The Current Debate and Future Development of Dual-Class Share Structures in China

*Min Yan**

Although mainland China has now allowed listings with dual class share structures (DCSS) in the wake of reforms made in Hong Kong and Singapore to accommodate differentiated voting rights arrangements, the debate over DCSS is far from over in China, much like in other jurisdictions that have recently permitted DCSS or are considering the permission of such share structures. Many Chinese domestic scholars call for more stringent regulatory safeguards as well as time-based sunset clauses to tackle the potentially increased governance risks associated with DCSS. This article aims to serve as a bridge between Chinese and English literature by shedding light on mainstream perspectives within China while also examining the latest developments in the field from a global perspective. It first challenges the questions on the legitimacy and reasonableness of DCSS based on the historical evolution of voting rights as well as empirical studies. It then critically analyses the impact of stringent regulatory measures and defines them as a double-edged sword. All current screening and safeguarding measures in China can be categorised as ex ante constraints, the essence of which is to constrain the exercise of superior voting power in to order to mitigate the effect of decoupling voting rights from cash flow rights under DCSS. Based on lessons from overseas DCSS development, this article argues that, for more flexible and competitive capital markets, China needs to relax rather than intensifying stringent ex ante mechanisms and rely more on enhanced ex post mechanisms to further promote DCSS listings.

1. Introduction

Dual-class share structures (DCSS) allow shareholders to adopt a differentiated voting rights arrangement.[1] The decoupling of control rights (ie, voting rights) from ownership rights (ie, the number of shares held, also known as cash flow rights) enables company founders to maintain control with a small percentage of share ownership.[2] Since the beginning of the 21st century, DCSS has experienced a revival in the United States' capital market, particularly among technology companies. For example, tech giants such as Google (now Alphabet) and Facebook have adopted DCSS for their Initial Public Offerings (IPOs). Major financial centres in Asia and Europe, such as Hong Kong (in 2018), Singapore (in 2018), and the United Kingdom (in 2021), have also modified their

* Reader in Law at the City Law School, University of London, United Kingdom. The author is grateful to Professors Junhai Liu, Qiong Fu, Yong Ding and the anonymous HKLJ referee for their insightful comments on the earlier version of this article. The usual disclaimers apply.

[1] Typically, the shares held by founding shareholders enjoy superior voting rights (also known as weighted voting rights, multiple voting rights or special voting rights), while shares held by small and external investors only possess ordinary voting rights or restricted voting rights. See, eg, Min Yan, "The Myth of Dual Class Shares: Lessons from Asian Financial Centres" (2021) 21 *Journal of Corporate Law Studies* 397, 397–398.
[2] Even in Anglo-American legal systems that uphold board-centrism, the superior voting rights of founding shareholders not only can help secure their board seats but also enable them to determine the majority of board seats. By controlling the board, they can effectively control the company's operations.

respective listing rules to accommodate IPOs by DCSS companies.[3] Mainland China is no exception, as in 2019, the Shanghai Stock Exchange (SSE) introduced the STAR market (ie, the Science and Technology Innovation Board) and permitted DCSS listing. In 2020, the Shenzhen Stock Exchange's ChiNext board also approved DCSS listing. Moreover, countries on the European mainland such as France and the Netherlands, as well as other major capital markets like Canada, have long allowed DCSS companies to go public. There is a widespread acceptance of DCSS across global capital markets.

However, the debate over the benefits and costs of DCSS is far from over and this holds especially true for China. For instance, Professor Junhai Liu, a renowned Chinese corporate law scholar, critically examined the advantages and disadvantages of DCSS in a recent paper, and proposed six legislative recommendations: "prohibiting (DCSS) in principle, allowing exceptions (for DCSS listing), strict screening, strict regulation, utilizing advantages and eliminating disadvantages, and mandating sunset provisions" based on the principle of shareholder equality and empirical evidence.[4] The author was involved in a submission regarding the United Kingdom (UK) Listing Review to the UK Treasury, which contributed to the amendment of the UK Listing Rules by the Financial Conduct Authority (FCA) in December 2021, to include rules 9.22A-F, thereby ending the prohibition of DCSS listing on the of London Stock Exchange's (LSE) premium listing segment.[5] Therefore, this article aims to provide Chinese domestic experts, scholars and policymakers with different dimensions of thinking by examining DCSS and their regulatory measures based on the experiences and practices of other jurisdictions. As China's regulatory safeguards align with the stringent standards observed in the Hong Kong Stock Exchange (HKEx) and Singapore Stock Exchange (SGX), the insights presented in this article can also offer valuable perspectives on the potential future directions of these jurisdictions.

The remainder of the article is divided into six chapters. Chapter 2 summarises the main controversies and criticisms surrounding DCSS. Chapter 3 responds to these controversies and criticisms, including analysing DCSS in relation to the principle of shareholder equality, the impact on corporate value, the rationality of time-based sunset mechanisms and potential corporate governance risks or moral hazards associated with such share structures. This article acknowledges that differentiated voting rights arrangements under DCSS do increase corporate governance risks to some extent, but argues that these risks or so-called "drawbacks" can be controlled through appropriate regulatory measures. Chapter 4 then discusses the main measures taken by major financial centres worldwide to address these drawbacks, while also summarising the stringent regulatory approach adopted by China. Chapter 5 examines and reflects on the impact, particularly the unintended consequences, of stringent regulatory measures and suggests

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[3] Yan (n 1 above) pp 398–399.

[4] Junhai Liu, "To Maximize the Benefit and to Minimize the Cost of the Dual-Class Structure of Listed Companies" [2022] 5 *Journal of Comparative Law* 169, 184 (刘俊海：《论上市公司双层股权架构的兴利除弊》，《比较法研究》, 2022 年第 5 期，第 184 页). Professor Junhai Liu holds key positions within China's legal landscape, and alongside other renowned Chinese legal scholars cited in this paper, they collectively wield significant influence. This makes them a potent force for instigating changes in rulemaking on DCSS.

[5] The submission is mainly based on the findings in Min Yan, "Permitting Dual Class Shares in the UK Premium Listing Regime—A Path to Enhance rather than Compromise Investor Protection" (2022) 42 *Legal Studies* 335–357.

that this double-edged sword may be an obstacle for Chinese companies considering DCSS IPOs domestically. Chapter 6 explores current regulatory strategies and proposes a new regulatory approach that reduces stringent *ex ante* screening and restrictions while relying more on *ex post* remedies. The final chapter concludes.

2. The Main Controversies and Criticisms Surrounding DCSS

The essence of DCSS lies in the decoupling of control rights from ownership rights. By allowing voting rights disproportionately greater than ownership rights, founders with superior voting shares can maintain corporate control even when their shareholding is below 50%.[6] Proponents argue that such decoupling protects visionary founders from the undue pressure of short-term investors and markets, allowing them to freely pursue and implement their long-term business ideas. However, critics are more pessimistic, asserting that the decoupling of voting rights from ownership enables shareholders with superior voting rights to insulate themselves from external market scrutiny, thereby impeding effective supervision by the market and investors. This, in turn, increases corporate governance risks and agency costs.[7] The main controversies and criticisms surrounding DCSS can be summarised into the following four areas.

First of all, DCSS is criticised for deviating from the principle of equal voting rights for shareholders which contradicts the principle of shareholder equality. For example, Professor Junhai Liu argued that shareholder equality is an essential characteristic of democratisation and modernisation of corporate governance.[8] Modern corporate governance rules generally adhere to the principle of one share, one vote and the principle of majority rule (ie, majority decision based on capital), thereby questioning the legitimacy of differentiated voting rights arrangements under DCSS.

Secondly, it is argued that DCSS may reduce corporate value. China's domestic scholars' pessimism towards DCSS is largely influenced by empirical analyses of such share structures in foreign jurisdictions. For example, studies find a positive correlation between a company's valuation and the founder's ownership percentage, but a negative correlation with the founder's voting rights.[9] In other words, the superior voting rights held by founders in a DCSS company, which exceed their shareholding proportion, can decrease the company's valuation. Scholars also find that the discrepancy between superior voting rights and ownership rights can also reduce the efficiency of a company's utilisation of cash reserves.[10]

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[6] Scholars have further pointed out that this decoupling serves as a governance contract mechanism, risk allocation mechanism, incentive mechanism, and self-protection mechanism between entrepreneurs and investors. Qiong Fu and Hengzhi Wei, "Differences in Voting Rights and Governance of the 'SSE Star Market'" (2019) 41(6) *Modern Law Science* 91, 91 (傅穹, 卫恒志: 《表决权差异安排与科创板治理》, 《现代法学》, 2019 年第 6 期, 第 91 页).
[7] See Yan (n 1 above) pp 403–404.
[8] See Liu (n 4 above) pp 175–176.
[9] Liu (n 4 above) p 172; also see Paul 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; Stijn Claessens *et al.*, "Disentangling the Incentive and Entrenchment Effects of Large Shareholdings" (2002) 57 *Journal of Finance* 2741, 2764–2765.
[10] Ronald Masulis, Cong Wang and Fei Xie, "Agency Problems at Dual-Class Companies" (2009) 64 *Journal of Finance* 1697, 1703–1705.

Thirdly, considering the negative impact of DCSS on corporate valuation (particularly some time after a company's IPO), there have been calls for companies that have gone public with such share structures to have a time limit on their differentiated voting rights arrangement. This would involve converting superior voting shares into ordinary voting shares. For example, Professor Liu has highlighted the "lifecycle effect" of DCSS, which suggests that the competitive advantage of DCSS companies diminishes over time until it disappears.[11] Accordingly, there is a legislative proposal for implementing a "time-based sunset" clause.[12]

Last but not least, it is argued that DCSS would increase corporate governance risks and moral risks, due to the separation of control rights and ownership rights. This means that founders with superior voting rights can reap the benefits of self-interested actions at minimal cost. The exacerbation of corporate governance risk and agency costs often forms the main theoretical basis for studies that argue for the negative impact of such a share structure on corporate values.

The arguments presented above reflect the sentiments of a broader community of Chinese domestic scholars, whose perspectives are likely to play a pivotal role in shaping the assessment and future course of developments in China's regulatory framework governing DCSS. Consequently, the following chapter will delve into and tackle these controversies and criticisms one by one.

3. Responses and Rebuttals to the above Criticisms

(a) Differentiated Voting Rights and Principle of Shareholder Equality

One share-one vote is indeed widely regarded as the fundamental principle of modern corporate voting.[13] However, throughout the long history of corporate development, one

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[11] See Liu (n 4 above) p 174.

[12] See Liu (n 4 above) pp 179–180. Another prominent corporate law scholar, Professor Ciyun Zhu, also expressed regret that China has not introduced time-based sunset clauses and argued: "contrary to the majority of conclusions formed in the field of economics through theoretical analysis and empirical research, the benefit of differentiated voting rights structures on corporate development is diminishing over time." Ciyun Zhu *et al.*, "The Introduction of Differentiated Voting System and Innovation to Restrain Corporate Control Rights—From the Perspectives of China and Japan" (2019) 13(2) *Tsinghua University Law Journal* 6, 23 (朱慈蕴，神作裕之：《差异化表决制度的引入与控制权约束机制的创新: 以中日差异化表决权实践为视角》，《清华法学》, 2019 年第 2 期，第 23 页). Many other Chinese domestic scholars also advocate for the adoption of a time-based sunset clause in China. See, eg, Shengjun Liu, "Dual Class Structure in the New Economy: The Theoretical Argument, Practical Experience and Chinese Effective Governance Access" [2020] 1 *Law Science Magazine* 83, 96 (刘胜军：《新经济下的双层股权结构：理论证成、实践经验与中国有效治理路径》，《法学杂志》, 2020 年第 1 期,第 96 页); Qingsong Wang, "Protection of Outside Investors under Corporate Control Enhancing Mechanisms: Taking the Institutional Environment in US and China Concept Stock as Example" [2019] 5 *Global Law Review* 143, 158 (汪青松：《公司控制权强化机制下的外部投资者利益保护——以美国制度环境与中概股样本为例》，《环球法律评论》, 2019 年 第 5 期，第 158 页); Ying Yu and Dedong Liang, "The System Construction of Dual-Class Share Structure in China" (2019) 61(2) *Jilin University Journal* (*Social Science Edition*) 66, 74 (于莹，梁德东：《中国双层股权结构的制度构造》,《吉林大学社会科学学报》, 2021 年第 2 期，第 74 页); Zhaohui Shen, "The 'Sunset Provisions' in the Dual-class Share Structure" [2020] 3 *Global Law Review* 71–84 (沈朝晖：《双层股权结构的"日落条款"》，《环球法律评论》, 2020 年第 3 期，第 71–84 页).

[13] Frank Easterbrook and Daniel Fischel, "Voting in Corporate Law" (1983) 26 *Journal of Law & Economics* 395, 408.

share-one vote has not been the only form. Professor Stephen Bainbridge, a renowned corporate law scholar, has acutely pointed out that the practice of limiting shareholder voting rights is as ancient as the corporate form itself.[14]

In addition to one share-one vote, corporate voting forms also include "one shareholder-one vote" and "limited one share-one vote". The former means that each shareholder, regardless of the number of shares held, has only one vote at the shareholders' meeting. The latter falls between "one share-one vote" and "one shareholder-one vote", where each shareholder has one vote per a certain number of shares until a certain level. For example, the *1837 Act Prescribing General Regulations for the Incorporation of Manufacturing and Mining Companies*, in the United States (US), explicitly stated that shareholders holding up to 15 shares had one vote per share, shareholders holding between 15 and 100 shares had one vote for every five shares, and shareholders holding over 100 shares have one vote for every 20 shares.[15] It can be seen that "one shareholder-one vote" and "limited one share-one vote" are both distinct from "one share-one vote" in terms of corporate power distribution.

A study on the voting rights of 1,200 randomly selected American companies in the early 19th century found that 38% of the companies adopted a one shareholder-one vote structure, while 27% of the companies adopted a limited one share-one vote structure.[16] This means that at that time, 65% of the companies did not follow a one share-one vote principle, and only 35% of the sample companies adopted one share-one vote. Even in the mid-19th century, a study on the voting rights of 135 American companies found that only 32% of the companies had a one share-one vote structure, while the rest either adopted a one shareholder-one vote or a limited one share-one vote model.[17] Accordingly, it is evident that one share-one vote was not always the mainstream choice throughout history. For a significant period of time, restrictions on shareholder voting rights were the foundation for most companies, indicating that differentiated voting rights were once the norm in history.

Professor Colleen Dunlavy, a business historian, finds that the adoption of one share-one vote only started to gain popularity and become mainstream in the late 19th century in the United States.[18] However, in the 20th century, there was a reversal in the trend of one share-one vote. Companies began issuing two classes of ordinary shares: one with voting rights, issued to insider shareholders, and another without voting rights, issued to external investors. This practice gradually became popular across the United States in the 1920s.[19] In the 1980s, the famous wave of takeovers in the United States largely

[14] Stephen Bainbridge, "Understanding Dual Class Stock Part I: An Historical Perspective" (9 September 2017), available at https://www.professorbainbridge.com.
[15] Colleen Dunlavy, "Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights" (2006) 63 *Washington & Lee Law Review* 1347, 1357.
[16] *Ibid.*, 1354–1356.
[17] *Ibid.*, 1358.
[18] One main reason for the shift to the dominance of one share-one vote was to encourage large-scale investments, and such a shift in continental European countries occurred relatively later than in the United States. *Ibid.*, 1359–1360.
[19] Min Yan, "A Control-Accountability Analysis of Dual-Class Share (DCS) Structures" (2020) 45(1) *Delaware Journal of Corporate Law* 1, 11.

contributed to the increasing use of DCSS as a defence weapon against hostile takeovers.[20] In the 1960s, DCSS was also widely adopted by many companies in the United Kingdom, including publicly listed ones, as a defence against hostile takeovers.[21] As a result, even though China currently adheres to the principle of one share-one vote, we should not be path-dependent and consider it as the only orthodox principle, dismissing any limitations on voting rights as deviating from the norm. History has shown us that corporate voting mechanisms can and should be adjusted according to the evolving needs of social and economic development.

Returning to the issue of shareholder equality, the principle of one share-one vote is primarily based on wealth-based equality, while one shareholder-one vote is based on individual equality.[22] Both approaches are forms of equality, but with different criteria and foci. The essence of wealth governance in the former is to entrust governance rights (ie, votes) to a minority of individuals who possess wealth, that is, majority rule by capital. If the pursuit is purely individual equality, the latter, one shareholder-one vote, is actually a more thorough form of equality. For example, in political voting, the principle of one person-one vote is fundamental, and we do not weigh someone's vote based on their wealth or the amount of taxes they pay. Of course, in the context of a company, a governance model that allocates voting power based on wealth is not unacceptable. However, it is not entirely accurate to simply define DCSS as inequality.

Compared to the equality of one shareholder-one vote, the differentiated voting rights in DCSS and one share-one vote seem to have more similarities, as they both concentrate corporate power in the hands of a few individuals — either those with superior voting rights or those with wealth. Thus, perhaps what we should pay more attention to is ensuring fair and equitable treatment of shareholders, where the interests of minority shareholders are not sacrificed for the benefit of controlling shareholders (ie, those with control power), rather than focusing solely on different forms of power distribution.[23]

While the default mode of modern corporate voting arrangement is generally one share-one vote in either common law or civil law jurisdictions, these legal systems do not prohibit alternative voting arrangements.[24] At the same time, shareholder equality is considered one of the fundamental principles of company law in many countries. For example, s 172 of the *Companies Act 2006* (UK) explicitly states that directors must treat shareholders of the company fairly, while also allowing the company's articles of

[20] DCSS can effectively help to ensure that corporate control remains concentrated in the hands of founders via the superior voting shares with weighted voting rights; therefore it has become a highly successful and popular defence weapon against hostile takeovers.
[21] Yan (n 5 above) p 338.
[22] Limited one share-one vote can then be seen as a balance between individual equality and wealth-based equality. It acknowledges the importance of individual equality by granting each shareholder an equal vote up to a certain threshold, while also considering the influence of larger shareholdings beyond that threshold; it attempts to strike a balance between two forms of equality.
[23] In other words, ensuring fair treatment of shareholders is more important than the forms of power distribution.
[24] This is not entirely the same as allowing DCSS companies to go public. For example, although the UK Listing Rules began prohibiting companies with dual-class share structures from listing on the London Stock Exchange's premium listing segment in the early 21st century, the UK Companies Acts have never imposed any DCSS restrictions for non-listed companies or companies listed on London Stock Exchange's standard listing segments.

association to adopt a dual-class or multiple-class share structure.[25] This demonstrates that allowing for differentiated voting rights does not necessarily undermine shareholder equality or fairness.

Moreover, investors as rational economic actors can choose to decide whether voting rights are a vital factor in their stock selection. If a sufficient number of investors do not accept inferior voting rights under DCSS,[26] the share prices of inferior voting shares will reflect this market demand by decreasing, thereby achieving another dynamic equilibrium. For companies, this will result in higher financing costs, which will be an important consideration for founding shareholders when deciding whether or not to adopt DCSS in the first place.

(b) Empirical Research on the Impact of DCSS on Firm Value

While there is empirical research suggesting a negative impact of DCSS on firm value, it is important to acknowledge that the empirical findings regarding DCSS are often inconsistent and conflicting.

Apart from the negative results mentioned earlier, other scholars have conducted empirical studies that find a positive correlation between DCSS and corporate performance. Multiple studies have shown significant improvements in metrics such as sales, employee count, research and development expenditure, and adjusted operating income for companies adopting DCSS.[27] Unlike previous empirical research, new studies have discovered that DCSS can significantly enhance the market valuation of high-growth companies and assist closely-held companies to enhance risk-sharing and foster restructuring that increases corporate focus and strengthens profitability.[28] A recent study analysing data from US companies between 1980 and 2017 found that companies with DCSS tend to have higher valuations, with an average Tobin's Q ratio 13% higher at the end of the IPO year compared to matched non-DCSS companies.[29] Additionally, research

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[25] Case law in both the United Kingdom and the United States has indeed affirmed the validity of differentiated voting rights arrangements. Even in Germany, as a representative country of the civil law system, which Professor Junhai Liu mentioned, the principle of shareholder equality is established through legislation. However, the outline of the German Future Financing Act, currently being prepared by the Federal Government of Germany, also explicitly recognises the positive role of DCSS. It is expected that Germany will soon open up DCSS in its capital markets.

[26] There have been many discussions in academia regarding shareholder homogeneity and heterogeneity, and DCSS undoubtedly provides investors with more choice and meets the requirements for differentiation. See, eg, Ciyun Zhu and Zhaohui Shen, "Classified Shares and the Evolution of Chinese Corporate Law" [2013] 9 *Social Science in China* 144, 148–149 (朱慈蕴、沈朝晖:《类别股与中国公司法的演进》，《中国社会科学》, 2013 年第 9 期, 第 148–149 页); Qiong Fu and Huajie Xiao, "Legislative Path for Constructing the Classified Share System in China's Joint Stock Limited Companies" [2019] 8 *Journal of Southwest Minzu University* (*Humanities and Social Science*) 114, 114 (傅穹，肖华杰：《我国股份有限公司类别股制度构建的立法路径》，《西南民族大学学报(人文社科版)》, 2019 年第 8 期, 第 114 页).

[27] 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; 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, 305.

[28] Jordan, Kim and Liu (n 27 above) 318–320; 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.

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

by the Morgan Stanley Capital International (MSCI), a global index provider, indicates that DCSS companies outperformed the market average between 2007 and 2017.[30]

The differing and sometimes conflicting results in empirical research on DCSS can be attributed to various factors, including different sampling methods, calculation models and macroeconomic conditions. Additionally, it is challenging to determine whether a company's better (or worse) performance is a result of adopting DCSS or if it is the better (or worse) performance that leads to the adoption of such a share structure. Considering that most recent DCSS IPOs belong to the high-tech and innovation sectors, the improved performance might be solely attributed to the specific company's high-growth nature. These aspects are difficult to ascertain and require further empirical research to explore. Consequently, it adds additional complexity to our interpretation of the relationship between DCSS and corporate performance or valuation.

The Chairman of the Institute for Governance of Private and Public Organizations, a Canadian think tank, believes that earlier research on the impact of DCSS on corporate performance tends to be more pessimistic, while recent research results are more optimistic.[31] One important reason for this shift in perspective could be the enhancement of regulatory measures, which have made the drawbacks associated with DCSS more manageable, thereby highlighting their advantages.

From the market perspective, it is evident that the market in general recognises and accepts DCSS. Taking the period from 2017 to 2021 in the United States as an example, 13 tech companies chose DCSS IPOs in 2017, 14 in 2018, 13 in 2019, 19 in 2020 and 55 in 2021. These numbers accounted for 43.3%, 35.9%, 35.1%, 43.2% and 46.2% respectively of all tech IPOs in the United States during those years.[32] In non-tech IPOs, there has also been an increasing trend in the adoption of such share structures. In 2020, 14 non-tech companies went public with DCSS, accounting for 11.6% of all non-tech IPOs that year. In 2021, the number of non-tech companies adopting DCSS increased to 46, representing 23.8% of all non-tech IPOs.[33] If DCSS did not bring positive value to companies, the market acceptance would not be as high as it is.

Looking at the period from 2000 to 2019, a total of 244 Chinese companies were listed on the New York Stock Exchange and NASDAQ in the United States. Among them, 98 companies adopted DCSS, accounting for 40.2% of the total number of Chinese companies listed in the United States during that period. Additionally, 146 companies adopted single-class share structures. During this period, one company converted from a dual-class share structure to a single-class share structure, while five companies converted from a single-class share structure to a dual-class share structure. Excluding these cases, there were 97 DCSS companies and 141 non-DCSS companies. An empirical analysis of this sample found that as of 31 December 2019, 18 DCSS companies had been delisted, accounting for 18.6% of all companies with such share structure, while 79 non-DCSS companies had been delisted, accounting for 56.0% of all companies with this share

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

[31] Yvan Allaire, *The Case for Dual-Class of Shares* (Institute for Governance of Private and Public Organizations, 2018).

[32] Jay R Ritter, *Initial Public Offerings: Technology Stock IPOs* (May 2022), available at https://site.warrington.ufl.edu/ritter/files/IPOs-Tech.pdf.

[33] *Ibid*.

structure.[34] Therefore, in terms of delisting rates, DCSS companies were significantly lower than non-DCSS companies, indicating a higher survival rate.

In short, given these complex empirical results, it is necessary to analyse them with a more dialectical approach rather than only focusing on the negative aspects when evaluating the impact of DCSS on corporate performance and value.

(c) Debate over Time-based Sunset

While Professor Liu Junhai generally holds a reserved attitude towards DCSS, he seems to acknowledge the competitive advantage that companies adopting such share structures may have in the period following their IPOs. However, there is much debate about the specific duration of this period, with some suggesting it is five years, others suggesting from six to nine years, and some even suggesting 11 years. Regardless of the length, this so-called lifecycle effect provides strong evidence for the implementation of time-based sunset clauses as a mechanism for exit within a specified timeframe.

Just as suggested by Professor Zohar Goshen from Columbia University and Professor Assaf Hamdani from Hebrew University, DCSS can better protect visionary founders from short-term market pressures.[35] However, the idea of perpetual retention of superior voting rights seems difficult to justify. Taking Viacom Inc as an example, despite approximately 90% of the company's shares being held by public shareholders, the founding shareholder maintained control via superior voting shares under DCSS for 26 years. However, in 2016, the 93-year-old founding shareholder, who also served as the CEO, was sued by other shareholders on the grounds of lacking legal capacity.[36] It is evident that exceptional leadership abilities may diminish over time due to aging and changes in the business environment. The potential value of DCSS can gradually erode as well. In other words, a currently successful founder or outstanding leader may lose their foresight after 10 or 20 years, or their leadership skills may become outdated. So, is a time-based sunset clause truly a perfect solution?

Firstly, looking at the major capital markets worldwide, it is worth noting that currently only the LSE has implemented a time-based sunset clause in its premium listing segment.[37] Although the HKEx, SGX and SSE adopted strict restrictions on DCSS listing, they have not adopted time-based sunset clauses. This indicates a degree of reservation towards implementing sunset clauses as a means of imposing a time limit for exit.

An important reason for this is that any arbitrary time-based sunset clause cannot accurately determine the appropriate *deadline*. Just as empirical research cannot definitively establish whether DCSS companies can maintain their advantages for five years or 11 years after an IPO, any specific time limit would be difficult to justify. For example, why should all superior voting shares convert to ordinary voting shares after seven years and not six or eight years? Well-known companies like Google and Facebook

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[34] Fa Chen, "Does the Dual-Class Share Structure Help Stock Markets Attract Issuers? Empirical Lessons from Global Financial Centres" (2023) 43 *Legal Studies* 159, 162. Additionally, among the remaining 79 DCSS companies, their total market valuation is 898.9 billion USD, whereas the total market valuation of the 62 companies with single-class share structures is only 117.6 billion USD. *Ibid*.

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

[36] Lucian Bebchuk and Kobi Kastiel, "The Untenable Case for Perpetual Dual-Class Stock" (2017) 103 *Virginia Law Review* 585, 587–588.

[37] London Stock Exchange's other listing segments do not have such restrictions.

have maintained their superior voting rights under DCSS for more than 10 years, and it may be precisely because of this that they have become great technology companies. If the superior voting shares held by founding shareholders were forcibly converted to ordinary voting shares after five or seven years, perhaps Google or Facebook would not be what they are today.

More importantly, time-based sunsets may exacerbate self-interested behaviour by shareholders with superior voting rights as the sunset deadline approaches. If shareholders with superior voting rights know that their shares will soon be permanently converted into ordinary voting shares with one vote per share, the probability of them abusing their control rights for rent-seeking purposes could significantly increase. Accordingly, the risk of increased agency costs in the face of imminent loss of control may far outweigh the benefits of the time-based sunset clause.[38]

Perpetual retention of superior voting rights under DCSS is essentially equivalent to the perpetual retention of control by corporate founders. However, the contributions of founders to the company cannot be perpetual, which is why this article agrees that perpetual retention is inappropriate. For example, when a founding shareholder with superior voting rights retires or is not able to participate in the corporate management anymore, it no longer makes sense for them to retain their superior voting rights, as seen in the case of Viacom Inc mentioned above. However, instead of arbitrarily setting a time deadline for automatic conversion of superior voting shares into ordinary voting shares, a more feasible option may be to rely on an event-based sunset mechanism, which would sunset superior voting shares depending on the occurrence of a particular event. For instance, when a founding shareholder no longer serves as a director or is no longer able to make substantial contributions to the company's development, the event-based sunset clause could be triggered, thereby ending the differentiated voting rights under DCSS. This is also why most leading stock exchanges, including the SSE, have adopted event-based sunset rather than time-based sunset.

Even in the United Kingdom, where a time-based sunset clause is adopted, there has been strong criticism of this approach. For instance, some scholars argue that this time-limited DCSS is not a true DCSS but rather "a five-year, takeover-blocking golden share and a five-year guaranteed founder board seat".[39] While it may address concerns of founders being acquired shortly after going public, more entrepreneurs will continue to seek listings on overseas exchanges such as New York, Hong Kong or Singapore, or choose to keep their firms private. The side effect brought about by time-based sunset clauses may deter many entrepreneurs from considering LSE's premium listing segment as an IPO destination.

(d) Corporate Governance Risks under DCSS

Before analysing the additional corporate governance risks and agency costs caused by DCSS, we must first acknowledge the rational apathy and collective action problems in

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[38] See, eg, Lucian Bebchuk and Kobi Kastiel, "The Perils of Small-Minority Controllers" (2019) 107 *Georgetown Law Journal* 1453, 1470–1474. Also see Charlie Xiao-chuan Weng and Jingjing Hu, "Every Sunset Is an Opportunity to Reset: An Analysis of Dual Class Share Regulations and Sunset Rules" (2021) 22 *Journal of Corporate Law Studies* 571–603.

[39] Booby Reddy, "Up the Hill and Down Again: Constraining Dual-Class Shares" (2021) 80 *Cambridge Law Journal* 515, 550. Further, such limitation is also going to be relaxed by the UK regulator, see n 47 and accompanying text below.

non-DCSS companies. Under the one share-one vote structure, most shareholders may choose to free-ride and not to actively participate in voting.[40] Furthermore, due to information asymmetry, lack of expertise and biases towards management, even if these shareholders exercise their voting rights, they are likely to make suboptimal decisions or steer the company in the wrong direction. This applies not only to retail shareholders but also to index funds and exchange-traded funds, which have become mainstream investment vehicles but typically passively track market indices and aim to match their performance. These passive funds often lack the motivation to allocate resources to understand company-specific information, and their voting is therefore unlikely to enhance corporate value.[41] Thus, weakly-motivated voters can undermine the influence of informed voters in exercising discretion or oversight. Conversely, DCSS concentrate voting power among those shareholders who have a deep understanding of the company and have sufficient motivation to vote. Importantly, in the context of heterogeneous shareholders, different shareholders may make inconsistent choices based on their preferences, thereby impacting the company's development.[42] Therefore, selectively concentrating voting rights among shareholders may not necessarily be a bad thing for a company.

Moreover, even in companies with a single-class share structure, the agency costs between majority and minority shareholders do not disappear. Controlling shareholders are always tempted by various opportunities to pursue the private benefits of control.[43] Even if they hold a majority of equity shareholdings, such as 80%, they still have the desire to pursue personal interests because doing so allows them to capture 100% of the private benefits while only bearing 80% of the costs.[44]

It is undeniable that as the ownership stake decreases, the costs of self-interested behaviour will also decrease, while the motivation to pursue private benefits will increase. Therefore, the differentiated voting rights under DCSS can indeed exacerbate this distortion of incentives, increasing the moral risk of founders compromising the interests of other shareholders for personal gain. However, these potential corporate governance risks or moral risks are not entirely uncontrollable. If appropriate regulatory measures can be implemented to mitigate these risks, then the drawbacks of a DCSS can be effectively controlled, which will be discussed in more detail in the next chapter.

4. Safeguarding Measures to Address Corporate Governance Risks under DCSS

(a) Raising Admission Criteria and Restricting the Exercise of Superior Voting Rights

Proponents and opponents of DCSS have contrasting views on the decoupling of voting rights from ownership rights. However, they generally agree that the increased corporate

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[40] Dorothy Lund, "Nonvoting Shares and Efficient Corporate Governance" (2019) 71 *Stanford Law Review* 687, 696.

[41] For more discussion, see Yan (n 5 above) pp 353–354.

[42] Easterbrook and Fischel (n 13 above) p 405.

[43] Ronald Gilson, "Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy" (2006) 119 *Harvard Law Review* 1641, 1663–1664.

[44] Such misalignment of incentives can still lead to conflicts of interest and potential exploitation of minority shareholders by controlling shareholders. For more discussion on the exacerbated "shirking" and "tunnelling" in DCSS companies due to the decoupling of voting rights from cash flow rights, see Junzheng Shen, "The Anatomy of Dual Class Share Structures: A Comparative Perspective" (2016) 46 *Hong Kong Law Journal* 477, 481–483.

governance risks and agency costs resulting from the decoupling are primarily due to the weakened protection of minority shareholders.[45] In comparison to a single-class share structure, minority shareholders holding ordinary or restricted voting shares are in a more vulnerable position when faced with controlling shareholders holding superior voting shares in a DCSS company. However, the corporate governance risks associated with self-dealing and other self-interested behaviours can be mitigated by restricting the exercise of superior voting rights and implementing strict regulations. This approach enhances the protection of minority shareholders holding inferior voting shares. That is why the current policy debates in countries like the United Kingdom and the United States are shifting from discussions on the pros and cons of DCSS (namely, whether to allow or prohibit such share structures in their securities markets) to focusing more on how to enhance investor protection, particularly for minority shareholders.

Regardless of whether it is in Asian markets like Hong Kong and Singapore or in Europe's United Kingdom, strict regulatory measures have been added to the respective listing rules when approving the DCSS listing. These safeguarding measures aim to mitigate the additional corporate governance risks that DCSS may pose. For example, Hong Kong and Singapore have set higher minimum market capitalisation requirements for DCSS companies seeking listing compared to non-DCSS companies. They have also imposed enhanced disclosure obligations upon such companies to facilitate market supervision. In terms of constraining the exercise of superior voting rights, Hong Kong, Singapore, and the United Kingdom have imposed restrictions on the maximum ratio between superior voting rights and ordinary voting rights. Companies listed on the HKEx and SGX cannot exceed a ratio of 10:1, while on the LSE cannot exceed 20:1. Additionally, when it comes to fundamental corporate changes (such as amendments to the articles of association, mergers, division, dissolution or changes in legal form) or decisions that may involve conflicts of interest (such as the appointment and removal of independent directors and/or external auditors), the superior voting rights are temporarily converted to one vote per share. Sunset provisions, in various forms, have also been adopted by different capital markets to better constrain the exercise of superior voting rights. Many stock exchanges that allow DCSS listings, except for the United States, employ event-based sunsets, where superior voting shares are permanently converted to ordinary voting shares when a specific event occurs (such as the transfer of superior voting shares or when the holder no longer serves as a director). The LSE is currently the only major global financial centre that adopts a time-based sunset. The FCA, the regulator of UK financial markets and the UK Listing Authority, has mandated a sunset clause of five years for DCSS companies listed on the LSE's premium listing segment, meaning that all superior voting shares will be converted to ordinary voting shares on a one vote per share basis five years after the company's IPO.[46] However, even the FCA is now considering to double it to a 10-year limit with the aim of mitigating the adverse effects on attracting potential high-growth firms from opting to list with such share structures.[47]

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[45] See, eg, Yan (n 1 above) pp 397–432. The empirical evidence discussed in the previous chapter also provides strong support for the notion that the decoupling of control rights and ownership can lead to increased agency costs and a positive correlation between the cash flow rights (ownership) of founding shareholders and the company's valuation.

[46] See UK Listing Rules, 9.2.22AR.

[47] FCA, *Primary Markets Effectiveness Review - Feedback to DP22/2 and the Proposed Equity Listing Rule Reforms: Consultation Paper CP23/10* (2023) 1, 34.

(b) The Regulatory Mode in Mainland China

China has adopted strict *ex ante* regulatory measures similar to those in Singapore and Hong Kong to address potential corporate governance risks associated with DCSS, particularly the possibility of exploitation by shareholders with superior voting rights.[48]

Firstly, more stringent requirements for admission criteria and minimum market capitalisation have been established for DCSS listing applicants. For example, any company intending to apply for a DCSS IPO must: (1) have an estimated market capitalisation of no less than RMB10 billion; or (2) have an estimated market capitalisation of no less than RMB5 billion and made an operating revenue of no less than RMB500 million during the previous year.[49] These thresholds are significantly higher than those for non-DCSS listing applications.[50] Meanwhile, since DCSS are only adopted by companies applying for listing on the SSE's Star market (namely, Science and Technology Innovation Board), similar to the HKEx and SGX, only technology or innovation firms are eligible to apply DCSS IPOs.

Secondly, disclosure requirements have been strengthened for DCSS companies. Listed DCSS companies are required to make a full and detailed disclosure of information, especially regarding the corporate governance risks associated with DCSS and corresponding shareholder protection mechanisms.[51] The board of supervisors is also required to provide its specific opinions on the compliance with the foregoing investor protection mechanisms and any potential abuse of superior voting rights in the company's annual report.[52] Enhanced disclosure obligations are designed to promote transparency, reduce the cost and difficulty for investors to obtain information and facilitate market supervision.

Thirdly, the exercise of superior voting rights is constrained through sunset clauses. Automatic conversion provisions for differentiated voting rights under DCSS are mandated for any of the following situations, including: (1) failing to meet their eligibility and minimum shareholding requirements; (2) the shareholder with special voting rights loses their actual control of shares; (3) the shareholder with special voting rights transfers these special voting shares, or delegates the exercising of special voting rights to others; and (4) the controller of the company is changed.[53] The event-based sunset also includes "ownership-based sunset", where DCSS is terminated when the portion of superior voting shares falls below 10% of all outstanding voting shares issued by the company.[54]

Restrictions on the exercise of superior voting rights are also reflected in matters involving fundamental corporate changes or potential conflicts of interest. In cases like (1)

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[48] As the regulatory measures on DCSS in China have already been discussed in detail elsewhere, eg, see Min Yan, "Differentiated Voting Rights Arrangement under Dual-Class Share Structures in China: Expectation, Reality and Future" (2020) 28 *Asia Pacific Law Review* 337, 345–351, this article will only touch upon them briefly.

[49] SSE's Star Market Listing Rules, art 2.1.4.

[50] SSE's Star Market Listing Rules, art 2.1.2(1) specifies that a listing applicant shall: (1) have an estimated market capitalisation of no less than RMB1 billion and made a positive net profit during the last two years totalling to no less than RMB50 million; or (2) have an estimated market capitalisation of no less than RMB1 billion and made a positive net profit and an operating revenue of no less than RMB100 million during the previous year.

[51] *Ibid*., art 4.5.1.

[52] *Ibid*., art 4.5.12.

[53] *Ibid*., art 4.5.9.

[54] *Ibid*., arts 4.5.9(1), 4.5.3.

amendments to the company's articles of association; (2) change of number of voting rights for superior voting shares; (3) the appointment or dismissal of independent directors; (4) the engagement or dismissal of an accounting firm which issues audit opinions on the periodic reports of the company; and (5) the merger, division, dissolution or change of legal form of the company, superior voting rights shares temporarily have the same voting rights as ordinary voting shares.[55]

Finally, following the logic underlying ownership-based sunset, to effectively restrict the unlimited dilution of the proportion of shareholdings with superior voting rights and control agency costs, the voting rights of each superior voting share are stipulated not to exceed 10 times the voting rights of each ordinary voting share.[56] Meanwhile, listed DCSS companies must ensure that shareholders with inferior voting rights shall have at least 10% of corporate voting rights.[57] On the other hand, shareholders who individually or collectively hold more than 10% of the issued ordinary shares can call for an extraordinary shareholder general meeting.[58] This effectively means that even if the votes held by these shareholders are below 10% of all votes, they can call for an extraordinary shareholder general meeting as long as they have 10% of all issued voting shares.

5. Implications of Strict Safeguarding Measures

(a) Market Reactions

When discussing whether stricter regulations, including the introduction of time-based sunset clauses, should be imposed on DCSS companies, it is worth recalling that why DCSS listings were permitted in the first place.

With intensified global competition, many stock exchanges believed that allowing the listing of DCSS companies was a necessary step to maintain competitiveness in cross-border IPO activities. Whether it is Hong Kong, Singapore, the United Kingdom, or mainland China, the permission of DCSS listing was aimed at increasing the flexibility of their respective capital markets to attract or retain more technology and innovation firms. For example, the Chairman of the Hong Kong Securities and Futures Commission said: "[Allowing DCSS companies 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."[59] The amendments to the UK Listing Rules at the end of 2021 were also primarily driven by the aim to catch up with this trend and make London a more attractive destination for entrepreneurs to take their companies public.[60]

An important judging criterion for the success of DCSS is the level of market acceptance, specifically whether companies are willing to adopt such a share structure and successfully go public with it. If newly listed companies are not willing to adopt DCSS, it indicates that the structure and its accompanying measures are not successful. Taking

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[55] In other words, superior voting shares will temporarily convert to ordinary voting shares. *Ibid*., art 4.5.10.
[56] *Ibid*., art 4.5.4.
[57] *Ibid*., art 4.5.7.
[58] *Ibid*.
[59] Enoch Yiu, "Securities Commission Backs Introduction of Dual-Class Shares on Hong Kong Stock Exchange" *South China Morning Post* (20 December 2017), available at https://www.scmp.com/business/companies/article/2124972/securities-commission-backs-introduction-dual-class-shares-hong.
[60] "HM Government UK Listings Review: Response" (21 April 2021), available at https://www.gov.uk/government/publica tions/uk-listings-review/uk-listings-review-government-response.

mainland China as an example, from the time when the SSE allowed the DCSS listing until 31 December 2021, a total of 371 companies were listed on its STAR market, but only four companies (UCloud Technology Co, Ltd (688158), Jing-Jin Electric Technologies Co, Ltd (688280), Sichuan Huiyu Pharmaceutical Co, Ltd (688553) and Ninebot Ltd (689009)) adopted DCSS. In the Shenzhen Stock Exchange's ChiNext board, which allowed DCSS listing from June 2020, to the end of December 2021, a total of 279 companies were listed, but none of them adopted DCSS. Taking the HKEx as another example, from the lifting of the ban on DCSS listing on 30 April 2018, until 31 December 2021, a total of 322 Chinese companies were listed on its main board; however, only 6 companies (Xiaomi Corp (1810), Meituan (3690), Kuaishou Technology (1024), Bairong Inc (6608), Linklogis Inc (9959) and SenseTime Group Inc (0020)) adopted DCSS. These figures indicate that the adoption of the DCSS by companies in these markets has been relatively limited, suggesting a cautious approach and a lower level of market acceptance.

Is this situation caused by a decrease in demand for DCSS by companies or the market? From the launch of the SSE's STAR market on 13 June 2019 and to the end of 2021, a total of 82 Chinese companies were listed in the United States, with 47 of them adopting DCSS, or 57%.[61] Upon further observation of these 47 companies, it is found that 12 of them fail to meet the minimum market capitalisation or revenue requirements specified in the STAR Market Listing Rules, while 13 companies cannot comply with the maximal voting difference of 10:1 between superior voting shares and inferior voting shares, and an additional eight companies fail to meet both these requirements.[62] In other words, out of the 47 Chinese companies listed in the United States with DCSS, 33 of them would not have met the listing criteria if they had chosen to list on the SSE in China, accounting for a high proportion of 70%. As a result, the demand still exists, but due to the strict admission thresholds and restrictions imposed by Chinese regulators, companies hoping to go public with DCSS have opted for other IPO destinations with their feet.

(b) The Unintended Consequences of These Stringent Measures

Strict admission criteria and regulatory measures can certainly effectively reduce the likelihood of abuse of superior voting rights by founding shareholders and the infringement of minority shareholders in DCSS companies. However, the accompanying side-effects of these safeguarding measures should not be ignored. For example, the previous discussion on time-based sunset provisions indicates that while their purpose is to terminate DCSS after a specific period, converting all superior voting shares into ordinary voting shares to protect minority shareholders, the accompanying side-effect is that as the sunset deadline approaches, the probability of shareholders with superior voting shares abusing their weighted voting rights significantly increases because they are faced with the imminent loss of control, thereby increasing agency costs.[63]

Another more explicit example is the restriction on the maximal ratio of voting rights differentials between superior and inferior voting shares. This ratio determines the

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[61] From 30 April 2018 (the day when the HKEx allowed DCSS listing) to 31 December 2021, a total of 120 Chinese companies were listed in the United States, with 74 of them adopting DCSS. See Chen (n 34 above) p 164.

[62] See nn 49 and 56above.

[63] See, eg, Bebchuk and Kastiel (n 38 above); also see Junzheng Shen, "Constructing the Regulatory Regime of Dual Class Share Structures From the Perspective of Private Benefits of Control" (2021) 33(3) *Peking University Law Journal* 819, 831–834 (沈骏峥：《论双重股权结构监管制度的构建 以控制权利益的内涵为视角》，《中外法学》, 2021 年第 3 期, 第 831–834 页).

percentage of share ownership required for founders to retain control. When the ratio is 2:1, which means Class A shares have two votes per share and Class B shares have one vote per share, the founding shareholders holding Class A shares need to hold at least 33.4% of the company's shares to retain control (ie, exceeding 50% of the voting rights).[64] If the ratio increases to 3:1 or 4:1, the founding shareholders only need to hold a little more than 25% or 20% of the shares, respectively.[65] If the ratio becomes 10:1, the founding shareholders can reduce their ownership to 9.1% without affecting their majority control over the company.[66] It is evident that as the upper limit of this ratio increases, founders with these superior voting shares can significantly reduce their shareholdings without losing control, thereby widening the disparity between control rights and cash flow rights. In the case of TerraForm Global, a NASDAQ listed company, Class A shares have one vote per share, while Class B shares have 100 votes per share,[67] meaning Class B shareholders only need 1% ownership to retain majority control of the company. Therefore, scholars and institutional investors who hold reservations about DCSS often call for limits on the maximal voting rights differentials.

However, if the upper limit is set too low, it will significantly deprive founding shareholders of the ability to obtain returns from external equity financing while retaining control, and it will not sufficiently protect visionary founders from short-term market pressures. For example, reducing the maximal voting rights differentials to a ratio very close to 1:1 would minimise the corporate governance risks arising from DCSS, but it would also erode the inherent value of such share structures. Thus, strict regulatory measures are a double-edged sword. On the one hand, they can reduce the potential corporate governance risks associated with DCSS, but on the other hand, they will weaken the original value of such share structure, which is the ability to allocate control rights and cash flow rights in a disproportionate manner.

6. The Way Forward

(a) Ex ante Restrictions vs Ex post Remedies

In response to the governance risks that allowing company founders to hold a small percentage of equity shareholdings while retaining control in a DCSS company may pose, especially the risks to minority shareholders, there are currently two main approaches, namely the *ex ante* restrictions and *ex post* remedies.

The United States is a prominent country that adopts the approach of *ex post* remedies. Due to its robust litigation system and culture, including class-action lawsuits and contingency fee systems, the United States currently maintains a fully open attitude towards DCSS listing, without imposing any additional admission or regulatory requirements. When the interests of minority shareholders are infringed upon due to the abuse of superior voting rights, they can seek protection and remedies under the existing legal framework. In contrast, many other jurisdictions, including the United Kingdom, Singapore and Hong Kong SAR of China, have adopted a more conservative regulatory approach of *ex ante* restrictions in recent reforms when permitting DCSS listing. They

[64] 100 ÷ (1+2) ≈ 33.4%.

[65] 100 ÷ (1+3) = 25%; 100 ÷ (1+4) = 20%.

[66] 100 ÷ (1+10) ≈ 9.1%. For more detailed discussion, see Yan (n 19 above) p 17.

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

impose strict requirements that all listed companies seeking differentiated voting rights arrangements must meet in advance to reduce the potential risk of harming minority investors.

As exhibited above, the regulatory model currently adopted in mainland China is mainly based on *ex ante* restrictions, which require DCSS listing applicants to revise their articles of association in advance and comply with corresponding admission and regulatory requirements. Compared to the United States, mainland China has more similarities with Hong Kong and Singapore in terms of concentrated shareholding structures and similar historical and cultural traditions. Moreover, China's *ex post* remedial mechanism is not yet fully developed, making strict *ex ante* restrictions indispensable at this stage.

By comparing the safeguarding measures for minority shareholders in DCSS companies in the amended Listing Rules issued by the HKEx and the SSE in April and June 2018 respectively, mainland China's Listing Rules cover almost all commonly used safeguarding mechanisms.[68] In addition, mainland China only allows companies listed on the SSE's STAR market to adopt DCSS and sets a requirement for the minimal proportion of superior voting shares out of all outstanding voting shares, which is a continuous obligation.[69] Non-compliance with this obligation will trigger a mandatory sunset provision to terminate superior voting shares under DCSS.[70] Accordingly, it can be said that China's *ex ante* restrictions are more stringent.

Whether it is raising admission criteria, imposing restrictions on the maximal voting differentials between superior and ordinary voting shares, or implementing mandatory sunset clauses, they all fall under the category of *ex ante* restrictions. Their objective is to prevent or reduce potential irresponsible and self-interested behaviour by constraining the ability of founders to exercise their superior voting rights. In contrast, *ex post* remedial strategies mainly focus on how aggravated shareholders can seek effective remedies once there is abuse of these superior voting rights. Since strict *ex ante* restrictive measures often overly constrain the exercise of control rights by founders, thereby compromising the value of superior voting rights under DCSS, we should not overlook the role of *ex post* remedial mechanisms.

(b) Some New Regulatory Strategies

The current focus on *ex ante* safeguarding measures, such as time-based sunset clauses and maximal voting differential, may lead DCSS into a deadlock. It restricts the ability of entrepreneurs and founders to retain control after raising external capital, which goes against the original purpose of allowing DCSS companies to go public. Additionally, the deterrents and restrictions under the *ex ante* mechanisms are based on assumptions of corporate governance risks and potential increases in agency costs brought about by DCSS, without evidence of widespread abuse of superior voting rights.[71] As a result, it may be time to reduce the mandatory *ex ante* restrictions on the eligibility of DCSS companies to go public, as well as the restrictions on how founding shareholders with superior voting rights exercise their control power.

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[68] Except that no unique stock code is provided to DCSS companies listed on the SSE.
[69] SSE's Star Market Listing Rules, art 4.5.3.
[70] *Ibid*., art 4.5.9(1).
[71] *Ex ante* mechanisms may also be more difficult to justify compared with those *ex post* remedial mechanisms since no abuse of weighted voting rights has actually occurred.

A feasible solution is to reduce the mandatory *ex ante* restrictions on the DCSS listing. For example, lowering the admission criteria,[72] relaxing the maximal voting differentials between superior and ordinary voting shares, and setting a lower minimal proportion of superior voting shares out of all outstanding voting shares can provide greater flexibility. This can be accompanied by more robust *ex post* remedial mechanisms. Firstly, when the abuse of superior voting rights under DCSS harms the interests of the company or minority shareholders, allowing minority shareholders to engage in class-action lawsuits would effectively reduce the difficulty and cost of seeking remedies and deter founding shareholders from attempting to abuse superior voting rights. The revised Chinese Securities Law, implemented at the end of 2019, allows aggrieved investors to initiate representative civil litigation against the company for fraudulent disclosure.[73] By the same token, when the legitimate rights of minority shareholders are harmed by shareholders with superior voting rights, the aggrieved shareholders should also be allowed to engage in class-action lawsuits. By improving the contingency fee system and reducing the cost of litigation risks, minority shareholders can be encouraged to actively seek remedies.

Secondly, the China Securities Investor Services Centre (ISC), a unique institution serving small and medium-sized investors in China, can provide support for public interest litigation. The ISC holds shares of each listed company on the Shanghai and Shenzhen stock exchanges and can exercise relevant shareholder rights, including litigation, on behalf of shareholders in DCSS companies where the superior voting rights are abused. Furthermore, the newly revised Chinese Securities Law also stipulates that the ISC can participate in securities litigation as a representative of investors when entrusted by more than 50 investors.[74] Meanwhile, the ISC can educate retail investors and raise awareness of the risks associated with DCSS, allowing the investors to make investment decisions after fully considering the potential benefits and costs of such share structures. Thus, the ISC can play an important role in protecting minority shareholders in listed companies with DCSS.

In short, China currently adopts a strict *ex ante* screening and preventive regulatory mechanism but lags behind in terms of *ex post* remedial mechanisms. Being more focused on *ex ante* measures than *ex post* measures will result in higher regulatory costs. Therefore, it is necessary to explore the establishment of a regulatory mechanism that covers both *ex ante* and *ex post* measures. Such mechanisms should effectively protect minority shareholders while reducing the difficulty and cost of listing for DCSS companies, thus achieving the original institutional purpose of permitting DCSS. Such a strategy will also better respect private ordering, allow the market to make choices, and let investors vote

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[72] Some scholars even suggested the complete removal of the minimum capitalisation requirement. See, eg, Li Guo and Yuchen Peng, "Regulating the Listed Companies with Dual-Class Share Structure: International Experiences and Reflective Takeaways for China" (2019) 56(2) *Journal of Peking University (Philosophy and Social Sciences)* 132, 143 (郭雳，彭雨晨：《双层股权结构国际监管经验的反思与借鉴》,《北京大学学报(哲学社会科学版)》, 2019 年第 2 期, 第 143 页); Yan Li and Li Li, "Dual Share Class under Corporate Governance: the Basis of Legitimacy and the Implementation Path of Localization" (2021) 39(4) *Hebei Law Science* 82, 93–94 (李燕，李理：《公司治理之下的双层股权结构: 正当性基础与本土化实施路径》,《河北法学》, 2021 年第 4 期, 第 93–94 页).

[73] *Chinese Securities Law 2019*, art 95.

[74] *Ibid*., art 95(3).

with their feet.[75] If there are no or very few companies choosing to go public with DCSS, allowing such share structures will be in vain and China will continue to lose high-quality listing resources.

This is not only for China but also for other jurisdictions that have recently permitted DCSS listings with stringent constraints. For example, the mandatory time-based sunsets and the restrictions on the exercise of enhanced voting rights for DCSS companies under the UK listing rules are criticised for failing to attract growth companies to list on the LSE.[76] Likewise, the very low number or absence of DCSS listings in the Hong Kong and Singapore should prompt policymakers in these regions to seriously reconsider their own stringent preventive regulatory mechanisms. Moreover, as increasing global competitiveness is a primary motivation for those leading financial centres to allow DCSS listings in the first place, further relaxing the constraints imposed on DCSS would be essential to achieve the overarching policy goal of attracting growth and innovative firms to list on their exchanges.[77]

7. Conclusion

Based on experiences from other jurisdictions and empirical data, this article critically examines DCSS and responds to the main criticisms against such share structures in the context of China. Firstly, by exploring the historical development of corporate voting and analysing different forms of shareholder equality, it concludes that the existence of differentiated voting rights under DCSS is legitimate and has a historical inevitability. Accordingly, it is unnecessary to overreact or simply equate differentiated voting rights with inequality or lack of shareholder democracy. Secondly, the potential costs associated with DCSS can be offset by its benefits. At the micro level, it provides greater capital structure flexibility for companies and allows visionary entrepreneurs to pursue their unique visions and long-term development without being influenced by short-term market pressures. At the macro level, it enhances the competitiveness of the securities market and facilitates the listing of high-tech and innovative companies, thereby expanding the capital market.

The increased corporate governance risks associated with DCSS can be effectively controlled through corresponding mandatory safeguards and regulatory measures. For example, introducing sunset clauses, limiting the maximal voting differentials between superior voting shares and ordinary voting shares and raising corporate governance standards (such as enhanced disclosure obligations) can mitigate the governance risks and agency costs arising from the decoupling of control rights from ownership rights. Thus, the debate over DCSS should shift from whether such share structures shall exist to how to restrain potential governance risks and protect minority shareholders more effectively. In

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[75] Policymakers and regulators should focus here on enhancing disclosure obligations for DCSS companies and better assisting the market in fulfilling its own role.

[76] Bobby Reddy, "The UK and Dual-Class Stock-Lite – Is It Really Even Better Than the Real Thing?" *University of Cambridge Faculty of Law Research Paper No. 18/2023*, available at http://dx.doi.org/10.2139/ssrn.4436612.

[77] For instance, the United Kingdom has swiftly altered its stance on DCSS listings and prepares to further loose the rules in order to lure growth firms and increase the competitiveness of its stock exchange. Ibid. Furthermore, beyond the issue of competitiveness, any prospective alteration to the rules governing DCSS in Mainland China could significantly impact the capital markets in Hong Kong and Singapore. This is because the vast majority of applicants for DCSS in these jurisdictions are from mainland China.

other words, we should focus on making DCSS listing better, rather than getting caught up in the debate of whether or not to allow DCSS listing.

The essence of these stringent safeguards and regulatory measures to mitigate corporate governance risks is to restrain the exercise of superior voting rights under DCSS and subject them to the constraints of external investors and market pressures. However, these measures intentionally or unintentionally weaken founders' control over the company. Consequently, while stringent *ex ante* safeguarding measures play an important role in protecting minority shareholders, we also need to recognise that they may reduce the attractiveness of DCSS to visionary entrepreneurs and founders. This explains the gap between policymakers' expectations regarding such share structure and the actual situation of DCSS listing in major financial centres in Asia (Hong Kong, Singapore and Shanghai). The primary institutional purpose of permitting DCSS listing is to ensure that founding shareholders can create more value by implementing their unique business ideas without worrying about market pressures. Any regulatory measures should not overshadow this primary value.

This article argues that while investor protection is important, excessive safeguards undoubtedly affect the intrinsic value of DCSS. Therefore, policymakers and regulators should focus on how to strike a balance between maintaining a flexible capital structure and controlling governance risks through exploring more *ex post* remedial mechanisms, to reduce the overreliance on the stringent *ex ante* measures. While easing some of these stringent *ex ante* measures might not be the elixir for addressing the low take up of DCSS among new IPOs, it does at least present a significant step in the right direction. Specifically, in mainland China, in addition to the current *ex ante* restrictive measures, both policymakers and scholars need to actively explore the class-action lawsuits under the newly revised Chinese Securities Law and the role that the China Securities Investor Services Centre can play in DCSS companies. Rather than simply raising admission criteria and imposing stricter limitations, it is essential to establish a comprehensive and balanced regulatory mechanism based on both *ex ante* and *ex post* strategies. This will reduce the difficulty of DCSS listing in the near future without compromising the protection of minority shareholders, and truly unleash the value of such share structures.