposed to being merely fleeting or episodic in nature.[382] As such, it purportedly "has a motivational effect that stimulates entrepreneurs to overcome obstacles and remain engaged."[383]

However, whereas intrinsic motivations of the above type are typically present on the part of first-generation (founder) controllers, they tend not to be so prevalent within second-generation family firms controlled by a founder-entrepreneur's descendant(s).[384] The same can arguably be said for entrepreneurial abilities, which are by no means certain to transmit through

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[377] *See A Tale of Passion*, *supra* note 371, at 37.
[378] *Id.*
[379] *Id.* at 38–39.
[380] *See* Cardon et al., *supra* note 364, at 526.
[381] *Id.*
[382] *Id.*
[383] *Id.* at 512.
[384] *See A Tale of Passion*, *supra* note 371, at 24, 33.

successive familial generations.[385] Indeed, Perez-Gonzales has found that firms where CEO successions run to family members (related either by blood or marriage) exhibit systematically lower profitability and weaker accounting performance than those firms which promote non-familial employees to CEO level.[386] Perez-Gonzales attributes this to the negative effect of nepotistic (vis-à-vis meritocratic) promotions decisions in effectively buffering familial CEO appointees from prior disciplining and screening by the external market for managerial talent.[387] Likewise, Bennedsen et al. have found that family firms which permit CEO successions to other family members systematically underperform (in terms of firm profitability) in relation to those family firms where professional non-family managers are appointed as successor-CEOs to the founder.[388]

From a corporate perspective, moreover, it is questionable whether the acknowledged business and investor benefits of having an autonomous entrepreneurial presence at the first-generation stage will persist throughout subsequent generations.[389] Empirical studies have shown that, whereas "[in] first generation family firms, the presence of the founder is the most powerful influence on organisational development ... [t]his founder centrality is reduced as the firm moves to the second generation."[390] At the second-generation stage, by contrast, "decision making becomes less centralised and personalised" in search of "new ways to revitalise and further expand the business."[391] It follows that "second-generation CEOs need to develop a more external

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[385] Curiously, it has been recorded that two-thirds of family businesses typically fail to survive beyond the first-generation stage due to succession-related difficulties. *See* Descovich et al., *supra* note 65, at 60 n.97.

[386] Francisco Pérez-González, *Inherited Control and Firm Performance*, 96 AM. ECON. REV. 1559, 1559, 1585 (2006).

[387] *Id.* at 1560–78, 1585.

[388] *See* Bennedsen et al., *supra* note 157, at 649, 669, 689.

[389] *Id.* at 653.

[390] Cristina Cruz & Mattias Nordqvist, *Entrepreneurial Orientation in Family Firms: A Generational Perspective*, 38 SMALL BUS. ECON. 33, 36 (2012) (citing Stéphanie Brun de Ponet et al., *An Exploration of the Generational Differences in Levels of Control Held Among Family Businesses Approaching Succession*, 20 FAM. BUS. REV. 337 (2007)).

[391] *Id.*

culture orientation [than founders] that places a greater value on signals from the external environment" such as emerging market trends and industry characteristics.[392] Accordingly, in those latter instances, it would appear that the abovementioned disparity between control and cash flow rights arising from a DCS structure, and the resultant insulation that this provides from external capital market pressures, potentially represents a much more significant governance problem than in the case of first-generation (founder) firms.

It is principally for the above reason that this Article, despite being otherwise supportive of a private ordering approach towards DCS structures, would nonetheless caution against embracing an *outright* deregulatory stance with respect to the issue of DCS sunset design. Indeed, whilst—in the present author's view—the above arguments against mandatory time-based sunsets remain compelling, there nonetheless remains a reasonable case for engendering the adoption of succession- or general transfer-based sunset provisions over perpetual DCS structures, especially in the family firm context.[393]

Accordingly, the present author would respectfully suggest that the SEC and principal domestic exchanges 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 CII's proposed time-based scheme.[394] The advantage of the former approach to sunset regulation is that, unlike the time-based model, it preserves a firm's contractual freedom over matters of

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[392] *Id.* Indeed, external environmental signals of this nature would appear to be a pertinent factor in engendering "entrepreneurial alertness" in second-generation familial controllers, which the economist Israel Kirzner has defined as the propensity to identify and respond to market disequilibria via so-called "frame-breaking": that is, identifying novel or contrarian strategies that entail departing from existing organizational thought frameworks. ISRAEL M. KIRZNER, PERCEPTION, OPPORTUNITY, AND PROFIT 148 (1979).; *see also* Connie Marie Gaglio & Jerome A. Katz, *The Psychological Basis of Opportunity Identification: Entrepreneurial Alertness*, 16 SMALL BUS. ECON. 95, 99–100, 104 (2001) (citing ISRAEL M. KIRZNER, DISCOVERY AND THE CAPITALIST PROCESS 56 (1985)).

[393] *See* Cruz & Nordqvist, *supra* note 390, at 33.

[394] *See* Sharfman, *supra* note 4, at 3–4.

DCS design insofar as its multi-vote shares (together with the economic interest therein) remain in the possession of their original holder.[395] However, in contrast to the pure private ordering approach to sunset design, the transfer-centered model insures against the risk of a business founder's diverse motivations and capabilities failing to transmit to her familial or other successors.[396] Relatedly, the transfer-centered model (unlike the pure private ordering approach to sunset design) is sensitive to the unique strategic and governance challenges faced by entrepreneurial firms on the death or retirement of their founder, which give cause to question the utility of continually entrenching second- and successive-generation controllers against outside challenge.[397]

Accordingly, it is this Article's contention that the case for consolidating founder-familial control across generational lines is insufficiently convincing to justify permitting DCS structures in perpetuity. At the same time, though, the present author acknowledges the significant sensitivity and context-dependency of the various market and behavioral factors at play in this area, and the fact that the surrounding academic and policy debate on DCS sunset design remains at a somewhat formative stage. Against this background, there is arguably something to be said for the suggestion that policymakers in the United States should continue to put their trust in private ordering as a prospective means of bringing about effective (self-) regulatory responses to the above concerns, unless and until the case for affirmative regulatory interventionism in this regard has been unequivocally made out.[398]

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[395] *Id.* at 33–34.

[396] A transfer-based sunset provision ordinarily achieves this outcome in practice by preventing multiple-vote shares from passing prematurely to heirs or other transferees without the prior authorization of non-controlling shareholders. *See* Descovich et al., *supra* note 65, at 60.

[397] *See* Sharfman, *Sunsets*, *supra* note 97, at 10.

[398] In this regard, Sharfman envisages that "[i]f the market is concerned about dual class share structures creating family dynasties, then it will at least include an event-based sunset provision such as unification upon the death or disability of the controller." *Id.*

CONCLUSION

The evolving debate on optimal DCS sunset design,[399] like the debate on the relative merits of dual- versus single-class stock more generally,[400] is unlikely to recede any time soon. It is reasonable to expect that, over the coming years, further entrepreneurially led e-commerce, social media and other tech-sector businesses will turn to public equity markets as a source of vital growth finance.[401] At the same time, the heightening specter of hedge funds and other activist shareholders in corporate governance will no doubt continue to provoke caution on the part of business founders about surrendering their control rights to prospective outside insurgents.[402]

As more and more companies and investor groups come to battle with these thorny issues—not just in the United States but globally—it is imperative that policymakers everywhere remain alert to the potential need for appropriate responses. At the same time, given the complexity and firm-specificity of many of the factors involved in the question of DCS sunset design, regulators must resist the temptation to impose overly hasty or blunt "solutions" to the perceived problems at hand. The inconvenient reality is that, with such polar interests and ideologies at play, any responsive action (or inaction) in this regard will almost certainly alienate one constituency or another.

Against the above background, this Article has sought to demonstrate that the transfer-centered sunset model recently implemented (in differing ways) by the Hong Kong and Singaporean listing authorities is, all things considered, the presumptively best—or, more accurately, *least worst*—of the principal available models in terms of striking an effective balance between the two core conflicting concerns at play.[403] These are, on the one hand, preserving scope for private ordering of DCS structures (or otherwise) at the individual firm level; while, on the other hand,

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[399] *See* Winden & Baker, *supra* note 24, at 8–9.

[400] *Id.*

[401] *See* Descovich et al., *supra* note 65, at 1, 33–34, 37; Goshen & Squire, *supra* note 101, at 807.

[402] Goshen & Squire, *supra* note 101, at 821.

[403] *See* Descovich et al., *supra* note 65, at 50–51.

protecting companies and non-controlling minority shareholders from the most worrying potential misuses of those structures.[404] While transfer-based sunsets are by no means immune from criticism themselves, it is the present author's contention that they are overall preferable to time-based sunsets in terms of moderating the above trade-off.[405] This is especially so if recent proposals to regulate the matter of DCS sunset design[406] are to be given serious consideration by policymakers.

For the foregoing reasons, it is therefore submitted that the SEC and main domestic market authorities should continue to resist calls from influential investor-related bodies for the introduction of mandatory time-based sunsets. For constructive inspiration in this regard, U.S. policymakers should look to Asia rather than at home, taking the recent Hong Kong and Singaporean market reforms as illustrative examples of best practice.[407] At the same time, pending the development of a broader consensus on the merits of regulating the matter of DCS sunset design in general, there is an arguable case for permitting private ordering to prevail in this area for the immediate time being.[408]

As the mixed history of previous reactive securities law reforms has demonstrated,[409] there is much truth in the age-old adage about fools rushing in where angels fear to tread. By the same token, when it comes to regulatory responsiveness to salient policy concerns the early bird seldom catches the worm, or at least the one they happened to be looking for at the time.

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[404] *See* Bebchuk & Kastiel, *supra* note 12, at 607, 618.

[405] *See supra* text accompanying notes 393–97.

[406] *See* Winden & Baker, *supra* note 24, at 10–11.

[407] *See* SGX Mainboard Rules, *supra* note 28, at 10; HK LISTING RULES, *supra* note 274, at 8A-5, 8A-7; Descovich et al., *supra* note 65, at 50.

[408] *See* Sharfman, *Sunsets*, *supra* note 97, at 2–3, 6, 8.

[409] *See* Descovich et al., *supra* note 65, at 92.