

# Dual Class Shares Around the Top Global Financial Centres

Dr. Flora Huang  
Essex Law School, UK

E-mail: [flora.huang@essex.ac.uk](mailto:flora.huang@essex.ac.uk)

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## **Abstract**

Dual class shares (DCS) offer additional classes of shares that provide holders with greater voting rights. The paper aims to investigate why leading financial centres have different attitudes towards DCS, with a focus on the recent reforms of their company law and listing rules with respect to DCS.

**Key words:** dual-class shares, financial centre, shareholder voting, stock exchange, listing rules, company law

# Dual Class Shares Around the Top Global Financial Centres

## I. Introduction

Dual class shares (DCS) which could be created either through initial public offerings (IPOs) or recapitalisations, offer different classes of shares that confer distinct voting and control rights on the holder. The divergence provides insiders with a majority of voting rights, despite their smaller residual claims.<sup>1</sup> The popularity of DCS has been paralleled with a takeover wave since 1980 and an increasing number of technology companies entering the stock market.<sup>2</sup> Many US companies like Google, Facebook, Groupon and LinkedIn, have favoured a DCS structure. However, not everywhere like the US welcome such structure.<sup>3</sup>

DCS, despite having long existed, are back to spotlight again due to the listing of Alibaba on the New York Stock Exchange (NYSE), the largest IPO in history.<sup>4</sup> The company chose the NYSE over the Hong Kong Stock Exchange (HKEx) and the London Stock Exchange (LSE) as the latter two prohibit the listing of companies that employ 'differential voting structures', namely DCS, while such structure is permitted in the US. The request by the company in its IPO application for the granting of an exemption from the one share-one vote principle has brought the debate over whether the bourses should relax their listing standards to allow certain listed companies to adopt DCS.

The paper aims to find out why the major jurisdictions particularly those leading financial centres have different views on DCS and how divergent they are. The

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<sup>1</sup> The dual class structure essentially creates a concentration of control that differs from concentrated ownership in general. See Walid Ben-Amar and Paul Andre, 'Separation of Ownership from Control and Acquiring Firm Performance: The Case of Family Ownership in Canada' (2006) 33 *Journal of Business Finance & Accounting* 517.

<sup>2</sup> Gregg Jarrell and Annette Poulsen, 'Dual-Class Recapitalisation as Antitakeover Mechanisms' (1988) 20 *Journal of Financial Economics* 129; and Kristian Rydqvist, 'Dual-Class Shares: A Review' (1992) 8 *Oxford Review of Economic Policy* 45, 48.

<sup>3</sup> HKEx, 'Concept Paper Weighted Voting Rights' (2014), 40, at <<http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082.pdf>> accessed 26 July 2015. Basically speaking, there are three types of approaches to DCS around the world. The first category is jurisdictions which permit such regime in both their corporate law and listing rules (e.g. the US, Canada and Sweden). The second category is to allow company to have DCS but having restrictions on listed companies, (e.g. Hong Kong, UK and Australia). The third one is that both corporate law and listing rules prohibit DCS structure, (e.g. Germany, Spain and Mainland China).

<sup>4</sup> On 19 September 2014, Alibaba, the largest Chinese e-commerce company, completed the largest IPO on the NYSE, raising US\$25 billion and surpassing the 2010 offering from the Agricultural Bank of China. See Nicole Bullock et al, 'Alibaba Closes at \$93.89 in NYSE Debut' (*Financial Times*, 20 September 2014), at <<http://www.ft.com/cms/s/0/8150f416-4002-11e4-a381-00144feabdc0.html#slide0>> accessed 26 July 2015.

target is on the top 5 global financial centres, namely New York, London, Hong Kong, Singapore and Tokyo,<sup>5</sup> partly because of their significance to the world economy, partly because of the close association between financial centres and stock exchanges.<sup>6</sup> The paper is structured as follows. After introduction, Section II will discuss the controversies of DCS from theoretical and empirical perspectives. Section III will investigate the attitudes of the five global financial centres towards DCS respectively, with a focus on the recent reforms of their company law and listing rules with respect to DCS. Section IV concludes by discussing the implication for other jurisdictions.

## II. Controversies over Dual Class Shares: Theoretical and Evidential Analysis

Lawyers and economists have divided opinions on DCS. In theory, DCS have been long criticised for violating the one share-one vote principle and destroying shareholder democracy.<sup>7</sup> One share-one vote is frequently described as a 'legal consequence' of shareholder primacy, and a bedrock principle of corporate governance.<sup>8</sup> The rationale for one share-one vote is that shareholders, as residual claimants, have the strongest interest in maximising firm value and should therefore have equal voting rights.<sup>9</sup> In contrast, the disjunction between

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<sup>5</sup> Z/Yen Group, 'Global Financial Centres Index 17', March 2015, 4, at <[http://www.longfinance.net/images/GFCI17\\_23March2015.pdf](http://www.longfinance.net/images/GFCI17_23March2015.pdf)> accessed 26 July 2015. In the light of market capitalisation by June 2015, the NYSE ranked No1 largest stock exchange in the world, followed by Nasda (2<sup>nd</sup>), TSE (4<sup>th</sup>), LSE (5<sup>th</sup>), HKEx (7<sup>th</sup>) and SGX (21<sup>st</sup>). Data from World Federation of Exchanges, Monthly report as of 30 June 2015, at <<http://www.world-exchanges.org/statistics/monthly-query-tool>> accessed 26 July 2015.

<sup>6</sup> Cassis states that stock exchanges set the pulse of financial centres. See Youssef Cassis, *Capitals of Capital The Rise and Fall of International Financial Centres 1780–2009*, (2<sup>nd</sup> ed., CUP 2006), 6. The Top 10 financial centres in the world, according to the Global Financial Centre Index, all have stock exchange headquarters. Stock exchanges certainly contribute to financial centres in tangible (employment, infrastructure) and intangible ways (image, brand, reputation). See Dariusz Wójcik, 'Revolution in the Stock Exchange Industry: Two-sided Platforms, Battle for Liquidity, and Financial Centres' (2010), 2, at <<http://ssrn.com/abstract=1653827>> accessed 26 July 2015.

<sup>7</sup> Sanford Grossman and Oliver Hart, 'One Share-One Vote and the Market for Corporate Control' (1988) 20 *Journal of Financial Economics* 175. Milton Harris and Artur Raviv, 'Corporate Governance: Voting Rights and Majority Rules' (1988) 20 *Journal of Financial Economics* 203. Milton Harris and Artur Raviv, 'The Design of Securities' (1989) 24 *Journal of Financial Economics* 255. The three articles support the optimality of the one share-one vote rule and argue that multiple classes of shares are not socially optimal.

<sup>8</sup> Frank n and Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991), 73 ('Votes follow the residual interest in the firm, and unless each element of the residual interest carries an equal voting right, there will be a needless agency cost of management.');

and Colleen Dunlavy, 'Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights' (2006) 63 *Washington and Lee Law Review* 1347, 1367. However, Hayden and Bodle argue that the assumption of shareholder homogeneity is false as corporate democracies tend to define the requisite institutional interest too narrowly and thus restrict the right to vote to shareholders alone. See Grant Hayden and Matthew Bodle, 'One Share, One Vote and the False Promise of Shareholders Homogeneity' (2008) 30 *Cardozo Law Review* 445.

<sup>9</sup> Herry Manne 'Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle' (1964) 64 *Columbia Law Review* 1427; Frank Easterbrook and Daniel Fischel, 'Voting in Corporate Law' (1983) 26 *Journal of Law and Economics* 395.

economic interest and voting power resulting from deviations from one share-one vote would makes blockholders more prone to pursue value-maximising actions. In the view of Easterbrook and Fischel, '[t]hose with disproportionate voting power will not receive shares of the residual gains or losses from new endeavors and arrangements commensurate with their control; as a result, they will not make optimal decisions.'<sup>10</sup> However, theory also recognises that one share-one vote comes with costs as it may deter entrepreneurs from going public to avoid the risk of the control and impair blockholders' ability to monitor management.<sup>11</sup>

The benefits and costs of DCS are summarised in the Canadian Coalition for Good Governance (CCGG) publication on dual class share policy.<sup>12</sup> On the one hand, DCS structures allow managers to concentrate on the sustainable success and profitability of the company, despite fluctuations in quarterly results.<sup>13</sup> Without worry about dismissal, managers will have less incentive to manage earnings at the expense of long-term value. In addition, they could also effectively reduce the likelihood that management is displaced in a hostile takeover so as to protect DCS companies from opportunistic acquirers.<sup>14</sup>

On the other hand, a discount to investor shares with inferior voting rights in a DCS structure may result in the extraction of private benefits and management entrenchment.<sup>15</sup> With few constraints placed upon them, managers holding superior class stock can entrench themselves into the operations of the company, regardless of their abilities and performance. However, it is unclear as to whether those risks actually lead to a negative impact on company performance.

There is extensive empirical evidence documenting the adoption and effects of DCS. But their findings are contradictory due to the differing approaches taken to analyse the impacts of DCS.<sup>16</sup> Some studies affirm the hypothesis that DCS

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<sup>10</sup> Easterbrook and Fischel (1991), n 8, 73.

<sup>11</sup> Mike Burkart and Samuel Lee, 'One Share-One Vote: The Theory' (2008) 12 *Review of Finance* 1, 40-41.

<sup>12</sup> See the CCGG Publication on Dual Class Share Policy in September 2013, available at <[http://admin.yourwebdepartment.com/site/ccgg/assets/pdf/Dual\\_Class\\_Share\\_Policy.pdf](http://admin.yourwebdepartment.com/site/ccgg/assets/pdf/Dual_Class_Share_Policy.pdf)> accessed 8 December 2015.

<sup>13</sup> Harry DeAngelo and Linda DeAngelo, 'Managerial Ownership of Voting Rights: A Study of Public Corporations with Dual Classes of Common Stock' (1985) 14 *Journal of Financial Economics* 33; and Valentin Dimitrov and Prem Jain, 'Recapitalization of One Class of Common Stock into Dual Class: Growth and Long-run Stock Returns' (2006) 12 *Journal of Corporate Finance* 342.

<sup>14</sup> Gregg Jarrell and Annette Poulsen, 'Dual-class Recapitalizations as Antitakeover Mechanisms: The Recent Evidence' (1998) 20 *Journal of Financial Economics* 129; and Van Thuan Nguyen and Li Xu, 'The Impact of Dual Class Structure on Earnings Management Activities' (2010) 37 *Journal of Business Finance and Accountings* 456, 457.

<sup>15</sup> Richard Ruback, 'Coercive Dual-Class Exchange Offers' (1988) 20 *Journal of Financial Economics* 153; Paul Gompers et al, 'Extreme Governance: An Analysis of Dual-Class Firms in the United States' (2010) 23 *Review of Financial Studies* 1051.

<sup>16</sup> Some studies compare different companies with and without DCS for the conclusion that DCS structures have a negative effect on performance. But it is disagreed by studies looking at the performance of listed companies in the period immediately following their IPOs, studies of companies that have unified a DCS structure, or studies of existing listed companies moving to a DCS structure. See HKEx (2014), n 3, IV 10.

structures allow the extraction of private benefits and increase agency costs and financial risks to non-controlling shareholders.<sup>17</sup> They observe that DCS structures tend to underperform single-class structures, reflecting in companies with stronger shareholder rights having higher firm value, higher profits, higher sales growth and lower capital expenditures, and fewer corporate acquisitions.<sup>18</sup>

In contrast, another group of empirical studies, though inconclusive, obtain opposite results that companies going public with DCS outperform their counterparts in terms of stock returns and accounting performance.<sup>19</sup> In addition, there are also subtle positive effects offered by DCS in some ways. DCS may be desirable because they are most likely to encourage managerial investment in firm-specific human capital and higher tender offers when there are multiple bidders with private benefits competing for control.<sup>20</sup>

More recently, one stream of research views that DCS are temporary structures kept until when the company requires new capital for expansion and growth.<sup>21</sup> This explains why a reverse trend has been witnessed in continental Europe that an increasing number of companies unify their shares into a single class in a view to increasing firm's market value and reducing the cost of new equity financing.<sup>22</sup>

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<sup>17</sup> Ronald Masulis et al, 'Agency Problems at Dual-Class Companies' (2009) 64 *Journal of Finance* 1697 (arguing that management are likely to exercise private benefits at the expense of outside shareholders in DCS companies). And Lucian Bebchuk et al, 'Stock Pyramids, Cross Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash Flow Rights' in Randall Morck (ed.) *Concentrated Corporate Ownership* (Chicago: The University of Chicago Press, 2000), 295-96 (arguing that cash flow rights or equity ownership of the controlling shareholder declines, the agency costs to non- controlling shareholders tend to rise at an alarming rate).

<sup>18</sup> Burgundy Asset Management Ltd., 'Second Class Owners?', September 1996, available at [http://www.burgundyasset.com/data/newsletter/1996\\_09\\_Second\\_Class\\_Owners.pdf](http://www.burgundyasset.com/data/newsletter/1996_09_Second_Class_Owners.pdf) accessed 23 October 2015 (finding that a tendency for companies with DCS to underperform in Canada but the performance differential is small). Paul Gompers et al, 'Corporate Governance and Equity Prices' (2003) 118 *Quarterly Journal of Economics* 107 (arguing that investors that bought companies with strongest rights and sold companies having weakest rights would have earned abnormal returns of 8.5 per cent per year).

<sup>19</sup> Ekkehart Bohmer et al. 'The effect of consolidated control on firm performance: the case of dual-class IPOs' in Mario Levis (ed.), *Empirical Issues in Raising Equity Capital* (1996). Amsterdam: Elsevier, 95-124. And Valentin Dimitrov and Prem Jain, 'Recapitalization of One Class of Common Stock into Dual- Class: Growth and Long-Run Stock Returns' (2006) 12 *Journal of Corporate Finance* 342.

<sup>20</sup> Harry DeAngelo and Linda DeAngelo, 1985. 'Managerial Ownership of Voting Rights: A study of Public Corporations with Dual Classes of Common Stock' (1985) 14 *Journal of Financial Economics* 33, 62. Mike Burkart et al 1998. 'Why Higher Takeover Premia Protect Minority Shareholders' (1998) 106 *Journal of Political Economy* 172 (arguing that higher takeover premia induced by competition translate into higher ownership concentration and are thus beneficial).

<sup>21</sup> Douglas Ashton, 'Revisiting Dual-Class Stock' (1994) 68 *St. John's Law Review* 863, 871 (arguing that DCS don't constitute 'a permanent alteration in a firm's ownership structure'). Ben Amoako-Adu and Brian Smith, 'Dual Class Firms: Capitalization, Ownership Structure and Recapitalization Back into Single Class' (2001) 25 *Journal of Banking and Finance* 1083.

<sup>22</sup> For the examination of DCS unification in Europe, see Anete Pajuste, 'Determinants and Consequences of the Unification of Dual-Class Shares' (2005) European Central Bank Working Paper Series No. 465; and Benjamin Maury and Anete Pajuste, 'Private Benefits of Control and Dual-Class Share Unifications' (2011) 32 *Managerial and Decision Economics* 355. For the

Despite the debates, DCS will likely persist and succeed in some jurisdictions. There is some consensus that without the availability of DCS, founders and entrepreneurs would be reluctant to take their companies public due to the fear of losing control. In the long run, it may lead to a curtailment in the growth of new and emerging companies.<sup>23</sup> Some proactivists even claim that there is no social need to constrain the choice of share structure because companies choose DCS will only do so if the benefits outweigh the cost.<sup>24</sup> But more realists propose that the centre of debate should be shifted to how the governance of DCS companies can be improved so as to minimise the added agency costs while still maintaining their inherent efficiencies and benefits.<sup>25</sup>

### III. Divided Stances of Global Financial Centres

This section examines the regulatory treatment of DCS in Top 5 global financial centres which have developed markets for trading listed securities.

#### A. New York

In the US the principle of one share-one vote that each shareholder is entitled to only one vote regardless of the number shares owned has been long discarded as a default rule under Delaware's company law but companies can opt out from it.<sup>26</sup> The NYSE and NASDAQ permit companies with pre-existing DCS structures

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unification of shares in individual country, see Ingolf Dittmann and Niels Ulbricht, 'Timing and Wealth Effects of German Dual Class Stock Unifications' (2007) 14 *European Financial Management* 163; and Olaf Ehrhardt et al 'Unification of Dual-Class Shares in Germany: Empirical Evidence on the Effects of Related Changes in Ownership Structure, market Value, and Bid-Ask Spreads' (2005) Swiss Finance Institute research paper series No.06-12. Both discuss the decisions of German DCS companies to consolidate their share structure from dual to single class. For other jurisdictions such as Brazil and the US, see Gabriela Engler, 'Why They Persist? An Analysis of Dual Class Structures and the Unification Process in the US and Brazil' (2014) 10 *Revista Direito GV* 23.

<sup>23</sup> Tara Gry, 'Dual Class Share Structures and Best Practices in Corporate Governance' (2005) Library of Parliament, 2, online: Parliamentary Information and research Service <<http://www.parl.gc.ca/content/lop/researchpublications/prb0526-e.pdf>> accessed 23 October 2015. And Daniel Cipollone (2012), 69.

<sup>24</sup> Kristian Rydqvist, 'Dual-Class Shares: A Review' (1992) 8 *Oxford Review of Economic Policy* 45.

<sup>25</sup> Chun-Keung Hoi and Ashok Robin, 'Agency Conflicts, Controlling Owner Proximity, and Firm Value: An Analysis of Dual-Class Firms in the United States' (2010) 18 *Corporate Governance: An International Review* 124 (suggesting that dual-class companies must seek additional control mechanisms to curb agency costs though controller proximity is unrelated to firm value). Daniel Cipollone, 'Risky Business: A Review of Dual Class Share Structure in Canada and a Proposal for Reform' (2012) 21 *Dalhousie Journal of Legal Studies* 62, 91.

<sup>26</sup> Delaware General Corporation Law Section 212(a) states: 'Unless otherwise provided in the certificate of incorporation...each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder.' For the general discussion on the 'one share, one vote' rule, see Chester Rohrllich, 'Corporate Voting: Majority Control' (1933), 7(2) *St. John's Law Review* 218 (noting the trend away from the strict rule of equal voting rights); Earl Sneed, 'The Stockholder May Vote as He Pleases: Theory and Fact' (1961) 22 *University of Pittsburgh Law Review* 23, 23-24 (noting that the policy of voting equality was comparatively short-lived); David Ratner, 'The Government of Business Corporations: Critical Reflections on the Rule of "One Share, One Vote"'

to list on their markets, but do not allow an issuer, once listed, to implement a DCS structure that would discriminate the interests of existing shareholders.<sup>27</sup>

The unbundling of cash flow and voting rights in the US dates back to 1925 when a few leading companies such as Dodge Brothers issued non-voting common stocks.<sup>28</sup> In response to the resulting public outcry, in 1926 the NYSE disapproved an issue of nonvoting common stock by releasing a statement that it would review the matter of voting control carefully.<sup>29</sup> After the statement, the NYSE prohibited the issuance of non-voting securities, although it did not formally announce the prohibition until 1940.<sup>30</sup> As to why the it opposed such voting rights, the NYSE Listed Company Manual states, '[C]onsistent with the Exchange's long-standing commitment to encourage high standards of corporate democracy, every listed company is expected to follow certain practices aimed at maintaining appropriate standards of corporate responsibility, integrity and accountability to shareholders.'<sup>31</sup>

While the NYSE keep restraint,<sup>32</sup> the other two national securities exchanges such as the American Stock Exchange (AMEX) and the National Association of Securities Dealers (NASD), with which the NYSE competed, had a similar but less rigorous prohibition respecting voting provisions for common stock.<sup>33</sup> As DCS

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(1970), 56 *Cornell Law Review* 1, 3-11 (generally outlining the development of the one share, one vote rule).

<sup>27</sup> NYSE Listed Company Manual, Rule 313(A) and NASDAQ Stock Market Rule 5640.

<sup>28</sup> Dodge sold a total of US\$130 million worth of bonds, preferred stock and nonvoting common shares to the public. Dodge was controlled, however, by an investment banking firm, which had paid only US\$2.25 million for its voting common stock.

<sup>29</sup> The NYSE released an announcement in January 1926: 'Without at this time attempting to formulate a definite policy, attention should be drawn to the fact that in the future the [listing] committee, in considering applications for the listing of securities, will give careful thought to the matter of voting control.' See Joel Seligman, 'Equal Protection in Shareholder Voting Right The One Common Share, One Vote Controversy' (1986), 54 *George Washington Law Review* 687, 694-97.

<sup>30</sup> In May 1940, the NYSE formally announced an official rule entitled 'Statement of Listing Requirements as to Preferred Stock Voting Rights' against such listings. See Richard Jennings, 'The Role of the States in Corporate Regulation and Investor Protection' (1958), 23(2) *Law and Contemporary Problems* 193, 228 (arguing that such statement provides standards of fairness to prevent inequitable arrangements in multi-securities structures). And S Robbins, 'An Evaluation of the New York Stock Exchange Listing Policy on Voting' (1978), *New York Stock Exchange Study*, 183 (stating that this apparently was 'the first formal published enunciation that the Exchange would refuse to list non-voting common stock').

<sup>31</sup> New York Stock Exchanges Listed Company Manual (1983) Section 3 para. 301. For a full discussion on this rule, see Seligman (1986), n 29.

<sup>32</sup> The NYSE allowed a few exceptions such as Ford Motor Company which was able to get around the prohibition by issuing a class with inferior voting rights rather than no voting rights. See Jason Howell, 'The Survival of the US Dual Class Share Structure' (2014), *Journal of Corporate Finance* 1, 5. But the DCS of the Ford Motor Company were opposed by some institutions and blockholders who attempt to eliminate the structure and move to one vote per share. See Ford Motor Company, 5 April 2007 Form DEF 14A, at <<http://yahoo.brand.edgar-online.com/Default.aspx?companyid=3404&formtypeID=148>> accessed 30 July 2015.

<sup>33</sup> See American Stock Exchange, Company Guide (1983) §§ 101-17. The AMEX did not implement a nonvoting prohibition until 1972, and AMEX standards for listing corporate securities are similar to NYSE, but less rigorous. See Jason Howell, 'The Survival of the US Dual Class Share Structure' (2014), *Journal of Corporate Finance* 1, 5. And Seligman (1986), 691-92 (discussing AMEX and NASD's restrictions on common stock voting rights).

became more common, a view expressed by Gilson emerged: instead of the banning of DCS, the focus became dual class recapitalisations where existing shareholders effectively coerced into giving up their voting rights.<sup>34</sup> This approach would allow companies to enjoy the benefits of DCS without the problem of coerced shareholders. This new approach led to the proposal of rule 19C-4 by the SEC on 7 July 1988. Under the rule, the SEC prohibited self-regulatory organisations from listing and trading the stocks of any company that issued new shares carrying more than one vote per share, but it allowed companies to issue shares with less than one vote per share and permitted those with unequal voting rights to still be traded.<sup>35</sup>

In the view of Bainbridge, the SEC's stance to object the strict one-share/one-vote standard rested on the basic ground that the various theoretical arguments in favour of a flat prohibition were unpersuaded, and the side effects of DCS on shareholder wealth were unclear and inconclusive.<sup>36</sup> Although rule 19C-4 is a useful starting point in determining which types of DCS require regulation, it is not a sound model for Self-Regulatory Organisation (SRO) rulemaking due to its inconsistency with general corporate law principles and uncertainty as to the rule's effect on other types of corporate transactions.<sup>37</sup> Furthermore, there was a debate over whether the SEC had the legal authority to enforce such policies on self-regulating stock exchanges. On 12 June 1990, a three-judge panel of the US Court of Appeals for the District of Columbia Circuit unanimously ruled that the SEC had exceeded its statutory authority delegated by the Congress.<sup>38</sup>

Despite the court's rejection of the 19C-4 rule, the NASD and the AMEX joined the NYSE to implement 19C-4 by allowing companies to introduce inferior voting shares in IPOs but barring them from reducing existing shareholders' voting rights through actions as 'the adoption of time phased voting plans, the adoption of capped voting rights plans, the issuance of super voting stock or the issuance of stock with voting rights less than the per share voting rights of the existing common stock through an exchange offer'.<sup>39</sup>

In spite of the regulatory efforts to develop a uniform policy on DCS in all the US markets, the adoption of DCS still receives criticism. For instance, in 2004 when

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<sup>34</sup> Ronald Gilson, 'Evaluating Dual Class Common Stock: The Relevance of Substitutes' (1987) 73 *Virginia Law Review* 807.

<sup>35</sup> The new listing standards created by rule 19C-4 prohibited a covered exchange from listing or continuing to list the equity securities of an issuer that takes one of the prohibited actions. It likewise prohibited a covered securities association from authorizing the equity securities of such an issuer for quotation and/or transaction reporting on an automated quotation system. The Inter- mountain and Spokane Stock Exchanges were the only national securities exchanges excluded from coverage. The NASD was the only securities association affected by the rule, just as the NASDAQ system was the only affected automated quotation system. Finally, only those issuers registered with the SEC pursuant to Exchange Act section 12, 15 U.S.C. Section 781 (1988), were covered by the rule. Exchange Act Release No. 25891 (July 7, 1988). See Stephen Bainbridge, 'The Short Life and Resurrection of SEC Rule 19C-4' (1991), 69 *Washington University Law Review* 565, 566-67.

<sup>36</sup> Bainbridge (1991), n 35, 578.

<sup>37</sup> *Ibid.*, 628.

<sup>38</sup> *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990).

<sup>39</sup> Section 313.00 of the NYSE Listed Company Manual.

Google went public with a DCS structure on NASDAQ,<sup>40</sup> the influential proxy adviser, Institutional Shareholder Services (ISS) ranking Google near the bottom of its corporate governance rankings, below any company in the S&P 500 stock index.<sup>41</sup>

Despite controversies, DCS remain a growing part of the US scene. In 2012, 79 out of 114 controlled companies in the S&P 1500 Composite posed DCS with disproportionate voting shares.<sup>42</sup> Studies have shown that companies are more likely to adopt DCS, especially in the American context, in the three scenarios: first, when the company operates in industries with a substantial increase in takeover activity; second, when management reputation has increased, because of good past performance or reputable new management; third, when the company drastically changes features, affecting its product market (e.g. relevant change in technology or entrance into a new market), requiring it to make decisions on risky long-term investment without guarantee of success in the short-run.<sup>43</sup>

The consequences of having a DCS structure have been reported by many. Adams and Ferreira review a wide range of empirical studies, and conclude that evidence on the value of the control premium strongly collaborates the hypothesis that sizeable private benefits exist, and that controlling shareholders enjoy private benefits at the expense of non-controlling shareholders.<sup>44</sup> However, the risks of entrenchment and private benefits may be outweighed by positive consequences of DCS, for example, greater capital structure flexibility and long-term returns.<sup>45</sup> Furthermore, The US legal and institutional frameworks also help minimise the negative effects of DCS by the dominance of professional investors, and a disclosure-based regime by imposing much stricter disclosure

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<sup>40</sup> Google's dual class IPO had class A shares (with one vote per share), which were sold to outsiders in the IPO; it also had class B shares (with ten votes per share), which were retained by the founders, Larry Page and Sergey Brin, as well as other insiders. See Google's website, '2004 Founders' IPO Letter', at

<<https://investor.google.com/corporate/2004/ipo-founders-letter.html>> accessed 30 July 2015.

<sup>41</sup> Kevin Delaney and Ann Grimes, 'For Some Who Passed on Google Long Ago, Wistful Thinking' (*Wall Street Journal*, 23 August 2004), (which quotes ISS special counsel Patrick McGurn: 'Because Google lacks the usual checks and balances provided at public companies by shareholder votes, holders must closely scrutinize the judgement of the company's top decision makers. Rank-and-file shareholders have no meaningful avenue for recourse – other than selling their low-vote shares, of course – if the company loses its way.')

<sup>42</sup> Investor Responsibility Research Centre Institute (IRRCI), 'Controlled Companies in the Standard & Poor's 1500: A Ten Year Performance and Risk Review' (2012), at <<http://irrcinstitute.org/pdf/FINAL-Controlled-Company-ISS-Report.pdf>> accessed 31 July 2015.

<sup>43</sup> Thomas Chemmanur and Yawen Jiao, 'Dual Class IPOs, Share Recapitalisations, and Unifications: A Theoretical Analysis' (2006) European Corporate Governance Institute (ECGI) - Finance Research Paper Series, 7.

<sup>44</sup> Renee Adams and Daniel Ferreira, 'One Share-One Vote: The Empirical Evidence' (2008) 12 *Review of Finance* 51, 79.

<sup>45</sup> Scott Bauguess et al, 'Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights' (2012) 36 *Journal of Banking & Finance* 1244.

standards and taking active enforcement actions against market abuse as well as a litigious culture.<sup>46</sup>

## B. London

The concept of one share-one vote is also the default position under the UK Companies Act 2006, but subject to any provision of the company's articles.<sup>47</sup> The Premium Listing Principles set out in Listing Rule 7.2.1AR apply to every company with a premium listing of their equity shares.<sup>48</sup> Under Premium Listing Principle 5, a listed company must ensure that it treats all holders of the same class of premium listed shares equally in respect of the rights attaching to such listed equity shares except where holders are in a different position.

On 2 October 2012, the Financial Conduct Authority (FCA) launched a consultation (CP12/25) on 'Enhancing the effectiveness of the Listing Regime', largely in response to market pressure to improve protections for minority shareholders in premium-listed issuers with controlling shareholders.<sup>49</sup> Following on from CP12/25, the paper (CP13/15) was published in November 2013 to propose to amend the way that the listing principles are applied to listed companies.<sup>50</sup> One year later, the FCA published the final rules (PS14/8) regarding the two consultations, which came into force on 16 May 2014 subject to some transitional provisions.<sup>51</sup>

As proposed in CP13/15, two additional Premium Listing Principles, representing a 'basic norm of behaviour for any company wishing to raise capital in a public market', now apply to premium-listed issuers as follows.<sup>52</sup>

- Premium Listing Principle 3: all shares in a premium-listed share class must carry an equal number of votes on any shareholder vote; and

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<sup>46</sup> Raymond Siu Yeung Chan and John Kong Shan Ho, 'Should Listed Companies be Allowed to Adopt Dual-Class Share Structure in Hong Kong?' (2014) 43 *Common Law World Review* 155, 174-179.

<sup>47</sup> Section 284 of the UK Companies Act 2006.

<sup>48</sup> See the website of the Financial Conduct Authority (FCA), at <<https://fshandbook.info/FS/html/handbook/LR/7/2>> accessed 31 July 2015.

<sup>49</sup> For the full text, at <<https://www.fca.org.uk/your-fca/documents/consultation-papers/fsa-cp1225>> accessed 3 August 2015.

<sup>50</sup> CP13/15 covers feedback to CP12/25, near-final rules based on the original proposal; consultation on the revised or new proposals as a result of feedback received, and the associated draft rules. See FSA, 'CP13/15: Feedback on CP12/25: Enhancing the effectiveness of the Listing Regime and Further Consultation' (2013), at <<https://www.fca.org.uk/static/documents/consultation-papers/cp13-15.pdf>> accessed 3 August 2015.

<sup>51</sup> FCA, 'PS14/8: Response to CP13/15 – Enhancing the effectiveness of the Listing Regime' (2015), at <<https://www.fca.org.uk/news/ps14-08-enhancing-the-effectiveness-of-the-listing-regime>> accessed 3 August 2015.

<sup>52</sup> Linklaters, 'Latest FCA Proposals: Enhancing the Effectiveness of the Listing Regime', November 2013, 16, at <[www.linklaters.com/.../A17407415\\_v0.0\\_Linklaters\\_Briefing\\_FCA\\_CP13\\_15.pdf](http://www.linklaters.com/.../A17407415_v0.0_Linklaters_Briefing_FCA_CP13_15.pdf)> accessed 3 August 2015.

- Premium Listing Principle 4: the aggregate voting rights of different premium-listed share classes should be broadly proportionate to their relative interests in the company's equity (taking into account the commercial rationale for the differences in the rights and the extent of dispersion and relative liquidity of the classes).<sup>53</sup>

In PS14/8, the FCA clarifies that the purpose of the new principles is to prevent artificial structures involving multiple classes with different voting powers, which are designed to allow a small group of shareholders to exercise control.<sup>54</sup> However, the FCA acknowledges that different share classes may also be used for other purposes, for example, closed-ended investment funds use them to meet the differing investment needs of investors. The new rules are believed to tighten the UK listing regime for premium listed companies and ensure the overarching framework of best corporate governance practices, although it remains to be seen how it will work in practice.<sup>55</sup>

After Alibaba was denied listing by Hong Kong on corporate structure concerns, a debate over whether the LSE changes listing rules to secure the high-profile listing has been brought up. Some market optimists criticise the LSE's inflexibility in corporate governance may affect its ability to attract big IPOs, and argue that the UK Corporate Governance Code to which premium listed companies adhere through a 'comply or explain' regime may provide a possibility for a DCS company to list in London.<sup>56</sup> However, both the FCA and institutional investors oppose to change rules and keep a firm stance on the principle of one share-one vote to protect shareholders' interests.<sup>57</sup>

Until now, DCS are still rare among British listed companies, though the UK has one of the most liberal regimes in this regard. What makes the UK different from the US in light of DCS: one is the superpower of institutional investors who

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<sup>53</sup> FCA (2013), Appendix X of CP13/15, 16.

<sup>54</sup> FCA (2015), PS14/8, para. 5.21-5.22, 31.

<sup>55</sup> James Healy et al, 'FCA Listing Rule Changes Applicable to Premium Listed Companies', Skadden, Arps, Slate, Meagher & Flom LLP, 8 May 2014, at <<https://www.skadden.com/insights/fca-listing-rule-changes-applicable-premium-listed-companies>> accessed 4 August 2015.

<sup>56</sup> For example, James Lyons, 'Alibaba vs Corporate Governance: Rules for Listing around the World', 7 November 2013, at <<http://www.growthbusiness.co.uk/growing-a-business/company-flotations/2430487/alibaba-vs-corporate-governance-rules-for-listing-around-the-world.shtml>> accessed 4 August 2015.

<sup>57</sup> Enoch Yiu, 'British Regulator Backs Hong Kong Stance on Alibaba IPO' (*South China Morning Post*, 20 March 2014), at <<http://www.scmp.com/business/money/markets-investing/article/1452681/british-regulator-backs-hong-kong-stance-alibaba>> accessed 4 August 2015. Also, a letter from the Council of Institutional Investors (CII) in response to Alibaba listing requested LSE to resist any pressure to change the listing standards to deviate from the principle of one share, one vote. See CII, 'CII Letter to the London Stock Exchange on One Share, One Vote', 27 March 2014, at <[www.cii.org/.../03\\_27\\_14\\_CII\\_letter\\_to\\_london\\_stock\\_exchange\\_one\\_share\\_one\\_vote.pdf](http://www.cii.org/.../03_27_14_CII_letter_to_london_stock_exchange_one_share_one_vote.pdf)> accessed 4 August 2015.

strongly support the one vote per share rule;<sup>58</sup> the other is the breakthrough rule which is 'a threat' to DCS.<sup>59</sup>

DCS are unpopular in the UK owing to market pressure and successful opposition from institutional investors.<sup>60</sup> The proportion of shares owned by institutional investors in the UK companies dramatically rose over the 1960s and 1970 simultaneously with the emergence of multiple class share structures.<sup>61</sup> The institutional investors, having a significant proportion of the shares in the UK market, have incentives to promote good governance by reducing the number of multiple class shares or non-voting shares.<sup>62</sup> As a consequence, listed companies on the LSE rarely employ derivations from the one share-one vote rule until today.<sup>63</sup>

In addition, the breakthrough rule is another reason why DCS are unflavoured in the UK. The breakthrough rule was adopted in the Takeover Bids Directive<sup>64</sup> with a view to eliminating certain pre-bid defences to takeovers. This rule enables a bidder who has accumulated 75 percentage of equity to break through the company's existing voting arrangements and exercise control as if the one share-one vote principle is upheld. Therefore, many observers have seen the breakthrough rule as an attack on controlling owners in DCS companies.<sup>65</sup> Established DCS would be undone or at least lose much of their significance.

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<sup>58</sup> Wolf-Georg Ringe, "Deviations from Ownership-Control Proportionality—Economic Protectionism Revisited" in Ulf Bernitz and Wolf-Georg Ringe (eds) *Company Law and Economic Protection* (OUP 2010), 228.

<sup>59</sup> Lucian Bebchuk and Oliver Hart, 'A Threat to Dual-Class Shares', *Financial Times*, 31 May 2002.

<sup>60</sup> Kritian Rydqvist, 'Dual Class Shares: A Review' (1992) 8(3) *Oxford Review of Economic Policy* 45, 47; Brian Cheffins, *Corporate Ownership and Control—British Business Transformed* (OUP 2008), 32. Paul Davies, 'Institutional Investors in the United Kingdom', in Daniel Prentice and Peter Holland (eds.), *Contemporary Issues in Corporate Governance* (Oxford 1993), 85-87.

<sup>61</sup> Ringe (2010), 228. Also, see Brian Cheffins, 'Law, Economics and the UK's System of Corporate Governance: Lessons from History' (2001) 1 *Journal of Corporate Law Studies* 71, 82; Andrew Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 *Cambridge Law Journal* 422, 426. Taxes imposed on corporate profits, taxation of managerial and investment income and inheritance taxes drive investors to permit ownership to separate from control. See Steven Bank and Brian Cheffins, 'Corporate Ownership and Control in the UK: The Tax Dimension' (2007) 70 *Modern Law Review* 778.

<sup>62</sup> Bernard Black and John Coffee, 'Hail Britannia? Institutional Investor Behavior Under Limited Regulation' (1994), 92(7) *Michigan Law Review* 1997, 2034; Cheffins (OUP 2008), 31; and John Armour and David Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation' (2007) 95 *Georgetown Law Journal* 1727, 1736.

<sup>63</sup> Amongst the companies examined by the Shearman & Sterling Study, only 5% had multiple voting rights in place. There were no non-voting shares at all. See Shearman & Sterling LLP, 'Proportionality between Ownership and Control in EU Listed Companies: Comparative Legal Study' (2007), 12, at <[http://www.ecgi.org/osov/documents/study\\_report\\_en.pdf](http://www.ecgi.org/osov/documents/study_report_en.pdf)> accessed 31 July 2017. In another report by Shearman & Sterling LLP, BP was the only company featuring multiple voting rights in the sample of 66 listed companies. But its ordinary shares were about 99.7% of the total outstanding capital. See Shearman & Sterling LLP, 'Report on the Proportionality Principle in the European Union' (2006), at <[http://ec.europa.eu/internal\\_market/company/docs/shareholders/study/final\\_report\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf)> accessed 31 July 2015.

<sup>64</sup> Art 11 of The Takeover Directive 2004/25/EC.

<sup>65</sup> Mara Faccio and Larry Lang, 'The Ultimate Ownership of Western European Corporations' (2002) 65 *Journal of Financial Economics* 365; and Morten Bennesen and Kasper Meisner

### C. Hong Kong

As a former British colony, Hong Kong's corporate and financial regime is largely inherited from the British system.<sup>66</sup> As a result, Hong Kong's rules are very similar to those in the UK where DCS have been systematically discouraged. The Hong Kong Companies Ordinance (Cap 622) allows a Hong Kong incorporated company to provide, in its articles, for the issue of multiple classes of shares with different voting rights.<sup>67</sup> However, such company is prohibited by the HKEx, regardless of pre- and post-listing, in order to provide fair and equal treatment to all shareholders.<sup>68</sup> The prohibition is set out in the Main Board Rule 8.11 (GEM Rule 11.25 for its junior bourse). The Listing Rule 8.11 uses the wording of the 1983 NYSE Listed Company Manual and states that the share capital of a new applicant must not include shares of which the proposed voting power does not bear a 'reasonable relationship to the equity interest' of such shares.<sup>69</sup>

The term of 'voting powers' in the Listing Rule is interpreted to be intended to restrict all DCS structures, including those that give enhanced or exclusive director election rights, and those that achieve the same effect by embedding such rights in the company's articles rather than by creating two classes of

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Nielsen, 'The Impact of a Break-Through Rule on European Firms' (2004) 17 *European Journal of Law and Economics* 259, 260.

<sup>66</sup> The Hong Kong law always follows the footsteps of the UK law. For example, the genesis of the current framework is the Hong Kong Companies Ordinance of 1865 that has mirrored the English Companies Act of 1862. Likewise, the UK Companies Act 1908 was followed by the Hong Kong Companies Ordinance 1911. The Hong Kong Companies Ordinance (CO) was designated as Chapter (Cap) 32 in 1933 and no significant legislative initiative in company law was introduced until 1984, which reflected the UK Companies Act 1948. See Horace Yeung and Flora Huang, 'Law and Finance: What Matters? Hong Kong as a Test Case' (2012), 3(1) *Asian Journal of Law and Economics* 1, 9. Again, the Hong Kong Companies Act 2014 codifies directors' duties under section 465 which is based on section 174 of the UK Companies Act 2006. See Kong Shan Ho, 'Codification of Directors' Duty of Care and Skill in Hong Kong: A Welcome Clarification of the Law', working paper, at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2618143](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2618143)> accessed 3 August 2015.

<sup>67</sup> Companies Ordinance (Cap 622), section 588(4) and section 50(4) of the Companies (Model Articles) Notice.

<sup>68</sup> Fair and equal treatment to all shareholders is a fundamental principle of Hong Kong's Listing Rules. Main Board Rule 2.03(4) (GEM Rule 2.06(4)) provides that: 'The Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and in particular that:.... All holders of listed securities are treated fairly and equally'.

<sup>69</sup> NYSE Listed Company Manual § 3 (1983) rule 313.00(D), and the HKEx Main Board Rule 8.11 provides that 'the share capital of a new applicant must not include shares of which the proposed voting power does not bear a reasonable relationship to the equity interest of such shares when fully paid ("B Shares"). The Exchange will not be prepared to list any new B Shares issued by a listed issuer nor to allow any new B Shares to be issued by a listed issuer (whether or not listing for such shares is to be sought on the Exchange or any other stock exchange except

- (1) in exceptional circumstances agreed with the Exchange; or
- (2) in the case of those listed companies which already have B Shares in issue, in respect of further issues of B Shares identical in all respects with those B Shares by way of scrip dividend or capitalisation issue, provided that the total number of B Shares in issue remains substantially in the same proportion to the total number of other voting shares in issue as before such further issue'.

shares.<sup>70</sup> The Rule entitles the HKEx to approve the listing of DCS companies on a case-by-case basis in exceptional circumstances,<sup>71</sup> however, none of the DCS companies has been admitted by the HKEx under such exception.<sup>72</sup>

The Listing Rule 8.11 has remained unaltered for more than two decades since its introduction for the sake of market integrity.<sup>73</sup> However, the HKEx has been recently under pressure to change Rule 8.11 in the wake of the rejection of Alibaba's listing plan which caused the loss of US\$300 million in anticipated advisory fees for Hong Kong's financial community and consequently the harm on its trading volumes and prestige.<sup>74</sup> In order to attract Chinese technology companies, the 108-page Concept Paper was published by the HKEx on 29 August 2014 to seek public views about DCS.<sup>75</sup> The Concept Paper is intended to evaluate the debate on whether DCS companies should be allowed to list. If there were enough support, this would be followed by a formal public consultation on changes to local stock market regulations. The Concept Paper considered the principles of investor protection, the current regulatory framework, the competitiveness of Hong Kong as one of the world's top listing venues as well as other jurisdictional practices on DCS.

Having reviewed all the responses to the Concept Paper,<sup>76</sup> the HKEx published its conclusions on 19 June 2015, stating that there is support for a public consultation on proposed changes to its listing rules and the acceptability of DCS.<sup>77</sup> In its conclusions, the HKEx noted that a majority of respondents had expressed support for the use of DCS in some circumstances, and expressed its belief that there are measures to put in place to mitigate the potential risks to investors posed by DCS. The draft proposal included a range of measures designed to offer extra protection for shareholders, such as restricting the use of DCS to companies of a certain size.

However, the draft proposal to change listing rules was unanimously opposed by the Securities and Futures Commission (SFC) on the ground that the current

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<sup>70</sup> HKEx, 'Concept Paper' (2014), n 3, para 82.

<sup>71</sup> See the HKEx Main Board Rule 8.11 (GEM Rule 11.25) for the exceptional circumstance.

<sup>72</sup> Charltons Solicitors, 'Hong Kong Stock Exchange Publishes Concept Paper on Weighted Voting Rights', Newsletter Issue 259, 29 September 2014, at <<http://www.charltonslaw.com/hong-kong-law/hong-kong-stock-exchange-publishes-concept-paper-on-weighted-voting-rights>> accessed 24 July 2015.

<sup>73</sup> The Listing Rule 8.11 was introduced in 1989 in response to a stock market turmoil in March 1987, which was triggered by announcements of three companies with intention to offer classes of ordinary shares with disproportionate voting rights (described as 'B' shares) via a bonus issue.

<sup>74</sup> Flora Huang (2015), 2.

<sup>75</sup> HKEx, 'Concept Paper' (2014), n 3.

<sup>76</sup> The responses were received from listed companies, HKEx staffs, professional bodies, market practitioners, institutional investors and retail investors. See the HKEx's website, 'Responses to the Concept Paper', at <<https://www.hkex.com.hk/eng/newsconsul/mktconsul/responses/cp2014082r.htm>> accessed 27 July 2015.

<sup>77</sup> For the full text of conclusions, see HKEx, 'Consultation Conclusions: To Concept Paper on Weighted Voting Rights' (2015), at <<https://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082cc.pdf>> accessed 27 July 2015.

proposal did not address how the Exchange's proposed conditions and safeguards pertaining to the structures could be monitored and what actions could be taken by regulators or public shareholders if they were not complied with.<sup>78</sup> It also criticised the regulators' subjective judgement on the eligibility criteria for DCS companies as it would give rise to regulatory uncertainty and could result in inconsistent and unfair decision-marking. Although HKEx's draft proposals offered a number of safeguards to prevent the abuse of its proposed DCS, the SFC questioned the adequacy of those safeguards in its statement. Last, the SFC concluded that Hong Kong's reputation would be harmed if DCS structures became commonplace, and emphasised that its regulatory function is to 'uphold the core principles of fairness and transparency which underpin Hong Kong's reputation as an international financial centre'.<sup>79</sup>

But the SFC's response was directed to primary listings and didn't mention the HKEx's proposals regarding secondary listings. Some commentators believe that the silence on secondary listing of DCS could be a good signal to potentially open the door for a DCS company which has already listed in a market with credible regulatory standards to list some shares in Hong Kong.<sup>80</sup> This could boost Hong Kong's equity markets by permitting secondary listings by US-listed companies with DCS structures and create a new way for companies to launch an IPO in Hong Kong even if their corporate structures would not meet the requirements for a primary listing. Following the SFC's release, HKEx announced that it would engage with the SFC to find out 'the best way forward in light of the views of the SFC' as any rule change must require the approval of the SFC.<sup>81</sup>

A subsequent question has been raised: why the US can embrace DCS while Hong Kong cannot? Many researchers and practitioners try to find out some attributors that cultivate the DCS companies in the US but are not available in other countries. They conclude that legal and institutional frameworks particularly relevant to DCS include a deeper professional investor base, better protection of minority shareholders' rights and a litigious culture.<sup>82</sup> Unlike its US counterparts, Hong Kong stock markets are dominated by retail investors and family companies with concentrated ownership, so the Hong Kong authorities place a strong emphasis on preventing abuses rather than curing these abuses.<sup>83</sup>

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<sup>78</sup> SFC, 'SFC Statement on the SEHK's Draft Proposal on Weighted Voting Rights', 25 June 2015, at <<http://edistributionweb.sfc.hk/t/ViewEmail/j/C5CD004D12EE9F25/F672ACDCDBF32846942A2DF08F503B7C>> accessed 27 July 2015.

<sup>79</sup> Ibid.

<sup>80</sup> Josh Noble, 'Hong Kong Regulator Rejects Proposals for Voting Change' (*Financial Times*, 25 June 2015), at <<http://www.ft.com/cms/s/0/12a62b6e-1b1f-11e5-8201-cbdb03d71480.html#axzz3h5fHZQoR>> accessed 27 July 2015. Also, see Ashley Lee, 'SFC Rejects HKEx Weighted Voting Rights Conclusions' (IFLR, 26 June 2015), at <<http://www.iflr.com/Article/3465852/SFC-rejects-HKEx-weighted-voting-rights-conclusions.html>> accessed 27 July 2015.

<sup>81</sup> HKEx, 'The Exchange's Response to the SFC's Statement in Relation to the Draft Proposal on Weighted Voting Rights', News Release, 25 June 2015, at <<https://www.hkex.com.hk/eng/newsconsul/hkexnews/2015/150625news.htm>> accessed 27 July 2015.

<sup>82</sup> Chan and Ho (2014), n 46, 175.

<sup>83</sup> A proportion of retail investors in Hong Kong is estimated to 36 percent. See Hong Kong Exchanges and Clearing Limited, Retail Investors Survey 2011 (2012), available at

This is also seen in the litigation system that distinguishes the two jurisdictions. Hong Kong takes a more ex-ante approach to prevent litigation from occurring in the first place by imposing more stringent IPO requirements and public disclosure while the US takes a more ex-post approach by providing various mechanisms to investors and lawyers to pursue lawsuits against abusers.<sup>84</sup> Due to the different institutional conditions, the fear exists that the adoption of DCS would 'easily lead to a lessening of confidence in Hong Kong as a major financial centre'<sup>85</sup>, which is why Hong Kong opposes the indiscriminate issuance of shares.

#### D. Singapore

Traditionally, Singapore held firm against the dilution of the principle of proportionality.<sup>86</sup> The Singapore Stock Exchange (SGX) issued guidance in 2011 that Singapore did not permit a listing of DCS on the ground that they entrenched control.<sup>87</sup> But the listing of newspaper companies is an exception. The Singapore Newspaper and Printing Presses Act mandates the issue of separate classes of shares with different voting rights by Singapore's listed newspaper companies such as Singapore Press Holdings.<sup>88</sup> Every newspaper that publishes in Singapore must create two classes of shares: management shares and ordinary shares. Each management shareholder has 200 times the voting rights of an ordinary shareholder over any resolution relating to the appointment/dismissal of a director or any staff member of the newspaper company.<sup>89</sup> Management shares can only be owned by Singaporean citizens or corporations that have been approved by the government, also permissions to hold management shares can be revoked by the government.<sup>90</sup>

When the world's best supported football giant Manchester United gave up Singapore for a New York listing raising US\$233 million in 2012 mainly owing to

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<<https://www.hkex.com.hk/eng/stat/research/Documents/RIS2011.pdf>> accessed 15 December 2015. In around 60 percent of listed Hong Kong companies, a family controls at least 10 percent of voting rights. See Richard Carney and Travers Child, 'Changes to the Ownership and Control of East Asian Corporations between 1996 and 2008: the Primacy of Politics' (2013) 107 *Journal of Financial Economics* 494.

<sup>84</sup> King Fung Tsang, 'Listing Destination of Chinese Companies: New York or Hong Kong?' (2010) 23 *Columbia Journal of Asian Law* 357.

<sup>85</sup> The Standing Committee on Company Law Reform, 'The Third Interim Report of the Standing Committee on Company Law Reform: B Shares' (July 1987), para 12. An extract from that report (including the relevant paragraphs) is included in Appendix 1 of HKEx, 'Concept Paper' (2014), n 3.

<sup>86</sup> Singapore Companies Act, section 64.

<sup>87</sup> SGX, 'The Capital Structure of Listed Companies in Singapore Regulators Column, Regulators Column, 20 September 2011, at

<<http://www.mondovisione.com/news/the-capital-structure-of-listed-companies-in-singapore/>> accessed 6 August 2015.

<sup>88</sup> Singapore Newspaper and Printing Presses Act (Cap.206), section 10.

<sup>89</sup> Ibid, section 10(1).

<sup>90</sup> Singapore's strict approach to press regulation in particular public expressive conduct reflects the ruling party's belief that the government has the trust and respect of the population fits [Singapore] better than the Western. Singapore Parliament, 'White Paper on Share Values' (1991), para. 41; also Thio Li-ann, 'Between Apology and Apogee, Autochthony: The "Rule of Law" Beyond the Rules of Law in Singapore' (2012) *Singapore Journal of Legal Studies* 269; and Po Jen Yap, *Constitutional Dialogue in Common Law Asia* (OUP 2015), 118-9

the denial of DCS by the SGX.<sup>91</sup> It raised the question as to whether the SGX missed attracting a global brand to list because of arcane corporate governance practices. Again, Alibaba went on to list in NYSE, achieving a spectacular success on its debut in 2014, which left some wondering how many DCS companies the SGX could afford to sacrifice for the sake of its one share-one vote principle.<sup>92</sup> The debate about allowing DCS in Singapore was put on agenda again in the light of the Government's process in revision of the Companies Act to remove the one share-one vote restriction.<sup>93</sup>

In April 2011, the amendments to the Companies Act were proposed by the Steering Committee for the Review of the Companies Act (Steering Committee) which was established in 2007 to undertake a comprehensive review of the Companies Act.<sup>94</sup> The proposal suggested to allow companies to issue non-voting shares and shares carrying multiple votes if their Articles allow it and subject to certain safeguards.<sup>95</sup> In doing so, the Steering Committee explained that the rationale was that multiple-vote shares and non-voting shares would allow such companies greater flexibility in capital management. On the other hand, the contrary view is that treating all shareholders equally in respect of voting rights is fundamental for good corporate governance and minority shareholder holders in particular in the Asian context where family companies are common.<sup>96</sup>

The proposal by the Steering Committee was accepted by the Ministry of Finance (MOF) in October 2012.<sup>97</sup> The MOF believes that the implementation of the proposal will align Singaporean law with the main stream of developed countries such as the US, which allow DCS.<sup>98</sup> In connection with the proposal, the MOF

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<sup>91</sup> Daniel Stanton and Fiona Lau, 'Exclusive: Manchester United drops Asia IPO for U.S.' (*Reuters*, 13 June 2012), at <<http://www.reuters.com/article/2012/06/13/us-singapore-us-ipo-manchester-united-if-idUSBRE85C0M020120613>> accessed 4 August 2015.

<sup>92</sup> Goh Eng Yeow, 'Dual-class Shares' May not be Apt for S'pore investors' (*Straits Times*, 15 October 2014), at <<http://business.asiaone.com/news/dual-class-shares-may-not-be-apt-spore-investors>> accessed 4 August 2015; and

<sup>93</sup> Dayne Ho and Stefanie Yuen Thio, 'Time to rethink dual-class shares for public listed companies in Singapore' (*Business Times*, 1 October 2014), at <<http://www.tsmplaw.com/news/Time%20to%20rethink%20dual-class%20shares%20for%20public%20listed%20companies%20in%20Singapore.pdf>> accessed 4 August 2015.

<sup>94</sup> MOF, 'Consultation Paper on the Report of the Steering Committee for Review of the Companies Act' (June 2011), at <[https://www.acra.gov.sg/uploadedFiles/Content/Publications/Public\\_Consultation/SCReportComplete28Jul.pdf](https://www.acra.gov.sg/uploadedFiles/Content/Publications/Public_Consultation/SCReportComplete28Jul.pdf)> accessed 4 August 2015.

<sup>95</sup> *Ibid.*, 16, 'Recommendation 3.4 - Companies should be allowed to issue non-voting shares and shares with multiple votes; Recommendation 3.5 - Section 64 should be deleted'.

<sup>96</sup> Drew & Napier LLC, 'Amendments to the Companies Act: (1) Multiple-vote Shares and Non-voting Shares; (2) Electronic Register of Members', 27 November 2014, at <[http://www.drewnapier.com/Publications-Events/Legal-Updates/Amendments-to-the-Companies-Act-\(1\)-multiple-vote](http://www.drewnapier.com/Publications-Events/Legal-Updates/Amendments-to-the-Companies-Act-(1)-multiple-vote)> accessed 5 August 2015.

<sup>97</sup> MOF and ACRA, 'Review of the Singapore Companies Act - Ministry of Finance's Responses to the Report of the Steering Committee for Review of the Companies Act', (3 October 2012), paras 70-75, at <[http://www.mof.gov.sg/portals/0/Public%20Consultation/AnnexA\\_SC\\_RCA.pdf](http://www.mof.gov.sg/portals/0/Public%20Consultation/AnnexA_SC_RCA.pdf)> accessed 4 August 2015.

<sup>98</sup> *Ibid.*, para.71.

stipulates that certain safeguards are to be introduced.<sup>99</sup> In May and October 2013, MOF and the Accounting and Corporate Regulatory Authority (ACRA) had sought two rounds of public consultation on the draft Companies (Amendment) Bill 2013.<sup>100</sup>

The Companies (Amendment) Bill (No.25/2014) was passed by Parliament in October 2014.<sup>101</sup> The Amendment allows public companies to issue different classes of shares with either no voting rights or multiple voting rights with the removal of the one-share-one-vote restriction.<sup>102</sup> SGX and Monetary Authority of Singapore (MAS) are reviewing where DCS could extend to listed companies. SGX's existing policy of not listing issuers with DCS structures will continue to apply pending the conclusion of the review.<sup>103</sup> From the first quarter of 2016, public companies in Singapore can issue ordinary shares with different voting rights.<sup>104</sup> By allowing DCS, Singapore's attractiveness as a listing destination would be enhanced.

Although the Amendment is believed to boost local markets, some commentators suggest that regulators should liberalise the regulatory framework in a calibrated way, rather adopt the US model of DCS structures wholesale.<sup>105</sup> One suggestion is limiting DCS to certain companies, such as technology companies

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<sup>99</sup> Ibid, para. 72. Safeguards include: (i) shareholders must approve the issuance of shares with different voting rights via a special resolution; (ii) information on the voting rights for each class of shares must accompany the notice of meeting at which a resolution is proposed to be passed; (iii) companies must specify the rights for different classes of shares in their Articles and clearly demarcate the different classes of shares so that shareholders know the rights attached to any particular class of shares; and (iv) holders of non-voting shares will have equal voting rights on resolutions to wind up the company or on those that vary the rights of non-voting shares.

<sup>100</sup> MOF and ACRA, 'Public Consultation on the Draft Companies (Amendment) Bill 2013' (2 May 2013), at

<[https://www.acra.gov.sg/Publications/Public\\_Consultation/Public\\_Consultation\\_on\\_Draft\\_Companies\\_Amendment\\_Bill\\_2013/](https://www.acra.gov.sg/Publications/Public_Consultation/Public_Consultation_on_Draft_Companies_Amendment_Bill_2013/)>, and 'Public Consultation on Additional Proposed Amendments to the Companies Act' (23 October 2013), at

<[https://www.acra.gov.sg/Publications/Public\\_Consultation/Public\\_Consultation\\_on\\_Additional\\_Proposed\\_Amendments\\_to\\_the\\_Companies\\_Act/](https://www.acra.gov.sg/Publications/Public_Consultation/Public_Consultation_on_Additional_Proposed_Amendments_to_the_Companies_Act/)> accessed 4 August 2015.

<sup>101</sup> On 15 April 2015, ACRA announced that the legislative changes to the Companies Act will be effected in two phases. The first phase will be implemented on 1 July 2015. The second phase will commence in the first quarter of 2016. See ACRA, 'Two-Phase Implementation of Companies (Amendment) Act 2014', at <[https://www.acra.gov.sg/Legislation/Two-Phase\\_Implementation\\_of\\_Companies\\_\(Amendment\)\\_Act\\_2014/](https://www.acra.gov.sg/Legislation/Two-Phase_Implementation_of_Companies_(Amendment)_Act_2014/)> accessed 4 August 2015. For the summary of the key changes of Companies Act, see Wai Yee Wan, 'Recent developments in Singapore on company law and regulation: review of the Singapore Companies Act' (2014), 35(5) *Company Lawyer* 143.

<sup>102</sup> The Companies Act (Amended) section 64 and 64A.

<sup>103</sup> ACRA, 'Key Legislative Amendments to Be Effected in Phase 2', at <[https://www.acra.gov.sg/Legislation/Companies\\_Act\\_Reform/Key\\_legislative\\_amendments\\_to\\_be\\_effected\\_in\\_Phase\\_2/](https://www.acra.gov.sg/Legislation/Companies_Act_Reform/Key_legislative_amendments_to_be_effected_in_Phase_2/)> accessed 6 August 2015.

<sup>104</sup> Drew & Napier LLC (2014); and Lance Lim, 'Recent Amendments to the Companies Act: Rethinking Dual-class Shares in Singapore – Caveat Emptor?', 1 January 2015, at <<http://www.lawgazette.com.sg/2015-01/1219.htm>> accessed 6 August 2015.

<sup>105</sup> Straits Times, 'Dual-Class Shares could help Boost Local Market', 16 November 2015, available at <<http://www.straitstimes.com/business/companies-markets/dual-class-shares-could-help-boost-local-market>> accessed 15 December 2015.

and mega-sized listings.<sup>106</sup> The former appears to be based on the recent trend of technology companies using DCS. For the latter, Large IPOs will attract institutional investors who are better equipped to evaluate company business and management. It has also been proposed that some restrictions and safeguards should be imposed on DCS, including the suspension of superior voting in certain trigger events such as insolvency or qualified accounts, and a three-year sunset provision for companies with existing structure.<sup>107</sup>

## E. Tokyo

Historically almost all listings on Japanese stock exchanges had been of common shares. The only exception was Inpex Corporation, a privatised oil company, issuing shares with veto rights (so-called golden shares) owned by the Japanese government in November 2004.<sup>108</sup> The provisions of the Commercial Code relating to joint stock companies were replaced by the Japanese Companies Act 2005,<sup>109</sup> which incorporated certain fundamental changes with respect to classes of shares. Article 108 of the Companies Act 2005 allows a stock company to issue more than one types of share. A company issuing more than two types of shares under its articles of association is called a *shurui kabushiki hakkou kaishi* (company issuing class shares).

In response to the Companies Act 2005, the Advisory Group on Improvements to the Tokyo Stock Exchange (TSE) Listing System published its 'Comprehensive Improvement Programme for Listing System 2007' in April 2007, discussing the requirements for listing of shares classified with respect to voting rights and the

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<sup>106</sup> Stefanie Yuen Thio, 'Is Singapore Ready for Dual-Class Shares?', *Business Times*, 15 October 2015, available at <<http://business.asiaone.com/news/singapore-ready-dual-class-shares>> accessed 15 December 2015.

<sup>107</sup> Mak Yuen Teen, 'Say "No" to Dual Class Shares', *Business Times*, 27 November 2015, available at <<http://www.businesstimes.com.sg/opinion/say-no-to-dual-class-shares>> accessed 15 December 2015.

<sup>108</sup> The term 'Golden share' arose in the 1980s when the British government retained golden shares in companies in privatized, and later the concept emerged in Russia and other European countries. They are typically held by the government in the process of the privatization of a government company. They empower the government the decisive voting rights, thus to veto all other shares in a shareholder meeting. The 'Golden share' concept was introduced to the Japanese Companies Act 2005 as 'preferred shares with veto rights' under Article 108. For the more details of the evolution of Golden share, available at: <<http://www.mutantfrog.com/2011/06/13/the-tale-of-inpex-and-the-golden-share>> accessed 14 October 2015.

<sup>109</sup> Japanese Companies Act was enacted in 2005 and is experiencing its first reform which resulted in 'the Outline for the Companies Act Reform' in 2012. Based on the Outline, the amendments to the Companies Act (including several provisions concerning corporate governance) were passed by the Diet on 20 June 2014 and took into effect in May 2015. The English version of the full legal text of Japanese Companies Act 2005 is available at <[http://www.wipo.int/wipolex/en/text.jsp?file\\_id=338223](http://www.wipo.int/wipolex/en/text.jsp?file_id=338223)> accessed 28 September 2015. For the details of the Outline, see Goto Gen, 'The Outline for the Companies Act Reform in Japan and its Implications' (2013) 35 *Journal of Japanese Law* 13. And for the latest amendment to the Companies Act, see Masamichi Sakamoto and Yohei Harima, 'Companies Act Reform 2014: Can the New Amendment to the Companies Act of Japan Strengthen the Corporate Governance System of Japanese Listed Companies' (2014) City Yuwa Partners, available at <[http://www.city-yuwa.com/english/publication/shared/PDF/JLG201415\\_cy\\_56-59.pdf](http://www.city-yuwa.com/english/publication/shared/PDF/JLG201415_cy_56-59.pdf)> accessed 28 September 2015.

circumstances in which such shares should not be permitted.<sup>110</sup> The new listing rules were implemented in July 2008, consolidating a draft outline of a new listing system for classified shares,<sup>111</sup> and the 'Listing System Improvement FY 2008'.<sup>112</sup> The new listing rules relax regulations on the use of certain kinds of DCS in IPOs. But existing-listed companies are still prevented from issuing a diverse assortment of class shares.

In the new rules, 'shares classified with respect to voting rights' are defined as shares with no voting rights, shares with voting rights exceeding other classes of shares, and shares with voting rights fewer than the other classes of shares. The TSE will decide whether a company is qualified to issue two or more classes of shares having different voting rights on a case-by-case basis, taking into account any concern that the interests of existing shareholders might be impaired. The examination of an application for the issuance of such shares will involve a formal examination and a substantial examination. A formal examination, equivalent to listing requirements of common stocks, will check the applicant company's conformity to the numerical criteria defined in the 'Criteria for Stock Listing Examination'.<sup>113</sup> The substantive examination will determine whether the scheme of the relevant shares respects the interests of shareholders on the individual application basis.

Cyberdyne, known for the HAL robot suit, was the first company with DCS listed in TSE in March 2014.<sup>114</sup> Cyberdyne is authorised to issue two classes of shares – common stock and class B stock. Shareholders of both classes of stock have the same rights with respect to dividends and distributions upon liquidation. But a class B shareholder has 10 times as many voting rights as a common shareholder given the same unit sizes. Class B shares were held only by Yoshiyuki Sankai, the president and CEO of the company, and two foundations for which he serves as a representative director.

After the IPO of Cyberdyne, the TSE again amended its listing rules on DCS in July 2014 in the course of the detailed examination of Cyberdyne's listing.<sup>115</sup> Two key points addressed in the 2014 amendment are (1) necessity and appropriateness

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<sup>110</sup> TSE, 'Comprehensive Improvement Programme for Listing System 2007', 24 April 2007, available at: <<http://www.jpx.co.jp/english/equities/improvements/general/tvdivq0000004iib-att/2007programjokyo-e.pdf>> accessed 28 September 2015.

<sup>111</sup> The contents of the Outline are summarised by Kazuhiro Yoshii, 'A New Share-listing System in Japan', July 2008, available at <[https://www.amt-law.com/en/pdf/bulletins3\\_pdf/080821\\_1a.pdf](https://www.amt-law.com/en/pdf/bulletins3_pdf/080821_1a.pdf)> accessed 15 October 2015.

<sup>112</sup> TSE, 'Listing System Improvement FY2008', 27 May 2008, available at <<http://www.jpx.co.jp/english/equities/improvements/general/tvdivq0000004iib-att/080527.pdf>> accessed 15 October 2015.

<sup>113</sup> An overview of the IPO on the TSE is available at the website of Japan Exchange Group (JPX), at <<http://www.jpx.co.jp/english/equities/listing-on-tse/new/basic/index.html>> accessed 15 October 2015.

<sup>114</sup> Nikkei, 'Cyberdyne to Debut on TSE Mothers Market in March', 20 February 2014, available at <<http://asia.nikkei.com/Markets/Tokyo-Market/Cyberdyne-to-debut-on-TSE-Mothers-market-in-March>> accessed 28 September 2015..

<sup>115</sup> Koji Toshima, 'Cyberdyne's Dual-class IPO', 9 December 2014, available at <<http://www.iflr1000.com/NewsAndAnalysis/Cyberdynes-dual-class-IPO/Index/1662>> accessed 28 September 2015.

for use of a DCS; and (2) a sunset clause.<sup>116</sup> The former requires that a DCS is necessary from the perspective of the common interests of shareholders to ensure that a certain person continues to be involved in the business, and the structure is appropriate to achieve such necessary purpose. Under this new rule, the TSE will examine the nature of shares of class stock and determine whether a DCS is necessary from the common interests of shareholders. The latter of sunset clause prescribes that the weighted stock converts to common stock if the necessity of the DCS ceases to exist.

Despite some restrictions on DCS, some worry that opening door to DCS may exaggerate agency problems by a group structure in listed companies, where public shareholders may be harmed by the activities of controlling shareholders or group-based management.<sup>117</sup> According to the TSE White Paper in 2015, among TSE-listed companies, 629 companies (18.4 percent) have controlling shareholders.<sup>118</sup> Out of them, 61.8 percent (11.4% overall) have parent companies and 38.2 percent (7.0 percent overall) have controlling shareholder other than a parent company. Insiders holding more voting rights relative to cash flow rights would extract more private benefits at the expense of outside shareholders, in particular in the context of Japan where a high percentage of a cross-shareholding structure between company and bank has severely destroyed transparency and information disclosure of capital market.<sup>119</sup>

#### **IV. Conclusion**

The weighted voting rights structure is always controversial and is criticised by advocates of corporate governance as it is regarded as a breach of the principle of one share-one vote. However, the findings from the empirical studies on ownership disproportionality do not entirely agree with the theory. Enthusiasts believe that DCS allow entrepreneurs to bring their ideas to the public market at an early stage, and enable companies to plan for the long term.

Around the Top 5 global financial centres, most of them welcome or have changed their rules to allow DCS. The permission of the use of DCS upon an IPO by New York which has the largest stock exchange in the world raises a difficult

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<sup>116</sup> TSE New Listing Guidebook, 'Guidelines for Listing Examination II 6.(4)', available at<<http://www.jpx.co.jp/english/equities/listing-on-tse/new/guide/tvdivq000002g9b-att/bv22ga0000001ufs.pdf>> accessed 14 October 2015.

<sup>117</sup> Hideki Kanda, 'Regulation of Controlling Shareholders in Japan', a presentation on EU Asia Corporate Governance Dialogue Conference 2015, available at<[http://law.nus.edu.sg/clb/events/EACG\\_Dialogue\\_Conference2015/pdfs/hideki\\_rcsj\\_slides.pdf](http://law.nus.edu.sg/clb/events/EACG_Dialogue_Conference2015/pdfs/hideki_rcsj_slides.pdf)> accessed 15 December 2015; and Sergey Chernenko et al, 'Agency costs, Mispricing, and Ownership Structure' (2010), NBER working paper No. 15910 (arguing that ownership structures including pyramids, business groups, DCS, are prone to agency problems.)

<sup>118</sup> TSE, 'TSE-Listed Companies White Paper on Corporate Governance 2015', 8-9, available at<<http://www.jpx.co.jp/equities/listing/cg/tvdivq0000008jb0-att/2015.pdf>> accessed 15 December 2015.

<sup>119</sup> Ronald Masulis et al, 'Agency Problems at Dual-Class Companies' (2009) 64 *Journal of Finance* 1697; and Teng-Kee Tan and Xiao Fang Fu, *Proceedings of the International Conference on Chinese Enterprise Research 2007* (World Scientific 2008), 169 (Usually 60-70 percent of corporate stock is possessed by banks in Japan. Consequently, not only is the agency problem not easy to be discovered, but a lot of information cannot be disclosed).

question for stock exchanges and financial authorities in other countries. Singapore and Tokyo follow in its footsteps to reform their listing framework and company law to grant such voting arrangement. On the other hand, they in particular Tokyo also try to prevent the misuse of DCS by examining the necessity and appropriateness of the structure. By contrast, London and Hong Kong stand firm on restrictions on such structure to protect investors from exploitation despite the long debates in an attempt to attract high-profile technology companies to list in the territory.

Researchers and practitioners have tried to find out why the attitudes towards DCS are diversified in different jurisdictions. There must be some reasons that DCS are permitted and work well so far in the US, yet such structures have been criticised elsewhere for insufficient investor protection. One possible explanation is the discrepancy in legal and institutional frameworks that allow listed companies to adopt DCS structure in favour of selected shareholders. In contrast to the US, the powerful position of institutional investors and the break-through rule in the UK may deter the development of DCS. Similarly, a paternalistic approach by Hong Kong to prevent exploitation of shareholders beforehand leads the authorities to choose shareholder fairness over profit. In a nutshell, the suitability and adaptability of DCS is largely path dependent on the pre-existing institutional frameworks of the exchange as well as the jurisdiction in concern.

One way or another, DCS provides plenty of material for argument between competition and shareholder protection. It also brings challenges to other jurisdictions whether to relax the ban on such shares, in pursuit of its push to become an appealing venue for emerging technology companies.