A CONTROL-ACCOUNTABILITY ANALYSIS OF DUAL CLASS SHARE (DCS) STRUCTURES

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ABSTRACT

Under dual class share ("DCS") structures, issued share capital typically includes two (or more) classes of ordinary shares carrying differentiated voting rights. The recent wave of high-profile DCS IPOs of high-tech companies bring back the spotlight on the debate of such share structures. While proponents praise the decoupling of voting rights from cash flow rights for protecting visionary entrepreneurs/founders from undue influence of outside investors and markets, and thereby giving them the freedom to pursue and implement their idiosyncratic business idea; opponents criticize such decoupling for destroying shareholder democracy and failing to align control with ownership incentive. After critically analyzing the economic rationale for one share – one vote as well as its underlying shareholder democracy, this paper rebuts most of the criticisms against DCS structures, but finds the concerns over increased governance risks are, to some degree, valid.

Although the proportionate voting is not an elixir for agency problems, the increased entrenchment of control caused by the insulation of control from ownership in DCS structures does increase governance risks. However, they are by no means uncontrollable. Mandatory safeguarding measures can help to mitigate the potentially greater agency costs associated with DCS structures. Thus, this paper arguing the debate over DCS structures lies on the weighing of merits and detriments of DCS structures, which is essentially the weighing of control and accountability. By adopting a control-accountability perspective, safeguards such as sunset provisions, limitation of voting differentials and alike are essentially to enhance the accountability part. Because control part and accountability part of DCS structures stand on the two opposite ends of the spectrum, enhancing the accountability part would inevitably compromise the control part, and the value of it, either intendedly or unintendedly. Therefore, this paper proffers a dynamic balance conception to help scholars and policymakers understand and evaluate the full impact of safeguarding measures.

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I. INTRODUCTION

An increasing number of high-profile technology companies such as Google (now Alphabet) (2004), Trip Advisor (2011), Facebook (2012), Snap (2017), Dropbox (2018), Eventbrite (2018), Zoom (2019)[1] choose to go public with dual-class share ("DCS") structures. Under DCS structures, issued share capital typically includes two or more classes of ordinary shares carrying differentiated voting rights at general meetings.[2] Normally, those founders and entrepreneurial managers, as insiders, receive multiple-voting shares, while public and outside investors receive single-voting

[1]Council of Institutional Investors, *Dual Class Companies List*, COUNCIL OF INSTITUTIONAL INVESTORS (Mar. 2020), https://www.cii.org/.

[2]*See, e.g.,* SGX, *Proposed Listing Framework for Dual Class Share Structures*, SINGAPORE EXCHANGE (June 26, 2018), https://sgx.com/ (defining a DCS as "a share structure that gives certain shareholders voting rights disproportionate to their shareholding. Shares in one class carry one vote, while shares in another class carry multiple votes." Meanwhile, DCS structures also extend to triple-class companies like Snap Inc. where Class A shares have no votes, Class B shares have one vote per share and Class C shares have ten votes per share).

shares.[3] Multiple-voting rights under DCS structures allow insiders to retain control with less than a majority of ownership stake in a given company.[4] In other words, the superior voting power decouples insiders' voting rights from their cash flow rights, thus it is disproportionate to their equity shareholding. With multiple-voting shares in hand, these firms are unlikely to be a takeover target because DCS structures a very successful takeover defense.[5]

People supporting DCS structures praise such decoupling, stating it protects visionary entrepreneurs and founders from undue influence of outside investors and markets, as well as provides the freedom to pursue and implement idiosyncratic business ideas.[6] Supporters of DCS structures view markets and investors as essentially myopic, where multiple-voting rights can help controllers overcome the temptation of short-termism and thereby create long-term value for both the firm and the society.[7] Opponents have approached DCS structures very differently, focusing instead on increased entrenchment caused by controllers' superior voting rights.[8] They genuinely believe in one share – one vote ("OSOV") and see it as an enshrined law and bedrock principle of corporate voting; therefore, holding that each element of residual proprietary interests shall carry an equal voting right, hence shareholders' voting power shall correspond with their shares of residual gains or losses.[9] In critics' view, decoupling insiders' voting rights from their equity shareholdings goes against shareholder democracy and fails to align control with ownership incentive, which ultimately results in suboptimal decision-making.[10] This paper revisits and reevaluates the cases both for and against DCS structures in order to examine the validity of these arguments. After a comparative and

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[3]Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 687 (1986).

[4]Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1459 (2019).

[5]*See*, *e.g.*, Seligman, *supra* note 3, at 687. DCS structures were largely motivated by their anti-takeover effects by concentrating power in the hands of small group of inside shareholders.

[6]Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 577-78 (2016).

[7]*Id.* at 580-81. In other words, founders and entrepreneurial managers with multiple-voting rights do not need to be concerned that they might be ousted if the short-term performance is unsatisfactory.

[8]*Id*. at 581-82.

[9]*See*, *e.g*., Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 409 (1983).

[10]This is different from OSOV, which apportions power among the shareholders according to their shareholdings in the company. *See* Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347, 1356 (2006).

critical analysis of the nature of OSOV and DCS structures, this paper rebuts criticisms in relation to deviation from shareholder democracy, as well as its economic rationale. Although proportionate voting under OSOV is not an elixir for agency cost problems, especially in the context of shareholder heterogeneity, this paper finds the concerns over increased governance risks under DCS structures are to some degree valid.[11] In other words, DCS structures are more likely to undermine investors and markets' monitoring, thus exacerbating risks of extraction for private benefits. The potential costs to holders of inferior voting shares would then lead to a discount to the value of these shares.[12]

Based on the theory of Kaldor-Hicks efficiency, there will only be economic efficiency if the gain from those who are made better off could outweigh the loss suffered by those who are made worse off.[13] Accordingly, there will be a business case for DCS structures if values to holders with multiple-voting rights can outweigh costs to holders of inferior voting shares.[14] Put differently, firm valuation would be improved if the benefits outweigh costs, and decreased if costs outweigh benefits. A significant body of empirical evidence[15] unfortunately offers little quantitative assistance in terms of whether DCS structures help companies increase firm value or not.[16] Nevertheless, safeguarding measures such as sunset clauses, limitations on voting differentials, enhanced disclosure requirements and alike can all be deployed to constrain potential negative implications of DCS structures.[17] The debate over the viability of DCS structures shall then be re-oriented towards how to restrain the potential governance risks brought on by such structures.

While these constraints can limit controlling shareholders' potential abuse of enhanced control, they may simultaneously compromise values of DCS structures. In order to strike a balance between the values and costs of DCS structures, particularly after incorporating appropriate safeguarding means, this paper proposes a dynamic balance conception

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[11]Iman Anabtawi, *Some Skepticism about Increasing Shareholder Power*, 53 UCLA L. REV. 561, 579 (2006).

[12]*Id*. at 586.

[13]*See* Nicholas Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549-52 (1939); John Hicks, *The Foundation of Welfare Economics*, 49 ECON. J. 696, 712 (1939); *see* John Hicks, *The Valuation of the Social Income*, 7 ECONOMICA 105, 105-24 (1940); *see also* BRIAN R. CHEFFINS, COMPANY LAW: THEORY, STRUCTURE AND OPERATION 15-16 (Oxford Univ. Press 1997).

[14]Anabtawi, *supra* note 11, at 586.

[15]*See infra* Section IV (discussing mixed and contradicted outcomes).

[16]*See infra* Section IV. Another interpretation is whether performance of DCS companies is better or worse than non-DCS companies.

[17]Bebchuk & Kastiel, *supra* note 4, at 1504.

that focuses on visionary founders' control versus their accountability.[18] Control and accountability stand on opposite ends of a spectrum. Every time a safeguarding measure is added to the equilibrium, founder accountability may be enhanced (namely, the potential governance risks are reduced), but their control may be correspondingly compromised (namely, the value of DCS structures would decrease), this in turn makes DCS structures less valuable for founders and entrepreneurs.[19] The dynamic balance conception proffered by this paper can therefore help researchers and policymakers fully evaluate the role and impact of existing and future constraints on DCS structures.

According to the latest *Global Financial Centres Index* ("GFCI 26"), a widely quoted source for ranking financial centers, leading financial centers in Asia continue to perform well – Hong Kong and Singapore are ranked in the Top 4 across the world, just behind New York and London.[20] Policymakers and those involved in exchanging stock are motivated to amend laws or, in the very least, listing rules to accommodate DCS IPOs.[21] For example, since the Hong Kong Stock Exchange ("HKEx") rejected the e-commerce giant Alibaba's request to go public with DCS structures and consequently missed the opportunity of hosting Alibaba's listing in 2014, it started to reconsider the viability of introducing DCS structures and finally revised its listing rules to permit DCS listing.[22] Singapore also recently amended its company laws to permit public companies issuance of shares with differentiated voting rights and allowed DCS to be listed on the Singapore Stock Exchange ("SGX").[23] This paper uses a control-accountability analysis to examine the institutional designs of DCS structures in these two jurisdctions.

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[18]HKEx, *Chapter 8A Equity Securities*, https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/h/k/HKEX4476_5103_VER10.pdf.

[19]*Id*.

[20]Mark Yeandle & Mike Wardle, *Global Financial Centres Index 26*, (September 2019), https://www.longfinance.net/media/documents/GFCI_26_Report_v1.0.pdf. Four more Asian financial centers are Shanghai, Tokyo, Beijing, and Shenzhen - ranked 5, 6, 7, and 9 respectively.

[21]*Id.*

[22]Enoch Yiu, *Securities Commission Backs Introduction of Dual-Class Shares on Hong Kong Stock Exchange*, SOUTH CHINA MORNING POST (Dec. 20, 2017, 7:28 AM), https://www.scmp.com/business/companies/article/2124972/securities-commission-backs-introduction-dual-class-shares-hong.

[23]Ministry of Finance (Singapore), *Report of the Steering Committee for Review of the Companies Act,* MINISTRY OF FIN. SINGAPORE (June 2011), https://www.mof.gov.sg/cmsresource/public%20consultation/2011/Review%20of%20Companies%20Act%20and%20Foreign%20Entities%20Act/Anx%20A%20SC%20Report%20Complete.pdf. However, contrary to the original expectation, there are very few DCS IPOs. *See infra* Section VI.

The remainder of the paper is organized as follows: Section II offers an overview of shareholder voting and critically examines the validity of OSOV that allows shareholders to cast votes based on their economic stake in a firm, particularly in the context of shareholder heterogeneity. The underlying similarity and difference between OSOV and DCS structures are also highlighted in this section. Section III discusses main theoretical arguments for and against DCS structures by focusing on the decoupling of voting rights from cash flow rights. Section IV observes empirical evidence to identify whether DCS structures can help increase firm value or not, namely whether there is a business case at all. Section V finds that increased governance risks can be controlled by constraints imposed upon shareholders with superior voting rights. This section further argues that viability of DCS structures are based on the trade-off between benefits and costs. Section V then examines various measures in restraining the potential costs associated with such structures. This section also introduces and discusses the dynamic balance conception to help better recognize and evaluate the full impact safeguards have in balancing entrepreneurs/founders' control with minority shareholder protection. Section VI reviews the recent reforms in Singapore and Hong Kong to see the DCS structures debate in context and applies the dynamic balance conception to analyze their institutional designs on DCS structures. Finally, the concluding remark is provided in Section VII.

II. EVOLUTION OF SHAREHOLDER VOTING

A. *The Rise of One Share-One Vote*

One share-one vote ("OSOV") is seen as "[t]he most basic statutory rule of voting" in corporate law, especially in a world of shareholder democracy.[24] The economic foundation of shareholder voting builds on shareholders' residual proprietary claims against incomes generated by the company, which provide them the best incentives to exercise their voting power in order to maximize the residual of the company.[25] As residual proprietary claimants, shareholders "reap the marginal dollar" of corporate profits and "suffer the marginal dollar" of corporate losses.[26] After shareholders' voting powers are matched with their residual claims and

[24]Easterbrook & Fischel, *supra* note 9, at 408.

[25]Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1446-47 (1989).

[26]Lynn LoPucki, *The Myth of the Residual Owner: An Empirical Study*, 82 WASH U. L. Q. 1341, 1343-44 (2004).

risks, shareholders are expected to be incentivized into choosing, and wholeheartedly supporting, optimal investment projects and decisions for the company.[27]

A shareholder's voting right, as a control right of firm, includes the ability to make all decisions not otherwise provided by contract and delegate them to directors.[28] According to Hayden and Bodie, the theoretical underpinnings of the voting right involve (1) the ability to vote, (2) the appropriate weight of the votes, and (3) the right to a qualitatively undiluted vote.[29] That is to say the mere ability to vote is not sufficient to ensure shareholders' meaningful participation in the corporation; it would also be essential to let the vote carry "an appropriate numerical weight" to reflect the varying degrees in which voters care about the outcome of voting.[30]

The conventional wisdom holds the extent to which shareholders would be affected in the corporate context as their residual proprietary claims are in proportion to their economic stakes, namely the cash-flow rights against the firm.[31] In order to control the agency cost of management, Easterbrook and Fischel argued that each element of the residual proprietary interest shall carry an equal voting right.[32] The economic rationale behind such proportionate voting is to grant shareholders voting power commensurate with their residual proprietary claims.[33] Therefore, the general corporate voting rule apportions power among shareholders based on their investment in the company.[34] In other words, the amount of shares held are deemed a perfect proxy for shareholder interest, as well as the degree in which they would be affected in a firm.[35]

This explains why the dominant corporate governance rule allocates shareholders' voting power "in proportion to [their] economic interest by mandating a single class of voting common stock that has both a residual interest in corporate profits and one vote per share."[36] Nevertheless, an essential premise of this economic justification for OSOV is shareholder

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[27]*Id*.

[28]Easterbrook & Fischel, *supra* note 9, at 402.

[29]Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 452-60 (2008).

[30]*Id*. at 451, 456.

[31]Easterbrook & Fischel, *supra* note 9, at 408-09.

[32]*See id.* at 409.

[33]*See id.*

[34]*See* Dunlavy, *supra* note 10.

[35]*See* Dunlavy, *supra* note 10.

[36]Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1945 (1996).

homogeneity, which assumes shareholders all share homogenous interests in maximizing residual profits in order to benefit from that maximization.[37] If shareholder interests are heterogenous, shareholders may have different incentives regarding corporate decision-making, including those other than maximization of residual profits.[38] Heterogenous incentives held by shareholders as voters would then make it impossible to aggregate their preferences into a consistent system of choices.[39] A lack of consistent choices for a corporation may lead to self-destruction.[40]

That is perhaps why Easterbrook and Fischel claim that in a given company at a given time, most shareholders are a reasonably homogenous group with an analogous objective.[41] Reinier Kraakman and his co-authors comment that those equity capital investors have, or at least are able to be induced to have, relatively homogenous interests.[42] In Anabtawi's words, "most observers of corporate governance law nevertheless regard divergences in the interests of shareholders as either insignificant or checked by the corporate law voting principle of majority rule."[43] They all attempt to show that inconsistent choices are likely to be avoided due to shareholder homogeneity.[44]

Unfortunately, different shareholders do have different interests ranging from risk preferences to expected returns.[45] First, shareholders with different expected holding periods would unavoidably have divergent preferences over the corporate decision-makings.[46] While short-term shareholders are more likely to pressure directors to adopt policies that would maximize short-term share prices, such as axing employees, reducing research and development ("R&D") expenses or selling

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[37]Hayden & Bodie, *supra* note 29, at 476.

[38]*See* Easterbrook & Fischel, *supra* note 9 at 405-06.

[39]*See id.* at 405.

[40]*See id.*

[41]FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 70 (Harv. Univ. Press 1991).

[42]REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 13 (3rd ed. Oxford Univ. Press 2017); *see also* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 15 (2nd ed. Oxford Univ. Press 2009) (using the phrase "*highly* homogenous interests" in the prior edition).

[43]Anabtawi, *supra* note 11 at 577–78.

[44]*Id*. at 579.

[45]*Id*. at 581-82.

[46]*Id*. at 581.

corporate assets,[47] long-term shareholders may be ready to sacrifice immediate profits for long-term development.[48]

Second, diversified shareholders care much less about firm-specific risk when compared to undiversified shareholders; shareholders who invest in a given company without diversifying are more sensitive to such risks.[49] Unlike diversified shareholders, undiversified shareholders would normally give up higher returns for reduced risks.[50]

Third, heterogenous expectations between inside shareholders and outside shareholders, hedged shareholders and unhedged shareholders also demonstrate how shareholders may have varying interests.[51] This issue can be further exacerbated by involving sovereign wealth funds and other government-directed investment vehicles as another type of shareholder. Both sovereign wealth funds and government-directed investment vehicles as shareholders are considered very different from traditional shareholders like private funds merely seeking to invest because of their political or strategic motives.[52] In short, the essential premise of OSOV is untenable in the context of shareholder heterogeneity and the case for maintaining OSOV is subsequently weakened.

B. *Rise of DCS Structures*

OSOV, which allocates the voting power among shareholders based on their shareholdings as proxy for residual proprietary interests in the company, can be best described as "plutocracy" or "governance by the wealthy."[53] While OSOV defined the plutocratic end of the spectrum, American and English common law, which upheld one vote per

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[47]Michael Jensen, *Paying People to Lie: The Truth About the Budgeting Process*, 9 EURO. FIN. MGMT. 379, 387 (2003). Professor Jensen has also argued that it is not impossible for directors to "increase this year's profits at the expense of future year's profits by moving expenses from this year to the future (by delaying purchases, for example) or by moving revenues from future years into this year by booking orders early (by announcing future price increases, or by giving special discounts this year, or guaranteeing to repurchase goods in the future, and so on)."

[48]*Id*.

[49]Anabtawi, *supra* note 11, at 584-85.

[50]*Id.*

[51]*Id.* at 583-93. For example, inside shareholders like directors with shares may be more concerned about job security and prefer to maintain the status quo when facing a hostile takeover, even though the offer may be in the best interests of the company. Or in the context of golden parachutes, insider shareholders who happen to be directors would have a greater incentive to facilitate the merger even if it is not in the best interests of outside shareholders.

[52]*See*, *e.g.*, Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 65 STAN. L. REV. 1345, 1362 (2008).

[53]Dunlavy, *supra* note 10, at 1355.

shareholder, defined the democratic end of the spectrum.[54] Limiting shareholder voting rights is as old as the corporate form itself.[55] Many corporate charters provided for one vote per shareholder regardless of the number of shares they owned.[56] An empirical study revealed the proportion of corporations adopting one vote per shareholder (thirty-eight percent) was greater than the proportion of corporations adopting OSOV (thirty-five percent) in a sample of some 1,200 American corporate charters in the early 19th century.[57]

Between these two ends of the spectrum lay the so-called prudent-mean voting rules that aim to better balance the rights of a person with the rights of property.[58] Prudent-mean rules gave shareholders one-vote-per-share only up to a certain ceiling.[59] In the above sample, the rest of the companies (twenty-seven percent) contained such prudent-mean voting rules.[60] Even in the mid-19th century, a sample of 135 corporate charters still showed a great majority (sixty-eight percent) adopted either democratic or prudent-mean voting rules as opposed to OSOV.[61] This clearly shows that OSOV is by no means a historical norm, but an alternative to restricted voting arrangements.[62] Over time, concerns that corporate power concentrated in the hands of a few large investors gradually pushed the voting rules to the opposite end of plutocracy.[63] OSOV only became familiar at the end of 19th century[64] in an effort to

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[54]*Id*. at 1354-55.

[55]*See* Stephen Bainbridge, *Understanding Dual Class Stock Part I: An Historical Perspective,* PROFESSOR BAINBRIDGE (Sept. 9, 2017), https://www.professorbainbridge.com/professorbainbridgecom/2017/09/understanding-dual-class-stock-part-i-an-historical-perspective.html.

[56]David L. Ratner, *The Government of Business Corporations: Critical Reflections on the Rule of "One Share, One Vote"*, 56 CORNELL L. REV. 1, 9-11 (1970); Samuel Williston, *History of the Law of Business Corporations Before 1800 (Part II)*, 2 HARV. L. REV. 149, 156 (1888).

[57]Dunlavy, *supra* note 10, at 1354-56.

[58]*Id*. at 1356-57.

[59]*See id*. at 1357. *An Act Prescribing General Regulations for the Incorporation of Manufacturing and Mining Companies* in 1837 provided a perfect example: "[I]n . . . elections, and in all other meetings, the stockholders shall be entitled to one vote for every share owned by them respectively, up to the number of fifteen inclusive, and to one additional vote for every five shares from fifteen to one hundred, and to one additional vote for every twenty shares over and above one hundred."

[60]*Id*.

[61]Dunlavy*, supra* note 10, at 1358.

[62]*See id.*

[63]Stephen M. Bainbridge, *The Scope of the SEC's Authority Over Shareholder Voting Rights*, 1, 3 (UCLA Sch. of L. Res. Paper No. 07-16, 2007).

[64]*See* Dunlavy, *supra* note 10, at 1359-60. Dunlay argued that the plutocratic turn was a distinctively American phenomenon at the turn of the century as European counterparts, including France and Germany, continued to restrict voting rights, especially for large investors.

encourage large scale capital investments through overcoming difficulties of accumulated voting rights.[65]

As analyzed in this paper, DCS structures concern yet another form of voting rules regarding shares that carry differentiated voting rights. Distinct from OSOV that gives all shareholders proportionate voting power compared to their equity shareholdings, DCS structures typically contain two or more classes of common shares where one class has significantly more voting rights, reflecting an oligarchic conception of the corporation.[66] During the first two decades of the 20th century, the trend towards OSOV began to reverse in the U.S. and firms began to issue two classes of common share, one with voting rights to insiders and the other with non-voting rights to outside investors.[67] DCS structures departed from OSOV by issuing different classes of ordinary shares with differentiated voting rights and gained its popularity in the U.S. in 1920s.[68]

While both democratic voting rules and prudent-mean voting rules disperse voting power among shareholders, plutocratic voting rules (namely, OSOV) distribute voting power to property.[69] As a relatively recent departure from the historical trend, oligarchic rules (namely, DCS) actually bear a closer affinity to plutocratic rules on the ground that both voting rules put control in the hands of a minority — either those who own shares with weighted voting rights or those who simply own a greater number of shares.[70]

The famous takeover wave in the 1980s largely led to an increasing use of DCS structures as an important takeover defense.[71] As insiders retain the *superclass* of shares with weighted voting rights, it is agreed that few takeover defenses are more successful than DCS structures.[72] In 2004, Google became the first technology company to adopt DCS structures for the purpose of retaining control in the hands of founders, and thereafter other technology companies have followed suit.[73]

According to the data regarding initial public offerings ("IPOs") by Tech and Non-tech firms with DCS structures during the 1980-2019 period in the U.S., DCS structures become increasingly popular especially

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[65] *See* Bainbridge, *supra* note 63, at 4.
[66] *See* Dunlavy, *supra* note 10, at 1366.
[67] *See* Bainbridge, *supra* note 63, at 4.
[68] *Id*.
[69] *See* Dunlavy, *supra* note 10, at 1356-57.
[70] *Id*. at 1387.
[71] *See* Bainbridge, *supra* note 63, at 6.
[72] *See* Seligman, *supra* note 3, at 687.
[73] *See*, *e.g.*, Dorothy S. Lune, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 704 (2019).

among technology companies as exhibited in Table 1 below.[74] For example, in 1980 there was only one out of seventy-one firms that went public to have adopted DCS structures; but in 2017, thirteen out of thirty Tech IPOs (43.3 percent) and seventeen out of seventy-seven Non-tech IPOs (22.1 percent) had DCS structures with unequal voting rights; and in 2019, thirteen out of thirty-six Tech IPOs (36.1 percent) and twelve out of seventy-six Non-tech IPOs (15.8 percent) adopted DCS structures.[75] DCS companies have played an important role and represented an increasingly large portion of the aggregate market capitalization of the leading stock indices.[76] Take S&P 500 for example.[77] While only five percent of the S&P 500 was composed of dual-class shares in 2007, the weight of dual-class shares in the index had risen to twelve percent by 2017.[78] Despite the controversy over a differentiated voting rights arrangement, empirical evidence has shown that IPOs with DCS structures are not only attractive for founders and entrepreneurial managers, but also popular with outside and public investors.[79]

1. Table 1

	Tech IPOs			Non-tech IPOs		
	Dual	Total	%	Dual	Total	%
1980	0	22	0%	1	49	2.0%
1981	2	72	2.8%	4	120	3.3%
1982	0	42	0%	0	35	0%
1983	3	173	1.7%	4	278	1.4%
1984	2	50	4.0%	5	121	4.1%
1985	1	37	2.7%	6	149	4.0%
1986	3	77	3.9%	21	316	6.6%
1987	1	58	1.7%	23	227	10.1%
1988	3	28	10.7%	6	77	7.8%
1989	1	35	2.9%	6	81	7.4%
1990	0	31	0%	7	79	8.9%

[74]Jay R. Ritter, *Initial Public Offerings: Technology Stock IPOs*, WARRINGTON C. OF BUS. (June 26, 2020), https://site.warrington.ufl.edu/ritter/files/IPOs2019Tech-Stock.pdf.

[75]*Id.*

[76]Andrew Winden & Andrew C. Baker, *Dual-Class Index Exclusion* 7 (Rock Ctr. for Corp. Governance, Working Paper No. 233, 2018), https://ssrn.com/abstract=3201578.

[77]*See id.*

[78]*Id.*

[79]Ronald Anderson, Ezgi Ottolenghi & David Reeb, *The Dual Class Premium: A Family Affair* 1, 30 (Fox Sch. Of Bus. Res. Paper No. 17-021, 2017); *see, e.g.*, Paddy Ireland, *Defending the Rentier: Corporate Theory and the Reprivatization of the Public Company*, THE POL. ECON. OF THE COMPANY 145, 162 (2000).

1991	7	70	10.0%	16	216	7.4%
1992	2	114	1.8%	16	299	5.4%
1993	3	127	2.4%	30	384	7.8%
1994	7	115	6.1%	26	287	9.1%
1995	8	205	3.9%	22	257	8.6%
1996	16	274	5.8%	45	403	11.2%
1997	10	173	5.8%	41	301	13.6%
1998	8	113	7.0%	21	168	12.4%
1999	22	370	5.9%	19	106	18.7%
2000	19	260	7.3%	7	120	5.8%
2001	2	23	8.7%	6	57	10.5%
2002	2	20	10.0%	12	46	26.1%
2003	3	18	16.7%	5	45	11.1%
2004	3	61	4.9%	10	112	8.8%
2005	9	45	20.0%	13	114	11.4%
2006	1	48	2.1%	10	109	9.2%
2007	5	76	6.6%	13	83	15.7%
2008	0	6	0%	3	15	20.0%
2009	2	14	14.3%	3	27	11.1%
2010	2	33	6.1%	7	58	11.9%
2011	5	36	13.9%	9	45	20.0%
2012	6	40	15.0%	10	53	20.5%
2013	5	43	11.6%	23	114	20.2%
2014	3	51	5.7%	18	153	11.8%
2015	14	38	36.8%	8	80	10.0%
2016	5	21	23.8%	4	54	7.4%
2017	13	30	43.3%	17	77	22.1%
2018	13	39	33.3%	13	95	12.6%
2019	13	36	36.1%	12	76	15.8%
1980-2019	224	3,126	7.2 %	521	5,484	9.5%

Source: (Ritter 2020)

DCS structures are also common in Europe.[80] A well-known survey conducted by Institutional Shareholder Services ("ISS") and European Corporate Governance Institute ("ECGI") in 2007 showed twenty-four percent of 464 sampled companies in sixteen European countries had DCS structures.[81] Similarly, another empirical study with a larger sample of

[80]SHEARMAN & STERLING LLP, INST'L S'HOLDER SERV. & THE EUROPEAN, CORP. GOVERNANCE INST., REPORT ON THE PROPORTIONALITY PRINCIPLE IN THE EUROPEAN UNION 25 (2007).

[81]*Id.*

4096 firms in fourteen western European countries also found roughly 23.5 percent of sampled firms (963 out of 4096) have DCS structures.[82] Apart from Europe, the rising popularity of DCS structures in Asia also leads some leading financial centers to accommodate the demand for firms going public with DCS structures.[83]

III. THEORETICAL INVESTIGATION

Weighted voting rights under DCS structures decouple insiders' control from their equity shareholdings in the company because one's voting rights can be disproportionately greater than their cash flow rights.[84] The separation insulates controllers from outside investors and market influence.[85] While proponents see such insulation as valuable, opponents see it as costly.[86] This section therefore critically discusses the theoretical arguments both against and for DCS structures.

A. *Arguments against DCS structures*

There are two main arguments against DCS structures. The first, and perhaps most compelling objection against DCS structures, is the deviation from OSOV and its underlying shareholder democracy.[87] For instance, the *New York Stock Exchange Listed Company Manual* claimed OSOV was grounded in the NYSE's "long-standing commitment to encourage high standards of corporate democracy . . . and accountability to shareholders."[88] More recently in 2018, Commissioner Robert Jackson of the U.S. Securities and Exchange Commission ("SEC") said that, "[F]or most of the modern history of American equity markets, the New York Stock Exchange did not list companies with dual-class voting . . . because [of] the Exchange's commitment to corporate democracy."[89]

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[82]*See* Morten Bennedsen & Kasper Meisner Nielsen, *Incentive and Entrenchment Effects in European Ownership*, 34 J. of BANKING & FIN. 2212, 2214 (2010).

[83]*See infra* Section VI.

[84]*See, e.g.*, Yvan Allaire, *The Case for Dual-Class of Shares*, INST. FOR GOVERNANCE OF PRIV. AND PUB. ORG. (Dec. 20, 2018).

[85]*Id*.

[86]*Id*. at 2.

[87]*Id*.

[88]Seligman, *supra* note 3, at 688.

[89]Robert Jackson, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty#_ftn4.

It is however controversial to equate *governance by wealth* with democracy.[90] OSOV that represents a plutocratic conception of corporation holds "voting by shares and distributing suffrage to property and not men is altogether inconsistent" with democratic principles of governance.[91] In the political arena for instance, voters cannot acquire more voting rights by simply having more property or paying more taxes.[92]

Moreover, the core concern of "shareholder democracy" in the context of plutocratic voting rules is the vertical relation linking shareholders and management, aiming at "correct[ing] a balance of power that ha[s] tilted dangerously toward [management]" through ensuring that shareholders are "sufficiently informed" and "able to vote their shares."[93] Therefore, democracy under OSOV is irrelevant to the horizontal relations among shareholders.[94] DCS structures that reflect an oligarchic conception of corporation, are in fact not fundamentally different from OSOV, that in turn reflects a plutocratic conception of corporation, on the ground that both voting rules put control in the hands of a minority — i.e., those who own shares with weighted voting rights or those who simply own a larger number of shares.[95]

The other main arguments against DCS structures focus on corporate governance risks, specifically the exacerbated agency problem both in merger negotiations and in corporate management generally.[96] Such arguments normally start with attacks on the separation of shareholders' control from their economic stake.[97] People bringing this type of argument are worried about controllers' twisted incentives in exercising discretion and monitoring because their voting rights are not proportionate to their economic interests.[98] Controllers with weighted voting rights can more easily obtain private benefits with disproportionally low costs.[99] Put differently, although DCS structures as an oligarchic conception of corporation bears a closer affinity to the plutocratic voting

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[90]Dunlavy, *supra* note 10, at 1355-56, 1384 (emphasis added).

[91]*Id.* at 1385 (quoting *The Contest Against Corporations*, N.Y. Times, Aug. 14, 1878).

[92]*Id*.

[93]Dunlavy, *supra* note 10, at 1365.

[94]*Id*.

[95]*See supra* notes 53-56 and accompanying text in Section II.

[96]*See e.g.*, Jeffrey Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 1, 18 (1988). DCS structures would lead to conflicts of interest like any other takeover defences: the job security of target firm's incumbent management versus the substantial premium for target firm's shareholders' shares.

[97]*See*, *e.g.*, Tian Wen, *You Can't Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies from Listing on the Securities Exchanges*, 162 U. OF PENN. L. REV. 1495, 1499 (2014).

[98]*Id*.

[99]*Id*.

rule, this objection mainly builds on the economic justification of the plutocratic voting rule.[100]

It is argued that only those who have a strong stake in the outcome of elections are more likely to make optimal decisions compared with those who are not affected by the outcome.[101] Shareholders, as residual proprietary claimants, have the strongest stake in the outcome of the election of corporate leadership and alike.[102] Their shares of residual gains or losses are regarded as perfect proxy for the varying degrees to which they would be affected by outcomes of these elections, and thereby the degrees to which they care about the outcomes.[103] Under the plutocratic voting rule, shareholders who want to exercise control — that is, to have more than fifty percent of the voting rights — must hold commensurate equity ownership stake and thereby the cash-flow rights in the company.[104] Consequently, the controlling shareholders will bear the majority effect of their own exercise of control, namely the substantial proportion of costs and benefits of their decisions.[105] Meanwhile, they would also be more willing to monitor management in order to lower agency costs.[106]

Such economic rationale offered by Easterbrook and Fischel for OSOV, the plutocratic voting rule, can however be rebutted on the basis that the shareholder homogeneity is a false promise. Granting shareholders voting power commensurate with their shareholdings cannot necessarily guarantee appropriate incentives in the context of shareholder heterogeneity.[107] The weakening justification for OSOV can in turn provide further ground for the deviation from it.

It is noteworthy that even under a concentrated ownership structure, agency costs between majority shareholders and minority shareholders would still exist.[108] If controlling shareholders are self-utility maximizers, then they may always have temptations to obtain *private benefits of*

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[100]*See supra* notes 53-56 and accompanying text.

[101]Grant Hayden, *The False Promise of One Person, One Vote*, 102 MICHIGAN L. REV. 213, 251-61 (2003).

[102]For example, the general view is that shareholders have greatest exposure to residual risk as a consequence of mismanagement.

[103]*See generally supra* note 10 and accompanying text above in Section II. Shareholders can then cast their vote and monitor managerial performance accordingly.

[104]*See* Dunlavy, *supra* note 10, at 1355-56.

[105]In other words, OSOV can better align corporate insiders' incentives with those of the outside shareholders.

[106]Louis Putterman, *Ownership and the Nature of the Firm*, 17 J. OF COMP. ECON. 243, 249 (1993).

[107]*See* Hayden & Bodie *supra* note 29, at 451, 452-60.

[108]*See id.* at 476.

control.[109] Even when a controller has a majority ownership stake, say eighty percent of equity capital, they may still have incentive to pursue private benefits since they could obtain all private benefits yet only bear eighty percent of costs.[110]

Nevertheless, with the decline of the percentage of ownership stake, costs of self-seeking conduct will correspondingly decrease and incentives of extracting private benefits increase.[111] Thus, differentiated voting rights under DCS structures are likely to exacerbate such distorted incentives. For example, if a controlling shareholder holds a portion, ***p***, of the company's equity capital and faces action that would decrease firm value by the amount of ***V***, but increase their private benefits by the amount of ***B***, following Bebchuk and Kastiel's model, this shareholder would choose the value-reducing action only if their pro rata share of loss ($p * V$) is smaller than the gain in private benefits (B), that is when $p * V < B$.[112] The equation implies when the portion of equity capital (p) decreases, the likelihood that the controller would favor value-reducing actions increases geometrically,[113] which is not inconsistent with Gilson's comment that "the less equity the controlling shareholder has, the greater the incentive to extract private benefits."[114] As a consequence, the likelihood of exploitation by the controlling shareholder with minority ownership stake and weighted voting rights, to the detriment of other shareholders, would be substantially higher.[115] Thus, while the ownership incentive under

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[109]Ronald Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1663-66 (2006). Such benefits can be either pecuniary, like tunneling corporate assets or opportunities, or 'non-pecuniary' that can vary from luxurious office to a desirable social status and political influence.

[110]*See* Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. OF FINANCIAL STUDIES 1051, 1085 (2010). In order to maintain the private benefits of control, the controller may also choose to sacrifice some firm value.

[111]*See* Gilson, *supra* note 109, at 1651, 1654.

[112]*See* Bebchuk & Kastiel, *supra* note 4, at 1467.

[113]*See id.* Returning to the above example where the controlling shareholder holds eighty percent of equity capital, and assuming a corporate action would result in a loss of V to the company but a gain in private benefits of $100 million to the shareholder, they would choose the value-reducing action if $V < \$125$ million ($100 million / eighty percent) and avoid it when $V > \$125$ million. Then under DCS structures with a typical 10:1 ratio, namely Class A shares have ten votes per share while Class B shares one vote per share, a shareholder only needs to have 28.6% of Class A shares to obtain eighty percent of votes, compared to eighty percent of shares under OSOV. For the same corporate action that would result in a loss of V to the company, but a gain in private benefits of $100 million to the shareholder, thus the shareholder would choose the value-reducing action if the $V < \$349.6$ million ($100 million / 28.6%) and avoid it when $V > \$349.6$ million.

[114]Gilson, *supra* note 109, at 1651.

[115]Mike Burkart & Samuel Lee, *One Share – One Vote: The Theory*, 12 REV. OF FIN. 1, 34-35 (2008).

OSOV cannot eliminate controlling shareholders' incentive to seek private benefits, the distortions inherent in DCS structures are potentially more severe.[116]

Different from the ownership incentive in the context of controlled companies,[117] there is a market for corporate control to discipline agency problems for a variety of widely held companies.[118] Economists see market forces as an ultimate disciplinary mechanism.[119] The threats of hostile takeover, and thereby threats of removal, would provide strong incentive for incumbent managers to perform and reduce agency costs.[120] In the eyes of critics, a differentiated voting rights arrangement would undermine market monitoring function, leading to increased extraction of private benefits.[121]

But market is far from perfect and share price is sometimes erratic which cannot fully reflect the market value of all future profits and growth that will accrue for a company.[122] The function of market discipline may be overstated if share price is not immune to manipulation.[123] However, like the foregoing discussion of ownership incentive, the lack of market discipline under DCS structures is still potentially more severe than that under OSOV.[124] Controlling insiders with weighted voting rights, who are normally incumbent management, are more likely to entrench themselves and insulate themselves from disciplinary forces of markets and other corporate governance mechanisms.[125]

In sum, concerns over increased governance risks under DCS structures are not ungrounded. As Bebchuk and Kastiel have argued, a small-minority controller who holds minority shares but weighted voting rights in a DCS company, "lacks both the discipline of the control market and the incentives generated by having to bear the majority of any effect

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[116]*See*, *e.g.*, Lucian Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VIRGINIA L. REV. 585, 616 (2017).

[117]Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. OF FIN. 1147, 1148 (2002). It is argued "[t]he power of the controlling shareholders to expropriate outside investors is moderated by their financial incentives not to do so. "

[118]*See* Bebchuk & Kastiel, *supra* note 4, at 1465.

[119]*Id.*

[120]*See id.*, at 1466. This is because the management of the underperformed firm, which is more vulnerable to a hostile takeover, would normally be replaced following a successful hostile takeover.

[121]*See*, *e.g.*, Lune, *supra* note 73, at 714-15.

[122]MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 128 (The Brookings Institution 1995); *see* CHEFFINS, *supra* note 13, at 8.

[123]MIN YAN, BEYOND SHAREHOLDER WEALTH MAXIMISATION 66 (Routledge 2018).

[124]*See* Bebchuk & Kastiel, *supra* note 116, at 602-03.

[125]*See id.*

on total market capitalization."[126] A caveat however is whether the fraction of shares held by a shareholder can fully represent their economic interests. The shareholder heterogeneity as discussed in Section II clearly tells us shareholders may have heterogenous preferences, implying their shares do not necessarily represent their interests.[127] When a shareholder prioritizes socially or environmentally oriented objectives over maximization of residual profits,[128] increasing their ownership stake would not necessarily alter individual incentives. Heterogenous interests can lead to shareholders exercising their discretionary powers differently, and the conventional wisdom behind tying voting power commensurate with equity shareholdings becomes less convincing. In other words, increasing a small-minority controller's ownership stake may not necessarily incentivize her to maximize the residual profits of the corporation. Even when a controller has a majority ownership stake, private benefit extraction such as tunneling and other means remain common and inevitable.[129]

B. *Arguments for DCS structures*

Similar to the focus of those criticisms on the entrenchment and increased governance risks, arguments supporting DCS structures also base on the separation between control and ownership. Controlling shareholders with weighted voting rights can retain control even if their ownership stakes fall below fifty percent.[130] Weighted voting shares can then help insulate holders of these shares from external market pressure.[131] The insulation criticized by opponents[132] is treated more positively by proponents.

In general, proponents believe that such insulation can provide visionary entrepreneurs and founders the freedom to pursue and implement their idiosyncratic business ideas without worrying unduly about stock market performance.[133] As is well documented, both markets

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[126]Bebchuk & Kastiel, *supra* note 4, at 1459 (discussing the effect of disciplinary market pressures on small-minority controllers of companies).

[127]*See* Anabtawi, *supra* note 11, at 583-93.

[128]In other words, increasing a shareholders' shareholding may not necessarily change their preference if they are non-financial oriented.

[129]*See, e.g.*, Bobby V. Reddy, *The Fat Controller - Slimming Down the Excesses of Controlling Shareholders in UK Listed Companies,* 38 OXFORD J. OF LEGAL STUD. 733, 736-37 (2018).

[130]*See* Bebchuk & Kastiel, *supra* note 116, at 606-07.

[131]*See id.* at 603.

[132]*See id.*

[133]Goshen & Hamdani, *supra* note 6, at 575-77.

and investors are myopic – favoring short-termism over long-termism.[134] Considering the threat of a hostile takeover bid, most managers would prefer short-term profit and immediate cash flow.[135] The insulation from disciplinary forces of the market for corporate control, *inter alia* takeover threats, is therefore seen beneficial for long-term performance. For example, the founders of Google defended the offering of DCS structures in their Registration Statement with the SEC on April 29, 2004 by saying that "[o]utside 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.'"[136] The increasing popularity of DCS structures also reflects the demand to maintain such long-term vision and control of these insiders.[137]

The cost of retaining control can also be lowered by insulation, which allows corporate insiders to obtain the benefits of outside equity financing while still retaining control over the corporation.[138] Contrary to OSOV, which deters potential shareholders who worry about risks of losing control from going public, multiple-voting shares can help them retain the control and ability to monitor the company when raising external equity capital.[139]

There also exists numerous economic incentives for management to invest substantial firm-specific human capital in a firm with DCS structures.[140] Because the rise of managers' firm-specific investment implies greater personal loss if managers are replaced,[141] incumbent

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[134]*See* YAN, *supra* note 123, at 65-69; *see also* Jeremy Stein, *Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior*, 104 Q. J. OF ECON. 655, 668 (1989).

[135]*See* Simon Deakin & Giles Slinger, *Hostile Takeovers, Corporate Law, and the Theory of the Firm*, J. OF L. & SOC'Y 123, 132 (1997) (discussing the pressures on managers to show short-term financial performance of the company); *see also* Alfred Rappaport, *The Economics of Short-Term Performance Obsession*, 61 FIN. ANALYSTS J. 65, 69 (2005).

[136]Google, Inc., *Form S-1 Registration Statement*, SEC (April 29, 2004), https://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm.

[137]*See, e.g.,* Pey-Woan Lee, *Dual-Class Shares in Singapore – Where Ideology Meets Pragmatism*, 15 BERKELEY BUS. L. J. 440, 445 (2018).

[138]Daniel Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. OF CHICAGO L. REV. 119, 139-40 (1987).

[139]By the same token, it may help overcome the reluctance of those family firms with strong desire for long-term control to go public, hence increasing the breadth and depth of capital markets.

[140]Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 ST JOHN'S L. REV. 863, 925 (1984) (finding a direct correlation between a manager's belief they will receive a return on their firm-specific investment and their willingness to enter such an arrangement).

[141]*See* Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1762 (1989); Margaret Blair & Lynn Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. OF CORP. L. 719, 734 (2006); *see* Fischel, *supra* note 138, at

managers would be reluctant to make even more substantial firm-specific investments.[142] The insulation from market pressures and takeover threats thus aid managers to overcome such reluctance. The firm-specific investments can then improve efficiency and advance the firm's long-term potential.[143] The social value would also be optimized if control rights are provided to those who value them more.[144]

Furthermore, agency costs are not the *only* "costs of governance" that needs to be controlled and minimized.[145] In addition to the traditional *agent* costs, Goshen and Squire have proffered the concept of *principal* costs, which are produced by investors' lack of expertise, information, talent or self-seeking conduct when they exercise control.[146] The *principal* costs include "principal competence costs" caused by honest mistakes and "principal conflict costs" caused by self-seeking conduct.[147] Logically, these costs must also be taken into consideration when determining the optimal voting arrangements. Take those weakly motivated voters for example. First, because of collective action problems and rational apathy, these voters would prefer not to exercise their voting rights and choose to free ride on other investors.[148] Even when participating, these voters' lack of information, coupled with principal conflict costs like pro-management bias, make it unlikely that their votes would be value enhancing.[149] Consequently, weakly motivated voters would dilute the voice of informed voters either in exercising discretions or monitoring. They are more likely to make a suboptimal decision or move their firm in the wrong direction.[150]

Different from retailer shareholders and active funds, passive funds are designed to automatically track a market index and match its performance. Passive funds, such as index funds and Exchange Traded

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136-37*; see also* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING (Free Press 1985). Relationship-specific investments pose unique contracting challenges, of which managers' firm-specific investments are a subset.

[142]Fischel, *supra* note 138, at 137.

[143]Kenneth Lehn, Jeffry Netter & Annette Poulsen, *Consolidating Corporate Control: Dual-Class Recapitalizations versus Leveraged Buyouts*, 27 J. OF FIN. ECON. 557, 563-64 (1990).

[144]Fischel, *supra* note 138, at 136-37.

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

[146]Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 786-88, 791-93 (2017).

[147]*Id.*

[148]*See* Lune, *supra* note 73, at 696.

[149]*See id.*

[150]*See id.*at 724-26. Meanwhile, managing voting for a larger group would also incur higher transaction costs.

Funds ("ETFs"), would often qualify as weakly motivated voters, lacking firm-specific information and incentive to devote appropriate resources in informed voting.[151] There is indeed an unprecedented shift from active to passive investment strategies.[152] Empirical evidence documented between 2008 and 2015 indciates that investors bought passively managed funds of approximately $1 trillion USD, while at the same time selling holdings of actively managed equity funds worth roughly $800 billion USD, and as of year-end 2015, passive index funds managed total assets invested in equities of more than $4 trillion USD.[153] The three largest passive funds, BlackRock, Vanguard, and State Street combined constitute the largest shareholders in 438 of the 500 S&P 500 companies.[154] Over the past ten years, active funds have had $1.3 trillion USD in outflows and their passive counterparts nearly $1.4 trillion USD in inflows.[155]

Therefore, contrary to the rationale in OSOV, providing voting rights to outside shareholders or institutional investors may not necessarily enhance monitoring or constrain governance risks.[156] In contrast, DCS structures can reduce agency costs by making management more accountable to its informed investors, who highly value their right to vote, while also minimizing the transaction costs associated with voting.[157]

IV. EMPIRICAL INVESTIGATION

Following the theoretical arguments over DCS structures, a critical empirical question is whether performance of DCS companies is better or worse compared to non-DCS counterparts. If DCS structures could help increase firm value, DCS structures can then be justified from an economic efficiency perspective,[158] and there would be subsequently a strong

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[151] *See* Lune, *supra* note 73, at 725.

[152] *Id.* at 712.

[153] Jan Fichtner, Eelke Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 299 (2017).

[154] *Id.* at 313.

[155] Kevin McDevitt & Gabrielle DiBenedetto, *Morningstar U.S. Fund Flows: Fed Rate Cut Doesn't Spur Inflows*, MORNINGSTAR RES. 2 (Aug. 2019), https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Fund_Flows_August2019_Final.pdf?cid=EMQ_&utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=18776 (Ten years ago, active funds had about seventy-five percent of market share, but a more recent analysis estimated the assets under the management of passive funds passed the assets under active fund by about $25 billion USD as of August 31, 2019, which makes passive funds representing 50.15% of U.S. equity markets.)

[156] Lune, *supra* note 73, at 713-14.

[157] *Id.* at 697.

[158] *See supra* note 13 and accompanying text.

business case for allowing companies to go public with differentiated voting rights. Despite the significant body of empirical work however, outcomes are at best inconclusive and mixed.

In DCS companies, minority controllers can retain high voting rights with very low cash-flow rights. One series of studies found negative correlations between DCS structures and firm value, while another series found evidence that DCS companies exhibit higher valuation than non-DCS counterparts.[159] For example, Gompers, Ishii and Metrick found that firm value is "positively associated with insiders' cash-flow rights" and "negatively associated with insiders' voting rights."[160] Put differently, insiders' weighted voting rights, which are disproportionately greater than cash-flow rights are seen as negatively associated with firm value.[161] This observation is confirmed by some other studies, which assert the larger wedge (i.e., divergence) between controllers' voting rights and cash-flow rights is associated with lower firm valuations.[162] Similarly, Masulis, Wang and Xie found that the increased wedge between insiders' control and cash-flow rights results in lower firm valuation and would negatively impact a firm's efficiency in utilizing its cash reserves as an important corporate resource.[163] In brief, this series of empirical studies tends to conclude that controllers' higher cash-flow rights are associated with higher valuations,[164] not materially different from the underlying economic rationale for OSOV.

By contrast, the other studies found a more positive correlation between DCS structures and firm performance.[165] For example, Lehn, Netter and Poulsen found that DCS companies have significantly higher growth in sales and number of employees, higher ratios of R&D expenditures, as well as higher increases in industry-adjusted operating income.[166] Such higher sales growth and R&D intensity is confirmed by Jordan, Kim and Liu's findings.[167] Evidences also showed DCS structures

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[159]Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. OF FIN. STUD.1051, 1052 (2010).

[160]*Id*. at 1084.

[161]*See id*.

[162]*See* Stijn Claessens, Simeon Djankov, Joseph P. H. Fan & Larry H. P. Lang, *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. OF FIN. 2741, 2764-65 (2002).

[163]Ronald W. Masulis, Cong Wang & Fei Xie, *Agency Problems at Dual-Class Companies*, 64 J. OF FIN. 1697, 1703-05 (2009).

[164]*See* La Porta, et al., *supra* note 117, at 1168.

[165]*See* Lehn, et al., *supra* note 143, at 559-60.

[166]*See id*.

[167]Bradford Jordan, Soohyung Kim & Mark Liu, *Growth Opportunities, Short Term Market Pressure, and Dual-Class Share Structure*, 41 J. OF CORP. FIN. 304, 305 (2016).

can increase the value of high-growth firms in terms of market valuation,[168] and help closely held firms raise economic benefits.[169] A more recent study with an extensive dataset of U.S. companies from 1980 to 2017 found that DCS companies tend to have higher valuations and their Tobin Q is an average of thirteen percent higher than that of their matched non-DCS counterparts at the IPO year-end.[170] The same study also found that higher valuation of DCS companies can be maintained for six to nine years subsequent to their IPOs.[171] Research from MSCI also showed that companies with DCS structures outperformed the market in the 2007 to 2017 period.[172]

In addition to the mixed outcomes from the above empirical work, the problem of endogeneity, namely whether the performance of a corporation was a reason for adopting DCS structures or merely a consequence of such structures,[173] further increases the difficulty to untangle the underlying correlation between DCS structures and a firm's valuation and performance.[174] Better performance may simply arise out of the high growth nature of a given company, especially considering most DCS IPOs recently fall in high-tech and innovative sectors.[175] Nevertheless, the chair of Institute for Governance of Private and Public Organizations ("IGOPP"), a Canadian think tank, argued the older studies are less favorable than the more recent studies on the impact of DCS structures on corporate performance.[176] For example, Table 2 below summarizes recent studies that observed when DCS companies

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[168]*Id*. at 318-20.

[169]*See* Scott W. Bauguess, Myron B. Slovin & Marie E. Sushka, *Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights*, 36 J. OF BANKING & FIN.1244, 1245 (2012).

[170]Martijn Cremers, Beni Lauterbach & Anete Pajuste, *The Life-Cycle of Dual Class Firm Valuation*, EUROPEAN CORP.GOVERNANCE INST.(ECGI) - Finance Working Paper No. 550/2018, 20 (2018), https://ssrn.com/abstract=3062895.

[171]*Id.* at 20-21 (finding values of both single and dual class firms tend to decrease significantly in the years subsequent to the IPO, four years afterwards the valuation premium of DCS companies start to disappear, and after six to nine years, DCS companies tend to have a significantly lower Tobin's Q, namely associated with lower valuations).

[172]Dimitris Melas, *Putting the spotlight on spotify: Why have stocks with unequal voting rights outperformed*?, MSCI (Apr. 3, 2018), https://www.msci.com/www/blog-posts/putting-the-spotlight-on/0898078592.

[173]Renee Adams & Daniel Ferreira, *One Share-One Vote: The Empirical Evidence*, 12 REV. OF FIN. 51, 85 (2008).

[174]Jeffrey Coles, Michael Lemmon & J. Felix Meschke, *Structural Models and Endogeneity in Corporate Finance: The Link Between Managerial Ownership and Corporate Performance*, 103 J. OF FIN. ECON. 149, 162-64 (2012).

[175]Furthermore, share prices of DCS companies such as Alibaba, Google and Facebook have all had significant gains since their IPOs.

[176]*See* Allaire, *supra* note 84, at 2.

outperform their non-DCS counterparts from short term to medium and long term.

1. Table 2*

Comparative annualized based performance of Canadian companies with or without a dual class of shares

Sources	5 years		10 years		15 years		18 years	
	D.C	S.C.	D.C.	S.C.	D.C.	S.C.	D.C.	S.C.
Bloomberg, "Dual-class share structure boasts some big gainers", The Globe and Mail, April 29, 2016.			12.0	7.1				
Fournier, P. and A. Katsoras, "The Family Advantage", National Bank of Canada, October 2015.**	13.5	6.1	11.3	5.6				
Ryan Modesto (5i Research), "The case for investing in companies with dual-class shares", The Globe and Mail, April 18, 2016.	4.2	-0.9	3.7	1.1				

Sources	5 years		10 years		15 years		18 years	
	D.C	S.C.	D.C.	S.C.	D.C.	S.C.	D.C.	S.C.
Spizzirri, A. and M. Fullbrook, "The Impact of Family Control on the Share Price Performance of Large Canadian Publicly-Listed Firms (1998-2012)" *Clarkson Center for Board Effectivenes s*, June 2013.					8.82	6.60		
Allaire, Y. and F. Dauphin, "Good Governance and Stock Market Performance " *IGOPP*, March 7, 2016.	8.66	3.78						

Sources	5 years		10 years		15 years		18 years	
	D.C	S.C.	D.C.	S.C.	D.C.	S.C.	D.C.	S.C.
Katsoras et al., "The Family Advantage — The Sustainable Outperformance of Canadian Family-Controlled Public Companies", National Bank of Canada, 2018.***							9.0	6.7

* D.C. = Dual Class; S.C. = Single Class. All table values are percentages (%).

** The 2015 version of the NBC study is based on thirty Canadian family-controlled public companies, and about two-thirds of those thirty firms had a dual-class shares structure.

*** The 2018 NBC study is based on forty-three Canadian family-controlled public companies, and about twenty-seven of those (sixty-three percent) had a dual-class shares structure.

Source: IGOPP compilation (2018)

While the inconsistent empirical results cannot offer us any conclusive answer on whether there is a robust business case for DCS structures, we can find the stream of negative impact of DCS structures predominately focused on the increased agency costs associated with the decoupling of control from ownership. The primary concern is the inadequate protection for shareholders with inferior voting rights, consistent with the foregoing theoretical arguments against DCS structures.[177]

Putting aside the focus at the individual firm level, a business case at the macro level is much clearer. Lucrative IPO fees incurred during listing to bankers, lawyers and other professionals are hard to resist. Take Alibaba, the world's largest retailer and e-commerce company, and its IPO

[177]The long-termism and immunity from market pressure among other interpretations underlying the stream of positive impact of DCS structures are also consistent with arguments supporting the weighted voting rights.

in the U.S. for example. This e-commerce giant handed out more than $300 million USD to investment banks involved,[178] and $15.8 million USD to lawyers.[179] Alibaba's enormous trading volume would further contribute huge fees to the New York Stock Exchange ("NYSE").[180] Apart from these fees, stock exchanges are also well motivated to make their capital markets more attractive for corporate founders and to host some of the most sought-after companies like Google, Linkedin, Facebook, and Ablibaba, which all preferred going public with DCS structures.[181] It is further fueled by competition from peer stock exchanges. For example, the Chairman of the Hong Kong Securities and Futures Commission ("SFC") said: "[allowing companies with DCS 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."[182] This may also explain the recent rising popularity of DCS structures in Singapore and Hong Kong, which will be examined in Section VI.[183]

V. TRADE-OFF BETWEEN CONTROL AND ACCOUNTABILITY

The foregoing discussions show mixed views toward the impact of the separation of "control" (i.e., voting rights) and "ownership" (i.e., cash flow rights). As the viability of DCS structures is essentially the weighing of the merits and detriments of such structures, it is important to know whether the values of greater capital structure flexibility, gain of entrepreneurs' idiosyncratic visions and long-term focus can, or cannot, outweigh the associated costs of deteriorated agency problems. While there is no conclusive answer as we saw above, the increased agency costs and governance risks are by no means uncontrollable. Mandatory safeguarding and ringfencing measures, such as introducing sunset provisions, limiting the wedge between controller's voting rights and cash-

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[178] *See*, *e.g.*, Trefis Team, *Alibaba Hands Out Generous Fees To Investment Banks Involved In Its IPO*, FORBES (Oct. 1,2019), https://www.forbes.com/sites/greatspeculations/2014/10/01/alibaba-hands-out-generous-fees-to-investment-banks-involved-in-its-ipo/#5819bb56e936.

[179] Natalie Stanton, *Why Alibaba's switch to a New York listing left Freshfields out in the cold*, THE LAWYER (Sept. 23, 2014), at https://www.thelawyer.com/issues/online-september-2014/why-alibabas-switch-to-a-new-york-listing-left-freshfields-out-in-the-cold/.

[180] *Id.*

[181] See *supra* notes 178-79 and accompanying text.

[182] *See* Yiu, *supra* note 22.

[183] *See infra* Section VI

flow rights, and enhancing disclosure requirements among others, can all help effectively mitigate the problems.[184]

Restrictions imposed to limit holders of multiple-voting shares can be seen as safeguards which are beneficial to holders of inferior voting shares.[185] Moreover, the values to controllers and the costs to non-controllers stand on both ends of the spectrum.[186] Every time a safeguarding measure is added to the equilibrium, the value of DCS structures to the controller will be compromised.[187] In other words, too many safeguards would inevitably undermine the expected values of DCS structures. This section first examines mechanisms that restrict controllers' superior voting power in order to increase their accountability, and later discusses the balance between control part and accountability part of DCS structures.

A. *Sunset Provisions*

Legitimate reasons for adopting DCS structures at the time of IPO, for example, may lapse over time. This is consistent with the empirical findings that valuation premiums of DCS firms over non-DCS counterparts tend to erode after a period of time, though there is yet a consensus on how soon such premiums would disappear.[188] For instance, Cremers, Lauterbach and Pajuste found DCS companies' valuation premium would disappear on average four to five years subsequent to the IPO, and then turn into discount after six to nine years.[189] Kim and Michaely found young DCS companies, namely those younger than their twelve years from IPO, have valuation premium while mature DCS companies, those older than or equivalent to twelve years from IPO, have discount compared to non-DCS counterparts.[190]

The first type of sunset provisions, time-based sunsets, can limit controllers' superior voting rights to a pre-defined period.[191] After the pre-defined period of time, multiple-voting shares would automatically

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[184]*See infra* Sections V.A-D.

[185]*See infra* Sections V.A-B.

[186]*See infra* Section V.A.

[187]*See infra* Section V.A.

[188]*See infra* text accompanying notes 189-90.

[189]*See* Cremers, et al., *supra* note 170, at 20-21.

[190]Hyunseob Kim & Roni Michaely, *Sticking Around too Long? Dynamics of the Benefits of Dual-Class Voting*, ECGI - FINANCE WORKING PAPER NO. 590/2019, 2-3 (2019), https://ssrn.com/abstract=3145209.

[191]MARY LEUNG & ROCKY TUNG, DUAL-CLASS SHARES: THE GOOD, THE BAD, AND THE UGLY — A REVIEW OF THE DEBATE SURROUNDING DUAL-CLASS SHARES AND THEIR EMERGENCE IN ASIA PACIFIC 56 (CFA Inst., 2018).

convert to single-voting shares. The Chartered Financial Analyst ("CFA") Institute and other corporate governance advocates see mandatory time-based sunset provisions as *the* most effective safeguards for protecting shareholders with inferior voting rights.[192] The case of Viacom Inc., where a controlling shareholder retained control over twenty-six years with weighted voting rights, demonstrates the difficulty for public investors, who aggregately own approximately ninety percent of Viacom's equity shareholdings, to intervene when the ninety-three-year-old controller was alleged legally incompetent in a legal battle.[193] Put differently, merits of superior leadership skills will fade over time due to issues such as ageing or changes in the business environment and alike. As time passes, potential costs of DCS structures tend to increase while potential values tend to decrease.[194] An individual who is a successful founder or excellent leader with unique talents and vision might not have superior leadership skills or vision ten or twenty years later, hence becoming an ill-fit choice for the firm. Perhaps this is why some DCS companies voluntarily adopt time-based sunset provisions, even in jurisdictions without mandatory time-based sunsets.[195]

It arguably makes sense to stop providing these controllers with superior voting power if they stop playing a role in the company because a main value of DCS structures is the protection of visionary controllers from market pressures that enable them to implement their idiosyncratic business ideas.[196] For example, if a visionary entrepreneur with weighted voting rights dies or becomes incapable of participating in the management or ceases to be a director of the company, retaining their superclass of shares with disproportionately greater voting rights can no longer be justified. Like the example of Viacom Inc. where the founder could still retain the control even though he was allegedly incapable of participating in the management, expected values of DCS structures would be eroded and ultimately outweighed by the costs of entrenchment.

The second type of sunset provisions is event-based, meaning it depends on the occurrence of a particular event. In this type of sunset, multiple-voting shares lapse when certain events[197] occur to prevent the holders of these shares from contributing to the company. Take for

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[192] *Id.*

[193] *See* Bebchuk & Kastiel, *supra* note 116, 587-88.

[194] *See id.* at 605-07.

[195] Council of Institutional Investors, *Companies with Time-Based Sunsets on Dual-Class Stock*, (Aug. 15, 2019), https://www.cii.org/files/8-15-19%20Time-based%20Sunsets.docx.pdf.

[196] *See supra* note 133 and accompanying text.

[197] For example, death, retirement, disqualification, incapacity.

example JD.com Inc., China's largest e-commerce company by revenue,[198] which listed in the U.S. with DCS structures in 2014. It set a voluntary event-based sunset at IPO by requiring conversion of all multiple-voting shares into single-voting shares if the founder, Mr. Richard Liu is no longer employed as the chief executive officer or cannot permanently attend board meetings due to any physical or mental conditions.[199] Restrictions can also be imposed on the transfer of multiple-voting shares. Take Facebook for example, multiple-voting shares will convert into single-voting shares if shares with weighted voting rights are transferred to persons who are not "affiliated" with the original holders.[200] The event can potentially be performance-related as well. That is to use a pre-specified financial performance outcome as an event to trigger the event-based sunset provision and convert multiple-voting shares to single-voting shares.

As exhibited in Section III, holders of multiple-voting shares may become indifferent to losses suffered by the firm due to the low percentage of equity shareholdings and decrease of overall ownership stake. Logically, at least in the context of shareholder homogeneity, there might be less economic incentive for them to make optimal decisions, such as with more efficient uses of corporate resources and opportunities, and more inclined to seek private benefits. This is in fact an important reason why opponents criticize the insulation of control under DCS structures from ownership. In order to prevent extreme situations where minority controllers with multiple-voting shares reduce their equity stake to a negligible level, and to ensure interests of the controllers align with other shareholders, the third type of sunset provisions is based entirely on controllers' ownership stake. These ownership-based sunsets will automatically convert multiple-voting shares to single-voting shares when the controllers' ownership stake falls below a pre-determined minimum threshold.[201]

B. *Limiting the Wedge*

As shown in Sections III and IV, a main criticism against DCS structures is in relation to the wedge between the control and economic interest of controllers. Following the logic underlying the ownership-

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[198]For more details, *see* http://ir.jd.com.

[199]HKEX, CONCEPT PAPER ON WEIGHTED VOTING RIGHTS 46-48 (Aug. 2014).

[200]*Id.* at 46.

[201]*Id.* at 46-47. For example, in AMC Entertainment Holdings Inc., shares with weighted voting rights will convert into OSOV shares if the founders of the company hold less than thirty percent of all outstanding shares.

based sunset provisions, limiting the wedge between voting rights and cash flow rights also aims to constrain the separation of control from ownership.[202] If the wedge gets wider, it implies the fraction of controllers' equity shareholding can go down without affecting their lock on control. An enlarged gap between controllers' voting rights and cash-flow rights may subsequently increase the likelihood of them to pursue private benefits via favor value-reducing decision-makings.[203] Empirical studies also suggest the wider the wedge, the lower the associated firm valuation.[204]

A key mechanism, other than ownership-based sunset provisions, is to limit the high voting rights to low voting rights ratio in order to manage the wedge.[205] The high to low voting ratio determines the fraction of equity shareholdings a controller needs in order to retain the control rights, namely more than fifty percent of votes.[206] For example, if high/low ratio is 2:1 — that is shares in the superclass have two votes per share and shares in the other class have one vote per share, then a controller would need to hold at least 33.4% of shareholdings in the company to retain the control.[207] If shares in the superclass have ten votes per share, namely high/low voting ratio becomes 10:1, then a controller only needs 9.1% of equity shareholdings to maintain the control.[208] If this ratio continues to increase to 20:1, a controller can reduce their equity stake to as low as 4.8% in order to retain their majority control over the firm.[209] It is clear to see that when the ratio increases, a controller can geometrically decrease their equity holdings without losing control, which would then enlarge the wedge between control and ownership.[210] For example, TerraForm Global, Inc. a NASDAQ listed firm that adopts DCS structures, has Class A shares that have one vote per share while Class B shares have 100 votes per share.[211]

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[202] *See* Bebchuk & Kastiel, *supra* note 4, at 1504. In this regard, ownership-based sunset provisions can also be seen as one way to limit the wedge.

[203] *See supra* notes 111-16. Put differently, the enlarged wedge would decrease the likelihood of the controllers to avoid decisions such as reducing corporate value and increasing private benefits.

[204] *See* Claessens, Djankov, Fan & Lang, *supra* note 162; *see also* Masulis, Wang & Xie, *supra* note 163.

[205] *See*, *e.g.*, Bebchuk & Kastiel, *supra* note 4, at 1505.

[206] For most resolutions, including removal of directors, only a simple majority (i.e., more than fifty percent) of the total voting rights is required.

[207] *See* Bebchuk & Kastiel, *supra* note 4, at 1478. If the high voting to low voting right ratio is 5:1, 4:1, 3:1, or 2:1, then the controller would need to hold at least 18.2%, 20%, 25%, or 33.4% of equity shares with high voting rights, respectively, to retain the majority control.

[208] *Id.*

[209] *Id.*

[210] *Id.*

[211] *See* e.g., Council of Institutional Investors, *supra* note 1.

This means holders of Class B shares require only one percent of shareholdings to retain the majority control of the company.[212] Therefore, an important way to limit the wedge is to limit maximal voting differentials.[213]

Some empirical evidence documented in Section IV also revealed that firm valuation is positively associated with controllers' equity ownership and negatively associated with their multiple-voting rights.[214] That is to say firm value can be enhanced if the wedge between controllers' voting rights and ownership stake is reduced; namely that ownership stake is increased to be commensurate with the voting power.[215] In effect, the rationale for limiting the wedge between voting rights and cash-flow rights is not fundamentally different from the economic justification for OSOV as discussed in Section II.[216]

Requiring a controller to have higher economic stake by retaining higher percentage of equity shareholdings is deemed a safeguard to mitigate expropriation risks.[217] Limiting maximal voting differentials is expected to increase ownership incentive to constrain potential agency problems caused by differentiated voting rights arrangements and to better align controllers interests with the public and outside investors' interests.[218]

C. *Disclosure and Other Means*

Another important way to constrain increased governance risks is to provide investors adequate information related to DCS structures via prospectus, annual reports and the like.[219] Details such as the wedge between voting rights and cash-flow rights, the overall voting ratio, sunset provisions and associated risks will all help investors assess potential risks and make informed decisions.[220] Outside investors would also benefit from knowing controllers' current and expected level of equity ownership stake.[221] Accordingly, disclosure can not only reduce outside investors'

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[212] *See supra* notes 159-64 and accompanying text.

[213] Non-voting shares, namely shares with zero voting rights, are an extreme case here as it represents an infinite ratio of high voting rights. That means a controller can reduce their equity shareholding to literally one share, as holders of the other class have zero voting rights regardless of their equity ownership.

[214] *See supra* notes 159-64 and accompanying text.

[215] *See supra* Section IV.

[216] *See supra* Section II.A.

[217] *See* LEUNG & TUNG, *supra* note 191, at 56.

[218] *See id.* at 19.

[219] *See generally* Bebchuk & Kastiel, *supra* note 4, at 1485 n.111.

[220] *See* discussion *supra* Sections V.A-B.

[221] *See* Bebchuk & Kastiel, *supra* note 4, at 1500.

costs and time of obtaining such information, but also provide them a greater picture of potential governance risks.[222] With adequate disclosure regarding the wedge between controllers' equity and voting rights among others, outside investors may better understand risks associated with DCS structures before making their investment decision.[223] Another good example is using the unique stock code to raise the awareness of DCS structures and help investors differentiate DCS companies from non-DCS companies.[224] Therefore, mandatory disclosure requirements can facilitate public and outside investors to make a more informed decision regarding investments.[225]

Controllers' weighted voting rights can be further limited in relation to fundamental corporate changes such as charter amendments or matters that most likely cause conflicts of interests like the removal or appointment of independent directors and auditors.[226] For all these decision-making processes, controllers' multiple-voting shares will temporarily convert to single-voting shares.[227] This enhanced voting process is to mitigate controllers' potential exploitation and to provide shareholders with inferior voting rights an equal say on important matters.[228]

Independent directors are thought by some scholars and policymakers as another potential option to mitigate governance risks under DCS structures.[229] For example, both Stock Exchanges in Hong Kong and Singapore do emphasize the independence of directors when permiting DCS listings, but their role in the internal governance system remains largely mysterious. Empirical evidence showed that independent directors can not prevent firms' excessive risk taking and that there were serious deficits in understanding the business functions.[230] Research also indicates positive correlations between the likelihood of corporate failure and the proportion of independent directors on corporate boards.[231] Despite that, this paper takes a more optimistic stand in that independent directors

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[222] *See id*. at 1501.

[223] It could also be argued that with the full disclosure, the invisible hand of market forces would function better and discount shares with inferior voting rights if potential costs outweigh benefits.

[224] *See infra* Table 3.

[225] *See* Bebchuk & Kastiel, *supra* note 4, at 1501.

[226] *See id.* at 1487.

[227] *See id.* at 1504.

[228] *See id.* at 1487.

[229] *See* Wolf-Georg Ringe, *Independent Directors: After the Crisis*, 14 EUROPEAN BUS. ORG. L. REV. 12, 20-25 (2013).

[230] *See id.* at 17.

[231] Hwa-Hsien Hsu & Chloe Yu-Hsuan Wu, *Board Composition, Grey Directors and Corporate Failure in the UK*, 46 THE BRITISH ACCOUNTING REV. 1, 4 (2014).

potentially have a material role to play in safeguarding shareholders with inferior voting rights within DCS companies.[232]

D. *Dynamic Balance Conception*

The trade-off between values and costs of DCS structures is essentially the trade-off between visionary founders' control and their accountability.[233] While controllers' control can potentially help create long-term value, their unaccountability may lead to increased agency costs and harmful economic effects. Because benefits to non-controllers and costs to controllers sit on the two opposite ends of the spectrum, safeguarding measures aimed to enhance the accountability part would inevitably compromise the control part.[234] This would cause a contention in relation to the degree of the safeguarding measures in limiting controllers.[235]

Take time-based sunset provisions for example. The contention here is the short *versus* long timeframe for this type of sunset provision; a shorter timeframe implies controllers' superior voting rights would lapse more quickly, and vice versa.[236] Opponents of DCS structures are understandably inclined to the accountability part, thereby preferring the shorter timeframe.[237] For instance, the Council of Institutional Investors ("CII"), a prominent DCS opponent, recently demanded limiting any company's DCS structures to seven years.[238] Nevertheless, the shorter the time dimension, the less benefits shareholders of weighted voting rights may receive, which is detrimental to the control part.[239]

The contention between high *versus* low equity thresholds for ownership-based sunsets is another example. The lower the equity threshold, the greater the controller can reduce their ownership stake without relinquishing control.[240] Accordingly, lower thresholds tend to be criticized by opponents as superfluous.[241] In contrast, a higher threshold,

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[232] *See infra* Section VI.

[233] *See* SINGAPORE EXCHANGE, Possible Listing Framework for Dual Class Share Structures 2, 7 (2017).

[234] *See id.* at 16, 18-20.

[235] *See* Bebchuk & Kastiel, *supra* note 4, at 1476..

[236] *See* SINGAPORE EXCHANGE, *supra* note 233, at 18.

[237] *See Dual Class Stock*, COUNCIL OF INST. INV., https://www.cii.org/dualclass_stock, 2.

[238] *Id.* Between October 2018 and September 2019, CII has submitted letters to NASDAQ, NYSE and the Delaware Bar to petition the exchanges or legislation to prevent companies retaining DCS structures beyond seven years after the IPO, unless each class, voting separately, supports extending that structure by a majority of outstanding shares.

[239] *See id.*

[240] *See* Bebchuk & Kastiel, *supra* note 4, at 1504-05.

[241] *See id*. at 1480.

say holding more than fifty percent of outstanding shares, would largely deny controllers' ability to obtain the benefits of external equity financing while retaining control.[242] Although shareholders with multiple-voting rights may be held more accountable under such a case, an important value of DCS structures would disappear.[243]

More evidently, the voting differentials which determine the wedge between the control and economic interests of controllers pose yet another salient challenge.[244] As established above,[245] the larger the differentials, the larger the wedge. In order to avoid extreme separation between voting rights and cash-flow rights, like holding one percent of equity shareholdings to retain the control under a high to low voting rights ratio at 100, limited high/low ratios are justified.[246] Nevertheless, if the ratio is too low, it cannot adequately protect founders or entrepreneurial managers from the very market pressure DCS structures aim to insulate. For example, if a high/low voting ratio is decreased to around one, although the concern over increased governance risks could be minimized, the value of DCS structures would vanish.[247] A lower ratio can also negatively affect the number and quality of firms' innovative outputs and exploratory research.[248]

In addition to the intended impact, like using time-based sunset provisions to constrain the control part by limiting controllers' weighted voting rights to a pre-determined period, there is also an unintended impact associated with safeguards.[249] For example, the time-based sunsets may create a temptation for incumbent controllers to self-serve when the pre-specified sunset deadline approaches.[250] The increased agency risk in the context of facing an imminent loss of control may outweigh any intended benefit of such sunset provisions.[251] By the same token, while the intended impact of wedge limitation is to restrict the divergence between controllers' voting rights and cash flow rights, its unintended impact is to increase the price of retaining control and decrease the benefit of external

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[242] *See* LINDSAY BARAN ET AL., DUAL CLASS SHARE STRUCTURE AND INNOVATION 13 (2019).

[243] *See* SINGAPORE EXCHANGE, *supra* note 233, at 23.

[244] *See* Bebchuk & Kastiel, *supra* note 4, at 1472-73.

[245] *See supra* notes 207-10 and accompanying text.

[246] *See* Bebchuk & Kastiel, *supra* note 4.

[247] *See id*. at 1478, 1505.

[248] *See* BARAN ET AL., *supra* note 242, at 40. The positive impact on innovation may offset the costs of insider control on firm value.

[249] *See* SINGAPORE EXCHANGE, *supra* note 233, at 18.

[250] *See id.*

[251] *See* Bebchuk & Kastiel, *supra* note 4, at 1470-71, 1474.

equity financing.[252] External shareholders will also be negatively affected when costs of financing rise.[253] The complexity poses a significant challenge in ascertaining an appropriate high and low voting ratio or time period for time-based sunset provisions.[254]

However, we should know the essence of these safeguarding and ringfencing measures is to help balance between control and accountability, which are on the two opposite sides of DCS structures.[255] While it might be difficult to ascertain a perfect balancing point, there exists a dynamic balance when the above discussed measures like sunset provisions, maximum voting differentials, and others are introduced into *equilibrium*.[256] Hence, both researchers and policymakers can use this dynamic balance conception to better understand the full impact of safeguarding measures. Put differently, a measure that over-protects holders of shares with inferior voting rights is not optimal as it would break the balance by compromising the very benefits of DCS structures.

VI. ANALYSIS IN CONTEXT

The benefits for DCS structures and the business case, especially for stock exchanges as discussed in Section IV, fueled amendments of laws and listing rules in both Singapore and Hong Kong to accommodate DCS IPOs.[257] This section will use the control-accountability perspective discussed in the foregoing section to analyze the institutional design of DCS in these two leading financial centers.[258]

A. *The Case in Singapore*

Singapore previously prohibited DCS structures with the enactment of *Singapore Companies Act 1967*.[259] Section 64(1) of the *Act* specifies that any equity share issued by such a company after December 29, 1967 shall confer the right at a poll at any general meeting of the company to only one vote in respect of each equity share, unless it is a management

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[252]*See id.*at 1471.

[253]*See id.* at 1467-68.

[254]Similarly, it is also challenging to set an appropriate equity threshold for ownership-based sunsets.

[255]*See* SINGAPORE EXCHANGE, *supra* note 233, at 14.

[256]*See id.*

[257]*See supra* Section IV.

[258]*See* Yeandle & Wardle, *supra* note 20.

[259]Companies Act, No. 42, Dec. 29, 1967, ch. 50, §64 (SG).

share issued by a newspaper company under Section 9 of the *Newspaper and Printing Presses Act*.[260]

Because of the increasing activities of global technology innovation and diversification of corporate financing requirements, the Singapore Ministry of Finance Steering Committee was set up in October 2007 to create an efficient corporate regulatory environment for doing business in Singapore.[261] In order to keep pace with international legal and technological developments, it proposed a corresponding revision in the process of reviewing company laws in June 2011.[262] The proposal suggested deleting Section 64 of *Company Act 1967* and permitting companies, subject to certain safeguards, to issue non-voting and multiple-voting shares if their corporate charters allowed it — thus giving companies greater flexibility in raising capital and investors a wider range of investment opportunities.[263] After Manchester United, one of the world's best-supported football clubs, ditched its plan of a Singapore listing with DCS structures and raised around $ 1 billion USD for a U.S. IPO in June 2012,[264] the debate about permitting DCS structures further pushed the Singapore government into revising the *Companies Act* on OSOV restrictions. The recommendations of deleting Section 64, namely the OSOV restriction and permitting DCS structures, among others, by the Steering Committee were finally accepted by the Singapore Ministry of Finance together with the Accounting & Corporate Regulatory Authority in October 2012.[265] After another round of public consultations in 2013, the *Companies (Amendment) Bill* (No. 25 of 2014) was passed by the

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[260]Newspaper and Printing Presses Act, No. 12, Jan. 1, 1975, ch. 206, §9 (SG). Moreover, § 10(11) stipulates "the holder of management shares shall be entitled either on a poll or by a show of hands to 200 votes for each management share held by him upon any resolution relating to the appointment or dismissal of a director or any member of the staff of a newspaper company."

[261]MINISTRY OF FINANCE (SINGAPORE), Report of the Steering Committee for Review of the Companies Act 16 (2011), https://www.mof.gov.sg/portals/0/data/cmsresource/public%20consultation/2011/Review%20of%20Companies%20Act%20and%20Foreign%20Entities%20Act/Annex%20A%20SC%20Report%20Complete%202.pdf.

[262]*Id*. at 41.

[263]*Id*. at 3-4.

[264]Daniel Stanton & Fiona Lau, *Manchester United drops Asia IPO for U.S.*, REUTERS (June 13, 2012), https://www.reuters.com/article/us-singapore-us-ipo-manchester-united-if-idUSBRE85C0MO20120613. It is reported, although Singapore government had indicated that it would have no problems with a dual class share issue, the long delays in approval finally pushed the club away.

[265]*See Review of the Singapore Companies Act — Ministry of Finance's Responses to the Report of the Steering Committee for Review of the Companies Act*, MINISTRY OF FIN. 41, 44 (Oct. 3, 2012), https://www.mof.gov.sg/portals/0/Public%20Consultation/AnnexA_SC_RCA.pdf.

Parliament in October 2014.[266] *Companies (Amendment) Act 2014* repeals Section 64 and re-enacts Section 64A.[267] The new section permits public companies to issue shares with differentiated voting rights conferring special, limited, conditional or no voting rights.[268]

After the legal reform in permitting DCS structures for public companies, the Committee on the Future Economy ("CFE") recognized that DCS listings are increasingly being considered in industries, especially in high-tech sectors.[269] The Singapore Stock Exchange ("SGX") then issued a consultation paper on *Possible Listing Framework for Dual Class Share Structures* in February 2017 and sought feedback on possible safeguards such as admission criteria, sunset clauses, and the appointment of independent directors.[270] Following two rounds of consultation, SGX finally permitted DCS companies to list in June 2018, allowing companies greater flexibility in capital management.[271]

Following the Steering Committee's recommendation, mandatory safeguards and restrictions were imposed upon listed companies with DCS structures to mitigate associated governance risks — this was expressly stipulated under the *SGX Mainboard Rules* rather than statutes.[272] First, SGX caps each multiple-voting share at ten votes per share and limits the holders of such shares to named individuals or groups.[273] Second, sunset clauses that automatically convert multiple-voting shares into single-voting shares are mandated for the events including (1) transferring multiple-voting shares to persons not in the permitted holder group, and (2) the holder of multiple-voting shares ceases services as director.[274] Third, independent directors are required to constitute a majority and serve as chairman to each of the board sub-committees: (1) an audit committee, (2) a nominating committee, and (3) a remuneration committee.[275] Fourth, multiple-voting shares are limited to one vote each regardless of their class on matters in relation to appointment and removal of independent directors

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[266]*See* Companies (Amendment) Act 2014, No. 36 (Nov. 18, 2014), https://sso.agc.gov.sg/Acts-Supp/36-2014/Published/20141201?DocDate=20141201#legis.

[267]*Id*. at 45.

[268]*See supra* note 265, at 47.

[269]*See* COMMITTEE ON THE FUTURE ECONOMY, Report of the Committee on the Future Economy 31 (2017).

[270]*See* SINGAPORE EXCHANGE, *supra* note 233, at 11, 13, 18-20.

[271]*SGX Launches Rules for Listing of Dual Class Shares Companies*, SINGAPORE EXCHANGE 1 (June 26, 2018), https://api2.sgx.com/sites/default/files/newsreleases/migration/sgx_launches_rules_for_listing_of_dual_class_shares_companies.pdf.

[272]MINISTRY OF FINANCE, *supra* note 261.

[273]*See id*.

[274]SGXMainboard Rules, ch. 2 pt. III r. 210 § 10 subsec. d (amended Feb. 7, 2020).

[275]SGX Mainboard Rules, ch. 2 pt. III r. 210 § 10 subsec. f (amended Feb. 7, 2020).

and auditors, variation of class rights, takeover, winding-up or delisting procedures.[276] There are many other measures including disclosure and continuing obligations adopted to align controllers' interests with that of public shareholders for ensuring accountability.[277]

B. *The Case in Hong Kong*

Though Hong Kong company laws allow a company's constitution to provide DCS structures,[278] the Hong Kong Stock Exchange previously prohibited companies to list with such structures since 1987. Rule 8.11 of the *Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited* provided that:

> [T]he share capital of a new applicant must not include shares of which the proposed voting power does not bear a reasonable relationship to the equity interest of such shares when fully paid ("B Shares"). The Exchange will not be prepared to list any new B Shares issued by a listed issuer nor to allow any new B Shares to be issued by a listed issuer… [except in exceptional circumstances].[279]

However, due to the regulatory competition, particularly Singapore's movement towards DCS listing and the desire to attract IPOs from mainland China,[280] Hong Kong also changed its long stance on DCS structures. The Stock Exchange of Hong Kong Limited ("SEHK"), a wholly-owned subsidiary of the Hong Kong Exchanges and Clearing Limited ("HKEx"), published conclusions in its concept paper on weighted voting rights in 2015, stating that there is support for a public consultation on proposed changes to its listing rules for allowing DCS structures.[281] Immediately afterwards, the Hong Kong Securities and

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[276]SGX Mainboard Rules, ch. 7 pt. IV r. 730B (Jun. 26, 2018).

[277]*E.g.,* SGX Mainboard Rules, ch. 2 pt. VIII r. 225 (Jun. 26, 2018); SGX Mainboard Rules, ch. 6 pt. II r. 610 (amended Feb. 7, 2020); SGX Mainboard Rules, ch. 7 pt. X r. 753 (June 26, 2018); SGX Mainboard Rules, ch. 12 pt. II r. 1206 (amended Feb. 7, 2020); SGX Mainboard Rules, ch. 12 pt. III r. 1207 (amended Feb. 7, 2020).

[278]Hong Kong Companies Ordinance, (2019) Cap. 622 pt. 12 div. 1 § 588(4).

[279]*Exchange's Concept Paper on Weighted Voting Rights*, CHARLTONS (Nov. 2014), https://www.charltonslaw.com/legal/ipo/Analysis-of-HKEx-concept-paper-on-weighted-voting-rights.pdf. It is noteworthy that no firm has been admitted by the Exchange under such exception.

[280]*See* Yiu, *supra* note 22.

[281]*Consultation Conclusions: To Concept Paper on Weighted Voting Rights*, HONG KONG EXCH.'S & CLEARING LTD., (June 2015), https://www.hkex.com.hk/-/media/HKEX-

Futures Commission ("SFC") unanimously opposed the draft proposal for primary listings with weighted voting rights under DCS structures.[282] After numerous discussions,[283] SFC finally supported the introduction of IPO with DCS structures on SEHK in 2017 in order to attract giant tech companies and new economy companies to list.[284]

Following a series of consultations, SEHK decided to implement a new Chapter 8A of the Listing Rules in April 2018, which sets out the qualifications for DCS listings, as well as essential safeguards.[285] Therefore, rule 2.03 (4) of the *Main Board Listing Rules* is modified from "…all holders of listed securities are treated fairly and equally" to "…all holders of listed securities are treated fairly and all holders of listed securities of the same class are treated equally."[286] This means SEHK will permit new listing applicants' DCS listing so long as can they demonstrate the eligibility and suitability for DCS IPOs.[287]

Eligibility as the first part of the entry requirement can be met by new applicants seeking DCS listing if they satisfy either (1) a market capitalization of at least $40 billion HKD at the time of listing, or (2) a market capitalization of at least $10 billion HKD at the time of listing and revenue of at least $1 billion HKD for the most recent audited financial year.[288] The suitability judgement is more complicated compared with the first part. Pursuant to the *Guidance Letter HKEX-GL93-18*, applicants

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Market/News/Market-Consultations/2011-to-2015/August-2014-Weighted-Voting-Rights/Conclusions/cp2014082cc.pdf.

[282] *SFC Statement on the SEHK's Draft Proposal on Weighted Voting Rights*, SEC. & FUTURES COMM'N, (June 2015), https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR69.

[283] *The Exchange's Response to the SFC's Statement in Relation to the Draft Proposal on Weighted Voting Rights*, HONG KONG EXCH.'S & CLEARING LTD., (June 2015), https://www.hkex.com.hk/news/news-release/2015/150625news?sc_lang=en.

[284] *See* Yiu, *supra* note 22.

[285] Consultation Conclusions: A Listing Regime for Companies from Emerging and Innovative Sectors, Hong Kong Exch.'s & Clearing Ltd., (Apr. 2018), https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Conclusions-(April-2018)/cp201802cc.pdf.

[286] HKEX, MAIN BOARD LISTING RULES AMENDMENT (UPDATE NO. 119) ch. 8A (Apr. 2018) (H.K.), https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Listing-Rules-Contingency/Amendments-to-Main-Board-Listing-Rules/2018/Update-No-119/mb_newregime_1804.pdf?la=en.

[287] *See id*. ("[IPO] applicants are expected to demonstrate the necessary characteristics of innovation and growth and demonstrate the contribution of their proposed beneficiaries of weighted voting rights to be eligible and suitable for listing with [DCS structures] as set out in guidance published on the Exchange website and amended from time-to-time.").

[288] *See id.* at § 8A.06.

must demonstrate it is an innovative company[289] with a track record of high business growth and high growth trajectory is expected to continue; holders of weighted voting rights have been materially responsible for the growth of the business and must be an individual who has an active executive role within the business, and a director of the issuer at the time of listing.[290]

Similar to SGX's approaches to mitigate increased governance risks, HKEx also adopts a stringent regime of safeguarding measures. First, the *superclass* of shares conferring weighted voting rights in listed DCS companies are capped at ten times the voting power of ordinary shares.[291] Second, sunset provisions are adopted to provide further protection to holders of inferior voting rights under DCS structures.[292] A controller's weighted voting rights must cease if the holder is "deceased; no longer a member of the issuer's board of directors; deemed by the [SEHK] to be incapacitated for the purpose of performing his or her duties as a director; or deemed by the [SEHK] to no longer meet the requirements of a director set out in these rules."[293] The weighted voting rights will also cease upon the transfer to another person.[294] Third, like SGX with certain resolutions requiring all shares to carry one vote each regardless of class, HKEx also requires OSOV to be applied for an amendment of the company's constitution, the variation of class rights, appointment or removal of independent non-executive director or auditors, and voluntary winding-up.[295] Fourth, in order to guarantee the independence of the board, rule 8A.30 requires a 'Corporate Governance Committee' comprised entirely of independent non-executive directors to monitor whether the listed DCS company was operated and managed for the benefit of all its shareholders rather than narrowly for controllers.[296]

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[289]HKEx, HKEX GUIDANCE LETTER HKEX-GL93-18, 2 (Apr. 2018), https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/g/l/gl9318.pdf. In doing so, it is expected to possess more than one of the following characteristics: (a) its success is demonstrated to be attributable to the application, to the company's core business, of (1) new technologies; (2) innovations; and/or (3) a new business model, which also serves to differentiate the company from existing players; (b) research and development is a significant contributor of its expected value and constitutes a major activity and expense; (c) its success is demonstrated to be attributable to its unique features or intellectual property; and/or (d) it has an outsized market capitalisation / intangible asset value relative to its tangible asset value.

[290]*Id.* at 3.

[291]HKEx, MAIN BOARD LISTING RULES AMENDMENT, *supra* note 286, at § 8A.10.

[292]*Id.* at § 8A.11-12.

[293]*Id.* at § 8A.17.

[294]*Id.* at § 8A.18(1).

[295]HKEx, MAIN BOARD LISTING RULES AMENDMENT, *supra* note 286, at § 8A.24.

[296]*Id.* at §§ 8A.30-31.

Further, listed DCS companies are required to entitle shareholders with inferior voting rights to cast at least ten percent of the votes at shareholder general meetings.[297] Rule 8A.23 again emphasizes that holders of inferior voting shares must be able to convene an extraordinary general meeting and add resolutions to the meeting agenda.[298] Among other enhanced disclosure requirements, a listed company with DCS structures "must include the warning *'A company controlled through weighted voting rights'* on the front page of all listing documents, periodic financial reports, circulars, notifications and announcements."[299]

C. *Balance Between Control and Accountability*

In addition to the benefits like flexible capital structuring and insulation from short-term market pressure at firm level, permitting DCS IPOs are expected to enhance competitiveness and profits for stock exchanges.[300] The subsequent relaxing of constraints on DCS structures and permitting DCS listings in Hong Kong and Singapore would nevertheless increase controllers' overall control.[301] In order to check potential abuse of the increased control and maintain the hard-earned credibility in corporate governance, both jurisdictions have adopted stringent and robust safeguarding measures to strike a balance.[302] In sum, while permitting firms to go public with DCS structures can enhance the control part from a control-accountability perspective, the mandatory safeguarding and ringfencing measures are deployed to enhance the accountability part.[303]

However, it is also likely to see measures like time-based sunset provisions or ownership-based sunsets not adopted at the institutional

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[297] *Id.* at § 8A.23.

[298] *Id.*

[299] HKEX, MAIN BOARD LISTING RULES AMENDMENT, *supra* note 286, at § 8A.37.

[300] Marc T. Moore, *Designing Dual Class Sunsets: The Case for a Transfer-Centered Approach* (Univ. College London, Working Paper No. 9/2019), https://ssrn.com/abstract=3478572.

[301] Ben McClure, *The Two Sides of Dual-Class Shares*, INVESTOPEDIA (June 25, 2019), https://www.investopedia.com/articles/fundamental/04/092204.asp.

[302] *Singapore details rules for offering dual-class shares, follows Hong Kong*, REUTERS (June 26, 2018), https://www.reuters.com/article/sgx-regulation/singapore-details-rules-for-offering-dual-class-shares-follows-hong-kong-idUSL4N1TS3E3; *Singapore details rules for listing of dual-class shares*, CNA (June 26, 2018), https://www.channelnewsasia.com/news/business/singapore-exchange-rules-listing-dual-class-shares-10471876.

[303] *See* sources cited *supra* note 302.

level, despite the fact that they would greatly enhance accountability.[304] From the perspective of dynamic balance, a legitimate explanation is that the intended and unintended impact of these measures would over-restrain the control of company controllers and thereby compromise the value of weighted voting under DCS structures.

1. Table 3

Mandatory Safeguarding Measures		HKEx	SGX	NYSE/ NASDAQ
Entry Requirements	Restriction to particular industries	Yes	No	No
	Minimum market capitalization	$10 billion HKD ($1.3 billion USD)	$300 million SGD ($213 million USD)	No
Disclosure Requirements	Enhanced disclosure	Yes	Yes	No
	Unique stock code	Yes	Yes	No
Restriction on Multiple Voting Shares	Event based sunsets	Yes	Yes	No
	Maximal voting differentials	10:1	10:1	No
	Temporary conversion on certain corporate decisions	Yes	Yes	No
Other Protections	Minimum equity threshold held by multiple-voting shareholders	Yes, 10%	Yes, 10%	No

Most of these safeguarding measures adopted by Singapore and Hong Kong cannot be found in the U.S., as summarized in Table 3

[304] *Singapore details rules for listing of dual-class shares*, *supra* note 302. In other words, these measures can still be adopted at firm level through private ordering.

above.[305] Only a limited number of firms have gone public with DCS structures in Singapore and Hong Kong so far.[306] For example, since the official approval in Hong Kong in April 2018, there were only two out of 218 newly listed companies in 2018 and one out of 183 newly listed companies in 2019 that adopted DCS structures.[307] And there is no DCS IPOs in Singapore since the approval in June 2018.[308] However, twenty-six out of 134 newly listed companies in 2018 and twenty-five out of 112 newly listed companies in 2019 adopted DCS structures in the United States.[309] Though such a comparison is by no means absolute, it may shed light on the trade-off between the two sides of DCS structures and explain the divergence between the expectation and the reality of DCS structures in Singapore and Hong Kong. Too many restrictions on the control side would inevitably compromise the value of the differentiated voting arrangements.

The purpose of all safeguarding measures is to reduce the insulation enjoyed by controllers under DCS structures, making them more vulnerable and then more enslaved to such pressure. Put differently, DCS structures are a design to make shareholders with superior voting rights less vulnerable to market disciplinary force, such as hostile takeovers, while the safeguarding measures are intended to reverse such trends by placing restrictions on controllers' insulation from market discipline. Thus, enhanced accountability would reduce the values of control. Restricted voting differentials and automatic conversion of multiple-voting shares mean decreased flexibility for founders or entrepreneurial managers and perhaps higher costs to retain control; likewise, increased disclosure obligations mean increased monitoring costs. It would not be impossible for HKEx or SGX to ease some of the constraints imposed upon companies choosing to adopt DCS structures in order to further attract more DCS listings. Suffice it to say, the dynamic balance conception offers a good perspective to investigate more than just the costs and values of DCS structures.

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[305] *Dual-Class Shares: The Good, The Bad, and The Ugly*, CFA INST. (2018), https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx.

[306] *See HKEx 2019 Annual Market Statistics* (Dec. 2019) https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/2019-Market-Statistics.pdf.

[307] *Id.*

[308] *SGX Stock Screener* (May 1, 2020), https://www.sgx.com/zh-hans/securities/stock-screener.

[309] Jay R. Ritter, *Initial Public Offerings: Updated Statistics*, UNIV. OF FLORIDA (June 24, 2020), https://site.warrington.ufl.edu/ritter/files/IPOs2019Tech-Stock.pdf.

VII. CONCLUSION

Debates over DCS structures among scholars and policymakers have been ongoing for more than a century. This paper revisits and rebuts most of the criticisms against DCS structures by critically analyzing the economic rationale for proportionate voting rights as well as its underlying shareholder democracy. On the one hand, shareholder democracy under OSOV is proved to be an untenable argument against DCS structures, and on the other, the proportionate voting underpinned by the conventional economic theory of OSOV is far from the solution to control agency costs, especially in the context of shareholder heterogeneity. Hence, efforts to categorically prohibit DCS structures are essentially misguided.[310]

Nonetheless, this paper admits that DCS structures, which allow disproportionate votes to insiders and insulation from takeover markets, may potentially lead to deteriorated agency problems. It is however important to note that these increased governance risks may first be outweighed by positive consequences of DCS structures, like greater capital structure flexibility, gain of entrepreneurs' idiosyncratic visions and long-term focus; and second, constraints can be placed on the DCS structures to limit the negative impact of DCS structures.[311] Therefore, the focus on the viability of DCS structures shall be re-oriented to restrain the potential governance risks brought by such structures. For the jurisdictions that either prohibit DCS structures altogether or mandate OSOV in listed companies, it is time they reconsider their stance. In other words, policymakers should adopt a more enabling stance by allowing firms to choose from different governance and voting arrangements. We know that one-size-fits-all solutions are problematic, so it would be untenable for any laws or listing rules to mandate some voting structures yet ban others. The right of choice should be given to individual firms and allow them, and ultimately the invisible hand of the market, to choose between OSOV or DCS structures. What the policymakers and regulators should really focus on is how to provide appropriate safeguarding measures to control the potential risks once DCS structures are adopted. Just as we see in Hong Kong and Singapore where changes have already been made after recognizing the values of taking a more permissive stance, countries like the United Kingdom and Germany should also rethink easing restrictions over DCS IPOs.

The trade-off between the benefits and costs of DCS structures is essentially the trade-off between visionary founders' control and their

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[310] *See also* Ashton, *supra* note 140, at 890-905.

[311] *Dual-Class Shares: The Good, The Bad, and The Ugly*, *supra* note 305.

accountability. The visionary founders' control implies potentially higher firm value in the long run, but it also means potentially greater agency costs associated with increased management entrenchment. The control-accountability perspective used in this paper clearly exhibits that the control part and accountability part of DCS structures stand on two opposite ends of a spectrum. Accordingly, the essence of all safeguarding measures like sunset provisions and maximal voting differentials is in theory to increase the accountability part. However, they would inevitably compromise the control part, whether they intend to or not. Thus, apart from the re-evaluation of DCS structures in general, this paper also proffers the dynamic balance conception to help evaluate the role and impact of both existing and future safeguarding measures. When facing the clear trade-off between control and accountability, it is important to help those with inferior voting shares hold company controllers accountable. However, we should not go too far to dismiss the very value of DCS structures as shown by the dynamic balance conception. This also means any future studies on safeguarding measures must also look into their unintended impact in order to find out a more balanced approach.

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