Dual Class Sunsets

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Old Debate, New Policies

The debate over dual class share structures has been ongoing for over a century. Yet every few years, dual class structures come under increased scrutiny and criticism – usually triggered by a specific event, such as a high-profile company going public with the founder retaining a class of supervoting shares – then the increased attention fades away. Recent policy changes by proxy advisory firms begin to take effect this year, and it will be interesting to watch this proxy season and next to see if the escalated pressure on companies with dual class structures will have any material effect. In December 2021, Institutional Shareholder Services ("ISS") announced that it was amending its policy on unequal voting rights originally adopted in 2015 to eliminate the exception for companies that had an unequal voting rights structure in place at the time the policy was adopted. Beginning in 2023, ISS will recommend its clients vote withhold or against directors if the company (even if previously grandfathered) employs a common stock structure with unequal voting rights. The policy does include a few exceptions, including for newly-public companies with a sunset provision of no more than seven (7) years. In November 2021, Glass Lewis announced a new policy regarding unequal voting rights which will be in effect for the 2022 proxy season. Glass Lewis will recommend voting against the governance committee chair at companies with a multi-class share structure with unequal voting rights if the company does not provide for a reasonable sunset of generally seven (7) years or less.

Policy Impact?

Whether the new policies will have a major impact remains to be seen. As a practical matter, it is highly unlikely that the new policies will lead to the shareholder(s) with the unequal voting rights (which usually represents a majority of the overall voting power) to vote against directors and thereby cause a failed election or majority withhold. Therefore, the effects of these recommendations will largely be symbolic. Look no further than shareholder proposals to eliminate unequal voting rights as a guide to the unlikeliness of changing actual vote outcomes. Despite support from investors, including the big three assets managers who all state their preference for "one vote one share" policies, none of the 48 proposals that went to a vote since Deal Point Data began tracking this activity in 2017 passed. On average, these proposals were only supported by approximately 28% of the voted shares. That said, high negative votes by independent shareholders can still provide reputational risk for individual directors and send the intended message that shareholders are dissatisfied with the current structure. In recent weeks, two companies announced plans to eliminate their dual class structure, and both referenced proxy advisory firms and "governance experts" as contributing factors. Carlisle Companies Incorporated disclosed it is seeking shareholder approval to eliminate its time-phased voting structure, citing reasons including "influential groups such as Institutional Shareholder Services and Glass Lewis generally disfavor enhanced voting rights for any group of stockholders". Constellation Brands, Inc. announced that the family that controls a majority of the voting power via its ownership of the 10-vote per share Class B Common Stock has proposed a transaction to convert the Class B shares into 1-vote Class A shares. In making the proposal, the Sands family cited "significant benefits", including that "a simplified structure would be better aligned with the 'one vote per share' governance that is widely supported by corporate governance experts".

Who is Affected?

Approximately 5% of the S&P 1500 and 8% of the Russell 3000 currently have a dual class common stock structure with unequal voting rights. There are three types of dual class structures.

Supervoting Rights
Companies with supervoting rights are those with more than one series of common stock authorized in the company's charter (and are outstanding) that are entitled to differing votes per share (e.g., Class A Common Shares have 1 vote and Class B Common Shares have 10 votes).

Enhanced Director Voting Rights
Enhanced director voting rights structures are those with more than one series of common with different voting rights related specifically to director elections. This includes situations where the additional class of common stock is entitled to elect a specified number or percentage of the board or are entitled to elect a designated class of directors regardless of the number of votes per share (e.g., Class A Common Shares elect 25% of the Board and Class B Common Shares elect 75% of the Board).

Time-Phased/Tenure Voting
The least common structure is the time-phased system (a.k.a., a tenure voting system) for determining the number of votes per common share. Under this system, the number of votes per share is determined based upon the length of time the holder has continuously owned the share (i.e., long-term holders have more votes per share than short-term holders). For example, a share held continuously for a minimum specified time-period will be entitled to 10 votes per share while newly acquired shares are entitled to 1 vote.

Stock Voting Rights and Control	**S&P 1500 (% with Provision)**	**Russell 3000 (% with Provision)**	**All DPD Companies (% with Provision)**
Number of Companies	1,500	3,016	3,446
Dual Class / Unequal Voting	5.1	7.8	7.9
Supervoting Rights	4.3	7.3	7.4
Enhanced Director Voting Rights	1.4	1.3	1.2
Time-Phased / Tenure Voting	0.2	0.1	0.1

Of those companies with dual class structures, a disproportionate number are recent IPOs. Over 61% of the companies in Deal Point Data's coverage universe with dual class structures completed their IPO within the last five years. Within the last 10 years, 84%. Interestingly, nine companies in the S&P 100, which represents the largest U.S. reporting companies, still maintain dual class structures despite that fact the most have been public for decades.

Sunset Provisions – Defined

A sunset provision provides a mechanism under which the "unequal rights" of the dual class/unequal voting structure will cease to exist if certain conditions are triggered. There are three types of sunset triggering conditions, and a company may have multiple conditions (e.g., upon the earlier of condition 1 or condition 2).

Time-Based
A time-based sunset provision is triggered, and the "unequal rights" cease, after a specified time-period or on a specific date (e.g., seven (7) years after an IPO).

Ownership-Based
An ownership sunset provision is triggered when the ownership or voting profile of the class(es) of outstanding stock fails to meet certain thresholds. For example, a company whose 10-vote Class B Common Shares automatically convert into 1-vote Class A Common Shares if the number of Class B Common Shares outstanding represents less than 5% of the aggregate number of Class A and Class B Common Shares

outstanding. Ownership-based sunsets are quite varied, with triggering threshold(s) determined using a wide array of formulas.

Event-Based
An event-based sunset provision is triggered upon the occurrence of one or more specified conditions (e.g., the death or disability of a founder, a vote of all supervote shareholders), irrespective of the specific point in time at which that condition or event took place.

Sunset Provisions – Prevalence

Major Index Companies
Of the 76 companies in the S&P 1500 that currently have a dual class structure, 30 companies (39%) have an active sunset (i.e., sunset is currently in effect and has not yet been triggered). None of these companies has a time-based sunset. Over half (53%) of Russell 3000 companies with a dual class structure have an active sunset. Of the 123 companies with an active sunset, 31 (25%) include a time-based based trigger, but only 14 of these companies has the seven (7) years or less sunset period sought by ISS and Glass Lewis.

Dual Class and Sunset (Current)	S&P 1500	Russell 3000	All DPD Companies
Number of Companies	1,500	3,016	3,446
Dual Class / Unequal Voting	76 companies (5.1%)	234 (7.8%)	272 (7.9%)
Active Sunset Provision	30 companies (39%)	123 companies (53%)	146 companies (54%)
Time-Based	0 companies (0%)	31 companies (25%)	38 companies (26%)
7 Years or Less (ISS/GL Policy)	-	14 companies (45%)	15 companies (39%)

Traditional IPOs
Of the 687 traditional IPOs tracked by Deal Point Data from 1/1/2017 through 3/31/2022, 91 (or 13%) went public with a dual class structure. Of those, 78 companies (86%) contained a sunset provision – half of which included a time-based trigger. Just under half (46%) of the time-based triggers fell within seven (7) years or less sunset period sought by ISS and Glass Lewis.

Dual Class and Sunset (at Time of IPO)	Traditional IPOs
Number of Companies	687
Dual Class / Unequal Voting	91 companies (13%)
Sunset Provision	78 companies (86%)
Time-Based	39 companies (50%)
7 Years or Less (ISS/GL Policy)	18 companies (46%)

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