Permitting Dual Class Shares in the UK Premium Listing Regime — A Path to Enhance rather than Compromise Investor Protection

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Abstract
Unequal voting rights arrangements under dual class share structures are increasingly favoured by entrepreneurs and founders of technology companies, in order to retain a degree of control over the company that is disproportionate to their equity shareholdings. The rise of such share structures around the world has put competitive pressure on the UK Government and the country's financial regulator to relax the one share, one vote principle in the premium listing regime of the London Stock Exchange, to ensure the UK equities market remains world-leading and fit for the future development of the economy. There is, however, a long tradition of institutional investors' distaste for dual class share structures. In fact, the near extinction of dual class listings in the UK capital markets can be largely attributed to the opposition of large British institutions. Therefore, this article will critically discuss the conflict between the demands to attract listings from high-tech and innovative companies and concerns of a race to the bottom in the UK context. It rebuts criticisms based on investor protection and argues that if dual class companies were permitted to list in the Premium Segment, the higher level of regulatory protection provided in the premium listing regime would help enhance minority shareholder protection and shareholder engagement. The additional safeguarding measures, as we have seen from other global financial centres, would also help to restrain the potential abuse of controllers' weighted voting power. Together with the market mechanism, permitting dual class listings in the Premium Segment should be welcomed.

Keywords: capital markets; corporate governance; dual class shares; premium listing; investor protection; UK Listings Review

Introduction

Since late 2019 the UK Government has been discussing the possibility of allowing dual class capital structures in the premium listing regime of the London Stock Exchange (LSE).[1] The revival of initial public offerings (IPOs) with dual class share structures in the US and the increasing popularity of such share structures in Asia has put pressure on the policymakers in the UK.[2] With the recent reform in the leading financial centres, such as Hong Kong, Singapore

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[1] D Thomas, P Stafford and P Jenkins, 'UK seeks change in listing rules to lure tech start-ups' *Financial Times* (5 November 2019) available at https://www.ft.com/content/d4d2da5a-fee8-11e9-be59-e49b2a136b8d; FT editorial, 'Why dual class shares deserve consideration' *Financial Times* (12 November 2019) available at https://www.ft.com/content/6f576e60-0231-11ea-be59-e49b2a136b8d.

[2] M Yan, 'The Myth of Dual Class Shares: Lessons from Asia's Financial Centres' (2021) 21 *Journal of Corporate Law Studies*, DOI: 10.1080/14735970.2020.1870843.

and Shanghai, many stock exchanges now see permitting dual class companies to list as a necessary step to 'stay relevant in a time of relentless competition in the cross-border IPO business.'[3] Discussions around dual class listing are essential if London wants to remain one of the world's leading markets and attract high-tech and innovative companies to list, especially in the context of Brexit and the COVID-19 pandemic.

There is indeed a growing demand for such flexible capital structures among the UK companies. For example, THG Holdings plc (THG) had a dual class IPO on the LSE Main Market's Standard Segment in September 2020. Its founder and chief executive, Matthew Moulding, who retained a 25.1 per cent stake in the company, got one special share, providing him with the ability to pass or prevent the passing of any shareholder resolution, regardless of the support any resolution may or may not have from other shareholders.[4] While THG's IPO falls short of the classic definition of a dual class listing,[5] the essence of the special share is to allow the founder to retain control with less than a majority ownership stake in the company, which is not materially different from dual class share structures.[6] THG raised £1.88 billion in its IPO, making it the best listing in London since Allied Irish Banks' IPO in June 2017.[7] More recently, Deliveroo, an online food delivery giant, also chose to list on the LSE with dual class shares, in March 2021. The Class B shares under the dual class structure provide the founder with 20 votes per share while holders of Class A shares have one vote per share.[8] As a result, the founder and CEO, Will Shu, had 57.5 per cent of votes while only holding 6.3 per cent of share capital immediately after the IPO.[9] Similarly to THG, Deliveroo can only apply for an admission to the LSE's Standard Listing Segment.

As is well known, choosing the standard listing instead of the premium listing makes THG's and Deliveroo's shares ineligible for inclusion in the FTSE UK Index Series.[10] This means passive funds, such as index funds and exchange-traded funds, cannot invest or trade their shares, which in turn compromises liquidity. Besides, not trading on the LSE Main Market's Premium Segment, which is deemed as London's gold standard listing regime, may further reduce the attractiveness of the shares and thereby increase the cost of capital. All these aspects do matter and may force potential issuers to choose other destinations to list their shares. Thus, the pressure on policymakers is also growing.

One year after the exploratory talks between the government and the investment industry on changing listing rules to lure new listings that might otherwise choose New York, Hong Kong

[3] M Leung and R Tung, *Dual-Class Shares: the Good, the Bad, and the Ugly — A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific* (CFA Institute, 2018) 39–41.

[4] THG Prospectus (10 September 2020) 20 and 186, available at https://www.thg.com/ipo-information/.

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

[6] In short, the weighted voting rights under dual class share structures enable founders to retain a degree of control over the company that is disproportionate to their equity shareholdings. See Yan, above n 2.

[7] S Gopinath and R David, 'THG Shares Soar After $2.4 Billion IPO to Ride Online Boom' *Bloomberg* (16 September 2020) available at https://www.bloomberg.com/news/articles/2020-09-16/thg-holdings-rides-online-shopping-boom-with-2-4-billion-ipo.

[8] 'The Company will have two classes of shares at Admission, Class A Shares and Class B Shares. The Class B Shares will not be admitted to listing or to trading on any stock exchange. On a poll, holders of the Class A Shares shall have one vote for every Class A Share held, and for so long as the Founder or a Permitted Transferee holds Class B Shares, the Founder or such Permitted Transferee shall have twenty votes for every Class B Share held.' Deliveroo Holdings plc's Prospectus (22 March 2021) para B.1.3 at 3, available at https://corporate.deliveroo.co.uk/protected_file/175/.

[9] Ibid.

[10] Only Premium Listed Equity Shares are eligible for inclusion in the FTSE UK Index Series. Section 4 'Security Inclusion Criteria' of *FTSE UK Index Series* (December 2020) available at https://research.ftserussell.com/products/downloads/FTSE_UK_Index_Series.pdf.

or Singapore,[11] Chancellor Rishi Sunak formally launched the *UK Listings Review*, led by Lord Hill, in November 2020. The aim was to propose to lift bans over premium listing with dual class shares. The final report of the *UK Listings Review* also recommended, in March 2021, changing the exiting *Listing Rules* to allow dual class share structures for premium listings.[12]

Resistance is, however, very much expected from institutional investors and the like. For example, the International Corporate Governance Network (ICGN), an organisation for institutional shareholders, expressed their strong opposition to dual class share structures immediately after the announcement of the Listings Review.[13] The Government Green Paper on 'Building our Industrial Strategy' has also noted that institutional investors and shareholder representative groups in the UK have opposed dual class share structures.[14]

The dilemma faced by the policymakers is between closing the gap with other global financial centres to lure IPOs, on the one hand, and racing to the bottom regarding the corporate governance standards, on the other hand. This article endeavours to explore the potential future development of dual class share structures in the UK, in particular whether institutional shareholders could once again successfully oppose the use of dual class capitalisation in the institutionally dominated UK equities market. In order to achieve that, the article will discuss the past trends of dual class listings in the UK and the current frictions, together with the experience and lessons from other global financial centres, such as Hong Kong and Singapore, in reforming their listing regimes to accommodate dual class IPOs. Contrary to the conventional view that permitting premium listings with dual class shares would compromise investor protection, this article argues that the permission would actually enhance minority shareholder protection and shareholder engagement in the existing UK listing regime. If investor protection is the genuine concern of those who campaign against dual class shares, then allowing dual class listing in the Premium Segment would provide those inferior voting shareholders with better protection than they have now in the standard listing regime.[15]

The remainder of the article is organised as follows. Section 1 analyses the rise and fall of dual class share structures in the UK in the twentieth century to offer some historical background. Dual class shares, especially non-voting shares, arose as a takeover defence in the emerging hostile takeover markets. However, such structures were disliked and resisted by institutional investors. Due to the growing influence of institutional investment in the late twentieth century, dual class listing has been almost eliminated from the UK. Section 2 then looks into the current call for reinstating dual class listings on the LSE Main Market's Premium Segment. This section discusses the founders' dilemma between retaining control and obtaining financial backing, and how dual class share structures can help founders to overcome the reluctance to go public. The corporate governance debate is critically examined in Section 3. The opposition to permitting dual class listings based on compromised investor protection and shareholder engagement is rebutted, because of the higher regulatory standards available in the premium listing regime. Additional safeguards are also discussed in this section as further reassurance. Section 4 examines the final report of the *UK Listings Review* and government responses. Together with the foregoing critical analysis, this section will explore the potential future of dual class listings on the LSE. The final section concludes the article.

[11] Thomas, Stafford and Jenkins, above n 1.

[12] J Hill, UK Listings Review (Final Report) (3 March 2021).

[13] ICGN, 'Letter response to Call for Evidence – UK Listings Review' (December 2020) available at https://www.icgn.org/policy/letters.

[14] FCA, Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape, Discussion Paper (DP17/2) (February 2017) para 1.21.

[15] This will be discussed in detail in Section 3 below.

1. Overview of dual class shares in the UK

(a) The historical path

Family-dominated firms were prevalent in UK public companies at the beginning of the twentieth century[16] and continued in many UK public companies until the mid-twentieth century.[17] Throughout the twentieth century, firms' rapid growth and expansion was through acquiring other companies.[18] Facilitated by vibrant stock markets and takeover markets, equity issuance played an important role in funding these transactions. Accordingly, family ownership was diluted when issuing new shares to raise finance for acquisitions.[19] It is estimated that more than half of the dilution in the first half of the twentieth century was associated with share issuance for acquisitions.[20]

All mergers and acquisitions that occurred between 1900 and 1950 were the result of an agreement between the merging companies, as the market for corporate control did not exist until 1953, when the first hostile takeover was launched.[21] Facing the emerging hostile takeover market and the threat of hostile takeovers, where the bidder could bypass negotiations with the target companies' directors, companies started to seek protection and erect defences. Dual class shares, normally with voting shares given to insiders and non-voting or limited-voting shares sold to outside investors, were one of the important anti-takeover measures adopted at that time; the unequal voting right arrangements helped to concentrate voting power into the hands of the family members, as the controlling party, and thereby make such dual class companies unlikely takeover targets.[22] For example, in 1965, about 15 per cent of companies listed on the LSE had issued dual class shares with unequal voting rights.[23]

However dual class shares, among other protective measures and takeover defences, did not last long due to the strong opposition of institutional investors. After studying the media coverage on dual class shares, Braggion and Giannetti found that there has been a "marked distaste" and a "prejudice" against the "undesirable practice" of issuing non-voting or limited-voting shares by institutional investors since the late 1950s.[24] The rise of influential institutional investors in the 1960s and 1970s led to their ability to deny dual class share companies access to the capital markets. Companies were forced to unify dual class shares and

[16] L Hannah, *The Rise of the Corporate Economy* (Methuen, London 1976) 54.

[17] L Hannah, 'Visible and Invisible Hands in Great Britain' in A Chandler and H Daems (eds), *Managerial Hierarchies: Comparative Perspectives on the Rise of the Modern Industrial Enterprise* (Harvard University Press, Cambridge 1980) 53.

[18] J Franks and C Mayer, 'Evolution of Ownership and Control Around the World: The Changing Face of Capitalism' in B Hermalin and M Weisbach (eds), The Handbook of the Economics of Corporate Governance (North Holland, Amsterdam 2017) 685–735.

[19] While families rapidly relinquished ownership, they retained control through their positions on the boards of directors. J Franks, C Mayer and S Rossi, 'Spending less time with the family: the decline of family ownership in the United Kingdom' in R Morck (ed), *A History of Corporate Governance Around the World: Family Business Groups to Professional Managers* (University of Chicago Press, Chicago 2005) 583.

[20] Ibid. Moreover, as Professor Cheffins pointed out, takeovers also fostered considerable dilution of blockholding among companies carrying out acquisitions in the second half of twentieth century. B Cheffins, *Corporate Ownership and Control: British Business Transformed* (OUP, Oxford 2008) 317.

[21] In 1953, Charles Clore launched the UK's first successful hostile takeover bid. Franks, Mayer and Rossi, above n 19, at 584.

[22] It is agreed that few takeover defences are more successful than dual class shares. J Seligman, 'Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy' (1986) 54 *George Washington Law Review* 687, 687. In the US, the rise of dual class shares also paralleled a takeover wave. See G Jarrell and A Poulsen, 'Dual-Class Recapitalization as Antitakeover Mechanisms' (1988) 20 *Journal Financial Economics* 129–152.

[23] Franks and Mayer, above n 18, at 685–735. In addition, voting restrictions and strategic block holdings, namely seeking protection under the wing of a friendly parent, are also used.

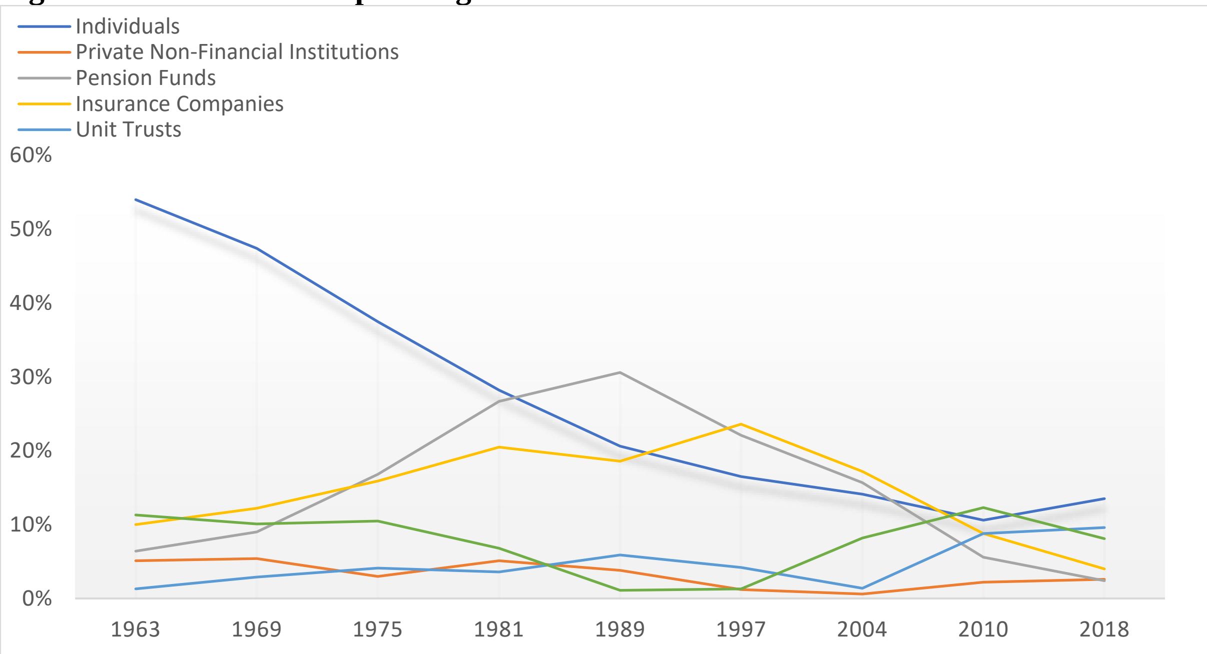
[24] F Braggion and M Giannetti, 'Changing Corporate Governance Norms: Evidence from the Dual Class Shares in the UK' (2019) 37 *Journal of Financial Intermediation* 15, 17.

abandon such share structures to cater for investor demand,[25] and dual class shares were virtually extinguished by the 1980s.[26]

(b) The growing influence of institutional investors

The evolution of the ownership pattern in the UK is detailed elsewhere, so this article does not intend to reiterate it. On the whole, the post-war punitive tax regime, where rates reached nearly 100 per cent of investment income,[27] and the favourable tax regimes for the use of insurance policies and pension funds to participate in retirement saving schemes[28] and capital raising for mergers, provided incentives to unwind control.[29] It is generally agreed that the influence of institutional investors in British companies dramatically rose over the 1960s and 1970s. At the same time, family ownership had been largely displaced in the late twentieth century.[30]

Figure 1: Share Ownership Change in the UK



Source: Office of National Statistics, Share Ownership time series dataset (2020)

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[25] The cost of capital and corporate governance would be affected by investor demand. It is pointed out that "institutional investors, who worked hand in glove with the stock exchange, were able to impose sanctions against firms that engaged in such practices, denying them access to outside finance, if, for example, they sought to use dual-class issues in new equity flotations." Franks, Mayer and Rossi, above n 19, at 610.

[26] Ibid.

[27] B Cheffins and S Bank, 'Corporate Ownership and Control in the UK: The Tax Dimension' (2007) 70 *Modern Law Review* 778, 780–782. See also Hannah, above n 16.

[28] The tax system encouraged the expansion of insurance firms and pension funds. P Davies, 'Institutional Investors in the United Kingdom' in T Baums, R Buxbaum and K Hopt (eds), *Institutional Investors and Corporate Governance* (De Gruyter, Berlin 1993) 257.

[29] Cheffins, above n 20, at 307. In addition, Cheffins outlined the main incentives of unwinding control from both sell side and buy side. Ibid, at 10.

[30] For example, the percentage of shares owned by institutional investors rose from 21% in 1957 to 60% in 1991. Cheffins and Bank, above n 27, at 781. In fact, the institutional ownership had grown to 60% by 1980 in the UK and remained roughly constant since then. See B Black and J Coffee, 'Hail Britannia?: Institutional Investor Behavior under Limited Regulation' (1994) 92 *Michigan Law Review* 1997, 2007.

Although a key feature of public companies in the UK, as in the US, is widely dispersed share ownership,[31] the UK equities market is more institutionally dominated than that of the US.[32] The twenty-five largest institutional shareholders held an absolute majority of the shares of many UK firms by the end of twentieth century.[33] Moreover, there are fewer regulatory barriers in the way of institutional shareholders' communication in the UK, which can reduce the coordination costs and free-rider problems.[34] The governance provisions of the *UK Companies Acts*, the *Corporate Governance Codes*, the *Takeover Codes* and the *Listing Rules* all provide mechanisms for institutional investors to intervene in the management of investee companies.[35] Accordingly, another important feature of the UK corporate governance system is the ability of (semi) dispersed institutional shareholders, such as pension funds and insurance companies, to achieve a sufficient level of coordinated action to be able to influence the rule setting as well as the management of portfolio companies.[36] This largely helps British institutional investors overcome the collective action problem that has plagued American institutional investors and be significantly more active.[37] Among the many notable pro-shareholder changes institutional shareholders have contributed is the "opposition to non-voting, restricted voting or multiple-vote shares in favour of the principle of one share, one vote".[38]

The near extinction of dual class shares in the UK can be primarily attributed to the dominance of institutional investors.[39] Institutional investors were concerned about the interference of such share structures in the takeover process and the potential for management entrenchment. Unequal voting rights under dual class shares separate controlling shareholders' voting rights from their cash flow rights and insulate them from the pressures of external investors and markets. Not surprisingly, institutional investors have sufficient incentive to resist unequal voting right arrangements, such as multiple voting shares or non-voting shares, and press for one vote per share. The low relative valuations of dual class firms compared to single class firms forced companies to abandon dual class capital structures in order to cater investor demand.[40] By having an increasingly significant proportion of the shares, institutional investors in the UK equites market have successfully opposed dual class listings. As a result, while the UK has a very liberal regime, dual class IPOs are extremely unpopular. Thus, it was institutional investors that prevented companies from having dual class shares.

In fact, we can see that the *Report of Company Law Committee*, led by Lord Jenkins in 1960s, was still in favour of the argument supporting voteless shares and concluded that the proposal to abolish non-voting shares was too drastic a step. The report recommended against legislative

[31] See eg R La Porta, F Lopez-De-Silanes and A Shleifer, 'Corporate Ownership Around the World' (1999) 54 *Journal of Finance* 471, 497.

[32] Black and Coffee, above n 30, at 2002.

[33] Ibid, at 2009. It is further pointed out that the five largest institutional shareholders control 30% or more of the shares of smaller firms.

[34] Ibid, at 2002.

[35] It is also pointed out that the government in effect delegated important areas of rule setting (such as takeovers and listing rules) to quasi-governmental organisations which were particularly open to collective institutional influence. P Davies, 'Shareholders in the United Kingdom' in R Thomas and J Hill (eds), *Research Handbook on Shareholder Power* (Edward Elgar 2015) 355–382.

[36] Ibid.

[37] Black and Coffee, above n 30, at 2002. It is also argued that the expectation of oversight is embedded in British culture, this may also result in British institutional investors being more interested in corporate governance than their American counterparts.

[38] Davies, above n 35.

[39] Franks, Mayer and Rossi, above n 19, at 585

[40] Braggion and Giannetti, above n 24, at 18–20. Additionally, concerns about agency problem in companies with dual class shares would be more likely to be heightened by media coverage, and media pessimism has a particularly strong effect on these firms. And this would also directly or indirectly affect investor demands. Ibid. See also *supra* n 25 and accompanying text.

changes to impose a statutory requirement of one share, one vote.[41] Such a proportionate voting rule, requiring equity shares to carry voting rights proportional to their cash flow rights, was not mandated in the *Listing Rules* in the twentieth century either. However, British institutional investors exercised their market level influence by refusing to purchase shares with unequal voting rights, which led to companies with dual class shares being a rarity on the LSE, even though the UK had one of the most liberal regimes in this regard.[42]

(c) One share, one vote for premium-listed companies

Entering the twenty-first century, facing continuous market pressure in connection with investor protection in companies with blockholders, especially the serious corporate governance problems posed by foreign companies who moved their primary listings to London in 2000s,[43] the Financial Conduct Authority (FCA), the regulator of UK financial markets and the UK Listing Authority, had reinforced minority shareholder protection. Among many others, the *Listing Rules* were also tightened to prevent artificial structures involving multiple classes with different voting powers, that would allow a small group of shareholders to exercise control.[44] With the intention of reinforcing minority shareholder protection, the FCA added the following two *Premium Listing Principles* relating to such restrictions.[45]

> Premium Listing Principle 3: 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 4: 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.

This is the first time that the 'one share, one vote' principle becomes mandatory for all premium-listed issuers in the UK. This reflects a desire for a level playing field, concern about possible discrimination against minority shareholders associated with dual class shares, and the

[41] D Jenkins, *Report of the Company Law Committee* (Her Majesty's Stationery Office, London 1962) paras 135 and 136:

> "The supporters of voteless shares take the view that in the event of discrimination by the voting section of shareholders against the holders of the voteless shares the Court would, under section 210 [of Companies Act 1948] or otherwise, intervene at the instance of the latter, and we think this view is well founded.
>
> We have found this question a difficult one, but after careful consideration of the arguments either way we have come to the conclusion that the case for abolition by law of voteless shares has not been made out. Notwithstanding the objections to which they may give rise in certain cases we think that their abolition would be too drastic a step. In any case it would be likely to encourage alternative methods of vesting control in the holders of particular shares or classes of shares. So far as we can see this could only be prevented by imposing a statutory requirement that equity shares should carry voting rights proportional to their rights to participate in the distribution of profits and assets, and that no other shares should have any ordinary voting rights. In our view any such requirement would be unduly restrictive."

In short, the Jenkins Committee argued that it may be desirable that control is retained by insiders, and the acceptance of dual class shares was accordingly reinstated.

[42] Davies, above n 35. This is also why it is argued that the absence of dual class shares in the UK by choice rather than by law. J Franks, C Mayer and S Rossi, 'Ownership: Evolution and Regulation' (2009) 22 *Review of Financial Studies* 4009, 4030.

[43] One of prominent examples is the 2011 boardroom bust-up at Eurasian Natural Resources Corporation pic, which clearly indicates controlling shareholders could cause governance problems, which were largely unprepared by the prior-2014 UK corporate governance system. For more detailed discussion, see B Cheffins, 'The Undermining of UK Corporate Governance(?)' (2013) 33 *Oxford Journal of Legal Studies* 503, 510–516.

[44] F Huang, 'Dual Class Shares Around the Top Global Financial Centres' [2017] *Journal of Business Law* 137, 144–145.

[45] Listing Rules (Listing Regime Enhancements) Instrument 2014 (FCA 2014/33) 7.2.1A.

potential exploitation of private benefits by controlling shareholders at the expense of the public benefits of minority shareholders.

The *Premium Listing Principles* are applicable to issuers admitted to the LSE Main Market's Premium Segment and enforceable by the FCA. This means while companies with differentiated voting rights arrangements are not eligible for the premium listing regime, companies with dual class structures are still eligible to apply for listing on the LSE Main Market's Standard Segment and Alternative Investment Market (AIM). The price for those choosing a dual class IPO in the UK is a "standard" rather than "premium" listing, meaning the company will be subject to comparatively lower corporate governance standards and its listed shares cannot be included in the FTSE or bought by tracker funds.

2. The call for reinstating dual class shares

While dual class shares are now almost non-existent amongst listed companies in the UK, such structures have become increasingly popular elsewhere.[46] Considering the rising popularity of dual class IPOs, especially among high tech companies such as Google (now Alphabet) (2004), LinkedIn (2011), Facebook (2012), Alibaba Group (2014), Snap (2017), Dropbox (2018), and Zoom (2019), the UK cannot afford to lose out in the race to attract and host such sought after companies. London needs to consider how it can remain one of the pre-eminent markets and lure technology start-ups away from New York, Hong Kong, Singapore and other financial centres. The *UK Listing Review*, led by Lord Hill, also aimed to close the gap with both the NASDAQ Stock Exchange (NASDAQ) and the Hong Kong Stock Exchange (HKEx). There is always a competitive pressure. For example, the Chairman of the Hong Kong Securities and Futures Commission said: '[allowing companies with dual class structures to list in Hong Kong] is a competition issue. It is not just the US — the UK and Singapore also want to attract technology and new economy companies to list. Hong Kong needs to play catch up.'[47]

According to the EY Global IPO trends report, in 2020 there were 1,363 IPOs recorded worldwide but the LSE only recorded 30 IPOs.[48] London is ranked 12th by number of IPOs and only accounts for 2.2 per cent of global IPOs.[49] Many of the largest technology companies have chosen dual class share structures to allow the founders to continue to retain some degree of control and to be insulated from the market for corporate control. Take the US for example: 13 out of 30 tech IPOs in 2018, 12 out of 40 tech IPOs in 2019 and 18 out of 42 tech IPOs in 2020 adopted dual class shares.[50] However, at the moment, the UK Listing Authority mandates that issuers with dual class shares cannot apply for "premium listing".[51] As Lord Hill noted to Chancellor Sunak, easing restrictions over dual class listings is not a radical new departure to try to seize a competitive advantage; rather it is about "closing a gap which has opened up".[52]

[46] M Yan, 'A Control-Accountability Analysis of Dual-Class Share (DCS) Structures' (2020) 45 *Delaware Journal of Corporate Law* 1, 12–14.
[47] See E Yiu, 'Securities Commission Backs Introduction of Dual-Class Shares on Hong Kong Stock Exchange' *South China Morning Post* (20 December 2017), available at https://www.scmp.com/business/companies/article/2124972/securities-commission-backs-introduction-dual-class-shares-hong.
[48] EY, Global IPO Trends: Q4 2020 (January 2021) available at https://www.ey.com/en_gl/growth/ipo-trends-2020-q4.
[49] Ibid.
[50] In total, 25 out of 112 newly listed companies in 2019 and 32 out of 165 newly listed companies in 2020 adopted dual class shares. See eg J Ritter, *Initial Public Offerings: Technology Stock IPOs* (December 2020) available at https://site.warrington.ufl.edu/ritter/files/IPOs-Tech.pdf.
[51] This determines issuers cannot access to the FTSE index, and means lower liquidity and higher costs of capital.
[52] J Hill, 'Letter to in the Chancellor' in the *UK Listing Review* (Final Report) (3 March 2021) at 9.

(a) Fear of losing control and the long-term focus

Research finds that the key influencing factor in the listing decision is control, and fear of a loss of control is the most important reason for most unlisted companies to stay private.[53] During IPOs, founders' equity holdings are diluted through the issuance of further shares, and their share of voting rights would fall accordingly under the one share, one vote principle. The loss of majority voting means they may lose the ability to determine the leadership of the firm. If the founders are involved in managing the company as directors and executives, they may be dismissed from leading the company by shareholders holding a simple majority of votes.[54] Noam Wasserman, an established Harvard Business School professor, has pointed out that in many cases founders gave up control of the board and the company in exchange for financial backing, while some entrepreneurs felt it was more important to maintain their ability to lead the business, even at the expense of increasing its value.[55] It is no wonder that founders with a strong desire for long-term control are reluctant to go public. In order to retain control, these companies may choose debt financing instead of equity financing. This will not only increase the costs of raising capital, but also restrict the access to capital markets for those pre-profit technology and innovative companies without a track record of profit making. In other words, some founders or entrepreneurs may choose to sacrifice fast growth by taking less money from outside equity investors in order to retain control.

Unsurprisingly, the fear of losing control of the company after an IPO is an important reason that UK tech-company founders are reluctant to list their companies.[56] While the UK is home to 17 tech unicorns, that is private and independent start-ups that are valued at over US$1 billion, such an emergence of privately-owned high-tech companies has not been reflected in tech IPOs.[57] Meanwhile, UK high-tech companies are disproportionately subjected to merger and acquisition activity compared with their international peers.[58] Many of the UK's privately-owned large high-tech companies (eg DeepMind) and LSE-listed high-tech companies (eg Worldpay) were eventually acquired by foreign companies.[59] The UK Listing Authority is also aware of the difficulty faced by early-stage science and technology companies and other scale-up companies[60] in accessing capital in public markets.[61] In short, the UK public market fails to provide a stable or long-term home for UK technology companies.[62]

The Oxera Report, commissioned by the European Union (EU), also strongly encourages flexibility in the use of dual class shares where national rules or practices prevent such share

[53] European Commission, Primary and secondary equity markets in the EU (Final Report) (November 2020) at 118.

[54] In the UK, a director can be removed by an ordinary resolution at a shareholder meeting before the expiration of his period of office, notwithstanding anything in any agreement between the company and him. Section 168 of *UK Companies Act 2006*.

[55] N Wasserman, 'The Founder's Dilemma' (2008) 86 *Harvard Business Review* 102, 107.

[56] B Reddy, 'Finding the British Google: Relaxing the Prohibition of Dual-Class Stock from the Premium-Tier of the London Stock Exchange' (2020) 79 *Cambridge Law Journal* 315, 316.

[57] UK tech IPOs on the LSE have far lagged behind the US. Ibid, at 318. When dual class recapitalisations are not possible, some firms would rather choose to remain or go private in order to maintain control if firms have good growth prospects. For example, see K Lehn, J Netter and A Poulsen, 'Consolidating corporate control: Dual-class recapitalizations versus leveraged buyouts' (1990) 27 *Journal of Financial Economics* 557–580.

[58] FCA, Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape, Discussion Paper (DP17/2) (February 2017) para 4.12.

[59] It is pointed out that UK technology companies are disproportionately the subject of merger and acquisition (M&A) activity compared with their international peers. FCA, Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape, Discussion Paper (DP17/2) (February 2017) para 4.12.

[60] These 'scale-up' companies are commonly defined as having an average growth in employees or turnover of more than 20% per annum over three years, with a minimum of 20 employees at the start. Ibid, para 4.9

[61] Ibid, paras 4.11–4.13.

[62] Reddy, above n 56, at 321. In contrast, the availability of private funds, such as venture capital and private equity funds can become alternative funding option. For founders who wishes to seek to retain control, when private financing becomes more widely available, it would serve as a substitute for going public.

structures.[63] One suggested change, as acknowledged in the UK government's Industrial Strategy Green Paper, is to make it easier for companies to list with dual class share structures on the UK equities market.[64] This may benefit the UK tech-industry specifically.

Permitting dual class listing on the LSE Main Market's Premium Segment could, however, help founders and entrepreneurs retain control while reaping the benefits of external equity financing.[65] The voting rights under dual class shares can be disproportionately greater than cash flow rights, so even if founders' ownership stakes fall below 50 per cent, they can still retain control via the weighted voting rights.[66] The degree of control retained by founders with high voting power may help them overcome their reluctance to going public by insulating them from short-term market pressures.[67] This is particularly meaningful for technology companies, where visionary founders can maintain control of the company and create more value by implementing long-term projects without worrying unduly about near-term uncertainty and stock market performance. For example, the founders of Google (now Alphabet) defended their offering of dual class shares by arguing: '…outside pressures too often tempt companies to sacrifice long-term opportunities to meet quarterly market expectations. Sometimes this pressure has caused companies to manipulate financial results in order to "make their quarter".'[68] Similarly, for THG, the prospect of relinquishing control was a major reason why its founder had previously been averse to going public.[69] The UK Government has also noted that unequal voting right arrangements in favour of companies' founders would allow them to focus more on long-term performance, and less on short-term market pressures.[70]

(b) Recent dual class IPOs on the LSE

Furthermore, the recent dual class IPOs of THG and Deliveroo also bring focus back to the debate on dual class share structures in the UK context, regarding whether the premium listing regime should be reformed to cater for dual class listings. The special share acquired by Matthew Moulding, the founder and CEO of THG, provides him with the ability to pass or prevent the passing of any shareholder resolution after the IPO.[71] In fact, Moulding acknowledged that the US market was far more accommodating of capital structures that gave founders enhanced voting power and he told the *Financial Times* that "many people in our position would go and list in the US. The level of rights put in place there for myself and the business would be more material."[72] Another high-profile dual class company, Deliveroo, also emphasised the ability of dual class structures to provide its founder and CEO, Will Shu, with

[63] European Commission, Primary and secondary equity markets in the EU (Final Report) (November 2020), p. 13. The report also highlights that there are 5,000 family-run companies above €50m in size that remain unlisted among the fourteen EU member states analysed, which could be a significant source of new listings.

[64] HM Government, Building our Industrial Strategy (Green Paper) (January 2017) at 67.

[65] Yan, above n 2.

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

[67] It is argued that dual class firms face lower short-term market pressure because they have fewer shares held by transient investors or short-term investors. Accordingly, there is a lower probability of being taken over. B Jordan, S Kim and M Liu, 'Growth Opportunities, Short Term Market Pressure, and Dual-Class Share Structure' (2016) 41 *Journal of Corporate Finance* 304, 327.

[68] Google Inc., *Registration Statement (Form S-1) No.333* (April 2004) available at https://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm.

[69] J Eley and S Provan, 'Hut Group targets £4.5bn valuation in London listing' *Financial Times* (27 August 2020) available at https://www.ft.com/content/481b0b9f-504b-482b-9c77-a63b20757d40.

[70] HM Government, Building our Industrial Strategy (Green Paper) (January 2017) at 67.

[71] THG, above n 4.

[72] Eley and Provan, above 70.

the ability to continue to execute on the long-term strategic vision to create long-term shareholder value after the IPO, while still allowing others to share in that growth.[73]

Given THG's and Deliveroo's expected post-IPO market capitalisation, they would be included in the FTSE 100 if their shares were admitted to the Premium Segment. However, due to the bans on dual class shares in the premium listing regime, their shares can only be admitted to the Standard Segment. Put another way, it is notable that some technology companies are even willing to opt out of an important index in order to maintain their control via dual class share structures. It is argued that such share structures respond to the evolving reality of capital market structure.[74] Suffice it to say, the demand from tech-company founders to protect their ability to maintain control and the enthusiasm of the Government to attract more IPOs contribute to the growing call for dual class share structures, especially for high-tech and high-growth businesses in the premium listing regime.

3. The corporate governance debate

Faced with a call to reinstate dual class listings, the UK regulator could ease restrictions on dual class share structures as control-enhancing mechanisms, in order to encourage companies to list without owners having to relinquish control of their companies. London is eager to attract the most successful and innovative companies to list, especially in the aftermath of Brexit and in the midst of the COVID-19 pandemic. There is also a clear policy goal to help UK markets to remain world leading and fit for the future shape of the economy, as reflected in the *UK Listings Review* launched at the end of 2020. The call to reinstate dual class share structures in the premium listing regime is essentially a call for more flexible capital structures to protect entrepreneurs' idiosyncratic visions.[75] The dilemma for regulators is to balance investor protection with this increased demand for flexibility and competitiveness. While acknowledging the potential benefits of dual class listings, the UK regulator is worried about the potential erosion of the UK corporate governance standards.

In fact, investor protection — to strengthen minority shareholder protection in particular — was a key consideration when the UK listing authority mandated one share, one vote for premium-listed issuers in 2014.[76] It was believed that the unequal voting arrangement under dual class share structures would unfairly impinge upon (minority) shareholders' rights and increases their risk of being abused.[77] However, if investor protection is the reason for rejecting dual class shares for premium-listed companies, then how can one justify permitting dual class listing on the Standard Segment, which may equally cause potential abuse of weighted voting power.[78] This section is therefore going to rebut criticisms that rely upon investor protection.

[73] Deliveroo, 'Deliveroo Selects London as Future Listing' (4 March 2021), available at https://uk.deliveroo.news/news/deliveroo-london-tech.html.

[74] J Fisch and S Solomon, 'The Problem of Sunsets' (2019) 99 *Boston University Law Review* 1057, 1064.

[75] Or say to insulate entrepreneurial management from shareholder pressure in general, which will be discussed in more detail below.

[76] FCA, Response to CP13/15 – Enhancing the effectiveness of the Listing Regime (PS14/8 2014) at 6.

[77] The weighted voting rights provided to the controlling shareholders make them virtually insulated from minority shareholders pressure and the disciplinary forces of the market for corporate control. Shareholders without weighted voting rights would subsequently lose their influence over certain types of material transactions.

[78] After all, the higher level of governance standards mandated in the in the premium sector would provide more regulatory protection to inferior voting investors, which is discussed in Section 3(b) below.

(a) (Institutional) Investors' dilemma

Most technology and new economy companies are a potentially high-quality resource for listing.[79] If more of them can overcome their reluctance to go public, both the breadth and depth of capital markets would be consequently increased. Even though companies are currently permitted to list with dual class shares on the LSE Main Market's Standard Segment and AIM, shares of these companies would not be eligible for inclusion in the FTSE UK Index Series, which means index funds and other passive funds cannot trade them.[80] Therefore, relaxing the prohibition on premium listing with dual class shares would encourage more dual class listings, which in turn would provide UK public shareholders with opportunities to take part in the success and growth of those companies.

While founders and entrepreneurial managers rarely want to cede control of their businesses, (institutional) investors will normally want to have some control over their future investment in most equity raisings. Permitting dual class listing would, however, reduce (institutional) investors' influence on both the controlling party and the incumbent management. Thus, similar to the classic dilemma for founders, where on the one hand they have to raise resources in order to capitalise on the opportunities before them, but on the other they are reluctant to give up control over most decision making in order to attract investors, the dilemma for (institutional) investors is that on the one hand they want to share in the success of the fast-growth companies with dual class share structures and enjoy a high return, but on the other hand they are reluctant to relinquish their participatory rights.

Conventionally, shareholders' voting power is the foundation for institutional shareholder engagement and monitoring, and it is tied to the economic returns on their shares. The decoupling of voting power from economic interests under dual class shares would cause the traditional ownership incentives to no longer work. In fact, this issue is twofold. First, the separation between voting rights and cash flow rights leads to the separation of ability and incentive to monitor: shareholders with weighted voting rights are able to discipline management, but may lack the financial incentive to do so; by contrast, shareholders with appropriate ownership incentives to monitor disloyal or ineffective managers may barely have the capability to effect a real change, due to their restricted voting power.[81] The decoupling of economic interest and voting power would systematically weaken the function of the market for corporate control.[82] Secondly, weighted voting rights under dual class shares would allow controlling shareholders to reduce their cash flow rights without affecting their lock on control. With a decline in the percentage of ownership stake, the costs of self-serving conduct would correspondingly decrease and the incentives to extract private benefits increase.[83] For example, a founder may choose the value-reducing action if their pro rata share of loss is smaller than their gain in private benefits, and dual class shares make it possible for a shareholder to retain

[79] This is also why Hong Kong, Singapore and mainland China recently changed their listing rules to accommodate these types of companies to list with dual class shares. M Yan, 'Differentiated Voting Rights Arrangement under Dual-Class Share Structures in China: Expectation, Reality and Future' (2020) 28 *Asia Pacific Law Review*, DOI: 10.1080/10192557.2020.1855794.

[80] This becomes increasingly important as there is an unprecedented shift from active funds to passive funds. For example, the 'Big Three' passive funds, *i.e.* BlackRock, Vanguard and State Street combined, currently constitute the largest shareholder in 87.6% of S&P 500 companies. Yan, above n 2. This is not to mention that an Index excluding dual class companies that outperform the market would also not be in the best interest of index providers who are also for-profit companies.

[81] Besides, shareholder proposals or informal dialogues which are seen by institutional investors as an effective means of enhancing accountability would also be less effective, especially when directors cannot feel any real threats.

[82] H Hu and B Black, 'Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms' (2006) 61 *Business Lawyer* 1011, 1014.

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

full control with a very low shareholding.[84] The distorted incentives exacerbated by dual class shares are regarded as one of the main reasons for institutional investors' resistance to such share structures and their prohibition in premium listings.[85]

As a result, despite it being argued that the enhanced voting rights provided to founders of companies such as Google, Facebook and LinkedIn have contributed to their success by insulating founders from short-term market pressures, many institutional investors and shareholder representative groups have opposed dual class shares, arguing that they would weaken the UK's high standards of corporate governance and disadvantage minority shareholders.[86]

(b) The rebuttal to the main criticism

The main criticism against the dual class share structures is that founders may use the disproportionate voting power provided by such structures to extract *private benefits of control* at the expense of minority shareholders or outside investors. This is the same situation that can occur in any company with controlling shareholders.[87] When the private benefit to a founder outweighs the costs he may bear from value-reducing actions, there will be adequate incentive for the founder to pursue such actions to the detriment of both minority shareholders and society as a whole.[88] Because the UK corporate governance system primarily targets arm's length investors,[89] the upset or frustration that can be caused by a controlling shareholder, either through holding a large block of equity or weighted voting rights, is understandable. However, it should be noted that companies in the UK are free to adopt dual class share structures, and eligible to apply for listing on the LSE Main Market's Standard Segment or Alternative Investment Market with such share structures. The right question to ask therefore becomes will banning premium listings with dual class share structures help to improve minority shareholder protection?

The *UK Listing Rules* that apply to premium-listed companies require an applicant company to demonstrate that it will be carrying on an independent business as its main activity.[90] That is to say, for premium-listed companies with a controlling shareholder, they are mandatorily required to be independent from their controlling shareholders and function independently. As part of the independent business requirement, where a listing applicant has a controlling shareholder[91] upon admission, the *Listing Rules* mandates a written and legally binding relationship agreement between the controlling shareholder and the applicant, to ensure the controlling shareholder will conduct transactions and arrangements with its company at arm's length and on normal commercial terms, and not prevent the company from complying with its

[84] A shareholder in a dual class company with a typical 10:1 ratio needs to hold only 28.6% of shares to obtain 80% of the votes, compared to 80% of shares under one vote per share. Further, he or she only needs as low as a 9.1% of shareholdings to retain majority control. L Bebchuk and K Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Georgetown Law Journal* 1453, 1478.

[85] Reddy, above n 56, at 336.

[86] Such opposition is well acknowledged in the government Green Paper published in 2017. HM Government, Building our Industrial Strategy (Green Paper) (January 2017) at 67.

[87] Such benefits can be either pecuniary, for instance via tunnelling corporate assets or 'non-pecuniary', such as desirable social status to political influence. See eg Gilson, above n 83, at 1663–1664.

[88] The less equity the controlling shareholder has, the greater the incentive to extract private benefits. Ibid, at 1651.

[89] B Cheffins, 'The Undermining of UK Corporate Governance(?)' (2013) 33 *Oxford Journal of Legal Studies* 503, 510.

[90] LR 6.4.1R of *UK Listing Rules*.

[91] According to the *UK Listing Rules*, the controlling shareholder means any person who exercises or controls on their own or together with any person with whom they are acting in concert, 30% or more of the votes able to be cast on all or substantially all matters at general meetings of the company. See FCA Handbook.

obligations under the *Listing Rules* or circumvent the proper application of the *Listing Rules*.[92] Such undertakings in the relationship agreement with a controlling shareholder are required to be disclosed in the company's annual report.[93] If the undertakings of independence are not complied with by the controlling shareholder, the listed company must notify the FCA without delay,[94] and all transactions with the controlling shareholder will be subject to scrutiny regardless of the size of the transaction.[95] The FCA also reserves power to cancel the listing as an ultimate sanction for non-compliance with the *Listing Rules*.[96]

A very common approach for shareholders to extract monetary benefits is to use related party transactions as an instrument for tunnelling, and the *Listing Rules* mandates strict scrutiny for such transactions or arrangements between a listed company and related parties.[97] The listed company is required to make a notification including the details of transaction, the related party and the nature and extent of the related party's interest in the transaction, and then to send related party circulars to shareholders.[98] Shareholder approval is required for related party transactions, and the listed company must also ensure the related party does not vote on the relevant resolution.[99]

Another dramatic type of transaction, where a controlling shareholder may have a personal agenda that clashes with the interests of minority shareholders, is where they want to delist the company and take it private.[100] For cancellation of listing, there are also special rules designed to protect minority shareholders in companies with premium listings.[101] First, a special majority of not less than 75 per cent of the votes is required for the resolution. And, secondly, if the company has a controlling shareholder, then a majority of the votes from independent shareholders is also required for the prior approval of the resolution.[102] Besides, independent directors are used to further ensure the accountability and protect the interest of the company as a whole. In a premium-listed company, the (re-)election of any independent director must be additionally approved by the non-controlling shareholders.[103]

However, all the above requirements only apply to a company that has premium listing.[104] In other words, the *Listing Rules* relating to independent business requirements, relationship agreements with controlling shareholders, additional scrutiny and shareholder approval for significant transactions, related party transactions and cancellation of listing, among others, cannot protect minority shareholders in standard-listed companies. And the *UK Corporate Governance Code* will not be applied to these companies either. This means that companies admitted to the Standard Segment are subject to significantly lower obligations when compared with their counterparts in the Premium Segment. If the genuine concern is about shareholder

[92] LR 6.5.4R of *UK Listing Rules*. Even after getting listed, the above-mentioned agreement is required to put in place at all times to ensure the controlling shareholder's compliance. See 9.2.2ADR *UK Listing Rules*.

[93] LR 9.8.4R (14) of *UK Listing Rules*.

[94] LR 9.2.24R of *UK Listing Rules*.

[95] LR 11.1.1CR of *UK Listing Rules*.

[96] LR 5.2.2G of *UK Listing Rules*.

[97] Related party is defined to include a company's substantial shareholders who have 10% or more of the votes. See LR 11.1.4R and 11.1.4AR of *UK Listing Rules*.

[98] LR 11.1.7R of *UK Listing Rules*.

[99] Ibid.

[100] Cheffins, above n 89, at 525.

[101] LR 5.2.5R of *UK Listing Rules*.

[102] Ibid. Not surprising, a premium-listed company should also put significant transactions to a shareholder vote according to LR 10.1 of *UK Listing Rules*.

[103] There are in fact two approvals: first, a simple majority of shareholder approval is required, and then a simple majority of non-controlling shareholders' approval is also required. LR 9.2.2ER of *UK Listing Rules*.

[104] LR 6.1.1R, 9.1.1R, 10.1.1R, 11.1.1R of *UK Listing Rules*.

protection, it would make more sense to permit dual class companies to list in the Premium Segment in order to impose higher corporate governance standards and provide a higher level of regulatory protection.

Take THG's IPO, for example. Its dual class share structure makes it ineligible to be listed in the Premium Segment. After the IPO, the founder is both the chairman and chief executive officer of THG,[105] he is also the indirect owner of the Propco Group, holding real estate used or occupied by THG under leases.[106] But because THG is not a premium-listed company, the principle relating to the division between the roles of chairman and chief executive in the *UK Corporate Governance Code* are not applicable, and THG is not required to explain any non-compliance in its annual report under the comply or explain approach.[107] Similarly, related party transactions (eg between THG and the Propco Group) will also be subject to less onerous scrutiny, as the relevant provisions in the *Listing Rules* are not applicable to companies with a standard listing.[108] If THG were allowed to be admitted to the Premium Segment, then a higher level of regulatory protection could be provided to investors.

Consequently, banning premium listing with dual class share structures *per se* will not help minority shareholder protection. Precluding companies with dual class shares from admittance to the premium listing regime, but allowing them into the standard listing regime with lower level of regulatory protection for minority shareholders, cannot be justified on the grounds of investor protection. Minority shareholder protection would be much better addressed by positioning shareholders with inferior voting power to use effectively the power available to them under the *Listing Rules*, rather than by precluding companies with dual class shares from listing in the Premium Segment. If mechanisms can be adopted to hold controlling shareholders accountable in companies with premium listings, the same mechanisms should also be able to help mitigate the risk of abuse by founders with multiple voting shares. For example, a listing applicant with dual class shares can be required to enter into a written and legally binding agreement with the holders of high voting shares, to ensure the latter would not prevent the applicant from complying with the *Listing Rules* or pursue self-interest at the expense of other investors. Related party transactions that are likely to lead to conflicts of interest would be subject to shareholder approval, and the related parties (ie, those shareholders with weighted voting rights) would not be allowed to vote on the matter.

(c) Safeguards as further reassurance

As explained above, dual class listing or capitalisation is a way for founders to overcome the founder's dilemma of retaining control while obtaining external equity financing. This explains why such share structures are favoured by many high-growth and high-tech companies across the world. However, the UK regulator understandably needs more assurance in connection with investor protection, in spite of the empirical evidence showing better performance from dual class companies. In fact, as demonstrated in jurisdictions permitting and encouraging dual class listings, safeguards can be adopted to alleviate concerns over potential abuse of weighted voting rights as a corporate governance risk. First of all, regulators can adopt an enhanced voting mechanism. For matters relating to amendment of a company's constitution, merger, division, dissolution and other fundamental corporate changes, multiple voting shares can be

[105] THG, above n 4, at 31.

[106] THG, above n 4, at 7.

[107] Provision 9 of *UK Corporate Governance Code 2018* states that: "The roles of chair and chief executive should not be exercised by the same individual. A chief executive should not become chair of the same company". However, the *Code* is only applicable to companies with a premium listing.

[108] The chapter of related party transactions only applies to a company that has a premium listing. LR 11.1.1R of *UK Listing Rules*.

limited to one vote each, regardless of their class, to constrain founders' ability to exercise their weighted voting rights. Meanwhile, for the appointment and dismissal of independent directors and external auditors, changing the number of voting rights, and other matters that are likely to cause a conflict of interest, founders' multiple voting shares can also be temporarily converted to single voting shares.[109] Such enhanced voting mechanisms can mitigate the potential abuse of power by shareholders with weighted voting rights and protect inferior voting shareholders by providing them with a say on important matters.

Another well-explored restriction on special voting shares is the sunset clause, which converts multiple voting shares into single voting shares.[110] Sunsets can be time-based, event-based or ownership-based.[111] Currently, the most common mandatory sunset provisions are event-based, where the sunset depends on the occurrence of a particular event. The design of sunset provisions is largely motivated visionary founders' or entrepreneurial managers' belief in their ability to create more value by implementing a longer-term project without the fear of losing control.[112] When they can no longer lead or contribute to the management of the company, the justification of retaining their superclass of shares with disproportionately greater voting rights would disappear. The event normally includes the transfer of the multiple voting shares and the death, retirement or incapacity of the holders of such shares.[113]

Thirdly, capping the maximum votes of the special voting shares can also serve as an effective means of constraining the divergence between the control and economic rights attached to them. For instance, the *Singapore Listing Rules* mandate that each multiple voting share shall not carry more than 10 votes per share.[114] The HKEx has a similar mandatory limitation on the ratio of high voting rights to low voting rights.[115] As the high-to-low voting ratio determines the fraction of equity shareholdings a controller needs in order to retain the control rights, the essence of limiting the maximal voting differential is to ensure founders' ownership incentive

[109] For example, Rule 730B 'Dual Class Share Structure' of the *Listing Rules of Singapore Stock Exchange (Mainboard)* specifies that: "For an issuer with a dual class share structure, the following matters must be voted through the enhanced voting process: (1) changes to the issuer's Articles of Association or other constituent documents; (2) variation of rights attached to any class of shares; (3) appointment and removal of independent directors; (4) appointment and removal of auditors; (5) reverse takeover of the issuer; (6) winding up of the issuer; and (7) delisting of the issuer." Similarly, Rule 8A.24 of *HKEx Main Board Listing Rules* also states that: "Any weighted voting rights attached to any class of shares in a listed issuer must be disregarded and must not entitle the beneficiary to more than one vote per share on any resolution to approve the following matters: (1) changes to the listed issuer's constitutional documents, however framed; (2) variation of rights attached to any class of shares; (3) the appointment or removal of an independent non-executive director; (4) the appointment or removal of auditors; and (5) the voluntary winding-up of the listed issuer."

[110] For example, see M Moore, 'Designing Dual Class Sunsets: The Case for a Transfer-Centered Approach' (2020) 12 *William & Mary Business Law Review* 93–166; L Bebchuk and K Kastiel, 'The Untenable Case for Perpetual Dual-Class Stock' (2017) 103 *Virginia Law Review* 585–630; J Fisch and S Solomon, 'The Problem of Sunsets' (2019) 99 *Boston University Law Review* 1057–1094. B Sharfman, 'The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuck and Kastiel' (2019) 93 *Southern California Law Review Postscript* 1–10.

[111] For more detailed discussion, see Yan, above n 2.

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

[113] For example, Rule 210(10)(f) of *Listing Rules of Singapore Stock Exchange (Mainboard)* specifies: "An issuer with a dual class share structure must have automatic conversion provisions which provide that a multiple voting share will be converted into an ordinary voting share on a one-for-one basis in the event that: (i) the multiple voting share is sold or transferred to any person… or (ii) a responsible director ceases service as a director (whether through death, incapacity, retirement, resignation or otherwise)…". Similarly, Rule 8A.17 the *HKEx Main Board Listing Rules* also specifies: "The beneficiary's weighted voting rights in a listed issuer must cease if, at any time after listing, the beneficiary is: (1) deceased; (2) no longer a member of the issuer's board of directors; (3) deemed by the Exchange to be incapacitated for the purpose of performing his or her duties as a director; or (4) deemed by the Exchange to no longer meet the requirements of a director set out in these rules."

[114] Rule 210(10)(d) of the *Listing Rules of Singapore Stock Exchange (Mainboard)*.

[115] Rule 8A.10 of the *HKEx Main Board Listing Rules* states: 'A class of shares conferring weighted voting rights in a listed issuer must not entitle the beneficiary to more than ten times the voting power of ordinary shares, on any resolution tabled at the issuer's general meetings.'

through allowing them to retain a higher percentage of equity shareholdings; this mitigates expropriation risks and better aligns founders' interests with those of outside investors.[116]

Fourthly, investor protection and managerial accountability under dual class share structures can also be checked by ensuring the independence of the board. For example, the *Hong Kong Listing Rules* mandate each listed dual class company to establish a corporate governance committee with independent non-executive directors to monitor the management of the company.[117] In Singapore, independent directors are required to constitute a majority of the audit, nominating and remuneration committees of dual class companies, and to serve as chairpersons of these board committees.[118] Thus, shareholders with inferior voting rights can be provided with the veto rights of electing independent directors, in order to increase the independence of the board from the controlling shareholders.[119] Last but not least, enhanced disclosure requirements that mandate information about the rationale for having such share structures, and the associated risks for non-controlling shareholders, can help to reduce outside investors' costs of obtaining information relating to dual class share structures. This also allows them to better understand the risks associated with such share structures before making an informed investment decision.[120]

In short, although dual class share structures may affect investors' ability to participate in the internal governance of companies, such structures do not necessarily mean inadequate investor protection. Just as the agency costs between majority and minority shareholders in single class companies with controlling shareholders can be controlled, the potentially increased risks caused by dual class shares are by no means uncontrollable. After all, regulators are expected to combine high standards of regulation with flexibility. The foregoing discussion on mechanisms of enhanced voting, sunset, maximal voting differential, independent directors and disclosure outlines just some of the examples the UK regulator could consider adopting as further reassurance to investors and as a check on the exercising of founders' multiple voting rights under dual class structures.[121]

(d) Shareholder engagement

While institutional investors may have a continuing bias in favour of passivity, as concluded in the Myners Report,[122] the British government has been applying non-legislative pressures since the beginning of the twenty-first century. The *Companies (Shareholders' Rights) Regulations*, *Stewardship Codes*, *Corporate Governance Codes* and various government consultations all aim to encourage shareholders to be more active and play a more important

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[116] When the ratio increases, it means a controller can drastically decrease their equity holding without losing control, which would then enlarge the divergence between their control and ownership which in turn increase the controller's incentive to extract private benefits. See eg Yan, above n 46, at 32–33.

[117] Rule 8A.30 of *HKEx Main Board Listing Rules*.

[118] Rule 210(10)(i) of *SGX Mainboard Rules*.

[119] Perhaps, more radically, special rights for minority shareholders to be represented by non-executive directors can also be considered in order to ensure the accountability.

[120] Typical risks may include investors' lack of control and exclusion from major indexes. For detailed disclosure requirements, see eg the *Singapore Listing Rules* where dual class companies are required to additionally provide: (a) A statement on the cover page of the document that the issuer is a company with a dual class share structure; (b) Details of the dual class share structure and its associated risks; (c) The rationale for adopting the dual class share structure; (d) Matters that are subject to the enhanced voting process and the implications to holders of ordinary voting shares; (e) Key provisions of the Articles of Association or other constituent documents relating to the dual class share structure; and (f) The following details for each holder of multiple voting shares (name of shareholder, number and total voting rights of multiple voting shares, number and total voting rights of ordinary voting shares). Rule 610 of *SGX Mainboard Rules*.

[121] However, it should be borne in mind that safeguarding measures are indeed a double-edged sword. Although they could help mitigate the potential abuse of enhanced control as corporate governance risks, these safeguarding measures would compromise the value of dual class shares. More discussion on this contention can be found in Section 4(b).

[122] P Myners, *Institutional Investment in the UK: A Review* (March 2001) at 89.

role in corporate governance, as it is believed that shareholder engagement could improve managerial accountability, including controlling excessive risk-taking. In particular, the *UK Stewardship Code* encourages institutional investors to exercise their stewardship responsibilities, including monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration.[123] However, the dual class structure would help insulate management from direct (institutional) shareholder pressure and allow them the freedom to manage. If the UK regulator aims to encourage institutional activism and increase (institutional) shareholders' impact on management, then permitting premium listings with dual class shares may have an impact on such a policy choice.

Again, the core of question is not about whether dual class share structures would compromise shareholder engagement, as dual class companies are always allowed to list in the Standard Segment or AIM. It is, rather, about the impact of permitting dual class listing in the Premium Segment. As we can see from the discourse in Section 3(b), as long as dual class listing exists, permitting dual class companies to apply for premium listing will allow (institutional) shareholders to play a greater role in relation to approving related party transactions, cancellation of the listing, and (re-)election of independent directors among other things. In other words, unless (institutional) shareholders decide not to invest into dual class companies at all, allowing these companies to list in the Premium Segment will only provide minority shareholders (ie, shareholders with inferior voting rights in the context of dual class companies) with more chances to engage, compared with solely allowing companies with dual class shares to be admitted to the Standard Segment. Further, enhanced voting processes and other mechanisms as explored in Section 3(c) would also ensure (institutional) shareholders' participatory rights relating fundamental corporate changes or matters that are most likely to cause conflicts of interest.

The *UK Companies Act 2006* also offers minority shareholders means to intervene when the company is not being run in a way that benefit all shareholders. When directors breach their duty to promote the success of the company[124] or other fiduciary duties by managing the company for the personal benefit of founders with weighted voting rights,[125] minority shareholders can seek to obtain leave from the court to initiate a derivative claim on the company's behalf if the board decides not to pursue the wrongdoer.[126] Section 994 of the *Companies Act 2006* also empowers a court to grant relief where a company's affairs have been conducted in a manner that is unfairly prejudicial to the interest of the minority shareholder. As acutely pointed out by Cheffins, the unfair prejudice under section 994 could also help to facilitate the enforcement of a relationship agreement with the controlling shareholder.[127] Accordingly, if stricter obligations can be imposed upon companies, this would potentially provide more grounds for minority shareholders to apply for relief under the *Companies Act 2006*. Thus, permitting dual class companies to be admitted to the Premium Segment, with its higher level of regulatory requirements, could enhance, rather than diminish, shareholders' engagement in dual class companies.

[123] For example, see the guidance to Principle 1 of *UK Stewardship Code 2012*.

[124] Section 172 of *UK Companies Act 2006*.

[125] For example, section 173 of the Companies Act 2006 requires directors to exercise independent judgement and in case a controlling shareholder also serves as a director, section 175 the duty to avoid conflict between personal interests and the interest of the company would deter any self-serving behaviour.

[126] Section 260–264 of *UK Companies Act 2006*.

[127] It is argued that if undertakings contained in a relationship agreement is breached by the controlling shareholder, section 994 petition could be a viable option. For more discussion see Cheffins, above n 89, at 529.

4. Future development and policy recommendations

Flexibility of capital structure and the multiple paths entrepreneurs can take to public markets are seen as central to cultivating entrepreneurship and innovation, one of America's greatest strengths.[128] As declared by the NASDAQ, dual class structures allow investors to invest side-by-side with innovators and high growth companies, enjoying the financial benefits of these companies' success.[129] The *Kalifa Review of UK FinTech* also highlighted the important role of dual class shares in improving the UK listing environment in order to reinvigorate the fintech sector, to drive growth and innovation.[130]

As is well known, UK company law does intentionally leave the affairs of internal corporate management to the company itself and remains silent on many areas of corporate decision-making.[131] It supports the private ordering of corporate governance arrangements including dual class shares.[132] The right question to ask is: will admitting dual class companies to the Premium Segment compromise minority shareholder protection in the existing UK listing regime? The main objection to such permission is based on investor protection and shareholder engagement, and this has already been critically examined and rebutted in Section 3. The higher corporate governance standards and regulatory requirements in the premium listing regime can offer more protection to minority shareholders than they currently enjoy in dual class companies in the Standard Segment.

(a) Lord Hill's report

Once the UK regulator's concern over maintaining high governance standards and investor protection has been appropriately addressed, there will be no further reason to continue banning premium listings with dual class structures.[133] Just as many other developed economies that have started and/or continue to support dual class structures, the UK is also attempting to follow this trend in order to make London a more attractive place for entrepreneurs to take companies public. Lord Hill's report highlights the importance of dual class listings and recommends changes in the *Listing Rules* in order to allow companies with dual class share structures to list on the LSE Main Market's Premium Segment.[134] Following the *UK Listings Review*, Lord Hill's report also identifies four key concerns: (1) conversion/termination, (2) sunset provisions, (3) (ratio of) voting rights, (4) scope of rights attached to Class B shares.[135] The first issue concerns when special voting shares will convert into ordinary voting shares on transfer, a classic event-based sunset scenario.[136] The second concern is about the time-based sunset. The third is about maximal voting difference between special and ordinary voting shares. The fourth concern is about the constraint over controllers' ability to exercise their weighted voting rights on certain issues, such as fundamental corporate changes or matters that are most likely to cause conflicts of interest.

[128] A Friedman, *The Promise of Market Reform: Reigniting America's Economic Engine* (May 18, 2017) available at https://corpgov.law.harvard.edu/2017/05/18/the-promise-of-market-reform-reigniting-americas-economic-engine/.

[129] Ibid.

[130] The Kalifa Review of UK FinTech (Final Report) (26 February 2021).

[131] This is due largely to the partnership tradition of the UK company law, where the constitution of the companies is regarded as essentially contractual. See LCB Gower, 'Some Contrasts Between British and American Corporation Law' (1956) 69 *Harvard Law Review* 1369, 1376.

[132] While the default position is one share, one vote, companies are generally allowed to design their own voting rules under the articles of association. See section 284 general rules of votes of *UK Companies Act 2006*.

[133] However, as discussed later, this does not necessarily mean (institutional) investors would like them.

[134] Hill, above n 12, at 11.

[135] Ibid, at 56–57.

[136] *Supra* Section 3(d).

Accordingly, Lord Hill's report proposes five conditions to allow dual class share structures for companies into the LSE's premium listing regime: (1) a maximum duration of five years; (2) a maximum weighted voting ratio of 20:1; (3) requiring holder(s) of B class shares to be a director of the company; (4) voting matters being limited to ensuring the holder(s) are able to continue as a director and able to block a change of control of the company while the DCSS (dual class share structure) is in force; and (5) limitations on transfer of the B class shares.[137] These conditions are essentially safeguarding measures that aim to constrain the holders of weighted voting power while allowing dual class companies to be admitted to the Premium Segment. They are not materially different from the safeguards discussed in Section 3(c), with the exception of the time-based sunset provision.[138]

(b) An optimistic future for dual class listing in the UK

It is, however, important to note that regulations alone cannot explain the rise and fall of dual class share structures. The absence of dual class listings in the UK is largely attributed to institutional investors' opposition,[139] and IPOs will not proceed or succeed without institutional investors' support. Shares are legal property in their own right,[140] which can be described in terms of their cash flow rights and voting rights.[141] The cash flow rights, such as rights to receive dividends, are economic rights that would not be directly affected by unequal voting rights arrangements.[142] By contrast, the voting rights, namely the governance rights, would be affected by such share structures. Accordingly, it is crucial to know whether UK institutional shareholders care about their governance rights.

While shareholder-friendly governance arrangements and fewer barriers in the way of shareholder coordination in the UK, as discussed in Section 1(b), may favour institutional shareholder activism, the domestic institutions have shifted a significant proportion of their equity investments out of the UK (holding more overseas equities than domestic equities) after the removal of restrictions on capital movements.[143] Non-UK institutional investors now hold half of the shares in the UK equities market.[144] The change in the composition of the institutional shareholder body brings the question of whether overseas institutional investors also have a high commitment to equity investment and shareholder engagement. Alongside incentives for institutional activism, there are also strong disincentives for them to act, including the belief in competitive market pressures and incentives, bias against getting 'locked in', costs and inconvenience of intervention, the 'race to the exit', insufficient resources and expertise, and the fear of government intervention.[145] This is why Paul Davies concluded that "it was clear that institutions often felt that the incentives not to intervene outweighed the

[137] Hill, above n 12, at 11–12.

[138] The decision of five years seems arbitrary, and it is understandable that institutional investors' campaigns on the time-based sunset provision may have an impact on this policy recommendation. See eg Moore, above n 110; Yan, above n 2; Fisch and Solomon, above n 74.

[139] Franks, Mayer and Rossi, above n 40, at 4030. See also *supra* Section 1. But removing the regulatory hurdles could at least help to test the market and keep the door open for potential investors.

[140] For example, Paddy Ireland points out that shares are "readily marketable commodities, liquid assets, titles to revenue easily converted by their holders into money" P Ireland, 'Corporate Governance, Stakeholding, and the Company: Toward a Less Degenerate Capitalism' (1996) 23 *Journal of Law and Society* 287, 303.

[141] Stephen Bainbridge argues that the ownership of shares represents "a proportionate claim on the corporation's net assets in the event of liquidation, the right to a pro rata share of such dividends as may be declared by the board of directors from time to time, and limited electoral rights". S Bainbridge, *Corporate Governance after the Financial Crisis* (OUP, Oxford 2012) 235.

[142] In particular, when appropriate safeguarding measures can be applied as discussed above, the economic rights contained in the shares shall not be the principal reason for institutional shareholders to reject dual class structure.

[143] It is also noted that the UK pension schemes now re-weight in favour of bonds and out of equity. Davies, above n 35.

[144] Office of National Statistics, Share Ownership time series dataset (January 2020) available at https://www.ons.gov.uk/economy/investmentspensionsandtrusts/datasets/shareownership.

[145] Cheffins, above n 20, at 377–381.

incentives to do so".[146] As a result, UK institutional investors rarely intervene to change management unless there are serious doubts about the integrity or competence of the incumbent management.[147] In other words, such interventions remain 'defensive' in orientation.[148]

Meanwhile, the rise of index funds and exchange-traded funds, which are designed to automatically track a market index and match its performance, also highlight that most investors are weakly motivated voters and will rarely use their voting power to participate in corporate governance.[149] While the UK's shift from active to passive investment strategies is modest compared to the unprecedented shift in the US,[150] there has been a steady rise in inflows to passive funds in the UK. Although passive funds do not yet dominate the UK markets,[151] the proportion of passive funds in the UK asset management market has increased from 11 per cent in 2015 to 28.6 per cent in 2020.[152] Accordingly, there are reasons to suspect that institutional shareholders' opposition to dual class listings is more an issue of psychological impact than governance impact.[153] If this is the case, then merely improving investor protection will not substantially change UK institutional investors' traditional distaste of dual class shares.[154]

While the success of dual class share structures relies upon market acceptance, institutional investors' *permission* should not become the prerequisite of relaxing premium listings with dual class shares on the LSE. On the grounds that institutional investors have the freedom to choose not to buy shares with unequal voting rights, or to bargain for a discounted price after taking into account their reduced ability to control the management, decisions for issuers to adopt dual class structures should be a choice of private ordering of corporate governance

[146] Davies, above n 35. Institutional investors' continuing bias in favour of passivity is also confirmed by the 2001 Myners Report.

[147] Black and Coffee, above n 30, at 2047–2048

[148] Ibid.

[149] Indeed, these passive funds lack both firm-specific information and incentives to devote appropriate resources to informed voting. See eg D Lund, 'Nonvoting Shares and Efficient Corporate Governance' (2019) 71 *Stanford Law Review* 687, 712.

[150] Between 2008 and 2015 investors bought passively managed funds of approximately US$1 trillion, while at the same time selling holdings of actively managed equity funds worth roughly US$800 billion; and as of year-end 2015, passive index funds managed total assets invested in equities of more than US$4 trillion. See J Fichtner, E Heemskerk and J Garcia-Bernardo, 'Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk' (2017) 19 *Business & Politics* 298, 299.

[151] Passive funds have already represented more than half of US equity markets and biggest shareholders in many big US companies. For example, the 'Big Three' passive funds, *i.e.* BlackRock, Vanguard and State Street combined, currently constitute the largest shareholder in 87.6% of S&P 500 companies. Yan, above n 2.

[152] The Investment Association, Investment Management in the UK 2019-2020 (September 2020) https://www.theia.org/sites/default/files/2020-09/20200924-imsfullreport.pdf.

[153] As discussed in Section 3, if the ultimate objective is to maintain or enhance minority shareholder protection, dual class companies should be allowed to list in the Premium Segment in order to hold superior voting shareholders (ie. the controlling party) more accountable and provide inferior voting shareholders with more protection. Similarly, institutional shareholders can also have more chances to engage in a dual class company with a premium listing.

[154] Enriques and Romano classified present-day institutional investors into "portfolio value maximizing" (PVM) shareholders, who have a preference for maximising the value of their portfolio as a whole, and "firm value maximizing" (FVM) shareholders who have interest in the performance of specific companies to make as much money as possible. By issuing dual class shares, the founders signal to the market that the company will be run as an FVM company instead of PVM company. In other words, dual class companies would primarily focus on firm value irrespective of the consequences that this might have for other firms in the economy. Enriques and Romano, therefore, concluded that the first best strategy for PVM institutional investors is advocating for the elimination of dual class shares to ensure that all firms behave as portfolio value maximisers; but if they cannot reach this outcome, the second-best option is to purchase stakes in firms controlled by FVM shareholders to enjoy additional profits brought by the dual class company though its growth may disrupt the activity of many of their portfolio firms. Just as the two authors observed in the controversial IPO by Snap: "despite their fierce opposition to dual class shares in general, and to Snap's IPO structure in particular, institutional investors purchased Snap's shares *en masse*". For more discussion see L Enriques and A Romano, 'Rewiring Corporate Law for an Interconnected World' (2022) 64 *Arizona Law Review* (forthcoming). Suffice it to say, shareholder protection is not always the primary reason for institutional investors to reject dual class share structures.

arrangements. Private ordering allows individual companies' internal affairs to be tailored to their own attributes and qualities.[155] Investors will buy shares only when they estimate that the value of the governance and economic rights they carry equals or exceeds their price.[156] On the other side, founders and entrepreneurs, as the controlling parties, would bear the cost of dual class shares.[157] When investors are adequately informed about the potential risks associated with unequal voting shares, these factors will be incorporated into their price, facilitated by competition for funding in public markets.[158] In other words, investors would be compensated for their reduced ability to control management by demanding a higher return. This means founders and entrepreneurs have to sacrifice a higher valuation for more control when the investors pay a fair price for inferior voting shares. Thus, in theory, the cost would be borne by the founders and inferior voting shares would not harm external investors.[159]

In fact, UK company law enables private ordering and the issuance of shares with unequal voting rights by providing default, not mandatory, rules. Once the UK regulator can be satisfied with the additional protection for inferior voting shareholders via various safeguarding measures, the bans over dual class structures in the Premium Segment should be released to allow individual companies and investors to make their optimal governance and voting arrangements. There would be no social need to constrain the choice of such share structures.[160] For example, the near extinction of dual class share structures in the UK in the late twentieth century vividly exhibits how investors can constrain such choice.

The London Stock Exchange has backed these relaxations on the use of dual class shares.[161] The FCA, as the UK Listing Authority, also welcomes Lord Hill's report for the *UK Listings Review*.[162] The FCA has committed to act quickly with the aim of publishing a consultation paper by the summer and seeks to make relevant rules (subject to consultation feedback and FCA Board approval) by late 2021.[163] The UK Government also welcomes Lord Hill's report and is committed to ensuring that the UK's markets are as competitive as possible, by supporting flexible capital structures to meet the needs of many different companies.[164] Thus it is very likely that bans over dual class listing on the LSE Main Market's Premium Segment will be lifted by the FCA when new rules are made later this year, and it can be expected that more technology companies will choose London to go public.[165]

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[155] B Sharfman, 'A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs' (2018) 63 *Villanova Law Review* 1, 2.

[156] D Fischel, 'Organized Exchanges and the Regulation of Dual Class Common Stock' (1987) 54 *University of Chicago Law Review* 119, 147.

[157] R Gilson, 'Evaluating Dual Class Common Stock: The Relevance of Substitutes' (1987) 73 *Virginia Law Review* 807, 808–809.

[158] Ibid; see also Committee on Capital Markets Regulation, The Rise of Dual Class Shares: Regulation and Implications (April 2020) available at https://www.capmktsreg.org/wp-content/uploads/2020/04/The-Rise-of-Dual-Class-Shares-04.08.20-1.pdf.

[159] Fischel, above n 156.

[160] K Rydqvist, 'Dual Class Shares: A Review' (1992) 8 *Oxford Review of Economic Policy* 45, 55.

[161] G Parker, D Thomas, P Stafford and M Vincent, 'Sunak to arm City of London for fightback with listings shake-up' *Financial Times* (1 March 2021) available at https://www.ft.com/content/a9e9de26-7f44-41e1-9dd6-3721a52c7d9c.

[162] FCA, 'FCA welcomes Lord Hill's Listing Review report' (3 March 2021) available at https://www.fca.org.uk/news/statements/fca-welcomes-lord-hills-listing-review-report.

[163] Ibid.

[164] HM Government, UK Listings Review: Response (21 April 2021) available at https://www.gov.uk/government/publications/uk-listings-review/uk-listings-review-government-response.

[165] It is reported that Deliveroo's decision to list in London over New York actually follows the publication of Lord Hill's UK Listings Review and Chancellor Sunak's endorsement. Deliveroo, above n 73; see also T Bradshaw, 'Deliveroo targets $10bn valuation in London IPO' *Financial Times* (4 March 2021) available at https://www.ft.com/content/f8108b89-419f-40e8-97c9-ce2c15b905e9. Therefore, there may be some immediate impact of relaxing the ban on dual class listing on the LSE. Nevertheless, with the increase supply of private capital, private financing may also compete with public equity markets for those founders who wishes to seek to retain control. When there is more money chasing deals (which also indicates higher

Last but not least, it should also be noted that strict safeguarding measures will restrain the founders' exercise of weighted voting rights, and hence deter the willingness of potential entrepreneurs to go public with such share structures.[166] They may be forced to choose other, less stringent, jurisdictions as a destination for dual class IPOs.[167] For example, Grab Holdings Inc., a Singapore-headquartered ride-hailing to delivery giant in Southeast Asia, avoided a primary listing on the Singapore Stock Exchange but chose a NASDAQ listing via a US$40 billion merger with a special purpose acquisition company (SPAC).[168] Its co-founder and CEO, Anthony Tan, obtained 60.4 per cent of the voting power while owning a stake of just 2.2 per cent after the listing.[169] Apparently, the maximal voting difference contained in the revised *Singapore Listing Rules* cannot accommodate the level of control Tan desired.[170] When the high/low voting ratio is 10:1, Tan is required to hold 9.1 per cent of shares in order to retain majority control over the company.[171] As he desired a much smaller equity stake, it is unsurprising that NASDAQ, which has much less rigorous rules on dual class shares, was chosen as a destination. In short, if the ultimate goal of permitting dual class shares in the premium listing regime is to boost the flexibility of UK capital markets and attract/retain innovative and high-technology companies to list in London, and to compete with the other international financial hubs, as suggested by the *Kalifa Review of UK FinTech* and Hill's *UK Listings Review*, then the proposed safeguards following the permission should also be very carefully considered and balanced.

Conclusion

Dual class share structures emerged as protective defences against the threat of hostile takeover in the UK in the mid-twentieth century. Such share structures typically include two or more classes of ordinary shares carrying unequal voting rights at general meetings, so they are chosen by controlling shareholders (eg founders) to retain control without having to bear excessive

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firm valuations), the bargaining position of founders in high-growth companies would be increased in negotiating for greater control rights and/or postponing the decision to go public. See eg D Aggarwal et al., 'The Rise of Dual-Class Stock IPOs' *Duke Law School Public Law & Legal Theory Series No. 2020-78* available at http://dx.doi.org/10.2139/ssrn.3690670. While the role of private capital markets becomes increasingly influential, a full analysis of its impact on dual class listing falls beyond the scope of this article. Suffice it to say, public markets remain important and relevant. First, founders' desire to stay private often conflicts with private equity investors' preference to go public. In particular, venture capital funds have a fixed life cycle and taking their portfolio firms public ensures a timely liquidation of their investment and carries considerable reputational benefits. See P Gompers, 'Grandstanding in the Venture Capital Industry' (1996) 42 *Journal of Financial Economics* 133, 147. Thus, a startup may choose to stay private longer before going public, but when it exceeds a certain size going public is still favoured, and IPOs remain the most efficient and profitable exit option in most cases. Meanwhile, public equity markets can provide a more continuous source of financing. See eg E Fontenay, 'The Deregulation of Private Capital and the Decline of the Public Company' (2017) 68 *Hastings Law Journal* 445, 463; M Ewens and J Farre-Mensa, 'The Deregulation of the Private Equity Markets and the Decline in IPOs' 2020 (33) *Review of Financial Studies* 5463–5509. In addition to IPOs, listed companies can raise additional equity capital through a secondary public offering or a follow-on issue. The status of being a listed company also increases their opportunities to access other sources of capital eg, through corporate bond market. The increasing availability of capital would in turn lower costs of capital, among others.

[166] The extremely low take-up of dual class shares in the new IPOs in Hong Kong, Singapore and Shanghai at least partly reflects the reduced attraction of such share structures when mandatory safeguards are stringent. In short, both the intended and unintended impact of these safeguarding measures might over-restrain the controllers' ability to control, and hence overly compromise the intrinsic value of dual class shares. Yan, above n 79.

[167] Or they simply stay private for longer considering the increase supply of private capitals. See *supra* n 165.

[168] Y Lee and Y Lee, 'Grab CEO Tan to Get Majority Voting Control in Record SPAC Deal' *Bloomberg* (15 April 2021) available at https://www.bloomberg.com/news/articles/2021-04-15/grab-ceo-tan-to-get-majority-voting-control-in-record-spac-deal; M Ruehl and S Palma, 'Grab co-founder set to dramatically increase voting rights with Nasdaq listing' *Financial Times* (19 April 2021) available at https://www.ft.com/content/4e23cd61-1a8d-4dc5-aba1-8565fce31882.

[169] Ibid.

[170] See *supra* n 114 and accompanying text.

[171] $9.1\% * 10 > (100\% — 9.1\%) *1$.

cash flow risk.[172] With the rise of institutional investors in the late twentieth century and their opposition to dual class capitalisation, dual class IPOs become increasingly unpopular and companies with dual class shares become almost extinct on the LSE. Moreover, the ban over premium listings with dual class shares on the LSE has effectively made London an international bastion of the one share, one vote principle.

However, in addition to some efficiency-based reasons for choosing dual-class structures,[173] this article finds that permitting dual class listings on the LSE Main Market's Premium Segment would indeed make more sense regarding investor protection and engagement. Companies admitted with premium listings will have more onerous continuing obligations imposed on them than their counterparts in the Standard Segment, which would in turn provide a higher level of regulatory protection for minority shareholders and more opportunities for them to engage. More importantly, investors, and especially institutional investors, can bargain and evaluate the price of inferior voting shares. The near extinction of dual class listings in the UK in the late twentieth century is a good example that the private ordering of voting rights, among other corporate governance arrangements, will lead to desired outcomes. A company intending to list with a dual class share structure should trade off the cost and the benefit of such a structure. As long as the investors pay a fair price for inferior voting shares when their limited ability to influence management is taken into account, the controlling party bears the potential cost, such as a low valuation. This can be further facilitated by the enhanced disclosure mechanism.[174] In short, there is no need to constrain the choice of individual companies' capital structures or voting right arrangements, since they would be constrained by the market.

The recent revival of dual class share structures has been fuelled by tech-company founders favouring it around the world. Competitive pressure is also pushing UK policymakers to relax the limits on such share structures in order to lure more tech IPOs and strengthen London's position as a leading financial centre. Not surprisingly, Lord Hill's report in the *UK Listings Review* has recommended allowing companies with dual class share structures to list in the Premium Listing Segment.[175] This move is welcomed by the LSE, FCA and Government. It is therefore reasonable to foresee that the FCA will permit dual class listings in the premium listing regime, accompanied by safeguards, in the near future. Of course, this will not be the end of the debate over dual class share structures in the UK. Institutional investors will continue to oppose such share structure, but the battleground will be soon shifted from assessing the desirability or permissibility of such dual class structures to how to safeguard holders of inferior voting shares.

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[172] See also R Adams and D Ferreira, 'One Share-One Vote: The Empirical Evidence' (2008) 12 *Review of Finance* 51, 58.

[173] Such as to avoid uninformed outside stockholders' interference, See eg H DeAngelo and L DeAngelo, 'Managerial ownership of voting rights: A study of public corporations with dual classes of common stock' (1985) 14 *Journal of Financial Economics* 33, 35. The change of UK institutions as well as prevalent passivity would also strengthen this type of argument. Empirical evidence also showed that dual class companies outperformed the market and dual class structures can materially increase the value of high-growth companies in terms of market valuation. See D Melas, 'Putting the Spotlight on Spotify: Why Have Stocks with Unequal Voting Rights Outperformed' *MSCI* (3 April 2018) available at https://www.msci.com/www/blog-posts/putting-the-spotlight-on/0898078592. State Street Global Advisors also issued a report finding that S&P 500 companies with dual class share structures outperformed their counterparts by over 26% over a 10-year period between 2007 and 2017. R Kumar, et al., State Street Global Advisors, *Shareholder Rights in the Age of Snap, Market Commentary*, (April 2017) available at https://docplayer.net/56433180-Shareholder-rights-in-the-age-of-snap.html. See also Jordan, Kim and Liu, above n 67, at 318–320; S Bauguess, M Slovin and M Sushka, 'Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights' (2012) 36 *Journal of Banking & Finance* 1244, 1245.

[174] Additional disclosure requirements can also be mandated in order to facilitate investors to make more informed decisions.

[175] Hill, above n 12, at 11.