The Myth of Dual Class Shares: Lessons from Asia's Financial Centres

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ABSTRACT

Distinct from proportionate voting rules, dual class shares offer a group of shareholders, normally corporate insiders, certain share classes with weighted voting rights. The weighted voting rights enable these insiders to retain a degree of control over the company that is disproportionate to their equity shareholdings. The recent revival of dual class shares in the US and reforms in the leading financial centres in Asia to accommodate listings with such share structures, has brought the spotlight back to them. While there are contradictory standpoints regarding the implication of separating insiders' control from their cash flow rights, the ongoing debate over the viability of dual class shares has largely been shifted to how to restrain the associated governance risks. Measures such as sunset provisions and limitation of voting differentials are designed to restrain the control stemming from multiple voting shares and provide mandatory safeguards to holders of inferior voting shares. However, these safeguarding measures, intentionally or unintentionally, compromise the value of differentiated voting arrangements. The extremely low percentage of new IPOs with dual class shares in Asia's leading financial centres at least partly reflects the reduced attraction of such share structures when mandatory safeguards are stringent. Thus, this paper argues that safeguarding measures are a double-edged sword, which not only help mitigate increased governance risks but also undermine the insulation of controllers from external investor and market influence; it calls for a more cautious use of such *ex ante* mechanisms in order that the initial purpose of permitting listings with dual class shares is not compromised.

KEYWORDS
Corporate governance; dual class shares; proportionate voting; safeguarding measure; investor protection; weighted voting rights

1. Introduction

Distinct from one vote per share, which gives all shareholders voting power proportionate to their equity shareholdings, dual class shares typically include two or more classes of ordinary shares carrying unequal voting rights at general meetings.[1] Corporate insiders,

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[1] For example, the newly revised *Listing Rules of Singapore Stock Exchange* defines dual class shares as a share structure that gives certain shareholders voting rights disproportionate to their shareholding. In other words, shares in

normally founders and entrepreneurial managers, receive shares with multiple voting rights, while public and outside investors receive shares with regular or restricted voting rights. The weighted voting rights under dual class shares allow insiders to retain control with less than a majority ownership stake in the company, and disproportionate to their equity shareholdings.[2]

The recent wave of high-profile technology giants, from Google to Facebook, that have gone public with dual class shares in the United States (US) led to the revival of the use of such share structures. For example, in 2018 in the US 33.3% of tech IPOs (13 out of 39) and 13.7% of non-tech IPOs (13 out of 95) adopted dual class shares; and in 2019, 36.1% of tech IPOs (13 out of 36) and 15.8% of non-tech IPOs (12 out of 76) adopted such share structures.[3] Dual class companies also represent an increasingly large portion of the aggregate market capitalisation of the leading stock indices: while only 5% of the S&P 500 was composed of dual class shares in 2007, the weight of dual class shares in the index had risen to 12% in 2017.[4]

Dual class shares have also gained traction among policymakers in Asia,[5] leading some top financial centres to carry out reforms to accommodate dual class listings. Hong Kong, Singapore and Shanghai, ranked among the top five global financial centres,[6] have all recently altered their laws and/or listing rules in order to permit listing applicants to adopt dual class shares. For example, the Hong Kong Stock Exchange (HKEx) relaxed its restriction over one vote per share in its listing rules and implemented a new Chapter on dual class listings in April 2018.[7] In Singapore, the company law was amended by enacting a new provision permitting differentiated voting arrangements to replace the old provision on proportionate voting,[8] and the Singapore Stock Exchange (SGX) permitted dual class listing in June 2018.[9] In Shanghai, a new Sci-Tech Innovation Board was launched in the Shanghai Stock Exchange (SSE) and new listing rules were enacted in

one class carry one vote, while shares in another class carry multiple votes. Meanwhile, such share structures also extend to triple-class companies like Snap Inc., where Class A shares have no votes, Class B shares have one vote per share and Class C shares have ten votes per share.

2 See eg Lucian A. Bebchuk and Kobi Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Georgetown Law Journal* 1453, 1459.

3 This can be contrasted with only 1 out of 71 companies going public adopting dual class structures in 1980. See Jay R. Ritter, *Initial Public Offerings: Technology Stock IPOs* (June 2020), at https://site.warrington.ufl.edu/ritter/files/IPOs2019Tech-Stock.pdf.

4 Andrew Winden and Andrew C. Baker, 'Dual-Class Index Exclusion' *Rock Center for Corporate Governance Working Paper Series No. 233* (2018) at 7. However, following the changes of eligibility criteria for inclusion of shares on 31 July 2017, companies with dual class shares would no longer be included in S&P Dow Jones Indices. More details can be found at http://press.spglobal.com/2017-07-31-S-P-Dow-Jones-Indices-Announces-Decision-on-Multi-Class-Shares-and-Voting-Rules.

5 It is pointed out that many stock exchanges see permitting dual class firms to list as a necessary step to 'stay relevant in a time of relentless competition in the cross-border IPO business.' Mary Leung and Rocky Tung, *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* (CFA Institute, 2018) at 39–41. The motivation for policymakers and stock exchanges will be discussed in greater detail in Section 3 below.

6 According to the latest *Global Financial Centres Index* ('GFCI 26'), a widely quoted source for ranking financial centres, Hong Kong, Singapore and Shanghai are ranked in the top 5 global financial centres just behind New York and London. See Mark Yeandle and Mike Wardle, *Global Financial Centres Index 26* (September 2019) at 4, at https://www.longfinance.net/media/documents/GFCI_26_Report_v1.0.pdf. Another three Asian centres namely, Tokyo, Beijing and Shenzhen are ranked 6th, 7th and 9th respectively. Ibid.

7 HKEx, *Main Board Listing Rules Amendment* (Update No. 119) (April 2018) at 5.

8 Section 33 of *Companies (Amendment) Act 2014* (No.36 of 2014).

9 SGX, 'SGX Launches Rules for Listing of Dual Class Shares Companies' (26 June 2018), at https://api2.sgx.com/sites/default/files/news-releases/migration/sgx_launches_rules_for_listing_of_dual_class_shares_companies.pdf.

March 2019 to allow companies to go public with dual class shares.[10] All these efforts are aimed at accommodating and attracting IPOs with dual class shares.[11]

Despite policymakers' enthusiasm for dual class shares, only a few companies have chosen to list in these three top Asian financial hubs with such share structures. So far there have been no dual class IPOs in Singapore.[12] In Hong Kong, only two out of 218 newly listed companies in 2018 and one out of 183 newly listed companies in 2019 adopted dual class shares.[13] In Shanghai, since the establishment of the Sci-Tech Innovation Board, there has been only one listing application for an IPO with dual class shares.[14] Compared with the dual class IPOs in the US discussed above, it is interesting to see the dichotomy between policymakers' enthusiasm and market acceptance. A relevant factor may be the stringent restrictions that all three leading financial centres in Asia have adopted, including sunset provisions, limitation of divergence between controllers' voting rights and cash flow rights, and enhanced disclosure requirements. Such measures reflect the view that, by separating corporate insiders' control from their cash flow rights, weighted voting rights increase the risk of entrenchment and tunnelling,[15] and therefore of tarnishing the three financial centres' hard-earned credibility in corporate governance.

The debate over benefits and costs of dual class shares has effectively shifted to how to safeguard holders of inferior voting shares from potential governance risks associated with such structures,[16] particularly in the above-mentioned leading financial centres in Asia, where they permit dual class listing on the one hand and impose stringent mandatory safeguarding measures on the other. This paper therefore attempts to examine how far such safeguards should go. It argues that constraints imposed upon the exercise of weighted voting rights would reduce the benefits of dual class shares and discourage prospective listing applicants from choosing dual class IPOs, in order to avoid additional compliance costs or oversights. It is the main purpose of this paper to address the issues pertaining to dual class shares, and to find the balance between the benefits and costs of such share structures.

[10] *Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange* were enacted in March 2019 and the Sci-Tech innovation board, a Nasdaq-style board, was officially launched in June 2019.

[11] It is worth noting that dual class shares are also common in Europe. A survey conducted by Institutional Shareholder Services in 2007 showed 24% of 464 sampled companies in sixteen European countries had dual class shares. See Shearman & Sterling LLP, Institutional Shareholder Services and the European, Corporate Governance Institute (ECGI), *Report on the Proportionality Principle in the European Union* (2007) at 25. Similarly, another empirical study with a larger sample of 4,096 companies in fourteen western European countries found that roughly 23.5% of sampled companies had dual class shares. Morten Bennedsen and Kasper Meisner Nielsen, 'Incentive and Entrenchment Effects in European Ownership' (2010) 34 *Journal of Banking & Finance* 2212, 2214.

[12] *SGX Stock Screener* (31 May 2020), at https://www.sgx.com/zh-hans/securities/stock-screener. Nevertheless, AMTD International Inc., a NYSE-listed and Hong Kong-headquartered financial institution, had a secondary listing on the SGX with dual class shares in April 2020.

[13] See *HKEx 2019 Annual Market Statistics* (December 2019), at https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/2019-Market-Statistics.pdf. There are another 42 companies newly listed in the first quarter of 2020, and none of them have adopted dual class structures. See *HKEx Market Data*, at https://www.hkex.com.hk/Market-Data/Securities-Prices/Equities?sc_lang=en.

[14] As of 31 May 2020, there are 105 companies listed on the SSE Sci-Tech innovation board, another 310 listing applications are currently in progress. See *SSE Market Data Overview* (31 May 2020), at http://star.sse.com.cn/en/marketdata/overview/.

[15] See eg Joel Seligman, 'Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy' (1986) 54 *George Washington Law Review* 687, 688; Tian Wen, 'You Can't Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies from Listing on the Securities Exchanges' (2014) 162 *University of Pennsylvania Law Review* 1495, 1499.

[16] Xiaochuan Weng and Jingjing Hu, 'Every Sunset is an Opportunity to Reset: An Analysis of Dual Class Share Regulations and Sunset Rules' (2021) 21 *Journal of Corporate Law Studies* (forthcoming). See also Marc T. Moore, 'Designing Dual Class Sunsets: The Case for a Transfer-Centered Approach' (2020) 12 *William & Mary Business Law Review* (forthcoming).

The remainder of the paper is organised as follows. Section 2 revisits the ongoing debate over dual class shares and the separation of insiders' control from their equity shareholding, which in turn provides the basis for the introduction of safeguarding measures in restraining the associated agency costs. Section 3 begins with an overview of the recent reforms of company laws and/or listing rules in the leading financial centres in Asia, and then examines how they balance the benefits and potential costs of permitting dual class listing. It can be observed that all these jurisdictions have imposed a stringent regime of mandatory safeguarding measures to restrain the associated governance risks, which is contrasted with the practice of minimal interference in the US, where a significantly higher percentage of companies goes public with dual class shares. The last part of this section looks into a possible explanation for the dichotomy between policymakers' expectations and market acceptance. Section 4 then critically discusses the main safeguarding measures, including sunset provisions, maximal voting differentials and enhanced corporate governance standards, that aim to restrict controllers' disproportionate voting power. Moreover, this section argues that safeguarding measures are a double-edged sword in balancing the benefits and costs of dual class shares, and then explores alternative strategies to help deal with the dilemma. The final section concludes.

2. Debate over dual class shares

The debate over dual class shares has been ongoing for more than a century. While both proponents and critics have focused on the separation between control and ownership, *i.e.* voting rights are separated from cash flow rights, there exist completely opposite interpretations and assessments. This section first examines the rise of dual class shares and then critically discusses both the benefits and costs of such share structures.

2.1 Rise of dual class shares

The economic foundation of shareholder voting builds on shareholders' residual claims against cash flows generated by the company, which provides them with the best incentive to exercise their voting power to maximise the residuals of the company.[17] Conventional wisdom holds that, in the corporate context, the extent to which shareholders would be affected is in proportion to their economic stakes, namely their cash flow rights. In order to control the agency costs of management, Easterbrook and Fischel have argued that each element of the residual proprietary interest should carry an equal voting right.[18] The economic rationale behind such proportionate voting is to grant shareholders voting power commensurate with their residual claims.[19] Therefore, the general corporate voting rule apportions power among shareholders based on their

[17] Frank H. Easterbrook and Daniel R. Fischel, 'The Corporate Contract' (1989) 89 *Columbia Law Review* 1416, 1446–1447.
[18] Frank H. Easterbrook and Daniel R. Fischel, 'Voting in Corporate Law' (1983) 26 *Journal of Law & Economics* 395, 409.
[19] See also Min Yan, 'Shareholder Control in the Context of Corporate Social Responsibility—A Fundamental Challenge to Modern Corporations' (2020) 50 *Hong Kong Law Journal* 1057, 1065–1067.

investment, namely shareholdings.[20] Correspondingly, shares held by shareholders are deemed as a perfect proxy for their interest in a company.[21]

Various alternatives to the proportionate voting rule exist, such as one vote per shareholder[22] or one vote per share but up to a certain ceiling.[23] An empirical study revealed that, in a sample of some 1,200 American corporate charters in the early 19th century, the proportion of companies adopting one vote per shareholder (38%) and one vote per share up to a certain ceiling (27%) was significantly greater than the proportion of companies adopting one vote per share (35%).[24] Even in the mid-19th century, a sample of 135 corporate charters still showed that a significant majority (68%) adopted disproportionate voting rules.[25] This clearly shows that one vote per share is by no means a historical norm. Proportionate voting only became more common from the end of the 19th century,[26] in an effort to encourage large-scale capital investment by overcoming the difficulties of accumulating voting rights.[27]

Dual class share structures are a different form of deviation from the proportional voting rule. They typically contain two or more classes of shares where one class has significantly more voting rights. During the first two decades of the 20th century the trend towards proportionate voting began to reverse in the US and companies started to issue two classes of common share, one with voting rights to insiders and the other with non-voting rights to outside investors.[28] The issuing of different classes of ordinary shares with differentiated voting rights gained popularity in the US in the 1920s, followed by a lull in dual class capitalisation in the next six decades.[29] The takeover wave in the 1980s led to a revival of the use of dual class shares as a takeover defence.[30] Because the

[20] See Colleen A. Dunlavy, 'Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights' (2006) 63 *Washington & Lee Law Review* 1347, 1356.

[21] The main economic implications of proportionate voting and its deviations are reviewed by Mike Burkart and Samuel Lee. See Mike Burkart and Samuel Lee, 'One Share-One Vote: The Theory' (2008)12 *Review of Finance* 1–49.

[22] See eg Colleen A. Dunlavy, 'Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights' (2006) 63 *Washington & Lee Law Review* 1347, 1354–1355.

[23] For example, a company may entitle shareholders one vote for every share owned by them respectively, up to the number of fifteen inclusive, and to one additional vote for every five shares from fifteen to one hundred, and to one additional vote for every twenty shares over and above one hundred. Ibid 1357.

[24] Ibid 1354–1357.

[25] Ibid 1358.

[26] Dunlavy argued that the plutocratic turn was a distinctively American phenomenon at the turn of the twentieth century as for European countries such as France and Germany restricting the voting rights, especially for large investors, remained common. See ibid 1359–1360.

[27] Stephen Bainbridge, 'The Scope of the SEC's Authority Over Shareholder Voting Rights' *UCLA School of Law Research Paper No. 07-16* (2007) at 4.

[28] Ibid 41. See also John C. Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 *Yale Law Journal* 1, 37.

[29] Dual class listing (issuance of nonvoting share in particular) was banned on the New York Stock Exchange (NYSE) between 1926 and 1985. Joel Seligman, 'Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy' (1986) 54 *George Washington Law Review* 687, 688. However, the other two national stock exchanges, namely the American Stock Exchange (AMEX) and the National Association of Securities Dealers Automated Quotations (NASDAQ) had less rigorous rules on dual class shares. For example, while the AMEX implemented a prohibition of non-voting common shares in 1972, it allowed Wang Laboratories and many other firms to list with dual class shares between 1976 and 1985. And there had been no restriction whatsoever on the NASDAQ. In order to remain competitive with the AMEX and NASDAQ, the NYSE finally permitted dual class listing in 1986. Ibid 704–705.

[30] See Jeffrey Gordon, 'Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice' (1988) 76 *California Law Review* 1, 4. In July 1988 the US Securities and Exchange Commission (SEC) adopted a modified version of Rule 19c-4, prohibiting those corporate actions having the effect of 'nullifying, restricting, or disparately reducing the per share voting rights of existing common stock shareholders of the company.' Stephen M. Bainbridge, 'The Short Life and Resurrection of SEC Rule 19C-4' (1991) 69 *Washington University Law Review* 565, 578. However, Rule 19c-4 was invalidated by the US Court of Appeals for the District of Columbia in June 1990 on the grounds that the SEC had exceeded its statutory authority. Ibid 625. See also *The Business Roundtable v. Securities and Exchange Commission*, 905 F.2d 406 (District of Columbia Circuit 1990).

multiple voting shares would help concentrate voting power in the hands of a small group of inside shareholders and make dual class companies unlikely to become a takeover target, it is agreed that few takeover defences are more successful than dual class shares.[31] At the beginning of the 21st century there appears to have been a significant increase in the popularity of dual class listings, particularly among high-technology and innovative companies in the US.[32] Despite the controversy over differentiated voting rights arrangements, empirical evidence has shown that IPOs with dual class shares are not only attractive for founders and entrepreneurial managers, but also popular with outside and public investors.[33]

2.2 Benefits of dual class shares

On the grounds that voting rights under dual class shares can be disproportionately greater than cash flow rights, the most important feature of such share structures is the separation between insiders' control and their equity shareholdings. Even when a controlling shareholder's ownership stake, and thereby cash flow rights, falls below 50%, he or she can still retain control via weighted voting rights.[34] The degree of control retained by insiders with superior voting power makes them virtually insulated from external investors and markets.

Such insulation is praised as it provides those visionary entrepreneurs and founders with the freedom to pursue and implement their idiosyncratic business ideas, without worrying unduly about stock market performance.[35] As is well known, both markets and investors have a tendency to be myopic, preferring short termism over long termism.[36] In particular, when facing (the threat of) a hostile takeover bid, a short-term profit or an immediate cash flow are understandably more appealing.[37] For example, the founders of Google (now Alphabet) used this reasoning to defend their offering of dual class shares in their Registration Statement with the US Securities and Exchange Commission.[38] The insulation from the disciplinary forces of the market for corporate control, *inter alia* takeover threats, is therefore seen as beneficial to long-term performance. The increasing

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[31] See eg Joel Seligman, 'Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy' (1986) 54 *George Washington Law Review* 687, 687.

[32] See eg Roberto Tallarita, 'High Tech, Low Voice: Dual-Class IPOs in the Technology Industry' *Harvard John M. Olin for Law, Economics, and Business Fellows' Discussion Paper Series No.77* (2018).

[33] Ronald Anderson, Ezgi Ottolenghi and David Reeb, 'The Dual Class Premium: A Family Affair' *Fox School of Business Research Paper No. 17-021* (2017). Arguably, the persistence of dual class shares reflects to some extent the *presumptive efficiency* of such structures. See eg Paddy Ireland, 'Defending the Rentier: Corporate Theory and the Reprivatization of the Public Company' in Andrew Gamble, Gavin Kelly and John Parkinson (eds), *The Political Economy of the Company* (Hart Publishing 2000) at 162.

[34] The majority voting rights will help these entrepreneurs or founders to retain the ability to determine the leadership of the firm. If they are part of the management team, the disproportionately greater voting rights would protect them from being dismissed from leading the management of the firm by other shareholders.

[35] See eg Zohar Goshen and Assaf Hamdani, 'Corporate Control and Idiosyncratic Vision' (2016) 125 *Yale Law Journal* 560, 577.

[36] See Min Yan, *Beyond Shareholder Wealth Maximisation* (Routledge 2018) at 65–69. See also Jeremy Stein, 'Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior' (1989) 104 *Quarterly Journal of Economics* 655, 668. Moreover, informational asymmetries may also result in the underestimation of entrepreneurs' idiosyncratic business plans by the outside investors.

[37] Simon Deakin and Giles Slinger, 'Hostile Takeovers, Corporate Law, and the Theory of the Firm' (1997) 24 *Journal of Law and Society* 124, 132. Similarly, failure to meet earning targets is seen as a sign of managerial weakness and, if repeated, can lead to a career-threatening dismissal. See eg Alfred Rappaport, 'The Economics of Short-term Performance Obsession' (2005) 61 *Financial Analysis Journal* 65, 69.

[38] Larry Page and Sergey Brin argued that '*...outside pressures too often tempt companies to sacrifice long-term opportunities to meet quarterly market expectations. Sometimes this pressure has caused companies to manipulate financial results in order to "make their quarter".*' Google Inc., *Registration Statement (Form S-1) No.333* (2004), at https://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm.

popularity of dual class structures, on the other hand, reflects entrepreneurs' preference for tools allowing a lock on such long-term vision.[39]

This insulation will also lower the price of retaining control, which allows insiders to obtain the benefits of outside equity financing while still retaining control over the company.[40] Unlike the one-share-one-vote principle, which may deter those who are concerned with the risks of losing control from going public, multiple voting shares can help entrepreneurs or founders to retain control and enhance their ability to effectively monitor their company.[41] By the same token, it may help overcome the reluctance of those family firms and state-owned enterprises with a strong desire for long-term control to go public, hence increasing both the breadth and depth of capital markets.

Another argument in support of dual class shares focuses on the economic incentives for management to invest substantial firm-specific human capital in the company.[42] It is known that the greater managers' firm-specific investment, the greater the personal loss if they are replaced.[43] So, the incumbent management would be reluctant to make substantial firm-specific investments if they had reason to fear that the return might be appropriated by an outside bidder.[44] The insulation from market pressures and takeover threats thus helps managers to overcome such reluctance.[45] The firm-specific investment can then improve efficiency and advance the company's long-term potential.[46] Providing control rights to those who value them more may therefore optimise social value.[47]

Investors' willingness to invest in dual class companies also demonstrates that 'agency costs are not the *only* costs of governance that need to be minimized'.[48] In contrast to the traditional *agent* costs, which are produced when managers exercise control, Goshen and Squire proposed the concept of *principal* costs, which are produced by investors' lack of expertise, information or talent, or their self-serving conduct when

[39] While this preference is mainly the entrepreneurs', the lock on long-term vision and control may also benefit the company and the market by protecting innovation and risk-taking from short-term market pressures. Such ability to take a long-term approach is particularly important for high-tech and innovative companies in their early years. Pey-Woan Lee, 'Dual-Class Shares in Singapore—Where Ideology Meets Pragmatism' (2019) 15 *Berkeley Business Law Journal* 440, 445.

[40] Daniel R. Fischel, 'Organized Exchanges and the Regulation of Dual Class Stocks' (1987) 54 *University of Chicago Law Review* 119, 139–140.

[41] Contrary to the argument that the separation between voting rights and cash flow rights causes controllers to lack financial incentives to monitor their companies, it can also be argued that leveraging voting power via dual class shares makes those controllers more effective monitors. Mike Burkart and Samuel Lee, 'One Share-One Vote: The Theory' (2008) 12 *Review of Finance* 1, 26–29. By the same token, it could also be argued that a rational manager with voting rights has an incentive to reject scale-expanding investments in order to continue extracting valuable private benefits of control.

[42] Douglas C. Ashton, 'Revisiting Dual-Class Stock' (1984) 68 *St John's Law Review* 863, 925.

[43] In other words, those skills or assets that cannot be redeployed to alternative use without a loss of value. See Oliver Hart, 'An Economist's Perspective on the Theory of the Firm' (1989) 89 *Columbia Law Review* 1757, 1762; Margaret Blair and Lynn Stout, 'Specific Investment: Explaining Anomalies in Corporate Law' (2006) 31 *Journal of Corporation Law* 719, 734. See also Oliver E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (Free Press 1985).

[44] Daniel R. Fischel, 'Organized Exchanges and the Regulation of Dual Class Stocks' (1987) 54 *University of Chicago Law Review* 119, 137.

[45] The firm-specific investment by management with a long-term commitment can also encourage employees to invest in the firm-specific human capital, which is extremely valuable for firms in the high-technology and innovative sectors. It may also help the firms to ingrain other important long-term stakeholder relationships. See eg Bobby V. Reddy, 'Finding the British Google: Relaxing the Prohibition of Dual-Class Stock from the Premium-Tier of the London Stock Exchange' (2020) 79 *Cambridge Law Journal* 315, 330–331.

[46] Kenneth Lehn, Jeffry Netter and Annette Poulsen, 'Consolidating Corporate Control: Dual-Class Recapitalizations versus Leveraged Buyouts' (1990) 27 *Journal of Financial Economics* 557, 563–564.

[47] Daniel R. Fischel, 'Organized Exchanges and the Regulation of Dual Class Stocks' (1987) 54 *University of Chicago Law Review* 119, 136–137.

[48] Bernard S. Sharfman, 'A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs' (2018) 63 *Villanova Law Review* 1, 21.

they exercise control.[49] The *principal* costs can be divided into principal competence costs, caused by honest mistakes, and principal conflict costs, caused by self-serving conduct.[50] They must also be considered when determining optimal voting arrangements. Take those uninformed and weakly motivated investors, for example. First, because of collective action problems and rational apathy, they would prefer not to exercise their voting rights and choose to free ride on other investors.[51] Secondly, when they do vote their lack of information, coupled with principal conflict costs like pro-management bias, makes it unlikely that their votes are value-enhancing.[52] Consequently, weakly motivated voters would dilute the voice of informed voters either in exercising discretion or monitoring. They are more likely to make suboptimal decisions or move their company in the wrong direction.[53]

Apart from retail shareholders, passive funds, namely index funds and exchange-traded funds, are designed to automatically track a market index and match its performance. They would often qualify as weakly motivated voters, lacking both firm-specific information and incentives to devote appropriate resources to informed voting.[54] There is indeed an unprecedented shift from active to passive investment strategies.[55] For example, the 'Big Three' passive funds, *i.e.* BlackRock, Vanguard and State Street combined, currently constitute the largest shareholder in 87.6% of S&P 500 companies, the most important American companies.[56] A recent analysis estimates the assets under the management of passive funds have exceeded the assets under active funds by about US$25 billion as of 31 August 2019, which means passive funds represent 50.15% of US equity markets.[57] All this demonstrates that providing voting rights to outside shareholders, including institutional investors, may not necessarily enhance monitoring or constrain governance risks, as conventionally expected.[58] In this regard, it is also possible to argue that adopting dual class shares can reduce agency costs by making management more accountable to their informed investors, who highly value their right to vote, while minimising the costs associated with voting.[59]

[49] Zohar Goshen and Richard Squire, 'Principal Costs: A New Theory for Corporate Law and Governance' (2017) 117 *Columbia Law Review* 767, 786–788 and 791–793.
[50] Ibid.
[51] Dorothy S. Lund, 'Nonvoting Shares and Efficient Corporate Governance' (2019) 71 *Stanford Law Review* 687, 696.
[52] Ibid.
[53] Ibid 724–726. The author also argues that the company would incur higher transaction costs when it must manage voting for a larger group, and transaction costs for these weakly motivated shareholders who nonetheless decide to vote. Ibid 723–724.
[54] Ibid 712 and 718.
[55] Between 2008 and 2015 investors bought passively managed funds of approximately US$1 trillion, while at the same time selling holdings of actively managed equity funds worth roughly US$800 billion; and as of year-end 2015, passive index funds managed total assets invested in equities of more than US$4 trillion. See Jan Fichtner, Eelke Heemskerk and Javier Garcia-Bernardo, 'Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk' (2017) 19 *Business & Politics* 298, 299.
[56] Ibid 313. The 'Big Three' collectively vote about 25% of the shares in all S&P 500 companies. Lucian A. Bebchuk and Scott Hirst, 'The Specter of the Giant Three' (2019) 99 *Boston University Law Review* 721, 736.
[57] Just ten years ago, active funds had about 75% of market share, and over the past 10 years active funds have had US$1.3 trillion in outflows and their passive counterparts nearly US$1.4 trillion in inflows. Kevin McDevitt and Gabrielle DiBenedetto, *Morningstar U.S. Fund Flows: Fed Rate Cut Doesn't Spur Inflows*, Morningstar Research 2 (August 2019), at https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Fund_Flows_August2019_Final.pdf?cid=EMQ_&utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=18776.
[58] For example, the Big Three did not bring any single shareholder proposal advocating governance change (even for the type they generally did support) between 2014 and 2018, during which period approximately 1,500 shareholder proposals were submitted. More discussion of this reactive-only approach can be found in Lucian A. Bebchuk and Scott Hirst, 'Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy' (2019) 119 *Columbia Law Review* 2029, 2101–2105.
[59] Dorothy S. Lund, 'Nonvoting Shares and Efficient Corporate Governance' (2019) 71 *Stanford Law Review* 687, 697.

Last but not least, an empirical study from Morgan Stanley Capital International (MSCI), an index provider, shows that companies with dual class shares outperformed the market.[60] There is also research indicating that dual class companies have a significantly higher growth in sales and number of employees, significantly higher ratios of R&D expenditures as well as a significantly higher increase in industry-adjusted operating incomes.[61] Dual class shares can also materially increase the value of high-growth companies in terms of market valuation[62] and help closely held companies to enhance risk sharing and foster restructuring that increases corporate focus and strengthens profitability.[63] On average, dual class companies' higher valuation than their single class counterparts can be maintained for six to nine years subsequent to their IPOs.[64]

2.3 Potential costs of dual class shares

However, the very benefit of dual class shares can turn out to be their main focus of dispute. Whilst proponents believe that the separation between voting rights and cash flow rights under dual class structures protects visionary entrepreneurs/founders' idiosyncratic visions and promotes long-term value, critics are more pessimistic about it. In the critics' eyes, the weighted voting rights help insiders to be insulated from market discipline, which in turn makes it easier for controlling insiders with superior voting power to entrench themselves.[65] This would then increase corporate governance risks, in particular exacerbating agency costs, both in merger negotiations and in the management of the company generally.[66] People holding this type of concerns believe a controller with weighted voting rights has stronger incentives to extract *private benefits of control*,[67] to the detriment of both minority shareholders and society as a whole.[68]

[60] Dimitris Melas, 'Putting the Spotlight on Spotify: Why Have Stocks with Unequal Voting Rights Outperformed' *MSCI* (3 April 2018), at https://www.msci.com/www/blog-posts/putting-the-spotlight-on/0898078592.

[61] Kenneth Lehn, Jeffry Netter and Annette Poulsen, 'Consolidating Corporate Control: Dual-Class Recapitalizations versus Leveraged Buyouts' (1990) 27 *Journal of Financial Economics* 557, 559–560.

[62] Bradford Jordan, Soohyung Kim and Mark Liu, 'Growth Opportunities, Short Term Market Pressure, and Dual-Class Share Structure' (2016) 41 *Journal of Corporate Finance* 304, 318–320.

[63] It is found that economic benefits typically arise when closely held firms adopt dual class shares. See Scott Bauguess, Myron Slovin and Marie Sushka, 'Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights' (2012) 36 *Journal of Banking & Finance* 1244, 1245.

[64] Martijn Cremers, Beni Lauterbach and Anete Pajuste, 'The Life-Cycle of Dual Class Firm Valuation' (2018) *European Corporate Governance Institute (ECGI) - Finance Working Paper No. 550/2018* at 20.

[65] If the controlling shareholders are involved in managing the firm as directors and executives, the insulation would protect them from being removed from running the firm. Furthermore, the management would not have any fear of losing their employment as long as the controlling shareholders' interests are satisfied.

[66] As with other takeover defences, dual class share structures would lead to conflicts of interest: eg the job security of the target company's incumbent management *versus* the substantial premium for the target company's shareholders' shares. See Jeffrey Gordon, 'Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice' (1988) 76 *California Law Review* 1, 18.

[67] Such benefits can be either pecuniary, for instance via tunnelling corporate assets or 'non-pecuniary', such as desirable social status to political influence. See eg Ronald Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 *Harvard Law Review* 1641, 1663–1664.

[68] In addition, there is another criticism against dual class shares from the perspective of shareholder democracy. See eg Joel Seligman, 'Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy' (1986) 54 *George Washington Law Review* 687, 688; Robert Jackson, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty* (February 2018), at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty#_ftn4. However, the core concern of 'shareholder democracy' in the context of one vote per share is the vertical relation linking shareholders and management, aiming at 'correct[ing] a balance of power that had tilted dangerously toward [management]' through ensuring that shareholders are 'sufficiently informed' and 'able to vote their shares'. See Colleen A. Dunlavy, 'Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights' (2006) 63 *Washington & Lee Law Review* 1347, 1365. So, logically, democracy under one share–one vote is irrelevant to the horizontal relations among shareholders. And this paper decides to leave this criticism at that.

It is argued that only those who have a strong stake in the outcome of elections make optimal decisions.[69] Shareholders as residual claimants are seen as having the strongest stake in the outcome of the election of corporate leadership and the like.[70] Their shares of residual gains or losses are seen as a perfect proxy for the varying degrees to which they would be affected by outcomes of these elections, and thereby the degree to which voters care about the outcomes.[71] Under a proportionate voting rule, any individual or group of shareholders who want to exercise control—that is, to have more than 50% of the voting rights—must hold a commensurate equity ownership stake. Consequently, controlling shareholders will bear a substantial share of the costs and benefits of their decisions.[72] At the same time, they would also be more willing to monitor managers as agents to lower agency costs.[73]

Such an economic rationale for proportionate voting, as offered by Easterbrook and Fischel and their followers can, however, be rebutted on the basis that shareholder homogeneity is false. An essential premise of the economic justification for allocating shareholders voting power in proportion to their economic interest, 'by mandating a single class of voting common stock that has both a residual interest in corporate profits and one vote per share',[74] is shareholder homogeneity. It assumes shareholders all share relatively homogeneous interests in maximising residual profits, in order to benefit from that maximisation.[75] If shareholder interests are not homogeneous, shareholders may then have different incentives regarding corporate decision-making, including those other than maximisation of residual profits. Heterogeneous incentives held by shareholders as voters would then make it impossible to aggregate their preferences into a consistent system of choices,[76] leading to 'self-destruction'.[77] That is perhaps why so many company law scholars are ready to argue that inconsistent choices are likely to be avoided thanks to shareholder homogeneity.[78]

Unfortunately, as is well established, different shareholders do have different interests.[79] The essential premise of proportionate voting is therefore untenable in the

[69] Grant Hayden, 'The False Promise of One Person, One Vote' (2003) 102 *Michigan Law Review* 213, 251–261.

[70] For example, shareholders, as claimed by the UK Company Law Review Steering Group ('CLRSG'), have the greatest exposure to residual risk as a consequence of mismanagement. CLRSG, *Modern Company Law for a Competitive Economy: The Strategic Framework* (DTI 1999) at 34.

[71] See Frank H. Easterbrook and Daniel R. Fischel, 'Voting in Corporate Law' (1983) 26 *Journal of Law & Economics* 395, 409. As the general corporate voting rule apportions power among shareholders based on their shareholdings in the company, shareholders would then have the appropriate incentive to cast their votes and monitor managerial performance accordingly.

[72] In other words, the proportionate voting rule can better align corporate insiders' incentives with those of the outside shareholders.

[73] See eg Louis Putterman, 'Ownership and the Nature of the Firm' (1993) 17 *Journal of Comparative Economics* 243, 249.

[74] Bernard Black and Reinier Kraakman, 'A Self-Enforcing Model of Corporate Law' (1996) 109 *Harvard Law Review* 1911, 1945.

[75] Grant Hayden and Matthew Bodie, 'One Share, One Vote and the False Promise of Shareholder Homogeneity' (2008) 30 *Cardozo Law Review* 445, 476.

[76] Frank H. Easterbrook and Daniel R. Fischel, 'Voting in Corporate Law' (1983) 26 *Journal of Law & Economics* 395, 405.

[77] Easterbrook and Fischel argued that 'If a firm makes inconsistent choices, it is likely to self-destruct.' Ibid 405.

[78] See Henry Hansmann, *The Ownership of Enterprise* (Harvard University Press 2000) at 11. Meanwhile, Easterbrook and Fischel claimed that in a given company at a given time most shareholders are a reasonably homogeneous group with an analogous objective. Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) at 70. John Armour, Henry Hansmann, Reinier Kraakman and Mariana Pargendler also commented that those equity capital investors have, or at least are able to be induced to have, relatively homogeneous interests. John Armour et al., 'What Is Corporate Law' in Reinier Kraakman et al. (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn Oxford University Press 2017) at 13.

[79] According to Fisher's separation theorem, in order to increase the present value of the company to the greatest extent possible, the management should disregard shareholders' different objectives due to their lack of expertise and make

context of shareholder heterogeneity, and the case for maintaining proportionate voting is subsequently weakened.[80] For example, when a shareholder prioritises socially-oriented or environmentally-oriented preferences over maximisation of profits,[81] increasing the ownership stake would not necessarily alter his/her incentives. Put differently, granting shareholders voting power commensurate with their shareholdings does not necessarily guarantee appropriate incentives as in the context of shareholder heterogeneity.[82] The weakened justification for proportionate voting can in turn provide further grounds for deviation from such voting arrangements.

Furthermore, the agency costs between majority shareholders and minority shareholders cannot be dismissed under a concentrated ownership structure with single class shares. Controlling shareholders, as rational economic actors, tend to pursue their own self-interest, and therefore always have the temptation to extract private benefits of control. Even when a controller has a majority ownership stake, say 80% of equity capital, private benefit extraction via, for example, tunnelling remains common and inevitable,[83] as she could obtain all the private benefits but bear only 80% of the costs.[84]

Nonetheless, with a decline in the percentage of ownership stake, the costs of self-serving conduct will correspondingly decrease and the incentives to extract private benefits increase.[85] So, differentiated voting rights under dual class shares are likely to exacerbate such distorted incentives. Following Bebchuk and Kastiel's analytical model,[86] a controlling shareholder would choose the value-reducing action if his/her pro rata share of loss is smaller than the gain in private benefits, and dual class shares make

investment decisions separate from shareholders' preferences. Irving Fisher, *The Theory of Interest* (MacMillan 1930); see also Ronald J. Gilson, 'Separation and the Function of Corporation Law' (2005) 2 *Berkeley Business Law Journal* 141–152. However, it becomes clear that companies may and shall have objectives other than maximising shareholder wealth. See eg Lawrence E. Mitchell, 'A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes' (1992) 70 *Texas Law Review* 579, 610–630; Min Yan, *Beyond Shareholder Wealth Maximisation* (Routledge 2018) at 80–81. Even assuming shareholder interests only comprise economic/financial profits, they may still have heterogeneous investment time horizons or risk preferences. In particular, first, shareholders with different expected holding periods would unavoidably have divergent preferences over the corporate decision-makings. Secondly, diversified shareholders care much less about firm-specific risk compared to undiversified shareholders, but shareholders who invest in a given company without also diversifying would be very sensitive to such risks. Indeed, undiversified shareholders would normally give up higher returns for reduced risks. Thirdly, heterogeneous expectations between inside shareholders and outside shareholders, hedged shareholders and unhedged shareholders also demonstrate that shareholders may have very different interests. For example, see Min Yan, 'Corporate Social Responsibility *vs.* Shareholder Value Maximization: Through the lens of hard and soft law' (2019) 40 *Northwestern Journal of International Law & Business* 47, 55–56; see also Iman Anabtawi, 'Some Skepticism About Increasing Shareholder Power' (2006) 53 *UCLA Law Review* 561, 583–593.

[80] See also Grant Hayden and Matthew Bodie, 'One Share, One Vote and the False Promise of Shareholder Homogeneity' (2008) 30 *Cardozo Law Review* 445, 500–504.

[81] Take socially responsible investment (SRI) funds for example, even SRI funds are arguably providing lower average returns than non-SRI funds, its market size in the US, was over US$12.0 trillion by the end of 2017, equivalent to a quarter of all investment under professional management in the US. *US SIF Foundation's 2018 Report on US Sustainable, Responsible and Impact Investing Trends* (2018), available at https://www.ussif.org/trends.

[82] That is to say, increasing one's ownership stake may not necessarily incentivise him/her to maximise the residual profits of the company.

[83] See eg Bobby V. Reddy, 'The Fat Controller: Slimming Down the Excess of Controlling Shareholders in UK Listed Companies' (2018) 38 *Oxford Journal of Legal Studies* 733, 736–737.

[84] Similarly, the controller may also choose to sacrifice some firm value in order to maintain the private benefits of control. See Paul A. Gompers, Joy Ishii and Andrew Metrick, 'Extreme Governance: An Analysis of Dual-Class Firms in the United States' (2010) 23 *Review of Financial Studies* 1051, 1085. However, it should also be noted that '[t]he power of the controlling shareholders to expropriate outside investors is moderated by their financial incentives not to do so.' Rafael La Porta et. al., 'Investor Protection and Corporate Valuation' (2002) 57 *Journal of Finance* 1147, 1148.

[85] Ronald Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 *Harvard Law Review* 1641, 1651. Meanwhile, the cost of doing so would also correspondingly be decreased.

[86] Lucian A. Bebchuk and Kobi Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Georgetown Law Journal* 1453, 1467.

it possible for a shareholder to retain full control with a very low shareholding.[87] Consistent with Gilson's comment that 'the less equity the controlling shareholder has, the greater the incentive to extract private benefits',[88] when the portion of equity capital decreases, the likelihood that the controller would favour value-reducing actions increases exponentially.[89] Thus, although the ownership incentive under a proportionate voting arrangement cannot eliminate a controller's incentive to seek private benefits, the distortions inherent in dual class shares are potentially much more severe.[90]

In addition, in the presence of a controlling shareholder, the market for corporate control cannot play its role of disciplining agency problems.[91] Market forces are seen by economists as an ultimate disciplinary mechanism. In particular, the threat of a hostile takeover, and thereby of incumbent managers' removal, would provide a strong incentive for insiders to perform and reduce agency costs.[92] In the eyes of sceptics, differentiated voting rights arrangements undermine market monitoring and its disciplinary function, leading to increased extraction of private benefits such as distorted investment decisions, tunnelling and inefficient perquisite consumption.[93]

Of course, the market is far from perfect and the share price does not always fully reflect the market value of all future profits.[94] The asymmetry of information may also cause outside investors to err in evaluating idiosyncratic and innovative projects,[95] making the impact of market forces a double-edged sword. Nevertheless, similar to the preceding analysis of ownership incentive, the lack of market discipline under dual class shares is still potentially more sinister than that under the proportionate voting arrangement. Controlling insiders with weighted voting rights, who are normally also the incumbent management, can more easily protect and entrench themselves against markets' disciplinary forces.[96]

As summarised by Bebchuk and Kastiel, a 'small-minority controller', namely one who holds minority shares but weighted voting rights in a dual class company, 'lacks both the discipline of the control market and the incentives generated by having to bear the

[87] A shareholder in a dual class company with a typical 10:1 ratio needs to hold only 28.6% of shares to obtain 80% of the votes, compared to 80% of shares under one vote per share. Further, he or she only needs as low as a 9.1% of shareholdings to retain majority control. Ibid 1478.

[88] Ronald Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 *Harvard Law Review* 1641, 1651.

[89] The likelihood of non-controlling shareholders expropriation by a controlling shareholder with a minority ownership stake but weighted voting rights would be significantly higher. Mike Burkart and Samuel Lee, 'One Share – One Vote: The Theory' (2008) 12 *Review of Finance* 1, 34.

[90] By the same token, the controller may also have structural incentives to avoid value-enhancing actions, because she would capture only a fraction of the efficiency gains that the transaction would produce while fully bearing the loss of the private benefits of control. See eg Lucian A. Bebchuk and Kobi Kastiel, 'The Untenable Case for Perpetual Dual-Class Stock' (2017) 103 *Virginia Law Review* 585, 616.

[91] Widely held companies are characterized by diverse ownership of shares without a single controlling shareholder while controlled companies have controlling shareholder(s) with majority equity stake in the company. See Lucian A. Bebchuk and Kobi Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Georgetown Law Journal* 1453, 1465.

[92] When a company underperforms, its share price will drop, making it vulnerable to predatory takeover offers. The management of the underperforming company would normally be replaced following a successful hostile takeover.

[93] See eg Dorothy S. Lund, 'Nonvoting Shares and Efficient Corporate Governance' (2019) 71 *Stanford Law Review* 687, 715.

[94] Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (The Brookings Institution 1995) at 128; Brian Cheffins, *Company Law: Theory, Structure and Operation* (Oxford University Press 1997) at 8.

[95] Zohar Goshen and Assaf Hamdani, 'Corporate Control and Idiosyncratic Vision' (2016) 125 *Yale Law Journal* 560, 597.

[96] That is exactly why Bebchuk and Kastie argued that 'without both market discipline and strong financial incentives, 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.' Lucian A. Bebchuk and Kobi Kastiel, 'The Untenable Case for Perpetual Dual-Class Stock' (2017) 103 *Virginia Law Review* 585, 603.

majority of any effect on total market capitalization'.[97] Although making voting power commensurate with equity shareholding is not a perfect solution to the agency problems discussed above, concerns over increased governance risks associated with dual class shares are real and valid.

In contrast to the empirical evidence exhibited in Section 2.2, there are other studies that find a negative correlation between dual class shares and firm value. For example, Gompers, Ishii and Metrick found that firm value is 'positively associated with insiders' cash-flow rights and negatively associated with insiders' voting rights'.[98] In other words, insiders' weighted voting rights, which are disproportionately greater than their cash flow rights, are seen as negatively associated with firm valuation. This observation is confirmed by some other studies, which assert that larger divergence between controllers' voting rights and cash flow rights is associated with lower firm valuations.[99] Similarly, Masulis, Wang and Xie found that an increased divergence between insiders' control and cash flow rights *i*) leads to lower firm valuation and *ii*) would negatively impact a company's efficiency in utilising its cash reserves as an important corporate resource.[100]

2.4 Middle ground

The starkly opposite assessments and mixed outcomes of empirical studies mystify dual class shares to a great degree. The problem of endogeneity, namely whether the performance of a company (for better or worse) was the reason for adopting dual class structures or a consequence of such share structures,[101] further increases the difficulty in untangling the underlying correlation between dual class shares and firm valuation/performance.[102] Better performance may simply arise out of the high-growth nature of a given company, especially considering that dual class IPOs most frequently involve high-tech and innovative companies.[103] In this regard, it seems the debate over dual class shares may never be settled.

However, we can find that the potential costs of dual class shares primarily stem from inadequate protection for holders of inferior voting shares. When weighted voting rights separate control from ownership stakes, the economic rationale that underlies proportionate voting is overturned. The increased agency costs associated with the separation between control and ownership are also highlighted by the empirical evidence, which indicates a positive correlation between controllers' cash flow rights and firm valuations.[104] Thus, a solution to mitigate potential costs lies in controlling the lack of accountability and opportunism.

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[97] Lucian A. Bebchuk and Kobi Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Georgetown Law Journal* 1453, 1467.

[98] Paul A. Gompers, Joy Ishii and Andrew Metrick, 'Extreme Governance: An Analysis of Dual-Class Firms in the United States' (2010) 23 *Review of Financial Studies* 1051, 1084.

[99] See Stijn Claessens, Simeon Djankov, Joseph P. H. Fan and Larry H. P. Lang, 'Disentangling the Incentive and Entrenchment Effects of Large Shareholdings' (2002) 57 *Journal of Finance* 2741, 2764–2765.

[100] The authors conclude that the marginal value of cash decreases by $0.08 per one-standard-deviation increase in the ratio of insider control rights to cash flow rights. Ronald W. Masulis, Cong Wang and Fei Xie, 'Agency Problems at Dual-Class Companies' (2009) 64 *Journal of Finance* 1697, 1703–1705.

[101] Renee Adams and Daniel Ferreira, 'One Share-One Vote: The Empirical Evidence' (2008) 12 *Review of Finance* 51, 85.

[102] Jeffrey Coles, Michael Lemmon and J. Felix Meschke, 'Structural Models and Endogeneity in Corporate Finance: The Link between Managerial Ownership and Corporate Performance' (2012) 103 *Journal of Financial Economics* 149, 162–164.

[103] For example, share prices of dual class companies such as Alibaba, Google and Facebook have all had significant gains since their IPOs.

[104] Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer and Robert Vishny, 'Investor Protection and Corporate Valuation' (2002) 57 *Journal of Finance* 1147, 1168. On the other hand, the long-termism and immunity

This is perhaps also why the current policy debate has begun to focus less on the general merits of permitting or prohibiting dual class shares and more on the appropriate means of safeguarding holders of inferior voting shares from 'manifest managerial unaccountability and the associated self-dealing risk'.[105] The following two sections will look into the safeguarding measures laid out by policymakers in Asia's leading financial centres.

3. Dual class shares in Asia's leading financial centres

Apart from the recent revival of dual class shares in the US, policymakers and stock exchanges in the Asia's leading financial centres are keen to accommodate such share structures. The top three financial centres in Asia (*i.e.* Hong Kong, Singapore and Shanghai)[106] have all recently amended their company laws and/or listing rules to accommodate dual class listing. This section examines the rising popularity of dual class shares in these three jurisdictions and the ensuing reforms, how these deal with the potential costs of such share structures and their market impact.

3.1 The reforms

3.1.1 Hong Kong

While Hong Kong company law allows companies' charters to provide unequal voting structures,[107] the Hong Kong Stock Exchange has since 1987 prohibited companies from listing with dual class shares.[108] As an outcome of competitive pressures, in particular Singapore's parallel moving towards allowing dual class listing and the desire to attract IPOs from Mainland China,[109] Hong Kong changed its long-held stance on such share structures. The Stock Exchange of Hong Kong Limited (SEHK), a wholly-owned subsidiary of the Hong Kong Exchanges and Clearing Limited (HKEx), published conclusions to its concept paper on weighted voting rights in 2015, stating that there was support for a public consultation on proposed changes to its listing rules, in order to allow dual class shares.[110] After some back and forth,[111] the Hong Kong Securities and Futures

from market pressure underlying the positive impact of dual-class shares are also consistent with arguments supporting weighted voting rights.

105 Marc T. Moore, 'Designing Dual Class Sunsets: The Case for a Transfer-Centered Approach' (2020) 12 *William & Mary Business Law Review* (forthcoming).

106 They are also among the top 5 global financial centres just behind New York and London. See Mark Yeandle and Mike Wardle, *Global Financial Centres Index 26* (September 2019) at 4, at https://www.longfinance.net/media/documents/GFCI_26_Report_v1.0.pdf.

107 Section 588(4) of *Hong Kong Companies Ordinance* (Cap. 622).

108 Rule 8.11 of *Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited* provided that 'the share capital of a new applicant must not include shares of which the proposed voting power does not bear a reasonable relationship to the equity interest of such shares when fully paid ('B Shares'). The Exchange will not be prepared to list any new B Shares issued by a listed issuer nor to allow any new B Shares to be issued by a listed issuer… [except in exceptional circumstances].'

109 For example, the Chairman of the Hong Kong Securities and Futures Commission said: '[allowing companies with dual class structures to list in Hong Kong] is a competition issue. It is not just the US—the UK and Singapore also want to attract technology and new economy companies to list. Hong Kong needs to play catch up.' See Enoch Yiu, 'Securities Commission Backs Introduction of Dual-Class Shares on Hong Kong Stock Exchange' *South China Morning Post* (20 December 2017), at https://www.scmp.com/business/companies/article/2124972/securities-commission-backs-introduction-dual-class-shares-hong.

110 HKEx, *Consultation Conclusions: To Concept Paper on Weighted Voting Rights* (June 2015) at 22–23.

111 For example, see Securities and Futures Commission, S*FC Statement on the SEHK's Draft Proposal on Weighted Voting Rights* (25 June 2015). HKEx, *The Exchange's Response to the SFC's Statement in Relation to the Draft Proposal on Weighted Voting Rights* (25 June 2016).

Commission (SFC) finally backed the introduction of IPOs with dual class shares on SEHK in 2017.[112]

Following additional consultations, in April 2018 SEHK set out the requirements for the listing of companies with dual class shares.[113] Accordingly, Rule 2.03 (4) of the *Main Board Listing Rules* is modified from '…all holders of listed securities are treated fairly and equally' to '…all holders of listed securities are treated fairly and all holders of listed securities of the same class are treated equally.'[114] That is to say, dual class listing can be permitted for new listing applicants on the HKEx, provided they can demonstrate their eligibility and suitability.[115]

3.1.2 Singapore

Singapore had prohibited dual class shares since the *Singapore Companies Act 1967*. Section 64(1) of the *Act* specified that any equity share issued by such a company after December 1967 shall confer the right, at a poll at any general meeting of the company, to one vote only in respect of each equity share.

Due to the increase in global technology innovation and diversification of corporate financing requirements, a Singapore Ministry of Finance Steering Committee was set up in October 2007 to create an efficient corporate regulatory environment for doing business in Singapore. In order to keep pace with international legal and technological development, the Committee suggested deleting Section 64 of the *Company Act 1967* and permitting companies to issue non-voting shares and shares carrying multiple votes—*i.e.* to give companies greater flexibility in raising capital and investors a wider range of investment opportunities—if their corporate charters allowed it, and subject to certain safeguards.[116] The *Companies (Amendment) Bill* (No.25/2014) was finalised by Parliament in October 2014. The newly enacted Section 64A repeals Section 64 and permits public companies to issue shares with differentiated voting rights, conferring special, limited, conditional or no voting rights.[117]

After permitting dual class shares for public companies, the Committee on the Future Economy (CFE) recognised that dual class listing is increasingly being considered in high-tech industries. The Singapore Stock Exchange (SGX) then issued the consultation paper on *Possible Listing Framework for Dual Class Share Structures* in February 2017 and sought feedback on possible safeguards, such as admission criteria, sunset clauses and the appointment of independent directors.[118] Following two rounds of consultation, the SGX finally announced, in June 2018, that companies with dual class shares would be allowed to list.[119]

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112 Enoch Yiu, 'Securities Commission Backs Introduction of Dual-Class Shares on Hong Kong Stock Exchange' *South China Morning Post* (20 December 2017), at https://www.scmp.com/business/companies/article/2124972/securities-commission-backs-introduction-dual-class-shares-hong.

113 HKEx, *Consultation Conclusions: A Listing Regime for Companies from Emerging and Innovative Sectors* (April 2018) at 9.

114 HKEx, *Main Board Listing Rules Amendment* (Update No. 119) (April 2018) at 5.

115 According to the new Chapter 8A of the *HKEx Main Board Listing Rules*, IPO applicants must 'demonstrate the necessary characteristics of innovation and growth and demonstrate the contribution of their proposed beneficiaries of weighted voting rights to be eligible and suitable for listing with [dual class shares] as set out in guidance published on the Exchange website and amended from time-to-time'.

116 Ministry of Finance (Singapore), *Report of the Steering Committee for Review of the Companies Act* (June 2011) at 16.

117 Section 33 of *Companies (Amendment) Act 2014* (No.36 of 2014).

118 SGX, *Possible Listing Framework for Dual Class Share Structures* (16 February 2017), at https://www.cfasociety.org/singapore/Documents/DCS+Consultation+Paper+(SGX+20170216)(Final).pdf.

119 SGX, 'SGX Launches Rules for Listing of Dual Class Shares Companies' (26 June 2018), at https://api2.sgx.com/sites/default/files/news-releases/migration/sgx_launches_rules_for_listing_of_dual_class_shares_companies.pdf.

3.1.3 Shanghai

Mainland China has operated a strict regime of one vote per share for public companies since its first Company Law in 1993.[120] This restriction remained largely unchanged in subsequent company law amendments.[121] Its pre-2019 listing regime also clearly forbade companies from going public with dual class shares. Such restrictions forced Alibaba, Baidu, Tencent, Xiaomi and other Chinese technology giants to choose IPOs in the US or, more recently, in Hong Kong, to adopt dual class shares.

This game of catch-up in mainland China was fuelled by the regulatory changes in Singapore and Hong Kong. In order to attract high-technology and new-economy companies from mainland China to list domestically, China has eased its restrictions on proportionate voting and permitted dual class IPOs by creating a Sci-Tech Innovation Board in the Shanghai Stock Exchange (SSE).[122]

In the *Opinions of the State Council on Promoting the High-Quality Development of Innovation and Entrepreneurship and Creating an Upgraded Version of Entrepreneurship and Innovation among all the People*,[123] the State Council explicitly repealed the ban on dual class shares. Accordingly, in January 2019, China's Securities and Regulatory Commission (CSRC), the national watchdog of stock exchanges, allowed high-tech and innovative companies to list on the Sci-Tech Innovation Board with differentiated voting rights arrangements.[124]

3.2 Mandatory measures coming with permission

The enhancement of competitiveness and the increase in profits for stock exchanges, as well as benefits such as flexible capital structuring and insulation from short-term market pressure at firm level, constitute compelling reasons for relaxing the prohibition on dual class shares in Hong Kong, Singapore and Shanghai. But all these jurisdictions are aware of the increased governance risks, as discussed in Section 2.3 above, and therefore have adopted various safeguarding measures to mitigate the exacerbated agency problems. In other words, permitting companies to go public with dual class shares comes with mandatory safeguards to constrain the potential abuses of increased control.

First of all, in order to limit the divergence between controllers' voting power and cash flow rights, the HKEx, SGX and SSE all cap each multiple voting share at ten votes per share and limit the holders of such shares to named individuals or groups. For instance, Rule 8A.10 'Restriction on Voting Power' of the *HKEx Main Board Listing Rules* states: 'A class of shares conferring weighted voting rights in a listed issuer must not entitle the beneficiary to more than ten times the voting power of ordinary shares, on any resolution

[120] Article 106 of *Chinese Company Law 1993*.

[121] For example, the latest Chinese Company Law 2013 requires that shareholders present at a general meeting shall be entitled to one vote for each share held. See Article 103 of *Chinese Company Law 2013*.

[122] Min Yan, 'Differentiated Voting Rights Arrangement under Dual-Class Share Structures in China: Expectation, Reality and Future' (2020) 28 *Asia Pacific Law Review* at https://doi.org/10.1080/10192557.2020.1855794.

[123] No. 32 [2018] of the State Council.

[124] CSRC, *Implementation Opinions on Setting up the Science and Technology Innovation Board and Launching the Pilot Program of the Registration System on the Shanghai Stock Exchange*, Announcement No. 2 [2019] of CSRC. This was then subsumed by the *Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange* (hereafter *SSE Sci-Tech Innovation Board Listing Rules*) in March 2019, allowing eligible listing applicants to go public with dual class shares. Article 2.1.4 of the *SSE Sci-Tech Innovation Board Listing Rules* stipulates: 'For the purpose of these Rules, the differentiated voting rights arrangement means a mechanism whereby an issuer makes an offering of shares with special voting rights in accordance with article 131 of the Chinese Company Law, in addition to ordinary stocks as generally provided for thereunder. Except that each special voting stock has more voting rights than each ordinary stock, the shareholders of special voting stocks shall have the same rights as those of ordinary stocks.'

tabled at the issuer's general meetings'. Rule 210(10)(d) of the *SGX Mainboard Rules* similarly states: 'Each multiple voting share shall not carry more than 10 votes per share. An issuer must specify the number of votes at IPO, and may not increase such number subsequently.' Article 4.5.4 of the *SSE Sci-Tech Innovation Board Listing Rules* also sets the maximum voting differential at 10:1, *i.e.* the high/low vote ratio should not exceed ten to one. All these requirements are aimed at restricting the discrepancy between controllers' weighted voting rights and their economic stake in a company, to ensure their accountability.

Secondly, all these jurisdictions adopt event-based sunsets which could convert multiple voting shares into single voting shares when a pre-specified event is triggered. For instance, Rule 8A.17 'Ongoing Requirements for Beneficiaries of Weighted Voting Rights' of the *HKEx Main Board Listing Rules* specifies such event-based sunsets in order to prevent the perpetuation of superior voting power. Death, retirement or incapacity of the controller would all terminate their weighted voting rights. Such events also include transferring shares with weighted voting rights to another person who is not 'affiliated' with the original holders.[125] The SGX also clearly provides such event-based sunset provision on the transfer of shares with weighted voting rights or when a controller ceases to serve as a director.[126] The Chinese version of event-based sunset provision is contained in Article 4.5.9 of the *SSE Sci-Tech Innovation Board Listing Rules*. There are four different pre-specified situations: (*i*) failing to meet eligibility;[127] (*ii*) the holder with superior voting rights loses the actual control of the shares; (*iii*) the holder with superior voting rights transfers these multiple voting shares or delegates the exercise of the superior voting rights to others; and (*iv*) control of the company is changed. This is not materially different from the HKEx and the SGX.

Thirdly, enhanced internal corporate governance standards are adopted to ensure managerial accountability. As independent directors are expected to help maintain high corporate governance standards,[128] the SGX mandates the independence of the chairman and the majority of members in sub-committees of the board,[129] and the HKEx mandates all dual class companies to establish a 'Corporate Governance Committee', comprised entirely of independent non-executive directors, to review and monitor whether the listed issuer is operated and managed for the benefit of all its shareholders (rather than merely for the benefit of the controllers).[130] In the SSE, the board of supervisors under China's dual-board structure is required to provide a specific opinion on compliance of shareholder protection mechanisms and abuse of weighted voting rights.[131]

There are also constraints on controllers' exercise of weighted voting rights in relation to fundamental corporate changes or matters that are most likely to cause a

[125] Rule 8A.17 of *HKEx Main Board Listing Rules*.
[126] See Rule 210(10)(f) of *SGX Mainboard Rules*.
[127] Article 4.5.3 of *SSE Sci-Tech Innovation Board Listing Rules* requires only directors who made and can continue to make a material contribution to development or business growth can hold the multiple voting shares under dual class shares.
[128] However, empirical evidence also shows that independent directors may not prevent companies' excessive risk taking and there were serious deficits in understanding the business. Wolf-Georg Ringe, 'Independent Directors: After the Crisis' (2013) 14 *European Business Organization Law Review* 401–424. Research also indicates positive correlations between the likelihood of corporate failure and the proportion of independent directors on corporate board. Hwa-Hsien Hsu and Chloe Yu-Hsuan Wu, 'Board Composition, Grey Directors and Corporate Failure in the UK' (2014) 46 *British Accounting Review* 215–227. Having said that, this paper still takes a conservative stance, namely independent directors potentially have a role to play in safeguarding shareholders with inferior voting rights in dual class companies.
[129] Independent directors are required to constitute a majority of each of the board's sub-committees performing the functions of an audit committee, a nominating committee and a remuneration committee, and serve as chairmen in these sub-committees. See Rule 210(10)(i) of *SGX Mainboard Rules*.
[130] See Rule 8A.30 of *HKEx Main Board Listing Rules*.
[131] See Article 4.5.12 of *SSE Sci-Tech Innovation Board Listing Rules*.

conflict of interest. The former circumstance includes amendment of a company's charter, merger, division, dissolution, and change of legal form of the company. The latter circumstance includes appointment and dismissal of independent directors and external auditors, and changing the number of voting rights contained in the multiple voting shares. When any of these decisions need to be made, controllers' multiple voting shares will temporarily convert to single voting shares in order to provide inferior voting shareholders with more protection. For example, Rule 730B 'Dual Class Share Structure' of the *SGX Mainboard Rules* specifies that multiple voting shares are limited to one vote each, regardless of their class, on matters relating to the appointment and removal of independent directors and/or auditors, variation of class rights, takeover, winding-up or delisting. Similar provision can also be found in the HKEx[132] and SSE.[133] In other words, for matters regarding fundamental changes and corporate governance standards, holders of multiple voting shares will not be entitled to more than one vote per share.

Last, but not least, all three jurisdictions require enhanced disclosure and mandate dual class companies to disclose information, including the rationale for adopting dual class shares, sunset provisions, impact of conversion and other details of such share structures, as well as their associated risks, in their listing documents and in their interim and annual reports. For example, Article 4.5.1 of the *SSE Sci-Tech Innovation Board Listing Rules* requires details of shareholders holding multiple voting shares and the quantity of these multiple voting shares, to be disclosed to all shareholders in a notice of the shareholder general meeting. It also requires the implementation and change of such an arrangement, as well as the implementation of measures for protecting inferior voting shareholders, to be disclosed in companies' periodic reports. Similar disclosure requirements can also be found in the HKEx and SGX.[134] Additionally, the HKEx and SGX have adopted a unique stock code to help investors differentiate dual class companies from single class companies.[135]

All these measures exist to restrain the control stemming from the weighted voting rights and provide mandatory safeguards to holders of inferior voting shares. Stringent measures also include stricter entry requirements. For example, dual class IPOs are only available for new issuers with a threshold of minimum market capitalisation[136] and those who are innovative with a track record of high business growth.[137]

[132] See Rule 8A.24 of *HKEx Main Board Listing Rules*.
[133] See Article 4.5.10 of *SSE Sci-Tech Innovation Board Listing Rules*.
[134] See eg Rules 8A.32, 8A.37–41 of *HKEx Main Board Listing Rules*; Rules 610 and 1207 of *SGX Mainboard Rules*.
[135] Take HKEx, for example. Rule 8A.37 states: 'An issuer with a WVR (weighted voting rights) structure must include the warning "A company controlled through weighted voting rights" on the front page of all listing documents, periodic financial reports, circulars, notifications and announcements required by these rules and describe the WVR structure, the issuer's rationale for having it and the associated risks for shareholders prominently in its listing documents and periodic financial reports. This warning statement must inform prospective investors of the potential risks of investing in an issuer with a WVR structure and that they should make the decision to invest only after due and careful consideration.' In Singapore, any circular sent by an issuer to its shareholders must include a statement on the cover page that the issuer is a company with a dual class share structure. See eg Rules 753 and 1206 of *SGX Mainboard Rules*.
[136] The minimum market capitalisation threshold is 10 billion HK dollars (*circa* US$1.3 billion) in Hong Kong, 300 million Singapore dollars (*circa* US$214 million) in Singapore and 10 billion RMB (*circa* US$1.4 billion) in Shanghai.
[137] For example, pursuant to the *Guidance Letter HKEX-GL93-18*, an applicant is expected to possess more than one of the following characteristics: (a) its success is demonstrated to be attributable to the application, to the company's core business, of (1) new technologies; (2) innovations; and/or (3) a new business model, which also serves to differentiate the company from existing players; (b) research and development is a significant contributor of its expected value and constitutes a major activity and expense; (c) its success is demonstrated to be attributable to its unique features or intellectual property; and/or (d) it has an outsized market capitalisation / intangible asset value relative to its tangible asset value. HKEx, *Guidance Letter (GL93-18)* (April 2018) at 2, at https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/g/l/gl9318.pdf.

3.3 Dichotomy between policymakers' enthusiasm and market acceptance

The debate over dual class shares in Section 2 exhibits mixed views about the insulation of voting rights (*i.e.* control) from cash flow rights (*i.e.* ownership). There is thus far no conclusive evidence showing the benefit of greater capital structure flexibility, gain of entrepreneurs' idiosyncratic visions and long-term focus may or may not outweigh the associated costs of deteriorated agency problems and governance risks. Although sceptics suggest potentially increased costs are caused by dual class shares, these are by no means uncontrollable. There seems to be some middle ground once appropriate safeguarding measures for holders of inferior voting shares have been adopted. In fact, this is exactly what the leading financial centres in Asia have aimed to do. On the one hand, they permit dual class shares, in order to gain the benefits of such share structures; on the other hand, in order to limit holders of shares with superior voting power, they impose restrictions, including the introduction of sunset provisions, limiting the divergence between controllers' voting rights and cash flow rights, and enhancing disclosure requirements.

Ironically, despite the enthusiasm for dual class shares at stock exchange and regulatory level in the top three Asian financial centres, very few companies have so far chosen to go public with such a share structure. Only three out of more than 400 newly listed companies on the HKEx,[138] one out of more than 100 newly listed companies on the SSE Sci-Tech Innovation Board[139] and no newly listed companies on the SGX[140] have adopted dual class shares. The reforms in permitting dual class listing, to provide more flexible capital structures and protect entrepreneurs' idiosyncratic visions, have thus far failed to stimulate a wave of dual class IPOs in any of these leading financial hubs.

The extremely low take-up of dual class shares in the new IPOs in Hong Kong, Singapore and Shanghai at least partly reflects the reduced attraction of such share structures when mandatory safeguards are stringent. This situation can be contrasted with the dual class IPOs in the US, where no such mandatory safeguarding measures exist.[141] For example, in the US 26 out of 134 newly listed companies in 2018 and 25 out of 112 newly listed companies in 2019 adopted dual class shares.[142]

While the US, the most prominent dual class structure jurisdiction, chooses not to adopt additional requirements and to maintain minimal mandatory safeguards, the top financial hubs in Asia take much more stringent measures to balance public shareholder protection with increased flexibility and competitiveness. However, both the intended and unintended impact of these safeguarding measures might over-restrain the controllers' ability to control, and hence compromise the value of the differentiated voting rights arrangement under dual class shares. The event-based sunset provisions, maximal voting

[138] See HKEx, *HKEx 2019 Annual Market Statistics* (December 2019), at https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/2019-Market-Statistics.pdf. There are another 42 companies newly listed in the first quarter of 2020, and none of them adopted dual class shares. *HKEx Market Data* (31 May 2020), at https://www.hkex.com.hk/Market-Data/Securities-Prices/Equities?sc_lang=en.

[139] *SSE Market Data Overview* (31 May 2020), at http://star.sse.com.cn/en/marketdata/overview/.

[140] *SGX Stock Screener* (31 May 2020), at https://www.sgx.com/zh-hans/securities/stock-screener.

[141] It would not be difficult to find that most of these safeguarding measures adopted by Hong Kong, Singapore and Shanghai cannot be found in either of the main US stock exchanges (*i.e.* the NYSE and the NASDAQ). In the US, there are no particular entry requirements such as minimum market capitalisation or industry restrictions; there are no restrictions on multiple voting shares or event-based sunset provisions; and there are no maximal voting differentials or minimal equity threshold held by multiple-voting shareholders. See eg Robin Hui Huang, Wei Zhang and Kelvin Siu Cheung Lee, 'The (Re)Introduction of Dual-Class Share Structures in Hong Kong: A Historical and Comparative Analysis' (2020) 20 *Journal of Corporate Law Studies* 121, 142–143.

[142] See eg Jay R. Ritter, *Initial Public Offerings: Technology Stock IPOs* (June 2020), at https://site.warrington.ufl.edu/ritter/files/IPOs2019Tech-Stock.pdf; Council of Institutional Investors, 'Dual Class Companies List' (March 2020), at https://www.cii.org/files/FINAL%20format%20Dual%20Class%20List%203-16-20(1).pdf.

differentials, enhanced internal corporate governance standards, including enhanced disclosure requirements and the like, are all designed to reinforce the conventional internal governance checks and external market for corporate control, thereby ensuring the accountability of those who hold multiple voting shares. However, the value of controllers' control will be reduced. For example, increased disclosure obligation means increased monitoring costs; and restricted voting differentials or automatic conversion of multiple voting shares mean decreased flexibility for entrepreneurial managers/founders and perhaps higher costs to retain control.

The core of all safeguarding measures is to weaken the insulation of controllers from the disciplinary forces of markets, making them more vulnerable and thus more tied to such pressures.[143] The value, and thereby attraction, of dual class shares is then reduced. This perhaps also explains why the reality largely deviates from policymakers' expectations in permitting dual class listings. Too many restrictions on the exercise of multiple voting rights may ultimately undermine visionary founders' or entrepreneurial managers' ability to create more value by implementing a longer-term project without fear of losing control. In other words, although safeguarding measures are helpful in controlling increased governance risks, excessive restraints can weaken the value of dual class shares. It is therefore essential to strike a balance between the two sides.

4. Revisiting the safeguarding measures

The success of dual class shares relies upon market acceptance. A stringent regime of mandatory safeguarding measures will discourage prospective listing applicants from choosing dual class IPOs in order to avoid the additional compliance costs or oversights. After all, the essence of dual class shares is to help entrepreneurs and founders alike, by allowing voting rights disproportionately greater than cash flow rights, to retain control and the ability to monitor after raising external equity capital.[144] When such capacity is over-restrained by safeguarding measures, as we have observed in the leading financial centres in Asia, the ability to issue shares with differentiated voting rights becomes less valuable. Thus, this section discusses the important role of safeguarding measures that help policymakers to find the middle ground between benefits to controllers and costs to non-controllers. It starts with an examination of the primary mechanisms that help restrict controllers' disproportionate voting power, and then looks at the cost/benefit balance of dual class shares.

4.1 Sunset multiple voting shares

The most powerful safeguarding measure is to terminate (or sunset) the dual class shares by converting multiple voting shares into single voting shares. There are three different types of sunset provisions: time-based, event-based and ownership-based.

The time-based sunsets limit controllers' superior voting rights to a pre-defined period. After the pre-determined period of time, multiple voting shares automatically convert to single voting shares. The Chartered Financial Analyst (CFA) Institute and other corporate governance advocates see mandatory time-based sunset provisions as *the*

[143] In this regard, dual class shares can be understood as a design to make shareholders with superior voting rights (or say controllers) less vulnerable to market disciplinary forces including hostile takeover, while the safeguarding measures are intended to reverse such a trend by placing restrictions on controllers' insulation from market discipline.
[144] See Mike Burkart and Samuel Lee, 'One Share-One Vote: The Theory' (2008)12 *Review of Finance* 1, 29 and 40–41.

most effective safeguards for protecting inferior voting shareholders.[145] The case of Viacom Inc., where the controlling shareholder retained control over 26 years with weighted voting rights, exhibits the difficulty that public investors, who in aggregate owned approximately 90% of Viacom's equity shareholdings, encountered when the 93-year-old controller was alleged to be legally incompetent in a legal battle.[146] Put differently, the merits of superior leadership skills will fade over time due to ageing issues or changes in the business environment. As time passes, legitimate reasons for adopting dual class shares at the time of IPO tend to lapse and the potential cost of dual class shares tends to increase.[147] An individual who is a successful founder or excellent leader with unique talents and vision when setting up the company may not maintain those superior leadership skills or vision ten or twenty years later, and could become a poor leadership fit for the company.[148] This is consistent with the empirical findings that the valuation premium of dual class companies over single class counterparts tends to erode after a period of time, though a consensus is yet to be reached on how soon such a premium would disappear.[149]

The second type sunsets multiple voting shares depending on the occurrence of a particular event. For example, the US-based dual class IPO of JD.com Inc., China's largest e-commerce company by revenue,[150] contained an event-based sunset provision by requiring conversion of all multiple voting shares into single voting shares if the founder, Mr. Richard Liu, was no longer employed as its chief executive or could not permanently attend board meetings due to his physical or mental condition.[151] The logic of this type of sunset provision is straightforward. If a visionary entrepreneur with multiple voting shares dies, becomes incapable of participating in the management or ceases to be a director of the company, it is hard to justify the retention of his/her superclass of shares with disproportionately greater voting rights. As with the example of Viacom Inc. above, where the founder could still retain control even though he was allegedly incapable of participating in the management of the company, expected values of dual class shares would be eroded and outweighed by the costs of entrenchment. Besides this, restrictions can also be imposed on the transfer of multiple voting shares. Take Facebook, Google, LinkedIn or Zynga, for example, where multiple voting shares will convert into single voting shares if shares with weighted voting rights are transferred to persons who are not 'affiliated' with the original holders.[152] In fact, the sunset provisions contained in the HKEx, SGX and SSE nearly all belong to this type,[153] where

[145] Mary Leung and Rocky Tung, *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* (CFA Institute, 2018) at 56.
[146] Lucian A. Bebchuk and Kobi Kastiel, 'The Untenable Case for Perpetual Dual-Class Stock' (2017) 103 *Virginia Law Review* 585, 587–588.
[147] Ibid 605–607.
[148] This is perhaps why some dual class companies voluntarily choose to adopt time-based sunset provisions even in jurisdictions without mandatory time-based sunsets. See Council of Institutional Investors, 'Companies with Time-Based Sunsets on Dual-Class Stock' (15 August 2019), at https://www.cii.org/files/8-15-19%20Time-based%20Sunsets.docx.pdf.
[149] For instance, some scholars found dual class companies' valuation premium would disappear on average four/five years subsequent to the IPO, and then turn into discount after six to nine years. See Martijn Cremers, Beni Lauterbach and Anete Pajuste, 'The Life-Cycle of Dual Class Firm Valuation' (2018) *ECGI - Finance Working Paper No. 550/2018* at 20–21. There is also research suggesting that young dual class companies (namely, firms younger than 12 years from IPO) have a valuation premium while mature dual class companies (namely, firms older than or equivalent to 12 years from IPO) have a discount compared to single class counterparts. Hyunseob Kim and Roni Michaely, 'Sticking around Too Long? Dynamics of the Benefits of Dual-Class Voting' (2019) *ECGI - Finance Working Paper No. 590/2019* at 2–3.
[150] For more details, see the official website of the company at http://ir.jd.com.
[151] HKEx, *Concept Paper on Weighted Voting Rights* (August 2014) at 46–48.
[152] The event can potentially be performance-related as well. That is to use a pre-specified financial performance outcome as an event to trigger the event-based sunsets and convert multiple voting shares to single voting shares.
[153] The only exception is the ownership-based sunsets in the SSE, which would be discussed in the following paragraph.

multiple voting shares convert to single coting shares when certain events (eg death, retirement, disqualification or incapacity) occur to prevent the holders of these shares contributing to the company.[154]

The third type is based on controllers' ownership stake and will automatically convert multiple voting shares to single voting shares when controllers' ownership stake falls below a pre-determined minimum threshold. For example, according to Articles 4.5.9 (1) and 4.5.3 of the *SSE Sci-Tech Innovation Board Listing Rules*, shareholders with multiple voting shares must hold 10% of all outstanding voting shares. When the portion of multiple voting shares held by controllers falls below the minimum threshold, *i.e.* 10%, all multiple voting shares will be converted into single voting shares.[155] As exhibited in Section 2.3, with the decrease of ownership stake, holders of multiple voting shares may become indifferent to losses suffered by the company due to their low percentage of equity shareholdings. Following the classical economic justification for proportionate voting, a lower ownership stake tends to imply less of an economic incentive to make optimal decisions for the company, as opposed to seeking private benefits. This is an important reason why opponents criticise the insulation of control from economic interests. Thus, the ownership-based sunset provisions are designed to avoid extreme situations where minority controllers with multiple voting shares reduce their equity stake to a negligible level.

4.2 Maximal voting differentials

Following the logic underlying the ownership-based sunset provisions as well as proportionate voting, another effective means of controlling the divergence between voting rights (*i.e.* control) and cash flow rights (*i.e.* ownership) is to limit the maximal voting differentials. In the critics' eyes, when the divergence between controllers' control and economic interest increases, the fraction of controllers' equity shareholding can go down without affecting their lock on control. Such an enlarged gap may subsequently increase the likelihood of their self-serving behaviour.[156] Empirical studies have also suggested that the wider the divergence, the lower the associated firm valuation.[157] Thus, this safeguarding measure is designed to limit such divergence by limiting the ratio of high voting rights to low voting rights.[158]

The high-to-low voting ratio determines the fraction of equity shareholdings a controller needs in order to retain the control rights, namely more than 50% of votes.[159] For example, if the high/low ratio is 2:1—*i.e.* Class A shares have two votes per share and Class B shares have one vote per share, then a controller holding Class A shares would need to hold at least 33.4% of shareholdings in the company to retain control.[160] If the ratio increases to 3:1 or 4:1, then a controller only needs 25.1% or 20.1% of equity

[154] See Section 3.2 above.

[155] Although there is no ownership-based sunset in the HKEx and SGX, the maximal voting differentials as discussed in the next subsection may also effectively control the minimum shareholdings through limiting the high to low voting ratio.

[156] Put differently, the enlarged divergence would decrease the likelihood of the controllers to avoid decisions reducing corporate value but increasing private benefits. See the discussion in Section 2.3 above.

[157] Stijn Claessens, Simeon Djankov, Joseph P. H. Fan and Larry H. P. Lang, 'Disentangling the Incentive and Entrenchment Effects of Large Shareholdings' (2002) 57 *Journal of Finance* 2741, 2764–2765; Ronald W. Masulis, Cong Wang and Fei Xie, 'Agency Problems at Dual-Class Companies' (2009) 64 *Journal of Finance* 1697, 1703–1705.

[158] See eg Lucian A. Bebchuk and Kobi Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Georgetown Law Journal* 1453, 1505.

[159] For most resolutions including removal of directors, only a simple majority (*i.e.* more than 50%) of the total voting rights is required.

[160] 33.4% * 2 > (100% — 33.4%) * 1.

stakes respectively.[161] If shares in the superclass have ten votes per share, *i.e.* the high/low voting ratio becomes 10:1, a controller can then reduce his/her equity stake as low as 9.1% to retain the majority control over the company.[162] It is clear that when the ratio increases, a controller can drastically decrease his/her equity holding without losing control, which would then enlarge the divergence between control and ownership. For example, TerraForm Global, Inc. a NASDAQ listed company that owns and operates contracted clean power generation assets, adopts dual class shares with Class A shares having one vote per share while Class B shares have 100 votes per share.[163] This means that holders of Class B shares require only 1% of shareholdings to retain majority control.

If costs of dual class shares do exist, and the firm valuation is positively associated with controllers' equity ownership and negatively associated with their weighted voting rights, limiting maximal voting differentials will help increase firm value. In other words, on the grounds that a higher economic stake through retaining a higher percentage of equity shareholdings is expected to mitigate expropriation risks,[164] this safeguarding measure can help limit the divergence between voting rights and cash flow rights and increase controllers' ownership stake, so that it is more proportionate to their voting power.[165] It is therefore not surprising to see that while the HKEx, SGX and SSE now permit dual class listing, they have all capped the maximal voting differentials in an effort to enhance ownership incentive. This is to *i*) constrain potential agency problems and *ii*) better align controllers' interests with outside/public investors' interests.

4.3 Corporate governance standards

Apart from terminating weighted voting rights and narrowing the discrepancy between control and ownership, enhancing corporate governance standards is expected to further protect inferior voting shareholders. For example, an enhanced voting mechanism is designed to constrain controllers' ability to exercise their weighted voting rights regarding fundamental corporate changes (such as amendments of charter) or matters that are most likely to cause conflicts of interests (such as removal or appointment of independent directors and auditors). In order to mitigate controllers' potential exploitation and provide inferior voting shareholders with a say on important matters, controllers' multiple voting shares will temporarily convert to single voting shares for that type of decision-making. As we can see from Section 3.2, such an enhanced voting process to restrict the exercise of multiple voting shares is now prevalent in the HKEx, SGX and SSE.[166]

Moreover, listing rules in these jurisdictions also mandate that shareholders with inferior voting rights shall have at least 10% of the company's voting rights at shareholder general meetings, which would effectively enable them to convene an extraordinary general meeting and add proposals to the meeting agenda.[167] There are also measures

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161 25.1% * 3 > (100% — 25.1%) * 1; 20.1% * 4 > (100% — 20.1%) * 1.

162 9.1% * 10 > (100% — 9.1%) *1.

163 See Council of Institutional Investors, 'Dual Class Companies List' (March 2020), at https://www.cii.org/files/FINAL%20format%20Dual%20Class%20List%203-16-20(1).pdf.

164 See Mary Leung and Rocky Tung, *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* (CFA Institute, 2018) at 56.

165 Non-voting shares namely, share class with zero voting rights, are an extreme case here as it represents an infinite ratio of high/voting rights. That means a controller can reduce his/her equity shareholding to literately one share as holders of the other class have zero voting rights regardless of their shareholdings.

166 See eg Rule 8A.09 and Rule 8A.23 of *HKEx Main Board Listing Rules*; Article 4.5.7 of *SSE Sci-Tech Innovation Board Listing Rules*.

167 Rules 8A.09 and 8A.23 of *HKEx Main Board Listing Rules*; Article 4.5.3 of *SSE Sci-Tech Innovation Board Listing Rules*; Rules 210(10)(g) and (h) of *SGX Mainboard Rules*.

designed to increase the independence of the board from the controlling shareholders. For example, the HKEx mandates each listed dual class company to establish a corporate governance committee with independent non-executive directors to monitor the management of the company.[168] In Singapore, independent directors are required to constitute a majority of the audit, nominating and remuneration committees of dual class companies, and to serve as chairpersons of these board committees.[169]

Another means to constrain increased governance risks is to provide investors with adequate information related to dual class shares via prospectuses, annual reports and the like. In the critics' eyes, a controller's fraction of equity capital largely determines governance risks in a dual class company; thus external investors would benefit from knowing controllers' current and expected level of equity ownership stake.[170] Enhanced disclosure can not only reduce outside investors' costs and time to obtain such information, but also provide them some *warning* of potential governance risks.[171] With adequate disclosure regarding the divergence between controllers' equity and voting rights, among others, outside investors may better understand the risks associated with such share structures before making their investment decision. The invisible hand of market forces may then discount shares with inferior voting rights. Therefore, mandatory disclosure requirements are designed to facilitate public and outside investors in making a more informed decision with lower costs. That is also why the HKEx, SGX and SSE all require listing companies with dual class shares to fully disclose details such as divergence between voting rights and cash flow rights, high/low voting ratio, sunset provisions and associated risks.[172]

4.4 Double-edged sword

While these safeguarding measures can help to mitigate the increased governance risks and agency costs, their essence is to restrain the founders' or entrepreneurs' exercise of weighted voting rights. Put differently, in order to ensure the managerial accountability and protect inferior voting shareholders, the ability to exercise weighted voting rights will be compromised. Such ability is, however, the key to ensuring insulation from market pressure, the most fundamental value of dual class shares, as discussed in Section 2.2. Thus, safeguarding measures are indeed a double-edged sword. When they help to seek for middle ground in favour of the protection of inferior voting shareholders, these safeguarding measures would compromise the value of dual class shares to the very people who choose such share structures in the first place. There is therefore a contention in relation to the ideal degree to which the safeguarding measures should limit controllers.

Take sunset provisions. The contention in time-based sunsets is the short-*versus*-long timeframe, as a shorter timeframe implies that controllers' superior voting rights would lapse more quickly, and vice versa.[173] Those who see costs in dual class shares are understandably inclined toward more stringent restraint, thereby preferring a shorter timeframe. For instance, the Council of Institutional Investors, a prominent sceptic of

[168] Rule 8A.30 of *HKEx Main Board Listing Rules*.
[169] Rule 210(10)(i) of *SGX Mainboard Rules*.
[170] Lucian A. Bebchuk and Kobi Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Georgetown Law Journal* 1453, 1500.
[171] Another good example is using unique stock code to raise the awareness of dual class shares and help investors differentiate dual class companies from single class companies as we can see in the HKEx and SGX.
[172] See Rules 8A.32, 8A.37–41 of *HKEx Main Board Listing Rules*; Rules 610 and 1207 of *SGX Mainboard Rules*; Article 4.5.10 of *SSE Sci-Tech Innovation Board Listing Rules*.
[173] Furthermore, there is no consensus as to whether time-based sunset provisions have positive value impact on firms in general. See Xiaochuan Weng and Jingjing Hu, 'Every Sunset is an Opportunity to Reset: An Analysis of Dual Class Share Regulations and Sunset Rules' (2021) 21 *Journal of Corporate Law Studies* (forthcoming).

dual class shares, recently demanded limiting all companies' dual class structures to seven years.[174] However, the shorter the time dimension, the fewer the benefits shareholders of weighted voting rights can obtain from such share structures.

The contention between the high-*versus*-low equity thresholds for ownership-based sunsets is another example. The lower the equity threshold, the more the controller can reduce his/her ownership stake without relinquishing control. Accordingly, lower thresholds tend to be criticised by opponents as superficial. By contrast, a higher threshold, say holding more than 50% of outstanding shares, would largely deny controllers the ability to obtain the benefits of external equity financing while retaining control. Though shareholders with multiple voting shares may be held more accountable under such a case, an important value of dual class shares would disappear.

The maximal voting differentials, which determine the divergence between controllers' control and their economic interests, pose yet another challenge. As we can see, the larger the differentials, the larger the divergence. Limiting such high/low ratios in order to avoid extreme separation between voting rights and cash flow rights, such as holding 1% of equity shareholdings to retain control under a high-to-low voting rights ratio of 100:1, can be understood. Nevertheless, if the ratio is too low, it cannot adequately protect visionary founders or entrepreneurial managers from the very market pressures that dual class shares aim to insulate them against. For example, if a high/low voting ratio is narrowed to very close to 1:1, although the concern over increased governance risks may be minimised, the value of such share structures would also be eroded.

One more useful illustrative example is the so-called 'coattail provision'—that is, when a takeover offer is received, dual class companies' voting decisions are to be made on the basis of single class shares.[175] If such a coattail provision is widely adopted, then the main merit of dual class shares, *i.e.* the insulation from market pressure, would largely be lost.[176] In other words, too many safeguards to increase managerial accountability and shareholder protection will undermine the visionary founders' and entrepreneurs' ability to create more value by implementing long-term projects with near-term uncertainty.

It is also vital to recognise both the intended and unintended impact of these safeguarding measures. For instance, an intended impact of time-based sunsets is to limit controllers' weighted voting rights to a pre-determined period. But such measures may create a temptation for an incumbent controller to pursue self-serving conduct when the pre-specified sunset deadline approaches, which can be deemed an unintended impact of time-based sunsets. The increased agency costs in the context of facing an imminent loss of control may outweigh the benefit such sunsets bring. Similarly, while a narrower high/low voting differential can limit the gap between controllers' voting rights and cash flow rights, it may increase the price of retaining control and decrease the benefit of external equity financing. Also, when a controller changes to debt financing, and thereby increases the costs of financing, outside and public shareholders will be negatively

[174] The Council of Institutional Investors ('CII') is an organisation of more than 140 public, union, and corporate pension funds and representing managers of US$25 trillion assets. Between October 2018 and September 2019, the CII had submitted letters to the NASDAQ, NYSE and Delaware Bar to petition the exchanges or legislation to prevent companies retaining dual class structures beyond seven years after the IPO, unless each class, voting separately, supports extending that structure by a majority of outstanding shares. See more details at https://www.cii.org/dualclass_stock.

[175] For example, the Toronto Stock Exchange ('TSX') implements a coattail provision as a takeover protective provision to ensure the holders of inferior voting rights are able to participate in a takeover bid on equal terms as those with superior voting rights. See Section 624(l) of *TSX Company Manual*.

[176] Whilst a coattail provision can effectively protect the interests of inferior voting shareholders, such a provision would largely undermine the initial purpose, the underlying benefits, of dual class structures.

affected as well.[177] A lower ratio can also negatively affect the number and quality of companies' innovative outputs and exploratory research.[178] Such complexity poses a nearly insurmountable challenge in ascertaining an appropriate range of high/low voting ratio or equity threshold for ownership-based sunsets.[179]

In short, safeguarding measures are a double-edged sword: they can effectively protect shareholders with inferior voting rights, but the price is to restrain visionary founders' and entrepreneurs' ability to exercise their weighted voting rights. Under a stringent regime of safeguarding measures, the expected attractions of dual class shares for those visionary founders and entrepreneurs would undoubtedly be reduced.[180] It is however fair to say that stock exchanges in Hong Kong, Singapore and Shanghai do, to some extent, realise the impact of the safeguarding measures as a double-edged sword. For example, measures such as mandatory time-based sunsets are not adopted at the institutional level, even though they would greatly enhance investor protection and have been strongly campaigned for by the Council of Institutional Investors, among others.

4.5 Alternative strategies

All the foregoing safeguarding measures are *ex ante* strategies that seek to prevent or deter potential managerial unaccountability and opportunism by restraining controlling shareholders' ability to exercise their multiple voting shares.[181] In contrast, *ex post* strategies primarily look to how aggrieved shareholders can seek remedies once problems from managerial unaccountability or opportunism have occurred.[182] Because the stringent *ex ante* measures tend to over-restrain the controllers' control and thereby compromise the benefits of weighted voting under dual class shares, it is worth considering *ex post* measures as an alternative to maintaining the hard-earned credibility in corporate governance.

In effect, none of the leading financial centres in Asia discussed in this paper has an effective and robust *ex post* regime such as robust private enforcement institutions relying on the financial incentives of a plaintiff bar.[183] This, perhaps, leads to their dependence on the *ex ante* safeguards in checking agency costs and protecting investors. But the success of dual class shares lies in their market acceptance. If no, or very few, companies

[177] There is also evidence to suggest that R&D investment may be adversely affected when debt capital becomes the main source of finance of a firm. In other words, high-tech and innovative firms would find more difficult to seek bank loans because of the higher risks and greater informational asymmetries associated with the R&D projects. Maria Maher and Thomas Andersson, *Corporate Governance: Effects on Firm Performance and Economic Growth* (OECD 1999) at 36.

[178] It is argued that the divergence has a significant positive impact on innovation as it offsets the costs of insider control on firm value. Lindsay Baran, Arno Forst and M. Tony Via, 'Dual Class Share Structure and Innovation' (December 2019), at http://dx.doi.org/10.2139/ssrn.3183517.

[179] By the same token, it also poses similar challenges for future empirical studies aiming to quantitatively assess the merits and drawbacks of these safeguarding measures in a systematic manner.

[180] They will probably vote with their feet and choose a less stringent regime like the US's to go public with such share structures.

[181] See John Armour, Henry Hansmann and Reinier Kraakman, 'Agency Problems and Legal Strategies' in Reinier Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn Oxford University Press 2017) at 37–38.

[182] Ibid. See also Robin Hui Huang, Wei Zhang and Kelvin Siu Cheung Lee, 'The (Re)Introduction of Dual-Class Share Structures in Hong Kong: A Historical and Comparative Analysis' (2020) 20 *Journal of Corporate Law Studies* 121, 131. For a more detailed discussion of the distinction between *ex ante* rules and *ex post* standards, see Louis Kaplow, 'Rules Versus Standards: An Economic Analysis' (1992) 42 *Duke Law Journal* 557–629.

[183] Robin Hui Huang, Wei Zhang and Kelvin Siu Cheung Lee, 'The (Re)Introduction of Dual-Class Share Structures in Hong Kong: A Historical and Comparative Analysis' (2020) 20 *Journal of Corporate Law Studies* 121, 137 and 141. The authors pointed out that Hong Kong and Singapore do not have a class action and contingency fee system, as we can observe in the US legal framework. Neither does Mainland China.

choose to go public with such share structures, permitting dual class listings would be fruitless.

The current focus on *ex ante* safeguarding measures, such as sunsets and maximal voting differentials, may result in a dead end. It restrains entrepreneurs' and founders' capacity to retain their control and ability to monitor after raising external equity capital, which defeats the purpose of permitting dual class listings. The compromise resulting from the deterrent and restrictions in the context of *ex ante* mechanisms may also be more difficult to justify since no abuse of weighted voting rights has actually occurred or has been detected.[184] It may therefore be time to reduce the restrictions around the eligibility of dual class listings and the way that holders with multiple voting rights can exercise control.

The double-edged sword resulting from a stringent regime of mandatory safeguarding measures should encourage more research on the *ex post* regime.[185] For example, aggregate litigation through representative proceedings in Hong Kong,[186] Singapore[187] and Shanghai[188] has the potential to become an effective route for inferior voting shareholders to seek remedies if control in the context of dual class shares is abused. Therefore a viable way forward is to reduce mandatory *ex ante* constraints on dual class listing to allow more flexibility, but couple this with enhanced *ex post* mechanisms.

5. Conclusion

The controversies over dual class shares lie in the contention between the benefits and costs of such share structures—*i.e.* the visionary founders' control (implying potentially higher firm value in the long run) *versus* the potentially greater agency costs associated with increased management entrenchment.[189] While the conventional economic justification of proportionate voting is far from the solution to control agency costs, especially in the context of shareholder heterogeneity, dual class shares, which allow disproportionate votes to insiders and insulation from takeover markets, would potentially lead to deteriorated agency problems.[190] In order to constrain the increased corporate governance risks associated with the separation between control and equity ownership, restrictions are imposed to limit multiple voting shares and the current focus has been very much reoriented to restraining the potential governance risks and protecting the holders of inferior voting shares. For example, the permission of dual class listings in Hong Kong, Singapore and Shanghai comes, in all cases, with a stringent regime of mandatory measures to mitigate the associated governance risks.

[184] In other words, stricter *ex post* mechanisms will be easier to justify after the occurrence of any suggested managerial unaccountability or opportunism. On a different note, it is also found that *ex post* sanctions are sometimes more efficient than *ex ante* sanctions in law enforcement. See eg Nuno Garoupa and Marie Obidzinski, 'The Scope of Punishment: An Economic Theory' (2011) 31 *European Journal of Law and Economics* 237, 240–245.

[185] Furthermore, other existing regulations such as related party transaction rules can also be explored further to mitigate the risk of abuse of weighted voting control.

[186] Order 15, Rule 12 of *The Rules of the High Court* (Cap 4A) (Hong Kong).

[187] Order 15, Rule 12 of *Rules of Court* (Cap 322) (Singapore).

[188] Similar to the representative proceedings in Hong Kong and Singapore, Article 95 of the revised Chinese Securities Law 2020 now allows aggrieved investors to initiate representative civil litigation against the company for fraudulent disclosure.

[189] The entrenchment of control would provide corporate insiders too much influence as minority controller and shield them from both internal governance and external market check. For more detailed discussion, see Section 2.3 above.

[190] While corporate insiders fully enjoy the private benefits of control, they will not bear the full costs caused by their value-destroying decisions due to the separation of control rights from cash flow rights. Nevertheless, even in the context of proportionate voting such agency costs, or say moral hazard, is also inevitable as long as a principal-agent relationship exists.

The essence of all safeguarding measures, such as sunset provisions, maximal voting differentials and enhanced corporate governance standards, is to make controllers less insulated from the pressures of external investors and markets. This would, however, compromise, either intendedly or unintendedly, the controllers' ability to exercise unfettered control. Therefore, even though safeguarding measures play an important role in helping inferior voting shareholders to hold controllers to account, we should not let too many restrictions be imposed on the exercise of multiple voting rights. A stringent regime of mandatory safeguarding measures would make dual class shares less attractive for those visionary entrepreneurs and founders, which explains the discrepancy between policymakers' expectations of dual class shares and what we have seen in the leading Asian financial centres. On the grounds that the main institutional purpose of dual class shares is to ensure founders' ability to create more value by implementing their idiosyncratic business ideas without the fear of market pressure, any institutional design of safeguards should not overshadow this main value.

In conclusion, the time has come for jurisdictions that prohibit dual class shares in listed companies to seriously reconsider their stance on such share structures. This is firstly because the potential governance costs may be outweighed by the benefits of dual class shares, such as greater capital structure flexibility, enhanced protection of entrepreneurs' idiosyncratic vision and long-term focus; and secondly, constraints can be placed on such share structures to limit their negative impact. Just as we have seen in Hong Kong, Singapore and Shanghai where changes have already been made after recognising the value of taking a more permissive stance, countries such as the United Kingdom should similarly consider easing restrictions over dual class listings in order to attract IPOs from companies in the high-technology and innovative sectors and to broaden capital markets.[191] More importantly, while investor protection is essential, too many safeguarding measures would undoubtedly affect the intrinsic value of dual class shares. Thus, what policymakers and regulators should really focus on is how to use this double-edged sword to strike a balance between maintaining a flexible capital structure and controlling the associated governance risks, or perhaps to explore more of the *ex post* mechanisms, to reduce the reliance on mandatory safeguarding measures as *ex ante* constraints.

[191] In the United Kingdom, dual class listing is only permitted on the Alternative Investment Market of the London Stock Exchange (LSE) and the Standard Segment of the LSE's Main Market, which are less attractive to investors than the Premium Segment of the LSE's Main Market. For example, the Premium Listing Principles 5 of *Listing Rule 7.2.1A* provides: 'A listed company must ensure that it treats all holders of the same class of its premium listed securities and its listed equity shares that are in the same position equally in respect of the rights attaching to those premium listed securities and listed equity shares.' A government consultation on the introduction of dual class shares for the Premium Listing Segment is currently taking place. Lord Hill's Review on Listings (*i.e.* the UK Listings Review) has specifically included the area of dual class shares, with an objective to propose reforms to the UK listing regime that will lure the most successful and innovative companies to list in the UK. More details can be found at https://www.gov.uk/government/publications/uk-listings-review.