Dual-class shares: a governance battle between stock exchanges / *The case of the UK*

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SUMMARY*: I. Introduction. II. Main concerns. a. Private benefits of control as key component. b. Reverse causality to investor protection. c. Is there any real need for regulation? III. UK listing framework. a. Listing Principle and Rule. b. General principle. c. Factors/conditions. d. General assessment. e. Underlying principles – the reform as a whole. f. Recent developments. IV. EU say on the matter – from no-regulation to loyalty shares (?). a. No-regulation. b. Loyalty shares – is the UK prepared for these? V. Recent trends in major stock indices. a. US. b. Canada. c. Hong Kong. d. Singapore. e. Dialogue with the UK reform. VI. Final remarks – what to expect next? VII. A glimpse on the Portuguese case. VIII. Conclusions.*

ABSTRACT: Countless studies have been produced over the last decades about dual-class shares and there are no signs of slowing down. These studies have been trying to track changing trends on the adoption of such structures – a train which appeared to have slowed over the last few decades, but which has gained a new thrust in recent years. Several legal systems around the world have been bringing disproportionate voting structures back into the spotlight and altogether reveal that firms are not ready yet to give up on these. The UK plays an uncertain role in this reform movement: important changes were introduced to the premium listing regime, although it is not clear if those will shift the status quo in London: this type of shares is rather unpopular. This article aims to shed light into this topic by going into the root of the UK current premium listing regime on dual-class shares and bringing it into dialogue with recent changes and trends in major stock indices[1].

[1] This article is based on the dissertation with the title "*Dual-class share structures in UK premium listed companies – closing an opened door or opening a closed door?*", submitted by the Author as part of the Master's in Law (LL.M.) in International Financial Law, in King's College London (2015/2016). I am grateful to Professor Eva Lomnicka for her critical and supportive supervision.

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KEYWORDS: Dual-class shares, private benefits of control, controlling and non--controlling shareholders, agency costs, corporate governance, stock exchanges.

RESUMO: Inúmeros estudos foram produzidos nas últimas décadas em torno das chamadas ações de dupla categoria ("dual-class shares"), e não existem sinais de abrandamento. Estes contributos têm procurado acompanhar as diversas tendências associadas à adoção destas estruturas – um comboio que parecia ter abrandado nas últimas décadas, mas que ganhou um novo impulso nos anos mais recentes. Vários sistemas jurídicos em todo o mundo têm vindo a trazer estas estruturas de voto desproporcional de novo à colação, e no seu conjunto revelam que as empresas ainda não estão dispostas a desistir do seu recurso. O Reino Unido assume um papel incerto nestes movimentos de reforma: foram introduzidas alterações importantes às regras de mercado regulamentado, embora não seja claro se terão o condão de modificar o status quo em Londres: este tipo de ações é raro. Este artigo pretende focar neste tema, partindo das bases regulatórias em torno das ações de dupla categoria vigentes no Reino Unido e convocando-as para um diálogo com as mais recentes alterações e tendências registadas em importantes índices bolsistas.

PALAVRAS-CHAVE: Ações de dupla categoria, benefícios privados do controlo, acionistas com e sem participação de controlo, custos de agência, regras de governo societário, mercados bolsistas.

I. **Introduction**

1. Countless studies have been produced over the last decades about dual-class shares ("*DCS*") and there are no signs of slowing down. Three levels of discussion were identified – *(i)* the theoretical debate on the efficiencies and risks arising from the adoption of these instruments; *(ii)* the empirical studies on the impact of these structures on firm value; and *(iii)* the construction of a regulatory environment to fit the conclusions under *(i)* and *(ii)*. While these studies have contributed to a fair consensus around the pros and cons of these structures, the debate is bound to continue regarding the best regulatory model to address both. One may say that the topic under *(i)* is fairly analysed and conclusions are clear, the subject under *(ii)* has been increasingly receiving attention over the years, but conclusions are far from being one-sided, and discussions on the matter under *(iii)* are ongoing with several legal systems searching for the most adequate regulatory and governance frameworks. This article takes the benefit of the studies under *(i)* and *(ii)* to focus on *(iii)*.

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2. Set against this background, our main drive is to build on the findings on the benefits and costs of multiple voting shares and assess whether the United Kingdom ("UK") regulatory initiative for *premium listed companies*[2], in place since 2014, provides for a fair balance between both. A stringent mandatory "one-share, one-vote" ("*OSOV*") rule is increasingly rare. Considering that neither an absolute ban nor an unrestricted allowance of *DCS* seems to be ideal, policymakers around the world have been devoting huge effort to find that uncertain *middle ground* between both governance extremes of the spectrum. The challenge several countries have been facing in recent times is to reach a formula which is able to address potential risks inherent to *DCS*, especially to non-controlling shareholders (entrenchment of control), while saving associated advantages (greater capital structure flexibility and long-term returns)[3]; in other words, to strike the right balance between two complex layers of conflicting interests. Whether and how such *balance* can be reached is a matter for regulation.

3. Changes to the UK premium listing rules offers an opportunity to discuss this matter at a broad-spectrum level by setting it against different approaches in major centres with diverse market and legal features – the United States ("US"), Canada, Hong Kong and Singapore[4] – and where the debate has recently heated (again). We seek to *(i)* provide an in-depth analysis of the changes to the listing framework in the UK in order to unveil the current regulatory stance, and *(ii)* bring it into dialogue with legal and governance approaches by said major stock indices, where changes have been recently implemented and discussions are ongoing too. This dialogue is important especially in light of the increasing regulatory competition among major exchanges to attract dual-class firms[5], mainly to encourage listings in fast-growing sectors. EU regulations around the popular so-called "loyalty shares" also merits attention and here too the debate is ongoing.

[2] See meaning in *n 55* below.

[3] Daniel Cipollone, "Risky Business: A Review of Dual Class Share Structures in Canada and a Proposal for Reform" (*Dalhousie Journal of Legal Studies*, Vol. 21, 2012) 86; Alexander Dyck, Luigi Zingales, "Private Benefits of Control: An International Comparison" (*NBER Working Paper Series*, Working Paper 8711, January 2002) 3.

[4] An exercise not intended to be comparative in nature.

[5] Hwa-Jin Kim, "Concentrated Ownership and Corporate Control: Wallenberg Sphere and Samsung Group" (*Journal of Korean Law*, Vol. 14, December 2014) 52; Flora Huang, "Dual Class Shares Around the Top Global Financial Centres" (*Journal of Business Law* (*forthcoming*) University of Leicester School of Law Research Paper No. 16-29, 2016) 21-22.

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II. **Main concerns**

a. **Private benefits of control as key component**

4. The key feature of multi-class share structures with imbalanced voting revolves around the separation between voting power and equity ownership, in that it allows some shareholders to control the company with relatively small economic risk[6]. The main consequence arising from disproportionate voting structures is therefore that controlling minorities may exercise a level of control over companies' affairs which is not reflected in the level of economic risk taken – controlling minorities (unlike controlling majorities) do not internalize most of the value effects of their decisions through shareholdings, which may represent only a small fraction of the cash-flow rights in their firms[7].

Since the general corporate governance principle is that equity interests should determine controlling powers, dual-class equity is said to generate critical agency issues related to entrenchment of control[8] and expropriation of private benefits ("*pb*")[9] of such control by controlling shareholders: the risk that the misalignment between the economic interest and the voting power may

[6] Scott Smarta, Ramabhadran Thirumalaib, Chad Zutterc, "What's in a vote? The short- and long-run impact of dual-class equity on IPO firm values" (*Journal of Accounting and Economics* 45, 2008) 95; Per-Olof Bjuggren, Johanna Palmberg, "The Impact of Vote Differentiation on Investment Performance in Listed Family Firms" (*Family Business Review*, XX(X), November 2010) 4.

[7] Guido Ferrarini, "One Share – One Vote: A European Rule?" (*Institute for Law and Finance*, Working Paper Series No. 47, April 2006) 12; Lucian Bebchuk, Reinier Kraakman, George Triantis, "Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights" (*NBER Concentrated Corporate Ownership*, Ch. 10, Randall K. Morck ed., University of Chicago Press, January 2010) 295.

[8] Tian Wen, "You Can't Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies From Listing on The Securities Exchanges" (*University of Pennsylvania Law Review*, Vol. 162, 2014) 1498 and 1501; Stephanie Ben-Ishai, Poonam Puri, "Dual Class Shares in Canada: An Historical Analysis" (*Dalhousie Law Journal*, 29.1, 2006) 143; Randall Morck, Daniel Wolfenzon, Bernard Yeung, "Corporate Governance, Economic Entrenchment and Growth" (*NBER Working Paper Series*, Working Paper 10692, August 2004) 1.

[9] Defined as "*pecuniary or nonpecuniary gain that the controlling shareholder acquires by virtue of its position, and does not share with minority shareholders*" – Ronald Gilson, Alan Schwartz, "Contracting About Private Benefits of Control" (Columbia Law and Economics Research Paper No. 436, Stanford Law and Economics Olin Research Paper No. 438, Yale Law & Economics Research Paper No. 461, 2012) 3. Such benefits may come in the form of self-dealing, related-party transactions, directing company's cash flow to personal projects, extravagant executive pay, special dividends, generous bonuses and stock option plans, and even other non-pecuniary items like prestige and social status – Cipollone (n 3) 68; Tara Gray, "Dual-Class Share Structures and Best Practices in Corporate Governance" (PRB 05-26E, Parliament of Canada <http://www.lop.parl.gc.ca/content/lop/researchpublications/

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incentivize those shareholders to divert large *pb* at the expenses of non-controlling shareholders (after all, the claimants of the residual cash flows generated by the firms)[10]. In short, controllers' incentives may become distorted and misaligned with the preferences of public investors[11] leading to those agency costs typically qualified as *pb*. Considering that a proportionality principle, which underlies a *OSOV* rule, seems to align the interests within a company in an efficient manner and facilitate takeovers while reducing the possibility of management entrenchment, *DCS* may potentially aggravate those issues linked to a separation between ownership and control[12]. Therefore moving away from the *OSOV* principle, considered the bedrock of good corporate governance standards, is seen with grain of salt.

5. It follows that several theoretical and empirical studies have held that multiple-voting shares are commonly associated with lower firm value[13]. However, a causal link between control enhancing mechanisms (in the form of vote-differentiated shares) and firm performance is yet to be established[14]. Complex discussions around the efficiency of share structures with inequi-

prb0526-e.htm> August 2005) 6-7; Bjuggren, Palmberg (n 6) 3; Belén Villalonga, Raphael Amit, "How are U.S. Family Firms Controlled?" (<http://ssrn.com/abstract=891004> July 2007) 47.

[10] Gilson, Schwartz (n 9) 3; Wen (n 8) 1497; Cipollone (n 3) 72; Bjuggren, Palmberg (n 6) 1; Michael Lemmon, Karl Lins, "Ownership Structure, Corporate Governance, and Firm Value: Evidence from the East Asian Financial Crisis" (*The Journal of Finance*, Vol. LVIII, No. 4, August 2003) 1445.

[11] Lucian A. Bebchuk, Kobi Kastiel, "The untenable case for perpetual dual-class stock" (*Virginia Law Review*, Vol. 103, number 4, June 2017) 602.

[12] Ronald Masulis, Cong Wang, Fei Xie, "Agency Problems at Dual-Class Companies" (*Journal of Finance (forthcoming)*, 3rd Annual Conference on Empirical Legal Studies Papers, ECGI - Finance Working Paper No. 209/2008) 2.

[13] Stijn Claessens, Simeon Djankov, Joseph Fan, Larry Lang, "Disentangling the Incentive and Entrenchment Effects of Large Shareholdings" (*The Journal of Finance*, Vol. 57, No. 6, December 2002); Karl Lins, "Equity Ownership and Firm Value in Emerging Markets" (*The Journal of Financial and Quantitative Analysis*, Vol. 38, No. 1, March 2003); Belén Villalonga, Raphael Amit, "Benefits and Costs of Control-Enhancing Mechanisms in U.S. Family Firms" (ECGI – Finance Working Paper No. 131/2006, July 2006) [and Villalonga, Amit (n 9)].

[14] Renée Adams, Daniel Ferreira, "One Share, One Vote: The Empirical Evidence" (ECGI - Finance Working Paper No. 177/2007, December 2007); Yu-Hsin Lin, Thomas Mehaffy, "Open Sesame: The Myth of Alibaba's Extreme Corporate Governance and Control" (*Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol. 10, 2016) 461; Morten Bennedsen, Kasper Nielsen, "Incentive and entrenchment effects in European ownership" (*Journal of Banking & Finance*, 34, 2010) 2213; Gabriel Morey, "Multi-Class Stock And Firm Value. Does Multi-Class Stock Enhance Firm Performance? A Regression Analysis" (Council of Institutional Investors II, May 2017), concluding that a multi-class common equity structure with unequal voting rights neither increases nor decreases a company's annualized return on invested capital.

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table voting rights seem to go from the intrinsic difficulty in measuring *pb*[15] to the assumption that controlling-related *pb* are always inefficient and should be ruled out[16].

6. On the flip side, a dual-class capital structure may be linked to capital growth for encouraging founders to raise capital from the public – without such structures, keeping the firm private or seeking less flexible forms of financial capital could be the only viable way to maintain control over the company[17]. As an anti-dilution tool, *DCS* structures may also work as a powerful anti-takeover mechanism by entrenching incumbent managers and directors and preventing proxy fights and hostile takeovers[18]. Coherently, it is often claimed that these structures provide dual-class firms with greater ability to plan and act over the long-term, therefore avoiding short-term actions with detrimental effects to firm value and performance[19].

In addition, a potential efficiency of these structures relates to monitoring benefits provided by controlling shareholders to all shareholders, since unbundling cash flow and control rights may allow dominant shareholders to diversify their wealth, leading to more dispersed economic ownership and a closer alignment of dominant and dispersed shareholder interests[20].

Some even highlight disadvantages behind a strict *OSOV* rule, in that it strengthens the position of managers, thereby aggravating the manager-share-

[15] Craig Doidge, "U.S. Cross-Listings and the Private Benefits of Control: Evidence from Dual-Class Firms" (*Journal of Financial Economics*, 72, 2004) 520.

[16] Efficiencies are underlined in several studies, even when the extraction dissipates value – Mike Burkart, Samuel Lee, "The One Share-One Vote Debate: A Theoretical Perspective" (ECGI – Finance Working Paper No. 176/2007, May 2007) 38.

[17] Burkart, Lee (n 16) 32; Scott Bauguess, Myron Slovin, Marie Sushka, "Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights" (*Journal of Banking & Finance*, 36, 2012) 1246; Stephen Glover, Aarthy Thamodaran, "Capital Formation: Debating the Pros and Cons of Dual-Class Capital Structures" (*Insights: The Corporate and Securities Law Advisor*, Vol. 27, No. 3, March 2013) 7; Raymond Chan, John Ho, "Should Listed Companies be Allowed to Adopt Dual-Class Share Structure in Hong Kong?" (*Common Law World Review*, Vol. 43, No. 2, May 2014) 155-156.

[18] Mira Ganor, "Why Do Dual-Class Firms Have Staggered Boards?" (<http://ssrn.com/abstract=2469650> July 2014) 17; Katie Bentel, Gabriel Walter, "Dual Class Shares" (*Comparative Corporate Governance and Financial Regulation*, Paper 2 <http://scholarship.law.upenn.edu/fisch_2016/2> 2016) 24; Paul Gompers, Joy Ishii, Andrew Metrick, "Incentives vs. Control: An Analysis of U.S. Dual-Class Companies" (*NBER Working Paper Series*, Working Paper 10240 <http://www.nber.org/papers/w10240> January 2004) 10.

[19] David Berger, Steven Solomon, Aaron Benjamin, "Tenure Voting and the U.S. Public Company" (<http://ssrn.com/abstract=2740538> March 2016) 3; Gray (n 9) 4.

[20] A point made by Bauguess, Slovin, Sushka (n 17); also Burkart, Lee (n 16).

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holder agency conflict[21]. In that sense there would be a certain potential in *DCS* to mitigate such governance problem[22].

b. **Reverse causality to investor protection**

7. An important link is commonly drawn between the level of agency costs entailed in *DCS* and the protection afforded to investors by legal, regulatory or corporate governance systems through different monitoring mechanisms (judicial, contractual and market-based): those agency costs are said to be higher in countries where investor protection is weaker[23], i.e., jurisdictions with stronger statutory and enforcement mechanisms of protection of non-controlling shareholders are associated with lower levels of *pb* extraction[24] and therefore seem to be better equipped to welcome disproportionate voting structures. However and interesting enough, since jurisdictions with better protection mechanisms afforded to non-controlling shareholders offer less room for *pb* diversion[25], multiple voting shares seem to be less searched for in such legal environments[26].

Thus, as alternative to a strict *OSOV* rule, the relevant agency costs could be dealt with through increased investor protection, i.e., by reducing *pb* through legal reforms[27]. To the extent a jurisdiction is well-served with governance safeguards to cope with the adverse effects of misalignment triggered by dual-class equity, listing of firms with *DCS* could then be considered.

[21] Burkart, Lee (n 16) 37-42.

[22] Wolf-Georg Ringe, "Deviations from Ownership-Control Proportionality – Economic Protectionism Revisited" (*Company Law and Economic Protectionism*, U Bernitz and WG Ringe ed., Oxford University Press, 2010) 221.

[23] Arman Khachaturyan, "The One-Share-One-Vote Controversy in the EU" (ECMI Research Paper No. 1 <http://ssrn.com/abstract=2005054> August 2006) 15-16; Lins (n 13); Bebchuk, Kraakman, Triantis (n 7) 306; Ferrarini (n 7) 24; Chan, Ho (n 17) 168.

[24] "Lack of Proportionality between Ownership and Control: Overview and Issues for Discussion" (OECD Steering Group on Corporate Governance <http://www.oecd.org/daf/ca/corporategovernanceprinciples/40038351.pdf> December 2007) 5-6; Bennedsen, Nielsen (n 14) 2220; Dyck, Zingales (n 3); Chan, Ho (n 17) 175; Evangelos Benosa, Michael Weisbach, "Private Benefits and Cross-Listings in the United States" (*Emerging Markets Review*, 5, 2004) 224.

[25] Doidge (n 15) 526.

[26] Ferrarini (n 7) 24; Bebchuk, Kraakman, Triantis (n 7) 306 and 312- 313; Doidge (n 15) 523.

[27] Ferrarini (n 7) 13-14 and 24; Bennedsen, Nielsen (n 14) 2221.

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8. Some studies[28] suggest that a good indicator of the quality of protection afforded to non-controlling shareholders within controlled firms is the *premium* that markets place on the class of shares owned by controlling shareholders. The reasoning is as follows: absent a proper legal framework of protection, the premium (and conversely the discount on the class of shares owned by non-controlling shareholders) is as large as the market may understand the room left for controlling shareholders to divert *pb* to be[29]. Consequently, an indicator of an efficient system of legal protection for non-controlling shareholders would consist of a small premium attached to superior-voting shares[30].

International data on the premium accruing to share classes with superior voting power[31] provides a measure of the degree of protection provided to non-controlling shareholders. The striking conclusion is the critical importance of the legal framework to protect non-controlling shareholders. With weak protection come large *pb*; with effective legal protection, only small *pb* accrue to controlling shareholders[32]. This data suggests a bigger appetite for *DCS* from investors under better regulatory environments and conversely a higher scepticism under corporate governance regimes affording less investor protection. This is based on the idea that *DCS* may be value-enhancing if strong mechanisms are put in place to prevent diversion of value by founders[33].

c. **Is there any real need for regulation?**

9. Discussions around regulatory initiatives have been focused on the need to either prohibit or restrain deviations from a *OSOV* principle. There is how-

[28] Tatiana Nenova, "The Value of Corporate Voting Rights and Control: A Cross-Country Analysis" (*Journal of Financial Economics*, 68, 2003); Dyck, Zingales (n 3); Morck, Wolfenzon, Yeung (n 8).
[29] Yvan Allaire, "Controlled Companies Briefing: Questions for Directors to Ask" (Chartered Professional Accountants of Canada <https://www.cpacanada.ca/en/business-and-accounting-resources/strategy-risk-and-governance/corporate-governance/publications/controlled-companies-and-boards-of-directors> 2010) 16 (Appendix D); Nenova (n 28) 326; Yvan Allaire, "Dual-Class Share Structures in Canada: Some Modest Proposals" (Institute for Governance of Private and Public Organizations (IGOPP) <http://ssrn.com/abstract=952043> November 2006) 10.
[30] Nenova (n 28) 342.
[31] Nenova (n 28); Dyck, Zingales (n 3); Morck, Wolfenzon, Yeung (n 8). It shows the UK with a voting premium of 10%, contrasting with the US, Canada and Hong Kong with premiums of 2, 3 and -3, respectively.
[32] Allaire (n 29 – "Dual-Class Share Structures in Canada …") 15.
[33] A point made by Lin, Mehaffy (n 14) 441.

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ever an increasing trend towards an alleviation of such banning and restrictive interventions.

A regulatory approach is commonly grounded on the need to protect non-controlling shareholders and therefore ensure high-standard governance practices which may attract investors and/or help to maintain companies' institutional investor base. A conflicting drive is to create a welcoming regulatory environment to dual-class firms, thus promoting a certain level of competitiveness against other stock exchanges[34]. The first goal calls for an adequate protection of investors and effective enforcement mechanisms in case of abuse by insiders, whereas the latter calls for greater flexibility and freedom of contract[35]. These concerns are clearly present in the UK reform under analysis, as much as in the recent steps taken by other important financial centers over the world (see *V.* below)[36]/[37].

The policy debate around regulating disproportionate voting structures is therefore commonly placed at three levels of interests: private interests of *insiders* (controlling shareholders/founders), private interests of *outsiders* (non-controlling shareholders/investors)[38], and interests of public nature, which focus on the need for stock exchanges to keep high levels of both corporate governance standards and competitiveness. Regulatory interventions attempt to conciliate all these interests, which are found in a dynamic and complex friction.

10. Moving from the *why* to the *how* to regulate, a risk inherent to a mandatory prohibition of deviations from a *OSOV* principle is that it is generally difficult or even impossible to estimate whether multiple voting shares will result in high agency conflicts, whether those conflicts will be mitigated by certain governance tools which may address weaknesses inherent in *DCS* firms and therefore protect shareholders in those firms (e.g., sunset clauses – which

[34] Wen (n 8) 1507.

[35] Marco Ventoruzzo, "The Disappearing Taboo of Multiple Voting Shares: Regulatory Responses to the Migration of Chrysler-Fiat" (ECGI, Law Working Paper No. 288, March 2015).

[36] "Consultation Paper CP12/25: Enhancing the Effectiveness of the Listing Regime and Feedback on CP12/2" (Financial Services Authority <http://www.fsa.gov.uk/static/pubs/cp/cp12-25.pdf> October 2012) Annex 2, A2:1.

[37] In particular after the implementation of a high-vote structure led Manchester United and Alibaba to list in the US as opposed to in the LSE.
Chan, Ho (n 17) 172; Wen (n 8) 1507.

[38] Paul Gompers, Joy Ishii, Andrew Metrick, "Extreme Governance: An Analysis of Dual-Class Companies in the United States" (AFA 2005 Philadelphia Meetings, Rodney L. White Center for Financial Research Working Paper No. 12-04, Rock Center for Corporate Governance Working Paper No. 39, May 2008) 15; Burkart, Lee (n 16) 40.

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automatically restore the *OSOV* within a reasonable timeframe –, disclosure of shareholder votes, buy-out protections)[39] and to which extent may any possible remaining issues outweigh all potential efficiencies[40]. Thus, discussions on the need for regulation tend to revolve around the strength of internal regulatory/ market tools in place protecting non-controlling shareholders. The main issue is that those *two forces at play* – the value-decreasing effect of the agency costs resulting from disproportional control and the value created by concentrated control[41] – are *competing* and *changing over time* in a dynamic way, even within a single company[42]. The concern is if regulation can keep *pb* extraction costs at a lower level than the benefits which outside shareholders may potentially draw from more efficient controller performance[43].

From this perspective, the most adequate regime on *DCS* could be one focused on a flexible allowance of such structures followed by strict control mechanisms across implementation focused on the proven effects of unbundling ownership from control, rather than an outright rejection based on an assumption of negative effects[44]. Coherently, the current general consensus seems to be that a proportionality principle (*OSOV*) should be the general starting point, as it offers the best alignment of incentives, yet *deviations* can be justified under certain circumstances[45]. The next chapter focus on whether the UK has taken such approach.

[39] Anita Anand, "Governance Complexities in Firms with Dual Class Shares" (*Annals of Corporate Governance*: Vol. 3: No. 3, 31 May 2018) 184-275, Bebchuk, Kastiel (n 11) 598-599.
[40] Huang (n 5) 6; Cipollone (n 3) 91.
[41] Huang (n 5) 9.
[42] Lin, Mehaffy (n 14) 461-462.
[43] Gilson, Schwartz (n 9) 6-7; Ronald Gilson, Jeffrey Gordon, "Controlling Shareholders" (*Columbia Law and Economics*, Working Paper No. 228; *Stanford Law and Economics Olin*, Working Paper No. 262, June 2003).
[44] Khachaturyan (n 23).
For instance, it has been submitted that passage of time since the IPO can be expected to affect the efficiency of *DCS*, with these structures becoming inefficient over time – Bebchuk, Kastiel (n 11). Voting premiums are said to increase with firm age, suggesting that *pb* increase over maturity, i.e., maturing dual-class firms experience increasing agency problems – Hyunseob Kim, Roni Michaely, "Sticking around Too Long? Dynamics of the Benefits of Dual-Class Voting" (*European Corporate Governance Institute (ECGI)*, Finance Working Paper N.° 590/2019, January 2019).
[45] Ringe (n 22) 221-222 and 238-240; Stephan Nüesch, "Dual-class shares, external financing needs, and firm performance" (*Journal of Management and Governance* (*forthcoming*) <http://ssrn.com/abstract=1773206> February 2015) 548; Burkart, Lee (n 16).

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III. **UK listing framework**

11. Changes to UK Listing Rules ("LR") in 2014 impacting premium listed companies appear to make waves on multiple voting shares regime, a field where silence prevailed until such moment. Although no prohibition or restriction existed until then in this main listing segment, the use of multiple-voting shares is far from being popular[46], mostly due to market pressure and successful opposition from institutional investors over the last few decades[47]. The push by these investors – who hold a significant proportion of shares in the UK market – to encourage a general principle of proportional ownership seems to be driven by a general preference for pro-shareholder governance standards[48]. In addition (if not for this reason), the London Stock Exchange ("LSE") has been encouraging listed companies to restrict to one class of shares[49]. The breakthrough rule in place is also said to undermine the effectiveness of a *DCS* scheme[50].

These changes brought along two key questions *(i)* from a policymaker point of view, were they targeted at expressly setting out a *middle ground* solution between *OSOV* and *DCS*?; *(ii)* did those aim to or succeeded in changing a long-lasting trend of *self-regulation through standards set by institutional investors*[51]?

a. **Listing Principle and Rule**

12. *DCS* structures are permitted under UK company law, although the *OSOV* concept is provided as a default principle[52], and are also allowed in stan-

[46] Huang (n 5) 11-12; Ringe (n 22) 226; Julian Franks, Colin Mayer, Stefano Rossi, "Spending Less Time with the Family: The Decline of Family Ownership in the UK" (*NBER Working Paper Series*, Working Paper 10628, July 2004) 1; Adams, Ferreira (n 14) 6.
[47] Huang (n 5) 11-12; Ringe (n 22) 223 and 226.
Of the International Corporate Governance Network's investor members (whose aggregate assets under management exceed $34tn), more than 80 per cent responded negatively in a member survey against dual class shares – George S Dallas, "Dual share structures could erode accountability at the top" (Financial Times, <ft.com/content/c6449e70-0617-11ea-a984-fbbacad9e7dd> 14 November 2019).
[48] Huang (n 5) 12; Ringe (n 22) 228.
[49] Ringe (n 22) 223; Huang (n 5) 2.
[50] Huang (n 5) 12; Ferrarini (n 7) 26. This rule enables a bidder with 75% equity to break through companies' voting arrangements and exercise control as if the *OSOV* principle is upheld.
[51] As Ringe (n 22) 230 calls it.
[52] UK Companies Act 2006, Section 284.

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dard listings[53]. Even though companies with *DCS* structures may list on the standard segment, this is usually seen as a second-best and unattractive listing option for lacking a clear purpose[54]; therefore, major companies generally focus on the premium listing, the main market of the LSE [55].

The Premium Listing Principle 4 sets forth that *where a listed company has more than one class of equity shares admitted to premium listing, the aggregate voting rights of the shares in each class should be broadly proportionate to the relative interests of those classes in the equity of the listed company*[56]. The Principle 4 is complemented with a rule (LR 7.2.4. G), which provides guidance to the Financial Conduct Authority ("FCA") on the assessment of such proportionality: the regulator should focus on *(1) the extent to which the economic rights of the classes differ; (2) the extent of dispersion and relative liquidity of the classes; and/or (3) the commercial rationale for the difference in the rights*.

Although market practice may have shown for a long period that not much attention was to be given to the subject, the UK regulator decided to have a say on the matter.

13. At first glance, it seems that a *general rule of allowance* of *DCS* structures under *broad conditions* was implemented, instead of a *general rule of prohibition* with *exceptions*, i.e., a strict *OSOV* subject to *deviations*. However, an assessment of each of those conditions is key to understand the material level of allowance. The reform could have brought the UK standing on *DCS* structures closer to *complete ban* (should the factors be very strict) or to

[53] Standard listings cover issuance of shares, Global Depositary Receipts, debt and securitised derivatives that are required to comply with EU minimum requirements. A standard listing allows issuers to access the main market by meeting EU harmonised standards only rather than the UK "super-equivalent" requirements.

[54] Advisors often tell companies not to pursue this option. "Discussion Paper DP17/2: Feedback on CP12/25: Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape" (FCA <https://www.fca.org.uk/publications/policy-statements/review-effectiveness-primary-markets> 14 February 2017).

[55] A premium listing is only available to equity shares issued by trading companies and closed and open-ended investment entities. Issuers with a premium listing are required to meet the UK's super-equivalent rules which are higher than the EU minimum requirements. A premium listing means the company is expected to meet the UK's highest standards of regulation and corporate governance – and as a consequence may enjoy a lower cost of capital through greater transparency and through building investor confidence (Source: London Stock Exchange website: <https://www.londonstockexchange.com/companies-and-advisors/main-market/companies/primary-and-secondary-listing/listing-categories.htm>).

[56] In addition, all equity shares in a class that has been admitted to premium listing must carry an equal number of votes on any shareholder vote (Premium Listing Principle 3).

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comprehensive acceptance (should the factors, in contrast, consist of broad safe harbors). Depending on our conclusions, one might be able to determine if and to which extent did the regulatory move envisage (even if indirectly) at generally *(i)* recognizing that shares with outsized voting rights may be efficient with limits and under certain circumstances, or *(ii)* preventing or highly discouraging the issuance of different voting share classes (except in residual cases) in light of its adverse effects.

14. Some see this intervention as a *formal ban*[57].

Qualification as a *ban* could find support in three instances: *(i)* allowance was the principle in place before the amendment and therefore it was tightened[58] as new factors have to be considered, *(ii)* the principle may unveil a ban, as the FCA became legally entitled to prohibit the listing of such structures, i.e., *DCS* evaluated as *broadly disproportionate* are to be banned; *(iii)* by reading the principle from another angle, it could be said that implementation of *DCS* is prohibited as a matter of rule, *unless* voting power bears a reasonable correlation with the equity interest inherent to the same shares.

Such wide construction, in granting ample room to the FCA when deciding on the allowance of dual-class equity, could support the view that the changes to the listing regime brought *DCS* closer to a formal ban – going from a fully unrestricted permission to a conditional allowance subject to regulator's case-by-case understanding.

15. A closer look shows that qualification as a ban may, however, not reflect the wording and rationale behind the listing framework to a full and accurate extent.

Firstly, the construction as *general rule of prohibition with exceptions* would fail to explain that the adoption of two classes of shares is allowed *provided* that a broad linkage between ownership and control power is met; a prohibition rule would otherwise be based on a strict 1:1 ratio between voting and economic rights, which is not the case; on the contrary, a broad proportionality principle indicates that going beyond a strict *OSOV* principle is allowed.

[57] E.g., Mak Teen, "Say 'no' to dual class shares" (Governance for Stakeholders <http://governanceforstakeholders.com/2015/11/28/say-no-to-dual-class-shares/> 28 November 2015).

[58] Huang (n 5) 11, who advocates that these rules are believed to tighten the UK listing regime for premium listed companies and ensure the overarching framework of best corporate governance practices.

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Secondly, such qualification would entail framing the three conditions as pure *exceptions* to a called prohibition rule. In our view, this is not accurate since the factors do not seem to consist of *safe harbors* (even though they may work as such in practice); on the contrary, we would deem those as a simple extension of the principle itself or explanatory subprinciples. We will see that the factors are construed in a neutral manner rather than as allowed or prohibited events, i.e., no specific course of actions are mandated or negated in order for *DCS* implementation to be permitted.

We are then led to qualify the UK current regime on premium listed companies as a *limited allowance rule*: listing of *DCS* structures is (still) permitted as long as certain conditions are met. In addition, the regulator policy seems to underline the purpose of restraining only "*flagrant examples*" (see *26*. below), an approach which also suggests that the general rule or driving principle should be one of acceptance.

While this theoretical exercise may seem of little relevance until tested in practice, the formal qualification is important when attempting to place the UK governance approach along with other jurisdictions (see *V*. below).

b. **General principle**

16. The relevant proportionality is that linking voting power and the "*relative interests in equity*". Even though this expression could comprise different realities, the policy statements and context surrounding the rule seems to point to economic rights – either in the form of right to dividends or of right to surplus capital on winding up. The wording of factor *(1)* of LR 7.2.4.G supports this view.

A principle stating that the aggregate voting rights of each class of shares should be broadly proportionate to the interests in company's equity seems rather empty and leaves for the three factors the role of indicating a clearer path. Even so, a hint is given by the adverb "*broadly*", lacking which the principle would simply express a *OSOV* rule: voting rights shall be *proportionate* to equity rights. The principle then mandates that said proportionality exists only in a *broad* manner, as opposed to a *strict* 1:1. It follows that the adverb opens room for a deviation from the proportionality principle and the level of such deviation is to be sought among the three conditions. Thus, unlike the suggested governance approach to *DCS* – a *OSOV* as principle and deviations as exceptions (see *10.* above) – the listing principle seems to incorporate the exception itself by implicitly indicating that deviations from the principle of proportional ownership may be acceptable.

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c. **Factors/conditions**

17. The LR 7.2.4.G states that, when assessing whether the voting rights attaching to different classes of premium listed shares are *proportionate*, the FCA will have regard to the following factors:

1) *the extent to which the rights of the classes differ other than their voting rights, for example with regard to dividend rights or entitlement to any surplus capital on winding up*

The main concern about *DCS* revolves around the extent to which voting and economic rights among each class of shares differ. *DCS* deviates from the 1:1 ratio reflected in a *OSOV* principle and clearly the associated governance issues depend on the level of such deviation, i.e., the generated agency costs increase with the extent of the wedge between control and cash-flow rights[59].

This condition seems to highlight that the adequate scale of different interests of different players should be achieved through an optimal overall balance between economic and voting rights within each class of shares (regardless of the strict difference in voting rights between classes), rather than by simply placing the voting rights at the same level on a mandatory basis. This means that the relevant wedge among *different classes* is not only that between voting rights, but also between the *economic rights*.

However, the first factor does not provide further guidance. The formula seems redundant in not going beyond the general principle of broad proportionality between voting and equity interests. The principle claims for a broad proportionality between such interests and the first factor goes on to state that the FCA will take into account the extent to which one differs from the other. The *ratio* of multiple-voting shares to subordinate-voting shares which is set to meet the criteria is a topic left unaddressed. It seems therefore that this factor fell short of what could be expected from a regulatory intervention in this regard: to provide a clear-cut level of proportionality between voting and equity rights (a *middle ground* or deviation).

The rationale underlying this condition seems to be that of providing support for the adoption of non-voting preference shares, an instrument where voting power is waived in exchange for a priority in economic rights and

[59] Bebchuk, Kraakman, Triantis (n 7) 296; Cipollone (n 3) 63; Lemmon, Lins (n 10) 1446; "Second Class Investors: The Use and Abuse of Subordinated Shares in Canada" (Shareholder Association for Research and Education (SHARE) <http://www.share.ca/files/Second_Class_Investors.pdf> April 2004) 21.

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which, unlike dual-class equity, is widely used in the UK. However, these structures do not represent a threat to the agency conflicts we are dealing with, as the absence of voting power deprives preference shareholders from any risk of *pb* extraction.

2) *the extent of dispersion and relative liquidity of the classes*

18. Dispersion and liquidity are a common concern on discussions around the allowance of multiple voting shares[60]. These structures are said to put a burden on companies that need to raise new equity capital and hence, care about their share price, liquidity and investor recognition[61]; single-class shares are generally linked to higher levels of liquidity and accordingly to increased market valuations[62].

High-voting shares are typically less liquid than low-voting shares since large part of these shares can be held in a block and not traded[63]. Consequently, to serve as incentive to investors, subordinated shares often pay higher dividends and are generally more liquid than shares with superior voting rights attached[64]. On the contrary, superior-class shares normally trade (should they trade at all[65]) at a *premium* over subordinated voting shares, reflecting a higher degree of company control through distinct voting rights[66]. Illiquidity of superior voting rights is therefore said to inhibit the effectiveness of the securities market as external monitoring mechanism, and to such extent may aggravate agency costs[67]. As such, the second factor focuses on the concern that *DCS*

[60] The need for Hong Kong dual-class companies to have a widely dispersed shareholder base and a highly liquid market in their shares was emphasised in the "Consultation Conclusions to Concept Paper on Weighted Voting Rights" (HKEx <https://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082cc.pdf> June 2015) 30, so to enable shareholders to exit easily in case they believe that the risk associated with such structures outweighed the value of their investment. See Khachaturyan (n 23) 15, concluding that efficiency implications vary with a degree of concentration of ownership.

[61] Anete Pajuste, "Determinants and Consequences of the Unification of Dual-Class Shares" (European Central Bank, Working Paper Series No. 465, March 2005) 14.

[62] *Idem* 15; Dimitris Margaritis, Maria Psillaki, "Capital Structure, Equity Ownership and Firm Performance" (*Journal of Banking & Finance*, 34, 2010) 625.

[63] Adams, Ferreira (n 14) 12.

[64] Gray (n 9) 3.

[65] Cipollone (n 3) 76; Gray (n 9) 3; Gompers, Ishii, Metrick (n 38) 9.

[66] Gray (n 9) 3; "Second Class Investors …" (n 59) 7-8; Bennedsen, Nielsen (n 14) 2226.

[67] Cipollone (n 3) 76.

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may be bought and sold readily on stock exchanges, i.e., the adequate measure of proportionality should ensure a given level of liquidity on listed trading.

The main concern arising from this factor is that the contrast between liquidity levels of different share classes may only be revealed ex-post, i.e., once multiple voting shares are implemented and have been listed. It follows that, a strict ex-ante assessment may not be possible to achieve (beyond market predictions) and in that sense this factor may also fall short of the proportionality exercise between voting and equity interests which one could expect to have been carried out – if nothing else, no specific index requirements on liquidity are set out.

Furthermore, it was clarified that the reference to *relative liquidity* reflects that a contrast in dispersion and trading levels of both classes may (rather than must) indicate that an *artificial structure* is present[68]. Also here, a discretionary analysis is left for the regulator to carry out on a case-by-case basis. Yet, this explanation may reveal that only a significant *contrast* in dispersion and trading levels should concern the FCA.

All in all, since no conclusive analysis has yet been reached on the effects of concentrated ownership structures to firm value[69], the focus on the levels of *dispersion* may lead to unsatisfactory conclusions and may be particularly striking once placed alongside the typical widely dispersed structure of UK listed companies. It follows that the lack of evidence on a negative correlation between disproportional ownership and firm performance[70] may also undermine the assessment on the allowance of a particular dual-class structure.

3) *the commercial rationale for the difference in the rights*

19. The idea that share structures with inequitable voting rights must be supported by good business reasons also gathers consensus. The issue arising from this formula is one of uncertainty since no further guidance is provided.

The purpose of regulatory intervention as set out in the policy statements (*prevent super voting shares or other structures that allow voting power to be kept within a small group of shareholders* – see *26.* below) makes it difficult to perceive which sound commercial reasons may justify a decision for allowance or prohibition,

[68] "Policy Statement PS14/8: Response to CP13/15 – Enhancing the effectiveness of the Listing Regime" (FCA <https://www.fca.org.uk/news/ps14-08-enhancing-the-effectiveness-of-the-listing-regime> May 2014) 31-32.

[69] See *n 13* above.

[70] See *5.* above.

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considering that in most cases multiple voting shares will lead to that inevitable outcome: creating or upholding a controlling status.

One may further question whether the decision to open the capital of a dual-class company to public without diluting control may in itself be considered a fair commercial reason. It remains to be seen if the regulator will dig deeper in order to save those structures with different voting rights resulting in a controlling situation with risk of *pb* whenever the overall benefits are shown to fall short of the generated efficiencies (collective gains).

From another angle, to the extent the focus have been placed on ex-ante business reasons, the formula "*commercial rationale*" may not offer a *safe harbor* to *DCS* on the basis of its positive ex-post governance effects, such as the encouragement of long-term investment. Since it may not be possible to predict or even measure such effects to a full degree, this condition may – same as the former two – fall short of the intended goal. One may after all be led to conclude that efficiencies related to the promotion of long-term value were not thought to ground the adoption of *DCS* from a commercial point of view in the first place.

d. **General assessment**

20. Overall, the premium listing principle coupled with the factors could have contributed to construe a solid legal framework around multiple voting shares. However, the absence of clear-cut safe harbors may have instead brought a new layer of uncertainty which was absent before.

The purpose of the regulatory intervention could have been to bring certainty to the markets on a delicate subject. This would have been the case should *(i)* the factors be clear-cut, objective and detailed, and work as actual gateways or deviations from a *OSOV* principle; *(ii)* the regulator necessarily consider those factors when deciding whether to accept or decline a particular *DCS* structure; and *(iii)* insiders be entitled to claim for an acceptance or rejection decision on the basis of compliance or non-compliance with the factors under a particular case.

However, the wording of the rules and the *wide* nature of discretion reserved to the FCA show that such regulatory outcome might not be achieved: *(i)* the key principle is one of broad proportionality between voting and equity rights which implicitly incorporates a deviation from a *OSOV* rule rather than this rule itself; *(ii)* factors are framed in a neutral and all-encompassing manner, instead of as clear-cut deviations from a *OSOV* principle or safe harbors; *(iii)* the first one paraphrases the main principle (which unnecessarily opens

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the door to non-voting preference shares), and the other two are a blurred extension of the same principle, i.e., the proportionality principle seems to be expressed in the first condition (which is redundant), while the other two conditions do not seem to narrow down such main principle; *(iv)* conjunctions "*and/or*" result in the FCA being free to consider all the factors altogether or a single one or only some, and *(v)* other factors may also be taken into account (the list is non-exhaustive), i.e., the FCA is not bound to take into account the provided factors and may even consider others.

21. The upside of the regime is that the factors revolve around corporate governance matters that must be addressed when deciding whether a dual-class firm may list, i.e., some of the most critical reasons that regulators must assess when deciding on the validity or invalidity of particular *DCS* mechanisms were laid down in the form of rules and this should be seen as a positive step. The downside is that the level of attention to be paid by the FCA to those matters is uncertain. Rather than clarifying which level of proportionality or *deviation* from a *OSOV* principle is allowed, the lawmaker took another path.

22. Three main causes may be at the origin of the broad nature of the principle and rule: *(i)* the wide purpose underlying the policy as stated (*prevent control to rest with small group of shareholders* – see *26.* below) would hardly be decoded into specific and detailed standards and commands; *(ii)* the fact that *DCS* have been in essence a market-driven subject and the policymaker may have decided to keep it that way; and *(iii)* the global reform seems to signal that the main concerns may be tackled through governance mechanisms restraining certain actions from insiders (see *24.* below).

A possible basis for such approach could then be that no issues shall arise as long as market players keep *DCS* in the shadow. However, if the market shows a shift in attitude, a different answer could be claimed. In such event, any uncertainty around the listing framework will have to be tackled by the FCA on a case-by-case basis and the source of decision may then turn out to be FCA's case law rather than the code. The main risk is one of *uncertainty*: had the regulatory approach been one of partial ban or partial allowance through clear-cut set of deviations from the principle of proportional ownership, investors could have been allowed to justify the validity of dual-class equity on the basis of fulfilment of those conditions.

23. The level of flexibility and discretion reserved to regulator through such a broad rule may lead to a poor regulatory outcome in terms of certainty and decision-marking consistency. The three conditions are construed as for-

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mal extension of the main principle rather than as deviations highlighting the circumstances under which *DCS* could be beneficial (safe harbors). This may move the UK regulation away from a sounder governance approach expressed through a *OSOV* rule as starting point and deviations shaped as exceptions. It may further pose difficulties in placing the UK rule alongside regulatory approaches from other stock exchanges with much clearer stances on the subject (see *V.* below). Finally, the uncertain theoretical and practical impact of the reform may lead dual-class companies to think twice before deciding to list in the UK stock market.

e. **Underlying principles – the reform as a whole**

24. The rule on *DCS* shall not be read in isolation.

The reform under analysis was in general aimed at improving corporate governance practices by increasing the vigilance over controlling shareholders[71] and the protection mechanisms offered to outside investors. The kick-start for the regulatory amendments was therefore the need that premium rules comply with high quality governance requirements where a controlling shareholder is present, by ensuring that investors have effective tools to influence companies' behaviour[72]. The UK reform was described by the FCA as a package of measures designed to strengthen non-controlling shareholders' rights where they are at risk of being abused[73]. The chief goal was then to preserve the attractiveness of the market for investors and the UK premium segment as a high standard benchmark of the regime as a whole[74]. Those measures focused on three areas[75]:

(i) placing requirements on the interaction between a premium listed company and a controlling shareholder via a relationship agreement:

> The requirement is for a written and legally binding agreement that is intended to ensure that controlling shareholders comply with independence

[71] See definition in LR 6.1.2A.
[72] "Consultation Paper CP12/25 …" (n 36).
[73] *Idem.*
[74] *Idem.*
[75] "Consultation Paper CP13/15: Feedback on CP12/25: Enhancing the effectiveness of the Listing Regime and further consultation" (FCA <https://www.fca.org.uk/news/cp13-15-enhancing-the-effectiveness-of-the-listing-regime> November 2013) 7.

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provisions[76]. The relationship agreement requirement is strengthened by a new regime of annual report disclosures and enhanced oversight measures in case of breach of such agreement by controlling shareholders[77].

(ii) providing additional voting power to non-controlling shareholders under the appointment of independent directors:

This is promoted by requiring that independent directors are separately approved both by shareholders as a whole and non-controlling shareholders as a separate class. The focus is clear: independent directors are said to have a critical role to play in promoting effective corporate governance and the dual-voting process aims to give non-controlling shareholders a greater voice in their election[78].

and

(iii) enhancing voting power for non-controlling shareholders under the cancellation or transfer of companies' premium listing:

This translates into the requirement of approval by a majority of the votes attaching to the shares of non-controlling shareholders in addition to the approval of 75% of shareholders voting on a resolution to approve a cancellation of listing or transfer.

The driver for this amendment was that cancellation of a listing removes from shareholders significant rights of participation in the governance of a company, it being essential that non-controlling shareholders are given a proper say in this decision[79].

25. *DCS* played a peripheral role within the whole reform when compared to the attention given to other governance tools and concerns. This may signal that the lawmaker deemed *DCS* as a market-driven subject and/or that issues arising from multiple-voting shares could be addressed from another angle: not by focusing on the shape of the instrument itself (and providing a more definitive stance on banning or allowance with safeguards), but through a general and neutral principle while addressing certain governance issues underlying *DCS*. A deeper look reveals that the reform aimed at generally solving some governance concerns which commonly arise from high-voting shares (managerial entrenchment and *pb* extraction).

[76] Set out in LR6.1.4D.
[77] "Consultation Paper CP13/15 …" (n 75) 7.
[78] *Idem*.
[79] *Idem*.

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It seems that the focus was placed on the improvement of governance standards rather than on carefully carving a strong regulatory framework around *DCS* mechanisms. In so doing, the regulator may have decided to leave shares with different voting rights free to be adopted, subject to a case-by-case understanding on its broad proportionality, and to focus on some of the issues which are commonly associated with such structures. Rather than setting out a complete ban or full acceptance of *DCS*, the regulatory approach was set to curb governance risks generally entailed in those structures (*pb* appropriation by controlling shareholders).

One may then question whether in light of the enhanced regulation on protection of outside investors there is still any real threat posed by dual-class firms in London markets.

26. The consultation papers and policy statements seem to indicate that the driving principle was to prevent super voting shares or other structures that *allow voting power to be kept within a small group of shareholders* and, in so doing, *prevent flagrant examples rather than focusing on borderline cases*[80]. Therefore, it seems that the regulator did not wish the rules to have a far-reaching effect. The main policy goal of the regulator was to prevent the listing of *artificial structures* designed to *allow control to rest with a small group of shareholders*[81]. Would this alone justify a regulatory approach?

Several studies have shown that retaining control by family groups is not in itself the main issue. The real concerns may arise from *how such group behaves*, i.e., if control translates in practice into a managerial entrenchment situation or cases of *pb* extraction by controlling shareholders. The UK approach may therefore be qualified as a *precautionary* one, construed under the strong assumption that a controlling status stemming from a dual-class scheme *may generate* agency costs and such risk was to be avoided outright. Although not much guidance is provided on what shall be deemed as *artificial structures*, the purpose behind the factors may have been to simply allow identifying (and preventing) specific instances of inefficient levels of *pb* extraction on a case-by-case approach. All in all, a strong emphasis was placed on preventing rather than on curing potential abuses.

27. To sum up, despite the broad *OSOV*, the UK reform may have alleviated important constraints on the implementation of *DCS* structures. The

[80] "Consultation Paper CP12/25 …" (n 29) 115; ""Consultation Paper CP13/15 …" (n 75) 12 and 70; "Policy Statement PS14/8 …" (n 68) 31-32.

[81] "Policy Statement PS14/8 …" (n 68) 31.

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improvement of governance mechanisms alone does not seem, however, to have eased the path towards the adoption of such unpopular class of shares and further regulation seems to be required to overcome the market bias against dual-class companies. While those mechanisms may have aimed at improving investor protection and therefore switch the UK's governance approach on *DCS* in force until 2014, resistance from institutional investors does not seem to have slowed over the years.

f. **Recent developments**

28. The Government and the FCA brought again the issue to the table in 2017 and there seems to be a shift in the traditional opposing attitude towards *DCS*.

In its Green Paper published in January[82], the HM Government summed up the discussion between those voicing in favour of such structures for allowing firms (particularly high growth and innovative businesses) to retain a long-term perspective by insulating founders from short-term market pressures, on one side, and institutional investors opposing *DCS*, who perceive a risk to high-quality corporate governance and the interests of minority shareholders, on the other side.

Through a discussion paper launched in 2017, the FCA itself raised the possibility of developing an "*international segment*" on which large international (non-UK) companies (particularly early-stage science and technology) with *DCS* structures could list, in order to enhance the attractiveness of UK primary equity markets[83]. The goals were clear: to create a new listing option for mature and successful overseas companies wishing to access UK markets and feeling that the current listing requirements could not be appropriate, and therefore to make the UK exchange an attractive venue for non-UK issuers with controlling rights mechanisms in place which would be incompatible with a conventional premium listing. This segment could then become attractive to companies with founders wishing to retain control rights. If the international segment proposal would be adopted, large international companies with *DCS* structure could consider listing in such segment[84]. However, it is also submitted that the devel-

[82] "Green Paper: Building our Industrial Strategy" (HM Government <https://www.gov.uk/government/consultations/building-our-industrial-strategy> 23 January 2017) 67.

[83] "Discussion Paper DP17/2: (…)" (n 54).

[84] John Ho, "Revisiting the viability to allow dual-class share structure companies to list in the financial market of Hong Kong" (*Common Law World Review*, April 2018) 19.

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opment of such segment would need to go hand in hand with appropriate protective devices for investors in order to foster market confidence.

The regulator seems to revive the old challenge: to find a listing framework which may accommodate foreign listings with different corporate governance structures (especially science and technology businesses) and provide issuers with access to so-called patient capital, while at the same time maintaining high investor protection standards. There seems to be now a willingness to deal with *DCS* in a thorough manner which was absent in the former reform addressed above.

On July 2017, FTSE Russell, a unit of London Stock Exchange Group Plc, took the stance that only companies with at least 5% of voting rights in the hands of public (unrestricted) shareholders will be eligible for listing. This stance is in line with the move taken by other major exchanges all over the world to restrict dual-class listings so as to keep high governance standards (even in more *DCS*-friendly environments, like the US – see *38.* below).

A recent report[85] that the Government is considering a relaxation of the listing rules in view of attracting high-growth companies sounded the alarm among institutional investors. The argument put forward is that London needs to evaluate how it can remain a pre-eminent market in which companies (especially tech start-ups) may consider listing in a post-Brexit world. Some advance that certain safeguard measures will be needed if London decides to go down the route of allowing *DCS*[86]. Therefore, the debate has been heated once again, yet so far no further steps have been taken.

IV. **EU say on the matter – from no-regulation to loyalty shares (?)**

a. **No-regulation**

29. In Europe, *DCS* listings are quite prevalent[87]. However, the approach on deviations from a *OSOV* principle among the European countries is far

[85] Daniel Thomas, Philip Stafford and Patrick Jenkins, "UK seeks change in listing rules to lure tech start-ups" (Financial Times, <https://www.ft.com/content/d4d2da5a-fee8-11e9-be59-e49b2a136b8d> 5 November 2019).
Also: Attracta Mooney, "Big investors fight back over dual-class shares" (Financial Times, < https://www.ft.com/content/bc220535-5055-47ce-811d-fc4a56d32937 > 24 November 2019).

[86] The editorial board, "Why dual-class shares deserve consideration" (Financial Times, <https://www.ft.com/content/6f576e60-0231-11ea-be59-e49b2a136b8d> 11 November 2019).

[87] Stock exchanges in Denmark, Finland, France, Germany, Italy, Norway, Sweden and Switzerland permit such listing. Bebchuk, Kastiel (n 11) 599.

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from being one-sided. A wide-ranging study carried out in 2007[88] concluded that no regulation should be put in place, i.e., harmonization at EU level was not needed. The report released by the European Commission on the assessment of impact of deviations from the proportionality principle[89] provided arguments for and against possible efforts aimed at making such principle binding. The main conclusion was that the current situation (permission of using corporate control re-allocation mechanisms) did not require any intervention[90]. The main reasons for the absence of a regulatory stance seem to be two-fold:

Firstly, arguments for and against controlling positions based on disproportionate holdings of control and cash-flow rights were thought to be inconclusive. Empirical studies have been failing to offer an accurate calculation of *pb* extracted from disproportionate voting structures and, as a result, of the real impact on firm value. Secondly, imposition of a mandatory *OSOV* rule could entail *extra-costs* to an environment well-equipped with devices (of either legal or non-legal nature) protecting outside investors[91].

30. In December 2007, the Organisation for Economic Co-operation and Development ("OECD") reached the same conclusion on the allowance of deviations from a proportionality principle: it is not appropriate to establish such principle as mandatory for listed companies[92]. The report comprises four main conclusions: *(i)* there is nothing *a priori* onerous about separating ownership and control; *(ii)* the cost of regulating proportionality would be considerable; *(iii)* strengthening corporate governance frameworks is a better alternative – it was submitted that if the source of inefficiencies is the spectre of excessive

[88] "Report on the Proportionality Principle in the European Union" (Proportionality Between Ownership and Control in EU Listed Companies: External Study Commissioned by the European Commission; Institutional Shareholder Services (ISS), European Corporate Governance Institute (ECGI), Shearman & Sterling <http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf> 18 May 2007).

[89] "Impact Assessment on the Proportionality between Capital and Control in Listed Companies" (Commission of the European Communities, Commission Staff Working Document, SEC (2007) 1705 <http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2007/sec_2007_1705_en.pdf> 12 December 2007).

[90] Speech at the European Parliament's Legal Affairs Committee (European Commissioner for Internal Market and Services, Charlie McCreevy, Speech/07/592 <http://europa.eu/rapid/press-release_SPEECH-07-592_en.htm> 3 October 2007).
Instead, the Commission shifted the focus to transparency requirements under existing EU legislation.

[91] Morten Bennedsen, Kasper Nielsen, "The Principle of Proportional Ownership, Investor Protection and Firm Value in Western Europe" (ECGI, Finance Working Paper No. 134/2006, October 2006) 3 and 28 = Bennedsen, Nielsen (n 14) 2213 and 2227.

[92] "Lack of Proportionality between Ownership and Control …" (n 24) 5-6.

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pb, then the first-best solution is to discourage the extraction of such benefits[93]; and *(iv)* specific issues can be dealt with through carefully targeted regulation.

The UK reform was not far from the EU approach. Even though the UK took a regulatory step where the EU discouraged countries to take one, the reform was such that it probably meets the conclusions set at the EU level: behind the rules we find a certain recognition that *DCS* are not necessarily inefficient; the UK reform did not engage in regulating proportionality in a true sense; on the contrary and mainly, corporate governance standards were strengthened. As seen above (*24.*), an alternative policy approach to deviations from *OSOV* is to reduce *pb* through legal reforms[94] and it seems that the UK regulator has decided to take this path: the amendment to the listing rules envisaged at improving investor protection by exerting discipline on company insiders, which may lead to a reduction of *pb* consumption.

b. **Loyalty shares – is the UK prepared for these?**

31. The debate has been carried on at the EU level and some European countries have also been experiencing some important changes towards greater flexibility. In 2014, the EU called for an important policy shift on this subject[95], by focusing on long-term investment as a way of countering increasing waves of short-termism[96]. It has been submitted that mechanisms incentivising long-term shareholding should be put in place in order to encourage positive and long-term shareholder engagement. Loyalty shares play a key role in this regard, by awarding double voting rights to shareholders dependant on the time-period that the shares are held, and have already been adopted in France, Italy, the Netherlands and Belgium, and will soon be adopted in Spain. These

[93] It was submitted that high standards of corporate governance and disclosure and a strong regulatory environment may serve to assuage institutional investors' uneasiness about *DCS* – "Lack of Proportionality between Ownership and Control …" (n 24) 31.
[94] Ferrarini (n 7) 13.
[95] By means of a proposal to amend the 2007 Shareholder Rights Directive – "Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement" (European Commission, COM (2014) 213 final, 9 April 2014). Proposal was for Member States to be required to choose between several means to promote long-term shareholding (e.g., additional voting rights, tax incentives, loyalty dividends or loyalty shares), having however been removed from the final text adopted by the Parliament.
[96] Ringe (n 22) 209 and 237.

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amendments may either create the perfect environment for *DCS* to thrive *or* make those less necessary.

32. Loyalty shares lead us to question whether its core feature – higher voting rights given to long-standing investors – may be seen as a reasonable *deviation* from a *OSOV* rule. One may in particular guess whether the *commercial rationale* underlying these shares could in theory meet the criteria under factor *(3)* of the UK LR 7.2.4.G (see *19.* above). We found three supporting points:

Firstly, the business rationale behind these share structures seems to be a valid one: it does not aim to entrench a controlling situation (even though it may produce that result) but operates as a form of compensation to active shareholders for their costly monitoring and the illiquidity of their equity holdings[97], i.e., the discrimination between shareholders has a sound motivation. Additionally, loyalty shares may benefit non-controlling shareholders as much as controlling shareholders – both may see their loyalty rewarded with more control rights.

Secondly, shareholders' long-term engagement is presented as an actual (occurred) state of affairs, therefore easing up the burden placed on shareholders to prove it, as opposed to having to prove (if ever accepted as *rationale*) the *likelihood* of a long-term commitment under a *DCS* structure at listing (IPO) stage (as seen in the UK premium listing reform).

Thirdly, double voting rights being attached to shareholders rather than to shares is also a feature that may distance loyalty shares from the issues associated with dual-class equity and therefore bring it closer to allowance – i.e., any controlling status would always cease with the transfer of shares; for such reason, loyalty shares may grant the benefit of control, but offer no economic advantage in case of transfer of shares (in the absence of a voting premium).

33. The UK initiative on premium listing regime indicates that loyalty shares might never gain much sympathy in this jurisdiction, as it seems that the spectrum of discussion is somehow distant from that underlying such equity structures. Lack of protection of outside investors against entrenchment effects of control is still present[98] and therefore implementation of loyalty shares is likely to face resistance from institutional investors[99]. This type of shares could

[97] *Idem* 42.

[98] Patrick Bolton, Frédéric Samama, "Loyalty-Shares: Rewarding Long-Term Investors" (*Journal of Applied Corporate Finance*, Vol. 25. No. 3, Summer 2013) 48.

[99] E.g., the opposition to proposals from Lord Myners for a "two-tier" shareholder register that would see greater voting rights given to longstanding institutional investors – Jane Croft, Kate Burgess,

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result in a controlling situation which the amended premium regime envisages at preventing in the first place. Moreover, the EU policy debate around the need to safeguard long-run performance as a way of tackling myopic behaviours from shorter-term and less-informed investors is in general absent from the UK regulatory initiative. On top of that, a potential reduction in the underlying liquidity of the shares could also represent an obstacle to its allowance[100] [as per factor *(2)* of LR 7.2.4.G] – see *18.* above.

34. While one could expect a strong opposition to loyalty shares from UK institutional investors, one may further question whether this behaviour results in an optimal governance outcome, especially at a time where several voices increasingly unveil a negative side of interventions by these investors[101] – institutional shareholders, part of the UK solution on *DCS*, have been identified as part of the problem[102]. However, signing up to stewardship codes[103] has been deemed by the UK policymaker as a better mechanism of encouraging long-term shareholding than double voting rights and it remains to be seen whether it will suffice and for how long.

"Myners' two-tier shares plan under fire" (Financial Times, <http://www.ft.com/cms/s/0/dae96d1e-7fc3-11de-85dc-00144feabdc0.html?ft_site=falcon&desktop=true> 3August 2009).

[100] Loss of liquidity is pointed out as a major concern related to these structures – Bolton, Samama (n 98) 44 and 47.

[101] "Proposal for a Directive …" (n 95) recitals 2 and 9, underlining that the current level of monitoring and engagement by institutional investors is inadequate and too focused on short-term returns, leading to suboptimal corporate governance and performance of listed companies.
Some studies estimate that only a small minority (circa 10%) of institutional shareholders care about long-run performance and are informed about company's long-term value – Bolton, Samama (n 98) 38; Jane Croft, Kate Burgess (n 99).

[102] Short-termism concerns are addressed by the "The Kay Review of UK Equity Markets and Long-Term Decision Making" (John Kay <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf> July 2012). Also see "Building a Culture of Long-Term Equity Investment. Implementation of the Kay Review: Progress Report" (Department for Business, Innovation and Skills <https://www.gov.uk/government/publications/kay-review-of-uk-equity-markets-and-long-term-decision-making-implementation-progress-report> October 2014). The study concludes that short-termism is a problem in UK equity markets.

[103] See "The UK Stewardship Code" (Financial Reporting Council <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx> September 2012), which complements the UK Corporate Governance Code (September 2014) for listed companies and applies on a "comply or explain" basis. This Code establishes stewardship responsibilities for institutional investors aimed to promote the long-term success of companies.

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V. **Recent trends in major stock indices**

35. A key concern around multiple voting shares relates to competitiveness of financial markets. The improvement of corporate governance standards by increasing protection of outside investors is commonly discussed alongside the need to ensure that stock exchanges will remain capable of attracting large companies, including those with dual-class structures. These goals are found in a conflicting relationship and regulatory interventions have been trying to deal with both in a balanced way[104] – this translates into interesting dynamics between the analysed stock indices.

36. Reasons to examine the legal systems below vary. It relates to their different features – both the *(i)* ownership structure (companies in the US present a widely dispersed-share ownership, as opposed to the prevailing concentrated ownership in East Asian countries)[105] and *(ii)* specific governance and listing frameworks on *DCS*, ranging from traditionally restrictive in Hong Kong and Singapore (yet not anymore) to permissive regimes (though under rather different governance structures) in Canada and in the US, resulting in *(iii)* contrasting outcomes in terms of popularity of *DCS* (common in the US and Canada and traditionally rare in Hong Kong and Singapore[106]), as well as to the fact that *(iv)* all these jurisdictions have been experiencing policy debates and regulatory changes on the matter.

37. The UK legal and market features relate to these jurisdictions in different ways. It shares with the US market a widely-dispersed ownership structure[107] – ownership and control structures are significantly more concentrated in Canada than in US[108] – differently from Asian countries, where a concentrated ownership structure largely prevails[109]; the UK legal approach on *DCS* was, until 2014, similar to the one taken by the US and Canada, though relying on far less governance instruments focused on protection of non-controlling shareholders; the reform on *DCS* for premium listed companies moved it away

[104] Ventoruzzo (n 35).
[105] Agency costs arising from the separation of ownership and control are less likely to be prevalent in companies with concentrated ownership, typical of Asian markets.
[106] Adams, Ferreira (n 14) 6.
[107] Morck, Wolfenzon, Yeung (n 8) 15.
[108] Yoser Gadhoum, "Politics and Finance: An Analysis of Ultimate Ownership and Control in Canadian and US Corporations. Part I" (*Problems and Perspectives in Management*, Business Perspectives, March 2005) 31.
[109] Chan, Ho (n 17) 167 and 176.

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from these legal systems to bring it closer to Hong Kong's framework (until 2018), albeit the improvement of corporate governance standards on protection of investors resembles those operated more than a decade ago in the US; furthermore, similarly to the UK, *DCS* were until recently rarely used in the analysed East Asian countries[110] (even if separation of cash-flow and control rights was indeed present through other mechanisms)[111], whereas they are more common in the US[112] and considerably more popular in Canada[113].

a. **US**

38. Focus on the US market is inevitable for a set of reasons.

First, the widely dispersed ownership structure found in Anglo-American jurisdictions has no equivalent in the world.

Secondly, there are no restrictions to the adoption of disproportionate voting structures. Corporations with dual class voting shares are allowed to list on the NYSE, NASDAQ and AMEX[114].

An additional reason relates to the longstanding popularity of *DCS*, which was historically seen as an important protection tool against hostile takeovers. These structures have recently been brought back into the spotlight mainly by high-profile technology companies raising capital in the US capital markets[115]. The listing of Snap Inc. in 2017, which went public only with non-voting shares, is the most recent example of US rather flexible positioning on the matter, surrounded however by waves of criticism[116].

[110] Stijn Claessens, Simeon Djankov, Larry Lang, "The Separation of Ownership and Control in East Asian Corporations" (*Journal of Financial Economics*, 58, 2000) 92.
[111] *Idem* 99.
[112] Ventoruzzo (n 35) 4.
[113] Yoser Gadhoum, "Power of Ultimate Controlling Owners: A Survey of Canadian Landscape" (*Journal of Management Governance*, 10, Springer 2006) 187-188.
[114] Olivia Wang, "The Dual-Class Share Structure" (Emory Corporate Governance and Accountability Review, Vol. 2, 63, 2015) 63-64. In NYSE, once shares are listed, companies cannot reduce the voting rights of existing shares or issue a new class of superior voting shares.
[115] In 2014 and 2015, there were 36 and 27 dual-class IPOs in the US.
Yvan Allaire, "The Case for Dual Class of Shares" (Institute for Governance of Private and Public Organizations (IGOPP) <https://igopp.org/en/the-case-for-dual-class-of-shares/> 13 May 2016) 2; Lin, Mehaffy (n 14) 440.
[116] More recently and also against opposing voices, in March 2019, Lyft, Inc. went public with a dual-class structure, with founders retaining around 49% of the voting power while holding less than 5% equity.

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Another important reason lies on the different environment when compared to other markets, e.g., Asian and, to a less extent, the UK. In short, legal and institutional frameworks are said to be available to safeguard the interests of investors and prevent controllers' abuses: stock exchanges are said to be more mature, the presence of influential and activist investors is significant and there is a strong litigious culture by non-controlling shareholders; in addition, companies with high-vote shares are subject to more stringent and ongoing disclosure and reporting obligations; enforceable fiduciary duties of loyalty are yet another important mechanism of constraining *pb* appropriation by controlling shareholders[117]. In general, the US regulatory environment is designed to protect non-controlling shareholders and, as such, significantly minimise the negative effects of *DCS* [118], which makes this country an attractive listing venue for dual-class companies[119].

The Sarbanes–Oxley Act of 2002[120]("SOX"), aimed to protect investors, introduced an extensive collection of corporate governance and disclosure reforms, board oversight provisions and improved internal controls – e.g., the importance of independent directors was expanded. Curiously, some say that a stronger emphasis on best corporate governance practices and scrutiny has led some US companies to abandon *DCS*[121], possibly because listing in the US was expected to reduce the ability of controlling shareholders to divert *pb* [122]. Some doubt that the monitoring mechanisms under the US legal, regulatory and institutional framework are enough to assure a great deal of protection to minority shareholders and therefore question the appropriateness of the soft rule of allowance of *DCS*[123].

Institutional investors too have been expressing strong opposition to the use of *DCS* structures and urging US exchanges to limit such implementation[124].

Some recent events already show a trend for restricting US traditional approach towards *DCS*. In July 2017, S&P Dow Jones Indices decided to exclude companies with multiple class share structures from some of its key

[117] Glover, Thamodaran (n 17) 6; Gilson, Schwartz (n 9) 4; Ronald Gilson, Alan Schwartz, "Corporate Control and Credible Commitment" (*International Review of Law and Economics*, 43, 2015) 120.

[118] Huang (n 5) 9-10; Doidge (n 15) 524.

[119] Chan, Ho (n 17) 174-175.

A significant number of well-known public companies have dual-class structures, among which CBS, Comcast, Facebook, Ford, Google, News Corp. and Nike.

[120] Effective as from 30 July 2002.

[121] Gray (n 9) 6.

[122] Doidge (n 15) 526.

[123] Wang (n 114), in particular 71-72.

[124] Bebchuk, Kastiel (n 11).

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indices (among which Snap Inc. itself)[125]. In October 2018, over twenty prominent executives, representing some of America's largest corporations, pension funds and investment firms, came together to sign Commonsense Principles 2.0., which includes a set of corporate governance principles for public companies, their boards of directors and their institutional shareholders (both asset managers and asset owners), and where it is stated that dual class voting *is not a best practice*[126]. The current case-by-case approach of the NYSE is also said to exacerbate uncertainty[127]. The listing of Snap Inc. with full non-voting shares seemed to have set up a clash, with stock exchanges pushing to loosen rules on multiple share classes[128].

b. **Canada**

39. *DCS* have been used by a range of investors to access Canadian capital markets, making it a common feature of these markets for a long time, despite the recent decreasing trend[129]. The emergence of shareholder activism in Canada in the last decade appeared to culminate in a certain resistance against shares with different voting rights – to a certain extent similarly to the UK – but a flurry of initial public offerings ("IPO") of subordinate voting shares[130] has shown a trend in the opposite direction.

The legal framework provides an additional reason to look at the Canadian regime, which is one of allowance of such structures for listed companies (in the absence of legal prohibitions)[131]. However, while Toronto Stock Exchange

[125] New York-based MSCI decided to keep companies with *DCS* structures after a long review.

[126] It is stated that "*If a company has dual class voting, which sometimes is intended to protect the company from short-term behavior, the company ordinarily should have specific sunset provisions, based upon time or a triggering event, which would eliminate dual class voting. In addition, all shareholders should be treated equally in any corporate transaction*".

[127] Chan, Ho (n 17) 166.

[128] Andrea Tan, Benjamin Robertson, "Index Giants Clash With Exchanges Over Shareholder Rights" (Bloomberg, <https://www.bloomberg.com/news/articles/2017-08-03/index-giants-clash-with-exchanges-over-shareholder-voting-rights> 3August 2017).

[129] In 2019, there were 69 dual-class companies listed on the TSX, down from 100 in 2005. Only 23 Canadian companies went public since 2005 with a dual-class of shares while 16 of the 100 have converted to a single-class - "Policy Paper No 11: The Case for Dual-Class of Shares" (Institute for Governance of Private and Public Organizations (IGOPP) <https://igopp.org/en/the-case-for-dual-class-of-shares-2/> 2019).

[130] "Canada Corporate Governance 2016" (International Comparative Legal Guides <http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2016/canada> 13 June 2016).

[131] Gray (n 9) 5; "Second Class Investors …" (n 59) 9.

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("TSX") does not impose an outright restriction[132], it has put in place a called *coattail provision* to protect non-controlling shareholders: an instrument requiring that, should controlling shareholders accept an offer for their shares, such offer must be extended to shareholders owning the other class of shares[133]. Furthermore, the Canadian Coalition for Good Governance ("CCGG") specifies a 4:1 ratio, therefore forcing multiple-voting shareholders to hold a meaningful equity ownership share[134]. The implementation of a mandatory voting cap restriction represents a practical step towards improving the regulation of dual-class firms and minimizing agency costs posed to non-controlling shareholders[135]. Similarly, the coattail provision seems to eliminate a key source of *pb* for controlling shareholders[136]. The CCGG further recommends that non-controlling shareholders elect at least one-third of all board members[137].

This framework enhances the attractiveness of *DCS*, to a certain point alike the US. However, the US framework on *DCS* is even more restrictive and investor opposition is more vocal[138], with the result of these structures being more prevalent in Canada[139]. However, a potential regulatory reform may be on the agenda to improve *DCS* governance. The Institute for Governance of Private and Public Organizations (IGOPP) published in 2019 a new policy paper[140] which revisits the state of dual-class public corporations in Canada and concludes that the benefits of the structures far outweigh their drawbacks, as long as they come with appropriate measures to ensure and protect the rights of minority shareholders[141].

[132] Gray (n 9) 5.

[133] Without such provision, a risk would exist that, in dual-class firms, controlling shareholders would sell their controlling interest at a premium while non-controlling shareholders would not receive a similar offer – Allaire (n 29 – "Controlled Companies Briefing …") 6.

[134] Shareholders would need to own 20% of equity to keep voting control (50% and more) over a dual-class company. "CCGG Publication: Dual Class Share Policy" (Canadian Coalition for Good Governance<http://www.ccgg.ca/site/ccgg/assets/pdf/dual_class_shar_policy_intro__steve,_sept_2013_.pdf> September 2013) 8-9.

[135] Cipollone (n 3) 64.

[136] Cipollone (n 3) 80; Allaire (n 29 – "Dual-Class Share Structures in Canada …") 7, 11-12 and 16.

[137] "CCGG Publication …" (n 134) 7-8.

[138] Gray (n 9) 3.

[139] "Second Class Investors …" (n 49) 10-11.

[140] "Policy Paper No 11 …" (n 129).

[141] IGOPP recommends a number of features to balance the advantages of a family-controlled business, access to outside capital and the interests of minority shareholders, e.g., 4:1 voting ratio, minority board representation, coattail and sunsets.

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c. **Hong Kong**

40. Listing in Hong Kong exchanges is dominated by a large number of family-controlled and state-owned companies. In terms of corporate governance landscape, the market generally lacked strong protection mechanisms for investors until very recently.

A large debate took place in recent years in Hong Kong on whether *DCS* should be permissible under their listing rules, which until 2018 *restricted* the use of such structures.

Departing from the *OSOV* principle, the HKEx Main Board Listing Rule 8.11 stated for over two decades 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*[142]. A formula resembling the UK rule analysed above.

Until recently, the Stock Exchange of Hong Kong ("HKEx") did not allow such structures based on the need to ensure a fair and equal treatment to all shareholders[143]. The HKEx first released a Concept Paper in 2014 to amend the listing rules to allow deviations from the *OSOV* principle underlying such restriction[144], which was opposed by the Securities and Futures Commission (the regulator – "SFC") on the account of the harmful reputational risks[145].

However, soon commentators pointed to the fact that Mainland China was competing to attract IPOs by high-tech companies with special shareholding structures and the Shenzhen Stock Exchange was seeking to ease rules on

[142] Unless differently agreed with the SEHK under exceptional circumstances [HKEx Main Board Listing Rule 8.11(1)]. So far, SEHK has denied the use of this exception – Wang (n 114) 64.

[143] A fundamental principle under the listing rules - Main Board Rule 2.03(4).

Huang (n 5) 13; Norman Ho, "A Tale of Two Cities: Business Trust Listings and Capital Markets in Singapore and Hong Kong" (*Journal of International Business & Law*, Vol. 11, 2012) 315.

The HKEx released in August 2014 a Concept Paper to amend the listing rules to allow deviations from the OSOV principle underlying such restriction, but the Securities and Futures Commission (the regulator – "SFC") unanimously opposed given its associated harmful reputational risks.

"Concept Paper: Weighted Voting Rights" (HKEx <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082.pdf.> August 2014).

"SFC Statement on the SEHK's Draft Proposal on Weighted Voting Rights" (<https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR69> 25 June 2015).

[144] "Concept Paper …" (n 143).

[145] "SFC Statement on the SEHK's Draft Proposal on Weighted Voting Rights" (<https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR69> 25 June 2015).

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listings of companies adopting these structures[146]. This was a main concern, especially after the giant Alibaba had decided in 2014 to move to a US stock exchange[147]. The SFC indicated that it would consider a relaxation of the rule as it could lose a generation of Mainland Chinese companies by sticking to the current rule[148], also in view of discussions in Singapore to take the same step[149]: the attractiveness of HKEx as IPO venue was at stake[150].

Hong Kong legal, regulatory and institutional shortcomings (e.g., lack of a strong class action deterrent and an activist investor culture) seemed to make this country less prepared to welcome a more flexible rule on *DCS*. Differently from the US[151], Hong Kong environment lacked corporate governance tools to prevent abuses from controlling-shareholders. Thus, any changes to Hong Kong stance had to be done in the context of a more structural governance reform aimed at increasing investor protection mechanisms[152]. A point that, as we mention below (*41.*), was also made in Singapore.

HKEx was then slowly reviving its efforts to bring in multi-share class structures so as to remain competitive in a global market for IPO, yet with large institutional investors fighting back, even in the US and Europe listing markets. In June 2017, the topic was resumed through a new Concept Paper[153], which signalled a threat to Hong Kong as an IPO centre posed by possible moves by major centres, like Singapore and London, to allow the listing of companies with *DCS* structures; the document also recognized that one major attraction of the US market for many such companies related to the allowance of *DCS* structures[154]. Hong Kong's ban on listings of companies with *DCS* structures was ruling out potential high growth issuers from seeking a listing in

[146] "Positioning Hong Kong as an International IPO Centre of Choice (Financial Services Development Council, Paper No. 09 <http://www.fsdc.org.hk/en/node/182> June 2014) 60.
[147] Chan, Ho (n 17) 172; Huang (n 5) 2; Lin, Mehaffy (n 14) 438.
[148] Kim (n 5) 51-52; Christopher McKinnon, "Dual-Class Capital Structures: A Legal, Theoretical & Empirical Buy-Side Analysis" (*Michigan Business & Entrepreneurial Law Review*, Vol. 5, 2016) 87. The issue around competitiveness is well emphasized in the "Concept Paper …" (n 143) 29-39, especially in relation to Mainland Chinese companies listing on US exchanges.
[149] Chan, Ho (n 17) 168-169.
[150] Ashley Lee, "One Step Ahead" (*International Financial Law Review* 32, December/January 2014) 26.
[151] Chan, Ho (n 17) 156, 175 and 180; Huang (n 5) 16.
[152] Chan, Ho (n 17) 180-181; "Consultation Conclusions …" (n 60) 32-33.
[153] "Concept Paper: New Board" (HKEx <https://www.hkex.com.hk/News/Market-Consultations/2016-to-Present/June-2017-Concept-Paper-on-New-Board?sc_lang=en> June 2017).
[154] 18 out of 33 (55%) US-listed Mainland Chinese companies with *DCS* structures accounting for 84% of market capitalisation were said to be from the information technology industry where the Hong Kong market was underweighted in.

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Hong Kong. The Paper then called for a broadening of listing eligibility criteria, while maintaining a robust regulatory framework. For that end, and same as in the UK[155], new listing segments allowing for *DCS* structures were proposed to welcome companies with non-standard governance structures, with a look at attracting mostly innovative companies in the technology sector.

The outcome of a large debate was new listing rules in place since April 2018, allowing for *DCS* under certain circumstances[156], and which are set to position the Hong Kong exchange to compete for large tech listings: HKEx will consider listing applications of companies seeking to deviate from the *OSOV* principle, under certain conditions and safeguards; issuers are expected to 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[157]. As expected, the new principles came along with strong non-controlling shareholders protection mechanisms[158].

d. **Singapore**

41. The status in Singapore until 2018 was one of ban of dual-class offerings for listed companies[159], mostly based on fears over control entrenchment[160]. However, and similarly to Hong Kong, discussions about the benefits of *DCS* soon became a priority in the agenda[161]. In 2016, an amendment to the Singa-

[155] See *III.f* above.

[156] Substantial restrictions are set out, e.g., *OSOV* shareholders must be entitled to cast at least 10% of the votes on general meeting resolutions; a class of *DCS* must not entitle the beneficiary to more than ten times the voting power of ordinary shares on general meeting resolutions; at listing *DCS* beneficiaries must be members of the board of directors; *DCS* beneficiaries must own at least 10% of the equity interest; a listed issuer must not increase the proportion of *DCS* above the proportion in issue at listing; *DCS* beneficiaries must cease if after listing they are no longer a member of the board of directors; the weighted voting rights must cease upon transfer of shares.

[157] In July 2018, Xiaomi became the first company with *DCS* to launch an IPO in the HKEx.

[158] The new Chapter 8A, which is excluded from Main Board Listing Rule 8.11.
Main focus is placed on disclosure of *DCS*, convening of extraordinary general meetings by *OSOV* holders, resolutions requiring voting on a one vote per share basis, independent non-executive directors and reporting requirements.

[159] SGX issued guidance on 20 September 2011 stating that Singapore did not permit a company to list with a dual-class share structure – "The Capital Structure of Listed Companies in Singapore" (SGX Regulators Column <http://www.mondovisione.com/news/the-capital-structure-of-listed-companies-in-singapore/ > 20 September 2011).

[160] *Idem*.

[161] McKinnon (n 148) 87; Huang (n 5) 16-19.

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pore Companies Act removed a *OSOV* restriction for unlisted companies[162], so as to provide companies with greater flexibility in capital management and this was expected to pave the way for further regulatory changes in order to capture high profile listings.

An interesting feature in Singaporean market is its typical concentrated ownership. Companies generally grow out of a majority family-owned environment or government-controlled entity[163]. However, until recently there was no evidence of superior voting shares in this country[164].

In 2016, the Singapore Exchange Securities Trading Limited ("SGX") decided to review whether *DCS* should be allowed for listed companies, with some voices claiming for a relaxation of the ban[165], notably to enhance Singapore's attractiveness as a financial centre.

Hong Kong's former restrictive approach on *DCS* structures was seen to create a gap in the market which SGX could fill in. The Ministry of Finance and the Monetary Authority of Singapore stated that a *DCS* structure could raise *entrenchment of control* issues and therefore the subject was one to be carefully evaluated by the SGX [166]. A concern was expressed around the fact that Singaporean companies were predominantly controlled by a group of shareholders, contrasting with other developed markets. All things considered, the banning approach remained in force.

In February 2017, the SGX issued a market consultation paper[167] with in-depth analysis of *DCS*, making the point that even if those structures would work in the US and other markets, it could not work in Singapore given the differences between those markets and Singapore's legal and institutional environment and approach to corporate governance[168]. Despite the long-discussed entrenchment and expropriation risks, some potential advantages were underlined, including supporting innovation, market competitiveness and expanding public financing channels for next-generation Asian companies, while at the same time those risks could be mitigated through a basket of governance safe-

[162] From the first quarter of 2016, unlisted companies became allowed to issue multiple-voting shares.
[163] Ho (n 84) 21.
[164] Claessens, Djankov, Lang (n 110) 82 and 92.
[165] Huang (n 5) 18-19
[166] This was the key concern under the issued guidance – see *n 159* above.
[167] "Possible Listing Framework for Dual Class Share Structures" (SGX <https://www.rajahtannasia.com/media/2716/sgx_dcs_consultation_paper_-sgx_20170216-final.pdf> 16 February 2017).
[168] Such as a fiduciary duty of loyalty owed by controlling shareholders and contingency fee-based class action system, both playing to the benefit of minority shareholders.

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guards[169]. However, also here international investors voiced strong concerns about moves to allow *DCS* listings in Singapore, pointing out that exchange's proposed safeguards could not be sufficient to offset risks related to weighted voting rights.

In 2018, the SGX started to consult on allowing companies to list with *DCS* and, in a move similar to the one taken by the rival Hong Kong (see *40.* above), ended up introducing new rules on the matter in June 2018, confirming a principle of allowance[170] subject to important restrictions and safeguards to mitigate governance risks[171].

e. **Dialogue with the UK reform**

42. The debate in the US is substantially akin to that ongoing in relation to the UK regulatory system: managerial entrenchment *versus* extra monitoring mechanisms. However, theoretical consequences of such discussions differ. Shareholder protection in US dual-class companies is ensured through a strict disclosure regime and fiduciary duties, backed by a strong enforcement power by the Securities and Exchange Commission ("SEC") and an aggressive litigious culture against insiders. These mechanisms seem considerably stronger than in the UK and, by potentially alleviating managerial entrenchment, implementation of *DCS* seems easier – the potential for *pb* extraction is lower in the US than in the UK. The US legal and institutional framework ensures enough

[169] Such as (i) maximum voting differential of 10:1, (ii) prohibition of post-listing issuance of multiple-voting shares, (iii) auto-conversion of owner managers' *DCS* into single-voting shares, and (iv) board independence.

[170] See Mainboard Rules – Rule 210(10) of Part III SGX Mainboard Listings (Chapter 2 Equity Securities).

[171] A *DCS* listing applicant must be *suitable* for listing with such structure and must specify the holders of multiple voting shares at IPO stage; 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; *DCS* holders must be appointed as a responsible director; automatic conversion of *DCS* into 1:1 ordinary voting shares in the event of transfer or the responsible director ceasing to be a director; holders of ordinary voting shares holding at least 10% of the total voting rights on a *OSOV* basis must be able to convene a general meeting; in any general meeting the number of votes that may be cast by holders of ordinary voting shares must be at least 10% of the total voting rights of the issuer; audit, nominating and remuneration committees must be independent; issuer must ensure that requirements relating to *DCS* structures and the rights of the multiple voting shares and ordinary voting shares are set out in the articles of association or other constituent documents.

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protection to safeguard their investors from controllers' abuses and therefore places this market at a privileged position to welcome dual-class firms[172].

Since the UK reform to the premium listing regime resembles that operated by the SOX – e.g., focus on board independency – one question whether the UK will narrow distances from the US as regards the (estimated) levels of *pb* extraction, especially considering that the (exceptionally similar) dispersed share ownership structure seems to be more welcoming for dual-class companies[173]. Influence of institutional investors who strongly support the *OSOV* rule in the UK[174] may however continue to pose an obstacle.

43. Differently from the UK approach, the Canadian legal structure seems to set out a *middle ground* – deviations from a principle of proportional ownership are accepted but those are controlled (e.g., through a voting cap restriction and a coattail provision, a key Canadian feature). The general approach has been one which recognizes the benefits of *DCS* when protection mechanisms in favour of non-controlling shareholders are in place. A similar regulatory step, one with specific governance tools to curb *pb* appropriation generated by *DCS*, is yet to be taken by the UK regulator.

44. Discussions around the adoption of disproportionate voting structures in Hong Kong were until very recently no different from that present in other legal systems, the UK included. Supporters and opponents long debated whether it would be possible to put in place sufficient safeguards or measures to mitigate the potential risks posed by *DCS* and the HKEx believed that it was possible to structure a regime with appropriate investor protections[175].

45. An explicit ban of *DCS* was also found in Singapore until very recently, yet discussions evolved as Hong Kong also prepared a relaxation of the rules. The two classic opposing points of view were found at issue: ensuring that Singapore would remain a competitive financial hub in the capital markets[176], while leaving its reputation as a strong regulatory and corporate governance venue untouched.

[172] Chan, Ho (n 17) 174-175.

[173] Given its potential to mitigate the agency costs arising from a conflict between the interests of shareholders and managers – see *6.* above. Also see discussion in *III.c.2)* above.

[174] Huang (n 5) 11-12.

[175] "Consultation Conclusions …" (n 60).

[176] E.g., the case of Manchester United which listed in the NYSE after disregarding the SGX due to its *DCS* structure (n 37).

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Amendments to the Companies Act in 2016 provided a boost to go further, as unlisted companies became allowed to issue varying voting shares, therefore aligning its regime with the US and the UK laws. The policymaker took a step further to even align the regulatory framework with that in force in Hong Kong, where a similar debate was ongoing, and therefore today both exchanges moved away from the UK to become closer to the US and Canada.

VI. **Final remarks – what to expect next?**

46. Overall, the UK seems to have been left alone as far as effective corporate governance regulation around *DCS* goes and may fall behind its competitors if no further action is taken.

There has been a clear increasing trend towards *(i)* a governance approach focused on improving protection of outsider investors to mitigate agency costs traditionally associated with *DCS* (mainly entrenchment of control risks) – e.g., improvement of board independency standards and of vigilance over related party transactions (especially suited for *pb* extraction[177]) are shared among these jurisdictions; *(ii)* a regulatory approach focused on a relaxation of a *OSOV* principle through deviations aimed at undermining the ability of controlling shareholders to extract *pb*, and *(iii)* a general acceptance of *DCS* structures subject to compliance with certain safeguards. These approaches attempt to preserve strong governance standards for non-controlling shareholders while keeping the stock markets as competitive financial centres – a balance which has long been at the crux of the international debate. Hong Kong and Singapore recently took a bold move and some expect the UK to follow path.

47. Current debates in the UK seem to be substantially similar to the one recently held in other major financial markets, such as Hong Kong and Singapore. Recent moves of these markets to widen their listing criteria in order to attract a more diverse range of issuers may call for a UK reaction. The intention of setting up a new "*international segment*" in London with less stringent listing requirements bears some conceptual resemblance with the idea of implementing a separate "*new board*" (as alternative to an amendment of main segment/board listing rules), which was formerly discussed in Hong Kong, to be later abandoned. The UK Government and regulator seem to be willing to take a more flexible approach towards an allowance of *DCS*, however stock indices

[177] Gilson, Schwartz (n 9) 33.

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may be ready to resist to such proposed reform. Recent moves by some major indexes (S&P Dow Jones and FTSE Russell) to block or restrict dual-class firms may give a boost for institutional investors who have been voicing against multi-class share structures and may after all discourage companies from adopting such structures.

48. All in all, nowadays the debate seems to be less around whether *DCS* firms should be admitted for listing and more focused on which governance tools should be put in place to deal with *DCS* and for how long should these structures be in place. London has long been standing firm on restrictions to *DCS*, however it may be tempted as never before to follow in Hong Kong and Singapore footsteps to relax the ban to ultimately attract emerging technology companies to list in the territory.

Those moves from rival exchanges and low *DCS* listings in London may then call for new action from policymakers to maintain the UK capital market as a competitive listing hub in the current post-Brexit environment, despite the powerful stance of institutional investors, which may still deter the development of such structures[178]. A lesson to be learned from the long and complex debate in Hong Kong and Singapore is that such challenge is not a minor one: the UK regulator will have to be prepared to dialogue with institutional investors and is expected to be required to take a firm step towards a deeper regulation on *DCS* regime (which did not happen in 2014, as analysed above) with enhancement of governance tools on protection of non-controlling shareholders specifically related to *DCS* (e.g., automatic conversion into ordinary shares upon share transfers/retirement/incapacity, minimum equity threshold held by controllers, maximum voting differential, time-based sunset provisions). The 2014 reform may have already paved the way to go further in this regard by reinforcing some protective mechanisms in the context of premium listed companies with controlling shareholders and hence addressing key investors' concerns over the governance of dual-class companies; however, a lot more may be required to overcome market pressures against *DCS* in the territory.

VII. **A glimpse on the Portuguese case**

49. Implementation of dual-class structures in Portugal is not legally possible in light of the direct prohibition rule set out in the companies code,

[178] Perhaps along with the so popular breakthrough rule.

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applying primarily to private companies but also to listed firms (in the absence of a specific rule for this type of companies): no multiple-voting is allowed[179]. This general rule places the country in the group of *OSOV* principle solid advocates, today a minority in Europe[180]. A rule which is then followed by the companies listed in the small-size Portuguese Stock Index.

50. An option under the corporate law is given to shareholders to attach a single vote to a group of shares[181] (as opposed to one share) under the by-laws, which may in practice allow at achieving a slightly different balance of powers – by depriving minority shareholders of their right to vote. However, since the rule must apply to all shares issued by the firm, a disproportionate structure of economic and voting rights (e.g., 1:2 or higher) attaching to different categories of shares – i.e., a proper dual-class instrument as analysed in this article – cannot be achieved in this jurisdiction[182].

51. Another option at the disposal of shareholders is the so-called *voting caps* or *ceilings*, which can be provided for in the articles of incorporation and are in fact commonly adopted in the vast majority of European jurisdictions. This mechanism also translates into a certain distortion of the *OSOV* principle which theoretically works for the benefit of non-controlling shareholders; contrary to *DCS*, these structures seem to favour dispersion rather than concentration of (or control over) voting power.

52. One additional slight deviation from the *OSOV* rule comes in the form of *non-voting (preference) shares*[183] granting a preferential dividend (minimum of 1% of nominal value) which can be issued up to half of the share capital[184]. This

[179] In quota companies (a type of private companies, typically small-size and/or family-controlled, with no dispersed ownership features) a special right can however be created to grant double voting to shareholders up to 20% of the share capital.
[180] Multiple voting rights can be created in several countries, such as Denmark, Finland, France, Ireland, Italy, Norway, Sweden and Switzerland – Wolfgang Bessler, Marco Vendrasco, "Corporate Governance and the Relevance of Shares with Unequal Voting Rights in Europe" (*Center for Finance and Banking Justus-Liebig University Giessen*, Version: 25 October 2019) and Jinhee Kim, Pedro Matos, Ting Xu, "Multi-Class Shares Around the World: The Role of Institutional Investors" (November 2018, unpublished).
[181] With a threshold set at EUR 1,000 of share capital.
[182] See João Nuno Pinto Vieira Dos Santos, "Ações de lealdade – A primazia dos interesses da estabilidade a longo prazo das sociedades anónimas" (*RDS*, VI, 2, 2014) 445-480.
[183] A type of *preferred stocks* or *preference shares*.
[184] A type of *DCS* found in almost all European jurisdictions.

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shows that a certain disproportionate voting structure can be implemented, not through increased but removal of voting power from certain type of shares: however, such removal can (only) be achieved in exchange for a preferred economic right[185] and this feature is enough to move this type of shares away from the rationale underlying *DCS* (and their related governance problems and aims). Despite some recent changes to the regime aimed at improving some of its features, this type of shares has not been gathering so many supporters either, at least as a governance tool to create or reinforce a controlling power status[186].

53. Not only *DCS* structures are not found in the country, loyalty shares are also absent in listed companies – both lack a legal basis[187] and regulation. Contrary to some of its European peers (see *IV.* above), not much attention has been placed on long-term incentives through vote as a driving governance remedy against waves of short-termism under the most recent corporate governance codes issued in the country and therefore a double voting scheme is far from becoming a reality[188].

54. In fact, the former 2010 Corporate Governance Code issued by the Portuguese Securities Market Commission (CMVM) (I.3.3.) set out that companies should ensure proportionality between voting rights and ownership through a specific *OSOV* rule. Under the 2013 CMVM Corporate Governance Code (I.3.)[189], the Portuguese regulator advised listed companies against the implementation of mechanisms which could create a misalignment between dividends and voting rights attached to each share, unless grounded in shareholders' long-term interests.

The 2018 Corporate Governance Code issued by the Portuguese Institute of Corporate Governance (II.1.), the one in force, states that the amount of shares granting in aggregate a single vote (which may be shaped in the by-laws – see *50.* above) should not be set at too high a level, having to specify in their

[185] Pedro Maia, "Voto e *Corporate Governance*. Um novo paradigma para a sociedade anónima" (Almedina, 2019) 377-379, pointing out that this mandatory "compensation" feature hinders the evaluation of the existence of private benefits in Portugal.

[186] In some cases non-voting shares are used to reward stakeholders (e.g., employees) through stock option plans or executive directors' remuneration plans.

[187] Yet there is no direct prohibition of creation of loyalty shares under the law.

[188] Loyalty links as reward for long-term investing seems to be rather established through so-called *loyalty dividends*, meaning an increased remuneration as opposed to increased control. For a thorough analysis of the topic, Fátima Gomes, "Dividendo de Lealdade?" (*II Congresso Direito das Sociedades em Revista, Almedina, Coimbra*, 2012) 401-418.

[189] Now revoked.

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governance reports the option taken whenever the same may create distortions to the *OSOV* principle.

55. While some scholars have been highlighting the importance of double voting and loyalty shares to possibly shake the Portuguese capital markets[190], we have seen no hints that Portugal could be next to join the short list of supporters of loyalty shares following the footsteps of pioneers France and Italy, a list which has been recently growing nonetheless (see *31.* above).

56. Before further consideration is given to the topic, it is yet to be properly assessed whether an excessive focus on short-term results (especially from institutional investors) is a key concern among the listing firms in Portugal and it is yet to be proven if express deviations from *OSOV* or a shareholder loyalty scheme would help at attracting to the Portuguese exchange those firms fearing a loss of control when going public. The few empirical studies made on the subject show no clear evidence on either point, in particular due to the lack of liquidity in the Portuguese stock exchange.

Clearly, if discussions evolve to a stage where these voting structures are to be allowed in code to deal with short-term performance pressures and bring flexibility into the Portuguese stock market (most likely through a reform of the companies code to remove the current formal ban), a governance revolution may be expected in order to properly address the issues posed by weighted voting rights, a lesson taken from the experience of other jurisdictions analysed in this article. So far no changes seem to be on the horizon.

VIII. **Conclusions**

a. A principle of proportional ownership deriving from a *OSOV* rule should be the starting point for providing an adequate alignment of incentives for non-controlling and controlling shareholders alike; yet, deviations from that principle can be appropriate.

b. As alternative to a strict *OSOV* rule, the relevant agency costs can be dealt with through increased investor protection: if a jurisdiction is well-served

[190] Quite emphatically Madalena Perestrelo de Oliveira, "Direito de voto nas sociedades cotadas: da admissibilidade de categorias de ações com direito de voto plural às L-shares" (*RDS*, VII, 2, 2015) 435-470, stating that separation between ownership and control is already achieved through other mechanisms (e.g., vote trading, proxy advisors) leading to deviations to *OSOV* which are commonly accepted and therefore suggesting a flexibility of the legal principle for listed companies.

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with governance safeguards to cope with the adverse effects of misalignment triggered by dual-class equity (*pb* extraction), listing of firms with *DCS* could be considered.

c. The *status quo* in the UK has been one of self-regulation through standards set by institutional investors; the premium listing regime in place sets out a *limited allowance rule*: *DCS* structures are permitted as long as certain open conditions are verified.

d. Conditions underlying those rules are construed as formal extension of the main principle (a broad *OSOV*) rather than as deviations highlighting the circumstances under which *DCS* could be beneficial. The absence of clear-cut safe harbors may result in regulatory uncertainty and the source of decision may turn out to be FCA's case law rather than the code.

e. The regulator seems to have deemed *DCS* as a market-driven subject and/or that the issues arising from multiple-voting shares could be addressed through a general and neutral principle while addressing governance issues typically underlying *DCS*.

f. Waves of short-termism have been highlighting the importance of preserving long-term value through control-enhancing mechanisms, such as loyalty shares, which may either create the perfect environment for traditional *DCS* to thrive or make it less necessary; however, the UK is not likely to welcome these structures.

g. Major stock indices have been experiencing reforms in recent times. Regulatory approaches differ, albeit underlying concerns are substantially common:

i. The US framework shows how strong monitoring mechanisms may mitigate some of *DCS* weaknesses in an effective manner;
ii. The Canadian regime shows that direct regulation on deviations from *OSOV* may alleviate agency costs;
iii. The broad principle of proportionality was recently removed from Hong Kong and corporations with *DCS* structures are now allowed to list on the main stock exchange, after a reform which brought important governance tools to improve investor protection;
iv. Likewise, recent discussions in Singapore around a relaxation of the strict *OSOV* rule ended up with an admission of dual-class companies, subject to restrictions and compliance with strong safeguards to the benefit of non-controlling agents.

h. An increasing trend was identified towards *(i)* a governance approach focused on improving protection of outsider investors to mitigate agency

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costs traditionally associated with *DCS*, *(ii)* a regulatory approach focused on a relaxation of a *OSOV* principle through deviations aimed at undermining the ability of controlling shareholders to extract *pb*, and *(iii)* a general acceptance of *DCS* structures subject to compliance with certain safeguards. These approaches attempt to preserve strong governance standards for non-controlling shareholders while keeping the respective stock markets as competitive financial centres.

i. The current debate seems to be less around whether *DCS* firms should be admitted for listing and more focused on which governance tools should be put in place to deal with *DCS* and for how long should these structures be in place.

j. London has long been standing firm on restrictions to *DCS*, however it may be tempted as never before to follow in Hong Kong and Singapore footsteps to relax the ban to ultimately attract emerging technology companies to list in the territory.

k. Those recent moves from rival exchanges may call for further action from policymakers to maintain the UK capital market a competitive listing hub in the current post-Brexit environment, despite the powerful stance of institutional investors, which may still deter the development of such structures.

l. The 2014 reform may have already paved the way to go further by reinforcing protective mechanisms in the context of premium listed companies with a controlling shareholder, therefore addressing key investors' concerns over the governance of dual-class companies.

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